2014 Heckerling Institute-Edited Reports

The following is an edited version of the reports by onsite reporters at the 2014 Heckerling Institute e-published on the ACTEC-PRAC and ABA-PTL listservs, reflecting primarily formatting and spelling corrections and arranged in the order presented at the Institute. **The text of the reports begins on page 7**.

The Purposes and Scope of the Institute

The Heckerling Institute on Estate Planning is the nation's leading conference for estate planners, including attorneys, trust officers, accountants, insurance advisors, and wealth management professionals.
Attendees enjoy unparalleled networking and professional development opportunities that make attending the Heckerling Institute a valuable investment for every estate planning professional.

This year's program will offer practical guidance on both planning strategies and practice development in the new wealth transfer tax environment. The program includes expanded coverage of the increasingly important areas of elder law, asset protection, and income tax planning without sacrificing coverage of traditional core estate planning topics such as GRATS, FLPs, life insurance, planning with trusts, and fiduciary administration. Attendees can either explore a broad range of topics in our general session lectures and afternoon panel programs, or can customize their educational experience by taking advantage of one of our specialized program tracks. Some of the highlights of this year's program include:

Recent Developments: The recent developments panel on Monday afternoon, featuring three of the nation's leading estate planning experts, will guide you through the most significant legislative, regulatory and case law developments of 2013.

Focus Series: This series will provide practical insights and guidance on the planning challenges and opportunities available to estate planners and their clients in a post-ATRA environment. Topics will include portability, evolving issues in planning with trusts, planning for clients that may not be subject to the federal estate tax, planning for larger estates (including how to maximize income tax savings), charitable giving, and the impact of the 3.8% health care surtax on both trusts and individuals.

Sessions in the focus series are designated:

Planning with Financial Assets: Our financial assets series will examine how to manage tax basis to maximize the "step-up" at death, provide an update on current developments involving life insurance, explore how fiduciaries across the country have applied the Uniform Principal and Income Act (UPIA), and focus on the applicability of UPIA to trust-owned life insurance. Sessions in the financial assets series are designated:

Litigation and Tax Controversies: This series will provide useful tips on preparing gift tax returns and handling a gift tax audit, explore the litigation issues associated with funding unfunded trusts, address current transfer tax audit and appeals issues, and consider the ethical problems that arise in estate and trust disputes. Sessions in the litigation series are designated:

Fundamentals: This year's fundamentals programs will begin with a look at how contemporary estate planning techniques have impacted traditional trust law, provide an overview of the important income tax issues involved in estate planning, and cover the essentials of asset protection planning.

Networking and Practice Development: The Institute is the national gathering place for estate planning professionals, offering a unique opportunity to exchange ideas and network with colleagues from around the

country. Attendees can also review the latest in technology, products, and services displayed by nearly 150 vendors in an exhibit hall dedicated entirely to the estate planning industry.

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2014 Institute Program Schedule
48th Annual Heckerling Institute on Estate Planning January 13 - 17, 2014

Monday, January 13
9:00 a.m. – 12:15 p.m.
Fundamentals Program
Back to School: A (Re)Introduction to the Law of Trusts
Robert H. Sitkoff
Contemporary estate planning has pushed the boundaries of traditional trust law, leading to profound change, if not a quiet doctrinal revolution. This session will take us back to school, as it were, for a primer on the law of trusts and a look at how the innovations of late fit or don't fit into traditional doctrine.
Reporter: Craig Dreyer

Mr. Sitkoff's presentation included 213 pages of materials compromising three chapters from Jesse Dukeminier & Robert H. Sitkoff's: *Wills, Trusts, and Estate*s (9th Ed. 2013). The session discussed the origins of trusts and how modern law has evolved and continues to apply many common law principles. He noted that recent trust law has been created through both a top down approach and a bottom up approach. Examples of recent laws include the prudent investor rule and the uniform trust code as well as the proliferation of techniques such decanting and asset protection trusts.

The guiding principle of trust law is the freedom of disposition of property which in America is unlike any other place. He discussed various cases that show our goal in American trust law is to allow the donor to dispose of assets over a period of time and provide a workable administration rules that balance the wishes of the donor with the obligation for the assets to be held for the benefit of the beneficiary.

Next he discussed how the law of wills governs the way you can express how you want to transfer probate property. He noted the main problems in this area of law involve authenticity, ensuring a volitional act, and interpreting the meaning of the decedent. He noted the best witness in these matters is always dead. A trust has similar issues, so it may be subject to the laws of wills in its execution, but provides us a private succession of property outside the public domain. He noted there are few limits on the ability to pass property other than laws of succession regarding spouses and minor children.

A trust is an arrangement where one person, the settlor, transfers property to the trustee to hold for the benefit of one or more beneficiaries. The trustee is subject to fiduciary obligations. A trust can be testamentary or inter vivos. An inter vivos trust can be created by deed (where another person is trustee) or a declaration of trust (where the settlor is trustee). He discussed the historical uses of trusts and how trust law is governed in a court of chancery.

Trust law is normally judge made law, but recently treatises have further defined trust law. He also noted that the Restatement 3rd of trusts is more innovative than the trust code, and sometimes deviates from the most prevalent laws throughout the country.

Hard data on trusts is troublesome due to privacy concerns, but there is a significant amount of value and fiduciary fees derived from trusts.

A trust allows bifurcation of ownership in that it separates legal from equitable title. Mr. Stikoff notes that under traditional common law, creditors of a trustee acting on behalf of a trust could reach the trustee's personal assets, but the trustee could reach into the trust for reimbursement. However, today creditors of a trust only have recourse to trust assets. This is one primary reason to ensure we earmark and follow assets held in trust. Trust law is the only body of law that does not require a public filing like an LLC that provides this entity style protection. (This explains why we often speak of trust as an entity today which follows substantive rules although technically is not correct).

Mr. Sitkoff then moved on to the subject of fiduciary duties. A trustee owes fiduciary duties of loyalty and prudence to beneficiaries. He notes that fiduciary duties can be broken down into four functions: custodial, administrative, investment, and distribution. You can also break up these functions by creating directed trusts.

The use of business trusts, such as for asset securitization and pension funds, dwarfs all other uses. Business trusts and trust like devices are common throughout the world. However, the use of trusts for donative transfer of

future interests is unique to America.

There are three things necessary to create trust: intent, ascertainable beneficiaries, and specific trust property. He further clarified that there is no need for a trustee or writing under the law of trusts. It is the law of wills and the statute of frauds that impose the writing requirement. The intent to create a trust can even be created when a person is ignorant of trust law. Furthermore, in order to determine proper analysis of trust issues, we must look to see if the trust is a declaration of trust, deed of trust, or irrevocable trust. In a deed of trust you have an inter vivos trust created by giving property to a third party as trustee who is subject to fiduciary obligations. We can look for intent along with conveyance of trust property. With a declaration of trust, the settlor is also the trustee. There is no requirement for a writing or an actual conveyance with a declaration of trust.

Mr. Sitkoff discussed various cases on the need to have Res or specifically identified property to have a trust. He noted there are remedies available for an invalid trust, such as resulting and constructive trusts. However, he also noted that a constructive trust is not really a trust, but a remedy in equity. He also noted that constructive trust is not a cause of action, but a remedy for restitution to prevent unjust enrichment. A resulting trust is a reversionary trust in equity, to the extent the trust assets are not necessary, the excess property reverts back to donors in interest.

In order to have an effective trust there must be ascertainable beneficiaries to call the trustee to account. This is a fundamental tenant of fiduciary law. He further discussed the evolution of this concept and how today the law has interpreted some non-ascertainable beneficiaries by stating it is a power of appointment given to the trustee to effectuate the donorâ€™s wishes. Also, historically you could not leave money to a pet, but many state statutes today allow for pet trusts or trusts for the preservation of graves.

Most donative trusts are gifts subject to a plane of time. This is a profound exercise of freedom of disposition where we allow dead hand control well into the future. Due to this profound ability, we need a management regime. Therefore, all duties must be exercised with fiduciary obligations and are subject to judicial review.

Initially trustees only had the powers given to them in the trust. Giving the trustee limited powers was designed to protect the beneficiary. At common law, the trustee had no powers other than those listed. Today, the trust code has a long list of powers, and we are giving the trustee all the rights of an individual. In order to protect beneficiaries in the case where a trustee has unlimited powers, we impose fiduciary obligations in the exercise or non-exercise of those rights.

There are two flavors for breaches of fiduciary duties. First, a trustee lacked power to act as the trustee did (this is getting extremely rare as default provisions are very extensive). The more common kind of breach today is although the trustee had the power, they were disloyal or imprudent in the way they acted as the trustee must manage the trust for the sole benefit of the beneficiary.

Mr. Stikoff then discussed the concept of prudence or the objective standard of care trustees must follow. Distributions are always subject to judicial review to see if the trustee reasonably and prudently exercised discretion. He notes that language such as sole, absolute, or irrefutable discretion does not mean there is no judicial review. (He notes a motion to dismiss on this issue is improper). All powers held by trustee are subject to judicial review. This language may lessen the scrutiny of the review, but it does not eliminate it. If a trust says a trustee shall not be personally liable for certain kinds of lesser breaches, this does not mean the trustee is not subject to equitable relief, it just means trustee shall not be subject to lesser breaches within the exoneration clause. However, an exoneration clause cannot exonerate bad faith, reckless indifference, or negligence since there are fiduciary duties. If you give someone property without a fiduciary duty, you are essentially giving them the property in fee simple.

Mr. Sitkoff then discussed the evolution of the prudent investor rule which is derived from the fiduciary duty of prudence. He noted that with a basket of non-perfectly correlated stock you can eliminate risk which is one of the only free lunches in investing, so all trustees should follow this. He noted there are times a non-diversified portfolio is acceptable if there are other benefits such as the use of a vacation home or family farm. If the settlor is still living, a step up in basis for low basis assets may also be a consideration not to diversify.

Trust instruments often authorize retention or waive diversification. These circumstances can be divided in two circumstances. First, â€œa trustee may retainâ€ is standard waiver. This is a powers provision in the trust

document and must be exercised prudently and with sound fiduciary obligations. The second type is when the trust says â€œyou must not sell.â€ A trustee may have duty to petition court for instructions on a mandatory provision since a court may offer deviation. A trustee may not cause harm to the beneficiaries. Also, statutes allowing waiver of duty to diversify may not be absolute, and there is not much case law under these statutes. Mr. Sitkoff noted that controlling property over time is not within the power of disposition, but is more about the ego of the settlor.

The duty to keep adequate records of administration prevents bad decisions. He notes that in the fiduciary world you should feed the file as records are your friend. Courts can also draw negative inferences for failure to have paperwork.

Mr. Sitkoff then further discussed the choice of trustee issues and how it has become more common to split trustee duties. This is a new area of law where we are splitting obligations of the trustee rather than delegating trustee functions. It is unclear how the application of trust fiduciary law to these circumstances with directed trustees will evolve.

Next, the duty of impartiality with multiple beneficiaries was discussed. He noted that this duty is misleading since it does not require impartial conduct and may actually require partiality. It simply requires the trustee to show due regard to the interests of the beneficiaries. He also noted that the prudent investor rule may skew the terms of the trust as it changes the principal and income allocations. However, most states have provided ways to remedy these issues such as using a unitrust statute or changing allocations between principal and income.

Mr. Sitkoff discussed the history of creditor protections in trusts. Currently, he noted that the trust code says no creditor other than spouse or child can ever stand in the shoes of a beneficiary. The spouse and children can compel a distribution to the extent beneficiary may have been able to compel a distribution. He notes that the 3rd Restatement says a creditor can attach to distributions required to be made by the trustee. He notes this view has been rejected by all uniform trust code states, which makes you wonder why they took this approach.

A settlor may also say a beneficiary may not alienate their interest. This prevents a creditor from obtaining an order making a trustee pay them a distribution (a spendthrift trust). The theory is that the donor has right to restrict property in trust, since the donor could always decide not to give the property. Mr. Sitkoff notes that we are alone in the world in taking this view. Other countries say beneficiaries can alienate their interests. Generally in America, only the surviving spouses and children may obtain an order against a spendthrift trust, which is a public policy exception.

He emphasized that congress has codified asset protection in trusts with 541(c)(3) of the bankruptcy code, which says that a trust beneficiary with a discretionary or a spendthrift trust will not have the trust assets included as part of the bankruptcy estate of the beneficiary. He also notes that if congress does not like what we are doing, they could easily change this provision and unwind tons of planning. He also discussed the evolution of self-settled asset protection trusts and noted they are contrary to common law. He also noted that there is no appellate decision regarding asset protection trusts located in other jurisdictions.

Mr. Sitkoff closed this 3 hour long session by discussing how modification, termination, and decanting have all evolved in an attempt to administer within the settlors intent, and carefully balance the intent of the settlor with the need for a prudent administration of the trust on behalf of beneficiaries.

2:00 – 2:10 p.m.
Introductory Remarks
Tina Portuondo, Institute Director
Patricia D. White, Dean, University of Miami School of Law

2:10 – 5:15 p.m.
Recent Developments 2013
Dennis I. Belcher, Carol A. Harrington, Jeffrey N. Pennell
Reporter: Herb Braverman

This panel of three well-known professionals in our area opened the three hour session by recognizing and thanking a host of other well known professionals who prepared and edited the extensive materials that were presented on Monday. The 225 pages of material is chock full of important references to the high points and developments of the past year (through the end of November 2013). Although I will briefly review the topics discussed in this lengthy session, it would certainly behoove any one who is interested to obtain the materials and the recorded comments of the panel. This session will be followed by an extensive question and answer session on Wednesday where those in attendance at the Institute will be able to have their questions answered by the same panel.

The panel opened with a conclusion repeated by other presenters in Florida, namely, that we are no longer merely estate planners--we are now going to be deeply involved with income tax planning as well; new estate plans will have to take into consideration how the combination of federal and state income tax issues will effect planning and that, in many instances, these issues will be more important than conventional estate planning issues. Planning will be more uncertain; there will be more variables, many of which cannot be known to a certainty as you plan for clients.

The panel turned to a discussion of the Fiscal 2014 Administration's Revenue Proposals, commencing with proposals that we have seen in prior years, although they indicated that the chances of tax law changes in 2014 (an election year) were "slim and none". Nevertheless, among the items that were mentioned as being on the list were (a) a minimum 10 year term for GRATS, (b) a 90 year limit on allocation of GST exemption, (c) the elimination of deductions for conservation easements over golf courses, (d) an extension of the lien under Section 6166 on estate tax deferrals, (e) a return to 2009 tax rates and exemptions and (f) an ongoing concern with sales and other transfers to grantor trusts. With respect to the latter, Professor Pennell discussed the Davidson case and the "no ruling list" to indicate that the IRS was clearly letting us know that it is concerned with this type of planning and its substantial benefits for our clients.

Among the new proposals on the list were (a) the GST tax treatment of HEETs (health and education exclusion trusts), (b) limiting stretch IRAs to 5 years from the participant's death, (c) limiting total accrual of tax-favored retirement benefits and (d) additional limits on the use of historic conservation easements (as well as those easements for "building up").

The panel then engaged in an extensive discussion of same-sex marriage and a number of issues and cases associated with this issue at the federal and state levels. Starting with the Supreme Court opinions in the Windsor case and the Hollingsworth case and turning to Obergefell in Ohio and Cozen in Pennsylvania, the panel reminded us of the complexities and problems cropping up in this area where states have different policies and even different agencies in the federal system are treating same sex marriages differently, making planning for these folks very difficult and demanding. See Rev. Rul. 2013-17 discussing the Federal decision to have agencies follow the state of celebration rule and it exceptions.

The panel then discussed the recent and many changes in state estate taxation and the issues that arise with trust mobility. For example, the estate tax has been repealed in Delaware, Nevada, North Carolina and Ohio, with more complexities to come as the states battle for ways to attract business to their jurisdictions.

A number of gifts, estates and trust issues were then discussed, as we learned that Professor Pennell stood by on New Year's Eve to be sure that the final regulations under Sec. 67 (re unbundling of certain estate or trust expenses) were not published in 2013, ensuring that they would not take effect until as least 2015; we were all quite relieved. Inadvertent QTIP elections were discussed and two PLR's were noted, namely, 2013-45006 and 2013-38003.

The panel then turned to a review of quite a few cases concerning a variety of issues, too many to discuss in detail in this report. However, here are the brief case references and the topics involved, which hopefully will guide you if you are interested in one or more of these topics currently. Elkins discussing fractional art interests, Tanenblatt regarding appraiser fee issues, Coons where a taxpayer with difficult facts loses an LLC case, Sommers concerning a revocable transfer, Kite is a private annuity transfer case.

The panel pointed out that one of the primary future concerns for our clients is planning which allows them to "acquire basis for income tax purposes."

A discussion of cases suggested that perhaps sales of assets for a private annuity (using Sec. 7520 tables) .will be treated "better" than similar transactions using SCINs. This came from a detailed discussion of the Kite I and II by the panel, including discussion of Sec. 2519 and Judge Paris's reliance on Rev. Rul. 98.

The panel discussed net gifts with Steinberg -v- Commissioner, 141 T.C. 8 (2013) and net net gifts were discussed. The first net gift is the income being paid by the donee in the transaction and the second net gift is the payment of estate taxes by the donee. This matter is set for trial at this time.

The panel discussed some issues relating to disclaimers, GST items, trust division and mergers PLR's, the Van Alen case for the duty of consistency in conservation easement cases, decanting, in terrorem clauses, DAPT's and payment and deposit issues in Syring and Winford cases.

The panel covered a lot of ground and, of necessity, jumped from issue to issue to cover the materials available. You must obtain the materials and the recorded comments to benefit fully from this extended session.

Tuesday, January 14
9:00 – 9:50 a.m.
Portability: Now Available in Generic Form (Focus Series)
Thomas W. Abendroth
Congress has made portability of the applicable exclusion amount a permanent part of the Code. It is now an integral part of the planning advice we prescribe to our clients. But in many respects, we still are experimenting with how best to use it. This session will review the current state of portability and its uses, both routine and experimental.
Reporter: Elizabeth Lindsay-Ochoa

As a side note: the speaker pointed out ahead of time that the outline uses the 2013 exclusion ($5.25 million), not the 2014 exclusion ($5.34) in its examples.

It has been two years since portability was enacted. The portability election is here to stay as an everyday consideration for estate planning. The issue is how to best use the election when planning for your clients.

This presentation is meant to serves as a framework to help determine the best way to use portability in your client's planning situations.

As a reminder, portability is the transferability of the unused applicable exclusion amount from the first spouse to die to the surviving spouse. Portability is available for gift and estate tax purposes. Portability is not available for the generation skipping transfer (GST) tax. Portability must be elected on the tax return and is available to all estates, regardless of size.

It is important to understand the unused exclusion of the last deceased spouse rule. This rule is also known as the deceased spousal unused exclusion (DSUE) amount. This DSUE amount creates an element of uncertainty as we have no predictability of when subsequent spouses may die. This is also problematic when there is a remarriage and that latest spouse dies before the DSUE from the first spouse has been used. The remarriage does not affect the DSUE amount, just the death the subsequent spouse. The outline has examples to how this concept works.

The Temporary Regulations provide rules on the order in which exclusion amounts are used when someone has both basic exclusion amount and DSUE amount. The surviving spouse who makes a taxable gift first uses the DSUE amount of the last predeceased spouse before his/her own applicable exclusion amount. Additionally, if a surviving spouse has used DSUE amount of predeceased spouse for lifetime gifts, and then has a subsequent predeceased spouse, the subsequent predeceased spouse's DSUE amount is not reduced or impacted by the

DSUE amount already used by the surviving spouse

Administrative issues were not discussed, although they are covered in the outline. The speaker stated that, although the answer was not clear, he thinks for estates under the filing threshold, 9100 relief should be available for those who miss the filing deadline.

Factors to use to determine if you want to employ portability:

· Increases in the exclusion amount, may make portability election wise However, you should take into account appreciation of assets
· Review the potential estate tax v. the potential capital gain tax
· Another way to look at the same issue is to review low basis gifts with the potential growth/appreciation and future income tax v. the step up in basis available at death
· Unrealized appreciation and gain from date of death of first spouse to the date of death of the surviving spouse
· Income tax rates now and the potential rates in the future
· Ages
· Wealth accumulation potential
· Life expectancy potential
· Nature and mix of assets
· Concentrated stocks
· Appreciation
· Depreciation
· Where client(s) live and may live
· Does the estate plan work the next day and also works in the future in a reasonable way
· Is the estate plan flexible enough if clients do not come back in to update the estate plan in the future
· Is the client inclined to make lifetime gifts
· Flexibility

Advantages and disadvantages of portability vs. Credit Shelter Trusts (CST)

<u>Portability advantages</u>

· Simplicity
· Second step up in basis (upon second spouse's death). This is not available in CST
· Solution for dealing with assets that may not be good to put into CST
· Depreciating assets, such as a promissory note
· Retirement accounts
· Residence

<u>CST advantages</u>

· Trust outside the estate - Guaranteed shelter of appreciation and income
· GST exemption can be elected
· Remarriage risks
· Avoiding potential audit issues
· State estate tax issues

Other issues to consider

Planning for the nonstandard family

Portability is an asset to surviving spouse. Absent an agreement, if they would not leave a significant asset to spouse, then the possibility of portability should also not be left to that spouse.

A prenuptial agreement should address portability. If there is not one, there should be some other agreement. The speaker discussed writing a clause into the estate planning documents that state "if do not elect (or only elect), will receive….." He was not sure if this clause would be enforceable.

States with a state estate death tax.

No state has state estate portability, except for maybe Delaware. Here, credit shelter trusts may work or some sort of combination of the CST or QTIP trust.

The planner should review the state estate exemption amount and determine what may make sense from there. Also be wary of clients who move in and out of state estate tax states.

Planning considerations

Estates under $5 million

- No longer need credit shelter planning;
- May want to use trusts for familial reasons or other personal reasons
- Still may need to change title of assets to use trusts;
- State estate taxes may still want to use CST
- Additional consideration for age and prospects for wealth accumulation

Estates $5 million – about $10.5 million

- May have already split assets up between them
- May not be able to fully use the applicable exclusion amount at first death, even if you try to. Any leftover exclusion can be saved for portability election.
- Trust planning can be used to shelter some assets, such as an inheritances
- The uncertainty in this plan is appreciation and you will need to review the potential unrealized capital gain in the CST v. the step up in basis
- Another consideration is the DSUE amount in a remarriage situation. The surviving spouse could save the DSUE amount by making a gift. But the surviving spouse may not be willing to make the gift.

Estates over $20M
- Portability provides a different opportunity. For example, what if deceased spouse leaves all assets to surviving spouse. The surviving spouse makes a gift to a grantor trust that acts like the CST ("supercharged" trust) using first spouses DSUE amount. This could be a better plan than a CST on its own. If clients' rely on this planning, please be sure the gift can be made if surviving spouse is incompetent at first spouse's death.
- Again, in states with an estate tax, you may want a CST for state amount.
- At this level of assets, clients may have already used their exclusion amounts. At this point, you may be just dealing with the yearly inflation adjustment amounts.

If you, as a planner, do not know what to do, you should put off the decision. Options under this include:

· Disclaimers. Assets either go outright to spouse or to a QTIP trust. The spouse can disclaim an amount which then pours into the CST.
· Single Fund QTIP. This plan puts the decision in the hands of the executor, who may be best suited to make the decision to choose to elect the marital deduction for the trust and rely on portability or not make the QTIP election for all or part of the trust. It allows for the decision to be made up to 15 months after the date of death, rather than nine months with a disclaimer.
· Clayton election. On a high level, this is where non-elected portion of the QTIP trust, the trustee can elect to allocate it to the credit shelter trust, thereby creating a trust for spouse and descendants.
· Flexibility for Credit Shelter Trust drafting credit shelter trusts to capture some of the basis step-up that otherwise is available with portability at the surviving spouse's death

Above all, flexibility is needed as portability is another tool planners can use in estate planning.

9:50 – 10:40 a.m.
Venn Diagrams: Meet Me at the Intersection of Estate and Income Tax (Focus Series) (Financial Assets Series)
Paul S. Lee
Post-ATRA planning for larger estates will increasingly focus on income tax planning, the management of tax basis, and maximizing the "step-up" in basis at death. This presentation will discuss: measuring the transfer tax costs (including state estate and inheritance taxes) against the income tax savings from the "step-up" on different types of assets; recapturing assets that have already been transferred; multiplying the applicable exclusion amount; using trust and partnership elections, distributions, and reorganizations to maximize the "step-up" and "split" income across taxpayers.
Reporter: Mike Sneeringer

Mr. Lee used a PowerPoint, humor and citations to his written materials to illustrate that the future of estate planning is unfortunately based, very much so, on the estate planner's ability to do math: statistics and mathematics are key.

Mr. Lee began by challenging estate planners to engage in proactive tax basis management: the estate planner should go through the client's assets and identify those assets that will not benefit from a step-up in basis. This is contrary to the estate planner's thinking prior to 2001 whereby estate planners were laboring under a Federal estate and gift tax exemption equivalent of $675,000, a maximum Federal transfer tax rate of 55%, a law that still provided for a state estate tax Federal credit and where almost every state had an estate tax; and all of estate planning was about avoiding estate taxes.

Mr. Lee discussed, and his PowerPoint illustrated, that two or three generations of estate planners did not need to think about income taxes; and where most estate planners used the same planning (no matter the state in which the planning took place). This is because:

a) The State of residence did not matter;

b) Income tax consequences were secondary;

c) Step-up in basis at death was less important because of relatively low capital gains tax rates;

d) During life, clients were told to transfer wealth as quickly as possible;

e) During life, clients were told to use up their estate and gift tax exclusion; and

f) Avoid estate tax inclusion for as many generations as possible.

Mr. Lee contrasted that, today, there is an increased income tax rates coupled with a falling transfer tax liability both at the Federal and state level. He compared New York and California to illustrate that while California no longer has a state estate tax and New York does, California has the highest income tax rate.

Mr. Lee's PowerPoint slide, the "Gap Map," illustrated that there is a huge differential between the estate tax and capital gain tax rates depending upon where the client lives. As a consequence, an estate planner in Florida will use a different plan for a client than an estate planner in California.

Mr. Lee referred to a forecasted applicable exclusion amount slide to indicate that, in twenty years, the applicable exclusion amount could grow to $8.95 million or about $19 million per married couple, and, as such, if a client dies with the right assets, that is $19 million of free step-up in basis… but only if the client dies with highly appreciated assets in his or her estate, and only if the client has his or her applicable exclusion amount intact and unused.

While Mr. Lee at first analogized that clients should never ever ever ever use the applicable exclusion amount during their lifetimes, he doubled back by clarifying that there are specific circumstances, and estate planners should verify that the applicable exclusion amount is "put to good use" before it is "thrown away."

Mr. Lee referred to estate planners now having the following considerations:

a) Income tax considerations must be considered in tandem with potential transfer taxes;

b) Estate tax considerations can save more in income taxes; and

c) State of residency considerations; not just where is the client going to die, but where are the beneficiaries going to reside and die?

The new "estate planning math" is infinitely more complicated. An updated estate planning equation consisting of the following was illustrated in a slide by Mr. Lee: the time horizon; spending; size of the estate; return and income tax characteristic of assets; expected income tax realization of assets; investment and non-investment income; state of residence of the grantor and the beneficiaries; and inflation.

Certain assets benefit from a step-up in basis while others do not. Pages 2-26 through 2-38 of Mr. Lee's materials were referred to, and then a PowerPoint slide further illustrated that on one end of the spectrum, assets such as creator-owned copyrights, trademarks, patents, art, and negative basis commercial real property (to name a few) are assets that are the most important in receiving a step-up in basis (and thus the client should die with these assets in his or her estate), while assets such as variable annuities, traditional IRAs and qualified plan assets are the worst assets to die with since by definition, they cannot be transferred out of a client's estate during his or her lifetime.

While every single state math calculation will be slightly different, the key is to keep in mind the state's nominal exemption. Mr. Lee indicated that the step-up in basis is a "theoretical" income tax savings… the only way the client gets a benefit is if the client sells the asset and some clients will never ever ever sell the asset.

Mr. Lee next stressed that because step-up in basis is becoming increasingly important, forcing estate tax inclusion will become increasingly important. Mr. Lee illustrated the classic example of an attorney creating a

dynasty trust to avoid estate tax inclusion at every level yet, twenty years later, a group of beneficiaries might be around who squander money at a rapid pace, yet the dynasty trust is now worth billions; how is the estate planner's new math to be used?

Mr. Lee also described planning with general powers of appointment to solve the above hypothetical. Pages 2-41-through 2-46 of Mr. Lee's materials describe the general power of appointment while pages 2-46 through 2-48 discuss forcing estate tax inclusion properly, using the general power of appointment. Instead of drafting a super complicated general power of appointment though, Mr. Lee suggested that the estate planner should utilize a trust protector with the discretion to grant a general power of appointment in the client's documents.

Mr. Lee then pointed out a potential planning technique for the billionaire generation x'ers and y'ers (Mark Zuckerberg was his example): reverse estate planning… pushing assets up the ladder to parents to get a step-in basis as parents are "closer to the applicable exclusion amount maturity date." This is discussed on pages 2-48 through 2-51 of Mr. Lee's materials, and Mr. Lee cautioned that this technique probably will not be used as kids simply do not trust the people around their parents.

Mr. Lee also commented on running the brackets and taxing income at lower effective tax rates. While not in his materials, Mr. Lee used a PowerPoint slide to illustrate that hypothetically if in 30 years a $10 million trust made no distributions, the trust would go up to $55.3 million, but if you instead "run the brackets" and distribute to one beneficiary, that $55.3 million figure will go up and if you distribute to four beneficiaries, you end up with 28% more assets (the "pie in the sky").

Mr. Lee added that the future of estate planning consists of "tax basis management" using planning techniques such as asset swaps. Mr. Lee cautioned that estate planners who advised clients to use up their applicable exclusion amounts in 2012 and 2013 hopefully used defective grantor trusts for this planning. Thus, estate planners can now advise such clients to provide the values of assets within those defective grantor trusts to swap assets out of the trusts with high appreciation, in favor of assets with little to no appreciation.

Mr. Lee ended his presentation with a brain teaser: How do you change the tax basis of a non-depreciable asset without death or a taxable event? Partnerships! Subchapter K; K for kryptonite! Mr. Lee indicated that estate planners should think twice about making the Code Section 754 election following the death of a partner. Instead, estate planners should advise partners in family limited partnership contexts with high and low basis assets to identify those partners at the end of his or her life, have a liquidating distribution to said partner, and then later, following said partner's death, the asset can be distributed back to the partnership.

10:55 – 11:45 a.m.
There's No Place Like Home, But Where's Home? The Role of "Residence" and "Domicile" in State Income and Transfer Tax Planning Foreign Service Officers, Corporate Executives, NBA Referees, and More
Richard W. Nenno
Most states assess an income tax and/or one or more transfer taxes and base taxability on whether an individual is a "resident" or is "domiciled" there. States such as Florida, which don't have an income or transfer tax, nevertheless offer rules to establish residence or domicile for individuals wishing to escape taxation elsewhere. This session will survey how key states define "resident" and "domicile", give planning pointers, and consider specific fact patterns.
Reporter: Kristin Dittus

Mr. Nenno pointed out that there are several factors that should be considered when discussing the tax consequences of residence and domicile with a client.

1. State Death Tax. Until recently most states offered a Federal Tax Credit, but that was phased out completely as of Jan. 1, 2005. In addition, some states also impose a gift tax and/or a GST tax. See his Appendix B for further details.

2. State Income Tax. Forty-four states impose an income tax on individuals, estates, and trusts. In 2013, the top rate ranged from 3.07% in Pennsylvania to 12.696% in New York City and 13.30% in California. See his Appendix A for further details.

3. Effect of Residence in a Taxing Jurisdiction. The U.S. Supreme Court has stated that a jurisdiction, such as New York, may tax all the income of its residents, even income earned outside the taxing jurisdiction, while tax on a non-resident is generally limited income earned within the jurisdiction. Being classified as a resident or nonresident for state income tax purposes can make a huge difference.

4. Determining Residence. Each state has its own unique requirements, however, guidelines generally require having a permanent place of abode in the state, physical presence, and spending more than 183 days in the state. Regarding the 183 day rule, part of a day in a state will count as an entire day unless the taxpayer is there under a travel exception. In contrast, domicile is generally determined by physical presence, maintaining a permanent home and intent to return to the state as a permanent home.

5. Policy Considerations. Taxpayers may want to consider relocation to minimize or reduce exposure to tax.

6. Risk of Double Taxation. This is a valid concern, especially for people who are commuters and may keep a commuter apartment or perhaps a vacation home in the non-domicile state. Specific problem areas include the New England area, as well as the metro areas of New York City and Washington D.C. There is generally no credit between the states for income or estate tax paid in another state. As an example, Mr. Nenno cited Texas v. Florida, 306 U.S. 398 (1939), where Florida, Massachusetts, New York, and Texas, all considered Mr. Edward H. R. Green as a domiciliary for death tax purposes and each assessed approximately $5 Million Dollars in death taxes. Under such circumstances, Mr. Green's estate of $36 million before his death would have been diminished to a deficit of $1.5 Million after his death (including the Federal Estate Tax of $17 million). In this case, the US Supreme Court determined that only one state could tax Mr. Green as his domiciliary state.

7. Challenges in Changing Your Domicile. Domicile is like super glue, easy to get on and hard to break ties with. To change domicile a taxpayer must show a break with the old domicile and the establishment of a new domicile by clear and convincing evidence.

8. Using Trusts. States with low income tax rates for trusts offered an advantage for some time in accumulating income in trust, however, the rise of Federal Income Tax rates on trusts has diminished this advantage.

9. Concerns for Florida Advisors. Clients will generally seek advice from advisors in non-taxing state, such as Florida, regarding how to change domicile.

10. Timing for a Change of Residence. Most clients become concerned with changing their residence to reduce their tax burden when they retire, however, establishing residence should be considered much earlier if possible. For the children of wealthy clients, where they attend college, get married, or buy a home are all important considerations. Other important factors are where a client regularly vacations, buys a second home or if a client chooses to reside near their children. For example, if a client lives in Pennsylvania, but commutes to Delaware and wants to buy a home by the shore, she may want to look into a home on the Jersey shore rather than in Delaware.

11. Individuals Living Abroad. If a client is overseas for some time, state law give guidance on when a citizen won't be taxes as a resident. As an example, Delaware law provides that an individual who is present in a foreign country for at least 495 full days in any consecutive 18 month period, and during such period of 18 consecutive months is not present in Delaware for more than 45 days, and does not maintain a permanent place of abode in Delaware at which the individual's spouse, children or parents are present for more than 45 days will not be considered a resident.

After covering these major considerations, Mr. Nenno expounded on some specific cases and circumstances that arise in this area of law that are found in his materials. His additional planning considerations and thoughts are as follows:

1. There are an abundance of cases that illustrate what the courts consider persuasive in determining residency, especially in commuter states like Virginia.
2. A client's first domicile will have lifelong consequences.
3. A client should take action (illustrated by case law) to establish a domicile in the new state and do all things possible to show abandonment of previous domicile.
4. If a client is unwilling to make a commitment to the above action plan, he or she may want to avoid asserting domicile in a new state.
5. As the client ages, changing domicile may not be feasible due to lack of capacity, health concerns and other factors.

11:45 a.m. – 12:35 p.m.
Health Care Surtax: Individuals - Dancing Under a 3.8% Limbo Pole (Focus Series)
Christopher R. Hoyt
The 3.8% health care surtax is triggered once a person's modified adjusted gross income (MAGI) exceeds $200,000 ($250,000 on a joint return). But several income sources are exempt from the surtax, including IRA distributions and certain profits from an S corporation. Techniques that can help an individual reduce MAGI may become increasingly popular, including installment sales, charitable remainder trusts and charitable lead trusts.
Reporter: Ted Preston

The 3.8% health care surtax is triggered once a person's modified adjusted gross income (MAGI) exceeds $200,000 ($250,000 on a joint return). But several income sources are exempt from the surtax, including IRA distributions and certain profits from an S corporation. Techniques that can help an individual reduce MAGI may become increasingly popular, including installment sales, charitable remainder trusts and charitable lead trusts. Here are some highlights from Prof. Hoyt's discussion of these issues.

Professor Hoyt explained several methods we can use to help our clients minimize the new 3.8% surtax imposed on certain trusts, estates and affluent individuals by the 2010 Health Care and Education Reconciliation Act of 2010 and its implementing regulations. He also explained a second new Medicare surtax of 0.9% which affects similarly affluent individual taxpayers. These new taxes have a significant effect on real tax rates for individuals, trusts and estates, and also increase effective rates on capital gains for some taxpayers.

One surtax-reduction strategy seeks to reduce Net Investment Income (NII), the income category upon which the 3.8% surtax is imposed. If an individual can reduce NII below a $200,000 threshold (or $250,000 for married couples filing jointly), the surtax will not apply. Trusts and Estates can effectively reduce the tax by converting NII into income that is not NII. A second strategy to reduce the surtax works by shifting assets that generate NII away from the trust or estate to individual beneficiaries whose income does not meet the threshold and will not

incur the tax. It may also be advisable to convert taxable income to tax-free income where possible in order to reduce NII.

In order to take advantage of planning opportunities and minimize taxes, practitioners must understand what is and is not Net Investment Income. NII consists of:

-Interest, dividends, annuities, royalties, rents
-Profits from a trade or business if the taxpayer does not materially participate (a passive activity)
-Profits from a trade or business of trading in financial instruments or commodities even if the taxpayer does materially participate
-taxable net gain from the disposition of certain property not held in a trade or business where the taxpayer materially participates.

Section 1411(a)(1) imposes a 3.8% surtax on the lesser of 1) NII or 2) the excess of the individual's Modified Adjusted Gross Income (MAGI) over the $200,000 threshold ($250,000 for married filing jointly.) The same surtax applies to trusts and estates at much lower thresholds ($12,150 in 2014.)

These surtaxes are anticipated to apply to 0.7 % of single taxpayer returns, and 7.6% of married joint returns. Those percentages will increase over time because the surtax threshold is not indexed for inflation. The practical effect of the surtax is also inflated for higher-income taxpayers by the 3% phaseout of itemized deductions, and the 2% phaseout for personal exemptions, both of which effectively increase Adjusted Gross Income (AGI) and MAGI. The net result of these combined surtaxes and phaseouts is a real tax rate that rises substantially for affluent taxpayers. As a result, planning strategies that reduce a taxpayer's income below the applicable thresholds or shift NII items from trusts and estates to beneficiaries who are not subject to the surtaxes, or convert taxable income items to tax-free income, can substantially reduce the net taxes for our clients.

NII is calculated and the surtax is determined using IRS form 8960. A new form, instructions and final regulations are now available.

Professor Hoyt's outline contains numerous nuances that will be of interest to practitioners, which cannot be covered effectively here. The outline is concise, by Heckerling standards, conveniently-footnoted, and is a useful starting point for practitioners seeking to assist their clients in minimizing these new surtaxes.

2:00 – 2:50 p.m.
When Business Life Insurance Results in Income or Compensation Depends on Who Owns the Policy
Donald O. Jansen
A must for closely-held business planners! Business life insurance has income/compensation results based on the owner: employee (executive bonus plans); employer and employee jointly (split-dollar); employer (key person, deferred compensation, self-insured medical).This presentation will review the strategies for all three to avoid or minimize the impact of ERISA, Section 409A and EOLI.
Reporter: Mike Sneeringer

Mr. Jansen method was to go through his outline to describe the three techniques of using life insurance as compensation for executives based upon ownership of the policy.

Mr. Jansen opened with some food for thought: when we hear the word "taxes" in regards to life insurance, we think transfer taxes (estate, GST and gift) as opposed to the income tax consequences when insurance involves an employee or employer.

The three techniques of using life insurance as compensation for executives based upon ownership of the policy are: compensation arrangements where the employee has all rights to policy (pages 5-1 through 5-18); compensation arrangements where executive and employer combine efforts (split dollar; pages 5-18 through 5-46); and employer owned compensation insurance (EOLI and COLI; pages 5-46 through 5-72).

Compensation Arrangements Where the Employee has all Rights to Policy

A) Mr. Jansen described this as the technique where an executive owns the life insurance policy, the employer pays the life insurance premium and the employer does not get the premium back.

B) The purpose is to provide a death benefit perk to the executive. If the life insurance policy has a high cash value, the life insurance policy is used as a retirement supplement.

C) The tax consequences are that the payment of the insurance premium is income to the employee and a deduction to the employer. However, the employer deduction is not automatic and Mr. Jansen stressed that the amount of the premium paid must constitute an ordinary and necessary business expense in connection with payment of reasonable compensation for personal services actually rendered.

1) Mr. Jansen noted that the estate planner must look not only to the income tax consequences, but also look to whether ERISA is applicable.

a) It is likely that the traditional Section 162 Executive Bonus Plan is a welfare death benefit plan subject to ERISA.

b) Of the cases cited on pages 5-4 through 5-5, Mr. Jansen specifically pointed out Halifax Packing Company v. Coyne that decided there is an ERISA plan if the plan requires an administrative scheme to operate

2) Mr. Jansen noted that many employers are antsy about so-called "top hat" welfare plans whereby the plan provides benefits for a select group of highly compensated employees, but if the insurance policy has a high cash value, the insured employee could leave, take the cash value and then go and work for the employer's competition.

a) Employers attempt to limit the executive from getting his or her hands on the cash value too early using Restricted Access Executive Bonus Plans. This is covered in great detail on pages 5-6 through 5-18 of Mr. Jansen's materials.

b) The executive cannot surrender, borrow against or withdraw funds from the life insurance policy without the consent of his or her employer for a period of time. Mr. Jansen described this as "velvet handcuffs."

c) The income tax consequences of the so-called "velvet handcuffs" are described on pages 5-8 through 5-14 of the materials. Mr. Jansen highlighted that while it is clear the Section 162 Executive Bonus Plan is includible in the executive's gross income under Section 61, the Restricted Access Executive Bonus Plan, with its restrictive policy endorsement and, perhaps, vesting schedule and reimbursement provisions, raises questions as to whether the split dollar loan regime, Sections 83 and 409A, would apply.

3) Mr. Jansen noted that if an employer wants to go further, it may have the executive enter into an executive side contract which would basically state that if the executive leaves the company within ten years, the executive must reimburse all or part of the premium payments, which were previously paid by the employer, back to the employer. This is an unfunded and unsecured promise to pay.

4) Mr. Jansen went into more detail on the issue of whether the Restricted Access Executive Bonus Plan is a pension benefit plan rather than a welfare benefit plan under ERISA. This is covered in greater detail on pages 5-14 through 5-16 of the materials.

a) Even if the plan is considered to be an employee pension plan, if it is an unfunded "top hat" plan applying only to a select group of management or highly compensated employees, only a written plan containing items such as a designation of a named fiduciary and a claims procedure is needed.

b) Mr. Jansen stressed that a statement must be filed with the DOL including requirements described on pages 5-15 through 5-16 of the materials. Failure to file this statement within 120 days after the plan is created will result in the requirement of filing annual reports on Form 5500.

Compensation Arrangements Where Executive and Employer Combine Efforts

A) Mr. Jansen described this as a "split dollar arrangement" whereby the employer assists the executive in obtaining life insurance by paying all or part of the insurance premiums. There are two split dollar arrangements:

1) Mr. Jansen referred first to the "loan regime" (described in greater detail on pages 5-19 through 5-31 of the materials) whereby the employer "loans" money to the employee in the form of obtaining life insurance coverage for the employee and then paying the life insurance premiums, while there is a collateral assignment of the life insurance policy to the employer to secure the loan.

a) Mr. Jansen stressed that you need a "real" loan with "real" income payments; no sham! The employer cannot indirectly pay the principal on the loan; if the employer is obligated to do so, then you do not have a loan; the premium payment then becomes a bonus.

b) Mr. Jansen also stressed that the employer should pay the loan.

2) Mr. Jansen then described the "economic benefit regime" (described in greater detail on pages 5-31 through 5-37 of the materials) whereby the employer owns the insurance policy and endorses to the executive all or part of the pure death benefit.

a) Mr. Jansen stressed that the employer has to own all the cash value; if the executive has excess, the executive is taxed on the cash value.

b) Mr. Jansen spent time describing the variation of an economic benefit regime combined with "switch dollar" whereby the policy is purchased under an economic benefit regime split dollar arrangement and at the point where the cash value of the policy equals the aggregate premium payments, the economic benefit regime is terminated and "switched" to a loan regime by making the employee the owner with an execution of promissory note in favor of the employer. This is described in greater detail on pages 5-32 through 5-33 of the materials.

Employer Owned Compensation Insurance

A) The final technique Mr. Jansen described is a concept whereby the employer may be the owner and beneficiary of insurance policies on the lives of its employees for many purposes, described in detail on page 5-46 of the materials. In most cases the employer is the sole owner and sole beneficiary of the policy.

B) Mr. Jansen acknowledged that this technique was at one time deemed "Janitor Insurance" by the media as certain employers bought huge life insurance policies on their employees without the consent of the employee.

1) Now under Section 101(j), employer-owned life insurance proceeds are taxable to the employer except for certain employees, directors and highly compensated employees. Mr. Jansen described Section 101(j) as the "sledge hammer."

2) Mr. Jansen then described the exceptions (two of them) in detail: exceptions based on employee status (pages 5-66 through 5-67 of the materials) and exceptions for amounts paid to the insured's heirs (page 5-67 of the materials).

i) The keys are notice and consent before the life insurance policy is issued. If notice and consent are undertaken after the life insurance policy is issued, problems occur unless the employer can prove that a "good faith" effort to satisfy those requirements was commenced and that the failure to satisfy the requirements was inadvertent.

Mr. Jansen finished his presentation by indicating that there will be a lot more detail on life insurance during his Wednesday Special Session with Mary Ann Mancini, titled "What's Hot in Life Insurance. "

2:50 – 3:40 p.m.
When You Must Adjust How, When, Why and What Do the Professionals Do? (Financial Assets Series)
Gail E. Cohen
More than 15 years have passed since the Uniform Law Commissioners promulgated the first Uniform Principal and Income Act in 1997. Through the years, professional fiduciaries have developed techniques and guidelines to assist in determining the appropriate manner to exercise discretion under the various state versions of the Act. This session will review the state laws, examine the cases that have arisen interpreting the laws, and discuss how professional fiduciaries across the country have applied the law.
Reporter: Michelle Mieras

More than 15 years have passed since the Uniform Law Commissioners promulgated the first Uniform Principal This session examined the use of the trustee's power to adjust or the use of a unitrust conversion to satisfy the trustee's fiduciary duties when faced with the inherently conflicting interests of current and remainder beneficiaries. One of Ms. Cohen's first calls in her role as a professional fiduciary exemplifies these issues. The call was from a surviving spouse and her stepsons who were concluding five years of litigation, and needed a corporate trustee. The meeting with the family was pleasant, and Ms. Cohen explained the need to invest in manner that balanced the interest of the surviving spouse as current income beneficiary, and her stepsons' interests as remainder beneficiaries. The following day she received a call from the surviving spouse who declared that she would not want any stocks in the portfolio; rather she was interested in generating income. Her colleague also received a call from the stepsons, who stated that they did not want any bonds in the portfolio. What options are available to the trustee to resolve these types of situations?

Ms. Cohen touched on the history of the Uniform Principal and Income Act, which is covered more in-depth in her 72-page outline. She noted the shift to an obligation to invest for total return (income and growth), while staying within the appropriate risk parameters. This blurred the line between income and principal from an investment standpoint, leading to the Uniform Principal and Income Act of 1997 (referred to by Ms. Cohen as the "UPAIA").

The UPAIA presents possible solutions when a trustee is confronted with conflicting interests of income and

remainder beneficiaries, as in the situation described above. One possible solution is the trustee's power to adjust allocations between principal and income. The requirements to exercise this power to adjust were examined. Ms. Cohen pointed out that the power to adjust is available in income distribution trusts but if and only if the trustee is pursuing a total return strategy in the first place and the trustee cannot otherwise be impartial between the income and remainder beneficiaries.

Ms. Cohen turned to the underlying investment strategies, and how this is at the root of the income/principal considerations. In order to determine the appropriate investment strategy, reasonable return must first be considered. As with any decision, the trustee should carefully document the process of determining the appropriate investment strategy. Appendix A of the materials includes an example of documentation of the decision process, including asset allocation strategies, return expectations, and a comparison of returns to inflation. Ms. Cohen reminded the audience that trustees are measured by the process they engage in when making decisions, and that documentation of the process is key.

Forty-seven states have adopted various statutes giving the trustee a power to adjust, and the practitioner must consult the law of the applicable state carefully. Appendix D of the materials includes a very helpful chart comparing the laws of each state, including factors a trustee should consider when deciding whether to exercise the power to adjust. Note that the power to adjust cannot be exercised in all circumstances. For example, the power to adjust cannot be exercised if it would affect the mandatory income distributions to a surviving spouse from a marital deduction trust.

A unitrust conversion may provide another solution for trustees facing the conflicting interests of income and remainder beneficiaries. Thirty-two states have enacted unitrust statutes, which permit a trustee to distribute a designated percentage of the trust assets each year to the current beneficiaries, regardless of the actual amount of income generated during the year. This again permits the trustee to focus on total return. Most state statutes will specify the unitrust percentage or range of percentage to be used. Unitrust conversion may be available when the power to adjust cannot be used, as in the case of a marital deduction trust.

Ms. Cohen then dove into the income tax implications of the Uniform Principal and Income Act. The IRS will recognize an adjustment between principal and income or a unitrust conversion if permitted under state law. She pointed out that the definition of income is key. As a general rule, trust distributions carry out ordinary income from the trust to the beneficiaries, but capital gains are typically taxed to the trust. After the enactment of the UPAIA in several states, the IRS changed the income rules to address perceived inconsistencies (i.e., allowing principal to be distributed to the income beneficiary while the trust – and ultimately the remainder beneficiaries – continues to incur tax liability for capital gains generated to raise cash for the distribution to the income beneficiary).

Consequently, the regulations specify a trustee's options to shift the tax burden to the beneficiaries receiving distributions, permitting capital gains to be included in DNI under certain circumstances, as long as the governing document or state law allows. Most states with unitrust laws have some form of ordering laws for unitrusts, which may be mandatory or default laws. These laws specify the character of the distribution to the beneficiary (net income, STCG, principal, etc.). Absent a mandatory ordering rule, the trustee of a unitrust can only exercise a discretionary power to allocate capital gains to DNI consistently over the entire term of the trust. This is more restrictive than the allocation of capital gains when a trustee exercises a power to adjust, which need not be done consistently year to year if the allocation is made reasonably and impartially.

While at first glance it may seem ideal to provide that capital gains are distributed, Ms. Cohen pointed out that the drafting attorney (and trustees in general) must be cognizant of situations in which it may not be advantageous to have capital gains distributed. For example, if a trust is administered in a state with a low

income tax, and a beneficiary lives in a state with a high income tax, it could be wise to not distribute capital gains. Additionally, the impact of the recently implemented 3.8% tax on net investment income on both the trust and the beneficiary should be considered. The outline walks through a few illustrations of these issues.

Ms. Cohen turned to the limited cases involving unitrusts and powers to adjust. The cases are discussed more extensively in the materials. A few of the highlighted cases addressed the potential retroactivity of a unitrust conversion, and the resulting effects (positive and negative) on the current beneficiary. Ms. Cohen pointed out the potential for a retroactive unitrust conversion to be used as a litigation and/or settlement tool, and misconceptions that a unitrust conversion will apply equally to successor income beneficiaries.

The materials and presentation concluded with a look at where we are now and where we are going. Ms. Cohen mentioned that this will be covered more in-depth at special session I-C on Wednesday, "Living and Working with the Uniform Principal and Income Act." She briefly covered the results of a national survey of institutional fiduciaries on their practices with regard to the power to adjust and unitrusts. The results show a preference by fiduciaries to use a power to invade (if available) rather than the power to adjust or a unitrust conversion. On the other hand, many fiduciaries find that the ascertainable standard often accompanying the power to invade does not give them enough flexibility to accomplish what could otherwise be accomplished via the power to adjust or unitrust because of the requirement to prove that the beneficiary needs the funds for the stated purposes. The full results of the survey are included in Appendix F of the outline. Ms. Cohen feels that the power to adjust and unitrust conversion present significant income tax planning opportunities and are currently under-utilized.

Going forward, the trend appears to indicate increasing litigation with regard to trustee decisions. She recommends that trustees get approval and/or consent from all involved prior to implementing decisions in order to mitigate the opportunities for litigation.

3:55 – 4:45 p.m.
Funding Unfunded Testamentary Trusts
Mickey R. Davis
You're helping the children administer their father's sizable estate.
You've reviewed the will of the predeceased mother, and ask about her bypass trust. The children were told, that Mom's will left everything to Dad. Is there any way to salvage the benefits that were supposed to have arisen from the bypass trust? Explore the fiduciary and tax issues that arise when a testamentary trust has gone unfunded.
Reporter: Joanne Hindel

Mickey started off his presentation by saying that most practitioners find that their clients don't want to do the funding after establishing the estate plan. He referred to the first section of his outline as discussing general funding issues but said that the focus of his presentation would be on situations when the client realizes that a trust that should have been funded wasn't.

Mickey said that he finds there are three steps in estate administration: administering the estate, preparing the estate tax return and funding the trusts.

He cautioned that you should be sure to coordinate probate with non-probate assets when considering funding by-pass trusts.

He also pointed out that assets can and often do change from the date of establishment of the plan. He said that the goal of funding formula clauses is to shoe horn as much of the probate property into the bypass trust without generating any estate tax at the first death.

Mickey said that he can best identify the formula clause about one year after a client dies. He also talked briefly

about the funding date and said that most practitioners just pick a funding date which the IRS does not scrutinize too closely. Revenue 64-19 does not mention funding dates at all.

His outline includes exhibits that support documentation of the funding process.

The primary focus of his presentation was on what happens when the bypass trust is not funded – when the second spouse dies and it is discovered that funding at the first death did not occur.

Is it too late to fund at the second death? This is driven primarily by state law.

He focused on what theories exist to permit reconstruction of an unfunded bequest made to a bypass trust years after the death of a spouse.

Estate planners often think of funding bequests with assets owned by the decedent at the date of death. Invariably however, time passes between the date of death and the date that bequests are actually funded and assets used to fund bequests are often not those on hand at death.

What if you represent the executor of the husband's estate. The wife died several years ago and her will contained a pecuniary bypass trust with a residuary outright marital bequest. When the husband dies it appears that no bypass trust was ever funded when the wife died. If the bypass trust cannot be reconstructed the heirs will owe estate tax at the death of the surviving spouse.

There are three plausible approaches:

1. The "Vested in the Bypass trust" approach which can be applied if the property at issue remained in the wife's name and the husband took no actions inconsistent with the ownership of the assets by the wife's estate or the bypass trust. Then title to the property can be found to be vested in the trustee of the bypass trust pursuant to state law. Mickey discussed the *Estate of Richard* case to demonstrate this approach.
2. The "Constructive Trust" approach: If the husband wrongfully holds the bypass trust property in his individual name then under the UTC or similar statutory or common law, a proper remedy would be to subject the property or proceeds to a constructive trust. Mickey discussed the *Stansbury* case to demonstrate this approach.
3. The "Debt Against the Estate" approach: If the husband was the executor of the wife's estate, in lieu of the constructive trust approach, an equally compelling argument can be made that the husband misappropriated the assets and can be considered to owe a debt to the unfunded bypass trust or its remainder beneficiaries. Mickey discussed the *Estate of Bailey* case to demonstrate this approach.

He pointed out that in the "Constructive trust" approach assets are excluded from the surviving spouse's estate whereas in the "Debt against estate" approach the assets are included less the debt.

One other theory is the Resulting Trust Approach based upon a PLR ruling 9338011 in which a trust was terminated when it should not have been (was originally funded but not maintained).

Issues pertaining to unfunded bypass trusts may have to do with whether the IRS will recognize the trusts years later but may also be a factor if the surviving spouse remarries and then wants to leave assets to a second spouse and exclude children by the first marriage.

The statute of limitations may not be a barrier if the parties entitled to the funding of the bypass trust – the beneficiaries- were not aware of the lack of funding.

He said that the IRS does not have this issue high on their hit list and does not always catch the issue of lack of funding.

If a settlement is reached among the parties, how can it be made binding upon the IRS? IRS is likely to accept the settlement if there is a showing of some wrongdoing. Don't need to have a lawsuit to make it binding on the IRS – most states have policies that favor family settlement agreements.

Mickey concluded his presentation by saying that the lesson to be learned is "don't give up." In his experience the lack of funding of a bypass trust occurs in three primary situations:

1. Client fatigue
2. Client wrongful behavior
3. Advisors recommending against funding

4:45 – 5:35 p.m.

Representing Clients with Diminishing Capacity: What to Know and How to Bridge the Gap
Robert B. Fleming
With the aging of our client base comes increased frailty, more frequent disability and greater susceptibility to exploitation and undue influence. Do you know how to best deal with clients as they become more vulnerable and dependent? How to recognize diminishing capacity, and what a lawyer can do about it? Who to call when you need assistance?
Reporter: Kristin Dittus

Mr Fleming began by indicating that we like to think of older clients as anyone older than ourselves. In reality, an older client that is suffering from dementia is likely 85 or more years old. Of all the people that are currently 70 years old, only 5% or less are probably dealing with dementia. Unfortunately, there are few good resources and studies at this time on the populous dealing with dementia.

Mr. Fleming dealt with the subject in a refreshingly light hearted way given the difficulty encountered in this area. Dr. Barry D. Weiss, of the University of Arizona College of Medicine and a very good gerontologist, was a valuable resource in contributing to these materials. There are two main varieties of dementia that compromise about 2/3 of the population which are (1) Alzheimer's disease and (2) Vascular Dementia. There is no known recovery for either of these.

Alzheimer's is generally characterized by a slow and gradual deterioration, while Vascular Dementia presents as more sudden steps down in capacity resulting from a series of small strokes. Client should consult a doctor to rule out poor diet or depression for diminished capacity. Mr. Fleming highly recommends and personally gives out the book, The 36 Hour Day, to his clients in need of guidance relating to dementia.

Some practical guidelines for assisting older clients to have a productive meeting with you include:

1. Avoid standing in front of a window or the light source which makes your face and features hard to see.

2. Older clients may have trouble hearing and will often try to read your lips. Make your lips visible, speak slowly, clearly and loudly. A client may ask you to stop shouting at them, but if they can't hear they will likely be too embarrassed to ask you to speak up.

3. It may help to adapt your furniture. Mr. Flemming raised the chairs in his office by 1.5 inches, not so much that it is visibly noticeable, but his clients really appreciate how easy it is to get up and out of them, especially with the addition of sturdy arms on the chairs.

4. Meet with the client alone. When confirming an appointment with a client by letter, Mr. Flemming incudes that he will need to meet with the client alone for the initial meeting. Often times a child will want to accompany an older client into the meeting, but it is vital to meet the client alone and get a perspective on the client's independent thoughts and capacity.

5. He has found a simple "noise machine" that creates a fan like noise in the lobby which prevents prying

relatives from overhearing loud conversations with elder clients

What does it mean to have dementia?

6. A doctor's diagnosis of dementia does not mean a client lacks testamentary capacity.

7. Hospitals use clinical tests to determine dementia, but this level of depth is unnecessary to commence legal work. These tests do, however, offer some useful questions to ask a client, such as: what is the maiden name of the client's mother, today's date, who is the current and previous president, city of client's birth, and names of the client's children. You may even be able to work these into normal conversation. For children's names, try not to read off information and then use confirming language such as "isn't that right." Get the client to provide you with the information and confirm the same later in the conversation if possible.

8. A client should have capacity to know what they are signing, what property is affected by the document.

9. Attorneys are generally good at determining capacity, but may have some trouble identifying undue influence or exploitation because it is difficult for an advisor to see how a client is treated outside the office and at home.

10. For ethical guidance review the ABA Model Rule of Professional Conduct 1.14, Client with Diminished Capacity, and also look at the American College of Trust and Estate Council (ACTEC) commentary on this rule that has more information on how the rule is applied. Under 1.14 an attorney is meant to have as "normal a relationship as possible with the client" and take the action that has the least negative effect on the person's wellbeing.

Also be cognizant of MR 1.16, Declining or Terminating Representation, and MR 1.19, Duties to Former Clients. Unless a letter was sent advising that the legal relationship was terminated, the attorney likely still represents the client. An attorney should do as much as possible to indicate to an older client's children that they are not the attorney's client. Have children wait in the lobby rather than join in meeting, do not meet with a child about the legal issues of his or her parents and do not share information about the legal representation without the client's consent and even presence.

Have "the talk" about end of life wishes with your family, and be aware of POLST Directives (Physician Orders on Life Sustaining Treatments) that are being enacted in many states.

Wednesday, January 15

9:00 – 9:50 a.m.
Wrapping Up Your Gift Tax Return with a Tidy Bow: Reporting Gifts with an Eye Toward Audit (Litigation Series)
Stephanie Loomis-Price, David Pratt
Did you file a record number of gift tax returns on behalf of your clients in recent years? Do you use formula clauses for gifts and sales? How do you report them? This dynamic duo will discuss audit-proofing (to the extent possible), including the reporting of formula transfers that may be highly scrutinized.
Reporter: Mike Sneeringer

Did you file a record number of gift tax returns on behalf of your clients in recent years? Do you use formula clauses for gifts and sales? How do you report them? This dynamic duo discussed audit-proofing (to the extent possible), including the reporting of formula transfers that may be highly scrutinized. Here are some of the

more significant highlights from this session.

Ms. Loomis-Price (the tax litigator) and Mr. Pratt (the estate and tax planner) used a back and forth dialogue to thoroughly cover the main ingredients to file an accurate and possibly “audit proof” gift tax return.

Mr. Pratt stated at the outset that practitioners looking for a greater focus on the line by line details of the gift tax return should consult his and Ms. Loomis-Price’s printed materials beginning at 9-1. Ms. Loomis-Price alluded to a four page checklist that she made available online on the ABA Real Property, Trust and Estate Law Section’s website.

Both Mr. Pratt and Ms. Loomis-Price stressed that the gift tax return needs to be meticulously put together. They compared the gift tax return to a United States Supreme Court brief in that you get one chance to make a good first impression.

Some tips that Ms. Loomis-Price quickly touched on were that the return should be created using a commercial gift tax return service, should be bound together neatly and should never be written or typed (using a typewriter); a handwritten return automatically invites unwanted attention from an IRS examining agent.

Ms. Loomis-Price then described how the statute of limitations works. Adequate disclosure triggers the running of the statute of limitations. Code Section 6501 and its accompanying regulations define “adequate disclosure.” The statute of limitations is generally three years but if a gift tax return is filed and it substantially omits a gift which should have been reported, the IRS can impose a six year statute of limitations. The IRS has some wiggle room with what constitutes “adequate disclosure” because a transfer is “adequately disclosed” only if it “sufficiently apprises” the IRS. Ms. Loomis-Price added that where fair market value is an issue, practitioners must be careful about what must be disclosed under the Regulations.

Mr. Pratt stated that there are two types of gifts: 1) gifts of easy to value assets (cash or marketable securities) and 2) gifts of hard to value assets.

Both Mr. Pratt and Ms. Loomis-Price stressed that in order to value marketable securities, the mean is used, not the highest or lowest price at any given time or the price of the marketable security at the end of the day. Mr. Pratt added that the practitioner should include the mean values of the marketable securities as an exhibit for substantiation. Ms. Loomis-Price stated that the marketable securities’ CUSIP number and the stock exchange where traded should be included.

Mr. Pratt then described gifts of hard to value assets. He pointed out Schedule A of the gift tax return to illustrate that there is a question that asks (paraphrasing): does the value of any item on Schedule A have a valuation discount… if yes, attach an explanation…. Ms. Loomis-Price called this question a “salary” for her, intimating that this question is the invitation to audit question. Mr. Pratt identified this question as one where the IRS will likely scrutinize the gift tax return if checked yes.

Mr. Pratt noted that the key is to show how the discount came about; substantiation! All information should be laid out; nothing should be hidden (Ms. Loomis-Price mentioned that if you have something to hide, you probably should not be doing the gift in the first place). Keys Mr. Pratt discussed were: identifying the trust, donor, donee, trustee, trustee’s address, and trust EIN to name a few. Mr. Pratt stressed that a copy of the trust and appraisal should be attached to the gift tax return.

Ms. Loomis-Price stressed that although you do not have to attach an appraisal, it is highly recommended. However, a qualified appraiser (with pristine qualifications) should be used and the appraiser should never be

related to the donor or affiliated with a donor's company. Ms. Loomis-Price noted that the IRS generally knows who is a good or bad appraiser.

Mr. Pratt and Ms. Loomis-Price then described the two types of commonly used formula clause/type gifts: a McCord gift or a Wandry gift.

Mr. Pratt described the facts and planning in the Wandry case (available in the materials at 9-23 through 9-24 and again at 9-26). The key to a Wandry gift is that the donor makes a gift of shares equal to a specified value; the donor is "backing into the value."

Ms. Loomis-Price then described the facts and planning in the McCord case (available in the materials at 9-19 and again at 9-25); she noted that she was second chair during its litigation. McCord differed from Wandry as it used a charity as the backstop. The key here is that when using a charity as the backstop, now the donor has public forces in place to defend the rights of the charities used. Ms. Loomis-Price also suggested that the practitioner make sure that the income tax implications be considered when engaging in this type of transaction.

Mr. Pratt then described variations to the McCord gift: a zeroed out GRAT as the backstop or an inter vivos QTIP trust as the backstop. Mr. Pratt cautioned, however, that both GRATs and inter vivos QTIP trusts have reporting requirements and elections that practitioners need to be aware of. Mr. Pratt touched on the variation of a transfer to a complete/incomplete gift trust. This is described in the materials at

Both Ms. Loomis-Price and Mr. Pratt added that the law surrounding Wandry is still developing and that clients should be cautioned to this fact before embarking on these types of gifts.

Mr. Pratt then described sales to defective grantor trusts. While a gift tax return cannot be filed without there actually being the requirement of having to file a gift tax return, Mr. Pratt suggested that the client transfer an amount of money or marketable securities greater than the annual exclusion in order to be able to report the sale on a gift tax return. Some clients may not want the risk, however, both Mr. Pratt and Ms. Loomis-Price agreed that best practice would call for reporting the sale in order to start the statute of limitations. Mr. Pratt also mentioned that because these types of transactions are now referred to on the estate tax return, there is more incentive to report them at the time the sale occurs, rather than waiting until death.

Ms. Loomis-Price concluded by saying that best practice would be for all charitable gifts to be reported on the gift tax return too, whether they are reported on the client's income tax return already or not. This is because it hurts credibility when the IRS asks (if the gift tax return is audited): why didn't you report those gifts too… what else did you forget to report?

9:50 – 10:40 a.m.

Because it Wasn't Complicated Enough – Estate Planning Issues for Same- Sex Couples in the Wake of the Supreme Court's Recent Decisions

Lee-ford Tritt

In the wake of the recent Supreme Court decisions in Windsor and Hollingsworth, the already complicated world of estate planning for same-sex couples has gotten even more complicated. The decisions went further than the federal government ever has in extending equal rights to same-sex couples, but left untouched the thicket of conflicting state laws that offer varying degrees of legal recognition of same-sex unions. This ever evolving legal landscape coupled with large numbers of migrating same-sex couples means that estate planning for same-sex couples will remain challenging. This session will discuss the recent Supreme Court decisions and the new issues that they raise for estate planners, including an overview of the minefield of choice-of-law issues that advisors must safely navigate.

Reporter: Elizabeth Lindsay-Ochoa

In the wake of the recent Supreme Court decisions in *Windsor* and *Hollingsworth*, the already complicated world of estate planning for same-sex couples has gotten even more complicated. The decisions went further than the federal government ever has in extending equal rights to same-sex couples, but left untouched the thicket of conflicting state laws that offer varying degrees of legal recognition of same-sex unions. This ever evolving legal landscape coupled with large numbers of migrating same-sex couples means that estate planning for same-sex couples will remain challenging. This session discussed the recent Supreme Court decisions and the new issues that they raise for estate planners, including an overview of the minefield of choice-of-law issues that advisors must safely navigate. Due to the newness and complexity of these issues, this report is longer that usual plus it is followed immediately by the report on the companion Special Session 1-D on the same subject.

The presentation examined the issues in a Post-*Windsor* (*United States v. Windsor* (570 U.S. ___ [133 S.Ct. 2675](2013)) and *Perry* (*Hollingsworth v. Perry* (570 U.S. ___ [133 S.Ct. 2652] (2013)) world.

The speaker emphasized the point that planners should not presume clients have the same predisposition on this matter as the planner does. These issues need to be discussed with clients, and documents should take into account how the clients feel on these matters.

Quick history of same sex marriages in the US

In 1993, Hawaii was the first court to review same sex marriage cases. The Hawaiian Supreme Court found discrimination against Same-Sex marriage to violate the Equal Protection clause of the Hawaiian State Constitution. *Baehr v. Lewin*, 74 Haw. 530 (Haw. 1993).

In 1996, the Defense of Marriage Act (DOMA) was passed. Mini state DOMAs are also passed.

In 2003, the Massachusetts Supreme Court holds that the limitation of benefits (including marriage) to same-sex couples was a violation of the State Constitution's Equal Protection clause. Same-sex marriages begin in 2004.

Today (Reporters comment: meaning 10:00 am on 1-15-2014), there are 17 states, DC and 9 Native American Nations that recognize same sex marriage. There are some states that allow domestic partnerships or civil unions. These types of unions vary rights, from limited rights up to the same rights as marriage. There are several states that ban same-sex marriage, may or may not recognize same sex marriage in other states and may or may not recognize same sex divorce. The outline goes into great detail on this. Finally, there is Utah where about 1300 couples married, the US Supreme Court issued a stay, Utah stating that it will not recognize those marriages, but the federal government saying that it will recognize these marriages. Yesterday, an Oklahoma Federal District Court allowed same sex marriage, but granted a stay pending an appeal.

What is interesting is that although far more states ban same sex marriage than allow it, about 40% of the US population live in same-sex marriage jurisdictions.

Windsor and Perry

Briefly, the rulings of *Windsor* and *Perry* did not repeal Section 2 of DOMA. This section is still in effect.

This section states "No State, territory, or possession of the United States, or Indian tribe, shall be required to give effect to any public act, record, or judicial proceeding of any other State,
territory, possession, or tribe respecting a relationship between persons of the same sex that is treated as a

marriage under the laws of such other State, territory, possession, or tribe, or a right or claim arising from such relationship."

The speaker noted that even if Section 2 is held unconstitutional, nonrecognition states may not have to recognize because of the public policy exemption from full faith and credit clause

Section 3 was the only section considered in *Windsor* and was declared unconstitutional. This was covered in detail on the Monday session and is in outline 16-20. The speaker noted that *Windsor* is not tax case, but constitutional law case in tax clothing. *Windsor* does effect interpretation and administration of tax law. But the same sex marriage issue is left to state law.

In *Perry,* the court ruled that proponents of Prop 8 lacked standing, thereby allowing same sex marriage in California. Within days California began issuing marriage licenses. Interesting to note is that California is also community property state.

After these cases, Federal guidance was issued including a Presidential memo to extend fringe benefits to all federal employees who are married using a place of celebration standard. Agencies have not been consistent on the guidance. Some agencies use state of residence and some use both. This creates problems. Careful planning and analysis will be required. The outline on pages 21-34 goes through the current agency guidance. The breakout session also went into this in greater detail.

It is important to note two of the rulings:

- IRS and the Treasury jointly issued Revenue Ruling 2013-17 along with two sets of Frequently Asked Questions that may be valuable to review. It also states that domestic partnership and civil unions are not considered marriage for federal purposes.
- IRS Notice 2014-1, relating to cafeteria plans, including health and dependent care flexible spending arrangements (FSAs) and health savings accounts (HSAs), as those two as those two provisions relate to the participation by same-sex spouses in certain employee benefit plans.

Real world implications

First, your analysis should include whether your client resides in a recognition v. a non-recognition state. Also need to include in your planning issues that arise if/when clients travel to or through states that do not recognize same sex marriage.

When same sex couples are considered married

Harry and Sal are married and reside in a recognition state. They should be treated exactly the same as other married couples as long as they do not ever leave the state. Tax, non-tax and probate issues are the same as other married couples.

It may be worth reviewing the outline as it includes techniques affected by *Windsor* on pages 35-49.

Keep in mind that marriage creates negative aspects as well, such as filing joint returns; marriage penalties now exist; and social security benefits may now be taxable. Related party rules also now apply making certain planning techniques unattractive, such as GRITs and below market loans.

Speaker noted some same sex couples may not wish to get married and there is also a trend for forgoing

marriage for opposite sex couples as well. A thought is, if clients are in a state that has domestic partnerships or civil unions and marriage, they may consider the non-marriage option of domestic partnership.

Additionally, legally married same sex clients should also look retrospectively since they are legally married from date of actual marriage (in a state that recognizes the marriage), not the date of the *Windsor* ruling. Planners should go back and review estate planning documents and beneficiary forms, GST allocations, grantor trust status, portability, etc. Reviewing and updating marital agreements, living wills, durable powers of attorney, health care proxies are also wise. It is recommended that clients should take these documents when they travel as well, when going through non-recognition states. Also, take any adoptions papers when traveling as well.

There may be possible refunds for taxes paid or 9100 relief. Also, it may make sense to advise fiduciaries to file claims for refunds, even if statute of limitations have run. There could be a potential liability to beneficiaries if claims are not filed.

When same sex married couples are considered unmarried

Louise and Thelma are married in Massachusetts. They have a child, JD. The family moves to Arkansas. In Arkansas, Louise and Thelma are no longer considered married for state purposes.

Generally there are at least four situations where this will occur:

- Same sex married couple who lives in a nonrecognition state, but travels to another state for the purposes of getting married before returning to their home state
- Same sex married in their home state which is a recognition state, but the couple later moves to a non-recognition state
- Same sex married couple who lives in a recognition state but vacations in a non-recognition state or has to travel through a nonrecognition states to get to their ultimate destination
- Same sex married couple who lives in a recognition states but owns property sitused in a non-recognition state.

Possible issues:

- Some non-recognition states do not recognize
- same sex divorce
- the validity of any contractual arrangement between persons involved in a same-sex relationship
- marital agreements between same-sex spouses
- (potentially) spousal support decree from another jurisdiction arising from a same-sex relationship/divorce
- May have denial of some federal benefits
- Inheritance and probate issues
- Burial instruction issues
- Health emergency issues
- Pretermitted spouse issues
- Community property issues

It is important to consider rights and privileges regarding marriage and children when these clients move and travel around the country

Domicile issues

Where the decedent dies domiciled is where there is jurisdiction over the administration of his or her estate. A decedent's domicile, however, is a conclusion about which survivors and their lawyers can disagree. And different states may claim that the same decedent was a domiciliary of its state. This can lead to inconsistent claims and determinations of domicile.

Riley (Riley v. New York Trust Co., 315 U.S. 343 (1942)) seems to imply that the U.S Constitution requires only a fair trial on the issue of domicile, not consistent results. So, it is possible to have inconsistent claims and inconsistent determinations of domicile.

Divorce issues

The main issue is where states lack jurisdiction in divorce cases because it does not recognize same sex marriage marriages. Also noteworthy, is that there is a recent North Dakota AG advisory opinion that states that if you are legally married as a same sex couple in another state, you do not have to seek a divorce if you "switch teams" and want to get a marriage license to marry someone of the opposite sex.

The practical fix is choice of venue in *marriage*. Certain jurisdictions that allow same-sex marriage also provide avenues for divorce for couples who were married in that jurisdiction but are unable to divorce in their current state of residence.

Maternity/paternity issues

There is a marital presumption or bias. Opposite-sex married couples typically enjoy the presumption of paternity attached to marriage. Generally, so long as a husband and wife are married at the time of birth, the husband is presumed under law to be the parent of the child. Depending upon the state, that presumption is rebuttable.

Now we have technology that can help the presumption should be reviewed for names on the birth certificates and adoptions. Additionally, there may be a valid same sex marriage and adoption but the state may not allow second parent adoption.

Construction issues in documents

Most important is good definitions in drafting that make sense for the client. The term of spouse and definition of child will be important in drafting of definitions as reliance on state law may not make sense.

The stranger-to-the-marriage-rule adopts a similar stance as the stranger to the adoption rule. Under the stranger-to-the-marriage-rule, the settlor of a trust is a stranger to a marriage (and therefore cannot be bound by its effects) *if at the time the trust was executed* the law of the state of trust situs chosen by the settlor would not have recognized such a marriage. This rule of construction could be overcome by evidence that the donor intended to include same-sex spouses. In addition, if the beneficiary was already married to a same-sex spouse and the donor knew about the marriage before drafting the instrument, the court could presume that the donor wanted the same-sex spouse included because the instrument did not specifically preclude same-sex spouses.

Public policy issues could also end up under construction issues.

Finally, it is best to avoid ancillary probate in nonrecognition states.

This law is currently very fluid, so what may be true now may not be trust tomorrow and this needs to be

thought about in estate planning.

10:55 a.m. – 12:35 p.m.
Question and Answer Panel-- Dennis I. Belcher, Carol A. Harrington, Jeffrey N. Pennell
Reporter: Herb Braverman

This panel returned on Wednesday morning to respond to questions submitted by the attendees of the Institute following their Recent Developments presentation on the previous Monday. As a result, the questions put to the panel were often follow ups to their prior presentation, so a certain amount of repetition was inevitable. Similarly, many of the topics discussed in this session have been or will be covered more thoroughly in various general and/or break out sessions during the conference.

The first area discussed concerned the use of defined value formula clauses similar to those found in Wandry. Mr. Belcher indicated in response to the question about using such formula clauses that he preferred not to do so, if an alternative was available. He was concerned that donor actions may have some impact on the gift that he would not want and could not control; similarly, he was concerned that the adjustment in the clause was to a number of shares or units and not to a dollar amount. Ms. Harrington defended the Wandry clause somewhat, indicating that the IRS probably could not successfully argue that formulas were "against public policy" as it had in the case itself; similarly, the case was not appealed by the IRS. The panel seemed to agree that dividing the gift between an outright portion and a GRAT or QTIP trust might be more beneficial and safer.

The next question of interest involved the interaction, if any, of portability planning and the use of a joint settlor trust by a married couple. It appears that there is limited use of the joint settlor trust these days and that portability planning could be used instead to get the advantage of the full applicable exclusion amount for transfer taxes. There was some discussion that these trusts are used to obtain a double basis step-up on the assets in the trust, however, Professor Pennell pointed out a number of PLR's that suggest that no double step up in basis would be obtained and he mentioned the circuitous transfer of property issues that could arise under IRC 1014(e). This question stems in part from the growing concern about income tax planning and maximizing basis to reduce income taxation--clearly an important theme at this Institute that has or will be discussed quite a few times by various presenters. For the $5-$10 million clients, Mr. Belcher discussed the possible use of a Clayton-style QTIP to provide flexibility in planning. The panel quickly acknowledged that there were concerns, including the possibility of GST issues and the issue of who has the power to make the QTIP election and how does that effect the result. Ms. Harrington suggested that this would be a tax election and not a power and that the IRS has not said anything about this device to date.

Ms. Harrington discussed a number of GST related questions, including the process for advising a non-resident, non-citizen of their obligation to file a GST tax return and to pay the tax (though she pointed out that IRS collection efforts for such a done may not be easily accomplished); basis adjustment for a taxable termination (see IRC 2654(a); and GST issues for the mentally incompetent donee.

A number of questions caused the panel to touch on the so-called "duty of consistency", for example where the IRS might insist that a taxpayer use a discounted basis value reflecting a discount taken on the asset in a 706 filing previously or challenging the grantor status of a trust that had not filed tax returns in prior years. Professor Pennell mentioned "equitable offset" doctrines, but noted that arguing the equities in a matter might be successful.

There was a discussion of the use of a formula gift with a credit shelter trust and a marital deduction trust that would qualify for QTIP treatment, apparently giving the spouse the power of appointment. The panel was not attracted to this suggestion, but thought that disclaimer planning might be better, though sometimes difficult to accomplish, or putting the entire estate into a QTIP trust and then adjusting with reverse QTIP election.

There was a question that prompted a discussion of DAPTs. Professor Pennell rattled off a number of federal and state court cases, some of which are mentioned in the Recent Developments materials, that were problematic for DAPTs in general. Ms. Harrington pointed out that courts in some jurisdictions were concerned about creditors and about getting hands on 'hidden" assets, when necessary. Off shore trusts were acknowledged to be available.

Another question prompted a discussion of SCINs and the role such notes played in the Kite and Davidson cases. In this question, it was being suggested that the measuring life for the note be a person other than the seller, for example his spouse. That intrigued the panel, but they agreed that the key is to value the asset being sold properly (to the satisfaction of the IRS agent) and that the SCIN have a defensible structure of premium value or interest rate. Professor Pennell pointed out that the IRS might prefer the use of a private annuity, constructed using the 7520 tables that are from the last census and therefore favorable to the IRS.

Ms. Harrington discussed SLATs briefly and some of the issues that might arise from the use of this device under 2036, for example, if the distribution were used to satisfy a support obligation of the grantor. She did not see any E-tip problems arising from the proper use of this device.

The session closed with some very brief discussions of the Delaware tax trap, installment notes between father and son (issues, if any, on cancellation of the debt) and the current unitrust distribution percentages.

The panel, as always, was entertaining, as well as informative.

2:00 – 5:20 p.m.
FUNDAMENTALS PROGRAM
Estate Planning Through an Asset Protection Lens
Gideon Rothschild, Daniel S. Rubin
With "permanent" portability and a $5,000,000 exemption, clients have begun to question the necessity of "estate planning". Fortunately, all signs indicate that the litigation explosion continues unabated, and that clients are demanding "asset protection planning" solutions from their estate planning advisors. This program will discuss ways in which an advisor can help clients integrate their estate and asset protection planning.
Reporter: Craig Dreyer

This session was part of the Fundamentals Programs. Mr. Rothschild and Mr. Rubin provided over 100 pages of material. Mr. Rothschild noted that asset protection is much larger than the asset protection trusts we always hear about. The primary purpose of this session was to show how to do estate planning with an eye towards maximizing asset protection. Mr. Rothschild noted that there are many ways to provide asset protection such as homestead, retirement accounts, and annuities. There is no one size fits all approach. In addition, Mr. Rothschild noted the increase in litigation today due to unpredictable judges and juries as well as attorneys working on a contingent fee arrangement. He noted that asset protection has become a much more mainstream practice area as a result.

Mr. Rothschild noted that asset protection by estate planners used to be viewed as questionable, but he questioned this historic view. He noted that avoiding liability is one of the primary reasons for setting up a limited liability company or corporation. He then discussed how it is also important to determine when to engage with a client regarding asset protection. He noted that 50% of asset protection calls come from clients once they are already in trouble and there is little that can be done. However, this shows that attorneys are not focusing enough advice on asset protection prior to their clients getting into trouble.

Mr. Rothschild noted that a fraudulent transfer has nothing in common with engaging in a fraud. A fraudulent transfer generally does not award damages to the aggrieved party in excess of assets transferred. Fraud requires misrepresentation, deceit, and a third parties detriment. Fraudulent transfer is a remedy for a transfer with intent to delay, hinder, or defraud creditors. In reality though, a fraudulent transfer does not have to be a transfer, but can be a conversion from exempt to non-exempt property. The law of fraudulent transfer is applied different depending on the state. States distinguish between present and existing creditors and future creditors. Future creditors are people who may have a claim in the future who are not foreseeable. He notes there is nothing wrong with protecting assets from future creditors. He noted that there are many asset protection techniques available such as owning exempt assets, buying insurance or purchasing annuities in some states. It

is important to keep this in mind while doing estate planning since in Florida the use of a private annuity in place of an installment sale may provide additional creditor protection.

Mr. Rothschild then discussed the downsides of entering into a fraudulent transfer. He noted the most significant downsides are: 1) if the debtor ends up in bankruptcy (the client will be denied a discharge in bankruptcy if there is a fraudulent transfer); and 2) there are criminal penalties In some states such as California where the transfer is a misdemeanor; and 3) it may be unethical for the advisor and result in disbarment or suspension of the professionals license.

Mr. Rubin then discussed how the rules of ethics for lawyers apply to asset protection. He noted there are three main model rules that may apply in an asset protection scenario. He noted specifically model rules 1.2(d), 4.4(a) and 8.4(c). He noted that model rule 1.2(d) prevents a lawyer form assisting a client in criminal or fraudulent behavior. Previously the rule only said illegal conduct. Today the conduct must be criminal and not just illegal. Therefore, he noted that rule 1.2(d) does not necessary apply to illegal acts, but only criminal acts. He noted that New York State defines fraud as conduct that is a fraud, but he notes that a fraudulent transfer is not a fraud. He further discussed rules 4.4(a) and 8.4(c) and noted that if the primary purpose is not to delay, deceive, or hinder creditors the transaction may still be appropriate under these rules. The materials provide an in depth analysis of these rules and related cases.

Mr. Rubin then discussed various scenarios where even with a possible judgment; there may be an overriding purpose that would make the transfer reasonable and complaint within the model rules.

Next he discussed if there an ethical obligation to provide asset protection advice. He discussed some cases that show a lawyerâ€™s obligation is to forward the interests of their client. So if not illegal, a lawyer has a duty of diligence to forward a clientâ€™s interests as long as it is legal. So there is likely an ethical obligation. Mr. Rubin noted that even if it is not unethical to fail to provide asset protection advice, the advisor could still be subject to civil liability. He noted an example with two orthopedic surgeons, and provided that leaving assets outright and implementing a plan using portability instead of a credit shelter trust would likely be malpractice.

Mr. Rothschild asked how much information is it necessary to obtain from a client when advising them. He noted that in many states a disclaimer can be a fraudulent transfer, so doing disclaimer planning without knowing enough about the client's financial situation may lead to problems. Furthermore, he posed the question about whether leaving assets unprotected to a beneficiary with a known creditor problem is malpractice if the client never asks?

Mr. Rubin noted that most estate planning will involve trusts. He noted it is very easy to integrate asset protection planning with your estate planning by using trusts. Today we often use a discretionary spendthrift trust, which is a combination of a discretionary trust with a spendthrift clause. The spendthrift clause prevents voluntary and involuntary alienation of a trust by a beneficiary. In a discretionary trust, the trustee has discretion over distributions and a creditor can't stand in the shoes of the beneficiary to enforce the claim since there is no concrete property interest. Mr. Rubin noted it is best to use both of these techniques. Mr. Rubin noted that we have a long history of creditor protection at common law, however ironically England spendthrift trusts do no provide protection from creditor claims.

Mr. Rubin then went on to discuss in detail the basis for the cases asserting asset protection. He discussed Nichols v. Eaton, 91 U.S. 716 (1875), where spendthrift clauses became generally accepted. Sligh v. First National Bank of Holmes County, 704 So.2d 1020 (Miss. 1997) which provided an exception to spendthrift trusts for intentional torts or gross negligence, but was soon thereafter overruled by the Mississippi legislature. Then he discussed Scheffel v. Krueger, 782 A.2d 410 (N.H. 2001), upholding a spendthrift clause even in the face of

horrific facts of child molestation. He noted these cases provide the basis for asset protection using spendthrift and discretionary trusts.

Mr. Rothschild then went on to discuss various trusts that can be used for asset protection purposes including an intervivos QTIP trust. He noted that portability is not indexed for inflation and does not provide any asset protection to the surviving spouse, so he still recommends not using portability in most cases. In addition, portability can be lost if a spouse remarries and the second spouse dies.

Mr. Rothschild next spoke about the asset protection benefits of owning property as tenants by the entirety over joint tenancy. He discussed the five unities required for tenancy by the entirety, but also discussed the downsides of owning property in these forms such as divorce and death where you will lose asset protection benefits.

Mr. Rubin noted that all forms of trust can be used to incorporate asset protection. QPRTS, GRATS, and charitable split interest trusts are all forms of trusts used for asset protection. A QPRT done for estate planning is even stronger against a fraudulent transfer claim because the planning has a substantial purpose other than to embarrass delay or hinder a third party. He noted that trusts should be thought of for estate planning, income tax planning, and asset protection purposes.

Mr. Rothschild then discussed testamentary trusts and how clients are often reluctant to use these trusts since they have preconceived notions about trusts being too restrictive. He notes that new trusts have much more flexibility and when combined with asset protection benefits are very hard to overlook. He noted that you can have very broad distribution powers and even give special powers, but you must be careful to avoid provisions that may allow a creditor to attack the trust. He does not like a beneficiary acting as trustee for asset protection purposes. He also noted that fees for corporate trustees are much more reasonable if they are also managing the money.

Mr. Rothschild and Mr. Rubin discussed the recent case Berlinger v. Casselberry (2013, Fla. 2nd DCA Nov. 27, 2013) which allowed assets reachable by discretionary trust beneficiary in spendthrift trust to be accessible by an ex-spouse. They noted that Floridaâ€™s enactment of law differs from the UTC. Also the case had extremely bad facts, which led to the court to issue a continuing writ of garnishment in favor of the ex-spouse.

Mr. Rothschild also spoke of benefits of holding property in retirement accounts and the asset protection benefits. Asset protection for inherited IRA's are still in flux throughout the country and the Supreme Court recently granted cert in a conflict between the 8th and 7th Circuits. In addition be careful when using trusts set up for IRA's since conduit trusts require distribution of income to beneficiaries opening the distributions to creditors, and while accumulation trusts can be designed you must be very careful in designating who the beneficiaries are and designating any power of appointments.

Mr. Rubin discussed options today such as outright gifts, limits to gifting with the applicable exclusion amount, and how most parties want to make a transfer in trust for multiple reasons. A transfer in trust can protect against transferee's creditors and divorce claims. If property is kept separate, it can also avoid equitable division in most states. A more significant concern is that the rule that inherited property is separate is not uniform in every state. Some states such as Connecticut, Massachusetts and Vermont do not follow these rules. This is one more reason to use a trust, since you never know where a trust beneficiary may relocate.

Mr. Rubin noted that a SLAT can also be beneficial asset protection trust. These can be made into dynasty trusts and are more effective than a testamentary trust. Protecting $5-10 million is a good reason to set up these trusts. For clients looking to protect more assets, we can set up a limited liability company. An asset protection

benefit of a limited liability company is that any retained interest in a limited liability company may only be subject to a charging lien by creditors. Mr. Rubin noted that most corporations do not provide this except in WY and NV. Another important leverage technique is an installment sale. He also noted the benefit of using annuities in Florida, and some strong case law behind using annuities for creditor protection.

Mr. Rothschild then discussed the options if you have a trust with bad provisions. He noted you may decide to decant if you are in a decanting jurisdiction. You can also look to change trustees to get favorable law since decanting is a matter of administration. Another option is to sell the assets to a new grantor trust if the old trust is not good for holding insurance.

Mr. Rubin discussed how clients often have substantial net worth, but not enough to want to give away a large amount of money. He went on to discuss the implications of using a self-settled domestic asset protection trusts as part of your planning. He discussed their implications and the full faith and credit clause of the U.S. Constitution. He noted that for over fourteen years we have had domestic asset protection trusts, and yet we still have no cases discussing full faith and credit clause of US constitution.

He then discussed that the same estate tax benefits can be obtained with a foreign trust. He noted two valid reasons to go off-shore. First, if you move a non-grantor trust offshore with a foreign trustee, it becomes a grantor trust due to IRC 679. He noted that in this situation you must watch out for section 684, since appreciated assets held at death may be subject to capital gains taxes at owner's death if those assets are outside of their estate. Second, he noted that judgments may not be recognized in foreign jurisdictions. He also noted that the cases where clients have gone to jail were using poorly designed foreign trusts that had very bad facts, however you can use these cases to better design your offshore trusts.

Mr. Rubin then moved on to the conflict of law issues with domestic asset protection trusts. He noted that the law designated by a settlor should be controlling, and should be respected with respect to creditors's ability to reach the interest of beneficiaries. A person domiciled in one state should be allowed to designate the law of another state as controlling. This has been codified in the restatement of the conflict of laws. He notes that section 270 of the restatement determines the validity of trusts and looks to the domicile. Section 273 governs creditor rights and says the designated law controls without exception. He believes that courts have intentionally misapplied section 270 of the restatement in certain egregious situations to reach a result. However, he thinks the law will be upheld in most instances.

Mr. Rothschild concluded the session by noting that even if a domestic asset protection trust would fail in your client's jurisdiction, if your client can move to the state where the trust is domiciled prior to enforcement of the judgment, there is no public policy exemption against enforcement. He noted the client can always move back to the other state after the judgment is settled. Mr. Rothschild discussed various issues and cases with the ability to appoint trustees by beneficiaries of trusts and suggested avoiding appointing any trustees in the beneficiaries' home state for a self-settled asset protection trust. He concluded by emphasizing that we should always speak with our clients about asset protection when they come in for estate planning.

2:00 – 3:30 p.m. - Special Sessions I

Session I-A
Planning for Estates Under $10 Million: A Rubik's Cube of Simplicity (Focus Series)
Martin M. Shenkman, Steve R. Akers, Christopher R. Hoyt
Estate planning for clients who may not be subject to the federal estate tax might, on first blush, appear seemingly simple; yet, the permutations of planning options are as legion. And like the Rubik's cube, a turn to align one issue, shifts another out of alignment. Planners will have to balance the often competing client

objectives of: maximizing income tax basis on death, minimizing state estate tax in a decoupled state, asset protection goals, and simplicity and cost consciousness if there is no federal estate tax, and more. Default reliance on bypass/QTIP planning will no longer suffice. Existing planning will also have to be re-evaluated, often resulting in an Alice in Wonderland like planning where taxpayers will affirmatively assert positions the IRS had historically used to challenge planning options. Welcome to the rabbit hole of FLPs with intentional 2036 strings, ILITs without typical Crummey powers, and more.
Reporter: Kristin Dittus

While there are many non-tax reasons that motivate planning, this session focused on the tax planning elements for estates under the Applicable Exclusion Amount ("AEA"), as indexed for inflation. Each speaker covered 3 different areas as set out below.

Mr. Shenkman strongly encourages practitioners to review their clients' existing plans and focus on repurposing such plans in light of the new tax planning paradigm. This would include review of FLPs, irrevocable trusts (ILIT, IDGT, SLAT), life insurance meant to pay estate tax, revocable trusts, beneficiary designations, and investment provisions in existing documents. Even if an FLP was formed with a desire for valuation discounts, it will also provide asset protection, the ability to shift income to lower generations, and it can get a step up in basis for more assets if 2036 estate tax inclusion is triggered. Credit Shelter Trusts can be used to shift income to family members with lower tax brackets. To get a step up on assets that were contributed to a Domestic Asset Protection Trust ("DAPT"), and move the trust to a jurisdiction that does not recognize such trusts to trigger estate inclusion before death. Other planning considerations may include relying on portability and retitling assets into joint ownership that were previously divided between spouses to equalize estates. Also, attorney's may want to reconsider removing or amending a gifting power under a power of attorney because it often leaves the door open for financial abuse by family members and may no longer be needed for tax planning reasons.

Plans for estates under the AEA in a "decoupled state" where the state estate tax exemption is lower than the federal AEA could use the following strategies:

1. Use a bypass or credit shelter trust for the state estate tax amount and may additionally provide that any assets in excess of that amount passes to a QTIP trust.
- Some states, like NY and NJ, require consistency on the federal and state tax returns

2. If assets are left outright to surviving spouse, he can make a gift to a Grantor Trust using the Deceased Spouse's Unused Exemption ("DSUE") to get assets out of the estate for estate tax purposes. The DSUE is not indexed for inflation, but if a gift is made as soon as possible following the first spouse's death, this effectively removes the appreciation of the gifted assets out of the estate and utilizes the full benefit of the DSUE. Additionally, the surviving spouse can use his swap power to get low basis assets out of the trust for the full step up in basis before death.

3. If the surviving spouse is concerned about having access to the assets, he can make a gift to DAPT using the DSUE in a jurisdiction that provides for DAPT. Mr. Akers discussed that intra family loans will continue to be part of our practices. Avoiding the use of the AEA during life will allow the AEA to grow significantly over time given the annual rate of inflation. Avoiding the lifetime consumption of the AEA will generally be very beneficial unless there is a highly appreciating asset a client wants out of the estate. Using loans rather than gifts will help achieve this objective. Loans should continue to be structured as a bona fide loan transaction (i.e. was there security, intent to pay back, interest charged, a schedule for repayment, etc.)

General trust income tax issues

1. Many income tax issues can be avoided by structuring a trust as a Grantor Trust, this is especially important with capital gains. Page 43 of the outline (Section 2) discusses how to get capital gains into DNI, and the trust agreement should provide that trustee can make this allocation.

2. Capital gains is receiving an additional tax (up to 23.8% from 15%, a significant increase) that provides strong motivation to distribute out income, but don't lose sight of the other reasons why the trust was established.

3. Build in as much flexibility as possible in the trust to swap assets with the Grantor to manage basis issues. Also, encourage your client to visit you annually to review which assets are where.

4. Planners may want to use the Delaware Tax Trap to trigger estate inclusion.

Mr. Hoyt covered retirement plans, generally referred to in this section as IRAs, in Section 3 of the outline

1. Mandatory Distributions. Two major penalties are in place, a 10% penalty for most distributions before the age of 59 ½ and a 50% penalty for not taking required minimum distributions ("RMD") after the age of 70 ½ or after retired (whichever is later). There is also a 50% penalty after the account holder's death if beneficiaries do not take a RMD.

2. Disclaimers. Disclaimers can be used even if a beneficiary has accepted a RMD in the year of the account owner's death. Disclaimers to a private foundation can be problematic, but a disclaimer to a donor advised fund, even with the disclaimant as an advisor to the fund, does not pose any problems.

3. Will we see the end of the stretch IRA? Sen. Baucus wants to limit the payout of any inherited retirement plan to a 5 year payout (unless the beneficiary qualifies under and exception) and Obama included this proposal in his 2013 budget. The panel thinks there is a good chance this could pass. If this becomes law, trusts will become more attractive to clients with large IRA.

4. Using a CRUT. Creating a two generation Charitable Remainder Uni-Trust for those clients who are charitably inclined will be a good option to achieve more favorable estate and income tax results. The CRT is exempt from income tax and contributing the assets results in a charitable deduction for estate tax purposes

Session I-B
GRATs Current Issues Regarding Creation, Maintenance, and Operation
John W. Porter, Carlyn S. McCaffrey
GRATs are an incredibly effective tool for shifting future appreciation to next-generation family members. Because of this, GRATs have long been on the Treasury Department's radar screen and are now seeing increased transfer tax audit scrutiny from the IRS. This presentation will address current issues involving the creation, maintenance, and operation of GRATs from the estate planning and audit perspective.
Reporter: Ted Preston

The Grantor Retained Annuity Trust (GRAT) allows a grantor to gift assets to an irrevocable trust and designate remainder beneficiaries to receive future appreciation in the value of the assets, without incurring a tax on the initial gift. In this regard, GRATs are a useful method to shift appreciating assets out of a grantors estate prior to the grantor's death. A typical GRAT divides the trust's assets into an annuity for the benefit of the grantor, while allowing the future appreciation of the asset in excess of that annuity to become the property of remainder beneficiaries after the annuity period has run. In order to transfer assets to the GRAT without incurring gift tax

liability, the grantor must retain an annuity payable from the trust which will pay back to the grantor no less than the fair market value of the initial gift plus interest at the rate established by IRC §7520. The GRAT takes advantage of differences between IRC §7520 interest rates and real-world investment returns for a given asset, which are often higher. The excess of the real returns produced by the trust assets over the §7520 rates passes to the remainder beneficiaries free of gift or other transfer tax.

The GRAT will pay a fixed annuity to the grantor for a certain period. The governing instrument for a GRAT must satisfy the requirements set out in IRC §2702. It is imperative that practitioners check their governing instruments carefully to ensure compliance, because the IRS scrutiny of GRATs focuses heavily on ensuring that compliance. Drafters must follow that regulation to the letter or risk incurring a gift tax on the value of the initial transfer of assets to the GRAT,

Today's presenters explained a number of reasons why GRATS are a useful mechanism for moving future appreciation out of the grantor's estate. GRATS provide regulatory certainty if they are properly drafted. The IRC provides clear guidelines for their use, and the IRS regulations and audit history support their use so long as practitioners draft the governing instruments carefully. GRATs provide valuation certainty, and can be structured to provide relatively precise profit levels for remainder beneficiaries, while providing advantageous transfer tax treatment. Most importantly, they provide our clients with a degree of regulatory certainty, since all the advantages are expressly sanctioned by the regulations. Thus, you can assure your client the technique will work. GRATs even work well holding hard-to-value assets by using an annuity based on a percentage of the actual value "as finally determined," provided practitioners are careful to file gift tax returns in order to trigger the statute of limitations (or audits) that will result in final determinations.

The presenters recognized that there IS some risk, but following the rules and the spirit of the law and regulations minimizes that risk. IRS has challenged valuations when they concluded that the valuations violated the "spirit" of the law. To avoid valuation arguments, practitioners should obtain a good solid appraisal and attach it to your gift tax return.

There has been a small increase in GRAT-related audits recently. The audits typically examine the guts of the governing instrument: are the provisions required by the statute present? Have annuity payments been made timely? Are valuation issues present? Clients don't seem to mind the audit results. Even if you lose on a valuation issue, it rarely requires your client to write a check and pay a tax. It simply results in larger payments to the grantor under formula-derived annuity clauses. IRS seems less inclined to pursue these audits for that reason: they very rarely result in additional tax collections.

Even if you include appropriate provisions, the service will look to the substance to ensure the provisions are followed. The service took this position (that statute requires actual implementation) and won in Atkinson.

The presenters included useful tips in the written materials, including numerous suggestions for practical methods of GRAT administration, selection of appropriate investments and methods to lock in appreciation when otherwise volatile assets have achieved gains that may not last. Their written materials are concise and will provide practitioners with a useful roadmap to drafting and managing GRATs for our clients.

Session I-C

Living and Working with the Uniform Principal and Income Act (Financial Assets Series)
Gail E. Cohen, George D. Karibjanian, R. Hugh Magill
This panel will examine the data collected from professional fiduciaries throughout the United States on the methodology used to implement the Act across various states. Learn the highly effective habits of corporate trustees and participate in a discussion of the relative merits of these different methodologies.

Reporter: Michelle Mieras

This session dove further into the issues presented at Tuesday afternoon's presentation entitled "When You Must Adjust – How, When, Why & What Do the Professionals Do?" and was based on the same 72-page outline.

Following a survey of the audience that revealed a good mixture of attorneys, corporate fiduciaries, accountants and individual trustees, Ms. Cohen began with a recap of Tuesday's presentation. The Prudent Investor Act governs the rules of investing for fiduciaries. This includes the requirement to invest for total return, which led to the implementation of the principal and income rules, including the power to adjust. This allows the trustee to treat the current beneficiaries and remaindermen impartially in obtaining a reasonable return.

Ms. Cohen reiterated her institution's investment decision process, beginning with a look at asset classes and their total returns and volatility. She reminded the audience of the diversification requirements. She described the trustee's job as mixing and matching the asset classes to get the best return with the lowest risk, which results in various investment strategies. From there, the yield expectations of various strategies are considered, including a comparison to inflation.

Mr. Magill pointed out that while the unitrust conversion is an important tool for the trustee, today's discussion mainly concerns the power to adjust. He pointed out Appendix D of the materials, which provides a great comparison of the power to adjust laws across various states. He reminded the audience that the power to adjust comes from a uniform act, so while states' power to adjust statutes may have slight variations, most statutes are generally uniform. This is in contrast to unitrust statutes, which were drafted from the ground up (as there was no uniform law), and the unitrust laws therefore vary significantly state by state.

When is the power to adjust available? The trustee must first determine and consider the governing law. Is the governing law set forth in the document? Has (or could) the governing law be changed by changing the trust's situs? Once the applicable state law is determined, look at the statutory requirements. Most states have three requirements for the trustee to exercise the power to adjust: 1) the trustee is currently investing in accordance with the Prudent Investor Act (note that this does not require that the Act has actually been adopted by the state), 2) the terms of the trust must provide for distributions of income, and 3) the trustee has to determine that it cannot administer the trust impartially, except to the extent the terms indicate a clear intent to favor one or more beneficiaries.

In assessing whether the requirements have been met, look for anything in the document that would prevent any of these requirements from being fulfilled. For example, is there a direction to maintain a concentration of assets or a requirement to invest in certain assets that prevents the trustee from investing for total return? With regard to the trustee's ability to administer the trust impartially, what kind of language in the trust is sufficient to permit the trustee to favor a beneficiary? Mr. Magill believes this is a state interpretive issue. If partiality is clearly provided by the document, but the trustee cannot be appropriately partial, the power to adjust is also available (so the power to adjust basically exists anytime the trustee cannot otherwise do what it is required to do as a fiduciary).

When considering whether to use the power to adjust, convert to a unitrust, or make a discretionary distribution, trustees should be cognizant of the contrary arguments. For example, a remainder beneficiary could object to a unitrust percentage he feels is too high, or argue that discretion was not properly exercised in making a distribution. The trustee needs to remain conscientious about the risk management side, and be sure that for each decision there is a process in place, the process is applied consistently, and the application of the process is documented.

Mr. Magill shared his company's process for considering the effect of a particular adjustment or distribution over the long-term of the trust, and noted that the process should take into account the needs and life expectancy of the beneficiary. Mr. Karibjanian noted that this should scare individual trustees, as they generally don't have the resources available to larger corporate trustees to undertake this analysis. Later in the session, Ms. Cohen noted that the OCC regulators are currently very interested in the processes trustees are following with respect to the power to adjust and unitrust conversions. Mr. Magill cautions against firm, specific policies which can be a trap in unexpected circumstances.

What is the trustee obligated to deliver to the remainder beneficiaries? Is it the original value of the trust adjusted for inflation? If so, would a power to invade principal suggest that the income beneficiary is preferred and negate this presumption? Ms. Cohen believes that the trust needs to grow at least at the rate of inflation, and deliver to the remainder beneficiaries the principal adjusted for inflation. Mr. Magill pointed out that the trustee's discretion comes into the analysis: compare the expectations of the remaindermen of a trust permitting distributions for a beneficiary's happiness (broad opportunity for distributions and less of an expectation of preservation of principal for the remainder beneficiary), versus a trust specifying distributions for a beneficiary's best interests (higher expectation of what will be available to remaindermen).

Mr. Karibjanian then moved onto the tax consequences of the powers to adjust. He joked that the only three words scarier than "you're under arrest" are "distributable net income." Capital gains can be allocated to DNI in three circumstances, and he highly recommends a review of the examples set forth in the regulations (and in the materials).

The unitrust laws were then examined. Mr. Karibjanian compared the developing unitrust laws to the increasingly complicated decanting laws being promulgated, as different states build upon (and try to improve upon) other states' laws. As mentioned above, the unitrust statutes vary highly state to state because they did not develop out of a uniform act. It is critical to review the applicable state's requirements for the trustee to exercise the unitrust power. States' unitrust percentages vary, as do their treatment of hard to value assets. State statutes also are inconsistent as to who must be notified of a unitrust conversion and the time to object to a conversion. Another aspect determined by state law is the extent to which an interested trustee may participate in the unitrust conversion.

Ms. Cohen points out that although the unitrust is touted as a solution, it raises a host of other issues. For example, are low-yield municipal bonds ever a suitable investment in a unitrust distributing 4% per year? The trend is for fiduciaries to try to exercise discretionary distribution powers (where available) instead of using a unitrust conversion or power to adjust. Reiterating the importance of process and documentation, she reminded the audience that even when the decision is not to convert to a unitrust, the trustee should document the consideration of the unitrust conversion and the reasons it is not being pursued.

Mr. Karibjanian noted that what we are really talking about here is potential litigation and risk mitigation. He recommended an ACTEC article by Margaret Sager that identifies red flags for which a fiduciary should be on the lookout.

Session I-D

(Same) Sex Ed: Practical Tips and Tricks When Planning for Same-Sex Couples

Lee-ford Tritt, Wendy S. Goffe, Nicole M. Pearl, Lauren J. Wolven

Same-sex couples (married, in civil unions or domestic partnerships, or in no legally recognized relationship) face unique challenges in the estate planning context. This session will provide some practical guidance on key components of an effective estate plan for same-sex couples, including dispositive instruments, marital

agreements, medical directives, beneficiary designations, arranging for the disposition of remains, adoption implications and other important considerations.
Reporter: Elizabeth Lindsay-Ochoa

Now that same sex couples have the right to get married, is it a good idea?

Because same sex couples never thought they had the chance to marry, some are not so sure about racing into marriage.

First, you should look at the legal status. It is easy to determine the rights if the couple is legally married in a recognition state. Under registered domestic partners or civil unions, planners need to determine what the legal status of these relationships is under state law. Some states have limited rights and some look exactly like marriage without using the word marriage.

Additionally where there are domestic partners/civil union laws, there may be state rights registries and county registries. Depending on where/how the same sex couple marries, the rights can differ.

The federal government has said that registered domestic partnerships and civil unions are not marriage for federal purposes. There are states passing conversion laws, which are converting domestic partnerships and civil unions to marriages. Washington is an example. This may surprise your clients on the change. Other states that enact same sex marriage may also give the rights to convert civil unions to civil unions to marriage (Illinois).

When there is a conversion or a marriage, you should review documents and discuss the consequences of what it means to become married on the federal and state level.

Some consequences to think about are: community property; duty to support (can be altered with a marital agreement); financial reasons; tax reasons; and benefits. For example, remaining as a domestic partnership in California may make the most sense (unless the couple wants federal benefits), same rights are married, such as community property and still get better federal tax benefits.

However, there is also difficulty with terminating domestic partners relationship. This is usually done with a divorce proceeding, but the couple will not have the federal tax rules that exist for divorces. So you may suggest getting married at this point and then subsequently getting divorced.

Couples that live in nonrecognition states and decide to marry have issues. Here is where state income tax returns then become more difficult. A couple of states will accept same sex joint returns, e.g. Colorado. Other issues to consider are problems obtaining a divorce or getting the proper documents in place to avoid default state laws.

Some of the states will continue to fight same sex marriage, e.g. Utah. Texas cases are going through the court system on the issue of same sex divorce. The Department of Justice announced Jan 10 that they will have federal recognition of marriage for the Utah marriages that occurred before the stay. Utah will not recognize the marriages.

<u>Federal Benefits</u>

New notice (came out after the material was turned in). IRS Notice 2014-1, December 16, 2013. Please disregard what is in the material on this particular subject. Place of celebration rule is not necessarily

true. There are some issues where state of residence is used or it is unclear.

· Cafeteria plans can allow participants change election as if it was a change in marital status (as of Date of Windsor)
· Employee who paid after tax basis for benefits in 2013 can receive a salary reduction for the treatment for the year even if the employer treats it as after tax for reporting purposes in the year 2013. Will need to review the tax reporting on this issue.
· FSA participants can go back to the start of the plan year and be reimbursed for same sex spouse and dependents of the same sex spouse;
· Joint HSA contributions
· What if both partners made contributions and are above the limit? Will need to pull the excess out prior to due date to avoid excise taxes
· If made joint dependent HSA limitation
· Excess is subject to income tax on joint return

For Retirement plans and QDROs, the law is unsettled. Plans can allow direct non-spouse beneficiary rollover, but not all plans allow. The RMD distribution amounts variances may be worth reviewing.

Social security does not apply state of celebration standard, but state of residence standard.

Medicare/Medicaid – Medicare applies state of celebration; Medicaid state of residence

Military benefits – Department of Defense applies state of celebration; VA uses state of residence

Parental Issues

If a child is born during a marriage or shortly after the death of one of the parents, the child is presumed to be a child of that marriage. The policy reason for this is to keep children eligible for benefits from both parents.

This presumption applies may not apply to same sex couples. Not every state has extended this presumption to same sex parents. Even when there is a presumption of parentage, it was recommended that if there is a non-genetic or biological parent, they should go through a second parent or adoption proceeding if the state allows this. This procedure may look similar to a step-parent adoption.

One of the things looked at is involvement of second parent in life of the child. If the parent qualifies, it is also to be aware that some states allow you can have three parents (such as California or Washington) on the birth certificate. Such as the biological parents and same sex parent.

If they cannot go through adoption (for example, will not receive consent from one parent), then they are left with equitable remedy in some states e.g., de facto parentage. This may be a long shot, but you look at factors such as natural or legal parent consented to the parental relationship; petitioner and child live together and assume burdens (and benefits) or parenting; and parent like position is available to create a parent like bond. Some states will limit this type of adoption only during intestacy proceedings.

Same sex adoption is not permitted in all states. Some states have gender neutral statutes. Some explicitly state they permit it. The same sex adoption can be a wise decision to receive employee benefits/COBRA/ etc.

It is important to note that the Uniform Probate Code does not contemplate second parent adoption. So if a parent wants to adopt child as step parent, in some states that cuts off the original biological parental

rights. This comes up often in non-recognition states as marriage does not have that type of presumption.

It is important to note that under the Full Faith and Credit clause, adoption proceeding should be recognized in all states.

Adult adoption used to often occur to have some sort of family relationship and allow inheritance. If will is declared invalid, adoption allows to the partner to inherit under intestacy.

In some states this is a felony and/or violates incest laws. Some states require the older partner to adopt younger partner. You can't undo an adoption as you can undo a marriage. However, Delaware and NH have granted a termination of an adult adoption on equitable grounds.

<u>Premarital agreement/cohabitation agreements and divorce issues</u>

Same sex couples may want to get divorced in a nonrecognition state.

· States that will allow the divorce may recognize a marital agreement or they may not
· Panel suggestion was a clause in the marital agreement that states that either party can remove that case back to state in a jurisdiction where the agreement can be enforced
· True contract like consideration for premarital agreement may still make sense
· Consider nexus for jurisdiction for divorce
· Look at the effective date of the premarital agreement; you may want to use an actual effective date not just stating the date of the marriage.
· Page 45 of the materials that discusses drafting issues in cohabitation agreement also applies to marital agreements

When a client does get married, the planner may recommend certain states to get married in based under long arm statutes on divorce. Some of these statutes might also state that if it is illegal for you to get married in your home state, you cannot marry in that state.

Drafting Estate Plan

Trust construction issues are important. Definitions are also important, such as spouse, descendants, classes of remainder beneficiaries, ability to act as trustee or appoint successor fiduciaries. Proactive planning can help avoid unexpected results. You should talk to clients about wishes and intent.

In definitions, you may want to consider domestic partners/civil unions. You should clarify that laws of state of domicile should not determine definitions of descendants. Sample language is in outline on pages 50-51.

These issues come up outside of just the same sex couple estate planning documents. Many clients may have a family member that has a same sex relationship. This could cause a close family member to be cut out of the plan unexpectedly.

What about preexisting documents?

If ambiguous, courts can look to donor's intent. In most states, direct or circumstantial evidence of donative intent can be introduced.

If donor intent unclear, courts look to construction preferences. This will differ from state to state for same sex

couples.

If there is a change governing law, that won't affect validity of administration of trust. Forum may help.

For trusts that are unambiguous (pg 53), court can reform trusts. Modification would comport with donor's intent, need mistake of law or fact in expression or inducement.

Unwinding transactions

Planners did very good planning with same sex partners that were considered unrelated parties prior to the allowance of marriage. Examples, QPRTs with swap power and GRITs.

For tax returns, you should review that fact that you could amend client returns. Rev. Rul. 2013-17 discusses some rules.

All sorts of questions, we still don't know the answer too. Some documents may need judicial reformation or agreements. Equitable recoupment may be useful where the statute of limitations has run. This is in the internal revenue manual for help to determine if you can use this.

Another issue is the divorcing spouse that was under 59 ½ and subject to a QDRO before *Windsor*. It is permissible to amend for early withdrawal penalty relief. Another place to review is spousal rollover now that you can use the spousal rollover rules.

There are many other areas to review, portability, applicable exclusion amounts, etc.   On the state income tax level, the states may not be required to issue refunds. Also important to note that the AICPA sent a letter to the IRS asking for more guidance on these issues on October 30, 2013. This letter may be helpful highlighting the current issues.

Other ways to help unwind transactions may be using decanting, trust protector clauses, moving situs and limited powers of appointment.

Session I-E
Public Benefits 101
Robert B. Fleming, Rebecca C. Morgan
Will or trust? Powers of attorney? Modern estate planning goes beyond those simple questions, even in an environment not dominated by estate taxes. Costs of long-term care and availability of public benefits loom large in planning considerations. Learn more about Medicare, Medicaid, Social Security and other government benefit programs, and how they affect your clients' plans.
Reporter: Joanne Hindel

Robert and Rebecca started out with the question why do you need to know about public benefits in the legal practice? It is because attorneys and their clients are getting older and questions pertaining to these benefits will be asked.

They briefly discussed the metaphor of the three legged stool – Social Security is one of the three legs – people used to be able to rely upon SS, their own retirement and accumulated wealth.

They discussed the WWII generation as the wealthiest generation who will pass on wealth to their descendants but the baby boomers will not be a wealthy generation nor will the generation that follows.

As a result the three legged stool has become one-legged: private pensions are disappearing and accumulated wealth is shrinking. SS is becoming the main source of wealth.

The panelists indicated that 50-60% of retirees get the majority of their resources from SS.

SS was not intended to be a one-legged stool however and attorneys will need to understand how to assist clients with planning for public benefits and the shortfall from the lack of those benefits.

Boomers are the ones talking to lawyers about their own planning or that of their parents.
Boomers are aging out of the sandwich generation and generations are living longer.

A big motivator for the elder law practice is the cost of long term care. Robert said that he tells clients if the cost of nursing home care will come out of your own resources expect to pay $6-7M per month. Average cost of in-home care is $10M month (factoring in 24 hour care with skilled assistance).

A common misconception is that the high level of care will not last long (most people believe they will die soon after entering a nursing home) however about 50% of people in nursing homes will be there 3-5 years.

About 2% of nursing home care is covered by private LTC insurance – about 5% of total nursing home care is covered by private and governmental LTC.

One question posed was how long should you purchase LTC for? The panelists indicated that if considering LTC you should buy for a period of 5 years.

One dilemma is if family members are care givers they may not be able to work full-time and then cannot plan adequately for their own care. The panelists urged the audience to have a candid conversation with family members.

Most clients indicate that they will not go to a nursing home but in fact, if they do not end up in a nursing home it will only be coincidental. The most common way into the nursing home is due to broken bones after a fall (broken hips).

Retirement age is creeping up – now 66 soon it will be 67. Medicare, however, kicks in at 65 whether or not you are retired.
Clients will often be confused as to what their benefits are.

Social Security retirement benefits represent an entitlement program – once a person is fully insured and reaches a certain age, the person is entitled to receive Social Security benefits.
Medicare benefits are tied to work history and age. Once a person is "eligible" for Social Security benefits and reaches age 65, the person is entitled to receive Medicare benefits. Some under-65 individuals are also entitled if their eligibility is coupled with having a disabling condition.

Means-tested public benefits refer to those government programs that look at income and/or resources as part of the eligibility determinations.
Medicaid, a health insurance program for low-income individuals, is a means tested program. Supplemental Security Income (SSI) is a means-tested welfare program. It provides subsistence-level income payments for eligible applicants.

Disability based programs include Social Security Disability and Supplemental Security Income and Medicare and Medicaid.

Social Security Retirement is a benefit tied to earnings history. To be fully insured, a worker has to have worked a certain length of time and have earned a certain minimum amount of money during that time. In addition to getting money, if eligible, the worker will also get Medicare and the spouse, dependents and survivors may also receive coverage.

A spouse may draw on a worker's benefits if the worker is fully insured. The spouse may receive up to half of the amount of the worker's benefits based on several factors, including the age of the spouse and whether the worker is drawing Social Security. A divorced spouse may actually draw on a former spouse's earnings record if the marriage lasted at least 10 years and the dependent former spouse is not presently married, has reached a certain age and the worker is able to draw benefits.

Social Security offers survivors benefits for certain relatives of the worker; typically widows/widowers and dependents.

The panelists strongly recommended that you should go to SSA.gov website and check out your own record.

The panelists also briefly discussed Veterans Benefits and mentioned that the benefits can be service and non service connected.
Aid and attendance is also available to service members as well as their spouses.

At the end of the presentation the panelists discussed some planning issues:

Same sex couples may have all their resources counted if they are in states that do not recognize same sex marriages.

Affordable Care Act – does it impact Medicaid planning? Perhaps you don't need to become eligible for Medicaid if you can afford health insurance through the Affordable Care Act. If you qualify for Medicare or need LTC the insurance through the Affordable Care Act may not be available to you.

Third party special needs planning entails drafting trusts that can protect eligibility for governmental benefits. In most states, trust terms must be fully discretionary without any support or health standard. If possible, indicate that the trust is to be for special needs.

Overall, the panelists emphasized the complexity involved in understanding governmental benefits but indicated that this area will become of greater importance to estate planning attorneys because of its increased importance to their clients.

Session I-F
Much Ado About Something: Clash of the Agent, Attorney, and Appraiser in Gift Tax Audits (in 4 Scenes) (Litigation Series) Stephanie Loomis-Price, David Pratt, Scott A. Bowman, Timothy K. Bronza
Far from Shakespearean comedy (and more like Odysseus's struggles), gift tax audits present clashes among appraisers whose valuations support gift tax returns, attorneys who are defending the returns, and IRS agents, who challenge the returns and underlying valuations. This saga will demonstrate the importance of presentation of the gift tax return, the appraisal, and materials provided in audit.
Reporter:Kimon Karas

This special session was a follow up to the presentation earlier in the day by Ms. Price and Mr. Pratt regarding Audit-Proofing Gift Tax Returns (Report #5). This session was an active role playing among the participants, Ms. Price as the IRS agent; Mr. Bowman as attorney for client; Mr. Bronza as the appraiser; and Mr. Pratt as the client. The session was based on the following fact pattern divided into 4 scenes.

Scene 1: Client, attorney and appraiser meet to discuss a transaction involving a gift and sale of an LP interest holding an equal value in marketable securities and real estate. Prior to the proposed transaction client owns 99% LP interest and 100% of the 1% GP. At end of year 1, client transfers to an irrevocable dynasty trust an interest in the LP equal to unused gift tax exemption which is believed to be $2M. On day 1 of next year, client assigns balance of his 99% LP interest to the dynasty trust in exchange for an interest only note with a principal balloon payment the on 9th anniversary. Client believes the value of LP, consisting of real estate and marketable securities to be $20M.

Scene 1 Initial Considerations:

1. Know your client. Does the client understand the transaction being proposed so that not only implementing the transaction but will client follow through with implementation and following documents.

2. Interview the appraiser including discussing the transaction that one is hiring the appraiser for; what the subject of the appraisal report is to be. What is appraiser's experience in testifying if federal tax cases. Provide appraiser with all documentation, distribution policy, investment policy. Request a fee proposal. Make certain the appraiser is a qualified appraiser as described the gift tax adequate disclosure regulations; i.e. i)one who holds himself out to the public; ii) qualified to appraise the subject property; iii) not related to donor. Discuss with business appraiser need for separate appraisal of underlying real estate.

3. Be cognizant of attorney/client privilege.

4. Who hires the appraiser-should be attorney to protect privilege. Follow Kovel. Open issue who pays the appraiser. Some suggest that client pay the attorney and attorney then pay appraiser; others feel client can pay appraiser directly and not jeopardize the privilege. Address payment in the fee letter with appraiser.

Scene 2: In year 2 appraiser prepares draft of valuation report. Attorney prepares year 1 gift tax return as agreed but forwards return to client to sign and file. Client signs and files return however finalized appraisal report (in fact appraisal has never been finalized as client never responded to appraiser to finalize return) is not attached to the return. Subsequent year's gift tax return is also filed without appraisal report as well. Upon receipt at Service Center year 1 return is placed in "Yes Box", i.e. #709 return reflecting on Question A on page 2 that a discount was taken on the gift tax return for the transfer of the LP interest. Year 1 return and year 2 returns both identified for "audit."

Considerations in Scene 2 developments.

1. The LP being valued is an investment holding company and appraiser will value based on a net asset value with some marketability overtones. Appraiser will consider lack of control/lack of marketability discounts. Distribution policy and actual distributions will be considered and in fact pattern 100% cash flow is distributed that reduces the discount.

2. Section 2036 notions, post execution the need to follow formalities, implementation.

3. Someone needs to take control monitoring the filing of the gift tax return. Most law firms if they prepare

the return they will also file the return. Return should be filed with Service Center by certified mail, return receipt requested, with making certain a complete executed return is maintained for files. Be cautious as IRS is known to have misplaced documents, filed returns, attachments. In that regard someone needs to be overseer for the transaction and filing of return that return is prepared, appraisals finalized, and all relevant documents/exhibits are attached to the return.

4. Appraiser's report must be reviewed and challenge assumptions and conclusions if not clear to the reader. The appraiser's conclusions must match the analysis.

5. Expect when filing the #709, if the "yes" question on discount is checked, must assume this return will receive higher scrutiny at Service Center.

Scene 3: Client receives notice from IRS agent that both years' returns have been selected for audit.

Scene 3 Considerations.

1. As a matter of course client should not attend audit although there may be an exception but that is generally rare.

2. If the attorney is not preparing/filing return, file must be documented who is accepting that role and confirming letter sent to all relevant parties.

3. Entity maintenance is extremely important as this information is requested at audit-annual minutes, review of investment policy, and documenting decisions and actions taken or not taken as that goes directly to business purpose.

4. In fashioning initial response to IRS be cognizant that all information being submitted, responses, etc. be with an eye toward litigation.

5. Also be concerned with shifting burden of proof by complying with all reasonable requests of IRS.

Scene 4: Who prevails.

Considerations/Conclusions to Scene 4.

1. Client should not be at the meeting.

2. Stephanie indicated that even in a 709 audit, Service has asked for 2036 type information.

3. Privilege. IRS has been requesting affidavits. Stephanie as a matter of course has denied that request. Issue when privilege should be waived. Stephanie suggests in a 2036 context should consider waiving since 2036 is subjective and key witness, client, is not available. The privilege belongs to executor but if waived client's advisors, attorney, accountant, financial advisor, can testify as to intent.

4. Had adequate disclosure been satisfied the statute limitations would have commenced.

3:50 – 5:20 p.m. - Special Sessions II
Session II-A

Venn Diagrams II: Tax Basis and Income Tax Planning for Larger Estates (Focus Series) (Financial Assets Series)
Paul S. Lee, Cassady V. Brewer, Ellen K. Harrison
This presentation will focus on the more complex planning techniques that create, sustain and maintain tax basis and maximize income tax savings. The panel will focus on: the use of partnerships to "shift" basis, income, and assets and to maximize the "step-up" in basis with the Section 754 election and partnership debt; creating estate tax inclusion and basis through elections, powers, and appointments in trust; preferred partnerships; planning with depreciable and depletable assets; and the use of trusts to defer or avoid state income taxes.
Reporter: Kristin Dittus

This presentation continued Paul Lee's initial presentation on Tuesday morning (Report #2) entitled "Venn Diagrams: Meet Me at the Intersection of Estate and Income Tax" with a focus on the more complex planning techniques that create, sustain and maintain tax basis and maximize income tax savings for larger estates (at least $20 million). The panel focused on: the use of partnerships to "shift" basis, income, and assets and to maximize the "step-up" in basis with the Section 754 election and partnership debt; creating estate tax inclusion and basis through elections, powers, and appointments in trust; preferred partnerships; planning with depreciable and depletable assets; and the use of trusts to defer or avoid state income taxes.

Mr. Lee revisited the importance of "tax basis management" (or "free basing" in the world of tax) before the death of the first spouse from his initial lecture, which several speakers referenced throughout the conference as vital to the future of estate planning. Mr. Lee used the same outline for both presentations and any page reference are to this outline. Unfortunately the very helpful illustrative slides used were not in the materials, but will be included in the final published materials.

Key Points:

Ø As quoted by Mr. Moore in the great words of Homer Simpson, "Partnerships, is there anything they can't do?"

Ø This material is by no means easy to digest, as an older gentleman next to me commented at the end of the lecture, "I'm not sure I understood a thing he said." However, after spending a lot of time with the materials, I assure you this proposal makes brilliant use of the partnership tax rules to augment the inside basis of existing partnership assets by distributing out high basis built in loss property (thereby stripping the basis of that asset). For most practitioners, understanding the material will require some time reviewing the very complex partnership tax rules of subchapter K.

Ø Not only are partnerships the centrifuge of basis, they are pass thru entities that allow us to work with income tax to shift the income tax liability to someone without necessarily giving them possession. Partnerships are the only way to disproportionately push out income tax.

Mr. Moore led the discussion with the following suggestions to maximize the step up in basis:

1. Limiting lifetime gifts to allow the Applicable Exclusion Amount ("AEA") to grow as much as possible, unless needed to gift highly appreciating assets to an IDGT as discussed below;

2. Gifting assets after they are stepped up in basis by the death of a first spouse;

3. Empowering the surviving spouse to gift assets from a QTIP or bypass trust; and

4. Electing portability and immediately making a gift of the Deceased Spouse's Unused Exemption ("DSUE") amount to a grantor trust. This provides more flexibly and benefits than a QTIP trust, but there may be non-tax reasons to use the QTIP instead.

Possible ways to get a step up on spouses' combined assets upon the first spouse's death. See pages 16 - 20 of the outline for further guidance on these techniques:

1. Achieving and Retaining Community Property Status. Under §1014(b)(6), community property gets a full step up upon the death of the first spouse. If a couple does not live in a community property state, they may be able to elect in under Alaska or Tennessee law.

2. Using a Joint Exempt Step Up Trust ("JEST"). Spouses form a Joint Revocable Trust, which either can terminate until the death of the first spouse and the first spouse has a general power of appointment ("GPA") over all of the assets.

3. Using a 2038 Marital Trust. A completed gift is made to an irrevocable trust established for the grantor's spouse as the sole beneficiary. The grantor can be trustee, should retain swap powers, and may terminate the trust early. Estate inclusion is triggered by the grantor's death under §2031, or by the beneficiary spouse's death under §2038.

4. Gift to a Lifetime QTIP Trust with Return to the Grantor. Because gifted assets are returning to the donor spouse, under §1014(e) the beneficiary spouse must survive more than one year for the assets to get a step up.

The panel discussed the following ways to maximize and multiply the step up in basis:

1. Gift highly appreciating assets to an IDGT with retained powers to swap assets and make loans / sell assets to the grantor, thereby reducing the estate with leveraged transactions.

2. "Reverse Estate Planning" where assets are pushed up a generation to get the maximum step up before passing to younger generations.

3. An "Accidently Perfect Grantor Trust" where a younger generation grantor moves zeroed out assets into a grantor trust and gives an older generation member a testamentary general power of appointment (GPA) which the older member allows to lapse. Failure to exercise the GPA allows the original transferor to be treated as the grantor and avoids tax to him, see Treas. Reg. §1.671-2(e)(5) and the assets get a step up in basis under §1014(b)(9). This idea was proposed by Melissa Willms and Mickey Davis.

At this point Mr. Lee kicked it up a notch with his free basing pursuits under the partnership rules of Subchapter K. The mechanics discussed below to increase the basis of partnership assets will require familiarity with the relevant and very complex rules of partnership law, please see a list of special considerations on page 60.

- The §754 election is a blunt instrument which lacks flexibility in its application.

- If a high basis partnership asset is distributed to a partner with zero outside basis, the asset would generally become a zero basis asset eligible for a "step-up" in basis on the partner's death. With a §754 election, the loss of this "stripped" basis would allow an upward basis adjustment to the other asset remaining inside the partnership. After the death of a partner, the now flush with basis property can be re-contributed to the partnership. See page 58.

- To avoid a violation of the single equity class share exception under 2701, such distribution should be a full or partial liquidation or redemption of the partner's interest.

- Clients may be surprised that we suggest distributing partnership property out before death after so many years of telling them to get property into a partnership before death.

Mr. Brewer lead us through a hypothetical on page 59 of the outline.

- In the hypo there is a pro-rata family LLC ("LLC"), with matching inside and outside basis; no debt; no discounting; and no mixing bowl transactions (this refers to the sale or exchange of property with built in gain or loss that occurs within 7 years from the time of contribution).

- To use the concepts in this lecture and avoid mixing bowl issues, it may be a good idea to get a family partnership set up so that the 7 year period can begin running on appreciated assets

- Among the properties in the LLC ($12M FMV, $4.5M A/B) there is one property, Parcel 1, that has a built in loss of $2.0M

- There are 3 equal partners who are Parent A, Child B, Child C (the partnership interest of each is: A/B $1.5M and FMV $4.0M)

- When A dies, a traditional 754 election is made which steps up both the inside and outside basis of A's partnership interest to $2.5M under §743(b). A's share then passes equally to his 2 children. Unity basis rules blend the basis of the owned and inherited shares (unlike stock) for each child as follows: A/B is 1.5 + 2.0 M = 3.5; FMV is 4.0 + 2.0 M = 6.0

- See page 81 for a discussion on the mechanical way the 754 election works

Vertical Slice Division of the Partnership - What Used to Work

- We are concerned about the built in loss on Parcel 1, and we are not getting as much step up as desired on the other two appreciated parcels, each with A/B $250k and FMV $5.0M

- Mr. Brewer discussed using a vertical slice division (with the assets over form) of the partnership to segregate the high basis - low value asset (Parcel 1 to the New, LLC) from the high value – low basis assets (which stay in the original LLC). Partners would retain the exact same proportions in the new partnerships, and upon A's death a 754 election would be made only for the partnership with the highly appreciated assets. See page 83 on why this avoids any complications with 2701, also any disproportionate division will likely trigger tax.

Problems arise with the Vertical Slice solution because recently enacted laws force a 754 election for any partnership where there is a built in loss that exceeds $250,000. Mr. Lee noted that one of the most significant things about making a partnership division is that it may provide a way to effectively get around the fact that a 754 election is basically irrevocable.

Transferring out Parcel 1 to A rather than Selling it.

- The reasons to transfer rather than sell could include no capital gains to offset the loss, it may have sentimental value, or produce income for A. The 754 election needs to be made when the property is distributed out to A.

- Affect on Basis in the Property. The basis of the property distributed ($4M) reduces A's basis dollar for dollar from $1.5M to zero and then can't go below that. This property has an inherent gain, however the minimal gain to A is outweighed by the significant gain in basis to the remaining partnership assets. A's share in the partnership will also be reduced to 20% from 33%. The hypo contemplates this occurring later rather than earlier in A's life.

- A dies. The property had a basis of $1.5 in A's hands which gets stepped up to $2.0M and then transferred equally to the children. Each child will get a $1M in basis as long as the IRS does not discount valuation.

- Affect on Basis in A's Partnership Basis. Basis increases from zero to $2M

- Under IRC 732(a) the in-kind distribution of Parcel 1 reduces A's basis in his membership interest to $0, and A takes a $1.5M basis in Parcel 1. Next, if an IRC 754 election is made at the time of the distribution, the $2.5M IRC 734(b) adjustment (i.e., the difference between Parcel 1's "inside" basis and its basis in A's hands) augments the "inside" basis of the undistributed property (Parcels 2 & 3). Under IRC 755, the IRC 734(b) adjustment is allocated according to a hypothetical sale approach, resulting in $1.25M being allocated to each of Parcels 2 & 3. Then, upon A's death, A's estate would benefit from a step-up in basis of both Parcel 1 and A's (the estate's) 20% membership interest in the LLC.

- Big Payoff During A's Lifetime. The above adjustments increase the basis on remaining assets in the partnership during A's life by $2.5M so that if the asset is sold there will $1.25M less gain that needs to be recognized on either property.

Going Over the "Family Partnership Hypothetical" Handed out for the Lecture

- A hypo was handed out at registration but is not in the outline. It has too much detail to cover here, but includes Mr. and Mrs. Developer (Mom and Dad) with 3 children, $25M in net worth, an FLLP, and is clearly reminiscent of a tax school exam

- Our goal in using the technique discussed above is to find a family partnership with both high basis low value assets (to transfer out to older generation partners) and high value depreciated assets (to get the basis step up for the loss of basis in the property distributed out)

- The FLLP holds securities ($9M) and a disregarded entity LLC that owns General Dollar stores for assets of $21M in real estate

- There is also debt of $10M which is personally secured by Mr. Developer

- Non-recourse debt rules say outside basis should be pro-rata unless there is disproportionate debt taken on by an individual (like Dad), then the outside debt is decreased by that amount.

- Partnership interests are not fungible, you can have the same value but not the same basis generally based on how the debt is allocated within the partnership

Discussion of the Hypothetical

- The $10 million non-recourse debt leaves Dad with most of the basis in the LLC. How can we re-allocate basis? It is unlikely the lender would agree to the partnership taking on the debt which would allow it to be

distributed evenly to each partner. Children can indemnify Dad, up to their basis amount (30%, then Kids each up by 3%, and Dad down by 3%).

- We could divide the partnership with a vertical slice (we have no more BIL as before, only appreciated assets) to spin off the securities; this allows kids to take on even more debt up to their basis (3.3%)

Income Tax Diversion if Possible

- Partnerships allow significant manipulation of income tax, which can be coupled with a partner who has residency in a low or no income tax state

- With the income tax spectrum being so different now among the 50 states, where a beneficiary lives could provide significant tax savings, especially for distribution of appreciated property

- Charitable Remainder Trusts will play a critical role for large estates, especially if we lose the lifetime stretch out option for inherited retirement plans

Using a Preferred Partnership

For very wealthy families, Mr. Lee considered a situation where there could be two non-grantor trusts, maybe one is GST exempt, with one trust in California (highest income tax state) and one trust in Nevada (no income tax state). These trusts could contribute all of their assets to a partnership. The Nevada trust would take back a preferred interest. The interest should be a qualified interest payment to avoid problems with 2701, which is an exception to the zero valuation rule. The California trust would take back a general common partnership interest. See pages 90 - 91. Cash items follow the cash flow which are flowing to the "no-income tax" state taxpayer. Even if assets grown in value, there is very little income tax liability generated. Be aware of 2701 issues if there are two trusts created by the same grantor with similar beneficiaries.

Session II-B
Clinical Trials with Portability (Focus Series)
Thomas W. Abendroth, Richard S. Franklin, Lester B. Law
The panel will discuss the use of portability in various common planning scenarios, including couples below and above the applicable exclusion amount, second marriages and blended families, clients with closely-held assets, and clients in states with state death taxes. They will focus in part on the situations in which portability may replace traditional credit shelter planning.
Reporter: Ted Preston

The presentation illustrated that we are still in the process of figuring out how portability of the Applicable Exclusion Amount (AEA) will affect estate planning in the future, and what changes we may need to make in our clients' existing estate plans.

Credit shelter trusts were the traditional way to use a decedent's applicable exclusion amount. There are a lot of estate plans out there that were written with an assumption that they were taxable estates, where that assumption is no longer valid. If those trusts are out there, we need to be thinking about whether we can get some of the assets out of them. Now that the AEA has risen to 5.34 million for an individual, most people will not use it up. Thus, we need to ensure that we preserve the unused exclusion amount following the first death, in case it becomes needed later.

The speakers designed a spreadsheet to crunch numbers and compare scenarios of estate sizes and how

portability of the AEA will play out. The outline provides numerous tables that present the results of pure number crunching comparing the results of various scenarios of estate size and planning approaches.

One important takeaway from the number-crunching is that we need to take into account the impact of spending levels and income taxes when we plan. The panelists seem to agree that we must preserve the exemption of the first to die, and try to find ways to use it. We are foolish if we let Deceased Spousal Unused Exclusion (DSUE) expire upon remarriage of the surviving spouse.

Using a portability-based plan instead of traditional A-B trust planning will lead to measurably better financial outcomes as a result of the income tax and the stepped-up basis in assets. The estate tax that was the focus of those old A-B plans is not really coming into play because it applies to so few estates.

Now we need to concentrate on income and basis planning and state death tax exemptions. If we are in states with state death taxes, they will play a much more important role in our future planning. States with large income taxes will play a larger role as well.

When planning for blended families, we are likely to start from a different place. We will need to discuss how much property goes to the kids and how much to the spouse. In the past we focused on the marital deduction to preserve assets from the estate tax on the first death. In the future, we can expect our clients to be less concerned about taxes, and much more concerned with family fairness issues. But those fairness issues don't make the existence of DSUE and it's portability unimportant. There can be significant economic consequences, so the election issue becomes important in second marriages. We should be very conscious of who makes the portability election, as it can create conflicts for a fiduciary. We should probably be selecting someone other than the surviving spouse to make the election, to avoid those conflicts, particularly in blended families. Our clients and malpractice carriers will not be happy if we create conflicts that lead to litigation.

The presenters discussed numerous subjects related to portability elections, mechanisms to step up basis in various scenarios, difficulties in drafting formula clauses and the future focus on particular assets when planning for stepped-up basis. Given that this presentation is heavily focused on comparing various scenarios and options by crunching the numbers, the written materials are particularly useful in understanding the issues we will need to keep in mind in future planning.

Session II-C
Recent Developments for Fiduciaries 2014
Turney P. Berry, Dana G. Fitzsimons, Jr.
With a focus on how fiduciaries and their advisors may best understand and manage fiduciary risk and related ethical challenges in an increasingly litigious and confrontational environment, the panel will review recent cases and statutory enactments from across the country and discuss trends and developments in several areas including: investments, concentrations, and special assets; surcharge exposure; disclosure to beneficiaries and evidentiary and ethical privileges; the fiduciary as client and conflicts of interest; modification of trusts; settlement, defenses, and limitations on actions against fiduciaries; jurisdiction; trust advisors; incapacity; and third party liability.
Reporter: Elizabeth Lindsay-Ochoa

The outline materials have fiduciary cases from around the country and give guidance to seeing what is being litigated. Below are the cases that the panel highlighted. The page numbers generally refer to the outline page numbers.

<u>Decanting modification and termination</u>

Page 16 of materials has three cases decided in area of common law of decanting. Why might this be important? If grandfathered GST, this may avoid the appearance of modifying the trust.

Morse v. Kraft, 2013 Mass. LEXIS 629 (2013). This Massachusetts case followed Phipps and did not give a blanket approval for decanting. Instead, this is a permissible power on a case by case basis. What the court said is that decanting was not something that would have been on the radar of a lawyer or client during the drafting. In the future, since decanting is now well known and the power to decant is not in the trust, this case may have come out differently.

Ferri v. Powell-Ferri, 2013 Conn. Super. LEXIS 1938 (2013). The Connecticut court applies Massachusetts law. This issue was vesting. There was a divorce proceeding and the beneficiary had already vested rights in the trust. The court invalidated decanting of trust that takes away the rights of the beneficiary.

Matter of Schreiber, N.Y. Surrogate's Court, No. 2012-369907 (Nassau County) allowed decanting before beneficiary rights were vested.

The speakers **noted** that the Uniform law commission has begun a decanting project expected Summer 2015.

Reformation Page 66 of the materials

In litigating the reformation, there is utmost importance of proof of intent of the settlor.

Dennis v. Kline, 2013 Fla. App. LEXIS 9614 (2013). This is a Florida case where adult adoptives are trust beneficiaries. The court reverses summary judgment granting reformation of trust under UTC to exclude adopted adult as trust beneficiary. Florida has state policy that allows adult adoptives in cases except for fraud.

Clairmont v. Larson, 2013 ND 85 (2013). Reformation proper under UTC to exclude descendants of child's ex-husband as trust beneficiaries.

Perpetual charitable trust page 54

Church of the Little Flower v. U.S. Bank, 2012 Ill. App. LEXIS 905 (2012). In this case, there is corporate fiduciary and the charity would rather have assets for its corporate endowment. All the beneficiaries consented. However, under the UTC, if all beneficiaries of the trust consent and it does not violate material terms, you can compel termination of the trust. This applies to non-charitable trusts.

What about split interest trusts? CRT would most likely be construed as a charitable trust.

Some Attorneys General may create statutes that deal with fees directly to change a trustee or push a statute that gives charitable beneficiary the right to change the trustee with theory to replace with corporate trustee.

State income taxation of trusts page 43

There are a series of cases that now cut back the ability of states to tax with very minimal contacts.

Three new cases:

McNeil v. Commonwealth of Pennsylvania, 2013 Pa. Comm'r. LEXIS 168 (2013). Pennsylvania domiciliary, DE

trustee, special trustees not in PA, beneficiaries were in PA. This was a discretionary trust. PA, said no, merely having PA beneficiary is not sufficient to impose tax on entire trust.

Kastner v. Division of Taxation, 2013 N.J. Tax LEXIS 1 (January 3, 2013). Undistributed income of a trust created under will of New Jersey domiciliary, but that has an out of state trustee and is administered out of state, is not subject to New Jersey income taxation for out of state income. The trust had an S Corp in NJ and assets in NY.

Not in the materials: *Linn v Dept of Rev. 2013 IL App 4th 121055 (December 18, 2013)*. 1961 trust was changed through a 2002 power of appointment where the assets were removed and put in new trust. This power was exercised by the trustee. Under the new trust, the only connection to IL was that original trust created by domiciliary. This was not sufficient for IL to collect state taxes.

Jurisdiction and Standing page. 94

Bernstein, et. al. v. Stiller, et. al., 2013 WL 3305219 (2013). Just because the trust filed a state income tax return does not mean that the state court had jurisdiction over trustees. The tax returns were filed in error.

Surcharge litigation

Going after the trustee that breach of duty.

Page 22 *Matter of Strong, 2013 N.Y. Misc. LEXIS 5447 (2013).* The trust had concentrations of Kodak stock and lack of diversification. Here, the court issued a surcharge, interest and disgorgement of fees. The court focused on breakdown of process that reviewed performance.

Page 36 *J. P. Morgan Chase Bank, N.A., et al v. Loutit et al, 2013 N. Y. Misc. LEXIS 452 (New York County Supreme Court 2013).* $56M of AIG stock are in several trusts. Some of these trusts were failed GRATs that were created under MA and NC law. Trustee brought a suit to settle account in NY where fiduciary was located. The beneficiary argued NY law would apply. Court holds that choice of law provision had a reasonable connection to the trust, and enforced exculpatory provisions and rejected the claims.

Discretionary Distributions

Page 25 *O'Riley v. U.S. Bank, N.A., 2013 Mo. App. LEXIS 1074 (2013).* Trustee favored Mom over the children in giving out distributions. Trust allowed giving of distributions to both Mom and children. Trustee gave to Mom. Child claimed breach of fiduciary duty. Court said there was not a breach because trust instrument stated that Mom could be favored. Court awarded fees to the trustee.

Important to note in UTC jurisdictions, there is a provision that under a trust dispute the court has the ability to shift fees and force beneficiary to pay fees if it will be good for justice.

Page 28 – *Langlois v. Stryker, 2013 Mich. App. LEXIS 1399 (2013)*. Trust provide for support for beneficiary. The question is what the appropriate standard of living. It is the standard of living at trust time is irrevocable.

Miscellaneous

Page 40 – *In re Lasdon, 2011 NY Slip Op 51710U (New York County Surrogate's Court, August 23, 2011); 105 AD 3d 499 (2013)*. If litigating surcharge, need proof of harm. This case was an undue delay in distribution of assets. There was no evidence that they would have sold the stock if received stock sooner.

Page 31 – *McCormick v. Cox, No. 3D12-1289 (Florida 3rd Dist. Court of Appeals, August 14, 2013).* Speaker said that DSUE amounts may be useful in a case like this. This case had a fiduciary action that affects the tax basis of asset. There was no estate tax on first death. Removal and $5.3 million surcharge of attorneys-trustee for undervaluing estate assets at death of first spouse, thereby incurring high capital gains taxes and 1031 exchange fees on later sale of property, and for taking excessive fees. Trustee was aware that there was a purchaser lined up to purchase asset for much more money than the valuation. The trustees were surcharged for not amending the return to get the value.

Page 32 *Rollins v. Rollins, 2013 Ga. App. LEXIS 332 (March 29, 2013)*. This ruling was appealed and argued last week in GA. Is trustee subject to trustee fiduciary duties when a business is held in the trust? Trustees must account for corporate level activities of entities held in trust where they have the individual control over the entities, and are subject to trustee duties for their entity level actions.

Page 34 *French v. Wachovia Bank, N.A., 2011 U.S. Dist. LEXIS 72808 (E.D. Wisconsin 2011); No. 06-C-869 (7th Cir. July 17, 2013).* Corporate fiduciary exchanged a life insurance policy for a better life insurance policy. This was done at request of family. Corporate trustee did not breach its duties by exchanging insurance policies for new policies obtained through its affiliate.

Case of beneficiaries that behave badly, i.e. the harassing beneficiary. Do you have a remedy? *Executor of the New York Estate of Kates, et. a. v. Pressley & Pressley, P.A., et. al., 2013 U.S. Dist. LEXIS 16873 (U.S. Dist. 2013)* on page 93 of the outline. No further suits related to the subject matter of prior litigation. This case had three unsuccessful litigations.

Page 30 *Hasty v. Castleberry, S13A0989 (Georgia S. Ct. 2013)*. Trustee breached his fiduciary duties by making $1 million gift out of marital trust to university capital campaign for which trustee also served as co-chair. The trustee used mom's trust to make a capital campaign for trust contribution. Trustee borrowed the money, loaned to mom and then mom gave to charity. Sued by sister for breach of trust.

Page 53 *Bernard and Jeanne Adler v. SAVE, 2013 N.J. Super. LEXIS 114 (App. Div. 2013).* This case is about the enforceability on a restriction put on a charitable gift by a donor. Animal shelter campaign whereby the donor said they would donate if there was a new shelter for large dogs and older cats. The charity never had enough money to do what is promised after the gift was made. Instead, the charity went to a neighboring community and built a small shelter. The court made the charity give the money gave back on fraud theory.

Page 56 *Matter of Mary R. Latimer Trust, 2013 Del. Ch. LEXIS 212 (2013).* Are perpetual cemetery funds charitable? In this case they are not charitable, so no cy pres.

Compare with a New York case where perpetual cemetery funds were considered charitable. *Lucker v Bayside 2013 NY App Div Lexis 8781 (12/31/2013)*. This case is not in the materials. This was a perpetual cemetery corporation run by Jewish congregation. The deceased families wanted to sue. The Court said that this was charitable, so the Attorney General is the one that has standing to sue.

Matter of Jaros (not sure of spelling or cite). This is an IL disciplinary proceedings board where the attorney was disciplined for drafting a revocable trust that benefited the charity that the attorney was the president of without telling the client. Board stated that the attorney needed a waiver for conflict of interest. Does not appear to be the materials.

Powers of appointment

The new uniform trust act makes certain kinds of errors easier to correct. See page 65 *Estate of Christiansen v. Stevens*, *2013 Fla. App. LEXIS 18525 (November 20, 2013).* A beneficiary tried to exercise to appointment and but just generally referred to it in a will. The court said that this didn't work and need substantial compliance

Choice of law is also something to think about. If appoint among spouses and descendants which state law are you using?

Nature of fiduciary duties of trustee of revocable trust page 44

Under common law, while a trust is revocable and settlor has capacity, duties of trustee are owed exclusively to the settlor.

UTC jurisdictions address this issue. See *Matter of Trimble, 826 NW 2d 474 (2013)* page 48 of outline.

Page 45 - California Supreme Court takes this up in *Giraldin v. Giraldin, 2011 Cal. App. LEXIS 1222 (September 26, 2011); 2012 Cal.LEXIS 11381 (California Supreme Court 2012); 2013 Cal. App. Unpub. LEXIS 2675(2013).* After settlor dies, remainder beneficiary can sue for actions while trust is revocable if breaches during the revocable period effect remainderman's interest.

Trust Protectors

New case to add to the outline McClain (now on appeal) 2013 Miss App Lexis 1258

Page 89 *Shelton v. Tamposi, No. 2010-634 (N.H.2013)*. This is under the NH directed trust statute. If trustee acted at direction of Investment Advisors powers the trustee is protected.

Trustee disclosure page 58

States have different approaches for UTC on this issue. *Wilson* case out of NC a few years ago, trustee disclosure was tested. The surcharge action was against dad and the beneficiaries wanted discovery as trustee. Settlor had turned off duties to disclose. Trustee always has mandatory duty to act in good faith. The beneficiary can compel discovery.

Bright was also discussed. This is a VA Supreme court case where the trust instrument did not turn off all rights disclose, just the disclosure to the non-qualified beneficiaries. The court was willing to enforce the trust terms.

Attorney-client privilege

Page 59 – *Mennen v. Wilmington Trust Company, 2013 Del Ch. LEXIS 204 (2013).*

Delaware has fiduciary exception to attorney-client privilege

Page 61 – *Adler v. Greenfield, 2013 Il. App (1st) 121066 (2013)* Communication between fiduciary as agent for client for communications of lawyer is protected under the attorney client privilege.

More miscellaneous

Page 82 – *Inglis v. Casselberry, 2013 Fla. App. LEXIS 18905 (2d Dist. 2013); Berlinger v.Casselberry, 2013 Fla.*

App. LEXIS 18908 (2d Dist. 2013). – This is a garnishment case. Husband was required to pay divorce alimony. His money that he was using to pay the alimony came from a trust. At one point the husband stopped paying. Wife goes to corporate trustee and asks for the money. Trustee claims that this is a discretionary trust, if there is any money comes out of the trust so it goes to satisfy alimony obligation, but can't force the money out. Trustee who voluntarily appears before the court and seeks relief cannot later claim the court lacked personal jurisdiction; court permits garnishment against trust for payment of alimony.

Page 104 - *Landy, et. al. v. Velez, Commissioner of New Jersey Department of Human Services, et. al., 2013 WL 3786295 (2013).* Mom and dad want to qualify for Medicaid so they give away assets in loans to beneficiaries and take back notes. Are the notes a countable asset? Usually not. However, this was part of the plan and collectable. The court used a theory that this arrangement was a trust like device and is treated like a self-settled trust.

Page 106 – *Doherty v. Director of the Office of Medicaid, 2013 Mass. Super. LEXIS 103 (August 14, 2013)*. 2000 Irrevocable trust and trustor put all money in the trust. Trustor was also a beneficiary of income and principal. Medicaid said she was not eligible to receive benefits. In 2010, the trustor died. The current beneficiaries went to court and had the trust reformed back to 2000 for scriber's error. Trust reformation after death cannot make applicant eligible for Medicaid.

Page 79 – *Huber v. Huber, 2013 WL 2154218 (U.S. Bankruptcy Court, W.D. Washington 2013)*. This is an asset protection case. A Washington resident real estate developer created an Alaska LLC and had son in charge. Took this asset, set up a $10,000 cd and gave to Alaska self-settled trust. He then filed for bankruptcy. The court held that there no substantial relationship to Alaska. This is a Washington trust and should be treated as such. It is important to note that the grantor always got the income from this trust or had his expenses paid from this trust. This trust had minimal contacts with state of jurisdiction.

Page 89 – *In re McKinney, 2013 PA Super 123 (2013).* The case involves the removal and replacement of trustee. Under the UTC, the "changed circumstances" removal statute permitted removal of trustee where proposed successor trustee was located closer to the beneficiaries and the removed trustee had different personnel assigned to trust due to series of mergers.

Page 107 – *IMO: Peierls Family Inter Vivos Trusts, No. 16812 (Del. Oct. 4, 2013); IMO: Ethel F. Peierls Charitable Lead Trust, No. 16811 (Del. Oct. 4, 2013); and IMO: Peierls Family Testamentary Trusts, No. 16810 (Del. Oct. 4, 2013)*. Delaware administrative law, regardless of choice of law in the document, applies to the trusts.

Page 98 – *Estate of Castro, Case No. 2013ES00140 (Lorain County, Ohio, June 19, 2013).* The man in the hospital couldn't write and dictated will who wrote it out on a tablet. He signed the tablet. This tablet was password protected and the man died. The tablet was preserved and handed into probate court. The Court said this was a valid will.

Page 98 *Ajemian v. Yahoo, 2013 Mass. App. LEXIS 73 (2013).* Massachusetts court determines enforceability of email user agreement in dispute over decedent's email accounts. There is a Uniform Act project that is nearing completion on this matter. Speaker noted that the providers are reasonably ok with the idea that an executor can stand in the shoes of the decedent and get digital access. Difficulties are where individuals are incapacitated. Choice of venue provision in the contract doesn't matter because no one reads them.

Page 72- *Rachal v. Reitz, 2011 Tex. App. LEXIS 5598 (July 22, 2011); 2013 Tex. LEXIS 348 (2013).* Is an arbitration provision binding on trust beneficiaries who do not sign agreement? Under common law it is not enforceable. This court in this case said yes it is. If you sue a trustee saying you have rights basically saying that

you accept a benefit under trust, therefore you accept trust terms. You assented and became a party to trust agreement.

Page 73 – *<u>In re Estate of Brown</u>, 27227, 2013 S.C. Lexis 31 (2013).* This is the estate of James Brown. The will skipped over children and the wives (intentional plural), and left assets to an education trust to grandchildren and a large charitable trust. The Attorney General intervened and convened a settlement conference, but did not invite the representatives of the estate and completely redid the intent of the will. The personal representatives objected. The South Carolina Supreme Court rejects settlement of singer James Brown's estate for lack of a good faith controversy, destruction of Brown's estate plan in favor or an agreement overseen virtually exclusively by the state attorney general, and for moving assets away from charity and turning them over to persons Brown intended to exclude.

Session II-D
How to Practice Law, Abide by the Rules of Professional Conduct, and Have a Life that Rules
Nancy C. Hughes, Louis S. Harrison
Want a life outside the practice that rules? Save 4 weeks of time annually by implementing techniques designed to manage your practice efficiently and competently, while complying with the Rules of Professional Conduct.
Reporter: Mike Sneeringer

Ms. Hughes and Mr. Harrison combined their humor and many years of practice for this Dr. Phil like approach to teaching estate planning attorneys balance.

Mr. Harrison began by discussing <u>email</u>: managing emails requires estate planning attorneys to be FIRM:

A) Focus on how to use emails to our effectiveness; how beneficial is it?

1) Although Mr. Harrison cautioned that we should not be afraid of emails, we need to manage them.

2) Mr. Harrison reminded the audience that life is much easier with the invention of email: we are no longer chained to the desk talking to clients on the phone for what would make a simple and quick answer via an email.

3) Mr. Harrison suggested that we never draft an email with the thought of coming back to it. He stressed that all attorneys should learn how to use "delayed delivery" for emails.

4) Mr. Harrison challenged the audience to avoid the "hot fudge Sunday;" this is the email dings, chimes, notices, pop-ups and everything else that alerts us that there is a new message of some sort.

5) It was suggested that instead of our inbox being our default outlook page, one's calendar should be the default; the estate planning attorney is now more likely to focus on meetings and the day's work than on emails.

6) Mr. Harrison suggested that we work somewhere different from our desk (avoids looking at the computer).

B) Intelligent use of quick keys. Mr. Harrison referred to his materials at page 9 for an intelligent way to use the quick keys on one's computer.

C) Review only once and remove. Mr. Harrison suggested that estate planning attorneys review emails only once: delete the email, delegate the email (if possible) or "do" the email (meaning respond to the email). Burying the email in one's inbox is the worst thing to do… at least get the email in motion (have an assistant pull

the file or print the email for review).

D) Manage client expectations. Mr. Harrison reminded that we have to realize that answering emails should not be automatic; life threatening crises are rarely conveyed via email.

1) Mr. Harrison suggested we not put our clients into the "respond as quickly as possible" mindset from the beginning.

2) Mr. Harrison explained the paradox of technology; technology should be our tool… we do not want to be a tool to technology.

Ms. Hughes then spoke about maximizing productivity. She argued that by maximizing productivity, estate planning attorneys will maximize profits and have a better life outside the practice of law.

Ms. Hughes referred to page 15 of her materials. She then gave a few pointers such as: setting boundaries with clients, setting boundaries with the estate planning attorney's staff, setting boundaries with colleagues and setting boundaries with one's self.

Ms. Hughes noted that she is a morning person; meaning she gets her best work done in the morning; this is her "peak time." She stressed that estate planning attorneys need to figure out their peak time of day and do their most tedious work at that time… during "off" times or non-peak times, estate planning attorneys should review emails or schedule conferences.

Ms. Hughes is a proponent of no client meeting days, setting regular drafting review days (but review the documents from home; take them home in a box!), recording billable time contemporaneously and reviewing all bills on one particular day at the beginning of the following month.

Probably Ms. Hughes biggest tip to the audience (in her opinion as she would later say) was to bring an associate or paralegal to a client meeting. This person can take notes, write up a summary memo about the meeting, be a face to the client (i.e., the client will mostly be communicating with this associate/paralegal; now the client can put a face to the name) and also enable the lead attorney to have a more productive meeting (the attorney is not bogged down taking notes).

Ms. Hughes also suggested having regular staff meetings, assigning file preparation and retrieving to the staff, using less paper (scanning all documents into the file that would need to be later referred to) and implementing a training program for new paralegals and attorneys.

Mr. Harrison discussed taking vacations. He put vacations for working estate planning attorneys into three categories: 1) the workcation (message on phone and email stating that you are out of the office; attorney works less but is still working); 2) the relaxcation (the attorney is out of the office and on vacation, but deals with lots of emails); or 3) the real vacation (the circa 1980 vacation where the attorney goes and has fun). Mr. Harrison noted that attorneys should ask themselves what is he or she trying to achieve from the vacation? Define how you would like to look at taking a vacation, be more disciplined, and pick an appropriate time of day to deal with work related things during the vacation (if that is what you would like to get out of a vacation.

Mr. Harrison suggested blocking off a week or two each quarter for vacation; if it comes to that week and you do not want to take a vacation, then you have a week or two free to do other work; or take the darn vacation! Also, eliminate excuses that prevent one from taking a vacation and make an easy exit and reentry strategy (no conference on the day before vacation, come back on a Saturday as opposed to a Sunday, and allow for two

days free of conferences following a vacation). “We work to take vacation; we don’t take vacation to work.”

Ms. Hughes suggested that we get rid of clients who make us crazy… either fire them or, if they fire you, do not try and win them back. Ms. Hughes’ main point on this topic was to let things slide and be the bigger person during a client divorce. Some suggested tips were to eat the outstanding legal fees and just hand over the file to the client, preferably get out when the time is right (i.e., no pending litigation or the most recent matter was just concluded) and honor the duty to the client (i.e., do not leave the client “lawyerless” at a hearing or litigation; properly go through the court to withdraw as counsel if that is the case, or give the client reasonable notice). Ms. Hughes did caution that in giving the client back the file, the attorney should make sure no internal only communications are remaining in the file or that there are no misfiled documents in the file.

Mr. Harrison then spoke about how to weed clients out. He broke an initial client call down into three aspects: listening (actively listening to the potential client; what are his or her needs); segueing (either moving forward with scheduling the meeting or referring the potential client somewhere else); and then scheduling the client for a conference. Mr. Harrison made no comment on how much or how little (if any) to charge for the initial client conference.

Once the client is scheduled for an initial conference, Mr. Harrison suggested a few things to do before the first conference: have the client send back a completed client questionnaire; Google the client; send the client your biographical information; and send the client your most germane writings (did you write an article about wills and trusts? Send that to the client).

At the initial conference, Mr. Harrison suggested that the estate planning attorney listen for “buzz words” that would result in “buzz kill”: the client had “many lawyers before you,” discusses “why I shouldn't pay my prior estate planning attorney,” wants to already have a discount, does not want to pay a retainer, is vindictive angry or vengeful, or wants to sue his old lawyer.

Mr. Harrison reminded the audience that they should reward good clients by writing a personal note around the holidays, sending a non-work email just to say hello or purchasing a gift for the client. Ultimately if estate planning attorneys increase retention on these good clients, more good clients will come.

Finally, Mr. Harrison and Ms. Hughes picked out two or three of their favorite fifteen action steps (as presented in their materials on pages 48 and 49). Mr. Harrison’s top two were turning off all icons, beeps and pop-ups that indicate a new message has been received, and practicing active listening with new clients. Ms. Hughes’ top three were setting aside a day each week, having a staff member pull the file so the estate planning attorney will know what is going on and having someone junior in the meetings. Ms. Hughes also suggested scheduling no more than two to three meetings in any given day as the estate planning attorney needs time in between meetings to decompress.

Session II-E
What’s Hot in Life Insurance (Financial Assets Series)
Donald O. Jansen, Mary Ann Mancini
This panel will discuss recent developments and current issues involving life insurance such as policy valuation; Crummey powers (when there is an arbitration clause, whether notice is necessary, etc.); substitution power in a trust holding a policy; policy sales; and charitable gifts of policies (CRTs, shark fin CLATs, etc.).
Reporter: Michelle Mieras

During this session, Donald Jansen and Mary Ann Mancini took a tag-team approach to present recent

developments in eight areas related to life insurance. The highlights of the eight topics, discussed more fully in their 40-page outline, are discussed below.

1. Crummey Withdrawal Powers:

Mr. Jansen pointed out three developments over the last few years in the world of Crummey powers.

Two developments stemmed from the Tax Court decision in *Estate of Turner*.

First, the *Turner* court addressed the effectiveness of a Crummey withdrawal power when the beneficiary is not notified of the gift to the trust. The IRS's position has been that where a beneficiary with withdrawal rights is unaware that a gift to trust was made, the Crummey power is not effective as to the beneficiary and the gift will not qualify for the annual gift tax exclusion. Practitioners have disagreed with this position, citing the character of the power as a general power of appointment. The IRS's treatment of a general power of appointment is not dependent on the holder's knowledge of the power in other circumstances; why would this general power of appointment be treated differently? Prior cases, including *Crummey* and *Cristofani* , included dicta indicating that the Crummey power is effective even if the beneficiary is not aware of the gift. In 2011, *Estate of Turner* directly confronted the issue. The Tax Court, citing to *Crummey* and *Cristofani*, stated that the test is whether the beneficiary had an enforceable right to withdraw assets which the trustee could not prevent, regardless of whether the beneficiary had notice of the gift. Mr. Jansen cautioned that this is just one case, and the best practice is to continue to give notice of gifts. Other courts might decide the issue differently. By giving notice, your client can at least avoid the cost of litigating the issue.

Turner also addressed whether Crummey powers apply to indirect gifts, such as when the grantor of an ILIT pays life insurance premiums directly to the insurance company rather than to the trustee. The IRS has taken the position that only direct gifts to trust qualify. In *Turner*, the court found that indirect gifts do, in fact, qualify. It is important to note, however, that the trust in *Turner* included provisions specifying that the beneficiaries' withdrawal rights were triggered by direct or indirect gifts. The moral of the story: include such language in trust agreements to best protect the clients against themselves and preserve the opportunity to argue the issue. Mr. Jansen noted that even if the trust agreement provides for withdrawal rights with respect to indirect gifts, the provision will be meaningless unless the trust has other assets available to satisfy the withdrawal rights if exercised.

The third development with regard to Crummey powers was CCA 201208026, which found Crummey withdrawal powers invalid because the trust contained 1) a mandatory arbitration clause and 2) a no contest clause. The mandatory arbitration clause theoretically prevented the withdrawal power from being enforced in state or federal court, meaning the power itself was not an "enforceable" right. Mr. Jansen pointed out that not all state laws will enforce a mandatory arbitration clause, so look to state law if you find yourself facing this issue. With regard to the no contest clause, the invalidity of the Crummey power resulted from the "economic doom" discouraging the beneficiary from enforcing his or her rights. Again, Mr. Jansen feels that state law may be an out if it includes exceptions for good faith and probable cause. Consider omitting these provisions from Crummey trusts to avoid these issues all together.

2. Valuation of Life Insurance Policies:

Ms. Mancini then addressed developments in the valuation of life insurance policies. This included a discussion of the difference between valuation for income tax purposes and estate and gift tax purposes, the relevant regulations (detailed in the materials for this session) and their safe harbor rules, and the difficulties and issues in valuing policies using the interpolated terminal reserve value. Ms. Mancini noted that it is not uncommon to

receive a Form 712 from an insurance company with multiple and highly disparate values, and the likely scrutiny from the IRS unless the highest value on the form is used. She then turned to the 2013 decision in *Schwab v. Commissioner*, notable for its statement that insurance valuation is a "slippery concept." The courts are looking at what is being done with the policy by the transferor and the recipient, which affects how the value of a policy should be determined. Ms. Mancini pointed out that when transferring a policy she will often ask for information from the insurance company ahead of time about what will appear on the Form 712. If the information is not available, it may be prudent to obtain an appraisal of the policy.

3. Incidents of Ownership – Retention of Right to Receive Dividends:

Advisors are aware of the significance of incidents of ownership and the existence of an economic benefit in the policy. The regulations provide non-exclusive examples. Court cases have expanded upon these examples. PLR 201328030 recently found that the retention of the right to receive dividends did not constitute an incident of ownership, and was instead a return of premium not amounting to an economic benefit from the policy. Mr. Jansen cautioned the audience that the result may differ if the dividends paid eventually exceed the premiums paid.

4. Federal Preemption: State Law Divorce Revocation of Designation of Spouse as Beneficiary:

Mr. Jansen discussed Hillman vs. Maretta, a 2013 US Supreme Court case addressing federal preemption of state law. Virginia, like many states, enacted a statute providing for the automatic revocation of the beneficiary designation of a spouse upon divorce. Virginia law went further, stating that if the state statute was preempted by federal law, the former spouse would hold the proceeds received via the beneficiary designation in constructive trust for those who would benefit absent federal preemption. The Supreme Court rejected this attempt to avoid federal preemption, finding that the basis of federal preemption applies not only for the convenience of the government (*i.e.*, to make it easy to determine the named beneficiary) but also for purposes of determining the order of beneficiaries.

5. Grantor Trust Powers' Impact on Insurance:

Ms. Mancini then reviewed certain grantor trust powers as they relate to life insurance. After a review of IRC Section 677(a)(3), discussed in detail in the materials, Ms. Mancini focused on the power to substitute assets and whether this particular grantor trust power could potentially cause estate tax inclusion when held in a non-fiduciary capacity with respect to life insurance. The 1975 *Jordahl* case is well-known, but deals with the substitution power held in a fiduciary capacity. For the answer to powers held in a non-fiduciary capacity, we have to look at recent revenue rulings. Rev. Rul. 2011-28 extended Rev. Rul. 2008-22 to apply to life insurance policies, holding that the power to substitute a life insurance policy held in a non-fiduciary capacity would not cause estate tax inclusion under IRC Section 2042(2) so long as state law or the governing document ensures the trustee has a duty to enforce and ensure that the substituted property would have equivalent value. There was some discussion about the possibility and opportunities of causing a third party to be treated as a grantor using the power of substitution, although there are arguments based on the statutory language that only the initial transferor could be given the right to substitute.

6. Variable Annuity CLAT:

After a brief overview of CLATs, Mr. Jansen's presentation focused on how much of an annual increase in the annuity payment is permissible. PLR 201216045 approved of a set 20% annual increase in annuity payments for twenty years. Shark fin CLATs, so named for the shape of the graphical representation for the increase in annuity payments, have significant potential to increase the amount of wealth transferred due to the low

annuity payments in early years. Many shark fin CLATs use life insurance policies, which works because of the guaranteed funds at death to pay the increased annuity. The disadvantage is that it is a CLAT, so the trust must be sufficiently funded at inception as no subsequent contributions can be made. Although there are no decisions evidencing what the IRS would do with shark fin CLATs, a few articles out there question the effectiveness of this type of planning. Mr. Jansen discussed the arguments presented, and pointed out possible rebuttals to the criticisms. One argument with potential teeth (or jaws?): the shark fin CLAT meets the definition of a personal benefit contract under IRC Section 170(f)(10). This remains an unanswered question, and no official guidance has been issued by the IRS.

7. Sale of Life Insurance Policy:

The sale of a life insurance policy generally falls into one of two categories: viatical settlements and other sales governed by the transfer for value rules. The transfer for value rules and five exceptions thereto are discussed in the materials. Ms. Mancini's presentation focused on non-viatical sales.

Two revenue rulings address the income tax consequences of policy sales. Rev. Rul. 2009-14 discusses the consequences of the sale of a policy held by an investor. Rev. Rule 2009-13 governs the sale of a policy by someone using the policy for its insurance protection (a non-investor). Ms. Mancini noted that a lot of practitioners disagree with the methodologies set forth in the revenue rulings, and cautioned about reporting requirements and potential penalties when choosing to file a return that does not conform to the revenue rulings. Practitioners also have differing interpretations of the revenue rulings which result in different calculations, and each practitioner is encouraged to review the rulings and decide for herself. Ms. Mancini presented a fact pattern for the sale of an insurance policy, and worked through the calculations of the amount and character of taxable income from a sale by an investor and then by a non-investor. She noted that the insurance company plays an integral role in determining the potential tax consequences, as they will need to provide the practitioner with certain information critical to the calculations.

8. Second-to-Die Policies:

Mr. Jansen concluded the session with a discussion of two recent developments in tax-free exchanges of second-to-die policies. PLR 201304003 approved of the tax-free exchange of a second-to-die policy after the death of one of the insureds with a single life policy insuring the survivor. PLR 201332004 approved of the separate sales of a husband's and wife's respective interests in a second-to-die policy, using two separate exceptions to the transfer for value rule. This effectively allowed a joint ILIT holding the second-to-die policy to sell the policy to a new ILIT of which only the husband was grantor without having the transfer for value rules apply.

Session II-F
Unfunded Testamentary TrustsFiduciary Liability Issues (Litigation Series)
Mickey R. Davis, Mary B. Hickok, David Pratt
Your client's father just died with a sizable estate, all of which passes to his new wife. You've reviewed the will of the client's mother who died ten years ago, and ask about her bypass trust. The client tells you that his Dad always said that Mom's will left everything to Dad. Is there any way to recover assets that should have gone to your client? Explore the surprising fiduciary issues that may save the day when a testamentary trust has gone unfunded.
Reporter: Joanne Hindel

Mickey started the presentation by discussing the problem of not funding bypass trusts. David indicated that he engages all clients in a discussion about when the funding will happen. David also said that he provides clients, in writing with how to fund and will offer to assist in the funding process.

Jeff and Mark indicated that as corporate fiduciaries they have software in place to track the funding of trusts. They may also have more knowledge of the financial life of the clients and have significant documentation in place to assist them in identifying whether a trust has been properly funded.

All the panelists agreed that if there are different representatives for various estate planning documents, there is an additional need to coordinate all the activity.

If you have multiple advisors, (CPAs and attorneys) they need to coordinate the efforts and one person should be the quarterback for all the activity. Often that can be a corporate fiduciary.

The panelists agreed that the situation pertaining to no step-up on the assets in a bypass trust has always been around but has now taken on much more significance because of changes in estate tax laws.

With increasing indexed exemption amounts there are still significant planning issues that are both tax and non-tax related.

Now, state tax consequences are more significant and residences of the beneficiaries are more important. Income tax consequences are also more important.

Mickey said that he believed a primary cause of unfunded bypass trust was client inadvertence.

He said he thought that clients get tired of paying legal fees and do not want to address the complexity (head in the sand).

If at the death of the first spouse certain actions must be taken by the surviving spouse (disclaimers) it is more important to coordinate efforts among the client advisors.

Once funding is considered, one of the greatest problems is tracking the original assets and how they may have changed in the interim. Clients do not want to spend time or fees in having an advisor track the original assets – corporate fiduciaries will do this as a matter of course so the cost is decreased.

If a period of time elapses before funding, interest may have to be charged.

However it is good advice at the death of the first spouse to wait with transactions so original assets are not changed too quickly.

There are three plausible approaches to funding bypass trusts later in time:

1. The “Vested in the Bypass trust” approach which can be applied if the property at issue remained in the wife’s name and the husband took no actions inconsistent with the ownership of the assets by the wife’s estate or the bypass trust. Then title to the property can be found to be vested in the trustee of the bypass trust pursuant to state law.
2. The “Constructive Trust” approach which can occur if the husband wrongfully holds the bypass trust property in his individual name then under the UTC or similar statutory or common law, a proper remedy would be to subject the property or proceeds to a constructive trust.
3. The “Debt Against the Estate” approach. If the husband was the executor of the wife’s estate, in lieu of the constructive trust approach, an equally compelling argument can be made that the husband misappropriated the assets and can be considered to owe a debt to the unfunded bypass trust or its remainder beneficiaries.

Jeff discussed the ***Estate of Richard*** case to highlight the “Vested in the Bypass Trust” approach to fixing an unfunded bypass trust. The impetus for the case was an attempt to reduce assets held in the father’s estate in order to reduce estate taxes owed and a deficiency imposed by the IRS. The court focused on the fact that the assets that were earmarked for the bypass trust were not retitled in the surviving spouse and the father took no overt actions to indicate that he was the owner of the shares.

Of course, succeeding in keeping the assets out of the estate of the surviving husband's estate might put the assets and their appreciation back into the estate of the wife who died years earlier.

David discussed the *Stansbury* case to highlight the "Constructive Trust" approach. Assets that were found to be held in a constructive trust for the benefit of another were not includable in the estate of the decedent. This case is distinguishable from *Estate of Richard* because the assets had been retitled but were still not considered owned by the decedent.

The constructive trust theory raises many issues on how to trace assets. If assets are commingled, the burden of proof is on the commingler to show which assets should not be considered held in a constructive trust.

Statutes of limitations issues can be addressed by focusing on when the wronged party finds out about the lack of funding.

The panel discussed the possible duty of a beneficiary to ask about the existence of the trust and possible benefits from it – could the courts move in that direction and hold the beneficiary partially responsible for not asking?

The panel then discussed the "Debt Against the Estate" approach and reviewed the *Estate of Bailey*. One issue to consider is what amount is appropriate to address for damages? The original amount or some projected amount based upon appreciation over time.

Interesting to contrast the success in funding bypass trusts long after the intended funding date with trying to create family limited partnerships long after the intended date of creation.

The panel discussed possible gift consequences when parties agree to the transfer of assets to an unfunded bypass trust or alternatively do not object to the transfer of assets.

The panel discussed which theory would be the best but concluded that it would be fact specific before any theory could be considered the best.

Thursday, January 16

9:00 – 9:50 a.m.
Must We Trust a Trust That's Just a Crust That Wast a Trust? (Focus Series)
Ronald D. Aucutt
This presentation will examine what some view as "un-trust-like" notions protectors, selectors, advisors, appointers, special trustees, directed trusts, secret trusts, virtual representation, in terrorem forfeitures, self-settled trusts, perpetual trusts, decanting, and the like and ask if what we call trusts are really worthy of the treatment accorded that venerable institution.
Reporter: Mike Sneeringer

Mr. Aucutt used an intellectually stimulating approach to push the audience to think about trusts on a higher level.

Mr. Aucutt began his presentation by giving a brief history lesson on how we came to today's current trust environment. He traced trust history from King Edward the Sixth to the implementation of the enactment of the GST, estate and gift, and federal income tax.

Mr. Aucutt noted that today, trust law has evolved to encompass some of the following terms: the Uniform Prudent Investor Act, the Revised Uniform Principal and Income Act, a Total Return Unitrust, diversification, decanting, and the relaxation of the RAP.

Mr. Aucutt then posed the question of whether we, as estate planning practitioners, are actually listening to our clients' needs with respect to trusts. Mr. Aucutt surmised that most of us are not, and merely draft the trust we think best for our clients. He challenged the audience to listen to the client before drafting.

Mr. Aucutt then asked whether life is acquisition or stewardship. He explained what makes up stewardship and opined that for some clients, trusts are not the answer… such clients would rather teach their children how to handle money by making distributions outright or during their lifetimes, rather than hide money in trusts until the client is dead. Mr. Aucutt said that although he may be naive, it would be key for parents and children to talk about money in order for the children to be able to handle the money when the time comes. He suggested that annual meetings (or more frequent intervals as necessary) occur between family members (beneficiaries and donors alike) and trustees in order to grasp what is going on with the family trust, including an annual accounting of the trust.

Mr. Aucutt then went on to describe what the core of a trust is: the ability to change the trust and the ability to challenge.

A) The ability to change the trust as time, values, and families grow and change.

1) Change can occur through decanting, non-judicial settlement agreement or through going to court.

2) Why should beneficiaries or trustees change what the grantor had done by creating the trust? Mr. Aucutt argued that the notion of change goes back to the beginnings in the formation of trust law itself; one cannot subject a trust to trust law and then expect that lawyers, judges and legislators will not change the law. Mr. Aucutt used a wonderful analogy: it is like buying a car for a child and then telling that child that he or she cannot drive the car.

B) The ability to challenge; someone must have a fiduciary duty to the beneficiary with respect to each function of a trustee.

1) Sometimes these "responsibilities" are divided among co-trustees, trust companies, trust protectors, etc.

2) The duties of loyalty and prudence are non-negotiable.

3) Someone's conduct must be accountable through the duty of care.

Mr. Aucutt then added that a fiduciary duty implies accountability. There are two components of enforceability: information and forum.

A) Information: keeping beneficiaries informed or being entitled to receive, on request, information of extraordinary events occurring during the life of a trust.

1) Mr. Aucutt wanted the audience to ponder: why do some states then provide no notice of accounting?

2) He added that the audience should review UTC Section 813 regarding the duty to inform and report (available on pages 23 through 24 of his materials).

a) Mr. Aucutt added that the drafters of the UTC could not agree on certain aspects of this section.

b) Mr. Aucutt referenced the recent developments in the law within this section. He suggested the audience review the <u>Wilson</u> case whereby the court stated that if the fiduciary's duties are not enforceable, the trust itself is not enforceable (for more information on this North Carolina case (see the Recent Developments Panel's materials from Monday.

3) Mr. Aucutt added that how can our clients be so naive to think that while the children are living in big homes and taking extravagant vacations, they do not realize that their parents are rich and that the money must go somewhere and come from somewhere?

a) The trust will just get bigger and bigger to the point where the child will be overwhelmed.
b) Why not give some money to charity?
c) Why not begin involving children early in an age appropriate way?

4) If information is that big of a worry, at least have someone appointed as a designated representative on behalf of the beneficiary to receive the information about the trust while the beneficiary is too immature to deal with the money.

B) Forum: initially, forum refers to courts.

1) Mr. Aucutt asked the audience why do we think it is prudent to limit a beneficiary's access to courts through a no contest clause or an in terrorem clause?

a) Mr. Aucutt noted that no contest clauses and undue influence often go hand and hand.

2) Is binding and mandatory arbitration a good thing? What if the arbitrator makes a mistake? How are you going to appeal?

a) Mr. Aucutt noted that the IRS is weary of arbitration clauses.

In finishing up his presentation, Mr. Aucutt pointed to his materials at page 27. He noted that the goal should be to make the trust "trusting."

A) The trustee must have an enforceable duty.

B) The trust should reflect a humble view of property ownership (because nothing lasts forever).

C) Trusts in their current form are not likely to last forever.

D) Do not overlook taxes; however, be tax smart… remember the worst penalty that the IRS can impose would be to re-characterize the trust as an entity such as a partnership or even worse, as an association taxable as a corporation.

E) Be careful when splitting up fiduciary duties such as the power to add trust beneficiaries or grant general powers of appointment.

Mr. Aucutt's final thought was that eventually creditors will have greater rights, there will be laws restricting entities and there will be a federal RAP statute passed.

9:50 – 10:40 a.m.

Ay ay ay NII! The 3.8% Tax on Trusts and Estates Planning and Administration (Focus Series)
John Goldsbury
The 3.8% health care surtax on "net investment income" (NII) is finally here for 2013. Proposed regulations are out; final regulations are scheduled for 2013. The tax applies to individuals and trust/estates, but there are several quirks applicable only to trust/estates. This session will focus on the latter, both on the planning side and the administrative side.

Reporter: Herb Braverman

Mr. Goldsbury spoke about the new 3.8% surcharge on trusts and estates (as well as on individuals). To this reporter it appears that this tax is just another effort by our country to resist the obvious need for tax simplification and for some efficiency in our lives and the lives of our clients and their entities. Instead of this, we have a new layer of taxation that may provide some badly needed revenues to the country, but may just cause more problems and costs within the tax and planning worlds. Needless to say, this new tax is complex, presenting us with the challenges of understanding it and then planning to minimize or avoid it altogether. Nevertheless, Mr. Goldsbury gave us a good and clear survey of the new tax and its implications for all of us.

Section 1411 of the IRC imposes a 3.8% surtax on individuals, trusts and estates. There were proposed regs in 2012, final regs in 2012 and now new proposed regs in 2013 (November). Of course, some individuals are excepted, for example, nonresident aliens, as are some trusts, such as certain business trusts, common trust funds, pooled income funds, trusts exempt from tax under IRC 501, charitable remainder trusts under IRC 664, certain foreign trusts, grantor trusts (disregarded for surtax purposes) and there are others to be read about in the regs when you have a moment. There are special rules for ESBTs, QSSTs and charitable trusts, that you will want to read also.

The surtax applies only to "net investment income (NII)". This is made up of 3 categories of income and there are also an array of deductions to consider. The first category is gross income from interest, dividends, annuities, royalties and rents, largely from passive interests. There are additional inclusions and exclusions listed in the regs you will be reading. The second category is gross income from a passive activity or a trade or business of trading in financial instruments or commodities. A passive activity is defined to be a trade or business in which you do not "materially participate." This includes LLCs and other closely held family businesses. The third category of income is net gain "to the extent taken into account in computing taxable income." This would not include such items as gain on the sale of a personal residence, sale of stock to an ESOP, gain on tax free like-kind exchanges or on tax free exchange of insurance policies, goodwill in the sale of a business, etc.

There are some permitted deductions in the calculation of NII; for example, those allocable to gross income from rents, royalties, businesses that generate NII, penalties on early withdrawals of savings, net operating losses under certain special rules, certain investment interest or expenses, amortizable bond premiums, fiduciary expenses deductible under IRC 212, etc.

Not included in NII are most qualified retirement plans and annuities, Roth IRAs, nonqualified deferred compensation plans, incentive stock options (ISOs), wages, salaries, income from the exercise of compensatory options, alimony, social security benefits, income from vesting restricted stock, etc., although some of these can affect modified AGI, which in turn can affect surtax results.

Mr. Goldsbury then discussed how much NII is surtaxed. There are thresholds, of which you must be aware. For marrieds filing jointly, over $250,000; singles, over $200,000; marrieds filing separately, over $125,000 and trusts and estates, over $11,950. Mr. Goldsbury provides a collection of charts in his materials that I commend to your attention.

Mr. Goldsbury then went on to discuss the difference between DNI and NII and why that is important for future planning. He also discussed how distribution decisions, among other treatments of assets through a year, will affect the calculation of NII and the surtax. This is complicated for a variety of reasons, including the different nature of the NII tax from other taxes we deal with during the year for our clients. See the regs, the examples set forth in the regs and in the Goldsbury materials.

10:55 – 11:45 a.m.

Help Me Fix My Trust!

Amy E. Heller

Mistakes happen. Laws change. Circumstances change. Any of these situations can cause a trust to no longer accomplish its intended purpose. This session will explore different methods available for fixing irrevocable estate planning documents and the tax and state law considerations in using the available approaches.

Reporter: Joanne Hindel

Amy started the presentation by indicating that she would cover what you can do when an estate planning document no longer works properly. Sometimes lawyers make mistakes and sometimes the document is fine but the laws change and finally, circumstances can change.

State laws provide a number of ways to change estate planning documents.

Amy said that there are five principle methods to change trusts:

Construction

1. Reformation
2. Division
3. Amendment
4. Decanting

First you have to determine which state law applies. Sometimes this is stated in the document and sometimes different laws can apply to different aspects of the trust.

Construction

With respect to the law governing construction, usually the law set forth by the settlor will apply.
If you want to change the law governing administration of a trust it may be possible to move administration to another more favorable jurisdiction but this does not always work.

Once you have chosen a state law to use to change the terms of a trust, you have to determine the federal tax consequences. In *Estate of Bosch* the court held that the IRS was entitled to have the Tax Court or another federal court determine the proper result under state law, unless a decision as to that result has been made by the highest court of last resort.

The completed transaction rule applies to changes made after a taxable event, such as the death of a testatrix or the transfer of property by gift to an irrevocable trust that has already occurred. The completed transaction rule should not apply to changes effected by construction proceedings.

There are a number of adverse tax consequences that can be caused by changing the terms of an irrevocable trust such as adverse gift tax consequences. It is also possible to jeopardize the GST protected status of a trust. Final GST tax effective date regulations issued on December 20, 2000 describe several types of changes that the IRS has concluded will not result in a loss of effective date protection.

Construction proceedings are used to ask a court to determine a settlor's intent when the words of the trust instrument are ambiguous or when they do not make provision for a particular contingency that has occurred. Courts will follow rules of constructional preferences. Extrinsic evidence can also be introduced into a proceeding.

If IRS accepts the construction it will operate retroactively to the date of the original agreement.

Reformation

Reformation is a proceeding in which a court is faced with unambiguous language that does not accomplish what the court concludes that the settlor intended.

There must be established by clear and convincing evidence that there was a mistake of fact or law and the intent of the settlor must also be established.

Reformations can fix a mistake by the drafter (scrivener's error) or to achieve a result the settlor would have wanted if aware of certain facts or laws.

Amy reviewed the tax consequences of both types of reformation proceedings and summarized a few cases on point.

Division

The power to divide a trust into two or more separate trusts may be useful in a number of circumstances such as for favorable tax consequences for marital, charitable or GST tax matters. Most states have division statutes in place and the UTC provides for it as well. Under the UTC version division allows the new trusts to have different terms as long as not inconsistent with the intention of the settlor.

Amendment

The power to amend can derive from the trust terms or from state statute. Most states have statutes that allow amendment by some combination of the settlor, trustee and the beneficiaries.

There could be tax consequences to amending trusts: for instance a beneficiary that consented to an amendment might be considered to have made a gift.

Decanting

The authority of a trustee to decant trust property generally comes from a state statute but some find a basis for it in common law. It can be extremely useful in a number of circumstances: for instance when a mandatory payout may not be in the best interest of a particular beneficiary. The trustee can distribute the assets of the trust to a new trust that will extend the payout period to the beneficiary.

21 states have enacted decanting statutes but they vary from state to state.

In 2011, the IRS indicated that it was studying decanting to determine likely tax consequences. To date, no guidance has been released. Amy discussed likely income, gift and GST tax consequences of decanting.

11:45 a.m. – 12:35 p.m.
Charitable Giving in the New Estate Planning Environment (Focus Series)
Turney P. Berry
This presentation will examine: planning for and creating charitable interests in trusts that are primarily non-charitable; using deferred gift annuities and charitable remainder trusts as long-term care and retirement planning devices and for other uses as tax rates rise; preserving ancestral homes and family farms through charitable transfers; and the use of charity when transferring business interests and investment portfolios. It will also consider selecting the best charitable device and recipient to meet the client's objectives and the effect of interest rate changes on charitable planning.
Reporter: Ted Preston

Mr. Berry's presentation offered numerous practical tips on charitable giving based on recent developments. He began his presentation with tips on the necessity for substantiating charitable deductions. He stressed that practitioners should just follow the rules carefully, because there is no such thing as "substantial compliance" on substantiation of charitable gifts. Tax courts are bound by strict construction of the statute. They don't bend.

How much is the deduction? When our clients donate property, the deduction is limited to their basis in that property. Cash donations get a full deduction. We should be adamant about bringing this reality check to our donor/clients: if a donor gets an income tax deduction, the charity ought to receive a check for at least the amount of the deduction. Promoters often propose schemes that suggest a donor can get a large deduction for writing a small check. Charitable deductions do not work that way. Independent appraisals are key, and we should advise our clients never to use a promoter to prepare an appraisal on the gift they are promoting. Their deductions hinge on the strength of the appraisals. Poorly supported and/or optimistic appraisals are a frequent item of interest for examiners. Berry also cited the frequency of disregard for appraisal rules on donations of conservation easements and facade easements.

Mr. Berry discussed the useful tip set out in Notice 2012-52, clarifying that a charitable organization may take title to a donated property in the name of a single member LLC for purposes of segregating any liability associated with the property, without jeopardizing the donor's deduction, provided the donation complies with all the requirements of IRC §170. This was a practical, positive development that can benefit our clients who wish to donate real property to charities, where the property may come with potential environmental or similar liabilities.

Mr. Berry cited an important rule practitioners should discuss with clients thinking about engaging in a series of transactions with a charity related to a donated property. A charity disposing of an illiquid asset within three years of acquisition has to report that sale to the IRS on form 8282. IRS uses this process to check into potentially abusive transactions between donors, related parties and cooperative charities. Mr Berry's word to the wise: wait more than three years before having your children buy back a property you just donated to a charity.

On a related note, Berry pointed out that public charities can safely engage in certain transactions with a donor's family that private foundations cannot. Keep those distinctions in mind. Also, we should discourage our private foundation clients from playing around with the self-dealing rules. Those rules are in place to keep private foundations from being abused. The rules and penalties are draconian. The draconian penalties are intended as a method to avoid self-dealing without spending the Service's enforcement budgets on it.

Mr. Berry suggested a method by which a trustee can make a charitable donation indirectly when the applicable trust doc doesn't explicitly allow for charitable contributions. Provided the trustee has authority to enter into partnerships, the trustee can contribute assets to a partnership controlled by other partner. The controlling partner may then make a charitable contribution of partnership income. A recent revenue ruling concludes that the charitable deduction passes through to the trust even though the trust cannot make direct contributions to charity.

Mr. Berry provides many additional practical pointers in his written materials, and they are worth a detailed review by practitioners who advise clients regarding charitable donations.

2:00 – 5:20 p.m.
Fundamentals Program
Income Tax Planning for Estate Planners: A Three Hour Tour
Samuel A. Donaldson
Just sit right back and you'll hear some tales … of fateful estate plans that failed to spot and deal with applicable federal income tax issues. Indeed, the weather starts getting rough for estate planners who forget about the income tax implications of the strategies they recommend to clients. This session will address several of the federal income tax issues estate planners regularly encounter, with an emphasis on recent changes and developments. Specific topics to be covered include basis in gifted property, the preferential tax rates for net capital gains, the exclusion for gain on the sale of a principal residence, the "Kiddie Tax," installment sales, like-kind exchanges, marital property transfers, the taxation of life insurance, and the income tax deduction for charitable contributions. And it's taught by a professor (not Mary Ann).
Reporter: Kristin Dittus

This report will cover the highlights from a three hour refresher class on applicable federal income tax issues that planners may encounter in practice. I apologize in advance for the lack of brevity in this summary.

After glowing introductory remarks from Sam Donaldson, including accolades for publishing crossword puzzles in the York Times, the infamously witty Sam Donaldson changed hats and took the podium as presenter. He opened with a review of the current tax brackets and rates. Problematic for American Taxpayer Relief Act (ATRA) is that the tax bracket thresholds are not adjusted for inflation. Also notable was the very thin margin for taxpayer's making any amount above $405,100, which jumps from the 35% rate to the 39.6% rate after just $1,650.

While ATRA includes many permanent changes to federal income tax, it also contained a number of "extenders" that postponed the sunset of many important rules until the end of 2013, the highlights of which are listed below. As of this writing, all of these items expired at the end of 2013 (but it is suspected many will be once again extended into 2014 and beyond). A quick note on deduction classifications: the highly sought after above the line deductions are better than the more laborious itemized deductions which require itemizing and are much preferred to miscellaneous itemized deductions which are only recognized to the extent they exceed 2% of the taxpayers AGI after all that trouble of itemizing.

1. Above-the-Line Deduction for Teachersâ€™ Classroom Expenses up to $250. It is hard to imagine why this deduction has not been made permanent, especially given its great impact on the annual budget
2. Sales Tax Deduction. Enjoyed primarily by taxpayers in states with no income tax.
3. Expanded Limitations for Contributions of Qualified Conservation Real Property. Qualified conservation easements have been a boon for taxpayers with real property that qualifies for this deduction (given in exchange for the loss of the value due to the restriction of the easement) up to 50% of the contribution base with carryover for 15 years who also had no real intention of converting the property in the first place.
4. Â§179 Expensing Election. Up to $500,000 for 2012 and 2013. Whatever is not deducted under §179 can generally take advantage of §168(k) 50% Bonus Depreciation, which is also a deduction that requires extending after 2013. The §179 dollar limitation is set to drop to $25,000 in 2014, a likely source of anguish for business owners.
5. Qualified Charitable Distributions from IRAs. This has been great for charitably inclined clients who would be subject to tax on a required minimum distribution (RMD) or expose all of their income to a higher tax bracket if they received a RMD as income.
6. 100% Exclusion on Gains from Sales of Section 1202 Stock. This was a 50% exclusion previously available to domestic C corporations with gross assets of $50 million or less.
7. Stock Basis Adjustments for Charitable Contributions By S Corporations. This is as close to a "grab and steal" as we have seen in this world of great deductions. For any property donated, shareholders take a pro rata deduction for 100% of the fair market value (FMV), but only need to recognize a reduction in basis that is a pro rata share of the adjusted basis of the contributed property.

Flavors of Gain and Loss: Ordinary Income and Loss v. Capital Gain and Loss

Not all income is taxed equally. In very general terms, a taxpayer will receive the more preferable rates of §1(h) on gains from the sale or exchange of "capital assets" held for more than one year. Most things can be capital assets with a few exceptions which can generally be categorized as "business type assets" such as inventory, property held for sale to customers, depreciable property, real property used in a business, and business accounts receivables. Never sell on the anniversary! In addition to being tacky, you will be punished with short term capital gain treatment (for assets held less than one year). While preferred to ordinary income, short term capital gain does not offer any great advantage in rate, but may be offset by capital losses, if any. Regarding holding periods, anything inherited from a decedent is long term.

Section §1231 Gains and Losses and Depreciation Recapture

Under §1231, depreciable property and real property used in a taxpayer's business will generally qualify for preferential treatment, if held for more than one year. However, if a taxpayer has the benefit of a depreciation deduction against ordinary income over the life of an asset and then sells the property, §1245 depreciation recapture rules provide that the gain on such asset will be taxed at ordinary income rates rather than at long term capital gain rates. Under §1250, the sale of depreciated real property used in a trade or business is generally taxed at a flat 25% rate.

Preferential Tax Rates

There are preferential rates for net capital gain (0% for low income taxpayers and 15% for middle income taxpayers) and higher tax rates for items such as collectibles and §1202 stock (28% rate). Even with a higher stated tax rate for an asset, a taxpayer will never pay a higher rate of tax on an asset than he pays on ordinary income. These elevated tax rates apply to taxpayers that are in a tax bracket that charges at least the same or higher tax rate.

Gifts

Gifts are excluded from gross income. A gift, as defined under *Duberstein*, is given out of "detached and disinterested generosity." Subsequent income on gifts or a gift of income (ie. rental income) are included in

gross income, as is any gift from an employer to an employee. Gifted assets have a carryover basis, which is the same basis the asset had in the hands of the donor and generally increased for the amount of gift tax paid, if any. See the outline for more detail and formulas regarding basis calculations. Using a part gift part sale is a good way for relatives to transfer assets, and the donee's basis is the greater of the amount she paid or the carryover basis. Gifted property with debt in excess of basis may cause a taxable transfer to the extent of the excess or "boot."

Basis upon death of a Decedent.
Section 1014(b) gives a decedent's property stepped up (or stepped down) basis to FMV on the day of a decedent's death, except on Income in Respect of a Decedent or IRD, such as tax deferred retirement assets or lottery winnings. In community property states, all of the community property assets will get a step up upon the death of the first spouse to die, which is a huge advantage to citizens of those states. Care should be taken to preserve the character of this property if a couple moves outside of a community property state.

Gain on Sale of Principal Residence:
Under §121, a taxpayer has a $250,000 exemption from gain on the sale of a principal residence as long as (1) she has owned and used the home as a personal residence for periods aggregating 2 years or more out of the 5 years prior to the sale, (2) has not used the exemption for 2 years before the date of the sale. Couples who are married filing jointly get the benefit of a $500,000 exemption as long as: (1) at least one of them owned the property, (2) they both used the property for 2 out of 5 years as stated above, and (3) neither of them used the exemption 2 years prior to the sale. There are some exceptions to qualifying for unforeseen circumstances in the outline, as well as special circumstances encountered after divorce. The §121 personal exemption cannot be used for property owned by a Credit Shelter Trust.

Kiddie tax. Net unearned income for qualifying children is computed at the parent's marginal rate. A parent may make an election under §1(g)(7) to report such income on his or her return, if neither is subject to the 3.8% surtax. If a parent is subject to the 3.8% surtax and a child is not, have the child file a separate return.

Installment Sales. Allowed for any property where there will be payments in the future. Use the "gross profit ratio" to report gain (which will reflect a percentage of both gain and basis in each payment). Only payments collected need to be reported, not a promise to pay in the form of a note. Cancelation of an installment obligation is seen as a taxable disposition, and is generally a gift so there is no income tax to the holder. The remaining balance on a note is IRD in the estate of the deceased holder with no step up in basis. If a holder tries to avoid ordinary income rates that are taxed to income interest the IRS will likely invoke the imputed interest rules of §483 and original issue discount rules of §1272-1275. If this is a sale transaction between related parties, the buyer should hold the property for at least 2 years to avoid scrutiny under §453(e)(5).

Like Kind Exchanges Under §1031. A taxpayer can defer gain on the sale of property that is used for business or investment purposes if she contributes the proceeds of that gain to purchase a like kind property. Any real property can be swapped for any other real property, however, the new property must be used for business or investment purposes. If additional consideration is received in the transaction, referred to as "boot," such consideration will not qualify for §1031 treatment and will be taxed accordingly.

Martial Property Transfer.
Under §1014 (a) there is no gain or loss recognized on a transfer of property to a spouse. If spouses separate and there are transfers incident to a divorce, these are also not recognized within 6 years of the divorce. Cash payments that generally qualify as "alimony" are included in the recipient's gross income under §71(a) and are deductible by the payor under §215.

Child Support.
Payments for child support are not considered to be payments of alimony (§71(c)(1)), therefore, such amounts are not included in gross income.

2:00 – 3:30 p.m. - Special Sessions III

III-A - Trusts We Trust
This session will sift through the pieces of trust law that were left after the morning's session seeking balance between aggressiveness and timidity in achieving clients' goals.
Ronald D. Aucutt and Bruce M. Stone
Reporter: Kimon Karas

This presentation was based on a specimen trust agreement prepared by the presenters, primarily Bruce. The audience was admonished multiple times by the presenters that the trust document was for discussion purposes only and not intended to be used as a “form” without careful professional consideration of the language and circumstances presented.

This report will summarize the topics/discussions that the form trust document presented and there were multiple other issues as well that time did not permit discussions of. Reproducing the referenced trust document language would make this report an entire trust document which is not the intent of this summary. If one is interested in the concepts, reference should be made to the specimen trust document from the outline for this session.

The presenters discussed that a trust should have a purpose and it should be described in the trust document. Bruce relayed that in a couple of circumstances his clients drafted the purposes that he edited but incorporated into the trust document. Bruce suggested this is an effective way to convey grantor’s intent (in the grantor’s own language) for the benefit of the beneficiaries. If there are questions in the future that the beneficiaries raise, the advisor can point to the language that was drafted by the grantor(s) in his/their own language.

Both Bruce and Ron suggested that even if one is not in a state that has a decanting statute, a drafter should consider adding decanting language.

On a power of substitution creating a grantor trust, pursuant to RR 2008-22, neither feel there must be any limiting language referring to Section 2036(b); however both do not use the reimbursement of income tax language as a matter of course as they believe it invites questions.

Drafting considerations should include document definitions relating to reproductive technology, i.e. who is a descendant, child, grandchild; similarly with same sex marriage being valid in many states and changing constantly, the definition of who is a spouse should be addressed or at least discussed with the client.

Trusts that divide the trustee’s duties among various types of advisors, trust protectors, investment advisers, and distribution advisors must be careful in describing the duties and whether such a position is a fiduciary. As to trust protectors, be specific in the document whether that position should be considered a fiduciary or not a fiduciary. It may not be binding on a reviewing body but at least make it known what grantor’s intent is.

The presenters discussed the income definition in the form trust document. The document permitted the trustee to periodically adjust income. The presenters suggested so long as any adjustments were made consistent with fiduciary standards permitting adjustments to income should not be an issue including marital or charitable deduction issues.

The presenters discussed exoneration issues with differing standards for an individual trustee compared with a corporate fiduciary. For example an individual is exonerated so long as conduct is not done in bad faith or reckless indifference to trust purposes or beneficiary’s interest versus corporate trustee whose conduct is governed by negligence standard. If the attorney drafting the document is a trustee or a member of the firm is a trustee with broad exculpatory language it is incumbent upon the attorney to discuss this with the client and document the discussion as well.

Be careful on exoneration language between trustees, co-trustees. If a co-trustee knows of trustee acting in bad faith even if there is exculpatory language in the document a real question whether the co-trustee can still sit idly by and not raise an issue of the co-trustee's "bad act or actions."

Watch language where duty of diversification is waived, i.e. requiring trustee to hold onto assets for an indefinite period of time. Need to be a balance between grantor's wishes and rights of the beneficiaries. Of course there are exceptions for trusts holding family residence, vacation home, and life insurance.

The presenters discussed the use of incentive clauses both stating they have used them but at the same time admitting they are difficult to draft to attempt to account for all possible situations that may arise in the future.

Spendthrift clauses should be drafted carefully. Most clauses address both voluntary and involuntary assignments. If one permits voluntary assignments both believed that this creates an internal document inconsistency. Depending on the applicable law, both Ron and Bruce expressed concern if trust is moved from the execution jurisdiction and the perpetuities period applicable in the transferred jurisdiction exceeds the permitted time period from the jurisdiction of execution.

Regarding choice of law, both presenters were okay with a change of location of the trust administration but were not in favor of modifying the language relating to the trust's validity or construction with the movement of the trust from its place of execution and applying the law of the jurisdiction to where the trust has been moved as to validity or construction.

Whether one uses an in terrorem clause depends on the jurisdiction. Bruce agreed with a question from the audience that a condition precedent might work in a jurisdiction that does not recognize in terrorem clauses. Apparently there is a recent Florida case approving the condition precedent language even through in terrorem clauses in Florida are unenforceable.

Session III-B Current Transfer Tax Audit/Appeals Issues: What's Hot? (Litigation Series)
John W. Porter
This presentation will address current estate and gift tax audit and appeals issues, including family limited partnerships and LLCs, recent case law, and tips for handling a transfer tax dispute before the IRS at the audit and appeals levels. Alternative dispute resolution mechanisms with the IRS, including Fast Track Settlement and Post Appeals Mediation, will also be discussed.
Reporter: Ted Preston

This presentation was presented by John Porter of Baker Botts' Houston office and his "mystery guest" Maricarmen Cuello, Appeals Team Manager from the Service's Miami Domestic Operations, Estate and Gift Team. While the approval process that allowed her to speak was apparently daunting, her input was helpful in allowing practitioners to understand a great deal about how the appeals process works, and the relationships between the Appeals Team and the Service.

There is a rich body of case law in this area, and lots of activity. Most transfer tax audit appeals are resolved at the audit level, and do not require appeals. A practical pointer for practitioners who hope to resolve audits earlier is to consider the evidence your clients can show the examiner regarding the purposes of an entity that results in deductions. Examiners are always interested in non-tax reasons for existence of the entities that hold marketable securities.

You get to the appeals process after an inability to reach an agreement with the examiner. The Appeals team strives to remain independent from the service, which helps reach fair and impartial results. The team is small, with only 9 appeals officers through the country. Oddly, none of them are located physically west of the Houston and Chicago offices. Phone and video conferences are common as a result.

Cases are assigned by location of the taxpayer and the inventory of appeals for each officer. There is no process whereby a taxpayer can request specific appeals officers or locations. These are specialized appeals officers who really know their stuff. Most have extensive experience in private practice before moving to the Service, so they understand the issues. You don't need to educate them. One officer has been with the service for fifty years, but

most of them are former private attorneys.

Cuello explained several of the procedural processes for the docketing of appeals that come before her team. Mr. Porter described many of the practical and procedural issues from the taxpayer's perspective.

The presenters discussed the pre-appeals process whereby examiners request conferences with appeals officers. This is a new process that arose from the complexity and size of many of the recent cases. It helps open up discussion, by giving the examining team the opportunity to pitch their case to the appeals officers. Mr. Porter agrees that this process is appropriate and helpful in complex cases. Taxpayers later have an equivalent opportunity for a similar conference.

Appeals has access to their own set of appraisers. These engineers and economists do not serve the examiners at the service, they only serve the appeals team. They can act as a check on abuses or errors by appraisers for the service or the taxpayer.

So what is the appeals team looking for in these presentations at an appeals conference? They want to see all of the issues in the examiner's report examined and analyzed. They want to hear the taxpayer's interpretation of relevant case law. If you think the service misinterprets case law, this is the time to tell appeals. Appeals will then receive a rebuttal report from the examiner.

Unless the case has been filed in district court, the service tends to encourage a trip through appeals first, before the tax court gets the case.

It is important for the appeals officer to know what the taxpayer's position is. It is important to get your memos describing your position to the appeals officer in a timely manner so they have time to review it well before the conference. These written presentations help narrow the issues and make the time more productive in the conference.

Fast Track Mediation and Settlement:

Mrs. Cuello described a number of fast-track processes for mediation and settlement that can save TP money by reaching settlement faster. The appeals officers are ALL trained mediators. They can help through a mediation process, and if their parties reach an impasse, the officer can put on his judge's hat and suggest how he would rule if he were sitting as a judge, in hopes that advice will break the impasse. That officer will not ultimately serve as the hearing officer if the case later goes to hearing.

All decision makers need to be present at the meeting or at least by phone, for the mediation to succeed. Examiners customarily decide between fast track mediation and fast track settlement. They typically choose settlement.

You can also request post appeals mediation. It is an interesting process where the appeals officer is present to present his view, almost like a third party. It sometimes works to resolve a case, and Mr. Porter indicated that clients look on it favorably, particularly if it resolves an audit short of trial.

Cuello explained some elements of the Appeals Team's approach and culture. They have strengthened their fairness and impartiality processes. They are not investigators or examiners. They take a quasi-judicial approach to cases. They avoid actions that would strengthen either party's case. They are clarifying their procedures to ensure impartiality and improve "customers" perceptions of their independence.

The primary point to takeaway from this presentation is that we have numerous tools available to reach resolutions to audits and appeals.

Session III-C - Thursday, January 16th
Practical Issues in Planning for the 3.8% Tax on Trusts/Estates(Focus Series)
John Goldsbury, Robert S. Keebler
This session will go over several examples (some from the regulations; some from the panelists) illustrating the 3.8% health care surtax as it applies to trusts/estates.
Reporter: Michelle Mieras

John Goldsbury and Robert Keebler shared this highly informative and entertaining session. Mr. Keebler gave a broad overview of the issues and opportunities with the 3.8% tax (and increased income rates in general) as it applies to trusts and estates. His materials consisted of eight fact patterns illustrating different issues, accompanied by his analysis and calculations. Mr. Goldsbury then took the stage, focusing narrowly on how capital gains may be distributed to beneficiaries, as he promised to do earlier in the day during his session on *The 3.8% Surtax on Trusts and Estates.* His materials for this session consisted of a summary of capital gains planning and the regulation governing DNI, and five common trust planning scenarios accompanied by his invaluable analysis.

Mr. Keebler began with a challenge: for the next 30 days, approach any tax question from the following income tax perspectives: 1) regular income tax, 2) alternative minimum tax (AMT), 3) net investment income tax (NIIT), 4) "extra" taxes now imposed on high earners. We have transitioned from a two-dimensional to a multi-dimensional tax analysis. The challenge for trust and estates is the ~$12,150 threshold where the maximum total income tax rate increases to 43.4%. This affects a significant percentage of trusts. In doing your analyses, timing of distributions become very important, as beneficiaries will often pay tax at a much lower marginal rate.

Mr. Keebler reviewed the basics of NIIT and trust rates. He pointed out that estates commencing in 2012 are grandfathered (not subject to NIIT) for their first fiscal year, and could carry estates of decedents who died toward the end of 2012 well through 2013 without having to face the NIIT issue. When dealing with CPAs for and beneficiaries of these grandfathered estates, make sure they understand this so that when a K-1 is issued, it doesn't all get taxed with NIIT. The responsibility of the various professionals in this process is up on the air right now, so he encourages everyone work closely with those on the receiving end of K-1s to ensure they understand. This also applies for the next few years as we all try to navigate these new waters. We're all in this together; let's help each other out.

A very helpful chart was available at the session (also available on Mr. Keebler's website) with a great flowchart about the application of the 3.8% NIIT and surtax examples.

We then turned to the eight fact patterns.

Case 1 dealt with planning to minimize exposure to the 39.6% ordinary income tax rate, 20% capital gains rate, and the NIIT. We need to consider not just the tax issues, but whether it is appropriate (and permissible) to make a distribution from the trust to beneficiaries. Remember to look at the document and the beneficiaries' circumstances (disability, addiction, etc.). We also need to have some knowledge of the beneficiary's income tax situation. For the next few years, we need to really nudge each other, our clients, and their other advisors to carefully think through these issues. Mr. Keebler presented an example demonstrating how significantly distributing/not distributing affects the income tax exposure.

Case 2 addressed portfolio construction. Does it make sense to switch from taxable to tax-exempt bonds in this higher tax environment? Should (or can?) the trustee invest in life insurance? Is the trustee conscientious of investment turnover and minimizing gain realized? Remember to look at after-tax return rather than focusing on minimizing taxes. Mr. Keebler pointed out that the average tax-exempt bond return might exceed the average after-tax return on corporate bonds. The investment options become very important in trusts unlikely to make distributions during a year.

Case 3 addressed the effect of charitable contributions. Note the distinction between charitable gifts reported on a Form 1040 and a Form 1041. On a 1040, charitable giving deductions are generally on Schedule A (below-the-

line deductions) and are subject to the 50%/30%/20% limitations. On a 1041, the adjustment is above-the-line and there are no percentage limitations. So charitable trusts are very powerful, because the deduction can shift NII from the trust to the tax-exempt charitable beneficiary. The takeaway from this example is that the charitable deduction is much more valuable at the trust level than on an individual's Form 1040.

Case 4 deals with the "very charitable" client. The very wealthy are often frustrated by the charitable deduction limits. How can we take advantage of the result discussed in case 3 above? One option is a non-grantor CLAT. The settlor does not receive an up-front deduction, but the CLAT receives a charitable income tax deduction for the annual annuity payments to charity. Because the CLAT is reporting income on its 1041 and is governed by IRC 642(c) instead of IRC 170, there are no AGI limitations, and the trust will pay tax only to the extent its annuity payments to the charity are less than the income generated. It also has the effect of reducing NIIT.

Case 5 presented issues of funding pecuniary bequests. Recall the general rule that the funding of a pecuniary bequest with appreciated assets accelerates the recognition of gain or loss (see Treas. Reg. 1.661(a)-2(f) and the *Kenan* case). This becomes very significant when a trust is to be funded with a pecuniary amount, with the now higher tax rates and low income threshold for trusts. Rapid funding becomes very important (but there is also potential for carrying out capital gains as Mr. Goldsbury discussed later in this session). If the executor thinks the asset will appreciate, fund quickly. But if the value will decline, they might drag it out. However, we don't have a crystal ball and most think the pecuniary gift should be fulfilled as soon as possible to minimize the fluctuation (and also the potential litigation).

Case 6 addressed smoothing out a client's income to keep income in a particular year below the threshold levels. Consider the use of charitable trusts, controlled sales (partial sales of assets spread out over time), or an installment sale. This is a great opportunity to try to get the client back to the 15% capital gains rates.

Mr. Keebler ran out of time, but mentioned that **cases 7 and 8**, discussed in the materials, address income shifting to children (using partnerships, charitable trusts, gifting of appreciated property, etc.) (case 7) and selling appreciated assets in an installment sale to a non-grantor trust and having the trust sell the asset two years and one day later (case 8).

Having been educated on several considerations with regard to the new income tax environment, by Mr. Keebler, Mr. Goldsbury dove into how we can work with capital gains. He reminded us of his morning session mantra (see Report #11) on how to get capital gains passed out for NII purposes: "the DNI results govern the NII results." He predicted that *the* planning opportunity in the future will be distribution of capital gains to beneficiaries, pointing out that it's the likely difference between the higher tax rates applicable inside the trust (due to the low income threshold) and the usually lower tax rates of beneficiaries. First, a set of warnings/disclaimers from Mr. Goldsbury: 1) The distributions we're talking about must be made per the trust terms consistent with the fiduciary's obligations, and presumably for non-tax reasons. 2) As discussed in his morning session, we need to be aware of the collateral effects of distributions on the beneficiary's income. 3) It's not always a choice, and we need to consider these issues with respect to mandatory distributions, too. With CYA out of the way, Mr. Goldsbury turned to the issues at hand.

Treas. Reg. 1.643(a)-3(b) is the operative regulation. Its three subparagraphs give five ways to get capital gain allocated to DNI (in very simplified terms – refer to the Regulation for full details):

- Method 1(a): allocated to income;
- Method 1(b): in the case of unitrusts, allocated to income as a matter of discretion, and must be exercised consistently and the allocation is subject to certain limits;
- Method 2: allocated to corpus but consistently treated by the fiduciary as a distribution to the beneficiary;
- Method 3(a): allocated to corpus but actually distributed to the beneficiary;
- Method 3(b): allocated to corpus but used by the fiduciary to determine the amount distributed to the beneficiary.

Note: Mr. Goldsbury's naming conventions for the methods relate back to the subparagraphs of the Regulation. Methods 1(a) and 1(b) are both set forth in subparagraph 1, method 2 in subparagraph 2, and methods 3(a) and 3(b) in subparagraph 3.

In addition to the five allocation methods, the Regulation sets forth two methods of authorization (governing instrument/local law, and reasonable/impartial exercise of discretion in accordance with document/law). These were briefly mentioned but not the focus of the session, and are explained more thoroughly in the materials.

How does a trustee exercise its discretion to allocate capital gain to DNI? They simply do it on the income tax return.

The key to deciphering the allocation methods lies in decoding the 14 examples provided in the Regulations. Mr. Goldsbury emphasized that it is important to know which of the five allocation methods each of the examples represents, which is not as simple a determination as it may at first appear. He developed a grid with allocations methods on the y-axis, authorization methods on the x-axis, and then assigned the Regulation's examples to an allocation and authorization method. For instance, Example 4 in the Regulation is an illustration falling under authorization method 1 and allocation method 1(a).

Knowing the allocation method determines which issues are significant in figuring out whether capital gains can be allocated under the circumstances. For example, if the applicable allocation method is method 2, we know that the consistency factor becomes critical. On the other hand, if the applicable allocation method is method 1(a), we know that consistency is irrelevant. Again, Mr. Goldsbury acknowledged that it is not always clear which allocation method would apply in a particular circumstance.

Mr. Goldsbury reviewed five common trust planning scenarios, walking through the allocation methods that would apply.

The **first scenario** involved a trust with mandatory income distributions and discretionary principal distributions. Examples 1 and 2 in the Regulation illustrate this, and we fall under authorization method 2 (discretionary) and allocation method 2, requiring consistency. Mr. Goldsbury pointed out a potential (but not certain) loophole: the consistency requirement is provided in terms of the fiduciary's actions. If a successor fiduciary is appointed, is the slate wiped clean allowing the new fiduciary to made allocations different that the prior fiduciary?

The **second scenario** is a trust with discretionary income and principal distributions. One planning opportunity would be to have the trust agreement provide that all capital gain shall be allocated to income, bringing it within allocation method 1(a).

The **third common scenario** is mandatory distributions at certain ages, and full distribution at a certain age. This is an example of allocation method 3(a).

One of the considerations pointed out by Mr. Goldsbury with regard to allocation method 3(a) is what "actually distributed" means. He feels it is safe to say that if everything has been distributed in a year, the capital gains must have been actually distributed to the beneficiary. On the other hand, what if the trustee had $100,000 in cash, $700,000 in securities, and sold some securities to make a $300,000 distribution? How do we determine if all of the capital gains were "actually distributed"? The same issue arises with mandatory partial distributions at ages (unless, possibly, the trust contained no cash and the trustee sold exactly enough assets to make the distribution – a highly unlikely scenario). The answer is not clear.

The allocation methods can also be looked at in reverse. What if we want to preserve some capital gain to be taxed to the trust? One option is to close a sale early (in a prior taxable year) and then make no distribution that year to trap the capital gain in the trust. The takeaway is that this is another planning opportunity, and it has become more significant with the changing tax landscape.

What about a 5x5 power (the **fourth common scenario**)? This does not work to pass out capital gains. Remember – we're talking about allocating to DNI. The 5x5 power causes the holder to be deemed the grantor with regard to the trust. DNI is not an issue in a grantor trust, as gain will already be taxed to the grantor.

The **fifth common scenario** was unitrusts. If the trust agreement/ state law specify the source of unitrust payments, we are under allocation method 1(a) (no discretion). If the agreement or law does not mandate the source of unitrust payments, we are under allocation method 1(b) and subject to the consistency requirement.

Mr. Goldsbury concluded his presentation with certain planning opportunities when making distributions in kind. Of note, he proposed that the Section 643(e) election to trigger gain on appreciated assets that were distributed is a manner in which to characterize capital gain to be actually distributed. If stock is distributed to a beneficiary, and the 643(e) election is made ten months later causing the beneficiary to recognize capital gain after the stock is already in their hands, how could that capital gain be thought of as not being "actually distributed" for purposes of allocation method 3(a) (see third common scenario above)?

Session III-D
The Alphabet Soup of International Planning
Gideon Rothschild, Scott A. Bowman, Ellen K. Harrison
This workshop will explore recent developments impacting foreign trusts including FATCA, OVDI and FATF, as well as planning with QDOTs, planning to avoid or minimize penalties attributable to UNI, and the final regulations concerning gifts from covered expatriates.
Reporter: Elizabeth Lindsay-Ochoa

Please note that Carlyn McCaffrey substituted as a speaker for Ellen Harrison.

FATCA (Foreign Account Tax Compliance Act)

This is a high level overview of the law.

FATCA was the legislative response to ongoing challenges in combating US tax evasion by taxpayers using undisclosed foreign financial accounts. The US believed there were large amounts of assets held offshore and undisclosed. The rules fall under Code Sections 1471-1474 and its regulations.

Under Section 1471, a 30 percent withholding tax is imposed on any "withholdable payment" to a "foreign financial institution" ("FFI") that does not meet the FATCA reporting requirements applicable to FFIs. Under Section 1472, a 30 percent withholding tax is imposed on any "withholdable payment" to a "non-financial foreign entity" ("NFFE") that does not meet the FATCA reporting requirements.

This is a stick to beat financial institutions into compliance.

Withholding will be simplified through the provision of Global Intermediary Identification Numbers ("GIINs") and a new W-8 BEN-E. As of November 15, 2013, the W-8
BEN-E remains in draft form.

There is also a requirement to withhold when the bank cannot figure out who the bank account holder is for tax reporting purposes.

The withholding requirements are also conditioned by US efforts to enter into "intergovernmental agreements" ("IGAs"). There are two model IGAs: "Model 1 IGA" and "Model 2 IGA".

To understand FATCA, the definitions are important to understand.

Financial Accounts are any depository account maintained by a financial institution, any custodial account maintained by such financial institution, and any equity or debt interest in such financial institution. It is not traditional traded marketable securities.

FFIs are foreign entities that are:

- Depository institutions, i.e. traditional banks
- Custodial institutions
- Investment entities (may be seen during estate planning)
- Managing investments

- Managed investment entity, e.g. holding company with portfolio of marketable securities that is managed by another financial institution
- Fund entities, i.e. hedge funds and private equity funds

It is obvious that large traditional banks are subject to this. But, under the investment entities, we may have estate planning entities subject to FATCA.

NFFE is any foreign entity that is not a financial institution or a foreign entity treated as an NFFE pursuant to a Model 1 IGA or Model 2 IGA.

21 Intergovernmental agreements exist that supplement and override parts of the FATCA regulations. Model 1 is where FFI reporting goes to jurisdiction to where entity is located. Model 2 is where FFI agreement with IRS to be a participating FFI under an FFI agreement

How does estate planning entities become to FATCA? Either as a FFI or NFFE

Analysis to see if subject to FATCA

- Domestic or foreign entity
- Domestic or foreign trust?

§ Treasury took the position that a trust could be engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, and commodities, and therefore could be classified as an FFI
§ Even if you believe that what you have is a domestic trust you need to pass both the court test **and** the control test

- Court test – Is US is able to exercise primary supervision over the administration of the trust?
- Control test - Does one or more US persons have the authority to control all substantial decisions of the trust?

If a foreign trust has a financial institution trustee and 50 percent or more of its gross income is attributable to investing, reinvesting, or trading in financial assets, then the foreign trust is an FFI.

If a foreign trust has a private trust company as its trustee, it is unclear whether it will be considered an FFI if 50 percent or more of its gross income is attributable to investing, reinvesting, or trading in financial assets. The answer can be found under the regulations, if the private trust company is considered a financial institution.

If a foreign trust has an individual as its trustee, it will not be considered an FFI even if 50 percent or more of its gross income is attributable to investing, reinvesting, or trading in financial assets. It will be an NFFE. However, if the individual trustee hires third-party service provider to perform investment activities, then the trust is an FFI.

If the trust holds only non-financial assets, including real property or tangible personal property such as art, the trust should be classified as an NFFE.

If the client falls under FFI or NFFE (please see outline for more detail), the taxpayer must comply and identify US owners.

The next step

FFI and investments – anyone with beneficial interest becomes US owners

Corporations and partnerships seem fairly straightforward. Trusts are harder. The planner needs review all the potential beneficiaries. Also, need to review if it is a grantor or a nongrantor trust and who is entitled to mandatory or discretionary benefits of the trust.

FFI is treated as having substantial US owners if any specified US person is treated as the owner of the trust under the grantor trust rules or any specified US person holds, directly or indirectly, more than a zero percent beneficial interest in the trust. In NFFEs, this amount is 10%. The planner should also be aware of attribution rules. The regulations have information on how to compute the value of the beneficial interest. This may be very difficult to determine.

FFI complies by being either:
- Participating FFI – enter into FFI agreement with IRS with reporting requirements
- Deemed Compliant FFI –
- As a sponsored FFI (may be good for trust) – trust company can sponsor trust and conduct the compliance
- Owner documented FFI – FFI provide to agent to require to withhold, information about the substantial US owners of the accounts

NFFE Complies
- Generally, in order to avoid being subject to withholding, an NFFE is required to provide a withholding agent either a written certification (contained on a withholding certificate or in a written statement) that it does not have any substantial US owners, or the name, address, and taxpayer identification number of each substantial US owner of the NFFE.

IMPORTANT: All of this compliance that we are imposing on foreign entities can also be on US entities, because of the reciprocal agreements.

Strategies for minimization tax on US beneficiaries of non-grantor trusts

- Is this truly a US trust?
- Usufructs can be trusts or life estates
- Mexican land trusts
- Is the foreign structure a trust? 7701(a)(4) regulations

Substance over form; some IRS guidance
- Is the trust foreign or domestic?
- Court test – court in US able to exercise primary supervision AND
- Control test – US persons have control over all substantial decisions
- Is the trust grantor or a non-grantor trust?
- If the creator is not a U.S. income tax resident

§ Grantor has power to revest title in herself;
§ All distributions must be to grantor or grantor's spouse during grantor's life;
§ Grandfathered trusts; or
§ Compensation trusts

Please see the regulations on this

If it doesn't meet any of these, then it is a foreign non-grantor trust

The speaker went into detail of the tax consequences of the trust classification

- Foreign grantor trust – No DNI or UNI
- If not than foreign nongrantor trust

§ US income is taxed like an NRA individual
§ Trust distributions carry out DNI
§ Beneficiaries pay tax on their pro-rate shares of each class of trust income included in DNI that is distributed in the year income accrues
§ Distribution in excess of the greater of fiduciary income and DNI attract the throwback tax if the trust has UNI
- Punitive interest penalty on the tax

§ Basically, this is a beneficiary's tax is calculated as if the income had been distributed in the year earned by the trust and interest was imposed for late payment. This is an inexact description of the tax, but an overview.

How to avoid the throwback tax?

- Intermediaries
- Loans from foreign trust and use of assets owned by a foreign trust sec 643(i)
- Can be a treated as a distribution unless you have a qualified obligation
- CFC (controlled foreign income) and PFIC (passive foreign investment company) attribution rules could apply. Beneficiary may still be taxed even if never received a trust distribution How do you figure out the

deemed ownership of the foreign nongrantor trust?

- Avoid CFC
- Avoid investing in foreign mutual funds
- Minimize impact of throwback taxes
- Stripping distributions, goes to a new trust to a different foreign trust or person, this is distribution of income
- Migrating to US – migrating the trust to the US. Decanting may trigger the throwback tax
- Default method - Form 3520 and Notice 97 34
- Resettlement -
- 645 election – extend period of time that the trust will not accumulate UNI. Treat trust as part of estate.
- Bunching income- so as long as distribution does not exceed the greater of DNI and trust account income (FAI), not subject. Ways to create FAI, zero coupon bond, annuity distributions, non-liquidating distributions from an entity such as a partnership
- Isolating taxable income and gains – distribute all of its income and gains to a foreign person, including another foreign trust, can make tax free distributions of principal to a U.S. beneficiary
- Other ideas may apply

Planning for basis step up – look at section 1014. If willing to deal with complexities can be a useful tool for clients.

OVDI Developments and Other Potpourri

Section 2801 – Part of the Exit tax. Make note that issues may be and why IRS is having a hard time. Look to ABA tax section analysis submitted to Congress submitted last year as a good overview of the issues and the comments submitted are also useful.

One specific item that caught the reporter's attention was the Tax section asking to repeal 2801 or change it significantly so it can be more workable.

OVDI program – offshore voluntary disclosure compliance. The nonreporting of a taxpayer under FBAR leads to penalties. Right now the penalty is 27.5% penalty, plus income taxes and interest of unreported financial assets, including real property that has been acquired with those financial assets. So far the Treasury has $5.5 billion in taxes and penalties. Only a few people have gone to jail. About 1/3 of audience said that they continue to receive calls on this issue.

The streamline process, which began in 2012, may help the accidental American. These are those folks that have lived overseas for many years and have little US source income. The client also needs to be a "low risk taxpayer" to qualify for the streamline process. This might be a good way to go. Taxpayer may also be allowed to streamline, even if the program didn't exist when initial submitted.

There is ongoing tension with complying with ethical rules with Bank Secrecy Act. The planners needs to do due diligence on his/her client. There are recommendations on this in the materials. There is also ABA Formal opinion 463. There is not a duty to rat on the clients. But, the speaker (Mr. Rothschild) could see trust registries in the future, like they have in Europe, with beneficiaries who have beneficial interests named on these registries.

Session III-E - Thursday, January 16th
UPIA and TOLI (Financial Assets Series)
Lawrence Brody, Gary L. Flotron, Richard A. Schwartz, Richard M. Weber, E. Randolph Whitelaw
The Uniform Prudent Investor Act (UPIA) requires all trustees to manage, monitor and evaluate trust assets and investments for the benefit of the beneficiaries of the trust; however despite numerous professional articles pointing out the applicability of UPIA to trust-owned life insurance (TOLI), the vast majority of trustees of irrevocable life insurance trusts (ILITs) either are unaware of or continue to ignore this duty with respect to TOLI. This multi-discipline presentation will examine the application of the provisions of the UPIA to TOLI; methods and systems to evaluate and manage the risk inherent in permanent life insurance; and which methods and systems will comply with UPIA and are "dispute defensible" for the trustee of an ILIT.
Reporter: Joanne Hindel

Gary started the discussion by stating that trustees holding life insurance in irrevocable trusts are at risk under the UPIA for not reviewing and diversifying the insurance policies.

The panel evaluated the systems and methods to evaluate the risks in holding life insurance policies.

Larry Brody started the review by discussing the effect of UPIA on trust owned life insurance.

The issues that ILITs raise stem from the transfer tax issues and in part from the unique character of the asset which ILITs own – life insurance policies.

In order to do anything with the asset – the trustee must have assistance from the insured – paying premiums or exchanging the policy.

For policies with ongoing premiums, depending on the policy type, transfers by the insured are critical. The trustee should have a plan with the insured to address the payment of premiums. If the trustee does not get the funds to pay premiums, it can engage in a number of options including: borrowing, withdrawal, surrender or exchange.

Policies are no longer “buy and hold” assets – they are “buy and manage” assets.

While there are many people willing to help a trustee purchase a policy there are not that many available to manage the policies.

Larry discussed the *In re Stuart Cochran* Irrevocable Trust and said that the issue was: whether it was prudent for the trustee to move the trust assets from insurance policies with significant risk and likelihood of ultimate lapse into an insurance policy with a smaller but guaranteed death benefit? Trial court and appellate court found for the trustee. Key Bank relied upon a documented process and used the advice of a delegated agent who had no financial incentive to approve the exchange. Key Bank examined both the existing and proposed policy before making the exchange.

The UPIA is a default rule and the question becomes which parts of the Act should be restricted or eliminated in ILITs. The trustee and the beneficiaries have different interests in this regard – what did the settlor intend?

Dick Schwartz then discussed basic policy review points:

The insurance policy is an asset and should be reviewed every 1-2 years.

Different policy types have different risks.

The Illustration is a not a guarantee and should be viewed in light of its limitations.

Policy exchange may be beneficial – if the insured is still in good health the policy should be evaluated to see whether restructuring is appropriate.

The most critical pricing factor for policies is the investment return but there are other pricing factors such as company expenses and profit margins.

The major inherent risks are company insolvency, the actual investment returns and volatility risk. The risk inherent in each policy type is cash value growth.

Keep in mind that the Illustration is not the policy and is not a guarantee. Further, Illustrations should not be used to compare different policy types but can be used to compare the same types of policies. Another possibility is to compare the Illustrations to a “standard policy”.

A trustee can mitigate risks by diversifying with respect to the carriers and policy types. Use conservative Illustration assumptions and don’t expect actual results to improve significantly, it at all, over the Illustration.

Depending on the policy type reviews of term and no lapse guarantee UL should be reviewed every two years

and UL, equity index UL, and variable every year.

The trustee should determine whether the client's needs have changed and should review the Illustration projections. The trustee should also consider whether the policy is no longer needed and whether a life settlement is appropriate or whether restructuring might be appropriate.

Dick Weber discussed policies and their Illustrations

In actuarial science you can know how many people will die at a given point in time but not who. From the trustee's perspective, to which life expectancy should an ILIT trustee manage a policy? Current assumption policies do not focus on guarantees in the manner of more traditional policies such as whole life. Current assumption policies do not have premiums in the traditional sense of the word. Instead, it is the policy owner's responsibility to pay in enough to carry the policy for all years.

In managing policies there are four remediation possibilities:

1. Increase funding premium
2. Decrease the death benefit
3. Exchange to a different style
4. Surrender or life settle

The best strategy for assessing and managing is managing!

Keep in mind that you want best value not necessarily best price. Be clear about the funding target.

Randy Whitelaw discussed documenting a prudent TOLI risk management process

Unskilled trustees handle about 90% of the ILITs in the marketplace.

The question of whether a breach of trust has occurred turns on the prudence of the trustee's conduct, not on the eventual results of investment decisions. The trustee is not a guarantor of the trust's investment performance.

Skilled and unskilled ILIT trustees generally lack life insurance product and policy evaluation expertise. The TOLI market has been the target of commission-motivated replacement schemes using policy analytics known to be neither credible nor appropriate for predictive value and policy comparison purposes. Skilled trustees usually delegate the life insurance expertise functions to third-party policy administrators. Unskilled trustees usually do not consider any life insurance activities to be their responsibility.

He concluded with the statement that prudence is a process but only if you can prove it.

Session III-F - Thursday, January 16th
Ethics in Charitable Gift Planning for All the Players
Conrad Teitell, Heather J. Rhoades
Many disciplines are involved. Professionals should know the ethics rules of their own professions and those of the others. Through 15 hypoethicals in this audience-participation session, you'll learn how to spot the issues and comply with the rules. In the process, you'll also learn important substantive rules. Not knowing your stuff is also unethical not to mention malpractice.
Reporter: Michelle Mieras

Mr. Teitell and Ms. Rhoades combined their humor with their compassion for the law in this interesting dialogue on the ethics of charitable planning.

Mr. Teitell and Ms. Rhoades referred to their materials for all of the hypotheticals. For more information, one should obtain the Heckerling materials presented by Mr. Teitell and Ms. Rhoades. Certain selections from the hypotheticals are used below to illustrate the discussions.

Mr. Teitell went through the keys to charitable planning which encompass confidentiality and ethics. He stated that the players in charitable planning are attorneys, accountants, appraisers, bankers, donors and development officers. He stressed that confidentiality, avoiding conflicts of interest, and competence by the planning attorneys were also important. He reiterated to the audience that attorneys must know what they are doing before planning in this area.

Ms. Rhoades read **hypothetical number one**. In the hypothetical, the donor met a "triple-threat" (lawyer, CLU and financial planner) on a dating website; although the two had a "platonic" relationship. The lawyer suggested that the donor create a NIM-CRUT. The NIM-CRUT was funded with a deferred payment commercial annuity.

Mr. Teitell suggested that attorneys should not represent someone that they are in an "amorous" relationship with, although ex-lovers and friends are ok to represent. He pointed out that whether funding a NIM-CRUT with a deferred payment commercial annuity is seen as self-dealing is a matter of state law (the IRS has acquiesced on the position). Mr. Teitell then discussed the Dupont case and the need for diversification.

Ms. Rhoades read **hypothetical number two**. In the hypothetical, the donor's assets were managed by a bank. The bank suggested that the donor create a CRUT, and then have the bank serve as trustee of the CRUT. The donor's attorney then created the CRUT.

Mr. Teitell noted the ethical question here of the bank wanting to serve as trustee, noting that the bank would receive fees for this.

Mr. Teitell then took a question from the audience regarding a lawyer drafting a bad CRUT, related to the issue of the lawyer in the hypothetical drafting the CRUT following the bank's advice to the donor. Mr. Teitell said that in many cases, whomever has the deep pockets gets sued. In this hypothetical, if the attorney drafted a bad trust, Mr. Teitell stated that likely if his firm was suing the attorney, they would get the attorney to sign something to toll the statute of limitations, and then go after the bank in court. He added that lawyers often try to protect their own.

Ms. Rhoades read **hypothetical number three**. In the hypothetical, the donor wanted to contribute a painting to charity. The donor requested that if the charity was going to sell the painting, it wait three years before doing so. The donor received an appraisal for the painting. The appraiser was recommended by the charity's development officer.

Ms. Rhoades then discussed the art panel. This information can be found on page 3 of Mr. Teitell and Ms. Rhoades' materials. Mr. Teitell added to her discussion that the art panel does not know who the gift of art is to; it only appraises the work of art.

Mr. Teitell then described that the donor wanted to wait for three years before the charity sold the painting because if the charity sold the painting, it would receive Form 8283 which would then make the charity disclose who they received the painting from. Mr. Teitell also noted that possibly the appraiser should not have been recommended by the development officer as there could be a question of independence between the appraiser and the donee.

In **hypothetical number four**, the IRS maintained that the painting donated was not deductible at more than the $100,000 basis. Mr. Teitell stated that this was because the donor was an art dealer; his deduction was limited to cost basis.

Ms. Rhoades read **hypothetical number five**. In this hypothetical, a life insurance agent suggested to a charity that the charity seek life insurance gifts as part of its planned giving program. The charity gave the life insurance agent a list of its big donors. The life insurance agent tells the big donors (after receiving their names from the charity) that the donors can created CRTs. The life insurance agent tells the donors that the fees to create the CRTs or ILITs (should the donors leave insurance to their families) would be zero if they used charity's lawyer or life insurance guy's lawyer. The second part of the hypothetical had the donor's lawyer drafting a CRT and ILIT without the donor first being cleared by a physical examination to obtain the life insurance. The donor flunked the physical examination.

Mr. Teitell noted that practitioners should consult state law as to whether a life insurance agent may split commissions with another professional. He noted the conflict of interest between the lawyer and the life insurance agent in the hypothetical. He also noted the ethical issues of a life insurance agent receiving a list of donors by the charity. Mr. Teitell's main discussion of this hypothetical centered around the donor creating trusts without being cleared for the insurance. He stated that practitioners should not create and seed a trust without having the insurance in place first (this is malpractice).

Ms. Rhoades read **hypothetical number six** which had a notary issue. Mr. Teitell explained that state law controls notary issues, yet notarizing should occur in the presence of the signor and that the notary generally cannot receive anything other than a fee for services. Mr. Teitell, after receiving a question from the crowd, added that the matter of whether a notary should know if a person is competent to have his or her signature notarized is probably a matter of state law.

Ms. Rhoades read **hypothetical number eight**. In the hypothetical, the issues were whether an attorney should prepare a codicil having not read any of the other legal documents, and discussed a $10,000 bequest in a codicil to charity.

Mr. Teitell noted the debate among the ACTEC listserv that codicils and revocable trust amendments should probably not be prepared without reviewing the underlying documents first. He also noted that a $10,000 devise to charity may not be the best planning technique if the $10,000 is of stock (losing the step-up in basis that one's heirs might be better off receiving), rather than $10,000 in a pension plan. He stressed that leaving $10,000 to charity in a POD account may be malpractice depending on state law (meaning the POD account can only be inherited by actual human beings).

Ms. Rhoades read **hypothetical number nine**. This hypothetical mirrored the Atkinson case. Mr. Teitell briefly described the Atkinson facts where a 95 year-old created a CRAT, paying her income for life with the payments continuing on to 3 family members and the 95 year-old's caretaker. The bank missed seven quarterly payments. In the hypothetical, the bank, lawyer and CPA were extremely cozy; however, Mr. Teitell questioned the concern: isn't this just networking that put the three of them together? Mr. Teitell noted that the problem is that if a charitable trust is not operated pursuant to the terms of the trust document from its inception, the IRS will disallow the charitable deduction. The charity will then have to pay legal fees to fight all of this.

Someone from the audience asked whether the attorney has a duty to make sure that the charitable trust payments are made. Mr. Teitell stated no; this trust may be receiving payments for 40 years or so. He then added that possibly, the accountant or CPA might have to verify that the payments are made.

Ms. Rhoades' **final hypothetical** was hypothetical **number ten**. In this hypothetical, the discussion related to the spousal right of election and whether an attorney could get one spouse to sign off on a waiver, despite the attorney doing the estate planning of both spouses. The takeaway from this hypothetical according to Mr. Teitell was that a lawyer, representing two spouses, should not have the other spouse sign the waiver without

informing the other spouse of the conflict of interest, and the fact that the other spouse might want to obtain separate counsel.

3:50 – 5:20 p.m. - Special Sessions IV

Session IV-A
Charitable Planning Today (Focus Series)
Turney P. Berry, Stephanie Casteel, Martin Hall
This panel presentation will consider in-depth the charitable giving strategies available to today's estate planners, including practical tips on designing the most effective strategies to meet your client's objectives.
Reporter: Kimon Karas

This special session was a follow up to Turney's earlier general session topic of the same title (see Report #11). Issues that were addressed are all in Turney's outline that were either covered in the general session or some topics that were not, such as Shark Fin CLATs, Gift Annuities, Disclaimer to Charity, Charitable Lead Trusts, and the just issued proposed regulation regarding uniform basis on the complete disposition of (termination) of a CRT.

Martin discussed the just issued proposed regulations under Section 1014 on the sale of the entire CRT interest. The regulation is Reg 154890-03 to be formally issued on 1/17/14. Lead interest (income interest) is a capital asset and the regs (uniform basis rules) address basis allocation between income/remainder interests. The general rule is that Section 1001(e)(1) does not apply but rather Section 1001(e)(3) applies when the entire interest is sold, both the lead and remainder interests. When the asset is sold the tax-exempt CRT obtains a tax cost basis in the newly acquired asset. IRS believes it is unfair for the lead interest to obtain basis in that circumstance. Accordingly, in allocating basis to the income interest when the entire interest is sold is there is an adjustment to the basis of the income interest by reducing that basis for i)undistributed net ordinary income under Section 664(b)(1) and undistributed capital gains under Section 664(b)(2). IRS continues to examine whether any change in treatment is warranted for the charitable remainder beneficiary.

Stevie next addressed disclaimer to charity. She discussed Christiansen formula disclaimers (permitted not a contingency as argued by the IRS the issue is one of valuation) as well as disclaimers of outright gifts to beneficiaries i.e. where not all family members are charitably inclined. In that situation certain family members can disclaim some or all of their inheritance to charity and others receiving their full share. If disclaimed portion is passing to family foundation caution is needed as the family member cannot have direction over disclaimed funds. Better solution to consider may be to a donor advised fund where the disclaimer restrictions are less of an issue so long as even if disclaiming party is on the board of directors that party does not vote as a member of the board on any distribution from the fund created with the disclaimed assets. One may disclaim an IRA even if decedent received a distribution in the year of death, reference RR 2005-36.

Next Martin discussed the 3.8% NII tax and charitable giving. A charitable gift does not reduce NII as it is a 'below' the line deduction and consequently has no effect on the NII tax of an individual. However, an individual can plan for the NII by i) donating appreciated property to a charity that otherwise would create NII if sold by the donor; or ii) transfer appreciated assets to a CRT although NII is allocated to the tiers and passes to the donor through the tier income allocation.

ERRATA re Report #14: One of our readers has questioned the accuracy of the following statements in the SS 4-A Report on Charitable Planning Today:

Here are the statements that were in the Report:

"Next Martin discussed the 3.8% NII tax and charitable giving. A charitable gift does not reduce NII as it is a 'below' the line deduction and consequently has no effect on the NII tax of an individual. However, an individual can plan for the NII by i) donating appreciated property to a charity that otherwise would create NII if sold by the donor; or ii) transfer appreciated assets to a CRT although NII is allocated to the tiers and passes to the donor through the tier income allocation."

"A trust however because of the distribution rules of Subchapter J, is taxed on its undistributed NII. In calculating a trust's undistributed NII two adjustments are made: i) distributions to beneficiaries under Sections
651/661 and ii) if the trust authorizes payments to charities under 642(c) the NII liability can be passed to the charity where the income will be subject neither to income or NII tax."

The reader states:

"I was not there, but I think quoting Martin Hall as saying "A trust however because of the distribution rules of Subchapter J, is taxed on its undistributed NII" immediately following the discussion of charitable remainder trusts is potentially confusing to the reader. A charitable remainder trust is an exempt entity and would only be taxed on UBTI."

Since the Reporter for this Session has yet to provide us with a requested clarification regarding the above and this is our Final Report, we are publishing the above as is so the rest of our readers can make their own judgment call on the accuracy of what was previously reported vs. what our reader has to say about it.

A trust however because of the distribution rules of Subchapter J, is taxed on its undistributed NII. In calculating a trust's undistributed NII two adjustments are made: i) distributions to beneficiaries under Sections 651/661 and ii) if the trust authorizes payments to charities under 642(c) the NII liability can be passed to the charity where the income will be subject neither to income or NII tax.

Martin also discussed RR 2004-5 that Turney discussed earlier where a trust owning a partnership interest can take a pass through charitable deduction for income distributions to charities made by the partnership. An indirect way for a trust to receive a charitable deduction that otherwise would not qualify for a deduction under the Section 642(c) limitations.

The next topic addressed was gift annuities. The panelists compared the restrictions of CRT with the flexibility of a gift annuity. Although similar to a CRT, a gift annuity is a form of bargain sale where the donor transfers cash/assets to charity in return for charity's promise backed by its general assets to make annuity payments to one or more individuals for their lifetimes. Some of the differences between the gift annuity and CRT include:

1. Gift annuity can be deferred, defer the annuity to a later date. More flexibility. Annuity payments can be variable or stepped.

2. Transfer of tangible personal property deduction is available immediately to donor.

3. Contributed residential property can be leased back by the donor-no self-dealing. Mortgaged real estate may be transferred in exchange for the gift annuity.

Steve next discussed charitable lead trusts (CLTs). A CLT is the reverse of a CRT where in a CLT the fixed or variable annuity is paid to charity for a determined period either for a term of years or by reference to the life

of one or more individuals with the remainder passing outright or in further trust for one of more non-charitable beneficiaries. Two gifts are made when the CLT is created: gift of current interest to one or more charities and a gift of the remainder to one or more non-charitable beneficiaries. Donor is liable for gift tax on the present value of the non-charitable remainder interest.

Treasury regulations permit an annuity amount that is initially stated as a fixed dollar or fixed percentage amount to increase during the annuity period. IRS prescribed forms in Rev Procs. 2008-45 and -46, permit a CLT to be constructed with back-loaded payments (aka Shark-Fin CLATs). The key to the CLAT is that the assets appreciate in excess of the Section 7520 rate. The intention of the back loading of payments is to hedge against market volatility allowing for significant fund build-up of funds ultimately passing to family member on trust termination. The issue at inception is determining the term of the CLAT. The panelists were fine with a 40-year term. In that event a charity may be inclined to sell its lead interest at some point rather than waiting out the entire 40-year term.

One of the caveats however, with escalating payments is that a balloon like feature may not be advantageous. The reason is the income taxes payable in the early years due to the mismatch between income and gains earned versus the low annuity level payment and correspondingly low Section 642(c) deduction. This becomes more important with the NII tax, too with a non-grantor CLAT.

The program concluded with a brief overview of the concepts Turney discussed in the morning general session regarding charitable gifts of partnership of LLC interest and transfer of remainder interests in farms or residences.

Session IV-B - Thursday, January 16th
How to Fix a Broken Trust
Amy E. Heller, Michael M. Gordon, Jonathan C. Lurie
This panel will use case studies to explore various methods to modify an irrevocable trust. Among other techniques, the panel will explore the use of decanting and trust amendment powers to effect modifications including extending the termination date of a trust, changing a trust's grantor trust status, bifurcating trustee responsibilities through the appointment of trust advisors and implementing quiet trust provisions.
Reporter: Herb Braverman

Ms. Heller gave a presentation to the general session which was a thorough discussion of how to fix estate planning documents that are somehow "broken". The Report of her general session presentation is in Report #11. In general, she discussed the tax consequences and advantages of several techniques, including construction actions, reformation, division, amendment and decanting, largely of trusts. Her materials briefly noted the decanting statutes in 21 states, with others to follow. I commend her general session presentation to you, including the informative materials

I found the afternoon session to not be as helpful as the general session. It was based upon a series of 6 case studies, dealing with fact patterns that may have suggested a broken document and one or more techniques for curing the "problem". These are all worth reviewing.

I did find the first scenario informative in that it dealt with the so-called concentrated position dilemma; it gave Mr. Gordon a good opportunity to discuss the actions his firm took in Delaware in the Peirels family trusts actions. This was good discussion of the Delaware decanting statute and the legal gymnastics required to reach the conclusion. Also discussed in this context were merger of trusts, non-judicial settlement agreements and judicial modification actions.

There were also discussions of issues arising from the desire to change grantor trust status of a trust, problems with "quiet" or silent trusts, the use of a trust protector, extending the duration of a trust and "cracking" a credit shelter trust.

Session IV-C - Thursday, January 16th
"Residence" and "Domicile" for State Income and Transfer Tax Purposes: A Closer Look
Richard W. Nenno, Christine L. Albright, Laurelle M. Gutierrez, Sharon L. Klein, Laura H. Peebles, David J. Slenn
This session will explore the meaning of "residence" and "domicile" for state income and transfer tax systems, focusing on the rules for establishing and escaping tax in California, Delaware, Florida, Illinois, New York, Pennsylvania, and other key states with sample calculations.
Reporter: Elizabeth Lindsay-Ochoa

Ms. Peebles reviewed the case studies in the materials and the potential income tax and estate tax consequences of living in particular states.

There were two fact patterns:

Fact Pattern No. 1

- Single
- $200k annual wages
- No itemized deductions other than state taxes
- State taxes paid in current year
- One child inherits estate
- $5 million estate

Fact Pattern No. 2

- Single Individual
- $2,000,000 of annual wages
- No itemized deductions other than state taxes paid
- State taxes are paid in the current year
- Estate value of $50,000,000
- Taxpayer's one child is the sole heir to the taxpayer's estate

States covered were:

California, New York, with and without NYC, Connecticut, New Jersey, Delaware, Pennsylvania, Illinois, Texas, Florida and Dual Residency with New York and Connecticut

Highlights, Pennsylvania has and inheritance tax, NYC has an income tax that adds quite a bit. Illinois had generally the worst tax consequences.

It was pointed out that it is possible to have dual state residency. This is why there was a dual residency example. This happens because states have different requirements for residency.

The presenters then dived deeper into tax and residency and referred back to the materials used in Mr. Nenno's presentation on Tuesday.

<u>New York</u>– page 104

New York has an income tax, which applies to individuals and trusts on all income. It also applies to nonresidents on NY sourced income. NY also has a state estate tax.

To determine residency, there are two ways to ways to establish residence: a domicile and statutory residence test. In NY, intent is a factor. If trying to show changed a residence need clear and convincing evidence.

On page 108, the nonresident audit guidelines are helpful to determine residency. There are three main categories:

- Primary factors, such as location of homes, business activities, location of sentimental items, family ties
- Subordinate factors, such as registration to vote; car
- Non-dominant factors, such as political contributions, bank accounts

How does this work in practice? See *Cooke* (In the Matter of the Petition of Gordon R. and Jennifer L. Cooke, DTA No. 823591, 2012 N.Y. Tax Lexis 86 (N.Y. Div. Tax App. 2012)), page 111.

It was determined that the taxpayers Mr. and Mrs. Cooke were not domiciled in New York City during the period in question, even though the amount of time spent in New York City and the Hamptons was almost equal. The taxpayer was able to show residence is in the Hamptons because there were deep ties to Hamptons. The reason why that was is because the court believes that the testimony was candid and credible.

Compare *Cooke* to *Ingle* (Ingel v. Tax Appeals Tribunal, 2013 N.Y. App. Div. Lexis 7084 (3d Dep't 2013). Taxpayer claimed domicile in Tennessee after moving from NY. The issue was the timing of change of domicile. The taxpayer claimed moved in March and under the audit, it was June. In April, the taxpayer sold highly appreciated stocks and did not include on NY tax returns. The court said, that the taxpayer did not meet burden of proof. The taxpayer did not change lifestyle and still had a lease. Essentially, the taxpayer's credibility was bad and lacked evidence. The testimony was vague evasive and conflicting

Page 112 - *Leiberman* (In the Matter of the Petition of Donald and Rose Lieberman, DTA No. 824101, 2013 N.Y. Tax Lexis 48 (N.Y. Div. Tax App. 2013)). The taxpayer moved to Florida from Queens. The taxpayers changed voting registration, driver's licenses and registered cars in Florida. There was little evidence on intent to abandon domicile and showed little evidence to leave domicile. It is better to arrange sentiment feeling and permanent association with new home.

In NY, there is the STAR exemption program for real property. STAR is the NY exemption for registration property as primary residence. If you use this, you should not have an inconsistent position when affirming domicile.

Page 114, discusses statutory residency. These factors include, permanent place abode, physical attributes for year round living, and taxpayer relationship to residence.

NY has also stated that the taxpayer was a resident because the residence home is suitable for year round living and even if it is not actually used. Two cases were pointed out under this

Page 114. In the Matter of the Petition of John J. and Laura Barker, DTA No. 822324, 2012 N.Y. Tax Lexis 7 (N.Y. Div. Tax App. 2012). The taxpayer had CT domicile and lived in CT. There was also a house in Hamptons which the taxpayer used in total for about 2 weeks a year. Tribunal said that this was a swelling and could use year round living. The taxpayer was in NY for 183 days for his job.

Factors used to determine a taxpayer relationship to dwelling on page 114.

Gaied v. Tax Appeals Trib., 101 App. Div. 3d 1492 (3d Dep't 2012). The taxpayer was domiciled in NJ and worked in NY. He helped pay maintenance for parents who lived in the NY apartment. He had no possession or room in the NY apartment, but did stay there on occasion. The Tribunal held that the taxpayer was a resident. There was compelling evidence that he maintained property and had a key. He also worked in NY 183 days for his primary job.

Taxation of trusts start on page 120

Resident trust in NY is one created by NY testator or grantor. Three exceptions to the general rule: If there is not any NY trustees; there is not any sitused assets in NY and is not any NY sourced income.

In 2010, there was a proposal to eliminate the three exceptions that never came about. But, the Department instituted filing requirement for trusts that meet the exception. The Fairness Commission that reviews state tax structure recommended closing this tax "loophole."

The Commission recommended reinstituting the gift tax and increasing estate tax exemption. This Commission report went to the Tax Relief Commission issued its report in December. This Commission recommends linking the NY tax exemption to the federal tax. Cuomo adopted the second report. We are looking for budget proposal. The other proposals are still being considered by taxation and finance.

If you have an advisor or protector that controls action of trustee, it is recommended that the planner tries to avoid being called the co-trustee in order to avoid NY tax. Make sure this person is domiciled out of NY, if you otherwise have a trust that does not have NY ties.

New Jersey Page 94

Many of the tests are similar to NY. However, NJ states that vacation homes are not permanent homes. NJ also has a state estate tax.

Taxation of trusts has the same exception as NY.

Illinois – page 74

Income tax went from 3.5 to 5%. This is a temporary tax measure and it is scheduled to go back down. Ms. Albright does not believe that will happen. There is also a 1.5% additional tax on trusts that is an IL resident. There is also a state estate tax.

What does resident mean?

Definition of who is a resident in IL does not have an absolute bright line test. They look to see if someone has a temporary or transitory purpose. What does that mean? The Regulation cited on 3-79 -3-81 of the outline are somewhat helpful. There is a facts and circumstance test and can be based on length of time.

Domicile is mentioned in the statute and the regulations. Generally, it is the true fixed permanent home is in IL and intends to return there whenever absent.

Page 82 – Reg. 100.3020(f) – modified to provide for two situations where there is a rebuttable presumption of IL resident. Need clear and convincing evidence.

Page 84 – Grede v. Ill. Dep't of Revenue, 2013 Il. App (2d) 120731-U (Apr. 22, 2013).Courts concluded not an IL resident even though he claimed the homestead exemption for IL property.

If an IL resident in one year, it is presumed to be IL in the next year if in IL more in that year than in any other state. What does that really mean? For example, what if client spends 5 months IL; 4 months in WI and 3 months in FL. The client spends more in time in IL than any other state, but more time out of IL in the other states. IL says this it is the residence. The regulation does not also include other countries. It also relates only to 2nd year. In the example, if in prior year lived in FL, the presumption does not apply.

Decoupling of estate tax is interesting. It uses the residency concept to enact, but there is not clear language in the state or regulations for what resident means. It is most likely that the state uses the same income tax definitions.

In IL, when is a trust taxable as an IL resident? Created by an IL testator – that will forever by an IL trust. Intervivos trust – where grantor lived when trust became irrevocable. If it is a grantor trust, it is not irrevocable trust – look at where grantor lived when grantor trust terminated.

Serious questions about constitutionality. Appellate court has held application of that statute if constitutional – Linn v Dept of Rev. 2013, IL App 4th 121055 (December 18, 2013). 1961 trust was changed through a 2002 power of appointment where the assets were removed and put in new trust. This power was exercised by the trustee. Under the new trust, the only connection to IL was that original trust created by domiciliary. This was not sufficient for IL to collect state taxes.

What is interesting, is that amount of tax at stake was less than $3,000. The family may have other trusts that they want to piggy back on this opinion.

California Page 17

In CA, it is easy to become resident and fall within taxing system.

You are a resident you are there for any reason except a temporary or transitory purpose.

A domicile is the true fixed permanent home. This is where attend to when absent. It's difficult to break that grasp. The only way you can is to establish new domicile and prove that the new domicile is for more than transitory or temporary purpose. Regulations go into this in detail Rev. and Tax Code Section 17014.

Whittell v. Franchise Tax Board, 231 Cal. App. 2d 278, 284 (Cal. Ct. App. 1964). Taxpayer had built a home on the Nevada side of Lake Tahoe. He spent 8-9 months in California and 3-4 month in Nevada. The taxpayer voted in Nevada, bank accounts in several places, had professional services in California. The taxpayer made charitable contributions in CA and NV. California did not relinquish domicile.

Noble v. Franchise Tax Board, 118 Cal. App. 4th 560 (Cal. Ct. App. 2004). The taxpayers were in Colorado previously. They moved and lived in California for 5 years. They then moved back to Colorado, purchased a residence there and after that sold securities. California said intent of leaving was not enough to change domicile. The taxpayer did not move until after they sold the securities and sold end there house in California at the end of the tax year. You actually need to go.

If individual stays more than 9 months, presumed to be California resident. Tourists are not residents if stay in California less than 6 months and have a residence outside of California. It is important to not have a business

or work in California.

Look to closest connections and if not clear, then purposes of why in California. There is a list of factors and the cases are fact specific.
Income tax of trusts and estates, all income is sourced to California stays in California. For non-sourced income, need to see if fiduciaries (not limited to trustees) are in California and non-contingent interest in California. Ministerial duties are ok if they occur in California. Look at all fiduciary residences and will apportion income that way. For example: there are three fiduciaries: One in California and the other two are not. So, 1/3 of the income is taxable in California. That does not mean the other 2/3 is subject to California tax. Now you need to do an analysis of non-contingent interest in beneficiaries. There is a gray area in between ascertainable standard and powers of appointment. If the same trust has two beneficiaries, one in California and one not, the remaining 2/3 from above, 50% goes to Cali.

California is aggressive to collect evidence to determine domicile in its investigation.

Florida page 67

Because there is no income tax and transfer taxes, moving to Florida may make sense. The trick here is to establish domicile. Page 67 gives some help. Florida also has good homestead provisions, etc. for asset protection.

There is a checklist in materials, that is not exhaustive that helps in how to obtain domicile. Declaration of domicile is one way to do it. It is quick and easy. But, this is not enough on its own.

You need permanent association with Florida. Social life is helpful, Florida doctors, hire trust and estate lawyers to update documents.

In re Lloyd, 394 B.R. 605, 609 (Bankr. S.D. Fla. 2008), page 70 of outline. Court says that debtor needed intent to go back to FL to show domicile.

Jakobot v. Am. Airlines, Inc., 2011 U.S. Dist. Lexis 64824 (S.D. Fla. 2011), page 73 of outline. Taxpayer tried to claim residency, using facts such as showing that the Facebook account indicating Florida is the residence. The profile picture was also in Florida. The court said that the person needs more than a google footprint to be Florida domicile.

Session IV-D - Thursday, January 16th
GST Tax: Post-ATRA Planning and Practical Pointers
Julie M. Kwon, Pam H. Schneider
This workshop will review factual scenarios to provide practical solutions to recurring GST tax problems in drafting, post-death administration and allocations, and examine options to mitigate adverse consequences of errors or take advantage of planning opportunities.

Reporter: Ted Preston

This presentation is difficult to summarize in a typical report, because it focused heavily on practical pointers. The presenters recognized that the Post-ATRA environment is presenting some new difficulties for practitioners, and invited the audience to participate throughout the presentation with questions and suggestions, and descriptions of the problems the audience members have experienced recently. The presentation played out as a running conversation between Kwon and Schneider, with frequent input from the audience.

If one theme surfaced more than others, it was the difficulties created by a GST exemption amount that increases with inflation each year. The difficulties presented by an increasing exemption create an especially vexing problem when making late allocations of GST exemption following a gift. The allocation of inflation-adjusted GST exemptions are simply not contemplated by Chapter 13 of the Code and the related regulations. This creates difficulties in determining inclusion ratios needed for the allocations. A great deal of discussion on this topic ensued.

You would be advised to review pages 6 through 14 of the presenters' outline in the printed materials to fully understand the implications of untimely allocations. Given the discussion among the presenters and audience, it seems apparent that this question is arising with some frequency, and will need to be addressed in future regulations.

The discussion suggested that the allocation of GST exclusion for gifts to a Crummey trust are also a problematic area. People routinely write gift tax returns for Crummey trusts as if they made numerous transfers directly to numerous beneficiaries, but what they really did was make a transfer to a trust, and those transfers are not automatically GST exempt. Practitioners may still need to allocate GST exemption to reach a zero inclusion ratio. Much of the problem is related to the tax software for GST tax forms. Much of the available software generates the wrong forms in this situation.

Practitioners are well-advised to review the written materials that accompanied this presentation for additional pointers. The presenters were unable to complete the discussion of the problems presented in the written materials because the discussions ran over time. The materials are rich with valuable advice and pointers.

Session IV-E - Thursday, January 16th
Ethics in Estate and Trust Disputes (a/k/a Tales from the Crypt) (Litigation Series)
Steven K. Mignogna, Charles D. "Skip" Fox, IV, Jessica A. Uzcategui
Ethical duties often collide in estate and trust disputes. This program will target the most crucial ethics issues and national trends including: conflicts of interest; confidentiality and privilege; duties in the drafting process; counsel fees; liability in court-appointed positions; and unauthorized practice of law. The session will benefit those professionals who create estate plans, those who deal with disputes and litigation about those plans and those who don't want to be the target of litigation.

Reporter: Joanne Hindel

Steve started off by saying with the increase in trust and estate litigation, the ethical pitfalls are becoming more apparent.

<u>Counsel fees were covered by Steven.</u>

He focused on potential fee shifting in which courts are considering awards against adverse parties. He reviewed the <u>*Niles*</u> case in which the court allowed the payment of fees by the wrongdoer.

He described a situation in which the issue of who his client was became important. Determining the identity of the client will also help determine who is responsible for payment of legal fees. In estate disputes in it essential to determine who the client is and who will pay the fees. You also need to determine in what role the lawyer is being hired.

In addition, you need to determine whether you will be paid by the client or from the estate or trust.

In contingent fee arrangements if the lawyer wants to recover fees and costs and the client has not received any funds, the lawyer may apply to the court for costs but should disclose the contingent fee arrangement. In general you should not handle estate and trust litigation on a contingent fee basis.

If a father calls to have the attorney prepare estate planning documents for his daughter and agrees to pay the lawyer, the lawyer can handle this but should get consent from all the parties.

Jessica then discussed attorney-client privilege

The rule is fairly uniform across all states and applies to most all legal matters. The general elements of the privilege are: it pertains to the information transmitted between a lawyer and client; in the course of the attorney-client relationship and in confidence.

Attorney-client privilege does not apply when a dispute arises between two people who claim interest from the same source. This is the exception to the attorney-client privilege that usually applies in estate and/or trust litigation.

Sometimes multiple individuals arrive at the attorney's office – attorney has to determine if all parties will be clients (two spouses for instance) or whether the third party, if not a client, is an indispensable agent. If not an agent, it is possible that communications by the third party will not be privileged since the third party will not be considered the client. Further, communications between the client and attorney, in the company of a third party, may cause the communication to not be considered to be privileged.

Some states have statutes that address the ability of other professional advisors to be present and not jeopardize the privilege.

After stating the basic rules, Jessica then covered a hypothetical to highlight circumstances where the privilege will still be retained and when it will be compromised.

She concluded by saying that the attorney should be very careful about the presence of third parties and be familiar with the particular state's laws on the issue.

One way to handle the presence of a third party is to consider having the client execute a POA for the third party. However an issue associated with that is whether the POA can hold the privilege on behalf of the client.

The panel discussed the use of e-mail correspondence from clients and the extent to which it is or is not privileged. It may depend upon where the e-mail is being sent from such as a Starbucks, the work computer or from home on a land line.

Rebecca then discussed the common interest doctrine which may serve to protect attorney-client communications, even when those communications have been shared with individuals outside the strict scope of attorney and client. Her advice was to use common sense when planning to share confidential information with multiple parties who have a common interest.

She also talked about the fiduciary exception to the attorney-client privilege and cautioned that you should know your state's laws on the issue. Some states accept gradations of the exception. For instance, in California, courts have rejected the fiduciary exception when a beneficiary seeks attorney-client privileged information from the trustee. However, a successor trustee in California may succeed to the attorney-client privilege of a

predecessor trustee with respect to "administrative" matters, but not with respect to "defensive" matters.

Skip then discussed lawyer competence.

He started by reciting the model rule dealing with competence of counsel. He said that estate planning attorneys whose practices often involve many different areas of the law should consider obtaining the requisite knowledge and skill in a particular matter through preparation and study if the lawyer lacks the necessary knowledge and skill.

He asked the audience whether this commentary to the model rules would actually protect the lawyer if some matter blows up. He emphasized that lawyers should only do the kind of work that they are capable of doing and bring in others to handle other areas of expertise.

He then talked about the possibility of the lawyer making a mistake in judgment and how that does not necessarily indicate a lack of competence. He reviewed a few cases in which trust beneficiaries attempted to sue lawyers for drafting documents that did not accomplish the estate planning that was intended and the courts have upheld lack of privity and not allowed the beneficiaries to sue the attorney. He also covered cases where the opposite occurred – with courts asking whether the beneficiaries were known as intended beneficiaries by the estate planning attorney.
Skip also discussed the model rule pertaining to providing effective and timely counsel to clients.

Steve then discussed the unauthorized practice of law.

He started with the *Guetersloh* case in which the court did not allow a trustee to represent himself because to do so would be engaging in the unauthorized practice of law. Rebecca mentioned that in California no fiduciary can represent him/her or itself.

Steve talked about the use of paralegals in the drafting of documents and then in the oversight of the execution of the documents.

Jessica then turned to court-appointed counsel.

She started with the ethical dilemmas for these attorneys: are they an advocate for the client or should they advocate for what they believe to be in the best interest of their client (which may differ from what the client wants). The model rules provide that the attorney should maintain a normal client relationship to the extent possible which may mean representing what the client wants not necessarily what the lawyer believes is in the best interest of the client. However, in addition the attorney should assist the court in understanding all the possible issues and should provide the court with all facts. The attorney may want to report to the court and allow the court to make an assessment based upon all the information. The attorney may also try to resolve issues of conflict. If all else fails, the attorney might have to ask to be removed or resign from representation.

Friday, January 17

9:00 – 9:50 a.m.
IRAs and Charitable Giving: Everybody Wins But the IRS
Natalie B. Choate
This presentation will explore how lifetime and at-death charitable giving with retirement benefits can solve estate planning problems and help charity while benefitting your low-, middle-, and high-income clients.

Including: How to draft and administer trusts so retirement benefits don't get blown up in the fiduciary charitable deduction minefield.
Reporter: Kimon Karas

NOTE: It is a personal feeling of your reporter, and Natalie also emphasized it, that this type of planning predisposes in the first instance that the client is charitably minded. If the client is only interested in one's family and maximizing value for the family, leave all assets to the family. Taxes most likely will be higher but the family will end up with more assets.

This topic addressed charitable gifts with retirement plan benefits. I would commend you to two sources, the outline as well as Natalie's text, Life and Death Planning for Retirement Benefits (see our Preliminary Report). The material is more complete than what was able to be covered in this session.

This summary will refer to IRAs but the concepts apply equally to qualified plans and 403(b) annuities. This topic does not address Roth IRAs as distributions from Roth IRAs are generally income tax free so there is no 'tax' benefit leaving a Roth IRA to charity. An IRA's loaded income tax consequences can be countered generally in one of two ways: i) leaving assets to an individual beneficiary with stretch out of payments, or ii) leaving assets to charity.

Natalie's presentation was based on a hypothetical consisting of an estate/trust with 2 beneficiaries and 2 assets an IRA and real estate in equal value, $1M each, with the goal for each beneficiary to receive ½ of the assets from the estate/trust. How best to design for maximum tax benefit to each beneficiary, acknowledging that either asset is worth the same to charity whereas asset passing to individual beneficiary carries with it income tax consequences. Whether charity receive cash or assets in kind it receives the same amount of value versus for an individual it makes a substantial difference. If an individual receives an IRA it comes with lurking income (IRD) versus an asset that receives a basis adjustment at death.

Natalie first addressed the separate share rule under Section 663(c). Under this rule income is prorated among all of the residuary beneficiary's shares even if the instrument grants the trustee the authority to select which beneficiary receives which asset and consequently steps must be taken to assure that tax consequences are addressed. Her example continued with cashing out of the IRA and its distribution to charity. Because of the proration of income under the separate share rule, steps must be taken in dealing with the IRA to minimize income allocation to the non-charitable beneficiary. Some considerations to address the issue and limit the income allocated to the non-charitable beneficiary:

1. Timing of distributions. Prior to cashing out the IRA deed the real estate to the individual beneficiary and at a later point in time, cash out the IRA. At that time there is only one share left, the charity's, so the proration rules are not relevant.

2. Transfer the IRA intact to the charity. Caveat some IRA providers will not allow for this. Planning point, address this in advance with IRA provider to determine if it will adhere to client's request and if not, consider locating a 'friendly' provider.

Next scenario continuing with the same hypothetical there is a pecuniary bequest to the individual with the remainder to charity. The IRA is passing to the residuary beneficiary. This scenario would have the same options as 1 above (pay the pecuniary bequest first and cash out the IRA at a later date when ready to pay charity) and 2, with a 3rd alternative. If the IRA is cashed out in the trust or estate there is income received and possibly not ready in administration to make distributions. That leads to a potential mismatch of income/ deduction because of the limitations of the Section 642(c) deduction. There is no DNI deduction for a

distribution from an estate/trust to charity. Thus only deduction is that under 642(c). However there are timing issue with the deduction: A trust must make payment to charity for the deduction - it cannot take a 'set aside' deduction whereas an estate can take a deduction for amounts 'set aside' for charity. Consequently in the example, to preserve the charitable deduction make a Section 645 election for the trust, the trust is then treated as an estate, and it can take a set aside deduction to the later payment to charity.

Natalie posited one additional scenario that she believes does not work and she invited anyone to come forward if they believed otherwise. This scenario is a pecuniary gift to charity with the remainder to the individual beneficiary. Possibly this might work if the only asset is an IRA.

Next Natalie analyzed whether one can in a governing instrument direct the IRA by document terms to the charity to 'fill up' the charitable gift with IRA benefits with the balance to the other beneficiaries. She referenced regulations under Section 642 which state that income cannot be directed to a beneficiary unless the direction has economic effect. She then referenced the 2007 CLT forms where it is provided that all amounts are to be paid from income first. She cited Reg 1.663-(c)-5, Example 9 where funding of A's share with IRA is respected. Her conclusion was that based on the apparent conflicting authority, what is permitted for one to do through documentation is one can direct 'income' but not classes of income. An IRA is an asset not a class of income. What Natalie believes is that one cannot say allocate municipal bond interest to A, as that is a class of income compared with the IRA which is an asset, not a class of income. Natalie did say some commentators disagree with that conclusion, primarily the Lane Zaritsky text.

Next Natalie discussed some lifetime giving alternatives. First it is clear there is no way for one to access IRA benefits without paying income tax. Clearly the income and charitable deduction for charitable payments with IRA benefits do not wash for a number of reasons, including the percentage limitation on charitable deductions, the various deduction phaseouts, and state income taxes.

She discussed the qualified charitable distribution available for IRA owners older than 701/2 who transfer assets directly to charity however limited to $100,000 per year. Even though this is a provision that is has been extended and is now currently the law, if one is considering a charitable gift she (along with Chris Hoyt who stated the same earlier in the conference) sees no reason not to do so and if the law is not extended into 2014 one can address that later in the year. She did caution however, for tax reporting purposes, that even if one made a charitable transfer they are still receiving an IRS Form 1099-R that does not reveal that the distribution is nontaxable. The duty is the donor's to report the distribution as nontaxable pursuant to IRS instructions for Form 1040 (2012).

Natalie concluded by urging the audience to consider a CRT as the beneficiary of an IRA. Her example is suppose child wants to assist elderly parent. If child names parent beneficiary there is an accelerated payout because of parent's age (corresponding income taxes) and the account obviously shrinks. Better alternative is to leave assets to CRT with parent as beneficiary. Parent receives an income stream for life that will not run out because of some artificial life expectancy table and child's estate receives a charitable deduction for the amounts passing to CRT.

9:50 – 10:40 a.m.
Asset Protection Planning Ethical? Legal? Obligatory?
Daniel S. Rubin
Professional ethical obligations, as well as the potential for civil and criminal liability, will give thoughtful counsel pause. The ethical advisor will always act to further his or her client's asset protection plan with appropriate due diligence and within permissible bounds as set forth under the governing rules of ethics the parameters of which will be discussed in this program.

Reporter: Kimon Karas

Asset protection planning (APP) generally refers to implementation of planning techniques intended to place assets beyond reach of one's 'potential future creditors.' This is a term of art referring to not yet existent and as yet unanticipated future creditors. In addition this planning may include planning to i) further protect assets that are already unavailable to creditors (i.e. advising a debtor's spouse to create protective device should she predecease debtor spouse) or ii) protect children or other beneficiaries with existing creditor issues (3rd party trust planning). Ethical issues are often raised in such planning.

Some of the theories that asset protection planning raises for attorneys that assist in a fraudulent transfer or asset conversion:

1. Is an unethical act;

2. Potential to generate civil liability (the more successful the planning the greater the risk);

3. Criminal liability.

APP raises concerns under the fraudulent transfer/conveyance laws. Although US law favors free alienability of property it also protects creditors' legitimate intersects. Fraudulent conveyance statutes date back to the English Statute of Elizabeth prohibiting the transfer of property with the 'intent to delay, hinder or defraud creditors.' Today in the US fraudulent transfer is governed primarily by state law

1. Uniform Fraudulent Conveyance Act;

2. Uniform Fraudulent Transfer Act (great majority of states-43 + D.C. and US Virgin Islands);

3. Statute of Elizabeth or civil law;

4. Bankruptcy Code provisions.

There are 2 forms of fraudulent conveyance:

1. Fraudulent transfer via insolvency. A transfer that makes a transferor insolvent.

2. Fraudulent transfer via intent, i.e. badges of fraud. Every conveyance made and every obligation incurred with the actual intent, to hinder, delay, or defraud, either present or future creditors. Opponents of APP say all APP incorporates intent. Badges of fraud include a multitude of items primary two of which are:

   a. Transfer occurred shortly before/after a substantial debt was incurred;

   b. Litigation was pending/threatened at time of transfer.

Similar to fraudulent transfer is the concept of fraudulent asset conversion, i.e. conversion of a non-exempt asset into an exempt asset to avoid a known creditor. In the bankruptcy context this is known as 'pre-bankruptcy exemption planning.' Pre-bankruptcy planning was given a stamp of legitimacy by the legislative history to 11 USC Section 522. Dan cited a number of authorities with the general standard announced by the authorities: "While pre-bankruptcy conversion of nonexempt to exempt assets is frequently motivated by the intent to put those assets beyond the control of creditors, which is, after all, the function of the exemption,

evidence of actual intent to defraud creditors is required to support a finding sufficient to deny a discharge." In re Reed, 700 F.2d 986 (5th Cir. 1983).

APP and Ethical Considerations. Neither the Model Rules of Professional Conduct nor its predecessor Model Code of Professional Responsibility address APP specifically and consequently the suggestion that APP is subject to some unique ethical considerations is necessarily suggested as being implicit under the governing rules. The rules that may apply to preclude an attorney from advising or assisting a client in effectuating a fraudulent transfer/conversion include the following:

1. Misconduct. A lawyer shall not,… engage in conduct involving dishonesty, fraud….;

2. Respect for Rights of Third Persons. A lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person…;

3. Representation Within the Bounds of the Law. A lawyer shall not…counsel or assist his client in conduct lawyer knows to be illegal or fraudulent. This is the Model Code language; the Model Rules references that a lawyer shall not assist in conduct the lawyer knows is criminal or fraudulent.

There are very few cases/ethics opinions relating to transfers of property in furtherance of APP.

On the other hand there may be an ethical obligation to provide APP. The US Supreme Court has stated that:" ((1))he duty of the lawyer, subject to his role as an 'officer of the court," is to further the interests of his clients by all lawful means, even when those interests are in conflict with the interests of the United States or of a State." In re Griffiths, 413 U.S. 717, 724 (1973).

Next Dan addressed civil liability considerations distinguishing between ethical concerns and civil liability. The preamble to the Model Rules provides, that 'violation of an ethical rule should not itself give rise to cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached,,' The bases for civil liability would include the following:

1. Civil conspiracy. There must be a tort otherwise no liability.

2. Civil aiding and abetting. Distinction between civil conspiracy and aiding and abetting is that civil conspiracy involves an agreement to participate whereas civil aiding/abetting focuses on whether a defendant knowingly gave 'substantial assistance' to someone who performed wrongful conduct. Again there must be a tort and further issue is whether a tort of aiding/abetting exists.

3. RICO liability.

Criminal Considerations. Generally in the US there is no criminal liability for effectuating a fraudulent transfer although there are exceptions.

1. State laws.

2. Bankruptcy. 18 USC Section 152(7).

3. Internal Revenue Code Section 7206(4).

4. Concealment of Assets from Conservator, Receiver, or Liquidating Agent . 18 USC Section 1032.

5. Transportation of Stolen Goods, Securities, Moneys, etc. 18 USC Section 2314.

6. Money Laundering Control Act of 1986. 18 USC Section 1956(a)(2).

7. RICO.

Techniques to Minimize Risk. In light of ethical concerns together with potential for civil or even criminal liability an attorney practicing in the area of APP must be very careful in accepting new client and representing them. All ethical proscriptions against assisting in a fraudulent transfer as well as potential civil or even criminal liability depend upon the attorney having acted 'knowingly' (which includes what reasonably should have been known) due diligence on the attorney's part if paramount.

An attorney must know 'your client's. " Considerations include source of client's wealth; particulars of client's business/employment; reason for seeking advice/assistance with APP; was client referred by a reputable source. Steps for attorney must undertake prior to accepting representation.

1. Engagement letter which outlines fraudulent conveyance under local law and that attorney is relying upon full and continuing disclosure by client in attorney's professional judgment whether transfers at issue are in fact permitted. A breach of client's full and continuing obligation to provide attorney disclosure is grounds for termination of client relationship.

2. Complete a comprehensive client questionnaire including some of the following:

    a. Any lawsuits;
    b. Tax reporting current, whether all taxes have been paid and any tax audits pending;
    c. Any legal actions pending/threatened;
    d. Client been convicted of a crime.

3. Affidavit of Solvency. This is an absolute where client swears/affirms i) no known pending or threatened claims; ii) no known investigations; iii) following any intended transfer(s) client will remain solvent; iv) none of assets that client intends to transfer were derived from 'unlawful activities."

10:50 a.m. – 12:00 p.m.
Estate Planning: The New Frontier
(Focus Series)
Martin M. Shenkman
ATRA, the final frontier. Thriving in the brave new world of permanent high exemptions and portability, applying new planning approaches and perspectives. Highlights of Heckerling. Capitalizing on changing demographics and client desires, harnessing technological efficiencies and more, to thrive in the post-ATRA environment. The reduced importance of the federal estate tax doesn't lessen the need for planning, it only changes the estate planning conversation for many clients.
Reporter: Kimon Karas

Marty presented the last general session of the 48th Heckerling Estate Planning Institute, the wrap-up session. The theme of Marty's presentation was, although the landscape has changed, estate planning is not 'dying.' Contrasted with some of the negative comments made by various commentators over the past couple of years regarding the future of the profession he is extremely optimistic for the future. He divides the population of clients into 3 general groups: (1) the ultra-high net worth client for whom traditional estate planning continues

unabated-i.e. the $5+M inflation adjusted exemption is useful but in no event obviates planning needs; (2) the moderate wealth group that he defines anywhere from $1M-$15M for which he sees as the real growth area for the practitioner community; and then (3) the lower wealth client practices that he refers to as not in a negative manner (the Medicaid client).

Repeating what others have said over the past several years as the federal exemption has been increasing from $3.5M, to and through repeal, to now $5.34M in 2014, inflation adjusted, is that tax-driven estate planning for the most part is over. The paradigm has shifted. With lower exemptions and many people facing an estate tax issue, the historical estate planning was viewed as attorneys providing a 'commodity,' the documents, to address tax planning to save or maximize credits, deductions. The clients were addressing the fear of estate taxes. Now the focus should turn to 'service' doing what clients should have been coming to attorneys for in the first instance, counsel, advice, and consultation. Marty shared an example of a recent client engagement. A few years before he met with the client where the result was approximately 70% of the invoice to the client related to document drafting; he recently met with same client and the total invoice was about the same even though rates have increased over the past several years, but the majority of the statement consisted of client advice, consultation and less time spent on document drafting. Primarily the change was the result of increased technology addressing documentation with the focus of the representation being client meetings/consultation and less professional time spent on document drafting. The profession must change client perception of attorneys in estate planning from being a commodity provider, documents, versus a counselor and advisor. For example he stated that back in 2010 he ceased preparing gift/estate tax returns. He is still involved in reviewing the returns but using others, primarily the accounting firms, to prepare the returns based on those firms being better equipped staff wise and technologically advanced to prepare the returns in a cost-efficient manner.

Marty then referred to prior wrap up sessions from 2010, Alan Rothchild's presentation, and from 2011, Jonathan Blattmachr's presentation. I was the reporter for both sessions and for a summary of the discussions I refer you to those prior summaries in the 2010 and 2011 Heckerling Reports in the ABA-PTL list and RPTE Section Heckerling archives (see top Intro to this Report). Marty however commented that the era of Legal Zoom being a competitor he does not agree with that. The Legal Zoom user is not the type of client that 'we' serve. His suggestion is that the estate planning attorney's competition is the wealth manager, who he views both as competition and an ally. He agrees that technology has changed and continues to change the profession (embrace technology-going paperless if that works for you); elder law is growing; client mobility is an issue that must be considered and addressed; and the concept of the family continues to evolve. He disagrees with Alan's comment that the estate planner must morph into other areas, real estate, etc. Marty believes there is plenty for the estate planner to do and to continue to do servicing traditional estate planning clients. He disagrees with Jonathan's conclusion of client web-based meetings being the norm; Marty believes there is no substitute for personal interaction at a very minimum at the outset of a client engagement. Web-based meetings may be the future for follow up meetings, document review with clients, etc., but not at the initial stage.

He believes the 'estate planning team' will continue to grow including the attorney, accountant, life insurance consultant, wealth manager and the newest addition to the team being the care manager. Marty submits everyone will have a role and all should rely on and use the expertise each of the professionals brings to the team.

Marty's advice is go back to the future. The estate planning attorney must focus on advice, guidance and counsel. Go forward with technology and back to roots of the profession of being counselors to one's clients. Estate planning attorneys' value to the client is independence and objectivity. Use it to your benefit as a counselor to the client.

As was discussed throughout the Institute Marty concurs that income tax planning will become ever more important. Income tax at both the federal and state levels will be playing a more significant role in future planning. Rather than global concepts of addressing assets, it will become an asset by asset approach and review. If the estate planning attorney is not conversant with income tax issues, one must bring that expertise to the team, relying upon the accountants, other advisors. With the speed of change and the need for expertise in a wide range of areas a collaborative approach to problem solving/guidance is ever more important. He also stressed the important of the psychological and emotional aspects of estate planning and referred to an article he was a co-author of, Exhibit G, to his written materials.

He also commented on the focus of bypass trust planning and creating basis on the 2nd spouse's death. Not to minimize the concept, however, he suggested that in most situations we are dealing with clients in their mid to late 70s. Over the past 20 years the average return on investments has been a paltry 2.1%. Stuff bonds, income assets into Trust B.

He addressed demographics and its influence on the future of estate planning. For example, a topic constantly discussed as a concern is that of divorce. The divorce rate among the general population is not the 50% standard that seems to be the number cited to. The real rate is about 44%. In the higher net worth strata the rate is lower yet so although there is concern it may not be as significant as is portrayed. Possibly one grants a power of appointment where one may have been hesitant to do so in the past. Five million baby boomers per year are retiring. Twenty percent of the boomers are supporting an elderly parent. At same time approximately 63% of boomers have one child at least 18 years or older and of this group, about 2/3rds are supporting an adult child financially. Marty refers to this as the 'sandwich' pressure. Consider for example the use of a CRT with the parent being the income beneficiary where income is available to the parent for their lifetime. Natalie Choate discussed this in her presentation, too. Review durable powers of attorney and consider whether gift giving powers should not be all downstreamchildren, grandchildren, but consider whether power should permit gifts upstreamparents. In that regard does it make sense to limit gift giving power at least as to parents to the annual exclusion amount. That may not at all be sufficient to support an elderly parent.

As we address the future we must consider the gender composition of clients as well. According to the Census Bureau estimated that by age 85 women will outnumber men by 4 to 1. The gap between female and male life expectancy has been narrowed. Additionally this also varies by socio-economic status as clients with means tend on average to live longer.

Marty discussed healthcare proxies. He referred to an exhibit in his outline where among other items he addresses religious views and other client wishes/preferences. Standardized documents may not address all issues: for example many people (130M) are living with chronic disease, 25M with COPD.

Marty concluded that what we do as estate planners will change but at the same time tremendous opportunities await in counseling, advising and consulting clients.

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Our on-site local reporters who will be present in Orlando in 2014 are Joanne Hindel Esq., a Vice President with Fifth Third Bank in Cleveland, Ohio; Kimon Karas Esq., an attorney with McCarthy, Lebit, Crystal and Liffman Co. LPA in Cleveland, Ohio; Craig Dreyer Esq., an attorney with Clark Skatoff, PA in Palm Beach Gardens, Florida; Herb Braverman Esq., an attorney with Braverman & Associates in Orange Village, Ohio; Kristin Dittus, a solo attorney in Boulder, Colorado, Michael Sneeringer Esq., an attorney with Nelson & Nelson, PA in North Miami

Beach, Florida, Michelle R. Mieras, a Senior Trust Officer with Bank of the West in Denver, Colorado, Theodore C. Preston Esq., an attorney with the Preston Law Office, PC in Elizabeth, Colorado, and Elizabeth Lindsay-Ochoa, a VP and Sr. Trust Counsel with Tompkins Financial Advisors in Ithica, New York.

The editor again in 2014 will be Joseph G. Hodges Jr. Esq., a solo practitioner in Denver, Colorado. He is also the Chief Moderator of the ABA-PTL discussion list.