Recent Developments with Practical Estate Planning Implications to Advisers

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A KEY ESTATE PLANNING GUIDE

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Recent Developments with Practical Estate Planning Implications to Advisers

Federal Estate Tax Repeal (or Not) (HZ)

Federal Estate Tax Repeal (or Not) -1

- What is the status of the proposals to repeal the estate tax?
- How does the continued uncertainly impact planning?
- How might repeal affect planning?
- Why planning must continue?
- What specific steps might planners recommend?

Federal Estate Tax Repeal (or Not) - 2

- Recommendations.
  - Continue planning.
  - Minimize risk of current gift tax being incurred.
  - Preserve ability to secure basis increase if that remains beneficial.
  - Infuse significant flexibility in the plan and documents (protectors, decanting provisions, loan provisions, ability to add charitable beneficiary and more).

Recent Developments with Practical Estate Planning Implications to Advisers

Asset Protection:

Klabacka (MS)

Asset Protection: Klabacka - 1

- In Klabacka v. Nelson, 133 Nev. Advance Opinion 24 (5/25/2017).
- The Nevada Supreme Court confirmed that Nevada domestic asset protection trusts (DAPTs) provided protection of trust assets from spousal support and child support claims.
- The Court recognized that Nevada's DAPT approach differs from Florida, South Dakota, and Wyoming, in that Nevada abandoned the interests of child- and spousal-support creditors, as well as involuntary tort creditors, to attract trust business.
- The Court held that breaching trust formalities of an otherwise validly created DAPT does not invalidate a spendthrift trust. Rather, it creates a cause of action for a civil suit against the trustee.

Asset Protection: Klabacka - 2

- The Klabacka decision does not address the most worrisome DAPT issue, which is whether a resident of a non-DAPT jurisdiction, who creates a trust in a DAPT jurisdiction, such as Nevada, will have that trust respected, i.e. will achieve the hoped-for asset protection goals.
- What does this holding mean considering the Uniform Fraudulent Conveyances Act comment on DAPTs? Can/should clients residing in non-DAPT jurisdictions continue to use DAPTs?
- What should practitioners do with respect to existing DAPTs?

Recent Developments with Practical Estate Planning Implications to Advisers

Assisted Suicide (MS)

Assisted Suicide - 1

- Six states (California, Colorado, Oregon, Vermont, Washington and Montana) now permit legal suicide, either through statute or case law.
- What steps should be taken to permit clients who wish to avail themselves of one of these laws to do so?
- Practitioners may for personal, religious or other reasons choose not to counsel a client on pursuing assisted suicide, but knowledge of the topic may be important to that discussion and the referral to other advisers.

Assisted Suicide - 2

- Legal suicide is when, after complying with strict procedures, a dying and suffering client may obtain prescription medication to end his or her life in a less painful manner. Common requirements of these laws may include:
  - Make the request personally.
  - Be a resident of the state permitting this. This requirement is an important part of planning that those living in other states should address, and preferably as early as possible after obtaining a diagnosis of the terminal condition.
  - Diagnosed to have a terminal illness with a prognosis of six months or less to live.
  - The dire health status must be confirmed by two physicians, including the client's primary physician and a second, consulting physician.
  - Confirmed as being mentally capable to make this decision by two physicians. They must specifically conclude that the client understands the consequences of the decision.
  - Confirmation that the decision is deliberate.

Assisted Suicide - 3

- To avail themselves of this option clients need to relocate to, and become a resident of, the states permitting this, with sufficient time and capacity to meet the strict statutory requirements.
- Be certain that the client understands and considers that this option may violate religious beliefs of the faith the client has adhered to. It may also deeply offend and upset family and friends. Encourage the client to discuss the entire matter with any religious advisers, mental health professional and others.

Recent Developments with Practical Estate Planning Implications to Advisers

Divorce Decanting – Ferri Case (MS)

Divorce Decanting: Ferri Case - 1

- Ferri v. Powell-Ferri, 476 Mass. 651 (2017).
- The court permitted decanting to safeguard assets in a poorly crafted trust or traditional style trust. The issue that arises in many states of the “veil of impropriety” from taking action just prior to a divorce did not deter the Ferri court.
- The key time events in Ferri included: 1983 - Creation of a trust for child/beneficiary; 1995 - Child/beneficiary’s marriage; 2010 - Child/beneficiary’s divorce; 2011 – Decanting of trust.
- In Ferri, The trustee had the discretion whether or not to pay trust assets to the child/beneficiary or to instead set them aside for the child/beneficiary. In addition, the child/beneficiary could demand increasing percentages of trust corpus at specified ages beginning with 25% of corpus at age 35 and increasing in increments to 100% of trust corpus after age 47.

Divorce Decanting: Ferri Case - 2

- The child/beneficiary's spouse filed for divorce in October 2010. At that time, the child/beneficiary had the right to demand 75% of the corpus of the trust. This made the trustees concerned that the child/beneficiary's ex-spouse might reach trust corpus. To endeavor to reduce this risk, the trustees decanted the trust assets into a newly created trust. While the decanting was in process the child/beneficiary's right to withdraw principal blossomed to 100% of corpus.
- The new trust, as would be anticipated, eliminated the child/beneficiary's right to demand trust corpus at specified ages. The new trust was formed in Massachusetts.
- While the Court determined that there is no specific decanting power under Massachusetts law, the trustee's power to decant depends on the governing instrument and the facts. The rationale justifying decanting in the instant case was based on the fact that since the trustees had the discretion to distribute trust property to or for the benefit of the beneficiary, the power of the trustee to distribute the property to another trust for the benefit of the same beneficiary should be subsumed under the broader distribution power Morse v. Kraft, 466 Mass. 92 (2013).

Divorce Decanting: Ferri Case - 3

- Consider whether the same result would have been realized if the child/beneficiary had requested the trustees decant, or were actually involved in the process (e.g., by consent to a non-judicial modification of the trust as discussed elsewhere in this outline).
- The decanting was done without the consent or involvement of the child/beneficiary. How would Ferri have been decided had a single email from child/divorcing husband to the trustee been found?
- This could make the success of the decanting in similar situations very fact sensitive as to the child/beneficiary's involvement.

Divorce Decanting: Ferri Case - 4

- Clients need to be educated that traditional or historic trust drafting commonly relied on techniques and provisions that are less than optimal, such as mandatory income distributions, mandatory principal distributions as specified ages, or as in the Ferri case permissible withdrawal rights of trust principal.
- To many clients assume erroneously that an irrevocable trust is inviolate and that with tax laws in flux no planning is necessary. Modifying old now inefficient trusts can be about much more than tax planning considerations as the Ferri case illustrates.
- Practitioners should encourage all clients with existing irrevocable trusts to meet to review those trusts. Whether for divorce, tax planning (whatever the future law changes provide), general asset protection planning or other reasons, modifying those old trusts through decanting might make improvements, or as in the Ferri case, save the trust assets.

Recent Developments with Practical Estate Planning Implications to Advisers

LLCs and FLPs:
Estate of Powell (HZ)

LLCs and FLPs: Estate of Powell - 1

- Estate of Powell v. Commissioner, 148 T.C. No. 18.
- The Powell case of provides reminders of many inappropriate steps that might be taken in FLP/estate planning. It also introduces a new interpretation of 2036(a)(2) and a risk of double counting practitioners should consider in planning.
- In Powell, the errors made in planning the decedent's estate, include misusing a power of attorney, engaging in aggressive last-minute planning, not having a business purpose for a family limited partnership, and running afoul of IRC §2036.

LLCs and FLPs: Estate of Powell - 2

Facts in Powell:

- Son began mother's estate planning August 6, 2008. Son created an FLP and transferred about $10 million in cash and securities from his mother's revocable trust to it in exchange for a 99% limited partnership interest.
- On August 7, son obtained a doctor's note that allowed him to act as agent under his mother's durable power of attorney for property due to his mother's incapacity.
- Son used the power of attorney to create a charitable lead annuity trust ("CLAT"), and transferred the 99% limited partnership interest to the CLAT.
- Nancy Powell died August 15, 2008.
- Son filed a gift tax return for the transfer to the CLAT. He valued the 99% limited partnership interest at $7.5 million after a 25% discount for lack of marketability and lack of control. This resulted in a gift to the remainder beneficiaries of just over $1.6 million. A reduction in value of $8.4 million.

LLCs and FLPs: Estate of Powell - 3

- Given the significant errors made in planning the decedent's estate, the Tax Court's outcome of including the assets in the estate is no surprise. So, what is it about Powell that has led commentators to describe it as "the most important Tax Court case addressing FLPs and LLCs in the context of estate planning since the Bongard case 12 years ago?" Bongard, 124 T.C. 95 (2005).
- There are two primary reasons:
  - 1) this is the first case where the tax court held IRC §2036(a)(2) applied even though the decedent did not own a general partnership interest; and
  - 2) in dictum, the tax court made some interesting comments about the potential for double taxation even though it did not apply in the Powell case.
- The Tax Court speculated that if the limited partnership interests increased in value between the time of the transfer and the decedent's death, the gross estate may have to include the increase in value of the limited partnership interests along with the value of the underlying assets at the time of the decedent's death leading to double taxation.

LLCs and FLPs: Estate of Powell - 4

- Several practical planning lessons practitioner can be gleaned from Powell, including the following:
  - Practitioners creating FLPs or other entities for clients might consider adding to the list of warnings the risk of the IRS asserting Powell-type arguments about estate inclusion in that post-transfer appreciation could result in a double counting, hence putting the client in a worse situation than if the entity had not been pursued.
  - Practitioners should review all client powers of attorney and tailor the gift provisions to what might be appropriate for the particular client's circumstances. For clients of significant means, the gift provisions should be tailored to permit whatever type of gift or other transfers that might be appropriate to planning, but constrained to minimize the risk of abuse.
  - Clients should be educated as to the importance of periodic reviews to endeavor to avoid the compressed planning time frame used in Powell. Rushed planning will almost assuredly increase the risks to the plan. Ongoing planning is the key to avoiding that.

LLCs and FLPs: Estate of Powell - 5

  - Non-tax purposes should be evaluated and corroborated for most planning. Document non-estate tax motives for estate tax transactions.
  - Every client plan has a "story to tell." Document the client planning scenario in a manner that corroborates the business and non-tax purposes for the plan in the client's particular situation. Document why the client wants the entity established.
- Practitioners might consider informing clients with existing FLP/LLC planning in place about the new issues raised in Powell including the risk of a 2036(a)(2) attack even without a GP interest as well as the risk of potential double counting. The latter could prove quite costly if asserted by the IRS in a situation with significant post-transfer appreciation.

Recent Developments with Practical Estate Planning Implications to Advisers

Portability: Relief for missed Portability Elections (HZ)

Portability: Relief for missed Portability Elections - 1

- Rev. Proc. 2017-34.
- This new Rev. Proc. provides significant leniency to make a late election of portability under IRC Sec. 2010(c)(5)(A).
- Any client whose spouse died after 2010 that did not file an estate tax return, and the estate of the deceased spouse was less than the estate tax exemption, should carefully consider filing an estate tax return under the Rev. Proc. to secure portability of that deceased spouse's used exemption ("DSUE").

Portability: Relief for missed Portability Elections - 2

- Many estates, particularly those who would not otherwise have been required to file an estate tax return, missed filing the requisite estate tax return and sought relief from the IRS to rectify the situation.
- The due date for electing portability for those estates not required by IRC Sec 6018(a) to file an estate tax return is prescribed by Regulation, and not by statute. Treas. Reg. Sec. 20.2010-2(a).
- Therefore, the executor of such an estate could have sought an extension of time to elect portability under IRC Sec. 2010(c)(5)(A). Treas. Reg. Sec. 301.9100-3. That was costly. The new Rev. Proc. offers a solution.

Portability: Relief for missed Portability Elections - 3

- There are three categories of clients affected:
  - Clients who need the DSUE. For example, husband died in 2011 with an estate of $2M and no estate tax return was file. Wife died in 2017 with an estate of $7M. Without the DSUE a tax would be due. If the DSUE secured by following the steps outlines in the Revenue Procedure estate tax will be avoided.
  - Clients who may need the DSUE in the future. An example would be the couple and estate above, but the wife is still alive so the results are not yet assured (e.g., she might engage in tax planning, the exemption may rise if the estate tax is not repealed, the estate tax might be repealed, etc.). For these clients, given the modest cost of compliance filing should be made.
  - Those that are unlikely under current law and circumstances to have use for a DSUE. For example, husband died in 2011 with an estate of $2M. Wife inherited that $2M and has $2M of assets of her own for an aggregate estate of $4M. Under current law there is no benefit to securing the DSUE. But what if wife remarries someone wealthy, might there be a benefit to having secured the DSUE from her first husband to cover gifts of her $4M estate? What if a future administration reduces the exemption and she becomes subject to an estate tax the husband's DSUE might have avoided?

Portability: Relief for missed Portability Elections - 4

- Many clients that could benefit might dismiss securing the DSUE as not worthwhile, just as they may have done if they made a conscious decision not to file following the death of their spouse.
- Now in particular, with the specter of estate tax repeal a possibility, practitioners need to discuss with their clients whether securing a DSUE is worth the modest bother and cost. Unfortunately, for most clients that will be unknown without the benefit of hindsight.

Recent Developments with Practical Estate Planning Implications to Advisers

Portability: Court Forces Election (HZ)

Portability: Court forces Election - 1

- Matter of Estate of Vose (390 P3d 238).
- In Vose the Oklahoma Supreme Court affirmed a trial court's order forcing the executor of a deceased spouse's estate to file a federal estate tax return and make a portability election.
- In Vose, the personal representative of the estate was the decedent's child from a prior marriage. The personal representative refused to make the election required to preserve the DSUE and transfer it to the surviving spouse even though the surviving spouse agreed to pay the cost to prepare and file the Federal Estate tax return to do so.

Portability: Court forces Election - 2

- In requiring the portability election be made by the personal representative the court reasoned that the right to portability of the DSUE was a beneficial interest in the estate for the surviving spouse. The court indicated that this right was independent of the surviving spouse's rights as an heir.
- The personal representative also argued that the decedent's and surviving spouse's prenuptial agreement constituted a waiver by the surviving spouse of any rights to the estate making a portability election. The Court determined that the antenuptial agreement did not bar the surviving spouse's interest in the DSUE.

Portability: Court forces Election - 3

- When considering Vose, should planners revisit all prenuptial agreements and expressly address portability if it was not addressed? What if state law does not permit amendment of prenuptial agreements?
- When the Vose decision is coupled with the leniency the IRS issued in Revenue Procedure 2017-34, to make a late filing for portability, practitioners may wish to alert clients facing a Vose situation to have counsel write a letter to the recalcitrant executor demanding that the filing be made.
- The Vose decision also addresses specifically many of the questions that practitioners would anticipate when making a portability election in second and later marriages and thus provides clear conclusions to use to evaluate such situations.

Recent Developments with Practical Estate Planning Implications to Advisers

Practice Management: Email Communications (MS)

Practice Management: Email Communications - 1

- Ethics Opinion 477 updates Ethics Opinion 99-413.
- New opinion 477 addresses the now common use of technology such as tablet devices, smartphones, and cloud storage.
- Practitioners should evaluate modifying their retainer agreements, and other client communications and documentation, to reflect how they are addressing these issues.

Practice Management: Email Communications - 2

- Each device and each storage location offer an opportunity for the inadvertent or unauthorized disclosure of information relating to the representation, and thus implicate a lawyer's ethical duties under Rule 1.1 of the ABA Model Rules concerning competency, confidentiality, and communication.
- Lawyers must take reasonable efforts to ensure that communications with clients are secure and not subject to inadvertent or unauthorized security breaches. Attorneys must use "reasonable efforts" to ensure the security of client information. This is a "facts and circumstances" test. What is "reasonable?"
- Comment 8 to the rule requires lawyers to be current regarding the benefits and risks associated with relevant technology. What steps should estate planning attorneys take to become current and to demonstrate that they are current?

Practice Management: Email Communications - 3

- What constitutes reasonable efforts is not susceptible to a hard and fast rule, but rather is contingent upon a set of factors. In turn, those factors depend on the multitude of possible types of information being communicated (ranging along a spectrum from highly sensitive information to insignificant), the methods of electronic communications employed, and the types of available security measures for each method. Attorneys must use “reasonable efforts” to ensure the security of client information. Consider:
  - Sensitivity of the information being transmitted.
  - Risk of disclosure if additional security measures are not taken.
  - Cost of additional measures.
  - The difficulty of adding additional safeguards.
  - Might additional safeguards adversely impact the lawyer’s ability to represent the client.

Practice Management: Email Communications - 4

- While the recent Ethics Opinion points out a number of issues, the details of what steps should be taken, how retainer agreements should be revised, what specific software should be used and precautions taken, etc. need to be addressed.
- Are you using secure email for documents? For documents with tax ID numbers? Not at all?
- The continued evolution of the technological environment in which estate planning attorneys practice remains a challenge. Inaction, however, is not an option.

Practice Management: Email Communications - 5

- **Sample Provision**: Consider including provisions in retainer agreements to address these matters: “Email and cellular telephone communications present special risks of inadvertent disclosure. However, because of the countervailing speed, efficiency, and convenience of these methods of communication, we have adopted them as part of the normal course of our operations. You consent to our use of Email and cellular telephone communications in representing you. Please do not assume we have received any text message unless you verbally confirm that we have.”

Recent Developments with Practical Estate Planning Implications to Advisers

Probate: Inheritance Right Interference (MS)

Probate: Inheritance Right Interference - 1

- Kinsel v. Lindsey, NO. 15-0403, Texas Supreme, Court May 26, 2017.
- In Kinsel the Texas Supreme Court refused to recognize a cause of action for “tortious interference with an inheritance” but may have left the door open for such an action if a future case with different facts. The case discusses undue influence and other issues that practitioners are likely to see with increasing frequency as the population ages.
- Lesey Kinsel (Grandmother) owned 60% of the ranch, and her step-children and step-grandchildren owned various shares of the other 40%. Grandmother deeded her share of the ranch to her inter-vivos trust in 1996. Under the trust’s terms, her 60% interest in the surface and minerals would pass to certain step-children and step-grandchildren, some of whom already owned interests in the ranch.
- The ranch in question was sold a mere month before Grandmother died thereby changing the beneficiary of the value involved.

Probate: Inheritance Right Interference - 2

- Her estate-planning documents were silent as to what would happen if the ranch were sold during her lifetime. So by default, any ranch-sale proceeds would pass to the trust's residual beneficiary—Lesey's only niece, Jane Lindsey.
- The beneficiaries who stood to inherit the ranch argued they were misled to believe Lesey was running out of money and needed to liquidate the ranch to cover the growing costs of her care. In reality, Lesey had around $1.4 million in marketable securities at her disposal. The beneficiaries who owned shares in the ranch argued they would not have agreed to sell if they did not believe it necessary to support Lesey.
- The court weighed benefits in the facts at hand to finding a cause of action for the tortious interference with an inheritance right versus the negatives of enlarging the body of Texas tort law and determined that they should not do so. The court stated that the law provided an adequate remedy in this case, the beneficiaries simply were unsuccessful in fully attaining it. Thus, the court appears to have left open the possibility of recognizing a cause of action for interference with inheritance rights if the remedy under other available causes of actions were not adequate.

Probate: Inheritance Right Interference - 3

Many questions:

- It is curious that the possible gap in the planning and documents did not receive more attention.
- Counsel should endeavor to stress-test dispositive schemes to identify what actions might alter the plan or undermine the testator's objectives. Perhaps the revocable trust dispositive provisions could have been more carefully crafted to have addressed this result.
- If Lesey needed funds and the sale of the ranch would have materially affected the dispositive results, perhaps a loan against the ranch may have funded lifestyle expenses (had that really been necessary) while preserving the dispositive scheme.

Recent Developments with Practical Estate Planning Implications to Advisers

Rev. Proc. 2016-49

(HZ)

Rev. Proc. 2016-49 - 1

- Before “portability” the IRS issued a ruling meant to help taxpayers. Rev. Proc. 2001-38, 2001-24 I.R.B. 1335, provided a procedure by which the IRS will disregard and treat as a nullity for federal estate, gift, and generation-skipping transfer tax purposes, a QTIP election made in cases where the election was not necessary to reduce the estate tax liability to zero.
- This was used in situations where the QTIP election was wasteful and IRS in ruling agreed to make the QTIP election void. But years later when portability was enacted, you would want a QTIP election in those same situations. Some practitioners were concerned that this would create a problem.

Rev. Proc. 2016-49 - 2

- This was addressed in Rev. Proc. 2016-49, where the IRS approved the use of a QTIP to assure portability.
- The executor of an estate electing portability of the decedent's unused applicable exclusion amount (DSUE) may wish to make a QTIP election without regard to whether the QTIP election is necessary to reduce the estate tax liability to zero.

Recent Developments with Practical Estate Planning Implications to Advisers

2704 Proposed Regulations

2704 Proposed Regs

- President Trump's Executive Order 13789 directed the Treasury to reduce tax regulatory burdens. The Treasury drew up a list, which was included in Notice 2017-38.
- This notice includes eight proposed and temporary regulations that might be eliminated.
- Number four on this list is the proposed regulations under Internal Revenue Section 2704.

Recent Developments with Practical Estate Planning Implications to Advisers

Same Sex Marriage: Notice 2017-15 (HZ)

Same Sex Marriage - 1

- After Windsor tax guidance was provided in Revenue Ruling 2013-17 and Treas. Reg. §301.7701-18. These both acknowledged the legal concept of retroactivity.
- Additional clarification was provided on January 17, 2017 with the issuance of Notice 2017-15.
- This new Notice provides procedures to recalculate the remaining applicable exclusion and remaining GST exemption to the extent that an allocation of that exclusion or exemption was made to certain transfers pre-Windsor, while the taxpayer was married to a person of the same sex.
- The objective is to restore exemption that should not have been used because the transfer was really to a spouse. But does the Notice really accomplish this intended purpose?

Same Sex Marriage - 2

- Same-sex couples that made prior taxable transfers should recalculate their appropriate gift exemption, DSUE and GST exemption and file amended returns.
- Taxpayers seeking relief under Notice 2017-15 must attach a statement supporting the claim for the marital deduction and detailing the recalculation of the taxpayer's remaining applicable exclusion amount as directed in forms and instructions issued by the IRS.
- The Form 706 or 709 used to recalculate exclusion or GST should include the statement "‘FILED PURSUANT TO NOTICE 2017-15" and statements described in the Notice.

Same Sex Marriage - 3

- Taxpayers may have used exemption, or even paid gift tax, on transfers to a same-sex spouse made pre-Windsor that now post-Windsor would should not have been done. If the limitations period has expired, the taxpayer can recalculate the taxpayer's remaining gift and estate tax exemption as a result of the recognition of the taxpayer's same-sex marriage. No credit or refund of the tax paid on the marital gift can be given after the expiration of the period for credit or refund.
- If qualification would require a qualified domestic trust (QDOT), or reverse QTIP election, the taxpayers must request 9100 relief to make such an election.

Same Sex Marriage - 4

- Same sex couples were not allowed to determine the generation assignments for GST tax purposes based on a familial relationship with the same sex spouse rather than on age. Now post Windsor they can.
- A taxpayer is also permitted to reduce GST exemption allocated to transfers that were made to or for the benefit of transferees whose generation assignment is changed because of the Windsor decision.

Conclusion and Additional Information

Conclusion

Conclusion

- While many are focused on the repeal issue that would obviously have a profound impact on estate planning there are numerous developments in 2017 that practitioners must be aware of. This presentation has reviewed only a few of them.

Additional information

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