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

Date: 01-Dec-16

From: Steve Leimberg's Estate Planning Newsletter

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Marty Shenkman

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

1. **9A – Mitchell Gans (Presented by others) – Fidelity-Philadelphia Case**.
    a. Installment Sales.
        i. Must navigate between 2036 and 2072.
        ii. 2036 would cause all assets into the client's estate.
            1. 4 elements.
                a. Transfer.
                b. Retention of an interest in the trust – string.
                    i. 2036(a)(1) triggered if transferor retains the right to income or possession or enjoyment of the transferred property.
                    ii. 2036(a)(2) right to determine the identity of the person who enjoys the income or possession of the property. This can only apply if the transferor retains a legally enforceable right.
                c. Retention of the interest for life.
                d. Bona fide exception doesn't apply.
        iii. If instead 2072 is applicable then a gift would be deemed made on the initial transfer.
            1. The IRS argued that a note sale was really a failed GRAT. Estate of Woebling v. Commr. Tax Court Docket 30260-13
    b. Related party sales.
        i. These include installment sales to grantor trusts.
        ii. The key test is the "reality of sale." This will be discussed throughout this outline.
        iii. IRS applies a substance over form argument on intra-family transactions.
        iv. IRS in attacking an intra-family or related party sale transaction will endeavor to treat the transaction as if it was a transfer to a trust with a retained interest and then apply IRC Sec. 2036 to argue for estate inclusion under a string theory.
        v. Many of the cases on note sale and other intra-family transactions provide a road map of what not to do in planning and administering these transactions.
    c. Paradigm – Sale to an unrelated third party.
        i. The approach to use in planning and implementing related party sale transactions is as if the transaction were a sale to an unrelated third party, not a related party or family trust.
        ii. IRC Sec. 2704 disregarded restrictions.
        iii. IRC Sec. 2036 strings held at death.
        iv. The transaction should have and corroborate an independent business purpose.

d. Wandry clause.
   i. The adjustment is based on values as finally determined for gift tax purposes.
   ii. If the construct to be used is a sale to an unrelated third party, the language of a Wandry clause requiring an adjustment solely for final values as determine for gift tax purposes seems to contradict the independent business purpose that the transaction should have.
   iii. What if the adjustment mechanism operated for other than just a change in value for gift tax purposes? Would that imbue more reality into the transaction? What if the clause/mechanism were invoked in the event of mistake or error? For example, should or could the price be changed if the price for each share/unit were determined to be wrong?
   iv. Note that the IRS is again challenging the Wandry approach in another court case.
e. IRS disregards sale transaction.
   i. The IRS can disregard the sale to a grantor trust as not constituting a "real" sale.
   ii. This would result in the FMV of the asset sold being included in the grantor/seller's estate.
   iii. If this occurs it may be possible that the interest included in the grantor/seller's estate is still discounted, e.g. stock in a closely held business or FLP interests. This can only occur if the sale is disregarded, but the entity whose interests were sold is not disregarded.
   iv. If the IRS succeeds in a challenge to disregard the sale the freeze portion of the transaction may fail but the discount portion may remain as that requires a separate line of attack.
f. IRS Disregards both Sale and Entity.
   i. This is a second theory on which the IRS may challenge a transaction.
   ii. If the IRS succeeds in challenging the entity as well as the sale, then the underlying entity assets may be included in the estate. This would eliminate all discounts.
   iii. **Comment**: Note that IRS 2704 proposed regulations when finalized, and depending on their terms, might reduce or eliminate the discounts regardless.
   iv. This results in including the underlying assets in the grantor's estate and ignoring the structure used (in addition to the sale above).
g. Pierre Case.
   i. Pierre v. Commissioner, T.C. Memo. 2010-106 (5/13/10) ("Pierre II"); Pierre v. Commissioner, 133 T.C. No. 2 (2009) ("Pierre I").
   ii. This case involved an LLC that was disregarded for income tax purposes but which was respected as valid under state law
   iii. Since the LLC was a valid respected entity under state law the LLC should be respected even if the grantor owned 100% and it was disregarded for tax purposes. State law restrictions on the entity still exist.
   iv. Bosch case says that you have to look at state law rights. Commissioner v. Estate of Bosch, 387 U.S. 456 (1967).

h. Beyer case.
    i. Estate of Beyer v. Comr., TC Memo 2016-183.
    ii. The case involved an installment sale of FLP interests to a grantor trust.
    iii. There were payments made for the taxpayer's personal expenses and for taxes to be paid by the taxpayer.
    iv. So the taxpayer wants the IRS to respect the structure/entity and the sale but the entity and structure were ignored by the taxpayer in paying personal expenses.
    v. What is the impact of the taxpayer's/grantor's child testifying that had the parent required resources they would have been extracted from the structure (entity and/or trust) to provide the parent with those resources?
    vi. All of this suggests an implied understanding exists which could undermine the sale and/or entity/structure.
    vii. In light of these bad facts the IRS disregarded the sale and the entity/FLP.
    viii. **<u>Comment</u>**: See the points made in so many presentations noted in this outline (Day One as well as Day Two) as to the importance of properly funding and operating entities, trusts, sales, etc. That seems to almost be the mantra of this year's institute.

i. Holliday Case.
    i. Holliday v. Comr., TC Memo 2016-51.
    ii. This case was a cleaner version of a note sale transaction then was the Byer case discussed above.
    iii. The Court did not find an explicit understanding between the family members/parties as to the use of fuds/assets.
    iv. Instead an implicit arrangement suggesting an implied agreement was inferred based on the facts and circumstances involved resulting in IRC Sec. 2036 strings.

j. Negate the implied understanding attack.
    i. Transactions should be planned, implemented and operated in a manner that negates the risks of the IRS or a court finding an implied understanding.
    ii. Does the grantor/seller/parent have sufficient retained resources to meet his or her needs so that he or she does not have to access assets inside the entity or structure?
    iii. Have forecasts completed by the CPA/wealth manager to support this.
    iv. Stone Case – TC Memo. In the Stone case the CPA had completed an analysis that corroborated that the parent had sufficient resources.

k. Grantor trust.
    i. What are the implications of a disregarded grantor trust?
    ii. If a grantor trust owns all interests in a general partnership and the client owns all limited partnership interests, is the limited partnership respected as a limited partnership? Or instead, if the grantor trust is disregarded is it treated as if the grantor/client owns both the GP and LP interests so that the FLP itself is disregarded? Does this destroy the integrity of the FLP?

iii. Consider the Bosch and Pierre case cases. The FLP should still be recognized because the fact that the grantor trust still has validity under state law.

l. More to worry about.
   i. There is a footnote in Beyer that although dicta, may provide an insight into the direction the IRS and perhaps the court might move.
   ii. The court in Beyer indicted that they have reservations about the assumption that since the entity is ignored for federal tax purposes whether in fact it should have two or more partners/members to be respected. In effect the court was saying it would like to ignore the holding in Pierre.

m. Does this misapply Rev. Rul. 85-13?

n. IRC Sec. 2036
   i. Requires several elements.
   ii. There must be a transfer and a retained interest.
   iii. Must retain the interest for the requisite time period.
   iv. The exceptions must not apply.

o. Fidelity-Philadelphia case.
   i. Fidelity-Philadelphia Trust Co. v. Smith, 356 US 274 (1958).
   ii. The case involved an annuity transaction.
   iii. The Supreme Court held that the 2036(a) strings could be avoided if:
      1. The transfer was not made in contemplation of death.
      2. Property was transferred to another in exchange for a promise to pay an annuity for life. The size of the payments is not determined by the income from the transferred property at the time the payments are made. The payments were not income from the property sold so that did not serve to bring the assets back into the estate.
      3. The promise is a personal obligation of the transferee.
      4. There is a bona fide sale with negotiation and agreement between two parties. Each party uses his own property to provide consideration to the other in exchange for the property interest to be received.

p. Conclusions/Recommendations on bona fide intra-family sale.
   i. What do you look for if you want a bona fide sale?
   ii. Will a guarantee help? Yes.
      1. Estate of Trombetta v. Commr., TC Memo. 2013-234.
      2. Decedent's children had guaranteed the annuity.
      3. This was a basis to defeat the argument of a retained string.
      4. If the guarantee is not credit worthy the guarantee will have no benefit. Estate of Fabric v. Commr., 83 TC No. 50 (1984).
      5. Document that the guarantor has sufficient creditworthiness.
   iii. What assets does the buyer have that will be collateral?
   iv. Will the buyer be able to make the payments as they become due?
   v. If the buyer has a problem will there be other assets available to cover the required payments?

vi. The note itself can be an IRC Sec. 2036 string.
vii. Relying on the assets to pay the note, is that a string?
viii. Need both funding and security.
ix. Rev. Rul. 77-193, 1977-1 CB 273.
    1. Decedent sold property to a corporation in exchange for an instalment note and died while the note was still outstanding. No 2036 string was found.
x. What steps should you take to support a real sale?
xi. Contribute seed money before the sale occurs. Endeavor to contribute seed gift sufficiently in advance to avoid a step transaction challenge.
xii. Use separate counsel.
xiii. Do you want or need an old and cold trust?
xiv. Complete a financial analysis.
xv. Need a real sale. Bona fide sale exception.

q. Sale of note.
    i. If note is sold does that solve the issue/risk?
    ii. Downside of a sale of the note is the Allen case

2. **<u>10B Glazier - Attorney Client Privilege</u>**.
    a. Rules of profession responsibility direct us to protect our client's confidences.
        i. What happens if litigation ensues post-death regarding the validity of a dispositive instrument?
        ii. While attorney must generally not reveal client privileges without consent the ethical duty is not as well defined post-death.
    b. Example.
        i. Long term client.
        ii. What happens if later in life client's capacity and health decline
        iii. New person comes into client's life and encourages them to revisit estate plan.
        iv. Client comes back and revisits plan.
        v. Client is not as sharp as they had been.
        vi. Does the client have sufficient capacity to execute?
        vii. Attorney must exercise independent judgement.
        viii. Perhaps consider having a psychological assessment done.
        ix. Then client does not return to you to complete the estate plan and a new attorney with none of the background you have does a new plan.
        x. Can you testify as to what you knew?
        xi. Are prior documents you drafted admissible in a later will or trust confidence. Might not just be will or trust, could be a deed, bank account title change documents and so forth.
    c. Discussion of example.
        i. Rules of professional responsibility differ in some instances from the attorney client privilege.
        ii. From an ethical perspective the obligation to maintain confidences extends to a broader class of communications than those covered by the attorney client privilege.

iii. See ABA Model Rules of Professional Conduct Rule 1.6 “Confidentiality of Information”
iv. There are conflicts between ethical duty to client and the attorney client privilege which is smaller than the ethical duty. It is an evidentiary edifice.
v. “What’s in my file is privileged.” It might be privileged, it might be work product, but there still may be issues.
vi. Attorney’s testimony is key to the hypothetical case described above.
vii. In a lack of capacity or undue influence case the attorney’s testimony can be extremely important o the outcome of the case. But the testimony you can provide, and the extent to which your file will be discoverable, may vary from state to state and be fact dependent.
viii. A trust officer, CPA or financial adviser, these issues may be relevant as well as if they acted as agent for an estate planning client and were part of conveyance of information to estate planning attorney so critical documents can be prepared the privilege may apply to these advisers as well.

d. What is privilege?
   i. It is an edifice intended to protect confidential communications.
   ii. It is the oldest of testimonial privileges.
   iii. The privilege originally belonged to the attorney and attorney had taken oath to keep confidences of clients and should not be required to break that.
   iv. The law has evolved.
   v. The law is supposed to be a search for the truth which outweighs the oath.
   vi. Attorney may have to go to court have an order of contempt issued to get case on point as to whether you are committed to disclose something client disclosed or whether you can produce your file.

e. Where do you get answers to define privilege.
   i. Some states have statutes on point.
   ii. Some states have rules of evidence that specifically addresses when have a claim through not against the decedent the privilege may not apply post-death for items communicated to attorney about client wishes.
   iii. Common law addresses these issues, but it is a patchwork.
   iv. Rule of evidence 501 for uniform rule of evidence states
   v. Rule of evidence 502(d) for uniform laws annotated states.
   vi. Majority of states have not adopted uniform laws.

f. You’ve been subpoenaed what do you do?
   i. You cannot just give over file and testify if the information is privileged as you will be in breach of your duty to your client.
   ii. Attorney may be defending instrument you drafted and want to disclose.
   iii. First analyze whether the privilege even applies.
   iv. If the privilege applies is there an exception to the privilege?
   v. If no exception look at facts. Has it been explicitly or implicitly waived. Post-death you might have waiver.
   vi. This is important. Undue influence cases are circumstantial so that there is broad discovery.

g. Privileged.
    i. Privilege is narrow as it is an exception to the general rule of liberal discovery.
    ii. Have to claim privilege before showing up for deposition.
    iii. Must prepare a privilege log and identify subject matter of communication you are claiming is privileged so court can determine if it is privileged.
    iv. The items you identify may be work product, but they may not necessarily be privileged.
h. Items that are not generally considered privileged.
    i. Clients name.
    ii. Appearance. “In the past had been dressed to the nines. That day looked disheveled.”
    iii. Handwriting. Example: “She could barely write her name that day. Very shaky.”
    iv. Facts are not privileged: “I received a subpoena.” “ I recorded a deed.” “I have a bank account and here is a statement.” Facts are not necessarily privileged.
    v. Subject matter of communications.
    vi. Attorney notes and observations.
    vii. Draft documented intend for public disclosure.
    viii. Documents delivered to third parties.
    ix. Documents which in the hands of the client would not be privileged. They may still be subject to attorney client ethical obligations but in litigation mode they may not be privileged.
    x. Observations by and communications to the attorney when acting as a witness. When you witness document you are not rendering legal advice so things you witness may not be privileged.
    xi. Communications to the attorney for other than obtaining legal ad vice.
    xii. Communications in the presences of third parties. There may be an exception for joint clients, e.g., husband and wife.
    xiii. Invoices (gray area). May be communication to client.
        1. There as a claim of undue influence in May in Illinois against the attorney pushing the client to make a charitable gift to a charity the attorney was involved in. The statements had to be produced and were not considered privilege.
i. Confidences cannot be apportioned.
    i. Once the privilege is waived regarding the execution of a testamentary instrumental communications relating to the preparation execution and subject matter of the instrument may no longer be privileged.
j. Since the privilege survives death how can it be waived?
    i. Common law or implied waiver.
    ii. Witness to execution.
    iii. When the claim is through as opposed to against the decedent.
    iv. Explicit or express waiver by client or executor? Statutory or rule of evidence but this varies from state to state.

v. End up if client to did not give consent to disclose information court may imply waiver.
vi. If you are a witness some courts say it is an express waiver, some say it is an implied waiver, but there is an exception.
vii. The claim that is under or through the decedent is generally is implied.

k. Waiver due to use of attorney as witness.
    i. Courts don't like attorney using privilege as both a sword and shield.
    ii. Some courts consider this to constituent an express waiver as opposed to an implicit waiver because the attorney now also holds the status of a witness.
    iii. This may or may not abrogate considerations of whether a claim is against or through the estate.
    iv. Brown v. Edwards (Indiana). Reciprocal wills for husband and wife. Surviving wife did not wish to retain testamentary plan after husband died. Attorney drafted documents for both of them. Privilege would apply. In Indiana the attorney can testify but that is not true everywhere. Brown v Edwards, 640 N.E.2d 401, 404 (Ind. App. 1st Dist. 1994).

l. Implied waiver theories.
    i. Clients want attorney to uphold estate plan. Attorney has best evidence of what client wants but it is not always allowed.
    ii. Through versus against.
    iii. Through: Claims of an heir or devisee of lack of capacity, undue influence, lost will or under or to set aside a deed of gift.
    iv. Against: An heir, devisee or third party claiming a breach of contract to make a will, compensation for services rendered, or to create constructive trust (this is a remedy not an actual claim).

m. Is the privilege substantive or procedural?
    i. Client signed later will with another attorney.
    ii. Is the privilege procedural? If so look to rules in jurisdiction where litigation is pending. Mobile society – this may not be where documents were created or executed.
    iii. If privilege is substantive in nature, if client contrasted with attorney concerning release of information,
    iv. Conflict of law issue can be complex. Cannot determine in advance what jurisdiction may control.
    v. Facts are critical.
    vi. Obtain explicit written waivers during the course of your representation and discuss the implications with your client.
    vii. Seek guidance – obtain a court order.
    viii. Carefully tailor discover requests.
    ix. In response to a request remember you will need to prepare a privilege log.
    x. Consider the possible implications of electronic communication.
    xi. Go to court and get an order for instructions as to what you can produce, what you can testify for, etc.

xii. In Maryland court held that prior plans are best indicator. If suddenly there is a significant deviation the prior plans and the rationale for the prior plans is important to determine the natural disposition.
xiii. Connecticut permitted testimony even as to unexecuted documents.
xiv. Sometimes various items are related, once you open the door.
xv. North Dakota case decedent taken 300 mile trip to meet new estate planning attorney and execute new documents. The beneficiary found the attorney. Court held door should be wide open for testimony.
xvi. Indiana case Gast v. Hall, 858 N.E.2d 154 (Ind. Ct. App. 2006).

3. **11B – Borowsky and Wallenfelsz – Spendthrift Trusts in Divorce**.
   a. Significantly divergent views of trusts in divorce.
   b. Example from Pfannenstiehl v. Pfannenstiehl, SJC-12031 (Mass. Sup. Jud. Ct. Aug.).
      i. Pot trust for kids and grandkids set up for years into marriage. Years later distributions start. Years later divorce.
      ii. Trustees turned off trust.
      iii. Is trust a marital asset?
      iv. Court said cut off of distributions to husband on eve of divorce was a manipulation. Record provides telling evidence that the spendthrift provision is invoked to masked husband's interests.
      v. Trustee shall pay amounts which trustee may in its sole discretion may deem advisable to pay for welfare etc. of members of class. Family court agreed with wife that this was an enforceable property right. Appellate court affirmed but then Mass. Supreme court reversed by concluding it was a discretionary trust and husband = Kurt could not compel the court to make a distribution. This was a single pot trust for 11 beneficiaries with an open class (for Settlors living issue so class could grow). Court was not willing to consider trust "spigot" being cut off but did speak of garnishing distributions.
      vi. **Comments**: Following are some lessons to learn from the Pfannenstiehl case.
         1. The trustees should not have ceased regular distributions on the eve of filing for divorce (ideally there should never have been regular distributions). The change emphasized the implied agreement that had to have existed between the trustees, the husband/beneficiary's brother and the family lawyer, and the husband/beneficiary. It would be preferable that trusts not make regular distributions. It might be possible to accomplish the beneficiary's financial goals by making less frequent distributions of varying amounts to break the implication of a regular periodic distribution. When cash flow is needed loans can be mixed into the equation to further break up the regularity of distributions. Another approach to reduce the risk of ongoing distributions is to have the trust buy and hold personal use assets. So, for example, instead of making distributions to in part support payments of a monthly mortgage the trust could purchase the house (or other personal use

assets). There are a number of ways to minimize the creation of regular distributions. All of these however require more proactive professional involvement in trust administration. If the trust has a support standard recommend that the trust be modified into a discretionary trust.

2. The fact that a trust has been in existence for a number of years before the divorce may not suffice to exclude that trust from the marital estate. Clients need to understand that risks may exist and be encouraged to take actions to address other risk points of even old trusts.
3. Traditionally irrevocable trusts have been viewed as immutable. However, in recent years the concept of decanting, merging an existing trust into a new trust with new administrative provisions, has taken hold. More than 20 states have enacted legislation permitting decanting. In fact, even a trust formed in a jurisdiction without a decanting provision can utilize a statute in another state to decant. Rather than accepting irrevocable trust terms as they exist practitioners should explore the possibility of decanting the trust into a more favorable trust structure. If the Pfannenstiehl trust had been decanted into a discretionary trust (and been operated that manner) the result may have been different. When planning a trust decanting consideration should be given to whether the process can be undertaken without involvement of the beneficiary who is concerned about divorce. In many instances the trustee or a trust protector may be able to effectuate the decanting. Keeping the beneficiary/client out of the process may deflect to some degree a later challenge that the decanting was pre-divorce planning.
4. Having a class of beneficiaries to which distributions can be made is preferable to having just one beneficiary. It should be more difficult for a court to attribute trust assets or income to one of many different beneficiaries. Although there were 11 beneficiaries in Pfannenstiehl (and the class remained open), the lower court nonetheless held that 1/11th of the trust was attributable to the husband/beneficiary. Likely the negative facts discussed above were a motivator for the court's action. While having multiple beneficiaries was not determinative in the lower court holding in Pfannenstiehl that should not dissuade practitioners from encouraging clients still using that approach.
5. Use a true independent trustee, such as a corporate trustee is recommended. The court in Pfannenstiehl viewed the brother and family lawyer as simply carrying out family wishes as to distributions, or the cessation of distributions on the eve of divorce. Using an independent institutional trustee can obviate those issues. Also, using an institutional trustee should provide for more experienced and professional trust administration that might have avoided some of the issues in Pfannenstiehl.

6. Form the trust from inception in a divorce trust friendly jurisdiction, e.g., Nevada or South Dakota. If the trust is in a jurisdiction whose law may be less favorable, e.g. Massachusetts (and after Kloiber some commentators suggest even Delaware is not as "friendly" as others may have thought), evaluate whether a change of situs could be completed. This may not require a decanting and, depending on the terms of the trust, it may be feasible for a trust protector to effectuate this change.

c. Gifts.
   i. Courts in Illinois will look at gifts and considered in income column. Court considered annual exclusion gifts since found long history of distributions. Court even said if gifts stop court might reduce amount.
   ii. This is at most an expectancy. How can court consider?
   iii. Courts are trying to look at practical reality.

d. Lessons of Pfannenstiehl.
   i. Even if court concludes it is not marital property can still opt to consider it. Court remanded saying it could be taken into account and used to determine equitable distribution. This is where many court decrees come out: treat as resource available to beneficiary even if not marital, but issue remains as to what degree it is considered.
   ii. What should support obligation be? Consider distributions from trust in considering support obligations. Court may determine that this is appropriate. Court may award legal fees which can be significant. Beneficiary spouse said "I don't have the money to pay the fees." Court said "go ask the trustee." The court order required that husband had to make a request for a distribution and threatened to hold him in contempt if he did not ask for the distribution. What does trustee do with such a court order?

e. Fundamentals of divorce law as it pertains to trust planning.
   i. Divorce court is trying to divide assets and property, whatever represents an economic interest.
   ii. Categorization of property as marital or separate property (i.e., not marital property).
   iii. For the marital property the court will divide that marital property. Under most jurisdictions are equitable distributions. What is fair and equitable, not necessarily 50/50 but what the court deems equitable.
   iv. Many factors are considered in making equitable distribution, such as other assets. Courts also look at arguments for or against, support, alimony and maintenance. They look at income, assets and resources. So regardless of whether assets are marital or not all may be looked at.
   v. Legal fees are considered. Courts have discretion as to award of legal fees. One party might be required to pay all legal fees.

f. Trust interests.
   i. A current or future interest in a trust may be defined by some courts as a marital asset. Divorce courts do not look at this the same way.
   ii. How does marital asset get allocated between spouses.

iii. Spouse who is beneficiary may be awarded the trust “asset” but other assets may thereby end up in the other spouses’ “column.”

iv. Indiana says gifted and inherited property are not marital assets but if commingled can become a marital asset. If parent gives gift outright and child/donee deposit in marital account it is commingled and may thereby become a marital assets. This can happen in a trust context.

v. Hardship exception is recognized in some states. If trust interest were a non-marital interest but thereby create a hardship the court can call it a marital asset and then divide it.

vi. Why can a trust interest be classified as a marital asset? One reason could be parties’ use of trust assets during the marriage. Courts will look at what interests the parties got to enjoy during the marriage. If parties enjoyed benefit of trust closing those trust doors before divorce “does not go over well.”

vii. Many professionals say courts view trusts “with suspicion” and some as a place “to hide money.”

viii. To the extent to which the beneficiary has a property interest in the trust. How open or reachable is the interest?

ix. Woods case.

    1. trust created fbo wife. Distribution to wife to help her purchase the marital residence. When the couple divorced the court said the property was a marital asset. That was so even though source was gift property from trust.
    2. Funds loaned to husband and wife out of wife’s trust to purchase a home were held not to be marital debts; the home purchased with a loan from the trust (but not the third-party trust) was treated by the trial court as marital property and this ruling was not challenged. Woods v. Woods, 788 N.E.2d 897 (Ind. Ct. App. 2003).

x. Case study: Trust purchased house, entered lease agreement with child/spouse living there and rent was real estate taxes only and child/tenant had to pay expenses. There were times they could not pay the “rent,” so dad paid, some rental payments missed, one year lease was never renewed. The house was the biggest asset and subject to challenge in divorce. Daughter’s matrimonial counsel claimed it was not her house rather trust owned it. Trust drafted under Illinois law but house and divorce were in California. California court said it had jurisdiction over trustee who was renting property in CA. CA court said it was a marital asset even though owned by trust because the couple enjoyed the use of it. Now that trust was “tainted” by a house that was marital asset was the rest of the trust also tainted? Had this more like a third party lease the situation may have been different. Hard to get clients in a family situation to do so.

xi. Case study: Family business interests are also given. If put into a trust and child/beneficiary is working and active in the business and child’s actions caused the appreciation of the asset that appreciation is a marital asset since it is the contribution of a spouse during the marriage. Salary and compensation to child out of business may not be commensurate to the work done.

xii. Court will look at trust agreement to see extent to which trust should be treated as a marital assets. If no spendthrift clause that may favor treatment as a marital asset. Also courts consider access and control the beneficiary has over trust property. Opposite (preferable) is if trust has a mere expectancy. When there is an ascertainable standard, or HEMS, it is "muddled." The trustee shall make payments for HEMS then the beneficiary has the right to compel the trustee to comply with the standard. Courts therefore may look at this right as an enforceable property right.

g. Power of appointment held by third party seems to be "bullet proof."
    i. Courts have held that divorcing child's parent can appoint the property away from the child prevents it from being treated as a martial asset.
    ii. Consider powers of appointment as a planning idea.

h. Divorce finalized and beneficiary of trust fails to pay.
    i. What are remedies?
    ii. Spendthrift clause is protective against general creditors but not exception creditors which depending on state law including spouse, former spouse and children/child support.
    iii. Court can garnish mandatory distributions.
    iv. For support trust creditor spouse may be able to get order requiring trustee to comply with support standard.
    v. For a discretionary trust can impose garnishment order but cannot compel distribution and only applies if distribution made.
    vi. If there I an abuse of discretion and can show trustee abused discretion, the creditor spouse may be able to compel a distribution.
    vii. Illinois has strict statute against third party trust: "no court except as otherwise provided in section shall order satisfaction of judgement out of trust if such trust has been created from a person other than the judgement debtor. A third party spendthrift trust should succeed. Illinois has only exception for unpaid child support, i.e., arrears in child support. There is some case law to suggest that perhaps a distribution from a trust can be attached but case law is murky. So even if a court says a trust is a marital asset how can that court reach trust assets? Practical difficulty. This creates a situation where trust will make no distributions, or first make distributions to pay these off.

i. FL case - Berlinger v. Casselberry, 2013 WL 6212023 (Fl. Dist. Ct. App. 2013).
    i. Third party spendthrift discretionary trust. Husband had to pay permanent alimony. Husband decided to stop paying alimony to former wife following remarriage.
    ii. The trustee was a step ahead and instead of making payments to beneficiary gave beneficiary credit card to use. Court went into some detail and found this arrangement quite offensive. It was hard to attach credit card bill payments. So court entered continued writ of garnishment over any distributions that trustee makes. This would include paying credit cards. So first would have to pay alimony and then come back to ask court

permission to pay beneficiary. So court did not have to pierce the trust just made it inaccessible to beneficiary.

j. Drafting suggestions.
   i. Use fully discretionary distribution standard. Don't use HEMS but often beneficiaries want to be trustee so you have no choice. Consider not making beneficiary a trustee and removing HEMS standard.
   ii. Always use the word "may" not "shall" so it is not an enforceable property right.
   iii. Use language of trustee acting in "sole and absolute discretion" to avoid imputation of a reasonableness standard. Sole and absolute suggests deference to trustees discretion
   iv. Require trustee to consider beneficiary's outside resources. If you have a reference to outside resources the professional trustee will want a net worth statement and tax returns to get a distribution and this can be frustrating for the beneficiary.
   v. Who should be the trustee? Often the beneficiary wants to be a trustee. Can do this with HEMS standard but in matrimonial "world" this can be problematic. Even using a family member can be problematic. In Pfannenstiehl family attorney was found not to be acting independent and brother was not viewed as independent. Best to name an independent trustee. If a divorce is pending have interested trustee be removed or resign.
   vi. Tweak the spendthrift clause. Say that the beneficiary cannot alienate property voluntarily or involuntarily. Add that it should suffice to deflect claims of spouse or former spouse. Add that beneficiary cannot compel distributions. All of these additions will corroborate grantor intent.
   vii. Put in third party powers, e.g., death of surviving spouse the power to appoint using a testamentary power of appointment that could defeat rights of child going through divorce.
   viii. Give trust protector the right to grant a power so you can toggle it on. This is similar to what might be used in basis planning.
   ix. Silent trust is a trust where the duty to disclose to a beneficiary is turned off. If represent the parents of a potentially divorcing child that the trustee should not disclose to beneficiary that the beneficiary has a trust.

k. Prenuptial agreements.
   i. Can be effective to insulate assets from being part of the marital estate.
   ii. Draft trust agreement with generous distributions to beneficiary but all are contingent on beneficiary's spouse signing a waiver to the trust.
   iii. Another variation include in trust agreement whether to decide whether he or she wats prenuptial agreement but if there is no prenuptial agreement distributions will be delayed. If valid prenup can make distributions at age 30 if no valid prenup no distributions until age 50.

l. Administrative considerations.
   i. Used when there is a sense that the marriage is in trouble.
   ii. A significant factor for many courts is the history of distributions. If trust doors are open and benefits are conferred and then the door is shut just

before the divorce. Closing the door may not be effective and may only anger the courts.

iii. Instead of regular systematic distributions use intermittent or for extraordinary expenses not for routine living expenses.
iv. Have beneficiary make a formal written request for a distribution so that there is a formality and it is not appear like an automatic or regular distribution. If trustee has documented a "no" to distributions this will look better.
v. Try to delay distributions.

m. Court Intervention.
   i. Many trusts are drafted under laws of State "A" but beneficiaries live in State "B" and it is court in State "B" that hears divorce.
   ii. Dahl v. Dahl, 345 P.3d 566 (Utah 2015).
      1. and settled a Nevada trust under Nevada law and wife's claim was trust was revocable on theory that since revocable it was marital property. The Utah court had to construe terms of the trust. There was no indication that the parties tried to have Nevada court construe terms of Nevada trust. Utah court held that the trust was revocable. Trust agreement said: "Settlor reserves any power to alter and amend…" It might have been meant to say settlor preserves "no power" but as a scriveners error said "any power." This result was not obtained and instead Utah Supreme Court held trust was revocable which effectively meant it was marital property.
   iii. IMO Daniel Kloiber Dynasty Trust U/A/D December 20, 2002, C.A. No. 9685-VCL (Aug. 6, 2014).
      1. Trust under DE law and parties from KY. When divorced KY court got involved in matters of trust administration. Corporate trustee in DE asked DE court to assert jurisdiction over trust.

n. Settlement.
   i. Is there a settlement possible?
   ii. Case law suggests that the trustee could spend a lot of money to defend against divorce court decree, etc. A lot of trust assets can be dissipated in defending these claims.
   iii. Even if divorce court won't look into trust assets, might have situation where court will look at trust and assets and resources and leave a beneficiary that was well off and now has little post-divorce and will become depending post-divorce on distribution.
   iv. Is there a way to forestall all of these expenditures? Taking a hard line that the trust is spendthrift and not considering options may not be in the best interests of the trust. There may be provisions in the trust to creatively address the divorce.
   v. Can beneficiary disclaim and pass trust assets on to the next generation?
   vi. Disclaimers can be useful.
   vii. Might a trust modification be useful?

viii. Don't have child/beneficiary resign as trustee in the midst of the divorce. In Kloiber husband resigned in divorce as special trustee and KY court ordered him to jail.

ix. Settlement agreement. Beneficiary may not be able to assign interest in trust but might be able to have an agreement as to a garnishment order that funds child support and alimony and then can make further distributions that are above the agreed garnishment amounts. This might be preferable that having judgement go through. This saved substantial trust resources in fighting the divorce.

4. **<u>12B – Shenkman – Religious Considerations in Estate and Ancillary Planning</u>**.
    a. Introduction
        i. Showing sensitivity to a client's religious concerns should be an integral component of estate planning. Religious goals can be achieved by integrating a client's religious concerns into the drafting of many common legal documents. Addressing the myriad religious, philosophical, cultural, and related issues in practice is not only beneficial to those clients for whom this is important, but can be intellectually rewarding and may lead to a deeper relationship with the client.
    b. Selecting Fiduciaries
        i. One of the most important decisions for a client seeking to imbue estate planning documents with religious values, or to transmit a particular religious heritage to a child or other heir, is the selection of fiduciaries that have some of the following characteristics:
            1. Knowledge of the particular faith.
            2. Affiliation or observance of that faith themselves.
            3. Sensitivity to the specific needs of the heirs in light of the client's religious goals and objectives.
        ii. In many instances, the person who best fits these criteria will not be the person best suited to handle investment and other fiduciary responsibilities, so that a combination of an individual fiduciary sensitive to religious concerns and an institutional co-fiduciary may be called for. It might be possible to name the person with the religious sensitivities a trust protector and name someone who can fulfill general trustee duties as trustee.
    c. Distributions.
        i. Agents and fiduciaries might be given guidance, and granted legal authority, to disburse funds for religious education (for example, supplemental religious education or private school), religious travel (pilgrimages to holy sites), charitable giving (to inculcate core religious values in heirs), and other purposes consistent with the client's religious goals.
    d. Charitable Giving.
        i. Many religions advocate the virtues of charity, and charitable giving can be tailored to reflect the unique nuances of a particular faith. Although many religions mandate tithing a certain percentage of income or assets to charity, others provide more specific standards. Yet others, such as the

Mormon faith, while providing guidance leave much to personal discretion. For example, charitable giving is an essential part of the Baha'i Faith as it demonstrates devotion to Baha'u'llah and represents the ideal of charity. Baha'is are expected to give a certain percentage of their incomes and assets to Baha'i charitable organizations through a mandatory donation referred to as "Huququ'llah" (The Right of God).

   ii. It is common for clients who are religious to make bequests in their wills to charity, permit agents under financial powers of attorney to make charitable gifts, and perhaps include charitable beneficiaries in trusts.

e. Heroic Measures.
   i. The provision in a living will that no “heroic measures" be taken is fraught with religious implications. Apart from the definitional issues of the phrase, clients with religious sensitivities should be queried for appropriate modifications. Although some religious clients may assume that they cannot ever withdraw life support without violating their religious standards, this is not always correct. The answer is often more complex and so infused with religious nuance that practitioners should adopt the standard language provided by the client's faith. For example, the Catholic Church does not mandate that a person be kept alive no matter what. A Catholic can decide to avoid overly but not ordinary means of care. "Ordinary means" could include feeding someone, assuring they have air to breathe, and so on. The Church believes that a patient must continue to receive ordinary care; otherwise the health-care provider effectively acts to cause the patient's death. Extraordinary means go beyond this and seek to reverse a process that is already underway. Extraordinary means can be antibiotics or surgery, among others. For a Hindu, the perspective may be that one lives as long as one naturally can and then accepts the end as and when it happens. If a person has suffered severe brain damage and there is no hope of recovery, there is no basis for prolonging life by artificial means under Hindu principles.

f. Pregnancy and Medical Decisions.
   i. A pregnant woman should carefully address the issue of pregnancy in her living will because medical decision making concerning a mother and her fetus varies greatly among different religions. Generally, Catholicism proscribes taking direct action that would cause the death of the unborn child, or the mother. The life of the mother cannot be chosen over the life of the unborn child, or vice versa, because all life is sacred and the right to choose is in God's hands alone. Unless this matter is expressly addressed in a living will, no one may know the degree of the client's devotion. Health-care providers cannot be expected to have the knowledge necessary to carry out the client's wishes without clear guidance from the client. In contrast, under Jewish and Islamic law, saving the mother's life is generally given preference to that of the fetus.

g. Pain Relief.
   i. Many patients and health-care providers view the alleviation of all pain to be an essential and ideal objective. There are exceptions.

    ii. For an Orthodox Christian, the act of suffering can be an experience providing for purification, redemption, and salvation. Although suffering is clearly not encouraged, pain relief to the point of making someone unconscious during their last days may prevent them from addressing profound and moving observances essential to their religious beliefs. The customs of the Orthodox Christian Church encourage adherents to be lucid during their last days so that they may be free to confess their sins and receive Holy Communion. If the attending physicians are not aware of this, they cannot be assumed to respect and foster this type of care.
    iii. Similarly, according to Buddhist tradition, consciousness near death directly correlates to the level of rebirth. Excess pain relief could undermine this. Buddhists believe, however, that suffering is the converse of the optimal state of being. A sensitive balancing of important goals is thus required.

h. Funeral and Other Post-death Arrangements.
    i. Most religions provide for post-death customs. Under Jewish law, autopsies and embalming are generally prohibited.
    ii. In the Buddhist tradition, it is a common belief that incense should be burned near death to help provide symbolism of the path upward toward enlightenment and to guide the believer's last thoughts upward. Many Buddhists believe that for a period following death, often for a minimum of at least one week, the spirit may remain with the body and, therefore, the body should not be moved. These traditions may be impossible to carry out in a medical or health-care facility, so it could be quite important to make advance arrangements to spend one's last days at home or in a hospice sensitive to these religious beliefs.
    iii. Some religions prohibit cremation; other religions or cultures favor it. Again, these issues can be addressed in a living will, health proxy, or in some instances the client's will (for example, if burial is in a particular foreign country or under other circumstances that will create considerable cost) authorizing and directing that in the Will permits the personal representative to pay for.

i. Disposition of Assets on Death.
    i. A secular will may have to be modified to reflect the Baha'i, Jewish, Islamic, or other religious laws of inheritance.
    ii. Both the Quran and Old Testament include detailed provisions on how inheritance must be handled. Although similar, they are typically applied in quite different manners in will drafting. These provisions need to be coordinated with tax, estate, financial and succession planning, and ethical issues.
    iii. For the Orthodox Christian, if the believer does not provide for his or her family and relatives, it is as if he or she has disowned the faith and is worse than a nonbeliever.
    iv. For Catholics, general guidelines of charity and justice should be respected.

j. Dispute Resolution.

i. For all faiths, issues of a religious or spiritual nature are perhaps best resolved through mandatory arbitration before a designated religious body, not a secular court. Both Buddhism and the Baha'i Faith incorporate principles that affect how disputes should be addressed.
ii. The disinheritance of an heir, the use of in-terrorem clauses, and perhaps the use of arbitration provisions need to be evaluated. See discussion by Pennell how in terrorem clauses are rarely upheld. Consider the religious implications.
iii. The Buddhist theory of karma provides that everything done in a particular life, as well as in past lives, influences and affects future lives. Undertaking to disinherit an heir out of anger can be viewed as cremating a negative influence that may be carried on through rebirth to the next life. Buddhism advocates that believers take action out of compassion and not anger.

k. Investment Standards and Policies.
   i. The Prudent Investor Act and the investment provisions of the governing document should be tailored to permit a religious or socially oriented investment strategy, if that is appropriate for the client.

l. General Directions to Adhere to Religious Considerations.
   i. If the client is involved in a particular business desires to tailor the operations of that business to certain religious precepts, then the governing documents for that entity should include a general directive that operations should conform to those religious principles. A threshold step to address a client’s religious concerns is to add a recital clause to each relevant legal document stating the client's desire that the operation of that entity and business endeavor shall be conducted with consideration to the specific religious requirements.

m. Agreement for Family Vacation Property.
   i. When drafting a trust that will hold a family cottage, or a tenants-in-common or similar agreement governing the use and ownership of a vacation property (for example, for children of one family or for a home shared by several families), religious sensitivities may be important to address.
   ii. Case Study: Three families purchase a beach house for shared use. An agreement governing the use of the vacation home is prepared. In addition to the usual issues concerning repair and maintenance, financing, religious sensibilities can be incorporated into such an agreement.
      1. Dates of use can be rotated to consider religious holidays. Sample Clause: *Each Child's family shall have the use of the vacation home for the Christmas holiday season (which shall be deemed December 20 through and including January 4 of each year) every other year on a rotational basis.*
      2. Religious dietary restrictions can be mandated for observance in the kitchen. For a Hindu client, this might be a prohibition on any non-vegetarian foods. For Jewish clients, Kosher religious restrictions can be mandated, along with the specification of the

standard for those restrictions (Reform, Conservative, or Orthodox). For a Muslim client, Islamic dietary restrictions, such as Hallal meats only, can be mandated. Sample Clause: *The Parties acknowledge that the kitchen in the Property shall at all times be maintained as a vegetarian kitchen, and no non-vegetarian food products containing eggs, fish, meat, or any derivatives of them shall be brought into the kitchen.*

3. Property financing can be required to be structured to comply with religious restrictions against charging interest (Islamic law restrictions on riba, for example).
4. In the event that a majority in interests of the Parties determines that financing shall be necessary or advisable, any such financing shall comport in all respects with Islamic law governing the charging of interest, Riba. In the event of any dispute or disagreement concerning how said laws shall be applied, the Parties agree that a determination shall be made by [Islamic Religious Authority].
5. A dispute resolution mechanism can be included that respects religious sensibilities (for example, a provision reflective of the Baha'i faith's views on striving for consensus and harmony and a mandatory mediation clause consistent with Baha'i principles, perhaps supervised by a local or regional counsel, mandated if a consensus decision is not achieved).
6. For some clients, activities antagonistic to their religious beliefs may be prohibited in private agreements (even if comparable provisions included in documentation for an apartment building rented to the general public would violate the law). Sample Clause: *No activities shall be permitted within the Property by any of the Cotenants or their guests or families that violate the precepts and principles of the Church of Jesus Christ of Latter Day Saints. Prohibitive activities shall include by way of example and possession or use of alcoholic beverages, or illicit drugs.*
7. Governing Documents and Religious Law. In addition to a general statement or recital clause, practitioners should endeavor to modify provisions in the governing documents to incorporate religious requirements. The following illustrates a sample clause that can be included in an operating agreement for a limited liability company engaged in property management and other related real estate activities for which the Muslim members are concerned that Islamic religious principles be respected. Sample Clause: *The Manager is authorized and directed to conduct activities and investments of the Limited Liability Company ("Company"), to the extent feasible, in accordance with Islamic religious principles. Such standard may include by way of example and not limitation, a prohibition against paying or earning interest based on a prohibition of making a guaranteed profit on capital. In the event*

of any dispute as to the application of Islamic investment standards the Manager shall consult [name organization or Imam] for further clarification. If such action is not feasible, or not determinative, the Manager may consult any Islamic scholar or Imam of the Manager's choice and rely on the determination of same.

iii. Depending on the client and circumstances, the above clause may be expanded to expressly prohibit the leasing of property to certain specified types of tenants such as a bar, liquor store, adult bookstore, or other tenants that would violate the owner's faith. Addressing these concerns on the formation of the entity can avoid significant conflict at a later operational stage.

n. Dispute Resolution Adhering to Religious Law.

i. See Pennell's lecture notes about in terrorem and mandatory arbitration clauses.

ii. If a religious provision is included in any legal document give considering to having any dispute or interpretation of that clause resolved by a religious body rather than a secular court. A number of faiths raise issues with dispute resolution and may require (or prefer) all disputes be brought before an appropriate religious body. This issue may be of concern for clients who are Buddhist or Baha'i. Also, for some faiths, the client may have a preference for a clause that calls for arbitration before a private religious body, a Beth Din or Jewish court for an Orthodox Jewish client, than to leave the parties to resort to suit in a secular court. The provision may be in the form of a mandatory arbitration clause in accordance with religious standards, or before a religious body, or for some clients, a mandatory, non-- appealable religious arbitration. How this is handled can vary considerably, even within the same faith. The following provision is illustrative for a client of the Baha'i Faith:

iii. Sample Clause: *With respect to the resolution of any disputes that arise under this Operating Agreement the Members shall endeavor to resolve any such dispute in a manner consistent with the B'ahai' values of honesty, trustworthiness, compassion and justice, and in a non-adversarial manner. Any dispute shall be submitted to binding, non-appealable arbitration in [CITY NAME, STATE NAME], in accordance with the decisions or recommendations to be designated by the Local Spiritual Assembly, or its successors. The Members agree that the holding of any such Local Spiritual Assembly be non-appealable. Each clause in this provision is intended to be severable. lf any term or provision of this clause is held to be illegal or invalid for any reason whatsoever, such illegality or invalidity shall not affect the validity of the remainder of this clause. This provision shall be construed in all respects as if such invalid or unenforceable clause or portion thereof were omitted, or if feasible reformed in a manner that were enforceable with alternative terms or provisions to effectuate as closely as possible my original intention to the extent lawful and practical. This clause shall be governed* *by and construed in accordance with the laws of the State of [STATE NAME] and each Member hereunder agrees to personal juris- diction in the State of [STATE NAME] and before the Local Spiritual Assembly hereinabove specified.*

o. Interest.

   i. Jewish and Islamic tradition raises prohibitions and restrictions on the charging of interest. Although these have generally been ignored in modem commerce, they have not been entirely ignored, and for a meaningful number clients these issues are of importance. Thus, in structuring a real estate transaction for a Muslim or Jewish client, issues of how the transaction can be structured to recharacterize or avoid interest charges should be addressed when the client desires.

   ii. Under Shari'ah (Islamic legal doctrines derived from the Quran, the teachings of the Prophet Mohammed, and interpretations by Islamic scholars), Muslims are prohibited from paying or receiving interest, called "riba," for the use of money. Although the term "riba" may be translated as "usury," tradition interprets the restriction to apply to all interest. This restriction does not prevent a modem commercial transaction; rather it will affect the documentation and structure of the transaction. Riba means unearned profits that are not reflective of business risk.

      1. Instead of charging interest on a financing transaction, the transaction could be structured with a sale to a middleman, who then resells the real estate to the ultimate purchaser. The price the middleman sells at would be inclusive of a profit that would be in lieu of an interest charge. This structure is referred to as "murabaha."
      2. Another approach is to structure a partnership arrangement, called "musharaka." The lender contributes funds to the partnership, and the partnership agreement provides that the lender will participate in the profits of this partnership in accordance with a pre-arranged formula.
      3. Another method by which a transaction can be structured is similar to a leasing arrangement. The lender can purchase the property and lease it to the intended owner. At the end of the lease term, the intended owner can purchase the property for the intended purchase price. The economics are identical to a financed purchase, but structurally the transaction transforms what otherwise would have been a prohibited interest payment into rent. This technique is referred to as "ijara."
      4. Inherent in each of the above modified transactions is an element of risk of ownership, so that the return to the lender is not a pure or guaranteed return equivalent to interest under Shari'ah.

   iii. Jewish law similarly restricts the charging of interest in certain transactions. In a real estate loan transaction for a Jewish client, a side agreement called a "heter iska" can be used to recharacterize what would be deemed interest under religious law, called "ribis," as a return on a "partnership" with the borrower. This document is intended to represent a mechanism to convert, under Jewish law but not secular law, the "interest" component to a non-- interest component. Jewish religious law strictly prohibits the paying or receiving of interest on certain loans. But, when monies are advanced in the course of a business transaction, an agreement may be entered into where- by the provider and receiver of these funds are considered partners, rather than lender and borrower. This "partnership" is based on the stipulation that, on request every loss must be proven by two trustworthy witnesses and all profits verified by oath. All consequent profits or losses are to be shared. To avoid these stringent requirements, however, the provider of the funds, under the legal document, agrees to waive his or her share of the "profits" in favor of receiving the fixed percentage of the money advanced. This percentage is then deemed for Jewish legal purposes to be profits, rather than interest on a loan. This agreement becomes effective when the receiver of the funds executes a form as set forth below.

iv. Both Islamic and Jewish law include prohibitions on the charging of interest. These concepts can be incorporated into powers of attorney, wills, and trusts. Under Islamic law scholars view what constitutes interest or "riba" differently, so that for different clients, different provisions may be warranted depending on the views of their advisers.

p. Conclusion.
   i. Estate planning strategies and documents can be tailored in myriad ways to reflect a client's religious sensitivities. Planning steps encountered in common estate plans may warrant modification to address a client's religious concerns. Many advanced estate planning techniques (for example, note sale to a defective grantor trust) require consideration of the prohibition on interest charges discussed in above.
   ii. Bear in mind that this discussion is only a sampling of considerations to alert practitioners to the need and context for raising these issues with clients. It is not a comprehensive listing.

5. **<u>Luncheon Presentation - Catherine Hughes – IRS Update</u>**.
   a. IRC Sec. 682
      i. How define income?
      ii. Trust accounting income?
   b. Basis consistency regulations
      i. Addresses compliance dates.
   c. Guidance on valuation of promissory notes.
      i. **<u>Comment</u>**: In the wake the Davidson and Morrissette this could have great interest for practitioners.
   d. 2032 alternate valuation regulations.
   e. 2053
      i. How to deal with personal guarantees.
      ii. Present value concepts to determine deductible expenses.
   f. Split interest trusts
      i. Administration of CRTs.

ii. When is the "foot-fault" so bad that the trust should be ignored and they should conclude you never created a CRT at all?
iii. Some items are fixable and others not.

g. 2801 Regulations.
   i. Transfer tax on US recipients from covered expatriates.
   ii. **Comment**: This is analogous to an inheritance tax on US Citizen and residents who receive gifts or bequests from certain expatriates. Query whether this tax will remain if Trump succeeds in repealing the estate tax?
h. 1411 NIIT.
   i. How it deals with trusts.
i. 529 ABLE regulations.
j. 6166 proposed regulations
k. FAQs portion of website updated
   i. Account transcript in place of closing letter – this has been updated.
l. Suspending GST PLRs regarding trust modifications
   i. Suspended until further notice.
   ii. Action taken because of insufficient resources to deal with requests.
   iii. If a PLR was filed before they will rule otherwise they will be returned.
m. Rev Proc 2016-55.
   i. CPI adjustment Revenue Procedure
   ii. Lowest income bracket for trusts $12,500 and NIIT tax under 1411.
   iii. $14,000 gift tax exclusion, no change.
   iv. Unified credit $5,490,000 in 2017.
n. Portability.
   i. Rev Proc. 2001-38 unnecessary QTIP elections. Process if unnecessary QTIP elections it would be voided. QTIP election did not have impact on decedent's estate but would adversely include in surviving spouse's estate and subject to 2519 risk.
   ii. With portability there are reasons to make election of QTIP to maximize the exemption, the DSUE, ported.
   iii. New Rev Proc supersedes prior Rev Proc. There is a process in place to void an unnecessary election but not available if estate made a portability election.
   iv. Rev Proc states how to void bad QTIP election in one of three ways:
      a. Supplemental gift tax return
      b. Amended estate tax return
      c. Spouse's estate tax return
o. CRAT.
   i. CRAT cannot be established under current law unless annuitant is at least approx. 70 years old or would flunk exhaustion test.
   ii. Took under consideration recommendation by CA Bar.
   iii. There is now another method to satisfy exhaustion test.
   iv. Language in rev proc treats language as qualified contingency so if you have language in rev proc causes early termination of CRAT with a distribution of the remainder to charity so you know the charity will get a significant interest.

v. If you include this language before you make an annuity payment you must compute after you make the payment would FMV of corpus decrease to less than 10% FMV of trust value on funding using a discount factor that is the same 7520 rate used when trust was created.
vi. Apply discount over duration of CRAT.
1. **Comment**: See discussion in Professor Pennell's outline above.

p. Basis consistency regulations.
i. Trying to finalize substantive part by end of January 2017.
ii. Many significant issues raised in comments, including two the following two which are being considered:
1. If you don't' record asset basis is zero to recipient.
2. Have to file reports and give to Beneficiaries within 30 days when it should be 30 days after distributing assets to beneficiaries.
iii. Form 8971 have been filed so IRS is reviewing the forms filed.
iv. The Form 8971 and instructions will be amended after final Regulations are issued.
v. If advisers have suggestions to improve form and instructions let them know.

q. 2704 Proposed Regulations.
i. **Comment**: There has already been much discussion in the literature of about Ms. Hughes comments and to what extent practitioners can or should rely on them. Two of these articles are: LISI Estate Planning Newsletter 2471 (October 31, 2016) at http://www.leimbergservices.com and Steve Oshins on Catherine Hughes' Keynote Address Regarding the IRC Section 2704 Proposed Regs., LISI Estate Planning Newsletter 2472 (November 1, 2016). The bottom line is that Ms. Hughes comments were welcome and appreciated and hopefully will be reflected in the final Regulations when issued. Practitioners still should nonetheless remain proactive and cautious since it is not possible to know when the Regulations will be issued, if they will be issued, and what they might contain. Certainly for transactions seeking discounts for non-operating enterprises, especially securities FLPs and perhaps even real estate rental entities, more caution may be in order if the discounts are necessary to the planning. All of this, however, will be made irrelevant if President Elect Trump is able to repeal the gift and estate tax as he has indicated he would. The disagreements on the likelihood of estate tax repeal succeeding are rather strong. Even more controversial is assessing the likelihood of a gift tax repeal succeeding since the gift tax is a backstop to the income tax. If repeal is in the cards how much attention would or should the Treasury devote to the 2704 regulations? How can we advise clients with yet this new and more dramatic uncertainty? There are no easy answers to any of this. Having to discuss another uncertainty with clients will only add to their frustration and further clients' perceptions of their planners as the "little child who called wolf." Has your client reminded you of your warnings in late 2012 about the supposed drop in the exemption? "So they may eliminate discounts, but you aren't sure how or

when or if, but they may even eliminate the estate tax so all this might be for naught?" Perhaps the safest approach is to proceed with planning so long as the end result of the planning is advantageous regardless of whether the estate tax is repealed, and to proceed at a pace that is designed to have the planning in place before the 2704 regulations might become effective, if that might be relevant to the planning. For most plans, if the result is the eventual transfer of assets into robust, grantor, dynastic trusts in trust friendly jurisdictions, that is likely a result that is desirable regardless of the outcome of Trumps efforts so that planning should proceed.

ii. This set of proposed regulations is trying to make 2701 and 2704 applicable again to achieve their intended purpose.

iii. Narrow regulatory exceptions that exist.

1. 3 year rule. Any lapse is taxable. In current regulations IRS provided exception that if did not change nature of assets transferred we won't tax lapse. Now narrowing that exception in the regulations because the Service has seen so many death bed transfers that they view as an abuse. They started with 3 year rule because traditionally under 2035 that was the time period.
2. Another regulatory exception that is being narrowed is comparison to local law and shortly thereafter most states changed partnership law assuring that there was no possible way the FLP could flunk the test of being more restrictive then applicable law. The exception in the Proposed Regulations is trying to narrow the exception.

iv. New category of disregarded restrictions to consider when value.

1. The IRS does not intend to do away with all minority discounts.
2. The IRS is not including a deemed put right. All they are trying to do what was done by statute in 2704. When 2704 was first enacted the commentary explained that it was trying to get rid of bells and whistles people put in FLP agreements to get bigger discounts.
3. They are not eliminating all discounts. They are just trying to capture the bells and whistles.
4. Marketability discount may be less than it would have been with whistles. Example: FLP agreement that is totally silent on disregarded restrictions. Doesn't' say you can get paid in 6 months or in something other than cash, doesn't say you can't get liquidated out before termination. It is silent. Your applicable law is silent and says nothing about LPs right to get out of FLP.
5. Under current rules appraiser applies lack of control and lack of marketability discounts.
6. Change the facts so FLP agreement says if redeem LP must pay with note over 20 years. That is a disregarded restriction and the appraiser must do discount appraisal without this disregarded restriction. There would still however be a lack of control and lack of marketability discount.

7. The above is what the IRS intended.
8. "There is no deemed put right and we are not getting rid of discounts."

v. Appropriate to confirm that it applies to all kinds of entities including LLCs and disregarded entities.
vi. Chapter 14 does not depend on whether you check the box. What kind of entity are you under the law which you created (i.e., not what tax election you made). If you are a corporation you test control under corporate statue. They tried to clarify this.
vii. Effect of 2704 on marital and charitable deductions. For first time said when dealing with asset side of 706 you can appraise decedent's holdings in two pieces, one piece 2704 intra-family and a second piece not intra-family (friends, employees, charities). Prior to this proposal on the asset side the decedent's 80% interest had to value as a controlling interest even though ½ when to spouse and ½ to charity. Now you would value as two separate 40% interests so you won't have as much of a charitable problem as you have now.
viii. Do you have a time line? "I have no clue." The IRS wants to get it right.
ix. Lapses if there is a lapse it is deemed to take place on date of death so don't go back and amend Form 709 when the transfer occurred. Whatever value is brought back into the estate is on the estate tax return not an amended gift tax return. There was confusion if made a gift before regulations are final and dies after final regulations are issues. There was no intent to make the provision retroactive. It is not a retroactive regulations.
    1. **<u>Comment</u>**: This addresses the concern over the year rule affecting transactions completed now but the transferor dies within in three years of the current transfer and after the Regulations become effective. The comment clearly indicated that the intent was not to apply the 3 year rule to transfers consummated prior to the effective date of the new Regulations once final. While this is reassuring practitioners should nonetheless be cautious as it is not assured that this and other favorable comments will be reflected in the final regulations for certain.
x. Here is an example Ms. Hughes provided:
    1. Operating business e.g.,, family owned C corporation 12% lack of control and 25% lack of marketability. The regulation doesn't propose to tell you what the discount is. It tells the appraiser that when computing FMV ignore the facts indicated in the regulations. The real question will these discounts change? The real issue is whether or not there is a disregarded restrictions, e.g., limiting payout to a 20 year note. The appraiser must ignore that one thing in doing the appraisal. If there is no disregarded restriction than 2704 won't apply.
xi. Is there a difference between a real operating entities versus a family investment entity? When 2704 was enacted Congress did not draw that

distinction and IRS is not drawing that distinction either. The IRS did not draw a distinction to a FLP with securities. 6166 deals generally with businesses and the issues are tough with real estate, e.g., a real estate developer or someone with real estate rental properties. What is personal investment versus business? The test use to be "who is cutting the grass." That really is not the correct test to define what a business is. The IRS did not wat the same level of confusion. What if a real operating business is "stuffed" with securities? Where and how do you draw the line?

1. Comment: The cautious interpretation might be, as indicated in the earlier comment that if the particular client matter involves a securities FLP or an entity that owns rental real estate, completing the transactions before the Regulations are effective may be prudent.

xii. Family control 2704(c) defines control for 2704. It is the same as under 2701(b)(2)(a) for corporations, "b" for partnership, and then for applicable family member which is not referenced in a or b. When the statute referred to b2 for control should have only referred to only a and b but proposed regulations use that definition in a and b.

xiii. Family recipient 2704(c)(2) this is different than 2701. Congress had a reason to exclude nieces and nephews from one and not the other. The Proposed Regulations take that approach.

xiv. Impact of regulations on basis under 1014. Will the IRC Sec. 1014 basis be different? No. The answer is no under current law and no under the proposed regulations. We are computing the date of death value under 2031 and that applies to 1014 and "we are not changing that."

xv. Adequate disclosure regulations require that if you take a position contrary to a proposed regulations you have to disclose that. What about the minimum put right? Ms. Hughes said that is not what the regulations do. What should you disclose? She could not comment as it is a procedural question.

6. **<u>13A – Stone – Mistake in Documents</u>**.

a. Find an old will that was missing after statute has run. What to do?

b. Elements of malpractice claim.

i. Duty of attorney to use such skill, prudence and diligence as members of profession commonly possess and exercise. This is not a requirement of perfection. Special expertise requires a higher standard.

ii. Breach of that duty.

iii. Proximate causal connection between the bread and the resulting injury.

iv. Actual loss or damage resulting from the attorney's negligence.

c. Estate planning malpractice ranges from improper execution, drafting errors, failure to make GST election, failure to timely file returns, etc.

d. Malpractice defenses and code of ethics do not fully overlap.

e. Everyone makes mistakes.

f. Privity.

i. Strict privity rule. Chem-Age Industries, Inc. v. Glover, 2002 SD 122.

ii. Friske v. Hogan, 698 NW 2d 526. 2005 South Dakota privity case. Strict privity preserves the attorney's duty of loyalty to and advocacy for the client.
iii. Not all states have a privity defense to a malpractice claim.
iv. Privity will not assuredly protect the attorney from a claim.
v. Heyer v. Fleig, 70 Cal. 2 223 (1969) Attorney undertakes to fulfill testamentary instruction of client the attorney realistically assumes a relations with the client's intended beneficiaries.

g. Husband and Wife.
    i. Rules differ by state.
    ii. Do you represent the husband and wife jointly?
    iii. Instead, do you represent the husband and wife each separately?
    iv. If you represent them separately there is no privity.

h. Chase v. Bowen.
    i. 771 So. 2d 1181 (Fla. DC 2000).
    ii. Daughter and mother used same law firm.
    iii. Attorney prepared will for mother omitting daughter. Court held attorney did not owe duty to any previous beneficiary even a beneficiary the lawyer is representing in another matter.

i. Written engagement letter.
    i. "It is dumb if you don't use a written engagement letter."
    ii. Specify not only what you are going to be responsible for but what you are not going to be responsible for.
    iii. Speaker excludes funding of trusts and has a separate engagement letter for that purpose.
    iv. Speaker gives memorandum to clients with instructions on how to fund and operate a trust.
        1. **<u>Comments</u>**: All the ideas above are great ideas, but it is often difficult to address any of these matters. Giving general funding instructions is a great idea and certainly should serve to put a client on notice of some of the many steps. The reality is that few clients are likely to read let alone follow up on those instructions. For clients with wealth levels such that they do not anticipate a federal estate tax the client perception may be that there is little need to follow up. This may be true even in the context of funding a revocable trust that has nothing to do with estate taxes, as in the context of the speaker's comments. There is also some concern that no matter how good a job the practitioner does, standard instructions are just that, "standard." They are unlikely to be able to address the unique circumstances of any particular client. Likely if a client were willing to pay for a set of funding and operational instructions that were tailored to his or her particular circumstances, he or she would be willing to pay for assistance. Also, the reality is that even if the instructions or actual assistance by counsel were flawless, time would undermine the proper operation of the trust. Unless the client meets regularly with

counsel, and unless all advisers collaborate to assure that the planning is carried out properly, success is unlikely. Even with something as simple as funding and operating a revocable trust, as clients change bank, brokerage or investment accounts, or amend ad restate their trusts, account titles and the trust often fall out of sync. There is a distinct message in more than a handful of presentations at the Notre Dame Institute about the importance of adhering to formalities of trusts, entities and plans. It should not be the practitioner's liability because a client is unwilling to spend the time, effort and most often the money, to fund and maintain a plan. Another approach, or perhaps an additional approach, to those mentioned, is to include in the retainer agreement/engagement letter a statement that if the client does not engage in annual review meetings it is unlikely for the planning to succeed. It is really only when a client returns and permits the team of advisers to collaboratively assure that planning is "in sync" that planning has a reasonable likelihood of success.

v. Significant Florida malpractice case
    1. Revocable trust was not funded and probate ensued creating considerable cost. Jury held for estate against attorney.
    2. Gunsler Case. 964 S. 2^{nd} 182 (2007).
    3. Counsel also recommended a QPRT and a 5-year QPRT was completed but the client died in year 4. The jury held against counsel.

j. Rules of Professional Conduct.
    i. See actec.org disciplinary rules and how they apply to estate planners.

k. Conflicts.
    i. The intended beneficiary sued.
    ii. Court held that privity was not required to sue for malpractice.
    iii. It is a balancing test.

l. Biakanja v. Irving.
    i. 49 Cal. 2^{nd} 647 (1958).
    ii. Decedent died after signing a will prepared by a notary public.
    iii. Entire estate left to plaintiff.
    iv. Court abolished privity defense stating in the absence of privity whether a lawyer would be held liable to a third party is a matter of policy involving the balancing of a number of factors.
        1. Extent to which the transaction was intended to affect the complaining beneficiary.
        2. Foreseeable harm of beneficiary.
        3. Whether beneficiary suffered harm.
        4. Closeness of connection between the negligent act and the injury.
        5. Public policy in protecting future harm.

m. There are three approaches to the privity issue in malpractice claims.
    i. Privity is required.
    ii. The middle ground approach followed by Florida and Iowa.

        iii. Tort or third party contract theories.
        iv. McAbee v. Edwards, 340 So. 2d 1167 (Fla. 4th DCA 1976) case.
            1. Court relaxed strict privity rule.
    n. Limits on attorney liability to beneficiary.
        i. However liability to beneficiary due to the attorney's negligence is limited to testamentary intent as expressed in the will. Extrinsic evidence is not to be considered.
        ii. There is no authority for the beneficiary to prove by extrinsic evidence the testator's intent other than as set forth in the will.
    o. Espinosa v. Sparber, Shevin, Shapo, Rosen & Heilbroner, 612 So. 2d 1378 (Fla. 1993).
        i. Lost will.
        ii. Heirs brought legal malpractice claim.
        iii. Exception when apparent attempt of client in engaging attorney was to benefit a third party.
    p. Lorrraine v Grover, Ciment, Weinstein & Stauber, PA, 467 So. 2d 315 (Fla. 3rd DCA 1985).
        i. Will included provision bequeathing home.
        ii. Florida homestead law would not permit transfer of house via will if minor child lived in home. Should have used deed instead.
    q. Iowa.
        i. Iowa approach.
        ii. Schreiner v. Scoville, 410 NW 2d 679 (Iowa 1987).
        iii. Attorney prepared will bequeathing property then helped client sell property. Attorney owed duty to inform that gift under will would adeem.
    r. Informing client.
        i. If the attorney discovers malpractice, hire counsel.
        ii. Talk to counsel, do not send an email.
        iii. If the attorney has committed malpractice he or she should inform the client.
    s. Consistent business practices.
        i. Quality control measures.
        ii. Develop good forms and keep them current. Use document assembly systems.
        iii. Eliminate metadata.
        iv. Have a second person review documents.
        v. Keep copies of interim drafts.
        vi. Attorneys should follow consistent business practices.
        vii. Deliver drafts to clients.
7. **<u>14B - Herzig and Jenson - Business and Estate Intersection</u>**.
    a. Look at transactions holistically.
    b. Governing documents
        i. Conflicts common between estate planning documents and entity or transaction documents.
        ii. Business law issues impact estate planning.

iii. Review corporate/entity documents and estate planning documents at one time and try to find disconnects.
iv. Are there restrictions on transfer that could affect/prevent
v. Are there "string" provisions where owner/shareholder wants to control and if they gave away equity interest and if the string provisions are in entity governing documents it could cause a 2036 issue and pull equity back into estate for tax purposes. Client may want to control corporation and corporate attorney may have no sensitivity to retained interest or implied retained interest.
vi. Often documents done by different attorneys at different times with little or no cross-discussion.

c. Buyouts.
   i. Corporate counsel may view removal of senior generation using a buyout provision. Example, if someone leaves reserve right to buyout stock.
   ii. If buyout says must first offer to other partners, if this is at a discount, and unrelated partner says that he will take it at that price. Example Mom is selling to kids trust and unrelated party exercises right of first refusal at that discounted price.
   iii. Have exception or carve out for transfers including sales to family or trusts for family.

d. Securities.
   i. Family units are a security.
      1. Are units in a family LP a security? Yes. What does this mean? State Blue Sky laws, 1933 Act, etc.
      2. Be certain comply with securities laws.
      3. If look at minute book pull out certificates. They should have a have a restrictive legend on certificates stating that they securities are not registered.
   ii. Securities laws may be relevant when for example a trust buys alternative asset class.
      1. Can a child's trust buy a security? Must be a qualified or accredited investor. How can a trust that may not have $5M meet these requirements?
      2. Rule 501(a)(7) provides that an irrevocable trust can qualify as an accredited investor if the assets of the trust are in excess of $5 million, the trust was not formed for the purpose of acquiring the securities offered and the purchase is directed by a 'sophisticated person.'
      3. Two requirements to meet:
         a. 33 act accredited investor rules.
         b. Qualified purchaser rules.

e. Private equity fund or hedge fund.
   i. Asset location considerations.
   ii. Which bucket should it be in?
   iii. First confirm trust terms permit the investment?

iv. Should it be in an irrevocable GST trust? If so does the irrevocable trust qualify as a AIQP?
v. If anticipate long term substantial growth private equity should be in a GST exempt trust.
vi. Security rules have not caught up with modern trust planning, directed trusts, etc. What they are looking for is who is making investment decisions? If large institutional trust company is the institutional trustee are accredited but if the investment trustee has this authority you need to look to that person to see if they are qualified. This may not work under SEC rules if investment adviser has decision making authority under the instrument.
vii. Also, does the terms of the trust permit this type of investment? Is the trust qualified to purchase the particular investment?
viii. The law looks to who is making the investment decisions but the law has not really kept up with modern trust drafting. If it is a directed trust then the investment advisor may be the person to look to.
ix. If named friend as investment trustee are they a qualified investor?
x. Be careful when read SEC rules as they have definitions that have different nuances then used in common usage or estate planning usage, e.g. “family member.”

f. Planning for liquidity events.
  i. Identify client objectives.
  ii. Review corporate documentation to be sure contemplated transfers are permissible.
  iii. May have various trusts and LLCs owning equity interests. Be sure each owner trust or LLC has an account set up in advance to receive proceeds. With Patriot Act etc. it takes time to open accounts so this should be addressed in advance.
  iv. Make certain you have appropriate advisers involved early in planning. Each transaction has its own elements and tax consequences and each may affect what type of planning is appropriate. Think of it broadly not merely from a trusts and estates lens. Consider pre and post transaction planning opportunities.
  v. Make sure you have provisions in documents to preserve flexibility to do the planning that may be available. Some examples of this are below.
  vi. Consider executive compensation issues, securities law attorney, tax accountants, investment advisers, and other team members.
  vii. Possible transactions.
    1. IPO – public offering
      a. May provide liquidity.
      b. Owner of business takes company public and may not get liquidity unless sell after IPO.
      c. Until they sell no diversification and no capital gains tax.
      d. What can you do if owner wants to sell and capital gains will be incurred

e. With an IPO securities law may impose a lock up period before can sell.
f. Shares may be restricted shares as owner may impact planning. Example, if set up a GRAT and an annuity payment comes due during lock up period, you may have captured pop in value from IPO but you cannot make the annuity payment. Must time transaction and annuity payment.
g. If client wants to do charitable planning you may need a carve out. You may be able to negotiate this in advance of the IPO. If no carve out and cannot make a gift during lock up period taxpayer may lose deduction.

2. Sale to a strategic third party buyer.
3. Sale to private equity firm
4. Sell to employees through an ESOP.
    a. If C corporation sells to ESOP planning can be structured so don't have to incur capital gains on sale to ESOP.
    b. Given time period 3 months before sale to ESOP to 12 months after and can reinvest proceeds in qualified replacement property. As long as QPRT remains in QRP you can defer capital gain from sale.
    c. Trigger gain only if sell QRP or lose QRP status.
5. Recap and distribute cash dividends through the transaction.

viii. Address issues in pre-planning process before liquidity events occur.
ix. Is client philanthropic?
x. Try to capture and plan for upside pop in value when hit the liquidity event: GRATs, installment sale, etc.
xi. What happens with funds in account after sale? Cash comes into accounts. Is someone reconciling to confirm correct amounts received in correct accounts. Is there a sweep mechanism in place to sweep into an interest bearing account. Need cash management plan in place.
xii. Evaluate borrowing needs. Transaction may happen near year end, or straddles tax years and there is not a lot of liquidity. May need lines of credit in place to fund pre-year end estimated tax payments or charitable contributions. Coordinating charitable deduction into year of sale to offset some of gain can be advantageous.

g. Estate planning techniques.
    i. Discuss pre-transaction to leverage value before "pop."
    ii. GRATs.
    iii. Note sales to grantor trusts.
    iv. FLPs/LLCs. Discounts before 2704 Regulations become final.
    v. Philanthropic planning.
        1. Private foundation.
        2. CRTs. Use in pre-transaction planning to defer capital gains.
        3. CLTs.
    vi. Timing gifts. How late is too late?

1. If transfer before the sale you are giving interest to charity but when sale occurs you don't incur the capital gain.
2. But on the flip side it is easier sometimes to sell (go through liquidity event) and just use cash to make charitable gift.
3. If want to time charitable gift before liquidity event question is how close can you get to liquidity event before you have an anticipatory assignment of income? The closer you get the greater the risk that the IRS will "unpack" the transaction and view charitable gift to avoid the capital gains tax.
4. There is an advantage to doing this before.
5. Consider AMT and phase outs. It is often not a dollar for dollar deduction which is why there is an incentive to make the donation before the transaction.
6. Rule of thumb some use if sale to a strategic third party buyer make gift before LOI = letter of intent singed. For IPO before S-1 is filed. For corporate inversion before shareholder approval of corporate inversion.
7. There are helpful PLRs and pro-taxpayer cases but all are fact intensive. Even if have LOI but sale is subject to so many contingencies IRS may not attribute all income to donor.
8. Recent merger terminated on basis of tax opinion that did not occur. "Uncharted territory."
9. Palmer case. D. Palmer, 62 TC 684 (1974), affirmed on other grounds, CA-8, 75-2 USTC ¶9726, 523 F2d 1308, and acq. 1978-1 CB 2.

h. Earn out.
   i. Percentage.
   ii. Are you undervaluing purchase price if multiple not received on the rest of the earn out?
   iii. How is income stream being calculated? Probability outcome chart.

i. IRC Sec. 1202 QSBS - Qualified Small Business Stock.
   i. PATH act made it permanent. Did not sunset was made permanent at 100% level.
   ii. Term should could require business to have QSBS election. Why?
   iii. It could be an integral part of the plan.
   iv. Consider with startups, entrepreneurs, investment in startup company, etc.
   v. QSBS provides preferential tax treatment.
   vi. Provides incentive to invest in small business by permitting some or all of gain to be realized tax free. If acquire at original issuance and hold for 5 years can use tax treatment that can be 100% of exclusion from capital gains tax up to 10 x basis, exclusion from 3.8% Medicare surtax and exclusion from AMT.
   vii. Requirements.
      1. Company must meet requirements.
         a. Stock must be issued after august 10 1993 by qualified corporation.

b. Company must be a US corporation, not a foreign corporation.
c. Must be organized as a C corporation for substantially all of the taxpayer's holding period.
d. Aggregate gross assets cannot exceed $50M before issuance of taxpayer's stock.
e. Gross assets determined based on adjusted cost basis not FMV.
f. Company must be engaged in an active trade or business and 80% of assets must be used in active trade or business. Regulations list types of industries that are excluded (accounting, hotel, restaurant, etc.). For this test use FMV.
g. Is the business doing something service oriented? If providing a service it is more likely not to qualify. There are many nuances because some businesses provide service and sell product.
h. Why set up a company as a C corporation? Most start as S corporation or LLC. If you have an LLC you can convert to a C corporation. You can use LLC for flow through taxation then convert.

2. Taxpayer must meet requirements.
   a. QSBS treatment can rollover to beneficiaries.
   b. Holding period tacks.
   c. No need for basis step up because of exemption.

viii. Can non-grantor trusts qualify for their own QSBS election?

8. **15A Justin Miller – Divorce Taxation**.
   a. Timing.
      i. Is it better to get done this year to file separately?
      ii. If unmarried on 12/31 can file as single or head of household (e.g. if can claim someone as dependent and maintaining upkeep of home). HH is preferable than single. Note that you can "trade" dependent exemption.
      iii. If living apart for six months and would otherwise qualify as HH even if still married may be able to file as HH.
   b. How to file?
      i. Two choices.
      ii. MFS.
         1. Generally less favorable as lose out on tax benefits.
         2. May be preferable if one spouse has significant medical expenses.
      iii. MFJ.
         1. Most of the time MFJ is preferable.
      iv. In high net worth divorces or if something suspicious is going on do not file MFJ as do not want joint return liability.
      v. By assigning MFJ spouse/client may be found jointly liable for all taxes interest and penalties.

vi. There is relief potential, such as innocent spouse relief, separation of liability or equitable relief. But there is no guarantee that client will qualify for these relief provisions, there are also legal fees, etc.
vii. Generally should MFS even if tax result is worse.

c. What if client reverts to maiden name.
    i. Do not file maiden name on tax return unless you changed with Social Security Administration (SSA).
    ii. Form SS 5.
    iii. If have not changed name with SSA will have mismatch with IRS.

d. Dependent Exemptions.
    i. What happens in divorce?
    ii. Generally custodial parent, whoever takes care of children for most nights, gets exemption.
    iii. If equal split then goes to parent with highest adjusted gross income.
    iv. Problem is that child may spend majority of nights with one spouse but divorce decree may say other parent is custodial parent.
    v. IRS concerns with tax rule not terms of divorce decree.
    vi. How can you give non-custodial parent exemption? File Form 8332 or a substantially similar form.
        1. Exemption automatically revoked if ex-spouse does not pay alimony. Cannot have condition so IRS disregarded.
        2. Use IRS Form don't create your own.
    vii. Form 8332 should be attached to tax return.
    viii. Can put in divorce agreement that custodial spouse is required to provide Form 8332 to non-custodial parent who is agreed to get exemption.
    ix. Why do this? One spouse may have too much income to benefit. Or custodial parent may be in low bracket abut doesn't get much tax benefit and other spouse makes more and in higher bracket but not so much more for exemption to be phased out.
    x. Cannot split one child's dependency exemption but can allocate exemption for each child to different spouses.
    xi. Could provide in even years H gets exemptions and in odd years W gets exemptions.
    xii. Trading exemption does not disqualify from other benefits.

e. House.
    i. Home sale exclusion $250,000 single and $500,000 married.
    ii. Must file MFJ to get $500,000 and either spouse must get ownership test. Most must use house as residence.
    iii. What if one spouse is temporarily absent during divorce? That time counts.
    iv. Try to plan to take advantage of $500,000 exclusion if possible.
    v. If owned home only 1 year can take portion of $500,000 if did not stay required time period because of "unforeseen circumstances" and divorce is an unforeseen circumstance.
    vi. If one spouse wants house and then sells they cannot get full $500,000 exemption. May be better off selling while still married.

vii.

f. Mortgage.
   i. Home equity indebtedness.
   ii. $1M plus $100,000.
   iii. $1.1M maximum mortgage for interest applied per house. What if unmarried and are just partners? If not married each individual gets their own $1.1M of mortgage on which they can deduct interests. Voss v. Comm'r, 796 F.3d 1051 (9th Cir. 2015), rev'g Sophy v. Comm'r, 138 T.C. 204 (2012).

g. Divorce expenses.
   i. Personal expenses and cannot deduct costs.
   ii. IRC Sec. 212 permits deduction of costs incurred for production of income. If collecting support/alimony fees related to that are deductible. Payor cannot deduct under this provision.
   iii. What about management or conservation of property held for production of income? QDRO expense related to that may be deductible.
   iv. Tax advise may be deductible.
   v. Must itemize to take advantage.
   vi. Subject to phase outs.

h. Tax carryovers.
   i. Charitable contribution carryovers.
      1. Example H made large deduction years ago. Gets 5 year carryover and now getting divorced. May have to prepare past MFS returns to see how carryover would have worked out if filed separately to see each spouse's carryover.
   ii. Capital loss carryover. State court decisions say it is up to state and may be able to allocate. IRS can determine amount of loss carryover but spouses can determine who gets benefit going forward.

i. Child support.
   i. Tax neutral.
   ii. No benefit from paying child support. Payee spouse does not have to pay tax on it.

j. Alimony.
   i. Above the line deduction for payor.
   ii. Taxable in year received as ordinary income by recipient spouse but no withholding so may have to increase withholding by filing new W4 or make estimated tax payments.
   iii. Must be required under PSA. Must be paid in cash. If make deal take piano in lieu of 3 months of alimony, that does not count. Must be paid in cash.
   iv. In most cases must stop at death but if state law does not stop it PSA should.
   v. If you want something not to be alimony so recipient does not pay income tax just state in agreement that it is not to be taxed as alimony.
   vi. Special rules for front loaded support and may be subject to recapture since it is akin to a property settlement. So if excessively high test it.

vii. Child support is not deductible and alimony is. What if characterize child support as alimony and have end at child's 18th birthday. Lester case and anti-Lester rules. If tied to child ages it is child support and may not be deductible. There are exceptions.

k. Life insurance.
   i. If owe former spouse alimony and die, alimony stops.
   ii. To protect former spouse commonly include life insurance obligations in the PSA.
   iii. What if have existing life insurance? May want to give ex-spouse existing policy to minimize estate taxes. Watch 3 year rule. If insurable might make more sense to just get a new policy.
   iv. If H owns life insurance it is included in his estate for estate tax purposes. If W owns it is not included in H's estate. If H makes premium payments post-divorce an characterize those payments as alimony.
   v. What if don't want ex-spouse to get all of insurance. Example, $2M policy want ex-spouse to get $1M and kids to get $1M, use an ILIT. Could eve structure ILIT to pay alimony as long as owned and balance to kids.

l. Retirement plans.
   i. Qualified plans.
      1. If going to divide in divorce must use QDRO = Qualified Domestic Relations Order.
      2. Must comply with specific rules.
      3. Must involve administrator of plan.
      4. If done wrong could adversely impact client and plan itself.
      5. Must be prepared to get part of plan to former spouse.
      6. Can divide plan with no tax consequence.
      7. You can use a QDRO as collateral to secure future payments.
      8. The alternative payee/former spouse will be taxed on funds received. But no 10% penalty for taking out money before age 59.5. This is a flexible rule.
      9. Many roll over into an IRA. This can enable ex-spouses to have less involvement with each other post-divorce. Also may give lower fees and more flexibility on getting
      10. Problem once roll over to IRA if you take out before age 59.5 there is again a 10% penalty (leniency above is lost).
      11. Solution might be to take part into rollover IRA and part into QDRO. Access the QDRO plan assets before 59.5 and at age 59.5 can roll over whatever is left into an IRA.
   ii. Non-qualified plans - IRAs.
      1. QDROs are not appropriate or needed for non-ERISA plans.
      2. What if financial institution requires QDRO? Change institution it is not required.
      3. How do you split IRA in divorce?
      4. Cannot give IRA to spouse while alive. Only two times can do this without tax consequences, post-death spousal roll over or if get divorced.

5. Must divide IRA pursuant to a divorce decree or a written instrument incident to such a decree. But what is a written instrument? Should be referenced in or attached to decreed or could have tax.
6. Any IRA transfer must be trustee to trustee. Do not have distributed to client or that is a taxable distribution.
7. Wait until actual divorce decree. If die before final decree and not officially divorced that could be a huge taxable event.
8. If do it properly it becomes the ex-spouse's IRA. She can add new funds, etc.
9. Substantially equal periodic payments. Don't modify IRA in this status. If getting divorce there are PLRs permitting dividing IRA in step status without it being treated as a modification. Safe approach is to get a PLR.

iii. Be certain to change the beneficiary designations. But it is not a priority for those going through divorce.

iv. Problem is ERISA preempts state law. If name former spouse and die former spouse can get money. Some state laws say former spouse removed as beneficiary under state law. What if spouse moves to a different state?

v. Everything must be updated post-divorce: agents, beneficiary designations, etc.

m. Property division.

i. IRC Sec. 1041.

1. Property transferred incident to a divorce no tax.
2. If it happens within one year or related to cessation of marriage no tax.
3. If more than six years presumed not related to divorce but can rebut it, e.g., litigation delayed.
4. Carryover basis.

ii. IRC 2516.

1. If not married must be pursuant to written settlement agreement.
2. Must occur within 1 year before or 2 years after.
3. Get it done in period to avoid gift tax issues.
4. Becomes an issue with prenuptial agreement. Agreed 10 years ago in prenup to give spouse assets and 10 years later get divorced. Must reflect in divorce decree or do a new agreement or there may be potential gift tax issues under 2516.

iii. How determine how best to divide assets?

1. Consider after tax results of each asset.
2. What is basis? What will tax costs of sale be?
3. Many clients focus on cash flow from asset not basis.
4. Will prior year's cash flow really be predictive of future cash flows?
5. You can run the numbers but that is not always sufficient.
6. Prepare a balance sheet. Determine post-divorce financial needs. What are client objectives and goals?

7. With gray divorce (over age 50) may have higher net worth and complex assets (vested and unvested).
8. What type of financial arrangements can be used to retain asset and pay other spouse cash?
9. How liquid is a particular asset? FLP investment interest may have good history of cash flow but may be very difficult to sell.
10. Capital market assumptions. What if market does not perform well.
11. Consider living expenses, possible health care costs in the future, inflation, etc.
12. BNY study of 2700 investment managers. 89% there was something substantially wrong with portfolio.

n. Support trust.
   i. Use in high net worth client.
   ii. Problem with alimony is former spouses have to interact.
   iii. Instead put it in a trust.
   iv. No need for interaction.
   v. What if there is a family business?
   vi. Example, wife is 10% owner in family business and cannot give to ex-husband. Perhaps she ca put 5% of interest in trust and ex-husband gets income for term of years then reverts to family.
   vii. What if uninsurable and cannot get insurance? Use alimony trust to guarantee alimony to hold assets since no insurance is feasible.
   viii. Use if ex-spouse is not financially sophisticated.
   ix. Financial insolvency risk. What if ex-spouse's career is risky? Example, professional athletes. Average NBA $5M earnings 60% broke a few years after retirement. Most professional athletes if there is alimony owed must won't be able to pay it. Use an alimony trust if client is going to get support from a professional athlete so payments will continue if becomes involvement or bankrupt.
   x. No income tax deduction on set up.
   xi. It is a grantor trust but IRC Sec. 682 says not taxed on income distributed to former spouse. Will be taxed directly on income, same character. If trust has $50,000 of income and $100,000 is paid, recipient spouse is taxed only on $50,000 of income.
   xii. Not clear what "income" is taxed to former spouse. Is it fiduciary accounting income or taxable income? This issue is on IRS priority guidance plan. Define in trust instrument what income shall be defined at. Might also say that if IRS changes rule former spouse will reimburse for tax payments made.
   xiii. At end of trust term money could come back to payor spouse or perhaps if doing estate planning as well have transfer to children.
   xiv. Front loaded support rules you can do this out of trust. These are not subject to IRC Sec. 71 alimony rules.
   xv. Can you use this for child support? You can but IRC Sec. 682 will not apply and all income will be taxed to grantor not to ex-spouse.
   xvi. How does it work?

1. Example $5M to trust.
2. 5% per year.
3. If trust has ordinary income it is taxed to former spouse to extent of payments. This may be better than grantor spouse including in income and trying to take a deduction.
4. If moneyed spouse/grantor does not need money back can set up to benefit for kids from a prior marriage as an example. Perhaps use up some of exemption. If set up while still married you can gift split.

9. **16B – Tritt - Obergefell Retroactivity** .
   a. When does same sex marriage begin?
      1. Consider the following hypothetical.
      2. 1992 Couple began to cohabit.
      3. 1998 commitment ceremony but no domestic partnership law.
      4. 2002 register as domestic partners
      5. 2004 Goodrich decision got married in Mass.
      6. 2005 had child, it was one's biological child.
      7. Did not adopt.
      8. Moved to Texas, non-recognition state.
      9. 2015 Obergefell decision.

   ii. When did marriage begin?
   iii. Most people would say marriage should begin June 2016 on Obergefell decision.
   iv. Some suggestion should go back to "real" marriage.
   v. Others suggest registration, cohabitation or commitment ceremony may be date to use.
   vi. Stakes are high. There are a wide range of rights and obligations to when marriage began.
   vii. Social security, marital property distributions in divorce decrees, parenting issues. Spousal immunity in criminal cases and much more is affected.
   viii. There is a lot of litigation over this issue.

   b. Same sex marriage
      i. 1993 Hawaii case said ban was unconstitutional.
      ii. 2004 Mass. First state that permitted same-sex marriage.
      iii. State recognition of marriage performed in other states.
      iv. Tectonic shift in 2015 that changed landscape.
      v. Many states grappling with idea.
      vi. Number of same sex couple marriages.
         1. In 2013 about 230,000 same sex couples had been married.
         2. June 2015 390,000
         3. Almost ½ million in six months post- Obergefell.
      vii. Impact.
         1. Numbers are much lower than anticipated.
         2. Some resist hetro-normative aspects of marriage.
         3. Some are not trusting of marriage.

4. Others feel they have been together for a long period without marriage why change.

c. Windsor.
    i. Estate case Section 3 of DOMA.
    ii. For federal purposes define marriage and spouse as opposite gender couples and Supreme court struck down and said equal treatment required under federal law.
    iii. Windsor created idea of lawful marriage. Except for Social Security purposes would only look for lawful marriage.
    iv. Created state non-recognition versus recognition dichotomy.
    v. If couple married in Mass. Moved to Texas depending on what federal benefit some received benefits and others did not receive so it created disparity. Looking at place of celebrating versus domicile would change result. So a same-sex couple in Mass may have received all federal benefits but a similarly situated same-sex couple in Texas may not have.
    vi. Recognition versus non-recognition states has created a host of lawsuits.

d. Obergefell a year after Windsor.
    i. Does 14th amendment require a state to recognize a same-sex marriage from another state.
    ii. States must recognize validity if lawfully performed in another state.
    iii. When US Supreme Court held that state law banning same sex marriage was unconstitutional it was as if that state never had that law.
    iv. So in hypothetical above the couple would retroactively be deemed to have been legally married even though at that time (i.e. before the Supreme Court held that state law against same-sex marriage was unconstitutional) Texas state law did not recognize the marriage.

e. What happened between Windsor and Obergefell?
    i. 2013-2015 most federal agencies recognized all same sex marriages if valid where performed. Social Security however looked to place of domicile. This created issue that some were receiving benefits and others were not depending on where they lived.
    ii. What happened to domestic partnerships after Obergefell? States have taken different approaches to spousal equivalents. Some states determined that domestic partnership statutes were not as useful as they had originally thought. Some converted over to marriage. Other states did not.
    iii. If registered as domestic partners in state of Washington they converted retroactively to a marriage, i.e., effective as of date of the registration as domestic partners were deemed married.
    iv. What are implications to retroactive marriage? What if did estate planning and did old fashioned GRIT but now retroactively married. Does the GRIT retroactively fail? What if divorce what does that do to state law community property law?
    v. Some states have eliminated domestic partnership and civil unions. Others have retained these statutes say for older couples who do not wish to marry.

vi. Social Security will look back to days in domestic partnership or civil union and add to married time to determine surviving spouse benefit.
vii. Community property creates issues.
viii. Federal government says it will not recognize marriage equivalents.
ix. Some states say community property has to be opposite sex but doubt these will stand up post Obergefell.
x. Now have uniformity for federal benefits.
xi. Federal employees Windsor resulted in federal benefits. Issue is how far do you look back? Recognize marriage but not clear.
xii. ERISA does not provide/mandate that spouses have to be covered. Cases are now addressing that if you offer benefits to a spouse can you not offer them to a same-sex spouse. Believe cases will not permit discrimination.

f. Retroactivity issues.
    i. What is impact?
    ii. Similar situation when changed definition of family and had to address this.
    iii. Look at non-marital children cases. At one point in history illegitimate child not deemed child of father. This was changed. What were implications. This is similar to changing definition of spouses.
    iv. Consider many ways in which this could affect probate as an example.