Steve Leimberg's Estate Planning Email Newsletter - Archive Message

#2598 Date: **06-Nov-17**
From: **Steve Leimberg's Estate Planning Newsletter**
Subject: **Martin Shenkman's Day 2 Notes from the 43rd Annual Notre Dame Tax and Estate Planning Institute**

The **43rd Annual Notre Dame Tax and Estate Planning Institute** was held on **October 26th and 27th** at the **Century Center** in South Bend, Indiana.
Members should click this link to review the meeting agenda: 43rd Annual Notre Dame Tax and Estate Planning Institute**.**

Because of the length of Marty's commentary, **LISI** has made his notes from Day 2 available to members through the following link:

43rd Annual Notre Dame Tax and Estate Planning Institute - Day 2

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

Martin Shenkman

CITE AS:

Notre Dame 43rd Annual Tax Institute
Day 2
By Martin M. Shenkman, Esq.

1. **<u>Current Developments of Importance to Estate Planners</u>** – Johanson, Akers, Loomis-Price
   a. Stretch IRA.
      i. It is on the table.
      ii. Skeptical that most people really do not take advantage of the opportunities it affords under current law.
   b. Trusts as beneficiaries.
      i. Generally only individuals may be designated beneficiaries (DBs) for purposes of a stretch of RMDs. Beneficiary must be an individual, but trusts may also qualify if a conduit trust, i.e. trust is a "weigh station" as if trustee endorses check over to the beneficiary. If the trust qualifies use life of oldest beneficiary for calculation. Requires: 1) valid under state law, 2) irrevocable, 3) beneficiaries identifiable from instrument, and 4) required documentation given to plan administrator. The issue that has arisen is if there is a wipe out clause in the trust with distant relatives, does that undermine the intent for the stretch if their lives are used, or worse a charity which has no life.
      ii. Recent PLR provides flexibility and leniency. PLR 201633025. End distribution if leave Notre Dame as charity if all beneficiaries die. Trust gave discretion to distribute to child and child's issue (3 grandchildren). Since died trustee made distributions that comply with RMD. Terminates at age 50. If child dies before 50 goes in further trust for grandchildren. If all die goes to testator's siblings. If no siblings to charity. Concerns raised. If all dies goes to siblings in their 70s and if no siblings to charity. Ruling gave favorable opinion. When testator die where child and three grandchildren. Regulations suggest that even a remote contingent beneficiary is to be considered in determining the DB. Reg. Sec. 1.401(a)(9)-5 Q&A 7(b). Useful ruling concluded that the other potential recipients are mere successors and the oldest child's life can be use.
      iii. Exercise caution as this is only a PLR
   c. Rev. Proc. 2016-47, IRB 2016-37.
      i. Rollover of plan or IRA must be done within 60 days. An extension had required a PLR. IRS will now permit a waiver (extension) of 60-day rollover.
      ii. Self-certification procedure. Rev. Proc. gives a form and taxpayer can check the appropriate box, e.g. serious illness. The financial institution is 100% protected if they act in accordance with this.
      iii. Can be verified on audit.
   d. Note Sale to Grantor Trust with Swap Power.
      i. 2 cases Louisiana and Colorado reach different conclusions.

ii. In re Condiotti, 14CA0969 (Colo. App. 2015). $9M corpus in trust and settlor said would exercise swap power using a $9M note. Issue was it a loan or swap. Court found it was a loan and an attempt to exercise a loan power not a swap. So, court did not have to address whether note was an equivalent value to assets being swapped.

iii. Estate of Benson v. Rosenthal, 2016 WL 2855456 (E.D. La. 2016). New Orleans Saints owner. Intentionally defective grantor trust. Grantor exercised exchange or substitution power for a promissory note and several hard assets. Trustee said he will not recognize it as a swap because in the trustee's view it is a loan transaction. The note was secured by hard assets and agreed to forgive loans that the trustee owed him individually. This was distinguished from Rev. Rul. 85-13 and Condiotti and the court respected the transaction. Key is that settlor was giving up something of value, not just a note.

e. Modify Grantor Trust to Add Reimbursement Clause.

i. PLR 201647001.

ii. Must swap in a non-fiduciary capacity. What is the difference between exercising in a fiduciary or non-fiduciary capacity?

iii. Grantor's were paying the income tax on the income distributed from trust to heirs.

iv. Due to unforeseen circumstances paying income tax became burdensome and there was no tax reimbursement clause.

v. Grantors asked IRS for a ruling that if local court permits can we include provision to the IRS issued the ruling and viewed it as a merely administrative provision. The IRS did not view it as inconsistent with Rev. Rule 2004-64. Court granted ruling as judicial modification of the trust.

vi. Panel raises question that a decanting cannot change beneficiaries but what is impact of the addition of a tax reimbursement clause. Is the addition of a tax reimbursement provision equivalent of adding a new beneficiary?

vii. Caution if trustee reimburses every year begins to look like and implied agreement and may be problematic.

f. Reformed GRAT.

i. PLR 201652002 reformed GRAT to add missing language permitted because of savings language.

ii. The trusts were intended to qualify as GRATs but lacked language required by the Regs, such as prohibiting the trustee from issuing a note to satisfy an annuity payment. Reg. Sec. 25.2702-3(d)(6).

iii. Trustee was given the power to amend the trust to assure that grantor's interest met the qualifications as a retained interest. This savings language may have been crucial to the favorable PLR (or not).

g. Powell case.

i. Estate of Powell, v. Comr., 148 TC No. 18 (May 18, 2017).

ii. Biggest tax court case of the year. Fully reviewed Tax Court case.

iii. Two substantive items:

    1. 2036(a)(2) caused estate inclusion of all assets in FLP even though decedent only owned an LP interest. Never had case with only LP interest only held by transferor included under 2036(a)(2).
    2. Judge went through analysis suggesting client could be hit with a double inclusion analysis. Discussed below.
iv. Facts.
    1. Son under power of attorney ("POA") transferred $10M assets into FLP for 99% LP interest.
    2. Sons gave notes in exchange for GP interests.
    3. Son under POA transferred all of mother's 99% FLP interests into a CLAT with payments to charity at end of each year and whatever left at mother's death passes to sons. There was a gift element to the CLAT plan.
    4. POA only authorized gifts to issue and only up to the annual exclusion amounts.
    5. Court held transfer to CLAT was void or voidable.
    6. Mother died 7 days later. Note that the case does not explain all facts mother actually died unexpectedly from sepsis. This is an appealable point.
v. Case was not tried but was decided on summary judgement motions.
vi. 2036(a)(1) is the classic IRS argument because of an attack using the implied agreement doctrine. The IRS does not have to show express retention of income using this attack.
vii. Intention in Powell was that mother was not going to have any interest whatsoever in the assets which is perhaps why the IRS focused the case on 2036(a)(2) to disallow discount. Court argued under (a)(2) that decedent alone or "in conjunction with" any other person can designate who can benefit from the property. This never occurred under a situation in which the decedent only owned an LP interest.
viii. IRC Sec. 2036(a)(2) arguments "have been addressed in only four prior cases: Kimbell and Mirowski both of which were taxpayer victories. In Strangi and Turner IRS won but those involved general partnership interest (50% of GP).
ix. Court said in Powell that full consideration exception did not apply.
x. How did court conclude 2036(a)(2) applied?
    1. Partners could have under LP partnership agreement could agree to liquidate. "alone or in conjunction with any other person." If TP joins with anyone doing anything (e.g. joins together to buy real estate) does that mean 2036(a)(2) apply? Very worrisome.
    2. If they had eliminated the provision from the partnership agreement it would not seem to have changed the result (i.e., that draft around may not suffice to avoid a Powell challenge). That is because the GP and majority of LPs could dissolve under state law, so that would not resolve unless state law default rules did not provide a similar right.

3. Son was mother’s agent through son and duties son owed mother. So, avoid this by not having mother’s agent as the person holding GP interest.

xi. Double inclusion analysis.

1. Judge Halperin on his own, not briefed, if made transfer for full consideration but if receive partial consideration you bring back full asset at date of death. Unfair to bring into the estate both the full value of the asset and what you received (i.e., LP interests) so under IRC Sec. 2043 you can subtract value of the consideration on the date of transfer. Bring back $10M assets but subtract value of 99% LP interest net of discount. So $10M - $7.5 = $2.5M plus value of LP. But in footnote he stated that could have double taxation if there was appreciation post-transfer.
2. Note that the concurring opinion of 7 judges felt that the partnership was merely the alter ego of those same assets so it should not also be included in the estate, i.e. no double counting.

xii. Powell is a terrible facts case but the question/worry is whether the holding will be limited to such bad fact cases? What is worrisome is the reasoning of the Tax Court in this case. Planners should try to differentiate their planning from this case.

xiii. Some cases have put limits on how far can go in terms of finding that the settlor could “in conjunction with others” modify a trust. These arguments not made in Powell.

xiv. Where are we now?

1. Qualification for the bona fide sale exception for full consideration is very important. Most cases TP have won are on this basis.
2. Is it better to not give partners right to unanimously dissolve partnership? That could be an important factual distinction.
3. Might this suggest change in thinking about FLPs? If Powell is correct 2036(a)(2) may apply. Consider 2035 if transfer within 3 years of death 2036 may still bring into estate.
4. Is the double inclusion really a concern?
5. Some commentators believe that this is merely a bad fact case, 99% LP owning securities transferred before death, and may not have significant impact.
6. Has the emphasis many planners made to not have transferor’s hold GP interests not the same concern in light of Powell?

xv. **<u>Comments</u>**:

1. Practitioners should review client powers of attorney. Agents exceeding their authority under a power of attorney was a problem in Powell and may well be a problem in many planning scenarios for clients lacking capacity. The decedent’s son used a power of attorney that granted him the power to make gifts of up to the $14,000 annual gift exclusion ($15,000 in 2018) to the principal’s family members to make a gift of $7.5 million to his family and his mother’s private foundation. This blatant misuse of the power of

attorney caused the Tax Court to disallow the gift. Revise powers for wealthy clients to include broader gift exclusions.

2. The need for a business or non-tax purpose for a transaction is not new. Most sophisticated estate-planning techniques, such as obtaining discounts for transfers of limited partnership interests, are required to have a non-tax purpose to obtain the tax benefits. The actions taken in Powell seemed to ignore this. Practitioners should not.
3. Last minute near death planning, while unavoidable in some situations, is never optimal. All members of the adviser team should push clients to meet with their adviser team at least annually and endeavor to keep planning current.
4. The tax court pointed out that 2043(a) allows the estate to exclude the value of the limited partnership interests at the time of the transfer. Then the Tax Court speculated that if the limited partnership interests increased in value between the time of the transfer and the decedent's death, the gross estate may have to include the increase in value of the limited partnership interests along with the value of the underlying assets at the time of the decedent's death leading to double taxation. After speculating about this potential, the tax court explicitly stated they are not addressing the issue in this case because it does not apply. But it cannot be clearer that estates that run afoul of IRC §2036 might be at risk under this theory of estate tax inclusion. Should practitioners warn clients of this possibility for existing FLP/LLC plans and future ones? If the facts in Powell were clearly so egregious is it necessary to warn clients of such a risk in planning that was done with more care and thought?
5. It warrants noting, however, that for clients below the current large $5,490,000 exemption ($5.6M in 2018), or in the event the estate tax is repealed, this discussion in Powell may prove instructive for practitioners endeavoring to trigger estate tax inclusion to garner a step up in basis on the partnership interests and through a IRC §754 election, the underlying partnership assets (which election may not be required if the underlying assets are included in the estate).

h. Syndicated Conservation Easement.
    i. Listed transaction.
    ii. Notice 2017-10, 2017-14 IRB.
i. Estate of DiMarco v. Commr., TC Memo 2015-184.
    i. Bequest to church "I regularly attend" but decedent attended two.
    ii. Alternate executor was the pastor of the church "I regularly attend."
    iii. Settled case 1/3rd to each church and son.
j. Rafert v. Meyer, 290 Neb. 219 (2015).
    i. Attorney drafted ILIT and was trustee. Completed policy application but used address in South Dakota even though insured lived in Nebraska.

    ii. Standard exculpatory clause that trustee shall have no obligation to …. First payment was made, second payment made but checks were not forwarded to insurance company and notice of non-payment was sent to South Dakota address.
    iii. Court looked at exculpatory clause but on appeal reverse. The terms of the trust do not prevail over trustee's duties and trustee cannot prevail.
    iv. Bottom line exculpatory clause in boilerplate unless client understands it may not suffice.

k. Graegin Loan.
    i. $6.5M loan for 15-year balloon note. Repayment of principal was prohibited. Accrued interest would be 10.7M. Duncan v. Commr., TC Memo 2011-255. Court accepted.
    ii. Estate of Koons – 18-year balloon note with principal prepayment prohibited. Accrued interest $71.4M Sec. 2053 deduction.
    iii. IRS priority guidance plan on three items affect transfer tax area one of which is applying present value concepts to IRC Sec. 2053 which may undermine Graegin loans.
    iv. For those considering Graegin loans endeavor to complete them before any new guidance is issued.

l. CCA 201614036.
    i. If do not report gift no statute of limitations.
    ii. Raises problem if client continues to make gifts because of cumulative nature of gift tax every later gift tax return underreports gifts.
    iii. Favorable reading if one year of inadequate disclosure that is for that one year only even if that affects impact of cumulative gifts in future years it does not keep the statue of limitations open.

m. Rev Proc. 2017-34, IRB 513.
    i. Extends time to file late portability election.
    ii. Bold print on top of form "FILED PURSUANT TO REV. PROC. 2017-34."
    iii. Only for estates otherwise not required to file estate tax return.

2. **<u>Practical Estate Planning Nuggets</u>** – Shenkman [thanks to Alan Gassman, Esq. for these notes].
    a. Various fiduciaries, agents and similar appointments.
        i. Planning for aging clients' needs to be broader and as one example should consider the potential for many conflicting financial agent (and agent "like") appointments.
        ii. When we draft powers of attorney but none of us look at the identity of who the client appoints, and possible conflicts and hazards from making the wrong choice.
        iii. What if one child is an agent for a durable power of attorney and another is the authorized signer on a safe deposit box, and yet others are appointed for the related matters discussed below, there can be a lot of confusion of who is in charge when the time comes to act.

iv. FINRA required the bank to have a contact person for the safe deposit box, and for brokers to have a contact person, and who will this be. Do you know who this is for your clients?
v. Social Security allows for the appointment of a representative payee who can receive and deposit Social Security checks, and perhaps take further actions for the client like paying bills. Most POAs include language giving this right to the agent. What is the likelihood an elderly client thinks of naming the POA agent when completing a form for the Social Security Administration?
vi. The lapse rate for long term care policies for women over 65 is 38%. The major reason for this is incapacity, so the industry gives the right to name a designee. Who is this designee?
vii. Under 529 plans you can name a successor account owner. If the client was named as initial account holder who is the successor?
viii. Funeral homes ask those making pre-death arrangements for the name of a person to be in charge as well. Some state laws permit the designation of a person to be authorized to make funeral decisions in a separate document. Does this conflict with health proxy terms?
ix. How about pay on death accounts at the banks. No matter what we do a bank teller can change an account into a pay on death account, and then it may go somewhere inconsistent with the estate planning documents.

b. Curci Asset protection lessons.
   i. Curci Investments, LLC v. Baldwin, Court of Appeal, Fourth Dist., Div. 3, CA G052764 Aug. 10, 2017.
   ii. The Curci case is one of many bad facts asset protection cases that involve a common theme that clients don't come back and let us administer the plans that they pay us to set up. If they don't come back and let the lawyer, CPA and wealth advisor monitor and assist with formalities then it is not going to happen.
   iii. Curci was a reverse piercing of an LLC where the creditor can reach into the LLC by piercing to get assets that the Member put into the LLC to satisfy claims against the member.
   iv. In this case there was a Delaware LLC that the debtor funded and lived off of. There were substantial assets involved under the LLC, and the debtor made personal use of these in several ways. The judge was not going to let this LLC go unpierced.

c. Balice Case – Piercing Trust as Nominee.
   i. Balice, (DC NJ 8/9/2017) 119 AFTR 2d ¶ 2017-5134.
   ii. The Balice New Jersey case involved people who put their home in a trust and tried not to pay income taxes. These people bought a "make it yourself" situation and the court found that the trust was a nominee of the taxpayers. The court listed several factors on what it takes to have a nominee relationship that can be ignored by a creditor.
   iii. Factors.
      1. Did the nominee pay adequate consideration for the property?

2. Did the taxpayer transfer property to the name of the nominee in anticipation of a suit or (or in this case in anticipation of IRS collection efforts).
3. Did the transferor continue to use the property?
4. Did the transferor retain enjoyment of the benefits of the transferred property?
5. Was there is a close relationship between transferor and the nominee.
6. Was the transfer recorded in the case of real estate.

iv. How different are these facts from a situation of setting up non-reciprocal spousal lifetime access trusts ("SLATs") for a couple that, perhaps among other assets, owns their vacation home? The trust did not pay for t the vacation home, it was likely a gift, the clients will continue to use and enjoy the property, there is a close relationship between the transferor and the nominee (the spouses may be investment trustees of the trust for example). One of the problems with bad fact bad law cases is that sometimes the factors they use to get to a just result can come quite close to good fact good planning scenarios.

d. Administration of plan and annual review.
   i. Tell clients in writing that if the client will not come back in a year (or at least periodically) for follow up then their plan cannot be expected to work. Consider including this warning in retainer agreements so that the client knows up front how important this is.

e. Assisted Suicide.
   i. The assisted suicide statutes are being used more than ever, and each advisor has to decide whether to get involved with this type of planning or to refer the client elsewhere. The client needs to reside in the state that they would make use of this statute in, so this needs to be discussed and the client can plan in advance on where they want to reside in their last months if they want to have this door open for them.

f. Cancer Statistics.
   i. 50% of men are diagnosed with cancer, and one in 3 women will be diagnosed to have cancer.
   ii. Join the American Cancer Society National Professional Adviser ("NPAN") network at https://www.cancer.org/content/cancer/en/involved/donate/planned-giving/professional-advisors/npan-form.html .

g. Charitable Giving by Older clients.
   i. A high number of people over age 65 give the bulk of the moneys that go to charity. Why not sit down with advisors and have financial modeling and forecasting to age 95 (or some other reasonable age, but bear in mind wealthier clients live longer) to be sure that they can make it financially. Often practitioners find the retirees are spending too much money and thus may run out.
   ii. Try the 30 second "financial plan" multiply the value of the investment assets (not homes and toys) by 4% and inquire whether the client can live

on that number they are good, but if they spend more than this there can be problem. It is important to let clients know if you think they may run out of money, and giving too much too early to charity may cause destitution later. While this is no substitute for a real budget and financial forecast, it is often a useful litmus test of issues at a meeting.

h. Change in domicile.
    i. Changing domicile and there are cases that come out each year which help to define what can be done and how this works. The recent Indiana ruling found that the taxpayer did not change their domicile. They had cars titled, voting registration, and a home in Tennessee. But after they moved they spent a lot of time in Indiana and ran a business there. Their tax returns erroneously indicated that they lived in Indiana, which was an error. CPAs need to be mindful of residency/domicile changes and be certain to report all relevant matters consistently.
    ii. In one case, the place where the dog lived was found to be the domicile.

i. Elder abuse.
    i. Elder abuse is epidemic and rampant and it is done mostly by family members, and is not reported from embarrassment and fear of worse repercussions. So as lawyers for the elderly we need to be very aware of situations where this might be occurring.
    ii. Encourage your clients to hire a care manager at the right time, to make sure that their care is appropriate.
    iii. A recent survey determined that people make their best decisions at age 50 and are at least starting to lose their abilities to make sound decisions at age 60. Where does that put us as planners when clients are procrastinating or keeping things short while in their 60's and then have much more limited capacity in later years when the hard decisions need to be made. Are clients waiting too long to address planning? Based on this study, most do.

j. Revocable Trust and IRA.
    i. Consider putting a client's appropriate assets in a revocable trust with a trust company as trustee to be sure that things are administered properly as the client ages, guard against elder abuse, etc. This is particularly important for isolated and vulnerable clients who may not have the close family or other trusted people to appoint.
    ii. For the IRA, which must be owned personally and not in a trust, you may be able make alternate arrangements to protect aging clients.
        1. Have an institution sponsoring a trusteed IRA arrangement hold the IRA and act as Trustee over the IRA under that arrangement. The IRA relationship is a formal trust settlement that many trust companies do offer.
        2. The institution may be willing to serve under a limited and carefully crafted POA so that it can move funds from the IRA to the revocable trust and administer them.
        3. The client may be able to execute instructions to pay the RMD to his or her revocable trust that will continue until changed.

k. Guardianship.
    i. A recent New Jersey case shows that no good deed may go unpunished, where the lawyer for the client was named as guardian and seems to have done an excellent job based on travel and attention to details with respect to Florida properties, etc. She hired a large regional accounting firm to do the accounting work, and the beneficiary challenged this as being a waste of the assets that would reduce the inheritance. Hiring an independent CPA firm is generally prudent and demonstrates independence and provides a check and balance on the guardian. Yet it was objected to.
    ii. Practitioners serving as guardians should read this case to learn:
        1. Steps that may be prudent and protective to take.
        2. How no matter what is done you may be challenged.
    iii. 58-2-2529 In the Matter of J.F., N.J. Super. App. Div. (per curiam), (February 14, 2017).

l. ILIT/SLAT.
    i. Evaluate folding ILIT's into SLAT's to eliminate possibly unnecessary trusts, avoid Crummey powers and annual gifts.

m. Clients need entity governing documents.
    i. What about when clients tell you that you don't need to charge them to draft an LLC Operating Agreement or a limited partnership agreement. The case involved 3 friends who set up an LLC and never got an Operating Agreement, and 2 of them signed an agreement with a capital call provision, and they were able to enforce this against the 3rd "friend".
    ii. While practitioners are looking for new ways to be relevant for clients no longer affected by an estate tax, it is not only about basis, reconsider (and see the next point) creating (or updating and improving) governing documents for client entities.

n. Tax distribution clauses.
    i. If you have a tax distribution clause, which is a provision that says that the FLP or LLC or S corporation must distribute enough moneys each year so that each owner has sufficient cash to pay their taxes. This clause can cause discounts to be reduced.

o. Medical Costs.
    i. Here is something very important for non-estate taxable clients. One study has come out showing that a couple age 65 will spend between $500,000 and $750,000 on health-related costs before they are both gone. Another study came to the conclusion that $404,000 would be the proper level.
    ii. For very wealthy clients these figures may put them at ease for such worries.
    iii. For merely wealthy clients these figures could be a necessary shock of planning reality. For clients with a $5M net worth this could be 10%+ of their wealth. For clients with $2.5M net worth this could be 20%+ of their wealth. That is a major concern.
    iv. The issue for most clients is no longer the estate tax but rather, financially surviving longevity, with its attendant health costs.

v. Consider the earlier discussion of sitting down with the clients to be sure that their assets can support spending 4% of principal can also afford to have a major hit against the assets for a health problem and still be able to live on what is left over.

p. Silver Divorce (Gray Divorce).

i. The U.S. has the highest divorce rate in the world, with roughly 45% of marriages ending in divorce. The divorce rate among adults ages 50 and older doubled between 1990 and 2010. Roughly 1 in 4 divorces in 2010 occurred to persons ages 50 and older. The rate of divorce was 2.5 times higher for those in remarriages versus first marriages while the divorce rate declined as marital duration rose. The traditional focus of gerontological research on widowhood must be expanded to include divorce as another form of marital dissolution. Over 600,000 people ages 50 and older were divorced in 2010.

ii. With sky high divorce rates, can you really represent both spouses in an estate plans? Should additional caveats be put into retainer agreements? Even 70-year-old clients have a risk of getting divorced.

iii. Can they each afford to live safely and comfortably if there is a divorce.

iv. When you set up a SLAT do you consider a possible divorce. Do you define "spouse" as whoever the grantor is married to, or do you say that only a new spouse can be a beneficiary if the first spouse beneficiary is deceased? Should the trust split in half, being one half for the spouse and one half for the children if there is a divorce?

q. Floating Spouse Clause and prenuptial agreements.

i. A client with a non-reciprocal SLAT had a floating spouse clause, divorced, and now the new wife is a beneficiary, but the client doesn't want her to benefit, so what do you do? Do you have trust protectors appointed who can change things around?

ii. Can the new spouse waive the right to be a beneficiary as part of the prenuptial planning? At least some matrimonial practitioners believe this is feasible, but the key is it must be addressed by planners doing those agreements.

r. Portability.

i. There is no way to predict what the estate tax will be. It seems very unlikely that the estate tax exemption will be lower in the future, but what if this happens and you did not advise a widower to file a Form 706 to get the portability allowance?

ii. The Vose case involved deceased husband and the son from his prior marriage refused to file an estate tax return. The son apparently hated the widow step mother and it is obvious that much more in legal fees was spent than a return would have cost. The court said that the return had to be filed as a matter of fiduciary duties since the wife is a beneficiary of the estate. Most clients will prefer for their will to require this if the surviving spouse requests this, but should the surviving spouse be required to pay the expenses attributable to the election. Matter of Estate of Vose, 2017 OK 3, Case Number: 115424, 390 P.3d 238, (Okla. January 24, 2017).

        iii. In Sower, the court affirmed the IRS right to audit returns claiming a portable exemption. In re Estate of Minnie L. Sower, et al., v Commissioner, 149 T.C. No. 11 (September 11, 2017).
    s. Emails.
        i. Opinion number 477 on what to do ethically with respect to e-mails.
        ii. Practitioners need to consider options and risks.
        iii. Consider adding/updating language in your retainer agreement authorizing the use of unencrypted e-mail since perhaps all practitioners use unencrypted email for most communications.
        iv. There is an array of products that might be considered for these purposes, e.g. Sharefile which provides a secure portal service and capability of creating client "vaults" available through Citrix.
    t. E-Signatures.
        i. E Signatures are being used in many areas of the law, and Marty is not using these for planning documents, but this may work well for Crummey power notices.

3. **Succession Planning for The Family Business with Active and Passive Children as Co-Owners** – O'Reilly and Breitstone.
    a. Introduction.
        i. Multi-disciplinary planning to facilitate succession of family business.
        ii. Issues/benefits of involving family.
        iii. Problems of treating children differently in the succession plan.
        iv. Entity documents can record, or even drive, succession.
        v. 80% of businesses want to last more than 1 generation but only 30% do.
        vi. Biggest cause of succession failure is the failure to plan.
        vii. How do you balance "fairness" and "equity?"
    b. Separate ownership from control.
        i. Voting versus non-voting stock. How to value?
        ii. Outside financing impacts planning. Whose personal guarantees will they want?
        iii. Separate family vs. non-family.
    c. Trust structures.
        i. Third party trustee.
        ii. GST/dynasty trust.
        iii. Incentive trusts.
        iv. Prudent investor act lists factors to consider including: general economic conditions, inflation, tax consequences, total return, other resources of beneficiaries, liquidity needs and the assets special relationship or special value to the purpose of the trust or to the beneficiaries.
        v. The last factor is key to family businesses held in trust.
        vi. What does trust instrument state?
        vii. Diversification to reduce risks impacts trustee decision. Do the special circumstances or special relationship to the asset suffice to mitigate against diversification?
        viii. Trustee is given a reasonable amount of time to diversify. How long is that?

ix. Trustee owes duty of loyalty and must invest trust assets solely in the interests of the beneficiary. What if trustee has relationship to business, e.g. an officer?
x. Duty of impartiality suggests caution in showing bias to or for any beneficiary.
xi. Uniform Prudent Investor Act (UPIA) delegation of investment responsibility.
xii. Trust can draft around some issues but not all, e.g. cannot relieve trustee of liability for breach of trust committed in bad faith or with reckless indifference.

d. Directed trusts.
   i. Insulates general trustee from liability for investment decisions held by investment trustee.
   ii. Positions/divisions: administrative trustee, investment trustee, distributions trustee and trust protector.
   iii. "Holding this umbrella is the trust protector, who has the ability to terminate or modify the trust in order to keep the three subdivisions of the trust operating efficiently."
      1. **Comment**: Be careful making any assumptions about the bifurcation of the trust functions and the roles of each category of trustee/fiduciary. There is little uniformity in how the various roles are defined, or the scope of duty of any role. Further, practitioners can, and often do, tailor each or all of these and other roles to meet differing objectives. Perhaps a more helpful paradigm for this type of planning is Lego and a "Lego-Approach" can be used to cobble together the right plan for each situation. Each of the various fiduciary roles can be sliced in a manner that fits the circumstances. For example, in many instances it may be best to leave the distribution role to the institutional trustee to provide better asset protection and tax planning through the independence and procedures (e.g., meeting of a distribution committee and the procedures it has) so in such cases the administrative and distribution trustee will be one and the same. The investment trustee can and often should be carved into more distinct positions. For example, the institutional trustee might invest liquid assets, a business investment trustee may have the responsibility for business investment deductions, and insurance matters may be bifurcated into a separate trustee to avoid 2042 issues.

e. Private trust company.
   i. Permits a more detailed structure and may avoid the involvement of a large institution.
   ii. Directors governed by business judgement rule.

f. Business entities.
   i. Types of entities.
   ii. Business judgement rule.

g. Which standard should apply that of trustee or business officer.

i. Is a trustee held to the standard of a trustee or the standards applicable to an officer or director?
ii. New York has held that when acting in dual capacities the standards of a trustee apply. In the Matter of Estate of Jacob Schulman, 568 NYS 2d 660 (1991).
iii. Consider reporting to beneficiaries.

h. IRC Sec. 6166 estate tax deferral.
   i. Requirements:
      1. Citizen or resident.
      2. Close business 35% or more of adjusted gross estate.
      3. Business must be closely held.
      4. Active business. Lease of real estate may be passive but if based on farm productivity may be active. Rev. Rule 75-366.
      5. Rev. Rul. 2006-34, 2006-1 CB 1171 lists factors to consider in determining if business is active.
         a. Time devoted.
         b. Was office maintained.
         c. Owner's involvement.
         d. Extent to which owner personally arranged for services, etc.
   ii. Lien.

4. **<u>Life Insurance: What Works, What May Not</u>** – Macklin.
   a. Term.
      i. Temporary insurance.
      ii. Premiums increase with age.
      iii. May not have guarantee.
      iv. Usually sold for blocks of time, e.g. 5, 10 years, etc. As insured gets closer to life expectancy gets costly.
      v. Only 2% of term policies pay death benefit.
      vi. No cash build up.
      vii. Best suited for short term needs or someone who cannot afford permanent insurance.
   b. Permanent insurance.
      i. Excess set aside in policy as investment and generates cash value.
      ii. May generate cash value, return, that can be used to pay premiums in future years.
      iii. 4 parts.
         1. Mortality expense.
            a. Preferred.
            b. Rated
         2. Lapse rate.
         3. Administrative costs, commissions, etc.
         4. Investment element.
      iv. 3 types.
         1. Whole life invested in general account and some credited to policy owner. Some retained. Most rigid and non-flexible policy.

Premiums must be paid every year. Premium is based on guarantee of minimum investment return (2-4%). Policy will assume that return occurs as calculate premium. Also, should have maximum cost insurance company can charge under contract. With whole life policy insurance company can declare a "dividend." It is an excess of the premiums refunded, excess based on investment returns in excess of anticipated. That dividend is typically used to buy additional life insurance in the policy called "paid up addition" or "PUA" which increases both cash value and death benefit. Could have dividend reduce premiums. This can reduce or eliminate premiums in future years. Cash value of whole life policy can be accessed by a loan.

2. Universal life. Only around for about 40 years. In mid-1970s interest rates were high. When interest rates change quickly creates lag on policy. Customers wondered why they should pay premiums up front to get refund later. Flexible premium adjustable life was another name for universal. Death benefit may be flexible as well usually reduced, may require underwriting to increase). Premium is less than a similar whole life policy as it is based on expected or actual current returns. Insurance company credits investment return to each policy on a monthly basis that it is generating on its investment pool.
3. Variable life. Structured as whole or universal, but usually universal. But key difference is that insurance company does not invest it in its general account. Policy owner directs investments among a family of mutual funds. No guarantee of investment performance by insurance company. Chance of a greater return that could reduce premiums to be paid. But higher volatility and greater risk.

v. Type of whole life is a risk analysis. How much risk to accept of lapse. Premiums for whole life is most costly since risk shifted to insurance company. Universal might have lower premiums since some of risk is moved to policy owner from insurance company. Variable life should in theory have lowest premiums since policy holder accepts the most risks.

c. Tax considerations.

i. Tax deferred investments.

ii. Generally, basis, premiums you paid into a cash value policy can be withdrawn before earnings.

iii. You can take a loan against the policy and not have to recognize the earnings.

iv. These benefits encourage the use of permanent variable insurance for tax advantaged investment.

v. The policy must be deemed a lawful life insurance contract for the above benefits.

1. Pre-1980s case law risk shifting analysis.
2. 7702 codified enacted with objective tests.

a. Death benefit shifting risk analysis. Should be buying for death benefit not for tax deferred investments.
b. For variable universal life policy is a cash value corridor test which requires death benefit not be less than a certain percentage, which factors in age, etc.

3. If fails policy is a modified endowment contract or "MEC." Just cannot take money out without taking earnings out first.

vi. Need diversification to avoid tax on income.
vii. Investor control doctrine.
1. If insured is in control of underlying investments will be taxed.
2. Series of Revenue Rulings provide guidance. HO 19
3. You can choose manger but cannot choose underlying stock investments.

d. Life Insurance Policy Illustrations.
i. Term insurance project premiums and death benefits function of insurers mortality experience and expenses.
ii. Past results not guarantee of future performance for mutual fund but for life insurance they show illustration of what it will do in the future. It is a projections of expected investment earnings only. Whole life and universal do give a guarantee but illustration will likely show what is currently happening. The should show current costs with respect to those policies.
iii. Might ask for illustration "in the middle" to show how things change.
iv. With variable illustration, it is an investment product regulated under FINRA. Can show illustration up to 12% return on investments but hopefully a more realistic figure is shown. They may show 0% illustration and hopefully a reasonable return based on guaranteed costs, etc. Variable illustrations may use an assumed management fee when actual fees may be higher or lower. Investment volatility is not reflected in illustration.
v. If projections do not come true what happens? Request and look at illustrations showing lower levels of returns to gain insight into what might occur.

e. Insurance company ratings.
i. Ratings provided by AM Bet, Fitch, Moody's and Standard & Poors.
ii. Comparisons can be confusing as each rating agency has many categories and they each use different systems.
iii. Look at services ratings but be careful and more due diligence might be required.

f. What works.
i. If considering portfolio of stocks, you might decide to sell and buy something else. Similarly, the investment products inside the insurance policy may not be performing and similar action should be take.
ii. Insurance is an investment and should be monitored.
iii. Insurance companies offer new polices all the time and those policies may have different assumptions.
iv. Accumulating investments inside the tax favorable structure of a policy, if the costs of the policy are less than the tax advantages, can be beneficial.

Tax deferred compounding can outweigh costs associated with the insurance element.

1. **Comment**: See notes on Blattmachr lecture Day 1 how tax-free compounding is the key to growing wealth.

v. Get a new illustration every few years and look at your policy performance.

vi. Watch surrender charges and new commissions. Nonetheless a new product might still be better.

vii. Premium financing.

1. For large policies how get money into ILIT? Use annual exclusion gifts but if still too large many used split-dollar arrangement.
2. Instead of split-dollar can fund large premiums by having wealth party lend money to trust for promissory note at AFR. Might be able to get third party financing, e.g. from a bank. Be careful there may be unrealistic expectations with respect to these loans. They may be a floating rate loan and the illustration may show that it remains at today's rates.

viii. Split-dollar.

g. What does not work.

i. Cannot control investments in private placement. So, insureds try to have agent handle this. Webber case. Indirect investor control does not work.

ii. Life settlements.

1. Grew out of viatical settlement market.
2. In one case tried to circumvent state insurable interest rules. Sun Life v. Conestoga 2017 US Dist. Ct E. TN, declared policy void for lack of insurable interests.
3. Market is still new and bids may vary considerable so evaluate sale options.

iii. Frozen cash value life insurance.

1. 7702 defines insurance, various tests.
2. Modified endowment if does not pass test.
3. IRC Sec. 7702(g) if does not meet definition of life insurance contract the income on the policy will be treated as ordinary income accrued by the policy holder during that year.
4. If doesn't meet any of those parameters can still be life insurance.
5. Subsection 7702(g) if individual enters contract that does not meet definition but is insurance the increase in cash value will be taxed to individual to extent they have access.
6. A frozen cash value policy provides that the cash values in excess of what you pay for premiums goes into a death benefit account. When dies it is thus insurance and not subject to income tax. Converts growth into insurance that is not taxable.
7. Is this all too good to be true?

5. **Mediation as An Alternative for Estate and Trust Disputes** – Kirkland.

a. Estate litigation is burgeoning.

i. Growing interest in using mediation to provide less intimidating format to air family issues.
ii. If family has public profile medication may minimize negative press.

b. Mediation.
  i. A form of settlement negotiation.
  ii. Neutral third party assists in reaching resolution.
  iii. Parties may or may not be represented by counsel.
  iv. It I s not arbitration.
  v. Goal is to facilitate communication which moves toward resolution of dispute.
  vi. Voluntary so parties must agree to submit.
  vii. Collaborative - mediator leads parties to decide many aspects of process.
  viii. Confidential.

c. Legislation.
  i. Trust and Estate Dispute Resolution Act ("TEDRA") - 2000.
  ii. Missouri UTC authorizes trustee to resolve a dispute using medication, arbitration or other alternative dispute resolution methods. Sec. 456.8-816(23).
  iii. Court can recommend mediation.
  iv. ACTEC 2004 report recommended state legislation to make arbitration clauses in wills and trusts enforceable.
    1. Schoneberger v. Oelze 208 Ariz. 591 (2004) clause not enforceable. Later statute changed law.
    2. Rachal v. Reitz, 403 S.W. 3d 840 (Tex. 2013) mandatory arbitration clause enforceable.

6. **<u>Removal and Surcharge of Fiduciaries: Practicality, Obstacles and Defending the Fiduciary</u> –** Glazier.
  a. Introduction.
    i. Longer term trusts more common. The longer the trust the more likely that you will encounter dysfunction and end up in court with someone unhappy with what the fiduciary did.
    ii. $12 trillion in financial and non-financial assets being shifted from greatest generation to the boomers. In next 40 years $40 trillion will pass from boomers to their heirs. Accenture "The Greater Wealth Transfer: Capitalizing on Intergenerational Shift In Wealth" (2015).
    iii. Lack of transparency and family dysfunction can increase likelihood of litigation as can disparate treatment of beneficiaries, the potentially devastating impact of downturns in the economy or declines in the value of assessments under the estate or trust portfolio.
    iv. When senior family member dies the dysfunction of the family "becomes the rule of the day."
    v. On front end try to understand goals of family, address issues of beneficiaries being treated differently, special assets, etc.
    vi. Estate planner is the first defense for the fiduciary down the road.
    vii. Discuss with client the possibilities and what the client would like to have happen.

viii. Not unusual to see surcharge and removal actions.

b. How do these surcharge and removal claims come about?
    i. Emanate from surcharge action, breach, request for removal of fiduciary.
    ii. What can the practitioner do?
    iii. States that adopt UTC do not adopt verbatim so be careful to read applicable law. The nuances can be important.
    iv. Adding protection, e.g. broad exoneration clauses, of fiduciary to document may eliminate recourse of beneficiary which may not be optimal or what client desires.
    v. Build in checks and balances.
    vi. If lawyer named fiduciary advise client of other options.
    vii. Discuss implications of exoneration provisions contained in an instrument as they may restrict or eliminate remedies for beneficiaries.
    viii. When defending a fiduciary stress, the trustee's intentions motives and state of mind so that you might afford the fiduciary to the greatest extent possible, with the benefits of any exoneration or exculpatory provisions contained within the instrument.
    ix. Attorney drafts person may not be covered by exoneration clause she wrote.
    x. Might exoneration clause protect a fiduciary who acted in bad faith?

c. What are duties that give rise to these actions?
    i. Duty of loyalty can give rise to surcharge or discharge action. Fiduciary is supposed to administer estate for benefit of trust. If fiduciary does for own benefit or affected by conflict, is voidable unless authorized in instrument, approved by a court, or ratified or consented to, or statute has run.
        1. Corporate fiduciary invests in own investments thereby looking after their interests rather than that of beneficiaries.
        2. Duty of loyalty includes good faith. UTC 814. This duty cannot be overwritten in the governing instrument. This overrides sole discretion provisions.
        3. Impartiality UTC 803 fiduciary must act impartially. Must treat all the same but not every beneficiary is the same. This can be modified in the instrument.
        4. Prudence UTC 804. To invest and administer assets consideration purposes, terms, distribution requirements and other circumstances.
        5. Incur only reasonable costs of admisntartion in relation to the trust property and its purposes UTC 805.
        6. Special skills using the fiduciary's special skills or expertise for the benefit of the trust/estate UTC 806.
    ii. Duty to inform, keep good records and segregate trust assets. UTC 810 and 813. Act as if exoneration clause will not work and keep good records and provide sufficient information to beneficiaries to keep them reasonably informed. Failing to do so will fail to keep statute of limitations running.

        iii. Duty to collect, control and protect property. UTC 809 and 812. Should house for benefit of surviving spouse in bypass trust or QTIP? What if tangible property is left for surviving beneficiary. Trustee may not have assets in their control but has duty to control. Should instrument address this?
        iv. Duty of care includes not only action undertaken by the fiduciary but also in selection and oversight of delegation of responsibilities to agents. UTC 807 and 808.
        v. Enforce and defend claims. UTC 811.
        vi. Follow settlor/testator's intent UTC 808. UPC 3-703.
    d. Trustee is not a guarantor of results.
        i. Absent a breach a trustee wont' be held liable for a loss or depreciation in value of the trust property or for a lack of profitability.
        ii. Have an investment policy statement ("IPS").
    e. Trust reporting.
        i. Not like probate court formalities if not in a supervised proceeding.
        ii. If beneficiary waives receipt of report waives statute of limitations.
        iii. Tax returns, financial institution statements, spreadsheets and check registers may be sufficient depending on the assets and circumstances.
        iv. Issue may be whether the report provided sufficient notice that the beneficiary knew or could have known upon reasonable inquiry.
        v. To start a shortened 1 year statute of limitations under UTC 1005 the beneficiary must be informed of the item allowed for commencing a proceeding.
        vi. It may be possible for the instrument to require notice of any objections to the form or content of a portion within a shorter period of time.
    f. Damages claimed.
        i. Beneficiary must still prove damages.
    g. Laches.
        i. Important defense.
    h. Attorney fees.
        i. Instrument or statute must provide for it.
        ii. Beneficiary must go out of pocket.
        iii. Home court advantage for fiduciary.
        iv. If trustee acted inappropriately may have to reimburse trust.
    i. Alternatives to removal.
        i. Independent trustee.
        ii. Checks and balances.
        iii. Use no contest clause.
7. **<u>Silent Trusts: Balancing Competing Interests and Implementing the Settlor's Intentions</u>** – Mann, Zhao and Cloud.
    a. Trustee duty to inform.
        i. Restatement Second of Trusts.
            1. Trustee generally does not have duty to provide information to beneficiary unless there is a request, or self-dealing, etc. Sec. 173.

        2. But even if trustee acts in good faith in not disclosing material facts, failure to disclose could be a breach of fiduciary duty.
    ii. Restatement Third of Trusts.
        1. More comprehensive approach to what trustee must disclose to beneficiary even without a request: existence of trust, status as beneficiary, right to further information, basic information about trust.
    iii. Even if no affirmative duty to disclosure on the trustee every state requires trustee to disclose information if requested by beneficiary and that information is material to the beneficiary protecting her interests.
    iv. UTC.
        1. Duty to keep beneficiaries informed is a duty of the trustee.
        2. Recognizes that some settlors want information kept from some beneficiaries such as those too young.
        3. Broad disclosure required to "qualified beneficiaries" defined as a distributee or permissible distributee of the trust income or principal, i.e. currently eligible to receive distribution and the first -line remainder beneficiaries.
        4. Sec. 813 provides for duty to inform. UTC Sec. 105 provides for ability to opt out of certain rules.
    v. State responses to UTC.
        1. 32 states have enacted but each state has some variations.
        2. Some states permitting non-reporting called silent trusts require reporting to a third person who acts as a surrogate for the beneficiary in regard to reporting during the silent period.
            a. **Comment**: What liability exposure might this surrogate, designated representative, face? What can the designated surrogate do to protect himself from a later claim? Can he document why it was in the beneficiary's interest not to receive disclosure? What steps should the surrogate take to monitor or react to the information obtained since the beneficiary who is not getting disclosures cannot?
b. Silent Trusts.
    i. Irrevocable trust in which grantor waives or restricts trustee's duty to inform some or all beneficiaries.
    ii. This is a departure from common law duty on trustees.
    iii. Period of non-disclosure varies, e.g., until beneficiary attains age 25 or 30.
    iv. Reasons for silent trusts include:
        1. Immaturity of heirs.
        2. Promote fiscal responsibility of heirs.
        3. Alternative to incentive trusts.
        4. Privacy concerns.
        5. Motivate settlors to engage in tax planning they would not do in the absence of silent trusts.
    v. Reasons not to use silent trusts include:
        1. Discussion of family wealth educates heirs.

2. Disclosure avoids litigation.
3. More difficult for trustees to inform beneficiaries.
4. Disclosure may prevent breach of trust.

vi. **Comment**:

1. While the concept of a quiet trust sounds great in theory, too much of a good thing may be rather dangerous. If no one who has an interest in the trust is getting disclosures, who will be watching the trustee's actions that has a vested interest in the outcome of the trust? On the opposite extreme, some institutional trustees take the position that, unless the trust provides limitations and state law permits it, they will send a statement of all trust assets to every beneficiary and every person named in the trust. Who might that include? Potentially a large number of people might get notice. Modern trust drafting favors listing all descendants as beneficiaries in many types of trusts A broad pool of beneficiaries gives the trustee wider latitude to distribute trust funds for whoever might be in need. Also, having a large pool of beneficiaries gives the trustee more options to spray income to beneficiaries in lower tax brackets, thus saving income tax every year. But every one of those beneficiaries may not be on the list to receive a copy of the trust financial data.
2. In McNeil v. McNeil, 798 A.2d 503 (Del. 2002) surcharged the trustee for failing to inform a current beneficiary of that status. In McNeil a beneficiary sought but was denied information even as to his status as a beneficiary. The McNeil court seems to have mandated disclosure but in that case there appears to have been a clear bias and damage to the beneficiary involved. The Court found a "pattern of deception and neglect over the span of many years." Further, McNeil does not seem to require disclosures to non-beneficiaries.
3. Non-reciprocal spousal lifetime access trusts ("SLATs") are often used by moderate wealth clients as an asset protection tool. In those cases, the funds transferred to the SLATs might well be accessed during the couple's retirement. Sending statements to children may undermine that intent and create an impression in the children that they have a greater then intended interest in those trust assets.

8. **<u>50-Year View of the Profession and the Future of the Profession</u> –** Johanson.
   a. An entertaining and fascinating look back at the history of estate planning. An important take away is perspective. The uncertainty we have today is not new or the first time there has been significant uncertainty or possible change. Yet practitioners have continued to thrive and adapt and remain relevant. Many of the issues we grapple with today are quite similar to the issues practitioners have grappled with for a long time.
9. **<u>Planning in a Period of Uncertainty, Including Uses of Defined Value Clause</u>** - Akers.

a. Legislation.
    i. Budget resolution. Budgetary neutral. Senate passed its budget calling for deficits. Back to house and passed October 26, 2017. Big debate over state and local taxes. Passed by 2 votes.
    ii. Going to introduce November 1 legislative language. Witting 5 days, November 6 mark up period in House Ways and Means Committed. They are assuring this will last only one week. Vote on week of November 13. Want bill on President's desk before Thanksgiving. By contrast 1986 act from date of introduction took 1.5 years to pass.
    iii. Byrd rule.
    iv. Plans introduced scored from $3 to $7.9 Trillion in deficits over 10 years. Senate resolution calls for only 1.5 Trillion in deficits.
    v. Sold as "middle class tax cut." Shows pounced on estate tax as an example of the framework not being a middle-class tax cut.
    vi. Several Republican senators have suggested that the estate tax is not a priority. So, it seems that the estate tax is a negotiating point, but "who knows." There will be "horse trading" going on. Some will vote for entire package to get it through even if that package includes items they do not like.
    vii. Tax reform pitched that it will grow economy so much that it won't produce deficits.
    viii. Estate tax is $240 billion over 10-year period that equates to 2% of corporate tax, e.g. 22% versus 20%.

b. What to do considering the uncertainty?
    i. Plan now, but minimize the risk of paying gift tax. GRATs and note sales mentioned as planning tools to use (see discussion of defined value mechanism below).
    ii. Basis step-up. If the estate tax is repealed IRC Sec. 1014(b) has a catch all. 1014(a) gives basis step up on property from decedent. 1014(9) is anything in gross estate gets a basis step up but if no estate tax this catch all is not available.
    iii. Review formula clauses in instruments as they may all be impacted by change. Are assets passing as intended?
    iv. Emphasis on flexibility.
    v. Testamentary planning.
        1. On first death bequeath all to a QTIP'able trust. That gives 15 months post-death to determine what to do. Consider Clayton QTIP approach and name someone other than spouse as executor to make the determination to avoid possible gift tax argument.
        2. The tax advantage of portability route is second basis step up on second spouse to die.
        3. If estate tax is repealed and no 1014(b)(9) would NOT get a basis step up for assets in a QTIP (IRC Sec. 2044).
        4. Could provide that if the estate tax is repealed give someone the power to grant surviving spouse a testamentary power of appointment. IRC Sec. 1014(b)(4) property passing under exercise

of testamentary general power of appointment will get the second basis step up. That is not enough as the surviving spouse would have to exercise that general power of appointment. In some states that might raise a creditor protection issue.

vi. Basis Adjustment Planning.
    1. May want basis step up for trust assets.
    2. Include beneficiary a testamentary power of appointment. C
    3. Can exercise LPOA in a manner to trigger 2041 Delaware tax trap to get estate inclusion. But if estate tax is repealed that won't work.
    4. GRATs are the safest way to transfer assets without gift tax issue. We will continue to see sales to grantor trusts.
    5. Have seen an uptick in interest in non-reciprocal spousal lifetime access trusts ("SLATs"). Backdoor access to the SLAT. Consider creditor issue. Say H creates trust for W and W predeceases. Can set up so H becomes beneficiary or W can include H through power of appointment. From a state law standpoint will that permit a creditor access. This is called the "relation back doctrine." If in a self-settled trust (DAPT) state, and client lives in such a state, no problem. Some states have statutes addressing relation back doctrine.

vii. List of non-tax things to do. There is lots of planning practitioners can and should do regardless of the status of the estate tax.

viii. Flexibility add someone with authority with right to make distribution to charity from the trust. Trust agreement must have provision that justifies distribution to charity to get trust income tax deduction. It can be discretionary. Using trust for charitable donations may have advantages no percentage limitations but the IRC Sec. 170 limitations apply to the extent of UBTI. Trust should direct that payments come first from gross income that is not unrelated business income, although it is not clear the IRS will respect that. If Trump legislation restricts charitable deductions by individuals it is not certain that those limitations will apply the same way to trusts.

ix. Asset protection, divorce protection.
    1. Consider including provisions limiting distributions to beneficiary being very limited unless spouse signs waiver of rights against trust.

x. SCINs
    1. Estate of Jonson v. Commr. TC No. 11708-16 May 16, 2106).
    2. Case recently settled for 1/9th of notice of deficiency amount.
    3. Individual lived for 7 years, did not involve health issues as in Davidson.
    4. Case involved inter-generational split-dollar life insurance issue.
    5. What is right to get payment back in 50 years. Large discounts. This case involved this issue and there was a settlement.

c. Defined value clause.
    i. Goal during uncertainty is to avoid gift tax.

ii. So, use defined value clauses with transfer planning.
iii. Five ways to do defined value clause.
    1. Formula allocation clause. Parties come to agreement as in McCord case.
    2. Formula allocation clause. How much to children and how much to non-taxable acceptable? Based on final gift tax determination. Christiansen and Petter.
    3. Wandry 2012 case that defines the amount transferred based on values as finally determined for federal gift tax. Instead of an allocation approach, by formula you define what is being transferred. Simpler approach but only one Tax Court memo in contrast to the formula allocations for which we have four cases.
    4. Price adjustment clause. This can work in a gift or sale context. Donee/buyer will give note to transferor if price is incorrect. This provision is used in bona fide business deals. 10th Circuit in King case approved. Other cases did not approve this approach.
    5. Procter approach does not work. Transferor takes back excess value.
iv. There is no general rule as to what the best approach is.
v. Summary of key cases.
    1. Commr. v. Procter.
    2. McCord v. Commr.
    3. Christiansen v. Commr.
    4. Petter v. Commr.
    5. Hendrix v Commr.
    6. Wandry v. Commr.
    7. True v. Commr.
vi. No need for defined value clause if transfer is well below remaining exemptions.
vii. Formula transfer based on an appraisal to be acquired in near future is not a concern for the IRS.
viii. Formula allocation approach should use confirmation agreement approach or the as finally determined for federal gift tax purpose approach. The latter is used more often. Disadvantage - a gift tax return must be filed when a sales transaction is done.
ix. Cannot have “wink” or side agreement.
x. Wandry case is what clients really like. IRS National Office non-acquiesced to this. The True v. Commr. was filed last fall. Made gift of units thought to be worth $34M Subject to transfer agreement that provided that if it is finally determined that value is greater than $35M the recipient will give a note for the difference. It is like a Wandry with a price adjustment. Trial date was set for January 2018. True case would be appealable to the 10th Circuit that held favorably in the King case which was a price adjustment case favorable to taxpayers. Also, IRS concern with Wandry is over use with unrealistic numbers

xi. When Wandry used in 2012 some planners thought of combining a Wandry with a trustee having the right to disclaim anything in excess of the amount by formula. We have disclaimer regulations permitting disclaimer by formula.
xii. Regulations. Last year's priority guidance plan included dealing with defined value clauses and the gift tax impact of that. This was omitted from the 2017 plan.
xiii. If use "as finally determined for gift tax purposes" is used must file gift tax return and be certain that the reporting is consistent with what happened. Describe the formula allocation clause that is used. This I s the most common approach used in practice.
xiv. Practical tips.
    1. If use formula allocation approach and some may go to pour over party have some significant value going to the pour over party so it makes sense for that party to hire advisers to look into this process.
    2. Should it be straight Wandry or a note structure like a price adjustment? The note is different then Proctor. But it may look "gimmicky" and is not common in a commercial transaction.

10. **<u>Pre-Sale Due Diligence: Getting Your Business Ready to Sell</u>** – Prangly and Sorrow.
    a. General pre-sale due diligence.
        i. Sale process.
            1. Sale process typically 6-12 months.
            2. Most sellers are not professional but most buyers are.
            3. MBO = management buyout.
            4. Sale to financial buyer.
            5. Sale to strategic buyer.
        ii. Financials.
            1. Clean up and recast financials.
            2. Appraise tangible assets and note real value.
            3. Consider audited GAPP financials.
            4. Sell off obsolete inventory, settle overdue payables.
            5. Clean up income statement, eliminate non-recurring or personal items (e.g., excessive travel and entertainment expenses).
        iii. Legal.
            1. Clean up legal and environmental issues.
            2. Confirm validity of contracts, agreements, etc.
    b. Purchase price adjustments.
        i. Deal risk may change transaction terms.
        ii. Contingent payment.
        iii. Escrow amounts.
        iv. Valuation process.
    c. Estate planning.
        i. Transfers of interests in business.
        ii. GRATs.
        iii. Sales to grantor trusts.
        iv. Freeze LLC.

v. Remainder purchase marital ("RPM") Trust.

d. Charitable planning.
    i. For business interests watch excess business holdings rule for private foundations.
    ii. CRT charitable bail out. Watch Palmer v. Commr., 523 F2d 1308 (8th Cir. 1975). If sale progressed too far before gift to CRT owner will be taxed on all gain.

e. Income tax considerations.
    i. Sale of C corporation consider S-election.
    ii. ESOP.
    iii. State income tax planning.
        1. Move from high tax state to low tax state before sale of entity.
        2. DING/NING.
            a. Transfer part of business entity interests to ING trust before sale.
            b. May avoid home state income tax on sale of interests.
            c. Grantor retains beneficial interest in ING trust so that the transfer is not a completed gift for gift tax purposes.
            d. Structure ING trust so that it is not a grantor trust.

11. **<u>Privileges When Hiring Appraisers, Preparing Gift and Estate Tax Returns</u>** – Loomis.

a. Planning for audit should begin at planning level.
    i. Attorney client privilege and work product doctrine do not protect all of file. Assertion of privilege might be interpreted by auditor that the taxpayer has something to hide.
    ii. When planning assumes each document drafted will be seen and reviewed by the agent.
    iii. How will each internal memo and letter look to the auditor?
    iv. Remember IRS has broad summons powers.

b. Attorney client privilege.
    i. Purpose is to encourage complete and truthful disclosure by client to counsel.
    ii. Definition: Where legal advice is sought from an attorney in his capacity as an attorney and the communication is made in confidence by the client for the purpose of securing legal advice, the communication will be protected from disclosure subject only to waiver by the client.
    iii. Privilege may protect the communication but still may not prevent the underlying facts from being disclosed.
    iv. Receipt and payment of attorney bills is generally not privileged.
    v. Privilege covers legal not business advice.
    vi. If trustee is removed must turn over records to successor trustee. But what happens regarding legal advice former trustee sought as to liability? Prior fiduciary must take affirmative steps to preserve privilege and withhold confidential documents from successor.
    vii. Preparation of tax return is not clearly protected by attorney client privilege.

c. Waiver.
   i. Any action inconsistent with the privily may result in a waiver.
   ii. In Tax Court party asserting privilege has to prove it was not waived.

d. Work product doctrine.
   i. Work product of attorney in anticipation of litigation is protected from disclosure.
   ii. Work product doctrine has different purpose then privilege. Purpose of work product doctrine is to encourage lawyers to prepare for litigation without fear of being forced to aid adversary at expense of their client.
   iii. CPA workpapers and work product were not historically protected. See tax practitioner privilege IRC Sec. 7525.
   iv. Tax practitioner privilege. May apply to individual authorized to practice before IRS. Covers tax advice within that scope. Does not apply with respect to participation in tax shelter.

e. Appraisal process.
   i. Any documents in appraiser's file including correspondence, notes, draft reports, etc. may be subject to disclosure to IRS.
   ii. Recommendation that attorney not client could hire appraiser.
   iii. Kovel agreement under US v. Kovel, 296 F. 2^{nd} 918, (2d Cir. 1961). If attorney engages expert who assists attorney in providing legal services.

12. **<u>How Courts Unravel Asset Protection Trust Strategies</u> –** Harrison.
   a. Types of asset protection trusts.
      i. Third party trusts.
         1. Protection against future creditors.
         2. Supplemental needs trust.
      ii. Self-settled domestic asset protection trust (DAPT).
         1. Protecting grantor assets from future creditors.
         2. Trying to protect from current/past creditors or known bad acts.
   b. "In the world of estate planning in 2017, there should be no outright distributions to children. All children's distributions should be in trust, and then the client…needs to balance the level of beneficiary-control over that trust, with the certainty of creditor protection that the trust may provide."
      i. **<u>Comment</u>**: This quote should be a key stone of planning yet it seems almost remarkable how many practitioners do not draft in this manner, or too quickly accede to client demands for other approaches. With the growing common use of decanting practitioners in all disciplines should push clients to meet with estate planning council and try to enhance the many existing/old trusts that have used other approaches.
   c. Trusts can be unwound in many ways:
      i. Beneficiary has withdrawal right with too much power. Frisch v. Frisch (US Bankruptcy Court, DC Mich. No. 13-80072).
      ii. Standard of distribution too broad.
      iii. Beneficiary serving as trustee.
      iv. Fraudulent conveyance (especially for DAPT).
      v. In divorce courts may create theory to pierce trust to provide child support or maintenance.

d. Spendthrift trust.
    i. If spendthrift clause not effective claimants can reach trust assets.
    ii. How does protection of spendthrift provision compare to protection afforded by a discretionary trust.
    iii. Spendthrift provisions are nearly ubiquitous in trust drafting.
    iv. Discretionary provision should succeed if trustee refuses to make distributions, and beneficiary cannot force trustee to distribute.
    v. Trustee may make distributions for the benefit of the beneficiary, and not direct to beneficiary, which may make it more difficult for creditor to reach it. However, in Berlinger the FL court permitted a creditor to obtain a garnishment order.

e. Beneficiary as trustee.
    i. Beneficiary can be trustee if distributions limited to HEMS and may provide protection from creditors.
    ii. McCoy v. McCoy 274 BR 751 (2002) let a creditor reach the trust because of use of term "desirable" in context of the trustee paying income or principal the trustee determines is required or "desirable" for the beneficiary under HEMS standard.
    iii. Recommendation is not to have beneficiary as trustee. If beneficiary is trustee should resign if concerns arise.
        1. **<u>Comment</u>**: might be better to have a trust protector empowered to change trustees terminate the beneficiary/trustee so it is not done by an affirmative act of the beneficiary.

f. Recommended steps.
    i. Don't name beneficiary as trustee.
        1. If client wants beneficiary as trustee a co-trustee structure with the beneficiary's distribution powers limited to HEMS may be preferable to the beneficiary as sole trustee.
    ii. No lifetime powers for beneficiary.
    iii. Fully discretionary during life of beneficiary.
    iv. No enforceable right of beneficiary to demand trust principal.
    v. Consider assets that provide a measure of creditor insulation, e.g. life insurance.

g. Attacks on DAPTs.
    i. Statute creating DAPT is violated.
    ii. Beneficiary's rights too great and equivalent of a revocation of the trust.
    iii. Exception to DAPT protection applies.
    iv. Fraudulent transfer.
    v. State's public policy violated. Huber v. Huber, 41013 (2013).

13. **<u>Income Tax Strategies for Trusts: Assignment of Income to Taxpayers in Lower Income Tax Brackets, Including State Income Taxes</u>** – Schoenblum.
    a. Trust income taxation.
        i. Potential to save state and federal income tax by shifting trust income to different beneficiaries.
        ii. Deduction to trust for distributions to beneficiaries.

1. IRC Sec. 651-652 deduction for trusts required to distribute income currently.
2. IRC Sec. 661-662 deduction for trusts not required to distribute income currently.

iii. Non-grantor trust reaches maximum income tax rate at about $12,000 of income joint return for individuals in 2017 do not reach maximum tax bracket until $470,700 of income.

iv. Design trusts to enhance income tax planning. Give trustee discretion to make distributions in varied amounts. Does this include inequitable distributions to the lowest income tax bracket = least productive, beneficiaries?

v. Consider use of LLC or FLP to receive distribution from trust so income will flow through to the beneficiaries but the cash can be kept inside the entity.

vi. Does the degree of discretion in the trustee raise concern? A protector could be appointed with power to change trustees. Alternatively, someone could be required to, and granted the power to, approve distribution.

b. Capital gains.

i. IRC Sec 643 capital gains are not included in DNI but treated as principal.

ii. Result can be capital gains taxed at higher trust rates.

iii. State trust accounting rules generally do not define capital gains as income but rather as capital gain.

iv. Treas. Reg. Sec. 1.643(a)-3(b) provides that capital gains may be included in DNI pursuant to one of three methods. It must be done pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary in accordance with a power granted to the fiduciary by applicable local law, or by the governing instrument if not prohibit by applicable local law.

v. Most states follow a version of the UPIA – Uniform Principal and Income Act.

vi. Consider clause in trust instrument that grants the trustee the discretion to allocate any or all capital gains to income Capital gains should be defined consistent with the tax laws.

c. NIIT 3.8% tax.

i. Tax reform may eliminate.

ii. IRC Sec. 1411.

iii. If distribute to beneficiaries tax avoided unless beneficiary's modified AGI exceeds threshold.

d. Kiddie Tax.

i. IRC Sec. 1(g) taxes child who has not attained the age of 19, or is a full-time student who has not attained age 24, etc.

ii. Kiddie tax can eliminate much of the income shifting benefit.

e. 65 Day rule.

i. Trusts can distribute income within 65 days of end of year and treat it as if distributed in the prior tax year.

ii. IRC Sec. 663(b) election.

f. State income tax benefits.
    i. Can trust shift income to out of state beneficiary and avoid state taxation?
g. Move trust situs.
    i. May require shifting of administration of the trust to a state that does not impose income taxes.
    ii. Trust should have clause permitting change in trust situs and location of trust administration.

14. **<u>Strategies for Donor Centric Charitable Giving</u> –** Beckwith.
    a. CLTs versus GRATs.
        i. Unlike a GRAT payments are to charity and if the assets don't outperform 7520 rate nothing passes to heirs.
        ii. CLATs are not limited to the 20% increase/year that GRATs are. Some practitioners are comfortable backloading CLAT payments with balloon payment, the so-called shark fin CLAT.
        iii. GRATs are grantor trusts. CLATs can be grantor or non-grantor. A grantor CLAT can generate an income tax deduction.
        iv. GRAT is ineffective if grantor does not survive the term, a CLAT can be created for a term of years and can compound growth outside the estate post-death.
        v. Testamentary CLATs can be created.
    b. CRTs.
        i. Characteristics.
            1. Provides specified distribution at least annually to one or more beneficiaries for life or a term of years (not more than 20).
            2. Irrevocable remainder paid over to charity.
            3. CRT must use calendar year.
            4. Annual payment cannot be less than 5% of net FMV of assets and cannot be more than 50%.
            5. Present value of remainder to charity must be 10%.
            6. Exhaustion test Rev. Rul. 77-374.
            7. Income tax deduction to donor on creation based on actuarial value of remainder interest.
            8. CRT is tax exempt (CLT is not).
        ii. Watch anticipatory assignment of income issue.
        iii. Variations.
            1. CRUT.
            2. NIMCRUT.
            3. Flip CRUT.
    c. Charitable gift annuities.

15. **<u>The Future Has Arrived: Are You Ready for Electronic Wills</u>? –** Stone.
    a. Electronic will.
        i. Uniform Electronic Transactions Act of 1999
            1. Defines record created by electronic means.
            2. An electronic record is information created, generated sent, communicated, or stored by electronic means.
        ii. Uniform Transactions Act 1989.

    iii. Electronic Signatures in Global and National Commerce Act (E-Sign act).
    iv. Electronic will is information in a digital medium.
    v. An electronic will is not a scanned copy of a paper will but rather a will created in electronic format.
  b. Cases.
    i. Taylor v. Holt, 134 SW 3d 830 (Tenn Ct. App. 2003).
      1. Will prepared on computer. Two neighbors acted as witnesses. Computer signature affixed.
      2. Court held valid.
    ii. In re Estate of Castro, Case NO. 2013ES00140 (Probate Div. Court of Common Please, Lorain County, OH 2013).
      1. Used Samsung Galaxy table to write a will.
      2. Before signed he was transferred to another facility. In second facility signed on table in presence of witnesses.
      3. Court accepted.
    iii. Litevich v. Probate Court, 2013 WL 2945055.
      1. Controversy over two competing wills.
      2. Used Legalzoom in 2011 to prepare will. Did not sign as believed will invalid unless notarized. Could not get notary and testatrix became incapacitated.
      3. Court held Legalzoom will failed to meet requirements for will.
  c. Statutes.
    i. Nevada 2001 legislation revised in 2017.
    ii. Florida introduced legislation in 2017 vetoed by governor.
    iii. Four other states introduced legislation for electronic wills but none were enacted: Arizona, Indiana, New Hampshire and Virginia.

16. **<u>Aggressive Tax planning and the Ethical Advisor: Beyond Zealous Advocacy and What to do When the Referral Proposes Questionable Structures</u>** – Kohn.
  a. As the exemption has increased practitioners have to compete more for clients and may be tempted/pushed to take aggressive planning positions.
  b. What are the limits of tax planning?
    i. Remaining in bounds of professional ethics while still advocating for client.
    ii. FLPs once were viewed as cutting edge or aggressive now "an essential tool of most professionals dealing with transfer tax planning."
    iii. Another strategy is sales to grantor trusts. An aggressive adviser might push the envelope undercapitalizing the purchasing trust or providing little or no security for the financed portion of the purchase price.
      1. **<u>Comment</u>**: If the reality of sale construct is considered there may be no need for security, seed gifts, or a down payment. Also, while many refer to a 10% capitalization of the trust as of Biblical origin it is more akin to the mythical Chimera. So, caution is also in order in suggesting that any particular approach or litmus test is essential, as it may not be. And with so many plans so fact intensive drawing conclusions must be done with caution.
    iv. FLPs.

1. Economic substance doctrine.
2. Intended transaction should have economic substance separate and distinct from economic benefit achieved by tax reduction. IRC Sec. 7701(o).

c. Step transaction and substance over form.
   i. A recommended transaction may be the compilation of a series of transactions that violate the step-transaction and/or substance-over-form doctrines.

d. Ethics rules.
   i. Rule 1.2 scope of representation.
   ii. Rule 1.15 declining or terminating representation.
   iii. Rule 4.1 truthfulness in statements.
   iv. Rule 9.4 misconduct.
   v. ABA Opinion 346. Ethical guidelines to be followed by a lawyer who issues a tax shelter opinion.
   vi. Circular 230.

e. IRC Provisions.
   i. IRC Sec. 6701 penalties for aiding and abetting understatement of tax liability.
   ii. IRC Sec. 6701A penalty for failure to include reportable transaction with information return.
   iii. IRC Sec. 7201 attempt to evade tax.

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