Martin M. Shenkman's Meeting Notes from Heckerling 2018: Day 2 both Morning and Afternoon Notes

These notes are prepared and published quickly without proofreading or review so be cautions that there will be typographical errors, citation omission and mistakes.

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**. Heckerling, as it is affectionately known, is the nation's leading conference for estate planners, attorneys, trust officers, accountants, insurance advisors and wealth management professionals. 2018 is the 52nd installment of Heckerling, and for those not fortunate enough to be in sunny Orlando, the meeting this year runs from Monday, January 22nd through Friday, January 26th.

These materials have been published with specific permission from the **Heckerling Institute on Estate Planning** and **LISI** very much appreciates the courtesy! Because of the length of Marty's commentary, **LISI** has made his notes from the sessions on January 23, 2018 available to members through the following link:

Related LISI Webinars: on February 2, 2018 2pm EST Marty will be joined by Jonathan G. Blattmachr and Joy E. Matak to present a webinar on creative trust planning strategies after the Tax Cut and Jobs Act of 2017 which will reflect ideas gleaned at Heckerling. Click here to register: **[LINK].** On February 8, 2018 1pm EST Marty will present a webinar on planning nuggets gleaned from the week long Heckerling proceedings, the highlights from the extensive notes LISI will publish. Click here to register: **[LINK].**

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Steve Leimberg recently noted that:

> Every tax professional in the country will (or should be) reading this book! This is the most complex and far reaching tax law passed in the over 50 years I've been studying, teaching, and writing about tax law and this resource arms you not only with the necessary and vital information you need to know but also the thinking and planning concepts of three of the brightest minds in the tax world!

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. His website www.shenkmanlaw.com has information of interest to advisers and you can register for his quarterly planning newsletter Practical Planner.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

1. **<u>Managing Tax Basis Today for Tomorrow</u>**. Paul S. Lee.
   a. Basis and use of exemption.
      i. Free basis step-up on first spouse death as a result of marital deduction.
      ii. $11.18M exemption increasing by chained CPI and in 2026 may drop to about $6.75.
      iii. Should you ever use exemption equivalent amount?
      iv. Exemption is amount you can pass away with no estate tax and free-basis setup up at death but only if you have it available at that time.
      v. GRATs and note sales are near zeroed out transfers so you do not have to use exemption equivariant amount and they shift value out of the estate.
      vi. But if we are to lose the increased exemption, e.g. from sunset, answer may be different.
         1. New IRC Sec. 2001(g)(2) claw back important to the analysis.
         2. If the Treas. Regs to be issued say that in 2026. If regs say if you make $5M gift today you are using bottom $5M you should have used up additional $5M today. Speaker suggests waiting and to see what the regs provide.
         3. **<u>Comment</u>**: Some practitioners suggest it is advisable to use exemption now because of the uncertainty of what might change with a future administration. Do they make tax Ouija boards?
   b. Asset classes – some benefit the most from step up, others less so, some not much.
      i. No benefit.
         1. IRD.
         2. IRAs.
      ii. In between benefit.
         1. QSBS qualified small business stock. Sec. 1202 Exclusion.
         2. High basis stock – minimal gain.
      iii. Best benefit.
         1. “negative basis” real estate – recapture.
         2. Bonus deprecation under Sec. 168 subject to Sec. 1245 recapture. Business Property now placed into service has 100% expensing upfront, and it is all considered ordinary income
         3. Patents
         4. Copyrights.
         5. Trademarks, created by others.
   c. Tax basis management basics: grantor trust swapping.
      i. Proactively swapping high basis assets for low basis assets accumulated in the trust. Trade low basis for high basis property.
      ii. Low income tax rate assets for high income tax rate assets.

   iii. Cash for liability. Cash has basis equal to face value. Put cash in trust and keep liability outside the trust.
   iv. Promissory note for appreciated assets. Trade your own self-created promissory note for appreciated asset in grantor trust. What is basis of promissory note on death? Not certain. S corporations and partnership rules take different view. Answer might be that basis in promissory note might be the tax basis of the property that you swapped it for at that time. Answer is not clear but if it is the only option it should be done.

d. Get rid of valuation discounts.
   i. Use the Powell case as a tool to avoid discounts. **Comment**: See discussion of Powell case in Monday afternoon current development notes. For a great analysis of the case see Steve Akers monograph on the topic.
   ii. Use general partnership ("GP") arrangement to negate discounts. Example:
      1. LLC has old and young partners. Old own 40% and young 60% and each has $11M+ exemption so perhaps none will have estate tax.
      2. How big of a basis step up can you get on the LLC at death?
      3. Your agreement could be drafted without restrictions can reduce discounts but may not eliminate all.
      4. Instead convert LLC or FLP to GP. Individual partners can drop their interests into wholly owned disregarded LLCs for liability protection before the conversion to maintain protection.
      5. 2701 exception does not apply to GPs.
      6. If you are a GP under state law you can get your pro-rata amount of share of assets in partnership so no valuation discount.
      7. Section 754 election.

e. How multiply step up in basis with debt?
   i. In separate property states can you get a multiple of the basis step up?
   ii. Use debt. Another concept is borrowing money.
      1. Example no debt - $10M asset, taxable estate = $10M and step up = $10M.
      2. Example with debt added – Gross asset value = gross estate $10M under Sec. 2031. Debt $9M Sec. 2053(a)(4). Taxable estate $1M. Step up is still $10M.
      3. Consider:
         a. Zeroed out transfers (GRATs, note sales). GRATs take time to move assets out of estate.
         b. Swaps for appreciated property.
         c. Private split-dollar loan. Loan $9M to ILIT and buy insurance policy on younger generation and promissory note used under the private split-dollar regs paying AFR and pays no interest just accumulates.
   iii. Asset in QTIP.

1. QTIP trustee can borrow funds and distribute asset to the spouse who can then make transfers to reduce value. **<u>Comment</u>**: Consider terms of QTIP and what it permits in terms of distributions to the surviving spouse, authorization to facilitate tax planning, etc.
2. Sec. 2044 inclusion is deemed ownership for estate tax purposes. Only net equity amount is included so debt would reduce value.

f. Community property.
   i. Trust in state permitting non-community residents to get community treatment.
      1. Double step up in basis no matter which spouse dies first.
      2. Elective consensual community property states are: AK, TN, SD.
      3. **<u>Comment</u>**: See current development notes Monday afternoon about IRS consideration of this.

g. JEST = joint exempt step-up trust. Alan Gassman, Esq. idea.

h. 2038 Marital trust for double step up in basis on death of each spouse.
   i. Grantor spouse funds marital trust today. It is a common law estate marital trust. You can have discretionary income and principal to the beneficiary spouse, but on death of the beneficiary spouse all assets must be paid to the estate of the beneficiary spouse.
   ii. Assets are moved out of estate and qualify for gift tax marital deduction. But give the settlor/donor spouse the right to terminate that QTIP trust at any point in time to cause estate inclusion under IRC Sec. 2038.
   iii. However, the QTIP trust must provide that if the QTIP is terminated all assets must go to the beneficiary spouse. So, even though settlor spouse can terminate it, it is a completed gift because settlor spouse cannot get it back.
   iv. Only one of two things can occur. Settlor spouse dies first. Included in settlor spouse's estate under 2038 because had right to terminate. If beneficiary spouse dies first to her estate and get step up.
   v. Make sure this is a grantor trust with a swap power.
   vi. Divorce would be a significant risk.

i. 1202 Qualified Small Business Stock ("QSBS").
   i. 100% exclusion.
   ii. Greater of $10M or 10 x the adjusted basis without regard to additions to basis after original issue. This may mean that a basis adjustment at death won't be included in the 10-x calculation.
   iii. Tax basis management prior to conversion.
   iv. Adjusted basis has a unique meaning in this context.
   v. Conversion from LLC to C corporation.
      1. Contribution of LLC assets for shares in C corporation.
      2. Want basis as high as possible.
      3. You could trigger capital gain on conversion to increase basis but that would be costly.
      4. Marking appreciated asset to FMV. If you used $100k to create assets and at time of conversion FMV of asset had increased to $5M under Sec. 1202 you use the $5M number not $100k.

j. Contract derivatives.
    i. David Handler, Esq. planning idea.
    ii. Using a contract derivative to transfer but still own the asset for the step-up.
    iii. Contract says I will give you the appreciation. You will buy rights to receive the appreciation.
    iv. How will you value the carried interest?
    v. Sec. 1061 must be considered (but makes no sense).
    vi. Example fully depreciated real estate. ‘Negative basis’ property. Use a contract derivative to sell to grantor trust all future appreciation on the asset. If you close out on contact before grantor dies may work. Downside if you pass away with obligation outstanding there are risks with the estate tax liability. May convert to ordinary income. So closing contract pre-death is critical.

k. How can you eliminate installment notes and get basis adjustment on assets outside the estate?
    i. $100M asset in an intentionally defective irrevocable grantor trust (“IDIGT”). Grantor sold asset years ago for $50M and has accrued interest for years.
    ii. IDIGIT has $100M assets and $50M liability and grantor has in his estate the $50M promissory estate. IRS has given up on death of grantor with note outstanding as being a sale recognition event. But under Sec. 1001 (Crane case) the IRS has not given up that on loss of grantor trust status there is a deemed transfer from grantor to grantor trust. That has associated with it a $50M liability and you have no basis. If no basis you may have gain under IRC Sec. 1001. If don’t pay off note before death some might suggest you trigger $50M gain. How do you get rid of the promissory note?
    iii. Create LLC and have the IDIGIT and the grantor each contribute assets to this new LLC. The LLC is a disregarded entity as IDIGIT and grantor are both the same. What happens to basis in shares in LLC and their capital accounts. The debt is associated with the asset. The LLC owns $100M asset and $50M note and $50M debt. If LLC owns the right to receive liability and owes liability the liability disappears. Since all of this was done in a disregarded entity (LLC owned by client and client’s grantor trust) there should be no taxable event. On Grantor’s death, the grantor owns ½ of disregarded entity an it gets converted to a partnership because the trust member is no longer grantor. Rev. Rul. 99-5 governs what happens when you have a deemed transfer and go from a disregarded entity. Treated as asset purchase and contribution. This should provide a full basis adjustment. IRC Sec. 754 election and a 743(b) adjustment can be used to reinforce that.

l. You have eliminated potentially ½ = $50M capital gain and more.
    i. How do you use a partnership do to real magic?
    ii. Basis stripping and basis shifting.

        iii. $200 assets each with $50 in basis. Which do you push into estate and which out of estate? Can you shift $50 in basis from one asset to the other? This may be done without death or a taxable event is use partnership law.
        iv. Need old and cold partnership holding asset for 7 years or asset purchased by partnership in order to basis shift.
        v. Asset A has basis $0 and FMV $100. Asset B has $100 basis and FMV $100. Old partner and young partner. Old partner as outside basis of -0- and capital account of $100.
        vi. Distribute high basis asset to low outside basis partner. In-kind distribution of property to partner with no basis in partnership interest. Doesn't matter if liquidation or redemption. When asset comes out it has a -0- basis. That is the basis strip. With 754 election you get an adjustment under IRC Sec. 734. You have moved $100 basis from asset B to asset A.
        vii. This would allow you to take basis from 20% property and add to 25% and 28% property. Life insurance has a wasted basis.

2. **Business Succession**. Thomas W. Abendroth.
    a. General comments.
        i. Every business and family ownership group is unique and no one way to accomplish succession. Each approach will have its own impact on business and family.
    b. Consider common themes.
        i. Appreciation.
        ii. Time.
            1. Start early.
            2. Client may not know what succession plan will be. Might evolve into a sale, pass to children, other options or combinations of options.
        iii. Flexibility.
            1. Don't be tied to any particular strategy.
            2. Diversification of planning techniques.
            3. Use multiple techniques depending on the situation to transfer business and achieve transfer tax savings. Transfer taxes may play less of a role then they had for many clients.
        iv. Bifurcation and control.
            1. Stock is viewed by someone as a 'package' but the rights to control, distribution, etc. don't have to be bound together.
            2. Traditional way to do this in a trust is to name a trustee to control and have others as beneficiary have benefits of the equity.
            3. In business setting the planning is more nimble.
            4. Can create voting and non-voting interests in the entity.
            5. Benefits include allowing senior family member to control but plan.
        v. Confirmation of concept that you can have different interests if held differently for property law purposes not aggregated for valuation.

            1. Estate of Bonner v US, 84 F.3d 96. Discount applied to valuation of ownership interests divided between decedent and QTIP.
            2. Estate of Mellinger v. Commr, 112 TC 4 (1999) widow held majority interest in her estate for estate tax purposes but about 27% was in her name and the balance was in QTIP and the two parts were not aggregated and estate could claim valuation discount.
            3. Decedent could be trustee and receive income from interests but could still have valuation discounts.
            4. Voting control considerations.

c. Basis step up/estate tax savings.

d. Diversification.
    - i. Diversification. Use of numerous estate planning techniques to reduce the value of the business in the estate.
    - ii. Assume that client's business is large enough that there will be an estate tax that is painful, disruptive, and could even potentially end the ability of transferring the business to the next generation.
    - iii. This will require a variety of techniques to properly move values of the business out of the estate to avoid the estate tax and allow for the transfer of the assets.
    - iv. Scenario: New business venture. Lots of opportunity for future appreciation. Any kind of business venture where the value is manageable enough to transfer through gifts or loans to trusts or other business members is a candidate. Real estate developers and hedge fund/private equity individuals may present opportunities for this planning.
    - v. IDIGT:
        1. Seed it through a combination of gifts and loans.
        2. Client and IDGIT invest in a family FLP/LLC.
        3. FLP/LLC then invest in the business venture.
    - vi. Private annuity or SCIN to make value disappear.
    - vii. LLC as family bank over time.
    - viii. Loan guarantees, notes, what is exit strategy.
    - ix. Use techniques in combination.

e. Non-tax considerations.
    - i. Prenuptial agreements – consider limiting only to family business.

f. Unhappy family member or branch.
    - i. Want out of family business.
    - ii. Education is key.

g. Sale of business.
    - i. Client comes to you shortly before the sale of the business.
    - ii. If they already have a term sheet, it makes using discounts tough, but it may still be possible.
    - iii. Use the chance of the deal falling through in due diligence as justification for a discount.

h. Planning does not involve estate planning benefit, but is worried about income consequence, is considering gifts to charity.

        i. Some DAFs may accept gifts of the stock if there is an exit strategy- but you cannot gift once the sale is certain. You have the right to receive the proceeds up until the point when the sale is so ripe that it is the equivalent of receiving the proceeds. Basically, did the charity have the stock for long enough to have a say in whether the sale would go through?

i. Bifurcation.
    i. Separate control from the equity in the business, then separate the equity to take advantage of discounts.

j. Divide control from the equity.
    i. You should separate the control at the entity level rather than the trust level- so create different kinds of stocks. Even in S Corps this is doable as voting is the only power you can bifurcate.
    ii. Non-voting stock lets the client who does not want to give up any control to make transfers.

k. When you isolate the voting control and equity, typically you will have a low amount of the equity as part of the voting bloc, so this allows you to transfer the voting control easier as the value is small in comparison to the entire value of the company.

l. Family Attribution.
    i. Cannot get discounts for loss of control when the stock is held between different family members. However, the IRS has constantly rejected this concept, as family cooperation is a tenuous concept. Therefore, attribution in this situation, closely held stock for estate purposes will be valued without consideration of attribution. Rev Rul. 93-12.
    ii. Estate of Bonner- If you have assets in the estate, but are held for property law purposes by different people, they are not aggregated for valuation purposes. For example, you have stock in the person's name and also a QTIP Trust, so both are in the estate, but held by different individuals, so you do not Aggregate the stock together for value, can get discounts for minority share, etc.

m. Decedent can hold almost every right over these items even if they are not receiving the equity value of the asset (trusteeship of a trust, voting rights, etc.) As long as the decedent does not have a GPOA over the interest that is held in the trust, the assets will be valued as if held by different people, not aggregated.

n. Non-Tax Factors:
    i. Children with ownership interests that reach adulthood. Advanced education of the children is important. Has the family talked to the kids about the importance of the family business or the legacy?
    ii. Have they been talked to about the role of items such as pre-nups, so when situations come up it is already in mind, rather than being completely blindsided? Pre-nups are usually more palatable to young couples if you limit that pre-nup to the family business, as all you are trying to do in that situation is protect the family business.

o. Family Members who do not want to be in the business anymore.

i. Education is key in this situation as well. There will also be polarized aspects here- some will view the business as a family legacy, and everyone should be involved.
ii. Family Advisory Boards are excellent in this situation, allows for moving family members through education and involvement, and can also be able to deal with getting out family members who do not wish to be involved anymore. Is it an all or nothing decision to the family? What about all the ancillary perks that the family members get? Consider tax consequences of the redemption as well if that is what is happening- they are complex and can be disastrous if not properly executed.

3. **Care and Feeding of a Dynasty Trust**. Diana S.C. Zeydel.
   a. Introductory comments.
      i. Grantor trusts have been the answer for decades now- but with the 2017 Tax Act what will be the changes that allow for Non-Grantor trusts to be used?
      ii. Trusts give you the ability to change the disposition of the assets after the transfer is completed.
      iii. Distributions: Less is more- the less you say the more flexibility you have, less chance of having to go to the courts for an interpretation.
      iv. Dead hand control.
      v. Precatory language – speaker does not really like it but sometimes has a salutary effect as some beneficiates read and take the precatory language seriously. **Comment**: Several speakers have mentioned the benefits of using precatory linage.
      vi. Powers of appointment to "refresh" trusts.
   b. Trustee ability to make changes.
      i. Flexibility, start in trust drafting, but also consider options below to create changes.
      ii. Decanting.
         1. FL cannot decant unless have absolute discretion.
      iii. Amendment.
         1. They work but more difficult to draft then decanting language.
      iv. Non-judicial modification.
   c. QTIP.
      i. Clayton.
      ii. Do you need disclaimer to move assets from marital to credit shelter trust?
      iii. Portability plan.
      iv. Create possibility to elect into portability, or not.
   d. Checks and balances over office of Trustee.
   e. Pot trust.
      i. Adds time for free from GST status but this is not the American mentality (on death each kid gets a share, but that reduces flexibility).
      ii. Can/will they permit to add spouses?
      iii. Will beneficiaries get along?
   f. Flexibility.
      i. Do you waive rule against self-dealing?

    ii. Do you waive prudent investor rule? You are then trusting trustees to go 'off book,' but it adds flexibility.
    iii. Do you divide during settlor's lifetime?
    iv. Situs.
        1. If you change to different situs you get law of administration of that new state and that might give you more flexibility.
        2. Change situs to get better state law on decanting.
        3. State law varies substantially.
    v. 2038 power.
        1. Skifter. Must engineer into trust from inception.
        2. Must include right to give settlor 2038 power to attract estate tax inclusion.
g. Tension between Flexibility and Fiduciary duty?
    i. How low can you go with respect to fiduciary liability?
    ii. In directed trust direction trustee has fiduciary duty to beneficiaries and administrative trustee has standard of willful misconduct which is less than good faith. Definition is difficult to pin down but notion is that it is lower than good faith.
    iii. General notion is if you have trustee that trustee should not be exonerated 100%. **Comment**: If you go too far is the arrangement still a trust?
    iv. While there is some standard of liability a directed trustee can be reduced to a very low standard.
    v. Corporate fiduciary can still be at the table even if not liable. They are still there and that is better than administration of the trust and that is better than just having a family member run the trust. The presence of a professional trustee makes administration better.
        1. **Comment**: This is an incredibly important point. Some practitioners loath to involve an institutional trustee for a range of reasons, but the reality is that the professionalism, formalities, processes and policies they can bring to the administration of a trust that family member trustees too often don't provide can be a tremendous benefit to the trust and enhance the likelihood of trust formalities being adhered to thereby assuring the success of the overall plan.
    vi. Dividing up office of trustee is just one step on the flexibility continuum.
        1. Started with delegation and obligation to supervise.
        2. Now with directed trust the outsider is responsible as if they were a trustee from the standpoint of liability which is the correct answer as they are performing the responsibilities of a trustee.
h. Old trust you want to modernize.
    i. What are remedies under state law if no decanting or other language in the trust?
    ii. What type of interest do people have in the trust? This will make a difference as to whether someone might be engaged in making a gift if non-objecting to making a gift on modification or other action with respect to the trust.

1. Vested. Subject to divestment. This interest is transferable and not subject to rule against perpetuities. Vested interest is estate tax includable even if subject to later divestment. May pass to beneficiary's estate unless there is a subsequent disposition. Must know what governing instrument says and whether you have an interest that could pass through estate to intestate hires. UTC extended the anti-lapse rule. If intend anti-lapse not to apply must be explicit.
2. Contingent remainder interest.
3. Executory

iii. US vs. Land 303 F.2d 170. When does ownership of decedent end and ownership of successors begin.
iv. Pierre case state law creates the property law rights and interests and federal tax law taxes those interests and rights.
v. Governing document controls. Start with state law right first, then figure out transfer tax consequence.
vi. A transfer tax is a tax on transfer, so an interest that disappears on death is not taxed.
vii. Rev. Rul. 67-370 regarding revocable trust. Decedent was to get interest on death of settlor but settlor could revoke trust. Defeasibility does not warrant assignment of nominal value if there is still a reasonable probably of estate acquiring an interest.
viii. Rev. Rul. 76-472 valuation of future interest with remainder to class of life tenants issue. If she could have more kids that does not make interest contingent, it is just a valuation question. Interest is taxable.
ix. Gift tax not imposed on receipt of property by donee. If property left hands of donor it is a tax on the donor's act of making a transfer. A completed gift to trust with open ended class is still taxable.
x. Chapter 14 could have completed gift of whole if cannot measure contingency.
xi. Anything can be gifted, property however conceptual or contingent. Why relevant? Because we are going to change a trust can a beneficiary be accused of making a gift subject to gift tax? Are beneficiaries consenting to gift and is there a potential transfer tax?
xii. If part of a prearranged plan and Rev. Rul. 77-299 it is a gift up front. Caution about pre-arranged plan of loans, may be treated as gift up front. Example: Loan $100k in year one and forgive $10k/year. With the prearranged plan argument that may all be construed as a gift in year one not in each of the next ten years.
xiii. Trust gave Beneficiary special power of appointment. What happens when beneficiary exercises inter-vivos special power of appointment? Is that a gift? Yes, and there could be a skip of if appoint to grandchild.
xiv. Rev. Rul. 75-550 pattern of distribution in a discretionary trust. Look at that to determine amount of gift if exercise a power.
xv. Beneficiary gave affidavit that will never need a distribution. IRS held that the advancement of principal to another beneficiary may be a nominal gift

but it may still constitute a taxable gift. The lesson: be very careful with exercise of lifetime powers.

i. Old and cold trust to change.
    i. Property owned by beneficiaries and if they collectively want to terminate the trust. Under UK law it works. UK law does not give the deference to the settlor's intent that American law does.
    ii. What is a material purpose of a trust?
    iii. Overtime we have given trustees more flexibility to make changes.
    iv. Estate of Brown 528 A. 2d 752 (Vt. 1987) - settlor intended to provide for lifelong income. Current and residual beneficiaries petitioned the court to terminate and distribute and court said no that it conflicted with a material purpose of the trust. You cannot do just anything.
    v. Restatement 3rd – what if a particular clause in the trust agreement, e.g. a spendthrift clause, might be boilerplate? May need to show settlor intent as to material purpose.
    vi. UTC reflects need to be flexibility as trusts have become longer. Six separate provisions allowing for modification. FL has 9.
    vii. What do we really know about settlor material purpose?
    viii. Settlor and beneficiary under common law can get together and terminate a trust. Peck v. Peck 133 So. 3d 587.
    ix. Common law might give every trust that flexibility but is there a 2036 problem that might be ignored?
    x. Helmholtz case - Draft against it in the trust and state that settlor and beneficiaries may not terminate trust.
    xi. Wiedenmayer v. Johnson 106 NJ Super 161 – because trustee had absolute and uncontrolled discretion decanting was permitted.

j. Tax issues of unwinding trust.
    i. If you have a completed transaction you may not be able to unwind.
    ii. If you have an incomplete gift you might be able to unwind. There may have been mistake at time of transfer, mistake in law or mistake in fact. Example – I transferred the wrong property. Breakiron case disclaimer undone because person who disclaimed did not understand law and did not realize it would be taxable after QPRT term over.
    iii. Bosch doctrine.
        1. IRS is not bound by state court. Must give proper regard. Tension between this and ordinary course of business doctrine that say you can unwind.
        2. Tension between GST regs and Bosch. Bosch says unless highest court of state but GST regs say bona fide dispute and settle in range of outcomes that may be OK and no adverse GST consequences (i.e., may not lose Chapter 13 exemption). If there is a bona fide dispute you should not have transfers or income tax results as among the beneficiaries.
        3. Could you try to fix that by obtaining a ruling from the highest4 court in the state?

4. In re Darby – taxpayer got increase in mandatory distributions and power of appointment by modification. Went to Supreme Court in Kansas and court held spendthrift clause is a material purpose and accomplishing a more favorable result is not the same as achieving the taxpayers probable tax intent. Modification is invalid.

iv. Rev. Rul. 73-142 may avoid adverse tax consequence if there was a mistake at the time of the transfer. This address GPOA and court construed it as not being a GPOA. This might be an opportunity in drafting, court might construe differently so consider stating what the tax intent so if there is a mistake the court can construe document properly.

v. Clues under GST regs. Trustee authority under governing instrument if trustee had ability to make change.

vi. GST trust concern is losing GST exempt status.

k. Summary considerations.

i. Administrative changes likely won't trigger tax problems.

ii. Voluntary transfer of rights might have tax consequences.

iii. Cannot extend time for vesting.

4. **Money in Politics**. Trevor Potter.

a. Charities and politics.

i. 1980s- Tax Exempt organizations did not have anywhere near the same amount of secretive influence they have today. They were largely barred from making political contributions as corporations were not allowed to make political expenditures without reporting.

ii. 2010- Citizen's United.

1. Removed the stopgap on ability for corporations to make political contributions. 501(c)(4)s have reported since then spending at least $650 million dollars on election activity. (c)(4)s are a small number of corporations, so the amount of contributions from this subset (80,000 total) are significant.

2. Only 10% of (c)(4)s make contributions, so the amount of contributions made per entity give them disproportionate influence. In addition, the (c)(4)s do not need to expose their name in making those contributions. They can (a) spend unlimited money, including corporate money, on political contributions, and (b) keep those contributions secret from the public.

iii. 501(c)(4) are organizations not organized for profit, but organized solely for the promotion of the public welfare? How did this style of corporation end up becoming a vehicle for political contributions?

iv. 501(c)(4)s are allowed to promote in political actions so long as that is not their "primary purpose".

v. 501(c)(4) groups seeking exempt status that do not fit elsewhere in tax code. Includes American Kennel Club founded in 1884.

vi. Under 10% of all C4s report political activity. This handful of political organizations doing business as C3 organizations are of concern as these organizations have become entities of choice for pollical donors seeking to spend money on elections without having their names disclosed.

vii. They can legally spend unlimited money on elections, including corporate forms, and keep donors' identities secret.
viii. 501(c)(4) defined as civic leagues etc. operated exclusively for social welfare.
ix. How did organizations that exist for social welfare end up deep in world of political campaigns?
x. What constitutes political campaign intervention, and what is the threshold for the amount of intervention that can be performed before it becomes the corporations "primary purpose" and therefore become a violation?
xi. Modern finance system dates to the 1970s. Complete change to the political system and the funding of political campaigns. 1976- Buckley v. Valeio, upheld most of the new laws, and found disclosure requirements were constitutional, but found a distinction between contributions and expenditures. Basically, the court upheld a limitation on contributing to a candidate, but could expend money as they wish if there is no cooperation with the candidate, as it was considered first-amendment protected speech.
xii. 1990s- Parties started raising money that exceeded the disclosure and expenditure requirements. They got around this through finding parties could raise unlimited funds for actions that were not federal politics- which ended up also including television ads.
xiii. Phony Issue Ads- an add that disparaged a candidate, but stopped short of expressly endorsing a candidate, to avoid the add being classified as a political add.
xiv. 2010: Corporate, State and Local election restrictions were completely removed under Citizens United. Corporations were deemed as unable to corrupt the viewpoints of individuals, and as such they could be allowed to have a voice and spend assets as they wish. However, Justice Kennedy indicated that prompt disclosure of the assets spent on political speech by a corporation would be needed, and indicated that it would allow shareholders and the public could hold them accountable. Since then, Justice Kennedy has indicated that the disclosure is not working as he thought it would.
xv. Super PACs- Political committees that can raise and spend unlimited amounts of cash, so long as they only use those funds to make independent expenditures rather than contributing them to candidates.
xvi. Super PACs have been found to have spent approximately $800M since 2010, and this is only the spending they are required to report through filing. The actual amount could be several multiples of this. Corporations are not required to report any spending for adds performed more than 30 days before an election.
xvii. Dark Money- the expenditures that are not required to be reported by corporations. Explosion of dark money.
xviii. More than $800M spent on federal elections since 2010, much of it corporate funding by 501(c)(6) business associations. And this is only political spending required to be reported.
xix. Supreme Court indicated full disclosure was supposed to occur.

xx. Regulators have not updated rules and partisan politics have prevented any action on this.
xxi. Test to determine if entity is entity subject to reporting is a ‘major purpose test.’ This became a major issue after Citizens United.
xxii. Crossroads GPS formed as C4 after Packs fundraising lagged because it had to disclose donors. The C4 has reported to FCC that it has spent 39M+. They estimate 20.8M was spent on what FCC considers campaign matters, 53% of budget. Is that not a ‘major purpose’? FCC found it must register but deadlocked and failed to support general counsel’s conclusion so still not registered and not disclosing its donors.
xxiii. IRS.
    1. Rules were criticized as overbroad and under-inclusive.
    2. In 2015 Congress used appropriations process to forbid IRS from engaging in rulemaking concerning C4 social welfare determination. So, IRS has been prohibited from clarifying the law.
xxiv. Political activity by groups that don’t disclose donors opens opportunity for corruption of office holders. Donors may engage in quid pro quo corruption and not disclosing groups can engage in ‘pay to play’ and hide the identities of foreigners seeking influence in elections.
xxv. Federal Election Commission (“FEC”) has been crippled through a 3-3 deadlock in the last few years, and have therefore been unable to promulgate rules to deal with the changing landscape, and deadlocks 3-3 even for enforcement of rules on the books.
xxvi. Major Purpose Test- is federal campaigning the major purpose of the group? Need to register as a political committee of the answer is yes.
xxvii. Crossroads- 501(c)(4) that in 2010 spent 53% of the total assets disbursed on political ads. FEC special counsel indicated that they should have to register as a political committee, but the FEC board deadlocked 3-3, and Crossroads has still not filed as a political committee.
xxviii. When a 501(c)(4) pays from its general funds for electioneering, a donor needs to only be disclosed when they received the contribution from that donor for a specific advertisement to be prepared. Due to this glaring loophole almost no 501(c)(4)s report the names of donors to the FEC.
xxix. IRS uses a facts and circumstances test to determine if an action is considered political activity- but that test remains vague and open to interpretation and has come under criticism. This was brought to the forefront in 2012 during the Tea Party revolution, where the IRS was criticized for "targeting" Tea Party organizations.
xxx. The Tea party scandal has hamstrung the effort by the IRS to classify an entity as a political organization.
xxxi. How much is too much? While a 501(c)(4) cannot have political action as its primary purpose, authorities have grappled with how much makes it the primary purpose. In 2015 Congress used the reconciliation process to prohibit the IRS from being able to promulgate rules to determine and define what a political organization is. Since 2015, that prohibition has been maintained with every budget law passed.

xxxii. Congress attached a rider to the appropriations bill in 2015 to prevent the FEC from making rules on the disclosure of political expenditures made, as well as the donors that give to the 501(c)(4)s.

xxxiii. Congress and the IRS in 2011 also removed another check on the PACs. IRS in 2011 was starting to review gifts made to 501(c)(4)s without providing a gift tax return. Congress indicated that contribution to a 501(c)(4) was not a taxable event, and the IRS backed off of auditing anyone for this issue.

xxxiv. 501(c)(6)s, which include trade associations, have begun to be used in the same manner as 501(c)(4)s for political activity. The only corporate type that is unable to perform political speech are 501(c)(3)s which are prohibited from doing so.

xxxv. Johnson Amendment- Prevents 501(c)(3)s from making political contributions. However, there has been considerable momentum in Congress to either partially or completely repeal the Johnson act. The ripple effect could be great if the removal gets through- as you could potentially make a charitable contribution to an organization that then uses the contribution for political speech.

5. Trusts and Estates Survey.
    a. Trusts and Estates magazine surveyed their readership as to a number of current points of interest. The findings were presented to the editorial board at their Heckerling lunch. A few highlights follow.
    b. Types of clients served.
        i. $25M+ = HNW 70% say they have none.
            1. **<u>Comment</u>**: This suggests that a substantial majority of practitioner's service clients who are now below the federal exemption for a couple of approximately $22 million.
        ii. 56% small business owners and partners.
    c. Top pressing concerns:
        i. 43% avoiding chaos and discord in family
        ii. 41% avoiding estate tax.
        iii. 36% protect children from mismanagement.
        iv. 35% business succession planning
        v. 22% asset protection.
    d. How will tax reform will affect practice.
        i. 47% too early to tell.
        ii. 13% hurt.
        iii. 66% expect no changes.
    e. Only 37% of practitioners will send out a global letter to clients about the new tax law.
6. **<u>Estate Planning in Anticipation of a Contest or a Difficult Beneficiary</u>**. S. Andrew Pharies.
    a. Grounds for challenge.
        i. Competency.
            1. Testamentary capacity.
            2. Contractual capacity.

            a. Higher standard than testamentary capacity.
            b. Must understand rights duties and obligations under contacts, alternatives to contract, etc.
    ii. Undue influence.
        1. Influencer is speaking to you through testator.
        2. Involves three elements.
            a. Influence.
            b. Destroys free will.
            c. Documents would not have been executed but for the influence.
        3. Happens in shadows so difficult to prove. If certain badges of undue influence exist shift burden of proof.
            a. Influencer is in a confidential relationship.
            b. Influence is a beneficiary.
            c. Influencer procured testamentary documents.
        4. Fraud, duress, and menace are similar to undue influence as some external factor has overcome the free will of the testator.
    iii. Mistake.
        1. Testator signed document that he or she did not understand, e.g. scrivener's error. It could some other fact.
        2. Could be grounds to reform or rescind the document.
b. What as planners do we do to create record?
    i. Mental competency.
        1. Have evaluation of client's competency.
        2. Is opinion of estate planning attorney sufficient? Perhaps not.
        3. Objective is to create evidence so even if attorney has client who is perfectly competent you might still get an examination as the person will not be there when the issue arises.
        4. Consider neurologist, psychiatrist, etc. In testing doctor should review medical records, administer standard test and important, test to the legal standard. Attorney should provide expert with the legal standard
        5. CA probate code Sec. 812 has codified a list of cognitive deficits to consider in making this determination. The list is comprehensive and useful to practitioners in any jurisdiction.
        6. Memorialize in written report and that should be accompanied by a broad HIPAA waiver. HIPAA waiver should allow report to be given to attorney and permit attorney after death of client to distribute report to others. The waiver is important to be able to use the report in future litigation.
    ii. Undue influence.
        1. Consider hiring a third-party (independent) attorney to interview client regarding factors of undue influence.
        2. Corroborate that duress etc. has not occurred.
        3. The drafting attorney will be a witness and do this as well but having an objective attorney 'without skin in the game' is helpful.

4. Use an attorney who is known to the courts.
5. This seems like a high-risk project with limited reward so it will likely be billed at a premium.

iii. Do you videotape?
1. No consensus.
2. Video can be incredibly powerful and what happens on video can overcome reason even with the trier of fact.
3. What is purpose of video?
4. Are you going to admit it as evidence? In some states it is permitted, and in others not. State of mind exception may permit admission.
5. Speakers view is that if client has no impairments, not just as to cognitive function but also as to appearance (looks good on video, not stage fright, etc.). If there is anything that is off (Parkinson's and movement issue, stage fright, etc.) avoid using video. It can be prejudicial to an extreme.
6. Use a professional videographer.
7. Establish chain of custody supported by affidavit from videographer to attorney to set foundation for litigator to use in future.

iv. This all helps build the case for the client.

c. Is there anything you can do to prevent the case from happening?

i. No contest clause.

ii. Too often used without much thought.

iii. Elements.
1. A no-contest clause is a forfeiture clause so unless the person is getting something under the will there is nothing for them to lose.
2. Consider giving that person something substantial so that they have to put that on the line.
3. Clause may have to define what acts can trigger the no contest clause. Be specific, direct contest, indirect contest, assistance to another contesting.
4. What documents are covered: beneficiary designation, entity documents, etc.
5. Should there be exceptions?
6. If you anticipate fiduciary will be defending document be certain that document allows or perhaps even requires that. Also, be certain that fiduciary has resources to do that.
7. Defense costs are a big issue and some parties use these costs as a weapon.
8. "Trustee is permitted reasonable compensation for counsel." That phrase may leave the payment of fees or the amount up to the discretion of the court to determine. You may want counsel to be hired in direction of trustee and that those costs not be challengeable or discoverable. Counsel retained should be able to charge their customary hourly rate.

9. How does defense cost get allocated?

d. Planning in anticipation of a direct challenge to the participants in the planning process.
   i. Tort of intentional interference with inheritance rights.
   ii. Punitive damages possible.
   iii. Action can be filed against participants in planning process including drafting attorney.
   iv. Elements.
      1. Must be interference with testamentary expectancy.
      2. Must cause change in testamentary disposition
      3. No adequate remedy in probate
   v. What can you do?
      1. Incorporate into no challenge clause.

e. **Comment**: In 2017 the Texas Supreme Court in Kinsel refused to recognize a new cause of action in Texas for tortious interference with inheritance rights. Kinsel v. Lindsey, No. 15-0403, Texas Supreme, Court May 26, 2017. The Kinsel case reviews undue influence, and several other issues common with aging clients. Although the attorney who drafted the decedent's documents and a real estate sale contract believed her to have capacity the courts found otherwise. However, the court did not find that the attorney had participated in undue influence. The court suggested that counsel must take such responsibilities seriously and carry out counsel's duties with care. Because the estate planning attorney believed the client had capacity the court did not find that counsel acted improperly in updating and supervising the execution of new estate planning documents. The court opinion did not address that the sale of a ranch while the decedent was alive would substantially alter the disposition of her estate. Counsel should endeavor to stress-test dispositive schemes to identify what actions might alter the plan or undermine the testator's objectives. Perhaps the revocable trust dispositive provisions could have been more carefully crafted to have avoided this result. Also, the grandchildren in Kinsel claim that they agreed to the sale of the ranch because they were misled to believe that their grandmother needed funds. Only later they became aware that she had approximately $1.4 million in marketable securities. However, if she needed funds and the sale of the ranch would have materially affected the dispositive results, perhaps a loan against the ranch may have funded lifestyle expense (had that really been necessary) while preserving the dispositive scheme.

f. Post-death modification to the plan.
   i. Everything that creates flexibilty8 can undermine testamentary intent.
   ii. Modifications, decanting, trust protectors, etc. can all modify or alter testamentary intent.

g. Weaponized fiduciary duties.
   i. How do you plan for this?
   ii. A lot can be done at planning but not administration stage.
   iii. Reduce profile of fiduciary relative to problematic beneficiary.
   iv. Consider structure of gift to problematic beneficiary.

v. If giving a share of residue then everything that happens in the administration will affect that person's interest so that they can complain about everything. If instead you bequeath or give only Blackacre or a pecuniary (dollar) amount then there is much less for them to complain about.
vi. Give trustee no discretion in terms of distribution or complete discretion. No discretion, an annuity interest, etc.
    1. Give bad beneficiary right to income everything the trustee does affects income so bad beneficiary can complain about anything.
    2. Next scale back to a uni-trust interest less to complain but can complain.
    3. If gift merely an annuity they get that dollar amount and there is even less to complain about.
vii. Structure trust or gift and consider how it will work. Consider attorney fees. Do you want a reasonable fee provision if the beneficiary will take you to court for everything? Perhaps not.
viii. Modify the fiduciary duties. Every or most states permit you to modify fiduciary duties: loyalty, self-dealing, impartiality, etc. Many can be modified and sometimes significantly. These duties can be customized. You can provide that duties are different depending on who is serving as trustee.
ix. May not be able to modify certain duties such as accounting, keeping beneficiaries informed, etc.
x. Consider state of situs with the modifications that are permissible.

h. Use entities.
    i. Insert business entity as in many instances you can go further than what trust law permits.
    ii. Forum shopping. Tougher to get a trust in DE need a DE trustee. Easier to form a DE, all you do for DE LLC is just form the entity in DE.
    iii. You can have entity waive duties that are un-waivable for a trustee.
    iv. Caution that if the trustee is both manager and trustee the same fiduciary duty applicable to the trustee may be applicable and in some states like CA and NY may need to separate/differentiate the persons serving in each capacity.
    v. Trustee can sue predecessor trustee. In CA successor trustee has attorney client privilege and can sue prior trustee and even counsel for prior trustee.

i. Mandatory arbitration.
    i. Not applicable in all states. If state permits this it can be a powerful tool as you can create thee rules and the forum in which challenges will be litigated.
    ii. In an arbitration clause you can pick the judge. In some states you can modify the rules that apply in arbitration, e.g. stating that a certain document will be admissible even though the law would not otherwise permit admission of that document.

7. **<u>Buy-Sell Agreements</u>**. Louis A. Mezzullo.
    a. General.

    i. Watch for differences in applying buy sell agreements to different types of entities.
    ii. Tax Cut and Jobs Act ("Act") points affect buy sell agreements.
    iii. Historical changes.
        1. 1986 Act repealed General Utilities doctrine so two levels of tax on dissolution of C corporation. Now most clients have pass through entities not C corporations. Comment: Consider liquidation cost if opt to shift to C corporation now.
        2. Before 1990 only 2 states had LLCs now all states have them. LLC has limited liability of a corporation and tax benefits of a partnership.
        3. 1990 Chapter 14 including IRC Sec. 2703 which limits ability to use buy sell agreement to establish value in a family held business.
        4. 2017 Act modified rules on termination of partnership for transfer of 50% or more in 12 months.
    iv. Objectives of buy sell agreement.
b. Redemption versus cross purchase.
    i. Entity redemption or purchase agreement can be assigned to owners for owners to buy instead of entity. If it is a hybrid agreement and shareholders of C corporation have the initial obligation and the corporation actually buys the stock you will have a constructive dividend to the shareholders as the corporation is satisfying an obligation of the shareholders.
    ii. Consider insurance (life and disability) to fund buy sell.
    iii. Consider trust or partnership to own policies to avoid multiple policies. Be certain that the partnership is recognized and if use a trust that you avoid transfer for value rules.
    iv. Corporation is subject to flat 21% tax so corporation will be in lower bracket then shareholders.
    v. Premiums are not deductible by entity.
c. Transfer for value problem.
    i. The proceeds could all be subject to income tax to extent they exceed what was paid for policy.
    ii. Exceptions transfer to insured, partner of the insured or to a partner in which insured is a partner, or to a corporation in which the insured is a shareholder.
    iii. In cross purchase estate cannot sell policies it owned on other owners without triggering transfer for value rules. This might be avoided if owners are partners in a partnership. HO7 IRS will not rule on whether a transfer of a life insurance policy to an unincorporated entity whose assets are life insurance on parties. Speaker believes IRS is wrong and the business purpose of funding a buy sell agreement should suffice.
d. AMT is gone after the Act.
e. Accumulated Earnings Tax ("AET")
    i. 20% tax on earnings in excess of what is needed in the business.
    ii. $250,000 exception. Less for personal service corporation.

        iii. Personal holding company tax and AEP are more of an issue after the Act.
        iv. Sec. 303 redemption provides capital gain treatment on a redemption if estate is 35% or more in close business but also permits avoiding accumulated earnings tax to extent of estates estate tax liability and administrative expenses.
    f. State law.
        i. May restrict ability of a corporation to redeem shares, or even an LLP or LP to redeem interests.
    g. Basis for income tax purposes.
        i. Cross purchase shareholders will get basis increase (only applies in C corporation).
        ii. In redemption shareholders won't get an increase in basis.
    h. 30% limitation on interest.
    i. Governing document.
        i. Exclude owners to be bought out from decision making as to buy out.
        ii. Should family members be permitted right to buy out interests before other owners have right to buy out interests so that the family unit can retain some interests.
        iii. What are triggering events for buy sell? Death, retirement, disability, divorce (so don't have ex-spouse as owner if not desired), etc.
        iv. Bankruptcy or insolvency of ownership should trigger buy out to avoid bankruptcy trustee being involved but if purchase price is not FMV may not be binding.
        v. Consider business appraisal to set value. Consider using method applied by the appraiser as the basis for the buy sell valuation formula. Consider attaching the appraisal as an exhibit.
        vi. Fixed price method.
8. **<u>Beyond the Private Foundation</u>**. Marin Hall.
    a. Donor wants to set up a wholly charitable vehicle for long term charitable goal.
        i. 501(c)(3) are private foundations unless they fit in certain categories, e.g. religious and medical, receive broad public support. Supporting organizations. All loosely called public charities. Everything else is private foundation.
    b. Characteristics of private foundation ("PF").
        i. Concentrated e.g. single donor, or members of donor's family.
        ii. Usually not involved in fund raisers, rather rely on wealthy family donors to fund.
        iii. Grant making entities, generally. Usually do not run their own programs, but they can.
        iv. PFs controlled by donor or members of donor's family or persons specified by donor.
        v. No requirement to have independent directors or outside trustees.
    c. PF subject to special rules.
        i. Donors.
        ii. Deductions.
        iii. Entity level requirements.

iv. Behavioral rules that prohibit foundations from engaging in certain activities.

d. Entity level considerations.
   i. Subject to entity level tax, 2% on net investment income. Can reduce in some circumstances.
   ii. Now not the only charity with an entity level tax as the Act imposed an entity tax on certain colleges.
   iii. Constrained rules on business holdings.
   iv. Prohibitory rule on self-dealing.
      1. Disqualified individuals include officers and directors, 20% owners of subanal contributors, family members. Broad group of individuals.
      2. Many activities are prohibited including all sales and leases unless without any consideration or rent, loans unless without interest, furnishing of goods and services unless without charge.
      3. Compensation and reimbursement – can only pay disqualified person for services if necessary and reasonable.

e. Supporting organizations.
   i. Formed to carry out purposes of one or more public charities (i.e. not PFs).
   ii. Cannot be controlled directly or indirectly by disqualified persons including those who are substantial contributors, family member of substantial contributors. They can be on board, they can participate, but they cannot be a majority and they cannot have veto power.
   iii. Relationship test which creates additional complexity. 3 types:
      1. Type I: Substantial degree of direction by public organization, i.e. a majority of offices and directors are appointed by the supporting organization. These are subject to most favorable rules. Consider this like parent/child.
      2. Type II: Same people who control supporting organization are performing similar functions at supported organization. Consider this like siblings.
      3. Type III: Operated in Connection with Supported Organization: This has harder eligibility requirements to satisfy.
         a. 3 tests.
            i. Responsiveness test. It is no longer enough that charity is named in supporting organization document that it can require accounting, now must actually show that they have a significant voice in the operation of the entity.
            ii. Notification requirement – must provide certain information annually, e.g. copies of tax returns, etc.
            iii. Integral part test. If functionally integrated must engage in activities to further the supported organization is engaged in. Examples are awarding scholarships or grants to individual who are members of class, holding title to assets that are part

of exempt purpose. An integral activity is not investing non-exempt use assets. In the latter case then the supporting organization is a nonfunctionally type 3 supporting organization. And two further rules must be satisfied or the organization is a PF and not a supporting organization.

1. Must have baseline level of support provided to supported organization so that it will be attentive.
2. Distribution requirement similar but not as onerous as PF rules. 85% of adjusted gross income and 3% (not 5%) of assets.

f. 501(c)(4) organization.
   i. Must be operated for social welfare purposes.
   ii. Overlaps with charitable purpose s since under C3 promotion of social welfare is included in meaning of charitable purpose.
   iii. These C4 organizations have been around a long time (1913 tariff Act). Traditional use is broad based member organization like a volunteer fire group or to support local parks. Also used by well-known public advocacy groups, such as NRA, ACLUE and AARP.
   iv. Nothing limits use to broad based community funded entities.
   v. Families can use these but there has been a concern over tax issues of funding. If a transfer to an entity is greater than annual exclusion amount there would be a gift tax liability associated with the transfer. This issue was resolved in 2015 in the PATH Act in which all transfers of funds to C4, C5 and C6 organizations were excluded from the ambit of the gift tax.
   vi. No income tax deduction on gifts to C4 organizations. So why would a client consider C4 for family philanthropy? A C4 can provide control to family. PF rules don't apply in this context.
   vii. Prohibition on private inurement and excess benefit (e.g. more than FMV paid for assets or compensation is more than reasonable) rules apply.

g. Donor Advised Fund ("DAF").
   i. Segregated fund or account maintained and owned by an existing public charity referred to as the sponsoring organization and over which donor is permitted to maintain certain advisory privileges.
   ii. Not control, merely advisory. Can extend to distributions of fund and how fund is invested.
   iii. Prohibited transactions cover anything that provides more than an incidental benefit to donor or donor's family. Not much guidance. Some recently issued
      1. Notice 2017-73. Still in comment phase until March 5, 2018.
         a. Grants from a DAF requested that results in tickets, membership benefits going to donor adviser. These would result in contribution deduction if paid by donor directly. DAFs cannot make grants that result in a quid pro quo.

b. DAF cannot make these distributions

2. Paying pledges – 'don't ask don't tell.'

h. Comparison of 4 entities.
   i. Transfer tax consequences that flow on funding to donor.
      1. Contributions to PF, DAFs and SOs all covered by transfer tax charitable contribution deduction.
      2. Exclusion for gift tax but not estate tax to Social Welfare organization. If remain in control at time of death there is a problem as it will be brought back into donor's estate. Or change to C3 before donor's death.
   ii. Income Tax consequences that flow on funding to donor.
      1. There is no income tax realization event on contributions of property to any of these organizations.
      2. In contrast to the above, contributions made to political organizations with appreciated property are subject to a realization event, and a tax to donor when those assets are used. This is why C4 lobbying donations are so valuable rather than to a 527-political organization.
      3. Gifts of cash. Rules govern amount that can be deducted in any year. 30% on contribution base (about AGI). Gifts to private operating foundations and pass through entities amount that can be deducted in any year is 60% of the contribution base (increased by TCJA from 50%).
      4. Biggest difference is in gifts of appreciated long term capital gain property. If given to DAFs or supporting organizations and to operating foundations and pass through entities the deduction can be measured by the FMV of the assets and deduction can be claimed up to 30% of AGI. However, for a private foundation the base is lower at 20% and only gifts of qualified appreciated securities is only asset that can qualify. Social welfare organizations no deduction for any type of property gift. Tangible property not used in a related purpose – limited to cost basis.
      5. Qualified charitable distributions ("QCDs") out of IRAs none of entities qualified with 2 exceptions: operating foundations or foundations for which a pass-through election has been made can be eligible for QCDs.
   iii. Administrative issues – how complex.
      1. Must create vehicle. This is most complicated for supporting organization because of involvement of supported charities who will have a say in the set up.
      2. Ease of setting up is the DAF as winner. All that is needed is a simple application to the sponsoring organization. But note that all DAFs are not the same. Donor should do due diligence on sponsoring organization before making gift. Will sponsor be able to provide assistance? What is scope of grantees? Will it include foreign charities? What are policies on successor advisers? What is

cost structure? There are many differences between the various DAFs.

3. Tax filing requirements. DAF is easy, no Form 1023 which is required for PF or supporting organization. DAF has no separate tax return like a Forms 990 or 990PF.
4. Social welfare organizations do not have to file for tax exemption and can self-declare for tax exemption. Only requirement is out of PATH Act from 2015 that notice must begiven on 8976 an electronic form that it intends to operate. So, no Form 1023 but does have to file a Form 990.
5. PF have most ongoing administrative work/vigilance. The Type III nonfunctionally integrated have filings, etc. DAFs have requirements but they are handled by sponsoring organization.

iv. Privacy.
   1. DAF can provide privacy.
   2. PF discloses identity on 990PF and available to the public on Guide Star so no privacy or anonymity.
   3. Supporting organizations not looking for anonymity as working with supported organization.

v. Breadth of charitable activities that can be undertaking.

vi. Control.
   1. With DAF no control, the privileges are advisory.
   2. Supporting organization, no control as supported organization must control. The substantial contributors cannot have veto power.
   3. PF and Social welfare organizations permit high levels of control

vii. Overseas grants.
   a. PF, DAF can make so long as grant does not constitute a taxable expenditure --- expenditure responsibility must be exercised.
   b. Supporting organizations cannot support foreign charities.
   c. Type IIs cannot. Because of close relationship of supported organization may run afoul of conduit rule.

viii. Grants to individuals.
   1. PF can make scholarship grants but have procedures approved in advance.
   2. DAFs cannot make individual grants directly.

ix. Political arena.
   1. All can make grants but C3 organizations cannot engage in political campaign activities.

x. Business interests.
   1. All charities including C4 are subject to tax on UBTI even if tax exempt.
   2. If the business is a pass-through entity this could be problematic as all pass through to charity.
   3. If charity is a corporation the 21% rate may have reduced UBTI tax cost, in some instances might increase cost.

4. Each charity must now look at each UBIT activity separately and cannot offset UBIT loses on one activity with gains on another.
5. Excess business holdings rule applies to DAFs and PF. Prevents them from holding any significant amount of business if donor or donor's family controls the business. There are some options but they may not be great. Can donate and try to satisfy the rule. Must get out in 5 years and in some cases 10. Could forgo an income tax deduction.

9. **<u>1846 Will of John Sutton: What's not so new in Will drafting and contests</u>**. Terrence M. Franklin.
   a. The presentation discussed a remarkable personal journey of the speaker, a glimpse into a painful and dark part of our history as a country, a fascinating legal adventure, and so much more. The notes below cannot begin to describe or do justice to this unique, fascinating and inspiring presentation. Readers are encouraged to read the author's article in Probate and Property on this story. It is a rare pleasure to hear anyone so passionate about such a noble cause and endeavor.
   b. John Sutton's will.
      i. Identified will.
      ii. Moved from GA to FL.
      iii. Fathers of Conscience (book) white men emancipated slaves. Sometimes single or were widowed and in many cases the court upheld testator's intent to allow for emancipation of enslaved person. Some cases went on appeal after challenge, claiming fraud or undue influence. In some cases, courts said they could discern testator's intent but statute may have provided that free Negro could not live in state (e.g. had to post bond to stay or be removed in 30 days
      iv. File included original will. Article Third listed salves as property. Article Fourth bequeathed salves as property to friend William Adams on conditions that he should remove the slaves to a jurisdiction outside of FL where they could enjoy freedom.
      v. Will never said they were his children but they had to claim that they were not his children.
      vi. Had affidavit similar to challenge in a modern day will contest challenging capacity, etc.
      vii. Will including language of a 'trust' as above. Failing the above he was required to personally take the property
      viii. File including property appraisal report including appraisal of the assets but did not include slaves in value as they were to be emancipated.
      ix. Judge William F. Crabtree, probate judge. Transcript was his handwritten notes of the trial. This included testimony of Gregory Yale, the attorney who drafted the documents.
   c. Visit www.LucySutton.com, where Terry blogs periodically and where people can access the facebook page for the novel he is writing based on "The Last Will of Lucy Sutton." Bits of history on property, slavery, videos, and more.

Marty Shenkman

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