The 2019 Heckerling Institute on Estate Planning

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A KEY ESTATE PLANNING GUIDE

ChronicIllnessPlanning.org

The 2019 Heckerling Institute on Estate Planning

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Basis After 2017 Tax Act

Basis as the New Focus of Planning

Basis After 2017 Tax Act - Overview

- Upstream planning with GPOAs
  - Testamentary GPOA of little help of new administration in 2020 changes law and G1 is still alive. A different type of planning is needed to succeed.
- What about downstream planning?
  - No mention.
  - Wealthy client's descendants should use their exemption. How can this be done? How can you get assets to say children without using G1/Parent exemption?

Basis and Community Property - 1

- When first spouse dies all community property gets a full basis step up on both sides, both decedent and survivor's half.
- Community property provides a huge advantage -- get an adjustment at first death for all property.
- Three states so far allow you to create community property even though the state does not generally have community property. Elect or opt in community property regimes: AK, TN and SD. See discussion below.

Basis and Community Property - 2

- If client moves from community property state to non-community property state, you may want to preserve the community property character. This may require segregating these assets so not commingled with other assets. In some states if income passes to joint account from community assets that may negate the community property character of those assets.
- Community property has other consequences besides tax, e.g. division of property in the event of divorce. Speakers also stressed the importance of the economic implications so while considering tax planning the non-tax implications could be significant.

1014(e) - 1

- There is no date of death value adjustment for property received by decedent if received from person who it is being left to. This is not an “in contemplation of death” rule but a strict 12-month rule. This is important in many planning transactions. IRC Sec. 1014(e).
- How do you determine if property has passed back to donor?
- Not a simple matter. Legislative history and few private rulings are not that helpful with respect to this.
- But if property passes back to donor in trust you may still have a problem. If donor is income beneficiary of recipient of income it may be a proportionate adjustment to basis.
- What if donor is discretionary beneficiary and no standard? No answer. Speaker believes it may be still proportionate, but it also presents a valuation challenge. What does this mean?

1014 - 2

- **Comment**: This might be a reason to at least include a credit shelter discretionary trust in wills (revocable trusts) even if they might only be funded by disclaimer. If the approach of a one-fund (one-lung) QTIP is used and a disclaimer (or Clayton) mechanism to fund a credit shelter trust to solely benefit the surviving spouse, it may make the likelihood of avoiding 1014(e) less likely to avoid 1014(e) if 1 year or less.
- If instead a more robust credit shelter for surviving spouse and descendants with discretionary distribution authority is used it may provide better near-death basis planning. If one spouse develops a health issue transferring appreciated assets to that spouse that will be bequeathed into the robust credit shelter may qualify for a basis adjustment whereas the simpler spouse only credit shelter may not.
- If it is a sprinkle discretionary trust with other beneficiaries did the transferor receive the assets back?

What's my Basis?

- Often clients do not know basis.
- Many believe that if you do not know your basis it is zero. Not so!
- The actual rule is if you can provide some information you shift the burden back to the IRS for the IRS to have to present a different basis analysis. IRC Sec. 7491 – you can shift burden to the IRS.
- Cohan v. Comr., 39 F.23 540. This is current rule. It is a "close enough is good enough" rule. Can approximate basis.
- Speaker suggests that many IRS agents use threat of no basis if it cannot be proven but that is contrary to the law.
- **Comment**: Why not have advisers reconstruct basis as part of estate planning and assemble records/calculations.

Basis Consistency Reporting - 1

- We always had basis consistency rules under case law. The Surface Transportation Act did not really change that in adding Code Sec 1014(f) and 6035. Added penalty rules under 6662 and 6724.
- 6035 says how to report - Form 8971.
- Temporary and proposed regulations published about 3 years ago. At end of 3 years of time the proposed regulations are no longer effective. If no one is working on regulations what is status? Priority guidance plan wanted to reduce burden with respect to those regulations.
- Consider so-called zero basis rule that was not prescribed by statute but in proposed regulations said after discovered assets have zero basis unless reported.
- Another issue is the continual reporting. Once Form 8971 is filed and then if beneficiary transfers inherited assets to her revocable trust she must issue an 8971 to herself for such transfer. Speakers believe that these subsequent reporting rules will be simplified.

Basis Consistency Reporting - 2

- Secondary transfer rule is unreasonable. Does not make sense and rules are not sufficient. Speaker believes that this rule might be fine-tuned or more likely eliminated in final regs.
- These rules contain an exception for cash. There is no single definition of cash in the Code and Regulations. Does cash include checks? Perhaps but one regulation suggestions that a check is not cash as you can stop payment on a check not cash. Is foreign currency equivalent of cash? The answer varies. Money market funds are probably not cash. Cash or “cash equivalents” would be preferable.
- Speaker Recommendation - There are no penalties for over reporting, e.g. for reporting a transaction that does not have to report. “When in doubt report.” Clients do not like the costs, but the penalties could be substantial. Isn’t it more prudent to over-report than risk a penalty by underreporting.

Basis Consistency Reporting - 3

- **Comment**: The speakers recommendation above is logical, but it is not clear that many (any?) practitioners are doing so for subsequent transfers at least.
- The Proposed Regulations governing basis reporting require reporting on subsequent transfers and that would require, for example, excessive reporting. If a QTIP trust is funded and thereafter distributes principal to the surviving spouse that would under the proposed regulations trigger a requirement for a filing. If the spouse then contributed those assets to a partnership or DAPT, another filing, and so on.
- The rules appear to be overreaching and not supported by the statute.
- There appears to be no logic for repeated reporting on each transfer. However, penalties may apply for non-compliance. When this issue was faced, conversations with many practitioners, failed to identify anyone who had made such filings. It seems as though most view the requirement as so onerous and unreasonable that it is simply being ignored by many if not most practitioners.

Basis and Portability Planning

- Portability is much more complicated than many initial thought.
- Do you file a return for portability? Some firms take the position that you should always do so. What liability risk might a practitioner face if no filing is made?
- **Comment**: See the IRS statistics on returns filed. Very few portability only returns seem to be filed. Not enough clients are heeding their advisers' recommendation to file and secure the DSUE.

Basis and Portability Planning - 2

- Speaker suggests putting client on notice of benefit of filing a return to secure the DSUE in writing.
- **Comments**: Consider going further to protect yourself.
- Some clients, particularly those with smaller estates, do not come back to counsel on the first spouse's death. They view the high exemptions as suggesting that the estate tax is irrelevant to their families and that coming back to counsel is an unnecessary waste of money.
- Put a caution about filing for the DSUE on firm websites and in firm newsletters (along with other general pointers like reviewing formula clauses in documents and updating partnership and LLC documents post-Powell, etc.).

What types of Planning Should Practitioners be Doing re: Basis - 1

- A portability plan of some type should be the default approach to planning.
  - Own assets jointly. **Comment**: Doctors - asset protection.
  - Consider one-fund or one-lung QTIP. **Comment**: Family structure? Consider Magill's comments on demographics.
  - If you run the "numbers" the portability type plan will almost always (unless huge rates of return realized on assets) be a superior result getting the double basis step up (on first and again on second death). **Comment**: What assumptions? Asset location?
  - Some clients have a forced credit shelter trust which does not permit the basis adjustment on the death of the second spouse. On death of the second spouse there is no basis step-up. When the exemption was $600,000 a default credit shelter trust was the right answer but that is not necessarily the case. **Comment**: For blended and other family structures a mandated CST of some amount may still be preferable.

What types of Planning Should Practitioners be Doing re: Basis - 2

- **Comments**: The speakers did an excellent job of balancing the pros/cons of different approaches, but here are a few more thoughts.
- See Lou Harrison's special session and his discussions of making the plan simpler.
- See also Hugh Magill's lecture notes on Tuesday about the changing dynamics of American family units. "Traditional" family units are perhaps ½ of all family units. So, for perhaps ½ of clients the new default approach (e.g. Clayton QTIP) suggested may not be optimal.
- So, use a portability plan might be the new default starting point. But for a lot of clients, a different approach may be needed.
- For example, funding a credit shelter trust for various beneficiaries appropriate to client circumstances might make sense for a lot of clients regardless of basis considerations.

What types of Planning Should Practitioners be Doing re: Basis - 3

- **Comments**:
- Life insurance might not be necessary to pay an estate tax but might be repurposed (or purchased) to address the personal issues involved.
- Keeping life insurance in a trust (since it doesn't need a basis step up) and other assets in the estate to gain a basis step up (whereas those other assets may have been gifted to trusts under prior tax law circumstances) might be useful.
- Also, consider the facts of the client's particular situation. Some of the basis issues can be addressed by wealth management approaches. The portion of an actively traded portfolio that is appreciated at any point in time is rather modest. So, asset location decisions might be part of the solution as well.

Basis Step-up on 2nd Spouse Death - 1

- Can we build in some mechanisms to get a basis step up on the second spouse's death if assets increased in value significantly?
- Give independent trustee right to distribute assets. This is the simplest approach. Trust merely directs moving assets from credit shelter trust into the beneficiary's estate.
- Can also pick and choose moving only appreciated assets.
- This provides considerable flexibility without much complexity.
- The trust might already have this authority in it without any modification or decanting.
- Consider drafting the flexibility of an independent trustee to make a discretionary distribution of principal.

Basis Step-up on 2nd Spouse Death - 2

- **Comment**: In the outline the speakers state: “The greatest risk is that the independent trustee may be shy in exercising the authority...” Will the trustee do this?
- What of liability risks?
- Silver divorce should be considered. What of remarriage of the surviving spouse?
- Will an institution ever be willing to make a distribution of appreciated assets given the loss of trust protections, exposure to the surviving spouse’s creditors, etc.?
- If an institutional trustee might be wary of making such a distribution how should a family or other non-professional trustee feel?

GPOA for Basis Inclusion - 1

- Use contingent general power of appointment. Under IRC Sec. 2041 this causes inclusion in the gross estate of decedent holds a GPOA. Sec. 1014(b)(9). You can use a formula. You can build a formula into the document. The challenge is the cost and complexity of the different scenarios. Can you have a power of appointment over specific property rather than just over the trust? Speakers believe that you can have a power over specific property.
- Kruz v. Commr., 101 TC 44 (1993). Spouse had right to withdraw specific assets after exhausting the marital trust. Unless independent act of significance you are presumed to have the power to exercise power to the maximum permitted.
- Give power to exercise the POA to amount of applicable exclusion. But can spouse control that amount? Yes, by making gifts. All the things that create deductions change the power of appointment. The Kurz case could create a difficulty in this context.
- There is no good definition of an “act of independent significance.” Getting married, divorced or having a child is an act of independent significance. So, if you are going to avoid the Kurz issue the formula should be “inaccurate.”

GPOA for Basis Inclusion - 2

- It should be the amount of the available exemption if ignore marital and charitable deductions. This means you are working off the gross estate not the taxable estate. Kurz should not have application to such a power. But the power of appointment will be smaller than you might want it to be as it might ignore, for example, charitable gifts. The formula to be safe from Kurz has to sacrifice accuracy.
- So, if you want to use a contingent general power of appointment structure it so person does not have the ability to affect the formula.
- You might then use, in addition to the gross or imperfect contingent GPOA, the next approach of giving a trust protector the right to grant a general power of appointment, etc. to try to capture what the above contingent formula may miss.
- You might also factor in how soon the asset will be sold. Unless the assets are sold, or can be depreciated, when will a benefit be realized? Will the heirs keep or sell the asset? When?

GPOA for Basis Inclusion - 3

- Trust adviser or protector can give beneficiary a general power of appointment.
- **Comment**: Be careful of who is given what power. Some practitioners appoint a trust protector to act in a fiduciary capacity (or state law may characterize the protector as a fiduciary). If a protector is acting as a fiduciary are they able to grant the GPOA? Perhaps a person who does not hold other powers a protector might be given (e.g. to remove and replace trustees) should be named, expressly in a non-fiduciary capacity, and given only the right to act with respect to the GPOA.

GPOA for Basis Inclusion - 4

- You may add some of the above planning to an existing credit shelter trusts by decanting.
- Use a contingent formula power of appointment.
- Give protector ability to grant additional power of appointment if modifications understate exemption.
- This way if fiduciaries are not able or don't act, or lack information to act, etc. there is something automatically then have distribution of assets and granting GPOA as backstops. This can increase opportunities to get a good basis result in a non-marital trust. These are sight modifications to the traditional use of GPOAs.
- Don't think only of surviving spouse. Consider that beneficiaries in the future may have unused exemption. Might be to give protector power to grant GPOA to any beneficiary not only the spouse.

GPOA for Basis Inclusion - 5

- What if surviving spouse has a new significant other? Will independent trustee permit movement out of assets? Trustee may face liability?
- When do you move assets? May not have much advance notice of surviving spouse's health. This becomes a practical issue of what can be done.
- Creditor protection issues. If there is any type of general power of appointment, if assets are distributed, what of creditor risks?
- What if exemption is reduced after you pulled assets out of the credit shelter trust?
- If the GPOA is not exercised most jurisdictions say not reachable by creditors. That is also the position of the 1st and 2nd Restatement, but not of the 3rd Restatement - considered that possession of GPOA may be reachable by creditors. If you are going to use a GPOA look at particular state law to see which Restatement view applies. There is a federal bankruptcy law case that addresses this issue.
- We always want property in trust. You cannot get property back into the trust and if distribute all trust benefits are lost.

Power of Appointment Support Trust ("POAST") - 1

- Use upstream gifts, e.g. G2 is wealthy and G1 is not so wealthy and has excess exemption.
- How do you get funds to G1 from G2 and protect from G1's creditors reaching assets or other issues reaching assets?
- Consider power of appointment support trust. This is an irrevocable grantor trust that includes an upstream beneficiary as a beneficiary of the trust. So instead of trust for only descendants add parents as beneficiaries. Give the trustee the ability to distribute to mother and to children, etc. The power can be discretionary and HEMS, etc.
- Add a contingent GPOA. If give a contingent GPOA on G1's death under 1014(b)(9) you get a basis adjustment on mom's death.
- If G1 does not exercise GPOA the trust remains a grantor trust as to G2 who is initial settlor.
- What about the issues/concepts in Cristofani (AOD 1992-09) wherein the court found mere naked Crummey powers went too far and were not valid. Might similar concepts as in Cristofani be raised by the IRS with the use of GPOAs? How far can you go with GPOAs?

Power of Appointment Support Trust ("POAST") - 2

- While the law does not require that the holder know about the power he or she has, that power holder. per the speakers, should know of the power. The law does not care if you are able to exercise the power. So, a power holder in a coma cannot from a practical perspective exercise the power, but that is not an issue.
- Apart from tax considerations, might the trustee have an obligation to inform a power holder?
- Consider the burden on mom's estate tax return. 6018 requires filing return for a taxable estate. When drafting contingent GPOA perhaps limit it to being $10,000 less than the unused exclusion amount so not caught for filing estate tax return. For GST purposes, if the automatic allocation rules may apply so return filing requirements should also not be triggered.
- Can use trusts reciprocally but consider reciprocal trust doctrine issue.
- What if G2 dies prematurely? How do you evaluate this risk?
- Must fund the trusts so G2 must use exclusion amount. What if G2 does not want to make a gift? POAST is a grantor trust giving G1 discretionary right to receive income and principal during lifetime and a GPOA is granted. If G2

Power of Appointment Support Trust ("POAST") - 3

- Must fund the trusts so G2 must use exclusion amount. What if G2 does not want to make a gift? POAST is a grantor trust giving G1 discretionary right to receive income and principal during lifetime and a GPOA is granted. If G2 doesn't want to make a gift you can use a GRAT. When pour over comes from typical GRAT flows to a non-GST trust. The receptacle trust at the back end of the GRAT can be the POAST trust and it can use G1's GST exemption.
- **Comment**: Does this really work? If the Blue Wave continues in 2020 the exemption may be reduced before 2026. Might the Obama Greenbook recommendations be revived? If the law changes after the 2020 election what benefit will a formula GPOA provide? At best it will be reduced by ½ or more. At worst if in artfully drafted it might trigger an unintended tax cost. A 2 year GRAT might not finish in time. What really might be preferable is using G1's unused exemptions more quickly.

Can you affirmatively use 2036 or other String Sections?

- Can you try to cause inclusion of assets from trusts using 2036-2038 rules?
- In the past getting assets out of the estate was the goal, now the exemption is so much larger, and the grantor may have unused exemption available. How can you get previously transferred assets back into the estate? Can you?
- Example – have grantor stop paying rent on house in trust. Then argue that because the grantor disregarded the form of the transaction it should be included in his estate. Taxpayers cannot raise substance over form generally. So, taxpayer cannot mismanage a trust and argue for it to be included in the estate.
- Can you decant and give the grantor a GPOA? That depends. Regulations state that the person who creates the trust can retain a power of appointment over it under 2041. They can retain a power to alter, amend or revoke. But if the trust is decanted is that effectively retaining a power of appointment? Not certain. What if you decant and give grantor the power to alter, amend or revoke – a 2038 power?

Skifter case raises problems To Affirmatively Use String Sections

- Estate of Skifter v. Comm'r, 468 F.2d 699 (2d Cir. 1972), aff'g 56 T.C. 1190 (1971). You cannot add a 2038 power to a trust and claim estate inclusion unless power was anticipated when the trust was created.
- Skifter is looking for something planned by the grantor initially. If you grant the settlor a GPOA after the trust was created, what happens?
- The rules on insurance under IRC Sec. 2042 should be read similarly to rules under 2036-2038 and under those rules the law is clear that you can only take into account powers that the grantor personally planned to have. Grantor had to be materially a part of retaining that power. Decanting does not involve the grantor. Under Skifter then, decanting to add these powers won't bring the trust assets back into the settlor's estate. Consider reformation if grantor asks for the reformation. A problem is what is or is not motivated/anticipated by the grantor? An issue is the lack of precedent.
- **Comment**: Consider non-judicial modification. But that requires, unlike a decanting, grantor involvement. The grantor may, however be able to merely non-object. Does that suffice?

Recent Developments

New Cases, New Regs, and More

Clawback - 1

- Prop. Regs. 20.2010-1(c); Reg-106706-18 provide favorable results assuring no clawback of the current high temporary exemption.
- If a client gifts $11.4M in 2019 and dies in 2026 when the exemption is $5M inflation adjusted assume $6M. The $11.4M is an adjusted taxable gift in the estate tax calculation so do you owe estate tax on the additional $5M? IRS held that taxpayers will not have this problem.
- What is the manner in which the calculations will be made to avoid a clawback? Start with gross estate + adjusted taxable gift. Calculate tentative estate tax. Subtract hypothetical gift tax (using rates in effect at the date of death) but using the basic exclusion amount (BEA) at the time of the gift. That was $11.4M. Subtract deductions, calculate estate tax due and apply credits. Applicable Exclusion Amount (AEA) is Basic Exclusion Amount + DSUE. Most would have thought the issue was how the gift tax was calculated, but the proposed Regs address this at the last stage of the calculation. Use the higher of the BEA that applied at the time the gifts were made, or at death.

Clawback - 2

- Example - Make $9M gift sheltered by exclusion. Dies after 2025 when exclusion has dropped to $5M indexed. BEA to determine how much estate tax credit to be received is BEA used in determining the gift credit which was $9M or the BEA at death. So, assume BEA is $9M and prevents decedent from paying estate tax on a gift made when exclusion was higher.
- Off the top gift tax issue. What if make gift of $5M today and makes no further gifts. If dies after 2025 no benefit of the larger exclusion. Some had speculated that gift would have been made off the top of the exclusion amount, but that was not addressed in the proposed Regs.
- **Comment**: Must plan differently for modest wealth clients who cannot use all of exemption. Perhaps one spouse only makes gifts so over $5M exemption. But, also consider impact of Blue Wave and that a lower exemption is possible so even the planning above might help. Finally may need to juggle asset titles so start now to mitigate step transaction issues.

Clawback - 3

- What if died during period of higher exemption and calculate DSUE off that larger amount. Surviving spouse dies after exclusion has declined. Does the surviving spouse on death get the DSUE based on the larger amount? Should be the DSUE calculated at the time of the first spouse's death? Yes, so the surviving spouse should obtain the benefit of the larger DSUE (i.e., based on the temporary high exemption that existed when the first spouse to die passed).
- **Comment**. Also, consider more robust planning than many executed in 2012. Gifts should not only be made in trust and not outright, but for many clients to trusts that they can access such as non-reciprocal spousal lifetime access trusts or domestic asset protection trusts. See comments below concerning the Wacker case and the reciprocal trust doctrine.

Badgley GRAT assets - 1

- Badgley v. United States, 2018 WL 2267566.
- Mortality risk is an issue with GRATs. **Comment**: Due real life expectancy analysis.
- Because the settlor died before the conclusion of the GRAT term there was estate inclusion. **Comment**: Can still do long term say 99 year GRAT and increase in rates or appreciation of assets will result in less than entire GRAT corpus being included in estate. If Blue Wave strikes in 2020 perhaps long term GRATs before new law change takes effect might make sense as rolling GRATs might be affected if Obama's Greenbook becomes the new administration's playbook.
- GRATs are also not useful for GST planning as you cannot allocate GST exemption until the GRAT term expired. **Comment**: Some have the GRAT remainder paid to an existing irrevocable trust so that the remainder is vested and then may have that trust, also not GST exempt, sell its remainder interest in the GRAT to another GST exempt trust thereby leveraging some portion of the value to a GST exempt receptacle.

Badgley GRAT assets - 2

- In this case the GRAT was funded with 50% interest in general partnership that owned income producing property. Income was greater than annuity payment.
- Executor included entire value of GRAT assets then filed later a claim for refund which IRS disputed. Agreed 2036 controls the issue.
- 2036(a)(1) includes in gross estate trust property if decedent retained income from property. The taxpayer argued that 2036(a)(1) did not apply since there was no authority that provided that the right to the annuity payment was equivalent to the right to the possession, enjoyment or right to income from the property transferred. IRS said it did apply. Court concurred with the IRS because a GRAT annuity provided the grantor the enjoyed the trust property. Right to the GRAT annuity was an implied right to the income.
- The case is on appeal to 9th Circuit.

Powell, Cahill, Morrissette – "In Conjunction With"/Split-Dollar - 1

- **Powell**: (2017) Held 2036(a)(2) applied right on transfer of property retention of right alone or in conjunction with another person to designate who might receive income from property. Other partners could have with decedent dissolved partnership and decedent could have received back the property and designate who could enjoy. How far idea might be taken?
- **Comment**: This "in conjunction with," as the speakers pointed out, is concerning as the scope of how far and in what circumstances it might be applied is uncertain. The Cahill court quoted the Powell FLP case on the requirement of "in conjunction with" ("Decedent's ability to dissolve * * * [her limited partnership] with the cooperation of her sons constituted a 'right * * * in conjunction with * * * [others], to designate the persons who shall possess or enjoy the property [she transferred to the partnership] or the income therefrom', within the meaning of section 2036(a)(2)."
- The case settled with the taxpayer giving up all issues on the split-dollar arrangement including $2M in penalties.
- 2703 issue – where might this get extended? To almost any contractual arrangement?

Powell, Cahill, Morrissette – "In Conjunction With"/Split-Dollar - 2

- **Cahill**: Irrevocable trust purchased policies on life of son and son's wife for $10M. Decedent's revocable trust borrowed $10M from the bank loaned pursuant to a split-dollar arrangement the $10M to the ILIT.
- Estate reported right to receive back this advance at $183,000 since not paid until death of son and son's wife so a large discount applied to the $10M advance. The IRS argued that the full cash surrender value at date of death of $9.6M should be included in decedent's estate.
- Court denied taxpayer's motion for summary judgement on 2036, 2038 and 2703.
- Reasoning of Judge Thornton is that irrevocable trust could have joined with the decedent's revocable trust and terminate the split-dollar agreement and decedent would have received back cash surrender value.

Powell, Cahill, Morrissette – “In Conjunction With”/Split-Dollar - 3

- Has “in conjunction with” become the IRS new weapon of choice?
- Powell and Cahill used the same approach in a family partnership and split-dollar case.
- Both cases are not bad, but horrible facts. Where does this all go?
- How far will the IRS take Cahill and Powell “in conjunction with” arguments?
- What impact to Wandry clauses?
- Should you restructure transactions to eliminate any remaining equity in transferor’s estate?
- For example instead of transferring 45% of 10 real estate LLCs perhaps transfer 100% of 5 real estate LLCs to negate and “in conjunction with” argument as to those.

QTIP Division – Powerful Tool for Temporary Exemption - 1

- PLR 201834011.
  - Revocable trust created a QTIP for spouse then a charitable trust, i.e., the residue to charitable trust.
  - Spouse and trustee petitioned to divide trust into two trusts. Trust one to be funded with pecuniary amount and trust two with balance. Assets to be divided on a non-pro-rata basis. Spouse intended to disclaim all of property of QTIP trust 1 so it would pass to charity.
  - Division of marital trust on non-prorata basis would not cause gain since each beneficiary held same interest sin trusts 1 and 2 as in prior trust.
  - Division would not disqualify trust 1 and 2 as QTIPs.
  - 2519. Marital deduction sensitivity risk is with surviving spouse giving away income interest. If dispose of any of income interest deemed to have made a gift of all of interests in the QTIP principal.
  - When spouse disclaimed interests of trust 1 she would make gift of all income and principal of trust 1 it would all qualify for the charitable tax deduction. This would not cause a gift of trust 2 so no 2519 problem for trust 2.

QTIP Division – Powerful Tool for Temporary Exemption - 2

- **Comment**: See Letter Ruling 201426016 (Mar. 11, 2014), "*Decedent's executor elected to treat Marital Trust as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Internal Revenue Code...The trustees of Marital Trust propose to divide Marital Trust into three separate trusts, Trust 1, Trust 2, and Trust 3. The terms of Trust 1 will be identical to the terms of Marital Trust…intend to convert Trust 2 to a total return unitrust with an annual unitrust payment equal to not less than three percent or more than five percent of the fair market value of the assets of Trust 2…petition Court for a court order to terminate Trust 3 and distribute the assets of Trust 3 equally to Decedent's children…the division of Marital Trust into three separate trusts each separate trust will be a QTIP trust under § 2056(b)(7) and the division will not be a deemed gift or other disposition under § 2519*."

QTIP Division – Powerful Tool for Temporary Exemption - 2

- **Comments**: For clients with existing QTIP trusts seeking to use their temporary estate tax exemption, these QTIP division rulings provide a valuable approach. Divide the QTIP and make an intentional 2519 transfer to trigger use of the remaining exemption with the remaining portion of the QTIP remaining intact and deferring estate tax. If the QTIP permits distribution of principal for planning purposes a distribution may provide an alternative planning option to distribute and contribute to DAPT. Another alternative is to create a 678 grantor trust as to the QTIP and engage in a note sale or other transactions to freeze the value in the QTIP.

Contributions by Trusts - CCA 201747005 - 1

- Trusts are not subject to percentage limitations that individual taxpayers are for charitable contributions.
- However, trusts are subject to the Code Sec. 642(c) special limitation that is not applicable to individual donors. Donations for trusts must be made pursuant to terms of governing instrument. Trust should authorize donations for trust to claim deduction.
- Trust was modified and then made donations.
- IRS held that it was created by court approving modification that was not contained in initial instrument. So, the charitable deduction was lost.

Contributions by Trusts - CCA 201747005 - 1

- **Comments**: With the growth in use of non-grantor trusts for income tax benefits, and the continuing trend to pass wealth in long term trusts, practitioners should consider including permission for trusts to make charitable contributions more often.
- Trusts can avoid the loss of donations because of the higher double standard deduction for some clients.
- For wealthier clients, as a greater portion of wealth tends to be received in trust, this can add important flexibility.
- If a trust cannot make a contribution because of the lack of authorization in the governing instrument consideration might be given to investing in a partnership that makes donations and passes deductions back to the trust.

Charitable Contributions of Appreciated Property by Trusts

- Green v. US, 880 F.3d 519 (10th Cir. Jan 12, 2018).
- Charitable donation rules differ for trusts from the rules applicable to individuals.
- Trusts are limited to a contribution deduction to basis. Trusts can only deduct amount of gross income paid to charity, so no gross income is being donated.
- The trust donated appreciated real estate. It should have sold the real estate and donated the proceeds.
- **Comment**: Most clients will not qualify for a charitable contribution deduction. Estimates were that 30 million taxpayers itemized in 2017 and that will drop to a mere 5 million. As a result, using Qualified Charitable Distributions from IRAs, bunching deductions and using non-grantor trusts, may all become more common planning tools. The Code Sec. 642(c) requirements trusts must meet for those donations to qualify for contribution deductions will become more important as the use of trusts for the purpose of circumventing restrictions on itemized deductions and higher standard deductions, will grow.

State Taxation of Trusts - 1

- State income taxation of undistributed income of a trust.
- If trust has minimal contacts with a state will it suffice to let the state tax income of that trust?
- Can a state where a beneficiary lives tax trust income even though the trust has no other contacts to that state? Several states including Illinois, Minnesota, NJ, and PA held no.
- Two cases this year adding to trend.
- MN – no other connections with MN and MN Supreme Court said if violated due process. . Fielding v. Commissioner of Revenue, 2018 WL 3447690 (Minn. July 18, 2018), aff'g 2017 WL 2484593.

State Taxation of Trusts - 2

- NC – current beneficiary in NC and that was enough for taxation, but NC Supreme Court held that it violated the constitution to tax. Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Dept. of Revenue, 814 S.E.2d 43 (N.C. June 8, 2018), aff'g 789 S.E.2d 645 (N.C. App. 2016). The court referenced Quill and minimum contacts that might be required. Important to the analysis was that the trust was a separate taxpayer from the beneficiaries who lived in NC. Kaestner – the settlor of the trust was NY and trustee initially was NY and changed to CT, contingent beneficiaries were not in NC. Infrequent communications with beneficiaries in years involved. Is that enough to establish minimum contacts so that NC could subject trust to income taxation? The case made an analogy to an entity. A beneficiary might be analogous to a shareholder. That should not be enough.

State Taxation of Trusts - 3

- South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (June 21, 2018).
- The Supreme Court concluded that a state can require company to collect a sales tax. The taxpayer had no physical presence in most states so does that mean those states cannot require that they collect sales tax? The Supreme Court held that physical presence is not the right test with the internet and electronic commerce. No longer need physical presence.
- The Quill case had required physical presence to charge sales tax. In Quill the court found that the sales tax requirements did not violate the due process clause – found a deluge of mailings to states that satisfied due process. Quill v. North Dakota, 504 U.S. 298 (1992).
- Quill had been cited in many of the recent federal income tax cases in terms of minimum contacts.
- In the Wayfair case how did they establish substantial nexus? Under NC law companies in other states will be required to collect sales tax? 200 or more separate transactions and $100,000 of sales into NC?
- Does the Wayfair holding affect trust taxation? If Quill, which required physical presence, has been overruled by Wayfair, will trust taxation change?
- MN and NC filed with US Supreme Court. Cert. granted for Kaestner.

Trust Modifications - 1

- Horgan v. Cosden, 249 So.3d 683 (Fla. Dist. Ct. App. May 25, 2018), review denied, No. SC18-1112, 2018 WL 3650268 (Fla. July 30, 2018).
- Beneficiaries agreed to a trust modification, but court refused to permit it.
- Beneficiaries wanted to terminate trust. Co-Trustee did not agree that settlor intended termination and objected.
- FL statute considers best interests of beneficiaries, etc. Reasons cited in the case were avoiding market fluctuation and fees.
- Co-Trustee argued settlor did not intend what was being attempted.
- The beneficiaries preferred a different course then what settlor intended, including intent that income beneficiary would get income distributions not a lump sum. Settlor expressly provided for income payments over his life even if did not spell out in the trust document.
- **Comment**: With decanting, trust protector actions, non-judicial modifications, exercise of powers, etc. having grown so common, some beneficiaries assume anything that they want done to an irrevocable trust will be rubber stamped by the courts. This case is a reminder that is not the case.

Trust Modifications - 2

- Shire v. Unknown/Undiscovered Heirs, 907 N.W.3d 263 (Ne. 2018).
- The trust provided for a modest $500/month payment to daughter then granddaughter.
- A good case could be made that such was not the settlor's intent so requested modification of the will. No beneficiary that were located disagreed.
- Judge appointed attorney to represent unknown beneficiaries did not consent.
- Court concluded looking at various modification statutes (411(a) UTC, 411(b) consent of all beneficiaries, 411(e) court could have modified if all beneficiaries agreed, 412(a) unanticipated circumstances but when Nebraska adopted it was for trusts after a certain date so it did not apply).
- Do not assume that trust can be modified just because beneficiaries agree.
- Be careful using pecuniary amounts in long term trusts.

DAPTs - 1

- DAPTs are a vital planning tool to use temporary exemption.
- Toni 1 Trust v. Wacker, 2018 WL 1125033 (Alaska, Mar. 2, 2018).
- Montana judgements issued by Montana court issued, etc. Put Montana real estate into Alaska DAPT after the judgements have been entered. Fraudulent transfers.
- Trustee of the DAPT brings an action in AK asking an AK court to determine that Montana law has no jurisdiction.
- AK law provides that AK law has exclusive jurisdiction over challenges to assets in an AK trust.
- AK Supreme Court said cannot bar MT court in this fact pattern.
- It was a transfer to defraud creditors and because of that some may suggest that the case provides little new law on the matter. Others say its bad facts so don't be concerned.
- What can be concluded:
- We know a DAPT works if all assets and other matters are within one DAPT state.

DAPTs - 2

- We know a DAPT does not work when all connections are in the non-DAPT state (like in Toni 1 Trust).
- **Comment**: Not all would agree with this conclusion and might state this differently, e.g. we know from Wacker that if there is a fraudulent conveyance a DAPT doesn't work regardless of which state is involved, but no more. Self-settled trusts are clearly different than fraudulent transfers. Nearly everyone in America takes some action to avoid future claims that might otherwise arise. Informed individuals enter prenuptial agreements when they marry to protect their assets if they get divorced. In fact, a common use of DAPTs is not nefarious or inappropriate avoidance of creditors, but as a backstop to legitimate premarital planning.
- What we do not know is what happens when there is a mix. We do not know how conflict of law issues will be resolved.

DAPTs - 3

- **Comment**: All that the Supreme Court of Alaska held was that Alaska could not require that proceedings relating to the transfer of assets to an Alaska self- settled trust be before an Alaska court. It did not invalidate self-settled trusts created in that state. Although courts in other jurisdictions entered a default judgment on fraudulent transfer allegations, the viability of Alaska self-settled trusts to shield trust assets from the claims of the grantor's creditors was not disturbed.
- **Comment**: With such current large temporary estate tax exemptions many clients should transfer substantial wealth to irrevocable trusts to secure as much exemption as feasible. How many moderate ("moderate" relative to the new exemptions) wealth clients will be willing to make such transfers will depend, in part on what practitioners can offer in terms of access to the assets transferred. Whether it is a DAPT, hybrid DAPT or some other variation, access will be the critical factor. Most or perhaps all of such clients might have no issues with fraudulent conveyances, or any creditor issues, but will want to merely take advantage of the current temporary exemptions. For married clients use of non-reciprocal spousal lifetime access trusts (SLATs) may be viewed by some as a more secure means of securing exemption and providing access. But single clients cannot avail themselves of SLATs. The differing result that some imply for the validity of DAPTs versus SLATs could put single clients at a substantial disadvantage compared to married clients in effecting such planning.

DAPTs - 4

- Given the need to use the large temporary exemption before 2026 (and perhaps before 2020 election results in changes to the estate tax) DAPTs and variations will be a critical planning tool.
- Consider Magill comments on family – many clients cannot use SLATs.
- Consider a variation of not having Grantor named beneficiary but rather giving someone in a non-fiduciary capacity a limited power of appointment to appoint trust assets to the grantor. That should not be a self-settled trust.

199A

The New 20% Deduction

199A – Final Regs - 1

- Corrected Final Regulations have been issued.
- Trusts funded for principal purpose of avoiding income tax under 199A will be disrespected.
- Even one non-grantor trust (not just multiple) will be disrespected/aggregated if established to avoid income tax under 199A. It will be aggregated with the grantor or other trusts for 199A purposes apparently without the need for 643(f). Does this only apply if trust created after enactment of 199A?
- What about a grantor trust that predates 199A converted to a non-grantor trust?
- This does not appear to negate other non-199A benefits of non-grantor trusts.
- Multiple trust examples from proposed Regs deleted. Also deleted was presumption of tax avoidance.

199A – Final Regs - 2

- ESBTs will have only one taxable income threshold.
- DNI will flow out taxable income for the threshold test. So a trust's taxable income for threshold purposes is determined after the 651 or 661 distribution deduction.
- Consider 678 Grantor trusts to shift trust income and 199A to child in lower bracket.
- Taxable beneficiary of CRAT/CRUT may qualify for a 199A deduction.

199A – Notice 2019-7

- Notice 2019-7 guidance on when rental real estate is an active trade or business to qualify for 199A.
- Triple net lease real estate will not qualify unless an active business of triple net leases.
- Cannot use safe harbor for rental of residence.
- Rental Real Estate Enterprise – flexibility in aggregating or treating properties separately for test but cannot aggregate commercial and residential real estate for testing.

199A

- Impact of restructuring entities and structures on buy sell agreements, estate plans, valuations, and more.
- Does cost of restructure pay with 2026 sunset? Will Blue Wave change rules earlier?

1202 Qualified Business Stock

Planning Opportunities

1202 Qualified Business Stock

- Qualified Small Business Stock ("QSBS").
- Sec. 1202.
- Maximum excluded eligible gain is greater of:
  - $10 Mil. in aggregate for all prior taxable years; or
  - 10 times adjusted basis (without regard to additions to basis after original issuance.
- $50 Mil. aggregate gross assets limitation:
  - Cash, and
  - Basis of property held by corporation (but contributed property is deemed to have basis equal to FMV).

Family Structure

Relationships,
Definitions,
Drafting

Reshaping American Family

- Dramatic change in household composition.
- Married households were 80% in 1950 now less than 50%.
- Marriage is a declining and some say unimportant institution.
- Increase in non-family and other households.
- Fastest growing segment unmarried heterosexual couples.
- The number of cohabiting adults who are age 50 and older has increased 75% in the last 10 years. Men's and women's marital status reflect a decreasing preference for marriage

American family composition

- 35% traditional heterosexual married with children.
- 31% no children.
- 34% blended, multi-generation, same sex, single parent.
- Consider impact on life insurance, financial planning and estate planning must consider the growing third segment.

Charitable Estate Plan

New Deduction Rules

Charitable Planning

- Doubled standard deduction eliminates most deductions for charitable contributions.
- 21 million people will no longer itemize.
- Double estate tax exemption eliminates most estate tax deductions for charitable contributions.
- **Comment**: Non-grantor trusts can provide an opportunity for some taxpayers to salvage a full deduction.

Charitable Planning

- Bunching deductions.
  - Use donor advised fund ("DAF")
- QCDs = qualified charitable distributions from IRAs for those over 70.5.
  - **Comment**: Consider QCD benefits when planning how much of your regular IRA to convert to Roth.
- Bequests of income not assets if no estate tax charitable contribution deduction.
  - "All of this estates' [trust's] income (including capital gains and IRD) shall be distributed to Charity. If the cumulative amount of income of this estate [trust] exceeds $50,000 then Charity shall receive only a cumulative amount of $50,000 and all excess income shall be retained or distributed to my beneficiaries at the discretion of the executor [trustee]."

Marriage and Divorce

TCJA Changes

Marriage and Divorce

- Alimony - the Act overhauls the traditional treatment of taxability and deductibility of alimony payments. Under the Act, alimony payments will no longer be deductible by the payor spouse nor will they be includible in the income of the payee spouse. The effective date indicates that this new rule will apply to any divorce or separation instrument as defined in IRC Sec. 71(b)(2) executed after December 31, 2018, or for any divorce or separation instrument executed on or before December 31, 2018, and modified after that date, if the modification expressly provides that these amendments made by the Act apply to such modification.

Marriage and Divorce

- If an existing trust will continue and will remain grantor as to the settlor ex-spouse, consider negotiating a tax reimbursement clause in the marital settlement agreement.
- **Comment**: 199A restructure – will it impact prenuptial provisions and change character of assets? Example restructure business to pay wages to client to reach 199A sweet spot. Does increase in wages change prenuptial impact? Business might be agreed to be separate but wages during marriage may be agreed to be marital property.

Prenuptial and Postnuptial Agreements

- May have required payment of spousal support and were based on anticipation or expectation of a deduction to the payor.
- It is unlikely that a prenuptial or post-nuptial agreement will be treated as a divorce agreement. If don't qualify as divorce or separation instruments under tax law, then benefit will change.
- Review postnuptial agreement and see if it has a severability clause. Saying each provision shall be severable and if a provision is invalid, unenforceable, etc. that shall not impair the operation or portions that are valid, etc. Upon any determination that a term or provision is incapable of being in force then parties shall negotiate agreement to effect original intent of the parties. A similar type clause may give payor spouse a basis to argue that payment amounts should be renegotiated based on that. Payor's spouse's position is that required payments should be reduced by tax savings payee does not have. Payee spouse would argue reduction should not be more than the tax she would have had to pay on receipt of the alimony had it been taxable.

Fiduciary Selection

Naming the Right Trustee or other Fiduciary

Fiduciary Selection

- Administrative and General Trustee. An institutional administrative and general trustee may be designated. This position will hold all trustee powers in the governing instrument that have not been allocated to other fiduciaries. For example, if the trust names a trust protector and investment trustee, the general and administrative trustee will have all trust authority not given to those other two positions. Naming an administrative trustee can permit the client to choose to have the laws of any state apply, while continuing to have flexibility and control over trust investments. There is some disagreement among commentators whether this approach suffices for a self-settled domestic asset protection trust ("DAPT"). A DAPT is a trust for which the settlor is also a beneficiary but for which the position is that the assets are out of the reach of the settlor's creditors and estate. For example, if the settlor lives in State A which does not permit self-settled trusts, and sets up a DAPT in State B which does, naming a trust company in State B as trustee, not all are convinced that this will suffice to protect the settlor from claims made in her home state against the DAPT.

Fiduciary Selection

- Distribution Trustee. The trust could name a person, or group of persons acting as a committee, to be responsible for trust distributions. Caution should be exercised as the power to distribute is a tax sensitive power that could cause trust assets to be included in the power holder's estate.
- Investment Trustee. This position has been called by a variety of names including "investment advisor," "trust protector," and so forth. A person could be designated to be responsible for investment decisions of the trust. This could include investments of securities and business and real estate interests transferred to the trust. The settlor might serve in this role but caution is in order. If the trust owns stock in a closely held business the trust objectives might be better served by proscribing the settlor from voting stock. In some trusts, it might be advantageous to bifurcate the investment trustee provision and provide for a separate trustee to manage marketable securities and to be responsible for family business or other private equity interests.

Fiduciary Selection

- Insurance Trustee. It might be advisable to bifurcate the investment trustee provision into several investment trustee positions. A person could be designated to be responsible for life insurance decisions of the trust. This person should not be the insured. By providing for a separate person to be responsible for insurance decisions, and including prohibitions against the settlor/insured being involved in these decisions, the trust can hold both life insurance and other assets. Some of the advantages of this include the ability to use a single trust instead to hold business interests and life insurance, instead of multiple trusts, and the ability to use income generated by trust investments to pay for life insurance premiums. If a new trust is created to integrate these characteristics review existing insurance trusts to determine if they can be decanted (merged) into this new trust to simplify planning.

Fiduciary Selection

- Power to Add Class of Individual Beneficiaries. Consider hybrid DAPT provisions. If the trust is formed in one of the states that permit self-settled trust as (DAPTs), the client can be a beneficiary of her own trust. However, if she resides in a state that does not permit these trusts, some advisers view it as too risky to create a DAPT in a state that does. But there is a hybrid solution that might reduce the risk some experts perceive, yet leave open the possibility of you benefiting from that trust. Do not name the client initially as a beneficiary. Instead give someone the right to add as beneficiaries of the trust the descendants of the client's grandparents. If the client is not a beneficiary initially the trust should not face that risk. But this may afford the client the possibility of being a beneficiary if he needs access in the future. Some practitioners are not comfortable with even a hybrid DAPT approach as they are concerned that if the settlor is even a potential appointee of the trust that could make the trust a self-settled trust and cause estate inclusion under IRC Sec. 2036 because creditors might be able to reach the corpus. These practitioners prefer to create a hybrid DAPT in a DAPT jurisdiction.

Fiduciary Selection

- Trust Protector. This is a person appointed in a fiduciary capacity (although some commentators disagree and believe the protector can act in a non-fiduciary capacity) to hold important powers over the trust, and perhaps to perform certain other defined roles. The protector may be given the power to remove and replace existing trustees, correct scrivener's errors, modify administrative provisions, change trust situs and governing law, the power to restrict or eliminate the right of the Trustee to use income of the trust to pay life insurance premiums on the life of grantor to facilitate turning off grantor trust status if that becomes desirable, and other powers depending on circumstances.
- Substitutor. This person, who may be the settlor or another person, can be given the power to exchange or “swap” assets of the trust for assets of equivalent. This can be a powerful mechanism to move assets between your client personally and the trust if it becomes advantageous, or merely desired, to hold an asset personally that is in the trust, or vice versa.

Fiduciary Selection

- Loan Designator. Another means of creating grantor trust status is to empower an independent person to loan the grantor/settlor principal of the trust without adequate security.
- Charitable Designator. One of the means of creating grantor trust status is to empower a person to add to the class of beneficiaries, such as a charity.
- Power of Appointment Holders. Powers of appointment should be included to provide further flexibility. Granting someone else the power to transmute limited powers of appointment into general ones can be used to cause some or all the trust assets to be included in an estate to qualify for a basis step up on death could that prove advantageous under a future tax system.

Parents of Minors

Planning Considerations

Parents of Minors

- Some states are called a “court appointed state” rather, the court appoints a guardian, but the will is given “due regard.” So, parent may not have ultimate say, only court will.
- Mother and father are the natural guardians of the child. But does not confer on them the authority to manage property titled in the child’s name. This will come as a shock to many parents. Example - Widow might have to be appointed as guardian of property of her own children.

Parents of Minors

- For states that have adopted the UPC framework for standby guardians, a parent may appoint a guardian to take office immediately upon the need. UPC 5-202 allows a parent to appoint a standby guardian in a will, trust or “other document”. The “other document” can be a general power of attorney that includes the standby guardian provisions, or it can be a separate, stand-alone document that is executed for the sole purpose of appointing the standby guardian.

Incapacity Disability

Definitions; Planning

Incapacity Disability

- After the financial durable power of attorney document is executed, if the principal is able, the principal and attorney-in-fact, or the first attorney-in-fact appointed in the document if there are more than one, should visit each financial institution and financial advisor that the attorney-in-fact may be required to work with in the future. A copy of the financial durable power of attorney should be provided to the institution. Typically, the document will be reviewed by the institution's legal counsel before the institution will honor it. By making this contact while the principal has capacity, any concerns of the institution can be handled by the principal and, if necessary, the document can be altered to accommodate the institution's concerns.

Q&A

Question and Answer Panel

Can grantor be reimbursed if trust is silent on the payment of tax?

- Millstein v. Millstein, 2018 WL 3005347 (Ohio Ct. App.), and 2018 WL 1567801 (Ohio Ct. App.).
- What if grantor tires of paying income tax on trust phantom income?
- Millstein father sued trust for reimbursement and court dismissed. Brought action under UTC to reform trust for tax purposes. But court said only beneficiary and trustee can bring such an action, not the grantor. Grantor created the situation and had no basis to change it.
- It also appears from the discussion that the Court in Millstein viewed the situation as having been created by the father, so he had controlled the creation of the situation.

Tax Reimbursements and Swap Powers – Other Planning Points

- With grantor trust the grantor is deemed to own trust property for income taxes and grantor pays all income on trust property. Also allows grantor to engage in swaps and asset sales without income tax consequences. Grantor's payment of income tax on income of trust is not a gift nor will it cause estate inclusion.
- Trust might authorize trustee to toggle off grantor trust status. Be careful this is not in the beneficiary's best interest and may raise questions of fiduciary liability to beneficiaries. It will also turn off ability to engage in tax free transactions after that. Could instead have a tax reimbursement clause. This can be helpful if there is a large one-time recognition event, e.g. sale of a business.
- Give trustee discretion to reimburse, but do not obligate trustee to do so.
- Caution that if reimbursement clause regularly exercised it may be a pattern and could create a problem. This could raise a 2036 inclusion issue if done over. It also raises fiduciary issues. "Not too often." Leave grantor with sufficient powers to turn off grantor trust status if it becomes problematic to continue to pay tax.
- Some states have statutes clarifying that reimbursement won't cause estate tax inclusion. NY and NH have statutory trustee power to reimburse grantor for taxes paid. In NY can only reimburse for capital gains..

Trust Wrongful Termination

- Trustee/beneficiary distributes all assets in trust to himself and other beneficiaries equally in violation of trust instrument and state law. Is there a tax issue?
- This could be viewed as embezzlement by trustee followed by a gift by the trustee.
- Receipt of money received illegally by taxpayer is taxable income even if there is an obligation to repay the money.
- Report as other income on Form 1040.
- Trust might be able to claim a loss.
- If trustee repays money no deduction since miscellaneous itemized deductions have been eliminated.
- **Comment**: Some clients are terminating old trusts, e.g. credit shelter trusts that no longer provide an estate tax benefit (often without professional adviser involvement). Practitioners should consider adding the above risk to the warnings given to such clients.

Long term GRAT

- GRAT designed to be 100 years.
- Badgley affirmed that regulations are valid. Badgley v. United States, 2018 WL 2267566, 121 AFTR 2d 2018-1816 (N.D. Cal. May 17, 2018); App. filed (9th Cir. June , 2018).
- Interest rate at time of death was lower than when the GRAT as set up so entire corpus of the GRAT was included in her estate under formula.
- Regulations require including portion of GRAT to satisfy the retained annuity based on the then 7520 rate.
- Create 100-year trust when 7520 rate is 3.4%. GRAT gives $35,245/year of an annuity for 100 years. That is worth $1M. Settlor will die before term.
- Benefit of technique is that it can succeed even if estate inclusion because the way the formula works.
- 7520 Rate increases substantially before settlor's death. May only have $705,000 at 5% 7520 rate to generate annuity.
- If 7520 rate stays the same but property increases substantially. So, amount to be included is $1,036,000 so excess is still excluded.

Evolutionary Planning

Tips

Firing a bad Client - 1

- How do you do it ethically?
- Lawyers are not indentured servants. Be nimble and get out of it as it will you better off.
- Don’t put it off.
- End it as well as you can.
- Maintain your reputation.
- Organize the file, clean up the file before you turn it over.
- Send them a “blue print” for the future. Examples: If they have to change a deed, tell them. If life insurance was not transferred to an ILIT tell them. Give them a blue print for the future so they cannot come back to you.

Firing a bad Client - 2

- Here's Lou's list of steps for firing a bad client and making life easier (and safer):
  - *"…give written notice of disengagement, preferably after you have had a conversation with the client.*
  - *The notice should provide the client sufficient time to engage a new lawyer…*
  - *The notice should include a refund of any fees paid in advance.*
  - *The notice should identify any filing deadlines (e.g., gift tax return; estate tax return) and should disclose the status of any work in process.*
  - *The notice should recommend that the client engage a new lawyer.*
  - *The notice should include the delivery of the client's file (and you should retain an electronic copy of the file).*"

Fiduciary Cases

State Law Developments

QTIP

- Comptroller of the Treasury v. Taylor, 2018 Md. App. LEXIS 717 (2018).
- MI husband died and will created QTIP for surviving wife.
- She moved from MI to MD and died intestate. MD then tried to tax QTIP trust.
- QTIP elections are MI and federal. Lower court held MD could tax the QTIP but on appeals it was reversed. Maryland could not impose its estate tax on the trust.
- MD tax law imposes estate tax on the transfer of the Maryland estate of a Maryland decedent. The MD estate is defined as the “federal gross estate,” but the tax law also refers to a QTIP taxable in MD as one for which an election was made for the decedent’s predeceased spouse on a timely filed MD estate tax return.

Spendthrift Trust

- Horgan v. Cosden, 2018 Fla. App. LEXIS 7375 (2018).
- Spendthrift trust income only to son and remainder to charity.
- Beneficiaries agreed to commute trust.
- Court rejected as settlor wanted to give son only income and protect him. It was a violation of settlor intent and cannot commute trust just because beneficiaries want to.
- “The plain trust terms reflect the settlor’s intent to provide the son with only incremental income distributions for life, and then give the principal to the colleges after his death. Terminating the trust would frustrate that intent and the trust purposes.”
- Trustee fees and market risk are normal part of trust expenses.

Trust Protector - 1

- Trust protector cases - Background.
  - Protectors provide for flexibility. Hot powers are with protector not beneficiary or settlor.
  - Little case law defining duties, etc. of the trust protector.
  - What should protector do and not do? Cannot rely on common law as there is none.
  - Sec. 808 UTC says a protector is presumptively a fiduciary and must act in interests of beneficiaries. However, states that enact to Uniform Trust Act (MI, GA, NM) repeals old Sec. 808 of UTC. Act doesn't apply to bare power to remove and replace trustee. Protector has right to compel trustee to provide accounting.

Trust Protector - 2

- Carberry v. Kaltschmid, 2018 Cal. App. Unpub. LEXIS 3900 (2018).
  - No duty to audit books or monitor.
  - Protector demanded settlement agreement.
  - Beneficiaries and trustees asked protector to stay out of it.
  - Protector sued trustees to account.
  - The trust terms do not entitle the protector to compel an accounting. The trust terms require the trustee to account to the beneficiaries only. None of the powers granted to the protector include the power to compel an accounting.
  - Court dismissed suit as state law only gives accounting rights to beneficiary. Note that new Uniform Trust Act would change that.

Trust Protector - 3

- In re Quintanilla Trust, 2018 Tex. App. LEXIS 8223 (2018).
  - Settlor and business partner had fight.
  - Andrew who was the Protector demanded accounting and threatened to remove trustee and insert a bank.
  - Trustee moved assets into a new trust via a merger or decanting with notice to beneficiaries and no notice to protector.
  - Neither the trust terms nor the trust code merger provision required giving notice of the merger to the protector.
  - Court permitted since trust terms did not give protector the right to an accounting and court saw no harm to beneficiaries.

Powers of Appointment

Limited, General and other Special Powers

What's included in powerholder's estate?

- 2041 requires powerholder estate include all property over which powerholder has GPOA at death.
- Limitations on exercise or the impracticability of exercise do not matter. The speaker's outline states: "*Mere existence of the power is sufficient, even if the powerholder does not know about the power or is incapable of exercising it at death (for instance, due to incapacity). See Estate of Freeman v. Commissioner, 67 T. C. 202 (1976); Rev. Rul. 75-350 (marital trust deduction allowed where surviving spouse was mentally ill during term of the trust); Rev. Rul.75-351 (minor had a general testamentary power of appointment even though minor couldn't execute a Will as a minor)*."

Termination Provision May Provide for Inclusion

- It is not uncommon for a trust to include a provision permitting the trustee to terminate the trust if it is too small to continue. This may be characterized as a GPOA if the trustee is a potential beneficiary. PLR 9840020.
- **Comment**: Would the result be different if the trust were instead terminated under state law permitting termination of a small trust instead of under the trust provision? Perhaps this concept provides a means of causing estate inclusion for old irrevocable trusts on the death of a trustee/beneficiary?

Upstream Sale to a Power of Appointment Trust (UPSPAT) - 1

- Son creates grantor trust. Sells assets to the trust for note. Trust gives mom testamentary GPOA over the trust assets so that the assets included in mom's estate getting basis step-up. Trust uses assets to pay off note. Trust remains grantor trust to son even after mom dies. Mom's estate is increased by zero but son gets basis step-up.
- Sale not intended to remove assets from son's estate so 2036 issues that some might interpret as requiring trust have seed gift not relevant. But sale to unseeded trust could have IRS argue note worth less than face. Similar to other sales to trusts with no or inadequate seeding a guarantee of part of the note might be used. Example, mom if she has any assets could guarantee part of the note to reduce that risk.
- Does mom's GPOA cause asset in trust to be stepped up to FMV, or will the value of the note reduce the amount of the step-up? If mom guarantees note then this concern would be reduced.

Upstream Sale to a Power of Appointment Trust (UPSPAT) - 2

- While that might be a safer approach some view the 20.2053-7 regulations as optional. Also, Crane v. CIR, 331 US 1 (1947) has basis increase based on FMV of property regardless of the associated debt.
- Watch out for creditors of mom.
- Mom (or whoever the GPOA holder is) should also be a beneficiary of the trust created to avoid an issue analogous to naked Crummey power holders that the courts have ruled against. in Cristofani v. Comm'r, 97 T.C. 74 (1991), acq. in result only 1992-1 C.B. 1.

Money Laundering

Adviser Responsibility

Money Laundering

- FATF's recommendations relevant to estate planners include:
- Customer due diligence (CDD) and record-keeping requirements
  - Should be required when:
    - establishing business relations.
    - carrying out occasional transactions.
    - there is a suspicion of money laundering or terrorist financing.
    - has doubts about the veracity or adequacy of previously obtained customer identification data.
  - The CDD measures to be taken are as follows:
    - Identifying the customer and verifying that customer's identity.
    - Identifying the beneficial owner and taking reasonable measures to verify the identity of the beneficial owner.
    - Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship.
    - Conducting ongoing due diligence on the business relationship.

Disclaimers

- Flexibility

Disclaimers

- Asset protection.
  - What is overlap of asset protection and disclaimers.
  - Planning to limit creditors, creating a “prenuptial agreement” by trust, etc.
  - A disclaimer might help.
  - You cannot always disclaim and avoid creditors. If you renounce it relates back to initial transfer date so may limit creditor claims. Relation back doctrine.
  - Limitations on avoiding creditors by disclaiming.
    - Drye v. United States, 528 U.S. 49 (1999) case.

Unwinding Insurance Transactions

Options abound

What makes a good policy?

- Good policy can mean different things.
- If uninsurable every policy may be good especially if need liquidity at death.
- Good policy is one in which the cash value has built up to extent it is performing quite well. More recently policies are performing better.
- A well performing policy with big cash value can make the transaction be bad, so it's a catch-22 about whether the policy and transaction are both good.
- May have riders that are good and cannot purchase those any longer. E.g. 98-year-old insured who has riders to continue the policy. That is reason to continue policy.
- No lapse guarantee policy you don't want to lose this since you have paid for this guarantee and may not be able to get that guarantee in a new policy today.
- Policy with rate of return that is better than current policies rates of returns.
- Policy that carrier offers higher reserves then is offered on new policy.
- No lapse guarantee policy doesn't have CV but the reserve supports the policy.
- Some policies offer creditor protection. Better to have an old policy purchased before needed creditor protection.

Self-Settled Trusts

DAPTs and More

Transfer to self-settled is it a completed gift - 1

- Private Letter Ruling 9332006 foreign trust concluded that transfer was completed gift. Creditors could not reach under local law.
- Private Letter Ruling 9837007 AK trust, IRS concluded gift complete.
- PLR 200944002 addressing completed gift transfer issue. Taxpayer requested IRS to rule if trust would be included in settlor's estate. IRS concluded that right of trustee to distribute to settlor does not cause 2036 inclusion but conclusion depends on facts and circumstances. If an implied agreement or pattern of distributions 2036 could cause inclusion in estate.
- CCA 201208026 matters beyond settlor control should not trigger inclusion.
- ING rulings are analogous if can relegate to creditor then trust will be a grantor trust which is not desire.
- Contrast traditional DAPT not concerned about removing from estate and may have been incomplete gift on purpose. Now to use exemption need DAPT jurisdiction and no retention of powers that would cause estate tax inclusion:
  - No veto powers.
  - No implied agreement.
  - Settlors creditors should not get access.

Transfer to self-settled is it a completed gift - 2

- To avoid an implied agreement, attack the settlor should view the DAPT as emergency fund and ideally no distributions should be taken.
- If settlor has power to remove and replace trustee estate inclusion issue. Successor trustee should not be related or subordinate.
- DAPT statutes have window during which claimants can reach trust assets. Consider state law exception creditors in DAPT jurisdiction. Is that a retained interest that might cause estate inclusion? Common exception creditor is spouse with alimony claim.
- Bankruptcy Sec. 548(e) clawback. If file for bankruptcy protection within 10 years after funding theoretical concern that had there been a bankruptcy filing could be a clawback. 548(e) requires finding of intent to hinder delay or defraud a creditor. Consider that this is no different than any gift. If you give $3M to daughter the fact that there is a fraudulent conveyance doesn't affect whether or not the gift is complete.

Accessing SLAT Assets - 1

- Floating spouse provision – defined who settlor is married to from time to time.
- Could provide if divorce spouse deemed deceased but then you lose access.
- Give spouse LPOA to appoint back to grantor. How does relation back doctrine impact that?
  - It's a problem because what clients would like to do, H creates trust for W and W has benefit of distributions, but H needs assets back when W dies. Give W LPOA to appoint back to H (as in a credit shelter trust).
  - But if W predeceases H and funds go to trust for H, that might be deemed a self-settled trust as to H.
  - A power of appointment is a power not a property interests. So, it's as if the property came from H not from W since W as a mere power holder did not have a property right. Those assets arguably could be included in H's estate.

Accessing SLAT Assets - 2

  - Set up credit shelter trust = CST in a DAPT jurisdiction. That is not a perfect result. If instead create an inter-vivos QTIP trust 17 states have addressed relationship back doctrine. Problem with inter-vivos QTIP is assets in estate so need further planning.
  - AZ, KY, NC, TN, TX and DE. Do not need QTIP election to cure relationship back doctrine.
  - 17 DAPT states. Most say to cure relationship back doctrine need to make a QTIP election.
- SLAT use life insurance on life of donee spouse so do not need to address LPOA back to donor spouse.

Minimum Distribution Rules Trusts

Tax Bracket Concerns

Consider Trust vs. Beneficiary Income Tax Brackets - 1

- Example. Family with 3 children in 20s and one of child is special needs receiving government benefits that are means tested. Wealth level is such that they cannot pay all expenses of special needs child, will need government benefits. Want to leave IRA to trust to help disabled by providing supplemental benefits. Cannot leave to a conduit trust for a disabled beneficiary since the income would flow out and would lose benefits. Can we still get a life expectancy payout using an accumulation trust? Yes, name accumulation trust as beneficiary but say when disabled daughter dies trust qualifies and goes outright to her siblings. Now have $1M IRA going into a trust that will not distribute all income to disabled daughter, so income not distributed will be taxed at the maximum income tax bracket.
- Who will pay income tax on the trust income and when? Perhaps parents should take out distributions during their lifetime from IRA that will be taxed at a lower bracket or do a partial Roth conversion.
- So merely qualifying for see-through trust rules may not suffice for income tax planning purposes.

Consider Trust vs. Beneficiary Income Tax Brackets - 1

- individuals have to have taxable income in excess of $612,000 before getting into 37% bracket. So how many beneficiaries are really worried about being in the top income tax bracket?
- But the trust will be in the maximum tax bracket at about $12,000 of individuals.
- Traditional IRA taxes have been deferred. No tax paid when earned or when investments earned income. The income is deferred and will be taxed. It is only a question of when the tax will be due. The only way to avoid the income tax is to leave IRA to charity.

Engagement Letters

Protecting the practitioner

Engagement Letters - 1

- Communicating terms of new or changed relationship.
- It's an art, not a science.
- "If you practice long enough you are likely to have an ethics complaint or malpractice claim."
- Client's come to us unhappy. Unhappy about taxes, unhappy about litigation issues. Unhappy about family issues. So, their unhappiness may have nothing to do with counsel.
- Being careful may be sacrificed as a result of the frantic pace of practice, or the fear of losing business.
- Engagement letters set expectation for attorney client relationship, delineate who is client, etc.
- Many clients do not know the rules that apply that lawyers are familiar with, how often you will communicate, etc.

Engagement Letters - 2

- If put it writing clients can understand it. Clients often do read the engagement letters.
- Engagement letters establish rules of confidentiality “secrets.” No secrets in joint representation among couple and attorney.
- Client getting divorced – might need permission from soon to be ex-spouse.
- Push issue if client does not sign and send back engagement letter.
- Client who does not want to sign engagement letter is a red flag. If you use engagement letters get them from everyone.
- ABA model rules and ACTEC commentaries on model rules consistently and strenuously encourage the use of engagement letters.
- How do you craft engagement letter? Look at mistakes others have made, and things others have done right.

Conclusion and Additional Information

Steps Planners Should take Now

Conclusion

- Planning has dramatically been affected by the 2017 Tax Act, but there have been a myriad of other developments practitioners should be aware of.
- Educate clients to plan now using DAPTs, SLATs and GPOAs before law changes.
- Draft in flexibility but consider case law developments on protectors, tax reimbursement, etc.

Additional information

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