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Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2348

Date: 25-Sep-15
From: Steve Leimberg's Estate Planning Newsletter
Subject: FLASH: Marty Shenkman's Notes from the 41st Annual Notre Dame Tax and Estate Planning Institute

The **41st Annual Notre Dame Tax and Estate Planning Institute** was held on **September 17th** and **18th** at the **Century Center** in South Bend, Indiana. Members should click this link to review the meeting agenda: **41st Annual Notre Dame Tax and Estate Planning Institute**

In addition to estate planning topics for high net worth individuals, this year's Institute featured sessions on income tax planning techniques providing immediate tax benefits that need not wait until one's death. Topics that relate to each other were clustered together so that each presentation built upon what was presented the hour before.

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

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in Paramus, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of more than 40 books and 800 articles. Marty is the Recipient of the 1994 Probate and Property Excellence in Writing Award, the Alfred C. Clapp Award presented by the 2007 New Jersey Bar Association and the Institute for Continuing Legal Education; Worth Magazine's Top 100 Attorneys (2008); CPA Magazine Top 50 IRS Tax Practitioners, CPA Magazine, (April/May 2008). His article "Estate Planning for Clients with Parkinson's," received "Editors Choice Award." In 2008 from Practical Estate Planning Magazine his "Integrating Religious Considerations into Estate and Real Estate Planning," was awarded the 2008 "The Best Articles Published by the ABA," award; he was named to New Jersey Super Lawyers (2010-13); 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. He sponsors a free website designed to help advisers better serve those living with chronic disease or disability www.chronicillnessplanning.org.

Because of the length of Marty's commentary, **LISI** has made his "Day 1" notes available to members through the following link: 41st Annual Notre Dame Tax and Estate Planning Institute- Day 1

Important Note: The Institute has extra copies of the printed volumes, the materials on a CD and on a flash drive. The Institue offers to sell its extra copies for those who did not attend in person for a modest price that includes shipping with no sales tax, the printed volumes for $175, the CD for $155 and the flash drive for

$155. If anyone is interested, they can contact the Notre Dame Conferance Center, Attn: Debbie Sumption, 115 McKenna Hall, Notre Dame, IN 46556 or e-mail Debbie at debbie.s.sumption.1@nd.edu

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

Marty Shenkman

CITE AS:

Notre Dame 41st Annual Tax and Estate Planning Institute
September 17 and 18, 2015
Part 1 of 2
By Martin M. Shenkman, Esq.

1. **1- Planning Ideas for Retirement Benefits**.
    a. Overview.
        i. When, whether and how to take distributions.
        ii. When, where and how to roll over benefits.
        iii. Roth IRA conversions.
        iv. Charitable gifts.
        v. Buying life insurance in the plan.
        vi. How to fit benefits into the estate plan. Another goal is to alert attendees to ideas they may not have heard of, as well as to evaluate ideas that probably do NOT work for the intended purposes.
    b. Basis.
        i. Plan distributions are tax free as a return of basis. See Form 8606 filed with Form 1040 when non-deductible IRA contributions are made.
        ii. State tax basis may be different then federal, e.g., state may not have permitted deductions for amounts deducted on the federal return.
    c. Clean up.
        i. Use IRS distributions to simplify accounts and eliminate small account balances. If the client has multiple IRAs a distribution from any IRA counts towards RMD for all IRAs. Use this to winnow down and close out small accounts.
    d. Donation.
        i. The client may believe that donating an amount equal to the RMD the client took to charity will be a wash with the deduction offsetting the income. Not always.
        ii. If the client doesn't itemize deduction there will be no benefit to the contribution.
        iii. If the IRA increased adjusted gross income (AGI) it may have increased the taxation of the client's Social Security benefits, reduced medical expense deductions (the 10% floor).
        iv. Some states will tax RMD but not permit charitable contribution deduction.
    e. Should You Take RMDs Early or Late?
        i. Older/Ill clients. Take RMDs early in the year to avoid the burden on heirs of having to make the RMDs before year end to avoid penalties.
        ii. For clients who might wish to make a contribution to charity it might be advisable to wait until late in the year because Congress for many years has reinstated the ability to direct the RMD to charity as a Qualified

Charitable Distribution. If the RMD is taken early in the year and later Congress reinstates the QCD it won't be possible to take advantage of it.

iii. Wealthy clients leaving an IRA to charity should generally take their RMD as late as possible. If they die during the year the charity will take the RMD for that year and the income tax that the client would have had to pay had he or she taken it will be avoided.

f. Cash Flow Worries.
   i. Retirees' major concern is not running out of cash flow especially if they live for 2, 3 or more decades after retirement.
   ii. If the client withdraws his RMD each year the mechanism as to how RMD is calculated will assure, absent poor investment performance or losses, that he or she will never run out of funds.
   iii. The RMD is calculated based on the Uniform Lifetime Table which assumes a joint and survivor annuity for the client and a hypothetical spouse/partner/beneficiary 10 years younger. This rate is recalculated each year. The result, the funds must last beyond the client's lifetime.

g. Lower Tax Myth.
   i. Many clients mistakenly believe that they will be in a lower tax bracket in retirement and the benefit of funding an IRA is to reduce the ultimate tax that they will have to bear.
   ii. Reality is that, especially for high income taxpayers, they may be in as high a bracket in retirement as before.
   iii. Further, income tax rates have been changed by Congress so frequently that any assumption is risky. Rates might be lower on contribution and higher in the years of withdrawal or simply be changed so frequently that no inference can really be made.

h. Domicile change.
   i. If the client is contemplating a change in domicile review the state taxation in the current and future home states as to retirement assets. Some states offer varying special tax treatment for retirement plan assets. It may prove advantageous to withdraw more funds before or after the move.

i. Should you roll Qualified Retirement Plan benefits into an IRA?
   i. Consider the asset protection benefits and the client risks/concerns over asset protection matters. What protection does the client's state afford IRA assets?
   ii. Rolling a QRP over to an IRA may afford more options on distributions. Some QRPs only permit lump sum distributions. Even if the QRP permits a life expectancy payout what if the plan is later terminated and a lump sum distribution made?
   iii. Use separate IRAs to hold QRP rollovers and regular IRA contributions since there is no cap on federal bankruptcy protection of QRP funds rolled into a separate IRA but IRAs funded with annual contributions are limited to only $1M of protection.

j. Non-Deductible IRAs.
    i. Some commentators believe these are a bad financial move because the same funds invested outside the IRA would not generate taxable income until sold, could qualify for favorable capital gains treatment and if held until death would get a step up in basis.
    ii. The asset protection benefits of a non-deductible IRA should be considered. It is a simple, no-cost means of creating a small protected pot of assets.
    iii. Making non-deductible IRA contributions increases the amounts that can later be converted to a Roth.
k. Investment Fees.
    i. Pay these out of personal assets not IRA assets, and especially not Roth IRA assets.
    ii. Exception is if your IRA has too much assets, paying fees inside the regular IRA will modestly address that issue.
l. Asset location.
    i. Hold assets producing current income inside the IRA where they will not be subject to current income tax until distributions from the plan are made.
    ii. Hold growth assets which do not generate income outside the IRA. Also, on sale these may be taxed at favorable capital gains rates where if they were held in the plan that gain would be taxed as ordinary income.
m. Qualified Longevity Annuity Contract (QLAC).
    i. Middle age clients can purchase a QLAC, perhaps in their 50s or 60s that will pay an annuity in the future. The QLAC begins payouts at age 85 and thus provides protection against the fear of running out of money at advanced ages (i.e. of significantly outliving average life expectancy). Beginning 7/24/14 QLACs can be held inside an IRA and the value of the QLAC will not be considered in the calculation of RMDs. Reg. Sec. 1.401 (a) (9)-5, -6.

2. **2- Real Estate: Integrating Income Tax Planning and Estate Planning**.
    a. Overview.
        i. Since real estate is a depreciable asset frequently leveraged with mortgage debt, it presents concerns and obstacles not typically encountered with marketable securities and closely-held business interests.
        ii. Many of the commonly-used estate planning techniques used for other assets may not be as effective for real estate, and if used for real estate can create additional tax problems.
            1. Example: If a charitable trust holds mortgaged real estate, the income tax disadvantage is that the real estate generates unrelated business taxable income for the charitable trust.
        iii. Some of the special income tax concerns that exit with real estate such as real estate with mortgage liabilities in excess of its adjusted income tax basis (the so-called phantom gain exposure).

iv. Certain estate planning techniques should not be used for real estate and other estate planning techniques typically used for real estate cannot solve these special income tax concerns.
v. Estate planning techniques particularly suited to solve the income tax obstacles found in real estate and can be designed to save both income taxes and estate taxes at death can also be used while the real estate owner is living to achieve income tax objectives such as deferral of the reporting of gain and converting ordinary income into capital gains.
vi. Preferred partnership freeze under Section 2701 can be used to eliminate the phantom gain inherent in negative basis real estate while still sheltering future appreciation in value from the estate tax. If the entity freeze is done with a partnership (or LLC taxed as a partnership) the initial transfer is treated as a contribution to the capital of the partnership. The retained frozen interest in the freeze partnership will be included in the developer's estate and therefore benefit from a basis step-up under IRC Sec. 1014 on his or her death. The structure of the freeze partnership may be able to allocate the liabilities in excess of basis to the frozen retained interest. The freeze partnership is structured with senior or preferred interests which receive a preferred return and liquidation preference, and a junior interest to which growth inures. The junior interest must be valued at 10% or more of the value of the partnership at the date of transfer. The requirements of 2701 must be met to avoid a deemed gift of the entire value of the partnership. The retained preferred interest must include a right to a qualified payment to have a value for 2701(a)(3)(A). This could include a payment equivalent to a periodic divided on a cumulative preferred stock. Facts and circumstances must be considered in setting the payment. Rev. Rul. 83-120.

b. Valuation.
i. Primary methods to value real estate include the net asset value (NAV) approach, often used if liquidation is contemplated, and the income approach, used for a going concern. See Weinberg TCM 2000-51.
ii. Use defined value clauses.

c. Basis.
i. IRC Sec. 1014 - Basis of property acquired from a decedent - generally fair market value of the property at the date of the decedent's death
ii. IRC Sec. 1015 - Basis of property acquired by gifts and transfers in trust - same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value.
iii. IRC Sec. 1016 – Adjustments to basis. Applies to any asset acquisition by purchase, construction, etc.
iv. IRC Sec. 465(b) (6) – must be at risk exception for "qualified non-recourse financing". Must have to get basis.

Qualified nonrecourse financing treated as amount at risk

For purposes of this section—
(A) In general
Notwithstanding any other provision of this subsection, in the case of an activity of holding real property, a taxpayer shall be considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing which is secured by real property used in such activity.
(B) Qualified nonrecourse financing
For purposes of this paragraph, the term "qualified nonrecourse financing" means any financing—
(i)which is borrowed by the taxpayer with respect to the activity of holding real property,…

v. With LPs and LLCs lead to IRC Sec. 752 with addresses recourse and non-recourse debt.

Increase in partner's liabilities
Any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, shall be considered as a contribution of money by such partner to the partnership.

vi. With real estate you can have capital accounts and "negative capital accounts." Although commonly talked about, there is no such thing as "negative basis." You can, however, have a negative capital account. Basis from debt creates potential for negative capital account.
vii. Taxpayers use to use deprecation to generate major deductions but unless the developer can now use component deprecation, the depreciation periods are 27.5 years for residential rental property and 39 years for all other property. There is no term in Code for "commercial" real estate, it is simply non-residential property.
viii. Use of GRATs and IDITs removes real estate assets from the estate so that, unless swapped back in, they will not qualify for a step-up that will eliminate the negative basis.
ix. Outright gift of property to an heir, rather than a grantor trust, will trigger gain if liabilities exceed basis.

d. Refinance.
    i. Can refinance and distribute proceeds and expand negative capital account.
    ii. When dispose of real estate may trigger phantom income.
e. Real estate cycles.
    i. Impact on value.
f. Entity.
    i. Never use a C corporation for real estate.
    ii. Never own real estate interests individually. Liability protection is paramount.
    iii. S corporations are not optimal for ownership of real estate.
        1. Limited to 100 shareholders.

    a. Can have six levels of family count as one shareholder.
    b. Nonetheless on larger projects this can prove very restrictive.
2. S corporations have limitations on who can be a shareholder.
    a. Non-resident alien cannot be a shareholder.
    b. C Corporation cannot be a shareholder.
    c. Another S corporation cannot be a shareholder unless structured as a Qualified Subchapter S Subsidiary and is disregarded.
    d. Cannot have a Subchapter K entity as a shareholder, e.g. a general partnership.
3. Cannot have more than one class of stock.
    a. Can have voting and non-voting stock without violating the one-class requirement.
    b. But all classes must have the same economic rights on distribution and liquidation.
    c. This can be quite problematic the way many real estate deals are structured. Example: Anchor tenant vacates 40% of the building and need $5M to create improvements to re-lease to a new tenant. Client wants to find investor who believes building will be good. Investor may be willing to put in the $5M but every practically any investor agreeing to this type of deal will want a preferred or priority return on income as well as a priority return of capital. Unfortunately that type of structure will violate the prohibition against a second class of stock.
    d. What if the S corporation drops the property into an LLC which in turn might provide the required allocations? This will accelerate the loan. There may also be a local transfer tax.
4. Basis is a major issue when using S corporations to own real estate.
    a. In an S corporation you get basis for capital contributions and for loans shareholder made to S corporation.
    b. Contrast this to a partnership in which a partner does not obtain basis for loans made to partnership. But a partner does obtain tax basis for partnership's loans from a third party if recourse based on loss sharing ratios. Who has final liability? If non-recourse get basis based on share of profits in entity. But in a partnership it is the entity's loan that creates basis, unlike an S corporation.
5. Basis step up on death of S corporation shareholder. When a client dies with an interest in an S corporation and adjusted basis is $100,000 and FMV is $1M. Estate will get a step up in basis from $100,000 to $1M. That is the stock in the S corporation is stepped up, but the inside asset, the real estate, remains stagnant. If later

sell assets inside the S corporation there will be gain recognized in the S corporation regardless of the basis in the stock.

a. Contrast this with a partnership in which IRC Sec. 754 permits you to step up the basis of that partner's asset inside the partnership so thereafter if the property is sold there is no gain as to that partner.

iv. Discounts.

1. 36% seems to be the going discount. 20% lack of control and 20% brings to 80% and another 20% for lack of marketability = 36% aggregate rate.
2. It is not clear if Regulations IRS indicates it will issue will apply to real estate or only to security entities.

g. Liability protection is paramount concern.

i. Entity structure and formality.
ii. Make certain client has adequate liability insurance.

h. Exit strategy.

i. Buy-sell arrangement.
ii. Litigation
iii. Mediation.
iv. Arbitration.

1. Unlike litigation it is not appealable.

v. "Russian roulette" buyout method.

1. Partner A sets price. Does not know if he will buy or sell at that price.
2. Partner B can then choose to buy A at that price or sell to A at that price.
3. What if a partner cannot afford buying and other partner knows that? You can include a mechanism that permits no matter what the price a payout out over 10 years, etc.

i. Capital gain versus ordinary income.

i. If convert low basis building to condominium you are converting to a dealer status and you will transform capital gain to ordinary income. Plan to minimize this impact.

1. Comment: Planning to minimize this impact might include transferring the property to an entity and appraising the fair value at that point in time. Bramblett v. Commr. 960 F.2d 526 (5th Cir. 1992). Whatever planning is to be undertaken should be coordinated with the estate planning under consideration. If the property will increase substantially in value after subdivision or renovation transferring the property to an irrevocable grantor trust, a GRAT or using some other freeze technique before that process is undertaken. If an appraisal is obtained as part of this planning that same appraisal may serve for gift tax purposes.

ii. Ordinary losses are more valuable.

j. Tax on Sale.

i. Recapture.

ii. 3.8% NIIT. IRC Sec. 1411.
    1. It may be feasible that even for a single property the developer's involvement may rise to the level of a trade or business.
    2. The final regulations address the self-rental exception so that property held in a separate entity may be treated as active for NIIT purposes.
    3. For grantor trusts the grantor is the litmus test, for non-grantor trusts the tests are applied at the trust level. Reg. Sec. 1.1411-3(a)(1).
        a. Comment: Be certain to plan who will be named trustee of any non-grantor trust created for a real estate client as this could be critical to the trust being deemed to materially participate for purposes of the passive loss rules (IRC Sec. 469) and the 3.8% surtax (IRC Sec. 1411). Frank Aragona Trust v. Commr. 142 T.C. No. 9 (March 27, 2014).
iii. IRC Sec. 1031 like-kind exchange.
    1. Clients living longer so is deferral more valuable?
    2. Note proposals in Obama Greenbook and to modify IRC Sec. 1031. President Obama has called for limiting 1031 treatment to $1M. Others have called for its repeal.
iv. IRC Sec. 1033 involuntary conversion.
    1. Get step up on death.

k. Always use a separate entity for each parcel of real estate.
    i. Never put multiple properties in one entity.
        1. Comment: IRC Sec. 355 may be used to separate/split a corporation that has an operating entity and real estate, etc.
    ii. Some lenders pushed this thinking it gave better security but realized bad property could taint others.
    iii. Avoid cross-collateralization.

l. Life Insurance.
    i. Watch reciprocal trust doctrine if use two trusts, one for each spouse.
    ii. Many real estate investors have inadequate cash reserves so first to die may make sense instead of what has been the more traditional approach for many other clients of using survivorship insurance.

m. IRC Sec. 6166.
    i. Extension of time for payment of estate tax where estate consists largely of interest in closely held business - Estate tax deferral.
    ii. Requirements.
        1. US Citizen.
        2. Business 35% of value of adjusted gross estate.
        3. Closely held business.
        4. Active business. For real estate owner must have active duties. PLR 802101; Rev. Rul. 75-366.
    iii. Will gifts taint qualification for 6166?
        1. Comment: Monitor percentage qualification requirements before death and consider using swap powers (to swap real estate back

into developer's estate) to assure qualification if IRC Sec. 6166 is desired.

iv. Consider government lien. IRC Sec. 6234. The IRS has to make a determination in each case whether to assert. Estate of Roski v. Commr. 128 TC 113 (2007).

n. Graegin loans.
   i. Many real estate investors leave cash in LLCs for improvements, etc.
   ii. This is exposed to creditors.
   iii. Consider distributing cash and recontributing to a financial LLC holding cash and which is insulated. This LLC could then be the source of a Graegin loan. Estate of Graegin v. Commr. 56 TCM (CCH) 387 9TC 1988).
      1. Comment: In a Graegin loan transaction a family entity (LLC above) or trust (often the ILIT owning the life insurance) can loan cash to a cash-strapped estate to pay taxes and if the loan is properly crafted it can enable the estate to deduct all of the interest to be paid over the term of the not pre-payable loan as an expense thereby reducing estate taxes. The leverage that a Graegin transaction can provide to a typical ILIT arrangement can be substantial adding the potentially large interest deduction to the benefit of growing the life insurance outside the developer's estate. With the increased focus on basis planning, especially for depreciable real estate, compare the results of retaining real estate in the estate and growing an insurance policy outside the estate in an ILIT enhanced by the Graegin arrangement.

o. Estate Planning.
   i. Focus on entity not individual. Creditor protection is vital.
   ii. Speaker forms many entities in Delaware.
      1. Creditor can only get a charging order.
         a. Comment: The norm for many practitioners is to create LLCs in the client's home state which is usually where the practitioner practices and the property is located. It can be preferable to use, as recommended, the laws of a more favorable jurisdiction and then have the LLC licensed to do business in the home state where the property is located. There is another aspect of this which practitioners should consider. If a trust has been created in a trust friendly jurisdiction, e.g., Alaska, South Dakota, Delaware or Nevada, to which LLC interests have and will be transferred, consider creating all LLCs under that state's laws. That arguably will enhance the nexus to that jurisdiction. Thus, not only may creditor protection for the LLC component of the structure be enhanced relative to the laws of the home state but the overall estate and asset protection planning itself may be strengthened. This might

be particularly advantageous if the trust in issue is a self-settled trust DAPT.

iii. Don't structure the LLC with the individual as a member rather structure two tier having a trust to benefit the individual be the member.

1. Comment. The "traditional" estate plan might fund a bypass trust and bequeath the remainder over the exemption amount (currently $5.43 million assuming no state estate tax) to a QTIP (marital) trust. But if the surviving spouse lives for many years after the death of the first spouse the appreciation in that QTIP will be included in the survivor's estate. While some practitioners suggest not funding a bypass trust so that a second basis step up will be realized on the surviving spouse's death evaluate what the different options indicate in terms of potential estate tax as well.

p. Undervaluation penalties.

q. Intra-family sale.

i. May provide for liquidity.

3. **<u>3- Decanting</u>**.

a. Overview.

i. Decanting and trust reformations.

ii. Recent developments in the case law on decanting of trusts.

iii. Recently released Uniform Trust Decanting Act by the National Conference of Commissioners on Uniform State laws.

iv. Various state laws and the differences in approach.

v. Income, gift, estate and GST consequences and considerations when a trustee proposes to engage in a decanting.

vi. Evaluate the limitations of decanting and decide whether alternative procedures need to be considered.

b. History.

i. Statute.

1. 1992 New York enacted the first decanting statute. Key objective was to address GST issues. It authorized a trustee to pour assets from one trust into another.

2. 23 states now have decanting statutes.

ii. Common law.

1. Phipps v. Palm Beach Trust Company, 142 Fla. 782 (1940). Trustee with absolute discretion to distribute trust assets to the beneficiaries could appoint the trust assets into another trust for those beneficiaries. "…the power vested in a trustee to create an estate in fee includes the power to create or appoint any estate less than a fee unless the donor clearly indicates a contrary intent." The power to decant was viewed as a lesser included power subsumed within the power to invade trust corpus outright in favor of a beneficiary.

2. Wiedenmayer v. Johnson 106 NJ Super. 161 (1969). The trustee was found to have absolute and uncontrolled discretion so a

decanting for the "**best interests**" of the beneficiary was permitted. The trust document included the following language: "to use for or to distribute and pay to."

3. Morse v. Kraft, 466 Mass. 92 (2013). Trustee of discretionary trust that permitted distributions "**for the benefit**" has power to exercise discretion by distributing trust proper to a new trust for the beneficiaries of the decanted trust. The court did not require beneficiary consent.
4. In re Kross 2013 WL 54798190 (Surr. Ct. NY Cty 2013) trustees sought approval to invade a trust for a special needs beneficiary to facilitate qualification for Medicaid.

c. Basis to Decant.
   i. Conceptually decant if the trustee had:
      1. The absolute discretion over the distributions of trust corpus.
         a. Some but not all statutes permit decanting even if the power to distribute is limited by a HEMS standard.
         b. Some statutes include protective language to avoid tax issues if a trust with a HEMS standard is decanted.
      2. The right to distribute property for the benefit of the beneficiary.
   ii. New York courts have approved the following as reasons for decanting.
      1. Changed family circumstances.
      2. Change in tax law.
      3. Eliminating Crummey withdrawal power.
      4. Modifying administrative provisions such as investment powers.
      5. Creating a directed trust.
         a. Comment: See Flynt case. http://shenkmanlaw.com/blog/2015/08/25/trust-friendly-states-great-choice-but-you-cant-always-get-what-you-want/
      6. Reducing administrative costs, e.g., by combining trusts.
      7. Modifying trustee provisions such as the appointment of trustees.
      8. Extending the termination date of the trust.
         a. Comment: See GST and RAP considerations below.
      9. Converting a grantor trust to a non-grantor trust or a non-grantor trust into a grantor trust.
         a. Comment: Should trustees of existing irrevocable trusts completed before the use of grantor trusts became so prevalent consider this as an option to add tax burn to the planning equation and to perhaps facilitate the swap of assets to gain a basis step up.
      10. Changing the state law governing the trust.
      11. Converting the trust into a SNT.
      12. Correcting a drafting error without going to court.

d. Power to decant.
   i. The power to invade the principal of a trust is analogous to a power of appointment over that property.

ii. A power to decant is held as a fiduciary power and must be exercised consistent with the trustor's intent. See Restatement 3rd Section 75.
iii. If the trustee can exercise the power or invade for his or her own benefit the power may be a GPOA.

e. Comply with Statute.
i. If decanting is to be effected under the terms of a statute compliance, such as a notice requirement, with the terms of that statute is essential. Harrell et. Al. v. Badger 2015 WL 3631639 (2015).

f. Ancillary considerations.
i. Should opinion of local counsel be obtained if decanting in a jurisdiction where counsel is not authorized to practice?
ii. Decanting is generally based on the trustee's authority to make discretionary distributions or by analogy to a power of appointment, and as such should be limited to its scope. Thus, no additional/new beneficiaries should be added to the decantee trust. Some statutes permit granting the beneficiary a power of appointment in the decantee trust and that power might include the ability to add beneficiaries who were not beneficiaries of the decanted/old trust.
iii. Must notice be given to beneficiaries? Some states require this, others do not.
1. Comment: Institutional trustees may require notification regardless of state law out of concern of the liability not notifying beneficiaries might create.
iv. A spendthrift provision may restrict the ability to decant in some jurisdictions but not others.

g. GST and rule against perpetuities (RAP) must be considered.
i. Some states appear to permit extension of the perpetuities period through decanting. This may have adverse GST implications. Many statutes prohibit this.
1. Comment: Consider the following clause: "In no event shall this Trust continue for a period beyond that period for which the Predecessor Trust Name U/A 8/1/05, Cal Client as grantor, could have continued without violating the applicable rules governing perpetuities, vesting accumulations, the suspension of a lineation and the like… The Trustee exercising the authority granted by this paragraph may not make a change that will violate any rule against perpetuities or similar rule limiting the duration of trusts applicable to the invaded trust."

h. Responsibility to Decant?
i. Consider:
ii. *"Indeed, one might conclude that a trustee, constrained by a fiduciary duty to act in the best interests of the beneficiaries, must always consider the benefits of a distribution in further trust, rather than outright, because a distribution in trust has the potential to give a beneficiary superior ta and creditor protection, while at the same time affording the beneficiary flexibility that the original trust may not have provided."*

1. Comment: Decanting can afford excellent flexibility to modify and improve a plan. The comment above suggests that the trustee should evaluate the pros and cons of decanting, if feasible, before making an outright distribution. Might it be advisable for a trustee of a traditional 25/30/35 trust to evaluate decanting before the beneficiary attains a specified age in order to decant into a trust that does not have that type of distribution mandate to improve tax and asset protection benefits? As decanting grows more common will beneficiaries demand this of a trustee? What about advisers? Assume a CPA is preparing a trust form 1041 and realizes that the income tax consequences of the trust are not optimal. Should the CPA meet with legal counsel to determine if a decanting may improve the negative tax attributes of the current trust? Similarly, if a wealth manager feels constrained by the terms of a trust from investing in the manner that is believed to be optimal, should or must decanting be pursued?

4. **4- Understanding Partnership Capital Accounts and Partnership. Special Allocations**.
    a. Overview.
        i. Introduce the estate tax practitioner to the basic rules of partnership capital accounts and partnership allocations under subchapter K of the Internal Revenue Code.
        ii. Allocation rule under §704(b), the role of capital accounts.
        iii. Capital account maintenance rules set forth in the §704 regulations,
        iv. Common allocation approaches used in partnership agreements.
        v. Specific allocation guidelines set forth in the §704 regulations, §704(c) allocation principles related to book-tax differences.
        vi. §754 implications upon certain transfers of partnership interests and distributions of partnership property.
    b. Partnership Capital Accounts and Special Allocations.
        i. Capital account is a tool to understand how allocations must be handled.
        ii. Distributions – identify situations that may have adverse effect.
        iii. IR Sec. 754 basis adjustment. What happens on death of a partner and redemptions are made. Interplay of provisions.
    c. What is a partnership for tax purposes?
        i. What you think is a "partnership" may not be.
        ii. If an agreement has partnership tax language that alone won't suffice to make characterize it as a partnership for tax purposes.
        iii. If you set up an entity it will be a partnership unless it has only one tax owner.
            1. Example – you may have multiple state law owners, e.g., several grantor trusts, and the client are each members/partners, but there is only one owner for tax purposes because the grantor trusts are not recognized for income tax purposes as separate from the grantor/client.

2. If Dad owns partnership interests directly and other interests through various disregarded grantor trusts you may have only one partner for tax purposes and that will not constitute a partnership.

iv. Some LLCs are taxed as S corporations. Choose LLC form for state law flexibility. So be wary that the tax status of an LLC should not be presumed to be a partnership.

v. IRC Sec. 761(f) not every situation warrants partnership tax treatment. In some instances when husband and wife are the only partners/members they may be a qualified joint venture (QJV) and not have to file a partnership tax return.

1. Comment: The QJV is not as broadly applicable as some believe requiring participation. Also, there may be advantages to filing a partnership income tax return Form 1065 in any event. It will help the CPA preparing it to have an opportunity to be more involved in the administration of the entity which will enhance the likelihood of entity formalities being adhered to. In the event of a suit or claim the results of the entities operation do not appear as a schedule C on Form 1040 which might trigger disclosure of the individual tax return. Instead if a separate entity return exists that can be disclosed without necessarily disclosing the personal return.

vi. Watch entities owned solely by husband and wife in community property states to be certain you really have a partnership and not a disregarded entity.

vii. You can elect out of Subchapter K partnership tax status. Reg. Sec. 7.761-2.

1. Comment: This might be useful to cure a violation of the IRC Sec. 721 investment company rules.

d. Partnerships.

i. Character of income is determined at the partnership level. If the partnership has capital gain it is allocated out to partnership.

ii. A partnership sells an asset it has held for over 1 year realizing long term capital gains. If a new partner joined the partnership only 6 months ago, because the partnership held asset more than 12 months, the character of the income flowing to that partner will be long term capital gain because the character is determined at partnership level.

iii. Form K-1 this is where partner is informed of partnership tax results.

1. Box L beginning capital, contributions, etc. ending capital account.
    a. Beneath that are 4 boxes. Those boxes tell us what the capital account is trying to reflect.
    b. 704(b) may be reflected.
    c. May reflect tax basis which is not a capital account concept.
    d. May be using GAP.
    e. So capital account on K-1 may not have bearing to partnership agreement.

2. Box about whether anyone contributed appreciate property. Knowing answer is important to allocation of tax consequences. See discussion below.
3. Capital account is not maintained on an income tax basis. A partners' capital account and outside basis may differ. You can use capital account to get a sense of outside basis, but don't assume they are the same.

e. 704(b) is main engine of partnership allocations.
   i. Not a GAAP principal it is a set of rules created under this Code Section.
   ii. 704(b) creates the criteria for when an allocation will be respected for income tax purposes.
   iii. The concept is to allocate tax items to the partner that has the economic benefit from the item, or who bears the economic risk of loss with respect to that item.
   iv. An allocation will be respected if it has "substantial economic effect" or if it is consistent with the partners' interest in the partnership (PIP). Treas. Reg. Sec. 1.704-19b)(3).
      1. Exceptions are provided for non-recourse debt and negative capital accounts.
      2. Regulations indicate certain other allocations will be respected.
   v. Allocation to be respected must have economic effect. The effect must be substantial. It is substantial if there is a reasonable possibility that the allocation will affect substantially the dollar amount to be received by the partners from the partnership, independent of the tax consequences.
   vi. Capital account is a drafting tool regulators gave us to support calculation of income.
   vii. Three requirements. Treas. Reg. Sec. 1.704-1(b)(2)(i).
      1. Must maintain proper capital accounts in accord with Treas. Reg. 1.-704(b)-1(b)(2)(iv).
      2. Must liquidate in accordance with positive capital account balances.
      3. Alternative test, either.
         a. Deficit restoration of the partner's capital account on liquidation.
         b. Adopt a qualified income offset (QIO) provision. Treas. Reg. Sec. 1.704-1(b)(2)(ii)(d).
   viii. Family investment partnerships are often straight vehicles. These have no special allocations and are merely a partnership ownership percentage is the same for capital, profits, etc. and all profits are simply allocated by those percentages. But if the partnership/LLC has liabilities and profits interest or priority allocations (see discussion in the real estate planning lecture notes above) capital account concepts must be addressed.
      1. Recommendation - You should have capital account language in the governing document in all cases.
   ix. If you don't have capital accounts, or don't maintain them as required under the regulations, you fall back to partnerships interest in the

partnership (PIP). This is more subjective. If you have to defend an allocation under PIP there is a greater risk the IRS may say that a particular partner is not entitled to a particular allocation because the allocation may not be consistent with the partner's interest in the partnership.

x. Economic equivalence" rule – if economic results in liquidation are the same as if you had maintained capital accounts correctly, then you will be treated as if you had kept them correctly.

xi. There is always only one tax basis and one capital account.

xii. Capital accounts endeavor to reflect a partner's position at a particular point in time.

1. Partner's capital.
    a. Increased by money contributed, and liabilities assumed (partner has personal liability).
    b. Increased by FMV of property contributed.
    c. Increased by allocable share of profits including tax exempt income.
    d. Decreased by allocable share of partnership losses.
    e. Decreased by distribution of money or FMV of property distributed.
2. Examples/Case studies in handout.
    a. 3 brothers contribute assets to partnership with varying values, one with debt.
    b. Capital account increased by cash contributed and net FMV of property contributed.
        i. A - So property of $1.6M less $600 of debt = $1M with basis of $700. Basis is $700k. Debt is non-recourse.
        ii. B - Third contributed securities FMV $1M with basis of $300.
        iii. C - Cash of $1M. Basis is $1M.
    c. 704(b) is not "tax". You don't pay tax based on 704(b) allocation. You pay tax based on your tax allocation.
    d. 704(c) if you contributed appreciated or depreciated property to partnership that inherent gain or loss can only be contributed back to the contributing partner.
    e. Capital accounts do not generally reflect a partner's share of liabilities/debt.
    f. IRC Sec. 752 regarding shares of liabilities. Get basis for share of partnership debt.
        i. A - First must take basis away from partner A. Gets $600K cash distribution because partnership assumes debt. Then immediately A gets 1/3rd back of $200. 700 – 600 + 200 = 300K.
        ii. B - $500K.
        iii. C - $1M + 200k debt = $1.2M.

g. What if C did not put in $1M assets but instead a personal note? Do not get any capital account credit for contribution of a note unless it is tradeable on an established market.
h. What if sell some of the securities C and realized $300K gain, contributed and realized gain?
i. This is a 704(b) economic profit of $600K each partner gets increase of $200K. Paid off debt so basis then is reduced by $200K for share of liability that is reduced so +200K 704(b) income less $200K debt paid = -0-. But B contributed appreciated property and this is allocated back to Partner B since he contributed the appreciated securities sold it is allocated back to just Partner B.

3. ABC brings in 4th person and reward him with profits interests. No capital contribution. They can re-value capital accounts. Regulations give you certain times events when you can re-value capital accounts. One of these is when you grant a profits interests. This is not a taxable event – it does not trigger a tax. The service provider (SP) partner has a value in his capital account of -0-. If Partnership liquidated right after joining this person must get nothing. SP should not get a positive capital account immediately.
4. Year 5 sell business. Must calculate two numbers 704(b) gain. Book gain is $1M ($8M - $7M). Must allocate remaining 704(c) gains to contributing partners.
5. Capital accounts have helped track tax allocations and has helped demonstrate substantial economic effect. It will help with allocation of non-0reoucrse debt.

xiii. Three types of allocations.
1. Book.
2. Tax.
3. Nonrecourse deductions.
a. See minimum gain chargeback.
b. If you allocate a deduction that partner is not obligated for, that partner must be charged back income when recognized. This rarely comes into play outside of real estate.
c. Nonrecourse debt is debt on which no partner bears the economic risk of having to satisfy the liability of partnership asses prove insufficient to do so.
d. Nonrecourse deductions are deductions attributable to property securing nonrecourse debt.
e. The allocation of these deduction is respected if the partnership agreement includes a minimum gain chargeback provision. Treas. Reg. Sec. 1.704-2(e)(3).

xiv. Allocations on K-1 is not “end of story” as to whether partner can use the allocation. There are a host of limitations on the deduction of loses.

1. If allocated deduction/loss but don't have sufficient basis, no deduction.
2. 465 at risk rules. If you want to take a loss based on share of liabilities may be limited.
3. 469 passive loss rules. If allocated loss attributable to trade or business you do not material patriciate subject to limitations.
4. Contribute built in loss property starting in 2004 limitations on who can get benefit of the loss.
5. Itemized deductions limitations.

f. Distribution and Allocation as Partner in non-partner capacity.
   i. Adopted in 1984 – IRC Sec. 707(a)(2)(A) addresses when a partners performs services and receives a related direct or indirect allocation and distribution. The payment can be treated as fee.
   ii. IRS issued proposed regulations addressing whether allocations to Service Provider (SP) should be an allocation or a fee. If it is classified as a fee, it is income ordinary to the SP and to partnership treated as if paid to a person in non-partner capacity.
   iii. Proposed regulations issued in July 2015.
   iv. Factors to consider.
      1. Entrepreneurial risk.
      2. Whether partnership status is transitory.
      3. Whether the allocation and distribution are close in time to the performance of the services.
      4. Whether facts and circumstances suggest person became a "partner" to obtain tax benefits.
      5. If the persons continuing profits interest is small relative to the allocation in question that suggests that the allocation was really a fee not an allocation.
      6. Whether the arrangement provides for different allocations or distributions with respect to different services. This was added by the 2015 Proposed Regs.

g. Disguised sale of property.
   i. Contribute asset and if within 2 years you get property out of partnership it is presumed to be a sale. This presumption can be rebutted.
   ii. If a partnership wants to make an in kind property distribution ascertain when property was last contributed.

h. IRC Sec. 707 guaranteed payment.
   i. Example 2% management fee is typically a guaranteed payment.
   ii. Any payment made without regard to partnership income is viewed as a fee.
   iii. You can inadvertently have a guaranteed payment.
   iv. If you make an in-kind distribution to a partner if this is treated as a guaranteed payment and if property has appreciated it is treated like a sale. Rev. Rul. 2007-40, 2007-1 CB 1426.

i. Hot Assets.
   i. IRC Sec. 751.

ii. The objective of this provision is that a partner should not be able to avoid share of ordinary income.
iii. Property included includes unrealized receivables or inventory items. These are referred to as "hot assets." This includes cash basis accounts receivables.
iv. If partnership collects on A/R you cannot avoid this by selling partnership interest and characterizing as capital. Gain.

j. Investment partnerships.
   i. In kind distributions are usually tax free. But if it is a marketable security the distribution is treated like cash. If get distribution of cash in excess of basis it is taxable.

k. 7 year rule.
   i. IRC Sec. 704(c).
   ii. If form partnership with marketable securities that are appreciated if partnership distributes to another partner within 7 years treated as a sale. Exception if the appreciated property is distributed to the contributing partner.
   iii. If contributing partner gets distribution of other property could be treated as taxable.
   iv. Must wait 7 years to avoid this gain. Then the general rule applies so that a distribution of appreciated property should not be taxable to the partner or to the recipient partner. IRC Sec. 731(a)(1), (b) unless the distributed property is marketable securities the FMV of which exceeds the adjusted tax basis of the recipient partner in the partnership.

l. Basis rules.
   i. IRC Sec. 734.
      1. Basis of partnership property is not adjusted as the result of a distribution of property to a partner unless a 754 election is in effect or there is a substantial basis reduction with respect to the distribution defined in IRC Sec. 734(d).
      2. 754 election is made in a written statement filed with the partnership tax return for the year in which the transfer or distribution occurs. It remains in effect for all future distributions and can only be revoked with the consent of the IRS.
   ii. Assume you can make an in kind distribution tax free (i.e., 2 and 7 year rules not applicable).
   iii. Basis in property partners receives will be the partnership's basis in the property.
      1. Exception – can never exceed outside basis. You can never exceed outside basis and if outside basis is less than the partnership's basis in the property distributed the recipient partner has to reduce the partnership's basis prorate for each asset to the amount of his or her outside basis.
   iv. If you are being removed from partnership with a liquidating distribution of property your basis in the property you receive is your basis in the

partnership interest. You take the property with the same basis. Your outside basis becomes the substituted basis for the property.

1. 754 keys off transfer of partnership interest or complete redemption of partner. Partner can "extract" basis from partnership.
2. Be mindful of basis before making an in-kind distribution.
3. What if have a built in loss when transfer partnership interest more than $250,000? Example partner dies at time when basis exceeds FMV of assets by more than $250,000 this rule applies.
4. Death is viewed as an opportunity to get a basis step up. But if the inside basis is more than FMV by more than $250,000 you have to take a step-down in basis. The test is inside the partnership.
5. The step-down is not optional and must be made as if a 754 election were in effect.
6. Elective investment partnership exception but family partnerships rarely will qualify for this exception.
7. Many partnerships don't like to make 754 elections and they will fight making it because of the cost, complexity, and other issues, etc.

2. **5- Insurance: Understanding Illustrations, Design Opportunities and Financial Evaluation**.
    a. Overview.
        i. While life insurance is commonly used in estate planning, the myriad of products, industry jargon, and voluminous illustrations can make understanding what is being purchased uniquely challenging.
        ii. Life Insurance is a mature industry that has struggled to maintain relevance in a landscape of higher estate tax exemptions and ever growing investment options.
        iii. But what is the true purpose of life insurance? Is there one true purpose?
        iv. The building blocks of an insurance policy and how they are assembled.
        v. What are all the hidden costs? How does this differ from any other product? Could there be a way to reduce the cost?
        vi. How does the initial funding affect the policy efficacy?
        vii. Insurance products – how they are typically illustrated, and what is shown – and not.
            1. Comment: This presentation reminds me of a comment Larry Brody made several times in an insurance presentation he gave at another program that the Code provisions he was referring to in an insurance discussion "would be incomprehensible to an attorney." Life insurance planning is complex and has become more not less complex. With an aging population the investment and long-term care features can be more important than estate tax planning features so much is different. These features only add to the complexity. The incredible complexity and almost infinite

variations of policy design decisions make much of this an area beyond what almost any non-insurance advisers can or should navigate.

2. Comment: Practitioners should consider what role if any they can or should play in regards to insurance analysis. Most estate planners do not have the skills to evaluate policy options, policy types, insurance carries, policy assumptions, etc. Therefore practitioners should not be held responsible unless they expressly undertake this type of analysis. It might be advisable to clearly delineate the scope of responsibility in an engagement letter/retainer agreement and if the practitioner is not intending to provide insurance selection guidance to the client that might warrant stating to minimize any misunderstanding the client might have that if the practitioner discusses generally uses of insurance in planning that should not be inferred to imply that he or she is undertaking more.

b. General considerations affecting life insurance.
    i. How can a client make an informed decision with respect to an insurance purchase?
        1. Transparency issues.
        2. Shortcomings of illustrations.
        3. Compensation issues.
        4. Complexity and lack of complete information to evaluate.
        5. Conflicts between agent's interests and client's interests.
    ii. Start with identifying the specific issues/goals the client is looking to insurance to solve. The insurance plan should be tailored to address those concerns.
        1. What is the duration for the need identified? Example: 10 year term to match a 10 year GRAT. Longer term goal to assure coverage until newborn is an adult. Permanent to cover estate taxes.
        2. Perhaps cash accumulation or long term care features are of paramount importance.
        3. Income tax advantaged investments may be the major or a significant concern.
        4. Asset protection.
    iii. Identify the type of product that best meets the goals identified.
    iv. A particular policy can be benchmarked against alternatives.
    v. Cost does not necessarily indicated product performance.
    vi. When, how and in what manner can cash be accessed from the policy?
c. Insurance as an Asset Class.
    i. Insurance has increasingly been viewed as an asset class.
    ii. Can negatively correlate with other asset classes.
    iii. Attributes can enable insurance to lower overall portfolio volatility.
d. Policy Types.
    i. Term versus permanent.

1. 70% of coverage purchased is term.
2. 30% of coverage purchased is permanent.

ii. Term Insurance.
1. Lowest cost insurance option.
2. No savings component, pure death benefit only.
3. To meet temporary needs such as replacing income, meeting divorce obligations, etc.
4. Conversion options and other provisions can vary significantly between policies.

iii. Whole Life.
1. In contrast to term, intended to remain in force for insured's life.
2. Premiums are fixed so insurers can invest long term. Contrast with Universal life for which premiums can vary and hence tend to be invested in bonds.
3. Conservative, guaranteed return and non-guaranteed dividend return.
4. Returns on whole life policies have been between 3-5% compared to long term stock market performance of approximately 12%.

iv. Equity Indexed Universal Life (IUL).
1. Contracts are based on a formula that endeavors to assure that cash value will not decline in a given policy year but that there is an upside based on some market index, but that upside is capped. Note that dividends and interest are usually excluded from the cap and these have historically be a large part of the return of many indices so that the client may misperceive what they are actually getting. For example, an EIUL may return only 60% or less of the particular market index.
2. Similar principle protection as a Universal Life but with lower guarantees and possible upside growth via linkage to a market index.
3. Monte Carlo simulations demonstrate that the downside protection these policies offer do not outweigh the loss of upside benefit because of the caps, etc.

v. Variable Universal Life (VUL).
1. Invested in securities, if the market drops there may be a need to make extra premium payments.
2. In the short term the impact of front-loaded insurance costs on the performance will make the results unfavorable when comparing alternative investment options.

vi. Private Placement Life Insurance (PPLI).
1. For ultra-high net worth client who is an Accredited Investor.
2. Focuses on cash accumulation inside insurance wrapper.
3. Minimum premiums significant.
4. Complex asset management decisions.

e. Policy Funding.

i. Insurer sets target premium which covers costs and insurance. Amounts paid in excess of target premium are excess premiums and can be added to the client/insured's cash value in the policy.
ii. Approximately1/2 of all accumulation life insurance is funded near the Target Premium. The stability of these policies is questionable.
    1. Comment: This is another indication of the TOLI disasters waiting. With this limited funding so pervasive there may be little cushion in the event of an issue. Many insurance experts have sounded TOLI alarms for years but few clients or insurance trust individual trustees seem to heed the warnings. The risk to the attorney/CPA is that if a policy implodes will they be caught by the shrapnel of the ensuing lawsuits even if they played no role in the policy design or selection.
iii. If intent is to grow cash value then client should fund policy to the maximum. If intent is primarily insurance coverage then may not fund much beyond target premium. But the lower the policy is funded the more the costs of the policy will be a drag on the cash value growth. Conversely, over-funding reduces the impact of insurance costs.

f. Guarantees.
    i. Beneficial if goal is insurance protection.
    ii. No free lunch there is a cost and the cost of guarantees is a drag on growth in cash value.

3. **<u>6-The Preferred Partnership Freeze.</u>**
    a. Overview.
        i. Section 2701 and the Regulations thereunder govern the gift tax consequences of transfers of equity interests in tax partnerships with multiple classes of equity.
        ii. The "freeze" partnership is intentionally designed to comply with Section 2701.
        iii. Consider examples of estate planning situations that may justify its use.
        iv. Some entities are structured to intentionally avoid the application of Section 2701, but have multiple classes of equity. Example; "reverse freeze" partnership that has an equity structure with preferred and common, but the preferred, rather than the common, is transferred to the junior generation.
        v. Section 2701 may apply to "profits interests" in partnerships.
        vi. Estate planners need to carefully navigate a host of issues when structuring transfers of interests in private investment funds such as hedge and private equity funds.
        vii. Consider Code Section 2701 and the historical underpinnings of the statute
        viii. In some instances a "vertical slice" approach to making transfers may avoid adverse tax results. In other instances "non-vertical" planning alternatives may warrant consideration.
        ix. Issues that can arise relating to the Section 2701 trust and entity attribution rules.

b. IRC Sec. 2701.
    i. Background.
        1. It provides a gift tax solution to some of the old 2036(c) estate issues.
        2. Family freezes.
            a. Preferred equity may only receive a 6-8% payment and therefore a preferred partnership freeze in some instances is not as good of a freeze or wealth shifting tool as selling an asset for a note paying a low interest rate. As a result the preferred partnership technique has been used less than other techniques. As discussed below this might change.
            b. Taxpayer can sell assets to a grantor trust and not recognize gain.
            c. There are special uses for preferred partnerships that make them a useful tool even in the current environment, some of these are discussed below.
            d. IRC Sec. 2701 has to be considered in structuring these transactions.
        3. Just because the transaction is compliant with IRC Sec. 2701 does not assure that the IRS will not still raise challenges under IRC Sec. 2036. Those issues are not "off the table" by virtue of complying with IRC Sec. 2701.
        4. Pre-1990 freezes versus freezes now are quite different.
            a. Discretionary nature of pre 1990 freezes has been removed.
            b. Now preferred interest can be structured as a preferred payment right.
            c. Right is quantifiable – can tell what parent will receive back and when.
    ii. 2701 applies when there is a transfer if the transferor or an Applicable Family member holds an Applicable Retained Interest immediately after the trust.
    iii. 2701 applies in the case of a "transfer." Transfer is broadly defined. It includes a traditional transfer such as gift or sale. It also includes capital contribution. Example Dad and Son each make a contribution to an LLC and take back interests that violate Section 2701 that too is a "transfer" for IRC Sec. 2701. Other types of changes in capital structure could similarly trigger a 2701 issue.
        1. Any time you see different interests consider whether there could be a 2701 issue.
        2. Planning ideas.
            a. Transfer a vertical slice of a partnership that has multiple classes of equity. This avoids 2701 and may meet client goals.
            b. Impose a fixed time term on the partnership. If the partnership will be liquidated at as future date the values

can be discounted in determining the value of the preferred interest.

c. Distribute profits before capital to make it more difficult for the IRS to argue that the capital is the senior interest.
d. Extraordinary Payment Right ("EPR"), like the unilateral right for a partner who withdraws, could trigger 2701.

iv. Preferred Partnerships May Grow in Popularity.
1. GRAT and IDITs are more popular now, but that might change.
2. FLP possible Regulations restricting discounts. Discounts are under attack. What might Treasury regulations do to them?
3. IRC 2701 is a statutory vehicle.
4. Proposals to restrict GRATs – 10 year term, etc. may chill the use of GRATs.
5. The Woebling case might chill the use of note sale transactions.
6. These developments might result in a greater emphasis on freeze transactions.

c. Concept of 2701.
i. 2701 requires that senior and subordinate interests exist to apply.
ii. The value of the residual or subordinate interest (e.g. common stock) which is typically given to a junior generation and to which growth in value of the entity should inure, is calculated under a subtraction method.
iii. The entire value of the entity is determined. Then the value of the preferred or senior interest is determined using the 2701 rules. 2701 seeks to disregard bells and whistles attached to the preferred equity interest or the senior equity interest. The remainder is the value of the common interest.
iv. By disregarding the bells and whistles the subordinate equity interest (e.g., common stock) increases in value under the subtraction method.

d. Preferred Stock freeze.
i. Parent owns 100% of common stock. Recapitalize company into preferred and common and then gift the common stock away to the junior generation.
1. Pre-2701 the parents/senior generation keep value of common stock low by keeping preferred stock worth almost all of the value of the company. On a subtractive valuation, the common stock would have very low value. Allows common value to be squeezed low.
2. 2701 in the "old days" the preferred shares were loaded with "Christmas tree ornaments" to increase their value. These were discretionary rights. Once common shares were transferred many of these discretionary rights were never exercised so that the transactions were abusive. Parents took credit for ornaments but never took advantage of them after the gift of the junior interest were made.
a. Types of rights.
i. Preferred had liquidation right.

ii. Conversion right.
iii. Put and call rights could be used to enhance value of preferred.
iv. Extraordinary payment rights.
v. Dividend rights – e.g., 12% but often non-cumulative and often they did not get paid and the value attached to dividend rights was not real.

ii. Common stock value includes "option value" it is associated with. IRS captured option value by saying it must equal at least 10% value of the enterprise plus debt provided by ancestors if that exists in the company.
    1. This is known as the "minimum gift rule."
    2. The government estimated that this would generate revenue when enacted by virtue of gift tax on gifts of 10%. That did not materialize.

iii. Applicable Family Member (transferor's spouse, ancestor of the transferor or his spouse and spouse of ancestor) must own an Applicable retained interest ("ARI").
    1. Applicable family member is spouse, ancestor of transferor or spouse, spouse of ancestor. Reg. Sec. 25.2701-1(d)(2).
    2. Applicable retained interest is an equity interest in as partners or corporation with respect to which there is either an extraordinary payment right ("EPR") or a distribution right. Treas. Reg. Sec. 25.2701-2(b)(1).

iv. The objective of 2701 was to end prior practices of putting values on discretionary rights. But the intent was not to be completely draconian. 2701 uses the concepts of "distribution rights" and "extraordinary payment rights" which might be retained (applicable retained interest) and these may be valued at -0- under the subtraction method. Mandatory payment rights (including death of person when would use actuarial value) could be valued under 2701.

v. Distribution right in a controlled entity it is valued at -0-. Distributions right is the right to receive distributions with respect to equity interest. Reg. Sec. 25.2701-2(b)(3).
    1. If the parent generation retains same class or a subordinate interest it is not deemed a distribution right.
    2. Payments made that are fixed in time and amount and not with regard to profits are excluded distribution rights.

vi. A distribution right on the preferred will be considered part of the value of the preferred under the IRC Sec. 2701 only if it is a Qualified Payment Right as defined under Reg. Sec. 25.2701-2(b)(6). This could be a cumulative distribution payable on a periodic basis at least annually with respect to an equity interest determined as a fixed rate or as a fixed amount. A fixed rate is a fixed relationship to a specified market interest rate. For the distribution to be included in the senior equity value it must be cumulative similar to a preferred stock interest.

vii. Preferred equity holders must elect qualified payment treatment on their tax returns.
    1. A Distribution Right can be valued at more than zero by making an election t treat it as if it were a Qualified Payment Right.
    2. This election is irrevocable. Reg. Sec. 25.2701-2(c)(2).
    3. If the election is made the interest would be valued at FMV based on the facts assumed and agreed in the election filed with the taxpayers' gift tax return.

viii. When determining the value attributable to this qualified payment right the "lower of" rule serves as a cap so that it cannot exceed its liquidation value. This rule provides that the retained interests are valued under the assumption that the Senior family member exercises his Extraordinary Payment Rights in a manner that results in the lowest value being determined of all of his retained rights. So if Mom had a Qualified Payment Right valued at $1M but also held a right to put her equity to the entity for $750,000 the lower $750,000 right would be the value in spite of still holding the $1M right.

e. Traditional preferred equity freeze partnership.
    i. Don't see very often any more.
    ii. Want to avoid doubt that you have complied with IRC Sec. 2701.
        1. You create cumulative preferred interests.
        2. Comply with 10% rule.
        3. Use preferred distribution to be high enough to support face value of preferred to avoid a "surprise" gift.

f. Applications of the Preferred Equity Freeze.
    i. Short Freeze.
        1. Example, stock in company that may go public. Freeze now so that the discount due to a prohibition on sale, etc. inure to the benefit of the junior interests
    ii. Operating Freeze opportunity.
        1. May be better to do an installment sale.
        2. This works when the return on entity assets will exceed the payment on the preferred equity interest.
        3. S corporation drop down. Drop business into freeze LLC and company keeps preferred equity in the drop down LLC with a higher rate of return. Common or residual interests are held by a person who contributes additional capital, such as cash, to be used in the business operations.
        4. Keep appreciation above preferred rate out of a C corporation using this approach?
    iii. High risk freeze.
        1. If business at risk of going "bust" may not be good asset to freeze. Example a new start-up company, lots of risk but potential for much gain.
        2. But could gift common which could be as little value of the enterprise.

3. If sell common may be more advantageous.

iv. Anti-freeze Gift.

1. The motivation for a partnership freeze may not only be to achieve wealth transfer. Senior generation may really want steady cash flow. So while transactions can be transfer tax advantageous there is often another motive. This can present interesting planning opportunities, even for smaller estates where the parent is not as concerned with transfer tax issues as she is with retaining cash flow. For example, if Mom has a $4M portfolio she may be primarily concerned with retaining the income from that portfolio. A large gift to the children would reduce her cash flow and might not be acceptable.
2. Instead of a preferred partnership freeze is structured Mom could retain a preferred interest and receive a payment that approximated the cash flow she had received before the transaction. While generally a preferred partnership freeze succeeds when the appreciation in partnership assets exceeds the payment to the preferred interests in this application the preferred partnership may still provide benefit and meet client goals if that hurdle return is not achieved. But for the use of this technique the parent may not have been willing to make a gift.

g. A child may want to get out of the partnership and might try to get out at face value rather than discounted value. That can undermine the planning for the entire family.
   i. Using a preferred equity freeze might offer a solution.
   ii. Some advisers have suggested different equity interests for say each child's family line so if a child is bought out at the benefit inures to his or her descendants. This however, could undermine the integrity of the transaction as it is not an arm's length structure used by unrelated parties.

h. Adequacy of coupon.
   i. Don't structure as a guaranteed payment under IRC Sec. 707(c) as the 2701 rules/definitions differ.
   ii. Don't want to run afoul of 2701.
   iii. Traditional gift issues with value of coupon.
   iv. If full and adequate consideration would be an 8% coupon and deal has a 5% coupon you have a gift issue.

i. Consider a Freeze transaction for a QTIP trust.
   i. Provides cash flow for spouse and if common interest is transferred to GST trust the growth above the coupon will be shifted out rather than be subject to estate tax on wife's death.

j. Preferred Partnership GRAT as way around ETIP rules.
   i. GRAT is great vehicle for gift tax free transfer. But GRATs may have 10 year minimum at some point if the Greenbook proposals are enacted.
   ii. Gifts to GRATs are subject to the estate tax inclusion period rules so that you cannot effectively allocate GST until end of GRAT because of ETIP rules.

iii. Idea – create a preferred partnership.
iv. Parent creates a longer term GRAT say 12 years and gifts assets.
v. Assume that the client/settlor has pre-existing funded GST trust.
vi. Combine the two planning concepts together.
vii. Parent has assets in preferred partnership with preferred interests. Dynasty trust takes back growth interests. Parent takes preferred interest with say 8% coupon and gifts that to long term GRAT and uses that preferred payment to satisfy the GRAT annuity payments to the parent as settlor of the GRAT. After GRAT term ends all value remaining is outside the parent's estate. Growth in GRAT is contained and won't be GST exempt (but the remainder or junior interests transferred to the dynasty trust will be).
viii. This puts a cap on the growth in the less GST efficient GRAT and growth has effectively been shifted to the dynasty trust which is GST exempt. This is a work-around the ETIP rules.

k. Substitute a CLAT for the GRAT in the above concept.
l. Preferred Equity Freeze.
    i. Increasing common from 10% to 15%.
    ii. Consider Rev. Rul. 83-120 factors.
        1. How risky of an investment is the interest?
        2. Key theme is "coverage."
        3. How strong is partnerships ability to make payments on time and to cover preferred liquidation preference for preferred?
    iii. Usually do this in one transaction into GST exempt trust not for annual gifts.
    iv. Grant a right of first refusal instead of giving the general partner discretion to approve transfers.
    v. Hackl Case. Issues with qualifying for annual exclusion. U.S. v. Hackl, 335 F. 3d 664 (2003)
m. Compounding preferred distributions.
    i. Requiring compounding can lower the preferred rate.
    ii. Suggestion to structure transaction so that preferred holders can require payment within 3 to 4 years.
n. Unintentional Freeze.
    i. Could inadvertently trigger a gift.
    ii. 2701 was written for corporations but has to be applied to partnerships. Partner may put in capital and receive a profit percentage and return without realizing that this arrangement could inadvertently run afoul of IRC Sec. 2701. You must look at each economic interest and evaluate.
    iii. 2701 says you can use regulations to split interests into common and preferred parts, but regulations have not be written.
        1. Concept of "phantom" regulations.
        2. There are cases that indicate IRS cannot penalize people by not issuing regulations that would help them.
o. Reverse Freeze.

i. Avoid IRC Sec. 2701 by gifting preferred and retaining residual or subordinate interest.
ii. If the preferred rate of return exceeds the growth in partnership assets this will reduce the residual or subordinate interest which the parent retains.
iii. The residual units in these plans can be worth less than 10% of the value of the partnership since the 2701 minimum gift rule does not apply since 2701 is not applicable.

p. Proportionately the same.
i. Exception to IRC Sec. 2710(a)(2) if applicable retained interest s(ARI) are proportionately the same as the transferred interests without regard to the non-lapsing division in voting power.
ii. Proportionality must bean something other than percentage vertical slice of every partnership right.
iii. A fractional division, as contrasted with a pecuniary division, does not create multiple classes of equity since it lacks the priority interest or preference required for a subordinate and junior interest.

q. CCA 201442053.
i. Control over partnership could force liquidation so it was an extraordinary liquidation right.
ii. Speaker suggests that although gift tax conclusions in CCA are correct little of the analysis is.

4. **7-When To Use Which Kind Of Policy For What, And Split Dollar and Premium Financing**.
a. Overview.
i. How to determine if a product or strategy is appropriate for a given situation.
ii. Is there actually a problem insurance can solve in the situation under review?
iii. Can life insurance can be an alternative asset class, or is it merely a sales pitch?
iv. What are the "new hybrid" products on the market and why do some claim they are dangerous.
v. Is there an appropriate place and use for the spectrum of products on the market?
vi. Does "buy term and invest the difference" make sense?

b. Agent Considerations.
i. How might agent commissions affect the policy recommendation?
ii. Sales commissions from permanent life insurance may range from 30% to 90% of the first year premium and thereafter from 3-10% of the subsequent premiums.
iii. Some insurance companies permit agents to dial down commissions on certain products. Has this been discussed?

iv. Is the agent contractually obligated to only sell products from a particular company so that he or she is thereby precluded contractually from evaluating other products?

c. Policy Issues and Considerations.
   i. Insurance policies are legal contracts with incredibly complex provisions.
   ii. Exclusions included in policies vary considerably from carrier to carrier.
   iii. What are the guaranteed rates of return for the policy under various scenarios?
   iv. Are there other types of policies or provisions that should be considered in the circumstances?
   v. What is the financial strength of each insurance carrier being considered?
   vi. What costs are associated with each policy?
   vii. What is the historical performance of the policy?
   viii. What are the life expectancy assumptions used in the policy? How does this compare to the assumptions used by other carriers?
   ix. Historically, how has the particularly insurance company increased or decreased the costs of insurance?
   x. What historical rates of return have been realized on the particular policy?
   xi. Spreadsheet the policy to identify additional issues. Consider:
      1. Policy year.
      2. Annual outlay.
      3. Costs of insurance.
      4. Administrative costs.
      5. Total contributions.
      6. Net death benefit.
      7. Death event rate of return.
      8. Probably of death.
      9. Net death benefit adjusted for 3%, 3.5% (or other) inflation.
      10. Cash surrender value of policy in each year.
      11. Rate of return if policy is surrendered for the cash surrender value in each year.
      12. How much the premiums paid would grow if invested elsewhere at various assumed rates of return, e.g., 5%, 6%, etc.
   xii. Monte Carlo simulations can be used to illustrate the expected mean, highest 20th and lowest 20th percentile performance of the policy.

d. Tax Advantages.
   i. Income tax free death benefit.
      1. If transfer for value rules not triggered.
   ii. Withdraw funds from the policy to the extent of the income tax basis in the policy without tax cost.
   iii. Generally to borrow from the policy without tax consequences subject to a triggering of taxable income if the policy is terminated.
   iv. Tax basis does not include the cost of insurance protection. ILM 200504001. The premiums paid must be reduced by the cost of the insurance protection to determine the tax basis in the policy on sale. Rev. Rul. 2009-13.

v. Dividends credited to the policy or paid to the insured reduce the investment in the contract. IRC. Sec. 72(e)(1)(B).
vi. Income tax costs may make insurance a favored and viable savings tool, but the costs can outweigh the tax benefits in some instances.

e. Buy Term and Invest the Difference.
   i. But do clients really invest the difference or just spend it? "Buy Term and Invest the Difference Revisited, "May 2015 Journal of Financial Service Professionals.
      1. Comment: Consider that even if the client invests the difference what will that difference really amount to? Consider what the average individual investor earns even if he or she invests. "The average investor's 20 year annualized return is astounding simply because of how awful it was. According to an analysis by Dalbar, the average investor earned 2.1% over the twenty year period ended Dec. 31, 2011. How did this compare to other asset classes? To make it very simple, the S&P 500 returned 7.8%, while the Barclays Capital US Aggregate Bond Index returned 6.5% over the same time period. A 50/50 blend of these two asset classes would have yielded a nominal annualized return of 7.2%." Michael Maye, "Average Investor 20 Year Return Astoundingly Awful," http://www.thestreet.com/story/11621555/1/average-investor-20-year-return-astoundingly-awful.html , 07/18/12returned 6.5% over the same time period. A 50/50 blend of these two asset classes would have yielded a nominal annualized return of 7.2%."
      2. Comment: What some of this suggests is that consideration should be given to what type of investor the client is. Just like there is self-selection by those buying $1M life insurance policies there is assuredly self-selection of those hiring sophisticated estate planners. If the client has sophisticated investment counsel he or she likely be earning a rate of return much higher than the average investor, and likely has a plan or intent to add to investments. Does this suggest that the analysis for the typical wealthy client working with sophisticated counsel and a reputable investment/wealth manager also should have a different analysis of the "buy term invest the difference" question?

f. Mortality/Health Issues.
   i. Some life expectancy tables use inaccurate life expectancy data that understates the risk of longevity.
   ii. American Actuarial Society did a study in 2012 that indicated that people who purchase a $1M life insurance policy are more likely to live longer than the normal population. These larger policy owners had ratios of actual to expected life expectancy in the 82-85% range. This is likely because those who can afford and do buy such a policy have more financial resources and education to afford to obtain, and know to obtain better health care. https://www/soa.org/files/research/exp-study/research-high-face-amount-final-report.pdf . A chart on page 14 of the study shows

that as policy size increases the ratio of actual to expected claims declines. Perhaps the wealthier the client the larger the policy and the better the mortality experience.

iii. Example:
    1. Carrier may illustrate life expectancy of 89 years.
    2. American Actuarial Society study might indicate a life expectancy of 91.
    3. The extended life expectancy for those purchasing $1M policies might be 93.
        a. Comment: The same clients who self-select buying a $1M life insurance policy are likely the same (or perhaps not even as selective a group) as those retaining sophisticated estate planning counsel. What is the life expectancy for the typical estate planning client that has no known health issue impacting longevity? If similar longevity analysis were applied to clients of sophisticated estate planners, e.g., outliving the table/anticipated life expectancy by 4 years + might this suggest that private annuities may prove unfavorable while longer term GRATs might be a winner?

iv. Insurance carriers may have more than a dozen substandard health rating classifications with charges from 125% to 500% of standard pricing.

v. Some agents may be entice carriers to reconsider health ratings based on particular facts of the case.

g. Long Term Care Rider.
    i. Long term care sweet spot is estimated at a net worth of $500,000 to $3M.
    ii. Some planners suggest that wealth clients self-insure and not buy long term care coverage.
    iii. Some planners suggest that wealthy clients would be better served by self-insuring.
    iv. Other planners suggest that wealthy clients use a long-term care rider on a permanent life insurance policy that permits the insured to access death benefits. Yet note that these policies have higher internal costs that should be considered in the decision process.

h. IRC Sec. 1035 Exchange.
    i. Tax free exchange of a life insurance policy or annuity for a substitute life insurance policy or annuity is permitted.
    ii. Evaluate the economics of the transaction. The cash value in the existing policies might be used to cover costs of the new coverage.

i. Modified Endowment Contract (MEC).
    i. IRC Sec. 7702A limits the amount of permit payments that can be made during the first 7 years of a policy.
    ii. If a policy is classified as a MEC any policy distribution including loans will be taxable as ordinary income to the extent the cash surrender value of the policy exceeds the investment in the policy. A 10% penalty may also be imposed unless certain exceptions are met.

j. Policy Structure.

i. If the policy is intended to serve as cash accumulation vehicle the death benefit should be minimized to the extent feasible to minimize the mortality drain on the growth in cash values.

k. Premium Financing.
   i. Consider the renewal risk on the financing since the term is often shorter than the policy life.

l. Inflation.
   i. What will inflation do to the purchasing power value of the policy in question?
   ii. A $1M policy in 40 years will only have a purchasing power adjusted for a 3% rate of inflation of about $300,000.

5. **8-Carried Interests, Private Equity Partners and Hedge Fund Partners**.
   a. Overview.
      i. Estate planners need to carefully navigate when structuring transfers of interests in private investment funds such as hedge and private equity funds.
      ii. The so-called "vertical slice" approach to making transfers, as well as certain "non-vertical" planning alternatives.
      iii. Issues that can arise relating to the Section 2701 trust and entity attribution rules.
      iv. Incomplete gift issues including issues with unvested interests and retained control.
      v. Valuation uncertainty issues and Section 2036 estate tax inclusion considerations.
   b. 2701, Carried Interests, Hedge Funds, etc.
      i. IRC Sec. 2701 can be used proactively.
      ii. 2701 can also be an unexpected “sword” that is unintentionally triggered when a deal is put together that “feels” right but inadvertently triggers 2701. There is no donative intent requirement in 2701.
      iii. Consider “vertical slice” considerations.
         1. Special profit allocation.
         2. 2/20 structure. The management company gets a 2% management fee annually, and 20% may be a special profits allocation to the GP.
         3. This may different in a hedge fund versus a private equity fund.
         4. Be mindful of potential application of IRC Sec. 2701.
         5. Distribution right is a right to receive a distribution with respect to any equity unless it is the same class or a subordinate class of equity.
         6. Carried interest is what has the upside growth potential. Objective is to try to get asset with lowest value and most appreciation potential out of the estate. But planning to achieve this might be constrained because of 2701 vertical slice planning.

7. Founders of a deal, as part of investment deal, may have to put dollars into the deal. This could trigger a large gift tax on a transfer.
8. Vertical slice has its natural limitations.

c. Ancillary issues.
   i. Can client legally gift the interests involved? Are there constraints on transfer?
   ii. What is the value of the entity and interests given?
      1. Launching new fund that is quite speculative. Client may view it as having only a nominal, if any, value. The IRS, however, may take a very different position on the value of a general partner's interests in a new fund.
   iii. Is the gift complete now or at some future date?
      1. Rev. Rul. 98-21 could not make completed gift since did not have exercisable rights under unvested stock options. The IRS may apply this reasoning to a hedge or investment fund. The stock options should be viewed differently then the rights under a partnership interest in which the client may have right to vote, or to current distributions, etc. The ruling should not be applied to many carried interest situations, but nonetheless, the IRS may apply this type of analysis.
      2. Unvested interests should be different then an unvested stock options.

d. Attribution Rules.
   i. Treas. Regulations. 25.2071-6.
      1. Entity Attribution Rules.
         a. Rules apply a proportionate ownership in the entity.
         b. Generally, attribute ownership of an equity interest owned by an entity as if owned by the owner of the entity.
         c. Apply a tiered attribution approach.
      2. Trust Attribution Rules.
         a. Example: A remainder beneficiary of a trust may be considered owner for IRC 2701.
         b. Basic Trust Rules. Trusts often have multiple beneficiaries and give the trustee discretion as to distribution. This rule assumes trustee discretion exercised in favor of a particular beneficiary to the maximum extent permitted. Reg. Sec. 25.2701-6(a)(4)(i).
         c. Grantor Trust Rules.
            i. Attribute ownership to the substantial owners of the trust. If a transfer results in the grantor no longer being treated as the owner it is a transfer for IRC 2701(e)(3).
         d. Multiple Attribution Rules. These apply when the above Basic and Grantor rules result in attribution of the same interests to multiple people. Tie-breaker rules. Some of

these rules seem to maximize the likelihood that ownership of an Applicable Retained Interest by the transferor, and to maximize the likelihood of a subordinate interest being owned by junior family members.

i. Grantor will be considered owner of interests for 2701 purposes. Children who are beneficiaries are considered under "base" attribution rules. Need to apply a tie-breaker rule to address this but often there is a bias to make the net of attribution as wide as possible. It will depend on the nature of the asset inside each trust and the beneficiary.

e. Non-vertical alternatives.
    i. Parallel Trust Transfers.
        1. Gift to complete and incomplete gift trusts.
        2. Incomplete trust should be non-grantor to avoid attribution rules being triggered.
        3. Shift off common growth to G2 or GST trust.
        4. This could be structured in many different ways under preferred partnership scheme.
        5. Still must address preferred partnership issues and value coupon properly.
        6. Avoid triggering 2701 and deemed gifts under general gift tax principles.
    ii. Rising Tide Trust.
        1. Client may feel sense of obligation to provide financial assistance to family as broadly defined.
        2. Transfers to some individuals, like parents and grandparents, or siblings, will not trigger 2701. So what if fund principal makes gift to a class trust for various family members who are not covered by 2701? The class of beneficiaries is crafted to intentionally exclude those relationships that would trigger 2701.
        3. What if fund principal transferred interest to class trust and trust sprinkles income to nieces, nephews, siblings, etc. What if in the future a power of appointment is exercised in the future shifting value to descendants of the fund principal? There is a real risk the power of appointment (POA) could be exercised in favor of someone that the fund principal does not wish to benefit. That real risk must be factored into the planning if there is an intent to structure the rising tide trust to eventually benefit family members that were initially excluded.
f. Technique summary.
    i. Planning does not change overall planning but does entail unique overlaps.
        1. GRATs.
        2. IDITs and note sales.
        3. Preferred partnerships.

ii. Challenges to grantor trusts, discount proposals, and Woebling may change the landscape in favor of preferred partnerships.
iii. Investing "at the ground floor."

6. **9 and 11-Undue Influence**.
   a. Overview.
      i. Undue influence: recognizing it, insulating and planning against it and litigating it.
      ii. Today vulnerable adults are falling prey to the undue influence of others. The tabloids focus on cases of the rich and famous, but persons with estates both big and small are potentially subject to undue influence. While such efforts can amount to criminal abuse of a vulnerable adult, it is more common to find instances where the influence is more circumstantial and subtle. In such instances a person who stands in a position of trust may engage in behavior (intentionally or unintentionally) that supplants the will and desire of the vulnerable adult with the will of the "trusted" individual. Because undue influence is generally a process as opposed to a single event, its growing prevalence as a basis for litigation which attacks the validity of estate planning documents, makes it of considerable import to estate planning attorneys and attorneys who litigate such issues. Therefore, it is important for attorneys to understand and be able to identify vulnerabilities and the indicia of undue influence. It is also important to understand some of options and practices that might be utilized to protect the integrity of the estate plan from the outset of the process thereby providing a possible defense to later attack as well as how to prepare for and litigate an undue litigation case when the need arises.
      iii. Attorneys often confuse the issue of competency with undue influence, but these issues are mutually exclusive, as one must be competent to be unduly influenced. If an attorney fails to focus in on or otherwise understand such issues and practices that might be utilized when preparing an estate plan for an otherwise vulnerable adult, that attorney may find themselves on the wrong side of the litigation and otherwise unable to defend the independence of a client's estate plan. In such instances, the failure to properly document observations and processes may unnecessarily eliminate a defense when a presumption of undue influence exists. In such instances the failure to take simple precautions and adequately document the process utilized to assess capacity and the absence of undue influence, may well undercut a finding of independence and enhance claims that the attorney merely acted as scrivener or worse yet a shill.
      iv. Ethical considerations may include: (1) identifying who the client is when family members are involved in the estate planning process; (2) the duties owed to the client; (2) the importance of the estate planner maintaining and exercising independent judgment; and (3) steps that the estate planner might consider when creating a plan for a client who would be considered

to be a vulnerable adult consistent with the obligations contemplated under ABA Model Rules of Professional Conduct.

b. What is undue influence?
    i. Influence that undermines free agency and supplants the will of the testator. The target does not act voluntarily or with understanding because of the undue influence.
    ii. Undue influence is persuasion that abuses a relationship.
    iii. It is a process, not a single event.
    iv. Not all influence is "undue." Someone might influence the testator's decision but if ultimately, it is the free will of the testator to make the particular decision, then the influence exerted is not undue.
    v. The influence to be "undue" must result in the target's mind being so controlled or affected by persuasion, pressure, artful contrivances, etc., that the will of the other person is substitute
    vi. The determination of whether or not there has been undue influence is very fact specific. Counsel must consider not only facts during the relationship but facts preceding and following the relationship.
c. Ancillary Considerations.
    i. A range of other factors might contribute to, or be intertwined with, undue influence. But undue influence does not require them.
    ii. Consider:
        1. Fraud.
        2. Duress.
        3. Misrepresentation.
    iii. The perpetrator often has inside knowledge and the instrument, e.g., a will procured under undue influence, might include an in terrorem clause making challenge more difficult/risky.
d. Diminished Capacity and Undue Influence.
    i. 1 in 9 people age 65+ have Alzheimer's, 1 in 3 age 85+ have Alzheimer's. Report 2014 Alzheimer's Disease Facts and Figures
    ii. Undue influence can go hand in hand with diminished capacity because diminished capacity may be the vulnerability that permits the undue influence.
    iii. But the target must have competency for undue influence. If the target did not have capacity to, for example, execute a document, the document would be invalid. But if the target had sufficient legal capacity to execute the document the issue of undue influence to make him or her execute the document may be relevant. Often it is the diminishment of capacity, but not the lack of it, that might make the target susceptible to the undue influence.
    iv. Capacity may be subject to interpretation.
    v. "AOX3" alert and oriented in all three spheres - does not demonstrate capacity.
    vi. Definition of capacity is based on applicable state law. It will vary based on circumstances and what is involved. There may different levels of

capacity to execute a will versus a power of attorney, or to complete an act like marrying.

vii. Administration of the mini-mental exam might be advisable.
    1. Comment: If the attorney does not have the expertise then a specialist should administer whatever exams or conduct whatever tests deemed appropriate. Cognitive functioning may be assessed by administering a Folstein Mini-Mental State Exam (MMSE). Should counsel do this or a care manager or other experienced professional? A care manager might choose to administer an MMSE along with SLOMS (St. Louis University Mental Status Exam) which evaluates cognitive decline in individuals with a higher education, and other tests to ascertain cognitive status. It is likely that the clients of most advisers will tend to be more educated that the average American (and wealthier) so that the testing should reflect this.

e. Presumption of undue influence.
    i. Shifts burden of production to the proponent of the instrument. FL Statutes 733.107.
    ii. Generally must prove existence of a confidential or fiduciary relationship, that the perpetrator benefited from the transaction and that the perpetrator had an opportunity to influence the target's decision. See In re Estate of Erickson, 202 Mich App 329.
    iii. A confidential or fiduciary relationship exists where:
        1. The target places trust in the integrity of the perpetrator and as a result of that trust the perpetrator gains power.
        2. The perpetrator assumes responsibility and control over the target.
        3. It may involve a traditional relationship of trust e.g., physician/patient, lawyer/client, etc.
        4. Perpetrator has a duty to act for the target.

f. Circumstances Suggesting Undue Influence Might Exist.
    i. Factors:
        1. Vulnerability.
            a. Medical conditions or medications may make client vulnerable.
            b. Emotional vulnerability.
        2. Dependency.
        3. Isolation.
        4. Family conflict.
        5. Lack of independent counsel.
        6. Conduct of the beneficiary.
        7. Target's actions inconsistent with longstanding values and beliefs.
        8. Sudden changes that enrich one individual.
        9. Direct funds to caretaker.
    ii. See Assessment of Older Adults with Diminished Capacity: A Handbook for Psychologists American Bar Association Common on Law and Aging – American Psychological Association, 2008.

iii. Restatement (Third) of Property Sec. 83. Comment e: "In the absence of direct evidence of undue influence, circumstantial evidence is sufficient to raise an inference of undue influence if the [challenger] proves that (1) the donor was susceptible to undue influence, (2) the alleged wrongdoer had an opportunity to exert undue influence, (3) the alleged wrongdoer had the disposition to exert undue influence, and (4) there was a result appearing to be the effect of undue influence.

g. Relevance of Informed Consent.
   i. There are similarities to the medical concept of informed consent and the estate/legal concept of testamentary capacity.
   ii. Determining how medical providers addressed issues of informed consent might provide insight as to how they would testify as to factors relating to testamentary capacity.
   iii. How did medical providers document matters pertaining to informed consent?

h. What Counsel Can Do.
   i. Exercise independent legal judgment.
   ii. Document/corroborate the exercise of independent judgment and relevant facts and circumstances in the case.
   iii. Provide documents to client in advance of signing and document that.
      1. Comment: Prepare and have the client execute "serial documents." Revise the estate planning documents to include some changes independent of the main dispositive scheme and have those revised documents executed perhaps a month after the initial documents. Creating serial documents with the same general dispositive provisions can serve to enhance the position of the plan.
   iv. Recommend a professional assessment if concerns about capacity, vulnerability or that there may be a suit.
      1. Comment: The fact that an independent assessment was recommended for one client, but is not the normal act of counsel may be an issue that will be addressed in any challenge.
   v. Hire a geriatric psychiatrist or other appropriate expert.
   vi. Be alert for signs of issues of capacity, suspicious circumstances, etc.
   vii. Engage client in dialogue when executing documents. Ask questions in front of the witnesses to establish capacity.
   viii. Do not permit beneficiaries to be present during document execution.
   ix. Involve a corporate fiduciary.
      1. Comment: Involving a corporate fiduciary under a revocable trust while the client is alive and continuing as a fiduciary under testamentary trusts can provide an incredible safety measure to protect a vulnerable client. Ongoing involvement of a corporate fiduciary might also exert a chilling effect on future challenges given the procedures, independence, in house counsel and other attributes of corporate fiduciaries.
   x. The fact that a client has been diagnosed with dementia does not preclude developing an attorney/client relationship.

7. **<u>10-Intent of Settlor - Construction</u>**.
    a. Overview.
        i. Settlor's intent is important in the administration of trusts.
        ii. How to make sure in the drafting of a trust agreement the settlor's intent can be manifested
        iii. Can and what outside of the trust agreement can reinforce this manifestation. After the trust agreement has been drafted, it needs to be interpreted.
        iv. Evaluate how to determine settlors intent (rules of construction regarding patent and latent ambiguities, advancements and assets that no longer exist, and how that has changed, recent court cases, the Restatement 3rd of Trusts, the Uniform Trust Code).
        v. The laws, boundaries and ethical considerations regarding the settlor's intent versus rights of the beneficiary.
        vi. Practical drafting tips to ensure settlor's intent is respected and potential conflicts of interest are addressed in the trust instrument.
    b. What did settlor intend?
        i. Construction case opinions often begin by stating that the Court must ascertain intent as that is paramount issue.
        ii. In the US the settlor's intent is key. Contrast this with the UK where after settlor dies the focus is no longer on settlor's intent. Is the US moving in that direction with decanting?
        iii. Claflin Doctrine.
            1. Claflin v. Claflin 20 NE 454 (Mass. 1989) must consider material purpose of trust.
            2. Recognition in Uniform Trust Code (UTC) that spendthrift clauses are boilerplate and not per se a material purpose of the trust.
            3. Restatement 3rd permits material purpose be waived.
        iv. Some trusts have a "material purpose" clause but most don't.
            1. Plain meaning rule. Cannot introduce extrinsic evidence.
            2. Concern that extrinsic evidence would open up to fraud.
            3. Some no longer limit to the 4 corners rule and will look at extrinsic evidence.
            4. FL has legislation permits looking outside will to ascertain settlor's intent.
            5. Court cases still seem to require proving ambiguity.
    c. New trusts – Modern Trend.
        i. UTC about 30 states have enacted.
            1. A bill is pending to enact it in New Jersey.
            2. Sec. 411(c) – inclusion of a spendthrift provision is not presumed to be a material purpose.
        ii. Restatement 3rd of Trusts 2003.
            1. Liberalized rules of Claflin doctrine.

2. Even a material purpose can be waived if beneficiaries agree and court confirms that the reasons for the modification outweigh the material purpose.

iii. 2012 trusts.

iv. Modern trusts statutes.

1. Decanting.
2. Virtual representation.
3. Perpetual trusts.

v. Material purposes is a constraint on modification, but what does that mean?

d. Court Cases.

i. Most issues are settled because of costs and difficulties of challenge.

ii. Never reference account numbers in a document as they change.

1. Interviewed bank employees.
2. Costly litigation.
3. Eckels v. Davis, 11 S.W. 3d 687.

iii. Kelly v. Estate of Johnson. 788 N.E. 2d 933.

1. Living room "furniture."
2. What was term furniture?
3. Was it everything including knickknacks?
4. Ultimately limited to just furniture because settlor was more specific about contents of other rooms.

iv. Dennis v. Kline, 120 So. 3d 11 (Fla. Dist. Ct. App. 2013).

1. Adult adoption.
2. FL court permitted someone adopted at age 27 to be considered a descendant.
3. Consider including default that must be adopted before age 18.
4. Some clients want younger age.

e. Public policy considerations.

i. Trusts that unreasonably restrain marriage are often held invalid. In re Estate of Feinberg, 919 N.E. 111 (Ill. 1898) enforced a provision to disinherit non-Jewish spouses and grandchildren. Court found it was not a restraint on marriage it was a question as to whether spouse could inherit.

ii. States are split as to whether self-settled trusts are permissible.

1. 15 permit.
2. Growing number.
3. Most states still hold it is against public policy.

iii. Trend to place importance on beneficiary's best interests.

1. Balance weight of settlor's intent with best interests of the beneficiary.
2. Some states, New Hampshire and Massachusetts have modified/eliminated the benefit of the beneficiary rule.
3. Intentional destruction of assets. Saunders v. Vautier (1841), 41 Eng. Rep. 482.
4. One trust required trustee to erect honorary statutes.
5. Courts have not upheld these as a waste of money.

6. Concentrated stock position.
    a. Could such provisions be harmful to beneficiary?
    b. Often sentimental attachment is stronger for settlor then for beneficiaries.
    c. Changes over time.
    d. Some courts have held trustee liable even if clear intent expressed by settlor to retain.

f. UTC has rules that are mandatory and cannot be overridden.
    i. Not all states have adopted.
    ii. Limits on how restrictive trust can be.
    iii. Must have legal purpose.
    iv. Cannot limit trustee's duty to act in good faith. Must act in fiduciary capacity and beneficiaries must have some recourse.
    v. Purpose of trust must be lawful, achievable and for purpose of benefiting beneficiaries.
    vi. You can hold company stock until value is -0- but cannot require trustee to do so.
    vii. Mistake in trust creations
g. Disclosure to beneficiaries.
    i. Can postpone disclosure in some states. Some states will not permit this.
    ii. If you prevent disclosure who is protecting beneficiaries from the trustee?
    iii. UTC requirement to disclose begins at age 25.
    iv. UTC provision is quite controversial.
h. What do people do because of issues around settlor's intent?
    i. Document in statement of intent or a material purpose clause in the document.
    ii. Others use a side letter of wishes about what settlor is intending to accomplish.
    iii. A material purpose clause or letter is goal based language. Not the "how." But what the objective is. This is not an incentive trust (which are difficult to administer and harmful to beneficiaries).
    iv. Overarching philosophy of what settlor intends.
    v. If boilerplate/rigid how much impact will they have?
    vi. Can/should you tie to settlor's "story" – "….this is how I got my start in my business…"
    vii. Costs and issues with such a clause are why some prefer letter of wishes.
    viii. A statement of intent can be helpful to determining distributions.
    ix. Could a statement of intent or material purpose restrict or prevent a decanting? One court interpreted such a clause as a "no modification" provision.
    x. Letter of wishes – a statement of intent with precatory language. It can be changed. State not binding to minimize IRC Sec. 2036 challenge. Concern over inconsistencies with trust and letter of instruction. Should the letter only be read by trustee and not by beneficiaries? Might beneficiaries use content of letter to pressure trustees to take certain actions?

xi. UTC permits extrinsic evidence even if the trust document is unambiguous. Sec. 103(20).
xii. Danger of "no decanting" clause is duration of modern trusts, risks/issues of a typo, etc.
xiii. Perhaps settlor might address when he/she might want the trust terminated.
xiv. Perhaps you can address as in the Kraft case (Mass.) decanting. Was it settlor's intent not to decant? Example – child/beneficiary with drug abuse problem may want to restrict decanting. Similarly for a spendthrift child.

i. Trust protector role.
    i. Minassain v. Rachins, WL 6775269 (Fla. 4th DCA 2014). Trust authorized protector to solve ambiguities to determine settlor's intent. Protector modified trust against beneficiary's litigation position. Court found that since trust was unambiguous the protector had no authority to act.

j. Heart string asset.
    i. What about specialty asset clauses? Example, to retain a closely held business, etc.
    ii. Waiving diversification, etc. Is this really what the settlor wants? Preferable would be "hold stock unless there is a reason not to."
    iii. Dumont Case – Kodak stock. Hold absent a compelling purpose.
    iv. GA allows you to retain assets and only holds trustee liable for gross negligence.
    v. Flynt case June 17, 2015 118 A.3rd 182. Old trusts with blanket retention clause and times have changed. Holding concentration of IBM stock. Moved trust to Delaware. Beneficiaries asked to make trust directed trust. Delaware courts did not believe that is what the settlor wanted. Result may have been different if there had been a material purpose clause about retaining family stock. When this trust was created there was no law permitting directed trusts.

k. Material Purpose clause.
    i. Is spendthrift clause a material purpose?
    ii. Perhaps state in trust that a material purpose of the trust is asset protection so a court won't remove spendthrift protection.

l. Family Bank Trust.
    i. What if you have a trust and you want the trust to make loans so you don't increase taxable estate of beneficiaries.
    ii. May be less risky for trustee to make a distribution since a loan is a risky investment. A material purpose clause will help that.

m. Modifications to Material Purpose Clause.
    i. "I want the children to invest in businesses if they can present a business plan."
    ii. "I want the trustee to fund educational experiences beyond standard university experiences."
    iii. Downside to the above is cost and difficulties of attorneys drafting these statements.

n. Letters of wishes.

i. Side documents.
ii. Commonly used overseas.
iii. Grantor's own words, typically range from a few sentences to several pages.
iv. What about controversial issues/requests in a letter of wishes? Can they be required to be held confidentially by the trustee?
v. Is it really helpful or hurtful? If done well it can help explain rationale of settlor and give guidance for distributions. If too specific can make it more difficult.

8. **11- Undue Influence Part 2 (See above).**

9. **12-Pre-Mortem and Post-Mortem Planning**.
   a. Overview.
      i. Practitioners advising clients when death is imminent and advising executors of estates have always needed to identify the unique circumstances for each family and provide design different solutions for each family. This has become particularly challenging in light of the current estate/income tax planning paradigm. Every near-death and post-death decision has to now be evaluated from the perspective of whether or not an estate tax will be incurred, the impact of an income tax-free basis step-up, the possible post death exposure to the 3.8% surtax, and the ability to shift income to lower bracket taxpayers.
      ii. Many of the traditional planning presumptions will no longer hold valid in this new tax environment. In fact, many commonly used planning strategies will be counter-productive for some clients.
      iii. Different tax positions in some instances will have a varying impact on different beneficiaries. Thus, practitioners will sometimes find themselves having to advise executors when the optimal tax decision for the estate may not be the optimal decision for each of the beneficiaries, and what is optimal for one beneficiary may not be optimal for another.
      iv. The complexity of these issues is compounded by the fact that many clients have not updated their wills, revocable trusts and other planning documents to reflect portability, basis step-up objectives, and other considerations. Interpretive issues, funding decisions, and other problems may compound the post-death planning considerations.
      v. Some of the topics to be considered include:
         1. Practical considerations in the exercise of swap powers. Swap powers have become ubiquitous in planning but too often are not prepared for or monitored. What can be done?
         2. Can or should entity governing documents and structure be modified to support a position that a trust is an active participant?
         3. How should valuation of estate assets be handled in light of the new income and estate tax paradigm?
         4. Using the Section 663(b) 65 day election.

5. Income tax trigger on funding pecuniary bequests is more costly and should be avoided.
6. Will the alternate valuation date election ever make sense? Executors will have to exercise greater caution.
7. Funding decisions, which assets to transfer to which trust will be more complex as growth outside the heirs or surviving spouse's estate will have to be weighed against the options for basis step up inside the recipient trust. The latter decision is complicated by the fact that those trusts can be modified by decanting.
8. Can a post-death trust be converted to a grantor trust as to that beneficiary?
9. General powers of appointment in varying shades make the planning environment more flexible and more treacherous. What steps can fiduciaries take?
10. Partnership and limited liability discounts may be productive for some clients but not others. What can be done to minimize discounts when advantageous or support them when desirable? What pre-death FLP and LLC transactions might be useful to accomplish this? Should the client or a trust repurchase FLP/LLC interests to avoid fractional shares? Can the change be effectuated by a mere changing in governing instrument? Evaluating the Section 754 basis election.
11. Investment decisions can be vital to the success of tax planning strategies. How should documents be drafted differently to address this type of planning? What should be in a client investment policy statement so that the client's wealth manager can carry out the intended tax plan?

b. Pre-Death Borrowing and Gifting
    i. A better option in many instances will be for the client to borrow money against the appreciated assets and gift the cash borrowed.
    ii. The cash can then be used or invested outside the taxable estate while retaining the highly appreciated asset in the estate for basis step up purposes. The net value included in the taxable estate (appreciated asset less borrowings secured by it) should be subject to a lesser estate tax.
    iii. A prudent cautionary measure for many clients, especially those subject to a state estate tax but not a federal estate tax, will be to arrange the lines of credit in advance so that borrowing can be completed in an expedited manner to consummate a pre-death gift.
c. Advancement of Charitable Bequests
    i. For most taxpayers, if a charitable bequest is made under a will no federal estate tax benefit will be realized. Paying that bequest in advance of death might provide an income tax charitable contribution deduction.
    ii. If the client is able, and if not perhaps the agent under a durable power of attorney if the authority is granted under the instrument, can prepay a charitable bequest and have the charity acknowledge in writing that the donation is an advancement of the bequest provided under the will.

iii. Include express provisions in durable powers of attorney addressing this right.

d. Swap-Powers.
   i. Swaps are a key to obtaining a basis step up on trust assets.
   ii. Too often these valuable tax powers are not actively monitored or planned for.
   iii. The frequency of monitoring should increase as the client's age or health risks increase.
   iv. Proactively create lines of credit.
   v. Prepare actual documents or templates of documents to be used to effectuate a swap in advance.
   vi. Should the exercise of a swap power should be reported on the client's gift tax return.
   vii. Have an independent appraisal completed to corroborate that the cash the grantor swaps into the trust for the stock is of equivalent value.
   viii. A defined value mechanism might be advisable to incorporate into the exercise of a swap if a hard to value asset, such as real estate or a family business interest is involved.
   ix. Who will exercise the swap power if the grantor is not capable of doing so? While it might seem that the agent under the grantor's power of attorney can do so, that will in the first instance depend on the terms of the trust which will control. What does it provide for?
   x. While the general powers given to an agent under a power of attorney might suffice to exercise a swap power, consideration should be given to whether they will and if the powers are clear enough or broad enough that the IRS and third parties that might be involved in or affected by the swap will be satisfied.
   xi. The trustee must have a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value. What can be done to corroborate this was done?
   xii. The substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries. What if, for example, the interest being swapped is in a family business interest and one of the beneficiaries is an investment trustee with the power to determine if that business should be held or not? What if one or more beneficiaries are actively involved in that business and others are not?

e. FLP/LLC Valuation Discounts
   i. If discounts are not advantageous can they be negated?
   ii. Liquidate the entity to avoid discounts.
   iii. Redeem or liquidate the client's interests in the entity to avoid discounts for the client but retain the entity for other partners or members.
   iv. Modify the governing documentation of the entity to negate discounts while retaining the other benefits of the entity. Consider a put right exercisable by the executor for pro-rata share of underlying asset value.

f. DAPTs
    i. From a pre-death planning standpoint a DAPT might be divided into two trusts pursuant to the terms of the trust instrument. One sub-trust might include all highly appreciated assets and the second sub-trust all other assets. The appreciated sub-trust might then have its situs changed to a non-DAPT state thereby causing that trust's assets to be included in the client's estate so that those assets may achieve a step-up in basis. The change in situs might be accomplished quickly by as little as an action by a trust protector thereby providing potent near death tax planning opportunity.
g. Post Mortem Planning.
h. What will post-mortem tax planning become for most practitioners?
    i. Post-Mortem Planning The Reality
    ii. Only 3,000-4,000 estates will be subject to a federal estate tax out of 2.5 million US residents who will die.
    iii. 2 million households in the U.S. with more than $3 million of investable assets.
    iv. 1.1 million with $3-4.9 million of investable assets.
    v. 654,000 households with $5-9.9 million of investable assets.
    vi. 196,000 households with more than $10 million of investable assets.
    vii. How many households realistically face a federal estate tax? How many decedent's estates will realistically need to address alternate valuation issues?
    viii. Ultra-high net worth individuals are defined as more than $30 million in net worth excluding the value of the person's principal residence.
    ix. They account for only 0.9% of all high net worth individuals.
    x. In 2009 it was estimated that there were 36,300 ultra-high net worth families in North America. How many might die in any given year?
i. Investment, Trust Funding, and Other Considerations
    i. Tax and non-tax decisions are intertwined.
    ii. asset "allocation" and "location" decisions can be very different.
    iii. Assets more likely to appreciate had historically been distributed to trusts that not taxed in a surviving spouse's estate (e.g., bypass), or GST exempt trusts likely to continue on for generations.
    iv. For many wealthy (but not ultra-high net worth) clients the opposite may be true post-ATRA. Fund bypass trust with non-appreciating assets (the bond portfolio) and have the surviving spouse or marital trust hold appreciating assets to obtain a basis step up on the death of the second spouse for those.
    v. Decision will also be affected by rights to distribute appreciated assets back to surviving spouse out of bypass trust, investment manager's confidence in controlling gains in the bypass trust, and whether the bypass trust was structured to be a grantor trust as to the surviving spouse to permit swaps.
j. Decision on what to sell and when should consider:
    i. Investment analysis, where gains should be recognized.

ii. Needs of beneficiaries – e.g. liquidity, current distributions, asset protection, etc.
iii. Estate distribution and cash requirements (e.g., to pay debts or other expenses).
iv. Estate's and beneficiaries' income tax consequences. This can be daunting to determine. Beneficiaries can be uncooperative, unsophisticated, etc. How can executor address wide variations in the tax picture of various beneficiaries (some in high brackets and high tax states, others not).

k. To fund, or not to fund.
i. Funding or not funding a trust may be a decision reserved to the executor (bypass/portability/Clayton).
ii. Trustee might have option to distribute out entire trust corpus (e.g. clause permitting distribution to current beneficiary under specified conditions). Some wills/trusts contain "kick out" clauses if the trust "is not economic to operate" or other vague language. What can/should be done in such instances? State law may assist. Example: NY has a statue permitting the termination of an uneconomic trust.
iii. What liability will the fiduciaries face if they don't fund a trust and instead distribute outright? Would an institutional trustee ever be willing to opt for such an approach?
iv. Without the constraints of a tax cost many more clients will play lawyer.
v. With no tax benefit from the bypass trusts provided for in many wills, many families simply won't fund the trust, even if mandatory under the governing document.
vi. How can practitioners deal with the unfunded trust?
vii. Identify the assets to be used to fund the trust.
viii. Determine, generally under state law, how income earned in the intervening period should be allocated among beneficiaries, including the to-be-funded trust.
ix. Be alert for discounts or premiums if a fractional interest in an asset is used to fund the trust.
x. A funding agreement, along with transfer documents, may confirm the decisions made.

10. **13-Modern Trust Design**.
a. Overview.
i. Trust design often receives short-shrift once key decisions such as distribution standards and trustees are made. A trust may be for the benefit of a child, allowing distributions for health, education, support and maintenance, and certain individuals are named as trustees in succession.
ii. However, that trust, and the trusts that may stem from it, could last for several decades, or possibly several generations. Thus, the trust agreement is the rule book that will govern the assets for a very long time, and it is critical that such a document be flexible enough to address the thousands

of unforeseeable events that will occur with respect to the assets, the beneficiaries, and the world at large.

iii. One should not just "slap together" a trust to receive the assets at the end of a GRAT or a dynasty trust to receive large gifts without at least considering the provisions discussed in these materials.

b. Investment Trustee (Investment Advisor).
   i. Naming an investment trustee should not cause trust assets to be included in that investment trustee's estate.
      1. No aggregation of purely administrative powers will cause a trust to be included in the power holder's estate. Old Colony Trust Company v. US, 423 F.2d 601 (1st. Cir. 1970).
      2. Power to manage trust investments was not equivalent to a power to control the beneficial enjoyment of trust assets under IRC Sec. 2036(a)(2) if required to be exercised in good faith and subject to fiduciary duty, nor were they equivalent to a power to amend, alter or revoke under IRC Sec. 2038. Estate of Willard V. King v. Comr., 37 TC 973 (1962).
      3. See US v. Byrum, 408 US 125 (1972).
         a. Comment: What are the possible implications of holding private equity that is not operated in accordance with arm's-length procedures?
   ii. Exclude:
      1. Voting stock in a corporation controlled by the investment trustee that was transferred to the trust by that investment trustee. IRC Sec. 2036(b)(2). Some commentators suggest that if the transfer was a sale for full consideration this would not apply.
      2. Life insurance if the investment trustee holds incidence of ownership under IRC Sec. 2042.

c. Trust Protector.
   i. Powers given to the protector may include power to amend the trust, direct the trust to take certain actions concerning investments or distributions.
      1. Comment: Distribution powers are tax sensitive and caution should be exercised in giving these powers to a protector. Consider instead limiting all distribution powers to an institutional trustee and giving the protector the right to replace the institution with another institutional trustee.
   ii. Consider giving the power to clean up scrivener's errors or adjust for changes in the tax law to the trustee instead of the protector.
      1. Comment: Will an institutional trustee which is frequently required to obtain situs in a trust friendly jurisdiction exercise the powers involved?

d. Powers of appointment.
   i. Granting limited powers of appointment (LPOA). See Treas. Reg. Sec. 25.2514-1(b)(1).

e. Dividing Trust.

i. Commonly trusts are divided when the last of the settlor and the settlor's spouse dies. This might mean the children are quite old before this occurs so give the trustee the right to divide sooner.

f. Discretionary distributions.
    i. Standards:
        1. Sole discretion.
        2. Equally or unequally.
        3. Considering beneficiary's other resources.
        4. To or for the benefit of the beneficiary.

g. Incentive trusts.
    i. Caution – exceptions to the standard or rule can swallow the rule.
    ii. Consider instead suggestive guidelines instead of mandatory rules.

h. Divorce clauses.
    i. Clause to remove former spouse and all family members of former spouse as beneficiaries.
    ii. Clause to remove former spouse and all family members of former spouse as fiduciaries.
    iii. May be advisable to terminate grantor trust status.
        1. If former spouse remains a fiduciary the trust could remain a grantor trust. IRC Sec. 674.
        2. If former spouse remains a beneficiary the trust could remain a grantor trust. IRC Sec. 677.

i. Child Born out of Wedlock.
    i. Consider addressing impact of reproductive technology.
    ii. Adoption issues? Maximum age?

j. Change of situs and Governing law.

k. Incapacity.

l. Merger/Decanting.

m. S Corporation provisions.

11. **14-Elder Law and Estate Planning**.
    a. Overview of the special needs of elderly individuals.
    b. How to plan for special needs that may or may not occur in the future in the drafting of the individual's general estate planning documents.
    c. How to make sure that one can maximize their Medicare benefits, especially when the individual's spouse or children still need regular health insurance.
    d. What public assistance is available and what can be done to maximize that public assistance?
    e. How to incorporate all of these late in life needs and concerns in one's current estate planning documents.
    f. Redefine.
        i. It is planning for long life, not planning for death.
        ii. Longevity planning.
    g. General.
        i. Dramatic changes to most estate planners practices.
        ii. Aging population.

iii. Changes in estate tax planning.
iv. Longevity planning.
v. Medicaid will become means tested in the future.

h. Core topics.
i. Health and personal care planning.
ii. Pre-mortem legal planning.
iii. Fiduciary Representation.
iv. Planning for incapacity.
1. Legal capacity counseling.
2. If you live long enough this issue will arise.
v. Public benefits advice.

i. Tools.
i. Wills and trusts.
ii. Planning for incapacity (power of attorney, health proxies and revocable trusts).
1. Client must have capacity to sign.
2. Durability.
3. Accountability of agent.
4. Abuse using powers of attorney seems widespread. In 1994 a survey indicated that 66% of those surveyed were aware of abuse. 64% of the abuse was committed by family members, 19% by other relatives, 6% by long term friends, and 3% by attorneys. Jonathan L. Federman and Meg Reed, Abuse and the Durable Power of Attorney: Options for Reform, Gov't Law Ctr., Alb. L. Sch. (1994).
iii. Asset protection.

j. Crossing bridge to Elder Law.
i. Long term care planning.
1. Both medical and non-medical needs.
ii. Special needs trusts (1st party).
iii. Guardianship and conservatorship.
iv. Elder abuse.
v. Medicaid asset protection trusts and Veterans Asset protection trusts.
vi. Crisis counseling.

k. Advising clients on long term care.
i. Crisis of uncovered liabilities.
ii. Medicare doesn't cover long term care.
iii. Medicare Part D.
iv. Medicaid is only government program that pays for long term care.

l. Long term care planning.
i. Long term care insurance.
1. Best way to fund costs of long term care.
2. Variety of products.
a. Traditional long term care insurance.
b. Partnership dollar for dollar protection.
c. LTC/life insurance hybrid.

i. Some clients are uncomfortable with the idea of paying for a LTC policy they may never need.

d. Traditional life insurance with long term care rider.
e. Should practitioners partner with a LTC professional or get licensed and sale products? What are the ethical issues? Should attorneys partner with LTC professionals to do seminars? Those who are uninsurable will need elder law practice.

3. Longevity boom and proliferation of chronic illness and insurance companies did not underwrite well. The insurance companies anticipated a lapse rate of 5% based on life insurance experience but it is really more like 1%. Low interest rate environment is such that insurance companies have earned less than anticipated when policies were underwritten.
4. What can clients struggling to pay premiums do?

ii. Self-insurance. Paying for long term care without Medicaid.
1. Costs can be significant.
2. Home health aid 44 hours/week is $45,760/year.

iii. Medicaid.
1. Remove assets from reach of Medicaid creditors.
2. Income may be mandatory or discretionary.
3. No principal to grantor.
4. Heirs are remaindermen and inherit.
5. Security features.
a. Choose initial trustee.
b. Grantor can retain power to replace trustee.
c. Choose initial beneficiaries but may change at any time.
d. With consent of all beneficiaries in some jurisdictions the trust can be amended or revoked.
e. Principal may be accessed by beneficiaries.
6. Medicaid Asset protection trust (MAPT).
a. Mandatory or discretionary income to grantor.
b. Principal cannot be given back to the client directly.
c. Assets including home, bank accounts, life insurance and business can be transferred.
7. Combine plans with long term care insurance.
8. Do both the trust planning and buy insurance and re-evaluate components of the plan in the future.

iv. For spouse.
1. Use pour back trust.
2. Create testamentary trust for surviving spouse.

m. Crisis stage.
i. Rule of halves.
ii. You can spend down on legal fees, you could improve a home which is exempt, you can prepay funeral and burial accounts, etc. You can use a spend down plan but some of the funds will not be exempt.

iii. Pay nursing home with ½ you kept. But in 2005 new rules enacted governing the number of months of ineligibility and the penalty. The number of months of ineligibility doesn't begin until you are Medicaid eligible and apply for Medicaid. You have to have only $2,000 in assets.
iv. Promissory notes.
v. Annuities.
vi. Geriatric care manager to coordinate care

n. Tax Considerations for MAPTs.
i. Should grantor trust status be triggered?
ii. Estate inclusion to achieve basis step up.
iii. Gift tax. Is the gift to the MAPT a completed gift?

12. **<u>15-Trust Design</u>**.
a. Overview.
i. Practical advice for trust design: a holistic approach.
ii. Fiduciary trust, legal, valuation and financial perspectives regarding design and structure of trusts, key provisions for every trust agreement, and building flexibility into trusts to adjust and evolve over time.

b. Administration.
i. Head sheet for each trust.
1. Summary of key provisions.
ii. Trustee's duty of loyalty should be considered.
iii. Secure and protect trust assets.
iv. Invest trust assets.
v. Distributions to beneficiaries.
vi. Record keeping, file tax returns.

c. Funding.
d. Corporate versus individual trustees.
e. Distribution standards.
i. Incentive trust standards.
1. Objective is often to address client concern that a large inheritance could harm heir.
2. Stimulate and reward productivity.
3. Discourage negative behavior.
4. How can you verify beneficiary achieves particular standards.

f. Tax apportionment.
g. Definitions.
h. Trust protectors.
i. Investment trustees.
i. Directed trusts
ii. Section 808 of the UTC.
iii. Facilitates holding private equity.

j. Virtual representation.
k. Decanting.
l. Portability.
m. Decoupling.

n. Same-sex marriage.
o. Artificial reproductive technology.
p. Digital assets.

13. **16-Reality of Sale Analysis – Sale to IDIT**.
    a. Overview.
        i. An installment sales to grantor trust properly structured is the best transfer tax strategy.
        ii. A financial comparison of the "IDGT" to other estate planning techniques in order to evaluate which estate planning technique is most appropriate for a particular client situation, using factors such as the age of the individual, an individual's personal health, level of net worth, station in life and the needs of the children and grandchildren.
        iii. When is the use of the IDGT preferred over a GRAT?
        iv. What can be done to make sure that the intra-family sale will be respected.
        v. Review the structure of a sale to a grantor trust in exchange for grantor trust's promissory note.
        vi. A description of sale in exchange for an annuity based upon an individual's life – a variation of the standard sale.
        vii. Discussion of Reality of Sale Cases: Income tax cases showing that such sale transactions are recognized with a fair price and if parties conduct demonstrates they intend to be bound by transaction.
        viii. The genesis of the 10% minimum funding myth.
        ix. Commentators' reaction to recent Tax Court decision in Trombetta. Do we really need to structure the transaction as an arm's length sale? Answer – No.
        x. Should the IRS's position regarding the applicability of Section 2702 in the Woelbing case discourage use of the sale technique? Answer – No.
        xi. Should the settlement in Davidson and the IRS's position in that case cause annuities based on life to be used rather than self-cancelling installment notes (SCINs)? Answer – Yes.
        xii. If the reality of sale tests are met, sales to Grantor Trusts should be successful. Practitioners should not abandon the technique because of the IRS's pending challenge in the Woelbing case. Use annuities for life based upon life rather than SCINs.
    b. Sale to IDIT – 3 alternatives.
        i. Promissory note.
        ii. Annuity based upon life.
        iii. SCIN – self cancelling installment note.
    c. Sale to IDIT.
        i. Planning device.
        ii. How to structure it.
            1. Violate income tax rules under 670 series to cause grantor trust status without violating 2036, 2037 or 2038 to avoid assets in the trust being included in the estate.

2. Transfer to the trust must constitute a completed gift.
3. Trust income remains, however, taxed to the grantor. Under Rev. Rul. 85-13 the trust does not exist for income tax purposes.
4. You can use the grantor's Social Security number as the trust's tax ID number.
5. Sales between grantor and trust have no income tax consequences. This permits us to sell assets to the trust that have appreciated in value without triggering/recognizing a capital gain.
6. We are able to convert equity into debt and use it as an estate freeze technique.
    a. Under Frazee case if have arms-length rate AFR
    b. Confirmed in True case, Fidelity-Philadelphia Trust Co).
        i. Interest is not tied to income generated by assets inside the trust.
        ii. 10% test came from this case. This what IRS said when Abin inquired as to how much equity must be in trust. This is not official and was merely an informal conversation in the 1990s. This has become a rule of practice.
    c. Its value will equal the face amount of the promissory note. So if transfer assets to a trusts for no more than the face value of the note then no gift should be found.
7. Rev. Rul. 2004-64 if grantor pays income tax on income generated by assets inside the IDIT, notwithstanding fact that grantor does not receive the income and that it is outside grantor's estate, paying income tax on that income is not a gift to the beneficiaries of the trust. This is a valuable attribute of the IDIT. The idea is that the income is received by the trust outside the grantor's estate. The income tax can be quite substantial and constitute a significant benefit to the beneficiaries of the trust.
8. GST benefits of the transaction are significant.

d. Sale to IDIT for Annuity.
    i. 50% probability of survivorship for one year test.
        1. IRC Sec. 7520 in valuing an annuity based on life can use tables for predicting life expectancy and it is binding on the IRS if have more than 50% chance of living one year.
        2. You can use IRS actuarial tables to value annuity if individual will live stated life expectancy if meet above test.
        3. If individual lives less than the above life expectancy payments on annuity stop.
        4. Assumption is that sale is for adequate consideration.
    ii. The exhaustion test.
        1. Problem with sale for a private annuity.
        2. Example: Asset worth $10 and sell to trust for annuity for $1/year for 10 years (ignoring interest).

3. What if sell for 10 years or seller's prior death. How much do payments have to be for annuity to still be worth $10? Must do this because of possibility that seller may die before 10 years are up and payments will cease before seller got $10 back. Assume under tab les the seller must get $1.25 each year. What if trust runs out of money in year 8 and does not have enough money to pay the principal. IRS is saying with exhaustion test is that we must consider this. But if the trust doesn't have enough money under assumptions used to value annuities then you cannot use these years in assuming payments will be made to value the annuity. So IRS is saying you only have an annuity for 8 years. How do you get other assets into the trust to avoid violating the exhaustion test? What if have a prior sale so you have sufficient assets inside the trust and surrender an existing note for an annuity.

iii. Use individual other than seller as measuring life.
   1. As an alternative can you use another person's life? What if you use the well spouse's life and have the ill spouse sell. Example: Wife sells assets to the trust for an annuity based on life expectancy of husband.
   2. Why limit to spouse of grantor? What if use someone else who is not related as the measuring life? There is nothing in the regulations that precludes you from doing this.
   3. CLT regulations address measuring lives only apply to CLTS and not to private annuities.

e. Income tax consequences if seller dies while note outstanding.
   i. Madorin case.
   ii. Some conclude loss of grantor trust status either during life or at death causes recognition of gain. Note and assets inside IDIT appear simultaneously.
   iii. Other conclude gain not recognized under Crane case. In Crane left assets encumbered by debt. What is income tax basis in hands of beneficiaries? Supreme Court held it should be determined under predecessor of Sec. 1014. The result was not to be determined under the predecessor of Sec. 1012 which deals with sales. Clearly if she had given it away during her lifetime there would have been a deemed sale even if debt was non-recourse. If you gift away property with liability in excess of basis it is a sale. But under Crane and under general principal that death is not an income tax event there is no gain recognized.
   iv. Include the promissory note in the value of the estate. There should be no sale that occurs. Assets in trust do not get a change/increase in basis since not included in the estate, although some disagree.
      1. Some argue at seller's death the assets in the trust get a full step up in basis. Basis is adjusted to FMV at date of death for an assets that passes by bequest devise or inheritance. If grantor trust is ignored for income tax purposes that means the seller owns the assets and

if moved at death it is by bequest, devise or inheritance. Speaker believes that interpretation is a stretch.
2. IRS has issued a Rev. Proc that it will not issue rulings on this and this issue is on IRS priority list.

v. Reality of sale cases.
vi. Cases involving sales to trust in exchange for annuity.
vii. Kite case.

f. Analysis.
i. What authorities exist for conclusion that sale transaction works.
ii. Hypothetical case facts.
1. If we wanted to structure sale to IDIT as simply as possible we would take an asset and sell it to a defective/grantor trust for the trust's promissory note.
2. This should result in the asset being transferred to the trust without gift tax consequence.
3. If asset goes down in value the trust only pays me back partially on note. Assets may be back in the seller's estate but no downside, just like a zeroed out GRAT.
4. Will the above transaction be recognized by the courts? Under a reality of sales analysis the answer should be yes.
iii. Supreme Court decision in Brown - the taxpayer sold assets to a charity in exchange for a promissory note. Charity was only obligated to make payments out of income generated by the property and was not liable on the promissory note. IRS argued that there was no risk on purchaser and should not be treated as a purchase and the seller should not get capital gains tax. IRS was trying to prevent seller from reporting capital gains and argued that the charity was merely a conduit. Supreme Court looked to price that was paid and found it was reasonable. The court also found that the parties followed the formalities of the transaction and held that the transaction would be respected as a sale. This is similar to the hypothetical above.
iv. The issue could be 2036 but this is why the structure satisfies the True case requirements discussed above with the note not being tied to income.
v. 9th Circuit cases.
1. Both income and estate tax cases.
2. Cases recognized that the sale is a sale and not a transfer with a retained life estate.
3. Part of the analysis is that the parties must set a reasonable price for the asset and follow the structure created.
4. If you follow the 10% test, the rule of the True case, etc. you "should be all right."

g. Key cases.
i. Trombetta.
1. Recent Tax Court Memorandum decision.
2. Transferred heavily mortgaged property into an annuity trust.

3. Value of the property transferred exceeded value of the annuity ant that excess was reported as a gift on the gift tax return.
4. Decedent was to receive payments for a specified power of time.
5. Decedent had ½ of trustee's role.
6. Trust instrument provided that if the trust produced income in excess of annuity amounts due decedent that excess could be distributed in trustee's discretion to the decedent. The IRS argued this was a 2036 issue and all property should be included in the estate. Tax Court agree with this argument of IRS.
7. Decedent as co-trustee could cause all income of trust to be distributed to herself which is a 2036 issue.
8. Instead of focusing on this the Court in a shotgun approach pointed to various reasons why the transaction was a sham. The court said that there was an understanding between the decedent and the children. The court looked to fact that annuity payments were not made. Guarantees where not enforced. There was no legitimate reason for the transaction. The True case did not apply to guarantees because children did not intend to make good on them.
9. The court may have reached the right result but the analysis of the court created concern amongst commentators.
10. Steps to take to minimize Trombetta results (speaker views all of these as an over reaction):
    a. Independent trustee.
        i. Speaker does not agree.
    b. 10% cushion funded with old and cold assets.
        i. Speaker does not believe this is the case.
    c. If interest in close business being sold to IDIT seller should dispose of all other inters tin the business and give up all contacts as officer, director or manager.
    d. Arm's length negation with trustees and beneficiaries represented by separate counsel.
        i. Family transactions are subject to close scrutiny but merely because a transaction involves family members does not mean it should not be respected.

ii. Woebling.
    1. IRS trying to apply 2703 and argue retained life estate because GRAT requirements are not satisfied.
    2. The IRS position is such that speaker does not feel practitioners should be discouraged.
    3. Similar to Karmazin case from many years ago and settled favorably.

iii. Davidson
    1. IRS position was that a SCIN is not an annuity so you cannot use annuity tables under 7520 and life expectancy tables to determine life expectancy of seller. IRS argued you must take seller's health into effect.

2. Payments under a SCIN are similar to a transaction characterized as an annuity, so "what's the big deal?"
3. Case was settled but it appears that SCINs should not be used when you want to use the actuarial tables. Instead use an annuity so that there is no doubt that the 50% test applies.

h. Summary.
   i. With an intra-family sale you are asking the IRS and Court to respect the sale as if it is a sale that took place in the real world.
   ii. You should do a financial analysis and be able to conclude that the seller can reasonably conclude that the buyer will be able to meet obligations on the promissory note. This is what is done in the real world.
   iii. Recommend the CPA create a future cash flow analysis of the purchased asset to show that the income and principal from the purchased assets will suffice to meet payments on note in a timely fashion.
   iv. In the end these cases are factual based. "Prove to me that this is a real sale."

14. <u>Lunch Talk - Trust Friendly Jurisdictions.</u>

a. Many of the trust friendly jurisdictions have no income tax.
   i. South Dakota generates funds from bank franchise tax and other sources.
b. Special purpose entity ("SPE").
   i. Use to house trust protector, trust investment adviser, etc.
   ii. Use for governance and situs.
   iii. Meeting of SPE has to take place outside home state so all fiduciary decisions are made outside of home state.
   iv. Think of benefits as contrasted to bad case like Huber.
      1. Comment: This is an interesting technique that has been discussed for a number of years. The difficulties in applying this approach is that it will add additional costs and complexity to what is almost assuredly a complex and costly plan. On the other hand, considering the dollars involved in so many trust friendly jurisdiction transactions, especially DAPTs, this approach should certainly be considered. Implementation may not be simple. How can, for example, the Investment Trustee confirm that he or she acted while outside of the home state?
c. Dynasty statutes.
   i. Common law statutes – a few left, Iowa, Mississippi, etc.
   ii. Uniform RAP.
   iii. Florida 360 years, and Nevada 365 years.
   iv. Murphy case states. Only case on unlimited duration RAP and IRS acquiesced. WI case in 1979. Court and WI statute dealt with vesting and timing issues associated with RAP.
   v. Unlimited duration states.
   vi. Look for state with Murphy statute since IRS has acquiesced to this but not to other states.

vii. If you did GST planning in another state you cannot extend RAP so if you change situs of existing GST trust you cannot extend. Some state statutes permit this but you should not do this.

d. You can change term, e.g., 1/3 at 25, 30 and 35. That language can be removed so that the trust becomes discretionary as to distributions.
    i. Family can be on distribution committee for non-tax sensitive distributions.
e. Dynasty trusts are not only for the ultra-wealthy. Asset protection and possibly other benefits can be useful for others.
    i. Comment: Those domiciled in a state like New Jersey with a very low $675,000 estate tax exemption but no gift tax should consider SLATs for married couples and DAPTs for single individuals in a trust friendly jurisdiction can be used to assure substantial access to assets yet remove those assets from the reach of a decoupled state estate tax.
f. Set up pour over dynasty trust funded with $10 while alive in trust friendly jurisdictions and fully funded at death.
g. Distributions.
    i. Some include a variety of clauses to promote family values.
    ii. No distribution if no prenuptial agreement.
    iii. No distribution unless earn money, an incentive provision.
    iv. This might benefit from a directed structure to keep the family involved.
h. Insurance.
    i. Use life insurance to fund the dynasty trust with the concept of it becoming a "family bank."
i. Asset protection consideration.
    i. Self-settled trust.
    ii. 15 states permit this.
    iii. Different levels of asset protection in different states.
    iv. Exception creditors differ in some states.
    v. Delaware, Alaska, South Dakota and Nevada are the better state.
    vi. Most assets should be in an LLC so have charging order protection as well.
    vii. Need statutes to support this.
    viii. State law should provide that a discretionary interest in a trust is not a property right.
    ix. Consider providing that if sue and fail liable for legal fees.
    x. Only cases against these have been bad fact cases.
j. Purpose trust.
    i. Perhaps the initial purpose trust was the Pet trust.
    ii. Many states have fixed the maximum duration of a pet trust by statute at 21 years.
    iii. Average bird lives 40 years and a horse 20 years.
    iv. Want longer duration purpose trusts.
    v. South Dakota and a few other states have broadened "purpose trusts' so can use for many things, e.g., maintenance of family property,

maintenance of private art collection, etc. May have no beneficiaries currently. Perhaps a protector can add beneficiaries at a later stage.

k. Private Trust Companies.
    i. $200,000 of capital in South Dakota to set up private trust company to serve as trustee.
    ii. Advantages are significant.
    iii. International benefits can be significant.