Steve Leimberg's Estate Planning
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Subject: Mary E. Vandenack, Abigail O’Connor & Martin Shenkman: 56th Annual Heckerling Institute Meeting Notes

“After hopes of returning to an in-person conference, the 56th Annual Heckerling Institute on Estate Planning was held virtually. Despite remaining virtual, the content was the usual top-quality information from experts. This outline contains our notes and observations from Heckerling 2022.”

Mary E. Vandenack, Esq., **Abigail O’Connor, Esq.** and **Martin Shenkman, Esq.**, provide members with their meeting notes from the 56th Annual Heckerling Institute on Estate Planning. https://www.law.miami.edu/heckerling.

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Here is their commentary:

EXECUTIVE SUMMARY:

Attending the 56th Annual Heckerling Institute on Estate Planning was another virtual experience. While we had hoped to gather again in person, the omicron variant of COVID-19 rained on that, and the conference went virtual in the final hour.

Although we are sad that we were unable to gather personally (and look forward to hopefully being in-person next year), the content and presenters achieved their typical topnotch level. Participants had access to excellent speakers and great information. This outline contains our notes and observations from Heckerling 2022.

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MONDAY MARCH 28, 2022

FUNDAMENTALS OF PARTNERSHIP TAXATION FOR ESTATE PLANNERS
Presenter: Paul S. Lee, Northern Trust

- Disregarded entities.
  - Will almost always become a partnership for income tax purposes, e.g., when grantor dies.
  - ***Authors' Note****: Example, an LLC is owned by the client and a grantor trust. The entity should be respected as a distinct legal entity for asset protection and other state law purposes despite not be recognized for federal income tax purposes. However, when the client dies the trust will become a non-grantor trust and the non-grantor trust and the client's estate will own interests creating a partnership for tax purposes. If the client's Social Security number was used because the structure was disregarded, a new Tax Identification Number will have to be obtained by the LLC. Also, the governing document may have to be revised to reflect the new tax status (see discussion below concerning a tax distribution clause). Form 56 may need to be filed with the IRS for the trust, etc*.
- Choice of entity.
  - Distinguish between the form of legal entity and tax status.
  - Check the box means that a legal entity that is a limited liability company for state law purposes can elect tax status of disregarded entity, partnership, S corporation, C corporation.
  - If one owner of LLC, the default is a disregarded entity.
  - If there are two or more owners, the default is a partnership.
  - But you can check the box.
  - Don't assume a default classification; LLCs and partnership are often taxed as S corporations or C corporations.
  - Only use S corporation for employment tax planning.
  - ***Authors' Note****: If the LLC checks the box to be taxed as an S corporation be mindful of the many rules restricting trust ownership of S corporation, etc. Also, many clients erroneously assume that with an S corporation status negligible or no compensation can be paid with the majority of income paid as a distribution to avoid FICA taxes. A safer approach may be to have the client's CPA or an appraiser present a reasonable compensation study to corroborate the compensation that might be sufficient to pay the key employee/owner.*
- Disregarded LLCs can have more than one member.
  - Two spouses in community property state owning an LLC that may be a disregarded entity if the interest held in LLC is in fact community property. This is so even though spouses are considered two separate taxpayers.
    - If you are in a separate property state, you cannot be a disregarded entity you will be a partnership.
    - If in community property state initial filing is critical. Must file initially as disregarded entity.

        - If community spouses divorce the disregarded entity becomes a newly created partnership.
        - ***Authors' Note****: See discussions below as to community property characterization. The rules are incredibly complex, the status may be changed, and perhaps care should be exercised by the CPA preparing the entity return to periodically corroborate that the LLC interest remain community property.,*
    - Grantor trusts are disregarded during the grantor's lifetime; but on death of grantor of grantor trust disregarded entity becomes a partnership.
- Contributions.
    - Contributions in exchange for a partnership interest are generally not taxable when contributing property and cash.
    - Example:
        - Partner A contributes assets.
        - Inside basis remains what was contributed. Outside basis of contributing partner is same as inside basis of what he or she contributed. Capital Account and value equate with each other.
    - General rule: contributions of property are generally non-taxable but all tax attributes, including holding period, remain the same.
        - You can have a split-holding period.
        - Partner A contributes two assets each with a different holding period.
        - ***Authors' Note****: Many security FLPs and LLCs have been formed, and no doubt many more will be formed in the future. Apart from possible valuation discounts, entities are a convenient way to aggregate interests from many smaller family trusts to a large investment entity to obtain access to investment vehicles that might not otherwise be available to the smaller trust/members. Asset protection considerations have driven many of these plans and should continue to do so. Practitioners should be alert to the risks of violating the investment company rules under Code Section 721 and inadvertently triggering gain. These rules are not intuitive, apply rather mechanical tests and those tests should be confirmed (tested) by someone on the planning team before consummating the formation of any entity taxed as a partnership owning primarily securities. See discussion below. Practitioners should also be aware of the publicly traded partnership rules.*
- Abbreviations used.
    - OB = outside basis.
    - IB = inside basis.
    - CA = Capital account.
- Exceptions to non-tax on formation.
    - Investment Company Exception.
        - May create tax on formation.
        - 80% stock and REITs.
        - ***Authors' Note****: If the investment company tax trap is inadvertently triggered it may be possible to unwind the formation even after it has been done to avoid the tax cost. For example, an election out of*

partnership tax status, amendment and restatement of the entity governing documents, etc. may help avoid the problem,

- Contributions of mortgaged property.
  - Basis of contributed property is $40.
  - Debt is $60 of debt.
  - Under *Tufts* and *Crane* you would trigger gain of $20.
  - If he, the contributing partner, is a 20% partner, then 80% of the debt is relieved and 80% of debt [80% x $60 = $48] is deemed relieved and cash distributed and negative $8 triggers gain [$40-$48].
  - Non-recourse debt.
    - Contribution of mortgaged property triggering gain is rare. You need low basis property, highly mortgaged and contributing partner has to have a small percentage of the partnership.
    - You can avoid gain all together if partner A agreed to remain responsible for the portion of debt that would trigger gain otherwise, $8 in the above example.
    - These rules do not apply to non-recourse debt. Non-recourse debt never causes gains as a result of minimum gain chargeback.
  - Carve out of *Tufts* and *Crane* rule specific only to partnerships. Debt in excess of basis rule does not apply when contributing asset with basis less than debt and instead partnership rules apply.
  - If as a result of contribution or another transaction a partner has a reduction in partnership debt it is treated as a distribution of money to the partner.
  - Distributions of money to a partner will reduce outside basis but never below zero. If money is distributed in excess of outside basis, you will trigger gain.

- Capital accounts.
  - Capital accounts is a balance sheet concept.
  - A and B form partnership and contribute $1,000 of cash and each are equal partners. Assets on left --- debts on right. Assets must equal Liabilities and the difference between them is capital account.
  - Partnership liabilities are not included in capital accounts. They are separately stated.
  - You can view capital accounts as net equity. If you sold all assets and paid off debt you would have capital account figure.
  - Capital account is the net equity – what you would get out of economic arrangement. That is, the capital account reflects the economic rights of each partner relative to other partners in the partnership.
  - Safe harbor rules come from substantial economic effect regulations. This requires on liquidation of the partnership that distributions be made in according to capital account balances. Generally pro-rata according to capital accounts other than in preferred partnerships.
  - *Author's Note: Practitioners should be clear about how to define capital account in operating documents. IRS now requires that partner capital accounts be reported using the tax basis method.*

- Outside Basis.
    - Outside basis represents each partner's contribution and interest in the partnership.
    - There is no such thing as negative basis. You cannot decrease outside basis below zero. Negative basis instead refers to negative capital accounts.
    - Outside basis is increased by money contributed, basis of contributed property, allocation of partnership income and gain, and a share of partnership liabilities.
    - Outside basis decreased by share of partnership losses.
    - How is this reflected on books?
        - Book tax disparity.
        - You have a capital account on tax basis and another on book basis. the disparity is important to understanding partnership taxation.
    - Why is outside basis important?
        - Determines amount of money that can be distributed without gain.
        - Partnership losses are allowable only to extent of outside basis.
        - Determines amount of gain or loss recognized on a taxable sale of a partnership interest.
        - Helps maintain historic tax basis of property (contributions and distributions are tax free).
    - Outside basis cannot decline below zero. A capital account, however, can be negative.
- Inside basis, outside basis and capital accounts.
    - Unitary basis rule.
        - Only in partnership rules.
        - Put in assets at different times as capital contributions.
        - Partnership interest of partner has one unitary basis. It is the full accumulation/aggregate of all assets regardless as to whether contributed at different times and regardless of whether contributed assets for different partnership interests (e.g., regular and preferred).
        - Unitary basis Rev. Rule 85-13: if grantor in a grantor trust contributes two separate assets at two different times for two different partnership interests, basis is shared because treated as the same taxpayer.
        - This presents planning opportunities and pitfalls.
        - Contrast stock where you can track basis of different lots. That concept does not apply to partnership interests.
- Exceptions to tax-free contributions
    - If partnership considered an investment company. See discussion above.
    - If contributing party is subject to recourse debt and there is debt in excess of basis.
- Pass-Through Taxation: Allocation of tax items.
    - Allocation of tax items in most FLPS are usually pro rata according to capital account balances.
    - Sec. 2701 -- Chapter 14 -- does not apply to transfers of the same class.
    - Allocation does not mean cash flow.
        - ***<u>Authors' Note</u>****: Strongly consider a tax distribution clause in the partnership agreement. Without one, partners may have income*

allocated to them and no cash to cover tax cost thereof. This is sometimes referred to as phantom income. Caution should be exercised as it may not always be advantageous to mandate a distribution to pay taxes. Even if that approach is agreed to, how can the tax cost of various partners/members be determined? Members may live in different states and have disparate income tax costs. So often some guesstimate/proxy percentage for state and federal taxation may be used. Also, consider the impact if the entity requires cash flow for operations or other pressing matters. Should a tax distribution be mandated no matter what? Is there a middle ground?
        - ***<u>Authors' Note:</u>*** *Some suggest that the phantom income that can be created is a powerful asset protection tool wherein a claimant who would seize a partnership interest would be allocated taxable gain while the partnership entity would withhold distributions thereby creating a negative economic result for a claimant and thereby enhancing asset protection. It is not clear that this concept will function as some suggest. Some asset protection practitioners advise the use of blocker LLC's so that asset protection can be achieved without completing terminating distributions.*
        - Allocations of income will increase outside basis, and distributions will decrease outside basis.
        - Tax distribution will not trigger gain. They offset each other.
- 704(c)
    - If you contribute property with built in gain or loss, then that gain or loss has to be allocated back to the contributing partner.
    - You cannot use the partnership to allocate gain or loss to other partners. In other words you cannot shift a gain (loss) to a taxpayer in a lower (higher) bracket for tax advantage.
    - Gain at contribution allocated to contributing partner under 704(c); and excess post contribution gain, called 704(b) gain, is allocated according to allocation scheme in the partnership interest.
    - Senator Wyden wants to change these methods.
    - What is a reverse 704(c)?
        - A and B contribute assets that appreciate.
        - Partner C admitted as equal one-third partner and contributes new asset 150 value 20 basis for 1/3rd interest.
        - What is reverse 704(c). Assures that any tax items resulting from previous contributions or activities must be allocated to those who received the benefit of it.
        - Reverse 704(c) says the $50 of gain accretion to value before Partner C admitted to the partnership must be allocated to Partners A and C. Book up capital accounts so assure preadmission gain (before Partner C admitted) is allocated only to A and B.
- Cash distributions are generally tax-free to the extent they do not exceed outside basis.
- Current distributions of property are generally non-taxable.

    - You still have an economic relationship with the partnership, and you may win or lose in the future.
- Liquidating distributions of property are different.
    - Ends relationship with partnership. Example, you are leaving the partnership.
    - Distribution out increases basis of asset to you if you are leaving the partnership and you put in the asset you receive. Your investment should equal the value of what you invested.
    - Liquidating distributions can both increase or decrease the basis of property. Upon distribution, the property's basis in the hands of the partner to which distributed will be the same as the partner's outside basis.
        - ***Authors' <u>Note</u>****: This is an important consideration in situations such as appreciating real estate inside a partnership*.
    - Distributions of marketable securities.
        - Marketable securities are treated as money to the extent of FMV but only for determining whether or not there should be gain.
        - There is an exception to creating gain for qualified investment partnership.
        - Never creates loss.
        - For all other purposes, in particular basis, it is treated as property.
    - Disguised sale rules.
        - Facts and Circumstances Test.
        - 3 elements:
            - Sale by partner to partnership in capacity not as a partner.
            - Sale by partnership to partner not in capacity as partner.
            - Sale by a partnership interest between two partners.
        - If one of these elements occurs within two years from contribution, there is a presumption of a disguised sale.
        - Distributions of current profits will not trigger a disguised sale.
- Mixing Bowl Rules.
    - Example – Partner A and B each contribute assets to partnership and within 7-years the asset that A contributed is distributed to Partner B in liquidation of his partnership interest. That is contributed property being distributed to another partner and that triggers gain. It is 704(c) gain and is allocated to Partner A. If the asset that B had been contributed within 7 years that gain would be allocated to Partner B.
    - Exceptions:
    - 1st Exception: If a 7-year difference in time, the rule does not apply and you do not trigger gain.
    - 2nd Exception: Distributions back to the contributing partner is not a mixing bowl transaction.
    - 3rd Exception: If Partner A and Partner B are grantor and grantor trust and if other partners make up partnership you should be able to distribute assets between the partner and the grantor trust and you fall under the exception for a distribution back to the contributing partner.
    - 4th Exception:

        - Hot assets – Code Sec. 751 enacted to prevent partners from shifting ordinary income disproportionately to other partners, and converting the income to capital gain.
            - Inventory items and unrealized receivables.
            - "Unrealized receivables" is a confusing term. It is ordinary income assets. It is so broadly defined that it includes many items of ordinary income such as Section 1245 recapture.
            - If you distribute capital gain to a partner, the normal rules cannot apply. It is deemed as if ½ of the ordinary income is allocated.
            - A proportionate distribution of hot assets will not trigger gain.
            - A disproportionate distribution of one type of property from a partner that only holds that type of property will not trigger gain under 751. Split the partnership into a vertical slice, so all capital gain assets are in one partnership, and other non-capital gain assets in another.
    - Taxable sale of partnership interests.
        - "Look Through" rule when you have a taxable sale of partnership interests. Capital gain portion of sale is determined by looking through to partnership assets at time of sale.
        - No distinction on liquidation of cash and property are generally better than a sale of a partnership interest.
- Partnership liabilities.
    - Affect outside basis.
    - Partner B contributes asset with $30 debt. Non-recourse.
    - On initial contribution the partnership takes on all liabilities.
    - Under Sec. 752 this is a deemed distribution of cash bringing B's outside basis to zero. Each partner is an equal 1/3rd partner, so B's share of non-recourse debt is pro-rata $10 so each partner has outside basis increased by $10 for debt.
    - Reduction in partnership liabilities can occur when there is a distribution of partnership property to a partner subject to a debt. Remaining partners have a reduction in their share of partnership liabilities (deemed distribution of money).
- 754 election.
    - Cannot change without IRS permission. Do you want the bookkeeping problems of doing this?
        - ***<u>Authors' Note</u>****: The administrative work if a partnership owns one real estate entity may not be that significant, but if the partnership owns a basket of assets, e.g. scores of marketable securities, the administrative burdens can be substantial. That can be exacerbated as future adjustments are made*.
    - Two types of inside basis adjustments. They are entirely different.
        - Inside basis adjustments created on distributions of property, e.g., on distribution of property basis adjustment under 734. These happen during lifetimes.

            - Asset is distributed to partner in full liquidation of partnership interest.
                - If partner C recognized a gain or loss upon liquidation the inside basis adjustment could only be applied to capital assets in the partnership.
                - Allocation of basis adjustment may be suspended until there are ordinary assets in the partnership to get the basis adjustment.
                - If have deemed gain or loss it is always capital, never ordinary, unless you have hot assets.
            - Mandatory adjustments: substantial basis reductions.
                - Only occurs with liquidating distributions.
                - Substantial basis reduction occurs if a liquidating distribution and basis of distributed asset is more than $250,000 or loss recognized of more than $250,000 results in mandatory basis adjustment even if no election is in place.
        - Other type of adjustment is under 743. This is the one most estate planners are familiar with. Applies on transfer of partnership interest on death where partnership can make election to have the decedent's inside basis adjusted to equal decedent's stepped-up outside basis. The inside basis adjustment is under a different code section. These happen after death.
            - Section 754 and inside basis adjustment under 743.
            - Before transfer must calculate each partner's share of inside basis in each asset and each partner's share of gain.
            - Without an inside basis adjustment, the partnership assets might be sold at a gain and a portion of that gain would be allocated to Partner D. Partner D would not be able to offset that gain until a liquidation of the partnership interest.
            - Unlike 734 which benefits all partners the basis adjustments under 743 only benefits the transferee of the partnership interest. There are mandatory basis adjustments under 743.
            - ***Authors' Note:*** *Estate planners should raise the issue of Section 754 as the election often gets overlooked. If you have a probate administration checklist (as a CPA handling compliance, as an attorney administering the estates or as a trust office) be certain that the potential for a 754 election is noted. Consider that if you have a template probate memorandum that is used and modified for each estate, include a brief explanation of 754 elections and a recommendation that the executor evaluate the potential benefits, and costs of such an election*.
        - If you have a new partner buy at a taxable sale it looks like a step up in basis, but it is rather a taxable event.
- Retirement/Death of Partners: Liquidation of Interests.
    - Deferred liquidation payments do not need to comply with the requirements of installment sales under Sec. 453 installment sales rules, and do not need to provide for a minimum interest rate.

    - Example: Five Year Installment sale contract with $100,000 paid each year to partner who left. Partner capital account was $500,000. His outside basis was $300,000. $100,000 of liabilities were allocated to exiting partner. No recognized gain in first three years as distributions reduced outside basis. Year 4 - $100,000 gain. In Year 5, relief of partnership debt triggers gain in addition to distribution.
    - Service partners have different rule under 736(a).
    - Death of partner and step up in basis.
        - Valuation discounts can mean a step down in basis not only a step up.
        - Some liabilities become non-recourse at death.
        - Can be beneficiary to not have 754 election in place.
        - If a 754 election is in place the share of inside basis goes down, driving down and increasing the amount of unrealized gain.
- Termination of partnership.
    - When a grantor trust becomes a non-grantor trust the IRS position is that there is a deemed transfer from the grantor to the now separate entity the now non-grantor trust. So for income tax purposes there is a transfer.
    - Prior to 2019 technical termination of partnership. The issue was that on depreciation deductions you restarted the life of property on a technical termination. This rule was eliminated.
    - When are you deemed to have terminated a partnership? Only if no part of any business or financial or operation of partnership is continued to be carry on by any of its partners in a partnership. IRS has used this to say passive holding of asset with no activity that is a termination of the partnership. The Courts have held that the mere collection of promissory notes is sufficient to keep a partnership from terminating.
- Rev. Rule. 85-13 transfers between owner and deemed owner trust proposed in 2021. Not included in Build Back Better but it may resurface.
- How to borrow basis from another legal entity.
    - Maybe circumvented by using the partnership rules.

RECENT DEVELOPMENTS 2021/2022
Presenters: Turney Berry, Wyant, Tarrant & Combs, LLP; Jonathan Blattmachr, Pioneer Wealth Partners, LLC; Carlyn McCaffrey, McDermott Will & Emery LLP

- Current Proposals
    - Billionaires' income tax is being presented again. This is really a proposed tax on those with $100M. Issue for assets with substantial appreciation especially a family business.
        - ***<u>Authors' Note</u>****: This may play well with some voters as an effort to tax the super-wealthy. The tax is on unrealized appreciation and perhaps may have a better chance of surviving a constitutional challenge then a pure wealth tax. However, few seem to believe that has much potential of being enacted, although predicting tax law changes is less certain then predicting the weather. It is also not clear what steps practitioners might advise clients that may be affected by this. Might it be possible that*

shifting wealth into irrevocable trusts may escape the tax assessed on assets held in the taxpayer's own name?

- Grantor Trust Restrictions
  - Current proposals are very unclear as to what they refer to. Might they refer to:
    - Proposal to include assets in grantor trust in grantor's estate at death.
    - Disallow Rev. Rule 85-13 when sell to trusts or pay out appreciated assets.
    - Changes to grantor trusts may be biggest change proposed.
    - ***Authors' Note****: While it is questionable providing any recommendations to clients based on uncertain proposals that may never be enacted, it does seem that, just as noted elsewhere in this outline, that shifting wealth to irrevocable but flexible and accessible trusts prior to changes being made may prove advantageous. If this type of planning provides asset protection, succession planning and other benefits, perhaps there is no downside*.
- Note valuation consistency.
  - ***Authors' Note****: This is discussed elsewhere in this outline. If an asset is sold to a trust for an AFR note, the note is deemed to be valued at face. If years later that note is contributed to an FLP along with other assets, and then FLP interests are sold to another trust, the note as an asset in the FLP may be valued at a discount from face based on the FMV standard of willing buyer/willing seller. The IRS has long wanted to address this whipsaw in valuation of notes.*
- Discussion of limiting donor advised funds as remedies for private foundations that don't want to pay out distributions.
- Estate tax proposals being talked about as income tax changes.
- Some commentators believe Biden budget proposals are designed to get Manchin on board.
- Sounds like another season of worrying about potential changes to grantor trusts.
- Shortening time period for which GST trusts will be protected. This too has been proposed. Phrased oddly. Limitation on duration of GST exemption. This is different (and perhaps better) than saying you cannot do perpetual trusts.
- ***Authors' Note****: What can practitioners suggest to clients? Many clients are frustrated with the ongoing cautions about pending tax law changes that practitioners have been warning about for several years. Do clients even have the interest in hearing about these proposals? On the other hand, whether or not practitioners have any responsibility to inform clients of proposed changes (we think not) it nonetheless may be advisable to do so. Practitioners should consider using e-newsletters, letters enclosed with billing, footers on bills, and other methods to inform clients of the existence of the Biden Greenbook proposals, and perhaps some of the general proposals included. Also, consider cautioning clients as to the obvious fact that there is no certainty as to what might occur, if anything.*

- Priority Plan for IRS and US Treasury (https://www.irs.gov/pub/irs-utl/2021-2022-pgp-initial.pdf)
  - Each year a statement of what Treasury hopes to accomplish in next fiscal year ending June 30.
  - There are over 150 items on the priority plan.
  - IRS Closing Letter must be requested and there is a fee of $67 that must be paid.
    - https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked questions-on-the-estate-tax-closing-letter
    - A closing letter does not preclude reopening an estate tax examination in some cases, as noted in **Chief Counsel Advice 202142010 (issued April 1, 2021; released Oct. 22, 2021)**. That CCA also confirms that if there has not been an examination of the estate tax return at all, then an examination may be begun without complying with the "reopening" protocols of Rev. Proc. 2005-32, 2005-1 C.B. 1206, under Section 7605(b), and notwithstanding the issuance of a closing letter (Letter 627).
    - **Authors' Note:** *Given the fact that a closing letter does not prevent an audit, you might choose to mention the option to a client, but you may choose not to advise clients to pay the fee, and the additional billing involved, to obtain one. Other practitioners might feel that regardless of the fact that it doesn't guarantee no audit that the personal representative should have a closing letter as a measure of protection, certainly in appearance, that the tax issues have been concluded, in planning distributions and perhaps other actions*.
  - Final regulation on basis consistency rules. Added to Code 2017 under 6035 and 1014 (f) saying inheritors of property have to use estate tax value.
    - A lot of work.
    - Inheritors will have to work with their advisors too.
  - Anti-clawback regulations.
    - Anti-clawback regulations provide that if exemption amount that applies to decedent's lifetime gifts exceeds the amount that is available at death, the higher exemption amount applies to lifetime gift.
    - Regs. Under Sec. 2010.
    - There is one exception to the rule for married couples. The final regulations provide that if a spouse elected portability while there was an increased exemption, the full increased exemption amount for the first-to-die spouse will increase the exclusion available to the surviving spouse.
    - Had said let it go but now want to address when gift is included in decedent's estate.
  - Alternate valuation date ("ADV") Valuation.
    - If sell property after two months, that is the value for estate tax valuation purposes even if the estate has elected the AVD.
    - If not, then 6 months after death value governs.
    - Tax free reorganization – date is not alternate valuation date. *Kohler* case 2006 Tax Court case permitted restructure to lower value.
    - IRS has proposed Regsthat generally any change will not be respected for valuation purposes.

        - Consider if own marketable securities and add those to a disregarded LLC post-death - it could create a discount by the alternative valuation date. That won't be respected.
        - ***Authors' Note***: *Apart from the still not finalized Proposed Regs. AVD planning might deserve more consideration. With the significant increases in equity markets many practitioners may not have seen many AVD cases. However, with the market volatility practitioners might opt to test estates at the AVD more routinely to endeavor to identify if there has been a decrease in value on otherwise taxable estates.*
    - 2053 Regs about valuing claims deductible for estate and gift tax purposes.
        - Claims deductible in full when paid even if contingent on death.
        - If not contingent, then deductible at present value.
        - Commentators say distinction between contingent and not contingent is not fair and Treasury may address.
    - Extension.
        - Provision under GST rules to permit instead of having to use 9100 relief.
    - Treasury is issuing new actuarial tables based on age.
        - If tables change, an income interest will be worth more.
        - If lead interest and remainder interest must always equal 100% of the property, if people live longer the life estate will be worth more and the remainder worth less.
        - Effects of this is it will be more difficult to meet 10% minimum value for CRAT.
            - But don't' do a CRAT do a CRUT.
    - Items not included on priority list.
        - Basis of property in grantor trust where grantor trust status terminates on death.
            - 2002 Blattmachr article took position that even though assets not included in grantor's estate you get an estate tax step up under 1014.
            - 2012 PLR said you get a tax-free step up in basis.
            - If you have such a trust, would you take the position to take a 1014 step up in basis? Sanders tax proposal expressly addressed this and Paskrell wrote Janet Yellen saying Treasury should address this.
            - Tax Notes article says virtually no practitioners take this position.
            - ***Authors' Note***: *A speaker at the Wrap up at the end of this outline disagreed with this interpretation. But differences in opinion are not new or rare in our profession. So, the practical issue is what if anything might practitioners discuss with clients in regard to this possible position? Some practitioners might opt to explain the planning option and possible position to clients as well as the risks of audit and penalties. Perhaps if there are such strong opinions in both directions the client should be given the option as to what approach to take. There is no question that some practitioners have successfully taken this position (success does not mean that the issue was raised on audit). But if this possibility is to be offered*

            - *practitioners should consider putting the risks and strong opinions otherwise into a cautionary communication to the clients.*
        - Gift tax effect of defined value gifts dropped, so *Wandry* still works.
            - ***Authors' Note****: While Wandry "works" that does not mean that clients will not face challenges on audit. Further, the Achilles Heel of Wandry clauses may prove to be the inartful administration of the mechanism as illustrated in the Smaldino case. Practitioners should increase efforts (and perhaps written cautions to clients) that income tax, gift tax, trust records, etc. all reflect the provisions in the valuation adjustment mechanism used.*
        - Nothing on family-owned trust companies.
        - What are tax effects of decanting? In 2011 IRS asked for comments but this is not on priority list.
            - ***Authors' Note****: While decanting has become somewhat more popular then sliced bread, practitioners might opt to nonetheless caution clients that some uncertainty as to tax impact remains.*
    - There are many with respect to income tax affecting 501(c)(3) organizations.
- Valuation Cases
    - *Warne v. Commissioner*, T.C. Memo. 2021-17 (Feb. 18, 2021).
        - LLC discounts issue.
            - Took position that lack of control and lack of marketability discounts taken were acceptable on controlling interest in LLCs.
            - IRS seemed to agree.
            - Tax Court said if everyone agrees then we only have to figure out amount of discount.
            - But why was there any discount at all? No marketability discount, but why lack of control? If don't own 100% you don't have total control and must consider other owners who can be a nuisance.
        - Charitable discount issue.
            - No 100% charitable deduction.
            - Measured by what recipient charity received, not what was included in the estate.
            - Planner should have given 100% to charity to avoid discount issue.
            - Could bequeath entire charitable amount to a DAF for example rather than separate charities so that the value would not be discounted.
            - Consider selling and distributing cash to avoid destroying value.
    - *Buck v. United States*, 2021 WL 4391091, 128 AFTR 2d 2021-6043 (D. Conn. Sept. 24, 2021).
        - Donor purchased real estate tracts. She gifted 48% of each tract and retained a 4% interest.
        - IRS argued against discounts. Should have valued as if she had held on to them until death.
        - Court disagreed as gift tax value is not based on what donor gives up but rather on what the donee receives.

        - 1993 Rev. Rule. 93-12 - donor gave 20% of corporation to each of 5 children and IRS conceded to discount. Why did the IRS take an opposite position in *Buck*? No idea.
        - Gifts of undivided interest in real estate to separate donees should be valued separately and not aggregated. Position taken by IRS was different from a previously issued Revenue Ruling 93-12. Court treated Revenue Ruling as a concession by the IRS.
        - Court said that value is based on what donee receives rather than what donor had prior to making gift.
    - *Nelson* case. *Nelson v. Commissioner*, 128 AFTR 2d 2021-6532 (5th Cir. Nov. 3, 2021), aff'g T.C. Memo. 2020-81.
        - 5th Circuit affirming tax court.
        - Formula clause based value of gift on appraised value.
        - Defined value transfer did not work because incorrect language used (not because the mechanism was faulty).
        - Mrs. Nelson owned 94% interest in a partnership.
        - The IRS didn't agree with valuation done by appraiser and argued on the split gift that $7 million tax owed.
        - Nelsons relied on formula clause based on appraisal and said they should not owe any tax.They lost, not because formula gifts don't work, but because they used **<u>the wrong formula</u>**. Their formula was keyed to what the appraiser said - **<u>not to what the IRS said</u>**.
        - Discussion in Court of Appeals and Tax Court implicitly approved use of formula clauses when used properly.
        - Taxpayers got double layer of discounts.
        - ***Authors' <u>Note</u>:*** *When using a formula clause,* ***<u>refer to values as finally determined for gift or estate tax purposes</u>****. This is not a place for creative writing. CPAs that are preparing gift tax returns should look at the transfer documentation to confirm whether the correct language was used and if not raise an issue with counsel. If the incorrect language was used might it be possible to correct that language as a scrivener's error? If a retroactive correction is made will it be effective?*
- CCA 202152018 (issued Oct. 4, 2021; released Dec. 30, 2021).
        - GRATs are the "original" formula clause. The Regs contain an adjustment mechanism if the annuity payment is specified as a percentage of the value of the asset not a fixed dollar amount.
        - Keep percentage of initial contribution that based on the end of the term there is something left you can determine in advance. If the value put into GRAT is much more if you have a formula annuity payment it should not matter.
        - GRAT was reasonably structured but appraisal was 7 months old. How bad is 7 months? Appraisal was prepared for Section 409A purposes. But CEO/Taxpayer knew at the time the company was being shopped, something the appraiser did not know.
        - Company was sold for 3 x the appraised value.
        - IRS might have said well the annuity should be greater as the value was wrong and the GRAT adjustment mechanism should be triggered. But the

IRS took a more radical approach because they viewed the appraisal as egregious, or perhaps more so that the taxpayer was not ethical using an old appraisal when he knew the company was being sold for much more. There was an intervening appraisal and gift to a charity with an inconsistent value and the IRS concluded that the taxpayer was trying to game the system.

- Under *Atkinson* - *Atkinson v. Commissioner*, 115 T.C. 26 (2000), aff'd, 309 F.3d 1290 (11th Cir. 2002) a CRT was challenged for not complying with the terms of the Regs. GRAT Regs are similar to CRT Regs. Based on an application of Atkinson, the GRAT failed.
- Valuation should take into consideration a pending merger.
- GRAT annuity treated as not being a qualified interest under Section 2702 because of undervalued appraisal (by analogy to *Atkinson*).
- ***<u>Authors' Note</u>****: Some have read the CCA as suggesting that a valuation that is 7 months old is not acceptable. That may be, but the real issue in the CCA was that the taxpayer was playing games. The taxpayer knew that there was a significant development subsequent to the appraisal and he hid that. So, while practitioners might question the validity of a stale appraisal, the bigger issue is proper disclosure. A potentially significant concern of the CCA does it suggest that a GRAT with a significant valuation understatement may be invalidated by the IRS as in the CCA rather than have the annuity merely adjusted? Perhaps a belt and suspenders should be used on funding GRATs with a defined value mechanism on the assets gifted to the GRAT so that the adjustment occurs outside the GRAT mechanism. Another consideration for planners is whether GRATs should continued to be used in valuation adjustment spillover mechanisms as a receptacle. Might a DAF or incomplete gift trust now be better options than a GRAT? Another practice consideration, did the advisers in the CCA know that the client was hiding information? Might practitioners consider obtaining a comfort letter from clients that all relevant facts have been disclosed to the appraiser and that no material changes in facts have occurred from the date of the appraisal to the date of the transfer?*

- *Smaldino* case
  - *Smaldino v. Commissioner*, T.C. Memo. 2021-127 (Nov. 10, 2021).
  - Step transaction issue.
  - Gift from husband to wife was disregarded and treated as a taxable gift by husband to trust. Because husband and wife had not split gifts, this was a gift all from husband to trust.
  - Some of the documents were not dated with the signature date. These documents simply referred to effective date. Formalities of admission of Mrs. Smaldino to LLC were not followed. Nothing ever showed Mrs. Smaldino as a member of the LLC.
  - Guaranteed payments in lieu of management fee. Appraiser subtracted these then 4 months later Mr. Smaldino gave those up but retained right to future management fees. Court discussed Sec. 2701 although not directly applicable to this.

        - Appraisal was after the gift and appraisal came to exact same value as was used for gift.
        - The results of this case should be considered in SLATs where a conclusion could pose significant issues if donor is also a beneficiary.
        - ***Authors' Note****: There are a myriad of take home lessons from Smaldino. The case should not be viewed merely as a bad fact case and dismissed or limited to being a step transaction case. The case provides a valuable checklist of many of the formalities and steps that should be observed in all estate planning transactions. These include, but by no means are limited to assuring consistency of income and gift tax reporting and the transaction documents with the intent for the transaction. Too often this does not happen. If the client has corporate counsel handling corporate documentation do they understand the estate plan? Are they communicating with the estate planning attorney? Does the CPA for the client understand the transaction and the compliance implications? Is the client pressuring advisers not to communicate in order to reduce professional fees? Have the records of the trustee been reviewed to assure that they properly reflect the transaction? It is not uncommon for one or more of the advisers to report the transaction as a transfer of the estimated interests rather than as a transfer of a fixed dollar amount. Another consideration of the case is step-transaction concerns. When spouses have a joint account is anything done to divide those assets before a gift is made? In many cases no. Further, it is common for practitioners not to report a gift on Form 709 between spouses if that was necessary to divide the joint account before one spouse made a gift. Perhaps the lack of documentation and formality in this regard should be reconsidered. So, if husband is making a gift to a SLAT of funds taken from a joint account (many clients do not maintain separate accounts) perhaps there should be the formality of a gift document signed by wife to husband to confirm that the assets were husbands. And perhaps that gift should be reflected on a gift tax return. Practitioners should take Smaldino as a reminder/caution not to have documents without a date reflecting when the document was executed. Even if the document has a prior effective date, the date of execution should be reflected on the face of the document.*
- ING. You might be better off in some cases having non-grantor trust.
    - Rev. Proc. 2021-3. The IRS broadens its no-rule position regarding ING trusts. Rev. Proc. 2021-3, 2021-1 I.R.B. 153, Section 5.01(9), (10), (15) & (17) (Jan. 4, 2021).
    - Since 1986 the grantor trust has been the darling of the estate planning community. Grantor trust tax burn is a key benefit.
    - In some situations a non-grantor trust might be preferable. Each trust if not subject to multiple trust rule gets a $10,000 SALT deduction, 199A deduction, etc. Also, a non-grantor trust may be used to avoid state income taxation.
    - 60 PLRs issued. Used commonly in CA and NY and other high income tax states.

- No gift tax going in the traditional incomplete gift trust. You could also get the property back as you the grantor are included in the class of beneficiaries.
- Rev. Proc. 2020-3 IRS said it will no longer issue favorable ING rulings unless you follow specific requirements. But then in 2021 IRS said it won't issue PLRs. This was again stated in Rev. Proc 2022-3.
- Attributes change in IRS policy to an article by Professor Couch.
- Can you still do an ING?
- While IRS could retroactively revoke the 60 PLRs going back to 1990. What about on a prospective basis? McKinney an 11th Circuit case. Notes that PLRs cannot be cited as precedent, but they can be used as authority. 7805(b) if IRS changes its mind it will likely do so on a prospective basis. Could state in trust "Grantor intends that this is not a grantor trust and grantor also does not want her transfer to be a completed gift. If grantor cannot achieve both of these goals then state the default you want." Law in the US is when you ascertain the intent of the grantor you must construe the trust in that manner.
  - NY *Fabri* case in 1953.
  - *Estate of Reid* 2082 Court said because Mrs. Reid did not intend assets to be included in her estate that trust should be construed in that manner.
- NY adopted an anti-ING rule.
  - If you create a trust which is an incomplete gift and it will be non-grantor trust for federal purposes it will remain a grantor trust for NY (i.e. despite non-grantor trust status for federal tax purposes).
  - ***<u>Authors' Note</u>****: An alternative in NY might simply entail making a completed gift ING. That may well avoid the NY restriction. Also, knowing that the exemption is scheduled to be reduced by ½ in 2026 for some clients a completed gift ING may be preferable in all events to endeavor to secure and protect their exemption before it is reduced. See comments above as to clawback.*
- Speakers - one does them without rulings. But now that they are not ruling on them another speaker is concerned that perhaps that might be too risky.
- Opportunity Zone calculations.
- Avoid state income tax. It is fairly easy to avoid state income tax for non-compensation income.
- Each non-grantor trust has its own SALT limit.
- Rev Proc in 2000-20-3. We will not issue you a favorable ruling for ING unless certain rules are followed. In 2021, IRS indicated that they will not issue rulings. That was repeated in 2022. This is not on priority plan.
- Incomplete gift. You can state in trust that grantor wants incomplete gift for estate tax purposes and non-grantor trust. Express intention as to purposes of trust and direct that it must be construed and administered to make transfers to trust incomplete.
- NY has issued an anti-ING rule.
- ***<u>Authors' Note</u>****: If a non-grantor trust is desired it may be possible to create a non-ING complex trust. INGs are not the only non-grantor trust approach. For example, if the client wishes to create a non-grantor variant of a SLAT that might be done by having an adverse party have to approve distributions to the spouse. That is a somewhat different approach/structure than an ING and may avoid the*

ING concerns. These non-grantor SLATs have been called SLANTs or SALTy-SLATs (as they may be used to secure greater SALT deductions).

- QTIP – how to get out of a QTIP
  - CCA and two PLRs on terminating QTIPs
  - Downside of QTIP is it creates difficulties for surviving spouse.
  - 2044 includes full value of QTIP in surviving spouse's estate.
  - Surviving spouse must get all income for life but there is no requirement that surviving spouse ever get any principal.
  - 5 Options to plan for QTIP
    - Gift by spouse of part or all income interest.
      - Issue if there is a spendthrift clause, but may be able to amend it.
      - This is a gift of not only the income interest but under Sec. 2519 it is treated as a gift of the entire value of the QTIP including the remainder interest.
      - Gift tax value of deemed remainder is calculated as a net gift as spouse making gift can recover estate tax obligated to pay. Not necessarily a bad approach. Surviving spouse might be able to use exclusion before it drops in 2026 and freezes value of assets in QTIP. Weigh this against loss of basis step-up.
      - If give away 10% of income interest still treated as giving away all income interest. If remainder beneficiaries are family, then under 2702 it will be treated as if a gift is made of 100% of the value of the trust - no matter how much spouse has retained.
      - Property included in gross estate under 2036 but won't achieve estate freeze so what has been accomplished? While it may secure exemption the anti-clawback rules might change this.
      - QTIP Trust Division Followed by Modification: PLR 202116001
      - QTIP Trust Division Followed by Disclaimer: PLR 202146001
      - Shows how spouse can surrender portion of income interest without triggering tax on all of interest. Answer is to divide the QTIP before making the gift. Relinquishment of interest in one trust won't be treated as relinquishment in another trust. So no 2702 issue as to other trust. The trusts are thus treated separately for tax purposes.
      - ***<u>Authors' Note</u>****: when practitioners are undertaking such transactions for a client consider cautioning the client in writing about the Kite case and the Draconian impact of a 2519 attack by the IRS.*
    - Sale by spouse of part or all income interest.
      - Similar to above.
      - But adverse income tax consequence that sale triggers income tax but under 1001(e) basis of income interests when disposed of by sale is zero.
    - Purchase by spouse of remainder interest.
      - If spouse buys remainder interest in the QTIP you cannot keep the remainder interest out of the spouse's estate but you have

        - depleted the value of the estate by the payment made for the remainder interest.
        - Rev. Rule 98-8 treated as termination of income interest triggering a gift tax and consideration of getting back remainder interest was not treated as full consideration in money or money's worth as it did not augment her estate.
    - Commutation of QTIP by taking actuarial interest.
        - QTIP Trust Commutation and Reciprocal Gift: CCA 202118008.
        - Commute interests.
        - Net gift by spouse.
        - Remainder beneficiaries won't be treated as making gift as in CCA.
        - Freezes value of trust assets.
        - Possible adverse income tax consequences. 201932001 PLR IRS took position that a similar transaction should be viewed as a purchase of income interest by remainder beneficiaries under 1001(e). Speaker believes PLR is wrong.
        - Is there a way around this? Avoid income tax problems if instead of terminating the trust, have the income beneficiary and remainder beneficiaries transfer interests in the trust to a partnership and rely on 721(a) saying no gain on transfer. In future surviving spouse may transfer partnership interest and may be able to use basis in partnership interest to avoid income tax except on appreciation. Be sure that under state law this does not cause a merger of interests. A merger would terminate the QTIP. Might have different trustees etc. to avoid merger.
    - Distribution of QTIP property to spouse to do own estate planning.
        - This is most popular approach but depends on trust agreement giving the trustee sufficient latitude to make distributions.
        - Consider incorporating into the governing instrument the authority and right to allow distributions of principal to spouse to engage in estate planning.
        - Issue to worry about 2013 *Kite v. Commr*. In *Kite*, distribution made to spouse and as part of preconceived plan, spouse then sold those assets to a trust for children. Tax Court held that was essentially a communication by the surviving spouse and she had to pay tax on remainder interest she got back. Purchase price was a deferred annuity.
        - Be sure that there is a lot of time between distribution and plan.
        - ***<u>Authors' Note</u>****: The facts in the Kite case may be viewed as extreme and not applicable to a particular transaction, but uncertainty remains and there is limited other law to look to for guidance. As suggested above, practitioners might consider cautioning clients of the potential risks in writing.*
- *Henderson* case
    - *Henderson v. Stuart*, 2021 WL 1956373 (Ind. Ct. App.).

    - Seemingly similar terms relating to trust distributions result in different treatment in varying contexts.
    - The terms were “necessary or desirable.” Focus on “desirable.” Does that contradict HEMS?
    - What is an ascertainable standard?
    - In Indiana Court said “desirable” is “longing” or “yearning” for trust assets, so under this standard it could result in a lot of trust assets being distributed under that standard.
    - If beneficiary is a trustee, then need to tighten the standard.
    - ***Authors’ Note****: Practitioners might find it safer to u*se the “tried and true” distribution standard of (HEMS) and avoid the temptation to use original and unique terms.
- *Wellin* case
    - Malpractice Case.
    - $100M+ of Berkshire Hathaway. Put into LP and sold LP units to a grantor trust. Wellin did that and children controlled the partnership and sold the partnership assets.
    - When Wellin did the sale, the underlying stock was $150M and note was $50M. That appears to be a tremendous estate tax result. Turns out that Mr. Wellin was not happy with the arrangement and sued to have it undone. Sued lawyer for negligence and more.
    - Taxpayer claimed lawyer never advised him of the risk. And trust was partner in partnership and partnership sold BH Stock and gain was attributed and passed gain back to Mr. Wellin of a huge gain.
    - Taxpayer claimed he was unhappy about this.
    - Why was client upset with such a great estate tax result and the tax burn which is the best attribute of a grantor trust under 2004-64 grantor gets tax bill and trust can grow free of income tax “the most powerful factor in all of financial planning.”
    - Trial in upstate NY in 4th Circuit decided that his claim against lawyer had not run by the statute of limitations. Lawyers wanted case dismissed for running of statute of limitations. Court’s narrow holding was that statute had not run.
    - Jerome Hesch testified on behalf of Mr. Wellin’s estate. Court said it was a failure to let Mr. Wellin know consequences of the tax plan.
    - Planners speaking to clients should advise clients that income earned in the trust will trigger tax on which the grantor is liable. 2004-64 can use tax reimbursement but it can possibly cause estate inclusion.
    - The Court in the *Wellin* case said Mr. Wellin never paid income tax on gain. Perhaps under *Rothstein* case (predates 85-13 Rev Rule all attributes of trust attributed to grantor) note that 85-13 specifically rejects *Rothstein*. Perhaps Mr. Wellin’s estate took a position that it did not have to pay the income tax. If that is true why is this suit still ongoing?
    - Perhaps it relates to the family. Mr. Wellin remarried and perhaps under his will the new wife would get the assets that was now in a trust for kids.
    - ***Authors’ Note****: Some* Bottom line for a case: whenever doing a transaction, you (lawyer) have to tell them (client) all of the consequences that could happen. Warn them. Preferably send them a letter or written memo – that explains the transactions in non-legalese, outline the reasons for doing the transaction, and

also outline the potential risks and consequences. There are a number of specific steps practitioners might consider. Create a template disclaimer that could be placed on the top of every memorandum that highlights the general risks of all estate tax planning, the requirements or expectations from the client, etc. This is no different than the standard disclaimers every financial firm appends to any analysis. Why aren't more lawyers using similar precautions? Consider including or expanding language in retainer agreements signed by clients stating that there are no guarantees to any planning and any possible positive result will almost always have an offsetting negative implication. Another step some may consider is developing a risk factor checklist, akin to the risk factors section in a private placement memorandum, that alerts clients to a range of common risks in any estate plan. Better yet that risk factors might be tailored to reflect the particular transaction involved. If clients are going to claim (whether factually correct or not) that they were not informed of risks, perhaps the message is that we as practitioners should be certain that they cannot say that they were not warned of risks. And when that is done in writing it is even more difficult for the client to deny such disclosures were made. Practitioners should also be alert to family dynamics. It is not possible to know in Wellin what the attorney could have known about family dynamics but from the case itself it appears that there were significant issues amongst family members. Caution should be exercised in identifying and addressing conflicts of interest in any family representation. Perhaps a standard conflict disclosure can be added to all retainer agreements and tailored to address each family's situation. Again, we cannot know what actually happened in Wellin from the limited discussion in the case, but using it as a warning to be even more careful in protecting ourselves is likely a prudent take-away.

  - NJ Case - *Raia* = large NJ firm sued for installment sale no basis step up at death.
  - ***Authors' Note****: Make sure to tell the clients all the consequences, good or bad, of the estate plan. While having the grantor pay the taxes may be a great estate planning strategy, many grantors come to hate doing so. Be totally clear about such consequence of a grantor trust before the client signs the trust. Again, some kind of written letter or memo, or a written acknowledgement by the client, will be helpful.*

- Notes and Private Foundations
  - Passing note to foundation is a self-dealing issue. This problem can be cured through the probate exception. You put note in an LLC and give non-voting LLC interests to foundation.
  - Notes and private foundations have been an issue for a long time.
  - Many outstanding notes because of so many installment sales to grantor trusts.
  - Can cure with probate exception. Take note and put it into LLC and give non-voting interests to the private foundation.
  - Some have tried to extend this and suggest we can do this while taxpayer is alive and some PLRs on this 2017 one as recently as 2021. IRS has concluded that this is a "bridge too far" that this is being studied.
  - If you get it wrong there is a 200% penalty.
  - IRS has not extended this to during life. IRS is studying the issue.

- Split Dollar
  - *Levine* case.
  - **Authors' Note**: there is an important aspect to the Levine case that the panel did not have an opportunity to discuss but which practitioners might consider. The case is worth a careful read from a non-split dollar perspective. The Court was positively impressed with numerous different aspects of how the plan was handled. These comments provide valuable suggestions for how all of us should endeavor to handle most estate plans, not only split dollar arrangements. For example, the Court was quite impressed that the attorney, Swanson wrote detailed memorandum to the clients explaining the transactions and even created a PowerPoint to illustrate the plan. This may have impressed the court as it was clear that the clients understood the plan. That is important. Read this discussion in conjunction with the comments above concerning the Raia and Wellin cases. Not only will detailed memorandum setting for the pros and cons of a plan likely help protect the practitioner, but the Levine Court cited those precautions and steps as positive to supporting the favorable tax result. For clients reluctant to incur the costs of a memorandum practitioners should point them to the Levine case.
  - This case involves a split-dollar life insurance arrangement. Marion Levine (Levine) entered into a transaction in which her revocable trust advanced funds that the ILIT used to pay premiums on life insurance policies taken out on her daughter and son-in-law. These policies were purchased and held by a separate and irrevocable life-insurance trust that was settled under South Dakota law. Levine's revocable trust had the right to be repaid under the split-dollar agreement for the greater of the cash value of the policies or the premiums. Decisions for investments within the irrevocable life-insurance trust, including for its termination, could be made only by its investment committee, which consisted of one person—Levine's long-time friend and business partner, Larson. Levine died, and the policies had not terminated or paid out at that time as her daughter and son-in-law were still living. The question was what has to be included in her taxable estate because of this transaction: (1) the value of her revocable trust's right to be repaid in the future (i.e., $2,282,195), or (2) the cash-surrender values of those life-insurance policies at the time of Levine's death (i.e., $6,153,478)?
    - The split-dollar arrangement in this case met the specific requirements of the Treasury Regulations. The policies in question were purchased and owned by the irrevocable trust, not Levine, and the arrangement expressly gave the power to terminate only to the trust's investment committee. Thus, neither IRC Section 2036(a)(2)—the general "catch-all" statute for estate assets—nor Section 2038—the "claw-back" provision for certain estate assets transferred before death—do not require inclusion of the policies' cash-surrender values because Levine did not have any right, whether by herself or in conjunction with anyone else, to terminate the policies.
    - The transaction was not merely a scheme to reduce Levine's potential estate-tax liability and there was a legitimate business purpose. There was nothing behind the "transaction's façade" that would suggest that

appearance of the express written terms of agreement and arrangement do not “match reality.”

   - ***Authors’ Note***: *The court was impressed that the attorney and family evaluated the need for the children to have planning and life insurance and that there were valid reasons for the insurance apart from the impact on Mrs. Levine’s estate.*

- Pursuant to applicable state law, the trust’s investment committee— one person—owed fiduciary duties to the trust and beneficiaries other than Levine, Levine’s daughter, and son-in-law, and the evidence illustrated that the written agreements afforded Levine no power to alter, amend, revoke or terminate the irrevocable trust such that its assets should be included in Levine’s estate pursuant to Sections 2036(a)(2) or 2038.
- The only asset from the split-dollar arrangement that Levine’s revocable trust owned at the time of her death was the split-dollar receivable.
- Make sure the trustee doesn’t have another fiduciary relationship.
   - ***Authors’ Note***: *In the Levine case Larson, who was the investment committee for the ILIT was also a co-agent under Mrs. Levine’s power of attorney with her two children. The IRS argued that this put him on both sides of the transaction, similar the Cahill case which was a taxpayer split-dollar loss. When planning a similar transaction endeavor to avoid any overlap of fiduciary roles.*
- Court said that the government’s mistake was that government did not address gift tax consequences.
   - ***Authors’ Note***: *Was there a gift at inception when Mrs. Levine advanced $6.5M and it was valued at about $2M?*
- 2036(a)(2) – same argument as *Morrissette*. Advancer of premiums and party getting death benefit could terminate the arrangement. It was in the contract between the decedent and other party to the transaction the taxpayer had the right to control beneficial enjoyment in conjunction with another person.
   - (a)(1) retain income
   - (a)(2) if can control beneficial enjoyment in conjunction with other parties its back in your estate. This holds true even if other party is adverse to you.
   - In *Levine,* no express statement that parties could get together and terminate. But as a matter of state law you can do a novation. Court in Levine did not accept this argument. They did this on the basis of two cases:
      - *Hemholz* Supreme Court case held ability granted under state law to terminate something is not the power to control beneficial enjoyment of property.
      - *Tully* case – Mr. Tully and partner could change things but that was not enough to cause estate inclusion.
   - ILIT trustee also was the grantor’s co-agent under her Power of Attorney. This comes out of *Strangi* case. *Levine* Court said it

      does not apply. In *Strangi* person who held property was son-in-law.
      - ***Authors' Note****: The positions Larson held as agent and investment committee may have been a close call and the better approach is not to risk this. Also, which the Levine Court did not discuss, Larson was a business partner and perhaps employee of the Levine family. How different was this situation really than the facts in the Cahill case in which the son's cousin and business partner was the ILIT trustee?*
    - 2703 Court ruled out that there was no restriction. Mrs. Levine could remove, but insurance was not held by her. IRS can argue that if you can get back asset you should be sure person has no other fiduciary relationship like attorney-in-fact so you can close off the argument. Make it an independent person to be there who has fiduciary duty to beneficiaries of the trust and the Levine Court noted this in the case. The only asset Mrs. Levine's estate held was the rights under the split-dollar agreement. She never had rights in the insurance policies as she never held any interests in them. So, the Regs under 2703 could not apply to disregard a restriction as to the insurance as she never held any rights to the insurance.
  - *Levine* Court told IRS it should rewrite its split-dollar regulations to change gift tax consequences on valuation of gift tax regulations.
- QTIP Trust – State imposition of estate tax.
  - Each case resolved in matter of estate.
  - *Evans – Estate of Evans v. Department of Revenue*, 368 Or. 430, 492 P.3d 47 (July 29, 2021).
    - Argument that the estate used was based on Supreme Court decision in *Kaestner* as Oregon left ability under due process to impose estate tax on trust that had no contacts with state other than right to distributions.
    - Court held nexus was sufficient for Oregon to impose tax.
    - Why was this tax in question relevant to *Kaestner*? This was an estate tax issue not an income tax issue.
  - Power of a State to Impose Tax on a QTIP who is a domiciliary of state at death but was established outside of the state.
  - Concern is that this case might also be used in income tax cases.
- Conservation Easements
  - TOT Property Case – Savings clause held ineffective to protect a $6.9 million deduction for a gift of a syndicated conservation easement that failed to comply with the regulations on proceeds of involuntary termination.
  - *Hewitt* case – Judicial extinguishment proceeds regulation held invalid because it did not satisfy procedural requirements of the Administrative Procedures Act. Administrative Procedures Act requires government agency to give fair notice of its regulations.
  - The problem in this area is syndicated conservation easements. The IRS is attacking these routinely.
- Corporate Transparency Act
  - Tries to prevent money laundering.

- Applies to entities required to file with state, such as LLCs, corporations, etc.
- Will create massive reporting headaches for entities often used in estate planning.
- Will create a national registry of beneficial ownership of reportable entities.
- This act requires more robust disclosure of direct and indirect ownership of private companies and raises some concerns about trusts.
- When regulations become effective, existing entities will have one year to comply.
- For entities formed after regulations become effective, you must comply in FOURTEEN days, which is very little time.
- Reporting Company – corporations, LLCs, and other similar entities created by filing a document with a secretary of state or similar office, as well as entities formed outside of the US that are registered to do business in the United States. Exempt companies include certain specified companies, companies with a physical presence in the US that employ more than 20 people and have gross receipts exceeding $5m and certain activities with no active trade or business.
    - Beneficial owners must be identified as well as company applicants. The term mostly refers to those who exercise substantial control over the entity.
    - Applies to entities but individuals will bear burden.
    - Joint ventures and general partnerships not created by filing documents with a state so they do not have to report and we may see more of these types of entities formed.
    - States may provide for limited liability entities that can be formed without filing.
    - Exemptions:
        - 23 exemptions listed. These include:
        - Banks and other companies already subject to supervision. Includes banks under Sec. 202 of the investment advisor act so that includes most private trust companies.
        - Large companies with 20 employees and $5 million of income.
        - Exempt subsidiaries. Must be 100% owned by exempt entities.
        - ***<u>Authors' Note</u>****: The exemptions discussed don't appear to apply to the typical scenarios estate planners see.*
- What information has to be supplied.
    - Must report all beneficial owners. That doesn't mean what trusts lawyers think. It applies to those who substantially control entity.
    - Any individual who directly or indirectly exercises substantial control over the entity.
    - Control is over important matters like what to sell, whether to merge, etc. so senior officers may be covered, and those who can remove those individuals may be covered.
    - If a trust owns 25% or more of a reportable entity, then the trustee may have to report.
    - Example: XYZ partnership controlled by 4 trusts each of which has one child as beneficiary. There is a manager with substantial control. Brother is protector and can remove manager. Grantor can remove brother.

            - 4 kids are included.
            - Manager of LLC included.
            - Brother as protector or investment adviser is included.
            - Grantor since he can remove protector is included.
            - The company may be able to identify who all beneficial owners are.
        - The company must identify its “applicants” this is the individual who filed the paperwork to form the entity and the associate and partner who in turn controlled or managed the person who was the applicant. Note that beneficial owners have to be reported only if current. But in contrast the applicant has to be reported/disclosed no matter how long ago the company/entity was formed. Only exception is for applicants that have died.
        - Must provide name, date of birth, address (for beneficial owner it is residential address) if move report new address in 30 days. If it is applicant in business of forming entities (e.g. CT Corporation) must use business all others must provide home address. Need a unique identification number like a passport, drivers license and a FinCen identifier. Must also send in a scan of the photo ID identifying you.
        - Company must provide unique identifying number, TIN, address, etc.
        - If you have a FinCen identifier that will make reporting easier. This may be advisable for those involved in entity formation. Clients who use law firms to form entities may insist on Fin Cen identifiers to make their reporting less onerous.
        - How do you get a Fin Cen number? Must give Fin Cen scan of drivers license or passport, etc.
    - What are penalties for noncompliance.
        - Willful violation $500/day up to $10,000.
        - Penalty applies to individuals who willfully provide false information.
        - Possibility of imprisonment of up to 2 years.
- ***<u>Authors’ Note</u>****: At some point all practitioners should inform clients of these requirements and the implications of them. Firms will have to create protocols to try to avoid missing the required reporting deadlines, and to endeavor to minimize the corrective reporting for changes in address etc. after the initial filings are made. This may be a massive and costly imposition on not only clients but on practitioners. Also, the disclosures will assuredly upset many clients who do not wish personal information disclosed.Strope Robinson* case – Transfer on Death deed
    - Case involved a decedent who designated his niece as beneficiary in his dwelling, using a TOD deed that reserved lifetime enjoyment to the decedent and transferred the property at his death. Sadly, he apparently did not consider that insurance policies do not run with the insured property, and he failed to bequeath his homeowner’s insurance coverage on that property. When the decedent’s ex-wife torched the dwelling shortly after his death, the niece was denied coverage because she was not a named insured, and the decedent’s estate was denied coverage because it did not own an insurable interest in the property.

    - As a practitioner, you want to make sure that the vehicles you use are insured. Also address the issues of who has an insurable interest. Be sure trustee has fire, liability and other insurance, etc. Perhaps should get title insurance as well.
    - ***Authors' Note****: The cost of a title rundown or new title policy is generally modest compared to the cost of the asset involved. Perhaps practitioners should add to the form cover letters used on planning transfers, as well as to template trust and other memorandum, a caution that the client should consult an insurance adviser about both assuring coverage before any transfer is consummated and about obtaining title insurance. For example, many QPRTs were established years ago when the exemption was much lower and interest rates much higher. Few QPRTs have likely been done in recent years unless there were unusual facts. Many QPRTs were done for quite long terms and may still be ending (but the same concerns obviously apply to old QPRTs that terminated years ago). If the house title passes to the children perhaps they should be cautioned to get a new title insurance policy to assure protection. Also, the children or trusts for heirs that are the back end of the QPRT should obtain new property, casualty and liability insurance and confirm that the new owners (children or trusts) are named insureds (and if it is trusts that the trustees are perhaps also listed as named insureds*).
    - ***Authors' Note: Several states are trying to address this issue legislatively.***
- SECURE Act Regulations.
    - Almost $30 Trillion in qualified plans and IRAs. Perhaps biggest class of assets for individuals.
    - Benefit there may be a deduction for what is contributed (or employer puts in and no income). And it may grow tax free.
    - 4 special rules when dealing with qualified plan or IRA.
        - It is almost assuredly in plan participant or IRA owner. Rev. Rul. 85-13 while a grantor trust doesn't exist for income tax purposes, there is a fear that the IRS will tax on even a transfer to a revocable trust. So, you may trigger an income tax and transfers of retirement assets to even a revocable grantor trust should not be risked.
        - No tax free step up in basis. All distributions out of plan, other than a Roth IRA, will be subject to tax. The tax costs on plan proceeds can exceed 80%.
        - You have very complicated rules to adhere to have a qualified plan.
        - Funds must be withdrawn starting at 72 years of age if you are the owner or plan participant.
        - State law may give surviving spouse benefits which you must address.
        - Rules relating to qualified plans and IRAs were changed in 2020 by Secure Act. Many changes were made some key ones of which are not beneficial.
            - You could name successor beneficiary who could withdraw over her lifetime (un-recalculated life expectancy). Could have paid to youngest grandchildren to get most stretch. That was eliminated for most beneficiaries.

        - Now adopted 10-year payout rule generally requiring if not an Eligible Designated Beneficiary ("EDB") must withdraw in ten years.
        - There are new payout rules for 5 categories of EDBs.
            - Proposed Regs give rules on who to comply with these requirements.
            - Test whether a trust can take a non-5-year payout you must have a DB = designated beneficiary. If no DB you have to withdraw over 5 years. If charity or estate must pay out over 5 years. If an individual = DB you can delay and avoid 5-year rule. It is complicated to test with a trust.
            - Regs address powers of appointment, decanting, and other issues.
    - We had thought if you have a DB you can get 10-year rule but that is not always the case.
    - The 10-year rule acts like the 5-year rule but you must ALSO take it out under the "at least as rapidly rule". This rule means you have to take out the funds for someone who reached 72 and began withdrawing over their remaining life expectancy which may be less than ten years.
- Real change of Secure Act was to eliminate slow payout the stretch for most beneficiaries. Only plan participant and spouse get the stretch (plus a few other specified EDBs). How do you get the benefit of slow payout from plan when it is no longer permitted?
- Answer is to consider having funds paid to an income only with make-up Charitable Remainder Unitrust (NIMCRUT).
    - It will have to be paid out in 5 years. Have entire IRA paid to a NIMCRUT. CRTs are exempt from income tax. So immediately following death pay IRA to CRT and no income tax will be incurred. NIMCRUT can pay out up to 11% if 20 year term.
    - By having funds put into an LLC with sole member the NIMCRUT the IRA proceeds will be distributed to LLC and income will be attributable to CRT and CRT pays no tax. NIMCRUT is obligated to pay lesser than unitrust amount (which can be as much as 11% for 20 years) or Fiduciary Accounting Income "FAI."
    - You can pay out nothing as income NIMCRUT has will depend on distributions it receives from the LLC of which the NIMCRUT is sole member. No excise tax since not UBIT. There is no fiduciary accounting income = FAI until the LLC makes distributions out to the NIMCRUT.
    - So, you could hold all funds in LLC for 20 years and that might give you a very beneficial tax deferral.
- We used to worry about naming a charity as a final taker. We weren't sure that could be done under old laws. We thought we had to avoid non-human beneficiaries to avoid falling under 5-year rule.
    - You cannot say pay income to spouse and on death to charity, but can say pay to spouse for life and then if brother is alive to him, but if brother is not alive on death of spouse you can now provide that it goes to charity. The charity is effectively a third-tier beneficiary and you can name

a third tier beneficiary as a non-human, e.g. a charity as the third tier beneficiaries are ignored under the proposed regulations.

- ***Authors Note***: *See discussion of Secure by Choat on Friday notes below*.

- Trusts and Divorce
  - Interest in a trust - how is it considered in a divorce?
  - *Earley* (NH), *Bournival* (NH).
    - These two cases followed Massachusetts law to conclude that trust assets were marital assets to be considered in divorce proceedings.
    - Be careful what you promise clients - it is not always bullet proof.
    - You want to assure flexibility to move trusts to another situs (although that will not always help).
    - ***Authors Note****: Consider having a trust protector in trusts with the authority to change governing law and situs. It may be possible, but as the Earley case suggests not assured, that moving the situs and governing law of a trust prior to the divorce may provide additional security. If the client that is going to be divorced is not the trustee (or an independent trust protector removes her) and the independent trust protector takes the action to change situs, perhaps those acts will not be attributed to the client. However, if the client is found to have orchestrated any of the changes it may be unwound by the Court as predivorce planning.*
  - Divorce planning and life insurance. Choice of law issues, case of *Sullivan* DE Chancery Court.
    - Wife had two policies
      - one governed by PA law.
      - Another was a group term policy governed by DE law.
        - DE law does not cut off divorced spouse's right to receive property whereas PA law did.
    - ***Authors Note****: The lesson of this case, like that of so many ERISA post-divorce cases, is practitioners should endeavor to proactively update all title and beneficiary designations post-divorce to avoid these issues. One challenge is that post-divorce many clients are simply burnt out and won't follow up further.*
- *Grossman* Case – NY.
  - A religious divorce and Israeli marriage constitute a valid marriage for estate tax purpose. *Estate of Grossman v. Commissioner*, T.C. Memo. 2021-65 (May 27, 2021).
  - H failed to obtain civil divorce from prior wife Hilda but they did get a religious Jewish divorce called a "Get".
  - That "get" permitted H to get married to new spouse.
  - On H's death he gave large assets to new wife but IRS disallowed marital deduction saying they were not married.
  - In NY in 2014 with few exceptions will recognize a marriage if valid where celebrated. Since marriage was valid under Israeli law since Israel recognized the prior religious divorce, the couple was deemed married for the marital deduction.

TUESDAY MARCH 29, 2022

PERPLEXING AND PRESCIENT TAX PLANNING POSSIBILITIES
Presenter: Paul S. Lee, Northern Trust

- Grantors and grantor trusts.
    - A grantor might be the owner for income tax purpose.
    - *Rothstein* case said Sec. 671 dictates that, when the grantor is regarded as "owner", the trust's income shall be attributed to him— this and nothing more.
    - The IRS responded in Rev. Rul. 85-13. The court's decision in *Rothstein*, insofar as it holds that a trust owned by a grantor must be regarded as a separate taxpayer capable of engaging in sales transactions with the grantor, is not in accord with the views of the Service.
    - Proposed Sec. 1062 as one of several ways to attack grantor trusts. Although this was never enacted when proposed in the last few years, it may resurface.
        - Disregard for sale or other transaction as owner of trust.
        - This would completely overturn Rev. Rule 85-13.
        - So, you may trigger gain if you make a transfer between the deemed owner and the deemed owned trust. That transfer must also be a taxable sale or exchange.
        - 1062 and the companion amendment changed related party rules to disallow a loss on what would otherwise be a taxable sale or exchange. That would eliminate what the taxpayer in Rothstein accomplished.
    - Note that grantor trust rules which were enacted to prevent income tax rate arbitrage between high income taxpayers and they are no longer needed because of lack of tax rate differentials.
- Are the partnership rules a work-around what 1062 would do if it is enacted in the future?
    - Rev Rule 84-53 Unitary basis rules.
    - Because of 85-13 when grantor and grantor trusts are treated as same taxpayer even if partners in a partnership their basis is combined for a number of tax concepts.
    - In 84-53 one partner acquired limited and general partnership interests and sold them in a taxable transaction. In determining basis you have for each interest you have to combine all basis you have and then allocate to each partnership interest. Since 1984 having to aggregate basis has expanded into other areas where basis is important for partnership tax purposes.
    - Outside basis is important as it determines cash you can get on a distribution without triggering gain, it determines loss you can recognize, it determines amount of gain on sale and it determines amount of basis on property you get when distribute it out.
    - 84-53 unitary basis concepts applies for other types of partnership transactions and may require aggregation.
- Use unitary basis to effectuate a swap.
    - Unitary Basis: Moving Basis without a Swap
    - Grantor and grantor trust own interests in partnership.
    - Same practical result as a "swap" under § 675(4)(C) power.
    - Possible workaround if proposed § 1062 (or similar) is enacted

    - If make disproportionate distribution have to adjust so continue to fall under single class exception under 2701.
    - Rule is on distribution basis of property will reduce down basis to distributee partner to extent of their basis but not below zero.
    - This shifts basis from taxpayer to taxpayer's grantor trust.
    - Under 1062 if enacted swap between grantor and grantor trust would be enacted. So, the question is will 1062 apply to the partnership transaction. Will "transfer" be defined broadly enough to include the partnership transaction. Generally, rule is that partnership rules supersede other rules and transaction with partner and partnership a non-taxable event. Will thus the partnership rules provide a work around for 1062 changes if made?
    - In a liquidating distribution if you get cash you can recognize loss on liquidation of partnership interest.
        - Liquidating distribution terminates interest in partnership as a taxpayer.
        - As long as grantor trust is in existence that "one" taxpayer remains so even though liquidating out grantor it is considered a current distribution not a liquidating distribution.
        - So there can be no loss on a current distribution (which would have been a liquidating distribution with a loss recognized but for the grantor trust). This can result in the shift of basis from the grantor to the grantor trust but no loss can be recognized.
        - What if convert grantor trust to non-grantor trust before liquidating distribution to the grantor?
  - Partnership disguised sales rules.
    - Facts and circumstances test. May have sale or exchange and 2 year rebuttable presumptions.
        - Sale by partner to partnership
        - Sale by partnership to partner
        - Sale of partnership interest between two partners.
    - If you are grantor and grantor trust in partnership even if you have related transfers 85-13 says you are the same taxpayer and disguised sale rules don't apply. That is incorrect and 85-13 doesn't avoid disguised sales treatment. This is because only 1 of 3 disguised sales transactions are between partners.
    - Under current law could swap if 1062 not enacted.
    - If 1062 is enacted then the disguised sale rules become more of a concern.
- Distributions of property are generally not taxable.
    - Mixing bowl rules, a 7-year rule, are an exception.
    - 85-13 makes mixing bowl rules not an issue.
    - 85-13 grantor and grantor trust are same taxpayer so any distribution by one to the other is deemed to be a distribution back to the original taxpayer even though the grantor and the grantor trust are separate legal entities.
    - If 1062 is passed it would be a transfer between a deemed owner and a deemed owner trust, the mixing bowl rules are not a sale between the grantor and grantor trust. They are merely an allocation of recontribution gain so they may not be triggered by 1062 as written.
    - So, a conversion from grantor to non-grantor trust is a deemed transfer from the grantor to the non-grantor trust.

    - Requires allocation of unitary basis.
- Section 2036 and the Inside/Outside Basis Conundrum.
    - *Estate of Powell* and *Estate of Moore*.
    - If you have partnership subject to 2036 so assets are included in the estate.
    - Amount included in the estate is per formula (in footnote in Moore).
    - Planning Opportunities.
  - When grantor trust status is terminated due to grantor's death, the trust comes into existence as a separate taxpayer for income tax purposes.
    - ***Authors' Note****: The above is an obvious but very important point that is often missed. All grantor trusts will one day become non-grantor complex trusts. That will assuredly happen on the death of the settlor, or perhaps at an earlier date if grantor trust status is intentionally turned off (e.g. by renouncing the powers/rights that characterize the trust as a grantor trust). Practitioners should bear this in mind when planning. So for example, if you create a grantor trust and just accept situs in the settlor's home state which is high tax it won't matter while the settlor is alive because, as a grantor trust, most states will respect federal grantor status and treat the income as earned by the settlor and subject to the high home state taxation. However, on death when it becomes a non-grantor trust nexus to the high tax state might assured continued state taxation, Perhaps changing situs before death, or planning situs in a low tax state from inception, might be advantageous.*
    - CCA 200937028 – A taxpayer transferred assets into a trust and kept power to substitute and trust assets did not qualify for a basis adjustment under 1014(b)(1) through (10).

SINCERITY IN ERROR – COMMON ERRORS AND ETHICS OF CORRECTION
Presenter: Lauren J. Wolven, Levenfeld Pearlstein LLC; Stephanie Loomis-Price, Winstead PC

- Apologies
  - Cognitive Dissonance can occur when we know we are wrong but want to be right.
  - Sincere apology – no blaming.
  - The long-term effect of apologizing allows better long term relationships.
  - Elements of a good apology:
    - Accepts responsibility for the wrong and doesn't hint that outside forces, or the victim, caused the offender to do what they did.
    - It's unqualified. If the apology contains a "but", it fails.
    - It offers to make amends.
    - ***Authors' Note****: A critical point the speaker made is that even if an apology might help ameliorate the situation with the client the malpractice carrier may not permit that to be done. Consider anytime there is an issue, even if there is and might never be a claim, consult with litigation counsel for an independent and objective litigation perspective on the matter. No matter how brilliant the practitioner if there is an issue or potential claim, it is difficult if not impossible to see the matter objectively. Get that insight early on. And if the litigator is also vested in the result as*

    - *a partner of the practitioner, consider having general counsel to the firm or even an outside attorney provide guidance.*
  - Ethics rules do not require an apology.
- Rule 1.4 Communications
  - This rule extends to mistakes. There is a duty to keep the client informed so that the client can make informed decisions.
  - A lawyer may not withhold information to serve the lawyer's own interest or convenience.
  - ***Authors' Note****: In the Wellin malpractice case above the court held that the statute of limitations did not toll until the client could have or should have known of the issue. Disclosure may be key to tolling the statute.*
- How to tell the client – with or without an apology?
  - Apology feels good.
  - Apology laws protect apologies that express sympathy and empathy - not the apology of a mistake.
  - Disciplinary matters. An apology is not necessarily an admission of liability for disciplinary purposes. It can be seen as a mitigating factor in disciplinary proceedings.
  - Short answer – If you make an apology, do not admit fault. This can be used against you.
  - ***Authors' Note****: The nuances of the above are very subtle. Review the apology in advance and perhaps write out the language to be used with the guidance of an experienced and independent litigator.*
- Malpractice claims
  - Courts now are permitting the approximation of future harm, so malpractice claims can now come before the claim is ripe.
  - Bulk of claims – 46% comes from substantive errors. Administrative errors are 28.5%.
  - Attorneys do <u>not</u> have a duty to ensure that a client executes a will timely. Just the opposite.
- *Parks* Case – A potential beneficiary brought malpractice action against attorney claiming that attorney had duty to make sure will was properly executed. In this case, court determined that attorney duty does not run to a beneficiary. If it did, it could potentially violate attorney's duty to the client.
- *Licata v. Specter* case – Attorney drafted will that failed to provide for required number of witnesses under state law. Will was declared invalid. Court concluded that an attorney owes a duty to those who can be foreseeably injured by negligence.
- ***Authors' Note****: The web of complicated and disparate emergency rules enacted during Covid for remote signings might create issues as to validity. Perhaps practitioners should contact clients who signed under those circumstances and suggest as a precaution signing documents again under traditional approaches to execution.*
- Attorneys should be on the lookout for common and unintentional mistakes and drafting errors.
- Drafting Errors:
  - Defined Term – *Paul v. Patton* case. Attorney failed to consider definition of "Beneficiary" and surviving spouse received one half plus twenty percent of share

intended for children by prior spouse because spouse was included in definition of beneficiary.
    - Lack of Specificity and Settlor Intent – Pay close attention to definition within document. San Antonio Area *Found. V. Land* case – Confusion arose around definition of "real property." Part of the real property had been sold in exchange for notes, cash, liens and agreements. Real property beneficiaries indicated that notes, cash, etc. were intended to be included in definition of real property.
    - *A v. V v. Hill Wallack* – Receiving a questionnaire completed by the client can help prevent liability.
- Legal Formalities
    - *Frederick v. Wallerich* – Failure to obtain a witness signature to an antenuptial agreement ultimately defeated the antenuptial agreement and impacted client's later will.
- Exceeding Knowledge
    - *Jill Petrie* case – Attorney did not include language to differentiate trusts in order to avoid reciprocal trust doctrine. Attorney was outside his expertise. This raised an issue of competency.
- Powers of Appointment and Marital Trusts
    - Section 2056(b)(5) trusts – Power of appointment trusts have specific requirements.
        - All income payable to spouse provision can be violated if there are restrictions on spouse's right to receive trust income.
        - A 2041 power of appointment must be exercisable in favor of spouse or spouse's estate.
        - Trustee cannot have right or ability to distribute trust property to any other person.
    - QTIPS
        - *Estate v. Rinaldi* – Terms of will required sale of shares at discounted price in certain circumstances. Court determined that this could diminish interest of spouse. As a result, trust did not qualify as a QTIP.
        - No portion of QTIP is allowed to be appointed to any person other than surviving spouse. If someone has power, after the death of the spouse, to appoint, it is sufficient to be treated as a QTIP.
        - Election must be made and assets allocated to the QTIP.
- Per Stirpes
    - There are two main variations of the per stirpes rule.
        - Classic per stirpes – Restatement Third provides a description.
        - Modified per stirpes – follows the same rules except with respect to first step.
        - Both variations are distinguishable from per capita distribution.
        - States have adopted different variations. Term should not be used without definition.
        - ***<u>Authors' Note</u>:*** *Specifically define per stirpes in your documents.*
        - Class gift. Single class.
            - Confusing: To my brother and sister per stirpes.
            - Correct: Descendants per stirpes.
        - WRONG: "<u>in equal shares</u> per stirpes" – creates ambiguity

- Estate Tax Apportionment Clauses
    - An apportionment clause should generally be used because IRC does not generally specify how estate taxes shall be apportioned.
    - If there is no apportionment clause, state law will determine how estate taxes will be apportioned.
    - *Lurie* case is an illustration of how an anti-apportionment clause can create unintended consequences. Trust provided for payment from residue with no right for reimbursement. Due to anti-apportionment clause, Trustee was unable to invade principal and there were insufficient assets in estate's residue. Court concluded that marital assets would be used which resulted in increase in estate taxes by reducing marital deduction.
    - GST taxes. GST taxes are charged to the property constituting the transfer so responsible party varies. Allocation to GST trusts depends on testator intent.
    - Considerations in Drafting
        - If there are different family lines, consider who should bear burden of taxes.
        - Take into consideration different types of trusts, probate assets and non-probate assets.

CURRENT ISSUES IN ESTATE AND GIFT TAX AUDITS
Presenter: John Porter, Esq., Baker Botts L.L.P.

- Prepare for audit. Be sure to have non-tax reasons for forming partnership. IRS is making broad requests. Be aware of privileges.
    - IRS asks for the entire file on audit.
        - Are files privileged?
        - Client and attorney must preserve at estate planning level.
        - If client shares communications with third parties, then privilege won't exist.
        - Emails can be subpoenaed on audit and in litigation.
        - You may have to testify as an estate planning attorney as to the reasons for creating an entity because the client may no longer be alive to do so.
        - In most trials, the courts have put attorney on witness stand to testify as to non-tax reasons for the entity as in the estate tax case the taxpayer is deceased.
        - Try to discuss non-tax reasons for plan in memos.
    - ***<u>Authors' Note</u>****: A key point the speaker made is that the best time to prepare for audit is not when the audit notice is received, but from the inception of the planning. Keep in mind the goals and objectives of the planning when crafting emails, file memorandum, etc.*
- Valuation is the number one issue.
- Valuation Discounts Vary
    - Attributes associated with the interest are very important
- Formula Transfers allows us to bring certainty to where there is otherwise uncertainty.
    - Defined Value Clause <u>as finally determined for estate/gift tax purposes.</u>
    - Defined value clause – *McCord, Hendrix* – use only if in Fifth Circuit

- ***Authors' Note****: Many practitioners use different types of defined value mechanisms in any jurisdiction. There is wide variation in the view of different practitioners of different valuation adjustment mechanism, so much so that it is impossible to conclude that one approach is better than another. For example, as discussed in the Authors' Note to the GRAT CCA above some practitioners may stop using GRATs as spillover receptacles in defined value mechanisms after that CCA. Other practitioners might only be more careful, or caution clients about using a GRAT as a defined value spillover receptacle if there is a material misstatement of facts concerning the appraisal. Many practitioners believe that a King price adjustment mechanism is secure and logical. Others question it as it is only a 10th Circuit case. Some practitioners endeavor to "diversify" their defined value mechanisms when completing complex transactions that require several defined value clauses – i.e., use a King on one, McCord on another, an incomplete gift trust as a spillover receptacle in one transaction and a GRAT on another, and so on. Generalizations or trying to rank techniques is difficult or impossible.*
- Price Adjustment Clauses – *King*
  - Term of promissory note are…and if the FMV of shares as finally determine for federal gift tax purposes is greater or less than the face of the note the face of the note shall be adjusted.
  - Include that the parties intend sale at FMV with no gift.
- Reversion clauses don't work – *Procter*

- Formula Language Matters
  - *Wandry* – I hereby transfer to ___ that number of shares of the Company with a fair market value <u>as finally determined for federal gift tax purposes</u> equal to $(specific dollar amount)
  - *Petter* – I hereby transfer 100 shares to the Company to taxable transferee and charity to be allocated between the transferees as follows: (1) that number of shares with a FMV <u>as finally determined for federal gift tax purposes</u> equal to specific dollar amount to transferee and (2) remainder to charity/GRAT/QTIP
  - *King* – I Hereby sell 100 shares of Company in exchange for a promissory note with a principal amount of $___
  - *Nelson* case – There was no definition of FMV or requirement to reallocate value. No language such as "as finally determined for federal estate or gift tax purposes." Tax Court determined that interests in partnership transferred were of fixed percentage interests and not dollar amounts based on values as finally determined for gift tax purposes. Language relied on determination by appraiser rather than on value determined for federal estate and gift taxes.
- Potential Donees of the Excess Amount Under Petter Style Formula Clause
  - Public Charity/Donor Advised Fund
    - Independent Fiduciary Obligation – Charity must report to state's attorney. general and Internal Revenue Service.
    - Subject to private inurement and excess benefit rules.
    - *McCord, Hendrix, Petter.*
  - Private Foundation
    - Self-dealing, and excess business holdings can make this an issue.

        - ***<u>Authors' Note</u>***: Proceed with the use of a private foundation (PF) with great caution.
        - *Christensen* case
    - Lifetime QTIP
        - ***<u>Authors' Note</u>***: *This seems to be a less common spillover receptacle because of the problems it poses.*
    - GRAT.
        - ***<u>Authors' Note</u>***: *See CCA above.*
    - If have QTIP or GRAT on back end use different trustees to have independence.
        - ***<u>Authors' Note</u>***: *So, for example, the client creates a SLAT in AK and does a note sale. The spillover is to a GRAT. Perhaps that GRAT should be established in Nevada with a different trustee, different state law, etc.*
    - None? Wandry
    - Consideration Adjustment – King
    - Have some value pass to party on back end – the receptacle. If you only just do a lid (dollar value clause reflecting what goes to taxable transferee so when you report for gift tax purposes the entity on the back end gets nothing of value it plays into an argument of the IRS in Christenson and Petter that the gift to that entity e.g. charity is conditional. That makes it difficult to qualify for the charitable deduction. If there is a large value going to charity as the transaction as reported this argument is more difficult for the IRS to argue that the charitable spill over is conditional.
    - ***<u>Authors' Note</u>***: *It might suffice, for example, to have 1/10th% interest in the entity involved given to a DAF or funded (with cash to cover initial annuity payments) to a GRAT, etc. to have the receptacle entity have "skin in the game." Also, then the entity will receive a K-1, report an interest for income tax purposes, etc. But as discussed above in the Smaldino case, be certain that the reporting on those returns is correct. If the GRAT received 1/10% of ABC LLC and the spillover under the defined valuation mechanisms, be certain that the legal documentation and grantor trust return for the GRAT reflect that it owns the actual interests it has rights to. Example "1/10% plus, for example, any excess value as defined pursuant to a defined value mechanism contained in a Stock Purchase and Sale Agreement dated 1/2/21."*
- Installment Sales to IDGT's – IRS is making some unique arguments.
    - Background.
        - Freeze value of units at date of gift and sale.
        - No capital gains tax.
        - Taxpayer pays all income tax.
    - Typical Structure gifts "seed" portion of an LP. There is then a sale of units from grantor to trust. Trust is a grantor trust. Growth is transitioned to trust for estate tax purposes. Income tax remains obligation of grantor.
    - *Pierre* issue – Step transaction issue. If sale and gift occur on same day, IRS will collapse the transaction into part sale, part gift.
    - ***<u>Authors' Note</u>***: *The reality is that in some transactions, especially during the pressure in 2020-2021 to complete planning for fear the law might change during the midst of the plan, transactions may have been completed quickly. Also, the steps in a transaction may not have had as much time pass between them as*

would have been desirable if other circumstances had existed. Thus, clients might be reminded of the risk they took to complete planning on an expedited basis. If a practitioner has no choice but to use a compressed timeframe for planning be certain that the sequence of steps is clearly corroborated even if that means inserting the time that each document was signed.

    - Note received on sale.
        - 7872 is not a safe harbor for note at AFR. It is only an interest rate safe harbor and there are other factors to consider in determining value of note such as lack of security, lack of covenants, balloon payment at maturity. All these may create risk premiums that require adding a premium to the base line AFR. The IRS is trying to relitigate the *True* case. This is an argument from the national office.
        - How avoid this? Make note as commercially reasonable as possible. Consider security. Pay some over time. Porter believes this is a losing argument for the government.
        - ***Authors' Note****: If a sale is to an old and cold trust perhaps assets in addition to or other than the assets being purchased in the instant note sale can be pledged as collateral. Consider a pledge and escrow agreement and having title documents held by an independent or professional as escrow agent.*
    - Estate Tax Arguments
        - IRS is arguing 2036/2038 with respect to interest sold. Position is that only the interest is being sold.
        - *Woelbing/Beyer* cases
        - Only source of payment is income earned by the trust from distributions from LLC and the LLC then immediately uses funds to pay off note obligations. This plays into IRS 2036 challenge that decedent retained interests in the entity.
        - Speaker says IRS is wrong.
        - But if you have guarantor with sufficient financial substance and/or trust is properly seeded helps deflect this.
        - IRS makes this argument made in *Woelbing* and other cases.
        - See Philadelphia case.
- Split Dollar Life Insurance Area
    - *Morrissette* case – Taxpayer won the battle but may have lost war. Decedent created three dynasty trusts, one for each son. Sons were trustees of revocable trusts. Each dynasty trust secured life insurance policies on sons. Trusts provided that shares of sons would be purchased by trusts. Life insurance was to fund purchase. Decedent paid the premiums on insurance policies in a lump sum. Trusts entered into split dollar agreements with revocable trust so decedent's revocable trust would be reimbursed at greater of cash advanced or cash surrender value.
        - Valued rights at $7.5M. IRS asserted estate inclusion of the value of the insurance policies under Sections 2036,2038, 2703. Consent right was restricted and should be ignored under 2703.
            - 2036 Decedent had legitimate non-tax purpose to enter into agreement for management succession purposes.

        - 2038 also did not apply to include cash surrender values in decedent's gross estate.
        - 2703 provisions of split-dollar agreement that prevented decedent form withdrawing cash value were respected and were comparable to agreements in third party transactions in light of the brothers' acrimonious relationship.
      - Taxpayer win was that taxpayer had a non-tax purpose for the arrangement. Thus, 2036 did not apply to include insurance or proceeds. 2038 and 2071 also did not apply.
      - Valuation holding – Primary issues affecting value were the data to be used to derive the present value discount rate and the assumption regarding early termination. Court rejected life settlement yields to determine value. Court adopted assumption that policies would only be in place for about 4.5 years because family and advisers had discussed cancelling the policies and adviser insisted not to cancel until past 3 year audit period, etc.
      - Penalty applied because appraised value was not reasonable given the brothers paid $30m for split dollar rights.
      - Valuation of interests was under different regimes. You may have paid $30M for insurance policies and for split-dollar rights but whether a gift occurred at that time is determined under 7872 Regs. Valued under FMV principles. Insurance agent and estate planning attorney marketed this as an estate planning strategy and attorney made recommendations to the appraiser to reduce the value. All this had court determine no defense to penalties.
    - *Levine* case – Decedent created a life insurance trust in 2008 with South Dakota Trust as trustee. Beneficiaries were decedent's children and grandchildren.
      - ***Authors' Note****: See discussion in the Current Developments notes above.*
      - Investment Committee controlled decisions on policies was Larson a family business adviser not a family member and also POA agent.
      - ILIT borrowed money under split-dollar agreement from revocable trust. Payment to revocable trust was CSV or amount advanced.
      - Key fact is that only the ILIT through the investment committee could terminate insurance.
      - Decedent died 2009.
      - 2036/2038 – Decedent did not have a right, alone, or in conjunction with any other person, to terminate the policies or right to receive the cash surrender value of the policies because only the irrevocable trust had that right. Insurance trust was irrevocable. Decedent had not right to change.
      - 2703 – Court stated 2703 applies only to property interests held by decedent at the time of death which was a split dollar receivable.
        - Because there were no restrictions on the split dollar receivable, 2703 did not apply. Court said 2703 only applies to property held at death. She held a receivable and there were no restrictions on that receivable so 2703 doesn't apply.
- Service is also auditing transactions in GRATs.

- Do terms of GRAT comply with 2702 regs?
- Is the GRAT operated in accordance with terms?
  - Substantiation of annuity payments
  - *Atkinson* analysis – CCA 202152018 – Appraisal must consider possible acquisition.
    - Company was in process of being acquired before GRAT was funded.
- **Authors' Note:** Use a *King* or *Wandry* formula on funding the GRAT. Yes, a belt and suspenders on GRAT plans, rather than relying on just the GRAT Reg valuation adjustment mechanism of an annuity based on a percentage of the FMV of the assets, may not become the norm.
- Valuation
  - *Grieve* case – Initial Transfer of Assets – IRS is looking at this.
  - Exercise of power of substitution
  - Use of hard to value asset to pay annuity
  - Consider using *Wandry* or *King* provisions when transferring hard to value assets.
- Tax Affecting S Corporation Cash Flows
  - Should S corporation be reduced by corporate level taxes in a DCF analysis.
  - *Gross* case – and other cases say no. IRS is taking a hard line approach on this.
  - S Corporation Job Aid for IRS Valuation Analysts says "absent a compelling showing that unrelated parties dealing at arm's length would reduce the projected cash flows by a hypothetical entity level tax, no entity level tax should be applied in determining the cash flows of an electing S corporation.
  - Appraisal should address reasons for any benefit or detriment.
- 2036 – most litigated issue
  - Provides "The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decent has at any time made a transfer."
  - Is there a legitimate non-tax reason for creating the entity? Centralized asset management, protection from creditors, etc. etc. Document these at time the entity is created.
  - Satisfy bona fide sale for adequate and full consideration exception.
    - Interests proportionate and value of contributed property credited to capital accounts.
    - Significant and legitimate non-tax reasons for the entity.
- 2036(a)(2) – retained right to designate persons who will possess or enjoy assets contributed or income from assets
  - Do not allow senior family member to have unlimited discretion in making distributions. Use a business judgement reasonable discretion standard. Use standards such as needs to preserve assets.
  - *Powell* case –
    - Partnership created under POA 9 days before death.
    - Decedent in conjunction with other partners could dissolve partnership and could control timing of distributions.
    - To avoid Powell 2036(a)(2) vote with other partners, satisfy bona fide sale test for full and adequate consideration you avoid 2036 and 2038.

    - Consider 2 membership interests, one who cannot vote.
    - Or have senior family member dispose of all interests in the entity more than 3 years before death. If no 2036 string within 3 years of death than 2036 doesn't apply.
    - Allen case looked at this issue. Best advice is only a small sliver of interest dispose of it.
    - Could also terminate the interests before death.
    - ***Authors' Note****: The Powell case was based on awful facts. As such, some practitioners feel that an actual operating business as contrasted with a recently created securities entity, may not face these issues. Other practitioners have created special voting interests and have those sold (not gifted) to a different trust than used for the primary planning with independent trustees to separate the liquidation and distribution powers from the taxpayer (as well as the right to amend those provisions in the governing document).*

DESERVE HAS NOTHING TO DO WITH IT: DECONSTRUCTING THE SELF-DEALING RULES FOR PRIVATE FOUNDATIONS ("PF")
Presenter: Brad Bedingfield, Hemenway & Barnes LLP

- In 1969, Congress adopted a split approach with different rules applying to private foundations than those that apply to public charities. All charities are subject to private inurement rules. Private foundations are additionally subject to private foundation rules.
- There are fixed standards of what you cannot do. Getting away from relying on subjective interpretations required under prior law. Idea is that PF are working under the highest fiduciary standards.
  - Disqualified person is a "super fiduciary" as to the PF.
- General principles.
  - Assume all transactions are forbidden as a default.
  - Do not assume an arm's length financial transaction with a disqualified person is permissible, it is not.
  - Don't focus on the detriment to the PF or the benefit to the disqualified person, just focus on existence of the transaction.
  - If you rely on an exception to a self-dealing category assume it will be strictly construed. Get a PLR if you can.
  - Disqualified persons can provide stuff to PF for free.
  - Anything a PF provides to a disqualified person is likely a problem.
- Six Categories of Self-Dealing
  - Payments to Government officials
  - Sale, Exchange or Leasing of Property
    - IRC 4941(d)(1)(A)
    - There is an estate administration exception
  - Lending of Money or Other Extension of Credit
  - Furnishing Goods, Services, or Facilities
  - Payment of Compensation or Payment or Reimbursement of Expenses
  - Transfer to, or Use By or for the Benefit of, a Disqualified Person
- Disqualified Persons – super fiduciary at to PF.

- PF Funder
- Substantial Contributors
    - Once a substantial contributor, always a substantial contributor unless no contribution or involvement for over 10 year.
- Foundation Managers
    - Officer, director, trustee of foundation
    - Individual with similar powers
    - Person having authority or responsibility
- More than 20% Owner of substantial contributor
- Family Members
    - Spouse, ancestors, children, grandchildren, great grandchildren, spouses of the foregoing, NOT siblings and cousins
- 35% Entities. If you control 35% of an entity, that entity is deemed to be controlled by you, and therefore that entity will be treated as disqualified person if you are a disqualified person. This is stricter than just “control.” Sec. 4946.
- 4947(a)(1) Trusts.
- 4947(a)(2) split interests trusts.
- PF has subsidiary it controls then the subsidiary treated “as if” it were the PF for purposes of these rules.
- Newman’s Own exception to excess business holdings. C corporation wants to have a financial transaction with a disqualified person and as a corporate entity it is not thinking about these rules but as a controlled entity it must.

- Who Should Worry About Self-Dealing
    - Private Foundations
    - 4947(a)(1) trusts
    - 4947(a)2) split interest trusts
        - CRTs
        - CLTs
    - Estates and certain trusts to the extent of PF expectancies.
    - Entities controlled by private foundations
        - PF control
        - DP control
- What Happens if there is self-dealing?
    - Penalties on DP
        - No reasonable cause abatement.
    - Penalties on Foundation Manager
        - Requires knowing violation and there is a cap on liability
    - Must determine when self-dealing act occurred
        - Leasing, lending, use of property – new act of self-dealing each year
    - Must determine amount involved
        - Generally greater of FMV at time of transaction and FMV at time of correction
    - Transaction must be corrected to the extent possible.
    - Correction can be a new self-dealing transaction so care must be exercised in that regard.
    - Self-dealing is identified each year.

- Try to correct self-dealing issue in year it occurred or in the following year you will have another penalty tax for that year on the same issue.
- The penalty is calculated on the amount involved. That is not the excess benefit, rather it is the "amount involved." Not the net benefit. It is the greater of all amounts, not the net. It is actually worse as it is greater of FMV at time of transaction, or the time of correction and the latter can be much higher.

- Sale, Exchange or Leasing of Property
  - Doesn't matter whether detrimental to PF or beneficial to DP
  - Any sort of exchange qualifies
    - Ex. Using appreciated property to repay interest free loan
  - Transfer of encumbered property – treated as a sale
    - Even if non-recourse
    - Exception for old and cold debt
    - First bit exception where DP status arises as a result of the transaction
  - Be aware of indirect sales. Example, foundation has problematic asset e.g. real estate and private persons want it. You could give it to a public charity and that public charity may later decide to sell it to the person who was a disqualified person as to the PF. Be careful of pre-arranged sale.
    - Through controlled organizations or intermediaries.
  - Corporate Reorganization Exception 4941(d)(2)(F)
  - Estate Administration Exception. If estate has assets going to PF the estate itself may not be a disqualified person. If more than 35% of interests go to disqualified persons it may be. If you want to make a sale out of the estate the sale could be self-dealing you can do this if you meet certain requirements:
    - During reasonable administration of the estate.
    - Need court approval
    - Many people get PLR as well.
    - Consideration must be FMV and that has to be assured
    - What the PF is going to get is at least as liquid as what the PF was going to originally get.
    - Using options can avoid requirement to have power to sell or reallocate.
  - Leasing is in the category. Anything charged even at cost is not allowed. Self-Dealing rules do not care if you gave the PF a good deal.
  - If you have real estate and the PF wants to use it for an event. You can lease it for free. But can you make PF pay its own maintenance expenses? Yes, but the PF must directly pay third party service providers and cannot reimburse you under a lease.
  - Anything other than an interest free lease to a foundation is self-dealing. It is okay to required PF to pay for janitorial services, utilities, and other maintenance costs so long as they pay that directly to the service providers.
- Lending of Money or Other Extension of Credit
  - Anything other than interest free loan from DP to PF is forbidden
  - PF can never lend money to DP
  - Watch out for indirect lending
  - Instead of giving notes put notes in LLC and give non-voting interests to the PF. So PF holds non-voting LLC interests not prohibited notes. PF cannot control LLC or it would be equivalent of owning notes. IRS stopped ruling on these note

LLC plans last year. So no longer can get PLR. ***<u>Authors' Note</u>****: See discussion above concerning the concerns of this technique.*

- Furnishing Goods, Services, or Facilities
  - Anything other than free is going to result in tax and penalties
  - If goods, services, or facilities from PF, must be provided to DP on same terms as everyone else and must be functionally related to foundation's charitable activities.
- Compensation Reimbursement of Expenses
  - Exceptions dominate the discussion in this area.
  - Compensation can be paid if reasonable and necessary and it is for personal services.
  - *Madden* case. A disqualified person had organization hire his company to provide maintenance and custodial services. IRS said it was self-dealing. IRS said no when you look at the regulations the stuff the Regs permit is white collar types of services, not janitorial types of services. Tax Court agreed with this.
  - Expenses must not be excessive, may include various non-cash benefits so long as aggregate compensation is reasonable and not excessive. See Sec. 162 of Code.
  - Look at all payments and compensation in the aggregate to substantiate reasonableness.
  - PF needs a copier. You buy it at Staples and PF reimburses you.
  - That could be a problem.
  - Remember a rent-free lease can be a problem with respect to reimbursement of maintenance under the lease.
  - So need another exception to avoid problem with reimbursement transactions.
  - Were you engaged in personal services? Was it reasonable and necessary to the charitable function?
  - Exception must apply.
- Transfer to, or Use By or for the Benefit of, a Disqualified Person – IRC 4941(d)(1)(E)
  - There is a catch all provision that notes that this is not limited to examples in regulations.
  - Consider indirect as well as direct benefits to DP.
  - Classic example is co-investing. You and your PF invest in a private foundation but by bringing PF along you get over minimum required investment. That is a self-dealing transaction, and you will get tagged.
  - Artwork of PF displayed in your residence is a problem.
  - If individual makes a legally binding pledge to charity the PF cannot satisfy it as that is akin to the PF satisfying a debt. Most clients do not understand or expect this.
  - Incidental benefits, e.g., reputation benefits are OK.
  - Benefits that flow to general public are incidental as you and therefore may be OK.
- Special Situations
  - Family Office Sharing Resources
    - Payments for office space can't be done by reimbursement to FO (assuming FO is a DP).

        - Any equipment or supplies must be provided for free or PF should have its own.
        - Employees – apply exception for personal services that are professional in nature.

DON'T BE LOST IN THE TRANSLATION - A PRACTICAL GUIDE TO ESTATE ADMINISTRATION INVOLVING FOREIGN ASSETS AND BENEFICIARIES
Presenter: Akaine R. Suzuki, Perkins Cole LLP

- Always consider involving an attorney in the other country. Also, use a translator.
- Other countries may have inheritance laws that are based on family relationships. Children may have different rights. Same sex marriages may not be recognized. Heirs may have differing definitions. There are treaties between some countries that resolve some of the issues.
- What if Japanese citizen died owning WA movable property and decedent domiciled in WA? Japanese citizen. Japan would apply same rule above, but there is a conflict because WA would apply WA law. If parties cannot agree on a solution the different dispositive provisions may result in litigation.
- Guardianships – common to have international issues.
- Foreign assets
    - Estate assets located abroad.
    - Who inherits the property? Is there a will or intestacy?
    - Other countries do not necessarily apply the same laws as the U.S.
    - Some countries apply the law of the place of citizenship.
    - Other countries apply religious laws.
    - Conflict of Laws – Renvoi.
    - May depend on whether property is movable or immovable.
- Intestacy
    - Intestacy distribution applies. The question becomes an issue of which country's rules apply. In the US, generally, the intestacy law of the situs state will control the succession of immovable property while the intestacy law of decedent's domicile will control the succession of movable property.
    - Other countries may apply a different set of rules. They may look to citizenship or religion.
    - Renvoi – Conflict of laws may send you to another jurisdiction, which might send you back to the first jurisdiction.
    - Those with assets abroad should have wills which address the distribution of foreign assets.
- Will the U.S. Will be recognized by the other country?
    - Intestacy problem can be alleviated by executing a specific will.
    - If you use a US will to distribute foreign assets, you should check with counsel in the country where property is located to determine the validity of testamentary instruments.
- Hauge Convention on Wills
    - This is a treaty among certain countries related to will validity. US is not a signatory but many states have incorporated the convention rules into their laws.
    - Uniform Probate Code contains provisions that are similar to above rules.

- Washington Convention
  - Another treaty is the Convention Providing a Uniform Law on the Form of an International Will.
  - Some states have adopted.
- One will v. multiple wills – In some cases, it is preferable to have multiple wills rather than a single global will. One reason is language. Another is the difference in legal systems.
- Steps/considerations.
  - May need translation of the will.
  - Even if a will can be translated, the concepts from one country like US rule against perpetuities may not exist in the other country.
  - If various country laws are similar using one will might suffice, but if not, a separate will may be better.
- Is coverage of each will sufficiently clear as to which assets are located in which country and governed by which will? Are there assets in a third country not governed by either will?
- Forced Heirship.
  - Provide minimal level of protection for specified family members.
  - US has family allowance or spousal right of election to accomplish similar goals.
  - Determine if local law may override provisions in will. It could be against estate, or it may be a monetary claim against the estate.
  - It may be an outright prohibition so that a will that violates these rules might be void.
- Administrative matter.
  - Trusts generally create issues in civil law countries.
  - Pour over will to revocable trust may be problematic.
  - It may be difficult or impossible to title assets in a trust. In Japan as an example the banks do not offer trust accounts even though US trusts are recognized there.
- How are beneficiaries and trusts treated under other countries' laws? How civil law countries view trusts for tax purposes can raise additional complications and issues. Trust may be looked through and beneficiaries taxed. Or the trust or the trustee may instead be taxed.
- Marital Property Issues
  - In the US, a change of marital domicile will also result in change of the governing law that applies to property acquired after domicile change.
  - Globally, the rules vary significantly.
  - Prenuptial agreements may or may not be allowed.
  - Definition of spouse may vary from country to country. Some but not all countries recognize same sex marriages.
  - Common law marriages may or may not be valid in other countries.
  - Polygamy is illegal in the US but permitted in other countries.
- Inheritance Procedures
  - Common Law – UK, Australia, Canada – probate is mechanism.
  - Civil Law – There is no probate. Instead decedent's assets and liabilities vest immediately in heirs.
- Trusts

    - Many civil law countries do not recognize trusts. Even in countries that have laws allowing trusts, their treatment may be very different than in the U.S.
    - Even in countries that will recognize the pour-over will and revocable trust, it will be easier to deal with the foreign asset if the bequest of the foreign asset is in the will rather than the revocable trust.
- Death Tax Treatment
    - Estates of U.S. citizens and non-citizens who are domiciled in the U.S. are subject to U.S. estate tax.
    - If there is tax in another country as well then there will be double taxation and multiple deadlines.
    - Treaties exist that may prevent the effect of double taxation.
    - Other countries have different laws regarding marital deductions – check the treaty.
    - If trusts are being used, surprising tax results can occur even in countries that recognize trusts. For example, transfers to a revocable living trust are generally taxable in China and assets held inside a trusts are deemed sold every 21 years and subject to tax.
- Managing Tax Issues
    - Coordinate with foreign advisor to minimize double taxation.
    - Estate of US citizen decedents and non-citizen decedents who were domiciled in the US will be subject to worldwide taxation by the US.
    - IRC 2014 foreign death tax credit provides some relief form double taxation.
    - There may be treaty-based credits with some countries such as Australia, Austria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, South Africa, Switzerland, and United Kingdom.
    - There are two types of treaties. The older type is the "situs" type treaty. The newer type of treaty is based on the OECD Model Tax Convention.
- State Death Tax Issues
    - Tax treaties generally do not apply to state-level taxes.
- Foreign Asset Disclosure Issues
    - Executor may be subject to asset disclosure issues.
    - Estate has filing requirements
    - Decedent also had filing requirements – did the decedent comply?
    - Corrective action may be necessary
- Step up in Basis
    - This is a US concept that may not apply in other countries.
- Foreign Beneficiaries
    - Non-US citizens who live abroad
    - Foreign Tax Issues
        - Inheritance Tax – Beneficiaries may live in a country that imposes an inheritance tax.
        - Income Tax – Estate administration can impact income tax liabilities.
    - US Tax Issues
        - Executor must file a 1041 regardless of amount of income if estate has a nonresident beneficiary.
        - Tax withholding may be required.
- Communication is critical.

    - Don't assume pre-knowledge on US system by foreign attorneys.
    - Over explaining is better than under.
    - Be clear how long administration takes in the US.
- Nonresident Decedents
    - Procedure to Claim Assets
        - Probate in US will be required but it may be an ancillary probate if foreign country requires probate.
    - Tax Status – For trusts with foreign person as a trustee will cause trust to be a foreign trust for US income tax purposes.
    - Estate Tax
        - Domicile of Decedent – Estate of an individual who was neither a US citizen nor domiciled in the US is taxed on a limited basis by the US. Only property in US is included in gross estate of a nonresident decedent.
        - For a non-US citizen decedent who is not domiciled in the US, the estate tax return must be filed using Form 706-NA.
- Miscellaneous Practical Issues
    - Death certificate if decedent died outside U.S.
        - If decedent was U.S. citizen - contact the Consulate or U.S. Embassy in that country.
        - If decedent was non-citizen – get foreign death certificate, but need to get it authenticated. If country is member of Hague Convention, then apostille will work. Otherwise the government will provide a different way to authenticate.
    - Obtaining notarized signatures
        - U.S. Embassy or Consulate usually provide notarial services.
        - Obtain seal of foreign notary.
        - Electronic notaries – are they acceptable? Depends on where you are submitting the document. If it is a deed you may need to check with county to see what they will accept.

ETHICS AND PROFESSIONALISM IN TODAY'S SOCIETY: HOW TO DISCUSS, ADDRESS AND PROMOTE DIVERSITY, EQUITY AND INCLUSION IN YOUR TRUSTS AND ESTATES PRACTICE AND WITH CLIENTS
Presenters: Steven K. Mignogna, Gerard G. Brew, Crystal West Edwards, Terrence M. Franklin, Richard W. Nenno, Young Conaway Stargatt & Taylor LLP

- Few African Americans have estate plans. Terrence suggested this results from the history of African Americans and that education is part of the solution.
- Legal Decisions For Impaired Clients
    - 1515 Broad raises a host of issues regarding the differences between disability, diminished capacity, and legal incapacity.
    - Estate Planning should seek to avert crisis legal issues.
    - In 1515 Broad, Supreme Court indicated that absent a determination of incapacity through a full guardianship proceeding, decisions of possible incapacitated person had to be accepted. The role of a GAL is not to take control

of decision making but simply to make a recommendation as to whether a guardianship proceeding should be pursued.

- Mechanisms to avoid guardianships and preserve autonomy.
    - Supported Decision-making is evolving in some states. This is a less formal arrangement as an alternative to more restrictive arrangements like guardianships.
- Comments/Suggestions by Speakers:
    - Talk about privilege to raise awareness.
    - Institutional racism is difficult to overcome. Various communities benefit if unintentional missteps become teachable moments.
    - Let those younger know that they have value and it takes time to become authentic.
    - Don't let concerns about being different keep you from reaching out.
    - Be aware of the talents and contributions of all. Be respectful of handicap areas.
    - Work to educate yourself as to how the world differs from your own experience.

ONE HUNDRED PERCENT OF MARRIAGES END: ELECTIVE SHARE (AND COMMUNITY PROPERTY) FOR MODERN LOVE AND MIGRATING COUPLES
Presenter – Terry L. Turnipseed

- Some states provide that a surviving spouse can take a share of a decedent's estate regardless of the will provisions. The majority of the states are elective share states. The remaining states other than Georgia have community property regimes.
- Some states have amounts that provide for support of spouse and minor children.
- Several states have homestead exemptions.
- Elective share rules serve as restrictions on disposition of one's estate.
    - GA allows only one year of support. All other separate property jurisdictions have an elective share.
    - State rules can vary dramatically.
    - Elective share rules generally allow surviving spouse to choose between 1/3 and ½ of the deceased spouse's property and applies in both testate and intestate situations.
    - Augmented estate model includes non-probate as well as probate assets. Not all states use augmented estate model.
- 9 states include more than probate assets but less than a fully augmented estate.
- Community property laws do not restrict testamentary dispositions specifically but are a limitation on ownership of property acquired during marriage. These laws provide that each spouse is a one-half owner of property regardless of formal titling. Thus, a decedent may not have the right to dispose of more than the decedent's one half interest in community property, not because the law requires the decedent to leave a portion of the other half to the decedent does not own the other half at all.
- Community property.
    - If you practice in a separate property jurisdiction you must understand basics of community property.
    - 9 states are full community property states: TX, AZ, CA and others. These 9 states represent 1/4th US population.

- 5 states including AK, TN, FL, SD have opt-in community property and allow residents and in some cases non-residents to opt in.
- Earnings during the marriage of spouses while domiciled in a community property jurisdiction and assets purchased with those earnings are community property. The community property does not include assets that were owned before marriage unless commingled, those will remain separate property. It also generally does not include gifts or inheritances even if received during marriage if not commingled.
- ***Authors' Note****: Commingling is often an issue in any jurisdiction. If a client has premarital assets that are separate property, planning to reduce the risks of commingling may be advisable. Practitioners have to exercise caution in how they advise one spouse as to these matters if they are representing the couple. Also, be alert to the provisions of a prenuptial agreement. The corpus of the separate property may be deemed separate while the income might be stated to be marital. If that is the arrangement consider structuring a brokerage account for just those separate assets but have all of the income (as defined in the prenuptial) automatically paid to a joint account at the same institution. That may avoid the commingling that could create an accounting nightmare if there is a divorce in the future.*
- It does not matter how assets are titled.
- One-half of the community property belongs to each spouse.
- Unlike the elective share that only applies at death, the community property characterization attaches as soon as property comes to the marriage.
- Many community property states require the signature of both spouses to sell, gift, transfer, or mortgage property. So, it protects the spouse much better than in contrast than an elective share rule which can be more readily circumvented through planning.
- There are no elective share statutes in any community property jurisdiction. On death each spouse can do whatever they want with their one-half of the community property but the other spouse must get ½ of the community property.
- In 5 of the community property jurisdictions there is quasi-community property. This is important when moving between jurisdictions. Quasi community property is treated as real community property if they lived in a community property state when income was earned. So, if earned in a separate property jurisdiction when income was earned, and if that income/property would have been characterized as community property had they then lived in a community property state, then the property will be quasi-community property.
  - Example: Couple lived in NY and later moved to CA.Income earned during marriage while domiciled in NY is quasi-community property. What are the ramifications of this? On death of spouse the income/property would be quasi community property and the surviving spouse would be entitled to one-half of the quasi-community property and the community property.
- So what is the difference between quasi community property and real community property? If the non-earning spouse dies first, she would not have any right to devise quasi-community property. So quasi-community property rules are only relevant if the moneyed spouse dies first.

    - AZ, NM and TX have quasi community property for death but do for divorce. NV doesn't recognize quasi-community property for any case.
- The general purpose of the community property rules is to protect spouses and family members from being disinherited.
- Advantage of community property
    - When first spouse dies, the surviving spouse enjoys a step up in basis to both shares for appreciated assets.
- Move from separate property jurisdictions into a community property jurisdiction.
    - Raises issues for non-monied spouse.
    - Example:
        - In NY, H is banker and earns substantial sums and keeps in separate account. That is H's separate property.
        - Retire to TX or NM.
        - H has a will leaving his entire estate to children from a prior marriage.
        - Once retired, H doesn't earn more money. H has separate assets in his name and W has no asset in her name and no community property is produced since nothing earned in that new community property jurisdiction.
        - H dies. W gets nothing because they live in a community property jurisdiction, there is no community property for W to receive, and the state does not have an elective share regime.
- Alaska community property trusts
    - A client outside Alaska can create an Alaska community property trust and have the benefits of community property.
- Reasons a client may wish to limit the amount passing the spouse:
    - Multiple marriages and children from other marriages
    - Tax Planning – It may be more efficient to leave property to descendants rather than a spouse.
    - Preservation of Family Business
    - Strained Relationship with spouse/pending divorce
    - Medicaid eligibility
    - Spouse with significant assets or income
- Be aware of other states' elective share laws.
    - Community property will retain its character when owners move from a community property state to a separate property state. Community property can be converted to separate property in multiple ways, including agreement between spouses. This should be an intentional decision.
    - Spouses may be domiciled in different states.
    - Clients move.
    - A client may be a non-spouse beneficiary of an out-of-state decedent. Decedent's spouse may be entitled to an elective share.
    - Clients have property located in various states.
- Elective share.
    - There are many reasons to plan around elective share.
    - Pennell study of wills over 30 years in various jurisdictions and studied how often disinheritance happened. He found only 4% of those dying disinherited the spouse. So, it is a small percentage.

- Pennell found that more woman disinherited male spouses than vice versa.
- Planning around elective share if it is not desired.
  - Techniques to do this:
  - In 19 jurisdictions that only have elective share on probate assets just retitle assets to POD designations on bank and security accounts, if you have a retirement account change beneficiary designation (but if an ERISA plan you can have half go to someone other than spouse without spouse's signature but for IRA can redirect 100%). You can put assets in a revocable trust in most of these jurisdictions and avoid the elective share.
  - Be aware of look-back periods. Some states will include assets transferred to non-spouse within certain period of death.

- Strategies to Limit Marital Shares
  - POD designations. In 19 jurisdictions that only have elective share on probate assets just retitle assets to POD designations on bank and security accounts, if you have a retirement accounts change beneficiary designation (but if an ERISA plan you can have half go to someone other than spouse without spouse's signature but for IRA can redirect 100%). You can put assets in a revocable trust in most of these jurisdictions and avoid the elective share.
  - For Jurisdictions that include non-probate assets in elective share.
  - Some states, like Florida, have trusts that qualify to a certain degree to satisfy the elective share, so the elective share can be controlled.
  - Marital Agreements
    - Elective share can be waived in marital agreements. All jurisdictions allow a spouse to waive the elective share. Premarital agreement is safer/easier than postnuptial agreement.
      - An irrevocable life insurance policy or a lifetime QTIP may be offered to achieve the waiver.
    - A premarital agreement is typically better than a postnuptial agreement.
    - Strategic Lifetime Gifts
      - States with elective share rules typically have a look-back period. UPC has a 2 year look back. Most states don't have a look back so you can make a deathbed gift and it will avoid the elective share. Note that this is very different than most community property jurisdictions as this will not work without spousal consent in those jurisdictions.
    - Change domicile to a separate property jurisdiction, like GA, that does not recognize elective share. Or move to a state that has a probate only elective share state and then make gifts to avoid the elective share.
    - You can move to a community property state that does not have a quasi-community property jurisdiction.
    - Set up an offshore asset protection trust. The Cook Islands and Nevis have been historic locations for this. If FAPT done properly after 6 months assets won't be reachable on shore.
    - What about Treasury obligations? Federal law preempts state elective share law. There are federal laws that address who can be recipient on death of savings bonds and T bills. Theoretically this should pre-empt

state law and this concept should apply in all separate property jurisdictions.
        - ILIT
            - This may work in all states. Trustee purchases life insurance and beneficiaries named are other than surviving spouse.
            - In Florida, the net cash surrender value of life insurance is included in the estate but all of the death benefit is payable to the surviving spouse.
            - At death it should not be included in augmented estate.
            - Under UPC you must outlive setting up ILIT for 2 years.
        - Set up joint account with a third party and only ½ may be brought back into the augmented estate for elective share purposes.
        - Retitle assets to fall outside of the state.
        - Purchase Treasury Obligations.
        - Get Divorced.
        - Offer spouse a gift of property in exchange for waiving the elective share.
        - Satisfy the elective share in the most advantageous way possible.
- Abatement.
    - If abatement where do funds come from? Surviving spouse usually has "super" creditor status and comes before any other creditors. Varies whether traditional abatement rules apply. Residual devises would abate first. Then general advises. The demonstrative devises then finally specific devises. Does your jurisdiction allow elective share to reach non-probate assets?
    - If only can reach probate assets elective share won't help much. UPC has all assets abate pro-rata. Personal representative would have to go after beneficiaries of non-probate assets which is not easy to do.
    - Some states, like Florida, may allow certain trusts designed to satisfy elective share.
- Ethical considerations.
    - Is it ethical for attorney to assist client to plan around elective share? Speaker says it is not only ethical but may be malpractice if do not bring up elective share, explain to clients and let them make a decision. Should also bring up community property concepts.
    - If representing both spouses and one brings up planning around elective share, what do you do? It may depend on what is in the retainer agreement. Clean approach is not to continue to represent either party.
    - Can a trust satisfy elective share? Depends on jurisdiction.

NEW NORMS IN TRUST LAW
Presenter: M. Read Moore, McDermott Will & Emery LLP

- General concepts.
    - Perpetual trusts.
    - Moving situs to save taxes.
    - Learn from trust lawyers outside US. Much of what we think is new is from law offshore.

- There has been a reordering of trust law:
  - What is beneficiary entitled to?
  - To whom does trustee owe duty?
  - It is not just the state in which you practice but families have ties to many states and as trust law has changed some state are further ahead than others?
- What is the relevant trust law?

- Will discuss four topics.
  - Provision of information to trust beneficiaries
  - Decanting
  - Non judicial settlement agreements
  - Directed trusts
- Providing Trust Information to Beneficiaries
  - Overarching concepts
    - Beneficiaries have the right to enforce the trust and hold trustee accountable.
    - Trustee needs to have finality – the way is to provide information to beneficiaries and give them the opportunity to approve or complain about it.
  - UTC generally requires trustee to keep qualified beneficiaries of a trust reasonably informed about the administration of the trust and of the material facts for them to protect their interests. Initially information to be provided to beneficiaries was initially on a list of provisions that could not be changed.
  - Key Requirements
    - Within 60 days, trustee must notify beneficiaries of existence of trust, identify of settlor, and right to request a copy of the trust instrument.
    - Annual report of trust property, liabilities, receipts, and disbursements including the source and amount of trustee compensation. Report is not an accounting. All qualified beneficiaries can ask for copy of trust.
      - This is current beneficiaries.
      - Future beneficiaries who take if current beneficiaries cease
      - Designed beneficiary or distributee at termination of the trust.
    - One year from time of getting a report to bring a claim for breach. This is balancing of keeping beneficiaries informed and giving trustees finality in the administration of the trust.
  - UTC makes most of these rules non-modifiable. Most UTC states have modified these rules in some manner. This is most modified provision.
  - California requires a trustee to notify trust beneficiaries when a trust becomes irrevocable and provide them a copy of the trust instrument. California also provides detailed rules on what an account must contain, including all receipts and disbursements, trustee’s compensation, and identity of trustee’s agents, their relationship to trustee, and agents’ compensation.
  - Texas originally had a statute requiring trustees to provide reports and accountings. That was later repealed resulting in common law being applied. Beneficiaries do have a right to demand an accounting.
  - Silent Trusts

        - Maybe client doesn't want beneficiary to know about the trust for a period of time.
        - Can we limit the right of beneficiaries right to information but continue trust for benefit of the beneficiaries?
        - How do you strike a balance between the trustee's interest in finality, the beneficiaries' interest in enforcing the trust, and the grantor's intent?
            - Delaware requires communication of "essential facts". Trust can in DE provide information to designated representative who is a fiduciary and limit disclosures to beneficiaries for a period of time. So, it is substituting the designated representative for the beneficiary. Shifts responsibility to another fiduciary.
            - South Dakota provisions are optional.
                - Can provide information for period of time to a protector.
                - Allows settlor or a protector to limit disclosures to beneficiaries for a limited period of time. The protector not just the settlor can specify this.
                - The time period can be renewed.
                - 2 year statute of limitations on bringing breach of trust claims depending on when the beneficiary received information.
            - *Wilson* case – North Carolina – There were restrictive provisions regarding information to beneficiaries. Court said that provision essentially restricted the beneficiary from enforcing the trust.
            - *Zimmerman* case in Ohio essentially came to a similar conclusion indicating that beneficiaries need enough information to enforce a trust.
        - ***Authors' Note***: *Some clients feel very strongly that trusts should be silent. But have they really considered the implications to monitoring the trustee if the beneficiaries have limited or especially no information? From another lens these rules do not really consider the circumstances under which many trusts, especially during 2020-2021 were created. Many "moderate" wealth couples, e.g. those with estates of perhaps $6-40M may have created non-reciprocal* SLATs or for perhaps for estates in the smaller range or for single clients one irrevocable trust (perhaps a hybrid DAPT, SPAT, or even DAPT). The purpose of these trusts was to safeguard exemption but the focus was on providing access to the client as these funds might be needed in retirement. These clients may in particular view these trust assets as "theirs" and not for their heirs. They may view themselves as having taken prudent action to save heirs estate tax if the assets are not spent down by them. The requirements to notify beneficiaries may contradict and even may undermine the fundamental goals and objectives these clients had for the trusts. It may be worthwhile in some of such instances to change the situs and governing law of these trusts to a jurisdiction that will permit the trusts to remain silent during the client's lifetimes.
- Trust Decanting

- Decanting has become a hot topic and has introduced a huge amount of flexibility.
- Decanting is not new. In trust law in England a trustee with discretion could appoint in further trust and even to new beneficiaries (e.g., charity) if for the benefit of beneficiaries.
- This should be discussed with clients specifically. Including a decanting provision should not be done without specific discussion.
- Significant differences in state law exists.
- All states have addressed how much discretion a trustee must have in order to access a decanting power.
- Trustee must exercise decanting in accordance with fiduciary duties, which keeps decanting from being a power to appoint.
- Issues include:
  - Does the trustee have the power? If the trust is silent does the law provide it? Different states have different laws? If a different state law applies for construction does that state law apply? So the threshold issue is does the trustee have a decanting power and if so under what – trust document or which state law?
  - If the trust has a power to decant in it and there is also state law power to decant is that in addition to the trust? Probably yes, so that the trustee has both the trust document and state law decanting power. So which is the trustee exercising?
  - What type of discretion does the trustee have as that will determine scope of the decanting power.
    - Trustee cannot benefit themselves by executing it.
    - Cannot undermine tax intent and status.
  - It is a fiduciary power and has to be exercised in best interest of the beneficiaries and must be exercised in a manner consistent with Settlor's intent. Distinguish the powers of appointment are non-fiduciary powers.
  - All states have some form of notice requirement. May have to notify beneficiaries and other office holders. See. Different time periods required in different states. SD and NV have made notice optional.
  - Default rule in silent trust states still may require telling beneficiaries of a decanting. But in all cases fiduciaries must think about notice and impact on them.
  - Tax law consequences unclear. In 2011 IRS was going to issue Rev Proc on tax implications of decanting but it still has not happened. But practitioners have done so many speaker says it is understood what the tax implications are.
- Is there a duty for the trustee to decant? Law and Uniform Act seem to suggest that there is no duty to decant.
- *Hodges* case – Trustees were not entitled to be reimbursed for their fees in defending the trust. Eliminating a beneficiary who does not agree can't comport with fiduciary duties of trustee.

- Nonjudicial settlement agreement
  - American rule focuses on settlor's intent.
  - Even in a decanting, many trustees will get beneficiary consent.

- 1984 WA state started.
- Added to UTC and improved over the years.
- Permits addressing many trust issues without court involvement.
- Agreement can include anything related to a trust as long as it is something a court could issue an order on, and so long as it doesn't violate a material purpose of the trust.
- A dispute is not required even though the agreement is called a "settlement agreement."
- McGregor case – Trust modification violated material purpose of trust.
- UTC says you need court approval to terminate, or modification of trust and court must determine that no violation of intent of trust. Some states have modified and permit NJSA to modify a trust so long as it does not violate a material purpose of the trust and don't need court approval.
- UTC has man provisions but many state variations in how enacted.
- Virtual representation provisions make this work well. Problem with going to Court typically required an appointment of a guardian ad litem to have all beneficiaries represent especially for minor and unborn beneficiaries. UTC solved this problem by coming up with a comprehensive rules on representations for minor, unborn and other beneficiaries. There are categories of automatic representation, e.g. a parent can represent child. A person with a power can represent those affected. This does not always work perfectly because of possible conflicts. So a designated representative can act on behalf of the minors, etc.
- ***<u>Authors' Note</u>****: Many institutional trustees will endeavor to have the trust changes achieved through a non-judicial modification agreement ("NJMA") rather than via decanting so that they as trustee do not have the liability exposure associated with the decanting. However, if there are changes being made to protect a beneficiary against a lawsuit or divorce the beneficiary's participation in a NJMA may undermine the objective.*

- Directed Trusts
  - This is the area where there is the most activity.
  - Fiduciary and non-fiduciary decision-making roles are divided among officeholders.
  - 2015 Uniform Directed Trust Act.
  - Statutes and uniform act don't say protector/director does specified things. Rather in trust instrument you can specify. It provides a guide saying we have a concept of trust protector but if you draft it right and state has a statute we'll provide some of the terms.
  - SD has a detailed statute that provides what person does if you use specified names.
  - This strategy is almost always used when trusts are administered in offshore financial centers.
  - US attorneys have long used various offices and roles in trusts.
  - Some states follow the UTC. Other states, such as South Dakota have provided more detailed rules about the various roles.
  - This is the area of the most litigation in recent years. There are even cases offshore. Exercise care in drafting.

- *Authors Note: A key point is that the irrevocable trust is not so irrevocable anymore. Careful consideration should be given to discussion with the client about what aspects of the trust should be considered material and whether the client desires to incorporated any limitations on post-death changes.*

QUESTION AND ANSWER PANEL

- Proposed changes to grantor trust rules – Biden Greenbook
  - Will require that the grantor pay gift tax when paying income tax for the trust
    - Will not apply to trusts created on or before effective date except to the extent funded afterwards
  - Any sale by grantor to trust will be treated as a recognition event
    - Will apply to all trusts no matter when created if the transaction happens after the effective date
    - WILL affect GRATs
- Proposed changes to GRATs
  - Minimum 25% remainder interest
  - Minimum 10 years
  - Prohibit declining annuity payments
  - Effective for GRATs created on or after date of enactment
- Gain recognition.
  - Far reaching if adopted.
  - Can you have gain recognition when transfer during lifetime or death? Is it constitutional?
- Discussion on promissory notes
  - Valuation
  - Potential impact.
    - If you do an installment sale to a grantor trust and got back 7872 rate say federal mid-term rate. As rates declined can you swap a new note? Some argued that there was gift and income tax effects on doing that. You can substitute a lower rate if note doesn't prohibit prepayment.
    - ***<u>Authors' Note</u>****: Other commentators strongly disagree with the above. If the note doesn't prohibit prepayment there is nothing to stop the borrower from prepaying so why would there be a gift tax issue if the note rate is lowered. There is uncertainty as to this all however. Some practitioners suggest that if a note refinance is to be consummated the borrower should "sweeten" the pot for the lender to perhaps help deflect those gift arguments. For example, a principal payment might be made, the term of the loan may be shortened, etc. Other commentators are emphatic that these steps should not be necessary.*
    - Issue is if you loan money and get AFR note if it is a real note you have not made a gift. Treasury can issue Regs to cause consistency in the rules. In proposed Reg 20.7872-1 says AFR note is worth face when the holder dies. Proposed in 1985 but has never been adopted. Biden administration is going to force a rule that in the Code you have to do it since Treasury is not doing this. It means if you have a client dies with

AFR note you now use normal willing buyer and willing seller but if law forces us to use face value.
    - This might close down split-dollar loan regime. Treas Reg. 61-22 is there a gift issue under Levine? Speaker says don't do an economic benefit split dollar regime.
    - Under current law you can discount a split-dollar loan regime note but that may change.

- Proposed billionaire's tax
  - Speaker says it's a campaign pitch not a real tax proposal.
  - It applies to Households (how will that be defined) worth more than $100M.
  - Proposal would say that billionaires must pay their fair share of tax and "income" will include appreciation but not on collectibles. So question is whether they can tax unrealized appreciation. Manchin is against this and believes unrealized appreciation is not income.
  - Concern is wealthy people borrowing on appreciated assets.
    - JP Morgan has $282 Billion in loans in high net worth section.
  - Top 10 Billionaires would pay 215 Billion under the tax as that is a large number as over 10 years 360 Billion so 2/3rds will be paid by 10 people.
- SLATs
  - ***Authors' Note***: *See previous discussions and Authors Notes on this topic.*
  - What about a couple with one monied spouse and one non-monied spouse? *Smaldino* case – monied spouse made a gift to non-monied spouse who made SLAT for monied spouse – IRS treated as step transaction.
  - ***Authors' Note***: *The facts in Smaldino were unusually bad so that case may not be an ideal touchstone for better planned transactions.*
  - What happens if money from trust comes from joint bank account? No step transaction because each owns half the account.
  - Suppose spouse's own promissory note as joint tenants (contrast tenants in common each spouse owns 50% but in joint tenants that is ambiguous). They should each be able to make gift and each should be treated as having made gift of ½ of the note.
  - Other options if one spouse doesn't have enough assets? Monied spouse makes gift. Put assets in donee spouse own account, hires her own estate planner, waits many months, then perhaps no step transaction. Spouse with money can purchase assets for a note.
  - SLAT problem arises when spouses want to create SLATs for each other about the same time. IRS may take position that H created trust in consideration of W creating trust for him and vice versa. IRS could unravel and plan may fail. What is a sufficient time period that can lapse between creation of trusts? It is not really a time issue it is a question of intent. If there is only a short time between them that IRS will argue that there was an understanding. Different years might help. Create trusts with different terms. One trust could be for exclusive benefit of one spouse and other trust can only get access if he needs for support. Consider Blattmachr's idea of a special power of appointment trust ("SPAT") where power holder can exercise power so that may be a further difference. Different times and terms should work.
- INGs

    - Opportunity to make non-deductible expenses deductible? Yes, provided it is a legitimate administration expense and to the extent you have income in the trust.
    - See the McCouch article 30 VA Tax Review 419 (2020).
    - Adverse parties. You are adverse for one purpose but not for other purposes. See article Sept 2012 Journal Taxation Zeydel article on when a gift to a trust becomes complete. IRS won't issue rulings but so far has not said it will change its position.
- Completed gift
    - If trust provides that a distribution can be made only with the settlor's consent then transfers to the trust are not a completed gift.
- General powers of appointment
    - Modifying trusts to give GPA to a beneficiary to get a step up in basis
    - Discussion re requiring exercise only with consent of third party
    - Creating a cap on the power so that the beneficiary's exercise cannot exceed available exclusion at the time of death, maybe a little less to prevent requirement for estate tax return.
    - What if not sure about value of mother's estate or amount of exemption at her death. So you create a cap on the GPOA so the amount she can exercise doesn't exceed exemption minus what is in her estate less $10,000 for safety. That enables mother not to file an estate tax return.
    - GPOAs can be extremely flexible. You might only apply the GPOA to appreciated assets. You can construct it to only apply to assets with FMV in excess of basis.
    - ***<u>Authors' Note</u>****: Does making a GPOA so detailed and refined raise a greater concern that the power will be viewed negatively by a court?*
- CRUTs for retirement benefits
    - Create an income only charitable remainder unitrust to receive retirement benefits
    - Create disregarded entity – LLC or partnership – and name the LLC (which is owned by the CRUT) as the beneficiary.
        - If have IRA paid to someone on Medicare they may lose benefits.
        - Want IRA protected from creditors.
        - Want pay out over long period of time.
    - Create lifetime income only CRUT.
        - For 20 years or lifetime trust will pay lesser of the CRTs fiduciary accounting income (FAI) or trust income.
        - You can pay 11% for each year for 20 years and fall within 664 10% remainder requirement.
        - Create a single member LLC disregarded. Name the LLC owned by NIMCRUT as the beneficiary of IRA. Income that comes in will be paid to LLC. It will be attributed to the CRT as the sole member. CRT can accumulate or report the gross income. Yet CRT is exempt from income tax. It is not UBT. But because it is held in the LLC there is no requirement to make a distribution since CRT will not have any FAI. When you want FAI you can have the LLC make a distribution to the CRT and then to that extent, including making up for prior years when less than income was paid out, the CRT will pay out and income tax will be incurred.

        - Negative tiers of income. Anything paid out may be ordinary income. But if favorable taxation, e.g. capital gains, you may get favorable rights.
        - You do lose the actuarial value of 10% of the CRT at death.
        - Need independent manager for LLC or otherwise you will have trust accounting income in the CRT.
    - CRT reports all of the gross income and is entirely exempt from income tax
    - Because held in LLC there is no requirement to make a distribution because the CRT will not have any fiduciary accounting income.
    - When you want fiduciary accounting income you have the LLC make a distribution to the CRT.
    - May 2020 Issue of Estate Planning Magazine by JB, Matt Blattmachr, and Richard Fox
    - Can it be a lifetime trust or limited to 20 years? No authority.
- Adequate disclosure
    - In this question, there is a 3 page appraisal by the CPA with the first two pages a list of securities and then 1 page about discounts.
    - Not enough. Need to explain how to explain factors, etc. Simple statement of a discount is not adequate.
    - ***<u>Authors' Note</u>****: Practitioners might also view an obviously inadequate appraisal as a concern as they may be deemed preparers of the return. If an appraisal is clearly inadequate perhaps the client may be warned in writing that the statue of limitations may not be tolled as the adequate disclosure rules might not be met. But consider the GRAT CCA above. If there is such a flagrant violation of the requirements for a "qualified appraisal" might their be worse consequences? What about penalties? If the appraisal is so inadequate might the IRS negate a Wandry or other mechanism that was supposed to apply as being in such bad faith as to be disregarded?*
- FLP with securities.
    - Fact pattern: Give away LP interests. Appraisal is done by CPA and is 3 pages long. Claims 25% lack of marketability and control discount. Is that adequate disclosure to start the statute of limitations running? 301-6501(c)-1(f). Under broad adequate disclosure rules that is not enough. You need to explain how you arrived at a discount, etc.
- Community property trusts
    - Florida is the latest state to join in the community property trust statutes
        - Community property not community property if taken out of trust - may not be respected as community property
    - Historical discussion re Alaska Community Property Act
    - *Angerhofer v. Commissioner*
    - On the first spouse's death, the survivor may benefit from a step-up in basis on 100% of an appreciated asset.
    - WI adopted uniform marital property act (UMPA). IRS issued ruling that it is treated as community property.
    - AK statute follows UMPA rights and liabilities with option for AK couples to opt in or for non-AK couples to create a trust and option to declare it to be community property. 1998. KY, SD, TN, FL have created similar statutes. But KY, SD and FL

doesn't have community property law. Blattmachr questions whether it will work in those states.

- How do you gift to avoid 2036, *Powell, Strangi,* etc.
    - ***Authors' Note****: See Authors Note above explaining different views of this issue and another planning approach some use.*
    - Nub of problem is 2036(a)(2) is if decedent in conjunction with others can control enjoyment unless you can demonstrate a non-tax purpose (which is a risk). Best way to create entity is to never be involved in the entity. Do it through an incomplete gift trust (doesn't have to be an ING).
    - Take $10M to put into an LLC or partnership. Put $10M into a grantor with children or others as trustee. Trust can have no beneficiaries during your lifetime. At death you can have a special power of appointment to designate where assets go. Then trustee can fund LLC and retain a 1% vote and sell 99% to another trust the non-voting interests. Then after some interval can dispose the 1% and taxpayer has never touched the transaction.
    - Should be difficult for IRS to apply 2036(a)(2) to this arrangement.
    - The fatal flaw may be the client having control.
- Could give client the right to remove children as trustees.
- Corporate transparency act – is a charitable entity required to report? NO. 501(c) exempt.

ELDER LAW AND SPECIAL NEEDS PLANNING
Presenters – Bernard A. Krooks, Littman Krooks LLP; Robert B. Fleming, Fleming & Curti, PLC

- Long Term Care
    - Average annual cost of long term care can readily exceed $100,000.
    - Medicare covers only nursing care and only some of it.
    - Custodial care is not covered.
    - Can you self-insure?
        - What may be needed to self-insure varies. One of the issues is whether a client is concerned only with making sure that he or she has sufficient assets to achieve care for life or if the client wants to ensure something is left for children.
    - Can divorce let my spouse get benefits for me?
        - Medicaid divorce can work in some states. Premarital agreements that limit requirements to pay are typically disregarded by the government.
    - Advance planning regarding financial and medical decisions are best addressed early.
    - Some clients consider writing the child with a disability out of their will and hope the siblings will take care of the disabled beneficiary. Generally, it is best to create a trust strategy that will provide for the disabled child.
    - Care should be exercised regarding naming family members as trustees.
- Long Term Care
    - Home. Most clients prefer to stay at home if possible. Home care can be very expensive. There is also a higher risk of abuse.

- Assisted living facility. This is an option for those who cannot or do not want to remain at home and require less care than a skilled facility will provide. Assisted living is typically custodial care in an apartment like setting. There are some restrictions and requirements on residents that would not apply at home. There is very limited regulation on assisted living facilities. When someone moves in to assisted living, consideration should be given to what happens when additional care is needed.
- Nursing Home. Skilled nursing facilities participate in Medicare and Medicaid programs and their attendant regulations. Nursing home cannot require a third party guarantee of payment but can require a facility representative.
- Continuing Care Retirement Community
  - CCRC's offer the entire residential continuum from independent housing to assisted living to nursing home care.
  - Venture capital is starting to get into this market.
  - CCRC's can be very expensive.

- Planning and Paying for Long-term Care
  - Private Pay. If paying privately, consideration should be given to the availability of any tax benefits.
  - Medicare. Medicare is a federally funded health insurance program administered by CMS and designed to provide basic medical care to people over 65 and older and individuals receiving social security disability. Medicare coverage is limited in many respects and there are numerous deductibles and co-payments required.
  - Medicare is a secondary payer. Thus, if an individual is employed and covered by his employer's health insurance, that insurance must provide coverage before Medicare will pay.
    - Enrollment. There is a seven month period to enroll beginning three months after someone turns 65. If period is missed, next period begins January 1 to March 31 but Medicare doesn't cover until July 1. There is a late penalty fee for those who do not enroll within the seven month period. This is a permanent penalty that must be paid as long as enrolled on Medicare. There may be an exception for those over 65 actively working.
    - Part A. This covers inpatient hospital stays, hospice and limited skilled nursing and home health care costs. Individuals who have worked for 10 years or more and paid at least 40 quarters of Medicare taxes will receive Part A at no charge. Otherwise premiums can be as much as $471 per month. Part A has a hospital deductible and then co-insurance. Skilled nursing care under Part A is limited. Medicare will cover up to 100 days per benefit period provided patient had a three day qualifying hospital stay immediately prior.
    - Part B. Part B covers doctor visits, outpatient procedures, diagnostic tests, medical supplies, vaccines, and certain screenings. There is a premium for Part B which varies based on income.
    - Part C. This is often referred to as the Medicare Advantage Plan. This is offered through Medicare approved private health insurance plans for individuals enrolled in Parts A and B. Benefits are received through Medicare Advantage Plan rather than through original Medicare.

    - Medicare Advantage plans provide all Part A and Part B benefits as well as certain other additional benefits such as vision, dental and hearing.
    - Part D. This is prescription drug coverage covered by insurance companies.
    - Medicare supplemental insurance (Medigap). This is supplemental health insurance sold by private companies to cover co-payments, co-insurance, and deductibles.
- Medicaid
    - This program provides medical care to the indigent and disabled. Medicaid is a payer of last resort. Each state has its own policies and interpretations of the federal rules. Medicaid is a third party payor. The Affordable Care Act created a new category of Medicaid called MAGI.
    - Medicaid eligibility. Medicaid may be eligible for those who are over age 65 or those who are blind or disabled. In some states, those who receive SSI qualify for Medicaid. An individual must be a US citizen, permanent resident or qualified alien.
    - Income and resource limits. States set their own rules within federal limits. There is significant variation. Not all states have an income cap.
    - Resources. A Medicaid recipient has limitations on resources, which vary by state. Certain assets are exempt (care, home in which individual or spouse is living).
- Transfers of Assets
    - There is a look back period that applies to Medicaid.
    - Most states do not require liquidation of a life estate; however if life estate is transferred during eligibility period, then a determination must be made that FMV was received.
    - If someone's name is added to an account in a way that limits the rights of the transferor, it may be considered a transfer for Medicaid purposes.
- Exempt Assets.
    - Retirement Accounts. Some states exempt retirement accounts if they are in payout status.
    - Annuities. Annuity will be non-exempt unless it is irrevocable, non-assignable, actuarially sound, and provides for equal payments during the term of the annuity with no deferral or balloon payments.
    - Promissory note. Note may be exempt if note is actuarially sound, has a reasonable rate of interest, with no deferral or balloon payments made and prohibit cancellation upon death of lender.
    - Residence. Primary residence is exempt with a cap on value.
    - Funeral/burial arrangements. Such expenses can be prepaid.
- Trusts.
    - Revocable trust is typically a resource.
    - Irrevocable trust. To the extent individual transfers and does not have access, a transfer to an irrevocable trust will be considered a transfer for less than FMV. Any trust which can be paid to or for the benefit of an individual will be an available resource. These rules apply to trusts which are created by individual, individual's spouse, by a person acting at

request or direction of individual or spouse or by a court with legal authority to act on behalf of individual or spouse.
        - Exception Trusts. These trusts are required to be disregarded in determining Medicaid eligibility.
        - Special Needs Trust. This is a trust for a disabled individual under 65. Some states require that all Medicaid costs be paid back.
        - Qualified Income or Miller trust. This is a trust established for a benefit of an individual in an income cap state if trust assets consist only of pension, social security and other income and state receives all amounts remaining in trust upon death of beneficiary up to amount paid by Medicaid.
        - Pooled Trust. This is a trust established by a non-profit association for a person who is disabled.
    - Getting Someone Eligible for Medicaid
        - Spend-down assets of person who needs to qualify. A spend-down can be planned out.
        - Convert assets to exempt property. Most states exempt the home as long as one spouse is living in the home. One option in the spend-down phase is to improve the home in a manner to allow the client to remain home as long as possible.
        - Convert assets to income for community spouse
        - Gifts
            - Be aware of lookback period. Gifts made during the lookback period will be considered a resource.
            - Ineligibility calculation. Calculating eligibility or ineligibility is a matter of very specific math that must be done accurately.
- Special Considerations for Spouses.
    - There are various federal protections for spouses.
        - Spouse will have an income allowance.
        - Spouse will have a resource allowance.
- Liens and Estate Recovery
    - States may not impose a lien on a Medicaid recipient's property prior to death based on individual's receipt of Medicaid institutional benefits unless the individual incorrectly received Medicaid benefits or when individual can reasonably be expected not to be released.
    - States are required by federal law to have an estate recovery program.
- Long Term Care Insurance
    - Long term care is regulated by the states.
    - Eligibility. Most states have a maximum age. Individuals must pass a physical and cognitive exam. Coverage typically has dollar limits and time limits. There may also be limits on providers of care and limits on coverage. LTCI often pays for custodial care.
    - Benefits paid pursuant to a long term care policy are typically are not subject to income tax.
    - There are state partnership policies that combine LTCI and Medicaid.
    - A newer product is short term care insurance.

    - *Authors' Note: Historically, long term care policies offered guaranteed premiums but such a product is currently very unusual. In recent years, hybrid products (combining long term care features with a death benefit) have become common.*
- Special Needs Planning
  - Types of special need trust:
    - Self -settled trust
    - Third Party Trust
    - Sole benefit
  - Public Benefits
    - SSD and unable to perform any gainful activity – Medicare
    - SSI Asset and Income criteria
  - First Party trusts
    - These are self settled payback trusts. Assets often come from a personal injury lawsuit.
    - 42 USC 1396p(d)(4)(A)
  - Third Party Special Needs Trust
    - Trust is created and funded with assets belonging to someone else other than the disabled person.
    - There is no requirement that "special needs" be used in the trust name.
    - There is no requirement to payback the remainder to cover Medicaid costs.
    - Special needs language is not required generally but likely should be included because some states do require it.
  - ABLE accounts

Each state can choose whether to have a program. An ABLE account, also known as a 529A account, can be created for eligible people with disabilities. States. These accounts have tax advantaged. There are limits on contributions and total value and such accounts should be coordinated with any special needs trust.

ETHICS OF FIXING BAD MOVES
Presenters: Wolven; Loomis-Price, Perry

- Some follow up regarding yesterday's presentation based on questions.
- Estate planning questionnaires are important.
  - Gives relevant information to attorney.
  - Document the factual background provided by client.
  - ***Authors' Note****: Consider as standard steps having clients provide a signed balance sheet, family data, as well as the questionnaire. Also, consider sending any documentation the adviser creates back to the client for confirmation if there are errors in it to reinforce the facts that the practitioner is relying upon to plan. Consider the strong language in the Levine case about having detailed planning memorandum. Those memorandum could recite facts to confirm them as well as highlight risks and issues in planning (and if no planning is done), etc.*
- Drafting Errors
  - Sometimes errors are blatant and sometimes just as not as precise as could be and creates ambiguity.
  - We are human and mistakes happen.
  - Ideal situation is to have everything reviewed by a second set of eyes.

- If solo and don't have staff have paralegal review certain provisions and at least proofread.
- ***Authors' Note***: *To what extent might document generation software reduce these risks? Not only is there a dedicated professional team creating the documentation but there is crowd-sourced comments. If a document generation program has 1,000 + users that is 1,000+ practitioners potentially reviewing language and provisions and commenting on them. What firm has that many professionals to ponder the terms of various provisions?*

- Ethics violations
  - Can be inadvertent. Ex: conflict check system did not work and firm ended up representing adverse parties.
  - Inadvertent disclosures. Most Federal and state rules have claw-back rules that allow us to get those back.
  - Do you have a duty to inform client if email sent to the wrong person?
- Administrative errors
  - Example: failure to get a witness signature to a document that requires a witness signature.
  - *Frederick vs. Warwick*.
    - Failure to witness prenuptial agreement and it was incorporated by reference into the will. But without witnesses it was invalid.
    - 6 years later divorce and court held prenuptial agreement invalid.
    - Each time there was a codicil or new will referencing the invalid prenuptial agreement was a separate cause of action.
- Duties and Obligations re honest mistakes
  - Duties to clients
    - Model rule 1.4. Reasonably informed client and client needs to be able to make reasonably informed decisions.
    - Advise client about mistake.
    - Can the situation be fixed? Advise client about solution.
    - Be pro-active.
    - Communicate issues with the clients
    - Issue of tolling.
    - Is there a way to resolve practically, like paying a penalty.
  - Duty to report to firm
    - Does the firm have a policy with respect to reporting mistakes?
    - Create a culture of reporting.
  - Malpractice carrier
    - Prompt notice of claims or potential claims.
    - Read the policy carefully. Be aware of any exclusions.
    - Contact insurance broker first if a good resource.
    - Get a good broker.
    - Call broker before calling insurance company as experienced broker may be able to give guidance as to how to proceed.
    - How do you report?
    - Consequences of reporting or not?

        - Accurately complete annual insurance application. Don't just check the boxes. Has something happened in the past year that might develop into a claim?
        - Speak to general counsel and carrier do not talk to other parties as you are now the client and you may ruin privilege.
- *Pelagotti* case. Cautionary tale about accurately completing annual insurance application.
- Minimizing Risk of Mistakes
    - Vet the client. If something feels off, reject.
    - Good conflict process. Cautious about waiving conflicts.
    - Good engagement letter, with headings.
    - Joint representation – requires additional language in engagement agreement and explain what happens if a conflict arises. Be clear.
    - Letter once estate planning project is complete? Maybe not for ongoing engagement.
    - Communicate frequently with client and ask whether goals have changed.
- *Bar Association versus Johnson*. Several complaints against the attorney by different clients.
- If you meet with someone that you do not represent, have a no-representation letter.
- Use checklists and calendar reminders.
- Be very cautious about initiating a fee dispute. May lead to malpractice claim, also may lead to reputational damage.

DOMESTIC PRIVATE PLACEMENT LIFE INSURANCE – IT AIN'T SO PRIVATE ANYMORE
Presenters: Mary Ann Mancini, Loeb & Loeb LLP; Lawrence Brody, Harrison & Held, LLP; Mike Cohn, Cohn Financial Group

- Domestic Private Placement Life Insurance (PPLI)
    - Really Private Placement Variable Universal Life (PPVUL)
        - Allow tax-deferred investment opportunities
        - Withdrawal earnings on a tax-free basis
        - Lower costs than traditional LI
        - Death benefit may be less important than the tax-deferred investment growth
        - Are "Securities" for SEC purposes and a prospectus is available
            - Policy owner must be accredited investor or qualified purchaser
        - Assumption is that in the long run equity driven returns will be greater than interest driven returns
- Advantages of being treated as LI
    - Distributions can be tax free when structured properly
    - Earnings are tax-deferred
    - Death benefit is generally tax free to the beneficiary
    - Exchanges can be tax free
    - May provide asset protection in those jurisdictions where cash values are shielded from claims of creditors
- Why PPVUL
    - Can have more transparency
    - Pricing can be more favorable

- Mortality charges are lower as less death benefit is desired compared to desire for tax free growth
- Typically little to no surrender charges that would be encountered with traditional LI

- Private placement.
  - 2002-3 came onshore after publication of important rulings.
  - 2002 IRS identified ways a policy holder could add money managers to an insurance dedicated fund. If met guidelines for IDF (insurance dedicated fund) guidelines.
  - This is an extension of VUL with IDFs.
  - PPLI is a security so policy owner must be a qualified purchaser (QP) and accredited investor (AI). Different rules for trusts, LLCs, individuals, etc.
  - Can add hedge funds and private equity (some of obstacles have been eliminated).
  - Pricing on PPLI is less than retail life insurance.
  - There is transparency you may not have on other products.
  - Commissions are lower and often negotiated perhaps 1-2% of premiums paid.
  - Cost of insurance charges are comparable to retail product but clients in private placement is usually buying the least amount of life insurance necessary to not be characterized as a MEC so it is a "different conversation." Because of this mortality charges are lower.
  - Come in single life or survivorship.
  - Private placement product can be designed with adviser and client to meet client objectives and be as economical as possible.
  - With bond yields low there has been a lot of interest of adding credit managers to the platforms.
  - Some carriers permit SMAs = separately managed accounts.
  - When designing PPLI policy consider cash value accumulation test or guideline test. Policy owner can decide which test insurance company should use. Cash value accumulation test maintains constant corridor between cash values and death benefit.
  - PPLI does not have a surrender charge you would normally have in traditional life insurance but may have income tax implications on termination.
  - Consider insurance carriers capacity in the private placement space and whether they will have to use reinsurance.
  - Within IDF it satisfies diversity requirements for Sec. 817 because IDF satisfies the requirements. You don't get this benefit with an SMA. Test quarterly and if a violation, have a 60-90 day period to correct it.
  - Also get attestation from manager that there is no violation of investor control rule. Family offices often want input into manager's control. Generally must give discretion to manager or investor control rules may be violated. Prohibition against client communicating with manager as to how IDF is doing. The manager can only communicate on broad big picture concepts, not on specifics. If don't want to give discretion to manager maybe should not use IDFs. There may be 100 well known mutual funds as well as 40-60 IDFs and SMAs so there is a lot of opportunities. Clients can move between managers on the platform, subject to

lock ups of manager. There are no income tax costs on move since it is inside the policy.

  - 1035 rules apply to PPLI and VUL. People who bought large amounts of life insurance they no longer need they can 1035 into VUL or PPLI and eliminate premiums or have a more efficient structure and broader access to investments.
    - 1035 requires same insured and same entity.
    - Insurance in ILIT who wants to 1035 into PPLI may not meet the rules. May have to distribute to LLC in which ILIT has interests and LLC may then buy the product.
  - Insured must be insurable at that point to do the exchange.
- Accredited Investors
  - Individual worth $1M or more including home.
  - Individual with $200K in income for past two years
  - Individual and spouse with $300K or more in income for past two years
  - Corp, Partnership, LLC, trust, or TE organization with assets exceeding $5M
  - Entity where all owners are accredited investors
  - Trust with a bank trustee
  - Rev Trust where grantor is accredited investor
- Qualified Purchaser
  - Individual that owns at least $5M in liquid assets
  - Family business or trust that owns at least $5M in qualified investments and was not formed to purchase the LI
  - Entity where each owner is a qualified purchaser
  - Trust or exempt organization not formed for purpose of purchasing the LI and decision makers are qualified purchaser
- Irrevocable Trust can be accredited investor if
  - Total assets exceed $5M
  - Not formed for purpose of purchasing LI
  - Managed by sophisticated person
  - OR if bank is a trustee or co-trustee which makes investment decisions
- Planning Opportunities
  - May have greater death benefit in the long run than traditional LI if investments are managed correctly
  - Could be used with non-qualified retirement planning to increase retention of employees particularly with Family Offices
  - Split Dollar deferred compensation plans due to potential for increasing cash values
  - Premium flexibility as premiums may be more or less, skipped, started up again if needed
  - Consider PPLI to provide benefits to fund a plan for top executives in family office. This can be attractive. This might give family office executives ability to participate in investments they would not otherwise have been able to participate in.
- Investor Control
  - Owner of PPVUL cannot exercise too much control or policy will be ignored and will be treated as if assets were owned directly by policy owner and subject to tax on income and gains
  - Policy owner may pick investment manager, but should not have control over specific investment assets. Limitations on the owner’s right to control the investments:

        - Insurer must be the owner of the separate accounts, not the policy owner
        - Can be no arrangement or plan with investment advisor on availability of specific assets
        - Investment decisions regarding what assets are to be available must be in the investment advisor alone
        - Policy owner may not communicate with investment advisor regarding selection of any investments
        - Policy owner has no legal or equitable interest in any assets owned by the insurance carrier
        - All decisions on the choice of investment advisor rest solely with the insurance company
- Minimum investment for domestic PPVUL is $250,000 for 4 years
    - Premium financing.
        - Anticipation that interest rates will increase this year.
        - Most clients who engage in premium financing buy general account products. These are product back by insurance company assets.
        - VUL and PPLI fall under Reg. U.
        - In PPLI when allocating to unregistered securities with long lock ups lenders look to be able to cash in policy. PPLI is not used for collateral purposes in premium financing. May do "loan re-loan" arrangement. Bank makes loan to client and client re-loans to entity or ILIT to buy PPLI with AFR pricing. The AFR loan becomes an asset in the estate of the owner. Reg U is the margin loan rule. Because PPLI and VUL are securities lending to purchase a security is a margin transaction and banks are limited to 50%. AFR is likely lower than the bank lending rate. But the client's loan may be a margin loan and that may have to be an unsecured loan transaction.

THURSDAY, MARCH 31, 2022

WHEN CHARITY DOES NOT END AT HOME – OPTIONS FOR TAX EFFECTIVE INTERNATIONAL GIVING
Presenter: Martin Hall

- Rev Rul 63-52.
- Foundation.
    - Minimum distribution requirements under 4942.
    - Foundation must determine if it has made adequate qualified distributions to equal or exceed this requirement if not an excess tax is owed and if not corrected another tax will be owed.
    - Foreign grants qualify but
        - Must be made only for charitable purposes.
        - One of 4 situations must be met
            - Grantee is foreign governmental unit and grant is for charitable purposes.
            - IRS determination letter that foreign charity is public supported charity.

        - Grantee is foreign organization with respect to which the private foundation has made a good faith determination that the grantee is equivalent to a US supported charity..
            - Rev Proc 2017-53.
            - Each PF must make its own determination and cannot rely on determination of another charity.
        - PF exercises expenditure responsibility over foreign charity.
    - Foreign grantee must show that it meets minimum distribution requirements that apply to a US PF. That is problematic.
    - PF might not count the foreign grant for meeting 5% payout requirement, or it could earmark it for specific purchase.
  - Taxable expenditure requirement.
    - Taxable expenditure is an amount distributed to another organization.
    - In the foreign context either expenditure responsibility must be exercised, or an equivalency determination made.
- Donor advised fund (DAF).
  - Can it make a grant to a foreign charity?
  - Yes, but the sponsoring organization of the DAF must exercise expenditure responsibility with respect to the grant or must make good faith determination of an equivalency determination.
  - If a client wants to make a foreign grant through a DAF check with the sponsoring organization. Some prohibit. Others will do it but will charge a fee for the work involved.
  - There are DAFs that specialize in this to facilitate grants outside the US. Seek out these types of funds at the outset.
- Supporting organization rules.
  - Must avoid conduit and lack of control rules that apply with respect to allowing a deduction.
  - Using a US supporting organization for foreign charity it is complex and speaker avoids it.
- Other ways gifts may be made to foreign charities and deduction obtained.
  - Gifts through other types of trusts.
    - Taxable trusts.
      - A regular taxable trust.
      - Governing instrument must authorize distributions for charitable purposes.
      - Does not have a
      - It is not 170(c) deduction but rather under 642C which does not have a domestic restriction.
      - In many documents there is often a definition of charitable purposes in the boilerplate referring back to 170(c) so if you want to allow a regular taxable trust to make distributions to foreign charities look carefully at how the boilerplate refers to charity and that it does not include 170(c)
    - CRT.
      - Must have as beneficiary US domestic charities IRS Sec. 664 requires 170(c) charities only.

            - You cannot have a CRT set up for a foreign charity.
            - Savings provisions in most trusts will thwart donor's intent.
            - Do not use CRT during lifetime or at death for support of foreign charity.
        - Different results for each.
- Treaties.
    - Only 3 treaties address charitable giving. Congress doesn't view treaties as the appropriate place to add or address deductions.
- Transfer tax rules
    - No domestic requirement.
    - No requirement that use be limited to use in the US.
    - Must meet basic requirements.
        - Organized exclusively for charitable purposes.
            - Be careful some overseas organizations use term "foundation" but are not foundations as we know it and may provide for private benefit which would disqualify them for estate tax charitable deduction.
        - Cannot engage in political or lobbying activities.
    - Can get deduction for gift to foreign government but only if limited to charitable purposes.
- Gift tax rule.
    - Comparable to estate tax rules above.
    - No geographical limitation.
- Treaties that cover charitable gifts and bequests
    - There are 5 of them.
    - Should make inquiry when drafting will etc. to confirm that the organization is a charity.
- Rules that apply to non-resident aliens (NRA).
    - When can NRA get a deduction under US tax system for a charitable gift.
    - General rule is NRA is taxed on effectively connected US income and certain other US source income such as dividends paid by US corporations to the NRA.
    - NRA can only claim deductions related to effectively connected income.
        - Exception in Sec. 873 for income tax deduction for charitable gift provided the gift is made to a US charity (not a foreign charity) regardless of whether the deduction is connected to US trade or business income.
        - But to claim the deduction the NRA must file a US income tax return.
        - Most NRAs taxpayers particularly those just getting passive income such as dividends, are very reluctant to file income tax returns with the US government. If they don't file no deduction.
- Estate and gift tax rules that apply to estates of NRAs.
    - Estate tax rule.
        - Sec. 2106 estate of NRA decedent is allowed charitable deduction against US gross estate (stock in US corporations, US real estate, etc.)

        - For donations to domestic US corporations organized for religious purposes, cruelty to children or animals, or to trusts but only if bequest is to be used inside the US.
        - On the NRA the bequest must be domestic.
        - A gift to a trust bequeathed funds must be used in US.
    - Gift tax.
        - NRAs subject to gift tax on US situated property.
        - Charitable gift tax deduction is limited to only if gift is to a US corporation for charitable purposes, US governmental entity for exclusively public purposes, or to a trust that limits use within US.

SUCCESSION PLANNING FOR THE CLOSELY HELD BUSINESS: UNIVERSALLY UNIQUE
Presenter: Joshua E. Husbands, Holland & Knight, Portland, Oregon

- "We don't sell widgets. Our job is to help our clients sleep at night." The last few years have been turbulent and that has extended to estate planning. We need to rethink how we do what we do.
- End goals of our jobs
    - Succession of Family Business
    - Succession of Business
    - Succession of Family
- The Parts and Pieces of Family Business
    - Family
    - Owners
    - Managers
- Development of Family Business
    - Founder, Entrepreneur
        - One business, one location, centralized patriarch, informal, instinctive, minimal.
    - Sibling Team
        - One business, several locations, leadership becomes sibling or family member, business strategy more professional and trusted advisors become part of the picture.
    - Cousin/Consortium
        - Several allied businesses or holding company. Leadership may be a non-family member. Strategy is more data based. A board of directors includes objective outsiders.
    - Leadership Transition is a 10-year process.
        - In family business, sometimes the founder steps back in because there isn't anyone else.
    - Each family business is unique in terms of succession. What is most important is that there be planning and discussion.
        - Family meetings
        - Face to face conversations
        - Work hard to listen

        - Become family members
- Business and Family Governance
    - This varies based on life stage of business.
        - Entrepreneurial Stage
        - Professional Stage
    - Construct policies and processes.
        - Business governance, operation and growth
        - Estate and financial planning
        - Next Generation Development
        - Compensation
        - Next Career or Retirement
        - Shareholder Education and Development
        - Values, Vision & Mission
        - Keep in mind that attorneys are not trained or qualified to advise clients in all of these contexts. This is an opportunity to work with other advisors.
    - Develop Clear Policies and Processes
        - Be clear about roles.
        - Create job descriptions and organizational charts.
        - Performance reviews.
        - Develop rules of entry into family business.
        - Structure exit rules.
    - Policies for Successful Business Succession
        - Employment/Participation of Family
            - Have rules and communicate them
            - Are family member wages FMV?
            - How are dividends decided?
            - Be clear on monetary benefits.
        - Buy/Sell Agreements
            - Ownership criteria
            - Voting rights
            - Expansion of the family
            - Under what circumstances can/should stock be bought or sold? How do you get out of family business?
            - Pay out terms
            - What is the role of the board of directors?
        - Code of Conduct
    - Developing Next Generation
        - Learn the business
        - Challenges include family member confidence, earning respect and credibility and various other factors.
        - There can be a lot of pressure on the next generation.
    - Senior generation can have trouble letting go.
        - Involve advisors who can facilitate.
    - *Authors' Note: It is not uncommon that a family business will constitute a significant portion of an estate and that there will be some family members who are involved and others who are not. Practitioners should discuss the issues*

related to having non-active family members as business owners. Such a structure may pose challenges for the family members who are working in the business and may also make it difficult for non-active family members to access the value from their inheritance.

IT SEEMED LIKE A GOOD IDEA AT THE TIME: MAKING CHANGES TO AN IRREVOCABLE TRUST
Presenter: Charles A. Redd, Stinson LL

- Earlier in our careers, we may have believed that "irrevocable" meant that a trust couldn't be changed.
    - Flexibility is touted as a positive thing. Errors do need to be corrected and antiquated provisions should be updated. Unanticipated law changes should be considered. But, sometimes beneficiaries just decide they want to change the terms of the trust. If you get a determined coalition of beneficiaries and they have the time and money in many cases they can effectuate almost any change in trust provisions they want.
- Methods of Changing or Terminating an Irrevocable Trust
    - Uniform Trust Code – 35 states
        - Nonjudicial settlement agreement ("NJSA"). This can be used by interested persons as long as a material purpose of trust is not violated.
            - Sec. 111 let's interested persons enter a binding non judicial settlement agreement so long as a material purpose of the trust is not violated.
        - Non-charitable Trust can be modified if settlor and all beneficiaries agree.
        - Judicial modification can be achieved if all beneficiaries consent.
        - Court may modify administrative terms due to unanticipated circumstances.
        - Court can modify to achieve settlor tax objectives.
        - Court can reform to satisfy settlor's intentions if they can be proved by clear and convincing evidence.
        - Trustee after notice to qualified beneficiaries can transfer trust's principal place of administration to another state. That will typically change governing law as to trust administration matters to the new state's law. Sec. 3528(f) DE decanting mechanism is available to any trust whose principal place of administration is in DE. So moving situs can change law etc.
        - TEDRA
            - In WA and ID all parties can get together and enter binding agreement as to trust and it is deemed by filing to have been approved by a court and its equivalent to a binding court order.
            - If you can change situs to WA or ID you have this mechanism to make change to trust with not material purpose limitation.
        - The above are largely engineered by the beneficiaries.
        - Need all beneficiaries. Just a majority of beneficiaries or just the adults will not suffice. Be certain virtual representations of rules are being

        followed. If a beneficiary is going to virtually represent another beneficiary there can be no conflict of interest.
    - Trustee can transfer place of administration.
- Trust and Estate Dispute Resolution Act
    - Two states have enacted.
    - All parties can enter into an agreement to resolve any matter related to a trust.
- Trust Decanting
    - Trustee exercises discretionary distribution authority set forth in an existing trust instrument by distributing not outright to the beneficiary to or for whom the Trustee is empowered to distribute but to another trust.
- What can you do under "decanting"?
    - You can do easily do innocuous things like fixing ambiguous language, fixing errors, etc.
    - Underlying decanting statute might permit changes in standards of distribution, direct distributions at different times, create new powers of appointment (several statutes expressly allow this).
- Some jurisdictions permit adding or removing beneficiaries in a decanting.
- Modification and Decanting are Different Concepts
    - A modification doesn't generally require active participation or approval of the Trustee so the Trustee's fiduciary duties aren't implicated.
    - Decanting is carried out solely by the Trustee. Trustee must consider fiduciary duties including impact on current and future beneficiaries.
    - Hodges case – Trustees decanted to trusts and result was to eliminate beneficiaries. Technically, New Hampshire statute allowed this but court held that Trustees were subject to a duty of impartiality.

- Possible Tax Consequences of Changing or Terminating Irrevocable Trusts
    - PLR 201932001 – Trust exists for lifetime benefit of son.
    - Descendants to receive remainder.
    - No principal distributions allowed under trust. Son and remainder beneficiaries got together and successor/contingent remainder beneficiaries: son, current remainder = first line remainder beneficiaries, and final contingent beneficiaries. All entered a settlement agreement and agreed to terminate trust and distribute actuarial values of all of their interests calculated under 7520.
    - IRS viewed the premature termination of the trust as a sale of beneficial interest by son to current first line beneficiaries etc.
    - Speaker feels ruling is wrong.
    - Son is life beneficiary and the first line and contingent beneficiaries all received amounts precisely equal to their actuarial interests in the trusts. No one conveyed anything to the current remainder beneficiaries. It was all property computed under 7520 so no one shifted any value to anyone else.
    - Rev. Rul 72-243 citing *McCalister* – these seem to support the conclusion that amounts received were the result of a sale or exchange of capital asset but speaker believes this makes no sense. These authorities do exist so that there is precedent that a termination of a trust may result in long term capital gain treatment, but it doesn't make sense.
    - Rev. Rul. 69-486 non-pro-rata distributions but there were none.

- Cottage Savings – IRS did not mention this as applicable in resolving tax consequences of terminating the trust.
- In gift tax portion of PLR HO-9 IRS says in present case the beneficial interests will be the substantially the same before and after. "Substantially the same" is the opposite of concepts in Cottage Savings finding tax consequences from changes in mortgage participation interests.
- Despite criticisms you cannot ignore the PLR.

- Gift Tax
    - CCA 202118008 – Premature termination of a QTIP trust results in a disposition of Spouse's qualifying income interest. Spouse was treated as having made a gift of entire trust property other than qualifying income interest. Distribution of QTIP assets to spouse was treated as gift by remainder beneficiaries. The gifts are separate and do not offset each other. 2519(a) must be considered anytime you consider terminating a QTIP trust.
- Overarching Principle – Trust modifications that alter or shift beneficial interests may give rise to a taxable gift. Regs say this. 26.2601-1b4… You don't see this in the gift tax regulations but it is clear in the GST Regs. Example 7 postulates simple fact pattern. Each beneficiary gets 1/3rd of trust while alive and they go to court with trustee and get modification of trust to increase A's share of income. IRS says in Example 7 this transaction involves a transfer by beneficiaries B and C to A.
- Modifying or termination of a trust by beneficiaries in a way that changes or sets up changes of beneficial interests may be viewed as exercising a power of appointment.
    - You have potential gift tax consequences but how does it work?
    - Where beneficiaries can get together and modify or terminate a trust it is analogous to the exercise of a power of appointment.
    - If beneficiaries have by analogy a power of appointment, is it a general power? 2514(c) makes it sound like a GPOA as beneficiary along with others can move assets out of a trust to themselves that is potentially a GPOA or a disposition that is analogous to a GPOA. But there are exceptions under the code section and in particular you don't have a GPOA if the power is exercisable only in conjunction with a person having a substantial interest in the property that is adverse to the power holder. Two prongs to the test: 1. Substantial interest in the property. 2514-3(b)(2) discusses "substantial interest" but it is not really helpful.
- Looking at a modification or termination of an irrevocable trust from the transaction being the equivalent of a GPOA with the applicability of the substantial interest exception the IRS believes that trust modification or termination has gift tax consequences. But speaker thinks if you analyze the positions of those involved you may find substantial adverse interests and you may be able to avoid the problem.
- Decanting by an interested Trustee who is a beneficiary in a way that eliminates value of his beneficial interest could be a transfer for value. The same result is likely not true for an independent trustee.

    - A modification or decanting that shifts a beneficial interest may have transfer tax consequences.
    - Potential transfer tax consequences of decanting.
        - Is it being engineered by an interested trustee or an independent trustee?
        - Regulations recognize if it has impact of shifting of beneficial interests it has gift tax implications.
        - If made pursuant to a fiduciary power limited by a reasonable fixed or ascertainable standard… But that suggests if not so limited it has transfer tax consequences.
        - What if an independent trustee exercises the power to decant, e.g. a bank/non-beneficiary. The independent trustee cannot make a gift as they have no beneficial interest. But if a beneficiary of the trust has a diminished interest and could have sued the trustee to reverse the decanting then that beneficiary may have made a gift when the expiration of the statute of limitations on the decanting expires.
        - Enter into Non judicial settlement agreement or getting a court order where court blesses concept that the decanting is approved before it is carried out Rev. Rul. 73-142 indicates that a judicially sanctioned decanting should be recognized as legitimate for tax purposes.
        - Is there a 2702 problem?
- Consider potential negative consequences of disregarding settlor intent. What can be done?
    - Not advocating not using decanting and modification as they serve valid purposes.
    - There are times when it can go too far.
    - To minimize damage in connection with trashing a settlor's legitimate dispositive expectations what can we do?
        - Include in client's estate planning documents a strong statement regarding dispositive desires and that they don't want them changed except in the most compelling of circumstances.
        - May want to prohibit decanting in some instances.
        - include an explicit statement in the will or trust as to material purpose of the client.
        - Include *in terrorem* clause against decanting or particular kinds of efforts to modify or terminate the trust will lose beneficiary status.
        - You might have limitation on decanting that can be done.
        - You might limit applicability NJSA under Sec. 111 so it cannot be done without court approval.
        - ***Authors' Note****: While these comments are reasonable some clients seek to prevent changes to a significant degree only to find circumstances to have changed substantially so that a change is necessary but now difficult or impossible to make.*
- What happens with irrevocable spendthrift trust and trustee changes governing law and that change has substantive effect and primary beneficiary is the trustee? The result is that the laws of new state don't recognize spendthrift status of trust because primary beneficiary is sole trustee. The existence of decanting power or change in governing law provision alone should not be a problem but when trustee effectuates it then you have

changed the trust into which you may have estate tax inclusion by the primary beneficiary.

SUCCESS IN SUCCESSION
Presenters: Melissa J. Wilms, Davis & Wilms, PLLC; Steven B. Gorin, Thompson Coburn LLP

- Conversion from Corporation to tax partnership.
    - Check the box.
    - Actual liquidation and drop down.
    - Example real estate client with S corporations and want to convert to LLC so each new business is now in an LLC and doing this over time. Phasing out corporations.
    - Going from corporation to partnership is a taxable event.
- Conversion partnership to corporation.
    - Possible without tax if no hot assets.
- Tips.
    - Focus on state law issues.
    - Asset protection.
        - May form state law LLC for better charging order protection and elect to be taxed as S corporation.
    - Change of control provision could result in property tax consequence.
    - F Reorg to get around S corporation issues in a sale.
- 2036(b) issues in transfer of corporate stock. What if use LLC instead? What is estate planning implication of retained control?
    - Check the box rules don't apply for valuation.
    - LLC is not a corporation for state law purposes so need to see if 2036(b) will past muster.
- Trusts as owners of entities.
    - S Corporations.
        - Ordinary non-grantor trust cannot be owner of S corporation.
        - Need QSST or ESBT.
        - QSST.
            - All fiduciary accounting income (FAI) must pass to beneficiary.
            - Beneficiary must make election.
                - Is S election being made by corporation at same time.
            - Within 2 months and 15 days of transfer of stock to the trust.
                - Special rule for death.
                - If held by revocable trust or If passing to testamentary trust make 645 election to be treated as qualifying trust it can be years after death you start the clock when it happens.
        - ESBT
            - Always taxed to trust at highest rate and no distribution deduction.
            - Trustee must be sure to hold sufficient cash to pay tax.
        - Negotiate when election is being made how distribution will come out to avoid phantom income situation.
        - You can convert from QSST to ESBT and vice versa.

        - Why do a QSST since all accounting income must be distributed out and usually don't want beneficiaries to get all the money. But if there is a large liquidity event like sale of stock you can dribble it out.
- Succession buy-sell agreements.
    - sample checklist for LLC. Easily changeable for another kind of entity.
    - 2703(b) a layer on top of existing buy sell rules:
        - Bona fide business arrangement.
        - Not a device to transfer such property to members of the decedent's family for less than
        - Comparability
    - *Blount* case 11^{th} Cir. Reversed.
    - *Connelly* ED Mo. 9/2021.
        - Had family members.
        - Did everything wrong.
        - If the buy sell is disregarded will the resulting liquidity also be disregarded?
        - Valuation – still have minority shareholders.
    - Try cross-purchase.
        - Life insurance LLC may protect from risks but takes time and expense to administer it.
        - The company pays for premium in redemption so getting money out of company to pay for premiums in cross purchase takes some effort and possible tax costs.
    - Child in business took lower salary so company would have cash flow to buy out other children not in business.
    - Using redemptions funded by life insurance.
        - Active family members and want to get stock over to them.
        - Bonus small number of shares which is modest compensation.
        - When redeem out decedent then the active family members get "springing" value and their interests increase.
- Employer owned life insurance issues.
    - If you violate rules life insurance is taxable income.
    - Effective for policy issued or materially change dafter 8/17/06.
    - Notice and consent must be obtained on or before issuance of policy.
    - Notice can be stone alone or can be incorporated into buy sell but must be signed before policy is issued.
    - Form 8925 must be attached to income tax return.
    - When filling maximum face amount fill in maximum policy may ever be (e.g. policy value may grow). You want to be protected in case amount paid out increases.
    - If no notice there may be some options to cure.
- Redemption of partner.
    - Can pay in installments without worrying about installment sale rules.
- What is being transferred and to whom in the succession plan.
    - Four elements of ownership.
        - Equity.
        - Income.
        - Growth.
        - Control.

- Possible successor owners.
  - Family members.
  - Employees.
  - Third party.
- Equality versus fair.
- Other considerations.
  - Knowing who the transferee will be can help figure out how to slice and dice the interests. If child not in business perhaps give not voting interest. For an employee maybe give incentive plan and not growth in company.
  - If there a possible sale, consider assignment of income doctrine? Is there a letter of intent? Is it binding or not?
  - Dickinson case cites back to Palmer case. This is a recent case.

- Charity.
  - Pre-sale giving.
  - Have conversation upfront with charity. Some charities may let you get up to 72 hours before closing if no binding letter of intent. Have the conversation with the charitable organization early on.
- Community property issues.
  - Look at how, when and where married couples got property.
  - State laws differ a lot!
  - It is not only state law, but what they agree to and what they bring to the marriage from a separate property state.
  - Is it sole management of one spouse or both spouse management?
  - Issues with entities.
    - What if separate property added to entity? Is it gift of ½ of the property to the other spouse who has ½ interest in the community property entity? Get an agreement.
    - FLP – entity increases in value due to time toil and talent that can allow other spouse to have claim on entity.
    - If you have 2 member H and W LLC that is disregarded for federal income tax purposes.
    - Basis adjustment to both halves of community property. It can step down as well as up and some people forget this.
    - If you want to maintain separate property character memorialize it in a marital property agreement or a partition agreement.
    - Consider transmutation agreement to transmute separate to community property. Be careful as to whether separate counsel is needed.
    - Property received by gift is separate property but what if it is put into a trust? If there is separate property that generates income in Texas that separate property income is deemed community property. Include language to make clear it is a gift of income as well if that is what the intent is.
    - Also the perspective in many community property states is "assume it is community property unless you can prove otherwise."
    - Have LLC
      - someone with separate property assets and put into an LLC.

        - Distributions from an LLC are akin to income so if make distributions of separate property inside LLC that may recharacterize it as being income.

- Deferred compensation.
    - Sec. 409A
    - Nonqualified deferred compensation.
    - Be wary you can use it to facilitate a sale.
    - In S corporation can structure non-qualified deferred compensation is not considered second class of stock generally, unless used to circumvent single class of stock rule.
    - Substantial risk of forfeiture defined differently under 409A and 83.
    - Violation causes acceleration of income tax and 20% penalty etc.
    - Must defer in advance of retirement and defer for 5 years.
    - Balance sheet affect – deferred compensation is a liability and may be a problem for loan covenants, etc.

MOUNTAINS ARE NOT FAIR OR UNFAIR – THEY ARE JUST DANGEROUS – PRACTICAL TIPS FOR SCALING THE SELF DEALING RULES FOR PRIVATE FOUNDATIONS
Presenters: Brad Bedingfield. Hemenway & Barnes LLC, Boston, MA; Neil T. Kawashima, McDermott Will & Emery LLP, Elinor Ramey, Steptoe & Johnson LLP

- Estate Administration Exception
    - Regs. Sec. 53.4941(d)-1(b)(3), provides that indirect self-dealing does not include a transaction with respect to a private foundation's interest in estate property, regardless of when title to the property vests under local law, if:
        - PR has power to sell.
        - Transaction approved by probate court.
        - Make sure consideration is FMV.
        - Transaction occurs before estate administration is closed.
        - Ensure that transaction results in foundation receiving an interest that is at least as liquid as the one it previously had.
    - IRS Letter Ruling 201446024 illustrates probate exception in a situation where there is an installment note issued by a trust. The executor proposed to create a "blocker LLC," which would hold the note and, in exchange, issue voting and nonvoting LLC units. The executor would buy the voting units, while the private foundation would receive the nonvoting units rather than the note. The IRS ruled that the estate administration exception protected the transaction.
    - See Treas. Reg. 53.4941(d)-(2)(c)(1) – Section II.D.2 – This reflects the issue to be considered regarding self-dealing when private foundation receives a note from DP.
    - IRS Letter Ruling 200635016, the IRS ruled that a nonexempt trust treated as a private foundation that owned nonvoting interests in an entity and had engaged in a transaction with one or more disqualified persons did not engage in indirect self-dealing.

    - IRS Letter Ruling 201145026. The IRS concluded that the sales of limited partnership interests between a marital trust and a testamentary charitable lead unitrust met the requirements of the estate administration exception.
    - *Dieringer* case – This case shows the importance of complying with Regs. Sec. 53.4941(d)-1(b)(3).
    - Option Agreement Exception
        - Treas. Reg. § 53.4941(d)-1(b)(2)(i)(c). Option agreement can be executed prior to death to create a framework and process for beneficiaries to purchase collection items from an estate that will otherwise go to a private foundation.
    - Treas. Reg. § 53.4941(d)-3(d). Market Value Purchase pursuant to a corporate reorganization.
    - Rev. Rul. 59-15. IRS generally respects bona fide settlements for IRC 642(c) purposes.
- Shared Facilities and Employees
    - DP may offer facilities to PF without charge and exclusively for charitable purposes. While PF may pay for costs incurred in relation to use of property, payment may not be made to DP. IRC § 4941(d)(1)(C); Treas. Reg. § 53.4941(d)-1(b)(3).
    - It doesn't work for a family office to provide space to PF even if PF reimburses expenses. It is too much like a lease.
    - Compensation Exception – Payments can be made for services that are professional or managerial in nature.
        - *Madden* case
    - Remainder Interest in Personal Residence
        - PF payment of improvements for remainder interest in residence could be self-dealing. Safest approach is to have life estate owner pay the expenses.
        - See PLR 200149040; Section II.G.11
- Adventures in Indirect Self-Dealing
    - Indirect Benefit. An example would be PF making expenditures to clean lake in residential area when DP owns adjacent land. Issue is "transfer to or use by for the benefit of DP".
        - Is benefit incidental and tenuous?
        - Grant to public charity without earmarking the grant for control by PF could work.
    - Indirect Sale. Foundation owns house but DP uses the house when in town. DP wants to buy house but cannot do so. Instead, PF gives house to public charity that sells house to DP.
        - Possible issues include sale or exchange of property, correction as act of self-dealing, and indirect self-dealing via intermediaries.
        - Possible solutions include having lease terminated for correction. Ensure independence of public charity directors. Have PC directors obtain independent appraisal. Consider PLR.

    - Co-Investing. DP and PF want to invest in passive investments through an LLC managed by investment advisors at DP family office. PF contributes money in exchange for LLC membership interests.
        - Possible issues include DP receiving compensation, sale or exchange or property, transfer to or use by DP, indirect self-dealing via control.
        - Solutions include following fact pattern of co-investing PLRs. Waive management fees for DPs. Ensure no benefit to DP from PF involvement.
        - Consider whether LLC is a DP.
- Miscellaneous Self-Dealing Matters
    - Liquidity Concerns. A PF may need to meet annual distribution requirement but be illiquid. DP is most likely person to purchase assets but sale would be self-dealing. Possible solutions include distributing property to a public charity (being careful to avoid indirect self-dealing); distributing property to a DAF; sell property to someone who is not a DP.
    - Pledges. Satisfaction of a personal pledge by a PF is self-dealing. An alternate is to have the PF make pledge directly or consider some form of hybrid pledge.
- *Authors' Note: Private Foundations can be an excellent tool for clients who are interested in creating a legacy of giving and involving younger generations. Practitioners should provide detailed guidance on the self dealing rules for those forming private foundations. Consider creating an easy to follow guide to avoiding making mistakes in this arena.*

STATE INCOME TAXATION OF TRUSTS: EVEN FLORIDA PRACTITIONERS SHOULD KNOW THIS STUFF!

Presenters: Richard W. Nenno, Young Conaway Stargatt & Taylor LLP; Matt Brown, Brown & Streza LLP; Toni Ann Kruse; McDermott Will & Emery LLP; Karin Prangley, Brown Brothers Harriman & Co.; Vincent C. Thomas, Young Conaway Stargatt & Taylor LLP

- Florida
    - No state income tax but may affect other clients.
    - *Rice* case neither NY nor FL advisers told the trustee that he could stop paying NY tax when he moved from NY to FL.
    - ***<u>Authors' Note</u>****: This is a common issue and opportunity. When CPAs are preparing 1041s they should not assume state income taxation falls under the common accounting acronym of "SALY" = same as last year. Review the factors creating taxation of the trust in a high tax state and determine if the trust can be restructured (e.g. divided so one successor trust has all state source income and the other trust none), change the trustee to a trustee in a no-tax state, etc.*

Consider that the savings can be substantial but too often clients and practitioners lapse into repeating whatever tax compliance and payments that were done in the prior year are merely repeated.

- How do you determine where a trust might be taxed?
    - How does state define resident trust in tax law and tax return instructions?
    - This can save a lot of money.
- Don't assume capital gains are to be included in DNI.
- Trustees may have a continuing duty to avoid tax.
- Where are the Planning Opportunities?
    - Non-grantor trusts with non-source income retained in trust.
    - Most states (except PA) recognize grantor trust rules.
    - Federal v. State Tax Savings – Consider both and all brackets when making distributions. Avoid assumptions.
    - Planning can save significant taxes.
    - Non-source retained income of non-grantor trusts, particularly capital gains.
    - Distributable ordinary income taxed as to source income in state where property or activity income.
        - So focus is not source income.
    - Most states recognize income of grantor trust.
    - CA $1M gain LTCG over $100,000 in state tax
    - Income tax brackets are more compressed for trusts.
        - Some trusts make larger distributions to beneficiaries and include capital gains. But those may be subject to state income tax where trust may escape state tax. That savings might offset most or all of the higher federal income tax.
        - See HO 5.
- How Do States Tax Trust Income?
    - Bases of Taxation – 9 states do not tax non-grantor trusts income: AK, FL, NJ, TX, WY etc
        - Most states tax capital gains at same rate as ordinary income with few exceptions.
    - Trust Created by Will of Domiciliary/Resident
    - Inter Vivos Trust Created by Domiciliary/Resident
    - Trust Administered in state
    - Trust Having Domiciliary/Resident Trustee/Fiduciary
    - Trust Having Domiciliary/Resident Beneficiary
    - Some states use multiple criteria
        - 28 states use resident trust if created by will of domiciliary or resident
        - 15 states classify trust as resident if administered in that state.
        - 6 states tax trust as resident if trust has resident beneficiary.
    - Cases:
        - Kaestner, NJ
        - Linn IL – Due Process
        - Fielding for MacDonald, MN – Due Process
        - McNeil PA – Dormant commerce clause
    - Constitutional Challenges

        - US Due Process Clause
            - Trustee must have link with taxing state.
            - Income must have rational relationship to taxing state
            - Physical presence not necessary
            - Unsettled whether non-statutory connections must be considered.
        - Dormant Commerce Clause
            - Trustee has substantial nexus
            - Tax must be fairly apportioned
            - Tax must be fairly related to services provided by taxing state
            - Tax must not discriminate against interstate commerce
        - Taxing State Will Have Difficult Burden in Many Cases
- What does all this meanit is probably unconstitutional to tax a trust just because testator was domiciliary but if you have a probate in the state you will lose. So use inter-vivos trusts.
- ING
    - Incomplete Gift Non-grantor trust self-settled trust in state with domestic APT rules.
    - INGs may be on borrowed time. See article McCouch, 39 Va. Tax Rev. 419 (Spring 2020). IRS has suspended issuing rulings.
        - Goals are for gift to be incomplete for gift tax purposes and to be non-grantor trust.
        - Trustor might later be able to get tax free distributions
        - NY treats ING trust as grantor trust
        - CA proposal to treat ING trust as grantor trust in 2022
        - Rev Proc 2021-3 IRS won't issue PLRs on INGs.
- New York Issues
    - NY has generated most of relevant case law and rulings on topic and many other states that tax trusts in similar manner (AL, IL, MD, MA, MO, NE, etc.) rely on NY cases for law.
    - Taxation of irrevocable non-grantor trusts.
        - Grantor trusts are pass through entities and income passes through to trustor.
        - NY treats trust as grantor trust if classified as such for federal rules. Taxed where grantor is resident.
    - NY tax rates get as high as 10.9% on income over $25M after 2021 increase.
    - Resident Trust
        - Trust created by NYS testator (domiciliary)
        - Trust created by NYS trustor (domiciliary)
    - Nonresident Trust – Trust that is not resident
    - Exempt Resident Trust - Some trusts are exempt codifying exempt resident trust exemption based on Mercantile case
        - No NYS trustee
        - No NYS assets

        - Real estate or tangible property can be converted into intangible property with proper structuring.
        - E.g. contribute NY real property into an LLC.
        - This is not a sure bet as sale of entity holding NY real property can be treated as NY source income, etc.
      - No NYS source income
          - NY Position is that $1 of NY source income will cause trust to fail.
          - Hard to police in a brokerage account.
      - Trustee must file informational return - IT-205-c to certify exempt status.
  - Throwback Tax on Accumulation Distributions
      - This is a tax on distributions of accumulated income to NY resident beneficiaries from Exempt Resident Trusts
        - NYS resident beneficiary is taxed on income received.
        - Undistributed income remains in trust and is taxed in trust.
        - Untaxed to NY prior year trust income may be carried out to NY beneficiary in a later year.
        - Exceptions to accumulation distribution rules:
          - Earned before 2014 when law went into effect.
          - Earned when beneficiary was not 21 or not a NY beneficiary.
      - Accumulation distribution rules do not include capital gains. Largest cost would be capital gains so this makes harshness of law less
  - Taxation of Trust
      - Resident: All NYC taxable income
      - Nonresident: All NYS source income
      - CRT: Not taxed at trust level
  - ING Trust option is not available since 2015
  - ***<u>Authors' Note</u>****: The NY ING restriction is only on incomplete gift non-grantor trusts. As noted in a prior discussion using a completed gift approach may avoid being subjected to the NY anti-ING restriction. But this may be academic if the profession is viewing INGs as too risky in the current environment.*
  - Planning
      - Including DNI for NYS beneficiary can be very costly.
      - There is more flexibility with nondomiciliary testator/trustor.
      - In trust drafting, build in flexibility.
  - NYC essentially mirrors NYS
- New Jersey
  - Recognize grantor trusts recognized for federal tax purposes
  - 2020 tax rate on non-grantor trust 10.75% This rate is not scheduled to change.
  - Different than NY in recognizing constitutional limits NJ Tax Court in Pennoyer and Potter follow rule that certain resident trusts are treated as non-resident and NJ tax authorities honor this rule. Analogous to exempt resident trust rules in NY.
  - Nonresident Trust: Trust not Resident Trust
  - Exempt Resident trust
      - No NJ asset

        - No NJ source income
        - No NJ trustee
        - Trustee must file informational return
    - NJ taxes all NJ gross income of resident trusts and NJ source income of non-resident trusts.
    - Trustee must file NJ income tax return and certify not subject to tax.
    - Not clear if advisors and power holders are included in NJ definition of NJ trustee so safest option is to have no NJ residents in any of these positions if trying to avoid NJ tax
    - CRT taxed at trust level as only exclusively charitable trusts qualify for exemption under NJ gross income tax. Undesirable.
    - ING trust option is available
    - Structure trusts to be a nonresident trust.
    - There is significant savings for trusts in avoiding NJ taxation.
    - NJ does not tax trusts that are non-domiciliary for other than source income so it might be worth considering.
    - Planning:
        - Structure trusts to be exempt resident trust whenever possible, including CRTs.
        - Any small amount of NJ income could tip the scales and lose the exemption.
        - So create two trusts instead of one:
            - NJ source income assets.
            - 2nd trust holds all other assets.
        - NJ hasn't conceded that a NJ beneficiary will not escape taxation so may even want to structure trusts separate for NJ versus non-NJ residents.
- Pennsylvania
    - Does not follow the federal grantor trust rules.
    - Tax rate for irrevocable trusts is flat 3.07%.
    - Taxation of testamentary and inter vivos trusts based on residence rather than domicile of grantor
    - Assesses throwback tax when Pennsylvania residents receive trust distributions.
    - McNeil case indicates that trsuts that meet definition of resident trust may still be taxed as non-resident trust based on due process and dormant commerce clause.
        - Trustees have tried to have resident trusts reclassified as non-resident trust based on McNeil.
    - Tax return instructions in PA should not f Rev 65 petition to be filed with board of appeals.
    - Resident – domiciliary or permanent place of abode plus more than 183 days
    - Taxes CRTs like NJ does.
    - ING trust is available. Pennsylvania treats all non-resident trusts as non-grantor trusts. Less complicated in PA But trust must be designed to produce incomplete gifts but no worry about non-grantor trust aspects as PA treats all trusts as non-grantor trust. Goal is to structure trust to avoid PA tax.

- Delaware
  - Tax Rates: Up to 6.6% over $60,000
  - Resident trust is one created by resident DE testator, created by DE settlor, etc
  - Nonresident Trust is any trust that is not a resident
  - Trust is taxed in Delaware if:
    - Resident Trust
  - CRT not taxed at trust level
  - No return required if no tax is due.
- Illinois
  - Record migration out of Illinois.
  - Net income tax 4.95%.
  - Net income tax/personal property tax replacement income tax 6.45%.
  - Grantor trusts don't pay replacement tax above but non-grantor trusts do.
  - Resident Trust
    - Testamentary trust at death of someone domiciled in state at death
    - Irrevocable trust if grantor was domiciled in state at time.
  - Linn v. Dept of Rev (IL 2013).
  - Exempt Resident Trust
    - No IL Trustee
    - No IL Asset
    - No IL source income
    - No IL beneficiary
  - Nonresident Trust
    - Not a resident trust
  - Recognizes a grantor trust on its basis for federal tax purposes
  - CRTs are not taxed at trust level
  - For Illinois purposes, a trust is not irrevocable as long as it is treated as a grantor trust in IL. As a result, such trust will not be an IL resident trust if the grantor ceases to be an IL domiciliary before the trust ceases to be a grantor trust under these provisions.
  - INGs – sort of work in IL
  - Taxation of Trust
    - Resident Trust – taxed on all IL net income
    - Nonresident Trust – Taxed on all IL source income
  - Planning Opportunities
    - Narrow down and navigate connections with IL
    - Trustee has a duty to minimize tax
  - Speaker sees IL landscape as follows:
    - No substantial IL contacts.
    - Overlay if grantor was not IL resident (and no IL testator creating trust) it is not going to be an IL trust.
    - If grantor is an IL resident who is dead or has moved out of IL you may be able to get trust out of IL taxation if no assets, income, etc.
    - If grantor is alive and is still in IL you may not be able to escape IL taxation.

    - If you take advantage of IL probate system (i.e., testamentary trust) you will be taxed in IL.
    - What if you have IL trustee? Lynn said if no trustee in IL it is a severed connection. If you have an IL trustee it is a connection and Lynn doesn't help resolve issue of IL taxation.
    - If you have IL beneficiaries rely on other state cases and try to consider position that not an IL resident trust. If there are no other connections you might escape IL even with IL beneficiary.
    - IL assets. There is good language in Lynn case to say if assets are not substantial you might be fine. Lynn sites MI case that non-income producing property did not make trust taxable.
    - Provide for easy path to get out of governing law. But even if have IL law but no other contacts to IL you might nonetheless escape IL tax.
    - Do you file a return if you feel trust is non-resident? There is risk in every case since Lynn is such a fact specific case.
- California
  - Return must be filed if net income over $10,000
  - Trust is a grantor trust if classified as a grantor trust for federal purposes.
  - Tax Rates up to 13.3%
  - 1% additional tax when over $1m. Applies to trusts.
  - No preferential capital gains rates.
  - Filing requirements.
    - Non-grantor trust with $100 taxable income, AMT or $10,000 gross income must file.
    - If no CA fiduciaries or vested CA beneficiaries and no CA source income no filing required.
    - Form 541. Same form if resident or non-resident.
  - Withholding on distributions to non-resident beneficiaries of 7% and on real estate sales 3.3% withholding to be withheld by escrow agent.
  - This applies only to CA source income.
  - Grantor trust rules.
    - CA follows federal grantor trust rules.
  - Distribution deduction on non-grantor trusts.
    - Trust is taxed on remaining income.
  - Resident Trust
    - Trust with resident fiduciary.
      - Accumulated income is taxed in CA.
    - Trust with resident noncontingent beneficiary.
    - Trust can be partially resident and partially non-resident.
    - Dual test unique to CA.
  - Resident Fiduciary
    - Fiduciary is anyone with fiduciary powers. This likely includes Trust Protector.
    - Asset Manager does not have to be in CA for fiduciary relationship to be present.

        - If CA resident individual trustee delegates duties to nonresident corporate fiduciary, then individual trustee is not a CA resident fiduciary.
        - Residence of corporate fiduciary is determined by where the corporation transacts the major portion of its administration of the trust.
        - If there are co-trustees, income is apportioned.
    - Throwback Tax
        - Rules provide for taxation of California resident beneficiaries on untaxed income from prior years through a throwback tax.
    - Nonresident Trust – CA taxes all taxable income if such trust has resident fiduciaries or all resident noncontingent beneficiaries but taxes only CA source taxable income attributable to nonresident fiduciaries or beneficiaries. Computation can be quite complex.
    - CRT is generally exempt from CA income tax.
    - CA did not enact UTC or UPC.
    - Avoid CA residents as managers of LLCs owned by trust.
    - Planning
        - Be wary of CA fiduciaries.
        - Analyze source income.
- Planning Considerations for New Trusts
    - Determine which state tax statutes apply.
    - Determine whether any imposition of tax violates the state's or the US Constitution.
    - Analyze source of income of trust assets.
    - Can you improve your situation with a adviser instead of a co-trustee? If it is a non-fiduciary you may improve your situation. But some don't use the term fiduciary but rather a control concept.

HOW TO MARRY A MILLIONAIRE (AND WHERE TO LIVE WHILE YOU ARE MARRIED) – A PRACTICAL DISCUSSION OF HOW ELECTIVE SHARE AND OTHER TESTAMENTARY RESTRICTIONS CAN IMPACT ESTATE PLANNING
Presenters: Jonathan Lasley, Suzanne Tucker Plybon, Alex S. Tanouye

- How to Marry a Millionaire
    - Impediments to Testamentary Transfers
        - Elective share – about 40 states
        - Community property restrictions
        - Homestead & family exemptions
        - Qualified retirement plans
        - Support
        - Dower and curtesy
    - Reasons for protecting surviving spouse
        - Prevent disinheritance
        - Fairness
        - Prevent spousal depending on government assistance

        - Surviving spouse should not be treated worse than in divorce
- Reasons for restricting surviving spouse's share
    - Other children
- Importance of being aware of elective share laws
    - Migrating clients
    - Property located in other states
    - Spouses in different states (domicile of decedent controls)
- Approaches to Elective Share
    - Probate only
        - May include revocable trusts in some jurisdictions
    - Augmented estate
        - Probate estate, joint accounts, retirement, revocable trusts, some gifts
        - Uniform Probate Code model
    - Fixed share
        - Some states: 1/3
        - Some states: % (Florida is 30%)
        - Some states it depends on the length of marriage
    - Using trust to satisfy elective share
        - Some states allow use of trusts
        - May be a % of trust assets
- Multijurisdictional estates
    - Is the value of the ancillary real property included in calculating the domiciliary elective share?
        - Probate only domicile – generally no
        - UPC Augmented Estate domicile – generally yes
        - Semi-augmented estate domicile – generally yes
    - Will ancillary state respect elective share in domiciliary state?
        - Doctrine of election – spouse cannot take under a will after electing against the same will
    - Does spouse have to file separate election in ancillary state?
        - AK, MD, MO, NY, NC, TN require separate election
    - What is impact of election in domicile estate on property located in ancillary state?
        - Community property domicile state – no elective share
        - Numerous states apply law of domicile
        - Some states apply law of situs: AK, DE, Iowa, ILL, Kentucky, Mississippi, NY, OH
        - Three states – right of election only if decedent domiciled there - FL, Iowa, NC
        - Georgia has no elective share.
        - Numerous states – law is uncertain
- Tips, Tricks, Traps
    - Waiver of elective share with prenuptial and postnuptial agreements
        - Consideration for waiver with lump-sum gift
    - Make lifetime gifts strategically and be aware of lookback period

        - Retitle assets to fall outside elective estate (more effective in probate-only administration)
        - Get divorced
        - Offer spouse something to discourage elective share – gift conditioned on spouse not electing against elective share
        - Satisfy elective share in advantageous way
        - Consider domicile
        - Remember property location
    - Ethical Considerations
        - Joint representation
            - Waivers already in place
            - Does plan affect spousal rights
            - Do the spouses have different goals
        - Representing spouse in administration of the first spouse
            - If spouse is PR and wants to file elective share claim – conflict

FRIDAY APRIL 1, 2022

ESTATE PLANNER'S GUIDE TO THE TREASURY'S PROPOSED REGULATIONS REGARDING SECURE'S CHANGES TO THE MINIMUM DISTRIBUTION RULES (AND A FEW OTHER THINGS)
Presenter: Natalie B. Choate, Esq.; Law Office of Natalie B. Choate/Ataxplan Publications

Ah, consider the irony of this topic as a start to April Fool's Day

- Proposed Regs issued February 23, 2022: https://www.federalregister.gov/documents/2022/02/24/2022-02522/required-minimum-distributions
- Overview of Secure Act Proposed Regs.
    - Much more complex than prior law.
        - Pre-Secure 3 types of payouts now 5 types of EDBs.
            - Surviving spouse
            - Minor child of participant
            - Beneficiary not more than 10 years younger
            - Disabled
            - Chronically ill
            - ***Authors' Note***: *The definition of disabled and chronically ill are quite strict and many clients with significant challenges may not meet the requirements.*
        - 4 sets of new distributions rules.
    - Generally Secure replaced life expectancy payout with generally a 10-year payout.
    - Secure 10-year rule inserted in Code regardless of whether participant died before or after RBD.
        - RBD is generally April 1 of year following year in which you reach age 72.

        - Proposed Regs have maximized differences in payout rules based on whether participant died before or after RBD.
        - This is so complex and plan administrators must address.
- 10-year rule issue.
    - All must come out at end of 10th year rule.
- At Least As Rapidly Rule.
    - Proposed Regs added another rule. If die after RBD April 1st of year after year in which turned 72. 401a9b1 benefits must be distributed "at least as rapidly" as before so if die after RBD this rule was not repealed and annual distributions are required under the "at least as rapidly rule."
        - If designated beneficiary = DB (a human being who is not an EDB, e.g. An adult non-disabled child) called a "plain old designated beneficiary" ("PODB"). The PODB must take annual distributions in first 9 years but EDBs don't. Those distributions are based on life expectancy.
        - Distributions have an annual track and other limit. What distributions must be taken starting immediately. The PODB must take life expectancy payout distributions based on life expectancy. Out limit year 10 the entire or 100% becomes the RMD and the outer limit stops it.
        - What if beneficiary reads 10-year rule and now proposed regs say you should have taken a distribution as a PODB in 2021? What do you do? The effective date of the proposed Regs is critical to this decision. The proposed Regs are supposed to be effective in 2022. For 2021 "any reasonable interpretation of the law of the existing regulations as modified by the Secure Act is deemed compliant." The Proposed Regs did not address issue of a PODB. They will have to do so.
        - What might IRS do?
            - Perhaps IRS will withdraw concept of at least as rapidly rule.
            - Maybe IRS will waive the at least as rapidly rule for 2021 then no issue.
            - Perhaps IRS will say if you did not take it in 2021 they will waive penalties provide you take a catch up distribution in 2022. Then PODBs would have to take a couple of 2021 and 2022 distributions in 2022.
            - Recommendation to clients – figure out what RMD under this rule would be under this rule and be prepared to take them both before the end of the year and prepare for that.
            - Fill out form 5329. IRS says you can rely on a reasonable distribution of law in 2021. Was it reasonable to thin that there were no distributions required under the 10-year rule? Yes, because publication 590B which discusses distributions from retirement plans was the only IRS information on this. That publication said no distributions required for first 10 years under the 10-year rule. The new Publication 590B that came out after Proposed Regulations has same language in it.
- New Minimum distribution trust rules.

- Mostly good news and is mostly a dramatic improvement. What has changed? This is better than prior law.
- Code tells us for RMDs who gets what payout period. Key is who is DB of the "employee" or for IRA an IRA "owner." Generally same basic rules.
- Code says if the employee has a DB then you get a 10-year rule or life expectancy payout for a EDB. But you need a DB to get to these payout periods
- DB is defined as an individual named as a beneficiary by the employee or plan document.
- What about a trust? A trust is not an individual? If you have a trust that meets certain rules you can look through the trust and treat it as if the participant named the trust beneficiaries directly as beneficiaries.
- 4 trust requirements for see-through trusts which have not changed. If trust meets these 4 requirements it is called a "see through trust". This is defined by this term in the proposed regs:
    - Valid under state law.
    - Becomes irrevocable on death.
    - Give copy to provider by October 31 of year after death. If you miss this deadline, you don't qualify.
    - Trust beneficiaries must be identifiable. How do you identify trust beneficiaries? If you cannot identify trust beneficiaries, how can it be a valid trust under state law? The Proposed Regs provide a new approach. Old approach was to identify oldest DB beneficiary i.e. the oldest person who could possibly benefit. While this may still be relevant the concept has been replaced with the concept of "identifiable" in terms of what changes may occur post-death.
- Once you figure out who trust beneficiaries are you must test the trust to determine which beneficiaries count as the employee-named beneficiaries. Then you can test to see if trust qualifies as a see-through trust. Are the beneficiaries PODBs, etc.
    -
    - Simple testing system (well in some cases).
    - 3 tier system to determine which beneficiaries count and which don't count.
        - 1st tier any beneficiary who could receive amounts in the trust that are not contingent upon or delayed until the death of someone else. These beneficiaries are entitled to get distributions or are eligible to get these distributions on the death of the plan holder. Example to my spouse for life and on her death to my children. The spouse is Tier 1 the children are not.
        - 2nd Tier are beneficiaries who could get benefits not distributed to the 1st tier beneficiaries. This description doesn't mention death of the 1st Tier beneficiary but that may be what it means. Example: Trust says income to spouse for life and on death distribute money to kids outright. Plan holder dies with spouse and child alive. Spouse is 1st Tier beneficiary and when spouse dies 2nd Tier beneficiary is the child. But if at time spouse dies all children

predecease money goes to charity. Charity is not a DB does trust flunk? Charity is a 3rd Tier and will only get money if all others die.
      - 3rd Tier. See example of charity above.
    - Example income to my spouse for life until his death or remarriage. It is an issue.
    - What if want trust to continue for grandchildren and further descendants these rules are looking at when money comes out of IRA and out of trust and goes into someone's pocket.
- What difference to above trust rules make?
  - Spouse.
    - Surviving spouse can rollover to her own IRA and does not have to take distributions until she reaches age 72.
    - When she starts taking distributions from her IRA she uses uniform life table which gives her a longer payout because it is based on IRA owners age plus a life of a hypothetical 10-year younger beneficiary.
    - Hold IRA as beneficiary (i.e., she does not have to roll it over). If she does that she is an eligible designated beneficiary = EDB. She can postpone start of distributions from the inherited account until decedent would have turned age 72. Then when she takes distributions over her life expectancy she gets to recalculate her life expectancy every year. All other beneficiaries get a fixed payout and reduce by 1 year each year. For surviving spouse, it only gets down to 1 year until age 120 so it keeps stretching for the surviving spouse.
    - Died before Secure enacted? Does she wait until deceased spouse would have reached 70.5 or 72? If decedent would have been subject to age 72 start of RMDs had he not died then surviving spouse has to determine when must start taking distributions. If deceased spouse born before July 1, 1949 he would have been subject to 70.5 regime so surviving spouse can only wait until
    - If EDB inherits a plan from an employee who died before required beginning date and EDB gets life expectancy payout but can also instead elect to use the 10-year rule. This was an IRS "add on." If decedent died before RBD I can take no distributions and then in year 9 rollover and extend to life expectancy. Proposed Regs say you will have to take catch up distributions.
    - Conduit trust definition.
      - A see-through trust the terms of which provide with respect to decedent's interest in retirement plan all distributions <u>upon receipt</u> by trustee will be paid to, or for the benefit of, the specified beneficiaries.
      - This definition is critical.
      - Conduit trust for surviving spouse would have distributions received from plan during life of spouse will be paid directly to or for the benefit of my spouse.
      - Trustee shall withdraw from the plan the amount required to be withdrawn from the plan each year. This may help focus trustee. If you want more you might say: "if the required amount to be

withdrawn above is less than income earned by plan during the year the trustee shall withdraw the greater amount so that all income from the plan is also withdrawn from the plan." You could go on and permit the trustee to withdraw for surviving spouse for HEMS or even discretionary. Don't leave greater of income or distribution as in for example 2020 the RMD was skipped, and interest rates were close to zero and the surviving spouse got almost nothing.

    - What does conduit trust give us from a tax perspective? Look at Tier system. Under a conduit trust only the first-Tier beneficiary counts. So if you have a conduit trust that on death of spouse goes to charity it doesn't matter as you only look at the first-tier beneficiary as spouse is considered the only countable beneficiary.
    - Trust will be able to use surviving spouse's EDB rules.
    - Another point on conduit trust definition. Mentions to or for the benefit of specified beneficiaries (plural). Before Secure conduit trust was not officially defined and it was not clear whether you could have a conduit trust for multiple beneficiaries. Now it is clear you can have multiple beneficiaries for a conduit trust.

- Accumulation Trust.
    - Client may want trustee to have control over money, e.g. spouse has gambling issue. An accumulation trust might solve the problem. An accumulation is any see-through trust that is not a conduit trust. And that term is now officially defined. "Income to spouse for life to children [or anyone]" that is an accumulation trust as spouse is not entitled to all distributions that come out of the plan.
    - She is only entitled to FAI i.e. any distributions that come out of the plan that are FAI. This is based on state law definition of trust accounting income. Under state law part of IRA distribution is income and part is not income, even though all has to be treated as income for federal income tax purposes.
    - Surviving spouse may not get under an accumulation trust all of plan distributions so you must look at 2nd tier beneficiaries.
    - Contrast a conduit trust where you do not care who comes after life beneficiary for tax purposes. In an accumulation trust it does matter who comes after current beneficiary, such as spouse.
    - Non designated beneficiary rule is that if you die before RBD it is the old 5-year rule that remains in the law. All must be distributed in 5 years of death. If die after RBD the payout period is the decedent's life expectancy if he had not died, the so-called "Ghost life expectancy."
    - If have trust and not all beneficiaries are EDBs you are stuck with PODB status. If you want trust to have EDB status all countable beneficiaries must be EDBs subject only to two exceptions. Can income to spouse remainder to non-disabled adult children get a

life expectancy payout. The answer is no post Secure. Prior to Secure that would have had a payout based on spousal life expectancy (assuming spouse was oldest DB).
            - If remainder beneficiary is a charity you have no DB status. If remainder is EDB you get EDB status. If remainder beneficiary is a PODB you get PODB beneficiary.
            - If name spouse and sibling you get life expectancy payout but whose life expectancy?
    - Minor beneficiary defined as anyone under age 21.
        - Minor child of decedent is EDB. State laws differ. IRS said state law doesn't matter nor does education status, it is someone under age 21.
        - EDB minor status payout rule is annual distributions over minor's life expectancy. But when minor reaches age 21 ceases to be EDB so then the 10-year rule kicks in. This is the "outer limit" so at age 31 all money must come out of IRA.
        - Take distributions over life expectancy until age 21 then 10-year rule applies.
        - Prior to the Proposed Regulations (and in Publication 590) at age 21 is that you flipped to the 10-year rule and you could stop taking annual distributions. But the proposed Regs say that the life expectancy payout continues during the 10-year period and the 10-year cap is just an outer limit. So, if EDB is age 2 on death, take annual distributions from age 2-30 and then at age 31 get 100% distribution.
        - Proposed regulations add to this that:
            - You can disregard any beneficiary that will only inherit if minor dies before age 31.
                - A minor child of the participant you can have an accumulation trust and still get minor beneficiaries life expectancy so long as money goes outright when minor reaches age 31. If minor gets all outright at age 31 then you disregard the 2nd Tier beneficiaries as they can only inherit if the minor dies before age 31.
                - But this requires that the minor gets all outright by age 31.
            - Rule of disregarding other beneficiaries applies to any minor so long as paid out outright fi minor (child of plan holder or not) gets all outright by age 31. You can disregard 2nd tier beneficiaries. "Special disregard rule."
    - Disabled and chronically ill.
        - Rules did not change from proposed regs.
- What happens with post-death changes to the trust.
    - Suppose trust says income to spouse for life and remainder to whoever spouse appoints by LPOA.
        - It's an accumulation trust as spouse does not get all plan distributions.
        - Must therefore count second tier benficiair8ies. But if she doesn't exercise LPOA it goes to kids.
        - Do you have to count whoever spouse could appoint to? Example, a charity? Under prior law it was unclear if had to count LPOAs.

        - Now powers of appointment we don't care who you appoint the property to unless and until you actually do it.
        - So if income to spouse for life and on death to who she appoints if not kids. Countable beneficiaries are spouse and kids. The mere fact that a POA could be exercised at later time we don't care.
    - Reformation or decanting after death.
        - Under prior law we did not know potential for those things happening.
        - State law permits you to decant a trusts even if trust silent.
        - Proposed Regs say all these post death changes like reformation, decanting and powers of appointment, the mere fact it may happen in the future, does not affect identifiable beneficiaries.
        - If it does exist? What if power of appointment is exercised, or the trust is modified before beneficiary finalization date of September 30 of the year after the year of the plan holder's death (that is the period from death until following year's September 30). You have that amount of time to clean up the trust. If those things include exercise of power of appointment, decanting or reformation if completed by that date the IRS will treat it as effective back to the date of death. This result is not fully clear.
        - Tried and true rule in tax law that if a change is made in a trust to reduce taxes it is not recognized for tax purposes. In contrast a change to correct a scrivener's error is recognized.
        - What about changes made after beneficiary finalization date of September 30 of year following death? Different effect. If you try to improve distribution period it won't work. You cannot improve the distribution after the September 30 date. If you make it worse it will accelerate the payment dates. IRS says it won't apply retroactively to the date of death. The negative change will happen the year after the change is made.
        - Overall these rules for post-death changes are generous.
        - Build in as many options for post-death changes as you can.
        - On beneficiary designation, if you have sub trusts, name sub-trusts directly. The proposed regs carried over the old rule that if you name trust as beneficiary and it divides into sub trusts it is treated as a single trust.
- Case study.
    - Died early in 2022 and want to advice beneficiaries regarding minimum distribution rules.
    - Had 3 IRAs. He was born in October 1, 1949 and died in 2022.
    - RBD would have been April 1, 2022 since turned 72 if had been born earlier in year would have been 70.5.
    - Left one IRA to cousin, one to sister and one to estate since did not fill out beneficiary designation and it defaulted to estate.
        - Cousin born October 2, 1959, 10 years and 1 day after so he is more than 10 years younger so not an EDB so he is a PODB. So he is subject to 10 year rule. All must be taken out by 12/31/32.
        - Daisy his sister is age 85 so she is older than the decedent and is an EDB. So she gets life expectancy payout. Next year is first distribution

year age 86 and under new tables life expectancy is 7.6 years. But since decedent died before RBD she can elect 10 year payout.

        - Estate gets a 5 year payout as a non-DB. It doesn't matter that cousin and sister are only beneficiaries under the estate.

    - If decedent had died on or after RBD all the above changes.
        - If you die on RBD it is treated as if died after RBD. Every beneficiary comes out different.
        - Cousin born October 2, 1959, 10 years and 1 day after so he is more than 10 years younger so not an EDB so he is a PODB. So he is subject to 10 year rule. All must be taken out by 12/31/32. BUT he must take RMDs over his life expectancy for first 9 years. There is also a year of death distribution and in fact two year of death distributions this year for 2021 and 2022. Must take out both by 12/31/22 if decedent did not take them out while he was alive. But year of death distributions may not be penalized for not taking it out for 2021 even though overdue. They might have until October 2023 to take out year of death distributions.
        - Daisy his sister is age 85 so she is older than the decedent and is an EDB. So she gets life expectancy payout. Next year is first distribution year age 86 and under new tables life expectancy is 7.6 years. But since decedent died before RBD she can elect 10 year payout. But now she doesn't have the option to elect the 10-year rule as decedent died after RBD but she does get the "longer of or shorter of" rule. During her lifetime she can take RMDs based on longer of decedent's life expectancy or her life expectancy so she can use decedent's life expectancy. But the Proposed Regulations apply an outer limit year which is the shorter of the two-life expectancy and that is her life expectancy of 7.6 years and she has to take out all of this by year 7.6.
        - Estate gets a 5-year payout as a non-DB. It doesn't matter that cousin and sister are only beneficiaries under the estate. Estate gets ghost life expectancy which a better result than the beneficiaries. So the worst beneficiary, the estate, gets the longest payout of all beneficiaries in this instance since decedent died after RBD.
        - *Authors' Note: The speaker pointed out that the complexity of these rules create potential opportunity for practitioners willing to learn them.*

WRAP-UP
Presenters: Stacy Eastland, Goldman, Sachs & Co.; Austin Bramwell, Milbank LLC; Ellen K. Harrison, McDermott Will & Emery LLP

- Paul Lee Partnership.
    - Advantages of avoiding disguised sale rules and mixing bowl rules. These rules have mechanical dates. In early 80s partners put in low basis assets and another person put in cash and the person who put in cash got out the low basis asset and the person who put in the low basis asset and etc. Congress in 1984 created mechanical rules.
    - Partnership basis shifting requires following elements:

    - Must have partnership that owns low basis assets or group of assets and a high basis asset or group of high basis assets.
    - Low or high basis assets must have been purchased by the partnership or contributed more than 7 years ago.
    - Partners with low outside basis.
    - Partnership has 30 M assets and all partners have zero basis.
    - Partnership borrows $25M from third party and invests in ETF or basket of securities.
    - Those partners who wish to remain in the partnership individually guarantee debt.
    - Purchase assets have high basis.
    - Partners looking to leave the partnership receive high basis ETF.
    - The ETF received by leaving parents get a zero basis. Where does zero basis go? It goes to the formerly zero basis asset hele by the partnership.
    - The now higher basis formerly low basis assets are sold and the debt is repaid.
    - You can use investment partnership or using this you can pick own stocks.
  - 704(c).
    - If you put in low basis asset and a lot of appreciation and later the asset is sold by the partnership up to the gain that existed when put into partnership, that will be allocated to contributing partner or donee of contributing partner.
    - Part of client retained gift to DAF or public charity. In Kerr case they said no 2704(b) problems as not applicable restrictions as you have a non-family member.
    - Benefit form income tax standpoint. Get immediate deduction for payment of preferred coupon. You get a second deduction on coupon as not taxed on it. It acts like a second deduction in going to charity. You cannot do this in a CLT but not so for gifts of a preferred interest.
    - 704(c) if partnership sells appreciated asset the gain inherent when contributed to partnership is allocated to the charity to the extent it is owned by the charity.
  - Grantor trust versus single member LLC.
    - Regs issued in 1996. Not only is it disregarded for income, but all activities are ignored.
    - With single member LLC you can have a deemed owner who creates a grantor trust and the grantor trust, owner and LLC treated as one for federal income tax purposes but for state law purposes treated as 3 separate persons.
    - Debt if you have debt coming back from grantor trust and concerned about capital gains, IDIT could contribute assets and debt to single member LLC and grantor contributes receivable to LLC and the debt is arguably extinguished.
- *Porter* Audit Questions.
  - Files must be in order.
  - Memo listing advantages of using entity.
    - Rationalize e.g. income tax basis shifting and 704(c) from charity.

        - You cannot have arbitration under trust agreement under most state laws but can in entity.
        - Better management for small trusts because small trusts can contribute all assets to entity and have better modern portfolio planning particularly with private equity investments.
    - 2036(a)(2) attack.
        - Show non-estate tax advantages of the partnership.
        - *Cohn* and *Byrum* if have reasonable standards that could be enforced they did not worry about it but in *Powell* said LP "in conjunction with others" you can amend the agreement. The Tax Court 1930 *Hemholz* case was discussed in *Levine*. That case holds that if your right is no more than what state law gives you that is not a 2036 or 2038 power.
        - John uses language in LP agreement to avoid it.
        - Give client investment and distribution power on standard. Trust has a small interest and that trust is only partner to amend or terminate and have independent trustee.
    - Installment sales being attacked.
        - Attack on value of principal.
        - Attack on too much leverage means retained interest in the trust.
        - Use Paul Lee idea of single member LLC. Make contribution to single member LLC take back managing and non-managing interests. Wait then give managing interests to trust. Leverage is on LLC interest. Taxpayer only has retained interest in single member LLC.
    - Subchapter S.
        - Tax effecting.
    - Defined value clauses.
        - Gave right to disclaim and pass to Donor Advised Fund (DAF). Everyone disclaimed other than specified value.
        - Worry about *Proctor*.
        - Force bargaining willing buyer willing seller and donor was not involved. Had to bargain with charity which was a DAF. Success in 5th Circuit before recent cases.
        - *Wandry* approved a formula saying I'm transferring certain value of property and without saying so balance was retained. The actual percentages are as finally determine for federal gift tax purposes. This formula "has become extremely popular". It has been approved further in the *Nelson* case.
            - Problem with *Wandry* style approach that may come up.
            - IRS will that if you use dollar formula clause and transfer $1M of units in FLP that leaves undefined what percentage you have transferred. The tax system doesn't have a way to finally determine percentage in a gift tax audit. Tax Court jurisdiction can determine value but if no audit there is no way to determine the actual percentage so donor has retained some undetermined percentage and perhaps IRS will look at this a second time on the estate tax return perhaps 30 years+ later.
            - Use a bifurcated formula. Instead of transferring $1M of FLP units. Transfer 1/10th 1% and balance is a formula. That means that the IRS can adjust the value but there is a potential adjustment and if you can

finally fix the 1/10th percentage it may be preferable to protect against IRS challenge and puts skin in the game.

- Mistakes by attorneys Wolven.
  - If an attorney makes a mistake the attorney has an ethical duty to disclose it to the client. Can you actually execute it?
  - Apologizing is good for the lawyer, good for the client but not approved by law. Some states authorize it but you have to still be very careful. Review with risk management colleagues and insurance carrier about an apology. The law has not caught up with psychological reality.
  - List of drafting mistakes that are easy to make.
    - Per stirpes.
    - Marital deduction drafting.
    - Tax apportionment.
  - Erosion of privity in malpractice claims.
    - NY case 10 years ago reversed NY strict privity so you can be held liable by a beneficiary who was not actually your client.
- Private foundations and Self-Dealing.
  - Rev Proc 2021-40 – IRS is no longer going to rule on plan it had blessed in series of 6 or so rulings that allows a promissory note payable by a disqualified person wrapped into an LLC and have the private foundation receive non-voting units. IRS had said this is not self-dealing. This is regrettable as installment sale to with large notes remaining in their estates.
  - Private foundation reimburses – self-dealing. You can reimburse for personal services as there is an exception but that has to be professional white-collar services but blue-collar services may not qualify. This may not be rationale but that seems to be what we have.
  - Co-investment between private foundation and a disqualified person. Form LLC together and invest together. IRS had approved this in several rulings but now will not rule on this. A Chief Counsel attorney has said that those rulings were issued under a different time and are not respected now by Chief Counsel Office.
  - Can you proceed without a ruling in a co-investment arrangement? If no fees and no one is paid and no benefit to disqualified person is there still self-dealing? Say LLC allows complete freedom of withdrawal? Opinions vary. What if crypto currency wallets stored in same place? Hard to view as self-dealing.
- Diversity and Inclusion.
  - Important as practitioners to have compassion for each other.
- Moore and Redd on trust modifications.
  - Evolving state laws of decanting, silent trusts, etc.
  - Decanting cases from English common law.
  - Law of trusts has changed so much must continue to update.
  - Important themes.
    - Much more variety across states than what had existed historically.
    - Duty of attorney's competence, e.g. quiet trusts is a controversial concept. To enforce trustee duties beneficiaries must have knowledge.
- Current developments.
  - 2023 Greenbook proposals.

        - Greenbook makes many of same proposals and prospects of enactment "are not great."
            - Attack GRATs.
            - Higher tax rates.
            - New proposal to impose gift tax when grantor pays income tax on grantor trusts.
            - Requirement that promissory notes be valued consistently. If you sell an asset for $10M promissory note and some years later a holder of the note makes a gift of the note what is the value of the note for gift tax purposes? Can you take the position that because the note is unsecured, a balloon, below market, etc. can you discount the value of that note? The proposal would shut that down.
            - Greenbook did not propose as they had before that grantor trusts would be included in the grantor's estate.
- Cases last year addressed mistakes and areas of potential mistakes by lawyer.
    - Warne.
        - Person owned controlling interest in business and made gifts to various charities and each charity received a non-controlling interests, so value of charitable deduction measured by what each charity received which was discounted for lack of marketability and lack of control. The interest included in the estate was valued without a discount. This can similarly occur in the case of the marital deduction. Where value of assets in estate differ from deductions you can get a tax.
        - Decedent could have left entire interest to a DAF or private foundation.
    - *Smaldino*.
        - Many mistakes in the plan.
        - One plan – typically one lawyer represents both spouses. Not easy to prove not part of a pre-arranged plan. Consider having donor spouse sell to donee spouse might avoid this issue but success of that might depend on note being treated as bona fide. Did donee spouse have wherewithal to pay
    - GRAT CCA.
        - Stock undervalued. Negotiations to do a merger at much higher price. The GRAT was disqualified.
        - Facts in the case were egregious but ruling is worrisome as we all thought a GRAT was a self-correcting mechanism, and no gift should follow but CCA suggested entire GRAT will fail if value is understated.
        - Porter suggested using defined value mechanism on transferring assets to a GRAT.
    - INGs.
        - Non-grantor trusts that are incomplete gifts.
        - Many rulings have blessed the transactions, but IRS recently announced that many rulings will be issued in the case.

    - Article by McCouch 39 Va Tax Review 2020 attacks INGs and points out inconsistent theories in rulings. Speaker would not do an ING now without a ruling and you cannot get a ruling.
- PLR 201245006.
    - Involved a trust where grantor retained right to all income and testamentary POA. That is not normally an intentionally defective grantor trust since included in the estate. In this instance assets not included in grantor's estate as the grantor was a nonresident Alien Rev Rul. 84-139 when inherit assets from NRA you get a basis step up even if assets not included in NRAs gross estate.
    - 1014 allows basis step up under 1014(b)(2) for assets in revocable trust and under 1014(b)(3) if grantor retains power of appointment get basis step up. These provisions per speaker would be superfluous if all grantor trust got basis step up.
    - Sanders included in his proposal that no basis step up on grantor trusts unless included in the estate. Speaker thinks people proposing the change did not have sufficient tax knowledge. This proposal suggests that there is a basis step up, but this would lead to the absurd result that an NRA puts in a revocable trust would not get a step up but assets in NRAs own name would get a basis step up.
- Split dollar economic benefit in *Levine* case.
    - Judge Holmes explained why 2036(a)(2) and 2703 did not apply to split dollar arrangement.
    - Key fact was that the trustee was an independent person who had genuine fiduciary duties that would be violated if agreement was terminated early.
    - Judge pointed to inadequate of gift tax regulations dealing with split dollar and told Treasury to modify the regulations.
    - Value of the split dollar receivable will have the value as finally determine for estate tax purposes and when the receivable is paid off their will be income tax.
- Administrative Procedures Act.
    - Only act after notice and chance to comment and government responds.
    - *Hewitt* case decided 11th Circuit 2022 held that portions of conservation easement Regs invalid since did not address comments by NY conservancy organization about condemnation proceeds.
    - 6th Circuit held the opposite way and said IRS did not have to respond to comments.
    - *Mann Construction Company* case held that IRS must follow Administrative Procedure Act.
- Corporate Transparency Act.
    - Will require reporting by beneficial owners includes corporation, LPs etc. created by filing with Secretary of State.
    - A trust is not a reportable entity but if owns interest in a reportable entity the beneficiaries of the trust may have to be disclosed.
    - Reporting requirements are onerous and time limits to file are short.

  - Many of us will need to get Fin Cen ID numbers to simplify reporting. Paralegal who forms entity and lawyers who oversee will need Fin Cen numbers to avoid having to update reports every time there is a change in circumstances.
  - If states waive filing requirement for limited liability entities this reporting may be reported but it is not clear that this will be done.
- International.
  - Notice 2012-52 gifts to a dual qualified charity. US requires donations to US entities. What if want to make donation to foreign entity. This notice gives a different option. UK charity wholly owned by a US corporation and US corporation made a check the box election to have the subsidiary disregarded for income tax purposes so in this case the donation to the foreign charity qualified as it was treated as owned by the US charity.
  - Work with foreign expert - don't assume you know it.
  - US probate avoidance techniques may not work as intended overseas.
  - Check treaties which vary Code Law.
  - Make election whether to have law of which domicile (habitual domicile) or nationality, govern estate. This might work to avoid forced heirship rules in certain jurisdictions.
  - Use of trusts is dangerous in civil law jurisdictions, e.g. France.
- Business succession planning.
- If you create an LLC with voting and non-voting interests and gift non-voting will you have a 2036 issue?

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

Mary Vandenack

Abigail O'Connor

Martin Shenkman

CITE AS: