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The Best, the Most Intriguing, and the Scariest Ideas Culled from the 2018 Institute and Elsewhere and How to Make Them Work for You and Your Clients

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I. **Tax Proposals and Related Matters**.

A. **Proposals Generally**.

1. These are in such flux that they have not been discussed here.
2. If passage of a bill happens, it will have a far-reaching effect on practitioners whether or not the estate tax is repealed.

B. **Senate Finance Committee Report.** [1]

1. The Senate Finance Committee Report was issued in October and essentially demonized practitioners for guiding clients to pursue tax planning ranging from annual gifts to more advanced techniques.
2. It is possible that any final tax bill that does not repeal the estate tax will toughen the rules to raise revenue for other tax reduction.

II. **ABLE Accounts**.

A. **Mississippi Enacts Able Legislation**.

1. **Take-Away**. Mississippi adopted the ABLE Act to encourage taxpayers to save assets in tax-exempt accounts to defray qualified disability expenses of eligible beneficiaries. Those making gifts to an ABLE account may deduct any contributions or payments from their Mississippi taxable income. April 11, 2017, S.B. 2311.
2. **Discussion**. ABLE accounts (Achieve a Better Living Experience) were created by the Tax Increase Prevention Act of 2014 to encourage private funding to assist disabled persons in maintaining a healthy, independent, and quality lifestyle. ABLE accounts are a tax-favored savings program similar to the IRC Sec. 529 qualified tuition programs. To benefit, the beneficiary must be disabled or blind, as defined under the Social Security Act, before age 26. Alternatively, the beneficiary may have a disability certificate on file with the IRS in which a physician certifies that the individual has a medically determinable physical or mental impairment resulting in marked and severe functional limitations that can be expected to result in death, or has lasted or is expected to last for at least 12 months, or is blind. Anyone can make nondeductible cash gifts to an ABLE account for the benefit of an eligible individual up to the annual gift tax exclusion amount. A 6 percent excise tax applies to contributions above the permitted amounts. Distributions from ABLE accounts, up to the amount of qualified disability expenses, are not included in gross income. Expenses which qualify are those related to the eligible beneficiary's blindness or disability (e.g., education, housing, transportation, training, health, wellness, financial management, legal fees). ABLE account assets are not included in means-testing for purposes of government benefits. Code Sec. 529A. A qualified ABLE program is a program established and maintained by a state, or an agency or instrumentality of the state that allows a person to make contributions to an ABLE account to meet the qualified disability expenses of a designated beneficiary who is a resident of the state or of a contracting state (Code Sec. 529A(b)(1)).

B. See planning comment under special needs trusts discussion below.

C. 529A ABLE accounts may provide a useful vehicle to assist many people with health and other challenges that use crowdfunding websites to raise funds for care needs not provided by governmental assistance. Perhaps Congress will take steps to enhance and liberalize 529A plans for that purpose. There has been discussion of increasing the age of disability from 26 to expand the reach of these plans.

III. **Agents**.

A. **Agent Appointment Conflicts**. [2]

1. **Take-Away**. Planning for aging (and incapacity) requires more than just the traditional preparation of a durable power of attorney (and perhaps a revocable trust). The multitude of

[1] The United States Committee on Senate Finance, "Estate Tax Schemes: How America's Most Fortunate Hide their Wealth, Flout Tax Laws, and Grow the Wealth Gap," October 12, 2017.
[2] See, Martin M. Shenkman and Sandra Glazier, "Lack of Coordination? The Potential for Best Laid Plans to Go Awry," Leimberg Information Services, Inc.

fiduciary and quasi-fiduciary appointments aging clients make, almost entirely without professional input, can create conflicts and inconsistencies in the administration of the client's affairs. Practitioners should expand the scope of their inquiry to determine all such appointments, be certain that they coordinate with the fiduciaries named under primary legal documents, and that they do not undermine the safeguards the planning team is endeavoring to create. As estate planning for aging clients grows in importance it also needs to evolve in scope to address a broader range of practical, non-technical, considerations. The practical advice is for planners to proactively address this issue and have it on their client meeting checklist to guide clients to coordinate these appointments. One thought is to have at least two fiduciaries (whether attorneys-in-fact or court appointed guardians) to minimize the possibility of financial abuse.

2. **Discussion**.
    a. There is a growing and potentially nettlesome issue with how aging clients appoint people to help them with financial matters. This could become an increasing problem for many clients but has yet to make most planners' radar screens. While addressing this risk is of paramount importance, the lack of coordination of how this is addressed could create considerable conflict. Consider each of the positions or appointments noted below. Be cognizant that the client might have yet other positions or appointments. Even when you coordinate, an agent can undo portions or the whole thing when we give them broad powers. Safeguards to prevent that should be considered. Practitioners often face conflicting objectives. There is often a goal to draft for flexibility and give agents broad powers because of the uncertainties as to what issues may arise. However, that same broad power may enable the agent so empowered to undermine the planning efforts or to commit elder abuse.
    b. Authorized signer on safe deposit box. Who has the client listed as authorized signers on their safe deposit box? The bank application may have been completed decades ago and the client may not even recall who has been named. If a former partner or former close friend is listed, or perhaps a child who is now alienated, what might the consequences be? How many planners even inquire about signers for safe deposit boxes? Consider the implications to a now alienated child being listed as successor agent and a different child is named executor and charged with distributing personal tangible property on death. Will that property be there? If the alienated child/signer is accused of stealing a particular piece of jewelry, how can the fact of that child's being granted such authority be overcome? Further, many clients do not list the details of tangible property in their wills or revocable trusts but rather provide general language authorizing an executor (or successor trustee of a revocable trust) to distribute property. In these situations, determining what the signer on the safe deposit box may have done versus the executor may be challenging. If the client/testator left a detailed list, and perhaps more so if that list were expressly incorporated by reference into the will, how might that impact the result if what is in the safe deposit box does not include valuable items on the list? What if there is both a list and scheduled property on the homeowner's insurance indicated the same property?
    c. Brokers will be required, under FINRA Rule 4512, "Customer Account Information," to make reasonable efforts to obtain the name of and contact information for a trusted contact person for a customer's account. 631,394 brokers are under FINRA's supervision.[3] Consider how many consumers will be asked by someone other than their estate planning attorney to designate a person to receive financial information.
    d. Social Security Representative Payee. The Social Security's Administration (SSA) has a Representative Payment Program that provides for financial management for a recipient of Social Security and SSI payments who is not capable of managing their Social Security or SSI payments. The SSA website states that "…we look for family or friends to serve as representative payees." A representative payee completes the Representative Payee Accounting Report online. You must be 18 or older to complete the Representative Payee Accounting Report online.[4] An FAQ on the website contains the following: "*We try to select someone who knows you and wants to help you. Our main concern is that*

[3] https://www.finra.org/about August 16, 2017.
[4] https://www.ssa.gov/payee/ August 5, 2017.

your payee is someone who can see you often and knows what you need. For that reason, if you live with someone who helps you, we usually select that person to be your payee. In most cases, someone who knows you asks us if he/she can be your payee. It may be a family member, a friend, a legal guardian or a lawyer. In some cases, social service agencies, nursing homes or other organizations offer to serve as payees. If you know someone you would like to have as your payee, tell a Social Security representative and we will consider your wish." [5] There is no indication in the materials that the agent who was selected with the guidance of legal counsel will be the person named, or that a durable power of attorney is even considered in the evaluation.

e. Long Term Care Insurance. Long term care lapse rates are surprisingly high and the main cause for the lapse is the individual's incapacity.[6] Generally, an insurer cannot cancel a policy for failure to pay premiums unless the grace period provided for in the policy passes and notice of the premium due is given. While traditionally the premium notice has been only sent to the insured, that has not proven sufficient to prevent large lapses in long term care policies. For example, an elderly insured might have mobility challenges or start experiencing cognitive issues before being diagnosed as having dementia or declared incompetent, when presumably the policy would begin payment. The industry has responded by permitting the insured to designate someone as an alternate. Long term care insurance companies permit policyholders to name a person who can receive notice if the premium has not been paid called a "lapse designee." In some instances, the insurance contract itself may provide for the designation of a person to receive secondary notice before a lapse can occur. Some state laws require such a procedure, some of the general terms of which will prove helpful for practitioners to understand in helping clients plan generally for this issue. For example, consider the Washington state statute:
"Unintentional lapse.
As a protection against unintentional lapse, each issuer offering long-term care insurance must comply with all of the following:
(1)(a) Notice before lapse or termination. No individual long-term care policy or certificate may be issued until the issuer has received from the applicant either a written designation of at least one person in addition to the applicant to receive notice of lapse or termination of the policy or certificate for nonpayment of premium, or a written waiver dated and signed by the applicant electing not to designate additional persons to receive notice.
(i) The applicant has the right to designate at least one person to receive the notice of termination, in addition to the insured.
(ii) Designation does not constitute acceptance of any liability on the third party for services provided to the insured.
(iii) The form used for the written designation must provide space clearly designated for listing at least one person.
(iv) The designation must include each person's full name and home address.
(v) If the applicant elects not to designate an additional person, the waiver must state: "Protection against unintended lapse. I understand that I have the right to designate at least one person other than myself to receive notice of lapse or termination of this long-term care insurance policy for nonpayment of premium. I understand that notice will not be given until thirty days after a premium is due and unpaid. I elect NOT to designate a person to receive this notice."
(vi) No less frequently than once every year the issuer must notify the insured of the right to change this written designation or to add a lapse designee, if the insured has not already designated a lapse designee."[7] This statute permits designating successive agents so that, perhaps, the same listing of persons listed as agent and successor agents under the client's power of attorney could be listed. Should power of attorney forms include an express designation of the agent as the person to act for the principal's long-term care

[5] https://www.ssa.gov/payee/faqbene.htm, August 5, 2017.
[6] . Hou, Sun and Webb, "Why Do People Lapse Their Long-Term Care Insurance?" Center for Retirement Research, October 2015, Number 15-17, page 1.
[7] WAC 284-83-025 http://apps.leg.wa.gov/wac/default.aspx?cite=284-83-025 , August 5, 2017.

policy as a designee? Will the insurance company accept that type of appointment? What if that statement conflicts with the person named under the insurance company form? If the insurance company respects the designee on its form, which would seem assured, and that designee is different than the agent under the power of attorney, the power of the agent may be emasculated as the agent may not have control over a significant and vital source of cash flow. Perhaps the checklist wealth advisers, attorneys and others use for an annual review meeting should include a question as to the status of this designee.

f. Health care agent and financial agent. There can also be a conflict between the medical power holder and the persons in control of the purse strings. **Sample Provision**: If I have executed a separate financial Power of Attorney form or document appointing any person or entity to serve as my financial agent or attorney in fact, I request that my Agent appointed herein cooperate with such financial agent, and keep such financial agent reasonably advised of expenses incurred, or likely to be incurred, in connection with my health care and related matters by my Agent under the powers granted in this Health Care Proxy.

g. Successor Account Holders on 529 and 529A plans. Consideration should be given to the persons named as successor account holders on 529 plans. Are they the same person named as agent? Are different persons named who may work at cross-purposes?

h. Agent for Funeral Decisions. While a client can address end of life decisions, including funeral and burial, in a health proxy, and authorize provisions in a will. However, too many people do not take these steps and some legislatures have acted. Thus, some state laws permit the appointment of an agent to control the disposition of a person's remains. Historically the right to make final arrangements and funeral decisions was within the purview of the executor. However, the cost and formality of creating a will, the fact that many consumers do not sign wills, and the cost and difficulty of changing a will if final wishes change, make the traditional approach inadequate and burdensome. This has prompted states to provide for a simpler alternative. For example, New York's statute permits the agent to provide special directions for the decedent to be cremated, that the body be buried in a particular grave at a specific cemetery, or that a particular funeral home handle the final arrangements.[8] The New Jersey statute permits the appointment of a funeral representative in a Will, even if it has not yet been admitted to probate. NJSA 45:27-22 Control of funeral, disposition of remains. What would occur if there is a caveat filed to the will?

"*a. If a decedent, in a will as defined in N.J.S.3B:1-2, appoints a person to control the funeral and disposition of the human remains, the funeral and disposition shall be in accordance with the instructions of the person so appointed. A person so appointed shall not have to be executor of the will. The funeral and disposition may occur prior to probate of the will, in accordance with section 40 of P.L.2003, c.261 (C.3B:10-21.1). If the decedent has not left a will appointing a person to control the funeral and disposition of the remains, the right to control the funeral and disposition of the human remains shall be in the following order, unless other directions have been given by a court of competent jurisdiction:*
(1)The surviving spouse of the decedent or the surviving civil union or domestic partner; except that if the decedent had a temporary or permanent restraining order issued pursuant to P.L.1991, c.261 (C.2C:25-17 et seq.) against the surviving spouse or civil union or domestic partner, or the surviving spouse or civil union or domestic partner is charged with the intentional killing of the decedent, the right to control the funeral and disposition of the remains shall be granted to the next available priority class as provided in this subsection.
(2) A majority of the surviving adult children of the decedent.
(3) The surviving parent or parents of the decedent.
(4) A majority of the brothers and sisters of the decedent.
(5) Other next of kin of the decedent according to the degree of consanguinity.

[8] New York's Public Health Law § 4201.

(6) If there are no known living relatives, a cemetery may rely on the written authorization of any other person acting on behalf of the decedent.
For purposes of this subsection "domestic partner" means a domestic partner as defined in section 3 of P.L.2003, c.246 (C.26:8A-3)."

Some advisers have suggested crafting a document separate from the last will and testament to address funeral and other last arrangements. That independent document could designate the person named in the will as the agent for these purposes. The document might also summarize the client's/decedent's wishes for any final ceremony, internment, etc. One commentator has suggested providing copies of a signed, witnessed and notarized funeral agent designation to the funeral home and others. While such advice is logical, consider the potential for conflicts. Many if not most health proxies and living wills address last rites, ceremonies, funeral, cremation and other matters. Will a separate funeral agent designation form conflict with the health care proxy and/or living will? What if the will is amended? Will the designation in the will differ? Also, what if the client wishes costly last arrangements? Does the agent under a funeral direction have the authority to commit funds to the arrangements that agent selects or does the authorization of that expenditure still lay in the hands of the executor? If it the financial aspects of these matters remain within the purview of the executor, must the will provisions be coordinated with and mirror the provisions and appointment contained in any separate funeral arrangement designation? How might a funeral agent designation conflict with a guardian for the person?

i. Power of Attorney may designate an agent to handle legal, tax and financial matters. Some powers are drafted to become effective only when the client becomes disabled, i.e. springing powers. However, because of the problems of demarcating exactly when someone is "disabled" perhaps it is becoming more common for powers to be drafted to become effective when signed. This avoids the complications for the agent of proving disability but also creates more potential conflict with the other appointments noted in this article. The agent under the power may have overlapping or conflicting roles with the successor trustee under the client's revocable trust (see discussion below), the designee under the client's long-term care policy, the Representative Payee for Social Security, and others.
j. Bank Accounts can present another source of conflict and confusion. When a client opens a bank account, often clerks encourage joint accounts, pay on death ("POD"), transfer on death ("TOD"), or other variations, to avoid probate. Too frequently clients open accounts at financial institutions which are convenient to them, and without consulting with their financial or legal adviser. If an account is opened in the joint name with another individual who is not the agent under the power of attorney, how might that impact the agent's ability to act? If a client has accounts that are denominated as POD or TOD, or joint with rights of survivorship, and funds are used out of one account, resulting in a disparate inheritance when the client dies, what might the impact be? Might there be an inference that the agent inappropriately favored using one account over another thereby shifting, perhaps undermining, the client/principal's dispositive scheme? So even if the account titles do not create a conflict in agent authority, if not properly planned they might create other difficulties.
k. Revocable trusts create potentially further issues. With an aging population, and more isolated and vulnerable seniors, it will become more common for clients to name institutions as successor trustees on a revocable trust to manage financial and other affairs as the client ages or grows infirm. Corporate trustees are loath to assume the role of agent under a durable power so the practical consequence is the client may name a friend, family member, neighbor, attorney or other as agent under a durable power of attorney and a corporate trustee as successor trustee under a revocable trust. As the client ages, what are the relative responsibilities of the individual agent under the power of attorney and the successor trustee (or co-trustee) under the revocable trust? Should the power of attorney state that the agent cannot make changes to the revocable trust except to ensure an intended tax benefit, etc.?

Corporate trustees are increasingly named as successor trustees under client's revocable trusts and this will likely evolve into a growing trend. This can be a prudent step, and an approach that will provide more professionalism and safeguards (assuming that the corporate trustee performs as required). Will the relative roles merely depend on who has title to which assets? That seems to be an inadequate analysis as both the agent and successor trustee have overlapping charges under the language in many trusts and powers of attorney. Both are often charged to provide for the principal's lifestyle and care. Is it reasonable to ever maintain that the corporate trustee has abrogated its authority or responsibility to the agent under the power of attorney? It would seem that most if not all clients who designate a corporate trustee are doing so with an intent that there be a level of independent corporate oversight on the principal's finances, or why else would an institution be named? Further, if institutions almost uniformly refuse to serve as agents under a power of attorney, might the fact that an individual is serving as agent contemporaneously with an institution serving as successor trustee perhaps suggest that the client/principal/trustee was merely left with no choice in designating an individual as agent even though they were seeking corporate professionalism for their finances? Might the relationship between an individual agent and corporate successor trustee be viewed more correctly as one akin to co-fiduciaries if the liens of responsibility based on the governing instruments overlap sufficiently? Might the interpretation of the relationship in part depend on the express language in each governing document relating to the relationship? For example, if the power of attorney contained express language authorizing the agent to modify or revoke the revocable trust that might suggest that the agent's power is paramount. On the other hand, consider the situation of a standard form power of attorney that included a standard provision permitting the principal to check a box permitting the agent to modify or revoke the trust, but that box was not checked. Perhaps that would suggest that in fact it is the corporate trustee whose power should be paramount. Who has authority over tangible personal property? The corporate or other trustee under the revocable trust or the agent under the power of attorney? If the assets were transferred to the trust, then perhaps the trustee would. If not, perhaps then solely the agent would. What should be done with respect to retirement account assets. If the client's intent was for the institutional trustee to manage all finances but an individual serve as agent, might the individual's actions with respect to retirement assets impact the institutional trustee's functioning as successor trustee under the revocable trust?

l. **Example**. What if the client named Child-1 as agent under a durable power of attorney, Child-2 as lapse designee on her long-term care policy, a sibling as Representative payee for Social Security and a neighbor on another financial matter. What happens in terms of managing an incapacitated client's financial affairs. What becomes of the potential conflicts of authority? Who makes which decision?

m. **Conclusion**. The result of the various appointments and designations, often made without the benefit of guidance and coordination with any professional advisers, could become a disaster. Because there may be no coordination of the persons named in these various capacities it may be difficult to determine which agent or appointee has authority over which matter. For example, most powers of attorney grant express powers over insurance matters to the agent. But what if a different agent is named as a designated representative under a long-term care policy? Which appointment, as noted above, governs? Given how fractionalized, geographically dispersed, and dysfunctional families are, the potential lack of coordination of agents could be for many a time bomb of financial confusion conflict, and litigation.

IV. **Alzheimer's Disease**.

A. **Take-Away**. The statistics on the incidence of Alzheimer's disease, and the anticipated growth in those affected are significant. Even more important to practitioners is the disproportionately large percentage of clients that view Alzheimer's as one of the biggest threats to their future post-retirement years. Practitioners should consider these figures in determining the nature of the conversations with their older clients. Alzheimer's will be a far greater worry than taxes for many clients.

B. **Discussion**. There is a 1 in 6 chance of developing Alzheimer's if you are a woman age 65 or over.[9] 5.3 million Americans had Alzheimer's in 2015 and it is estimated that this figure will grow to 13.8 million by 2050.[10] In a recent survey conducted by Merrill Lynch, 54% of respondents said Alzheimer's is the most frightening disabling condition that one can encounter later in life. "People cite Alzheimer's as the scariest health condition of later life (54 percent), more than cancer, strokes, heart disease, diabetes and arthritis combined."[11]

V. **Art**.

A. **Valuation**.

1. **Take-Away**. The IRS memorandum discussed below provides practical guidance and reminders on appraisal methodology. When valuing multiple individual items for donation it may be preferable to have a separate appraisal report prepared for each individual item. Be certain to adhere to the specifics of the statute and Regulations, including assuring that the appraiser meets the criteria as a qualified appraiser.
2. **Discussion**.
   a. This IRS Memorandum addressed art valuations, appraisal reports and valuation understatement penalties.[12] The IRS evaluated whether the taxpayer complied with the appraisal requirements of IRC Sec. 170 concerning non-cash charitable contributions.
   b. Single appraisal report. The taxpayer completed the form for Noncash Charitable Contributions (Form 8283) and attached a single appraisal for multiple works of art rather than a separate appraisal report for each donated artwork. The appraisal listed, appraised and valued each artwork individually and then added the values of the individual items together to calculate the total fair market value for all of the items contributed. While the IRS discussed the issue, it did not conclude that separate appraisal reports were necessary.
   c. Qualified Appraiser. One issue was whether the appraiser was a qualified appraiser because he was regularly used by the taxpayer for appraisal services.[13] A qualified appraiser must comply with a number of requirements including that the appraiser regularly performs appraisals for which compensation is received. The IRS was concerned because the appraiser was regularly used by taxpayer for appraisal services. The IRS evaluated the proportion of appraisals completed for the particular taxpayer versus other persons and held that the appraiser did not meet the requirements.
   d. Valuation penalties. The IRS determined that because the values claimed by the taxpayer for the charitable contribution deduction exceeded the correct values by more than 200%, the taxpayer is liable for the 40% gross valuation misstatement penalty under section 6662(h). The IRS Office of Art Appraisal Service did not perform an appraisal of each of the items donated. Rather, it selected items based on a random statistical sampling, and appraised only these items selected and concluded based on that sample that the values of all of the items donated were overstated by at least 200%. The Memorandum concluded that a sampling methodology was inconsistent with the Regulations which provide: "The determination of whether there is a substantial or gross valuation misstatement on a return is made on a property-by-property basis."[14]

VI. **Asset Protection**.

A. **Business Asset Protection.**

1. **Take-Away**. Clients with closely held business interests may have many opportunities for asset protection planning. Below are a few ideas that some practitioners may not have considered.[15]

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[9] Women and Alzheimer's Disease, Alzheimer's Association, March 2014.

[10] 2015 Alzheimer's Disease Facts and Figures, Alzheimer's Association, 2015.

[11] "Health and Retirement: Planning for the Great Unknown," was conducted by Merrill Lynch research in partnership with Age Wave. "Merrill Lynch Study Finds Health Is the Cornerstone of a Happy Retirement, and Greatest Financial Worry," September 12, 2014, http://newsroom.bankofamerica.com/press-releases/global-wealth-and-investment-management/merrill-lynch-study-finds-health-cornerstone-

[12] Office of Chief Counsel Internal Revenue Service, Memorandum Number: 201711009, Release Date: 3/17/2017.

[13] IRC Sec. 170(f)(11)(E)(ii).

[14] Treas. Reg. Sec. 1.6662-5(f)(1).

[15] The author acknowledges Alan Gassman, Esq. for the ideas listed in this section.

2. **Discussion**.

a. In the event of a creditor calamity, the lender having a lien on corporate assets will be paid first to the extent that money is owed and secured by the assets of the company.

b. While a typical investor with $1,000,000 of real estate might have bank financing of $700,000 to $800,000, a comparable family business or investment entity may have no debt. Consider having that entity owe another family-related entity or trust, at arm's length and secured by the assets of the family entity, a debt. This may assure that in the event of a claim against that family business or investment entity, the family members or trust holding debt owed by the entity to them could be paid from a forced sale of the entity assets before a judgment creditor would be paid.

c. For a client owning a business or professional practice, have the business or practice guarantee debt that is owed by a related party. For example, the business or professional practice entity might guarantee a mortgage owed on real estate that is leased to the business or practice. Further, consider having the tenant's assets pledged as additional collateral for the loan so that in the event of a claim the bank holding the mortgage on the leased property would be able to call the loan and force a sale of the assets of the business entity or professional practice, resulting in the proceeds from sale reducing the amount of the mortgage on the real estate, and not being available to the creditor holding a judgment against the business or practice entity.

d. Another approach might be to have the business entity enter into a long-term lease with the landlord entity, and provide a lien against the corporate assets so that the landlord entity would be able to accelerate rents to be owed significant monies and force the sale of business or professional assets to pay for the accelerated rents. For example, the lease might provide that in the event of default all future rents during the lease term shall be accelerated.

e. Planners should be aware of the doctrine of marshaling of assets, whereby a court may require that a lender that is "over collateralized" to give up cross-collateralized assets. However, cases in this area are uncommon, and it may do no harm to have the assets of a business or professional practice cross-collateralized or given as security in the manner described above, so long as reasonable. This might result in encouraging plaintiff's counsel to settle for malpractice or other insurance policy limits, or otherwise in a more favorable manner rather than competing with a related party creditor, or a third-party creditor, who might be allegedly over-collateralized.

f. Income tax may be incurred if an S-corporation or C-corporation issues a note to a shareholder. The note issued may be characterized for tax purposes as an amount distributed to the shareholder. In an S-corporation situation, a shareholder receiving an actual or deemed distribution exceeding his or her basis in the stock of the S corporation, will recognize income as if a distribution was made. Therefore, it is common to have a note extended that is less than or equal to the amount of the basis in the stock to avoid imposition of income tax on the creation of the indebtedness. An alternative method will be to establish a new company that can own the existing company and to have the subsidiary/existing company owe money to its parent company, which can generally be effectuated on an income tax free basis.

g. **Example**. Oldco may be an operating entity and John Smith, its shareholder, may have a basis in Oldco of $50,000. Oldco may have $300,000 worth of assets. John Smith may form Newco as an S-corporation and then transfer his ownership in Oldco to Newco in a tax-free capital F reorganization. Oldco may thereafter give a note to Newco in the amount of $150,000. Since Newco will be considered to be a disregarded entity owned by Oldco, there will be no tax imposed by reason of the note being given. If Oldco were to be sued well after the note is given, then Newco would be able to foreclose upon the assets of Oldco and receive the first $150,000 of value given, leaving very little, if anything, for a judgment creditor.

h. In addition to leveraging assets of professional and investment corporations, it may be possible to divide both assets and activities so that cause of action or lawsuit against one operating entity would not cause loss of all assets and other affiliated operating entities.

B. **DAPT and Child Support and Alimony.**

1. **Take-Away**. The Klabacka holding is a positive development for domestic asset protection trusts ("DAPTs") and suggests that the very protective statute in Nevada, that excludes a divorcing spouse as an exception creditor, will be respected. However, the Klabacka decision does not address the most worrisome DAPT issue, which is whether a resident of a non-DAPT jurisdiction, who creates a trust in a DAPT jurisdiction such as Nevada, will have that trust respected, i.e. will achieve the hoped-for asset protection goals.

2. **Discussion**.
    a. In Klabacka, a Nevada DAPT was upheld as protecting assets from both spousal support (alimony) and child support claims.[16]
    b. Distribution of the parties' assets held in DAPTs (which the Court referred to as self-settled spendthrift trusts, or "SSSTs") was, perhaps, the most contested issue in the Nelsons' divorce.
    c. Husband (Eric) and wife (Lynita Nelson) signed a separate property agreement ("SPA") that transmuted their community property into separate property which each then transferred into his or her respective separate property trust. Later, the parties converted those trusts into self-settled spendthrift trusts or DAPTs.
    d. Some of the pertinent facts in the case included the following.
        (1) Each DAPT included the following clause: "No property (income or principal) distributable under this Trust Agreement, . . . shall be subject to anticipation or assignment by any beneficiary, or to attachment by or of the interference or control of any creditor or assignee of any beneficiary, or be taken or reached by any legal or equitable process in satisfaction of any debt or liability of any beneficiary, and any attempted transfer or encumbrance of any interest in such property by any beneficiary hereunder shall be absolutely and wholly void."
        (2) The parties named themselves as the investment trustee for their respective DAPTs.
        (3) Both the SPA and the DAPTs were signed, written agreements.
    e. The Court reviewed the requirements to find a valid DAPT.
        (1) No specific language is required to create a valid spendthrift trust (DAPT) in Nevada. NRS 166.050 provides that a spendthrift trust is created "if by the terms of the writing …the creator manifests an intention to create such a trust." In addition to the spendthrift requirements, to create a valid SSST, NRS 166.015(2)(a) requires the settlor to name as trustee a person who is a Nevada resident. Further, NRS 166.040(1)(b) provides that the DAPT must: (1) be in writing, (2) be irrevocable, (3) not require that any part of the trust's income or principal be distributed to the settlor, and (4) not be "intended to hinder, delay or defraud known creditors."
        (2) The Court also noted that to determine the validity of the trusts, one must first look to the words of the trust agreement to determine if the settlor had the intent to create a spendthrift trust. If the trust's language is plain and unambiguous, then courts determine intent from this language alone. If the meaning of the writing is uncertain, incomplete, or ambiguous, parol evidence of the circumstances is admissible to determine the settlor's intent.
    f. The trusts' plain and unambiguous language confirmed the intent to create spendthrift trusts. In fact, one approach is to state that expressly in the trust instrument and by specific reference to the approach state statute. There was no evidence that either trust was created to hinder, delay, or de-fraud known creditors. The Court determined that the SPA and DAPTs were valid and unambiguous and therefore found that the district court erred in considering parol evidence to determine the parties' intent behind the SPA and DAPTs. The Court also held that the district court erred in ordering Eric's personal obligations to be paid by Eric's DAPT. The DAPTs were funded with separate property stemming from a valid separate property agreement.

[16] Klabacka v. Nelson, 133 Nev. Advance Opinion 24 (5/25/2017).

g. If the DAPTs were properly formed would breaches in trust formalities undermine the integrity of the trusts? The Court held that breaching trust formalities of an otherwise validly created DAPT does not invalidate a spendthrift trust. Rather, it creates a cause of action for a civil suit against the trustee.

h. NRS 166.120(3) provides that a spendthrift trust beneficiary has no power to make any disposition of any of the income; nor shall the interest of the beneficiary be subject to any process of attachment issued against the beneficiary, or to be taken in execution under any form of legal process directed against the beneficiary or against the trustee, or the trust estate. The trust estate and the income of the trust estate shall go to and be applied by the trustee solely for the benefit of the beneficiary, free of any obligations of the beneficiary whatsoever.

i. Although the Restatement (Third) of Trusts §59 (Am. Law Inst. 2003), provides "[t]he interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for . . . support of a child, spouse, or former spouse," that is contrary to Nevada law. Despite the public policy rationale used in the other jurisdictions, Nevada statutes explicitly protect spendthrift trust assets from the personal obligations of beneficiaries.

j. The legislative history explicitly mentions child support as an example of a debt that would not be free from attachment if known at the time the trust was created. However, the trust assets would be protected from attachment as to debts unknown at the time the trust was created. This protection extended to child- and spousal-support obligations unknown at the time the trust was created

k. The Court recognized that Nevada's DAPT approach differs from Florida, South Dakota, and Wyoming, in that Nevada abandoned the interests of child- and spousal-support creditors, as well as involuntary tort creditors to attract trust business.

C. **DAPT Chart**.

1. **Take-Away**. DAPTs remain controversial. Naysayers continue to suggest their shortcomings and risk. Yet the number of states permitting DAPTs has continued to grow. In appropriate circumstances, with proper caution to clients, and reasonable safeguards, DAPTs might remain a useful tool in the planner’s tool kit. In assessing the pros and cons of the growing number of states that permit self-settled trusts, practitioners may find an annual chart created by attorney Steve Oshins helpful.
2. **Discussion**. Steve Oshins published his annual DAPT rankings listing Michigan, Tennessee and Ohio, as top DAPT jurisdictions.[17] Whether you concur with the methodology or even the creation of such a chart it does demonstrate that the number of states permitting DAPTs has continued to grow, and some of the newer states joining the ranks have endeavored to push the envelope of protection further. This process, as illustrated in the Klabacka case discussed elsewhere in this outline, has been respected by some courts. For DAPT naysayers (and see the discussion of the UVTA and other matters elsewhere in this outline) consider the following quote from the article: “…after 20 years of DAPTs there still hasn’t been even one court case where a plaintiff has been able to get a judgment or settlement and then access the debtor’s DAPT for payment, except where there was a bankruptcy or fraudulent conveyance.”

D. **Disclaimer**.

1. **Take-Away**. While disclaimers may provide an effective mechanism to protect assets against claims in some jurisdictions as to state law claims, it is not assured in the case of federal tax liens and under the Bensal case, federal debts as well. Perhaps two lessons can be learned from the case. First, if a client is going to execute a disclaimer effort should be made to identify any federal liens or debts. The most important lesson, which practitioners understand but too many clients not only often do not understand, but in many instances combat, is that all gifts and bequests should be made in long term trusts. A simple trust might have avoided the issue altogether in Bensal.
2. **Discussion**. In Bensal the court would not respect a relation back doctrine for a disclaimer as fraudulent transfer.[18] The relation back doctrine generally protects a disclaimer from being challenged as fraudulent transfer. This is because under the doctrine it is as if the disclaimant

[17] “2017 Steve Oshins Releases 8th Annual Domestic Asset Protection Trust State Rankings Chart...with a Huge Surprise!” Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #342, April 24, 2017.

[18] U.S. Small Business Administration v. Bensal, http://cdn.ca9.uscourts.gov/datastore/opinions/2017/04/04/14-17404.pdf

predeceased the decedent and never had an interest in the property. The Court's reasoning was that the Federal Debt Collection Procedures Act preempted state law under the Supremacy Clause and the SBA could therefore void the disclaimer as a fraudulent transfer.

3. In Bensal, the defendant guaranteed loans a business borrowed from a bank. The U.S. Small Business Administration ("SBA") also guaranteed the loan. The business defaulted on the loan and the bank obtained a default judgment against the business and the defendant individually both of whom assigned the judgment to the SBA. Thereafter, the defendant's father died leaving a bequest. The defendant, Bensal, disclaimed (renounced) that inheritance resulting in the assets passing to his children under California law. Unfortunately, because of the preemption the disclaimer failed.

E. **Fraudulent Transfer**.

1. **Take-Away**. Not that practitioners need another reminder, but the Leathers case provides one. Be cautious to identify pending issues and claims before consummating any transfers.
2. **Leathers**.
    a. In Leathers, the court held that a taxpayer fraudulently transferred assets to a trust to avoid tax debt.[19]
    b. The IRS had consistently maintained that the transfer of mineral interests to a trust was fraudulent. Under Kansas law, a transfer by a debtor is fraudulent as to a creditor if the debtor makes the transfer with actual intent to hinder, delay or defraud the creditor. The direct testimony from the individual and the trustee that the purpose of the trust was to protect the transferor's mineral interests from the IRS. The IRS tax liens took priority over any interest the trust might claim.
3. **PNC Bank**.[20]
    a. Illinois Attorney Who Transferred Nearly All His Wealth to a Delaware Series LLC Loses Summary Judgment Motion Against His Creditor's Lawsuit Based on Fraudulent Transfer Grounds
    b. In PNC Bank v. Udell, the U.S. District Court for the Northern District of Illinois concluded that an Illinois attorney who transferred nearly all his wealth to a Delaware Series LLC a year after entering into a personal guarantee, mostly lost his summary judgment motion against his creditor's lawsuit which was based on fraudulent transfer and similar grounds.

F. **Fraudulent Transfer- Transfirst**.

1. **Take-Away**. Practitioners might not need another reminder that creating entity structures (LLC, corporation, partnership, trust) to protect assets will not succeed if the debtor himself does not respect the integrity of those entities. But Transfirst provides that reminder. [21] The debtor asserted that the only remedy against an LLC was a charging order, but the creditors argued that the entities were shams, and endeavored to pierce the LLC to reach underlying assets. The creditor similarly asserted the right to pierce a trust and the debtor claimed that such an action against a trust was inappropriate. If entities of any type, or even trusts, are used to defraud creditors, courts may well craft a means to disregard or pierce them. Further, optics can be important in creditor cases. When the debtor lives a lavish lifestyle while claiming no access to assets, the result will more likely be less favorable to the debtor. While Transfirst is another bad-fact case, it should nonetheless serve as a reminder that clients with complex structures must meet regularly, not less frequently than annually, to review the maintenance and operation of those structures with their entire advisor team and assure they are operated with all appropriate formality. Clients with legitimate business purposes for entity and trust structures should corroborate them.
2. **Discussion**.
    a. The creditors obtained a fraud judgement against Magliarditi in the U.S. District Court in Texas. The case was transferred to Nevada where the Magliarditi's lived and the creditors filed a new claim in Nevada against the couple and various entities they claimed to be the alter-egos of the couple.
    b. In Transfirst Group, Inc. the husband and wife acted for years to defraud their creditors and avoid paying a large judgment obtained against them.

[19] M.R. Leathers, CA-10, 2017-1 USTC ¶50,212, May 4, 2017.
[20] PNC Bank, N.A., v. Udell, 2017 WL 3478814 (N.D.Ill., Aug. 13, 2017).
[21] Transfirst Group, Inc. v. Magliarditi, 2017 WL 2294288 (D. Nev., May 25, 2017).

c. In these efforts, the husband utilized various legal entities he indirectly had influence over, including manipulative transfers of assets between them. Creditors asserted that the husband used those entities as his alter egos and on that basis they tried to disregard the entities and trust as shams and pierce them to reach assets to satisfy the judgement due them. To achieve this goal, the creditors would have to demonstrate that the entities were controlled and so influenced by the person, Magliarditi, that they were merely his alter ego. They would have to show that there was a sufficient unity of interests that the debtor and the entity/alter egos were inseparable. Finally, they would have to show that respecting the independence of the entities, under the circumstances involved in the case, would result in an injustice. Showing a commingling of entity and personal funds, the creditor using the funds as his own, ignoring formalities of the entities and so on, could provide a basis to pierce the entities. In Transfirst there were hundreds of thousands of dollars of unsubstantiated transactions and undocumented loans and husband's personal expenses were paid for by the entities.

d. In Transfirst the debtors argued the husband did not own interests in the entities but the wife did, and she owned those interests with her own separate property as a result of a transmutation agreement which changed community to separate property. The court found that the husband did not have to own interests in the entities, but rather it was his exertion of control over the entities that was key. Despite the wife's professed ownership, she demonstrated little knowledge of the entities and decisions were made by the husband/non-owner.

e. The debtor argued that the alter-ego/piercing concept should not apply to limited partnerships because the general partner is always liable for entity debts. The court dismissed this argument but did note that piercing may not be appropriate if the result is to force a partner to be a partner with a third party that he did not choose to do business with.

f. The case also discussed the concept of reverse piercing, where the individual's debts could be paid by the entity pierced as a result of creditor demonstrating the entity is the alter-ego of the individual insider.

G. **IRA and Bankruptcy.**

1. IRA accounts are often used as part of asset protection planning when state law provides protection for such accounts from creditors. However, caution and practicality should not be disregarded in such planning. In a recent case, the debtors filed for Chapter 7 bankruptcy. They should have retained IRA funds intact but did not do so. Immediately after the filing, they withdrew funds from their Roth IRAs depositing the funds into their personal checking account and then used those funds towards a down payment on residence and for living expenses. Their bankruptcy filings claimed full exemption for the Roth IRAs even though the funds had already been withdrawn and spent. No surprise, the bankruptcy trustee objected.[22]

H. **LLC Piercing- Greenhunter.**

1. **Take-Away**. LLCs are ubiquitous in asset protection planning. Even single member LLCs have been commonly used in many plans. Greenhunter raises questions as the security of using single member LLCs in that context. Some commentators on this case have suggested that clients use separate accountants for different entities. That is, however, impractical. From a pricing, coordination and consulting perspective many clients would logically and rightfully balk at such a suggestion and it makes no sense from a business perspective. These same commentators suggested assuring adequate cash in entity bank accounts. While that is generally a reasonable suggestion it ignores business realities, especially for startup entities, and the realities of enterprises that have multiple endeavors, e.g. a chain of retail stores or series of apartment buildings. It is not uncommon to use excess cash flow from one project or property to fund cash shortfalls in others. While practitioners would routinely recommend such transfers be properly accounted for, and in many cases, might recommend documentation in a note agreement, the holding and reasoning in Greenhunter, and the comments from some analyzing the case, might set a worrisome precedent.
2. **Discussion**.

[22] In re Chambers, No. 16-00552 (Bankr. N.D. Iowa Aug. 24, 2017.

a. The Greenhunter case is perhaps another bad fact LLC asset protection case, but is potentially a worrisome case.[23] The facts in a very simplified manner are that the LLC in question entered a consulting contract with the plaintiff. Plaintiff/consultant sought payment for services and found that the defendant/employer had no assets so the consultant sued the sole member of the defendant/employer single member LLC.

b. The court acknowledged the general viability and protection an LLC can afford its member but determined that when the member of the LLC so influenced by the member that the requisite separateness of the LLC and its member ceases to exist, the veil or protection of the LLC can be pierced to avoid injustice, unfairness, etc.

c. The court considered several factors in its analysis. The court found fraud by the member. Inadequate capitalization existed in that there were many times when the LLC had no funds in its entity bank and the sole member made periodic transfers to infuse cash. The fact that the consultant submitted seven invoices none of which were paid was viewed as further corroborating the inadequate capitalization. While these facts might support such a conclusion there are many situations practitioners encounter with similar facts, especially in a start-up enterprise, that may not be alarming. The court also found an intermingling of the member and the LLCs finances, based on facts practitioners will find to be disconcerting. The sole member and the LLC used the same accountant. Most clients use the same accountant for many or all of their enterprises. There was overlapping ownership. That too is common. The court noted that the member and the LLC each had separate bank accounts and books and records. That is a factor that too many clients fail to address. The court even cited filing consolidated returns, permissible under the tax laws, as a negative factor. Finally, the court cited manipulation of assets and liabilities between the LLC and its member.

I. **LLC Piercing- Curci.**

1. **Take-Away**. This is yet another bad fact case. The creditor in Curci behaved in a manner that anyone would find objectionable, and he clearly controlled the LLC in question. There were major mistakes in ignoring the entity formalities and seemingly little beneficiary purpose in the entity both of whose members personally were liable on a debt. The real issue is what commentators and courts will read into such a case and whether this will result in a broadening of the attack on legitimate investment entities.[24]

2. **Discussion**.

a. Overview. In the Curci Investment, LLC case the court permitted a reverse veil piercing of an LLC to reach the creditors assets.[25] The debtor (Curci) sought to add the creditor's investment LLC (JPBI) as a judgment debtor on a multi-million-dollar judgment it had against the creditor (Baldwin) personally. It warrants note that the creditor's wife also was liable on the loan to debtor. This may have been an important fact in distinguishing the case and permitting reverse piercing. The debtor claimed that the creditor held virtually all the interest in investment LLC personally, controlled the investment LLC's actions, and appeared to be using the investment LLC as a personal bank account. The debtor argued that under these circumstances it would be in the interest of justice to disregard the separate nature of investment LLC and allow the debtor to access the investment LLCs assets to satisfy the judgment against the creditor, Baldwin. The lower court citied an earlier case, and held that reverse veil piercing, was not available in California.[26] On appeal, Curci asserts Postal Instant Press is distinguishable (corporation versus LLC and differing facts in the instant case), and urges us to conclude reverse veil piercing is available in California and appropriate in this case. The appeals court determined that the prior case was distinguishable, and that reverse veil piercing is possible under the circumstances in the case. It remanded for the lower court to make a factual determination as to whether the investment LLC's veil should be pierced.

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[23] Greenhunter Energy, Inc. v. Western Ecosystems Technology, Inc. (2014 WY 144).

[24] Marty Shenkman & Alan Gassman on Curci Investments, LLC v. Baldwin: California Court of Appeals Allows Reverse Veil Piercing of LLC, LISI Asset Protection Planning Newsletter #351, (September 11, 2017) at http://www.leimbergservices.com
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[25] Curci Investments, LLC v. Baldwin, Court of Appeal, Fourth Dist., Div. 3, CA G052764 Aug. 10, 2017

[26] Postal Instant Press, Inc. v. Kaswa Corp. (2008) 162 Cal.App.4th 1510.

b. Facts.

(1) In January 2004, the creditor created a Delaware limited liability company, hold and invest cash balances of the creditor and his wife. It had two members, creditor held a 99%-member interest and his wife a 1%-member interest. Creditor was the manager and the chief executive officer of the investment LLC. In these roles, and given his membership interests, creditor determined when, if at all, the investment LLC would make distributions.

(2) Two years after forming the investment LLC the creditor personally borrowed $5.5 million from debtor's predecessor in interest. One month after executing the note, creditor settled eight family trusts to provide for his grandchildren. The investment LLC loaned $42.6 million to three family general partnerships formed by creditor for estate planning purposes. Although all of these loans were due to the investment LLC, creditor and his wife list them as “Notes Receivable” on their personal financial statements.

(3) The debtor sued and obtained a judgement. The creditor did not respond to the discovery, and the debtor filed a motion to compel resulting in sanctions against the creditor.

(4) Creditor, as manager of the investment LLC, executed amendments to the family notes for $42.6 million to extend their terms by five years to July 2020, with no consideration. While the case did not explain why, presumably this was to further delay their repayment to defer the point in time when the investment LLC might have cash if the debtor pursued it.

(5) The debtor made a motion in August 2014 and after that date any monetary distributions made by the investment LLC to the creditor, in his capacity as a member of that LLC, were ordered to be paid to the debtor instead.

(6) Debtor at the time of the trial had received no money as a result of the charging order. However, the creditor had caused the investment LLC to distribute $178 million to him and his wife, as members, between 2006 and 2012. There were no distributions made subsequent to the October 2012 entry of judgment on the note due debtor.

(7) Debtor argued that the investment LLC was the creditor’s alter ego, that creditor was using the investment LLC to avoid paying the judgment and that an unjust result would occur unless that LLCs assets could be used to satisfy creditor’s personal debt.

c. Entity. The court noted that ordinarily a corporation is considered a separate legal entity, distinct from its stockholders, officers and directors, with separate and distinct liabilities and obligations.[27] The same is true of a limited liability company (LLC) and its members and managers. That distinction can be disregarded by the courts if being used to perpetrate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose. The distinction can also be disregarded under an alter-ego doctrine when the actions of the entity are deemed to be those of the equitable owner.

d. Piercing. The distinction between owners and entities may be disregarded if there is such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist. There must also be an inequitable result if that distinction is recognized. Piercing the entity veil will be permitted when justice requires. This is a fact sensitive analysis. Reverse veil piercing arises when the request for piercing comes from a third party outside the targeted business entity. In the instant case, the court noted that the debtor had spent five years trying to collect on the debt.

J. **<u>Phantom Income Impact on Claimant Seizing on FLP or LLC</u>.**

1. **<u>Take-Away</u>**. Asset protection lore has suggested that a benefit of using an FLP or LLC as a component of asset protection planning is that a claimant who sues and successfully seizes the debtor’s interest in the entity will only be an assignee of that interest entitled to the distributions made with respect to that interest, if any. A further claimed protection is that the successful creditor could have to report a proportionate amount of FLP or LLC income even if no

[27] Sonora Diamond Corp. v. Superior Court (2000) 83 Cal.App.4th 523.

commensurate distribution of cash was made. That phantom income (taxable income with no distribution causing the creditor to be out-of-pocket to pay the income tax) was a further disincentive to a claimant pursuing such an interest. Is this tax "hammer" as assured as some commentators and practitioners believe?

2. **Discussion**.
    a. Commentators suggest that the creditor protection that FLPs and LLCs afford is enhanced by a judgement creditor who obtains a charging order receiving a Form K-1 from the FLP (or LLC taxed as a partnership) making the creditor responsible for the distributive share of FLP or LLC profits even if the entity makes no distributions. Should this result ensue the creditor would bear the tax cost of a distribution that was not received, and that cash outflow would further motivate the creditor to negotiate a settlement more favorable to the debtor.
    b. This conventional explanation may not be accurate in that the charging order only provides the creditor a right to receive the debtor's partnership or LLC distributions if those distributions are in fact made.[28] Whether a judgment creditor will be allocated FLP/LLC's profits, even if no distributions are made may depend on whether the charging order is characterized as an assignment of the debtor's FLP/ LLC interest to the creditor, rather than it merely serving as a lien on that interest. If the lien characterization is appropriate, the creditor should not recognize income tax on phantom income not distributed. The lien theory will generally prevail.
    c. With respect to an LLC, a judgement creditor generally does not obtain access to the underlying entity assets of the LLC (exceptions might apply if the creditor can pierce through the LLC because entity formalities were so disregarded by the members). The creditor is prohibited from levying on the interests in the LLC, and instead can only receive a lien against the debtor/member's economic interests in the LLC. A charging order remains in force while the judgment is outstanding. Once the judgement is satisfied the charging order is released and the debtor again receives distributions associated with the membership interest involved.
    d. The model LLC act that many states have adopted at least in part, refers to a charging order as a lien. The Uniform Limited Liability Company Act ("RULLCA") Sec. 503(a) provides that "a charging order constitutes a lien on a judgment debtor's transferable interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the judgment debtor."

K. **Trust Administration**.
1. While this PLR might be classified as a gift or GST tax topic it is included here under "asset protection" as an illustration as to how identified errors in administration might be cured. Query whether the IRS respecting the correction would be viewed in the same manner by a court if a claimant were trying to pierce the trust for an asset protection claim?
2. In this PLR the beneficiary of a trust inadvertently made state and federal tax payments that should have been paid by the trust. The IRS held that this would not result in estate or gift tax issues[29] Specifically, the IRS held that these inadvertent payments would not constitute a constructive addition by beneficiary to the trust.[30] The beneficiary had a right to recover as against the trust. The taxes which were inadvertently paid by the beneficiary were reimbursed by the trust to the beneficiary, along with interest and legal fees.

L. **Uniform Voidable Transactions Act ("UVTA")**.
1. **Take-Away**. Non-DAPT residents face, according to some commentators, more uncertainty because of the UVTA. Therefore, using non-self-settled trusts (e.g., non-reciprocal spousal lifetime access trusts or "SLATs" if married), multiple trusts, layers of LLCs and FLPs owned in part by trusts, and other steps to bolster their DAPTs is advisable. While adding additional protections and layers to a DAPT might help address creditor issues (but in the Transfirst case

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[28] Michael Geeraerts, "Who Gets K.O.'d by the K- -1? The Creditor or the Debtor?" The CPA Journal, January 2017, page 50; Rev. Rul. 77- 1 37(1997-1 C.B. 178). See also, Jay Adkisson, "The Misunderstood Charging Order," Forbes, Apr 30, 2013. https://www.forbes.com/sites/jayadkisson/2013/04/30/the-misunderstood-charging-order/#161896e51d41.

[29] PLR 201735005 (8 May 2017).

[30] Reg. Sec. 26.2601-1(b)(1)(v)(C).

discussed elsewhere it did not), it is not clear that it will bolster the estate tax objective (assuming no repeal and that estate tax minimization remains of value). Other commentators suggest a hybrid DPAT approach in which the settlor is not named a beneficiary of the DAPT but a person, acting in a non-fiduciary capacity, can add a class of persons such as the descendants of the settlor's grandparents, as beneficiaries in the future. Perhaps if the grantor's financial situation has improved sufficiently he or she might even renounce any rights as a beneficiary of an old DAPT in light of this comment.

2. **Discussion**.
   a. In March 2017 Michigan and Utah enacted variations of the Uniform Voidable Transactions Act ("UVTA"). They joined California, Georgia, Idaho, Iowa, Kentucky, Minnesota, New Mexico, North Carolina and North Dakota. Note that Michigan had DAPT legislation and still enacted the UVTA.
   b. What impact does the UVTA have on self-settled trusts? UVTA Section 4, Comment 8, provides that a transfer to a self-settled domestic asset protection trust ("DAPT") is voidable if the transferor's home state does not have DAPT legislation.[31]
   c. The Comment provides: "By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under § 10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y."
   d. **Example**: Jane created a DAPT in 2012 as she was worried that the exemption would be reduced from $5M to $1M. Her investment portfolio outside the DAPT has grown so substantially in the years since the DAPT was funded she is no longer worried about having access to it. Since her status as a beneficiary is a solely discretionary power held by an independent institutional trustee her advisers do not believe that a taxable gift could result from her renouncing that beneficiary status. They might nonetheless opt to report the renunciation as a non-gift transaction on a gift tax return for Jane.
   e. Despite the broad statement in the Comment, it is questionable whether a court outside of a state that has adopted the UVTA would not go through a "normal" conflict of laws analysis, meaning, perhaps, that having virtually all contacts with a DAPT state may mean the Comment would not be followed.

M. **Trust Disregarded as Nominee.**

1. **Take-Away**. The IRS successfully pierced a trust created by a taxpayer to satisfy a tax lien on the basis that the trust was a mere nominee for the taxpayer and could be disregarded. The lessons of this case provide some insight to practitioners and clients structuring trusts for asset protection planning.[32]
2. **Discussion**. The court determined that a trust to which the taxpayer transferred his residence was a mere nominee and permitted the IRS to foreclose on property to satisfy a federal tax lien. A nominee is a person or entity who "holds bare legal title to property for the benefit of another." The following can be evaluated in determining whether the person or entity is a nominee on behalf of another:
   a. Did the nominee pay adequate consideration for the property.
   b. Did the taxpayer transfer property to the name of the nominee in anticipation of a suit or (or in this case in anticipation of IRS collection efforts).
   c. Did the transferor continue to use the property.
   d. Did the transferor retain enjoyment of the benefits of the transferred property.
   e. Was there is a close relationship between transferor and the nominee.
   f. Was the transfer recorded in the case of real estate.
3. The taxpayers had unpaid tax liabilities for many years, brought suit, and the court held in favor of the IRS. The taxpayers attended a seminar that taught how to create trusts to obtain tax protection and then they signed a quitclaim deed transferring title of their property to a trust for no consideration. Following deeding the house to the trust the taxpayers continued to live in and exercise control over that property. At one of the trials the taxpayer admitted that the trust was

[31] See: http://www.wealthmanagement.com/estate-planning/two-dapt-states-adopt-uvta?
[32] Balice, (DC NJ 8/9/2017) 119 AFTR 2d ¶ 2017-5134.

created to protect the property from liabilities. Although the taxpayer did in fact record a deed transferring the house to the trust the court found that all the other factors indicating a nominee were met.

VII. **Assisted Suicide**.

A. **Take-Away**. While the phrase itself may evoke strong emotions on each side of the issue, "assisted suicide" is a concept that every practitioner must understand.[33] When a client faces a diagnosis of a terminal illness, especially one anticipated to be rife with pain and suffering, practitioners may be called upon to engage in a conversation about the options, one of which for the client may include assisted suicide. Any advising clients as to end of life decisions should be aware of the developments in this area. As the population ages and medical technology continues to advance, the conscious decision of those with terminal conditions and severe pain and/or the loss of quality of life, to choose whether to end their lives, will sadly occur more frequently. Practitioners may for personal religious or other reasons choose not to counsel a client on pursuing assisted suicide, but knowledge of the topic may be important to that discussion and the recommendations to other advisers. But while some states have moved in the direction of permitting assisted suicide, other states have moved in the opposite direction prohibiting assisted suicide.[34]

B. **Discussion of Law Supporting Assisted Suicide**.

1. Colorado passed Proposition 106, the End of "Life Options Act," on November 8, 2016. This brought the number of states permitting this to a total of six. These states all permit what many refer to as "legal suicide." Five states now have statutes that permit this: California, Colorado, Oregon, Vermont, and Washington. Montana has a court decision that is viewed as permitting similar actions.
2. Legal suicide is when, after complying with strict procedures, a dying and suffering client may obtain prescription medication to end his or her life in a less painful manner. A few states permit this process, but only for terminally ill individuals who have less than a six-month life expectancy. Common requirements of these laws may include:
    a. Make the request personally as the patient of your physician for self-administered aid-in-dying medication.
    b. Be a resident of the state permitting this. This requirement is an important part of planning that those living in other states should address, and preferably as early as possible after obtaining a diagnosis of the terminal condition.
    c. Be an adult, which is generally age 18 or older.
    d. Communicate an informed decision to health care providers. Thus, an agent under a health care proxy may not be permitted to do this for a client.
    e. Diagnosed to have a terminal illness with a prognosis of six months or less to live.
    f. The dire health status must be confirmed by two physicians, including the client's primary physician and a second, consulting physician.
    g. Confirmed as being mentally capable to make this decision by two physicians. They must specifically conclude that the client understands the consequences of the decision.
    h. Confirmation that the decision is deliberate. This is accomplished by requiring the client to make two oral requests, at least fifteen days apart, and one written request, that are specific as to what is being requested, to the client's primary physician. Clients should be encouraged to discuss these wishes in person with their physician Regardless of your physician's response, the client should request that the physician to record the request in the client's medical record. This request should constitute the first oral request under the law. Advise the client to obtain a copy of that record (patient chart) to have proof of the request. The written request must also be witnessed by at least two other persons who meet certain requirements.
    i. After all prerequisites are met some states require a waiting period before the prescription can be written. Some states require that a final attestation form be completed 48 hours before taking the medication to provide yet a further waiting period for the client to reconsider.

[33] See https://www.deathwithdignity.org for more information about this topic.
[34] See Josefa Velasquez, "NY High Court Rejects Constitutional Right to Assisted Suicide," NYLJ Sept. 8, 2017, page 1.

3. Death certificates will list the cause of death as the person's terminal illness, not physician-assisted suicide. If this is an important consideration for the client, verify that the laws of the state under consideration provide for this.
4. If a client has been diagnosed with a terminal illness, faces the prospect of severe pain, loss of quality of life, and wishes to avail himself of the assisted suicide laws in one of these states, it may be prudent to move to a state permitting assisted suicide to have the availability of this option if chosen. That move should be made while there is capacity to effectuate establishing residency in the chosen state and to carry out the requirements above which require sufficient capacity over a period of time to corroborate understanding and intent.
5. Be certain that the client understands and considers that this option may violate religious beliefs of the faith the client has adhered to. It may also deeply offend and upset family and friends. Encourage the client to discuss the entire matter with any religious advisers, mental health professional and others.
6. The California, Colorado, Oregon, Vermont, and Washington Death with Dignity laws allow mentally competent, terminally-ill adult state residents to voluntarily request and receive a prescription medication so they can die in a peaceful, humane manner in a place and time of their choosing. Death with Dignity is one of many end-of-life care options available. Montana does not have a statute that codifies the right to assisted suicide. In 2009, Montana's Supreme Court ruled that there is nothing prohibiting a physician from prescribing medication to hasten the patient's death.

C. **Discussion of Law Not Supporting Assisted Suicide**. In contrast to the discussions in the preceding section, New York held that statutes criminalizing assisted suicide are constitutional. The court determined that such restriction do not violate the due process or equal protection clauses. While the court stated that anyone, regardless of physical condition, if competent, can refuse unwanted lifesaving medical treatment that does not extend so far as to permitting assisted suicide. The court found a legitimate state purpose to guard against misuse or abuse of assisted suicide, and preserving life.[35]

VIII. **Attorney Client Privilege**.

A. **Take-Away**. The court held that certain emails were protected from disclosure to the IRS because of the attorney client privilege.[36] The IRS claimed that the privilege was waived as a result of the two taxpayers sharing documents. It was held that they had not waived the privilege as they had jointly retained counsel. The court found that the two taxpayers had a clear commonality of interests. Practitioners should be mindful that the terms of the engagement letter or retainer agreement might prove quite important in protecting the privilege.

B. **Discussion**.

1. Two physicians sought advice from counsel who assisted them in forming C corporations that elected tax treatment as Section 831(b) captive insurance companies. In 2014, the IRS began auditing the captives as well as the physician's practices. As part of its audit the IRS issued a summons directing the physicians to produce several categories of documents for examination. They produced all of the documents requested in the summons, except for a series of email communications exchanged between the physicians and their attorneys which they stated were protected by the attorney-client privilege.
2. The court reasoned that the physicians had properly invoked the attorney-client privilege, because each email predominately involved legal advice within the retention of counsel. What might be the quantum of legal advice that an email must incorporate to be so characterized?

IX. **Cancer Statistics**.

A. **Take-Away**. The statistics concerning the diagnosis of cancer are astounding. Planning for cancer is not something that practitioners might be called upon occasionally to address. Rather, it is something that a significant proportion of clients, staff and clients will all face. The harsh realities of this suggest that all practitioners should give thought to having a "cancer" conversation with clients when it arises and be prepared to address not only the technical planning implications but the emotional considerations as well.[37]

B. **Discussion**.

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[35] Myers v. Schneiderman, 2017 N.Y. Slip Op. 06412, Ct App 9-7-17.
[36] Micro Cap KY Insurance Company, Inc., DC Ky.) (Apr. 5, 2017).
[37] Shenkman, "Having Tough Client Conversations About Health Issues: A cancer diagnosis can affect estate and financial planning," Jul 26, 2017, http://www.wealthmanagement.com/estate-planning/having-tough-client-conversations-about-health-issues.

1. Cancer statistics:
    a. 1 in 2 men will develop cancer in their lifetime and 1 in 4 men will die from cancer.
    b. 1 in 3 women will develop cancer in their lifetime and 1 in 5 women will die from cancer.
    c. Around 1,688,780 new cancer cases are expected to be diagnosed in 2017.
    d. Around 600,920 Americans are expected to die from cancer in 2017. That translates to 1,650 people per day.
    e. Still, we've seen a 23% decline in cancer death rates since 1991.
    f. There are more than 15.5 Million survivors alive today.
    g. Nearly half (46%) of all cancer survivors are 70 years of age or older.
    h. Non-melanoma skin cancer: 5.4 million new diagnosed cancers every year in 3.3 million people.
    i. Lung cancer: 220,000 people annually. Two primary types: small cell and non-small cell. Lung cancer claims nearly 155,870 lives annually.
    j. Breast cancer: The most common cancer in women. Invasive breast cancer: 255,180; non-invasive (in situ): 63,410 annually.
    k. Prostate cancer: 161,360 people. The most common cancer in men, most over age 50.
    l. Colorectal cancer: 135,000 people annually.
    m. Bladder cancer: 79,030 people annually.
    n. Melanoma: 87,110 invasive each year; 74,680 non-invasive (in situ) people annually.
    o. Non-Hodgkin lymphoma: 72,240 people annually.
    p. Kidney cancer: 63,990 people each year. Mainly people over 40, but one type of kidney tumor usually affects young children.
    q. Leukemia: 62,130 people a year. It affects both adults and children, and kills more children under age 20 than any other cancer.
2. "When the client is facing a real threat to longevity, the conversation is ever more difficult. Whether the cancer will prove fatal to a client, a cancer diagnosis invariably alters health and life itself. Survivors may fear a recurrence, which can be immobilizing. Cancer impacts not just the patient but also the entire family and other loved ones. The conversations an advisor should have need to be broader than the mundane questions necessary to complete a living will or health proxy. Empathy, hearing and understanding the client's personal concerns and responding to them can be reassuring to the client on this journey. Practitioners need to recognize the incredible challenges the client and family face. They should make efforts to educate both the cancer patient/client and the family and loved ones on steps that they can take to preserve or gain control over the aspects of life affected by cancer. Some of the questions practitioners might address include:
    a. What cancer diagnosis do you have? What stage? Is it advanced? Is it localized?
    b. What's the impact on life expectancy? Practitioners need to explain that the time frame is essential to determine how urgent planning might be, or whether there's sufficient time to plan with less pressure.
    c. What's your prognosis? What's the anticipated disease course and treatment? This can be difficult as some clients don't assimilate information from their physicians or are uncomfortable.
    d. What are the likely consequences of the treatments? What are side effects? Will it impact your ability to function? Will it impact your ability to work and if so for how long and to what extent?
    e. What's the anticipated financial cost of the treatment course? What insurance coverage do you have, and how much of the costs might it cover or not? Some treatments are so costly that the phrase "financial toxicity" has been used to describe the consequences. Practitioners should ask the client whether he's discussed costs of care with his medical professionals.

C. Having tough conversations with a client diagnosed with cancer may be essential to your having the information to provide the advice and professional guidance the client and family require.

X. **Capital Gains**.

A. If a client is converting a low basis building to condominium they may be converting to a dealer status and will transform capital gain to ordinary income. Plan to minimize this impact. Planning to minimize this impact might include transferring the property to another entity and appraising the fair value at that point in time or arranging for a tax-free exchange under IRC 1031.[38]

B. Concentrated positions may be planned for in a manner that can reduce the concentrated holding risk while deferring tax costs.[39]

XI. **Captive Insurance Company**.

A. Captive insurance companies have been touted by many as an incredible economic savings in insurance costs and a significant tax benefit. A recently case highlights the risks of this planning technique.[40] The court found that premiums were not priced properly, there was inadequate risk distribution, and that there were circular flows of cash.

XII. **Cause of Death**.

A. **Investigation Costs Non-Deductible**.

1. **Take-Away**. The hobby loss deduction limitation rules can surface in many areas of planning, even probate matters. Practitioners should be mindful.
2. **Discussion**.
   a. The Fifth Circuit affirmed the Tax Court's holding that a taxpayer could not deduct the costs of investigating his father's death because the investigation was not motivated by profit.[41]
   b. A deduction is permitted to an estate for costs incurred with respect to the production or collection of income, but the primary reason for having incurred those costs must have been to generate profit.
   c. The hobby loss rules of IRC Sec. 183 prohibit deductions in excess of the hobby income if the activity is not engaged in for profit. Reg. § 1.183-2(b) enumerates factors to consider in determining whether a taxpayer has a profit motive:
      (1) Expertise.
      (2) Time and effort expended in carrying out the activity.
      (3) Amount of profits.
      (4) Taxpayer's financial status.
   d. The taxpayer claimed business expenses from investigations into the cause of his father's death after receiving an anonymous letter stating that his father did not commit suicide, but rather had been murdered. Taxpayer argued that this was a business opportunity that, if publicized, could result in book and movie. Significant costs were incurred hiring private investigators and a writer to draft a manuscript. The IRS held these costs non-deductible hobby losses since there was no profit motive. The Fifth Circuit found that the Tax Court's determination was correct applying the factors set out in Treas. Reg. Sec. 1.183-2(b).

XIII. **Charity**.

A. **Advisers and Donations**.

1. As the nature of estate planning evolves and changes the charitable gift expert (a major gifts officer or planned giving officer) should have more participation on the estate and financial planning team. Collaboration of the charitable giving experts and the more traditional members of the estate planning team can help craft more tailored gifts, donor agreements, and meet client charitable giving objectives. But are advisors and gift planners collaborating? How can advisers do better?[42]

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[38] Bramblett v. Comr.. 960 F.2d 526 (5th Cir. 1992).
[39] Thomas Boczar and Mark Leeds, "The 21st Century Tontine Lookalike: Tax Aspects of Stock Protection Funds," Taxes The Tax Magazine, p. 34 Sept. 2017.
[40] Avrahami v. Commissioner, 149 T.C. No. 7 (Aug. 21, 2017).
[41] Vest v. Comm., (CA 5 06/02/2017) 119 AFTR 2d ¶2017-813.
[42] See: https://www.linkedin.com/feed/update/urn:li:activity:6304390546085408769; http://sharpenet.com/give-take/charities-advisors-war/ .

2. Advisors can do better at connecting dollars to impact, via specific gifts, to specific charities, for specific programs, with an appropriate gift agreement.[43] Advisors can also serve clients more effectively by asking better questions about a client passion, purpose, and philanthropic motivation and impact.
3. Nonprofit gift planners can do better, with high net worth donors, in asking good questions before making the "ask" for a donation.
4. Questions might include:
   a. Do you have an overall philanthropic plan?
   b. Where do we fit in it?
   c. Are we in your top five charities?
   d. What would it take for us to move up?
   e. Do you have charitable tools in place? DAF? Foundation? CRT? CLT? Legacy?
   f. Are your current charitable tools allocated to a particular cause now? Could our organization be benefited in some way via those existing tools?
   g. Other than you, who else will make the decision about a big gift?
   h. Do you have any large assets that you might be considering selling, now or in the future?
   i. Do you have any advisors you will consult to see if the gift makes sense, and to structure the gift most efficiently?
   j. May I have your permission to meet with your advisors to be sure we come up with the best possible proposal for you?

B. **<u>Age of Donors</u>**.

1. **<u>Take-Away</u>**.
   a. If donations in fact increase significant at older ages that might suggest several considerations that affect planning. First, budgets and forecasts based on a different level of giving may need to be updated to be accurate. Powers of attorney and revocable trusts that address gifting should be reviewed to be certain that they permit charitable gifts. Consider how language like "in accordance with my historical pattern of giving" might be interpreted if that pattern has changed?
   b. Practitioners should recognize that most donations are made by older clients. See the discussions below concerning longevity. While encouraging clients to donate is a noble endeavor, be certain that the clients have had reasonable financial forecasts completed to an appropriate age so that the donations are in fact sustainable without adversely affecting the client's ability to sustain their lifestyle for an appropriate time period. For example, an endowment construct for sustainable charitable giving might facilitate the client maximizing donations without undermining financial security.[44] Incorporating a line item for gifts (whether charitable, to heirs or for additional luxury purchases) into the financial projections/Monte Carlo simulations it is suggested is a better threshold analysis for determining appropriate gifts from an economic perspective, e.g. what can be given in any year without undermining long term financial objectives. This approach could free more wealth for transfer at earlier dates than the mere tax approach. Once the economic parameters are determined, then it can be evaluated how the gift transfer should be made from a tax perspective.
   c. It may prove advantageous for many future donor/clients to begin their donations at an earlier stage of their lives. If the prospective donors are in higher income tax brackets while working, i.e., before retirement at younger ages, they might be counselled to ramp up donations then, make them to donor advised funds, and then determine which charities to allocate those donations to after retirement when perhaps, based on the statistics, they have more time to focus on philanthropic endeavors. The statistics might indicate a significant sub-optimal donation pattern for many taxpayers concentrating donations in post-retirement years when they are in lower income tax brackets and will garner lower tax benefits from donations that might be made earlier.

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[43] Acknowledgements to Phil Cubeta, MSFS, CLU, ChFC, CAP, Assistant Professor of Philanthropy, The American College of Financial Services.

[44] Jonathan G. Blattmachr, Esq. and Martin M. Shenkman, Esq., "Practical Planning Strategies for the Future," Chapter 19, 49th Annual Heckerling Institute on Estate Planning, 2016.

2. **Discussion**. IRS data indicates that a disproportionate amount of charitable contributions, both in terms of the number of gifts and dollar amounts donated, are made by individuals over the age of 55. 21 percent of itemizers over the age of 65 give one-third of all gifts that were deducted. These taxpayers also made average gifts nearly twice as large as those made on average by taxpayers who itemize.[45]

C. **Charitable Lead Trust ("CLT")**.

1. See discussion of PLR 201730018 below regarding the conversion of a non-grantor CLT to a grantor CLT.

D. **Commercial Co-Venture**.

1. The use of creative charitable giving strategies is likely to increase as tax benefits wane, and as many clients seek active ways to make a positive impact. One interesting application might be referred to as a commercial co-venture arrangement. While the variety of structures is perhaps limitless, this might take the form of a vendor agreeing to donate a portion of its sale proceeds to charity, or even to a particular charity. The contents of the commercial co-venture agreement are regulated by state law which are designed to protect consumers and ensure that the vendor fulfills its commitment to donate to charity. State requirements might include: the vendor disclosing the percentage of the proceeds that will benefit charity, filing a copy of the commercial co-venture agreement with the charity, or even making annual reports to the state's attorney general. Compliance with the laws in all states where the products will be sold is necessary. A commercial co-venture arrangement is different from an endorsement arrangement whereby a nonprofit agrees to promote a vendor's product in exchange for a licensing fee. An endorsement arrangement may raise questions regarding conflict of interest and commercialism.
2. It might be advisable that the arrangement be clearly disclosed on the charity's website indicating that the charity is merely a recipient of a percentage of the proceeds of the sale and is not making any endorsement or other statement about the product. Ideally, the disclaimer might appear on the packaging indicating, in addition to the percentage of proceeds to be donated, that the charity is merely a beneficiary of proceeds from the sale of the product and does not endorse the product.

E. **Conservation Easement.**

1. A court determined that a conservation easement deduction should be respected as having met the requirement for "contemporaneous written acknowledgment"[46] for the taxpayer's charitable contribution deduction. [47]
2. Background. Under Code Sec. 170, a taxpayer is allowed a charitable contribution deduction for a properly substantiated contribution or gift to or for the use of an organization organized and operated exclusively for charitable or educational purposes. Code Sec. 170(f)(3) generally bars a charitable contribution deduction for a contribution of an interest in property that is less than the taxpayer's entire interest in the property, but an exception is made for a qualified conservation contribution, i.e., the contribution of a qualified real property interest exclusively for "conservation purposes". (Code Sec. 170(h), Reg. § 1.170A-14(b)(2))
3. Under Code Sec. 170(f)(8)(A) to qualify for a charitable contribution deduction the taxpayer must substantiate the contribution with a contemporaneous written acknowledgment of the contribution by the recipient charitable organization that meets specified requirements. The acknowledgment generally must include a description and good faith estimate of the value of any goods or services provided. Substantial compliance will not suffice to meet the substantiation requirements. A deed signed by recipient charity, contemporaneously with the donation of the conservation easements, and which describes the property may suffice.
4. The donor executed a deed granting a qualified charity an easement over the facade of its building. That deed as recorded. The deed recited consideration of $1.00 and that the donor granted, gave conveyed, and sold unto the charity irrevocably, a perpetual preservation easement. However, the deed of easement contained no reference to any goods or services being furnished by the charity to the donor.

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[45] Robert F. Sharpe, Jr., "Who Makes Charitable Gifts and Why?" May 18, 2017 http://www.wealthmanagement.com/high-net-worth/who-makes-charitiable-gifts-and-why .

[46] IRC Sec. 170(f)(8)(B).

[47] 310 Retail, LLC, TC Memo 2017-164.

5. On audit, the IRS disallowed the contribution deduction in full for failure to satisfy the Code Sec. 170 requirements. The court held that the deed itself satisfied the IRC Sec. 170(f)(8)(B) contemporaneous written acknowledgment requirement and included an acknowledgement that the charity did not supply any goods or services to the donor in exchange for the gift. The deed stated that it represented the parties' entire agreement and the only consideration mentioned was the $1.00 and other good and valuable consideration.

F. **Estate tax impact on Giving**.

1. In 2010, when the estate tax was temporarily repealed, gross charitable bequests in IRS tax filings totaled $7.49 billion — a 37% drop from $11.9 billion the previous year. The tax returned in 2011, and charitable bequests soared to $14.36 billion.[48]

G. **Incomplete Gift Eliminates Deduction**.

1. **Take-Away**. Because the donor did not part with dominion and control over the donation of a building no deduction was permitted.[49]
2. **Discussion**.
    a. The Fakiris case addressed whether a charitable donation was complete. The taxpayer/donor failed to reduce the deduction at all for the sales price. Since the transaction was characterized as a bargain sale under the Regulations (a transfer of property which is in part a sale or exchange of the property and in part a charitable contribution, as defined in section 170(c), of the property) the taxpayer should have reduced the donation claimed by the proceeds.[50]
    b. The sales contract for the theater to the charity prevented the donee charity from selling that property during the 5-year period after obtaining the deed, and the seller/donor had the right during that period to transfer the theater to another charity. These conditions survived the transfer of the deed to the donee. As a result, the donor/seller retained dominion and control over the theater property so that the donation was an incomplete gift, and the charitable contribution deduction was disallowed. Reg. Sec. 1.170A-4(c)(2).

H. **Private Letter Rulings**.

1. PLR 201713002 and 201713003 (March 31, 2017), a CRT avoided the private foundation excise rules under IRC Sec. 4947(a)(2) because the grantor/donor did not claim any charitable contribution deduction for income tax purposes, IRC Sec. 170, or for gift tax purposes IRC Sec. 2522. The IRC Sec. 4941 prohibitions against self-dealing, and the IRC Sec. 4945 rules governing taxable expenditures generally apply to a CRT, but only if a deduction is allowed. [51] One commentator speculated as to the rationale for this unusual approach as follows: "Perhaps what they were trying to accomplish was to avoid gain on sale of a highly-appreciated asset in a transaction that would have otherwise violated the self-dealing rules—a sale by the trust to a family member or other disqualified person. Code section 4941(d)(1) defines self-dealing as including any sale or exchange of property between the private foundation (in this case, the charitable remainder trust) and a disqualified person such as a family member. Or perhaps the plan was to have the stock redeemed by a corporation in a transaction which would have otherwise been a self-dealing transaction because the corporation was a disqualified person as defined in Code section 4946 and a redemption offer to all shareholders was either undesirable or not practical for other reasons." [52]
2. PLR 201714002 (April 7, 2017) held that a trust did not qualify as a charitable remainder trust ("CRT") because it was not properly operated as a NIMCRUT. It distributed more than its annual net trust income to the beneficiary holding a unitrust interest. The court ordered termination of the failed CRT would trigger excise taxes.

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[48] Sahil Kapur, "GOP plan to kill estate tax sets up charitable giving conflict," Aug. 31 2017, https://www.financial-planning.com/articles/gop-plan-to-kill-estate-tax-sets-up-charitable-giving-conflict .

[49] George Fakiris v. Commissioner, Docket No. 18292-12, 2017 Tax Ct. Memo. LEXIS 121 (2017).

[50] Reg. Sec. 1.170A-4(c)(2).

[51] IRC Sec. 4947(a)(2).

[52] See, Larry Katzenstein, "PLRs 201713002 & 201713003 Illustrate the Interplay Between Code Sections 664 and 4947," LISI Charitable Planning Newsletter #262 (May 15, 2017) at http://www.leimbergservices.com .

3. PLR 201720003 (May 22, 2017) gave a trust a 120-day extension to elect to treat a charitable contribution as made during a prior year. The IRS found that the trustee acted reasonably and in good faith, and granting the extension did not prejudice the government's interests.
4. PLR 201723005 held that a distribution of an LLC that owned a note from a disqualified person to a private foundation did not trigger a self-dealing problem.
5. PLR 201729014 held that an exchange of investment assets of a charitable remainder trust for units in the endowment of a charitable beneficiary was acceptable.

I. **Reasons Clients Donate**.

1. **Take-Away**. With the shift of estate planning away from tax minimization to broader based and humanistic planning, practitioners should more frequently have charitable conversations with clients. Understanding what motivates clients to donate may also guide practitioners in how to have charitable conversations. Rather than focusing primarily on tax benefits, emphasize how the donation may help the client achieve his or her philanthropy goals. A different emphasis may help clients move forward with charitable planning and also expand the role the estate planner plays from merely tax minimization opportunism the donation presents to negotiating donor agreements to help clients achieve other personal goals.
2. **Discussion**. When wealthier donors, defined as those with incomes higher than $90,000 per year, received a message that framed charitable giving as an opportunity for individual achievement, they were significantly more likely to donate than when they received a message that stressed common goals. Donors also gave more when they were asked to come forward and take individual action, than when they were asked to join their community and support a common goal.[53]

J. **Statistics**.

1. For details of charitable bequests by state and size of gross estate see IRS recently issued 2016 data.[54]

K. **Substantiation**.

1. An LLC was denied a charitable contribution deduction for donating a remainder interest in real estate since it did not provide data on the donor's adjusted basis.[55]

L. **Tax Proposals**.

1. The Trump tax proposals have included a doubling of standard deductions and elimination of most itemized deductions with the possible exception of home mortgage interest and charitable contribution deductions. While at the time of this writing there is no certainty of what might occur, it is possible that most taxpayers may lose charitable contributions deductions, perhaps not. Proposals have been suggested to preserve contribution deductions even if the taxpayer does not itemize. Perhaps, some variant of this may find its way into final legislation.[56]

M. **UBIT.**

1. TAM 201741019 held that a trust's activities from partnerships and debt financed property that were not substantially related to the trust's exempt purpose generated unrelated business taxable income ("UBTI").[57]
2. A charitable organization under IRC Sec. 501(c)(3) is generally exempt from federal income tax. However, this exemption doesn't extend to the organization's UBTI, as defined in IRC Sec. 512, income from any unrelated trade or business (as defined in IRC Sec. 513) regularly carried on and which isn't substantially related to the performance by the organization of its exempt purposes. Code Sec. 511 imposes the UBTI, at the corporate tax rate on the unrelated business income of IRC Sec. 501(c) organizations, and at the estate and trust tax rates on the UBTI of charitable trusts.
3. IRC Sec. 514(a) provides that a percentage of income and deductions from debt-financed property is included in computing UBTI. An exception under Code Sec. 514(c)(4) provides that acquisition indebtedness does not include indebtedness related to the performance of the charities exempt purpose.
4. If less than a substantial amount of the use of any property is related to the organization's exempt purpose, then only the portion of the property the use of which is substantially related isn't treated

[53] Ashley V. Whillans, Elizabeth w. Dunn and Eugene M. Caruso, "How to Get the Wealthy to Donate," May 12, 2017, https://www.nytimes.com/2017/05/12/opinion/sunday/how-to-get-the-wealthy-to-donate.html?_r=1 .
[54] https://www.irs.gov/statistics/soi-tax-stats-estate-tax-statistics-filing-year-table-3 .
[55] RERI Holdings I, LLC, et al v. Comr., TC, Jul. 5, 2017.
[56] The Universal Charitable Giving Bill (HR 3988).
[57] TAM 201741019 (Oct. 16, 2017).

as debt-financed property. A property's use is substantially related to the organization's exempt function if 85% or more of its use is devoted to the exempt purpose. This is a facts and circumstances test.

5. In the event an organization to which Code Sec. 511 applies is a member of a partnership regularly engaged in a trade or business which is an unrelated trade or business with respect to such organization, the organization will include in computing its UBTI so much of its share (whether or not distributed) of the partnership gross income as is derived from that unrelated business and its share of the deductions attributable thereto. (Reg. § 1.512(c)-1)
6. Gross income derives from an "unrelated trade or business" under Code Sec. 513(a) if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. (Reg. § 1.513-1(d)(1))
7. A trade or business is "related" to exempt purposes only where the conduct of the business activities has a substantial causal relationship to the achievement of exempt purposes.
8. The issue in this ruling was whether the membership interests and debt-financed assets held by the trust generated UBTI or was it exempt because the activities giving rise to the income were substantially related to the trust's exempt purpose. The IRS found that trust held interests in partnerships (including partnerships that held debt-financed property), and that the relationship between Trust's exempt purpose and the businesses of the partnerships, and the use of property purchased with debt, was not sufficient for purposes of Code Sec. 513 and Code Sec. 514. Accordingly, income from the partnerships or from property purchased with debt, was UBTI to the trust.

XIV. **College Savings (IRC Sec. 529) Plans**.

A. **Few Wealthy Clients Use 529 Plans, But Perhaps Many More Should**.

1. **Take-Away**. While at some level of wealth 529 plans may be viewed as so insignificant to not be worth the bother, for most wealthy clients they may provide significant tax and asset protection benefits for modest or no cost (e.g., no legal counsel is generally necessary). Advisers should make more of an effort to inform clients of the benefits 529 plans can afford them.
2. **Discussion**.
   a. Despite the substantial benefits of college savings plans (simplicity, no need for a trust, income tax benefits, estate tax benefits, etc.), only 16% of wealthy investors have opened 529 plans. More surprising, the more those surveyed indicated that they relied on their financial advisers, the less likely they are to use 529 plans. The study found that 21% of ultra-high net worth (more than $5 million net worth) investors currently have 529 plans. Only 17% of high net worth ($1-5M net worth) investors have 529 plans.[58]
   b. Perhaps wealthy taxpayers are missing out on what might be an even greater income tax advantaged investment strategy then many advisers realize. What better income tax shelter is there than a 529 plan? In a 529 plan, many advisers believe all you can gift is the annual gift exclusion amount and that up to five years of exclusion amounts can be front loaded at one time for a maximum contribution of $72,000 (2017 annual gift exclusion of $14,000 x 5). However, states may permit a donor to fund 529 plans up to greater amounts, e.g., $350,000+. The excess over the $72,000 annual exclusion amounts will constitute a taxable gift. But for many wealthy clients the high exemption amounts make this at most a theoretical issue. What better use of gift tax exemption then a 529 plan? If a wealthy client gifts $350,000 to a 529 plan a grandchild who ultimately attends college and graduates school could utilize substantial sums for those costs. But what if there is significant money left in 529 plan because of the front loading? See Regulations under 529. Grandchild can treat as taxable gift and rollover to great grandchildren. Each generation can roll remaining funds to next generation and continue income tax shelter in perpetuity.[59]

XV. **Closely Held Business**.

A. **1202 Exclusion**.

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[58] Study by the Spectrum Group investment research firm. Salinger, Tobias, "Are advisers steering wealthy clients away from 529 plans?" March 21, 2017, https://www.financial-planning.com/news/hnw-clients-and-529-plans-researched-by-spectrem-group.

[59] Acknowledgement to Jerome Hesch, Esq. for this planning concept.

1. Code Sec 1202(a) permits the exclusion from gross income of a portion or all of the gain from the sale or exchange of qualified small business stock ("QSBS") held more than five years. The gain exclusion is 100% for stock acquired on or after Sept. 28, 2010, and a lower percentage in certain prior years. A recent PLR confirmed a corporation's qualification for this benefit. In PLR 201717010, the IRS ruled that gain from the sale of company stock qualified for the partial exclusion of gain under Code Sec. 1202(a)(1). To qualify the corporation had to be a qualified trade or business as defined in IRC Sec. 1202(e)(3). The corporation must have 80% or more of its assets used in the active conduct of a qualified trade or business. The performance of services in the field of health care is excluded. The IRS held that the corporation's use of proprietary technology to perform medical tests constituted being engaged in a qualified trade or business for purposes of Section 1202.

XVI. **<u>Decanting; Reformation and Non-Judicial Modification</u>**.

A. **<u>Boilerplate Impact</u>**.

1. What impact might language counsel generally includes in a trust have on the flexibility that is intended to be infused into the instrument? For example, if a trust includes language similar to the following: "Notwithstanding anything contained in this instrument or any statute or law, to the contrary, Settlor shall have no right, either alone or in conjunction with any other persons, to revoke, amend or modify this trust." This language, or something like it, might be included to endeavor to avoid estate tax inclusion under IRC Sec. 2036.
2. What if the settlor of such a trust wishes to take advantage of statute that permits a non-judicial modification by agreement of specified parties? See for example the discussion below of the Delaware non-judicial modification statute.
3. Might the above language inhibit or prevent such a modification?
4. Should practitioners comb the boilerplate in their forms and modify or eliminate such restrictive langue? Might such a provision hampering flexibility to deal with changed circumstances?[60]

B. **<u>CPAs Role in Decanting</u>**.

1. CPAs might view the responsibility of addressing issues such as decanting of a trust to be solely within the purview of counsel, and outside their realm. But is that a reasonable or safe assumption? If a CPA is preparing a Form 1041 for a trust and identifies a less than optimal income tax result (e.g., taxation in a state that may not be that important to the trust and parties involved) should the CPA initiate a decanting discussion? Historically, an "irrevocable" trust was viewed as irrevocable, inviolate, but decanting and other practices have made that irrevocable status less stable. If a CPA should hold a copy of the signed trust instrument in a permanent file for a trust, can the CPA rely on the fact that the trust is "irrevocable" for not suggesting to the client that change might be advisable to consider?
2. When preparing a Form 1041 for a client's trust, consider whether the trust is optimally structured for income tax purposes, both state and federal. Discuss with the trustee, if appropriate, the possible benefits of changing the income tax situs of trusts in high-tax jurisdictions to see if, on a preliminary basis, the individual should review this with counsel. In some instances, decanting an old, less-than-optimal trust into a new, better-crafted one can save tax costs that offset the cost of the process within the first tax year. Decanting can be described as creating a new trust with identical beneficiaries but improved administrative provisions; the old trust is then merged or poured into the new trust, and the old trust terminates.
3. Consider including a short memorandum or letter with all Forms 1041 advising clients to meet with a CPA or attorney to review possible issues with old trusts that might warrant corrective action. Include articles in client communications recommending the review of all insurance, credit shelter (bypass), and other existing irrevocable trusts. A credit shelter trust may have been set up on the first spouse's death to save estate tax at a time when the exemption was a mere $1 million. Now, there may be no estate tax savings, and the trust may merely create hassles and costs, or worse, prevent valuable income tax basis adjustments upon death of a surviving spouse. Individuals with trusts that distribute assets at specified ages (e.g., when a child attains age 30) to should review the possible benefits of decanting with their estate planners.

[60] Acknowledgement to Andrew T. Wolfe, Esq., Hartman & Winnicki, P.C.

C. **Division of Trust**.

1. See below, "Trust – Division."

D. **Ferri Case - Divorce Decanting**.

1. **Take-Away**. Practitioners should encourage all clients with existing irrevocable trusts to meet to review those trusts. Whether for divorce, tax planning (whatever the future law changes provide), general asset protection planning or other reasons, modifying those old trusts through decanting might make improvements, or as in the Ferri case, save the trust assets. It would be preferable, unlike the Ferri case, to have the decanting completed well in advance of the divorce or other event attacking the old trust. Clients need to be educated that traditional or historic trust drafting commonly relied on techniques and provisions that are less than optimal, such as mandatory income distributions, mandatory principal distributions as specified ages, or as in the Ferri case permissible withdrawal rights of trust principal. Too many clients assume erroneously that an irrevocable trust is inviolate and that with tax laws in flux no planning is necessary. Modifying old now inefficient trusts can be about much more than tax planning considerations as the Ferri case illustrates. The Ferri case also suggests an important point that should not be overlooked. Decanting is a process, unless the governing instrument provides to the contrary, to be carried through by the trustees, not by the beneficiary.
2. Practitioners and clients alike should be cautious to monitor communications and the process to assure that the beneficiary seeking protection is not directing the decanting process or the favorable result achieved in Ferri may not be replicated. But even less might be required for the decanting to be tainted for matrimonial purposes. If state law requires notice to the beneficiaries of the decanting, or if an institution is trustee and as a matter of course or policy notifies all beneficiaries of the decanting, might the mere notification of the beneficiary taint achieving a Ferri result? Might the safer course be to move the trust to a state where the statute does not require notice to the trust beneficiaries and thereafter decant under that state's laws without any notice? Does the change in governing law and situs require notice to all beneficiaries?
3. The Connecticut Supreme Court held that the trust assets, while outside of the reach of divorcing spouse for property settlement purposes, they would be considered for the determination of alimony.
4. It should also be noted that the Massachusetts Court (which the Connecticut court asked for a determination on the validity of the decanting as the trust was a Massachusetts trust) did not have a state decanting statute to influence the outcome of the decision. If there is applicable state law, and more than 20 states now have decanting statutes, the contents of that statute will be critical to the outcome. Also, see the discussion under "Matrimonial" below concerning various ways to modify a trust with consideration to divorce.
5. **Appeal's Court Discussion**.
    a. While the court held that trust assets were moved out of reach of a divorcing wife for property settlement purposes, the trust's assets may be considered for alimony determination purposes.[61]
6. **Lower Court Discussion**.
    a. The facts in the Ferri case are summarized and simplified as follows.[62]
    b. The key time events in Ferri included:
        (1) 1983 - Creation of a trust for child/beneficiary.
        (2) 1995 - Child/beneficiary's marriage.
        (3) 2010 - Child/beneficiary's divorce.
        (4) 2011 – Decanting of trust.
    c. Parent created a trust for the sole benefit of a child in 1983. The trustee had the discretion whether or not to pay trust assets to the child/beneficiary or to instead set them aside for the child/beneficiary. In addition, the child/beneficiary could demand increasing percentages of trust corpus at specified ages beginning with 25% of corpus at age 35 and increasing in increments to 100% of trust corpus after age 47.
    d. The divorce was filed by child/beneficiary's spouse in Connecticut in October 2010.

[61] Ferri v. Powell-Ferri, 476 Mass. 651 (2017), Ferri v. Powell-Ferri, SC19432, SC19433, Powell-Ferri v. Ferri, SC19434, Morse v. Kraft, 466 Mass. 92 (2013).

[62] Ferri v. Powell-Ferri, 476 Mass. 651 (2017).

e. The child/beneficiary had the right to demand 75% of the corpus of the old trust at the time of divorce based on the trust terms. This made the trustees concerned that the child/beneficiary's ex-spouse might reach trust corpus. To endeavor to reduce this risk the trustees decanted the trust assets into a newly created trust. While the decanting was in process the child/beneficiary's right to withdraw principal blossomed to 100% of corpus. The specific process was that the trustees of the old trust created a new trust naming themselves as trustees. Then they distributed assets from the old trust to the new trust in a decanting. The decanting was done without the consent of the child/beneficiary. The new trust, as would be anticipated, eliminated the child/beneficiary's right to demand trust corpus at specified ages. The new trust was formed in Massachusetts.

f. The Connecticut Court requested that the Massachusetts Court determine whether the trustees of the old trust validly distributed trust corpus from the old trust to the new trust. While the Court determined that there is no specific decanting power under Massachusetts law, the trustee's power to decant depends on the governing instrument and the facts.[63] The rationale justifying decanting in the instant case was based on the fact that since the trustees had the discretion to distribute trust property to or for the benefit of the beneficiary, the power of the trustee to distribute the property to another trust for the benefit of the same beneficiary should be subsumed under the broader distribution power. The Court noted broad discretion afforded the trustees in the old trust, the anti-alienation provision, the beneficiary withdrawal rights, and the settlor's affidavit regarding his intent in creating the trust. The Massachusetts court concluded that the terms of the old trust and the facts involved corroborated the parent/trustor's intent to permit decanting.

g. Query whether the same result would have been realized if the child/beneficiary had requested the trustees decant, or were actually involved in the process (e.g., by consent to a non-judicial modification of the trust as discussed elsewhere in this outline). This could make the success of the decanting in similar situations very fact sensitive as to the child/beneficiary's involvement. Perhaps, a better move would have been to move the trust to a state with a strong decanting statute.

E. **ILIT Decanting**.

1. **Take-Away**. The Court's holding supports the conclusion that the provisions of a trust agreement are paramount and may govern later actions.
2. **Discussion**.

a. The New York County Surrogates Court approved the transfer of a life insurance policy from an old trust to a new trust which effectively removed certain beneficiaries of the old trust. The Court found that the action was an acceptable exercise of the trustee's discretionary power to distribute principal under the old trust agreement.[64] That old trust gave the independent trustee discretion to distribute principal to one or more beneficiaries in the trustee's discretion. That discretion could be exercised even if it resulted in the exclusion of some of the beneficiaries. Written notice, however, had to be given to the beneficiaries.

b. The court determined that a decanting may be accomplished under the terms of the trust's governing instrument without regards to New York statutory requirements.[65]

c. The court held that the lapse of a Crummey withdrawal right did not require written notice to the beneficiaries of their withdrawal rights and rather, is governed by the terms of the trust.

F. **PLR 201709020**.

1. The IRS held that the trustees' decanting of an irrevocable trust into separate irrevocable trusts for the benefit of the grantor's descendants did not result in income, gift, or estate tax consequences, nor did it affect the inclusion ratio for GST tax purposes.

G. **PLR 201711002**.

1. The IRS held that there would be no GST tax consequences when trustees combined various trusts into new trusts that did not result in a shift of any beneficial interest to a lower generation.

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[63] Morse v. Kraft, 466 Mass. 92 (2013).
[64] Matter of Hoppenstein, NYLJ 1202783016744, Sur Ct, NY County 2017.
[65] EPTL Sec.10-6.6.

H. **PLR 201732029**.

1. The IRS ruled favorably on the gift, estate, and GST tax consequences of a proposed reformation and modification of a 1985 GST grandfathered trust. The issue arose because of an inconsistency in the governing document that could have resulted in excluding descendants of a deceased beneficiary. The matter was attributed to a scrivener's error. The local court conditioned its approval of a reformation on a ruling first being received from the IRS confirming no adverse tax consequences to the reformation.
2. The IRS held that that the proposed reformation will not cause Trust to lose its GST exempt status under IRC Sec. 2601 or result in any GST tax liability to any beneficiary or Trust. Further, the IRS held that the shift in value to the possibly excluded beneficiaries proposed reformation will not result in any gift tax liability to any beneficiaries under IRC Sec. 2501, or any estate tax liability to any of the beneficiaries under IRC Sec. 2001.

I. **QSST - Can It Be Decanted**.

1. If a qualified Subchapter S Trust ("QSST") is decanted will that undermine QSST status? [66]
2. In PLR 9014008, the IRS held that the QSST's trust accounting income must actually be distributed to the beneficiary. It cannot be distributed to a beneficiary's grantor trust, even though the grantor trust is treated as owned by the grantor, and is essentially a non-entity for tax purposes. In the ruling, the QSST trustee proposed to distribute the QSST's trust accounting income not to a minor beneficiary directly, but to a grantor trust established for the minor's benefit. The grantor trust, unlike a custodial account, would have continued into the minor's early adulthood and provided some protection from spendthrift tendencies on the part of the minor. The IRS ruled that the distribution of trust accounting income to the minor beneficiary's grantor trust would violate the current income distribution requirement of a QSST.
3. In PLR 9442036, the IRS ruled that distributions from several trusts that held S corporation stock and that were created for a legally incompetent beneficiary, to a disability trust with the same beneficiary rather than directly to the beneficiary, would not prevent the trusts from qualifying as QSSTs under §1361(d). Section 1361(d) generally requires that a QSST have only one current income beneficiary and that all distributions be made only to that beneficiary. However, due to the beneficiary's incompetence, the income from the stockholding trusts could not be distributed to the beneficiary directly, but had to be paid for the beneficiary's use and benefit. Because the only function of the disability trust is to receive and administer distributions from the stockholding trusts named for the beneficiary, the stockholding trusts are considered to make distributions directly to the beneficiary. The beneficiary is treated as the current income beneficiary for purposes of applying §1361(d)(3), and consequently the stockholding trusts are QSSTs provided a timely election is made. In PLR 9442036, the IRS distinguished PLR 9014008, in which it ruled that distributions from a QSST to a grantor trust rather than directly to the current income beneficiary would disqualify the trust as a QSST, stating that the new ruling is limited to situations in which there is an incapacitated current income beneficiary.
4. Some commentators believe that the 1990 PLR may be wrong especially if the donee trust in a decanting is also structured as a QSST. Although the beneficiary of a QSST can't have a currently exercisable special power, and although decanting might give her one, it does not appear that a QSST should be disqualified merely because somewhere in the future a decanting could occur and give the beneficiary a lifetime special power. A court might rule that a trustee can't decant a QSST. Also, if a grantor trust is disregarded, then it is unclear why a decanting into a trust that is grantor as to the transferor trust would pose a problem.[67]

J. **Virginia**.

1. Virginia has enacted the Uniform Trust Decanting Act, effective July 1, 2017. SB 913, VA. CODE. ANN. § 64.2-778.1 (effective2 07/01/2012).

XVII. **Demographics**.

A. **Marriage Statistics**.

1. **Take-Away**. Many estate planning lectures and articles continue to assume a nuclear family in the scenarios they illustrate. However, such families only constitute 54 percent of American families.

[66] Acknowledgements to David Harrison Kirk, Lad Boyle, Diana Zeydel, and Mitchell Gans, for comments on this issue.
[67] Rev. Rul. 85-13, 1985-1 C.B. 184, 1985-7 I.R.B. 28.

Thus, traditional planning concepts only apply to about ½ of American families. Planning needs to change to conform with new societal norms. Perhaps those who are vocal naysayers of self-settled domestic asset protection trusts ("DAPT") should consider the implications to planning. Married couples can use non-reciprocal spousal lifetime access trusts ("SLATs") for effective asset protection planning while perhaps enabling the couple as a whole to have access to all the wealth transferred and protected. But that planning paradigm is inappropriate for perhaps half of American family units. Should nearly half of family units be so restricted in permitted asset protection options that neither a SLAT or DAPT is available to them? There is another aspect to these statistics that practitioners should consider. If married couples are wealthier, it is likely that they comprise a greater percentage of the family units which practitioners see since wealthier families are more likely to seek the services of an estate planning specialist. So, while the statistics for the population as a whole are that only about half of families are traditional nuclear families a much larger percentage of an estate planner's client base may be comprised of such families.

2. **Discussion**.
   a. While the share of U.S. adults who are married has been falling steadily over the past 40 years, married people continue to earn most of the nation's income and pay the majority of taxes.[68] according to a Pew Research Center analysis of IRS tax administration data.
   b. In 1970, 69% of adults were married, and they paid 80% of all federal income taxes. As of 2014, the share of married adults had dropped to half of the adult population (50%) but the share of income taxes paid by them fell much less, to 74%. The same period saw a sharper decline in the share of all tax returns filed as married (either "married, filing jointly" or "married, filing separately"). In 1970, married returns accounted for 60% of all returns, but fell to just 38% in 2014 – the most recent year that complete tax data are available. The fact that married Americans continue to pay roughly three-quarters of the nation's income taxes, despite their declining share of the adult population, is in part a result of the changing demographics and economics of marriage.
   c. Marriage is increasingly linked with higher levels of education, which are in turn linked to higher incomes.
   d. The marriage/education gap has widened as the share of high school graduates who are married has fallen more sharply than the share of college graduates who are married. In 2015, 45% of adults 18 and older with a high school degree, but no college, were married. In contrast, 62% of those with a bachelor's degree or higher, were married.
   e. In 2014, the average income tax return filed by a married couple reflected an adjusted gross income ("AGI") of $115,100, which was more than three times that of the average AGI on an unmarried income tax return, $35,200.

XVIII. **Digital Assets**.

A. **Take-Away**.

1. Practitioners should counsel clients to address digital access as part of every estate and disability plan. Merely including language in a durable power of attorney authorizing an agent to access the principal's digital assets is not sufficient. There are a host of digital estate and disability planning apps but a problem many face is that the information may not be kept current. Creating and maintaining such data should be part of the estate planning discussion. This might include suggesting that the client, or an IT consultant hired to help an IT challenged client, set up a password vault apps, such as 1Password or Keeper security, that can store URL, passwords, account numbers, and other confidential information for every digital relationship a client/user has. Personal financial software or apps, such as Quicken, may be used for personal financial record keeping. These programs may digitally integrate with the in-house computers for the banks and brokerage firms used by the client. Social media apps, such as Facebook, may be used by clients to store photographs and other information. Clients may or should also use backup apps, such as Sugarsync, Carbonite or DropBox, to store photographs and a range of other personal data. Who has the client directed to have access to these apps in an emergency? Is that person the same as the agent named under a financial power of attorney or someone different? If different, will the person with digital access cooperate with and assist the financial agent? What about successors?

[68] David H. Lenok, "The 50 Most Common Family Types in America," Jul 20, 2016, http://wealthmanagement.com/high-net-worth/50-most-common-family-types-america .

Has the client prepared the designee to access this information? Does the client inform the designee when the password and other access data is revised?[69] Some clients retain a password list on paper only believing that provides greater security. Will the paper be able to be found in an emergency? Might it be accessed by a perpetrator because it is not secure? Will the writing be sufficiently legible to be useable? One character that is unclear could make a vital password unusable. Regardless of what approach is used, using a third party's login credentials to access their account without proper legal authorization may violate federal and state law. If the person the client entrusts with the digital information is the same person authorized as agent under a durable power of attorney or revocable trust with digital access, that might address the authorization issue, at least in part.

2. The legislation was proposed in 2014 by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"). Approximately 23 states have enacted a version of the uniform act and approximately 18 others are considering legislation.

B. **New Jersey**.

1. New Jersey enacted legislation recognizing a fiduciary right to obtain control of a decedent's digital assets.[70]
2. Default rules concerning third-party access to digital assets are provided for. The mere listing of electronic information such as an account name is distinguished from the actual content of a particular website. Fiduciaries are generally allowed to access account catalogue information (e.g. sender, recipient, date and time). They are not, however, granted access to the content of digital files and may require a court order to do so.
3. The default rules provided by the statute can be modified by the account provider (e.g., email provider, website) in account setting options or the terms of service all of which might address future access by third parties. This unfortunately will create confusion and few clients will be aware of what the various websites and services they use provide for. For example, a website might permit the account owner to specify that their account be deleted on their death. Clients might ignore the options, or check a box inadvertently resulting in an undesirable result. The account options might permit the client to designate an individual to have access to her account on death. Some might even provide the flexibility for the client to specify the scope of the access to be permitted. While this can be a helpful step, it is not assuredly sufficient. If the terms of service or the account setting options permit the client to name an agent then coordination with the client's power of attorney may be necessary or advisable.
4. If there is a conflict between what the client specifies in her estate planning documents and what the account settings and/or terms of service provide for, the latter will control. As such, clients should be advised that they must review account settings and terms of service as it will likely be impractical for practitioners to do so. The reality is that there will be considerable arbitrariness of the results which may not be known until it is too late for corrective action.

C. **Virginia**.

1. Virginia adopted the Uniform Fiduciary Access to Digital Assets Act that will enable fiduciaries to manage digital property such as computer files, web domains, but not electronic communications such as email, text messages, and social media accounts, unless the original user consented to such access in a will, trust, power of attorney, or other record.[71]

XIX. **Domicile**.

A. **Indiana**.

1. Taxpayers were found liable to pay Indiana personal income tax since they could not demonstrate that they had changed domicile to state other than Indiana. The pronouncement discussed the general rules of changing domicile and applied them to the facts in the particular situation. The taxpayer must be physically present in the new state and simultaneously intend to establish a permanent residence there. In the instant case addressed, the taxpayers claimed residency in Tennessee and claimed as proof of their changed intent a Tennessee voter identification, cars titled in Tennessee, ownership of a Tennessee home, and Tennessee mailing address. But the taxpayers continued to own a home in Indiana and even claimed a homestead. They spent a considerable part

[69] Acknowledgements to Gary Greenbaum for suggestions on this topic.
[70] New Jersey enacted A3433/S2527, the Uniform Fiduciary Access to Digital Assets Act on Sep. 13, 2017.
[71] Va. Code §§ 64.2-116 through 64.2-132, SB 903, HB 1608.

of their time in Indiana, operated a business in Indiana, and their federal income tax returns indicated an Indiana address. The finding was that the facts did not support a change in domicile.[72]

2. Another Indiana case addressed the issue of whether a change of domicile in fact occurred and the taxpayers prevailed in demonstrating that they had in fact moved their domicile to a new state. The taxpayers moved their most important personal possessions to Florida, joined clubs in Florida, had only modest wages in Indiana.[73]

B. **<u>New Jersey</u>**.

1. Older case law often provides relevant discussion of the determination of domicile that can be useful for practitioners addressing the desire of clients in high tax jurisdictions to change their domicile for tax purposes.
2. Domicile is very much a matter of the mind - of intention. One may be acquired, or changed to a new one, when there is a concurrence of certain elements; i.e., an actual and physical taking up of an abode in a particular State, accompanied by an intention to make his home there permanently or at least indefinitely, and to abandon his old domicile. A person has the right to choose his own domicile, and his motive in doing so is immaterial. The change may be made to avoid taxation, so long as the necessary ingredients for establishment of the new domicile are present. Mere residence, regardless of its length, is not sufficient. It has been said that concurrence, even for a moment, of physical presence at a dwelling place with the intention of making it a permanent abode, effects a change of domicile. And once established, the domicile continues until a new one is found to have been acquired through an application of the same tests.[74]

C. **<u>New York</u>**.

1. In a recent New York case consideration was given to the taxpayer's dog in the determination of domicile.[75] The New York tax authorities accepted the change in domicile by the Chairman of Match.com from New York to Texas, in part, because he moved his dog to Texas. The taxpayer was a New York resident until 2009, when he accepted a CEO position at Dallas, Texas based Match.com. He then listed his New York apartment for sale and began renting a one-bedroom apartment and a car in Dallas. He executed an amended employment agreement that listed his principal place of employment as Dallas. He joined a gym in Dallas and obtained prescriptions and medical care in Dallas, obtained a Texas driver's license and voter registration, finally he also moved his dog. In the following year, 2010, the taxpayer completed the sale of his New York apartment, but shortly thereafter accepted a position requiring him to be in New York City until mid-2011. During the years in which the taxpayer had moved domicile to Dallas he continued to own both a car and boat in New York. He also continued to summer in the Hamptons. The court held that the taxpayer's move of his dog, a "near and dear item," to Dallas for the period of time he claimed to be domiciled there, sufficed to corroborate his change in domicile to Dallas.

XX. **<u>Elder Financial Abuse and Aging</u>**.

A. **<u>Take-Away</u>**.

1. Concerns over the burgeoning growth in elder financial abuse are and will continue to result in new regulations and requirements that affect many in the financial and estate planning professions. Presently, care managers are mandated reporters who must by law report suspected elder financial abuse. The list of those who are likely required to do so will expand. Practitioners in all fields should give consideration to what and when to report suspected abuse. Attorneys in particular need to be mindful of the impact of attorney client privilege and various ethical rules in determining how to proceed.
2. Estate planners and other advisers should all make the elder financial abuse issue part of the financial and estate planning discussion. This should be done at a much earlier age then most advisers anticipate since the ability to make sound financial decisions peaks before retirement age.
3. As discussed in a preceding section of this outline under "Agents" planners should consider how this appointment of a "trusted contact" will coordinate or conflict with other agent appointments. This further demonstrates the concerns of how disjointed rules and planning by so many different agencies and planners could result in planning nightmares.

B. **<u>Securities Regulators</u>**.

[72] Letter of Findings No. 01-20170138, Indiana Department of Revenue, July 26, 2017.
[73] Schmidt v. Department of Revenue, Indiana Tax Court, No. 49T10-1306-TA-00055, August 15, 2017.
[74] Lyon v. Glaser, 60 N.J. 259, 288 A.2d 12 (1972).
[75] In re Blatt, N.Y. Tax App. Trib., N. 826504, February 2, 2017.

1. The SEC approved rules relating to financial exploitation of seniors.[76] New FINRA Rule 2165, "Financial Exploitation of Specified Adults," has been adopted to permit members to place temporary holds on disbursements of funds or securities from accounts of customers for whom there is a reasonable belief that financial exploitation is occurring. Also, amendments were made to FINRA Rule 4512, "Customer Account Information," which will require members to make reasonable efforts to obtain the name of and contact information for a trusted contact person for a customer's account.[77] Financial advisors are being urged to have their clients prepare a "diminished capacity" letter.
2. The North American Securities Administrators Association ("NASAA") released a study of how broker/dealers are endeavoring to address suspicions of financial fraud, abuse or dementia among their senior investors.[78] Based on a series of exams of 39 individual broker/dealers, the NASAA found more than half (54 percent) lacked a formal definition of who is even classified as a "senior" customer. Despite that lack of addressing such a vital fundamental, 90 percent of broker/dealers had either a dedicated team, or at least an internal process in place, for dealing with suspicions of elder abuse or instances of diminished mental capacity when it arises. When individual cases where escalated in a firm, 62 percent of the time the situation was referred to adult protective services. Rarely (4 percent of the time) were cases referred to local law enforcement. While it's laudable most firms have procedures in place to handle these cases, only 41 percent had developed a simple form where elderly clients had identified a trusted contact person.

C. **<u>Studies of Elder Abuse and Related Issues</u>**.

1. A 2011 MetLife study estimated the annual financial loss suffered by victims of elder financial abuse to be at least $2.9 billion. A study issued by True Link Financial, a financial services firm that helps older adults and their families protect themselves from fraud, estimated the loss from elder financial abuse at $36.5 billion. Most experts believe the problem is under reported because victims are embarrassed, or reluctant to accuse family or others close to them that frequently comprise the perpetrators. An Investment News survey of 591 advisers found that 62% had seen or suspected financial abuse of an elderly client at least once. However, 56 percent of those advisers who believed abuse may have occurred did not report it. About half of people over the age of 80 show some signs of impaired memory or cognitive problems. Certainly, factors that lend themselves to abuse. Elderly victims of financial abuse tend to be female and white, according to last year's New York State Cost of Financial Exploitation Study. The study also estimated that for every case referred to authorities, between 10 and 44 cases remain undetected. It was estimated that elder financial abuse victims report just 2 percent of cases. In the Investment News survey, 65 percent of advisers identified a family member as a suspected perpetrator, while 30% pointed to a friend or acquaintance, and 30% believed it was a caregiver. Bank of America Merrill Lynch surveyed its advisers last year to identify the most common perpetrators of elder financial abuse and found that 71% cited children of the victim, with 32% flagging other family members and 18% identifying anonymous fraudsters.[79]
2. Numerous cognitive studies over the years have shown that decision-making ability declines with old age and that this can have an effect on important financial decisions. Texas Tech University (TTU) recently published a study on this topic and found that after age 60, one's ability to make smart financial decisions begins to suffer. While peak financial decision-making ability occurs at age 50 according to this study and many others, from age 60 onwards, a gradual decline begins and decision-making quality is significantly impacted by one's 80s and 90s.[80]

D. **<u>Migell Case</u>**.

[76] Regulatory Notice 17-11.

[77] Rule 2165, and amendments to Rule 4512, all become effective February 5, 2018.

[78] "Firms Better at Handling Suspected Elder Abuse, But Few Have Emergency Contacts," WealthManagement.com Morning Memo, July 7, 2017.

[79] Christine Idzelis, "Advisers on front lines in battle against financial abuse of the elderly," April 3, 2017, http://www.investmentnews.com/article/20170403/FEATURE/170339977/advisers-on-front-lines-in-battle-against-financial-abuse-of-the .

[80] "50 is Peak Age for Financial Decision Making," Sept. 18, 2015, Serena Elavia, http://thetrustadvisor.com/headlines/peak-age .

1. A Massachusetts Appeals Court ordered that real estate and other assets be returned to elderly, infirm woman.[81]
2. The case involved the guardianship of Alice Migell, a nursing home-bound 83-year-old widow.[82] A complaint in equity was filed against her son and daughter-in-law to recover over $2.5 million in assets after an investigation by the local protective services agency revealed that Alice was the victim of a scheme to strip her of her assets.
3. The son was a trustee and acted under a power of attorney for Alice. Both the son and daughter in law boasted about how they did everything for Alice because she couldn't take care of herself. They tried to use that relationship as a justification for, if not entitlement to, keeping proceeds from selling property held in trust and receiving outright conveyances of other valuable real estate. The Appeals Court, however, agreed with the trial judge's determination that both the son and daughter-in-law stood in a relationship of trust and confidence toward Alice. Although they were defendants in this action, and so wouldn't ordinarily bear the burden of proof, the finding of a fiduciary relationship shifted the burden of proof. Both the son and daughter-in-law were found guilty of criminal contempt, with the son receiving a 45-day jail sentence.

E. **Retirement Accounts**.

1. **Take-Away**.
   a. Many seniors are not only vulnerable but isolated. They have no one to name that is trustworthy or responsible to manage assets. One approach to address this is to name an institutional trustee to manage assets transferred to a revocable trust and institute other safeguards in the event the institutional trustee proves unreliable.[83] A significant hurdle in this planning approach is that under present tax rules an IRA cannot be transferred to a revocable trust to be safeguarded by an institutional trustee and other mechanisms as that would trigger deferred income tax. Some efforts have been made to have the IRS modify its rules to permit this.
   b. The client might name an institutional trustee become comfortable enough to serve as agent under the client's power of attorney to provide protection for the IRA in that manner. However, many institutions are loath to do so.
   c. It may be feasible for the client to name a person with a very limited power of attorney to only direct payments from the IRA to the revocable trust under which an institution might be willing to serve.
   d. A final but limited approach might be for the client while able to sign an instruction to the institution holding the IRA to make periodic distributions, e.g. of the RMD, to the revocable trust. This option, however, becomes more complex if the client is under the age for which withdrawals can be made or if current employment prevents distributions.
   e. **Sample Provision**.
      (1) *TRUST-COMPANY, doing business at *ADDRESS, shall serve as Agent ("Trust Agent").
      (2) The Trust Agent shall have no obligation to serve hereunder unless it either has actual notice of Principal's incapacity, even if this Power of Attorney is not a springing power, or has received written notice from the Principal requesting that Trust Agent commence serving hereunder.
      (3) Trust Agent may resign at any time without regard to other restrictions hereunder, other than to give notice to any successor Agent, guardian or committee.
      (4) Trust Agent's sole and exclusive power hereunder shall be to transfer assets to Principal's Revocable Trust for which Trust Agent serves as sole Trustee.
      (5) Receive compensation based on its regularly published fee schedule.
2. **Discussion**.
   a. An example of a client situation simply illustrates the importance for some clients of being able to transfer an IRA to their revocable trust. **Example**: Sandra is in her mid-80s.

[81] Robert J. O'Regan, "Estate Plan Protects Widow From Son's Breach of Fiduciary Duty," Nov 15, 2016, http://www.wealthmanagement.com/estate-planning/estate-plan-protects-widow-sons-breach-fiduciary-duty .
[82] Guardian v. Migell, 2016 Mass. App. Unpub. LEXIS 1056 (Nov. 2, 2016).
[83] Shenkman, "Estate Planning for the Chronically Ill, Aging, and Otherwise Vulnerable or Isolated Client," Probate &, Property, May/June 2016, at 23.

Her partner has advanced Alzheimer’s disease. Her one son is financially imprudent and she has set up a lifetime trust for him naming an institutional trustee. Sandra has worked with the same institution for decades and has a close relationship with them. To address the risks she perceives she might have as she continues to age, and the reality that she has no one to rely on financially, she has created a revocable trust and named the institution she has worked with for so long as successor trustee. She has transferred title to her home and financial accounts to the trust but her primary asset is an IRA. She is uncomfortable naming her son as agent under her durable power of attorney (“POA”) because of his past financial dealings. Her options include: 1) naming her son but carefully limiting the powers he can exert under the POA, e.g. no modifications to the IRA, 2) naming the institution as agent but that has proven a difficult if not impossible route, 3) transferring her IRA to her revocable trust but that presents too much of a tax risk in that the transfer might be viewed as a taxable disposition of the IRA.

b. If it were permissible to transfer the IRA to the client’s revocable trust, the protective nature of the plan might be enhanced by providing that the trust could not be revoked by the grantor, which may provide better protection against predators than a typical fully revocable trust. A trust protector could be granted the power to revoke the trust thereby reverting all asset back to the grantor. All benefits during the employee's lifetime could be required to be distributed solely to the grantor, or used for his benefit and any undistributed IRA assets at death could be required to be distributed to the designated beneficiaries of the IRA. Some commentators would argue that a transfer of the IRA to a trust so constructed should not be deemed a transfer under any other provision of the Code, so that it should not be deemed a transfer under Reg. Sec. 1.408-4(a)(2).

c. A proposed resolution has been put forth to address revocable trusts holding IRAs.[84] The proposal does not address ERISA qualified plans, including 401(k)s, only IRAs.[85] The proposal was limited to only IRAs as that avoided having to also address the matter with the Department of Labor. A question was submitted at the annual meeting of the Tax Section's Committee on Employee Benefits held jointly with Treasury in Washington several years ago, but no response was received. That is problematic given the burgeoning elder financial abuse statistics discussed above.

d. Even if the IRS gave clearance to transfer IRAs to revocable trusts, there still would be a problem of the state law prohibitions on such transfers (except in states that permit it, e.g., Alaska). If the IRS did act, but states did not, then all IRA accounts would have to be transferred to revocable trusts naming a trustee in a state that would permit this, e.g. an Alaska trust.

e. One reason for focusing primarily on IRAs is that, most employees (perhaps around 70%) roll their 401(k)s over into IRAs when they retire, which is usually before the problems of dementia and other disabilities arise. But based on the discussions above concerning the optimal age for financial decision-making delaying this until retirement age could be problematic. Thus, it has been suggested that by solving the IRA issue indirectly the problem for 401(k) plans would also be addressed.

f. Some commentators believe that if you transfer an IRA to a grantor trust, and the transfer is not a completed gift, the IRS would have to recognize that as a permitted transfer in view of the IRS’ explicit insistence since 1985 that the grantor trust is the same as the taxpayer/transferor/plan holder.

g. Unfortunately, it seems the IRS may take the position that such plans cannot be transferred to any trust without causing the plan to become disqualified. This position is antithetical to the steps being taken by FINRA and other federal agencies to address the growing elder financial abuse epidemic. The IRS position however is not fully clear, and that lack of clarity has served to prevent practitioners from transferring IRAs to revocable trusts to provide protection. The lack of certainty as to the IRS position results from the IRS having not officially taken the position that the transfer of an IRA to a revocable trust

[84] Acknowledgements to Jonathan Blattmachr, Natalie B. Choate, Martin Cowan, Trent Kiziah, and Letha McDowell for this discussion.

[85] ABA Resolution 107 submitted on behalf of the Senior Lawyers Division of the ABA to the ABA House of Delegates concerning the protection of IRA accounts.

is prohibited. In fact, they have allowed transfers of inherited IRAs to trusts (even irrevocable trusts) in several private letter rulings (transfers were by minors or disabled beneficiaries).

h. A regulation provides that the transfer of an IRA by gift is a deemed-distribution event. It terminates the status of the IRA as an IRA. To avoid the effect of that Regulation the transfer to an elder-protecting revocable trust would have to be an incomplete gift but even that may not avoid the adverse effect. This might also require that the revocable trust cannot grant a trustee the power to transfer trust property to someone other than the plan holder during lifetime. That might be an issue with the common gift provisions many revocable trusts include.

i. In PLR 200127027, the decedent owned several IRAs and a QRP. His estate plan left everything to his Wife and Son (or trusts for them), disinheriting Daughter, who challenged the plan claiming undue influence. In a compromise settlement, the decedent's estate plan was set aside, and a portion of the would pass to pursuant to that agreement. The IRS held that the dispute was bona fide and the settlement was reasonable, so the IRS permitted the spouse to rollover the IRA payable to her under the settlement agreement.

j. The IRS approved a post-death change of beneficiary for an IRA based on undue influence.[86]

k. IRA accounts do not have to be transferred to a revocable trust to benefit from the protections/advantages of trust format as some institutions offer trusteed IRA arrangements which can permit the trustee to pay the IRA owner's bills, distribute RMDs, etc.

XXI. **Exemption and Exclusion Amounts**.

A. **Inflation Adjusted Figures for 2018**.

1. For 2018, the estate, GST and gift tax exemption is $5.6 million per individual, an increase of from the $5.49 million 2017 figure of $110,000, or $220,000 for a married couple. Practitioners should consider recommending to clients to consider topping off irrevocable trusts with additional transfers.
2. The annual gift exclusion amount increases by $1,000 from $14,000 in 2017 to $15,000 for 2018. Practitioners should be certain to update forms used for powers of attorney and caution clients that old powers of attorney that may not reflect inflation adjustment language might be worth updating. Further, clients should be notified that if they have made and are considering making annual gifts that they can increase them by $1,000/year/donee. Forms used for Crummey powers should be updated if gifts are increased.

XXII. **Family Office**.

a. Ultra-high net worth investors prefer multi-family offices instead of wealth management or financial planning firms. The factors cited are responsiveness and the holistic approach that multi-family offices take.[87]

XXIII. **Gift Tax**.

A. **Adequate Disclosure**.

1. Practitioners should carefully weigh the benefits of filing returns and advise clients of the pros and cons. If a filing is not made, or if made does not adequately disclose the gift, the statute of limitations for an audit will not toll. Practitioners are reminded of the importance of both filing a gift tax return, and of assuring adequate disclosure on the gift tax returns filed.[88] In the FAA the taxpayer failed to provide a description of the method used to determine the value of the property so that the disclosure was not adequate. A gift is not adequately disclosed unless it is "reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported.[89] A gift is adequately disclosed if the gift tax return reports certain

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[86] PLR 200707158; PLR 201432029.

[87] "The Super Rich Prefer Multifamily Offices," Aug. 30, 2017 http://www.wealthmanagement.com/retirement-planning/workers-save-more-retirement-when-nudged-employers citing Forbes Aug 29, 2017 Why The Ultra-Wealthy Prefer Multi-Family Offices, Russ Alan Prince , citing study by John Bowen, founder of CEG Advantage.

[88] IRS Field Attorney Advice 20172801F (released 7/14/2017); IRC Sec. 6501(c)(9).

[89] Reg. Sec. 301.6501(c)-1(f)(2).

information, including a description of the transferred property and any consideration received by the transferor, and a detailed description of the method used to determine the fair market value of the gift.

B. **Decanting – Should You File**.

1. Since a decanting of an existing trust, when there is no change in beneficiaries should not constitute a gift many practitioners might view that as not triggering a gift tax reporting obligation. Several practitioners general view is to report and fully disclose a decanting, and to thereby toll any statute of limitations. Some suggest that since the law on decanting is not clear that safer approach might be to report decanting transactions.

C. **GST Allocation Schedule**.

1. **Take-Away**. Too often clients complain about the costs of preparing a gift tax return, after all is it is in their view a short and simple form. The case below exemplifies that a gift tax return is nuanced, and the potential adverse results for failure to comply with the regulations may be severe.
2. **Discussion**.
    a. On a gift tax return the taxpayer elected out of the automatic allocation rules with respect to the gift to a Trust. The attorney who prepared the return correctly reported the transfer to the trust as an indirect skip on Schedule A, Part 3. The attorney also allocated GST exemption to the transfer on Schedule D, Part 2, Line 6. However, the attorney failed to attach a Notice of Allocation for the transfer as required under the instructions and the Regulations. So, the issue was whether what was disclosed on the return sufficed to allocate GST exemption as intended, even though the disclosures did not meet all the requirements. Fortunately for the taxpayer (and the attorney) the IRS determined that the compliance was close enough as it substantially complied with the requirements for making an allocation of GST exemption to the transfer to the trust.
    b. Husband did not literally comply with the instructions to Form 709 or the requirements in the regulations for allocating GST exemption to an indirect skip in accordance under IRC Sec. 2632(c). However, the IRS noted, literal compliance with the procedural instructions to make an election is not always required. Elections may be treated as effective where the taxpayer complied with the essential requirements of a regulation (or the instructions to the applicable form) even though the taxpayer failed to comply with certain procedural directions.[90]
    c. Thus, an election that does not strictly comply with the instructions on Form 709, or the applicable regulations, will be deemed valid if the information on the return is sufficient to indicate that the personal representative intended to make the election. Based upon the facts submitted the IRS held that the Form 709 contained sufficient information to constitute substantial compliance with the requirements of IRC Sec. 2632(c) to allocate GST exemption to an indirect skip, and therefore the taxpayer was deemed to have allocated GST exemption to the transfer to Trust.

D. **Net Gift**.

1. The Tax Court held that no estate tax deduction was permitted for the gift tax that was unpaid on a net gift on the date of decedent's death because the son would reimburse the estate.[91]

XXIV. **Grantor Retained Annuity Trust**.

A. **Take-Away**. Grantor retained annuity trusts ("GRATs") remain powerful planning tools in uncertain times but traditional applications of the GRAT technique might be modified in light of current circumstances.

B. **Discussion**.

1. GRATs are a useful tool, especially in a time of uncertainty concerning the possibility of estate tax repeal is as many practitioners view the regulatory based valuation adjustment attributes of GRATs as a valuable safeguard to avoid an unintended gift tax cost. The annuity amount is expressed as a percentage of the initial fair market value of the property transferred to the GRAT. Thus, if a tax audit results in a valuation adjustment the annuity payment would be increased and no gift tax should result. The current still relatively low interest rates provide another means of leveraging wealth through GRATs as the hurdle rate to exceed for wealth to shift remains low by

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[90] Hewlett-Packard Company v. Commissioner, 67 T.C. 736, 748 (1977), acq. in result, 1979-1 C.B. 1.

[91] Estate of Sommers, (2017) 149 TC No. 8.

historical standards. Practitioners should consider whether certain variations in planning a GRAT might be preferable in the current planning environment.

2. A common GRAT approach is to use short term rolling or cascading GRATs. Short term rolling may be less than optimal if interest rates rise substantially and when future GRATs are created higher rates may apply. Practitioners may wish to consider using longer term GRATs to minimize leakage of the equity interests back into the Grantor's estate and re-GRAT'ing in a higher interest rate environment. If the appropriate circumstances are present, it may be possible that the cash flow from the entity can pay the annuity amount and avoid leakage of equity interests into the client/grantor's estate. The factors to achieve this might include: The value of the discount is sufficient; cash flow from the entity is adequate; the grantor's life expectancy is such that the GRAT can be for a sufficient term that the results are obtainable. **Example**. Family business is valued at $15 million and generates an 8% dividend distribution. 10% of the business is contributed to a GRAT. The pro-rata enterprise value is $1,500,000, which is discounted to $1,000,000. The actual dividend on the 10% interest is $1,500,000 x 8% = $120,000. A ten year GRAT is created. The required annuity payment of $110,000 results in a taxable gift of $1,497.00. On this basis, the cash dividend from the equity interests will suffice to make the annual annuity payment.
3. GRAT immunization may need to be reconsidered if longer term GRATs are used. A successful GRAT, with significant upside/appreciation inside the GRAT could be "immunized" (the appreciation frozen/secured) by swapping out the highly-appreciated asset and substituting in a low volatility asset, such as cash. This would serve to "lock in" the appreciation realized outside the taxable estate. One difficulty with a longer term GRAT is that early success may be offset by future failure in asset performance. That could undermine/reverse the initial success. The client might address this risk in part through a future exercise of a swap power (power of substitution under IRC Sec. 675(4)(C)) to capture and immunize the volatility in a GRAT. The grantor can exercise a swap power over a GRAT without a negative gift tax consequence. PLR 200846001. A swap power should also succeed if the trustee has an obligation to confirm that the property substituted is of equivalent value.[92] With the 2-year cascading GRAT structure immunization is relatively simple in that substituting cash for a volatile asset might mean a low return asset (cash) is inside the GRAT for perhaps a year or so. If GRATs are structured for longer terms to lock in current low 7520 rates, immunization takes on a new challenge. Perhaps strategies other than cash immunization, like a portfolio with moderate risk but some growth potential, or on which positions are collared, might be used so that some appreciation might be achieved over the remaining term, but without the volatility that might reduce the already realized gain inside the GRAT. Might insurance products become part of the immunization plan? Might bond portfolios maturing on the GRAT termination provide a simple option?
4. Another negative of a longer term GRAT is that death during the term of the GRAT could undermine the plan by causing a substantial portion (and possibly all) of the assets held by the GRAT to be included in the grantor's gross estate for Federal estate tax purposes. The probability of death during the term of a GRAT can be estimated using the 90CM mortality tables which are based upon the 1990 census. The mortality risk of long term GRATs might be addressed by: Using a tier of GRATs to increase the likelihood of the grantor outliving some (e.g., 6, 8, 10 year GRATs); insuring the risk (e.g., if the longest GRAT is 10 years, purchase 10-year term life insurance); or by quantifying the risk by having an actual life expectancy analysis completed for the grantor and use that knowledge to set the term of the GRAT.
5. Practitioners should also consider another important variation of the traditional GRAT strategy when evaluating how best to capture discounts before the effective date of the Proposed Regulations, given the legislative risks posed by future rolling GRATs and the current historically low interest rates. The 99-year GRAT applies the GRAT transfer strategy in a manner that appears to comply with the technical requirements of the Treasury Regulations but which seeks to take advantage of the potential for a significant increase in interest rates between the date the GRAT is established and the date of the client's death. While practitioners must consider the key risk of the 99-year GRAT strategy that forecasting interest rates is a dangerous endeavor and there certainly is no assurance that interest rates will be meaningfully higher on the client's death, it does seem quite reasonable to anticipate that the current historically low interest rates are likely to increase

[92] Rev. Rul. 2008-22, 2008-16 I.R.B. 796, Treas. Reg. Sec. 20.2036-1(c).

over the course of the next 99 years. If interest rates do rise sufficiently as expected, the 99 year GRAT approach could significantly reduce the portion of the entity interests originally contributed to the GRAT that will be includable in the Grantor's estate. Practitioners should be forewarned that the Treasury does not approve of this strategy and several proposals have been made for Congress to eliminate the 99-Year GRAT legislatively.

6. **Example**. The client contributes $1 million to a 99-year GRAT in July 2016 when the 7520 rate is 1.8%. An annuity of $21,700 nearly zeros out the value of the GRAT, leaving a current gift value of $582.63. Assume that in year six, the client dies and as of the date of death, the 7520 rate had increased to 6%. The amount of the GRAT that must be included in the client's estate is $21,700/.06 = $361,667. In other words, at the higher interest rate, only $361,667 of principal of the GRAT is required to be included in the client's estate to generate the $21,700 initial annuity amount.
7. Another consideration might be to create an irrevocable, non-GST, grantor trust to receive backend of the GRAT and it owns it absolute. The grantor can buy remainder back resulting in a merger of the remainder and annuity/lead interest. Consider using a SLAT/Hybrid DAPT to maximize access. Make the remainder GST exempt by having that new trust sell its remainder interest to an old dynasty trust.

XXV. **Guardian**.

A. **Guardian for Incapacitated Ward**.

1. **Take-Away**. A New Jersey case evaluated the performance of a court appointed guardian for an incompetent ward.[93] The case highlights the fact sensitive, "he said/she said" nature of the performance and compensation of a guardian for an incapacitated ward and highlights several of the gray issues that guardians can face and steps that might be useful to consider. One of the key steps the guardian seemed to do right to protect herself was hiring outside experts, in particular a reputable regional CPA firm to handle accountings and a real estate appraiser and broker to sell residential real estate, although it should be noted that she was challenged on each of these.
2. **Discussion**.
    a. Total Fees. When the attorney was appointed as guardian the net assets of the ward totaled $2,330,579.42. After the ward's death, the guardian transferred to the estate the remaining assets of the guardianship, which totaled $1,979,472.17. Some of the decline was due to the decline in the value of a Florida residential property from the appraised value at the inception of the guardianship, to the lower appraised value at the conclusion. The total corpus, income, and final distribution commissions, approved by the court after litigation was $108,259.46. From some perspectives that fee might seem significant for an estate that might be viewed by some practitioners as not particularly complicated, two residential properties and a limited number of assets, but which the court described as complex and large. The reality, as in so many of these cases, it is impossible to ascertain whether the fee was too large, too small or appropriate for what was involved. When the difficulties and stress of the litigation are factored into the analysis might any fee have been inadequate? On the other hand, the attorney guardian received legal fees for the litigation.
    b. Are Short Cuts Worthwhile. Another question might there have been a better way to have handled the guardianship. The sole beneficiary appears to have been a single charity. Perhaps some steps might have been handled with less formality if approved by the single remainder beneficiary to save on costs. On the other hand, when the attorney/guardian was confronted with difficult litigation perhaps her inclination to be more formal in terms of accounting, physically visiting the property in Florida, and perhaps other steps, may have been a wise move given what followed.
    c. Duties of Guardian. A guardian is given rather wide latitude to make reasonable judgments on how to handle the ward's affairs. A guardian may expend or distribute so much or all of the income or principal of the ward for the support, maintenance, education, general use and benefit of the ward. This can be done in the manner, at the time or times, and to the extent that the guardian, in an exercise of a reasonable discretion, deems suitable and proper. Clearly, given the challenges the guardian faced

[93] 58-2-2529 In the Matter of J.F., N.J. Super. App. Div. (per curiam), (February 14, 2017). See also, http://www.wealthmanagement.com/estate-planning/beware-risks-assuming-role-guardian .

here every guardian should maintain clear records and document the basis and rationale for expenditures made. The court found no evidence that the conduct of guardian was gross misconduct that was willful or fraudulent. The court found that guardian acted in what she believed was the best interest of the ward. Anyone serving as a guardian should be mindful that the types of challenges and allegations faced by the guardian in this case could be awaiting them, deserved or not.

d. Florida Real Estate. The guardian and ward resided in New Jersey but the ward owned a residence in Florida. The guardian made multiple trips to Florida to inspect the property. The justification for those trips, and in particular the costs incurred, were challenged by the remainder beneficiary. Of note is that the Florida residence was in considerable disrepair, substantial mail had accumulated, and personal effects of the ward were found in the premises. The court concluded that not to have physically inspected the property would have been a dereliction of the guardian's duty. The remainder beneficiary also sought a surcharge of $143,000, based on the difference between the initial $210,000 appraised value of the Florida condominium and the $67,000 ultimate sale price. It appears from a reading of the opinion that the guardian acted prudently in that she hired an appraiser to value the property and listed it for sale. She thereafter reduced the selling price multiple times presumably as the real estate market in the area declined. It would not appear that the guardian could have neglected the effort to sell the property with so many price changes. The court found no evidence showing that there was a ready, willing and able buyer during the guardianship and did not revisit the trial court's determination that the guardian should not be surcharged for the decline in price.

e. Accounting Fees. The attorney/guardian took what would seem to be a prudent and appropriate step of hiring a reputable CPA firm to provide accounting services. It would have seemed that the remainder beneficiary would have viewed this as providing independent corroboration that financial matters were handled appropriately and independently. Yet instead, the remainder beneficiary in an Orwellian-twist, challenged the guardian for dissipation of the ward's assets since she, the guardian, had an MBA and presumably could have done the accountings as part of her fee as guardian. The court noted that the law grants a fiduciary the conditional authority to employ accountants, at the expense of the estate, without reducing commissions. Whether fees are chargeable depends on the skills and background of the fiduciary and the nature of the accounting services. Charges are not permitted for services that would be "usual, customary or routine" for the particular fiduciary, given the nature and skills of the fiduciary. The court determined that the accounting fees were reasonable in view of the size of the ward's estate and the duration of the guardianship, and it was appropriate to charge the estate for the amount. While it would seem that retaining an independent CPA firm would almost always be prudent and appropriate, unfortunately the court's analysis suggests that caution is in order for fiduciaries taking this step.

f. Attorney Fees. The guardian was a licensed attorney and performed professional services in addition to her fiduciary duties in defending the litigation, she was awarded attorney fees for that work. The court determined that the guardian acted beyond her duties as guardian in preparing legal pleadings and litigating the application to settle the accounts. It is not clear whether the guardian would have been better advised to hire outside counsel, similar to what she did in hiring an independent CPA firm, appraiser and broker.

B. **Parent Presumptive Guardian for Minor Child**.

1. This is an issue that comes up more than occasionally with clients. When a divorced client prepares a will and designates a guardian what happens if he or she does not wish to name the other parent? The other natural parent will generally be recognized as the guardian regardless of what is stated in the client's will, unless the surviving natural parent is unfit or unusual circumstances are present. The court will have to determine whether it was appropriate to consider the best interests of the child as the appropriate standard in awarding custody of a fit biological child to a third party instead of the surviving parent. In a New Jersey case, the court held that was the incorrect standard. Instead, a presumption exists in favor of the surviving biological parent. But, that presumption can be rebutted by proof of gross misconduct, abandonment, unfitness, or the existence of "exceptional circumstances," but never by a simple application of the best

interests test.[94] While other states may have different standards, this may be useful as a discussion point when clients raise the question.

C. **Standby Guardians**.

1. **Take-Away**. Practitioners should consider designating a standby guardian for clients with minor children. The designation of a guardian under the will does not address a potentially significant gap in planning in that in the event of the incapacity of the parent what mechanism or document provides for a guardian for the minor child? It would appear none. New York law provides for the appointment of a standby guardian for a minor child. Even if state law where the client resides does not have a comparable statute might using a similar approach at minimum confirm to a court who the client would want named to serve in such capacity? If the client has already executed a will designating a guardian would such an additional document if not recognized by state law provide any incremental confirmation to the court of who would be desired to serve beyond what the guardian designation in the will implies? It would also seem that if the client is a married couple that the form might designate the other parent (i.e., other than the signer) first, or instead indicate that the guardians named should not serve until neither parent is able to serve.
2. **Discussion**.
   a. New York law provides for a person designated pursuant to subdivision four of this section as standby guardian whose authority becomes effective upon the death or incapacity of the infant's parent, legal guardian, legal custodian or primary caretaker or upon the debilitation and consent of the parent, legal guardian, legal custodian or primary caretaker.[95]
   b. A parent, a legal guardian, a legal custodian, or primary caretaker may designate a standby guardian by means of a written designation, signed by the parent, legal guardian, legal custodian or primary caretaker in the presence of two witnesses at least eighteen years of age, other than the standby guardian, who shall also sign the writing. Another person may sign the written designation on the parent's, legal guardian's, legal custodian's or primary caretaker's behalf and at the parent's, legal guardian's, legal custodian's or primary caretaker's direction if the parent, legal guardian, legal custodian or primary caretaker is physically unable to do so, provided the designation is signed in the presence of the parent, legal guardian, legal custodian or primary caretaker and the witnesses.[96]

XXVI. **Hart Scott Rodino**.

A. Practitioners should be mindful that large estate planning transactions may trigger reporting requirements under Hart-Scott-Rodino Antitrust Improvements Act ("HSR").[97] HSR imposes an obligation to file a premerger notification report form with the Premerger Notification Office of the Federal Trade Commission ("FTC"). This is all quite unintuitive since a sale of interests in a closely held or family business to a trust created by the family can hardly be viewed as negatively impacting competition, but meeting the filing requirements, or finding an exemption, is necessary to avoid potential onerous penalty provisions.

B. Acquisitions resulting from a gift, intestate succession, testamentary disposition or transfer by a settlor to an irrevocable trust may be exempt from the filing or other requirements of HSR.[98] However, the conclusion is not so simple or obvious. There could be an impact to the trustee and trust protector provisions, and, specifically, who should have the ability to remove and replace trustees.
For example, a settlor's retention of the ability to remove and replace the trustee, or the right of a trust protector to do so, of an irrevocable trust might cause the trust's voting securities to be treated as part of the settlor's ownership share of an entity for purposes of HSR testing.

C. For example, if the trust protector of a trust has the contractual power to remove and replace 50 percent or more of the trustees, the protector may be considered a control person. Pursuant to informal conversations with the FTC staff that power of the trust protector must be absolute and not, for example, merely the power to name a successor trustee without the power to remove, and not in instances where the power to remove and replace is subject to consent of a third party. The company is its own Ultimate Parent Entity

[94] Watkins v. Nelson, 163 N.J. 235 (2000).
[95] SCPA Sec. 1726(1)a.
[96] SCPA Sec. 1726(4)a.
[97] See Jay D. Waxenberg and Jason A. Lederman, "The intersection of trusts and anti-trust: Why you, an estate planner, should care about Hart-Scott-Rodino," 51 real Property, Trust and Estate Law Journal, at 431.
[98] Sec. 802.71.

("UPE") in that no other entity "controls" it; and after the acquisition, and the protector might be viewed as in "control" of the entity by virtue of holding 50% or more of its voting securities.

D. In addition to control meaning holding 50% or more of voting securities, there is an alternative control test for control of corporations of having the contractual power presently to designate 50% or more of the directors. If a person did hold that power that person may be viewed as the UPE or, post-acquisition, a UPE in addition to the protector. Query whether an investment advisor or investment trustee in a directed trust who can vote the equity interests might thereby be classified as a UPE based on the above. This nonetheless may not affect the HSR analysis as to whether the Sec. 802.71 exemption applies.

E. If the exemption does not apply and filing is required, the protector or perhaps investment trustee may be considered the "acquiring person" and the company (since it is currently its own UPE) would be the "acquired person". Should that occur then perhaps both the trust protector and the company could be required to file. There would be one filing fee which would be based on the value of voting securities of the company that the protector would "hold" as a result of the acquisition (both what is currently held and what is being acquired). The filing fee would be based on the size of the transactions.

F. In testing HSR filing requirements, holdings of spouses are considered to be the holdings of each them.[99]

G. An informal opinion was obtained from the FTC that a note sale transaction to a grantor trust was in fact exempt under Sec. 802.71 even though the transfer would meet the HSR size of transaction and size of person tests.

H. The FTC did not dispute the view expressed that essentially internal, estate-planning-driven transfers of family businesses to a trust should be exempt, while acquisitions by a trust from third parties should not.

I. Technicality of being transferred to trust that transferor is settlor of … also a sale is an issue since not a gift.

J. No reason why government should be concerned about a family transaction as this has nothing to do with significant businesses combining.

K. The regulators responded that they do not think that trust protector status is significant. Any time a large transaction is contemplated a mergers and acquisition specialist should be involved to parse through the exceptions to confirm no filing needed.

XXVII. **<u>Health Care Proxy</u>**.

A. **<u>Take-Away</u>**. A substantial majority of Americans do not have health care related documents. While no doubt practitioners prepare health care proxies and/or living wills for clients, what about children, family and other loved ones of clients? Clients will often be responsible to deal with medical emergencies of their family and loved ones, who, in the absence of appropriate documentation will have to bear a greater burden. Perhaps practitioners, in light of the statistics below, should encourage clients to address planning for these they will be responsible for.

B. **<u>Discussion</u>**. A surprisingly small percentage of Americans have health care proxies or other health care related documents. One study estimated that only 26% of adults have any type of advanced directive. Of the more than 7,900 respondents to the survey, 26.3 percent had an advance directive.[100] The small percentage was attributed to the lack of awareness in making medical wishes known. Another study estimated that a quarter (26 percent) of Americans currently have an advance directive, such as a living will.[101]

XXVIII. **<u>Individual Retirement Account</u>**.

A. **<u>IRA Bequeathed to Spouse Instead of Charity Not Reformed.</u>**

1. **<u>Take-Away</u>**. In a New York case, the court refused to remake a tax inefficient estate plan that bequeathed a $3.2 million IRA to the surviving spouse and the remainder to charity.[102]
2. **<u>Discussion</u>**. The court was requested to revise the plan to leave the IRA to the charity and the remainder to the spouse in a manner that would have rectified the income tax inefficient estate plan the decedent left. The plan was inefficient as the surviving spouse would recognize substantial gain. The court noted that the decedent bequeathed his IRA almost five years after he executed the will and trust and for the IRA beneficiary he named his spouse. Further, the

[99] Sec. 801.1(c)(2).
[100] "New Study on Advance Directives," Dec. 16, 2013, https://www.nhpco.org/press-room/press-releases/new-study-advance-directives .
[101] 2014 study by the American Journal of Preventive Medicine. "Nearly Two-Thirds of Americans Don't Have Living Wills -- Do You?", Mar 21, 2016, http://newsroom.acep.org/2016-03-21-Nearly-Two-Thirds-of-Americans-Dont-Have-Living-Wills-Do-You .
[102] Matter of Sukenik, 2016 N.Y. Slip Op. 31217U (New York County Surrogate's Court June 28, 2016).

reformation requested by the surviving wife was not attributable to a drafting error or later changes in law. Also, in the years after these documents he did not take any steps to address the tax inefficiency of his plan. In the case neither the foundation that was the charitable beneficiary, nor the state Attorney General, objected to the plan. Despite what seemed like an uncontested request the court would not act.

XXIX. **Insurance and Insurance Trusts**.

A. **Suicide**.

1. A suicide exclusion does not need to use any specific language to comply with a state statute.[103]

B. **Transforming an Old Irrevocable Trust into an ILIT**.

1. **Take-Away**: Many old irrevocable trusts have significant assets but were not designed to hold life insurance. A client may have a current insurance need, and/or an existing irrevocable life insurance trust ("ILIT") to which the client makes annual gifts and for which the trustee issues annual Crummey demand notices, to pay premiums on existing policies. Either of these common situations might be improved by modifying the existing irrevocable trust so that it can hold life insurance (and if there is an existing ILIT decanting or merging it into the modified irrevocable trust). This approach can permit redeployment of significant dollars in the old irrevocable trust to cover insurance premiums, simplifying the client's planning by eliminating extraneous trusts, and improving their overall planning by modernizing the remaining trust in the process. In some instances, the impediment to achieving these benefits is that the old irrevocable trust does not have a person who can serve as trustee for the life insurance. This might occur for a host of reasons. The trust might have named the spouse as a trustee or co-trustee without a separate insurance trustee provision and the spouse cannot have powers of life insurance on her life without creating estate inclusion issues. In other situations, the trust might have named an institutional trustee who will not approve the insurance the clients wish to have the trust purchase, or for which the economics of involving the institution are not viable. Whatever the case, there are no doubt many old irrevocable trusts that can be made more flexible to become insurance trusts in addition to whatever other type of trust they might have heretofore been. How can this transformation be accomplished? While some modern trusts are so flexible that they by their terms might permit a host of modifications (e.g., trust protector action), few older trusts are so malleable. That leaves two possible approaches to use to achieve the desired ILIT-like result. The old irrevocable trust could be decanted into a new trust, or perhaps a non-judicial modification of the old trust might achieve the desired result. Delaware has a particularly robust, although relatively new, statute governing non-judicial modification. The gist of either approach would be to modify the terms of the old irrevocable trust to add insurance provisions and in many cases to bifurcate the trustee role, or perhaps more specifically the investment trustee or advisor role, into a general investment adviser position and a separate insurance adviser or trustee provision naming someone independent to serve in the latter capacity. This bifurcation may permit the client to continue to serve as the investment trustee of her trust determining which family business interests to retain, but a new independent person who would not be insured by the trust, would hold all insurance related powers. If the trustee must effectuate the decanting to achieve these goals, especially an institutional trustee, the availability of a non-judicial modification to which all parties consent, not just the institutional trustee, may prove a more alluring path. The following discussion reviews the use of a non-judicial modification of the old trust to accomplish this objective.
2. **Discussion**:
    a. The Delaware non-judicial modification statute is quite broad: "Notwithstanding any provision of law or a trust's governing instrument limiting or prohibiting amendment of the trust, an irrevocable trust may be modified to include any provision that could have been included in the governing instrument of a trust created upon the date of the modification upon written consent or written nonobjection of the trustor, all then serving fiduciaries and all beneficiaries even if the modification violates a material purpose of the trust."[104]

[103] Jennifer Mullen Collins v. Unum Life Insurance Company, 2017 WL 2875159, No. 16-1636, Submitted: December 20, 2016, Decided: July 6, 201, Appeal from the United States District Court for the Eastern District of Virginia, at Norfolk. Reported in LISI Employee Benefits and Retirement Planning Newsletter #682.
[104] 12 Del. C. Sec. 3342(a).

b. A number or requirements must be met for a trust to avail itself of this approach. Delaware law must govern the administration of the trust. This requirement can be met if the trust has a Delaware corporate trustee. 12 Del. C. Sections 3332(b) and 3340. The settlor must be living and competent. A number of different persons must consent, or not object, to the modification including: The settlor, all fiduciaries (this may include a separate general, administrative, investment and distributions trustee), and the current beneficiaries must also consent.

c. The requirement for all beneficiaries to consent could raise complications if the current beneficiaries include minors, incapacitated or not locatable. It may be possible for another beneficiary to represent the interests of the minor or other beneficiary by virtual representation.[105] The Delaware statute provides: "…a trust having a beneficiary who is a minor or incapacitated who may not be represented by another pursuant to subsection (a) or subsection (b) of this section, the surviving and competent parent or parents or custodial parent (in cases where 1 parent has sole custody of the beneficiary), or guardian of the property of the beneficiary may represent and bind the beneficiary for purposes of any judicial proceeding or nonjudicial matter pertaining to the trust; provided that, in the case of a beneficiary represented by 1 or both parents, there is no material conflict of interest between the beneficiary who is a minor or incapacitated and either of such beneficiary's parents with respect to the particular question or dispute. Furthermore, such representative may, for all purposes, represent and bind an unborn person or unascertainable person who has an interest, with respect to the particular question or dispute, that is substantially identical to the interest of the beneficiary who is a minor or incapacitated represented by the representative, but only to the extent that there is no material conflict of interest between the beneficiary who is a minor or incapacitated represented by the representative and the unborn or unascertainable person with respect to the particular question or dispute."[106] The governing instrument and circumstances should be reviewed to confirm that there is no material conflict.

d. **Sample Provision**: "Beneficiary Name on behalf of herself and by virtual representation in accordance with 12 Del. C. Sec. 3547: on behalf of all contingent successor remainder beneficiaries (and all minor, unborn persons and persons whose identity or location is unknown and not reasonably ascertainable), including [list all known here]."

e. What about persons holding powers in non-fiduciary capacities? The statute does not appear to require such persons to consent to the non-judicial modification. However, since the modification may affect the powers they hold, and at minimum will change the instrument under which they have authority to act, consider having such persons acknowledge the modification. This might include a person given the authority to add a non-charitable beneficiary, a person holding a swap or substitution power, someone who can make a loan to the grantor, or to add a class if individual beneficiaries (e.g., as in a hybrid DAPT).

f. The modifications can include any provisions that could have been included in the governing instrument of the trust when created.

g. The modifications to facilitate transforming the old irrevocable trust into an ILIT might include the following:

    (1) Modify the trustee appointment provisions of the old trust to add a new insurance trustee and make conforming changes to the instrument's definition of Trustee if necessary.

    (2) Add appropriate powers for the insurance trustee to deal with life insurance if not contained in the initial trust. For example, if the trust is a directed trust with an institutional general trustee, the insurance trustee should be granted powers to direct the general trustee to acquire and retain life insurance on the life of any individual (or the joint lives of any individuals) in which any beneficiary has an insurable interest.[107] Provisions should be granted governing the right to borrow on policies, to enter and terminate split-dollar plans, designate the beneficiary

[105] 12 Del. C. Sec. 3547.

[106] 12 Del. C. Sec. 3547.c.

[107] For example, for a directed Delaware trust, in accordance with 12 Del. C. Sec. 3313.

under the policy and to exercise non-forfeiture provisions, conversion privileges and other options available under the policy.

(3) Make conforming changes to trustee termination and replacement provisions, e.g. modify a trust protector's powers to include removal and replacement of the newly appointed insurance trustee.

XXX. **Investments**.

A. **Active funds outperform passive funds for a surprising reason**.

1. **Take-Away**. There is a myriad of options clients can select from in planning their estates. Investments can range from passive to active and any combination in between. There is much debate as to whether passive or active management is superior and the disagreements vary depending on asset classes, objectives, etc. At least one recent study has suggested that passive outperforms active management because of the difference in fees. But there are other views and factors to consider. Fiduciaries can range from a friend or family member who generally has limited experience acting as a fiduciary, to a professional fiduciary. While the decisions can be independent they are often interrelated. The options are important to a host of estate and financial planning goals which may include: 1) investment returns, 2) proper administration of trusts (and the estate in general), 3) asset protection, 4) minimization of the risk of elder financial abuse, etc. On one end of the spectrum a client can name a family member as an agent under a durable power of attorney and purchase passive investments such as index funds. Media reports have touted the cost advantages of various passive investing. Perhaps, on the opposite end of the spectrum a client might retain a trust company to manage assets. One of the rationales to avoid professional trustees is the increased cost and what some believe better performance of passive investments. A recent study, discussed below, suggests that over the long term active management outperforms passive management. The reason active management prevails is that investors tend to stay invested longer. Perhaps, a study evaluating the incidence of elder financial abuse, preserving sufficient assets for longevity, proper trust administration and the impact on lawsuit and divorce claims, etc. would demonstrate the advantages of clients using professional management for trust services in contrast to relying on family and friends. Just as investor behavior undermines investment performance, hence favoring active investing, might not individual behavior undermine trust administration and many of the safeguards practitioners craft to protect aging clients and clients concerned about creditors and predators? When discussing planning options with clients, do practitioners address the possible advantages from an investment and administration perspective of clients relying on professional active trust and investment management? With the increasing importance of longevity planning and planning for advanced age make this option more important to explore?
2. **Discussion**.
   a. A new Dalbar study shows that active investments produce superior investor returns over long time periods, while passive investments have better investor returns over shorter periods.[108] Many studies have shown that active managers consistently underperform passive investments. But how does investor behavior affect these returns? Dalbar attributed the higher investor returns in active to the tendency of these investors to stay invested for longer periods. Investor return is defined as the change in assets, after excluding the effects of sales, redemptions and exchanges, For the 15-year period ending Dec. 31, 2016, annualized investor returns were 4 percent for actively managed funds, compared to 2.85 percent for passive funds. For the five-year period, investor returns were 8.51 percent for active and 8.12 percent for passive. Meanwhile, for the three- and one-year periods, investor returns were 5.4 percent and 9.4 percent for passive, respectively, compared to 3.66 percent and 6.73 percent for active. The explanations for why active investments caught up with the superior investment statistics of the passive funds include better investor retention during market downturns, asset allocation and capital preservation strategies of active investments.

B. **Christian Investing**.

1. Estate and financial planning should reflect client religious preferences. This can be all encompassing from provisions in living wills, burial provisions, lending requirements, dispositive schemes and even investing. Inspire Investing has rolled out two new ETFs in an attempt to bring

[108] "Does Active Produce Better Investor Behavior?" Diana Britton WealthManagement.com, Mar 01, 2017.

low-cost indexing to biblically responsible investing (BRI).[109] The article noted that Inspire research estimated investment assets of $13.7 trillion are controlled by Evangelical Christians.

2. How should investment provisions of powers of attorney, trusts and wills be modified to reflect this to avoid a fiduciary carrying out the client's wishes from being challenges as violating the Prudent Investor Act?

C. **Millennial Socially Oriented Investing**.

1. 67% of millennials say they want investments to reflect their social and environmental values. 76% of millennial women indicate this preference.[110]
2. Is it necessary to modify investment provisions of powers of attorney, trusts and wills to reflect socially oriented investing this to avoid a fiduciary carrying out the client's wishes from being challenges as violating the Prudent Investor Act? Has this become so common and the investment options so sophisticated that there might be no need? Should a directive be included in any event?

XXXI. **LLCs and FLPs**.

A. **754 Election**.

1. With so much talk in the estate planning community about basis adjustment, practitioners will need to be more concerned about Code Section 754 basis adjustments when the fair market value of a partnership interest (or an LLC taxed as a partnership) exceeds the partner's (member's) share of the inside basis of the partnership assets, the assets inside a partnership can effectively receive a basis adjustment in the hands of the decedents estate if the entity makes the appropriate tax election. This will also require that the general partner (manager) and governing instrument permit the election. Fortunately, with the increased focus on basis maximization, the IRS has taken lenient positions with respect to a number of IRC Sec. 754 basis adjustment matters as illustrated below.
2. It is no longer required to have signatures for a Code Section 754 basis adjustment to be effective.[111]
3. An LLC taxed as a partnership was granted an extension of time to elect to have a basis adjustment under IRC Sec. 754 filed.[112] The IRS granted a 120-day extension finding that the LLC acted in good faith following a member's death and that the government's interests were not prejudiced. The requirements of Reg. Sec. 301.9100-1 and 301.9100-3 were met.
4. Seeking a basis increase in assets has become a focus of much of estate planning. If a taxpayer transferred partnership or LLC (taxed as a partnership) interests but they were included in the taxpayer's estate on death, then will the partnership (LLC) be required to make a 754 election to step up the basis in assets on death? The IRS held that, if the partnership's assets are included in the decedent's gross estate under IRC Sec. 2036, those assets will be subject to a basis adjustment without the requirement for a IRC Sec. 754 election.[113]

B. **Classification**.

1. How should an LLC be characterized? Single member LLCs are generally treated as disregarded entities for income tax purposes. In fact, some estate planning strategies rely on this treatment. When an LLC has multiple members, it is often characterized as a partnership for income tax purposes. In some instances, practitioners may prefer to characterize an LLC as an S corporation, perhaps under the belief that a better result might be attainable for payroll tax purposes. Depending on the results of tax reform efforts the optimal characterization might change. The IRS provided leniency to make the entity determination and granted the electing entity a 120-day extension to file the entity classification election under on Form 8832.[114]

C. **Operating Agreement is it Necessary**.

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[109] Thomas Seubert, "Two New ETFs for Biblically Responsible Investors Make Their Debut Inspire Investing looks to undercut fees of other faith-based funds," Feb 28, 2017, http://www.wealthmanagement.com/etfs/two-new-etfs-biblically-responsible-investors-make-their-debut.
[110] Anne Ackerley, "How millennials can save the world while saving for retirement," April 17, 2017, http://www.nasdaq.com/article/how-millennials-can-save-the-world-while-saving-for-retirement-cm774446 .
[111] NPRM REG-116256-17, Oct. 12, 2017.
[112] PLR 201742001, Oct. 23, 2017.
[113] PLR 200626003.
[114] IRC Sec. 7701; PLR 201731011, Aug. 7, 2017.

i. **<u>Take-Away</u>**. Clients, especially family members or close partners, often view the formalities of a written agreement as a waste of money, after all, they all "get along." Well, all partners get along, until they do not. A New York case highlights the dangers of clients ignoring the importance of a thought out written governing document. This case is a good reminder to clients that the formalities are well worthwhile. As the focus on estate planning for many client wanes, assuring that clients have requisite governing documents for entities should be given more attention by practitioners.

ii. **<u>Discussion</u>**.

a. Three members formed a LLC and initially operated without a written operating agreement, which meant state law default rules applied. Two of the three members, a majority, adopted a new written operating agreement that provided for capital calls.[115]

b. A capital call was made and the third member who did not sign the agreement, did not contribute additional capital as required, and his interests in the LLC were reduced.

c. That third non-contributing member argued that the operating agreement was invalid because it was adopted by less than all members. However, New York Limited Liability Company Law Sec. 402(c) provides that the operating agreement may be adopted by "the vote of a majority in interest of the members entitled to vote thereon."

d. The non-contributing member argued that there was an oral agreement but the law contemplated only a written agreement, and if that written agreement does not address a particular rule, state default rules apply. Limited Liability Company Law Sec. 417 requires a written operating agreement, and where there is no operating agreement, or the operating agreement fails to address issues in dispute, the default provisions under the Limited Liability Company Law govern. Since the written operating agreement specified that a member's interest may be reduced proportionally if the member fails to make a requested additional capital contribution, the non-contributing member's interests could be reduced. For example, in Delaware all members must agree to any provision unless the original LLC operating agreement provides otherwise.

D. **<u>Partnership Audit Rules</u>**.

1. Centralized partnership audit, rules enacted as part of the Bipartisan Budget Act of 2015, become effective in 2018. The IRS has issued proposed regulations for implementing the new rules. Partnerships and LLCs should review their governing documents to determine if modifications to reflect these new rules are advisable. There may be disparate treatment between state and federal audit rules generally, or states may have adopted the old rules and not changed to the new partnership audit rules. Of concern under the rules is that a partnership representative has power to bind the partnership in an agreement with the IRS. This power in some instances may be limited in the partnership agreement.

E. **<u>Powell v. Commissioner.</u>**

1. **<u>Take-Away</u>**. The recent case of Estate of Powell v. Commissioner provides reminders of many inappropriate steps that might be taken in estate planning.[116] These errors, while familiar to most practitioners, nonetheless are worthy of reviewing as reminders of how not to structure estate plans and asset protection plans in the future. Several practical planning lessons practitioner can be gleaned from Powell, including the following.

a. Practitioners should review all client powers of attorney and tailor the gift provisions to what might be appropriate for the particular client's circumstances. For clients of significant means, the gift provisions should be tailored to permit whatever type of gift or other transfers that might be appropriate to planning, but constrained to minimize the risk of abuse. Where gift powers are inappropriate they should be expressly limited or excluded. Too often practitioners have relied on boilerplate annual gift provisions for durable powers when fine tuning in one direction, or the other, might be preferable for the client. See discussion elsewhere in this outline.

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[115] Shapiro v. Ettenson, (2017 NY Slip Op 00442, 1st Dept. Jan. 24, 2017).

[116] Adapted from Ray Prather and Martin M. Shenkman, "Estate of Powell v. Commissioner, 148 T.C. No. 18," ABA e-Report, July 2017, https://www.americanbar.org/content/dam/aba/publishing/rpte_ereport/2017/4-July/Estate%20of%20Powell%20Article%20ABA%20Jul%2014%202017_ml.authcheckdam.pdf .

b. Clients should be educated as to the importance of periodic reviews to endeavor to avoid the compressed planning time frame used in Powell. Rushed planning will almost assuredly increase the risks to the plan. Ongoing planning is the key to avoiding that.
c. Practitioners should review governing documents to confirm they support the intended transactions. If not, alternate arrangements should be evaluated.
d. Non-tax purposes should be evaluated and corroborated for most planning. Document non-estate tax motives for estate tax transactions. Even as planning shifts from estate tax minimization to income tax planning and asset protection planning, documenting business purposes for any transactions will remain important. This is not a new consideration in FLP and other discount planning, but perhaps Powell can be viewed as a reminder of the importance of crafting transactions to demonstrate non-tax business purposes.
e. Every client has a "story to tell." Document that story to corroborate why the client wants the entity established.[117] Stone and other cases have very long opinions in part because they discuss in detail the contemporaneous discussions, the estate planning attorney's notes, and more.
f. Family partnership/operating agreements should be reviewed in light of the Powell case. Consider amending all governing documents to assure that a senior generation (e.g. a parent) has no right to vote on liquidations, distributions or partnership agreement amendments associated with liquidations or distributions. An alternative is to liquidate these entities but that would eliminate the control and asset protection and other benefits. Action should be taken at least 3 years before death.
g. For clients with active operating businesses, as contrasted with a mere FLP holding passive security investments, the section 2036 exception argument seems strong and the client and planner may feel comfortable relying on that. The case law, especially when passive security holding entities are involved, differs as to whether the facts meet the "legitimate and significant nontax reason" test, so practitioners should consider what can be done to corroborate the non-tax reasons.
h. Another consideration might be to amend FLP and LLC governing documents more than three years before death to give a special "termination and liquidation" right to someone other than the client, so that the client has not ability to force a liquidation or distribution without such consent.
i. The right to consent should be given to someone not serving as agent for the client under the client's durable power of attorney (and perhaps also not serving as a successor trustee under a revocable trust for the client). In the wake of the Strangi case some practitioners had the termination right held by the trustee of a family trust who could be replaced with an unrelated party by the Grantor.
j. But under the Powell analysis, if all of the partners could together act to amend the partnership agreement to delete the restrictive saving provisions as a matter of state partnership law, would the reasoning of the Powell majority still apply?

2. **Discussion**.

a. The decedent's son made several fundamental mistakes when planning his mother's estate. While it's no surprise that the Tax Court ruled against the estate, the Tax Court's reasoning on at least one point was novel. After summarizing the case, the errors made in planning the decedent's estate, including misusing a power of attorney, engaging in aggressive last-minute planning, not having a business purpose for a family limited partnership, and running afoul of IRC §2036 will be reviewed. The discussion will cover the Tax Court's extension of IRC §2036(a)(2) to limited partnership interests and the possibility of double taxation (or an increased step up in basis) in FLP inclusion cases.
b. The facts in Powell can be summarized as follows:
    (1) Nancy Powell died on August 15, 2008. Her son Jeffrey Powell began his mother's estate planning a mere nine days earlier, on August 6, 2008. First, he created a limited partnership, NHP Enterprises LP ("NHP"), naming himself as general partner. Next, he transferred about $10 million in cash and securities

[117] Estate of Bongard v. Comm'r, 124 T.C. 95 (March 15, 2005).

from his mother's revocable trust to NHP in exchange for a 99% limited partnership interest.

(2) On August 7, Jeffrey obtained a doctor's note that allowed him to act as agent under his mother's durable power of attorney for property due to his mother's incapacity. He used the power of attorney for property to create a charitable lead annuity trust ("CLAT"), and transferred the 99% limited partnership interest to the CLAT. The CLAT paid the annuity interest to the Nancy H. Powell Foundation for the remainder of his mother's life. The CLAT named Jeffrey and his brother as remainder beneficiaries upon his mother's death.

(3) The power of attorney Jeffrey used contained two significant provisions related to this transaction. First, Jeffrey had the power "'[t]o grant, convey, sell, transfer, mortgage deed in trust, pledge and otherwise deal in all property real and personal, which the principal may own.' The POA also authorized Mr. Powell '[t]o make gifts on the principal's behalf, including, but not limited to, forgiveness of loans, to a class composed of the principal's children, any of such children's issue, or any or all to the full extent of the federal annual gift tax exclusion under Internal Revenue Code Section 2503(b) or any successor statute.'"

(4) Jeffrey later filed a gift tax return for the transfer to the CLAT. He determined the value of the 99% limited partnership interest to be $7.5 million after a 25% discount for lack of marketability and lack of control. This resulted in a gift to the reminder beneficiaries of just over $1.6 million. The IRS issued deficiency notices for the gift tax return and the estate tax return.

c. The tax court determined that the assets gifted to the CLAT were includable in the decedent's estate under IRC §2033 (property in which decedent had an interest) or IRC §2038 (revocable transfers) because Jeffrey exceeded his authority granted under the power of attorney when making the gift. The underlying cash and securities transferred to NHP for the limited partnership interests were includable in the estate under IRC §2036(a)(2) (transfer with right to designate enjoyment of the property) because the decedent had the ability, when acting along with her sons, to dissolve NHP. The Tax Court found that the exception in IRC §2036 (transfers for full and adequate consideration) did not apply in this case because Jeffrey had no significant nontax reason for the transfer. And the court also found the cash and securities could be includable under IRC §2035 (certain gifts within 3 years of death). To prevent the double taxation that would have occurred by including the gifted NHP interests and the underlying assets transferred to NHP in the estate, the court found that IRC §2043(a) (allowing an estate to exclude the consideration received for an IRC §2036 or §2035 transfer) applied to the estate tax return.

d. Planning mistakes.

(1) Misuse of donor's power of attorney. The first mistake in Powell, is an issue that estate planners see frequently - agents exceeding their authority under a power of attorney. Here the decedent's son used a power of attorney that granted him the power to make gifts of up to the $14,000 annual gift exclusion to the principal's family members to make a gift of $7.5 million to his family and his mother's private foundation. This blatant misuse of the power of attorney caused the Tax Court to disallow the gift.

(2) Aggressive last-minute estate planning. The second mistake in Powell is using aggressive estate planning at the last minute. But was it really? Some commentators believe that the mother in the Powell case died unexpectedly from an infection prior to her intended release from the hospital. Many of the more sophisticated estate planning techniques require time to implement. Compressed planning might implicate a step-transaction doctrine challenge. The step-transaction doctrine is intended to have the tax consequences reflect the economic substance of the transaction. If the step-transaction doctrine is applied, then a multiple-step process is treated as one transaction, e.g., transferring property to an FLP and then transferring FLP interests to younger generations collapses into a single indirect gift of the underlying property, without the FLP

wrapper, to the younger generations. This issue has been explored in many prior cases. For example, in Pierre[118] the taxpayer gifted 9.5% of her interest in an FLP and sold 40.5% of the FLP interests to each of two trusts (resulting in a transfer of the entire FLP) twelve days after funding the FLP with cash and marketable securities. In exchange for the sale of the two 40.5% interests, the taxpayer received promissory notes of which no principal had been paid eight years after the transfer. The taxpayer's valuation expert set a 36.55% discount on the FLP interests. The IRS argued the step transaction doctrine applied to both the gift and the sale of the FLP interests because neither transaction had any economic substance. The Tax Court agreed, reasoning that transfers on the same day when nothing of tax significance occurred between the transfers, should be aggregated. Similarly, in Senda[119] the Tax Court applied the step-transaction doctrine when entity interests were transferred at same time that the entity was funded. The step-transaction doctrine also applied in Linton and Heckerman.[120] There was same day funding of partnerships and transfers of interests, and the documents were figuratively all signed on the same table.

(3) Not all transactions that occur in a short period of time become indirect gifts under the step-transaction doctrine. In Holman only six days passed between funding and transferring partnership interests.[121] The IRS argued the gift occurred six days after funding the partnership, and the taxpayers contemplated that gifts would be made at that time of funding. Therefore, the IRS said the gifts and funding should be collapsed. The Court disagreed saying that volatile nature of public stock means there is tax-independent risk during the time period. Likewise, in Gross[122] the Tax Court refused to apply the step-transaction doctrine when 11 days passed and the assets were a mixed portfolio. While there are no hardline rules for the time periods between different stages in a plan being effectuated, few practitioners find it surprising that the nine-day period in Powell helped to undermine the plan.

(4) The other issue in Powell involving last minute estate planning is the plan did not account for the decedent's situation. The decedent's son knew of the decedent's imminent death. But when calculating the gift to the CLAT, Jeffrey Powell did not consider his mother's health. Even if the gift to the CLAT were valid, his allocation of the gift between the charity and the remainder beneficiaries would not have been allowed.

e. Business purpose lacking. Most sophisticated estate-planning techniques, such as obtaining discounts for transfers of limited partnership interests, are required to have a significant and legitimate non-tax purpose to obtain the tax benefits. Some examples of non-tax benefits include:

(1) Transfers: Allowing for a gradual transfer of family assets.

(2) Restrictions: Limiting members from transferring partnership interests to protect family assets.

(3) Investment Pooling: Joint investing of family assets.

(4) Management: Centralized management was cited a good non-tax reason in the Stone case holding that involving the family's next generation in the management of the FLP as an important purpose for the entity is a significant non-tax reason.

(5) Succession: Even if you have a senior family member involved, such as in Kimbell[123] centralized management was important because at some point, she would lose the ability to manage assets and would want a rational mechanism to

[118] Pierre v. Commr. (133 TC No. 21, No. 753-07, 8/24/09, in supplemental memorandum 99 T.C.M 1436).

[119] Senda v. Comm'r, TC Memo 2004-160 (July 12, 2004).

[120] Linton v. United States, 638 F.Supp. 2d 1277 (W.D. Wash. 2009) and Heckerman v. United States, U.S. Dist. Ct., Cause No. CO8-0211-JCC (W.D. Wash. July 27, 2009).

[121] Holman v. Comm'r, 130 T.C. No. 12 (May 27, 2008).

[122] Gross v. Comm'r, TC Memo 2008-221, 96 T.C.M. (CCH) 187 (Sept. 29, 2008).

[123] Kimbell v. United States, 244 F. Supp. 2d 700 (N.D. Tex 2003).

manage them. She did not want to rely on her power of attorney ("POA") or a guardianship proceeding. In cases with similar situations, the IRS has argued that a trust could be created to provide for management. However, the argument to be made is that the objective is to keep assets together under one umbrella. For example, the parents may have confidence in some children, but not in others. Perhaps they don't want all the children to manage assets.

(6) Flexibility: The FLP vehicle, as a tool, is more flexible than a trust which will become irrevocable after death. The flexibility afforded by FLPs is itself a justification for using them for non-tax reasons.

(7) Asset Protection: Protecting assets from creditors or divorce is a significant rationale for the use of FLPs, but it remains a contentious issue. Creditor and divorce protection is a reason why transfer restrictions are generally included.

(8) Avoiding Partition: Dividing assets can be avoided with an FLP. For example, putting a ranch in FLP and gifting interests can avoid partitioning the land. The IRS will argue that avoiding partition is a testamentary purpose, but estate planning must consider current (lifetime) problems and those problems that arise after death.

(9) Other Lifetime Objectives: Several cases have all discussed having lifetime objectives intertwined with testamentary purposes.[124] The IRS will push back on this claiming FLPs have only a testamentary purpose but the case law is supportive of taxpayers on this point.

(10) In Powell, the mother had no apparent family investment philosophy that the NHP structure was intended to continue. She had already ceded control through the power of attorney, and her incapacity negated many of the business purposes described above. Also, the decedent's two children's contribution of property to the limited partnership consisted of unsecured promissory notes – a fact that led the concurring opinion to conclude the limited partnership was merely an alter ego for the underlying assets, and as such should not be recognized.

f. Running Afoul of Section 2036.

(1) Internal Revenue Code Section 2036 is frequently used to bring prior transfers into the gross estate. If a decedent transferred property while retaining "the possession or enjoyment of, or the right to the income from, the property" (IRC §2036(a)(1)) or the right to direct (either alone or with another person) who has possession, enjoyment of, or the right to income from the property (IRC §2036(a)(2)) for a time that is based on the decedent's life, unascertainable, or does not end before the decedent's death. IRC §2036. IRC §2036 also contains an important exception for "bona fide sales for an adequate and full consideration in money or money's worth."

g. In Powell, the court found the decedent retained power to direct enjoyment of the property. To do so, the court relied on Strangi[125] wherein the decedent owned a 99% limited partnership interest in a family limited partnership. The decedent then created a corporation to be the general partner. The decedent owned 47% of the stock in the corporation. The tax court found the decedent held a retained interest in the family limited partnership under §2036(a)(1) by retaining possession or enjoyment of the property and the 5th Circuit Court of Appeals affirmed. The tax court in Powell extended the reasoning of Strangi to §2036(a)(2) by stating the decedent retained the power to direct the possession or enjoyment of the property along with her children who were the other partners in the family limited partnership, NHP.

h. Importance of Tax Court's Opinion.

(1) Given the significant errors made in planning the decedent's estate, the Tax Court's outcome is no surprise. So, what is it about Powell that has led commentators to describe it as "the most important Tax Court case addressing

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[124] Estate of Black v. Comm'r, 133 T.C. 15 (2009), Estate of Mirowski v. Comm'r, TC Memo 2008-74, Stone, and Estate of Murphy v. United States, No. 07-CV-1013, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009).

[125] Strangi v. Commissioner, 417 F.3d 468 (5th Cir. 2005).

FLPs and LLCs in the context of estate planning since the Bongard[126] case 12 years ago?" There are two primary reasons: 1) this is the first case where the tax court held IRC §2036(a)(2) applied even though the decedent did not own a general partnership interest; and 2) in dictum, the tax court made some interesting comments about the potential for double taxation even though it did not apply to the case.

(2) Extending 2036(a)(2) to limited partnership interest. Previous cases that discussed IRC §2036(a)(2) involved decedents who maintained general partner status of the family limited partnership (or in the case of Strangi, a 47% ownership in the corporation that acted as general partner). Here the decedent owned only limited partnership interests. This case establishes that the applicability of §2036(a)(2) does not depend on the type of ownership interest in the partnership. What matters is the actual powers held by the owner. So, while important, the lesson should not be surprising.

i. Comments on Potential Double Tax.

(1) The other important aspect of the Powell case is dictum included in the case. The Tax Court held that the invalid transfer of the limited partnership interests to the CLAT caused the interests to be included in the gross estate. The tax court also held the underlying assets of the limited partnership were included in the gross estate under §2036(a)(2). The reason the estate is not double taxed for the limited partnership interests and the underlying assets of the partnership is because IRC §2043(a) allows an estate to exclude the consideration received for property included in the gross estate under IRC §2036 or §2035.

(2) In Powell, the gross estate received consideration – the limited partnership interests – in exchange for transferring the underlying assets of the partnership. Therefore, the value of the limited partnership interests was excluded from the estate. Because the assets were transferred to the family limited partnership a week before the decedent died, the court found the value of the limited partnership interest on the date of death equaled the value of the limited partnership interests at the time of the transfer.

(3) The majority opinion could have ended its discussion of 2043(a) at that time, but it didn't. Instead the Tax Court pointed out that 2043(a) allows the estate to exclude the value of the limited partnership interests at the time of the transfer. Then the Tax Court speculated that if the limited partnership interests increased in value between the time of the transfer and the decedent's death, the gross estate may have to include the increase in value of the limited partnership interests along with the value of the underlying assets at the time of the decedent's death leading to double taxation. After speculating about this potential, the tax court explicitly stated they are not addressing the issue in this case because it does not apply. But it cannot be clearer that estates that run afoul of IRC §2036 might be at risk under this theory of estate tax inclusion.

(4) It warrants noting, however, that for clients below the current large $5,490,000 exemption, or in the event the estate tax is repealed, this discussion in Powell may prove instructive for practitioners endeavoring to trigger estate tax inclusion to garner a step up in basis on the partnership interests and through a IRC §754 election, the underlying partnership assets.

j. Practitioners creating FLPs or other entities for clients might consider adding to the list of warnings the risk of the IRS asserting Powell-type arguments about estate inclusion in that post-transfer appreciation could result in a double counting, hence putting the client in a worse situation than if the entity had not been pursued. As aside, could post-transfer appreciation present an opportunity for clients with non-taxable estates to gain more basis?

F. **Tax Distribution Clauses in Flow Through Family Entity Governing Documents**.

[126] Bongard, 124 T.C. 95 (2005).

i. **Take-Away**. While much attention has been given to tax reimbursement clauses in irrevocable trusts, practitioners should give new consideration to tax distribution clauses that might be included in the governing instruments of flow through entities. Review all family partnership, operating and S corporation shareholder, agreements. Depending on the circumstances, determine whether adding, or removing, a tax reimbursement clause should be addressed, added or modified, in light of changes in the estate tax laws and perhaps other circumstances.

ii. **Discussion**. Is it time to reconsider tax distribution clauses in some family operating agreements? Should family LLC operating agreements now include tax reimbursement clauses that perhaps were not previously included? Reimbursing equity holders of flow through entities for their approximate federal and state income tax cost is a common issue to address in governing documents. Some practitioners may have intentionally not provided for tax reimbursement provisions under the premise that it might have detracted from the quantum of valuation discounts. The non-reimbursement approach may be even be imbedded in standard forms that a practitioner has used for family entities. Should this be reconsidered for most wealthy clients, but perhaps not for ultra-high net worth clients, considering the now much higher estate tax exemption and potential for repeal? In some instances, the concern over the impact on discounts have been obviated by tax law changes and amending governing documents to mandate a tax reimbursement distribution might provide important relief or safeguards. In dysfunctional families where those in control of the family entity might intentionally use phantom income to inconvenience (or worse) other family owners, the clause might be especially important. In other cases, the mandated distribution might reduce the divorce and asset protection benefits the entity would offer absent such a provision.

iii. **Sample Provision**. Tax Distributions. The Manager shall cause the Company to distribute to each Member for each fiscal year of the Company, subject to the establishment of reasonable Reserves in the discretion of the Manager, an amount of cash which equals: (i) the amount of taxable income allocable to the Member for such year, multiplied by (ii) the combined maximum individual federal and state income tax rate attributable to such taxable income (determined as if all Members were residents of [name state here] and taking into account the deductibility of state income taxes for federal income tax purposes, if any is anticipated for most Members). Such distributions shall be made no later than ninety (90) days after the end of the fiscal year, and in the discretion of the Manager may be made quarterly or on any other basis during the year, based upon estimates of the taxable income for the year. All amounts so distributed shall be treated as amounts distributed to the Member, shall be reduced by any other amounts distributed pursuant to this Agreement, and any amounts withheld with respect to the Member pursuant to this Agreement.

G. **UCC and Certification of LLCs**.

1. If you are structuring the sale of LLC interests to a grantor or defective trust, should those LLC interests being sold be certificated?
2. LLC membership interests may be considered securities and may be governed by the Uniform Commercial Code.[127] Is there any benefit to continuing certification (i.e. issuing actual certificate to confirm the membership interests each owner has)? What is the impact/import of the UCC status as a security? It appears that LLCs can have certificates but do not have to. In many cases, LLCs that had issued certificates in the past may cease to do so. Thus, over time it will become uncertificated.
3. The UCC permits "opting in" to make it clear that the membership interests are treated as securities (as opposed to general intangibles) for purposes of Article 8 of the UCC. In both cases, you can achieve perfection by filing a UCC-1 financing statement.
4. If the issuing entity has not "opted-in" to Article 8 and the interests are treated as general intangibles, the certificate is not relevant for perfection/priority. There is a risk that the issuing entity can subsequently opt-in and, as such, commercial lenders may include covenants prohibiting the issuer from "opting-in."
5. Opting in, i.e. treatment as a security provides a superior method for perfecting security interests in the LLC membership interests, which is often desired by commercial lenders. What about a family members selling to a family trust for a note? If LLC interests are being sold to a trust, and

[127] New Jersey Uniform Commercial Code Sec. 8-103(c).

the seller is securing a note from the trust for part or all of the purchase price, might certification be desirable or advisable?

6. if there is a certificate, someone can achieve a higher level of priority over the secured party with a filed UCC-1 financing statement if they either have possession of the certificate or if they achieve a “protected purchaser” status under Article 8. If there is no certificate, the order of filing is what determines the relevant priority, although the Company can always subsequently issue a certificate and there is a risk of losing priority (the secured party can include covenants limiting the ability to issue new certificates, but if they do, someone can achieve priority). From a lender perspective, the best scenario is that the LLC has “opted-in” to Article 8 and has issued certificates, which certificates are delivered to the Lender with an assignment executed in blank.

XXXII. **Loans**.

A. **Gift vs. Loan**.

1. **Take-Away**. A recent case highlights yet again the problems clients encounter by not documenting transfers that are intended to be loans. While this particular issue arose in a matrimonial context, it provides a lesson applicable to so many client undocumented advances.[128]
2. **Discussion**. Father sued his daughter ("Wife") and her soon to be former husband ("Husband") for the return of $280,000 provided by him to the defendants in connection with the purchase of real property. Father and Wife contend this money was a loan to both defendants, Husband and Wife, that was to be repaid to father within six months of the closing on the real property. Defendant Husband contends the transfer was a gift which he has no obligation to repay father. Husband also argued that if the transfer was characterized as a loan, it was made only to Wife for which he the Husband bears no liability. The court found the Husband’s arguments unpersuasive because, in part, the loan was used to purchase a property in which the Husband’s business would operate. Further, the advance was made during the Husband and Wife’s marriage and benefited both. Therefore, the court found that the transfer was a loan that constituted marital debt that should be shared by the parties.

B. **Close Corporation**.

1. **Take-Away**. Taxpayers distributed funds from a business but did not report the distributions as compensation and instead tried to argue that the distributions were non-taxable loans. The court looked at traditional criteria to support a loan and found them to be lacking and recharacterized the transfers as compensation. In the context of estate planning, if clients took distributions out of a closely held business interest as purported loans it might undermine the entire transaction. While practitioners certainly did not need yet another case confirming that purported loans would be treated as something else, it serves as a reminder as to how easily client planning can get off track.
2. **Discussion**. The Tax Court rejected a taxpayer's attempt to characterize payments from his family corporation as loans instead of compensation.[129] The IRS argued that the taxpayers had unreported income which included wages, rental income, and gambling income, along with significant advances from a company of which they were sole officers and which was controlled by the husband's/taxpayer’s father. The Court rejected their claim that the advances were loans, finding no evidence of loans. There were no facts corroborating that the parties intended to create a bona fide debtor-lender relationship. Factors the court considers in evaluating whether a particular transfer should be characterized as a loan may include:
   a. Ability of the borrower to repay.
   b. Existence of a debt instrument.
   c. Security for the repayment.
   d. Interest being paid.
   e. A fixed maturity date.
   f. Repayment schedule.
   g. Records of the parties confirming the transfer was a loan.
   h. Conduct of the parties corroborating loan treatment.
   i. Whether the borrower actually made payments on the note.
   j. Whether the lender had demanded repayment.
   k. Possibility that the transfers or purported loans were disguised compensation for services.

[128] Gillman v. Gillman, 139 AD3d 667 (2d Dep't. 2016). March 16, 2017 J.D. v. A.D., [Index Number Redacted by Court], NYLJ 1202780893018, at *1.

[129] Zang v. Commissioner, T.C. Memo 2017-55 (April 3, 2017).

XXXIII. **Long Term Care**.

A. **Costs**.

1. **Take-Away**. A concern of many clients, even many wealthy clients, is whether they will be able to maintain their lifestyle for the duration of their lives, especially with the potential for longevity. While for ultra-high net worth clients the cost of health care may not represent a risk. These estimates for health care costs might actually put them at ease about a worry that may not be as real as some worry. For many otherwise "wealthy clients" who are spending at, or worse above, what might appear to be sustainable burn rates, the costs of medical care in later years could undermine their financial security. For more moderate wealth clients ("moderate" in terms of estate tax planning) these statistics could be one of the most important planning issues for these clients to address. For a client with a $5 million net worth, medical expenses post-age-65 could erode 10% of their wealth. For clients with a $2 million estate post-age-65 health care costs could erode 25% of their wealth. Thus, for many clients this could be the most crucial issue to their later life planning. Recent studies on long term care and medical costs give practitioners general figures that can at least be used for discussion purposes. For practitioners looking for an issue to discuss with moderate wealth clients that no longer worry about the estate tax, go no further.
2. **Discussion**. Long-term care costs were estimated by one source at $500,000 to $750,000 for a couple.[130] For a healthy 65-year-old couple retiring this year with a future adjusted gross annual income of less than $170,000 after adding in any tax-exempt income, projected lifetime health-care premiums add up to $321,994 in current dollars. This includes premium payments for Medicare Parts B and D, supplemental insurance premiums, and dental premiums. (The supplemental premium figure used is a national average, and premiums can vary greatly from state to state.) But the figures do not reflect the full range of likely expenses such as deductibles, co-pays, and costs for hearing, vision, and dental care, etc. If those additional costs are added in the total rises to $404,253 in current dollars.[131]

XXXIV. **Malpractice**.

A. **Third Parties Named in Unexecuted Documents Cannot Sue**.

1. **Take-Away**. Practitioners should always be mindful of the risks posed by those believing that they should have been entitled to a greater inheritance. While the persons in the Agnew case were prevented from holding counsel responsible because they were named in an unsigned document perhaps practitioners might consider further protective steps. If a document is unsigned, perhaps had counsel sent a confirming communication to the client/testator that the draft document was not signed, or even more so that it was not signed and why the testator opted not to sign, that might have made the challenge more difficult.
2. **Discussion**.
   a. The court faced the question as to whether individuals who are not named in an executed testamentary document had standing to bring a legal malpractice action against the testator's attorney, as purported third-party beneficiaries to the contract for legal services between the testator and his attorney.[132]
   b. The facts in the case included the following.
      (1) November 2003, the testator, Agnew, retained counsel to draft various estate planning documents. The lawyer drafted a Will and an amendment to Agnew's Revocable Trust, which was first established in 1994.
      (2) Over the next several years, Ross drafted various amendments to both the Revocable Trust and the Will, as directed by Agnew, including a 2007 trust amendment, were executed by Agnew.
      (3) As of 2010, Agnew's Will bequeathed specific gifts of cash and property to selected friends and family members, including the relatives who ultimately sued.

[130] Mark Miller, "Turning Longevity Risk Into Dividends," Apr 25, 2017; http://www.wealthmanagement.com/retirement-planning/turning-longevity-risk-dividends .
[131] Suzanne Woolley, "How Much to Save for Health Care in Retirement," Jun 22, 2017; http://www.wealthmanagement.com/retirement-planning/how-much-save-health-care-retirement .
[132] Estate of Agnew v. Ross (Jan. 19, 2017).

(4) In March 2010, Agnew was admitted into hospice. One of the relatives contacted the attorney and told him Agnew wanted to make changes to his estate plan.

(5) August 18, 2010, the attorney met with Agnew to discuss amendments to various existing testamentary documents and to establish a new trust. During the meeting, Agnew related to counsel that he wanted to limit the amounts going to charity and provide more funds to the family members.

(6) Counsel drafted an amendment to the Revocable Trust (the 2010 Trust Amendment), which continued to provide for gifts to the charities, but which for the first time provided that the residue of the revocable trust was to be distributed to the family members. A revised Will was prepared which provided for pecuniary bequests to the family members and their children. Agnew did not, however, sign the revised Will or the 2010 Trust Amendment at that time.

(7) September 2, 2010, counsel met with Agnew and Agnew did sign the Florida Trust dealing with other matters, and the 2010 Will, which directed the residue of his estate should be distributed in accord with the revocable trust. Agnew did not, however, sign the 2010 amendment to the revocable trust.

(8) Agnew died in January 2011.

(9) The family members sued counsel (and his partner and firm) alleging that the attorneys breached the contract to provide legal services to their client Agnew, when counsel failed to have Agnew execute the 2010 revocable trust amendment. Specifically, appellees claimed to be third-party intended beneficiaries of the contract for legal services between Agnew and Ross, and as a result of Ross's breach, appellees were denied sums of money to which they were entitled under the 2010 Trust Amendment.

c. The trial court dismissed the negligence claims against counsel because the relatives did not have attorney-client relationships with appellants to support those claims. However, the trial court concluded appellees could potentially establish they were intended third-party beneficiaries of the legal services contract between the law firm and Agnew, and allowed that breach of contract claim to proceed. The court dismissed these claims because to maintain the breach of contract action against counsel as third-party beneficiaries to the legal services contract they would need to show that there is an "otherwise valid" document naming them as recipients of all or part of the estate. Since the amendment to the revocable trust was never signed their claim failed.

d. Further, for the relatives to have standing as a third-party beneficiary to the contract of others, her right to performance must be appropriate to effectuate the intentions of the parties, i.e. the testator Agnew. Only the executed estate planning documents, and not the unsigned amendment to the revocable trust, could be used to demonstrate intent. An executed testamentary document naming an individual as a legatee is a prerequisite to that individual's ability to enforce the contract between the testator and the attorney he hired to draft that particular testamentary document.

e. The draft amendment to the revocable trust was held not to constitute proper evidence of the testator's intent in an independent litigation arising out of an alleged breach of contract. The court reasoned that public policy considerations weigh against allowing a party to use an unexecuted testamentary document to establish standing to sue the testator's lawyer for breach of contract as a third-party beneficiary under Restatement Section 302.

XXXV. **Matrimonial**.

A. **Alimony**.

1. The issue in Quintal was whether payments made to constituted alimony as defined in IRC Sec. 71(b) such that the payor is entitled to deduct the pursuant to IRC Sec. 215. The payor spouse deducted the payments as alimony on his return but the payee spouse did not report them as income on her return.
2. The court reviewed the requirements for deducting alimony payments. IRC Sec. 71(b)(1), which defines "alimony" as any cash payment if (A) the payment is received by a spouse under a divorce or separation instrument, (B) the divorce or separation instrument does not designate such payment as a payment which is not includable in gross income under section 71 and not allowable

as a deduction under section 215, (C) the payor and payee spouses are not members of the same household when the payment is made, and (D) the payment obligation terminates at the death of the payee spouse and there is no liability to make either a cash or a property payment as a substitute for the payment after the death of the payee spouse. Section 71(c)(1) provides the general rule that subsection (a) shall not apply to that part of any payment which the terms of the divorce or separation instrument fix (in terms of an amount of money or a part of the payment) as a sum which is payable for the support of children of the payor spouse.

3. There was clearly ambiguity in the agreement and exhibits in part relating to extensive last-minute handwritten changes. However, the court interpreted the agreement, and found the following clause determinative: "In accordance with Section 71(b)(1)(B) of the Code, the Husband and Wife expressly agree to designate and hereby do designate all payments required in this Exhibit as excludable and non-deductible payments for purposes of Sections 71 and 215 of the Code, respectively."
4. Due to conflicting language in divorce decree the court held that the spousal support payments were ineligible for alimony deduction.[133]

B. **Beneficiary Designation**.

1. Gregory Poston, acting on behalf of his incapacitated son Craig, appealed a trial court's judgment granting the motion for summary judgment of defendant-appellee, Lori Shelby–Love. This court affirmed the lower court's conclusion in a case involving undue influence and other issues.[134]
2. With an aging population, and significant incidence of chronic illness and disability at all ages, issues of undue influence, unjust enrichment, and constructive trusts perhaps used to solve these challenges, will become more common.[135]

C. **Gray Divorce**.

1. **Take-Away**. Does the growth in later-life divorce, so-called "gray divorce," change how practitioners should plan? What, if anything, should be disclosed in retainer agreements concerning this possibility? If irrevocable trusts, such a s non-reciprocal spousal lifetime access trusts ("SLATs") are to be used, how should "spouse" be defined in those trusts? While it might be common, perhaps the norm, to assume that if couple retaining estate planning counsel is married for many years and indicates no concern over divorce, is that a reasonable conclusion in formulating representation in light of the growth of gray divorce? If not, what options really exist to address this issue? What if anything should be addressed in a retainer agreement with counsel? If a CRT is planned should consideration of a future division be addressed at the planning stage. If a significant charitable gift with naming rights is being planned for an older couple, should the possibility of divorce and its impact on naming be addressed? Might it be advisable in some situations (e.g., prior to any significant wealth transfers) to have the couple's wealth manager do sensitivity analysis on the financial forecasts for the possibility of divorce? Does the risk of gray divorce suggest a more common use of institutional trustees rather that friends or family members who might be impacted by that divorce should it occur?
2. **Discussion**. The U.S. has the highest divorce rate in the world, with roughly 45% of marriages ending in divorce. The divorce rate among adults ages 50 and older doubled between 1990 and 2010. Roughly 1 in 4 divorces in 2010 occurred to persons ages 50 and older. The rate of divorce was 2.5 times higher for those in remarriages versus first marriages while the divorce rate declined as marital duration rose. The traditional focus of gerontological research on widowhood must be expanded to include divorce as another form of marital dissolution. Over 600,000 people ages 50 and older were divorced in 2010.[136]

D. **Innocent Spouse Relief**.

1. **Take-Away**. While innocent spouse relief can be a valuable safeguard, it can be very difficult to qualify, exemplified by the cases below.

[133] Quintal, TC Summ. Op. 2017-3 (Feb. 2, 2017).

[134] Gregory S. Poston on Behalf of Craig S. Poston, v. Lori A. Shelby-Love, No. 104969, 2017 WL 3189249; Civil Appeal from the Cuyahoga County Court of Common Pleas, Probate Court Division, Case No. 2015 ADV 207589, as discussed in LISI Estate Planning Newsletter #2582 (September 20, 2017).

[135] See also, the discussion of the Williams v. Pahlck, and Kinsel v. Lindsey, cases below.

[136] The Gray Divorce Revolution: Rising Divorce among Middle-aged and Older Adults, 1990-2010, by Susan L. Brown and I-Fen Lin, Department of Sociology Bowling Green State University, March 2013.

2. **Discussion**.
   a. A physician was not entitled to innocent spouse relief as she knew that some portion of the tax had not been paid, and had a basis to understand that the tax reported on the returns would not be paid. She was aware of her husband's poor credit and outstanding debt before they married.[137] Innocent Spouse Relief Granted Despite Passive Losses Being Erroneously Claimed (Windy W. Harris, TC Summ. Op. 2017-21 (3/30/2017)) Innocent Spouse Relief Granted Despite Passive Losses Being Erroneously Claimed (Windy W. Harris, TC Summ. Op. 2017-21 (3/30/2017))
   b. Prior to divorcing the taxpayer and her husband filed married filing joint return income tax returns. The return for the year prior to divorce include two Schedule C's, one of which reflected a profit for the wife's income as a real estate broker, and the other reflected a tax loss of for the husband's cattle ranching business, in which the wife never materially participated. The tax deficiency was primarily due to disallowed deductions for the cattle ranching business. The wife requested and was granted innocent spouse relief from joint and several liability concerning the cattle ranching because the IRS did not demonstrate that she had actual knowledge of the erroneous deductions. The wife, it was determined, did not have the tax background to understand that husband's cattle business lacked a profit motive.[138]
   c. The wife was not entitled to innocent spouse relief for the tax deficiency due to her spouse's unreported unemployment compensation since the court found that she knew that her husband had received unemployment compensation. The fact that she did not know that he had chosen not to have federal income tax withheld on the unemployment compensation did not provide a basis for relief.[139]
   d. The Tax Court dismissed, for lack of jurisdiction, an individual's untimely petition for review of the IRS's denial of innocent spouse relief. The taxpayer requesting relief failed to file her petition by the deadline required under Code Sec. 6015(e)(1)(A).[140]
   e. A claim for equitable innocent spouse relief was held to be timely because the limitations period was tolled from the time she submitted an incorrect form (Form 8379 - Injured Spouse Allocation), until she filed the correct form (Form 8857 - Request for Innocent Spouse Relief).[141] The incorrect form, in the court's opinion, fairly apprised the IRS that she was actually seeking innocent spouse relief. The equities also weighed in favor of innocent spouse relief as the taxpayer spoke little English, was subject to domestic abuse, and she was not responsible for the deficiency involved.

E. **IRAs and Divorce**.
1. **Take-Away**. As practitioners are aware, carefully structuring how retirement assets will be handled in a divorce is critical. The instant case should serve as a reminder to potential clients why hiring counsel to address these complex issues is essential.
2. **Discussion**.
   a. A couple negotiated their divorce without counsel. The husband distributed funds from his IRA and gave half to his wife before the divorce was finalized. The husband withdrew the total proceeds of the IRA and deposited them in a joint checking account. The next day he wrote two checks whose amounts totaled half the amount he received, one to pay off one of wife's debts and one to the wife. The husband was held liable for the 10% penalty under IRC Sec. 72(t)(1) for an early distribution from a retirement plan, with respect to both his and his wife's shares of the IRA distribution.[142] The exception provided under Code Sec. 72(t)(2)(C) for a distribution to an alternate payee pursuant to a qualified domestic relations order ("QDRO") did not apply. The court entered a consent decree of dissolution of marriage but noted that neither party had a retirement, pension, deferred compensation, § 401(k) Plan and/or benefits, because the IRA had already been terminated.

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[137] Ryke, TCM (Jul. 26, 2017).
[138] Windy W. Harris, TC Summ. Op. 2017-21 (3/30/2017).
[139] L.F. Wilson, TC Memo. 2017-63, Dec. 60,875(M).
[140] Rubel, USTC ¶50,224 (CA-3), (May 15, 2017).
[141] Palomares, 108 TCM 582, Dec. 60,088(M), TC Memo. 2014-243, (CA-9), (Jun. 2, 2017).
[142] Summers, TC Memo 2017-125.

b. The transaction may have been structured to entitle husband to a Code Sec. 72(t)(2)(C) exception for wife's 50% share. But it was not. The IRA distribution was made directly to husband and he deposited the check into a bank account and subsequently transferred to wife half of the proceeds. Although wife ultimately received the proceeds, the distribution itself was made to husband, not, as required by Code Sec. 414(p)(8), to "a former spouse...who is recognized by a domestic relations order as having a right to receive" a share of the proceeds. The distribution was not made "pursuant to a qualified domestic relations order."

F. **Loans**.

1. See discussion under "Loans" above.

G. **Loss on Divorce Payment**.

1. **Take Away**. Tax planning for the consequences of provisions included in any matrimonial agreement should be evaluated, planned for and to the extent feasible addressed in the relevant matrimonial agreement.

2. **Discussion**.

a. While the case is unusual, it does illustrate the complexities and some of the issues that can arise when business and litigation issues become part of a divorce settlement.[143]

b. Husband was an owner of a family business with his sister. Husband paid himself substantial compensation from the business, or according to his sister in another complaint, excessive compensation. Husband and wife divorced while the litigation over the compensation payments between husband and his sister was ongoing. The marital settlement agreement included an obligation on the wife to reimburse husband for ½ of whatever husband had to pay his sister in settlement of their suit. The agreement provided that the husband and wife would be jointly and severally liable for all damages, costs, attorney fees and other expenses incurred with respect to the litigation.

c. The suit was settled after the divorce and the now ex-wife paid the husband $300,000 as her share. The ex-wife sought to deduct the $300,000 as a loss but the IRS was victorious in denying the deduction.

d. The payment did not qualify for a tax loss deduction. A loss is permitted that is sustained during the tax year, not compensated for by insurance, and incurred in a transaction entered into for profit. IRC Sec. 165(c)(2)). The court found that the loss had nothing to do with a business venture or investment.

e. The ex-wife also was held to not qualify for treatment under the claim of right doctrine. IRC Sec. 1341. This doctrine provides certain tax benefits if:

(1) An item was included in gross income for a prior tax year because it appeared that the taxpayer had an unrestricted right to such item; and

(2) A deduction is allowable for the current tax year because it was established after the close of the prior tax year that the taxpayer did not have the unrestricted right to the income item.

f. The IRS argued that the claim of right failed because the return of the income was voluntary and a taxpayer cannot use IRC Sec. 1341 for amounts voluntarily repaid. The court also noted that a taxpayer must demonstrate a connection between the right to the income at the time it was received, and the subsequent circumstances necessitating a refund of that tax. The court viewed the ex-wife's payments as constituting part of the agreement she entered as part of the divorce settlement.

H. **Trusts**.

1. See discussion of Ferri v. Powell-Ferri, 476 Mass. 651 (2017) above under "Decanting."

2. **PLR 201707008**.[144]

a. **Take-Away**. This PLR provides an interesting way that a payee spouse may secure his or her interests in income/cash flow from the payor spouse while providing protections to the payor spouse's interests in the assets involved.

[143] Mihelick, (DC FL 10/11/2017) 119 AFTR 2d ¶ 2017-5358.

[144] Feb. 17, 2017.

b. **Discussion**.

(1) The divorce settlement provided for the creation of a trust to benefit the wife. It was to be funded with stock in the husband's business. The wife was to receive the net income from the trust and, in the trustee's discretion, principal. However, the trustee cannot distribute stock or sell the stock. On wife's death, the stock held in the trust, and any other trust corpus are to be distributed back to the husband, or his estate.

(2) The IRS held that the husband will not recognize gain on the transfer of stock as it is incident to the divorce under IRC Sec. 1041(a). The husband will not be deemed to have made a gift under IRC Sec. 2516 to the wife by virtue of the transfer of stock to the trust as there was adequate consideration for the transfer based on the wife's relinquishment of her marital claims. If the husband dies before the wife the value of what is included in his estate will be reduced by the remaining income interest retained by the wife.

I. **Prenuptial Agreement.**

1. The use of so-called floating spouse clauses has become more common in irrevocable trusts. Naming as a beneficiary whoever the settlor may be married to at any particular time gives the settlor a greater opportunity to indirectly benefit from assets in the trust. If the current marriage ends in divorce a future spouse can become a beneficiary. Also, given the growth in silver or gray divorce discussed elsewhere in this outline, a floating spouse clause gives greater assurance that the person the spouse wishes to benefit will so benefit.
2. But what if the settlor does not wish a new spouse to benefit from an existing irrevocable trust perhaps a SLAT, through a floating spouse clause that agreement might incorporate? It would seem possible that a prenuptial agreement with the new spouse could, if it expressly addresses and limits those rights, suffice to prevent new spouse from benefiting from particular assets, e.g. life insurance, in the existing SLAT under a floating spouse clause.

XXXVI. **Partnerships**.

A. See discussions above under "Limited Liability Companies ("LLCs") and Limited Partnerships."

XXXVII. **Passive Losses**.

A. The Tax Court held that a plastic surgeon's share of income from an LLC operating a surgery center was passive income. The Court did not require the physician to aggregate the surgical center interest with those of the physician's practice for purposes of determining whether the surgeon was a material participant in the surgical center.[145] Further, the surgeon had only a 12.5% interest in the surgical center and never had management responsibilities.

XXXVIII. **Personal Representative**.

A. The decedent owed over $340,000 in unpaid federal income tax liabilities. The decedent was survived by his wife and four minor children. The decedent's wife, was appointed executor. The court found personal liability under the federal priority statute of an executor of an insolvent estate who transferred ownership of estate assets to herself without making any effort to pay the decedent's outstanding tax liability.[146]

XXXIX. **Pets**.

A. Pet visitation therapy furthered the tax-exempt purpose of the exempt IRC Sec. 501(c)(3) organization which offered hospitalized children and elderly nursing home residents pet therapy to lessen stress, socialization, etc.[147]

B. See the discussion of "Domicile" above.

XL. **Portability**.

A. **Take-Away Generally**.

1. Three significant developments, and one interesting statistic, concerning affecting portability are discussed below. Each of these has important planning implications, individually. When considered collectively additional planning lessons can be gleaned.[148]
2. Practitioners should consider communicating to clients about the possibility of making late portability elections to secure the DSUE. Tax uncertainty should encourage clients to secure a

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[145] Hardy v. Commissioner, T.C. Memo. 2017-16 (1/17/2017).

[146] United States v. McNicol, No. 15-2214 (1st Cir. 2016).

[147] PLR 201719018, (May 15, 2017).

[148] See, Glazier and Shenkman, "Portability, Perhaps Permanent, But Not Easy," Estate Planning Review—The Journal, Oct. 19, 2017, at 184.

DSUE while they can, not dissuade them from doing so. Same-sex couples that had not been aware of or could not file for portability should do so.

3. New prenuptial agreements should address the DSUE with specificity in light of the recent suit over this issue and married couples might wish to sign a limited post-nuptial agreement dealing with this issue.
4. For all the benefits of securing a DSUE for even small estates it appears that few are heeding that recommendation. The IRS recently released only 606 estates under $5 million filed no-tax estate tax returns in 2016 (presumably to secure the DSUE).[149]

B. **Audit of DSUE**.

1. **Take-Away**.
   a. The IRS can and in fact will audit estate tax returns filed solely to secure the deceased spouse's DSUE. While practitioners expected this result, the Sower case confirms it.[150] A key take-away from Sower is that the race to the bottom to prepare quick and inexpensive estate tax returns since "its' only for portability, there's no tax due," is a risky gambit for practitioners pursuing that type of work.
   b. Sower demonstrates the importance of care (and maintenance of backup) in the preparation of the first to die 706 filed to preserve DSUE and the potential chilling effect of reliance on an incomplete or inaccurate return. Since the IRS can revisit the first return in the assessment of tax due on the second, a significant change in value could place the second return in a significant understatement penalty position.
   c. Portability is relatively new – what about second to die spouse returns filed decades from now which rely upon timely filed the first to die returns intended to provide portability of DSUE?
   d. In Sower, the surviving spouse's DSUE was reduced following an examination of her deceased husband's estate tax return. The opinion, discussed in more detail below, includes several arguments and issues concerning portability that will provide additional clarity to practitioners.
2. **Discussion.**
   a. Facts.
      (1) Husband died in 2012. His estate did not use all of his basic exclusion amount ("BEA") allowed under IRC Sec. 2010(c)(3). His estate filed Form 706 and reported a deceased spousal unused exclusion ("DSUE") and elected portability. That return reflected that zero prior taxable gifts had been made when in fact nearly $1 million in gifts had been made and reported on Forms 709 filed in 2003, 2004 and 2005.
      (2) In 2013 the IRS sent the husband's estate Letter 627 which showed no estate tax liability for Frank's estate and which stated that the return had been accepted as filed.
      (3) Wife later died in 2013 and her estate claimed the DSUE reported by the first to die spouse, husband's estate. Her estate tax return also neglected to report her prior taxable gifts just as her husband's return failed to do.
      (4) The IRS audited the estate tax return filed by wife's estate, and as part of that audit examined the estate tax return filed in 2013 by the husband's estate which calculated the DSUE available to wife's estate. The IRS reduced the amount of that DSUE by the amount of taxable gifts that had been given by the husband during his lifetime, but did not determine or assess a deficiency against husband's estate. The IRS did determine an estate tax deficiency against wife's estate because an estate tax was due after the DSUE amount was corrected. The executors of wife's estate challenged the right of the IRS to take these actions.
   b. Background on DSUE.
      (1) A unified credit against the estate tax is provided. IRC Sec. 2010. This credit effectively reduces the value of the estate for the purpose of calculating the tax. It includes both the basic exclusion amount ("BEA") and in the case of a

[149] https://www.irs.gov/statistics/soi-tax-stats-estate-tax-statistics-filing-year-table-1 .
[150] In re Estate of Minnie L. Sower, et al., v Commissioner, 149 T.C. No. 11 (September 11, 2017).

surviving spouse, the deceased spousal unused exclusion amount (“DSUE”). IRC Sec. 2010(c)(2).

(2) The DSUE is the lesser of the basic exclusion amount or the excess of the applicable exclusion amount of the last such deceased spouse of such surviving spouse, over the amount with respect to which the tentative tax is determined under IRC Sec. 2001(b)(1) on the estate of such deceased spouse. IRC Sec. 2010(c)(4).

(3) If the estate of the predeceased spouse elects portability, the later- deceased spouse’s estate can effectively reduce its taxable estate by the amount by which the basic exclusion exceeds the sum of predeceased spouse’s taxable estate and adjusted taxable gifts. IRC Secs. 2010(c)(5)(A), 2001(b)(1).

(4) The IRS is given the authority to examine the estate tax return of the predeceased spouse to determine the DSUE amount, regardless of whether the period of limitations on assessment has expired for the predeceased spouse’s estate. IRC Sec. 2010(c)(5)(B).

c. Holdings.

(1) The Tax Court sided with the IRS on the issues raised and these conclusions are important for practitioners to be aware of.

(2) The IRS had authority to examine the estate tax return of a predeceased spouse to determine whether the correct DSUE amount was reported by the second to die spouse’s estate. IRC Sec. 2010(c)(5)(B). The period of limitations on assessment for the estate of the predeceased spouse is not implicated because no tax is being assessed against the estate of the predeceased spouse. This has important implications to practitioners in light of the Vose case which indicates that the surviving spouse may have a right to force the filing of a return to secure the DSUE. Specifically, while it may be obvious that the parties in such an instance will have to negotiate who should pay the cost of filing that return and how that amount will be determined, the parties should also endeavor to address who will pay the cost of the audit of that return and how that amount will be differentiated from the costs incurred in auditing the second to die spouse’s return.

(3) The IRS was not precluded from auditing the first to die spouse’s estate tax return merely because the IRS sent a letter stating that the estate tax return of a predeceased spouse has been accepted as filed. Such a letter does not constitute a closing agreement which would have precluded a later examination under IRC Sec. 7121. The wife’s executors also argued that the IRS should be estopped from auditing the return of husband’s estate because of the text of the estate tax closing letter. The Letter 627 sent indicated that the IRS would not reopen or examine the husband’s estate tax return unless there was evidence of fraud, malfeasance, collusion, concealment or misrepresentation of a material fact; a clearly defined substantial error, or a serious administrative error. The Tax Court explained that Form 866, “Agreement as to Final Determination of Tax Liability,” and Form 906, “Closing Agreement on Final Determination Covering Specific Matters,” qualify as closing agreements to preclude further examination. The letter sent did not. The rationale of the Tax Court was that the letter did indicate the hallmarks of any other kind of agreement, i.e., negotiation followed by offer and acceptance.

(4) An audit of the estate tax return of the first to die spouse in which the IRS reviews the records in his possession and asserts no additional tax is not a second examination under IRC Sec. 7605(b). Further, the estate of the second to die spouse cannot challenge whether an examination of the estate tax return of the first to die spouse is an improper second examination because only the examined party can seek protection from a second examination under that provision.

(5) The Regulations under IRC Sec. 2010 do not prohibit the IRS from examining the first to die spouse’s return.

(6) The effective date of IRC Sec. 2010(c)(5)(B) does not preclude the IRS from adjusting the DSUE amount by gifts given before Dec. 31, 2010.

C. **Relief for missed Portability Elections**.

1. **Take-Away**.

a. Any client whose spouse died after 2010 that did not file an estate tax return, and the estate of the deceased spouse was less than the estate tax exemption, should carefully consider filing an estate tax return under the leniency provided by a recent IRS Revenue Procedure, to secure portability of that deceased spouse's used exemption ("DSUE"). Practitioners should consider communicating this important message to all clients so that those affected may take action. The cost benefit of this for many clients should be relatively simple. The cost of having an estate tax returned prepared merely to secure the DSUE should be rather inexpensive. There are three categories of clients affected. First are clients who need the DSUE. For example, husband died in 2011 with an estate of $2M and no estate tax return was file.

b. Wife died in 2017 with an estate of $7M. Without the DSUE a tax would be due. If the DSUE was secured by following the steps outlines in the Revenue Procedure estate tax will be avoided. For these clients, the benefits of filing are clear. The second class of clients might be those who may need the DSUE in the future. An example would be the couple and estate above, but the wife is still alive so the results are not yet assured (e.g., she might engage in tax planning, the exemption will rise if the estate tax is not repealed, the estate tax might be repealed, etc.). For these clients, given the modest cost of compliance filing should be made. The third category of clients are those that are unlikely under current law and circumstances to have use for a DSUE.

c. For example, husband died in 2011 with an estate of $2M. Wife inherited that $2M and has $2M of assets of her own for an aggregate estate of $4M. Under current law there is no benefit to securing the DSUE. But what if wife remarries someone wealthy, might there be a benefit to having secured the DSUE from her first husband to cover gifts of her $4M estate? What if, regardless of what happens to the estate tax under a Trump Administration, the estate tax is reinvigorated under a future democratic administration such that a tax might be due? While the likelihood of these scenarios might be viewed as modest, the cost of having an estate tax return filed to secure the DSUE may be only a few thousand dollars.

d. Is that modest cost worth the potential benefit? At a $4M estate level the cost is insignificant, although the client might not view it as such. Even if the exemption is not needed, the downside is generally limited to the cost of filing (and the statute of limitations on an audit remaining open which needs to be evaluated but which in most instances involved may not be a material concern). While many clients that could benefit might dismiss securing the DSUE as not worthwhile, just as they may have done if they made a conscious decision not to file following the death of their spouse. Now in particular, with the specter of estate tax repeal a possibility is securing a DSUE worth the modest bother and cost? Unfortunately, for most client that will be unknown without the benefit of hindsight. However, even if the estate tax system is repealed but reinstated by a future administration, having secured the DSUE may prove worthwhile. For most, the cost of filing is not a heavy price to pay "just in case." An additional category of clients which could benefit from an assessment of the potential benefits of preserving DSUE includes same sex married couples, especially those whose spouse died prior to 2013 (and the issuance of the U.S. v. Windsor and, perhaps, Obergefell v. Hodges decisions). These clients may not have considered the benefits of filing a form 706 to preserve the first spouse's DSUE because at the time of the spouse's death the option did not exist. The window of opportunity for all of these clients.

2. **Discussion**.

a. Portability was supposed to simplify the estate tax system. Prior to portability, if one spouse died, to secure that deceased spouse's exemption required affirmative planning in most cases. The deceased spouse's will or revocable trust generally would have had to include a credit shelter trust to benefit the surviving spouse but avoid inclusion in the survivor's estate thereby securing the exemption. Title to assets had to have also been structured to facilitate funding of that trust. If the required planning was not implemented, which generally required incurring legal fees and bearing the cost and complexity of the planning, the exemption of the first spouse would have been wasted. The law was modified in 2010 to provide a simpler low-cost alternative so that taxpayers that did not hire more sophisticated estate planning counsel, could also benefit from the exemption of the first spouse to die. Later legislation made portability permanent.[151]

b. Portability was intended to facilitate the surviving spouse being able to secure the deceased spouse's unused exemption ("DSUE") by merely making a portability election. That DSUE could then be applied to lifetime and then testamentary transfers of the surviving spouse.

c. Unfortunately, simplicity was not really achieved by the portability concept because the mechanism to secure it, namely filing a federal estate tax return, is not understood by many taxpayers and the cost of compliance is viewed as an impediment to filing by many, especially if the benefits of porting the exemption are not assured. Decedent's whose estates exceeded the exemption amount had to file estate tax returns and thus were less likely to miss the filing requirement, but regardless, were not covered by the recent Revenue Procedure. As a result many taxpayers, particularly those who would not otherwise have been required to file an estate tax return, missed filing the requisite estate tax return and sought relief from the IRS to rectify the situation. The due date for electing portability for those estates not required by IRC Sec 6018(a) to file an estate tax return is prescribed by Regulation, and not by statute. Treas. Reg. Sec. 20.2010-2(a). Therefore, the executor of such an estate could have sought an extension of time to elect portability under IRC Sec. 2010(c)(5)(A). Treas. Reg. Sec. 301.9100-3.

d. Portability terminology is key to understanding the provision. The applicable exclusion amount ("AEA") is the sum of the basic exclusion amount ("BEA") and, for the case of a surviving spouse, the DSUE amount. IRC Sec. 2010(c)(2). The basic exclusion amount is the $5 million inflation exemption amount. IRC Sec. 2010(c)(3). This Regulation provides the standards by which the IRS can determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation or other administrative guidance and not by statute.

e. Requirements for Leniency.[152]
   (1) The executor satisfies all requirements of Section 4.01 of the Revenue Procedure.
   (2) Action must be taken by the executor. This is either the executor appointed under the will. If there was no person appointed as executor, then by a non-appointed executor. Treas. Reg. Sec. 20.2010-2(a)(6)). The action required is filing a complete and properly prepared estate tax return, Form 706. The return must be filed on or before the later of: (1) January 2, 2018, or (2) the second annual anniversary date of the decedent's date of death. The "complete and properly prepared" criteria are set forth in the regulations. Reg. Sec. 20.2010-2(a)(7). The tax return must state at the top of the form: "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)."
   (3) The decedent had to have been survived by a spouse.
   (4) The decedent died after December 31, 2010.
   (5) The decedent was a citizen or resident of the United States on the date of his or her death.
   (6) The executor was not required to file an estate tax return for the estate based on the value of the gross estate and adjusted taxable gifts. IRC Sec 6018(a). This obviously does not include the requirement to have filed to secure the DSUE. If, subsequent to the grant of relief under the Revenue Procedure, it is determined that, based on the value of the gross estate and taking into account any taxable

[151] Section 303(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296, 3302 (2010), amended § 2010(c) of the IRC Sec. 101(a) of the American Taxpayer Relief Act of 2012 (ATRA), Pub. L. No. 112-240, 126 Stat. 2313 (2013).

[152] Revenue Procedure 2017-34, Internal Revenue Bulletin 2017-26, dated June 26, 2017.

gifts, the executor was required to have filed an estate tax return under § 6018(a), the leniency of an extension will be void.

(7) The executor did not in fact file a federal estate tax return within the time required by for filing an estate tax return. Treas. Reg. Sec. 20.2010-2(a)(1). If a return was filed, but the executor affirmatively opted out of the portability election, the leniency of the Revenue Procedures appears to be available. Treas. Reg. Sec. 20.2010-2(a)(3)(i). This result, while favorable to taxpayers is not as clear as to why it was included as the executor in such a situation obviously understood the filing requirement. Perhaps this leniency is being offered because many executors filing did not understand the implications of portability.

f. If the estate is granted relief under this Revenue Procedure the estate tax return is considered to have been timely filed for purposes of electing portability, and the DSUE amount of the decedent will be available to the surviving spouse (or the estate of the surviving spouse) for application to the surviving spouse's transfers made on or after the decedent's date of death. The application of the DSUE will follow the sequences provided for in the Regulations. Reg. Sec. 20.2010-3 and 25.2505-2. of the Gift Tax Regulations.

g. Relief is not without exception. If the increase in the surviving spouse's applicable exclusion amount attributable to the addition of the decedent's DSUE amount as of the decedent's date of death results in an overpayment of gift or estate tax by the surviving spouse (or his or her estate), no claim for credit or refund of that tax paid may be made if the period of limitations under Code Sec. 6511(a) for filing a claim for credit or refund of an overpayment of tax has expired. Thus, the extension of time to elect portability granted under the Revenue Procedure does not extend the period during which the surviving spouse or the surviving spouse's estate may make a claim for credit or refund.

h. Revenue Procedure 2017-34 includes three examples which illustrate application of the new rules. These are reproduced below.

i. Revenue Procedure Example 1. Predeceasing Spouse (S1) dies on January 1, 2014, survived by Surviving Spouse (S2). The assets includible in S1's gross estate consist of cash on deposit in bank accounts held jointly with S2 with rights of survivorship in the amount of $2,000,000. S1 made no taxable gifts during life. S1's executor is not required to file an estate tax return under § 6018(a), and does not file such a return. S2 dies on January 30, 2014. S2's taxable estate is $8,000,000 and S2 made no taxable gifts during life. S2's executor files a Form 706 on behalf of S2's estate on October 30, 2014, claiming an applicable exclusion amount of $5,340,000. S2's executor includes payment of the estate tax with the Form 706. Pursuant to this revenue procedure, S1's executor files a complete and properly prepared Form 706 on behalf of S1's estate on December 1, 2017, reporting a DSUE amount of $5,340,000. The executor includes at the top of the Form 706 the statement required by section 4.01(2) of this revenue procedure. The filing of the return satisfies the requirements for a grant of relief under this revenue procedure and S1's estate is deemed to have made a valid portability election. The Service accepts S1's return with no changes. To recover the estate tax paid, S2's executor must file a claim for credit or refund of tax by October 30, 2017 (the end of the period of limitations prescribed in § 6511(a)), even though a Form 706 to elect portability has not been filed on behalf of S1's estate by that date. Such a claim filed on Form 843, Claim for Refund and Request for Abatement, in anticipation of the filing of the Form 706 by S1's executor will be considered a protective claim for credit or refund of tax. Accordingly, as long as the Form 843 is filed on or before October 30, 2017, the Service can consider and process that claim for credit or refund of tax once S1's estate is deemed to have made a valid portability election and S2's estate notifies the Service that the claim for credit or refund is ready for consideration.

j. Revenue Procedure Example 2. The facts relating to S1 and S1's estate are the same as in Example 1. S2 makes a gift to Child of $6,000,000 on December 1, 2014. S2 has made no prior taxable gifts. On April 15, 2015, S2 files a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, claiming an applicable exclusion amount of $5,340,000. S2 tenders payment of the gift tax with the Form 709. To recover the gift tax paid, S2 must file a claim for credit or refund of tax (protective or otherwise) within the time prescribed in § 6511(a) for filing a claim for credit or refund.

k. Revenue Procedure Example 3. The facts are the same as in Example 2 except that S2's Form 709 claims an applicable exclusion amount of $10,680,000 including a DSUE amount of $5,340,000 from S1's estate. As a result, the Form 709 reports no tax due and S2 tenders no gift tax. Although the portability election, once made, makes S1's DSUE amount available to S2 retroactively to S1's date of death, that DSUE amount is not available until the election is made. Because S2 files the Form 709 before S1's estate makes the portability election, S2's claimed application of the DSUE amount will be denied and gift tax on the transfer will be assessed. To recover that gift tax once the portability election has been made by S1's estate, S2 must file a claim for credit or refund of tax (protective or otherwise) within the time prescribed in § 6511(a) for filing a claim for credit or refund.

D. **Executor Required to Make Portability Election**.

1. **Take-Away**.

a. The Vose case may provide a valuable precedent when, especially in a second or later marriage, the personal representative refuses to file a federal estate tax return to secure the unused exemption for the surviving spouse. The trial court's order summarized below provides a logical template for how this should be handled. When the Vose decision is coupled with the leniency the IRS issued in Revenue Procedure 2017-34, to make a late filing for portability, practitioners may wish to alert clients facing a Vose situation to have counsel write a letter to the recalcitrant executor demanding that the filing be made. The Vose decision also addresses specifically many of the questions that practitioners would anticipate in making a portability election in second and later marriages and thus provides clear conclusions to use to evaluate such situations.

b. Carefully draft an agreement with the surviving spouse. Will she pay cost of return preparation plus the cost for the personal administrator to provide data? What if there is an audit of that information on the surviving spouse's estate which is permitted. The indemnification for costs should include that as well. What if the surviving spouse obtains her own appraisal that differs from the estates appraisal? What happens? What if the estate did not obtain appraisals but objects to the appraisals the surviving spouse obtains as they impact how assets may have been distributed under the estate or are lower thereby providing a lower basis adjustment?

2. **Discussion**.

a. The Oklahoma Supreme Court upheld the trial court's holding that required a personal representative of a deceased spouse to file a federal estate tax return and make a portability election thereby making the DSUE available to the surviving spouse.[153]

b. The key events and dates in Vose include the following.

(1) On May 24, 2006, prior to their marriage, the surviving spouse and Decedent entered into an antenuptial agreement that is relevant to this cause of action.

(2) The decedent and the surviving spouse married on June 3, 2006.

(3) Anne S. Vose, the decedent, died intestate on January 22, 2016. C.A. Vose, Jr. is the surviving spouse. Robert E. Lee, III is the current administrator of the estate (personal representative), and also decedent's son from a prior marriage.

(4) On August 10, 2016, the surviving spouse filed his application to compel administrator to timely prepare and file a federal estate tax return for purposes of irrevocably electing portability of decedent's deceased spousal unused exclusion amount.

(5) On November 8, 2016, the District Court entered its order effectively granting the surviving spouse's DSUE application. That order included the following: ordered, if a DSUE is available, that the administrator (personal representative) timely file an estate tax return electing portability of the DSUE and allow the surviving spouse 60 days to review the return and documentation prior to filing. It also ordered the surviving spouse to pay for the filing of the return if a DSUE is available.

c. Thus, the situation in the Vose case is similar to what a practitioner might hypothesize as a likely portability problem affecting portability and many second marriages. The

[153] Matter of Estate of Vose, 2017 OK 3, Case Number: 115424, 390 P.3d 238, (Okla. January 24, 2017).

personal representative of the estate was the decedent's child from a prior marriage. The personal representative refused to make the election required to preserve the DSUE and transfer it to the surviving spouse even though the surviving spouse agreed to pay the cost to prepare and file the Federal Estate tax return to do so.

d. The personal representative argued that, pursuant to IRC Sec. 2010 and the applicable regulations, the decision to elect portability of the DSUE is discretionary and entirely his to make as personal representative. The Court, however, found that the statute as a whole is silent as to the effect state laws might have on how the administrator must make that choice concerning portability. The district court ordered the personal representative to elect portability in response to arguments that his fiduciary obligations as an estate administrator under Oklahoma law compel him to do so. The result, an election of portability, does not directly conflict with IRC Sec. 2010, which allows such an election

e. The personal representative (the decedent's son from a prior marriage) further argued that the district court had no subject matter jurisdiction over the matter, and that its order compelling him to make the election is directly contrary to federal law and any state law. The court rejected these arguments.

f. In requiring the portability election be made by the personal representative the court reasoned that the right to portability of the DSUE was a beneficial interest in the estate for the surviving spouse. The court indicated that this right was independent of the surviving spouse's rights as an heir. This right to obtain the DSUE was also stated to be a sufficient interest to support the surviving spouse standing to bring the claim.

g. The personal representative also argued that the decedent's and surviving spouse's prenuptial agreement constituted a waiver by the surviving spouse of any rights to the estate making a portability election. The Court determined that the antenuptial agreement did not bar the surviving spouse's interest in the DSUE. The Court reasoned that the DSUE is not a simple property acquired by one party over the course of the marriage according to existing laws in effect when the agreement was made. It is an interest created by the federal tax code that was unknown at the time the antenuptial agreement was signed. The antenuptial agreement was entered into on May 24, 2006, and portability of the DSUE was enacted as an option under the federal tax code in 2010. While the decedent and surviving spouse clearly intended a comprehensive waiver of their marital rights under the law as it existed at the time, the agreement was silent as to portability because the change in law was unforeseeable to the parties when the contract was made. The Court reasoned that a spouse could not waive what was not known. So, the Court concluded that the antenuptial agreement did not bar the surviving spouse from asserting an interest in portability of the DSUE.

h. The Court also addressed the broader context or reasoning as to why it felt the personal representative had to pursue the DSUE. The Court noted that the administrator is responsible for the faithful administration of the estate's property, has a duty to preserve the estate, has a general duty to take charge of all the effects and personal assets belonging to the decedent and to preserve the same from damage, waste, and injury. The Court viewed preserving the tax benefits of the DSUE within the context of the broad general fiduciary duties of the personal representative.

XLI. **Powers of Attorney**.

A. **Georgia enacted a Uniform Power of Attorney Act**.

1. Georgia enacted a Uniform Power of Attorney Act effective July 1, 2017. The act provides a statutory form power of attorney.[154] The act endeavors to encourage third parties to accept powers, and to provide better protection to those using powers against predators. Powers executed prior to the new act will remain effective but commenters have already recommended that principals execute current documents. New powers must use the statutory form or provisions that substantially reflect the language if third parties are going to be required to accept the power. You want the new ability to force acceptance of the POA. To be valid a new power must be signed by the principal (or by another person in the principal's presence and at the principal's instruction), and attested and signed by one or more witnesses and a notary public all of whom must be in each

[154] House Bill 221, adding new Chapter 6B to Title 10 of the Official Code of Georgia. This new Chapter begins at Code Section 10-6B-1.

other's presence at the time the document is signed. A number of people will have the right to request that a court review an agent's actions. A photocopy or an electronically transmitted copy of an original POA has the same effect as the original POA.

B. **Gifts Under a Power of Attorney (or Revocable Trust).**

1. **Take-Away**.
    a. The Powell case (discussed elsewhere in this outline) is all a "buzz" in the estate planning community. One of the issues discussed in Powell is the fact that the donor's durable power of attorney did not authorize the gifts made. This case should serve as a reminder to all estate planning professionals, not merely those focused on planning for large taxable estates, that failing to tailor a gift provision under a durable power of attorney (or revocable trust) can be a costly oversight. Too often gift provisions under a durable power of attorney, or revocable trust, is relegated to the status of "boilerplate." The gift power is a critical provision that should ideally be tailored to the client's unique circumstances and modified as those circumstances change. The key to this is not a change in planner skills, but rather, educating clients that a durable power of attorney is not a simple, basic or boilerplate document. Clients need to understand the importance of the gift provision at various wealth levels, and practitioners need to view powers of attorney generally, and gift provisions in particular, as a valuable service, rather as an adjunct or "throw-in" with a will or revocable trust plan.[155]
    b. See comments elsewhere in this outline concerning charitable donations and how statistical data on giving patterns might impact language used in gift provisions.
2. **Discussion**. There is a myriad of different objectives for a gift provision in a power of attorney. The default provision tends to be a provision permitting annual gifts up to the annual exclusion amount.
    a. If any type of gift power is desired it should be expressly provided for in the durable power of attorney. Standard or statutory forms may not suffice to confer the power to gift.[156]
    b. For wealthy clients that rarely sufficed, and in particular with high exemptions flexibility to utilize those exemptions can be important. For ultra-high net worth clients permitting the agent to make gift transfers to use the exemption may not suffice and broader powers might be advisable to facilitate complex transfer planning.
    c. For moderate and wealthy clients permitting gift transfers and other planning to reduce state estate and inheritance tax may be worthwhile. For example, gift transfers made may minimize or avoid the New Jersey inheritance tax, if made more than three years prior to the donor's death. Depending on the facts it may not be appropriate to add those non-Class A beneficiaries under a will to a broad annual gift provision as the donor/testator's intent might be merely to make a specified pecuniary gift to that person. If the inheritance tax will be triggered, paying that gift more than three years in advance of death might be worthwhile. A means to accomplish the goals of making only that pecuniary gift, avoiding inheritance tax, and not enlarging the interest of that beneficiary may be achieved by adding the following clause to the gift provision under a durable power of attorney.
    d. **Sample Provision**: "Any person named under Principal's will or revocable trust to receive a pecuniary sum as an advancement of that sum."
    e. The estate planning environment has changed. With most clients not subject to any transfer tax, an aging population and burgeoning incidence of elder financial abuse (often achieved through abusing a power of attorney), a different approach to the common gift provision may be advisable for many clients. In some instances, it may be advisable to expressly provide that no gifts shall be permitted to be made by the agent. This may eliminate a common spigot for elder financial abuse. This modification may be so important for some elderly or infirm clients that it alone may justify revising and resigning the power of attorney.
3. **Sample Provision**.

[155] Powers of Attorney, Feb 21, 2015, by Martin Shenkman and Jonathan Blattmachr Esq. Kindle Edition.
[156] For a discussion of the Agent's right to make gifts under Connecticut law see: "Does an Attorney In Fact Have Power to Make a Gift Under the Short Form Power of Attorney Statute?", Comment, 10 Conn. Prob. L. J. 369 (1996).

a. The Agent is authorized to make gifts as provided herein. Such gifts may be made outright, in cash or property, to an adult, or to a person under the age of majority according to applicable State law under the State Gifts to Minors' Act or Transfers to Minors' Act in custodial form, or to a trust for the benefit of any such minor. If an irrevocable trust exists for such person, and such person is the sole current beneficiary of such trust, the gift may be made to such trust for the benefit of such person.
b. Amount of Gifts.
    (1) Gifts made under this authority to each Authorized Donee in any calendar year may be made up to the maximum amount that is excluded as a taxable gift under Code Section 2503(b) and 2503(e), or any successor statute, effective as of the date of any gift. Although this amount is presently limited to $14,000, Principal recognizes that such amount is indexed for inflation and may be increased. This provision shall not limit gifts permitted under other provisions.
    (2) Gifts in the preceding paragraph may be doubled, currently to $28,000, for gifts split with Principal's spouse.
    (3) Gifts may be made in amounts paid for educational or medical expenses (as defined under Code Section 2503(e)).
c. Principal authorizes Agent to make the maximum gifts permitted to a Code Section 529 college savings plan for the benefit of any Authorized Donees, as defined below. Principal acknowledges that this may be Five (5) times the annual gift amount to the extent permitted by current tax laws.
d. Principal authorizes Agent to make the maximum gifts in the form of contributions to a Qualified ABLE account under Section IRC Sec. 529(A) of the on behalf of any Authorized Donee for whom such contribution would be appropriate. All contributions shall be made in cash. Contributions made for the benefit of any Authorized Donee shall not exceed the annual contribution limits from all sources pursuant to IRC Sec. 529(A)(b)(2)(B) and the aggregate excess limitation (from all sources) as imposed by IRC Sec. 529(A)(b)(6).
e. Principal authorizes Agent to make gifts if such gifts may reduce the state level estate or inheritance tax which the Principal or Principal's spouse, may face.
f. Principal authorizes Agent to make gifts of up to Principal's remaining federal gift tax exemption amount so long as such gifts are made to irrevocable trust for which Principal is grantor.
g. Principal understands that any of the above amounts may be changed by legislation following the execution of this Power of Attorney, and such changed or indexed amounts shall apply.
h. Gifts to Principal's spouse may be unlimited so long as no federal gift tax is incurred.
i. Permissible donees ("Authorized Donees") hereunder shall include:
    (1) Principal's spouse, child or stepchild of Principal and their descendants, as well as any person who shall be married to any of the foregoing. In addition, Authorized donees shall include any person to whom Principal has had a longstanding practice of making annual gifts.
    (2) An irrevocable trust for which Principal was the settlor.
j. Agent Self-Dealing.
    (1) The power granted in this paragraph may be exercised by the Agent without regard to any laws concerning self-dealing.
    (2) Principal specifically grants to the Agent the right to make gifts to himself or herself, his or her spouse, and their issue if such persons are within the class of Authorized Donees as defined above.
    (3) Any gifts made by an Agent to himself or herself shall be limited so as not to exceed an "ascertainable standard" as such term is defined under applicable Treasury Regulations, and so as not to create a general power of appointment that could cause inclusion in the Agent's estate of any property over which the Agent has authority hereunder.
k. Methods of Gift Transfers.

(1) The Agent may make gifts by the transfer of property, or cash, or by relief of or forgiveness of any indebtedness, through entering split dollar, loan, sale or other arrangements that accomplish Principal's donative intent.

(2) The Agent is expressly authorized, but not required to, make loans using Principal's credit or any of Principal's assets to acquire cash to fund gifts so that property which is or may become appreciated can be retained in Principal's estate to potentially qualify for a step-up in income tax basis on Principal's death. Principal recognizes that this may affect the ultimate distribution and transfer of wealth.

XLII. **<u>Private Foundation</u>**.

A. **<u>Take-Away</u>**. Restructuring a note into an indirect interest in an LLC which a foundation cannot control enabled the taxpayer to contribute a note that would otherwise be an act of self-dealing to her foundation.

B. **<u>Discussion</u>**. In PLR 201723005 the IRS reviewed the following fact pattern. Parents created a foundation. Family members now control three of the four director positions. Father died and is survived by mother. Mother sold assets to a grantor trust in exchange for note. Mother wished on her death to be able to give any remining note to the foundation to benefit the foundation. However, a direct transfer of the note would be an act of self-dealing. So, she instead proposed transferring the note to an LLC in exchange for 1% voting and 99% non-voting interest and transferring, after her death, the 99% non-voting interests in the LLC holding the note to the foundation. A son of the parents, who is also a director of the foundation, would be the sole manager of the LLC. Although the note was from a disqualified person with respect to foundation, it would not constitute an act of direct or indirect self-dealing under IRC Sec. 4941 because the foundation will not control the LLC holding the note.

XLIII. **<u>Practice Management and Ethics</u>**.

A. **<u>90/10 Rule</u>**.

1. **<u>Take-Away</u>**. All practitioners know of the 90/10 rule. 10% of the bad clients cause 90% of a professional's grief. Lou Harrison's list of tips to ferret out these bad clients more quickly is invaluable.[157]

2. **<u>Discussion</u>**.

a. Lou Harrison listed 9 rules for avoiding those bad clients that make an advisers life miserable. This is sage advice that too many of us have known but not listened to.

b. The prospect has had too many advisors before you and may even refuse to name them. Or, worse, he wants to consult with you about how and why he shouldn't pay his prior advisor.

c. The prospect thinks all previous advisors are "idiots" or makes otherwise derogatory statements about advisors in general.

d. The prospect can't demonstrate he can pay for the cost of your services, balks at paying a retainer and/or asks for a special reduced rate or payment terms.

e. The prospect wants to be not just a priority, but the sole and primary priority.

f. You don't agree with the prospect's legal position.

g. You don't believe the prospect is being truthful.

h. The prospect is vindictive, angry and vengeful.

i. The prospect is a family member.

j. The prospect indicates he knows his stuff, what he wants to do and just wants the advisor to do the front-end work for him.

B. **<u>Avvo</u>**.

1. **<u>Take-Away</u>**. With the explosion of social media lawyers want to stay current and generate new business, but the parameters of what is ethically acceptable, and not, are still evolving. New York State recently issued an ethics pronouncement addressing paying for internet marketing services.[158] The opinion concluded that a lawyer may not pay a marketing fee to participate in Avvo Legal Services, because the fee includes an improper payment for a recommendation in violation of Rule 7.2(a). The Opinion does not appear to prohibit lawyers from listing their background on Avvo, however. There are a host of concerns and issues raised by the analysis in this Opinion. Even if the information provided by Avvo is deemed a recommendation, is an Avvo

[157] "The 90/10 Rule: How To Spot The Bad Apples," Jun 06, 2017, http://www.wealthmanagement.com/high-net-worth/9010-rule-how-spot-bad-apples .

[158] Opinion 1132 (8/8/17) addressing the issue of "Paying nonlawyers for a recommendation or referral."

recommendation based on whatever criteria it uses less useful or accurate than the word of mouth or other forms of recommendations consumers otherwise rely upon to select counsel? Avvo appears to collect data and add attorney information without input by the particular attorney. If an attorney then corrects the public information Avvo used in such a listing by adding factual data, should correcting Avvo's listing be deemed under any condition false or misleading advertising? The issues and concerns that supported the opinion are intended to protect consumers of legal services, but the nuances of what is and what is not acceptable are very difficult to differentiate and could pose challenges to attorneys with the dizzying pace of technological change.

2. **<u>Discussion</u>**.
   a. An attorney wanted to participate in Avvo Legal Services, which is a service of Avvo, Inc. The attorney would offer legal services through Avvo's website and pay the marketing fees that Avvo charges to lawyers who obtain clients via the Avvo website. The question is whether it is permissible under the New York Rules of Professional Conduct (the "Rules") to pay Avvo's marketing fees. Avvo allows potential clients to choose participating lawyers in various practice areas for a fixed or flat fee. The Avvo website (www.avvo.com) says: "Experienced lawyers on demand. Hire yours" and "Work with highly rated, local lawyers near you," and it contains a guide called "How to find and hire a great lawyer."
   b. Avvo assigns every lawyer in a jurisdiction an "Avvo rating." The rating is calculated based on information Avvo collects from lawyer websites and other public sources (such as the type of work the lawyer does and the number of years the lawyer has been engaged in that work), as well as on information the lawyer has chosen to add to the lawyer's Avvo profile (such as publications, CLE presentations, speaking engagements and positions with bar associations and their committees). Avvo's website says that each attorney's rating "is calculated using a mathematical model, and all lawyers are evaluated on the same set of standards. Avvo does not seek or accept any payment for an Avvo rating. However, lawyers who supply more information may receive higher ratings than lawyers who supply less information. Avvo says it scores all information objectively, and does not use subjective data such as client reviews. Although Avvo assigns a rating to all lawyers in a jurisdiction, lawyers cannot offer their services through Avvo unless they meet Avvo's minimum criteria and sign up with Avvo to be listed on the site and agree to Avvo's pricing schedule and marketing fees. According to Avvo, the criteria for participation include a minimum Avvo Rating, a minimum client review score, and a clean disciplinary history.
   c. A prospective client seeking legal services through Avvo first chooses an area of law practice and a state or city. The Avvo site says: "Choose an area of law to find top- rated attorneys near you." Next, the prospective client chooses a type of legal service or "package." The Avvo website says: "Packages include advice sessions, document reviews, and start-to-finish support." Advice sessions (called "Avvo Advisor") come in two varieties – the prospective client may either (i) click on a specific lawyer, who is required by Avvo to call back within one business day, or (ii) click on "have a lawyer call me now," in which case Avvo sends a text message to all lawyers in the selected practice area and locale, and the first available lawyer calls the prospective client. When using the first of these varieties of advice session, the client is free to choose from the entire list of lawyers who are licensed in the client's state and who offer the service the client seeks to purchase.
   d. Avvo's website does not say, "We recommend that you choose this lawyer." Rather, Avvo furnishes information about lawyers (including client reviews, peer reviews, and Avvo ratings) and allows clients to choose the lawyer. Avvo describes its service as simply "facilitating a marketplace" where consumers can choose from among all of Avvo's participating lawyers.
   e. Once the prospective client has chosen a lawyer (or opted for "have a lawyer contact me now") and selected a specified legal service, the client clicks on a button that says "Buy now." The lawyer then contacts the client. (Phone calls from a participating lawyer to a client initially go through an automated Avvo "switchboard" so that Avvo can time the calls, but Avvo asserts that it cannot listen to the calls.) Once the lawyer and client have

completed a phone call of at least eight minutes, Avvo charges the client's credit card for the full amount of the fee for the selected legal service.

f. Avvo provides what it refers to as a satisfaction guarantee and will refund the fee to the client (or allow the client to choose a different participating lawyer at no additional charge) if (a) the lawyer does not deliver the services for which the client has paid, or (b) the client is not satisfied with the lawyer's services. Avvo claims to consumers that it stands behind their services. Avvo considers this satisfaction guarantee to be part of its marketing costs, reasoning that the satisfaction guarantee makes participating lawyers more attractive than lawyers who do not offer a satisfaction guarantee.

g. At the beginning of each month, Avvo pays each participating attorney all of the legal fees generated through Avvo by that attorney in the previous month, and separately charges each attorney a "marketing fee" for each legal service the attorney has completed during the prior month (unless Avvo has refunded the client's payment). As an example, Avvo's website tells lawyers that "if a client purchases a $149 document review service with you, you will be paid the full $149 client payment into your deposits account. As a separate transaction, you will be charged a $40 marketing fee from your withdrawals account." The amount of Avvo's marketing fee depends on the service. For more expensive legal services, Avvo generally charges lawyers a higher marketing fee. An FAQ on Avvo's website explains the marketing fee depends on the service. The marketing fee is not directly proportional to the price of the legal service. The marketing fee is not a fixed percentage of the legal fees, but it is generally greater for higher-priced services than for lower-priced services.

h. Avvo explained that the correlation between its marketing fees and the price of Avvo legal services reflects two interrelated concepts. More expensive legal services cost more to market. For example, Avvo says that its ad placements on Google and on online advertising networks cost more for more expensive services, and cost more for more competitive keywords. Also, Avvo's marketing fee covers the credit card processing fee, which is a fixed percentage of the total legal fee, so a higher legal fee necessarily entails a higher credit card processing fee. Avvo says that its customer service costs are higher for more expensive services. For example, Avvo says that its "platform usage" and "customer care" expenses are higher for more expensive services, because clients raise more questions about more expensive services. Avvo employs a team of live customer care representatives who handle client inquiries via phone, email, and electronic chat.

i. The opinion cautions that Avvo raises questions under the Rules in addition to the marketing fee issue. Avvo markets the services of participating lawyers. Attorneys, under Rule 7.1(a) are prohibited from participating in an advertisement that contains statements or claims that are false, deceptive or misleading. The Rules also require that certain ads contain prescribed disclosures, such as the label "Attorney Advertising," and information about the lawyer whose services are advertised. Even though Avvo, not the lawyer, creates and disseminates the information, each participating lawyer is deemed to be participating in the advertisement and has a duty to assure that the website is consistent with Rule 7.1. This means that a participating lawyer must determine that the website does not make false, misleading or deceptive statements or claims, or otherwise violate the Rules. While the rationale for this requirement is clear, the task is perhaps impossible given the scope of the internet and the speed at which postings can change. What about the flip side of this issue when a consumer posts baseless criticism's or worse about an attorney on the web? What recourse does counsel have in those situations?

j. Lawyers may not use Avvo ratings (or any other ratings) in their advertising unless those ratings are bona fide professional ratings. The Avvo website constitutes advertising of lawyers who participate in Avvo Legal Services. The opinion does not state that lawyers who have listings on Avvo, or add to those listings, but who do not participate in Avvo Legal Services, constitute advertising.

k. For a rating to be bona fide it must evaluate lawyers based on objective criteria, or legitimate peer review, in a manner unbiased by the rating service's economic interests, and are not subject to improper influence by lawyers who are being evaluated. Since the lawyer being evaluated on Avvo can or must input most of the relevant information into the Avvo system does that constitute improper influence by the lawyer? But if the information inputted is merely factual data could that constitute improper influence?

l. If the rating is not bona fide, it would be false and misleading in violation of Rule 7.1(a)(1). The Opinion concluded that insufficient facts were available to determine whether Avvo's rating system meets the criteria for a bona fide professional rating.

m. The opinion noted a myriad of other issues that participating in Avvo may raise. The fact that Avvo sets the amount of the legal fee for each service raises questions about whether a participating lawyer can deliver competent legal services for Avvo's chosen price and whether a lawyer is allowing Avvo to interfere in the lawyer's independent professional judgment regarding how much time to spend on a matter. The marketing fee also raises questions about whether lawyers who participate in Avvo Legal Services are improperly sharing legal fees with a nonlawyer. Avvo's satisfaction guarantee raises questions about confidentiality. How does Avvo avoid receiving confidential information when evaluating whether to refund the legal fee a client has paid through Avvo?

n. A lawyer shall not compensate or give anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client Whether paying Avvo's marketing fee complies with Rule 7.2(a) depends primarily on what a lawyer is purchasing when the lawyer pays Avvo's marketing fee. If the lawyer is paying the marketing fee solely to obtain advertising and marketing services from Avvo, then the lawyer is not giving Avvo something "of value" to recommend the lawyer, but is instead paying Avvo for marketing services, which does not violate Rule 7.2(a). If, however, the marketing fee also includes a payment to Avvo for recommending the lawyer, then the payment constitutes giving something "of value" for a recommendation, which does violate Rule 7.2(a).

o. The opinion discussed payments to nonlawyers for advertising in a "deal-of-the-day" service similar to Groupon or Living Social. There, the deal-of-the-day service negotiated with lawyers to obtain a discounted legal fee. Potential clients who wanted the lawyer's discounted services used a credit card on the deal-of-the-day website to purchase a voucher for the lawyer's services. The website then deducted "a percentage of the gross receipts as its compensation" and paid the balance to the lawyer. It was determined that this was payment for a novel form of advertising which was permissible, and not compensation for the referral of a client. Pertinent to this conclusion was that the website had no contact with the coupon buyers other than collecting the cost of the coupon and that the website did not take any action to refer a potential client to a particular lawyer. These findings were contrasted to the Avvo approach with the opinion found to be different.

p. Pertinent to finding Avvo's marketing service inappropriate is that lawyers may ethically pay nonlawyers for advertising and marketing services, but they may not pay for a recommendation.

q. Avvo was found to be creating an impression that it is making a recommendation because Avvo gives each lawyer an Avvo rating, on a scale from 1 to 10. The Avvo website states that the Avvo Rating enables a potential client to find "the right" lawyer, and Avvo's website claims that its ratings enable potential clients to choose the right lawyer for their needs. Even if Avvo ratings are "bona fide," within the meaning of Rule 7.1(b)(1), which was not addressed in the opinion, the Opinion held that the inclusion of Avvo Rating on behalf of participating lawyers implied an impermissible recommendation. This conclusion was reached even though Avvo's website never describes a rating as a recommendation, and it contains several warnings about the limitations of its ratings. The Opinion noted that despite cautions about the ratings on the Avvo website, the website also extols the benefits of being able to work with highly-rated lawyers and thus gives potential clients the impression that a lawyer with a rating of "10" is "superb," and is thus a better lawyer for the client's matter than a lawyer with a lower rating. Because Avvo Legal Services is the very party that will benefit financially if potential clients hire the lawyers rated by Avvo it is not permissible. This does not seem to affect or apply to lawyers who have listings on the Avvo website without participating in the Avvo service.

r. Query whether the Avvo rating system is less objective then the Martindale-Hubbell Peer Review Ratings?

C. **Client Business Dealings.**

1. **Take Away**. Borrowing money from a client likely doesn't sound like an advisable transaction to most attorneys, but if a loan is made, or any business dealing with a client is pursued, caution is in order, as a recent Iowa case reminds practitioners.[159]
2. **Discussion**.
    a. The attorney in the instant case had a checkered prior ethics history. Some of the points the court noted included that he engaged in a series of trust fund violations, e.g. premature withdrawal of attorney fees from the trust account. The attorney had previously been suspended from practicing because of unethical conduct. The estate was the beneficiary of a life insurance policy on decedent and the insurance company paid the proceeds to the attorney who deposited the funds in his attorney trust account. The attorney borrowed $20,000 from the administrator of an estate he represented in violation of the rules of professional conduct. The loan was taken from the attorney trust account prior to a written note being signed. The administrator eventually sued the attorney who settled.
    b. The Board charged Powell with violating Iowa Rules of Professional Conduct 32:1.8(a) (improperly entering into a business transaction with a client), 32:1.8(b) (using information relating to representation of a client to the disadvantage of the client), and 32:1.9(c) (using information relating to the representation of a former client to the disadvantage of the former client). The commission found Powell violated Iowa Rules of Professional Conduct 32:1.8(a), 1.8(b), and 1.9(c).

D. **Corroborate Documents Explained to Client.**

1. **Take-Away**. Use technology to meet ethical obligations. For example, document generation software can create document summaries and other explanatory tools to provide to clients at modest additional cost. Email (or perhaps as discussed elsewhere in this outline a secure email option or portal) can enable a practitioner to provide clients with draft documents in advance of meetings. Saving a copy of those emails in the client's file corroborates that the client had the documents in advance of the meeting or signing. Practitioners should consider taking advantage of these tools to more easily and inexpensively meet ethical requirements and corroborate that they have.
2. **Discussion**.
    a. An attorney has a duty to explain the terms of agreements, contracts and other legal documents to clients. The duty to explain is derived partially from the Rules of Professional Conduct ("RPC") and partially from the case law dealing with legal malpractice actions. Therefore, a failure to explain may lead to ethics grievances and/or malpractice claims.
    b. Client-Lawyer Relationship – ABA Model Rule 1.4 Communication "A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation." ABA Model Rule 1.4(b).
    c. "An attorney in a counselling situation must advise a client of the risks of the transaction in terms sufficiently clear to enable the client to assess the client's risks." [160]

E. **Document Retention; Client Files**.

1. Does the firm have a document retention policy? Does that policy reflect the realities and differences of estate planning from other practice specialties? Is the firm using a general document retention policy for all files and matters? Many of the ethical rules concerning document retention and client files were developed in an era when storing files was a cost and burden to the attorney. Do those same concepts apply today with electronic storage? While the cost of electronic storage may be viewed as nominal does the opposite approach of saving every item forever really help the client or practitioner? What is the cost of reviewing volumes of data if a question arises? Is there a

[159] Iowa Supreme Court Attorney Disciplinary Board v. Rodney Powell, 2017 WL 4077959, No. 17-0254, Supreme Court of Iowa, Sept 15, 2017; Iowa Supreme Ct. Att'y Disciplinary Bd. v. Powell (Powell II), 830 N.W.2d 355, 356–57 (Iowa 2013); Iowa Supreme Ct. Att'y Disciplinary Bd. v. Powell (Powell I), 726 N.W.2d 397, 408 (Iowa 2007); Powell II, 830 N.W.2d at 356.

[160] Conklin v. Hannoch Weisman, 145 N.J. 395, 413 (1996).

better middle ground? What should be incorporated into the firm's retainer agreement to address these policies?[161]

2. As part of the firm's file retention and destruction policy, it should create a retention and destruction schedule for the electronic documents with the same timing for the destruction of electronic records as for the paper records.
3. If an attorney or staff member creates or edits an electronic business record using a home computer, laptop, or other device, that person must save the record on the firm's electronic document management system as soon as possible. No firm attorney or staff member is permitted to store electronic business records anywhere other than the firm's electronic document management system.
4. Should the partner on an account be provided the ability to override a standard destruction date? If not overridden how many years should documents be retained? Some firms set a destruction date equal to ten years from the date the matter is designated closed. Other firms use shorter periods, some seem to have retained every file since the firm's inception. Should estate planning and estate administration files be permanently retained?
5. Should, prior to physically destroying any client file, a letter be sent by the firm to the last known address of the client, offering the transfer of the files to the client in lieu of destruction.[162]
6. In an electronic paperless practice, what is a client file? If clients are given all original signed documents to hold, have received any letters or memorandum, can it still be reasonably said that counsel has a "client file" to ever turnover? The client may well have the entirety of the file.

F. **Email Communications and Electronic Data**.

1. **Take-Away**. Technological advances are changing practice. Attorneys need to assess the security and other protective measures they take with respect to communications and electronic data. While the recent Ethics Opinion points out several issues, the details of what steps should be taken, how retainer agreements should be revised, what specific software should be used and precautions taken, need to be addressed. The continued evolution of the technological environment in which estate planning attorneys practice remains a challenge. Inaction, however, is not an option.
2. **Discussion**.
   a. A recent ethics opinion reflects the now common use of tech such as tablet devices, smartphones, and cloud storage.[163]
   b. Each device and each storage location offer an opportunity for the inadvertent or unauthorized disclosure of information relating to the representation, and thus implicate a lawyer's ethical duties under Rule 1.1 of the ABA Model Rules concerning competency, confidentiality, and communication
   c. Comment 8 to the rule requires lawyers to be current regarding the benefits and risks of associated with relevant technology. What steps should estate planning attorneys take to become current and to demonstrate that they are current? Are there competencies the attorney herself must have or may an attorney rely on in-house or independent IT consultants?
   d. Lawyers must take reasonable efforts to ensure that communications with clients are secure and not subject to inadvertent or unauthorized security breaches. The Opinion states: "What constitutes reasonable efforts is not susceptible to a hard and fast rule, but rather is contingent upon a set of factors. In turn, those factors depend on the multitude of possible types of information being communicated (ranging along a spectrum from highly sensitive information to insignificant), the methods of electronic communications employed, and the types of available security measures for each method." Attorneys must use "reasonable efforts" to ensure the security of client information. This is a facts and circumstances test. Consider:
      (1) Sensitivity of the information being transmitted.
      (2) Risk of disclosure if additional security measures are not taken.
      (3) Cost of additional measures.

[161] Sandra D. Glazier & Martin M. Shenkman, "Drafting and Updating Your Retainer Agreements," Trusts & Estates, July 2017, at 2.
[162] Opinion 692 of the Advisory Committee on Professional Ethics dated January 8, 2001 and the Supplement Opinion thereto dated October 28, 2002.
[163] Ethics Opinion 477, May 11, 2017, updates Ethics Opinion 99-413.

(4) The difficulty of adding additional safeguards.
(5) Might additional safeguards adversely impact the lawyer's ability to represent the client.

e. The reality remains that most lawyers commonly use unencrypted email when communicating routinely with clients. The vagueness of the above standards is important given the wide variations in practice, and perhaps the relative difficulties smaller firms may have in adapting to new technologies and practices as contrasted with larger firms?

f. The Opinion recommends that a lawyer should understand how their firm's electronic communications are created, where client data resides, and what avenues exist to access that information. One difficulty with applying the above is that it is not only vague, but perhaps only with hindsight may counsel know the consequences of a breach.

g. The Opinion does provide some specific examples which lawyers should take heed: "A lawyer has a variety of options to safeguard communications including, for example, using secure internet access methods to communicate, access and store client information (such as through secure Wi-Fi, the use of a Virtual Private Network, or another secure internet portal), using unique complex passwords, changed periodically, implementing firewalls and anti-Malware/Anti- Spyware/Antivirus software on all devices upon which client confidential information is transmitted or stored, and applying all necessary security patches and updates to operational and communications software. Each of these measures is routinely accessible and reasonably affordable or free. Lawyers may consider refusing access to firm systems to devices failing to comply with these basic methods. It also may be reasonable to use commonly available methods to remotely disable lost or stolen devices, and to destroy the data contained on those devices, especially if encryption is not also being used. Other available tools include encryption of data that is physically stored on a device and multi-factor authentication to access firm systems."

h. The Opinion cautions that if client information is of sufficient sensitivity, a lawyer should encrypt the transmission and determine how to do so to sufficiently protect it, and consider the use of password protection for any attachments. Alternatively, lawyers can consider the use of a well vetted and secure third-party cloud based file storage system to exchange documents normally attached to emails. Perhaps using programs such as ShareFile to transmit secure emails, or password protected PDFs, should be more common.

i. The opinion does appear to differentiate routine communications not requiring the above precautions: "Thus, routine communications sent electronically are those communications that do not contain information warranting additional security measures beyond basic methods. However, in some circumstances, a client's lack of technological sophistication or the limitations of technology available to the client may require alternative non-electronic forms of communication altogether."

3. **<u>Sample Provision</u>**: Consider including provisions in retainer agreements to address these matters: "Email and cellular telephone communications present special risks of inadvertent disclosure. However, because of the countervailing speed, efficiency, and convenience of these methods of communication, we have adopted them as part of the normal course of our operations. You consent to our use of Email and cellular telephone communications in representing you. Please do not assume we have received any text message unless you verbally confirm that we have."[164]

G. **<u>E-Signatures: Should They Be Incorporated into Your Practice</u>**.

1. **<u>Take-Away</u>**. Electronic wills may not be sanctioned (yet) as discussed later in this outline under "Wills." However, the electronic march forward continues and practitioners may wish to consider, if they have not already, electronic signatures of documents to make their practices more efficient, provide better client service, etc.
2. **<u>Discussion</u>**.

[164] Sandra D. Glazier & Martin M. Shenkman, "Drafting and Updating Your Retainer Agreements," Trusts & Estates, July 2017, at 11.

a. E-signatures would permit clients and others to digitally sign documents instead of the traditional hand-written signature. E-signature permits the signer to use a computer mouse to indicate agreement to and signature on a document.[165]

b. Intellectual property counsel routinely use e-signature on filings. "In 2015, online sales of physical goods amounted to 294.45 billion US dollars and are projected to surpass 485 billion US dollars in 2021."[166] Purchasing goods on line subject the buyer to a legally binding contractual arrangement with the seller. Clicking a ubiquitous "I Agree" button on a website subjects the party to a legally binding click wrap contract.

c. Signatures can mean many things. A rubber stamp has been recognized as a signature, such as on a check. A mark made by a testator who is injured, ill or illiterate and therefore cannot sign a signature, has been accepted. For example, "The term signature includes any memorandum, mark or sign, written, printed, stamped, photographed, engraved or otherwise placed upon any instrument or writing with intent to execute or authenticate such instrument or writing."[167] A testator can even direct someone else to sign the testator's name to the will on his or her behalf. "(1) It shall be signed at the end thereof by the testator or, in the name of the testator, by another person in his presence and by his direction, subject to the following…(C) Any person who signs the testator's name to the will, as provided in subparagraph (1), shall sign his own name and affix his residence address to the will but shall not be counted as one of the necessary attesting witnesses to the will."[168] A fingerprint was recognized in lieu of a signature on a will when the testator could not because of health issues sign.[169]

d. Vendors have products that comply with the 2000 U.S. Electronic Signatures in Global and National Commerce Act (ESIGN), and the Uniform Electronic Transactions Act (UETA), among others. For example, Citrix, the provider of ShareFile for secure email and client portals, has a product "RightSignature" a form of online e-signature.

e. An electronic signature system should be capable of identifying the signer. It should uniquely link the document to the signature. A multi-variate authentication process can be used which includes email address verification, IP address tracking, biometric signature algorithm, and other information. Visual identification may also be incorporated as a form of verification. This allows the parties to use webcams to incorporate their photographs into the final digital document.

f. While the estate planning world has not yet accepted e-signatures on documents like wills, what about Crummey powers? Why would a beneficiary's electronic signature not suffice as proof that the trustee gave that beneficiary notice of a gift? Many client's families are geographically dispersed and if counsel could provide this as a service it would likely be much appreciated. There is no requirement that the beneficiary affirmatively acknowledge receipt of the notice. A return email acknowledging the beneficiary's receipt of notice of the gift may actually be more than the law requires.

g. The IRS position is that the donor must give the beneficiary a reasonable length of time to learn of, and to exercise, the right to demand distribution before it lapses.[170] The PLR included the following language which has been excerpted and which makes clear that the focus is the beneficiary having notice or knowledge of the contribution of property to the trust and the right of withdrawal. There is no specification of a permissible or

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[165] https://www.g2crowd.com/products/rightsignature/reviews; https://rightsignature.com/legality/electronic-signature-laws; http://www.keytlaw.com/rightsignature/ ; https://rightsignature.com/legality.

[166] "Retail e-commerce sales in the United States from 2015 to 2021 (in billion U.S. dollars)," August 6, 2017, https://www.statista.com/statistics/272391/us-retail-e-commerce-sales-forecast/.

[167] New York Consolidated Laws, General Construction Law - GCN § 46. Signature.

[168] New York Code. Estates, Powers & Trusts, Article 3, Sec. 3-2.1 - 3-2.2 - Execution and attestation of wills; formal requirements.

[169] Matter of Albert, N.Y.L.J., discussed in Jennifer F. Hillman, Esq., "Making Your Mark: Using a Fingerprint When a Testator Cannot Sign the Will," April 23, 2013, https://www.lexisnexis.com/legalnewsroom/estate-elder/b/estate-elder-blog/archive/2014/02/06/making-your-mark-using-a-fingerprint-when-a-testator-cannot-sign-the-will.aspx .

[170] Rev. Rul. 81-7, 1981-1 CB 474; PLR 200123034.

impermissible means of giving that notice and hence no reason to suspect that a Crummey notification delivered via email would not suffice:

(1) …the trustee must reasonably notify the person who would exercise the demand power of its existence and of any contributions that are made to the trust that are subject to the power. If any child of Grantor is serving as trustee of this trust, then he or she shall be deemed automatically to have received the notice required to be given by the trustee under this Item.

(2) … a child of Grantor shall exercise his or her demand power by a written request delivered to the trustee within thirty days of being notified of any contribution that is made to the trust with respect to the child.

(3) … The courts have recognized that if the beneficiaries are given the power to demand immediate possession and enjoyment of corpus or income, they have a present interest. Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968). See also Rev. Rul. 73-405, 1973-2 C.B. 321.

(4) … In the present case, the trustee of Trust is required to provide Grantor's children reasonable notice of contributions to Trust. In addition, Grantor's children are granted adequate time following notice in which to exercise their right of withdrawal… Accordingly, if the trustee gives prompt notice of the contribution to Trust to Grantor's children, or their custodian, and assuming there is no understanding or agreement, express or implied, that the withdrawal right will not be exercised, a contribution to Trust will qualify as a present interest and will qualify for the gift tax annual exclusion under § 2503(b).

h. In order for a gift to be a transfer of a present interest the donor must confer a real and immediate benefit upon the donee. Without knowledge that a gift is being transferred it is not possible for the donee to have the real and immediate benefit of the gift according to the IRS.[171] There is nothing suggesting that an email notification should not suffice.

i. The Turner case of course said the beneficiaries do not even have to know of the right.

j. One commentator has advised that he sold a home in Minnesota that he held title to as trustee of an Alaska trust and signed all contract documents electronically. Perhaps the march towards electronic signatures as an integral part of estate and trusts practices is well underway.

H. **Estate Planning Definition.**

1. **Take-Away**.

a. Discussing the definition of estate planning, especially for sophisticated practitioners that have spent most of their lifetime in the field might seem trite and irrelevant, but perhaps it is not. Clients almost universally misunderstand and improperly define what "estate planning" is. It is common for clients to view estate planning as nothing more than signing a will, and perhaps addressing estate taxes.

b. Now that estate taxes have become irrelevant for all but the ultra-high net worth client, that component of the definition has become meaningless. If the estate tax is in fact repealed, estate tax planning as it presently exists may change dramatically or become irrelevant even for the ultra-high net worth client. So, what relevance do estate planners have for most Americans? It has tremendous relevance but that relevance will often hinge on using a much broader definition of what constitutes estate planning, and most important, educating clients as to what estate planning is really about. The broad definition of estate planning, if embraced by wealth managers and trust officers, might motivate them to include the estate planning attorney as a regular member of the planning team, and not merely a scrivener to draft new documents when they determine necessary.

c. Few people return to their estate planning attorney for a yearly review because they view an estate plan as a will or trust and "I have that." Most people don't involve their CPA in their estate plan because "They do my tax return." Care managers are only barely starting to be included on the estate and financial planning team. So, what is estate planning? Here's a mediocre definition that came up near the top of a Google search: "The act of preparing for the transfer of a person's wealth and assets after his or her death." That is far too limiting. Investment planning, retirement planning, asset protection planning and

[171] E. Fondren, 45-1 ustc ¶10,164, 324 US 18.

the range of other things we all need to do to make sure our lives are full, safe and financially secure, are excluded from that terse death-focused definition. What about religious concerns, health challenges and so much more? Estate planning should be more about planning for life then death. It should encompass the transmission of values not just money. It should provide peace of mind from a myriad of tax, legal, financial, insurance and other risks. It is tough to come up with a universal definition, but what is assured is that if your definition is too narrow, you may not be helping your clients sufficiently.

2. **Discussion**. Following are definitions and discussions of estate planning from various practitioner and commentators.
    a. Robert Laura: "…as we seek to do what's in our clients' best interests, we need to begin to examine more than asset allocation, income needs, and behavioral finance… and references to comprehensive or holistic planning need to include aspects of longevity and healthy aging as we embrace the notion that happiness and well-being in retirement are dictated by things such as relationships, mobility and brain functionality, not just dollars…"[172]
    b. Charlie Douglas: According to a recent WealthCounsel survey, three-fourths of Americans are confused regarding their thoughts about estate planning. This lack of clarity around estate planning helps explain the lack of public engagement, where 64 percent of Americans don't even have a will. "Estate planning" is a multidisciplinary process where planning professionals are collaboratively engaged in protecting, preserving and enhancing the family through the accumulation, conservation and distribution of one's assets and values. As we wait for professional and academic organizations to collectively bring about a much-needed makeover to "estate planning," practitioners may do well to retool their skillsets to have a broader focus beyond financial capital. Estate planning practices should also consider modernizing so that, for example, more attention could be paid to "cloud-based collaboration." Technology now provides those engaged in estate planning with communal programs such as ShareFile (for storing and sharing important client planning documents) and GoToMeeting (for virtual client/advisor meetings), and they'll increasingly be used by progressive planners who seek to serve the client in a more collaborative and more cost-efficient manner.[173]
    c. NAEPC: The National Association of Estate Planners and Councils has various working committees that have tackled the definition of what constitutes estate planning. Draft definitions circulated for discussion in the Summer of 2017 included some of the following:
        (1) "Estate planning encompasses the purposeful accumulation, conservation, preservation, and transfer of an estate by establishing clear goals and objectives through planning and implementation of an estate plan. The overall purpose of the estate planning process is to develop a plan that will promote and achieve the estate planning goals, values, and objectives of individuals and their families and to carry out their charitable goals, if any. Estate planning has come to include and mean lifetime planning that leads to creation, conservation, and transfer of assets. Estate planning should also facilitate the intended and orderly transfer of property at death, taking into consideration the family unit and the potential costs of different methods."
        (2) The NAEPC Definition of estate planning as shown within the AEP application goes on to list a set of activities. Estate planning activities could include the following functions appropriate to the applicant's respective disciplines:
            (a) Administering or planning estates and trusts.
            (b) Analyzing existing life insurance coverage for continuing relevance.
            (c) Analyzing proposed transactions for estate and gift tax implications.
            (d) Attending Estate Planning Council Meetings and Other Estate Planning Educational Events.

[172] Robert Laura, "The New Science Of Retirement Planning," Jun 15, 2017 at http://www.fa-mag.com/news/the-new-science-of-retirement-planning-33275.html.

[173] Charlie Douglas, "Estate Planning Needs an Extreme Makeover," http://www.wealthmanagement.com/estate-planning/estate-planning-needs-extreme-makeover, May 15, 2017.

(e) Charitable/gifting planning.
(f) Designing estate plans.
(g) Designing Qualified and Non-Qualified Retirement Plans.
(h) Developing strategies to minimize potential estate and gift taxes, including generation skipping taxes.
(i) Developing programs to conserve assets during lifetime and at death.
(j) Drafting estate planning documents.
(k) Leading clients through a discovery process to determine the ultimate purpose they want their wealth to accomplish for them, their families and the institutions and causes they care about most.
(l) Life settlements of life insurance policies.
(m) Preparing estate and gift tax returns, including generation skipping tax returns.
(n) Preparing fiduciary accountings.
(o) Preparing fiduciary income tax returns.
(p) Proposing life insurance solutions consistent with estate plans.
(q) Retirement distribution planning.
(r) Succession planning.

d. Steve Leimberg's definition: "The process of accumulating, conserving, and distributing an estate in the manner that most efficiently and effectively accomplishes the client's objectives and that person's beneficiaries' needs and circumstances."

e. Bob Esperti and Reno Peterson (provided by Dave Holaday): "Estate planning is the process of controlling and protecting your assets during your life and passing your assets to whom you want, when you want and the way you want while minimizing taxes and expenses."

f. Phil Cubeta: "Estate planning may be broadly defined as the process of accumulation, management, conservation, and transfer of wealth considering tax, legal and personal objectives. The goal of estate planning is efficient transfer of assets."

g. York and Howell: Estate planning that's designed and intended to meet the demands of the 21st century should look and feel different from traditional planning. First and foremost, it should be beneficiary-focused and more concerned with preparing future generations to maximize their own potential than about transferring financial wealth for the sake of the wealth. Second, it should be customized and based on the specific goals, values and beliefs of the client. A multigenerational wealth plan can't be built on outdated assumptions. The planning needs to recognize that families are unique, and their planning should also be unique. Only after you know the goals will you have the ability to know when and how to use the tools. Third, it should be purpose driven. Trusts, limited liability companies, charitable strategies and other wealth-transfer devices should be seen as nothing more than tools to accomplish the family's goals. The key to being purpose driven is to focus on what provides for family continuity and not just on what provides for financial continuity. Finally, because a family changes over time, the plan should include regular conversations as well as maintenance and updating to stay relevant and effective.[174]

I. **<u>Internet Lead Generation Payments</u>**.

1. **<u>Take-Away</u>**.

a. A New York ethics opinion was issued addressing the payment of internet marketing fees.[175] Lead generation is when a payment is made to a vendor for leads for potential clients. A lawyer may pay a for-profit vendor for client leads obtained via a website on which potential clients provide contact information and agree to be contacted by a participating lawyer. However, a number of requirements must be met:

(1) The lawyer who contacts the potential client has been selected by transparent and mechanical approach that does not suggest that it is based on an analysis of

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[174] "Pushing Wealth Transfer Plans Into The 21st Century," David R. York, Andrew L. Howell | May 12, 2017 http://www.wealthmanagement.com/high-net-worth/pushing-wealth-transfer-plans-21st-century.
[175] Opinion 1131 (8/8/17) overrules N.Y. State 902 (2012).

the potential client's legal problem, or the qualifications of the attorney to be named.

(2) The service does not explicitly or implicitly recommend any particular lawyer.

(3) The website complies with the requirements of Rule 7.1.

b. A lawyer who purchased the lead may ethically call or email the prospective client if the potential client has invited the lawyer to do so.

2. **Discussion**.

a. Consumers wanting to be contacted by a lawyer submit their contact data (including the method by which the lawyer may contact them), their geographic location, and the practice area in which they seek legal advice. The vendor then searches its database of participating lawyers to identify all lawyers who state that they engage in the requested practice area in the requested geographic area. The vendor selects a lawyer meeting the geographic and practice area criteria based on criteria unrelated to the lawyer's qualifications, e.g., in the order in which the attorney registered with the vendor. The mechanism to choose the attorney is clearly described to potential clients. The vendor forwards the potential client's information to that lawyer so that the lawyer may contact the prospect in the manner requested.

b. The participating lawyer pays a fixed monthly fee to the vendor or a fee for each such potential client, and the fee does not vary depending on whether the lead results in retention of the lawyer or the amount of the fee the lawyer charges the client if retained (contrast this with the facts and issues raised in the Avvo opinion discussed elsewhere in this outline). If the potential client decides not to retain that lawyer, or if the assigned lawyer has a conflict of interest and cannot represent the potential client, the potential client may request that the website/vendor provide the prospects information to another participating lawyer.

c. Because of the wide variation in the structure of the many web-based services operating in this area, this opinion does not attempt to address every factual permutation that may exist. This caveat is significant in that the variations in so many web based marketing and related services are endless and constantly changing.

d. One of the issues to be cautions of is the distinction between an online directory and an online recommendation. Lawyers can use online directories that permit consumers to filter lawyers by objective criteria. But if the functionality of the website becomes a recommendation and not just a directory it would be impermissible.[176] Another prior opinion held that a lawyer could not pay a marketing company a fixed fee each time the marketer made an introduction to a potential client.[177]

e. Rule 7.1 governs lawyer advertisements. Rule 1.0(a) defines "advertisement" for purposes of the various advertising restrictions in the Rules. If the vendor's website is a communication "on behalf of" a lawyer, or "about" the lawyer's services, and for the "primary purpose" of retention of the lawyer it is an "advertisement" within the meaning of Rule 1.0(a).

f. Rule 7.1(a) prohibits a lawyer from participating in an advertisement that: "(1) contains statements or claims that are false, deceptive or misleading; or (2) violates a Rule." Rule 7.1 also requires that certain advertisements contain prescribed disclosures, such as the label "Attorney Advertising," and information about the lawyer whose services are advertised. Even though the Service, not the lawyer, creates and disseminates the Service's website, each participating lawyer is deemed to be participating in the use and dissemination of the advertisement within the meaning of Rule 7.1(a) and therefore has a duty to assure that the website is consistent with Rule 7.1. This means that a participating lawyer must determine that the website does not make false, misleading, or deceptive statements or claims, or otherwise violate the Rules. Again, as commented upon elsewhere in this outline, this can be a daunting if not impossible task for an attorney. Websites that provide information about lawyers change, third parties can add information, the attorney may not even have knowledge of some of the websites and what

[176] N.Y. State ethics opinion 799 (2006).
[177] N.Y. State ethics opinion 902 (2012).

they in fact include. Websites may collect public data on lawyers and create their own data base without informing the attorneys involved.

g. Rule 7.1(h) requires that advertisements must include the name, principal law office and telephone number of the law firm whose services are being offered. A previous opinion concluded that lawyers may not engage in advertising on the internet, including "group advertising," without complying with this Rule. While this may have initially been directed at the radio and television advertisements that advertise general phone numbers or contacts for specific types of cases, many of the internet legal websites are different. The potential client must be informed of the identity of the lawyer to whom his call will be referred, and there is no discretion in referrals on the part of the vendor.

h. The opinion suggested that the vendor could comply with Rule 7.1(h) by providing a link to a list of all participating attorneys with the required contact information, or a list of all participating attorneys who fall within the geographic and practice area parameters that may be set by the potential client, along with the required contact information. In this way, the potential client will know the names and addresses of the lawyers from which the website may designate a lawyer who will contact the potential client. How relevant in an age of electronic communication is a physical address? With paperless offices, web-meetings, phone forwarding and email begin ubiquitous, a physical office address may provide little relevant information to a prospective client.

i. Rule 7.2(a) states that a lawyer cannot compensate or give anything of value to a person or organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client. Rule 7.2(a) is a problem if the lawyer pays the vendor to "recommend" the lawyer, or if the lawyer pays the Service to obtain employment by a client. However, if the vendor complies with the advertising rules and the lawyer's payment is reasonable for that form of advertising, a lawyer's using the vendor will not violate Rule 7.2 unless the Service is deemed to "recommend" the lawyer. Recommendation would include identifying a particular lawyer to a potential client as "a right" lawyer for the client's situation after an analysis of either the potential client's legal problem, or the lawyer's qualifications to address that problem. The concern is that identifying "a right" lawyer implies some qualitative, comparative assessment of the lawyers available to perform the services the potential client requires and that cannot permissibly be done.

j. The vendor’s activities would not constitute a "recommendation" if the vendor/website does not state that it is making a recommendation, and if it also makes clear that: (i) being included on its list of participating lawyers requires only a payment and the Service does not vet the qualifications of such lawyers, other than, for example, confirming the lawyer's good standing with the licensing authority, if that is the case, (ii) the Service's selection of a participating lawyer from that list is the result of a neutral process that involves no evaluative judgment, and (iii) when a lawyer is chosen by the Service, it does not mean the selected lawyer is the "right" lawyer for the client's needs, or that the lawyer is otherwise preferred over other lawyers.

J. **Next Gen**.

1. **Take-Away**. Are practitioners missing a tremendous opportunity to assist clients and secure their heirs as future clients? Should practitioners be educating their clients as to the importance of giving some information to their descendants about their estate plans?
2. **Discussion**.

a. Two-thirds of ultra-wealthy families with more than $20 million of net worth were “apprehensive” about sharing details with their children of what they stood to inherit, and only 10 percent of them had given complete information about their inheritance to their heirs, mostly out of a fear of dampening their work ethic, but also a concern that their heirs simply wouldn’t be able to grasp the implications of what was coming to them.[178] For families that have wealth likely to last for generations, this often expands into an entire family governance structure that helps to formalize the way money is disbursed,

[178] Information based on a poll by Wilmington Trust discussed in: “How the Wealthy Talk to Their Children,” https://www.nytimes.com/2017/05/19/your-money/talking-to-children-about-inheritance.html?smid=tw-nytimesbusiness&smtyp=cur&_r=2 .

and the rules of money within the family. For families with far less wealth, not talking about money while still funding their children's lifestyles can have a more detrimental effect. The parents could run out of money they will need in retirement.

b. It is interesting that while wealthy families appear to be avoiding discussing estate plans with their heirs, trust law and the trust industry have moved in the opposite direction favoring disclosure. Will the different objectives collide?

c. While some states permit quiet trusts, many do not and many, perhaps most, trusts do not contain restrictions to make a trust a quiet trust. A "quiet" trust is one for which disclosures of information concerning the trust do not have to be made. While a client might not want their descendants seeing a statement that reflects the wealth of dollars they have in a trust, especially while the client hopes that the heirs learn how to become financially prudent. Some states have enacted laws permitting silent trusts. Often when these are done disclosures are limited until a beneficiary attains a specified age. The Uniform Trust Code Sec. 813 requires keeping qualified beneficiaries reasonably informed and Sec. 105(b)(8) prohibits waiving the duty to inform qualified beneficiaries over 25 years of age. Many clients find the entire idea of notifying beneficiaries of a trust surprising. Institutional trustees will conform with applicable law concerning required trust disclosures. Few individual trustees are aware of the requirements to disclose trust information to beneficiaries and others. These trustees could face significant liability exposure for the failure to disclose. Thus, there may be situations where institutional trustees will disclose information to beneficiaries of a trust when the parent of that beneficiary may not have provided any information about that parent's overall estate plan.

K. **Office**.

1. **Take-Away**: Technology has and continues to transform the provision of legal services, including estate planning, and even the very concept of what constitutes a law practice. Unfortunately, state and other ethics rules and requirements are struggling to adapt, leaving practitioners facing potentially problematic traps, not just for the unwary, but for those trying to stay abreast of technological innovation to better serve their clients. Another perspective. The entire construct of a physical office and its attendant requirements is not only outmoded, despite the professed claims of how it serves to protect clients, but it challenges the ability of attorneys to provide lower costs legal services, including estate planning, and worse it could serve to inhibit, if not prohibit, disabled attorneys from working in a manner that is practical in light of their challenges. The following discussion addresses a few of these considerations.
2. **Discussion**.

a. The United States Supreme Court declined to review a challenge to New York's Judiciary Law Section 470, which requires non-resident New York attorneys to maintain a physical office in New York State "for the transaction of law business." April 17, 2017. The Second Circuit had held that Judiciary Law Section 470, which exempts New York residents from the physical office requirement, was Constitutional.[179]

b. New York Ethics Rule 7.1(h) identifies several reasons for the office address requirement.[180] Disclosure of a physical address should facilitate a prospective client's ability to make an intelligent selection of lawyer. How so? As discussed elsewhere in this outline there are significant issues facing services such Avvo which some might argue are endeavoring to make legal services more accessible electronically. A physical location enables members of the public or clients to meet with the lawyer, contact the lawyer by mail, and serve legal papers. With so much of communication occurring by email, web conference and other forms of electronic communication, is this really still the case? It has also been suggested that the absence of an address could be misleading by suggesting a physical proximity to the recipient that does not in fact exist. When so much of attorney client communication is by electronic means how relevant is this? If a client is incapacitated and finds it difficult to travel to counsel's physical office, or if counsel herself is the one facing limitations, is this perspective correct? Is it morally defensible?

[179] See Schoenefeld v. Schneiderman, et al., 11-4283-cv, April 22, 2016.
[180] NYSBA Ethics Op. 756.

c. An attorney practicing in the District of Columbia resided in Massachusetts. When the attorney renewed her Maryland Bar membership she identified the address of her D.C. law office as her principal office, although she spent most of her time working from her home, or office space, in Massachusetts. The Disciplinary and Admissions Committee of the District Court of Maryland denied her application, based on a requirement concerning a principal law office. The District Court disagreed and granted the attorney's application to renew her membership.[181]

d. New Jersey's rule provides: "An attorney need not maintain a fixed physical location for the practice of law, but must structure his or her practice in such a manner as to assure, as set forth in RPC 1.4, prompt and reliable communication with and accessibility by clients, other counsel, and judicial and administrative tribunals before which the attorney may practice, provided that an attorney must designate one or more fixed physical locations where client files and the attorney's business and financial records may be inspected on short notice by duly authorized regulatory authorities, where mail or hand-deliveries may be made and promptly received, and where process may be served on the attorney for all actions, including disciplinary actions, that may arise out of the practice of law and activities related thereto."[182] How relevant is any physical location to maintaining prompt and reliable communications so much of which is via electronic means unrelated to physical location? The trend for client files is electronic cloud based files, not physical files. Similarly, financial records may be more accurate and more easily inspected if in electronic format which has no correlation to any particular physical location.

XLIV. **<u>Probate</u>**.

A. **<u>2032</u>**.

1. PLR 201719014 (May 12, 2017) addressed relief to make a late election of alternative valuation date ("AVD"). The children of the decedent, as co-personal representatives, hired counsel who prepared and filed Form 706 on a timely basis but failed to advise the co-personal representatives to make the election for alternate valuation under IRC Sec. 2032 on Form 706. Thereafter, the co-personal representatives retained an accounting firm to advise the estate and prepare the decedent's final income tax return. That accounting firm advised them of the election for the AVD under IRC Sec. 2032. With that advice and within one year after the due date of the Form 706 (including extensions), the co-personal representatives filed a supplemental Form 706 making the AVD election under IRC Sec. 2032.
2. Relief will be granted under Reg. Sec. 301.9100-3 when the taxpayer provides the evidence to establish that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government. Reg. Sec. 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election. On this basis, the IRS granted an extension of time to make the AVD election.

B. **<u>Administration</u>**.

1. J.P. Morgan was sued for improper administration of an estate. The bank was found to be incompetent in its administration of the estate, unreasonably delayed administration, failed to meet financial deadlines (e.g. allowed stock options to expire). The surviving spouse's wishes to sell certain stock were ignored. The jury found actual damages and mental anguish of the surviving spouse.[183]

C. **<u>Error</u>**.

1. In PLR 201704005 (Jan. 27, 2017), the IRS permitted an estate to correct errors made by an attorney in the administration of an estate of not dividing a QTIP trust into GST exempt and non-exempt trusts. The IRS permitted the estate to sever the trust into an exempt trust and a non-exempt trust, and to make a "reverse" QTIP election under IRC Sec. 2652(a)(3). The PLR also held that a modification of the decedent's revocable trust pursuant to a court order would not

[181] In re Application of Carlton, 708 F. Supp. 2d 524 (D. Md. 2010).
[182] Rules governing the Courts of the State of New Jersey 1:21-1(a)(1).
[183] Case No. PR-11-3238-1: In Re: Estate of Max D. Hopper, Deceased, Jo N. Hopper v. JP Morgan Chase Bank, N.A., et al (Probate Court of Dallas County, Texas).

constitute a taxable disposition of trust assets for federal income tax purposes and the trusts and beneficiaries will not realize gain.

D. **Graegin Loan**.

1. **Take-Away**.
    a. Graegin loans can be valuable probate planning tools to fund estate tax and even to reduce that tax. The facts in the Koons case pushed the envelope in that there was adequate liquidity available without a Graegin loan, the estate had access to those funds, and the terms of the loan itself appeared excessive.
    b. Note that the IRS is considering action to apply present value concepts to Graegin loans which could undermine current planning opportunities.
2. **Discussion**.
    a. Issue. While the Koons case addressed a number of issues, the discussion following will focus on the denial of an interest deduction on a Graegin loan.[184]
    b. Facts. The facts in Koons are in part summarized very succinctly as follows. Decedent's revocable trust comprised the majority of his estate's assets, and the trust's primary assets was interests in an LLC. The estate's remaining liquid assets were insufficient to pay its tax liability. The trust held 70.42% voting control over the LLC, and because the LLC had over $200,000,000 in liquid assets, the trust could have ordered a pro rata distribution to obtain these funds and pay its tax liability. But the trustees of the trust declined to direct a distribution of the trust's interest in the LLC to pay the estate tax liability, stating that immediate payment would hinder the LLC's plan to invest funds in operating businesses. So, the trustees obtained a loan from the LLC in exchange for a promissory note bearing an annual interest rate of 9.5%. No payment was due for 18 years and principal and interest were scheduled to be repaid in 14 installments between August 2024 and February 2031. Prepayments were not permitted and the projected interest payments would total $71,419,497. The Estate filed its tax return in June 2006, claiming a $71,419,497 deduction for interest on the loan as an administrative expense. The IRS denied the deduction.
    c. Reality check. Does a 32-year period for repayment of a loan constitute a reasonable period? With a Graegin loan the longer the loan term the greater the interest charge, the larger the interest deduction and the less the tax. How far can a taxpayer push the concept before a court would find it unreasonable?
    d. Tax Court. The Tax Court held that the Estate was not permitted to deduct the projected interest expense on the loan from the LLC to the trust. In reaching this holding, the Tax Court concluded that the loan was not necessary to the administration of the estate because, at the time the loan was made, the LLC had over $200,000,000 in liquid assets and the trust had a sufficient voting interest to force a pro rata distribution in the amount of the debt. The court also rejected the Estate's argument that the loan was preferable because a distribution would have depleted the LLC of cash that could have been used to purchase additional businesses. As it noted, the loan also depleted the LLC of cash. Additionally, the Tax Court observed that the loan would ultimately be repaid using the trust's distributions from the LLC, such that it merely delayed the use of distributions to pay the Estate's tax liability. Further, the loan repayments were due 25 years after Koons's death, which hindered the proper settlement of the Estate.[185]
    e. Law. Expenditures that are not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions.[186] Expenses incurred to prevent financial loss to an estate resulting from forced sales of its assets to pay estate taxes are deductible administration expenses.[187] In Graegin, the estate held a substantial number of shares of voting stock of a closely held corporation. However, it lacked sufficient liquidity to pay its tax liability and, as a result, obtained a loan from a third party rather than selling its voting stock. The court concluded that the interest payment was necessarily incurred and properly deducted as an

[184] Estate of Koons v. Commissioner, Case No. 16-10646 (4/27/2017).
[185] Koons v. Comm'r, 105 T.C.M. (CCH) 1567 (2013).
[186] Reg. Sec. 20.2053-3(a).
[187] Estate of Graegin v. Comm'r, 56 (CCH) 387 (1988).

administrative expense. In reaching this conclusion, the court recognized that the loan was necessary to avoid a forced sale of the stock, and that the interest payment was thus necessarily incurred. In contrast, an interest deduction should be denied if the estate can pay its tax liability using the liquid assets of an entity, but elects instead to obtain a loan from the entity and then repay the loan using those same liquid assets.[188]

f. Court of Appeals. The Appeals court reviewed the facts and law in detail and analyzed and dismissed various positions advocated by the taxpayers. For example, the taxpayers argued that the trustees of the trust did not have the legal authority to order a pro rata distribution from the LLC because of their fiduciary duties under Ohio law. They claimed that decedent's long-term investment philosophy, to which the LLC's members and managers adhered, required that the LLC retain liquid assets for investment purposes and that they would have breached this fiduciary duty by ordering distributions to the detriment of this business model. The Appeals Court found that these duties do not permit minority owners to frustrate the rights of the majority to exercise control over the entity, nor would a pro-rata distribution be suspect. The trust's distributions from the LLC would be used to satisfy the estate's tax obligations regardless of whether the estate paid its tax liability immediately or obtained a loan and then repaid the tax liability gradually. The Eleventh Circuit Court of Appeals affirmed a Tax Court decision denying an estate tax deduction for interest on the Graegin loan.

E. **<u>Inheritance Right Interference</u>**.

1. **<u>Take-Away</u>**.

a. A suit against a fiduciary failed for lack of finding any breach of fiduciary duty or misconduct.[189]

b. Beneficiaries of a trust appealed the grant of summary judgment dismissing their action for tortious interference with inheritance rights, and breach of fiduciary duty.

F. **<u>Inheritance Right Interference</u>**.

1. **<u>Take-Away</u>**.

a. The Kinsel case reviews undue influence, and several other issues common with aging clients. Although the attorney who drafted the decedent's documents and a real estate sale contract believed her to have capacity the courts found otherwise. However, the court did not find that the attorney had participated in undue influence. The court suggested that counsel must take such responsibilities seriously and carry out counsel's duties with care. Because the estate planning attorney believed the client had capacity the court did not find that counsel acted improperly in updating and supervising the execution of new estate planning documents.

b. The court opinion did not address that the sale of a ranch while the decedent was alive would substantially alter the disposition of her estate. Counsel should endeavor to stress-test dispositive schemes to identify what actions might alter the plan or undermine the testator's objectives. Perhaps the revocable trust dispositive provisions could have been more carefully crafted to have avoided this result.

c. Also, the grandchildren in Kinsel claim that they agreed to the sale of the ranch because they were misled to believe that their grandmother needed funds. Only later they became aware that she had approximately $1.4 million in marketable securities. However, if she needed funds and the sale of the ranch would have materially affected the dispositive results, perhaps a loan against the ranch may have funded lifestyle expense (had that really been necessary) while preserving the dispositive scheme.

2. **<u>Discussion</u>**.

a. The Texas Supreme Court in Kinsel refused to recognize a new cause of action in Texas for tortious interference with inheritance rights.[190] The court determined that a more

[188] Estate of Black v. Comm'r, 133 T.C. 340 (2009).
[189] 38-2-4166 Williams v. Pahlck, N.J. Super. App. Div.
[190] Kinsel v. Lindsey, NO. 15-0403, Texas Supreme, Court May 26, 2017.

traditional remedy of imposing a constructive trust sufficed to address the undue influence it found.[191] The issues analyzed in the case are of the type that with an aging population practitioners will see with far greater frequency.[192]

b. This case arises out of the sale of a family-owned ranch. Lesey Kinsel (Grandmother) owned 60% of the ranch, and her step-children and step-grandchildren owned various shares of the other 40%. Grandmother deeded her share of the ranch to her inter-vivos trust in 1996. Under the trust's terms, her 60% interest in the surface and minerals would pass to certain step-children and step-grandchildren, some of whom already owned interests in the ranch.

c. The allocation of Grandmother's estate (what the court referred to as an inheritance allocation) changed over time. Under a third amendment to her trust executed in 2004, her 60% share would be split between J. Frank Kinsel, Jeff Kinsel, Carole Edwards, and Cathy Collins. Her estate-planning documents were silent as to what would happen if the ranch were sold during her lifetime. So, by default, any ranch-sale proceeds would pass to the trust's residual beneficiary—Lesey's only niece, Jane Lindsey. It is curious that this possible gap in the planning and documents did not receive more attention.

d. Carole, Cathy, and Virginia Kinsel, acting on behalf of the late J. Frank Kinsel (the Kinsels), would eventually sue Jane, Lesey's nephew Bob Oliver, attorney Keith Branyon, and his firm, Jackson Walker LLP, over their role in the sale of the ranch a month before Lesey died. The Kinsels argue they were misled by Jane, Bob, and Keith to believe Lesey was running out of money and needed to liquidate the ranch to cover the growing costs of her care. In reality, Lesey had around $1.4 million in marketable securities at her disposal. But if the ranch were sold and the Kinsels' inheritance adeemed, Jane would receive Lesey's share of the ranch-sale proceeds as the trust's residual beneficiary. The Kinsels who owned shares in the ranch argue they would not have agreed to sell if they did not believe it necessary to support Lesey. As noted above it is unclear why a mortgage was not taken out on the ranch to fund the perceived living expenses rather than a sale. There was no discussion about the possible incurrence of capital gains on a sale that may have been avoided had the property been retained until death.

e. The Kinsels sued Jane, Bob, Keith, and Jackson Walker, arguing they unduly influenced Grandmother, and that Grandmother lacked capacity to execute the fourth and fifth amendments to her trust or to sell her share of the ranch. They sought damages for tortious interference with their inheritances rights, statutory and common-law fraud, and conspiracy. The Kinsels also sought imposition of a constructive trust on Grandmother's share of the ranch-sale proceeds that flowed to Jane as residual beneficiary.

f. On appeal, the court reversed the trial court's award for damages for tortious interference with an inheritance on the basis that Texas had not recognized such a cause of action. The court of appeals upheld the trial court's imposition of a constructive trust but narrowed its scope to capture only the proceeds from the sale of the ranch that were attributable to Grandmother's interest.

g. The courts evaluated Grandmother's infirmities and their bearing on her mental capacity.
    (1) There was some dispute over the court's listing of physical infirmities but it was noted that evidence of physical problems that are consistent with or can contribute to mental incapacity and hence are probative.
    (2) Grandmothers physical challenges contributed to her mental incapacity according to an expert board-certified forensic psychiatrist.
    (3) She had mild to moderate dementia and cognitive impairment.
    (4) She experienced confusion about her medication.
    (5) Her executive functioning was impacted.

[191] The court did note that the Second Restatement of Torts recognizes liability from a person intentionally preventing another from receiving from a third person an inheritance or gift that they would otherwise have received, through fraud, duress, or other tortious means. Sec. 774B (1979).

[192] See also, Hunton & Williams LLP, "Tortious Interference with Inheritance Rights in Texas? Still an Unanswered Question," June 1, 2017, http://www.lexology.com/library/detail.aspx .

(6) She was found not to have the overall mental capability to transact business or sign legal documents.
(7) Grandmother was consistently confused, forgetful, and unable to comprehend conversations and documents.
(8) She would ask for a car she no longer owned.
(9) She could no longer understand jokes.

h. The court weighed benefits in the facts at hand to finding a cause of action for the tortious interference with an inheritance right versus the negatives of enlarging the body of Texas tort law and determined that they should not do so. The court stated that the law provided an adequate remedy in this case, the Kinsels simply were unsuccessful in fully attaining it. Thus, the court appears to have left open the possibility of recognizing a cause of action for interference with inheritance rights if the remedy under other available causes of actions were not adequate.

G. **Intestacy and No Trusts**.

1. **Take-Away**. State law may permit counsel to salvage an intestacy and create trusts for minor beneficiaries. The example below illustrates the New Jersey statute in this regard. Query whether creating such a statutory trust might be used as a "hook" to then decant into a more robust long-term trust that can provide further benefits.[193]
2. **Discussion**. In an intestacy with minor beneficiaries inheriting under state law a statutory trust established must make one-third distributions at ages 25, 30 and 35, and the remainder payable to the beneficiary's estate. The court can determine different ages and terms.
3. The New Jersey statute reads as follows:[194]

a. 3B:12-54.1 Trusts for certain beneficiaries providing deferred distribution of funds.

b. In the event that any part of an intestate estate passes to the decedent's issue pursuant to N.J.S.3B:5-4, and if any such issue shall not have attained the age of 18 at the time such part of the intestate estate would pass to such issue, such part may pass as follows:

(1) The parent or guardian of such issue or any other individual with standing may apply to the Superior Court, Chancery Division, Probate Part in the county in which the decedent was domiciled for permission to place all, or any part, of the funds passing to such issue in a separate trust for the exclusive benefit of such issue.

(2) The terms of the trust may provide as follows:

(a) The trust assets and the income therefrom shall be used for the exclusive benefit of the beneficiary, including but not limited to the beneficiary's health, support, maintenance and education, including college and post-graduate work, in the discretion of the trustees;

(b) The beneficiary shall have the right to request distributions of trust principal as follows: one-third of the principal after attaining the age of 25 years, one-half of the then balance after attaining the age of 30 years, and all of the then balance after attaining the age of 35 years; or at such other ages as the court, in its discretion, shall determine;

(c) Should the beneficiary die prior to the termination of the trust, the remaining trust principal and accrued income shall be distributed to the beneficiary's estate;

(d) Two individual trustees, or one corporate trustee, or a combination thereof, shall serve at all times, with or without bond, as the court shall determine in its discretion; and

(e) Such other terms and conditions of the trust as the court shall determine in its discretion.

(3) In ruling on such an application, the court:

(a) …

(b) shall consider all relevant factors, including but not limited to the amount of money involved, the availability of other resources for current maintenance and support, the stability of the entity offering an

[193] Acknowledgement to Bruce Steiner, Esq. of Kleinberg, Kaplan, Wolff & Cohen, P.C.
[194] 2013 New Jersey Revised Statutes, Section 3B:12-54.1.

investment covered by the application, income tax consequences, any special needs or vulnerabilities of the minor and the financial and psychological consequences of putting all or a substantial part of the minor's estate out of reach for a long period of time.

(c) The court shall retain jurisdiction of the trust until its termination. The beneficiary's parent, guardian, trustee or other individual with standing, including the beneficiary if he or she has attained the age of 18 years, may apply to the court at any time for modifications to the terms of the trust. Modifications may be made in the court's discretion.

H. **Lien Priority**.

1. **Take-Away**. The Federal estate tax lien took priority over administrative expenses of the estate.[195]
2. **Discussion**.
    a. IRS liens over property that had been held by the decedent had priority over the payment of the estate's administrative expenses. Once the IRS files the appropriate notice of the federal tax liens its lien prevails over all other interests, except for purchasers, holders of security interests, mechanics lienors, and judgment lien creditors whose interests are perfected at the time that the notice of federal tax lien is filed. The government must be paid first when the estate of a deceased debtor has insufficient assets to pay all of its debts. Personal liability may be imposed upon a fiduciary of an estate who fails to honor a priority claim of the government.
    b. When the federal tax liens exceed the assets of a probate estate, the federal tax liens have priority over the payment of the executor fees and other administrative expenses, including attorney fees and funeral expenses. The Government can, however, in its discretion allow for the payment of reasonable administrative expenses.[196]
    c. When a federal tax lien is filed, the governing law is the Federal Tax Lien Act under IRC Sec. 6321-23 which provides that if any person liable to pay any tax neglects or refuses to pay after demand, the amount due, together with any costs, becomes a lien on all property (and rights to property, real or personal) of such person. There are a few exceptions for purchasers, holders of security interests, mechanics lienors, and judgment lien creditors whose interests are choate at the time that the notice of federal tax lien is filed. Estate administrative expense creditors are unlikely to come within this list of exceptions.
    d. The court rejected the executors argument that no reasonable attorney or executor would serve facing the risk of being unpaid because of priorities. The court stated that this issue was resolved by the procedures set out in the Internal Revenue Manual Sec. 5.5.2.4(3) which permits the IRS in its discretion not assert priority over reasonable administrative expenses of the estate. The IRS even indicated in the instant case that if the executor provided corroboration of payments she made to maintain the estate property, it would allow those unreimbursed expenses to be paid ahead of the federal tax liens.

I. **Refund Claim**.

1. An estate's refund claim was dismissed for lack of jurisdiction, and not being timely. The executor did not proffer corroboration showing that the statute of limitations should have been tolled on the decedent's personal return.[197]

J. **Release of Lien**.

1. **Take-Away**. It is rather odd that as the federal estate tax exemption has grown, so fewer and fewer taxpayers face a federal estate tax, and as the specter of repeal is seemingly quite real, the administrative burdens of the estate tax continue to grow worse. Last year the burdens of the Form 8971 basis consistency rules appeared. More recently, new rules apply that will affect the sale by an estate of real estate that could create significant difficulties and complications for estate administration. Form 4422 "Application for Certificate Discharging Property Subject to Estate Tax Lien," was issued in September 2016.[198] Although the IRS has provided some leniency since its initial proposals, this will represent additional burdens, that in some instances could be

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[195] Estate of Frederick Alan Simmons, (DC IN 07/31/2017) 120 AFTR 2d ¶ 2017-5109.
[196] United States v. Spiekhout, No. 1:15-cv-01097-TWP-MPB, 2017 BL 267183 (S.D. Ind. July 31, 2017).
[197] Kirsch Est., DC NY, Aug. 28, 2017.
[198] April 5, 2017 Memorandum for Director Specialty Collection, Offers, Liens & Advisory, Director Specialty Examination Estate & Gift Tax.

problematic for the estate. While some planning suggestions or filing, positions are noted below, it is not certain what relief they will provide.

2. **<u>Discussion</u>**.
    a. The implications of these liens are potentially problematic for an estate. Before the executor (or in some instances the trustee of a revocable trust) sells any real property that is part of the decedent's estate, the executor must first have the IRS to "discharge" that property from either the estate or the assessment tax lien. To discharge property from a lien is to remove the lien's effect. This allows the buyer to take title to the property free and clear of the tax lien.
    b. This issue will arise when an estate is selling real estate and either the title company or the buyer's attorney wants a document releasing any IRS liens. The estate may have to deposit the entire proceeds of the sale with IRS and it will be treated as a payment of estate tax or with an escrow agent the IRS agrees to. The agent must be bonded.
    c. On the date of death, a federal estate tax lien comes into existence. The lien attaches to all assets of the decedent's gross estate that are typically reported on the estate tax return Form 706. IRC Section 6324. This estate tax lien does not have to be publicly recorded to be valid. A further lien, called an "assessment lien" arises when estate tax is assessed and may be recorded in addition to the lien provided above under IRC Section 6324. IRC Section 6321.
    d. What must be filed with the IRS to release the lien? The executor must apply for a "Certificate of Discharge from Federal Tax Lien." If the IRS determines that an estate tax return Form 706 was not required, it will not issue a discharge certificate. Instead, it will issue Letter 1352, Request for Discharge of Estate Tax Lien, stating that there is no estate tax return filing requirement.
    e. The application for discharge will require that, among other items, the following must be filed as exhibits:
        (1) Short form of letters testamentary. If there was no probate proceeding because the decedent relied on a revocable trust, will the IRS will accept the trust document as satisfactory or will this require a probate filing to obtain letters for the executor?
        (2) The inventory and appraisement of the estate assets.
        (3) A copy of the will. Presumably if the primary dispositive document is a revocable trust both the pour over will and revocable trust must be filed. If the IRS determines that the tax liability for the estate has been fully satisfied or adequately provided for, it may issue a certificate discharging all or specific property from the lien.[199] If a marital or charitable deduction is being claimed, documents should be provided (the will and/or revocable trust) that authorize those deductions.
        (4) Copy of the Form 706.
        (5) Copies of documents related to the sale of property. The Form 4422 instructions indicate that this could be a copy of the sale contract and closing statement (or proposed closing statement), This could be difficult if the potential buyer wants to know that IRS liens will be released before incurring the costs of counsel preparing sale documents.
        (6) The name, address, and telephone number of the closing attorney or representative of the settlement company.
        (7) IRS Form 4422 "Application for Certificate Discharging Property Subject to Estate Tax Lien." Authorization that the person filing the Form 4422 can represent the estate before the IRS. The application should be submitted at least 45 days before the transaction date for which the certificate of discharge is needed. A statement giving the reasons for applying for the certificate must be attached. If the IRS has issued any other discharges on this estate, the application must include the dates and the amounts.
        (8) Attach a description of the property for which you want a certificate of discharge. Show the value of the property and the basis of the valuation. If the

[199] Treasury Reg. Sec. 301.6325-1(c)(1).

property consists of real estate, attach a separate legal description and a preliminary title report for each parcel.

(9) An inventory and appraisement reflecting all assets of the estate.

(10) Form 8821, Tax Information Authorization. Completing this form gives the Internal Revenue Service the authority to contact individuals or companies, if necessary, when determining if the discharge is appropriate.

(11) Requests for discharge of property described on lien Forms 668-H or 668-J. As always, the IRS may request additional information if the above is not sufficient in their view.

f. The completed Form 4422 and all supporting documents noted above should be sent to: Internal Revenue Service Advisory Estate Tax Lien Group, 55 South Market St. Mail Stop 5350, San Jose, CA 95113-2324, Attn: Group Manager.

g. The proceeds may have to be escrowed from the real estate sale. If the Form 4422 shows an estimated estate tax liability, and the estate has filed an extension to file the tax estate tax return (Form 4768) and paid the estimated tax liability in full, then a discharge from the lien, without escrow, may be appropriate. Similarly, if Form 706 has been filed and the estate tax paid, then a discharge of the lien, without escrow, may be appropriate.

h. What if the executor created a single member disregarded limited liability company ("LLC") and transferred the real estate into that LLC? Would that result in the tax lien applying to the LLC and not to the underlying property and thus avoid the lien attaching to the underlying real estate and thus permit the sale of the property? If this did work will it even be feasible to do? If there is an existing mortgage on the property, one that would be paid off from the proceeds of sale, will there be an issue of transferring title from the decedent's estate into the LLC to consummate the sale? Will this require more administrative burdens to address with the lender? For a cooperative apartment, will the lien attach to the shares? If so will the cooperative permit the transfer of the apartment shares to an LLC?

i. Other commentators have suggested that even having assets held in a revocable trust might avoid the technical application of the lien rules. If that is even a possibility it is yet another of the long list of growing reasons that a revocable trust (not a will) should be the default plan in every jurisdiction.

j. The IRS has apparently been willing to review the structure of the governing instrument (will or revocable trust) and if it is obvious that the entire estate is non-taxable (e.g., funding of family or credit shelter trust to the maximum exemption and the balance to a marital deduction bequest whether outright or QTIP) they may simply waive the lien.

K. **<u>Reliance on Tax Advisor</u>**.

1. The executors of the estate filed the estate tax return, and paid the estate tax, on the date that their attorney advised them to do so. Unfortunately, the date was after the actual due date and the amount they paid was in excess of the amount actually due. Because the return was filed late and the tax paid late, the IRS assessed penalties and interest. After examining the facts of the case and the case law in the area, the executors' reliance on counsel was deemed to be reasonable and no penalties and interest were warranted.[200]

XLV. **<u>QPRT</u>**.

A. **<u>Unraveling a QPRT that is no Longer Beneficial</u>**.

1. **<u>Take-Away</u>**.

a. A moderate wealth client may have created a qualified personal residence trust ("QPRT") when the estate tax exemption was much lower, perhaps $1 million. Now, with the high $5 million inflation adjusted estate tax exemption, and the possibility of repeal, that QPRT may provide no estate tax benefit whatsoever, and result in a negative tax consequence of losing a basis step-up on death that would have triggered no estate tax cost to obtain. Even if a state estate tax cost might be incurred it may be less costly than the benefit a basis step-up might provide. Might it be possible to negate the tax effect of the QPRT and obtain a basis step up?

b. Many qualified personal residence trusts (QPRT) were created when the estate and income tax systems were very different. For example, a QPRT may have been created

[200] Estate of Hake, 119 AFTR 2d 2017-727 (DC PA, 2/14/2017).

when the estate tax exemption was merely $1 million; now, with the exemption at $5 million (adjusted for inflation), there may be no estate tax benefit whatsoever from the old QPRT. Worse, if the QPRT succeeds and concludes, a potentially highly appreciated house might be transferred to the designated remainder beneficiaries without a step-up in income tax basis. If these trusts are reviewed, it may be possible to identify such situations and take proactive action.

c. **Example**. Jane created a 15-year QPRT 12 years ago. Jane's estate, inclusive of the house, is worth $4 million. While it was anticipated that there would have been a substantial estate tax when the QRPT was created, there will be none now, but a valuable basis step-up will be lost. It may be possible for Jane to sign a lease at $1 per year for life to rent the house following the QPRT term. That lease arguably would cause estate inclusion on Jane's death, thereby unraveling the now-negative tax effects of the QPRT. This type of planning, however, entails risks. Will the trustee be willing? What liability might the trustee face for violating the trust terms? Will violating the trust terms negate the intended tax effects?

2. **Discussion**.

a. The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has, at any time, made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth) by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death, the possession or enjoyment of the property.[201]

b. The value of a residence occupied rent-free by a donor after he transferred the title to his son and daughter-in-law, pursuant to an express or implied understanding by all the parties, is includible in the donor's gross estate under IRC Sec. 2036(a)(1).[202]

c. In a QPRT private letter ruling the IRS allowed the remainder beneficiaries to lease the residence back to the grantor after the end of the retained term without it being included in the grantor's estate, provided the grantor pays a fair market rent.[203] At the end of the trust term, the Grantor and the remaindermen (the Grantor's two sons) will enter into a lease agreement under which the Grantor will have the right to continue to reside in the Penthouse after the trust term ends. The lease agreement provides that the Grantor will pay a fair market value rent as determined by appraisal and will pay all real estate taxes as well as all costs for maintenance, utilities and repairs. If the Grantor survives the 10-year term provided by the Trust, section 2036(a)(1) of the Code will not apply because the Grantor will not have retained an interest in the Penthouse for a period not ascertainable without reference to his death or which did not in fact end before his death. However, this ruling is conditioned upon our understanding that the amounts the Grantor will pay as rent to his sons after the termination of the Trust will in fact be equal to fair market value rent, taking into account all of the terms of the lease. Otherwise, Rev. Rul. 70-155 may be applicable.

d. Might the above authorities suggest that if prior to the death of the grantor/donor of a QPRT if a less than fair market rent lease is signed for a period that is only ascertainable with reference to the grantor/donor's death, that the residence held in the QPRT will be included in the grantor/donor's estate and qualify for a basis adjustment at death? If a lease of $100/month for life were signed, it would violate the above authorities but if it also violates the fiduciary duties of the QPRT trustee, can it be disregarded by the IRS?

XLVI. **Referral Fees**.

A. Effective January 31, 2017, CPAs must disclose in writing any commissions and referral fees that they receive. Prior to this ruling, verbal disclosures were acceptable.[204]

XLVII. **Regulations**.

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[201] IRC Sec. 2036(a)(1).
[202] Rev. Rul. 70-155, 1970-1 C.B. 189.
[203] PLR 9249014 (Sept. 4, 1992).
[204] Kenn Heaslip, "Recent Ethics Rulings," March 30, 2017, https://www.njcpa.org/stay-informed/topics/article/2017/03/30/recent-ethics-rulings.

A. The Treasury Department on July 7 released Notice 2017-38, which identifies the regulations that are under review for burden reduction as specified by Executive Order (EO) 13789.

1. Proposed Regulations under section 103 on the Definition of Political Subdivision (REG-129067-15; 81 F.R. 8870).
2. Temporary Regulations under section 337(d) on Certain Transfers of Property to Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) (T.D. 9770; 81 F.R. 36793).
3. Final Regulations under section 7602 on the Participation of a Person Described in Section 6103(n) in a Summons Interview (T.D. 9778; 81 F.R. 45409);
4. Proposed Regulations under section 2704 on Restrictions on Liquidation of an Interest for Estate, Gift and Generation-Skipping Transfer Taxes (REG-16311302; 81 F.R. 51413). "…Treasury and the IRS currently believe that these proposed regulations should be withdrawn in their entirety. Treasury and the IRS plan to publish a withdrawal of the proposed regulations shortly in the Federal Register."[205]
5. Temporary Regulations under section 752 on Liabilities Recognized as Recourse Partnership Liabilities (T.D. 9788; 81 F.R. 69282).
6. Final and Temporary Regulations under section 385 on the Treatment of Certain Interests in Corporations as Stock or Indebtedness (T.D. 9790; 81 F.R. 72858);
7. Final Regulations under section 987 on Income and Currency Gain or Loss With Respect to a Section 987 Qualified Business Unit (T.D. 9794; 81 F.R. 88806).
8. Final Regulations under section 367 on the Treatment of Certain Transfers of Property to Foreign Corporations (T.D. 9803; 81 F.R. 91012).

XLVIII. **Retirement planning**.

A. **Estate as Beneficiary**.

1. The decedent's surviving spouse was eligible to roll over an IRA even though the estate was named as the beneficiary of the account.[206]

B. **Missed Rollover**.

1. A taxpayer, suffering from severe depression, was entitled to a hardship waiver from the 60-day rollover requirement for two retirement account distributions.[207]

C. **Retirement Age**.

1. **Take-Away**. Increased longevity is resulting in later retirement dates. This obviously puts pressure on assuring that retirement savings will suffice for the lengthening life expectancies. Even some moderate wealth clients that had focused on saving estate taxes in past years may now need to refocus on assuring sufficient funds. This has a myriad of implications to estate plans. Consider:
    a. Many clients make annual exclusion gifts to children and other heirs even if there is no longer an estate tax benefit. Can they afford those gifts? If they cease the gifts what will the impact on the heirs be? Might a slower weaning process be appropriate? Note, as discussed above, most wealthy clients have not discussed their wealth or estate plans with heirs so the cessation of gifts and the entire process might take heirs by surprise.
    b. Will clients need to access funds given to irrevocable trusts that they are not beneficiaries of? Were those wealth transfers preceded by financial forecasts to determine if the client could part with the wealth involved and nonetheless meet financial goals?
    c. Should steps be taken proactively now to make available additional resources moderate wealth clients may need access and perhaps should never have transferred to structures that prevented access?
    d. Have the aging clients realistically assessed the potential for future health care costs discussed earlier in this outline on their future financial forecasts?
    e. This discussion might be similar to the "giver's remorse" some clients experienced following the 2012 gift tidal wave triggered by the unfounded fear that the transfer tax exemption might decline from $5 million to $1 million in 2013. But this remorse may be due to the client's poor planning, inadequate savings, and other factors.

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[205] "Second Report to the President on Identifying and Reducing Tax Regulatory Burdens," Executive Order 13789, Steven T. Mnuchin, Secretary of the Treasury October 2, 2017, page 3.
[206] PLR 201736018.
[207] Trimmer, TC, Apr. 21, 2017.

f. Might it be feasible to decant an existing trust into a more robust trust that permits greater access? **Example**: Parents set up a dynastic trust in 2012 and gave $10 million to the trust that benefits only heirs. To save costs the trust was formed and administered in the client's home state whose laws do not permit tax reimbursement provisions. The trust was also a fairly simple dynastic trust. One spouse was named trustee. Perhaps the situs and governing law of the trust can be moved to a better jurisdiction, and an independent trustee named. The trust might then be decanted into a new more robust trust under that new state's laws and permit loans to the settlor and tax reimbursement. Those two changes might provide some meaningful financial flexibility to the clients. It may be preferable for planners to address such modifications now before they are needed, rather than at some future date when the clients' cash needs are so great that the loan and tax reimbursement provisions would have to be triggered in the year of the decanting.

2. **Discussion**.

a. What is in your clients' forecasts? Among workers age 60 and older, 50% intend to wait until they turn 70 to retire, or have no plans to retire at all. More people decide to leave the workplace for good past the traditional retirement age, as the average life span is increasing.[208]

b. The average life expectancy is 85 for men and 87 for women. Thirty-eight percent estimated they would only need to make their savings last for about 12 to 17 years, which could mean they would run out of money in retirement.

c. Fidelity suggests you withdraw no more than 4 to 5 percent of a client's nest egg be spent each year, adjusted for inflation. That's commonly known as the 4 percent rule. While there is much discussion in the financial literature as to the appropriateness of a 4% withdrawal rate, it certainly can be used as a simple litmus test to guesstimate how at risk a client is for future cash flow problems.

d. Health care costs: Fidelity estimates that a 65-year-old couple retiring in 2016 would need roughly $260,000 to cover health care costs during retirement.[209] Studies cited earlier in this outline suggested substantially greater figures.

D. **Withdrawals from Retirement Plans**.

1. Retirees need to be careful not to run afoul of IRS retirement account withdrawal rules. The IRS levied over half a billion dollars in fines in just a two-year period for missed retirement plan withdrawals and contributions that break the rules. [210]

XLIX. **Revocable Trusts**.

A. **Trust Protector**.

1. **Take-Away**. Consider incorporating a trust protector provision into most revocable trusts to provide a check and balance on the trustee and the ability for someone to challenge inappropriate actions by a trustee. With the aging population, revocable trusts can be more important as a tool to protect aging and less capable clients then as merely a means of avoiding probate. But to accomplish that objective practitioner may need to rethink drafting conventions.

2. **Discussion**.

a. The Uniform Trust Code ("UTC") Sec. 603 treats a revocable trust as will substitute. Thus, while the settlor of the revocable trust is alive and has capacity, the trustees only has duties to the settlor, not the remainder beneficiaries. The beneficiaries under a will cannot challenge what the testator does in terms of spending pre-death. Similarly, remainder beneficiaries under a revocable trust do not have right to challenge what the testator does with wealth before death. While the settlor is alive, the trustee has no obligation to report to remainder beneficiaries. Even if the remainder beneficiaries under a revocable trust believe the trustee is acting inappropriately, they are not entitled to

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[208] Article from CBS Moneywatch, "70 is the new 65 for retirement." April 06, 2017, https://www.financial-planning.com/news/70-is-the-new-65-for-retirement .

[209] http://www.msn.com/en-us/money/savingandinvesting/most-people-flunked-this-retirement-quiz-can-you-pass-it/ar-AAo6z2f?li=BBnb7Kz&ocid=DELLDHP#page=9 .

[210] "How to "Retire Abundantly," April 21, 2017. http://www.wealthmanagement.com/technology/french-bank-employs-ibms-watson?NL=WM-27&Issue=WM-27_20170421_WM-27_745&sfvc4enews=42&cl=article_7_2&utm_rid=CPG09000005740948&utm_campaign=9197&utm_medium=email&elq2=521ff9100c574b71957d08bef7628a72#retire

accounting. Courts have struggled with the misdeeds of the trustee and trying to craft a remedy and held that although the beneficiaries cannot obtain information while the trustor is alive, they may obtain that information later.[211]

b. One approach to address this issue is that if the grantor is incompetent the aggrieved beneficiaries might endeavor to have the Court appoint a guardian to raise issues on behalf of the settlor. However, this is cumbersome, costly and time-consuming endeavor that almost assuredly would be fought vigorously by the trustee using trust funds to do so.

c. Proactive steps should be taken when planning and drafting a modern revocable trust to address these shortcomings in the law and thereby assure that while a settlor/beneficiary is alive but "fading" that protection is in place. Consider perhaps an institutional trustee or co-trustee, a CPA in a formal role as monitor, and also, as noted above, naming a trust protector to serve in a fiduciary capacity. This latter step could be a significant and vital change in the application of a modern revocable trust. If a trust protector is appointed, consider expressly designated that person to serve in a fiduciary capacity. While many commentators believe protectors always act in a fiduciary capacity the law is not fully clear so specifying this can avoid any issue as to status.

d. For example, the family members that might have traditionally been named as a successor trustee to the settlor, might instead serve in the capacity as trust protector with an institution being named as trustee. This approach can transform the protective features a revocable trust can provide to an aging, infirm or at-risk client. This can retain family, friends or others in vital fiduciary positions, reduce the responsibilities and demands they face, and better protect clients. Individuals serving as trust protector could be given the unfettered right to terminate and replace the trustee. This would provide a powerful check and balance on any trustee and this mechanism alone may resolve the concerns some clients have over naming an institution.

e. In some instances, it might be advisable to limit the trust protector's replacement power to solely naming a successor institutional trustee to avoid the risk of the protector appointing herself or someone who will do her bidding, thereby undermining the safety of the client's plan.

L. **S Corporations**.

A. **Basis**.

1. S corporation shareholders cannot deduct any losses their S corporations incur as they are subject to the at-risk rules and the passive loss rules. Also, S corporation shareholders are allowed to deduct losses only to the extent of their tax basis in the stock. Unlike partners in partnerships, shareholders in S corporations do not receive basis for corporate debt. A recent case is a reminder of S corporation loss deduction limitations and how clients can misunderstand the rules.
2. The taxpayer owned 50% of an S corporation that developed and sold real estate. The business was heavily leveraged and most loans were guaranteed personally by the taxpayer/shareholder. The S corporation defaulted on its loans and the lenders sued the taxpayer on her guarantee. The judgments against her resulted in liens against her assets. To utilize the S corporation tax losses, she increased her stock basis in her S corporation stock by her pro rata share of the unpaid judgments. The Tax Court held against her stating that a basis increase in her S corporation stock would only have been appropriate when she actually made payments on the guaranties.[212]

B. **Death of Grantor**.

1. A grantor trust is eligible to hold S corporation stock as a grantor trust. On the death of the grantor, grantor trust status ends. The resulting trust continues as an eligible S corporation shareholder for two years after the death of the trust grantor. After that period expires, the trust becomes an ineligible shareholder. The recipient entity, often a trust created under the grantor trust or clients will/revocable trust, can make a QSST or ESBT election. If not, the S corporation election could terminate unless the IRS grants relief. In the PLR, the taxpayer failed to make a timely election.[213]
2. More specifically, upon the decedent's death, the shares held by the trust were transferred to two resulting or remainder trusts. The remainder trusts qualified under IRC Sec. 1361(c)(2)(A)(ii) as

[211] Tseng v. Tseng, 352 P.3d 74 (Or. Ct. App. 2015).
[212] Rupert and Sandra Phillips, TC Memo 2017-61 (4/10/2017).
[213] PLR 201709016 (Mar. 3, 2017).

eligible shareholders for two years from the settlor's death. Unfortunately, timely elections to treat the resulting trusts as qualified subchapter S trusts ("QSSTs") after this period was not made. The consequence was that the resulting trusts became ineligible shareholders, causing the S corporation election to terminate.

3. The IRS held that the S corporation election was inadvertently terminated within the meaning of IRC Sec. 1362(f) due to the trustee's failure to make QSST elections but pursuant to the provisions of IRC Sec. 1362(f), the S corporation will be treated as continuing.

C. **Inadvertent Termination**.

1. **Take-Away**. Although LLCs may be the default choice for new entities, the number of S corporations remains tremendous. S corporations grew from about 800,000 in 1986 to 4.2 million in 2011.[214] With this tremendous number of S corporations, and the complex array of requirements that must be met to maintain tax favored S corporation status, practitioners should be mindful of the potential traps for unwary clients to violate a requirement. This is particularly true in the estate planning arena when S corporation interests are owned by trusts.

2. **Discussion**.
   a. If an S election is inadvertently terminated, the IRS can waive the effect of the terminating event for any period if the corporation timely corrects the event, and the shareholders agree to be treated as if such election had been in effect.
   b. S corporation shareholders must be Individuals who are U.S. citizens or residents; a decedent's estate; certain types of trusts (grantor, ESBT, or QSST); or certain tax-exempt organizations. An S corporation cannot have a shareholder who is a nonresident alien, partnership, corporation, or ineligible trust. If a shareholder resides in a community property state, the spouse must also meet the requirements of being an S corporation shareholder since the stock is treated as a joint asset if acquired during marriage. This can be a problem if an intended shareholder is married to an ineligible spouse. While S corporation shareholders' agreements often include restrictions on transfers to ineligible shareholders, that alone will not suffice and vigilance is required. S corporations are also only permitted one class of stock. Thus, if the corporation issues preferred stock, or any second class with different economic interests (voting variations are permitted), the S election would terminate. If the S election is inadvertently terminated the IRS may provide relief. The frequency of the rulings addressing inadvertent terminations, some for the current year being listed below, suggests how commonly this occurs.

3. In PLR 201702007, the IRS concluded that the termination of an S corporation election was inadvertent within the meaning of Code section 1362(f).

4. In PLR 201709015, the IRS granted relief for the inadvertent termination of an S corporation election.

5. PLR 201721004 (May 31, 2017) an S corporation was granted relief for an inadvertent terminations of S corporation status resulting from a trust beneficiary's inadvertent failure to make a timely qualified subchapter S trust ("QSST") election for the trust that originally held the S corporation's shares.

LI. **Same Sex Marriage**.

A. **New Jersey Domestic Partners**.

1. **Take-Away**. This holding treats a domestic partner as a spouse for New Jersey estate tax purposes.

2. **Discussion**. The surviving partner of a domestic partnership filed a New Jersey Inheritance Tax return treating the deceased domestic partner as a spouse. However, because no spousal deduction was permitted for domestic partners under the New Jersey Estate Tax, he did not claim a spousal deduction. Later, he filed an amended estate tax return claiming a marital deduction for New Jersey Estate Tax purposes. This deduction was authorized to members of a civil union, but not for domestic partners. The New Jersey Tax Court affirmed the denial of the marital deduction and he appealed arguing that the Domestic Partnership Act violates the equal protection guarantee of the

[214] William McBride, "America's Shrinking Corporate Sector," Jan. 6, 2015, https://taxfoundation.org/america-s-shrinking-corporate-sector/ .

New Jersey Constitution. The Court held that there is no rational basis for the marital deduction to be different under the New Jersey Inheritance Tax Law and the New Jersey Estate Tax law and permitted the deduction.[215]

B. **Notice 2017-15**.

1. **Take-Away**. Same-sex couples that made prior taxable transfers should recalculate their appropriate gift exemption, DSUE and GST exemption and file amended returns.
    a. Windsor[216] overturned the law governing same-sex marriages by holding that Section 3 of the Defense of Marriage Act ("DOMA")[217] was not constitutional. After Windsor tax guidance was provided in Revenue Ruling 2013-17[218] and Treas. Reg. §301.7701-18. These both acknowledged the legal concept of retroactivity. Additional clarification was provided on January 17, 2017 with the issuance of Notice 2017-15. Notice 2017-15 which provides procedures to recalculate the remaining applicable exclusion and remaining GST exemption to the extent that an allocation of that exclusion or exemption was made to certain transfers pre-Windsor, while the taxpayer was married to a person of the same sex.
    b. **Example**. When a married individual (A) makes a gift or bequest to A's spouse (B), A is entitled to claim a gift or estate tax marital deduction for the gift or bequest under §2523 or §2056 if the requirements of those sections are satisfied. Because of this marital deduction, A does not have to use any of A's applicable exclusion amount to exclude that spousal transfer from tax, thus preserving A's applicable exclusion amount for other gifts and bequests. Prior to the decision in Windsor, if A and B were of the same sex, A was not allowed to claim the marital deduction for a transfer to B, and A's applicable exclusion amount (if any) would have been applied automatically to reduce the amount of the gift or estate tax due.
    c. Taxpayers seeking relief under this Notice 2017-15 must attach a statement supporting the claim for the marital deduction and detailing the recalculation of the taxpayer's remaining applicable exclusion amount as directed in forms and instructions issued by the IRS.
    d. The Form 706 or 709 used to recalculate exclusion or GST should include the statement "'FILED PURSUANT TO NOTICE 2017-15" and statements described in the Notice.
2. **Gift and Estate Exemption**.
    a. Taxpayers may have used exemption, or even paid gift tax, on transfers to a same-sex spouse made pre-Windsor that now post-Windsor would should not have been done. If the limitations period has expired, the taxpayer can recalculate the taxpayer's remaining gift and estate tax exemption as a result of the recognition of the taxpayer's same-sex marriage. No credit or refund of the tax paid on the marital gift can be given after the expiration of the period for credit or refund. The Notice applies to the recalculation of the remaining applicable exclusion amount of a taxpayer and the recalculation of any deceased spousal unused exclusion amount allowed to be included in the applicable exclusion amount of that taxpayer's surviving spouse.
    b. With respect to the applicable exclusion amount applied to a transfer between spouses that did not qualify for the marital deduction for federal estate or gift tax purposes at the time of the transfer, because of DOMA, taxpayers can demonstrate that transfer qualified for the marital deduction and to recover the applicable exclusion amount previously used, even if the limitations period applicable to that return for the assessment of tax or for claiming a credit or refund of tax under §§6501 or §§6511, has expired. If, however, qualification for the marital deduction or a reverse qualified terminable interest property (QTIP) election would require a QTIP, qualified domestic trust (QDOT), or reverse QTIP election, the taxpayers must request 9100 relief to make such an election.
    c. While this notice allows taxpayers to recalculate their remaining applicable exclusion amount as a result of the allowance of a marital deduction, it does not extend the applicable time limits on electing to split gifts made by a spouse under §2513.

[215] 35-2-3398 Rucksapol Jiwungkul v. Dir., Div. of Taxation, N.J. Super. App. Div.
[216] United States v. Windsor, 570 U.S. ___, 133 S. Ct. 2675 (2013).
[217] Public Law 104-199 (110 Stat. 2419).
[218] Revenue Ruling 2013-17, 2013-38 I.R.B. 201.

3. **GST Exemption**.
    a. Similar issues might arise with respect to GST allocations. Same sex couples were not allowed to determine the generation assignments for GST tax purposes based on a familial relationship with the same sex spouse rather than on age. Now post Windsor they can. The rules also apply to allocations of a taxpayer's GST exemption made on a return filed, or by operation of law (e.g. by the automatic allocation rules) as of a date, before the date the Notice was issued. This can be done regardless of whether the Code Sec. 6511 limitations period has expired. A taxpayer is also permitted to reduce GST exemption allocated to transfers that were made to or for the benefit of transferees whose generation assignment is changed because of the Windsor decision. The Notice applies only to the recalculation of the taxpayer's GST exemption that was allocated to a transfer to, or to a trust for the sole benefit of, one or more transferees whose generation assignment for purposes of that exemption allocation should have been determined based on the family relationship as the result of the Windsor decision, and who are, therefore, non-skip persons.
    b. With respect to a taxpayer's GST exemption that was allocated to transfers made prior to the recognition of same-sex marriages for federal tax purposes, to or for the benefit of one or more persons in a same-sex marriage and/or any other person(s) whose generation assignment is determined under §2651 with reference to a same-sex spouse, certain exemption allocations to transfers to persons now recognized to be non-skip persons as defined in §2613(b) will be deemed void. So, taxpayers who made such transfers will be permitted to recalculate the amount of their remaining GST exemption.

C. **Parenting**.

1. **Take-Away**. While the holding in the case below is helpful the couple may have avoided the need for court involvement had they proactively confirmed the relationships with, for example, the domestic partner adopting the children, or executing a co-parenting agreement.
2. **Discussion**. The court found that the partner undertook a permanent, unequivocal and responsible parental role in the children's lives, and that they would be substantially and negatively affected if she was removed. Therefore, the court held that there was a de facto parentage relationship between the two biological children and her domestic partner.[219]

LII. **Secrecy**.

A. **Germany**.

1. As of October 1, 2017, legal representatives of corporate entities (companies, partner- ships), other private law corporations (private law foundations, co-ops, associations) and trusts are obliged for the first time to report their beneficial owners to the newly established German transparency register. Reports must be filed electronically via the following web- site: www.transparenzregister.de.
2. With these recent amendments of the German Anti-Money Laundering Act (GwG) the German legislature implements the EU Fourth Anti-Money Laundering Directive, which directs all member states to establish a national transparency register. Similar regulations will therefore enter into force in other EU jurisdictions.
3. Legal entities, registered partnerships, trusts, fiduciary entities, as well as incorporated foundations have the duty to initially report their beneficial owners to the German transparency register as of October 1, 2017.
4. There are no exceptions for non-German beneficial owners, e.g. trustees resident in Germany have to fulfill the transparency duties for foreign trusts and their beneficiaries.
5. Beneficial owners are always and exclusively natural persons. They are obliged to provide the reporting legal entities and partnerships with any relevant information. Trustees should already be in possession of the information concerning beneficiaries of a trust. Each natural person that acts as custodian of a fiduciary entity, or is entitled as trustee or protector of a foreign trust, qualifies as beneficial owner. The same applies for beneficiaries of trusts and individuals who can control distributions of profits or exercise control over investment or administrative decisions.
6. Reporting obligations imply the notification of full names, date of birth, place of residence, as well as the nature and extent of economic interest for every beneficial owner, which includes the percentage of shares and voting rights.

[219] Thorndike v. Lisio, 2017 ME 14, (Maine Supreme Judicial Court), Jan. 19, 2017.

7. German resident trustees must also report the citizenship of the economic owners (e.g. beneficiaries) of the trusts they are managing.
8. Violation of the reporting duties is a misdemeanor and a fine can be imposed. The upper limit of administrative fines for violations of the GwG has been increased from EUR 100,000 to EUR 1,000,000.[220]

LIII. **Statistics**.

A. **Take-Away on Statistics and other Studies Presented in this Outline**.

1. All practitioners are aware that the population is aging, that health care costs are a significant concern for clients who are not ultra-high net worth, and that some clients have inadequate post-retirement savings. However, putting real data and statistics to the generally accepted facts above makes the points clearer and more specific. Also, the magnitude of the actual data might be surprising and suggest that many otherwise wealthy clients may also face financial challenges if their budgets are adjusted for the reality of later-life medical costs and projected out an appropriate number of years to reflect potential longevity. These merely wealthy, but not ultra-high net worth, clients comprise a significant swath of the client base of many practitioners. The planning that has traditionally been done for them, especially at times when exemption amounts were lower and flexible modern trust drafting not the norm, may prove less than optimal, and perhaps dangerous. Longevity and health costs might require practitioners to revisit and rethink prior planning.
2. As the role of estate planners continues to evolve from that of an estate tax minimizer to an estate counselor, the conversation has to change from will and tax planning to more profound and deeper discussions about spending, finance, goals, objectives and more.[221] As the discussion below from Kitces indicates, research suggests that the incremental pleasure clients realize from the marginal dollar of expenditure may be negligible. While clients undoubtedly view reducing lifestyle expenditures as incredibly unpleasant, is it as bad as they fear? Might practitioners have to begin this new line of discussion to help clients facing the financial implications of increased health care costs get back on track?
3. With tools like trust protectors, persons holding powers in non-fiduciary capacities, decanting, or perhaps non-judicial modification, practitioners should reexamine these older plans against the litmus test of current financial forecasts. Collaboration with wealth managers will be critical to the re-examination of prior planning, and in particular, existing irrevocable trusts. The examination should be accompanied by realistic forecasts using actual budget data adjusted as indicated above. If those forecasts indicate too high a risk of financial failure, practitioners armed with that knowledge can endeavor to adjust prior planning when feasible. This examination of existing irrevocable trusts should in many cases evaluate the income tax basis of trust assets and whether strategies, such as substitution of personal assets for trust assets, distributions or other transactions, should be pursued to improve tax basis planning.
4. The above process will present new challenges. As noted elsewhere in this outline, few clients have discussed their estate plans with heirs. Now those same clients may have to not only discuss their planning with their children, but obtain their consent to modification of prior planning. Handled properly, this process can safeguard existing clients, and involve next-gen in an active manner as new clients.
5. There is another take-away, the clients most practitioners serve, even those referred to in this outline as “moderate wealth” (in terms of the relationship to the $5 million inflation adjusted exemption amounts for a couple, and the ultra-high net worth clients that seem so often to the be the focus of planning articles and symposia) are far wealthier than the average American. Some of the statistics presented below, such as the Pew data on wealth classes, will drive that point home. The implications of this are important. Little of the data and advice both clients and practitioners are exposed to in the general media are relevant to the wealth level of the clients practitioners generally serve.
6. A challenge for many estate planners is that the conversations alluded to above seem to generally occur with wealth managers and not estate planning attorneys. The differing business models (quarterly meetings at no extra charge with wealth managers, versus coming back maybe in five years to reluctantly meet with an estate planning attorney who bills for the time) seem to

[220] Information provided by P+P Pöllath + Partners, Berlin, Frankfurt and Munich mailing October 19, 2017.

[221] The phrase “estate counselor” was introduced in Chapter 19, Blattmachr and Shenkman, “Practical Planning Strategies for the Future,” Heckerling Institute on Estate Planning 2016.

encourage the exclusion of the estate planning attorney from this discussion. That could be a dangerous mistake for clients. But absent wealth managers collaboratively brining estate planning attorneys into the discussion how will it occur?

B. **Health**.

1. **Take-Away**. This type of data may be more precise and useful to planning any techniques that rely on life expectancy (e.g., a GRAT) then the general health cost statistics cited elsewhere in this outline. Might the planning standard for those clients with moderate wealth or more become a real or actual life expectancy analysis and actual estimate of health care costs completed as part of a financial and estate plan to incorporate into budgets and financial forecasts? For moderate wealth clients, this may be essential to their avoiding running out of resources in later years. For wealthier clients, it may provide guidance to optimize health care planning and increase current gifting or spending by quantifying such costs.
2. **Discussion**.
   a. A range of new ventures aim to help financial advisors and their clients predict medical costs and plan their finances accordingly. Genivity uses proprietary algorithms to project out-of-pocket medical and assisted living costs that help ensure clients are spending their money smartly on current health care costs while also saving enough for long-term expenses, according to ChicagoInno. Genivity's Halo Assessment, which takes clients through 13 questions regarding hereditary health and personal habits, predicts how many healthy, active years a person is likely to live, how long they should expect to require assisted living care and how much they should expect to pay.[222]
   b. The wealthiest men are outliving poorer Americans by a widening margin. In the early 1980s death rates of the wealthy and the general population were similar. At ages 65 to 79, men in the wealthiest 1% were 12% less likely to die than the average American man in any year in that range. In the most recent estimates the wealthiest men in that age range had mortality rates 40% lower than average."[223] Planning for what most practitioners would view as even a moderate wealth client has to be viewed in light of realistic life estimates otherwise financial forecasts could be materially incorrect, wealth transfers inadvisable, etc.

C. **Longevity**.

1. **Take-Away**. Planners should expand the estate planning conversation to discuss longevity statistics and the implications to planning. Clients need to consider longevity risks, including the risk of outliving financial resources, estate and related planning steps to manage assets at advanced ages, etc. For many clients, the extra years of life expectancy might dampen gifting to family and even charity. For others, it may have no financial impact but may motivate greater attention to more protective planning and documents then merely a power of attorney.
2. **Discussion**.
   a. A 10-year-old child today has a 50 percent chance of living to age 104.
   b. Some demographers have speculated that the first person ever to live to be 150 is alive today.
   c. Both individuals and society need to prepare for a time when it is common to live to 100. A new mind-set about aging and solutions for helping older adults to live better as they live longer. Some have begun to refer to this as "disrupt aging." This is important to health, wealth, and self. Outdated stereotypes about aging need to be replaced.[224]
   d. For men who live to age 65, average mortality is 86.6 years. For women who live to age 65, average mortality is 88.8. But real or actual life expectancy is not about averages. Among women with average health, 31 percent will live to 90 and 12 percent will make it to 95. For women in better than average health, 42 percent will live to 90 and 21 percent will live to 95.

[222] "Startup Helps Financial Advisors Predict Medical Costs," May 25, 2017, http://www.wealthmanagement.com/high-net-worth/mar-lago-losing-galas .

[223] Ben Steverman, "The older the client, the wealthier they are? What new IRS data shows," Aug. 23 2017, https://www.onwallstreet.com/articles/the-older-the-client-the-wealthier-they-are-what-new-irs-data-shows .

[224] Jo Ann Jenkins, "Live to 100. Plan on It. Disrupt Aging is not just about reimagining old age," AARP. http://www.aarp.org/politics-society/advocacy/info-2017/jeanne-calment-plan-to-live-to-100-jj.html .

e. For couples with better-than-average health, one surviving spouse will make it to 100.[225]

f. Consider that there are strong correlations between wealth and education and health. Thus, the clients many advisers serve would generally have greater life expectancy. If financial forecasts are limited to say age 90 is that adequate? If a gift program has been pursued without the benefit of appropriately long forecasts demonstrating adequate wealth, what should be done?

D. **Retirement**.

1. In 2016 the World Bank estimated that the life expectancy of the average American is 79, up from 75 in 1995. In 2015 there were 72,000 hundred-year-olds alive and by 2050 that number is expected to exceed 370,000.
2. According to the Economic Policy Institute, retirement savings for the average American family is approximately $95,000 and 50% lack any retirement funds.
3. Just five to 10 years ago, most financial advisors assessed clients' longevity rates between ages 85 to 94. Only 4% of financial planners accounted for clients living until 95 to 99, according to a recent Investment News article. Consider that gift planning in 2012 when so many large gifts were made in anticipation of the decline in the federal estate tax exemption in 2013 that those gifts, if they were based on financial models, were based on life expectancy assumptions that were likely too short.
4. The historical 4% annual withdrawal rate may be too generous for clients that live well into their 90s or beyond. The Investment News survey reported that 54% of advisors recommend lower withdrawal rates to reduce the chance of running out of retirement funds.[226] What does this suggest for clients that currently cannot spend anywhere close to as little as 4% of their resources a year?

E. **Savings**.

1. According to a report from the Economic Policy Institute (EPI), many Americans have some catching up to do. The mean retirement savings of a family between 50 and 55 years old is $124,831. For families with members between 56 and 61, the mean retirement savings is $163,577. But those numbers aren't representative of the state of American retirement. Since so many families have zero savings and since super-savers can pull up the average, the median savings, or those at the 50th percentile, may be a better gauge than the mean. The median for families between 50 and 55 is only $8,000. For families between 56 and 61, it's $17,000.[227]
2. Following are some shocking statistics that indicate the state of financial and retirement planning for many Americans.[228] One in ten homeowners owe more on the mortgages then the value of their home. Almost 30% of households age 55 and older have no pension or retirement savings as of 2013. Six of ten people age 50 and older support an adult child or other relative. Have clients support for a child or other relative been factored into their budget and financial forecasts?
3. If this is the state of the average American family, it is unlikely that many planning articles or other materials that are targeted at a mass audience will be written towards the client base of advisers. The risks of so much information directed at a different audience read by advisers clients should be a concern.

F. **Spending.**

i. **Spending Declines with Age**.

a. Consider the impact of the following on forecasts, determining gifts and charitable contribution capacity, etc. As we age, we're becoming less and less optimistic about our financial health, according to a study by financial planning startup United Income. The study found that in 2014, adults over 64 were more than 40 percent less optimistic about their future financial health, over 30 percent more skeptical about future economic growth, and 40 percent less convinced of future stock market increases. The

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[225] Based on Social Security Administration mortality data. Mark Miller, "Turning Longevity Risk Into Dividends," Apr 25, 2017; http://www.wealthmanagement.com/retirement-planning/turning-longevity-risk-dividends .

[226] Barbara A. Friedberg | May 24, 2017, Retirement Planning for Clients Who Outlive Savings, http://www.investopedia.com/retirement/retirement-planning-clients-who-outlive-savings/#ixzz4iHl8SF8I .

[227] "Here's how much the average family in their 50s has saved for retirement," April 22, 2017 http://www.msn.com/en-us/money/retirement/heres-how-much-the-average-family-in-their-50s-has-saved-for-retirement/ar-BBA7S5E?li=BBnbfcL&ocid=DELLDHP .

[228] "Money Missteps" AARP Bulletin April 2017, page 10.

study found that the average adult age 60 or older will trim their spending by 2.5 percent each year, about 20 percent over 10.

b. Spending also drops faster for people in their 80s compared to those in their 60s and 70s, falling by about 30 percent on average over 10 years. Why? Weakening confidence in financial health as we age.[229]

c. This data might to some extent counter-balance some of the issues and concerns noted elsewhere in this outline, but spending less because of fear, rather than because of an affirmative or conscious desire to do so, does not seem pleasant. Good planning should enable client to have better control over spending, not reduce it because of unplanned for fears.

ii. **<u>Spending "Within Your Means"</u>**.

a. The following is a profound thought on spending, budgeting and financial forecasting from one of the industry's true thought leaders. The ideas presented below go to the heart of what spending is about, what it really means to clients, and suggests a conversation that likely few practitioners have with clients. But as the role of the estate planner continues to evolve from an estate tax minimizer to an estate counselor, this topic will become a more important part of the discussion. Further, for those wealthy clients for whom longevity planning suggests potential future financial issues, and meaningful discussion about what the client's current spending provides the client may be vital to that client's getting back on financial track.

b. "Try to 'live within your means'" is a staple of prudent financial advice – recognizing that not everyone earns the same income ("means"), and therefore not everyone can afford to spend the same. It prescribes that rather than trying to keep up with the Joneses – and their lifestyle spending – the client should live within his or her means, instead.

c. Ultimately, all of this raises very interesting questions about what it really means to live within your means, and what "prudent" spending really is. Should 'reasonable' spending be evaluated based on dollars or percentage-of-income?

d. Yet the interesting caveat to this is that at least some research suggests our happiness (i.e., emotional well-being) doesn't materially increase as our income (and associated spending) rises above $75,000/year. Which means the couple with $500,000 of income, even if they're "just" spending 50% of that – or about $250,000/year – is still far past the point of getting much additional happiness from their spending dollars. In other words, maybe it is more appropriate to view their budget as excessive, relative to the "happiness threshold" where more income and spending isn't associated with more happiness. Even if we gross up their $75,000 spending target a bit for their high cost-of-living area, they're still spending way, way beyond the happiness threshold. Not to mention well beyond most other people's happiness threshold.[230]

e. While it is unlikely that a wealthy client will dramatically reduce spending and lifestyle because of a philosophical discussion with their estate planner, that discussion might have important impact on longer term spending decisions that might be prudent to assure financial solvency into the advanced ages that many clients may well see.

G. **<u>Wealth Classes</u>**.

1. **<u>Take-Away</u>**. Numbers are often used to define groupings such as ultra-high net worth who are defined as those are people with investable assets of at least $30 million, excluding personal assets and property such as a primary residence, collectibles and consumer durables.[231] Merely wealthy has been defined as a $5 million net worth.[232] Below are statistics from a Pew report which provide a more realistic and broader based perspective on wealth.

2. **<u>Discussion</u>**.

a. Middle class.

[229] "Adults Are Losing Confidence In Their Financial Well-Being," WealthManagement.com Morning Memo 6/1/2017 citing Matt Fellowes, CEO of United Income, as told to Fox Business.

[230] Kitces, "The Happiness Spending Threshold And What It Really Means To Live Within Your Mean," May 31, 2017, https://www.kitces.com/blog/live-within-your-means-recommended-happiness-spending-threshold-75000 .

[231] http://www.investopedia.com/terms/u/ultra-high-net-worth-individuals-uhnwi.asp

[232] Robert Frank, "What is Wealthy," CNBC, July 22, 2013, https://www.cnbc.com/id/100904381

(1) Pew, which defines middle class as adults whose annual household income is two-thirds to double the national median ($55,775 as of 2016), details the national middle-income range for various household sizes.

(2) "The income it takes to be middle-income varies by household size, with smaller households requiring less to support the same lifestyle as larger households," Pew explains.

(3) Here's the breakdown of how much you have to earn each year to qualify as middle-income, depending on the size of your family: Household of one: $24,042 to $72,126; Household of two: $34,000 to $102,001; Household of three: $41,641 to $124,925; Household of four: $48,083 to $144,251; Household of five: $53,759 to $161,277.

b. Upper class.

(1) The median income of American households decreased significantly from 1999 to 2014 across the lower, middle and upper classes, according to Pew Research Center.

(2) The research group found that "nationwide, the median income of U.S. households in 2014 stood at 8% less than in 1999, a reminder that the economy has yet to fully recover from the effects of the Great Recession of 2007-2009."

(3) Despite this decline in income, members of the upper class are still doing well for themselves. Pew defines upper class as adults whose annual household income is more than double the national median ($55,775 in 2016), after incomes have been adjusted for household size. Smaller households require less than larger households to support the same lifestyle, Pew notes. Of course, there's more to class than income — upper class can also be identified by net worth, education and occupation, for example — but household income can be a useful tool by which to group people.

(4) Here's the breakdown of how much you have to earn each year to be considered upper-income, depending on the size of your family: Household of one: Minimum of $72,126; Household of two: Minimum of $102,001; Household of three: Minimum of $124,925; Household of four: Minimum of $144,251; Household of five: Minimum of $161,277.

H. **Wealthy Definition**.

1. $1 million isn't considered wealthy anymore. According to a new survey from Charles Schwab, the new barometer for wealth sits at $2.4 million. The survey of 1,000 Americans ages 21 to 75 found that being wealthy could also be defined in a variety of ways, including enjoying life's experiences and being able to afford what you want. Still, $2.4 million is 30 times more than the $80,000 net worth of the typical U.S. household, Money.com reports.[233]

I. **Wealth and Longevity**.

1. In 1980, a 50-year-old man in the wealthiest fifth of the income distribution could expect to live five years longer than a 50-year-old man in the lowest-income group. By 2010, the gap between them had jumped to 12.7 years. the poorest fifth of 50-year-old American men can now expect to live just past 76, six months shy of the previous generation. The richest 50-year-olds should make it almost to 89, seven years longer than their parents' generation.[234]

J. **Wealth and Taxes**.

i. The 40 percent estate tax currently affects just 0.2 percent of estates, or approximately 5,460 estates in 2016. But the tax will raise between $25 billion and $34 billion annually over the next decade, the Congressional Budget Office has estimated.[235]

K. **Wilmington Trust Wealth Study**.

1. Wilmington Trust sponsored a study of wealth that has fascinating implications to the planning process.[236]

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[233] "The New Definition of 'Wealthy'," WealthManagement.com Sun 22, 2017; http://www.wealthmanagement.com/high-net-worth/new-definition-wealthy.

[234] Ben Steverman, "The Rich Are Living Longer and Taking More From Taxpayers," Apr 24, 2017http://www.wealthmanagement.com/retirement-planning/rich-are-living-longer-and-taking-more-taxpayers .

[235] Tax Policy Institute study, https://www.reuters.com/article/us-usa-tax-estate/white-house-weighs-abandoning-estate-tax-repeal-in-republican-tax-push-idUSKCN1BU2YS .

2. 67% of inheritors were not given complete details of their inheritance before receiving it. And nearly 1/3 of wealth holders do not plan to share inheritance details with their heirs, due to concerns over demotivation.
3. 91% of respondents agree that they have an obligation to ensure wealth endures for future generations, but they must be prepared and educated before wealth transfer begins.
4. After inheriting, 63% continue working, 45% maintain their present job, and 7% devote themselves full-time to philanthropic endeavors.
5. 44% of respondents worry about becoming targets of predators or scams.
6. 59% of both senior and younger generations see their advisors as playing a role in their education.
7. 53% of wealth holders prefer informal meetings with their family advisor to discuss educational topics.
8. 93% of respondents ranked having an advisor they can trust as important. Clients may prefer firms with a fiduciary distinction, and advisors from those firms should remind clients what this means for them, which is that their best interests are always protected and put above all else.
9. Inheriting wealth can be, and often is, a life-changing experience, even for an individual who was born and raised in a highly affluent family. Nearly three-quarters (72%) of respondents had more than $50 million, while 44% estimate their family wealth in excess of $100 million. It is clear that they intend to retain a significant amount of wealth within the family. Two-thirds of all respondents anticipate their individual inheritance to exceed $10 million, and one-third of them expect their inheritance to surpass $25 million. The respondents had received, on average, 52% of their inheritance at the time of the survey. Equally important as the amount of assets that families intend to transfer between generations, or perhaps even more important, is how they intend to do so. Contrary to popular belief, wealth transfer is hardly a singular event characterized by an oversize bequest upon the death. In fact, our survey shows that only 8% of respondents received all of their inheritance in an outright bequest, and only one-third received all of it via a trust. However, the use of some type of trust was almost ubiquitous, with 92% of individuals identifying themselves as beneficiaries of a trust. A majority of respondents have been involved in a hybrid approach to wealth transfer: 59% of them received their inheritance via both a trust and an outright bequest payment. The survey found most respondents received their inheritance in structured payouts over time. Trust distributions tend to come earlier in their lives, often from trusts that skip a generation to benefit those two or more generations below the trust creator. Outright bequest payments tend to occur when their parents pass away.
10. 48% of wealth holders say they share complete inheritance knowledge with their heirs, while only 33% percent of wealth holders received full information from their own benefactors.
11. Wealth holders were less likely to share the amount with their heirs than their family was with them (30% vs. 10%). Consider the impact of the rules governing qualified beneficiaries, and the use of a silent trust.
12. The fact that 89% of survey respondents feel that they are obligated to learn to manage their wealth opens the door for families to work with their wealth professionals on communication plans and educational programs that focus not only on financial challenges families face, but also the "softer" issues. Against this backdrop, it's illuminating to examine the types of subject matter about which successful families wish to learn.

LIV. **Trusts.**

A. **Division of a Trust**.

1. **Take-Away**. The IRS held in 201721006 (May 26, 2017) that a QTIP trust could be divided into parts followed by a renunciation of one of the resulting QTIP trusts by the surviving spouse. This illustrates a valuable post-mortem means of restructuring a marital trust to accomplish a number of different goals. This technique could be used to make assets in part of a QTIP available to children or other heirs immediately, rather than having to wait for the death of the surviving spouse. It might provide a means to use some portion of the surviving spouse's gift exemption to avoid state estate tax in a decoupled state that does not have a gift tax.
2. **Discussion**.
   a. Facts. The facts in the PLR include in brief the following. The Trustee of a marital trust proposed dividing the marital trust into two separate shares: Marital Trust One and

[236] "Navigating The Wealth Transfer Landscape," by Wilmington Trust In partnership with the Institute for Private Investors and Campden Research, 2017.

Marital Trust Two. Each share would be administered as a separate trust for the benefit of Spouse upon the same terms as the initial marital trust. The surviving spouse will then renounce any interests he has in Marital Trust One. The trust property of Marital Trust One will be divided into separate trusts pursuant other articles of the governing instrument.

b. 2056. Dividing the QTIP trust into two parts pursuant to a power to divide under the governing instrument and state disclaimer law will not taint the qualification of either resulting trust. The IRS held that after the division of the initial marital Trust into Marital Trust One and Marital Trust Two, the surviving spouse will continue to have a qualifying income interest for life in both Marital Trust One and Marital Trust Two. Accordingly, the division of Marital Trust into Marital Trust One and Marital Trust Two will not disqualify Marital Trust One and Marital Trust Two as QTIP trusts under IRC Sec. 2056(b)(7).

c. 2519. One issue was whether, when the surviving spouse renounced his interests in Marital Trust One, he would be deemed to have made a gift of the property of Marital Trust Two under IRC Sec. 2519. The IRS held it would not. Specifically, when the surviving spouse renounced his interests in Marital Trust One, the renunciation is deemed a gift of his income interest in Marital Trust One under IRC Sec. 2511, and a gift of all the property owned by Marital Trust One, other than his qualifying income interest in Marital Trust One, under IRC Sec. 2519. Spouse's gift tax liability for the transfer of his qualifying income interest in Marital Trust One will be determined under Reg. Sec. 25.2511-2. The surviving spouse was not deemed to have made a gift of the property in Marital Trust Two under IRC Sec. 2519.

d. 2044. After the surviving spouse renounced his interests in Marital Trust One, no part of Marital Trust One deemed transferred under IRC Sec. 2519 will be includible in Spouse's gross estate under IRC Sec. 2044(b)(2).

e. 2702. When the surviving spouse renounced his interests in Marital Trust One, his interests in Marital Trust One will be separate and distinct from his interests in Marital Trust Two. Therefore, when the surviving spouse renounces his interests in Marital Trust One, his interests in Marital Trust Two are not treated as a retained interest for purposes of IRC Sec. 2702(a)(1).

B. **<u>Directed Trusts, Uniform Act</u>**.

1. On July 19, 2017, the National Conference of Commissioners on Uniform State Laws approved the Uniform Directed Trust Act at a March 17-18, 2017 Drafting Committee Meeting.[237]
2. The draft act notes that there is no consistent vocabulary for the non-trustee powerholder in a directed trust. Many terms are common in practice, including "trust protector," "trust adviser," and "trust director." It also notes that there is considerable uncertainty about the fiduciary status of a non-trustee that has a power over a trust and about the fiduciary responsibility of a trustee concerning the actions taken or directed by the non-trustee.
3. Under the Uniform Directed Trust Act, a trust director has the same default and mandatory fiduciary duties with respect to a power of direction that would apply to a trustee if a trustee held the same powers and a directed trustee is liable only for the trustee's own "willful misconduct." This concept was based in part on the Delaware statute.[238]
4. Under the Uniform Directed Trust Act a beneficiary's primary recourse for a trust director's misconduct is an action against that trust director for breach of fiduciary duty to the beneficiary. The beneficiary also has recourse against the trustee, but only to the extent of the trustee's own willful misconduct. Thus, the usual duties of trusteeship are preserved in the trust director, and in addition. the directed trustee also has a duty to avoid willful misconduct.

C. **<u>Fiduciary or Not</u>**.

1. **<u>Take-Away</u>**.

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[237] The act is available at: http://www.uniformlaws.org/shared/docs/divided%20trusteeship/2017mar_UDTA_Mtg%20Draft.pdf ; See Charles Rounds, Jr., Uniform Directed Trust Act Approved," Aug 03, 2017, http://www.wealthmanagement.com/estate-planning/uniform-directed-trust-act-approved .

[238] Del. Code Ann. tit. 12, § 3313 (2016).

a. State statutes may inadvertently affect the ability to use certain planning techniques. For example, a state statute that mandates that all powers holders in a trust must act in fiduciary capacity may prevent granting a person the power to add a beneficiary or to loan the settlor trust assets as those powers may not be feasible to exercise in a fiduciary capacity. The following discussion reviews these issues considering possible ambiguity in the North Carolina statute that appears to mandate that all power holders are to act in a fiduciary capacity.
b. Article 8A of the North Carolina General Statutes, establishing the "power holder" under NC law, is intended to provide clarity of the powers a Trust Protector may have in North Carolina trusts and establishes that anyone acting as a power holder acts in a fiduciary position. Yet, due to the broad definition of a power holder and the kinds of powers that the statute establishes as those of a power holder, it blurs the lines on whether other common trust positions (i.e. a person with the ability to loan trust assets to the Settlor without collateral ("Loan Director"), a person with the ability to add a charitable beneficiary to the trust ("Selector"), etc.) can be considered non-fiduciaries. The powers held by a Loan Director or Selector could not function if the person holding them was considered a fiduciary, as the Loan Director or Selector would violate their fiduciary duty by exercising those powers. Making a loan without adequate security might be impractical for anyone in a fiduciary capacity to consummate. Similarly, how can a Selector add a charity to the class of beneficiaries if a fiduciary duty is owed the current beneficiaries?
c. It is unclear whether a practitioner can safely add Loan Director or Selector provisions to trusts governed by North Carolina law in a non-fiduciary position. Any practitioner establishing a trust in North Carolina should carefully review N.C.G.S. § 36C-8A and determine in what manner Loan Director and Selector provisions should be included. Practitioners in other jurisdictions that have enacted trust protector or other statutes addressing these issues should review those statutes to determine if similar ambiguities arising in the North Carolina statute exist in their own state.
d. When a practitioner wants to include a Loan Director, Selector, or any other provision in a trust where the person must act in a non-fiduciary capacity, the practitioner should consider establishing that trust under state law that is clear and unambiguous that those positions can act in a non-fiduciary capacity.

2. **Discussion.**
    a. The definition of "power holder" in § 36C-8A-1 is broad, including any "person who under the terms of a trust has the power to take certain actions with respect to a trust and who is not a trustee or a settlor…" While the North Carolina legislature may have intended for the statute to apply to a person performing actions that have become common with the Trust Protector position, by creating such an inclusive definition of power holder the statute becomes applicable to any other positions created within the trust, including the Loan Director, the Selector, or any other position the trust drafter may have included beyond a traditional trustee.
    b. The powers of a power holder outlined in § 36C-8A-2 provide some clarity of the legislature's intent regarding the scope of this statute. Reviewing the various powers conveyed to the power holder in § 36C-8A-2(a)(1) through (3) and § 36C-8A-2(b)(1) through (5) provides several arguments that the statute does not apply to the Loan Director or Selector positions.
    c. § 36C-8A-2(a)(1) through (3) establishes that a power holder can have the power to direct, or consent, "Investments…" for the trust (§ 36C-8A-2(a)(1)), or any "Discretionary distributions of trust assets…" (§ 36C-8A-2(a)(2)), ending with a general statement of "Any other matter regarding trust administration…" (§ 36C-8A-2(a)(3)). The powers listed here are of the nature traditionally held by a trustee. However, the powers held by a Loan Director or a Selector are a relatively new creation in trust law, and not within the traditional purview of a trustee. An argument can be made that the term power holder under the statute does not apply to the Loan Director or Selector positions, as they are not conferred powers traditionally held by a trustee.
    d. The ability of a power holder to "modify or amend" the trust to "achieve favorable tax status under applicable law" and "take advantage of law governing restraints on

alienation…" is provided in § 36C-8A-2(b)(1). Adding a Loan Director or Selector provision creates grantor trust status in the trust, and the concept of achieving favorable tax status can be argued to make the statute applicable to anyone holding a Loan Director or Selector position. However, the inclusion of a Loan Director or Selector position itself is the cause of the favorable tax status, it is not the result of a modification or an amendment of the trust, as the statute contemplated for a power holder.

e. The capability to "increase or decrease the interests of any beneficiary" is given to a power holder in § 36C-8A-2(b)(3). The Loan Director's ability to loan assets to the Settlor do not have the result of increasing or decreasing a beneficiary's interest in the trust. However, an argument could be made that the Selector's ability to add a charitable beneficiary has the effect of decreasing the interests of current beneficiaries by reducing their share of the trust assets. When drafting trusts with Selector provisions, a practitioner should carefully consider the scope of the Selector's ability to add beneficiaries to the trust, and attempt to mitigate arguments that the Selector is a power holder based upon decreasing the interests of beneficiaries.

f. The core concern of the statute is established in § 36C-8A-3, "Duty and liability of power holder" which states that a power holder is a fiduciary, unless one of the exceptions outlined in § 36C-8A-3(a)(1) through (3) apply to the power being exercised. If it is determined that a Loan Director or a Selector falls under the definition of a power holder as discussed above, the Loan Director or Selector will be considered acting in a fiduciary position unless the practitioner can argue the actions are taken under one of the three exceptions:

g. 36C-8A-3(a)(1)- A power holder is not a fiduciary when acting to remove and appoint a trustee or power holder. This is not applicable to any of the powers held by a Loan Director or Selector.

h. 36C-8A-3(a)(2)- The power "constitutes a power of appointment held by a beneficiary of a trust." This is not applicable to any of the powers held by a Loan Director or Selector.

i. 36C-8A-3(a)(3)- Any power that when exercised, or not, only affects the interests of the power holder and no other beneficiary of the trust. The powers held by a Loan Director or Selector can be seen as affecting the interests of other beneficiaries, as the inclusion of the provisions granting Loan Director or Selector powers confers grantor trust status on the trust. In addition, it can be argued the Loan Director provision changes interests of other beneficiaries through changing the nature of the assets the beneficiary has an interest in, from either liquid or illiquid assets to an interest in a promissory note from the Settlor held by the trust. As discussed above, the authority of a Selector can be argued to change the interests of other beneficiaries due to the dilution caused by adding a charitable beneficiary.

j. In 36C-8A-8, the statute vests any powers held in the trust by a power holder back to a trustee when no power holder is available to exercise those powers. The powers held by a Loan Director and Selector cannot be exercised by a trustee, which lends credence to the concept that the Loan Director and Selector are not power holders, and thus not held to the fiduciary standard. Consider adding a provision to any trusts including Loan Director and Selector provisions stating that a person cannot serve as both Trustee and Loan Director or Selector.[239]

D. **<u>Flexible Trust Drafting in Light of Repeal Uncertainty</u>**.

1. **<u>Take-Away</u>**. Estate planning should not be deferred because of estate tax repeal and other tax uncertainties. Rather, planning should be done with more flexibility to provide more options to address whatever tax environment develops.

2. **<u>Discussion</u>**.

a. Trust protectors have become more common in irrevocable trusts. Giving a person the power to change the governing law and situs, and to take other steps infuses flexibility into an irrevocable trust to respond to future changes.

b. Before swap powers became a primary mechanism of creating grantor trust status, trusts sometimes included a right for a person, acting in a non-fiduciary capacity, to add a charitable beneficiary. This right, during the grantor's lifetime, characterizes the trust as a

[239] Acknowledgement to Joseph H. Mitchiner, Esq. of Mitchiner Law Firm, PLCC for contributions in this section.

grantor trust. With all the uncertainty over income and estate tax law changes, consider adding a broader charitable designator provision. If the estate tax is repealed there may be no downside to making charitable gifts of trust assets. If the income tax rules for charitable contribution deductions become more restrictive perhaps it will be advantageous from an income tax perspective to make the gifts out of a trust instead of by the individual. Don't have the power end on the grantor's death, permit it to continue in perpetuity since the purpose is not merely to trigger grantor trust status, but to add flexibility to planning. If the estate plan is successful, significant wealth will be shifted out of your estate to long term irrevocable trusts. What resources will future generations direct to charity if their inherited wealth is in trust with no charitable beneficiaries?

c. Swap powers should continue to be used to create grantor trust status and provide flexibility to shift appreciated assets. This power can be a useful tool to build in flexibility. The settlor can transfer family business interests to an irrevocable trust, locking in valuation discounts available under current law. But if the settlor later wants to return those assets to her name, she can swap in an equivalent amount of cash and receive the business back. This could be useful to obtain a basis step up on death. It could enable the settlor to change dispositive schemes and transfer the business to another heir. If a capital gains tax on death is enacted, the settlor could reverse swap shifting appreciated assets into the trust (the opposite of what most do under current law) to avoid a capital gains on death.

d. Loan powers can be added to a trust. Similar to the charitable designator, it had been common to include a power to a person acting in a non-fiduciary capacity to make loans to the settlor of the trust. Adequate interest should be charged but adequate security is not necessary. This too would have characterized the trust as a grantor trust. While grantor trust status can be assured with a swap power, perhaps a loan provision should still be included, but now more for providing a means for the settlor to access trust principal than for grantor trust characterization. If the estate tax is repealed the settlor might be more comfortable with the planning knowing that there is a means to provide access to trust funds, even if that is as a loan.

e. Powers of appointment should be included to provide further flexibility. Granting someone else the power to transmute limited powers of appointment into general ones can be used to cause some or all the trust assets to be included in an estate to qualify for a basis step up on death could that prove advantageous under a future tax system.

f. Consider that beneficiaries holding the ability to direct how assets pass on their death may not understand how tax, trust, creditor, and divorce law work in the real world, thereby exposing future generations to loss of Trust assets? Might it be advisable to require the exercise of a Power of Appointment to be conditioned upon an in-person consultation with a qualified lawyer? The following language has been suggested:[240]

    (1) "Each Primary Beneficiary of a separate trust created hereunder shall have a limited Power of Appointment (as defined in Section X of this Trust Agreement) with respect to the property remaining in such separate trust upon the beneficiary's death, either outright or in trust, and in such proportions as the beneficiary may choose, among the lineal descendants of the Grantor (other than the power holder), provided that this restriction to the lineal descendants of the Grantor shall not apply if there are no descendants of the Grantor other than the power holder then surviving. This power of appointment shall be a limited power of appointment, and the beneficiary shall be prohibited from appointing the property to the Grantor, to himself or herself, to his or her estate, to his or her creditors, or to the creditors of his or her estate, provided that there will be a power to appoint to the creditors of the estate of a Primary Beneficiary to the extent necessary to prevent federal generation skipping tax from being imposed on this Trust or any assets under this Trust at any time. The power shall be exercised, if at all, by a specific reference in the beneficiary's Last Will and Testament duly admitted to probate by a court of competent jurisdiction which shall refer to this Trust Agreement. Notwithstanding the above, and in order to

[240] Planning idea and sample language provided by Alan Gassman, Esq.

assure that the Primary Beneficiary has been properly counseled with respect to the advantages of keeping assets under trust for future generations, such power shall not be exercisable unless such Primary Beneficiary shall meet physically to confer with a lawyer who has at least ten (10) years' experience to discuss the advantages of maintaining assets under trusts to facilitate protection of beneficiaries from creditors, divorce, estate taxes , and improvidence, and no exercise of such power shall be considered to have occurred unless such qualified lawyer signs a letter contemporaneously with the execution thereof to confirm that the execution follows a consultation with such lawyer which provided input and advice with respect thereto."

(2) "Further, at any age as an adult, such Primary Beneficiary shall have the power to designate the successor Trusteeship to take effect upon the death of the Primary Beneficiary of such separate trust or any trusts created therefrom, by a signed writing delivered to the Trustee then serving or by specific reference to this power in the Primary Beneficiary's Last Will and Testament, provided that in order to be able to exercise such power, such Primary Beneficiary shall meet physically to confer with a lawyer who has at least ten (10) years' experience to discuss the advantages of maintaining assets under trusts to facilitate protection of beneficiaries from creditors, divorce, estate taxes, and improvidence, and without such consultation, as evidenced by a letter from such lawyer confirming that the consultation occurred and that the above was discussed, no such exercise of the power to designate the successor Trusteeship shall have any force or effect."

g. Consider granting a person the ability to create an IRC Sec. 2038 power. The trust could give the trustee, or perhaps a third party acting in a non-fiduciary capacity, a power to grant the settlor the right to control the beneficial enjoyment of trust assets. This would cause estate tax inclusion in the settlor's estate under IRC Sec. 2038. A corporate trustee may be unwilling to exercise such a power so it may be advisable to grant the power to an individual. Consider giving the power to a non-fiduciary. This can provide a mechanism to cause estate inclusion and obtain a basis step up on the settlor's death if that proves advantageous. It might be advantageous to grant the trustee the right to select which assets to grant this power over. If an asset has declined in value, it may be preferable to avoid changing the basis at death. Caution, if the estate tax is repealed, there will presumably be no Section 2038, so how the step up in basis would be effected under a repeal regime is uncertain.

h. Long term or perpetual trusts should be favored. Have trusts last a long time or forever. If a client leverages wealth out of his estate, why not keep it out of whatever tax system the future might bring. Long term trusts protect your heirs from suits, divorce, and more.

i. Incorporate decanting powers into the trust instrument. Give the trustee the power to merge the trust into a new and improved trust so administrative provisions can be modified to address future circumstances. Decanting can be used to add or remove a swap power, add an insurance trustee provision so insurance can be added to a trust that did not provide for it, and so much more. Even if you are able to accomplish the desired modifications with a trust protector action, or non-judicial modification by beneficiaries, including broad decanting powers in the instrument may prove helpful.

j. Consider hybrid DAPT provisions. If the trust is formed in one of the states that permit self-settled trust as (DAPTs), the client can be a beneficiary of her own trust. However, if she resides in a state that does not permit these trusts, some advisers view it as too risky to create a DAPT in a state that does. But there is a hybrid solution that might reduce the risk some experts perceive, yet leave open the possibility of you benefiting from that trust. Do not name the client initially as a beneficiary. Instead give someone the right to add as beneficiaries of the trust the descendants of the client's grandparents. If the client is not a beneficiary initially the trust should not face that risk. But this may afford the client the possibility of being a beneficiary if he needs access in the future. Some practitioners are not comfortable with even a hybrid DAPT approach as they are concerned that if the settlor is even a potential appointee of the trust that could make the trust a self-settled trust and cause estate inclusion under IRC Sec. 2036 because creditors might be able to reach the corpus. These practitioners prefer to create a hybrid DAPT in a DAPT jurisdiction.[241]

E. **Grantor/Non-Grantor Conversion**.

1. **Take-Away**. The conversion of a split-interest trust such as a charitable lead trust ("CLT") to a grantor trust will not trigger adverse income tax consequences, but it will also not permit claiming a charitable contribution deduction. For a donor/settlor to a CLT to obtain an income tax deduction the CLT must be a grantor trust when the transfer is made by the donor to the trust. A later conversion will not salvage the income tax deduction.
2. **Discussion**.
   a. In PLR 201730018 (July 28, 2017) the IRS held that the conversion of a non-grantor trust to a grantor trust was not a taxable transfer of property.
   b. The trust is seeking to amend its governing agreement, pursuant to state law to add a power to substitute. The person to be named in the new article to hold such power, the Substitutor, will be given the power, exercisable at any time in a nonfiduciary capacity (within the meaning of IRC Sec. 675(4)), without the approval or consent of any person in a fiduciary capacity, to acquire or reacquire trust principal by substituting other property of an equivalent value, determined as of the date of such substitution. The person to be named as Substitutor is not a trustee of Trust. The IRS held that adding the substitution power would make the charitable trust a grantor trust as to the settlor.
   c. Rev Rul 85-13 describes the income tax effects of a non-grantor trust becoming a grantor trust, which effects did not include the realization or recognition of any income by the grantor-owner by reason of the conversion. The IRS held that the conversion of the trust from a non-grantor trust to a grantor trust will not constitute a transfer of property to the grantor from the trust under any income tax provision.
   d. The IRS held that there would be no gain recognized on the conversion of the trust from a non-grantor trust to a grantor trust.
   e. The person named Substitutor is a sibling of the grantor. The rationale for naming the sibling of the settlor rather than the settlor is to avoid a disqualified person holding such power to avoid a substitution of assets with the trust, which is a charitable trust, from constituting an act of self-dealing. The PLR noted that a split-interest trust would be treated as a private foundation. IRC Sec. 4947(a)(2) provides that in the case of a trust which is not exempt from tax under IRC Sec. 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in IRC Sec. 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under IRC Sec. 170, IRC Sec. 4941 applies as if such trust were a private foundation and imposes an excise tax, paid by the disqualified person, on each act of self-dealing between a private foundation and a disqualified person for each year in the taxable period, and requires correction of the act of self-dealing which would include any direct or indirect transfer to a disqualified person of the income or assets of a private foundation. of IRC Sec. 4941(d)(1)(E). Rev Proc 2007-45, 2007-2 CB 89, Sec. 8.09(1), provides that the exercising of a power to substitute trust assets as described in Code Sec. 675(4) may result in an act of self-dealing under Code Sec. 4941. The sibling named as Substitutor would not trigger an act of self-dealing if the swap power were exercised.
   f. While the donor to a grantor charitable lead annuity trust may claim a federal income tax charitable deduction under IRC Sec. 170(a) in the year that assets are irrevocably transferred to the trust. Rev Proc 2007-45, Sec. 8.01(2) no deduction will be permitted on the conversion. The IRS also held that the grantor could not recognize a charitable contribution deduction on the conversion of the trust from a non-grantor trust to a grantor trust because the conversion of trust from a non-grantor trust to a grantor trust is not deemed a transfer of property held by trust for income tax purposes. Without a transfer, the grantor cannot claim an income tax charitable deduction under IRC Sec. 170(a).

F. **Incomplete Gifts to SLATs**.

1. Contributions to, and distributions from, two identical lifetime irrevocable trusts, did not trigger gift tax liability to the beneficiaries or members of the trusts' Distribution Committee. [242] Husband

[241] Acknowledgement to Mike Horlic, Esq. for some of these points.
[242] IRS Letter Ruling 201742006.

and wife each created a trust for the benefit of themselves and their children. Distributions from the trust were to be determined by the grantor and a distribution committee which included the grantor. At the inception of the trust, the Distribution Committee was composed of the grantor and two of the three children. The IRS indicated that how the trust would be operated would determine whether the grantor would be deemed an owner of a portion of the trust. The grantor's gifts of property to the trust were not subject to gift tax, because the grantor had retained powers under the trust such that the transfers were not completed gifts.

G. **ING Trust**.

1. The IRS issued a series of favorable private letter rulings approving the use of the incomplete gift, non-grantor trusts technique ("ING" trusts). PLR 201718003 to PLR201718012.
2. PLR 201729009 (July 21, 2019) the IRS discussed the ING technique where the distribution committee controlled income and principal.

H. **Modification, Court Ordered**.

1. The power of beneficiaries to modify a trust did not extend to a modification that would allow the beneficiaries to replace the corporate trustee.[243]

I. **Non-Judicial Modification**.

1. See "Decanting…."

J. **Privilege – Attorney Trustee**.

1. Does the attorney-client privilege protect communications between the trustee and its counsel? If so, is it discoverable should litigation occur between the trustee and the trust beneficiaries? What about privilege as between counsel of a predecessor trustee and a successor trustee? [244]

K. **Seattle Trust Taxation**.

1. Seattle Approved an income tax on trusts.[245]

L. **Special Needs Trusts ("SNTs")**.

1. Empower the trust protector to conform SNT to meet state law and to demand a financial accounting as well as reports as to activities on behalf of the special beneficiary.
2. Authorize the Trustee to make a contribution or contributions to a Qualified ABLE account under Section 529(A) of the Internal Revenue Code on behalf of the beneficiary. All contributions shall be made in cash. Contributions made for the benefit of the beneficiary shall not exceed the annual contribution limits (from all sources) as imposed by Section 529(A)(b)(2)(B) and the aggregate excess limitation (from all sources) as imposed by Section 529(A)(b)(6). [246]

M. **Severance**.

1. PLR 201731006 (Aug. 7, 2017) An extension of time was granted to sever a marital trust into two separate trusts, and a reverse QTIP election.

N. **State Taxation of Trusts**.

1. Minnesota cannot tax inter-vivos trusts as resident trusts based solely upon the domicile of the grantor.[247]

O. **Swap Powers**.

1. Is anyone really monitoring swap powers? Are lines of credit set up to facilitate quick action for a terminally ill client? Since appreciated assets inside the trusts will not receive a step-up in income tax basis on death the use of the swap or substitution power contained in the trust must be monitored to swap assets back into their estate that are significantly appreciated before death. Who has the information or ability to monitor when such a power can be used? Also since the trusts are grantor trusts, harvesting gains and losses for the settlors personally should be coordinated with such actions for the trust. If the settlors wish to make a charitable donation, if trust property is

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[243] Trust Under Agreement of Edward Winslow Taylor, No. 15 EAP 2016 (PA July 19, 2017).

[244] Fiduciary Trust Int'l of Cal. v. Klein, 216 Cal.Rptr.3d 619 (Ct. App. 2017); Forney v. Forney, No. E063262, 2017 WL 1833138 (Ct. App. May 8, 2017) (unpublished). See also, Hunton & Williams LLP, "Privilege Is It Anyway? - Issues Involving Successor Trustees," June 29 2017, http://www.lexology.com/library/detail.aspx?g=f4fbe8c6-a422-4994-ad38-42d263dd81dd&utm_source=lexology+daily+newsfeed&utm_medium=html+email+-+body+-+general+section&utm_campaign=aba+rptel+subscriber+daily+feed&utm_content=lexology+daily+newsfeed+2017-06-30&utm_term .

[245] Council Bill 119002.

[246] Acknowledgements to Bernard A. Krooks, Esq. for these planning ideas.

[247] Fielding v. Comm'r of Rev., 2017 WL 2484593 (Minn. Tax Ct. May 31, 2017).

more highly appreciated then personal property they should swap the property back into their names and then make the donation using that property.

2. PLR 201647001 provides important reminders on swap powers and tax reimbursement clauses that have become so ubiquitous that some may have become lax in their use. The modification of an irrevocable trust to include a tax reimbursement clause did not cause adverse tax consequences. The PLR stated: "Due to unforeseen and unanticipated circumstances, payment by the Grantors of the income taxes on Trust's income has become unduly burdensome…Under Statute, the court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration, or if, because of circumstances not anticipated by the settlor, modification will further the settlor's stated purpose or, if there is no stated purpose, the settlor's probable intention." The PLR discussed Rev. Rul. 2004-64 concerning the tax reimbursement clause added. assuming there is no understanding, express or implied, between either Grantor and the Independent Trustee regarding the Independent Trustee's exercise of discretion, the Independent Trustee's discretion to satisfy either of the Grantor's obligation would not alone cause the inclusion of the trust in Grantor's estate. However, such discretion combined with other facts (e.g., an understanding or pre-existing arrangement between Grantor and Independent Trustee regarding exercise of this discretion; a power retained by Grantor to remove the trustee and name the grantor as successor; or applicable local law subjecting the trust assets to the claims of Grantor's creditors) may cause inclusion of Trust's assets in Grantor's gross estate. With respect to the swap power the PLR cited Rev. Rul. 2008-22 concerning avoiding estate inclusion. The swap power must be exercisable in a nonfiduciary capacity, to acquire property held in the trust by substituting other property of equivalent value. The trustee must have a fiduciary obligation (under local law) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value. Also, the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries.

P. **Reformation**.

1. PLRs 201723002, 201723003, 201737001 and 201737008, the IRS ruled on the tax consequences of the court-ordered reformation of a trust.

LV. **Valuation**.

A. The Court was addressed the valuation adjustments for paintings, including discounts for the risk of cleaning the paintings and artist attribution.[248]

LVI. **Wills**.

A. **Digital Wills**.

1. **Smart Phone Will**. A will on an iPhone was admitted to probate.[249] www.queenslandreports.com.au/docs/db_keydecisions/

B. **Florida**.

1. The Florida Governor vetoed a bill proposing electronic wills be permitted.[250] The proposed bill would have sanctioned the witnessing and notarization of a document by video observation. A rationale for the veto was concerns about adequately ensuring authentication of the identity of the parties to the transaction.[251]

C. **New Hampshire**.

1. New Hampshire is considering digital wills permitting testators to execute wills on-line with electronic signatures.

D. **E-Notarization**.

1. All states are authorized to accept some form of e-notarization in conformance with the Uniform Electronic Transactions Act (UETA) which was approved in 1999 by the National Conference of Commissioners on Uniform State Law (NCCUSL).

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[248] Estate of Kollsman v. Commissioner, T.C. Memo 2017-40 (February 22, 2017).

[249] Estate of Karter Yu, www.queenslandreports.com.au/docs/db_keydecisions/ .

[250] Craig R. Hersch, "Florida Governor Vetoes Electronic Wills Act," Jun 28, 2017, http://www.wealthmanagement.com/estate-planning/florida-governor-vetoes-electronic-wills-act?NL=WM-17a&Issue=WM-17a_20170628_WM-17a_440&sfvc4enews=42&cl=article_1&utm_rid=CPG09000005740948&utm_campaign=9933&utm_medium=email&elq2=baaecc7b569c4695ab7bfc0ef9316c12 .

[251] Florida House (CS/SB 277) and Senate (CS/SB 206), modeled after the Uniform Electronic Transactions Act.

2. The Electronic Signatures in Global and National Commerce (ESIGN) Act was passed in 2000 by the federal government and grants legal recognition to electronic signatures.
3. The National Notary Association (NNA) made remote notarizations a topic of their annual conference.