57TH ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING

HECKERLING 2023

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AMERICAN BAR ASSOCIATION

Real Property Trust and Estate Law Section

57th Annual Philip E. Heckerling Institute on Estate Planning January 9-13, 2023 *Heckerling 2023– Reports*

Heckerling 2023

University of Miami School of Law Center for Continuing Legal Education
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http://www.law.miami.edu/heckerling

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Heckerling 2023 – Report 1

Monday Fundamentals Program

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning that is being held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling .
This report includes coverage of the Monday morning Fundamentals session. Report 2 will cover the Monday afternoon Recent Developments session.

FUNDAMENTALS PROGRAM
Using and Misusing the Marital Deduction
Speakers: Lauren J. Wolven, Julie Miraglia Kwon, Cynthia G. Lamar-Hart
Monday, January 9, 2023
ABA Reporter: Mary Elizabeth Anderson
Take Home Thought: Being a good planner is more than being a good code nerd – it's about asking the right questions.

Basic Requirements to qualify for marital deduction (2056(a)):

- Property passes or has passed from the Decedent
- To the Surviving Spouse, and
- Included in the Decedent's gross estate

Types of Marital Deduction Bequests:

- Outright - keep it simple, avoid conditions except 6-month survivorship requirement.
- Qualified Terminable Interest Property ("QTIP"): 2056(b)(7) – assets pass from decedent with a qualifying income interest for life of spouse and election is made. Income cannot be paid to or controlled by anyone other than spouse.
- General Power of Appointment Trust: 2056(b)(5) – must include the spouse or spouse's estate under general power.
    - Payment to creditors is not sufficient for the marital deduction
    - Spouse can have a lifetime limited power which would not be allowed in QTIP.

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- Estate Trust – Income can be accumulated, and assets do not have to be income producing, but assets must be paid to spouse's estate.
- Qualified Domestic Trust (QDOT) – non-citizen spouse trust
    - Citizenship is measured at the time of filing the estate tax return, not at death
    - If the surviving spouse becomes a citizen after decedent's death and before date of filing, a QDOT is not required.

Simple Planning – Outright disposition to Surviving Spouse and Portability

- Easiest method to qualify for the marital deduction is an outright, in fee, transfer to surviving spouse
- Transfer of the deceased spouse's unused exemption through portability simplifies planning for tax purposes, but other non-tax factors should be considered.

Advantages to relying on portability:

- Simplification – no longer have to worry about balancing asset values and ownership between the spouses
- Step up in basis – assets owned by the surviving spouse receive new basis at spouse's death, compared to assets held in a credit shelter trust which will not receive new basis
- Avoids state death taxes – no need to have separate formula allocations for state and federal tax limits

Drafting Tip – A number of states do have state level death taxes. Good planning will provide state exceptions in the event the client moves to a state that does have a state estate tax.

Disadvantages of Portability

- Deceased Spouse Unused Exemption (DSUE) is lost if the surviving spouse remarries and survives another spouse
- Required to file an estate tax return – subjects the estate to potentially unnecessary risks, costs, and disadvantages
- Rev. Proc. 2022-32 expands the time for filing a portability return from 2 years to 5 years

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- Simultaneous deaths could prevent use of DSUE unless the estate plan addresses survivorship
- DSUE does not grow and may not cover appreciation of assets in surviving spouse's estate

Practice Tip – Always include a DSUE calculations on the federal estate tax returns –even if the value is 0. Including the DSUE calculation allows for future DSUE if values are later adjusted.

Disclaimer Planning

- May push assets from outright disposition to QTIPable trust,
- Can be used to decrease marital deduction – allows surviving spouse to wait and see before funding credit shelter trust or qualifying assets for marital deduction
- Can be difficult to force the assets into the correct location if cascading disclaimers through multiple generations are required.
- Should draft in contemplation of disclaimer – Documents should direct the assets in a specific manner in the event of a disclaimer.
- Not valid if there is an acceptance of benefits.

Planning Tip - Disclaimer planning should be clearly expressed in client communications. Do include a note in the cover letter and send a clear reminder about the time requirements to protect the plan (and the planner) from a client's failure to remember the details.

Generation Skipping Transfer (GST) Tax Issues – the type of transfer matters

- Outright transfers and general power of appointment trusts cannot use the decedent's GST exemption. Any exemption allocated by the decedent is wiped out when the assets are included in the surviving spouse's estate because the surviving spouse is considered the transferor for GST purposes.
- Reverse QTIP election allows decedent to remain as transferor for GST purposes.

Drafting Tip: Cannot have a partial reverse QTIP election. Trust instrument should allow for separate GST exempt trust to apply the reverse QTIP election over the correct amount of assets to create a fully exempt share and non-exempt share.

Fun with funding formulas

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Two basic categories:

- Pecuniary
- Fractional

Three formulas:

- pecuniary marital
- pecuniary credit shelter
- fractional

Eight potential options:

- True worth pecuniary,
- Fairly representative pecuniary,
- Minimum worth pecuniary,
- True worth reverse pecuniary,
- Fairly representative reverse pecuniary,
- Pro rata fractional,
- Pick and choose fractional,
- Single fund.

Most planners pick one or two options and rarely deviate. However, planners should be thoughtful about types of funding for different estates and assets.

- There may be an opportunity to push appreciation to a smaller portion of the estate, or family dynamics may require the spouse or credit shelter to have a fixed amount not subject to valuation risks.
- Additional expenses may be avoided by using a funding formula that does not require the revaluation of a hard to value asset.

Lifetime Planning with the Marital Deduction

Only applies to citizen spouses. Non-citizen spouses do not have an unlimited marital gift deduction, but rather receive an enhanced annual exclusion amount.

Terms that Qualify for the Marital Deduction:

- Charitable remainder trusts with spouse as the sole non-charitable beneficiary
- Unitrust payments defined as the greater of accounting income or a % of total trust assets

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- Donor spouse may become a beneficiary of the trust if they outlive the beneficiary spouse.

Lifetime transfers allow the use of the beneficiary spouse's exemption while donor spouse maintains control over the ultimate disposition of the assets, and allows donor spouse to use GST exemption.

Practice Tip: Make the reverse QTIP election to use donor spouse's exemption. Do not make the election if you want beneficiary spouse exemption to be used.

Donor spouse may be able to create lifetime QTIP for asset protection planning:

- Donor spouse can set up trust for beneficiary spouse, and
- At beneficiary spouse's death, donor spouse can become the beneficiary of the trust.

Watch out because some states treat these trusts as self-settled trusts subject to donor spouse's creditors.

Divorce and Deduction Planning

- Do take advantage of the marital deduction to make transfers of property between spouses prior to the finalization of the divorce.
- Do review grantor trust status and consider whether powers given to the former spouse will continue to trigger grantor trust statues and whether that status should remain on or be turned off.

Our 2023 **Reporters** are:

- **Beth Anderson, Esq.**, an attorney with Wyatt, Tarrant & Combs, LLP in Louisville, Kentucky;
- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;
- **Katharine Griffiths, Esq**, an attorney with Holland & Knight in Tampa, Florida and
- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank);
- **Alexa Langweil, Esq**., an attorney with Schafer Thomas Maez PC in Broomfield, Colorado;
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Heckerling 2023 – Report 2

Monday Recent Developments Program

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning that is being held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2022 brochure is available at www.law.miami.edu/heckerling
www.law.miami.edu/heckerling.

This report includes coverage of the Monday afternoon Recent Development session. Report 3 will include some of the Tuesday General Sessions.

RECENT DEVELOPMENTS

Speakers: Steve R. Akers, Samuel A. Donaldson, Beth Shapiro Kaufman
Monday, January 9, 2023
ABA Reporter: David J. Slenn
Materials by: Steve R. Akers, Turney P. Berry, Samuel A. Donaldson, Stephen W. Murphy, Jeffrey N. Pennell, Charles A. Redd, William I. Sanderson, and Howard M. Zaritsky
Edited by: Ronald D. Aucutt

Federal Legislation.

The panelists covered noteworthy developments in the first 11 months of 2022, as well as some developments from 2021. The discussion started with a review of federal legislation, which focused on the Inflation Reduction Act. The panelists addressed the lack of estate tax proposals (that prompted many to transfer wealth towards the end of 2021) in the enacted legislation. One issue that could impact planners is the increased IRS funding, which should result in more IRS audits. Panelists turned to the SECURE 2.0 Act as part of recent omnibus spending bill. Some of the highlights covered by the panelists include:

- Increased in age for required minimum distributions
- Roth treatment for matching contributions
- Rollovers and 529 Plans
- Reduction of excise tax (for not making RMD)
- IRA Charitable rollovers (one time only, up to $50,000, rollover into a charitable remainder trust or charitable gift annuity)
- Roth plan distributions for 401k plans
- Conservation easements

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The panelists then turned to the possibility of the applicable exclusion amount changing with the current Congress, concluding it is highly unlikely the amount will go down.

2023 Budget Proposals.

Panelists considered the administration's 2023 budget/Greenbook proposals, which they don't see happening with this Congress.

- Deemed realization of gain on death
- Grantor trusts
    - gain recognition on transactions between grantor and grantor trust and
    - paying income tax on grantor tax.
- Limited duration of the GST exemption
- Limits on private foundations that use DAFs to satisfy the 5% distribution requirement.

These proposals are worth discussing with clients to make them aware of how things could change.

Administrative Guidance: Final and Proposed.

Panelists moved on to discussing to administrative guidance from Treasury with proposed regulations in February under the original Secure Act. One panelist joked about how the Secure Act's original title was "Substantial Help Impacting Taxpayers Act." The proposed regulations help us implement Secure 1.0, and address various items, including:

- What it means to be a "minor" – we now have a universal rule (21)
- Situations where you have eligible designated beneficiaries mixed in with designated beneficiaries in a trust scenario, which would require considering separate trusts
- If there is a 10-year payout, some felt you could wait until end of 10th year, but the regulations provide that if the participant was already taking Required Minimum Distributions (RMDs), then starting in the year after death, there must be an RMD for each of the first nine years with complete distribution in the 10th year (and no penalty for failure to make distributions in 2021-22)

Corporate Transparency Act (CTA)

Planners should be aware of these rules, which will be addressed in more detail in another Heckerling program. The US has been viewed by other countries as a tax haven because you can form entities here and not tell anyone who actually owns them. The CTA will address this. There are two

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sets of regulations, a set of final regulations and proposed regulations on another topic.

Final regulations provide the scope of what this will cover, and include definitions such as a "reporting entity" and exclusions from the definition. If an entity is a reporting entity, it must file information about "beneficial owners". The panel focused on whether a trust owns an interest in a reporting entity, and who must report as a beneficial owner. For entities formed after 2023, Reporting Companies "applicants" must report their applicants– which can include lawyers and others. These rules do not take effect until January 1, 2024, which is less than a year away.
Things to do:

- Until January 1, 2024, we should get ready and, get educated about these laws.,
- If you have clients with LLCs they're not doing anything with, consider shutting them down to avoid reporting.
- If a client wants to form an entity, consider setting it up this year to avoid the applicant reporting requirement.

<u>Exceptions from Anti-Clawback Rules</u>

The panel addressed anti-abuse provisions to the anti-clawback regulations, finalized in 2019. These anti-abuse provisions were provided in proposed regulations issued in April of 2022. Professor Donaldson mentioned how anti-clawback solved a problem that was never a problem to begin with, but has now been idiot-proofed with proposed regulations. He provided an example of how the general anti-clawback rule operates, and then how the new anti-abuse provisions would apply to deny an estate the benefit of the anti-clawback provisions.

<u>Actuarial tables, estate expenses and portability</u>

- The panelists finished up their discussion of administrative guidance by covering a few more issues. The actuarial tables were updated, with the new mortality tables applying once regulations are finalized. In the meantime, you can choose between current numbers or numbers under the proposed regulation.
- Estate administration expenses were also addressed – many estate tax audits involve this item. The proposed regulations applied a present value concept (if expense paid more than 3 years after date of death, discount to present value to determine how much deductible), it determined when interest is deductible, when a

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decedent's guarantee would be deductible, and appraisal requirements.

- o Consider making administration expense payments/prepayments before the 3 year mark to avoid discounting.
- o The regulations give us 11 factors (drawing upon case law) to consider in applying the "actually and necessary incurred in the administration" and "bona fide in nature" tests pertaining to interest payments. None of these factors are dispositive, but you should review these to get a better idea of how the IRS will approach your interest deductions

- There is an extension of time from 2 years to 5 years to make portability election by filing an estate tax return with special language

Treasury-IRS 2022-23 Priority Guidance Plan.

Every year the IRS tells us what projects it is working on. A big focus for rest of this year is Inflation Reduction Act guidance. Three new items were on this plan in our area:

- The basis of assets in grantor trust,
- Qdots (changing obsolete references) and
- Portability.

The panelists discussed why the is IRS focusing on the basis of assets in a grantor trust. The general rules under section 1014 seem fairly straightforward, especially as to assets held in trust where the assets are not included in the grantor's estate. The panel surmised a couple of esteemed colleagues wrote an article that suggested you could get a step up in basis for grantor trust assets not included in the estate. Per Beth Kaufman: this really isn't a debate; the answer is clear (no). Professor Donaldson agreed and said only flat-earthers would believe to the contrary.

Federal Transfer Tax Developments.

The panelists covered important cases, IRS rulings, etc., all involving transfer tax topics addressing gross estate inclusion, valuation, claims against the estate, marital and charitable deductions, gifts made

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indirectly through a spouse, GRATs, GST, portability, and creditors' rights issues.

- *DeMuth*. The son's power of attorney permitted son to make annual exclusion gifts for dad. Dad was about to die and son realized he did not make annual exclusion gifts yet.
    - Son wrote 11 checks to donees before dad died.
    - Of the 11, only 1 was paid by drawee bank before dad's death.
        - Another 3 were deposited with depository banks of donees, but did not clear donee bank for payment.
        - The other 7 checks were in the possession of donees.
    - If the gift is complete, it is not part of dad's gross estate. If the gift is not complete, the funds are subject to estate tax.
    - The question is whether the donor or donor's agent has the power to issue a stop payment to call money back – until the donor or agent loses this ability, the gift is not complete.
    - So only 1 gift (the one paid by the bank) was complete here.

- PLR 202206008, a family modified an irrevocable trust to add a formula GPOA for a beneficiary up to the extent it would not cause payment of estate tax. Two letter rulings were requested and granted:
    - GPOA would not cause trust to lose its GST exempt status.
    - Only formula amount would be included in the decedent/beneficiary's gross estate – not all trust assets. The IRS granted this ruling with very awkward language, suggesting that only to the extent a GPOA is *exercised* would the assets be in the gross estate (which we know is not correct – only assets *subject* to GPOA are in gross estate.)
    - The panel cautioned not to use this formula language verbatim. In these formula GPOAs, you should also consider adding language expressly ignoring the availability of the marital or charitable deduction. This is to avoid all of the trust being included in the beneficiary's gross estate. Also consider which assets are subject to GPOA, and consider limits on the GPOA, requiring consent of non-adverse party.

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- *DeMatteo:* The Tax Court denied summary judgment involving the valuation of life insurance policies (appraisal (taxpayer) versus interpolated terminal reserve value(IRS)

- *Sorensen:* Application of a *Wandry* clause. The parties settled, however, the panelists addressed a number of important planning observations one should consider with the use of *Wandry* clauses:

    - How the transaction is <u>documented</u>,
    - How the parties should <u>acknowledge</u> the shares transferred, and
    - How the transaction is <u>actually carried out</u>.
    - Also consider the taxpayer in this case might have been motivated for the *Wandry* clause's failure given the explosion in value.

- <u>Interest rate / inflation adjustments</u>. The panel turned to the current Section 7520 rate, how it compares to historic rates, and how 2022 was the end of the low interest rate era. Higher interest rates will impact on other figures. The gift tax annual exclusion was $16,000 in 2022, and is now $17,000 in 2023, perhaps $18,000 next year. The basic exclusion was $12,060,00 last year, and this year, it is $12,920,000; the $860,000 increase to the basic exclusion amount was the largest ever attributed to *inflation* rather than *legislation*.

- <u>Valuing gifts with GRATs</u>. The panel turned to cases/audits involving GRATs, including the *Baty* case. *Baty* involved a transfer of publicly-held stock to a GRAT by an insider where there were ongoing merger discussions involving the company. A 2019 CCA regarding this case took the position that the valuation should take into account the merger. The taxpayer eventually filed a petition in Tax Court to contest the IRS position. The petition made many strong arguments in favor of using the NYSE market price. The IRS conceded this case before going to trial.

- <u>Securities/GST issues</u>. After discussing securities law issues, the panel turned to PLRs related to GST election relief under 9100. What's not in the rulings are situations where there is an election out of automatic allocation and then permission is requested to make a late allocation (i.e., undoing an election you made and not making a new allocation). Relief has been denied, not with adverse rulings,

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but just refusing to rule. Some people feel you should always opt out, one panelist does not subscribe to this.

- Personal liability for estate tax. The panel discussed fiduciary liability and how a trustee may face liability just as an executor/personal representative. This should be considered before taking on the appointment as a fiduciary.

Charities and Charitable Contributions.

- Assignment of income. The panel covered the *Keefer* case, and how the assignment of income doctrine could apply to provide a horrible result for donated property. This case also involved a misstep involving failure to comply with strict compliance with contemporaneous written acknowledgment requirement.
- Conservation easements. The panel moved on to the controversy surrounding conservation easements, and how defective deeds involving the property resulted in a denial of deduction. The panel then focused on how the IRS's failure to comply with the APA worked to the taxpayer's benefit in *Hewitt*. This discussion turned to how the IRS's failure to comply with the APA has also impacted its ability to enforce reportable transaction reporting requirements.

State Law Developments.

The panel discussed the *Yost* case, where an ex-son-in-law tried to get out of paying a loan obligation, arguing the ex-father-in-law always intended the note to be a gift to avoid paying gift tax. The *Jones* case involved a testator who initialed every page of his Will but forgot to sign the signature page. The will was held to be valid with the panel noting that the decision reflects a trend liberalizing will execution formalities. Another case turned on the Oxford comma, with the takeaway being to pay close attention to its usage, or consider redrafting to avoid its usage and avoiding misinterpretation.

Drafting tips. The panelists closed the program with a discussion of drafting errors, including the use of the term per stirpes. The panel advised drafters to fully understand how the state defines per stirpes, and in any event, to consider including a definition to avoid different results. The panelists also noted how some drafters use "in equal shares" where it is not appropriate, or the phrase "share and share alike" which is not helpful.

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- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank) ;
- **Alexa Langweil, Esq**., an attorney in Philadelphia, Pennsylvania
- **Michelle R. Mieras, J.D., LL.M., CTFA,** a Senior Vice President with BOK Financial Private Wealth in Denver, Colorado;
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Heckerling 2023 – Report 3

Tuesday, January 10th General Sessions

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This report covers some of the Tuesday General Sessions.

It's a Nice Place to Visit, but Do You Want to Live There?

Speaker: Amy K. Kanyuk
Tuesday, January 10, 2023; 10:25 a.m.
ABA Reporter: Alexa Langweil

One Big Thing: When establishing a new long-term trust for a client, an attorney is not expected to know the law of all fifty jurisdictions; however, an attorney should understand her clients' objectives and have a basic knowledge of where those objectives can be met most effectively. If said jurisdiction is one in which the attorney is not licensed to practice, she should find a skilled attorney in that other jurisdiction who can confirm the benefits available there and participate in the drafting.

First step is to figure out a client's objectives. Then, an attorney should determine which state has laws that allow the client to best fulfill those objectives for the trust and for the conveyance of the client's wealth.

- Once a trust is established, the speaker believes a trustee does not have a duty to monitor the trust and tax laws of every state and move the trust to another state if its laws seem preferable.
- When establishing a trust, set the trustee up for success by including language authorizing the trustee to change the situs and governing law, as well as clarifying that the trustee does not have a duty to continually forum shop.

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Keep in mind that the right jurisdiction may be the client's home state and for some clients, the comfort of keeping things local may outweigh the benefits another jurisdiction may provide.

If it seems like another jurisdiction may be a better choice, **determine** how much of a connection exists between the trust and the other state to ensure:

- that the governing law designated in the trust agreement will apply if there is an issue in the validity or the construction of the trust,
- that the settlor's home state cannot assert that its laws apply due to a public policy of the home state.

The more contact with the chosen jurisdiction the better. If the settlor is a nonresident of the chosen state, the trustee must be a resident (a corporate trustee should have a physical presence and administer the trust there, and if possible, custody trust assets there).

Factors to Consider in Choosing a Jurisdiction for a New Long-Term Trust:
Rule against Perpetuities: Certain states have abolished the rule against perpetuities, while others have extended the vesting period (e.g., 365 or 1,000 years). Establishing a long-term trust in one of these jurisdictions, and allocating GST exemption to it, dollar for dollar, will produce a trust:

- that is not includible in the gross estates of the trust's settlor or its beneficiaries; and
- distributions from which are not subject to the GST tax.

When establishing a trust to which the rule against perpetuities does not apply, an attorney should include language limiting the duration of the trust to the perpetuities period if otherwise the rule would be violated.
Directed Trusts: Historically, all of a trustee's duties – administration, investments, and distributions – were held by the trustee alone, and the trustee was a professional trustee that had the resources and knowledge to manage the trust properly. Despite the benefits of a professional trustee, clients may want certain decisions, especially those related to investments and distributions, to be made by someone other than a third party who is not intimately acquainted with the family and the family's finances.

This led to directed trusts, which allow unbundling of fiduciary duties among various participants, rather than conferring all of those duties on

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one unitary trustee. With a directed trust, the trustee exercises the powers conferred on the trust advisors only at the direction of the trust advisors, who are almost always themselves fiduciaries.

Cautions: Each state approaches directed trusts differently:

- standard of liability imposed on the trustee,
- nature and scope of the trust advisor's powers

The trustee's liability may affect the client's choice of trustee, as well as any potential trustee's willingness to serve.

Prudent Investor Rule: The prudent investor rule is based on modern portfolio theory, which the speaker summarizes as "don't put all your eggs in one basket." The Uniform Prudent Investor Act, adopted in 46 states, requires trustees to follow the prudent investor rule, under which the trustee has a duty to diversify the trust assets unless "the trustee reasonable determines that because of special circumstances the purposes of s trust are better served without diversifying." While diversification is the default rule, the UPIA states that in the trust agreement, the settlor can expand, restrict, or eliminate the diversification requirement and the trustee won't be liable if it acts in reasonable reliance on the provisions of the trust agreement.

Diversification issue: Modern portfolios may contain assets such as bitcoin, artwork, hedge funds, crowdfunds, and NFTs, which presents an issue as the UPIA may not provide sufficient protection for trustees to avoid the diversification requirement.

- Trustees have been held liable for failure to diversify even when the trust agreement specifically authorizes or requires the trustee to hold a concentrated position.
- To address this problem, some states have statutorily enhanced the protections available to a trustee who doesn't diversify based on the express language of the trust agreement.

What to do:

- Attorneys with client wishing to fund a trust with undiversified assets should look for a jurisdiction with more protection than the UPIA provides.

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- Alternatively, establish the trust in a jurisdiction that permits **private purpose trusts**, a trust established to carry out a specific purpose, which could be the ownership of a concentrated position or nontraditional assets. Purpose trusts are unenforceable at common law, so an attorney must find a jurisdiction that has a statute allowing noncharitable perpetual purpose trusts.

Asset Protection: Almost every client is concerned with protecting assets left to their beneficiaries from the claims of the beneficiaries' creditors.

- **Agreements that create third-party trusts should contain spendthrift clauses.** States differ in whether they have exceptions to the spendthrift exception. Some states won't enforce spendthrift clauses for certain creditors, particularly child support and alimony, whereas others have no exceptions. Regardless, if a trust is fully discretionary with no mandatory distribution and withdrawal rights, the spendthrift clause doesn't add a great deal of protection, as the beneficiaries don't have property interests that can be attached by creditors (they have mere expectancies).

- **Choosing a jurisdiction that has common law showing the state's propensity to protect trust assets is also important**, but results-oriented judges may find a way around the protection that a discretionary spendthrift trust can provide, especially when the creditor is sympathetic (e.g., former spouse/children).

- As for **self-settled trusts**, historically, it has been considerably harder to protect a settlor's own assets from creditors. However, about twenty states have statutes allowing the formation of self-settled **asset protection trusts** ("APTs"), designed to protect the trust assets from the claims of the settlor's creditors. An APT can be set up as a long-term trust that continues beyond the settlor's life, and it may be possible to use an APT to avoid state income tax and exclude the trust assets from the settlor's estate. It's not entirely clear whether a person who is not a resident of an APT state can form a trust in a state with an APT statute and still obtain the desired asset protection and tax benefits, so it's important to advise clients of this uncertainty. **In selecting an APT state, attorneys should consult the ACTEC comparison chart.**

Nonjudicial Trust Modification: Choosing a jurisdiction for a new long-term trust should include an analysis of the tools available in a particular state that can be used to change an irrevocable trust without having to go to

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court. **Ensure that trustees have the flexibility to make changes in the future. Remember that even if state law allows for nonjudicial modification, attorneys should confirm that tax consequences of said changes.**

Decanting, a trustee exercising its power to distribute trust principal to or for the benefit of a beneficiary by distributing the assets to a new trust, has evolved rapidly, and in some states is now tantamount to a trustee modification power. Trustees often use decanting to correct a trust's administrative provisions, to correct errors or ambiguities in the trust agreement, and to address changes in tax laws, but it can also be used to change beneficial interests, which attorneys should be careful in doing.

Given the popularity of decanting, it is not unlikely that a long-term trust will be decanted in the future, so analyzing the decanting laws of the relevant state is advisable when selecting trust situs.

Consider whether the state law allows decanting when the trustee doesn't have discretion, and whether the state requires or authorizes the trustee to notify beneficiaries of the decanting.

Nonjudicial settlement agreements: Many states now allow trusts to be changed through a **nonjudicial settlement agreement** between the interested parties, which in most cases are the trustee and the current and first-line remainder beneficiaries. NJSAs, as authorized under the UTC, can be used for almost any purpose, except it cannot be used if it would violate a material purpose of the trust or if it contains conditions that a court would not approve (both require the trustee to make judgment calls).

Takeaway: To provide a trust with maximum flexibility, look for a jurisdiction with liberal options for nonjudicial modification. If a client wishes to rule from the grave, the attorney should examine the relevant state's nonjudicial modification laws, and if necessary and possible, should include language in the trust agreement stating that those nonjudicial modification tools don't apply to the trust or restricting them in some other fashion.

State Income Taxation of Trusts: The state income taxation of non-grantor trusts at the trust level is usually a significant consideration in choosing the jurisdiction in which to establish a new long-term trust. The settlor and her advisors must consider the bases upon which a particular state imposes its

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income tax, and take affirmative steps to avoid taxation in states with which the trust might have contacts.

The easiest way to limit exposure to state income tax is to establish the long-term trust in a state that does not tax the income of non-grantor trusts. However, even trusts that are created in no-tax states might be subject to tax in another jurisdiction, depending on the income tax bases in that jurisdiction. In the trust agreement, the settlor can control some of the factors that might affect a state's imposition of income tax on the trust; e.g., the trust agreement could require or authorize a change of trustee if it would reduce the income tax burden on the trust. Given the uncertainty that multiple fiduciary participants bring to the income tax analysis, **the settlor should consider limiting the participation of non-trustee fiduciaries living in states that tax the trust on the basis of a resident trustee.**

Quiet Trusts: A **quiet trust** either doesn't require the trustee to provide information to the beneficiaries or actually prohibits the trustee from providing information.

Accounting to the beneficiaries, however, is crucial to the trust relationship. The common law requires the trustee to inform and report to the beneficiaries, but a few of the UTC states and several non-UTC states have made the duty to inform and report a completely default law, meaning the settlor can waive any and all requirements to report to the beneficiaries, even if a beneficiary asks for such information.

To keep the terms of a long-term trust and information about its administration and assets private, establish the trust in a state:

- That permits a trustee to have a silent trust or
- That allows accountings to be provided to a designated representative who receives such information on behalf of the beneficiaries.

The speaker advises the use of a quiet trust, but also permitting the trustee to account on its own initiative.

No Contest Clauses and Pre-Mortem Validation Procedures:

- **A no contest clause** discourages litigation when a beneficiary is disappointed with her inheritance, providing that a beneficiary receives nothing under a will or trust if she challenges the validity of

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the document. Usually, a no contest clause states that any beneficiary who challenges the document will be treated as if the beneficiary predeceased the settlor without descendants, even if the beneficiary actually has descendants, as this may be sufficient incentive against litigation.

Every state except for Florida upholds no contest clauses in some manner, most interpreting such clauses narrowly and won't enforce them if the beneficiary has probable cause to contest the validity of the agreement.

When a client anticipates unhappy heirs, the attorney should examine the relevant state's interpretation of no contest clauses.

- Alternatively, a settlor concerned with potential litigation from unhappy beneficiaries can bring an action during his life to establish the validity of the trust.

These pre-mortem validation procedures work well, as the settlor is the best witness as to his capacity or intent. These procedures are especially useful when a client knows that someone will challenge the trust after his death, as such procedures usually result in a court order that the trust is valid, making a contest likely to be unsuccessful.

Lloyd Leva Plaine Distinguished Lecture
What's Under the Robe?

Speaker: Judge Maurice B. Foley
ABA Reporter: Joanne Hindel

Key Take Aways:
A person's upbringing and personal life as well as professional life will influence their judicial philosophy. Judicial philosophy is a "big deal", and every judge is influenced by their judicial philosophy.

Judge Foley was appointed to the United States Tax Court by President William J. Clinton on April 9, 1995; reappointed by President Barack Obama on November 25, 2011; and elected as Chief Judge for a 2-year term effective June 1, 2018 and re-elected February 21, 2020 for a second 2-year term effective June 1, 2020.

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He received a Bachelor of Arts degree from Swarthmore College; a Juris Doctor from University of California, Berkeley School of Law; and a Masters of Law in Taxation from Georgetown University Law Center. Prior to his appointment to the Court, he was an attorney for the Legislation and Regulations Division of the Internal Revenue Service; Tax Counsel for the United States Senate Committee on Finance; and Deputy Tax Legislative Counsel in the U.S. Treasury's Office of Tax Policy.

Personal life influencers:

Maurice Foley was raised by a father who was an air force sergeant and postal worker and raised five children. He recounted how his father had told him that "your mother and I are going to spend every penny we earned so you kids cannot fight over the money" –his father even threatened to swallow the last cent if it had not been spent at the time of his death!

Judge Foley explained that he became interested in tax during his college years- especially when his political science professor explained how tax incentives could get Republicans to agree with Democrats and how tax incentives are used to encourage certain economic behavior. At the age of 19 he told his professor that he wanted to be a tax attorney and this professor became a life-long mentor.

Professional life influencers:

At the IRS he learned the importance of clarity and being sure that something is not subject to multiple interpretations. Proper placement of commas and clauses- following the strict dictates of Congress.
Judge Foley became very aware of the limits on the Executive Branch's authority – what did Congress say?

Legislative drafting sessions really changed his life. At one session he sat in the back as a newly licensed attorney and found he could not figure out what the attendees were talking about – it took a number of sessions to figure that out.

The person running the meeting was often asleep! A day or two after each session there would be a draft that synthesized all the gibberish into a coherent document.

He learned how to draft rules that really accomplish what a proposal is supposed to do.

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He was hired by the Senate Finance Committee to handle individual tax issues including the estate and gift tax issues. That experience gave him the opportunity to see the intersection between economics and politics and he learned that the nexus between the economic and political system was the tax law.

Development of his judicial philosophy:

Judge Foley witnessed the Senate Finance Committee hearings for the nominations of Renato Beghe, Carolyn Chiechi, and David Laro for appointment to the United States Tax Court.

Judge Foley conveyed an excerpt from these hearings before the Senate Finance Committee in which each candidate was questioned as to whether the Tax Court or Congress should close a loophole in legislation created by Congress. Judge Beghe said that Congress should close the loophole. Both Chiechi and Laro also took that position.

Judge Foley learned that the Senate Finance Committee members wanted to be sure that the power to change the laws rests with Congress- not with the judges.

The clear message was "Don't try and read our minds – just follow the rules and if it is not clear – let us know and we will fix the law".

Judge Foley provided one example of his own judicial philosophy in the dissent he wrote in McCord v. Commissioner, 120 T.C. 358 (2003), rev'd sub nom., Succession of McCord v. Commissioner, 461 F.3d 614 (5th Cir. 2006). In that case Petitioners' family owned a limited partnership. In January 1996, petitioners executed an assignment agreement (i.e., specifying in dollar amounts the net fair market value of interests) that irrevocably transferred their limited partnership interests to GST trusts, their sons, and charitable organizations. The Commissioner contended that the petitioners understated the fair market value of their donated interests. The Tax Court relied upon the assignment agreement and agreed with the taxpayers. Judge Foley wrote a dissent.

The Fifth Circuit reversed the Tax Court; upbraided it for employing a novel approach neither advanced nor briefed by either party; rebuked it for improperly relying on the donees' post-gift confirmation agreement; emphasized that it "violated the firmly- established maxim that a gift is valued as of the date that it is complete ... [and] that subsequent

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occurrences are off limits"; and stated "we cannot improve on the opening sentence of Judge Foley's dissent:

Undaunted by the facts, well-established legal precedent, and respondent's failure to present sufficient evidence to establish his determinations, the majority allow their olfaction to displace sound legal reasoning and adherence to the rule of law. *Succession of McCord*, 461 F.3d at 626.

A brother's advice

After he wrote that dissent his brother called him and told him to have someone escort him to his car and check under the car for bombs. But his judicial colleagues did not hold his dissent against him.

Closing thoughts

Judge Foley generously and candidly shared some of his personal and professional history to provide the audience with an understanding of what exists "under his robe" and how he arrived at his particular judicial philosophy.

You're Fired! Whether, When, and How to Terminate Representation of a Client (Including Ethical Considerations)

Speaker: Bruce M. Stone
ABA Reporter: Katharine G. Griffiths

Lawyers do **Two Fundamental Principles of Firing a Client:**

1. not have an absolute right to fire a client.

   Exception: You <u>must</u> fire a client if the representation of that client will result in you violating the rules of professional conduct or other laws.
2. It is a fiduciary decision to fire a client.

Ethical Considerations

If your situation does not fall within the exception to number one above, then you can fire a client in the following scenarios:

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- The termination can be accomplished without material adverse effect to the interests of the client.
    - This is a facts and circumstances test.
    - The determination of material adverse effect must be in good faith and must be reasonable.
    - Considerations:
        - Will it take the client so much time looking for a new lawyer that it would prejudice client?
        - Will there be duplicative fees for a new lawyer to get up to speed?
        - Does the client have confidential information relevant to the representation that is so sensitive the client will not want to disclose that information again to a new lawyer?
        - Are there deadlines, like statute of limitations?
        - Can you assist the client in getting new counsel and assist new counsel to get up to speed without incurring fees?
    - If no material adverse effect, there need not be any justification for termination.
- Client gives informed consent to the termination.
    - You must communicate adequate information about the material risk of termination to the client. You should provide the client with all of the facts and circumstances, the advantages and disadvantages, and the client's options and alternatives.
- Client persists in course of action using your services that you reasonably believe is criminal, fraudulent, or in breach of the client's fiduciary duty.
    - Your belief that this is happening must be reasonable.
- The following reasons for firing a client require that you balance your interests with the client's interests. If the harm that will be caused to the client by the termination substantially outweighs the

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harm to the you, you cannot withdraw unless the client gives informed consent.

- Client insists on taking action that is repugnant or imprudent.
- Client fails to fulfill substantial financial obligation to you (i.e., not paying fees).
- Client is making the representation unreasonably difficult.
- Your relationship with the client has become irreparably broken.
- Other good cause.

How to Fire a Client (Examples)

- Don't hire them in the first place!
  - Mr. Stone made it clear that the easiest way to fire a client is to never hire the client in the first place. Unlike firing a client, a lawyer has unfettered discretion to not hire a client (except that you cannot refuse to hire a client for illegal discriminatory reasons).
  - Mr. Stone emphasized that you should trust your instincts here. If you have a bad feeling about a potential matter, you likely should not take it, because those matters often become the matters you want to get out of later.
- How to fire the client who won't take your advice.
  - Mr. Stone provided an example of a client who does not follow your advice and requests that you draft a much simpler estate plan that does not incorporate your estate tax savings plan.
  - Rather than drafting the basic documents, Mr. Stone suggested firing the client because otherwise you may face a lawsuit from the beneficiaries upon the client's death when a big estate tax bill is incurred.
    - This client could be fired if there is no material adverse effect to the client.
    - This client could also be fired because client insists on taking imprudent action.

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- In most situations, the detriment to the client will not substantially outweigh the detriment to the lawyer in this scenario.
- Communicate the reasons for the withdrawal to the client. Be concise, use plain English a non-lawyer can understand, and do not make any negative comments about the client.

- How to fire a client who is experiencing mental decline.
  - Mr. Stone provided the example of a client in mental decline with family members who don't like each other and will likely litigate after the client's death. Client now asks you to re-draft estate planning documents in a way that shift interests among the beneficiaries. In your opinion, the client no longer has testamentary capacity.
  - You could potentially fire the client if there is no material adverse effect, there is irreparable breakdown of the relationship, or because there is other good cause.
  - However, if there is no one else who can look after the client's interests, such as a court-appointed guardian, Mr. Stone thinks you should not terminate the representation.

At the end of the day, Mr. Stone emphasized that the most important thing in these situations is to, in the words of Spike Lee, "do the right thing."

Our 2023 **Reporters** are:

- **Beth Anderson, Esq.**, an attorney with Wyatt, Tarrant & Combs, LLP in Louisville, Kentucky;
- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;
- **Katharine Griffiths, Esq**, an attorney with Holland & Knight in Tampa, Florida and
- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank) ;
- **Alexa Langweil, Esq**., an attorney in Philadelphia, Pennsylvania

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- **Michelle R. Mieras, J.D., LL.M., CTFA,** a Senior Vice President with BOK Financial Private Wealth in Denver, Colorado;
- **Michael Sneeringer, Esq.**, an attorney with Porter, Wright, Morris and Arthur, LLP in Naples, Florida,
- **David J. Slenn**, **Esq.,** an attorney with Akerman, in Naples, Florida.

The **Report Editor** is **Bruce A. Tannahill, J.D., CPA/PFS, CLU, ChFC, AEP.**, Director, Advanced Sales, for Mass Mutual Financial Advisors in Wichita, Kansas,

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Heckerling 2023 – Report 4

Tuesday, January 10th General Sessions

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning that is being held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling .

This report covers the balance of the Tuesday General Sessions. The other Tuesday General Sessions were covered in Report 3. Report 5 will cover some of the Wednesday General Sessions.

Not Too Rich, Not Too Poor: Goldilocks Planning for the Middle-Rich Clients Who Need Our Help

Speaker: Turney P. Berry
ABA Reporter: Craig Dreyer

GOAL OF SESSION

Mr. Berry's goal was to discuss how we implement plans for middle rich clients. He noted that often these strategies use very basic trusts without much complexity. He noted that there are more complex and efficient ways to implement these strategies, but they may not be appropriate for the middle rich due to increased cost, complexity, and risk.

WHO IS MIDDLE-RICH?

In order to implement planning for middle rich clients we need to discuss who they are. Generally middle rich can eliminate estate tax with minimal planning.

- Rich people are the top 1% who have between $12-13 million in our world
- Middle rich probably have twice that amount although the definition is flexible.

HOW TO START EACH MEETING

- Who do we represent?

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- Do we have a proper engagement agreement?
- Have we identified potential conflicts?
    - With people living longer, we have multiple people who have significant interests in a in a single transaction.
    - Be sure to get the appropriate conflict waivers.

GATHERING INFORMATION

Mr. Berry prefers to gather information from clients by talking with them rather than having them come into the office with a bunch of prepared forms. By speaking with your clients, you often learn more than simply the information on a questionnaire.

- You can see if both parties are really interested in the meeting,
- The relationship between the parties, and
- You often can learn about family issues that may not be observed otherwise.

Even though clients are rich, you still need to do the basic groundwork and determine how assets are titled and do the basic estate planning documents.

GOVERNING STRUCTURE OF TRUSTS

Mr. Berry noted that while one can make a career drafting terms for governance structure we still have to deal with people, who are generally terrible, so there are two main categories of governance in trusts:

- trusts where beneficiaries have control, or
- trusts that have an independent third party in control.

He noted that grantor trusts are the backbone of most middle rich clients' estate plans. It is also important to determine the best ways to preserve a married couple's Deceased Spouse Unused Exemption (DSUE).

CLIENT NEEDS IN PLANNING

Clients generally always want control and income. So as planners we often try to accommodate these.

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A. Control- Planning with grantor marital trusts is often a great way to achieve these goals for clients and should be the centerpiece of most plans. These trusts provide a level of control and flexibility most clients are willing to agree to.

   a. We can also use voting and non-voting shares, but we must be careful to gift voting shares 3 years prior to death.

   b. Other options include Powers of Appointment in trusts, but the law gets murky between people who have fiduciary responsibilities and those who do not, and we cannot rely on the title in the document.

B. Income – One way to avoid the issue is to transfer non-income producing assets, but we must be careful as many of these items, such as real property or residences, still need cash flow to pay property taxes and other expenses. Options to provide cash flow include:

   a. Use a swap power to swap non-income producing property for cash to satisfy any cash needs.

   b. For cash flow on income producing property, sell the property for a note, which can produce income/cash flow for the term of the note.

Steps for clients to take after Implementation of the initial estate plan

1. Make annual exclusion gifts,
2. Use applicable exclusion as much as possible,
3. Implement Grantor Retained Annuity Trusts (GRATS), since the taxable gift can be reduced or even eliminated.

Session Takeaway

The Middle Rich prefer to receive assets back rather than pay an unexpected tax.

Mr. Berry noted using formula allocations to trust followed by a trust provision leaving a portion of the trust residuary to Donor Advised Fund is a great way to give clients finality in their planning.
He recommended that no one should die without full use of their exemption in 2023 and suggested accomplishing it by providing a

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Circumscribed General Power of Appointment to a trust. He defined a circumscribed general power of appointment as:

1. A testamentary power to
2. The creditors of the powerholder's estate,
3. Subject to approval by a nonadverse person,
4. Of an amount that when added to other assets in the powerholder's estate doesn't exceed the powerholder's applicable exclusion amount,
5. Over appreciated assets.

Goblins Lamentation List: Unscrambling "Installment Obligations"

Speaker: Paul S. Lee
ABA Reporter: Kristin Dittus

This presentation focused on income tax planning with installment obligations. The title is an anagram of installment obligations. Installment sales became part of the Internal Revenue Code in 1920, more than 100 years ago.

Deferred Payment Obligations in Estate and Income Tax Planning:

- When an installment sale is between the grantor and a grantor trust, including an irrevocable defective grantor trust (IDGT), no income tax is recognized.
- Taxable notes, for assets sold to a non-grantor trust or a third party, will have a combination of gain, return of basis and interest. The buyer receives a full step up in basis at the time of the transaction before all the payments are made.
- Intra-family promissory notes generally do not have deductible interest and are often done to Intentionally Defective Grantor Trusts ("IDGT").
- *The only difference for the above installment obligations are the income tax consequences*.

The Installment Method: The Basics on Taxation

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Calculating the Gross Profit Percentage ("GPP") discussed in IRC §453 is essential to determining the seller's tax consequences. The GPP is the Gross Profit (Selling Price less the Adjusted Basis) over the Contract Price. The selling price and the contract price are the same if there is no debt on the property.

- Installment method applies by default unless the seller elects out.
- There are no requirements on how payments must be made over the term of years.
- Payments must carry adequate interest.
- For a 30-year interest only balloon payment, you can defer the gain for a significant time.
- Only restriction is the term must be less than the seller's actuarial life expectancy at time of sale.
-

(IN)Eligibility for the Installment Method: Assets & Transactions

Mr. Lee used a Venn Diagram to illustrate sales that can be taxed under the installment method.

- Dealer Dispositions and Sales of Inventory are typically **ineligible**, **except** for dealer dispositions of (1) residential lots and timeshares (must apply the AFR interest at sale), and (2) property used in business of farming.

- Nondealer Transactions that are **ineligible** include (1) marketable securities; (2) sale of depreciable property to related persons (depreciable in hands of the buyer); (3) any gain attributable to recapture that is taxed as ordinary income under IRC §§1245 or 1250.

- IRC §1250 recapture that is taxed at 25% rate **is eligible**.

- Sellers discussed in presentation are mainly nondealers.

IRS charges interest on deferred tax liability above $5 million - IRC §453A(a)(1)

Interest Charge is calculated by (Underpayment Rate) x (Applicable Percentage) x (Deferred Tax Liability). The imprecision of this calculation is addressed in the special session.

- The interest charge is a dollar for dollar increase in the tax (not "interest" as an ordinary income item).

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- It applies every taxable year including the year of sale.
- The charge will go down over time unless: (1) the obligation is an interest-only balloon payment, and (2) it increases if interest and income tax rates rise in the future.
- It can affect both spouses if filing jointly.
- The interest charge is non-deductible.

The Pledge Rule of IRC §453A(a)(2):

Pledging a Taxable Installment Note for a loan as collateral will be treated as a payment on the obligation. It is unclear whether the pledge of an interest in a partnership that holds a Taxable Installment Obligation will trigger the Pledge Rule, and this will be explored further in the special session.

IRC §453(e): Resale of purchased property by a related party within 2 years of the first sale treated as a payment.

- If the sale price exceeds the outstanding installment obligation, it will be deemed to complete payment of the obligation, and tax liability is due even if you do not actually receive the full payment.
- A "second disposition" includes a gift or other taxable transfer of the installment obligation, but not any transfer after the earlier of the death of original seller or related party buyer.

Planning point: Sellers want to avoid resale of asset by a related party within 2 years if at all possible.

Not "Rushing" Related Party Sales.

The title references the case *Rushing v. Commissioner*. Mr. Lee gave an example involving spouses with 30-year interest-only "balloon" payment ($10 million in year 30).

- In year 3, the property sells for $11 million, resulting in $1 million in capital gain but no state income liability.
- They reinvest after tax proceeds, growing to $35 million, and in year 28, they pre-pay the obligation.
- Benefits include:

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  - o State and federal income tax deferral,
  - o No interest charge payable,
  - o A wealth transfer of $25 million that remains in the trust.
  - o Flexibility of ability to prepay if advantageous.

Adjusted Basis of Taxable Installment Obligations.

IRC §453B(b) provides the adjusted basis is:
- Excess of the face value over
- unrecognized income if satisfied in full.

The adjusted basis of the installment obligation increases by the amount of gain recognized, NOT the amount of non-taxable basis returned to the seller. Basis allows us to determine the result at death, gift, or other transfer.

Transfers at Death, Gifts, and Taxable Dispositions.

1. **Death-Related Transfers** - Generally, NOT a taxable disposition.
    - Income in respect of a decedent (IRD) so no basis adjustment under IRC §1014.
    - *Notable Exception* - Distribution to the obligor is a taxable disposition.
    - Distribution to a beneficiary as part of a residuary or specific request is NOT a taxable disposition, but if using to satisfy pecuniary obligations, it is taxable.
    - Transfer to a joint tenant by right of survivorship is NOT a taxable disposition.
2. **Taxable Dispositions** – Result is amount of gain or loss on a taxable disposition is either the amount realized or the fair market value of the obligation.
    - Sale or exchange, or gifts.
    - Contributions to and distribution from a **non-grantor trust**.
    - Sale or exchange of an interest in a partnership that holds an installment obligation.

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- Cancellation of the Obligation. If the obligor and oblige are related persons on the cancelled obligation, the fair market value will be deemed to be no less than the face amount of the obligation. There is no analogous rule for gifts.

3. **Non-Taxable Dispositions**

- Transfers between grantor and grantor trust (as to both income and principal).
- Transfers to a spouse or a former spouse incident to divorce (but NOT a trust for the benefit of a spouse).
- Non-substantial modifications that do not "materially change" rights of the seller to receive income.
- Partnerships -- §721 contributions and §731 distributions– covered in the special session.
- Corporations -- §351 contributions and §361 liquidation distributions

Flexibility to Determine When Gain Is Recognized

- Ways to accelerate gain and create a taxable disposition include:
  - electing out of installment sale treatment,
  - resale by related party within 2 years,
  - prepayment of note, and
  - a sale, exchange, gift or pledge.
- Benefits of recognizing gain prior to the death of a taxpayer include:
  - Reducing the taxable estate (by the tax liability) and
  - Eliminating an IRD item from the estate.

Comparing Installment Obligations and Promissory Notes at Death

- If you die with a taxable note, treated as IRD and no basis adjustment under §1014

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- An IDGT note and intra-family loans are both capital assets at death and receive §1014 basis adjustment

When you lose grantor trust status during lifetime, there is a deemed transfer of the underlying property in the IDGT to the trust.

- With ongoing payments to the grantor, becomes a taxable installment note.
- Gain will be recognized to the extent of:
    - The face amount of the obligation
    - In excess of the basis of the assets (important to determine basis for this reason).
- If the asset is not eligible for the installment sale treatment, the conversion will trigger 100% of the gain on the sale.
- Imputed interest will apply if interest on the note is less than AFR.
- Obligation converts from a capital asset (IDGT Note) to IRD.

Planning point: Avoid problems by paying off the note before conversion to non-grantor trust status.

Partnerships are the most sophisticated vehicle for planning with installment obligations and can accomplish more than you can with two individual taxpayers. Mr. Lee will go into detail on Thursday's special session III B, covering 754 elections, sales of the partnership interest, and contributions and distributions of the note.

***"You're No Good, You're No Good, You're No Good, Baby, You're No Good "* – Saying Goodbye to the Recalcitrant Trustee**

Speaker: Craig M. Frankel
ABA Reporter: Michelle Mieras

One Big Thing: The trust agreement (read it!) and/or state law likely grant many options to remove and replace a trustee with varying degrees of court involvement. Have a conversation with the trustee first to see if the issue can be resolved or the trustee is willing to resign.

First Things First

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Don't jump directly to litigation. If communications fail and trustee removal and replacement becomes the chosen path, **read the entire trust agreement** (not a trust summary) to identify any available trustee removal and replacement powers.

- This may be hiding in the form of change of situs or appointment of a trust protector to open further avenues to accomplish the goal.
- Determine the applicable state law, and if situs may be changed to a state with more favorable laws, ask whether a trustee removal action in a new state would be easier than the trustee removal action in the original state.

Avoid the Need to Resort to These Methods

Drafting attorneys should consider how to draft better trusts to avoid the potential issues inherent in an involuntary trustee removal and replacement action by including:

- Functional trustee removal and appointment provisions, even if given to a third party.
- Specific direction about whether the settlor approves of various removal and appointment options that may be available under the law, including circuitous routes such as decanting.

Options If You Must Pursue Removal

If the trust agreement doesn't provide for the removal and replacement of a trustee without cause and the trustee will not resign, consider the following **seven options**. Even citing the applicable state law providing these options may help convince the trustee to step down.

Recommendation:

- **If you do have to wield litigation,** consider that the drafting attorney may not be the attorney best-suited to pursue it, and they may end up being a witness in the matter.

1. Non-judicial Settlement Agreement (NJSA):
Uniform Trust Code ("UTC") § 111 permits interested parties to get together and **enter into a binding settlement agreement, without court action**, regarding trust matters. The NJSA will not be valid to the extent it violates a material purpose of the trust or includes matters that could not be

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otherwise approved by the court. While the **NJSA is the easiest of the seven options,** if available, it raises several issues:

- **Every interested party must sign off on the NJSA**, but the definition of interested party may be unclear. The trustee's status as an interested party depends on the context and whether the court considers a trustee's service to be an administrative versus a substantive power.
- **UTC 111 lists several matters that an NJSA may address**, including the resignation or appointment of a trustee, but **jurisdictions differ on whether the list is exclusive or inclusive.**

Recommendation: While not required, **obtaining court approval of the NJSA is advisable** to prevent any later argument that the NJSA was not approved by all interested parties, violated a material purpose of the trust, or included a matter that a court could not otherwise approve.

2. Modification by Consent:
UTC § 411 and the Restatement (Third) of Trusts ("R3T") § 65 contemplate non-charitable trust modification by consent. The comments to the UTC, some state statutes, and one state decision (Pennsylvania) prohibit using this section to modify a trust to remove a trustee, but perhaps the modification could alter other problematic terms causing beneficiary-trustee conflict or empower someone to remove and replace the trustee.

- **Where the settlor and all beneficiaries agree to modify**, they may do so even if the modification violates a material purpose of the trust. Some states require court approval, others don't.
- **Where all beneficiaries agree to modify, but the settlor does not or cannot agree**, the modification may occur as long as it is not inconsistent with a material purpose of the trust. Again, some states require court approval, others don't.
    - R3T § 65 permits such a modification with court approval even if it violates a material purpose as long as the court determines that the benefits outweigh the thwarted material purpose.
    - If not all beneficiaries agree, some states permit modification subject to court approval, with the added requirement that the interests of all beneficiaries are protected.

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Whether or not the trusteeship constitutes a material purpose of the trust impacts the availability of the options, and that answer varies by state. States also differ in whether the determination of material purpose is confined to the four corners of the document or may expand to encompass all surrounding circumstances.

Recommendation: If material purpose interferes with modification to effectuate trustee removal, is there a workaround via change of situs, modification to provide removal powers to a trust protector, or decanting?

3. Modification for Unanticipated Circumstances:
UTC § 412 permits a court to modify a trust's administrative or dispositive terms due to **circumstances not contemplated by the settlor, if it furthers the settlor's purpose of the trust**. R3T § 66 provides similar guidance.

- Consider this option when there is no other cause to remove a trustee.

4. Removal for Lack of Cooperation Among Co-Trustees:
UTC § 706(b) permits a court to remove a trustee for **lack of cooperation with other co-trustees (not a trustee's lack of cooperation with beneficiaries)** which substantially impairs administration of a trust. This is commonly relied upon by corporate trustees having difficulty getting an individual co-trustee to act.

Recommendation: Estate planners can help avoid lack of cooperation situations by including trust provisions that address co-trustee impasse or ties.

5. Removal for Trustee's Unfitness, Unwillingness, Failure to Administer:
UTC § 706(b) also permits a court to remove a trustee if it determines **removal is in the best interests of the beneficiaries** because of the trustee's unwillingness, unfitness, or persistent failure to effectively administer the trust properly.

- Unwillingness can't be a single event; it has to be a pattern.
- Unfitness could be a long-term pattern of mediocre performance.

6. **Removal for Substantial Change of Circumstances:**
7.

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UTC § 706(b)(4) permits court removal of a trustee in cases of **substantial change of circumstances or all beneficiaries have requested removal**, if removal is in the best interest of the beneficiaries, and removal is not inconsistent with a material purpose of the trust.

- The change of circumstances at issue here is external, and not evaluated from the settlor's viewpoint.
- Determination of material purpose again becomes critical.

8. Removal for Cause:
9.

As a last resort, consider litigation to remove a trustee for cause.

- This is **the most expensive and time-consuming path**, and often the least successful. The burden is on the accuser to shows that the trustee committed a serious breach of trust.
- Consider whether your state permits a jury trial. If not, are there other causes of action that could be added to permit a jury to hear the case?

Our 2023 **Reporters** are:

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- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;
- **Katharine Griffiths, Esq**, an attorney with Holland & Knight in Tampa, Florida and
- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank);
- **Alexa Langweil, Esq**., an attorney with Schafer Thomas Maez PC in Broomfield, Colorado;
- **Michelle R. Mieras, J.D., LL.M., CTFA,** a Senior Vice President with BOK Financial Private Wealth in Denver, Colorado;
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Heckerling 2023 – Report 5 - Revised

Wednesday, January 11th General Sessions

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning that is being held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling.

This report covers two of the Wednesday General Sessions. The third Wednesday General Session will be included in a later report. Report 6 will cover some of the Wednesday Special Sessions.

Revision note: Due to a technical problem, the original Report 5 did not include the complete summary for General Session 9, Current Trends in Special Needs in Elder Law. This Report includes the complete summary.

Current Trends in Special Needs and Elder Law

Speakers: Bernard A. Krooks, Tara Anne Pleat
ABA Reporter: Kristin Dittus

Three recent gifts for special needs planners:

- Federal Legislation
- Proposed Regulations on the SECURE Act
- Supreme Court case *Gallardo v Marstiller*, 596 U.S.___; 2022 WL 1914096 (June 6, 2022).

What is Special Needs Planning? An estate plan that allows government support of a beneficiary while also reserving additional "supplemental" assets for the beneficiary to maintain a high quality of life. Even wealthy clients can be affected by the enormous cost of long-term care.

The SECURE Act (2019) – The crossover between special needs planning and individual retirement account (IRA) distributions. IRA refers to all types of retirement accounts.

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- Imposed a 10 year rule to distribute assets, except for Eligible Designated Beneficiaries (EDB) who can still receive the lifetime stretch IRA.
- **EDB includes**:
    - surviving spouses,
    - persons not more than 10 years younger than the decedent,
    - minor children of the decedent
    - individuals who are disabled or chronically ill (these are today's focus).
- 10-year rule will apply to remainder beneficiaries after the death of the EDB.
- If account owner dies before having to take Required Minimum Distributions (RMD), it may be beneficial to take the distributions over the 10-year term to minimize taxes because no need to make any distributions until month 11 of the tenth year.

IRC §72(m)(7) –Defining a Disabled Individual. Defines an individual as disabled if they are unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which is expected to result in death or to be of long-continued and indefinite duration. It refers back to 72(t) distributions, which are early IRA distributions allowed without a 10% penalty. For individuals under 18 there is no "substantial gainful activity" test, so the focus is on physical or mental impairment. Some minors are treated as adults to determine disability. **Safe Harbor to Qualify as Disabled.** The IRS provides little guidance on proving disability. A safe harbor provides qualification if the individual receives Social Security ("SS") disability income (their own or from a parent) or they receive Supplemental Security Income, a federal income maintenance payment for impoverished individuals, under 65 and a disability determination from SS administration. Individuals are evaluated by the IRC §72(m)(7) standard above and are expected to have the disabled condition for at least 12 months.

Estate Planning Client has a disabled child and wants to qualify for the stretch IRA?

- Qualifying as chronically ill is easier than qualifying under the safe harbor requirements.

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- IRC §7702B(c)(2) defines a chronically ill individual. Provides Medicaid long term care qualifications, such as trouble with activities of daily living or requires supervision due to cognitive impairment.
- SECURE Act requires these conditions to be indefinite or lengthy in nature.
- Certification by a licensed healthcare practitioner, done at the moment of IRA owner or participant's death, but no need to re-certify.

Challenges to Safe Harbor Qualification:

- Person under 18 has insufficient work record
- SSDI requires 40 quarters of work, problem for stay-at-home parent.
- The resource and income tests are often exceeded by a parent's assets and income "deemed" to the child.

Proposed Delay in Time Period to Define a Disabled Child. Ms. Pleat worked with the Special Needs Alliance (SNA), which is a qualification based group similar to ACTEC, to propose that at or pre-death certification that a beneficiary is disabled or chronically ill (DCI) should not be required because it is common for disabilities to arise or be known later in a child's development. If a child is an EDB due to age, allow for proof of disability until end of EDB period when child is 21. An alternative way to qualify could be a certification of disabilities by state waiver programs that help children with disabilities.

ABLE Account Relevance to SECURE Act. ABLE accounts allow contribution of $17,000 a year and are intended as a savings account for disabled people. No requirement to disclose underlying health information to the account administrator but must have records in the event of an audit. Mr. Krooks believes the same concept will apply to SECURE IRA account.

Trusts for Disabled People – For the first time the Treasury Regulations have included reference to conduit and accumulation Trusts. The new Applicable Multi Beneficiary Trust or (AMBT) is a see-through trust with more than one beneficiary; (2) all of the trust beneficiaries are designated beneficiaries (individual or qualifying trust); and at least one trust beneficiary is disabled or chronically ill.

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- Type 1 AMBT: Can be a revocable trust where at least one beneficiary of two or more is DCI. The trust must provide it will be divided immediately upon the death of the account owner into "separate trusts" for each beneficiary. Get the benefit of using oldest DCI beneficiary lifetime for stretch out.
- Type II AMBT: One or more beneficiaries are DCI and no individual (other than the DCI beneficiary) has any right to the account owner's interest in the retirement account until the death of all of the DCI beneficiaries. Upon death remainder beneficiaries are subject to the 10 year rule.
- New SECURE 2.0 allows a Charity as a Remainder Beneficiary**.** Original SECURE Act required individual remainder beneficiaries. SECURE 2.0, §337, provides a carveout for Type II AMBT. Under §408(d)(8)(B)(i), dealing with Qualified Charitable Distributions, an organization described in §170(b)(1)(A) shall be treated as a designated beneficiary.
- This Qualified Charitable Distribution provision does not permit distributions to Donor Advised Funds and most private foundations. Mr. Krooks recommends safe drafting would stay within these guidelines and does not endorse using a special power of appointment to appoint assets beyond a §408(d)(8)(B)(i) entity.

Type II AMBT Highlights:

- Primarily intended to be a Special Needs Trust (SNT), but does not have to be as restrictive as an SNT.
- Proposal includes a request for the final regulations that permits distributions to those who support the DCI beneficiary, such as a travel companion and those necessary for care giving. These payments would be income to the DCI.
- Under PLR 200620025 a taxpayer requested transfer of an IRA to a first party SNT without tax on the transfer. A first party SNT is a self-settled trust where Medicaid can recover their costs on the death of the grantor. The IRS allowed this in 2006 and in 2017, and the speakers are trying to get this into the final regs.

Pot Trusts Don't Work with AMBTs. Sprinkle Powers to multiple beneficiaries in a Discretionary Pot Trust that includes a DCI beneficiary are no longer allowed by the new AMBT rules.

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- Having only the DCI beneficiary restricts the ability to distribute income outside the trust, thereby creating the problem of tax on accumulated income in the trust at the higher trust tax rate.
- Alternative strategies to avoid tax on the accumulated income include contributing the income to an ABLE account (not more than $17,000 a year) or having the beneficiary contribute income to a first party SNT.
- A stretch may not be necessary if beneficiary is unlikely to have long life span.

he IRS is seeking comments on whether an SNT can have a poison pill provision and still meet Type II AMBT requirements.

- A poison pill provision is a boilerplate termination provision directing the trust to terminate or make distributions to other beneficiaries if government agency attempts to treat trust as available resource.
- Typically, they are found in a first party SNT to ensure that no other beneficiary receives trust payments until death of DCI.

Ms. Pleat allows Trustee to amend and remove this provision.
The speakers closed with the new SECURE 2.0 §126, allowing tax and penalty free rollovers from Section 529 accounts to Roth IRAs if certain requirements are met.

America the Gradual: An Update on How Anti-Money Laundering Initiatives Affect Estate Planners

Speakers: M. Read Moore, Nancy G. Hende
ABA Reporter: Michelle Mieras

One Big Thing: The US is on a path toward stricter reporting requirements that impact lawyers planning with entities, as demonstrated by the Corporate Transparency Act of 2021 and subsequent introduced legislation. While the ABA and other professional organizations have successfully intervened on behalf of lawyers thus far, the possibility looms that lawyers themselves could become subject to additional Bank Secrecy Act reporting requirements, with potential negative consequences to representation of clients.

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Corporate Transparency Act of 2021
US Slow to Adopt Reporting Requirements

The US lags behind other countries in adopting anti-money laundering ("AML") recommendations. While fighting crime, terrorism, and corruption does not seem controversial, the tools to do so tend to favor transparency over privacy, creating political backlash.

After more than a decade of defeat, the **US recently imposed reporting requirements via the passage of the Corporate Transparency Act ("CTA")** (but not without the drama of a Presidential veto and subsequent Congressional override), **establishing a national database of beneficial owner information**.

- A **beneficial owner** is the **individual who ultimately owns or controls the entity**. The goal is to look through the entity (and however many additional layers) to get to the actual human being behind the entity.
- The **CTA focuses on smaller businesses that are not otherwise heavily regulated**.
    - Ask: was the entity created simply by filing a document with a state, tribe, or territory?
- **Many exceptions exist**, including an exception for large operating companies.

Recommendation: If you represent an entity that teeters on the edge of meeting the large operating company requirements (gross revenue and/or number of employees) to qualify for an exception to the CTA, carefully monitor that entity and consider whether adjustments (e.g., acceleration of income or entity restructuring) may be made to qualify the entity.

Beneficial Owner Information

The term **"beneficial owner" does not refer to who financially benefits from the entity, but instead focuses on who has control of the entity**, and includes:

- Each individual who directly or indirectly owns 25% or more of the entity (ask: who has the ability to dispose of that interest?), <u>and</u>

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- An individual with control over the entity (e.g., a CEO, senior officer, in house counsel, or anyone performing similar control functions).

Lawyers have cautioned their clients against divulging the sensitive information that will now be collected under the CTA. This information includes the person's full legal name, date of birth, picture of their government identification, and – of most concern to some clients - their physical residential address.

- **Entities subject to the reporting requirements ("reporting companies") are responsible for gathering the beneficial owners' information**, then providing it on the designated form to FinCEN. While the CTA database is not public, there may be concerns about the security of that information in the entity's hands.

Reporting Deadlines and Obligations

Entities are required to report and keep information up to date.

- An existing entity has until the end of 2024 to file its initial report.
- Entities created on or after January 1, 2024 have 30 days from the time formation to report the information.
- Changes to beneficial ownership Information must be reported within 30 days of the change.

Recommendation: Individuals may obtain a FinCEN identification number and provide the identification number, rather than their information, when beneficial owner information is required. This shifts the updating responsibility away from the entity to the individual, and enables the individual to avoid providing their personal information to the entity.

Company Applicants

Beginning January 1, 2024, **anyone who actually files an entity formation document with the Secretary of State, and the person who directed the filing, must provide the same information under the CTA as a beneficial owner**.

- A lawyer creating an entity for clients, and anyone directed to actually file the document (e.g., paralegal) must provide the beneficial owner information.
- **Lawyers and their staff should consider obtaining FinCEN identification numbers** to prevent the need to provide this information to the entity for reporting, as described above.

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Lawyers Enforcing the Law
Are Lawyers Financial Intermediaries?

- Lawyers help form entities and trusts, assist with asset transfers, and give tax advice, leading to being viewed by some as financial intermediaries, part of the financial system, and, by extension, should be subject to the Bank Secrecy Act ("BSA") requirements.
- This would require lawyers to:
  - determine the beneficial owners of entity clients;
  - identify and verify client identity; and
  - engage in governmental reporting for potential money laundering, without letting their client know.
- This requirement already exists in the European Union and the UK. Canada has a softer system that omits the governmental reporting requirement for lawyers.

The US Has Not Gotten There… Yet:

- The US has not yet implemented rules subjecting lawyers, even those acting as financial intermediaries, to BSA requirements.
- The ABA argues that the existing oversight of attorneys and the Model Rules of Professional Conduct already impose sufficient self-regulation.
  - Lawyers are prohibited from assisting a client with criminal activity, which requires the lawyer to know their client, as addressed in the ABA's Formal Opinion 491 in 2020. More recent proposed changes to the Model Rules and their comments move toward implementing due diligence requirements.
    - In 2010, the ABA issued *Voluntary Good Practices for Lawyers to Detect and Combat Money Laundering and Terrorist Financing*, suggesting how lawyers perform due diligence. This was later affirmed in a 2013 ethics opinion.

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- Furthermore, governmental reporting requirements would thwart a lawyer's ability to provide certain clients with effective representation.

But Legislation Has Been Introduced:

- In late 2022, the ENABLERS Act surfaced in Congress, and would have made certain lawyers subject to the BSA requirements imposed on banks, including performing client due diligence and filing suspicious activity reports. The Enablers Act was passed by the House as part of the National Defense Authorization Act, but dropped by the Senate.

Recommendation:
Be vigilant for possible legislation. Contact your Senators and Representative if you do not want lawyers to be subject to BSA requirements.

Our 2023 **Reporters** are:

- **Beth Anderson, Esq.**, an attorney with Wyatt, Tarrant & Combs, LLP in Louisville, Kentucky;
- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;
- **Katharine Griffiths, Esq**, an attorney with Holland & Knight in Tampa, Florida and
- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank) ;
- **Alexa Langweil, Esq**., an attorney with Schafer Thomas Maez PC in Broomfield, Colorado.
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Heckerling 2023 – Report 6

Wednesday, January 11th Special Sessions

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning that is being held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling .

This report covers cover some of the Wednesday Special Sessions. Report 7 will cover Thursday General Sessions.

Special Session I-C: Review of the Past Year's Significant, Curious, or Downright Fascinating Fiduciary Cases

Speaker: Dana G, Fitzsimons, Jr.
ABA Reporter: Michelle Mieras

One Big Thing: The continuous flow of estate and trust litigation imparts valuable lessons made possible by the suffering of others.
Mr. Fitzsimons discussed more than 80 fiduciary cases from across the United States during this 90-minute session. A portion of those cases are reflected below.

The Intersection of Estate Planning and Elder Law

- Attorney appointed as guardian of estate executed a will on behalf of the ward. **The guardian's failure to adhere to notice and hearing requirements related to the creation of the will did not divest the probate court of jurisdiction to probate the will**.
  - Furthermore, the appointment of the guardian did not divest the ward of capacity and the burden of proving lack or testamentary capacity was not met. *In re Est. of Wiatrek*, 2022 Tex. App. LEXIS 5704 (2022).

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- In a dispute over a ward's conservator's petition to modify the ward's revocable trust, the **court protected the privacy of the ward's estate plan and neuropsychological evaluation, as it outweighed the rights of public access**. *Kennedy v. Anne P. (In re Conservatorship of Estate of Kennedy)*, 2022 Cal. App. Unpub. LEXIS 1154 (2022).
- Where the ward himself, rather than his conservator, signed his will, the **provisions requiring a conservator to obtain court approval did not apply**.
    - Again, the existence of the conservatorship did not negate the ward's testamentary capacity. *In re Estate of Davies,* 2022 COA 90 (2022).
- Although state law prohibited a conservator from seeking a dissolution of marriage claim, the **conservator was permitted to pursue an action against the spouse for support and maintenance of the ward**. *Dover v. Ball*, 2022 S.C. App. LEXIS 79 (2022).
- Probate court appointed daughter as father's conservator and guardian. Investigation launched for reasons other than daughter's actions found that the daughter had used some of her father's assets for her own benefit. Daughter was convicted in criminal proceedings and sentenced to 15 years based on her knowingly obtaining control of an elder person's assets with intent to deprive. The conviction was reversed because the court appointing her as conservator and guardian gave her control of the assets; she did not improperly obtain control. *State v. Forbes*, 2022 Mo. App. LEXIS 271 (2022).
- Daughter suffered significant injuries from which she was to never recover. Mother, as settlor and trustee, established a special needs trust for daughter's benefit with payments received following the accident. The SNT defined its purpose and intent to supplement daughter's quality of life. A decade later, following a miraculous recovery, daughter sought to terminate the SNT, and mother objected. **The court terminated the trust due to circumstances not anticipated by settlor (the miraculous recovery) and because termination and distribution of the trust assets to daughter facilitated the trust's stated purpose**. *In re Special Needs Trust ex rel. Moss*, 2022 Mich. App. LEXIS 4094 (2022).

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Investments

- Trustee (also remainderman) was **not negligent in taking 37 days to liquidate assets, during which value dropped significantly**. Fiduciaries holding securities during economic stress and downturns are to be shown leniency. **The Prudent Investor Rule is a question of conduct, not investment performance**. *Matter of Najjar*, 2022 N.Y. Misc. LEXIS 3193 (Monroe County Surrogate 2022).
- The requirements and duties under corporate law are different from those under trust law. **Actions protected in the corporate context by the business judgment rule may still violate a trustee's fiduciary duties.** by *Jemison v. Jemison*, 2022 U.S. App. LEXIS 18258 (3rd Circuit 2022).

Charities

- Trustee ordered to **refund legal fees incurred and paid from trust** in efforts to reform trust that had clear provisions that applied when one charitable beneficiary lost its charitable status. *Matter of NBT Bank N.A. (Stark)*, 2022 N.Y. Misc. LEXIS 32 (2022).
- Organization created a trust to manage intellectual property and retained the power to amend or revoke, which under the organization's operational rules could occur with the vote of two-thirds of its regional delegates. One of the regional delegates sued the trustee, but had no standing because **the trust was revocable and therefore no special interest standing could exist**. The organization itself, as settlor, had oversight over the trust administration. *Autonomous Region of Narcotics Anonymous v. Narcotics Anonymous World Services, Inc.*, 77 Cal. App. 5th 950 (2022).
- Where a trust agreement included incomplete blanks in a charitable gift provision, the charitable gift failed. **Further, as the charity at issue was not a US charity, the court would not favorably construe the document in favor of the charity**. *Chi. Trust Co., N.A. v. Vlachos*, 2022 Ill. App. Unpub. LEXIS 1470 (2022).

Disclosures and Discovery

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- The **trust terms overrode the statutory (UTC) provisions requiring disclosure of information to remainder beneficiaries**. *Brock v. Brock*, 2022 Tenn. App. LEXIS 311 (2022).
- Where a beneficiary's only interest in a trust is to purely discretionary distributions, the **beneficiary has vested rights and is entitled to a copy of the trust agreement, but is not entitled under Nevada law to an accounting**. *Nedder v. Deluca*, 2022 Nev. LEXIS 81 (2022).
- **Fiduciary exception to the attorney-client privilege applied.** The trustee's duty of disclosure trumped the attorney-client privilege, even where the trustee personally paid the attorney fees. *In re Trust of Scaife*, 2022 Pa. Super. LEXIS 227 (2022).
- The **trustee only owes duties to the settlor of a revocable trust**, and the remainder beneficiaries have no rights to bring a claim. *Lewis v. Worley (In re Va. Worley Trust)*, 318 Ore. App. 127 (2022).

Distributions

- Where one beneficiary pursues ongoing litigation, **trustee was permitted to withhold 20% of the beneficiary's specific devise to pay expenses of litigation**. *In re Estate of Sterchak*, 2022 Pa. Super. Unpub. LEXIS 2802 (2022).
- Independent trustee distributed approximately $1.2 billion from a marital trust to a surviving spouse who already possessed similarly large funds. The terms of the trust agreement permitted discretionary distributions for any purpose. **Discretion does not mean the trustee may do anything; all acts of discretion are reviewable for abuse.** *Diller v. Richardson*, 2022 Cal. App. Unpub. LEXIS 1621 (2022).
- Where the settlor asserted capacity in order to remove a trustee, the settlor cannot then assert lack of capacity in lawsuit against trustee for following her distribution directions. *Garlick v. Wells Fargo Bank, N.A., 2022 Cal. App. Unpub. LEXIS 4773 (2022).*
- Carefully consider the **impact of retirement plan assets held in trust when converting to unitrust**. *Matter of Canandaigua Nat'l. Bank & Trust Co.*, 2022 N.Y. Misc. LEXIS 724 (2022).

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- **Trustee could not withhold distribution to beneficiary upon age attainment** despite trust provision allowing withholding from a beneficiary "when … in the opinion of our Trustee [the beneficiary is] unable … to properly manage his or her affairs," and despite the beneficiary's alleged substance abuse and criminal activity. *In re Trust of Harrison*, 2022 Pa. Super. Unpub. LEXIS 16 (2022).

Fiduciary Succession

- Trustee removal unjustified where trustee began adhering to discretionary distribution terms of trust after years of making percentage distributions. **Beneficiaries needed justification to remove the trustee even when using no-fault removal process.** *In re Amended & Restated Deed of Trust of Holdship*, 2022 Pa. Super. Unpub. LEXIS 3012 (2022).
- Successor trustees and beneficiaries released and indemnified prior trustee. However, the trust assets were appointed to a third party via the exercise of a non-general power of appointment, and the **third party appointee was not bound by the release and indemnification and could pursue action against trustee**. *Grove v. Morton Cmty. Bank*, 2022 IL App (3d) 210177 (2022).
- **A beneficiary may exercise its power of appointment without regard to any fiduciary duties owned when also acting as a trustee**. *In re Trust Under Deed of Trust of Jack*, 2022 Pa. Super. LEXIS 388 (2022).

Trust Modification

- **Where trust provisions specified that the trust could be amended by a notarized document, a non-notarized amendment was not valid**. *Balistreri v. Balistreri*, 75 Cal. App. 5th 511 (California Court of Appeals 2022); 2022 Cal. LEXIS 2627 (California Supreme Court 2022).
- Where trust provisions specified that the trust could be amended by an acknowledged instrument, a **non-acknowledged instrument amending the trust is valid despite not complying with the amendment requirements specified in the trust agreement**. *Haggerty v. Thornton*, 2021 Cal. App. LEXIS 763 (2021); 2021 Cal. LEXIS 8899 (2022).

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- Under the UTC, **stating a method in a trust agreement by which the trust may be amended without making it the exclusive means does not preclude other methods of amendment**. In this case, emails between the settlor and counsel were determined to be a valid amendment. *In re Omega Trust*, 2022 N.H. LEXIS 60 (2022).

Special Session II-A: Upside Down with a Perfect View

Speakers: Amy K. Kanyuk, Todd A. Flubacher, Miriam Wogan Henry, Sarah Moore Johnson
ABA Reporter: Mary Elizabeth Anderson

Key Takeaway: Many trust jurisdictions have similar laws; the ultimate goal is to create the trust in a jurisdiction that is set up for success in the long term.

Factors for Situs Selection:

- Stability of trustees in the state
- Reliability of state's long-term commitment to the industry
- Responsiveness to updates in state laws and public policies
- Availability of competent trust officers with the history and experience to tackle complicated issues
- Options for successor trustees
- Competition among trust companies – healthy competition breeds competence

Planning Tip: Utilize existing relationships with banks and investment managers to establish a connection with a trust company.
When searching for a corporate trustee interview several potential options.

- Do ask how certain issues would be handled.
- Do consider the types of trustee relationships – private trust company, directed trustee, co-trustees, administrative trustee (many cannot provide investment management services)

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- Do research whether the company provides an adequate bank/regulatory environment, under-capitalized companies may have lower upfront costs but pose higher risk if they cannot protect the trust assets
- Do consider connectivity issues with trustee – time zone, geographic location, ease of ability for grantor/beneficiaries to connect with trustee

When choosing between jurisdictions, do consider:

- Whether judges are elected or appointed
- The qualifications to serve as judges – do they need to be lawyers
- Number of appellate courts – how many levels/chances is there to appeal an issue
- Depth of published case law and predictability of the law
- Availability of competent local counsel

In perpetuity (or just a really long time): Several states have retained the rule against perpetuities, and many allow grantors to opt-out of the period. Continue to include a perpetuities waiver or savings clause in trust boilerplate in the event a trust is moved to a state with a different perpetuities period. Segregate assets into separate shares when modifying, merging, or receiving additional assets, if the assets could be subject to a different perpetuities period.

Investments and Diversification: Waiving the prudent investor rule may not eliminate a trustee's liability. Consider a purpose trust to hold a close concentration of assets and allows the trustee to deviate from the prudent investor rules and other fiduciary duties that may not otherwise be waived

Trust Modifications: Without court approval, they come in many different varieties including non-judicial settlement agreements, decanting, exercise of powers of appointments, or trust protectors' powers to amend.

- Do consider who your client is when you are working through the type of modification method. Decanting is preferred if you represent a grantor/beneficiary. Consent modifications protect a trustee.
    - Decanting could trigger sales treatment under *Cottage Savings*. Recent rulings indicate that if the trust is always subject to the trustee's ability to decant, as authorized by the

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instrument or state law, exercise of the decanting power will not trigger *Cottage Savings* or sale treatment. Trust decanting remains on the Service's no ruling list. Drafters should add a decanting provision to trust instruments to continue to grant the trustee the power to decant in the event the trust moves to another state without such a power.

- Consenting to a trust modification is not without gift or estate tax concerns. Depending on the modification, consent could trigger §§ 2036 or 2038 inclusion because the consenting party has "implied control" over the trust assets. Beneficiaries may be making a gift if they consent to a change that reduces their interest in the trust.
  - What constitutes a consent that would trigger gift/estate liability?
  - Is a non-objection a consent?
  - Can a beneficiary not object but waive a time period?

The answers to these issues remain unknown.

- Do consider who is receiving the information about the modification. Are all interested parties receiving adequate notice either directly or indirectly through representative.
  - If the trust has a designated representative for notice, does the trust instrument waive conflicts and fully bind all beneficiaries by representation.
  - Review PLR 201233008 in which the Service determined a consent modification did not result in estate inclusion for grantor but issued no opinion on gift tax issues for the beneficiaries.

Creditor Protection: Each state's spendthrift provisions may have different exceptions for spousal or child support, tort actions.

- Advise the client that no trust is fully exempt and actions outside of the grantor's or trustee's control – beneficiary's actions and laws of beneficiary's domicile – may open the trust to attacks.

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- Consider whether a beneficiary should serve as sole trustee of their trust.
- Contemplate having a co-trustee with limited power to veto the beneficiary trustee's actions while still allowing the beneficiary trustee to maintain most of the control over the trust.

Drafting Tip: Long term trusts should avoid automatic distribution provisions. Any mandatory power opens the trust to creditors.

- Do consider prohibitions on payments to exception creditors under the spendthrift provisions.
- Alternatively consider "intent language" expressing the grantor's intent to benefit only named beneficiaries and not any other third party, including spouses of beneficiaries.

Self-Settled Domestic Asset Protection trust (DAPT): The goal is to be in a jurisdiction where the courts will uphold the statutes. Nexus with the state is key.

- Two tests to pass -- One under the DAPT statutes, and the other under the conflict of laws between states.
- Need to do more than the minimal contacts under the DAPT statute to pass the conflicts test.
- The statute of limitation period is a red herring when selecting a jurisdiction for a self-settled domestic asset protection trust (DAPT). No action of any kind can be brought against the assets of the trust unless there is a fraudulent transfer.
  - The statutes apply to a person who has successfully brought a fraudulent transfer claim within the limitations period.
  - No one should be setting up trusts that may run afoul of a fraudulent transfer.

DAPT is dangerous territory and any potential client must be fully vetted before taking on the work. It is easier to say no at the outset, than try to extract yourself from a bad client relationship.

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- Avoid accommodating a client that will risk your license or reputation.
- Do advise clients on expectations and on-going costs of administration and the diligence required to continue to protect the assets.
- Clients should treat DAPT as the nest egg and avoid using the assets held in the trust.

State Income Taxation of Trust: non-grantor complex trusts

- Do ask client about goals of paying or forgoing state income tax
- Do consider taxes in order to be tax efficient
- Do not let the tax consequences dictate the trust jurisdiction to the detriment of the trust administration

It is possible for more than one state (or none) to tax trust income. Factors to consider include:

- Residence of the grantor - can the state continue to tax the trust after grantor moves/dies.
- Where is the trust administration if the trust has multiple trustees residing in different states.

If state tax is important, consider including a provision that would prohibit a change (or require a removal) of a trustee, if the trustee change would increase the tax liability of the trust.

- ➢ Consider drafting trust terms that permissively allow trustee to move a trust for taxes purposes, but do not make it a duty that the trustee is obligated to continue to move the trust.

Ethical Concerns and Fiduciary Liability

Special purpose entities can be used with trusts for a variety of reasons. Entities are most commonly used to hold assets the corporate trustee does not want to directly manage.

Example: A trust owns a limited liability entity interest in an entity that holds an underlying high-risk asset. This protects the trustee from unwanted

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liability, but potentially increases risk from loss of oversight. If the entity manager unilaterally takes actions contrary to the trust terms or purposes, the trustees could be liable.

- A new trend to create special purpose entities to serve as role of investment advisor or representative for notice purposes is also not without risk.
    - If the entity is undercapitalized, liability protection may be thin to none and the underlying entity owners/managers could be personally liable.
    - May need state law authorization for an entity to serve in a fiduciary role.
    - Without proper authorization, the entity could be deemed an illegal private trust company.

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Heckerling 2023 – Report 7

Wednesday, January 11th Special Sessions

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This report covers two of the Wednesday Special Sessions. Report 8 will cover the remaining Wednesday Special Sessions.

Special Session I-A: Split Dollar Is Still Alive and Kicking – Fundamentals and Intergenerational Update

Speakers: Donald O. Jansen, G. Michelle Ferreira, Mary Ann Mancini

ABA Reporter: Katharine Griffiths

What is a split dollar arrangement?

A split dollar arrangement is a means of financing premium payments on a life insurance policy. There are two split dollar regimes:

1. Economic benefit regime
2. Loan regime

Economic Benefit Regime

Mr. Jansen explained the basics of the economic benefit regime. Under the economic benefit regime, the payer of the premiums is the owner of the policy. The exception to this involves an irrevocable life insurance trust ("ILIT"). An ILIT can own the policy for estate tax purposes and the donor can own the policy for income tax and gift tax purposes by getting the cash value of the life insurance policy, and this will still fall under the economic benefit regime. In the context of an employer and executive, the employer pays the premiums and owns the policy.

There are possible tax consequences associated with the economic benefit regime. For the non-owner, there are three possible tax consequences:

1. In the employer/executive context, the premiums are income to the executive.

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2. The cash value of the policy will be taxed to the executive if: (1) the insured has access to the cash value; (2) the employer does not have access to the cash value; or (3) the employer's creditors do not have access to the cash value.

3. Other amounts received by the executive (e.g. dividend from policy or money borrowed from policy) will be treated as compensation to the executive from the employer.

There can also be tax consequences for the owner as well.

1. If the executive reimburses the employer for the premium, that will be income to the employer.

    a. Thus, the employer should pay for the entire premium every time.

2. In the ILIT context, the payment of premiums by the donor is treated as gift to the ILIT and not income to the ILIT.

Loan Regime

Ms. Mancini explained the basics of the loan regime, which is the most popular regime. Under the loan regime, the premium payer loans money to the owner of the policy and the owner provides a promissory note in return. In the context of an employer and executive, the employer pays the premiums and the executive is the owner of the policy. To qualify as a loan regime split dollar arrangement, the loan must be secured by the insurance policy.

There are potential issues with the loan regime:

1. Loans with an interest rate below the applicable federal rate ("AFR") will create imputed interest during the life of a loan, which could create income and gift tax consequences.

2. If you use a nonrecourse loan without a nonrecourse statement, a harsher test is used to determine if the AFR is adequate.

3. If the lender waives or forgives interest, the lender will be deemed to have transferred money to the borrower, and there will be a deferral charge on this, unless it is a nonrecourse loan with a nonrecourse statement.

4. Stated interest paid directly or indirectly by the lender or a person related to the lender will be ignored. This likely will be treated as a below-AFR loan, but there are no rulings on this issue.

5. Loans must be repaid on a first in first out basis, which can prevent the repayment of high interest loans before lower interest loans.

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6. Issues with using a grantor trust:

    - Depending on the basis of the policy and the loan amount, there could be taxable gain on termination of grantor trust status.

    - When the grantor dies, does a deemed transfer occur right before death or after death? There is no good answer on this, so ideally you should pay off the loan before the grantor dies.

Which regime should you use?

This depends on what is most important to your client. There are three primary considerations:

1. Who is going to own the cash value of the policy?
    a. The loan regime is best for giving the most cash value to the executive. All the employer gets back is the premium loan and accumulated interest.

    b. The economic benefit regime is best if the client wants the employer to own all of the cash value.

2. Who is going to control the investment of the cash value?
    a. The owner controls the investment.
        i. If you want the executive to control investment, you should use the loan regime.

        ii. If you want the employer to control investment, you should use the economic benefit regime.

3. Which one is the cheapest?

    a. If the client wants the cheapest option, look at whether the interest rate or the premium amount is lower.
        i. If the interest rate is lower, go with the loan regime.

        ii. If the premium is lower, go with the economic benefit regime.

        iii. Switch dollar: you can go from the economic benefit regime to the loan regime if the AFR lowers.

Why use a split dollar arrangement?

1. Cross purchase agreements
    - Can be used to fund the purchase of shares upon death of shareholder in closely held business.

2. Employee perk

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- Split dollar arrangements allow the employer to pay premiums while the employee gets the benefit of the life insurance.

3. Informal funding of deferred compensation
   - An employer needs to set aside money to fund deferred compensation. Mutual funds will be depleted by income and capital gains taxes, but life insurance cash value compounds income tax free.

4. Wealth transfer
   - Split dollar arrangements can prevent the payment of gift tax or the use of the gift and estate tax exemption because the donor pays the premium with only a small gift to the ILIT.

What are intergenerational split dollar arrangements?

An intergenerational split dollar arrangement is one in which a parent buys life insurance on the lives of their adult children. The parent gets the cash surrender value of the policies or the amount of the premiums, whichever is greater. An ILIT will own the policy.

What you need to know about intergenerational split dollar arrangements

Based on her experience litigating the most recent and only successful intergenerational split dollar arrangement case in *Levine v. Commissioner*, Ms. Ferreira says you must consider the following:

1. The client must have sufficient liquidity to live on outside of the arrangement.
2. Intergenerational split dollar arrangements are ideal if the children and the client will have a big estate tax bill.
3. The adult children must be insurable.
4. Avoid death bed planning.
5. Under no circumstances can the donor have a right to unwind the agreement (alone or in conjunction with another person).
6. The fiduciaries involved (for example, the trustee of the ILIT and the attorney-infact for the donor) should be independent and receive no benefit from the arrangement.
7. Only the ILIT should own the policies.
8. You should not use a grantor trust.
9. Decedent should not own the policies under any circumstances.

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10. Legal documents should be very clear and carefully drafted. Additionally, the file should be consistent about the plan.

Ms. Ferreira noted that all of the cases on intergenerational split dollar arrangements are in the economic benefit regime, not the loan regime. Additionally, none of the cases touch on potential gift tax issues with these arrangements, and Ms. Ferreira suspects the IRS may go after those arrangements for gift tax purposes. Thus, it is important to make full disclosure of these arrangements on a gift tax return to begin running the statute of limitations (this saved the *Levine* estate!).

Special Session I-B: Practical Planning for Special Needs Beneficiaries

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Speakers: Bernard A. Krooks, Robert B. Fleming, Tara Anne Pleat

ABA Reporter: Alexa Langweil

What You Should Know: Special needs planning has changed as a result of the SECURE and ABLE Acts (and new regulations for both). The panelists reviewed case studies focusing on how to plan for retirement accounts when there is a special needs beneficiary and discussed special needs trust funding and administration issues, including the taxation of special needs trusts.

2022 Budget Bill Changes (reflect changes since Heckerling materials submitted)

- **Families First Coronavirus Response Act and Enhanced Federal Medical Assistance Percentage end on March 31, 2023**
  - The most significant change might be to the pandemic treatment of Medicaid eligibility (pandemic will be "over" on 4/1/2023).
  - Transfer penalties and asset limitations for most public benefits programs waived for current recipients from December 2019 through March 31, 2023 o Rolling 90-day waiver o Budget bill sets 4/1/2023 as date for states to begin reconsiderations
    - No penalty for earlier steps
    - Must be completed by 12/31/2023 (expect steady trickle of clients seeking guidance)
    - No recovery for "overpayment"

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- **SECURE 2.0 includes the ABLE Age Adjustment Act** o ABLE Act and

  SNTS can work together:

  - **Practice tip**: In drafting third-party SNTs, include provisions authorizing trustee to establish or fund ABLE accounts in their discretion. If your state Medicaid agency is comfortable with it, include a similar provision in all of your first-party SNTs.
    - Improved autonomy
    - Daily expenses
    - Housing – rent is speaker's first choice for use of an ABLE account
    - "Personal needs" – speaker's second choice for use of an ABLE account
  - Basic ABLE Rules:
    - One account
    - Can be established in any state
    - Disability must occur by age 26
    - $17,000/year maximum (with some special rules, e.g., if working, can contribute up to the federal poverty level)
  - ABLE Age Adjustment Act, allows ABLE accounts to be established for individuals if their disability began before they attained age 46, effective 2026

Funding the Special Needs Trust (Practice Recommendation: Do not include "Special Needs Trust" in the name of the Trust. If the trust purchases real property, why should neighbors know that one has a Special Needs Trust?)

- For wealthy families, review ability to provide care without reliance on public benefits
- Is life insurance a good funding source?
  - Be careful if funding a SNT with life insurance and one wants to take advantage of the lifetime annual exclusion by making lifetime gifts and having a Crummy withdrawal right for the beneficiary with special needs. Several problems exist:

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 The right of withdrawal is considered an available resource, regardless of whether it's exercised.

- If they fail to exercise it, potentially they've made a gift back to the trust or to the other beneficiaries, which may or may not be subject to a penalty period for Medicaid and/or SSI causing a loss of benefits.
- Evaluating (and valuing) IRAs and qualified plans as possible sources

  - A disabled child or an SNT for a disabled child can stretch the IRA, whereas other children cannot (may not be as useful based on the actual life expectancy of the beneficiary). Also likely true that a disabled child's tax rate is lower than the other children's.

- Doesn't the beneficiary need the family home? Where will they live?
  - Be realistic. Is it wise to leave a large family house with significant expenses to a disabled child, especially if the family house is the only resource?
  - If the house goes to a disabled child who continues to receive Medicaid benefits past their 55th birthday, the home will be subject to estate recovery.
  - If SNT funds are applied to maintenance/upkeep, may have provided inkind support and maintenance.
  - When purchasing the house, is it wiser to obtain a mortgage or apply in cash? It depends: depends on the buyer, what the other funds are, interest rates.

SNT Taxation/Administration:

- **Most self-settled SNTs, by virtue of their terms, are grantor trusts**. Often, they are not treated as such when looking at income tax returns, but it is what practitioners should expect to see/how they should be treated for tax purposes.
  - Ms. Pleat files a 1041 with a grantor trust information letter and obtains a separate EIN. Mr. Fleming does not obtain an EIN (and therefore no 1041 is filed). Mr. Krooks states there is no set of circumstances in which a selfsettled SNT is anything other than a grantor trust (including if the trust is established in a DAPT state).
- **Third-party SNT (requires a separate EIN) may be a Qualified Disability Trust.**

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- Generally, if a trust is created for a person with a disability determination and such individual is the only individual receiving benefits during their lifetime, it can be classified as a Qualified Disability Trust, which receive the benefit of a personal exemption.
- Is the trust a grantor trust – to the original grantor? If a parent establishes a trust for a special needs child and names themselves as the remainder beneficiary or trustee or it's revocable, it can still be a grantor trust to the parent (but not to the child). It depends on whom it's a grantor trust in respect to.
- Mechanically, one obtains the QDT exemption by simply checking the box.

Trustee Selection

- Should a sibling be named as Trustee?
  - Being a trustee of a SNT is fairly broad in its responsibilities. It includes not only money management, but also making distributions, determining what can be done without disturbing public benefits and if you're affecting public benefits, why. If a sibling trustee is named as remainder beneficiary, do the parents trust that self interest won't come into play?
  - **Consider the nature of the disability.**
  - **Practical tip:** Suggest a sibling who believes they can handle the role "test drive" being responsible for the disabled sibling.
- **As a practical matter, who can be trustee and who should be trustee are two very different concepts.**
  - **Practice tip:** Ms. Pleat advises clients to appoint professional fiduciaries to deal with money management and appoint family members in advocacy roles within the trust, e.g., trust protectors or trust monitors.
- **Ms. Pleat advises families considering corporate trustees to be aware that they won't necessarily work with the individuals, so focus on their systems.**

Case Study #1: The Value of Retirement Accounts:

- Three children: two successful businesspeople, and one (Chris, 20) with a disability

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- Assets: $700K home, IRAs/401(k)s of $2.5M, other financial investments of $2M
- How to fund Chris's SNT?
  - House? (Parents expect Chris to live at home, with no real understanding of how this will play out, but more likely that Chris will end up in a group home. So sell the house and divide the house between the three children? Or adjust other assets to account for house proceeds?)
  - Retirement accounts? Prior to SECURE Act, guidance would be to leave no retirement benefits to SNT as machinations were difficult. However, with SECURE Act, flipping this guidance because of the stretch available to disabled beneficiaries. You must determine how much beneficiary likely needs, which is an impossible question.

Case Study #3: How to Account:

- How do you account to someone without cognitive ability to review the accounting? How do you put an accounting together, especially when expenditures are being made by a beneficiary who is competent enough to go out and make expenditures, but isn't necessarily providing receipts to a trustee?
- Perhaps **consider privately paid case managers and advocates** who step in and provide that additional layer of support (these third parties are likely to be where a great deal of trust funds go, as they serve as replacements for parents who had been providing advocacy and support free of charge.) Ms. Pleat advises trustees to bring their accountings to court and have them settled every five

  years. For large expenditures such as a house purchase, particularly in the firstparty trust context where the state has a right of repayment, seek court approval to protect the trustee before that transaction is undertaken.

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- **Beth Anderson, Esq.**, an attorney with Wyatt, Tarrant & Combs, LLP in Louisville, Kentucky;
- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;
- **Katharine Griffiths, Esq**, an attorney with Holland & Knight in Tampa, Florida and

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Heckerling 2023 – Report 8

Wednesday, January 11th Sessions

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling .

This report covers The Question & Answer panel and a Wednesday Special Session. A later report will cover the remaining Wednesday Special Session. Report 9 will cover some of the Thursday General Sessions.

Question & Answer Panel

Speakers: Steve R. Akers, Samuel A. Donaldson, Beth Shapiro Kaufman

ABA Reporter: David J. Slenn

Summary: In this program, panelists answered questions from registrants involving timely estate planning topics, many of which were discussed during the Recent Developments 2022 program featuring the same panelists. This summary covers several of the numerous questions the panel addressed.

SECURE 2.0 & Conservation Easements. The panel addressed issues pertaining to upcoming conservation easement reportable transaction requirements as well as SECURE 2.0’s impact on conservation easements.

- Advisors should review the safe harbor provisions and consider opportunities to correct defective deeds. Advisors should also be mindful of upcoming filing requirements, which will include a 90-day reporting period applicable to those who participated and did not disclose.
- Another question involved whether IRA plan assets can be used to fund a charitable gift annuity.

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    - Yes. Steve Akers commented that this issue was another part of SECURE 2.0, where, on a one-time only basis, up to $50,000 may be used to fund a charitable gift annuity. The 5% required payout might be problematic for joint annuities over two lives where the individuals are less than 62 years of age.

Potpourri of Filing Questions. Beth Kaufman then dealt with a series of questions involving filing requirements. These questions involved filing requirements for swapping assets into and out of grantor trusts (no requirement but Beth offered advice pertaining to adequate disclosure to a non-gift transaction with hope that it would start the running of the statute of limitations).

- Other questions involved whether there is a method to file the 706 when filing the 706 is not otherwise (due to the exemption) required to specifically allocate GST exemption on Schedule R if you don't want to rely on the rules that automatically allocate GST exemption at death.
    - Yes, you can always file a 706 even if you do not have assets exceeding the filing requirement – just make your allocation on Schedule R.
- She also answered a question asking for the current thinking about reporting charitable contributions deducted for income taxes on Form 709.
    - Yes, the Code requires the gifts be reported unless all gifts fall under annual exclusion threshold.
    - Why do we care? You potentially face a penalty for omission of gifts that could extend the statute of limitations.
- Another question involved gifts discovered after a decedent's death for which no gift tax returns were filed and no PR/executor has been appointed. The question was whether a trustee of revocable trust can sign on behalf of spouse to split gifts.
    - No. The Section 2513 regulations provide an executor or administrator of a deceased spouse can sign consent. The trustee is neither, so you must get a PR/executor appointed. Also, consent must be given to *all* gifts during that year, and only for gifts *prior* to the spouse's death.

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- This question can be contrasted with the *Sander* case covered on Monday's Recent Developments involving the proposed expanded definition of executor under Section 2203 for estate tax purposes.

Spouses, "Accidentally Defective" Trusts & *Bittner*. Professor Donaldson addressed several questions involving spouses.

- One asked whether a US citizen dies leaving assets to noncitizen surviving spouse who has a green card and is domiciled in US, file 706 to elect portability (yes).

- Another question involved a spouse who formed an intentionally defective grantor trust and the taxpayer sells assets to spouses trust in return for note. Professor Donaldson confirmed that the couple must include the interest income on their joint return.

- Professor Donaldson wondered if lawyers ever create "accidentally defective" grantor trusts, and how we must look to clients since we offer them "defective" trusts with "Crummey" powers.

- Professor Donaldson also addressed the controversy related to when the penalty for failure to file an FBAR applies – per return versus per account. The Supreme Court agreed to hear an appeal involving this issue in the *Bittner* case.

-

***Wandry* Questions**. Steve Akers handled questions involving *Wandry* clauses (should they be avoided, should another note be created for difference between the appraised value and the finally determined value, etc.) Steve suggested avoiding the complexity if possible, but if dealing with hard to value assets, the option of a defined value clause should be discussed. Does the *Wandry* clause create a red flag? Steve suggested "no," at least not like it was in the past.

- The panelists agreed that a charitable formula clause is the safest option for a belt and suspenders approach, but you must have a charitably-minded client…and if the client is charitably-minded, consider not using *Wandry* but instead, use a formula allocation clause with 3 cases as support.

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Clawback, SSSTs, Grantor Trust Status. Professor Donaldson addressed how anti-abuse should not apply (i.e., permit the use of the higher exemption) in a scenario involving a self-settled trust, with the assumption that "you're in a jurisdiction that recognizes domestic asset protection trusts." The question becomes if distributions are made to the grantor, perhaps there is a disguised arrangement or implied understanding, which would be detrimental.

- Another question was whether a trust protector should be a fiduciary. Professor Donaldson said the answer depends on who the client is – if the client is the trust protector, probably not, if the client is the settlor, you would want the trust protector to have fiduciary constraints.
- Professor Donaldson is comfortable modifying trusts to change grantor status.

Nobody "Nose." Steve Akers addressed a scenario nobody knows the answer to. Can assets of trust that's a 50% grantor trust with respect to a surviving spouse be distributed to trust that is wholly grantor with respect to the surviving spouse without triggering gain? Steve advised consideration to splitting trusts to make things easier, with attention given to the nature of assets used in dividing trusts.

GST Clarification. Beth addressed a request for clarification. She had previously mentioned how the IRS is reluctant to give 9100 relief (which relates back) to make late allocation of GST where you timely filed an opt-out election. The person who submitted the question is drawing a distinction worth making; if you make opt-out of automatic allocation, you can make a manual allocation of GST to that trust. When you do that, that application of exemption is effective when you make it – it is not retroactive.

Estate Planning Version of Groundhog Day? Another question was more of a complaint about how planners continuously plan for last-minute changes in tax law, only to find out nothing happens. Will clients start tuning lawyers out or are we doomed to repeat this forever? Professor Donaldson recommended therapy for those who have an existential crisis with their practice.

- Professor Donaldson acknowledged how it seems like we're on a treadmill, but (hopefully) we all agree that no client should ever feel coerced into making a gift any larger than what the client would

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make wholly absent of what is happening to the transfer tax exemption amounts.

The pressure should be, <u>if you want to make a gift</u>, acting sooner rather than later will be in your best interest.

Special Session II-B: Running the Gamut on Planning for the Middle-Rich

Speakers: Turney P. Berry, Robert K. Kirkland, Suzanne Brown Walsh, Melissa J. Willms
ABA Reporter: Kristin Dittus

Key takeaway: The Panel began with a reminder that all of our clients are likely to be incapable at some point, and it is our obligation to keep their primary and collateral documents up to date for their circumstances.
Important Considerations for Powers of Attorney (POA)

- Does the General POA give the agent the ability to amend a Revocable Trust?
  - If so, does the Trust match, limit, or conflict with this provision?
  - Does the Grantor want those powers given to the Agent? A lot of financial lifetime planning for incapacity can be accomplished in the Trust rather than giving POA agent broad authority to act.
- Does the line of succession make sense for the powers of attorney?
- Medical POA should be one agent if possible.
- Client Update Requests are an opportunity to reconnect, you can check in on client capacity, and whether overall fiduciary choices as good fit for existing circumstances.
- Goal is uniformity throughout the states, this would be ideal for clients who have multiple state residences. There is a proposed uniform law for a one-page Medical POA document that could simplify health care choices for clients.
- Young Adult Package. Alert clients about getting POAs for kids who turn 18. It provides a chance to check in with clients and maintain goodwill with them.

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Top Ideas on Planning for Middle Rich Clients

- **Test Trust**. This is a grantor trust for descendants funded with a modest amount of money by one spouse where the other spouse and child serve as co-trustees.
    - The purpose is to educate the whole family on the use of the trust (what are the best assets for funding, how it feels to give a gift, and see how children handle using the money).
    - Gives family time to educate their children and adjust future gifting.
- **SLATS**. Spousal Lifetime Access Trust is an inter vivos bypass or QTIP trust.
    - Be clear on who you represent.
    - Advise the client on the risk of divorce.
    - If both spouses want to gift to each other, wait at least one tax year before creating the second SLAT and be sure trusts are not reciprocal.
    - If you're in a community property state, you will need to partition to separate assets. This results in the grantor losing twice the gift amount because you have to partition out $10 million to gift to the trust and $10 million to the community property spouse. Trust property can be transmuted back to community property.
    - Identify if your client is more worried about death or divorce, and if they want spouse removed as beneficiary upon divorce.
    - A trust protector can add a charity or the donor spouse as a beneficiary in the future. Donor spouse can be named as a remainder beneficiary depending on state law. Use caution to avoid limiting spendthrift protection.
- **Upstream Planning for Basis Adjustment**.
    - Capture available Applicable Exclusion Amount (AEA) by a senior generation (SG), ideally someone old, ill, and no longer driving, by giving them a General Power of Appointment (GPA) over trust assets. This allows a step up in basis for trust assets upon their death.
    - Can add SG member as a beneficiary but do not have to.

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- Giving a GPA is not a good fit if SG has or may have creditors or require Medicaid long term care assistance. SG may appoint assets away from desired beneficiary.
- **Safeguards**: require consent by a non-adverse party to exercise GPA, can limit GPA as desired, such as using a testamentary GPA and only as to appreciated assets.
- **Good Marketing Tool**. Easy to explain to clients and give them good ideas.
- **Give Surviving Spouse GPA over Credit Shelter Trust**. Use a trust protector to modify trust and get a step up in basis on assets at surviving spouse's death.

- **Retirement Planning.**
  - For clients who hate required minimum distribution (RMD), the IRA (IRA will refer to all types of retirement accounts) can purchase a Qualified Longevity Annuity Contract (QLAC) and defer distributions until 85 years of age, up to the lesser of $125,000 or 25% of the IRA. **Note:** SECURE 2.0 changed the limit to the lesser of $200,000 or 100% of the IRA.
  - Reduce compensation income by making a tax deductible contribution if still working, will reduce income effect of RMDs.
  - Can rollover existing IRA into new employer plan, but all of it will be subject to ERISA if the new plan is.
  - Roth conversions are a popular and useful tax avoidance tool for the second generation after SECURE.
  - Beneficiary designations should be reviewed and updated. Spouse outright is still best result in most cases, but not for second marriages. Do not name revocable trust directly with distributions to kids and charities, rather name a trust that qualifies as an Applicable Multi-Beneficiary Trust (AMBT) type I or II. You can use a split percentage between spouse and charity if charitably inclined, very beneficial because no income tax is paid by the charity.
  - Use Beneficiary Designation Attachment – to customize designation especially if using disclaimer planning.

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  - Minority Deferral of Distributions until age 31, only applies to IRA owner's children not grandchildren.

- **Blended Family and Second Marriage Retirement Planning**
  - Using a QTIP or Martial Deduction Trust as the beneficiary of an IRA results in single life expectancy under SECURE rather than receiving the benefit of a spousal rollover.
  - QTIP Trust requires the beneficiary to receive the greater of RMD or amount of income earned by the IRA, results in reduced accumulation of income for remainder beneficiaries.
  - Split IRA between kids and spouse. If you give spouse IRA and kids non-IRA requires constant monitoring to equalize assets.
- **GRAT Planning – Great for Risk Free Transfers**
  - Use a spreadsheet to track expected outcome with a Grantor Retained Annity Trust (GRAT). Use date of funding, not date of signing, for calculations.
  - Treasury Regs prohibit paying with a note under 2702(3)(b)(1). Payment is often done in kind with appropriate valuation.
  - Will GRAT Fail or Succeed?
    - If GRAT is going to fail, does client want to buy out assets or re-GRAT?
    - If the GRAT is a success, will want to freeze asset values by (1) buying asset out with cash or (2) note using interest rate from origination date of GRAT.
  - Rolling GRAT. Clients love to see an Exhibit to show payments and payout. This is also easy to update when you roll to a new GRAT.
  - Elect out of Automatic GST Allocation. Estate tax inclusion period does not terminate until the GRAT term ends.
  - **Even if you have no exclusion left, you can still GRAT**.
- **QPRT – Qualified Personal Residence Trust**

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  - Expressly sanctioned and low risk. Not favored with low interest rates because low rates depress the value of the retained interest.
  - At the end of the term, the grantor has to pay rent. Rent payments are a wealth transfer tool that avoids estate and gift tax.
  - Document termination of trust and rent paid. Rent has to be for fair market value, helps to maintain the property.
  - Suggestion to prepay rent for life expectancy to get more assets out of the estate and use for substantial property improvements desired by the next generation.

- **Gift Remainder Interest of Home to Charity that can be Purchased by Grantor Trust**
  - Remainder interest gift of home results in income tax deduction for value of remainder interest in the home, based on the fair market value of the house, discounted for the donor(s) life estate.
  - A grantor trust created by the donor can then buy the remainder interest from the charity. The estate for client gets a deduction for the charitable contribution, and then deeds over the remainder to the trust. See page 157 of the outline.

- **Charitable Planning with IRAs**
  - Clients under 59.5 can avoid early 10% withdrawal penalty through substantially equal periodic payments (SEPP) and use those payments to make charitable gifts.
  - Lump sum distribution to person born before Jan. 2, 1936, avoids gross income inclusion and has lower tax rate.
  - Qualified replacement property received by a business owner who sold stock to an Employer Stock Ownership Plan defers capital gain. Gifting it to charity permanently avoids some or all of the tax on the sale.
  - The qualified charitable distribution of $100,000 is now indexed for inflation.

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- SECURE 2.0 allows gift to a charitable remainder trust or charitable gift annuity up to $50,000.

- **Charitable Gifts with DAF and from Trust**
  - Using a Donor Advised Fund (DAF) allows high degree of control over gifted assets and is more economical than creating a Private Foundation (PF). IRS is likely to increase scrutiny with DAF popularity. A client can use a DAF-to-DAF transfer if unhappy with administrator. A terminating PF can transfer to a DAF.
  - Add ability to gift to charity to your Revocable Trust. An amendment adding the provision will not be considered part of the governing instrument, so consider reforming the trust.
  - A Revocable Trust can form an LLC or partnership to make the charitable gift and receive deduction. Assets must be something that can ordinarily be deducted. Allows flexibility on annual amount. See Rev. Ruling 2004-05.

BEST TIPS FROM EACH PANEL MEMBER
Suzanne Brown Walsh

1. Intrafamily loans.
   - Applicable Federal Rate (AFR) interest is better than commercial banks and easier for child to obtain financing.
     - Document the loan and structure as normal mortgage to educate child about real-world situations.
     - Allow prepayment.
     - Do not document the intent to forgive interest payments or loan will be disregarded by the IRS.
   - De minimis loans under $10,000 avoid AFR interest requirements.
   - Income Tax de minimis loans under $100,000, Section 7872(d)(1) eliminates income interest reporting requirement to the extent of child's annual investment income. Foregone interest should be reported on IRS form 709 but not the 1040.

Melissa Willms

- Think of core estate planning documents as irrevocable because they may need to go into action immediately.

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- o Our job is to reduce client's estate value, transfer insurance into an ILIT with a sale of the policy – not a gift.

Robert Kirkland

- o IRA distributions after the SECURE Act require more thought with 10-year payout for most inheritors.
- o Encourages Roth conversions to help descendants with reduced taxes or use IRA distributions for charitable gifts.

Turney Berry

- o A trust with withdrawal power over another trust is considered the income tax owner of the second trust. Many trusts are created from a previous trust.
- o If two separate inheriting trusts for children have beneficiaries that want to change assets, the originating trust can exercise the withdrawal power to avoid a sale of assets between children's trusts. The originating trust withdraws assets from the subsequent trusts, then can re-distribute the assets to trusts as desired by the children. After a decent amount of time, the withdrawal power can be released. See Private Letter Ruling 201633021.

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Heckerling 2023 – Report 9

Thursday, January 11th – 12th General Sessions

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling .

This report covers two of the Thursday General Sessions. Report 10 will cover some of the Thursday Special Sessions.

With Strings Attached": Designing and Documenting Charitable Gifts Today

Speaker: Alan F. Rothschild, Jr.
ABA Reporter: Joanne Hindel

Key Takeaway:
Donors and charities both benefit from a well drafted gift agreement.

From a charity's perspective, the "perfect gift" is a completely unrestricted, immediate one. While unfettered gifts are much sought after by charities, many of today's donors seek more control over their gifts.

For centuries donors have wanted to place restrictions on gifts and charities have wanted to have flexibility to use donated funds differently if circumstances change over time.

The key is to have a well drafted gift agreement.

Well-drafted charitable gift agreements should address the following points:

1. Who are parties to the agreement?

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2. What are the intended purposes or anticipated outcomes of the gift?
3. What restrictions or conditions does the donor desire to place on the use of the funds?
4. How should future changes in circumstances be addressed?
5. Is the gift fully expendable or an endowment fund?

Contemporary gift agreements often raise additional points:

1. Privacy vs. publicity.
2. Naming (and un-naming) issues.
3. Management fees.
4. Standing and enforcement of agreements.
5. Philanthropy focused on constitutionally protected groups.
6. Donor involvement.

Parties

- Who is the Donee? Defining the donee is important because there are many similarly named charitable organizations.
- Who is the Donor? Equally important is the thoughtful analysis and documentation of the intended donor. On its face this determination appears even more straightforward than the donee's identification, but there are legal and tax implications which merit thoughtful consideration of the donor's identification as well.

Charitable Purpose

Clearly describe the charitable purpose and the donor's broad goals so these can be faithfully followed by the charity. Include sufficient flexibility to avoid burdening the charity with a purpose which does not achieve the intended benefits.

Restrictions and Conditions

Today's donors often seek greater control over how their contributions are used. Careful thought must be given to structuring these requirements so they do not run afoul of the Internal Revenue Service's rules on the

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deductibility of charitable contributions or create hurdles that impede the desired benefit of the gift to charity. There has been a great deal of attention in the press and in courtrooms on this issue in recent years.

- Where the top 1% of donors count for nearly 80% of a typical capital campaign, the issue of creating restrictions and conditions on the gift will likely not go away.
- The new generation of entrepreneurs who have achieved mega-wealth status are no longer satisfied with endowed chairs or even buildings bearing their names. They want input into hiring, to dictate subjects being studied, and even a business or political bent on the research they fund.

Addressing changing circumstances

A key element in crafting a gift agreement's statement of charitable purpose is the anticipation of future changes in circumstances.

Standard Contract Terms

The development, execution, funding, and implementation of a charitable gift agreement can take place in a number of jurisdictions. This makes it prudent to designate the state law which will govern.
A large number of template gift agreements prepared by charities or the donor's counsel fail to include a standard merger clause similar to the following:

This Agreement contains the entire understanding of the Parties with respect to the subject matter of this Agreement. This Agreement supersedes all other agreements and understandings, both written and oral, between the Parties related to the subject matter of this Agreement.

Modification of existing gift agreements

Consider the practical and equitable ways to modify a gift agreement to reflect changes in circumstances such as the elimination of an academic program. This can be provided for through language in the Agreement itself.

Absent specific language in a gift agreement, state law, and frequently the Uniform Prudent Management of Institutional Funds) Act (UPMIFA), will govern the procedure for alternate uses where funds from a gift, endowed or not, cannot (or will not) be used for its original purposes.

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UPMIFA provides three ways that a nonprofit can modify restrictions on funds:

1. By donor consent,
2. By court order, and
3. For certain small funds, with notice to the state attorney general's office on a nonjudicial basis.

Enforcement of Gift Agreements

Historically, once a gift was complete, state law overwhelmingly provided that the donor no longer had standing to enforce the terms of the gift. Rather, these rights inure to the benefit of the public, usually enforceable by the state attorney general's office.

Courts have become increasingly open to the idea that donors, their estates, or descendants have the right to take legal action if the gift conditions are not honored, including the possible rescission of the misused gifts.

Race and Gender Based Philanthropy

In recent years, there has been an increased interest by both donors and the courts in race and gender-based philanthropy, particularly in the area of financial aid. For example, a successful Black physician may decide to establish a scholarship program at his alma mater, or affiliated foundation, restricted to African-American medical students only.

- ➢ This is an extremely complicated and evolving area of law. Many charities are finding that their scholarship funds, gift acceptance policies, and donor communications do not address either the current legal environment or what might be ahead in light of the Supreme Court's current consideration of college admissions cases.

Conclusion

Charitable gift agreements should:

- Anticipate that circumstances can change in the future
- Understand the need for and the purpose of a charitable gift agreement and
- Understand how funds are administered by charitable institutions (particularly pursuant to UPMIFA)

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A well drafted charitable gift agreement can protect both the donor and charity and reduce the odds that a situation doesn't turn sour, or even worse, end up in court or on the front page of the newspaper.

Change is inevitable – plan for these changes with a Plan B and Plan C.

Watch Your Steps--Don't Abuse Substance in Transfer Tax Transactions

Speaker: Carol A. Harrington
ABA Reporter: Katharine G. Griffiths

Key Takeaway: Learn from the mistakes of the people in the cases discussed below in which the transactions were not honored by the courts. It is less instructive to look at successful cases because what happened in those cases is not guaranteed to work in the future.
In the past, anti-abuse doctrines were mostly applied in the area of income tax, not transfer tax. This is because substance and form are often the same in the area of transfer tax. Additionally, a business purpose often does not apply because we are dealing with gratuitous transfers. However, these doctrines are becoming increasingly relevant in the transfer tax context.

Substance Over Form Doctrine

- *Helverling v. Gregory*: To avoid a dividend by taking a distribution of appreciated shares of a subsidiary, the taxpayer did a tax-free reorganization, then liquidated the corporation, which kicked out the shares to her. The substance over form doctrine was applied to treat this as a dividend to the taxpayer.

Step Transaction Doctrine

- The steps or transactions are collapsed into a unified transaction if this doctrine applies.
- Three tests:
    1. <u>End result test</u>: The parties always intended to get to the end result.
    2. <u>Mutual interdependence test</u>: It would be fruitless to do any of the steps without doing all of them.
    3. <u>Binding commitment test</u>: When the first step is taken, there is a binding commitment to complete all the steps.

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Sham Transaction Doctrine

- Factual sham: the transactions that are supposed to happen never actually happen.

Economic Substance Doctrine

- Now codified in IRC § 7701(o): A transaction has economic substance if:

  (1) transaction changes the economic position of the taxpayer in a meaningful way apart from the tax effects; and
  (2) the taxpayer has substantial purposes for entering into transaction apart from federal income tax effects.

Business Purpose Doctrine

- Tax laws that would reduce taxes are not applied if the only purpose of the transaction is tax reduction.

These Doctrines in the Transfer Tax Context

Reciprocal trust doctrine:

- ***Estate of Grace***: Husband and wife set up trusts for the other spouse within 15 days of each other. **Holding**: this was the same as them setting up a trust for themselves.
- ***Estate of Bischoff***: Husband and wife set up trusts for grandchildren and named other spouse as trustee. The trustee had powers that, if the donor had retained those powers, would have pulled the trusts into the donor's gross estate. **Holding**: *Grace* applies even if no economic benefit.

Reciprocal transaction doctrine:

- ***Sather***: Three brothers and their wives each had three children. Each parent made an annual exclusion gift for benefit of their children and their nieces and nephews for a total of nine annual exclusion gifts each. **Holding:** Gifts were interrelated so each parent was only entitled to three annual exclusion gifts.

Indirect/conduit transfers:

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- ***Heyen***: Decedent gave stock to 29 non-family members. Twenty-seven of them then gave the stock to Decedent's family members. **Holding:** Only two of the 29 gifts qualified for the annual exclusion (the ones who did not transfer the stock after the gift).
- ***Brown***: Husband made a gift to his wife who immediately gave the same amount to a trust. They split gifts on the Form 709 and the husband wrote a check to the wife for the exact amount of the gift tax owed. **Holding:** This was a prearranged plan and the husband was the one who made the gift to the trust.

Sales for notes/loans

- ***Deal***: Taxpayer sold remainder interest to children in exchange for promissory notes. The next day, taxpayer forgave an amount on the notes equal to the annual exclusion. She did the same in subsequent years. **Holding:** This was a gift, not a sale.
- ***Estate of Maxwell***: Decedent sold her home to her son for a promissory note and mortgage, but continued to live in the home and paid rent in an amount similar to the interest payments on the note. She also forgave principal each year in the amount of the annual exclusion. **Holding:** This was a gift, not a sale.
- ***Bolles***: At outset of the loan, the Decedent's son could repay, but after a while it became clear he could not repay. **Holding:** Loan split into a bona fide loan and a gift.
- ***Estate of Moore***: Loans made to children from Family Limited Partnership with no repayment schedule, no payments ever made, and no efforts ever made to collect. **Holding:** These were gifts, not loans.

Retained interests

- ***Lee***: Decedent transferred stock to son and retained no legal rights on the face of the transaction. Son then paid all dividends to his father who reported them on his income tax returns. **Holding:** IRC § 2036 applied.

Minority discounts

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- ***Murphy***: To avoid dying with a majority interest in a company, Decedent transferred 0.88% interest to each of her children. She died 18 days later. **Holding:** No minority discount was allowed.
- ***Pierce***: Taxpayer made a gift of a 9.5% LLC interest to a trust and sold a 40.5% LLC interest to the trust in exchange for a note on the same day. **Holding:** Gift and sale collapsed into one transaction and no minority discount was allowed.
- ***Smaldino***: Husband transferred LLC units to wife. Wife then transferred those units to a trust. Husband transferred his remaining units to the same trust. Wife testified she made a promise that she would transfer the assets to the trust. **Holding:** This was a prearranged plan and no minority discount was allowed.

How to Avoid Anti-Abuse Doctrines:

1. Provide enough time between transactions for changes to theoretically take place.
2. Notes should have:
    a. A real expectation of repayment.
    b. A written promissory note.
    c. Interest.
    d. Security.
    e. Fixed maturity date,
    f. Demand for repayment.
    g. Actual repayment, and
    h. Consistent records and tax reporting.
3. Compliance and follow up - your client's life is going to change;
4. Proper tax reporting.
5. Actual trust document.
6. Proper capital accounts.
7. For reciprocal transfers, don't just rely upon *Levy* by giving one spouse a power of appointment;

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8. No coercive techniques.
9. No retained interests; and
10. Avoid powers to amend/decant.

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- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
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Heckerling 2023 – Report 10

Thursday, January 12th Sessions

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This report covers the remaining Thursday General Session and a Thursday Special Session. Report 11 will cover additional Thursday Special Sessions.

General Session: Structuring Inbound Investments into U.S. Markets (Layover Required)

Speaker: Scott A. Bowman
ABA Reporter: Joanne Hindel

One thing to know:

The United States has long been a safe haven for non-U.S. investors. However, crafting the right structure to facilitate a non-U.S. investor's inbound investment is complex.
Outside of our own borders there is a lot going on. Coups, attempted coups, impeachments, wars, movements from the far right, China grappling with domestic policy issues- citizens of these countries are seeking the stability of the United States economy and market.
Flight Analogy

Scott Bowman used the analogy of getting on a plane- understanding the basic flight rules and then flying through the Bermuda triangle but coming out safely on the other side.

The Basics

Bowman started his presentation by covering the basics of taxation of noncitizens.

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The threshold question for determining the U.S. taxation of the U.S. activities of a noncitizen is the individual's tax residency for U.S. income tax purposes. A noncitizen will be treated as a resident if the individual satisfies the substantial presence test or the lawful permanent resident test.

- **Lawful Permanent Resident Test**
  - An individual is treated as a resident if the individual is a lawful permanent resident ("green card" holder) of the United States at any time during the calendar year.
  - Sometimes referred to as the green card test.
- **Substantial Presence Test**
  - Determines residency by counting the number of days that the individual spends physically present in the United States
  - Sometimes referred to as the "day counting" test.

Income Tax Treatment of Nonresidents

The residency of a noncitizen is critical to establishing the tax base on which the individual will be liable for U.S. tax. Although a resident is subject to U.S. income taxation on a worldwide basis (in the same manner as a citizen), a nonresident is subject to tax only on certain classes of U.S. source income:

1. Fixed or determinable annual or periodical income ("FDAPI") from U.S. sources:
   a. Generally, dividends, interest, rents, royalties, and other portfolio income that is not effectively connected with a U.S. trade or business).
   b. Taxed on a gross basis and subject to withholding at the source at a flat rate of 30 percent.
2. Income that is effectively connected ("ECI") with the conduct of a trade or business in the United States ("USTB"):
   1. Includes business profits and operating income.
   2. Taxed on a net basis at the federal level at graduated rates of up to 37% and may qualify for the 20% deduction for eligible pass-through income.

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Treatment of Foreign Nongrantor Trusts

The taxable income of a foreign nongrantor trust is determined in the same way as that of a nonresident individual, subject to the modifications provided in Subchapter J, Chapter 1, Subtitle A of the Code ("Subchapter J").

Trusts can be either resident (a "domestic trust") or nonresident (a "foreign trust"). A domestic trust is one that:

- A court within the United States is able to exercise primary supervision over its administration (the "court test") and
- one or more U.S. persons have the authority to control all of its substantial decisions (the "control test").

If a trust fails the court test or the control test, it is a foreign trust.

The More Complicated

Bowman touched on a number of the complicated aspects of taxation of non-residents.

Third Party Withholding on FDAP
I

Foreign taxpayers are subject to a specific U.S. withholding regime if:

- They are not engaged in a USTB (United States trade or business), but
- Receive income from U.S. sources,

Any FDAPI earned by these taxpayers is subject to a 30 percent flat tax rate on the gross payment amount.

Gains from the Sale of an Interest in a Partnership that Owns U.S. Real Property

Gains from the disposition of an interest in a partnership, whether domestic or foreign, are subject to Foreign Investment in Real Property Tax Act (FIRPTA) tax to the extent attributable to U.S. real property interests owned by the partnership.

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U.S. Activities of Family Offices

At higher levels of wealth, individuals may operate through more complex investment and family office structures. If a nonresident invests in a partnership (U.S. or foreign) and that partnership is considered to be engaged in a USTB, the partnership's USTB will be attributed to the nonresident.

Use of Foreign Entity as Estate Tax "Blocker"

A non-U.S. investor who wishes to make investments in U.S. situs assets may instead consider holding these assets indirectly.
Objective is to have the U.S. situs assets not be subject to U.S. estate tax:

- Directly own an interest in a non-U.S. situs asset and
- Have the structure respected for U.S. estate tax purposes

These structures are commonly referred to as estate tax "blockers." Typically the non-U.S. investor will hold the blocker entity in a transparent revocable foreign grantor trust that becomes irrevocable at the grantor's death.

Planning tip

As a matter of best practice, a practitioner advising about the creation of an estate tax blocker may wish to follow some of the practices that have developed when planning with domestic family limited partnerships:

- Considering (and documenting) the non-tax reasons for the creation of an entity.
- In the cross-border context, the following are often highly significant issues:
    - Non-U.S. succession laws (such as forced heirship or Sharia law),
    - Post-mortem administration
    - Avoidance of multi-jurisdictional probate, and
    - Other governance objectives are often highly significant issues.

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Incorporating planning to achieve these objectives into conversations around U.S. estate tax exposure is well advised.

Restructuring options

Not surprisingly, non-U.S. investors often make inbound investments without first obtaining comprehensive tax planning advice. This often leaves the investor owning directly interests in U.S. situs property that would be subject to U.S. estate tax if the non-U.S. investor were to die. The challenge then becomes how best to restructure in order to insulate the assets from future estate tax exposure and without triggering gain as part of the restructuring.

Conclusion

Finally, Bowman cautioned against the planning in which the client just leaves everything to a charity because even then you must proceed with caution when advising a non-US investor.

Special Session III-A
Meet the New Trust: Same as the Old Trust?

M. Read Moore, Christopher P. Cline, Stacy E. Singer
ABA Reporter: Beth Anderson

Key takeaway: New laws for trust administration and modification are generally codifications of existing common law principles. When in doubt stick to the old-fashioned methods that have existed for years because they work and the courts understand them. At the end of the day, the new trust really looks much like the old.

Purpose

Every trust drafted starts with the purpose, because purpose dictates how the trust is drafted and administered. The purpose of most trusts is protection:

- Protecting beneficiary from taxes.
- Protecting beneficiaries from themselves – minors, special needs, substance abuse, may also include a trust with business interests.

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- Protecting beneficiaries from other beneficiaries – second spouse and children from prior marriage.
- Protecting beneficiaries from creditors – future creditors due to high risk employment, protection from future (ex)spouses; or
- Protecting grantor's money from people the grantor doesn't like – limiting who can benefit from the grantor's wealth.

Drafting tip – Discuss what the client trying is to accomplish. Drafting is easier with a clear understanding of what the client is trying to achieve. Consider whether the client should document in writing why they are doing what they are doing.

- Should this precatory language be in the document as a statement of intent or letter of wishes? It needs to clearly state that the language is merely precatory and does not override the trust language.
- A better solution may be the grantor communicating with the family during their life. The more communication within the family, the more likely the family becomes comfortable with the plan.

Flexibility

Directed Trusts – critical for unique assets that require specific expertise but can cause problems in other scenarios. Key points for using directed trusts:

- More defined the scope and powers the better success of the trust.
- Directed trusts are an alternative to co-trustees. They serve an important purpose, typically carving off investments and direct the trustee with respect to specific assets.
- In many cases the best person to make decisions over a specific asset is not the best person to be a trustee overall.
- Succession for the person in power is critical. Many times the trust protector or director is selected for their relationship to the grantor or assets under control. Having a successor person or process for appointing a successor is key to keeping the trust structure in place.

Non-fiduciary office holders – trust directors are generally fiduciaries. Key is that they only have the powers expressly granted to them and these powers are non-fiduciary in nature.

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- Add huge flexibility but at what cost.
- There is always a fiduciary, cannot waive all fiduciary liability – someone will always be responsible.
- Do specify who is responsible for what decisions. Avoids confusion when the grantor is not available to sort out the intent.
- Important to have flexibility built into documents, but must identify the fiduciary and the non-fiduciary roles and their responsibilities.

Practice Tip: It doesn't make any sense to have a protector review something that the trustee routinely does and does not require an exercise of discretion. Distributions, removals, appointments are good protector oversight categories.

Modifications by consent (Non-judicial Settlement Agreement (NJSA))
You do not need a controversy to have an NJSA – it's merely an agreement among the parties. An NJSA can be an easy way to correct a mistake, oversight or change in law, and can make the trust administration much easier.

- Requires representation for minor and unborn parties.
- Big variance on whether a NJSA can modify a trust – most states provide for actions that anything a court could approve. Some states specifically restrict/prohibit modifications.
- Whether you can enter into an NJSA depends on where the trust is being administered and the governing law.
- NJSA requires informed consent and requires disclosures that the family may not want to have.

Tips:

- Caution the use of virtual representation and the conflicts that may exist on a specific issue.
- Risky to force representation into the fewest number of beneficiaries.
- Need to do the long math, review all the steps and project the future consequences if the NJSA is challenged or deemed invalid.

Decanting

Few states have common law decanting, and now most states have a statute authorizing decanting. Review each state's law to determine if

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the state will recognize the power within the trust instrument or only in the statutory law.
Drafting Tip: If the grantor does not want future changes to specific terms or by specific means, consider a material purpose clause to restrict decanting, or limit modifications for only changes in law or tax purposes. When decanting:

- Do follow/review the statute/provision terms when decanting.
- Read the whole document, review the actions allowed, beneficiaries allowed, terms allowed. Do not want to create an invalid exercise and improperly transfer assets out of the original trust.
- Consider that a NJSA can be combined with trustee's exercise of decanting, using a NJSA to approve the decanting.
- Do review the prior trust perpetuities period when exercising the power. Consolidating old trusts by exercise of power could trigger different RAP periods.

Drafting powers of appointment can be dangerous, especially lifetime powers, to ensure you don't create creditor issues or gift/estate issues. Powers of appointment have more historic law compared to decanting and NJSA, but drafting the power is critical.

Communication with Beneficiaries should be early and often. A silent trust is rarely a good idea. Enforcement of trusts is based on knowledge of trustee's actions. A trust that does not have any reporting requirements is not a trust.

- The notion that beneficiaries will become corrupt if they know there's a trust is flawed. Do counsel the client for transparency and openness. Knowing about potential benefits can shape life choices for the better.

- Disclosure doesn't always mean full disclosure. Notice to a designated representative can make sense when there are beneficiaries who are not in a position to understand the nature of the trust – minors/disabled/hostile former spouse.

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  - Notice starts the limitations period. Beneficiaries often can file actions only after property notice/information about an issue. Silent trusts extend the liability period.

- The more informed a beneficiary, the smoother the trust administration.
  - Trustees should consult with and inform a beneficiary about decisions related to the trust. Keep them informed, share the process of administration with the beneficiary so they can understand the process.
  - Understanding beneficiary's concern and listening to beneficiary's input may help the trustee make more informed decisions.

- Individual trustees should avoid thinking just because the trustee has the authority doesn't mean the trustee should exercise that authority without some input from the beneficiary.

Beneficiary Control helps keep the trustee in line. Although the power may need to be qualified or restricted, a beneficiary with the power to remove and replace the trustee puts the person with "skin in the game" in control of the trustee's actions.

- The beneficiary should have the ability to move on from a broken relationship.
- Generally, more beneficiary control the better because it forces both sides to work together to accomplish the purpose of the trust.

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- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank).
- **Alexa Langweil, Esq**., an attorney in Philadelphia, Pennsylvania
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Heckerling 2023 – Report 11

Thursday, January 12th Special Sessions

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling.

This report covers some of the Thursday Special Session. Report 12 will cover additional Thursday Special Sessions.

Special Session #: III-B:
Shedding More Light on Planning with Installment Obligations

Speakers
Paul S. Lee and Cassady V. Brewer ("Cass")

ABA Reporter: Michael Sneeringer

One Big Thing: According to Paul Lee: partnerships are where you need to be planning if you are planning with installment obligations.

Summary: A question and answer format provided listeners with answers to frequent and rare questions related to planning with installment obligations. If Paul Lee is the play-by-play announcer, Cass V. Brewer is the color commentator.

What happens to accrued or unpaid interest on a promissory note when there is a conversion from a grantor trust to a non-grantor trust? Paul believed that when there is a conversion, there is accrued interest. Cass indicated nothing has been reported and that it is only on the conversion that you have a transaction for income tax purposes. Cass mentioned you can get into the imputed income interest rules when this occurs.

What happens when a taxpayer does an installment sale using a non-grantor trust, the asset inside the trust goes down in value, and the sale price needs to be adjusted? Paul described that under 453(b), a

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downward modification of the sale price is not a taxable disposition at all. Cass believed that the difference in the income tax treatment has to do with whether it is a recourse debt loan or nonrecourse debt loan.

What do you think about converting a trust from a grantor trust to a non-grantor trust; what about a non-grantor trust to a grantor trust? Paul opined you should not convert from a non-grantor trust to a grantor trust; if a client is thinking of doing this, he or she should do this with a lot of caution. Paul indicated the better conversion is grantor trust to non-grantor trust.

What is the issue when a grantor trust loans the asset back to the grantor-spouses? Cass noted that the fact that the original seller has liquidity again runs afoul of the whole reason for doing the installment sale.

When is a good time to turn off grantor trust status? Paul opined you are in a much better place when you turn off grantor trust status by reason of the grantor's death.

What happens when debt on property transferred to a trust subject to an installment obligation IS NOT in excess of basis? Paul noted:

- If the applicable AFR is 5% at the time of the conversion, then there will be imputed interest each year;
- The interest charge rule applies (at a 7% underpayment rate and 20% capital gain rate);
- The obligation is income in respect of a decedent ("IRD") if the grantor dies with the obligation.

What happens when debt on property transferred to a trust subject to an installment obligation IS in excess of basis? Paul noted:

- No additional taxes are incurred if there is a taxable disposition;
- The interest charge rule and pledge rules technically apply, but no extra taxes will be due;
- If the non-grantor trust sells the property within 2 years of the conversion, no additional taxes are due to the grantor.

During this discussion, Cass added that if the property sold was subject to third party debt, such as bank debt, and the buyer wants to buy it subject to the debt, under the normal installment basis sale rules this is treated as if the buyer made a cash payment.

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What happens upon the death of the grantor (converting a disregarded entity to a partnership)?

- Under Revenue Ruling 99-5, the conversion of a disregarded entity, such as an LLC, to a partnership created by the transfer of an LLC interest to another taxpayer is treated as the purchase of assets and contribution to a new partnership.
  - A taxpayer accomplishes:
  - No recognition of gain,
  - The installment note is not included in the grantor's estate, and
  - The assets get a partial basis adjustment under 1014.

Cass reminded the audience that a partnership does not exist for income tax purposes, in his opinion, unless the parties agree to share profits (that there is a profit "interest" amongst the parties). But Cass added owning real estate or other income producing property within the partnership makes this "requirement" easy to accomplish.

Does the marketable security partnership work to achieve installment sale treatment? Paul opined that the marketable security partnership probably does not work. He indicated that in the 1990s, many of his clients were pitched this idea by promoters. He added that he told his clients not to do this planning back then. In this transaction:

1. There is a related party, non-grantor trust.
2. Taxpayers hope for:
   a. No interest charges payable,
   b. An inside basis adjustment, and
   c. Long-term deferral of capital gain.
3. But what actually results according to Paul, is:
   a. There is a recognition of gain on the parties' sale of partnership interests,
   b. No installment sale treatment, and
   c. The inside basis of the marketable securities is increased under IRC § 743(b).

Why discuss a planning technique called the "marketable security partnership" from the 1990s? Paul desired to highlight an example of planning that that does not work prior to discussing a planning example that LIKELY works.

- In the “likely works” category of planning, the partnership has other property included in the partnership, in addition to the subject property where taxpayers desire installment eligible property.

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- In order for this "likely" planning to work, the seller may not directly or indirectly have control over the proceeds or possess the economic benefit therefrom. This "likely works" directive comes from the *Rushing v. Commissioner* case.

How do you shift basis to an installment obligation, and how does this work? Paul discussed that under the Treasury Regulations and Code, this "shifting" works. He indicated that there are certain requirements:
a. All of the assets must have been in the partnership for 7 years or more.
b. There must be one asset that is fully flush with basis; and
c. You need a group of partners who have zero or significantly lower basis than the partnership assets that are currently in the partnership.

Basis shifting following the death of a partner. Paul ended discussing of basis shifting in the context of a death of a partner, an IRC § 754 election and IRC § 734(b) adjustment.

1. If an IRC § 754 election is made, an adjustment of basis under IRC § 734(b) occurs when:
    a. A partner recognizes gain due to a distribution of cash in excess of outside basis, or
    b. Property is distributed that results in a reduction of basis on the distributed property.
2. The adjustment results in an increase to the inside basis of the partnership assets.
3. Any basis adjustment due to gain from a distribution of cash must be allocated to capital assets.
4. Under IRC § 755, any increased basis adjustment is allocated first to appreciated property in proportion to the amount of unrealized appreciation, with any remaining increase allocated to all of the properties within the same class in proportion to fair market values.
5. There is a possibility of allocating basis to an asset above its fair market value, creating the possibility of a recognizable loss to the partners.

Special Session III-C, Diving Deeper into Charitable Gift Agreements,

Speakers: Alan Rothschild, Jr., Michele McKinnon, and Shirley McLaughlin.
ABA Reporter: Kristin Dittus

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The speakers used several discussion questions as the springboard for analyzing charitable gift agreements and potential problems that may arise.

Question 1 - Releasing Restrictions on Gifts

A university decides to eliminate the men's lacrosse and women's field hockey teams. Men's lacrosse fund has a $1 million and women's field hockey has $20,000. Neither gift agreement addresses the issue of changed circumstance. The donor wishes to transfer the lacrosse fund.

- The university should look to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) for guidance. Options include:
    - Modify agreement with donor's consent, must continue to be charitable purpose.
    - Modify through attorney general (AG) if impractical to continue or circumstances change beyond gift agreement guidance.
- 60-day notice to AG to consent to modify smaller funds. It's best to contact AG's office to discuss before sending consent request.
- Donor Cannot Transfer Funds. Donor typically loses standing once the gift is complete. AG has standing. Try to keep new purpose close to donor intent.
- **Lessons**:
    - Include donor's intent and a change in circumstances clause (allowing board approval for change in purpose) in gift agreement.
    - Allow donor and spouse to amend, but if too easy, may end up constantly negotiating with the charity.

Question 2 – Racial Restrictions and Investment Restrictions. Charitable intent to gift to a Women of Color Investment Fund.

Eliminating discrimination and prejudice is part of Code Section 501(c)(3). There is a general trend towards improving equality and diversity, but also litigation from white plaintiffs asserting they are prejudiced by lack of access to funds or benefits on policies or grants to improve the lives of black, indigenous and people of color (BIPOC).

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- A charity must serve a public rather than a private interest, which is referred to as a "charitable class." Being a BIPOC associated group is not indicative of a charitable class. Gift purposes are limited under 170(c) for donors; and charitable purposes are limited under 501(c)(3).
- Donors and grantmakers often want to support BIPOC organizations and programs - without running afoul of their charitable purposes or other anti-discrimination laws. Look for additional data to create a "charitable connection" for the cause to be supported, such as economic standing, education level, or regional location.
    - If there is illegality in a donation, such as donating a park that can only be used by white people, the gift could be considered complete, and the restriction ignored or the entity can return the gift. The gift is often returned.
- **Current Litigation Cases**: This area is frequently the subject of litigation so lawyers should be consider recent cases in their planning.
- **Current Supreme Court case on race and admission**s. The Supreme Court recently heard two cases involving the consideration of race in the college admissions process. We will continue to see more activity if decided narrowly or will have wide-ranging implications if decided more broadly.
- **Options for Making Gifts**:
    - Make general support gifts and grants, award prizes, find a charitable purpose, charitable class, and conduits (those who serve desired objectives),
    - Use a section 501(c)(4) for profit separate structures.

Question 3 – Administrative and Other Fees on Restricted Gifts. A university proposes the addition of fees be charged to restricted funds because there are limited unrestricted funds to help with administrative expenses and fundraising. The fees are typical at existing nonprofits.

- Fees should be based on the costs incurred to administer or manage the fund. Many organizations charge fees without donor consent despite the lack of supporting language in UPMIFA. You need to be able to justify the fees.

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- Get donor consent to the fees in new agreements.
    - Fees are being used for charitable purposes which is the operation of the charity.
    - Consistency and consent are important, but for older institutions or funds, fees were likely never addressed in the fund agreement.
- Provide Fee Information. Some institutional clients do not want to add the fee amount in the agreement, but prefer to reference the fees as part of their "investment or management policies." These policies should be given to the donor.
- Risks Include:
    - A donor complaining to the AG and having to reimburse the fund for fees.
    - Adverse publicity by the donor which can be far reaching with social media.
- Negotiating Fees: Some charities may say they are inflexible on fees but if the donor threatens to go elsewhere, they are likely to negotiate.

Question 4 –Changing a Donor's Name on the Gift

- Name Changes or Statute Removal is A Common Issue Today:
    - When bad acts by the donor are discovered, they cast a shadow on the donor's name related to a building or endowed fund.
        - Bad acts can include a person who publicly supported white supremacy or wealth built on slave communities. The bad actor's association with the charity can have a chilling effect on future donations or participation in an endowed fund program.
- Parties Affected:
    - Many donors may have given to the fund over time.
    - The charity may reach out to living family members of the donor. Some will understand the need for change, whereas others will object.

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- Governing Law on Changes:
  - New agreements generally address the policy on name changes. Old gifts have limited documentation and guidance on name changes.
  - It can be hard to determine the governing law. It may be treated as a contractual matter related to the gift agreement.
- Gifting anonymously avoids future naming issues and criticism of family history. High net worth clients may prefer privacy with modern gifts.

Question 5 – Difficult Donors. A donor's family has a successful durable medical equipment business, and he wishes to endow a research professor position at a university for durable medical equipment. He wants to retain significant control over the selecting committee for the position, for both he and his descendants to retain standing to enforce the terms of the gift agreement, and to have total indemnity from future claims since testing on humans is required.

Problems:

1. Donors who remain significantly involved will feel like the gift is still their money and will be difficult if their desires are not met.
2. Input on the selecting the scholarship recipient may make it more like a donor advised fund (DAF) which has significant restrictions on scholarships.
3. The gift may not qualify for a tax deduction.
   a. Typically, academic appointments are made independently by the school and without non-academic influence.
   b. With a donor trying to retain so much influence it appears not to be a completed gift.
4. There is a private benefit to the donor if the devices to be tested that are sold or developed by his company, creating another problem with the gift deduction.
5. Immunity provisions are common, but in this case it may leave the university liable and protect the person responsible.

Goals:

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1. Best for the organization to have a policy related to permitted donor conduct to avoid a personal conflict with a potential donor. Encourage donors to let the experts make those kinds of decisions and provide the donors intent in the gift agreement to guide the organization.

2. UPMIFA is a well thought out law created with input from a lot of educated people representing a number of different perspectives in these situations.

3. Gift agreements should have the goal of longevity and sustainability over a long period of time. Organizations should have a uniform agreement and try to limit modifications for each gift to avoid creating inadvertent problems, conflicts, and mistakes in the agreement.

4. Limit Donor Standing. It can be appropriate for a donor to retain standing, but limit it to donor and spouse. Once standing is extended to next generation, they can have very different goals from the donor and have conflict among themselves.

Attendee Questions:

1. *What happens when the AG doesn't act and there is a clear violation of the agreement?* This can happen. The AG has standing but the donor typically does not. Look to contractual obligations. Consider contacting an investigative reporter or public relations person committed to the cause. Publicity can influence the AG to get involved and pressure the organization to fix the problem.

2. *What about a gift of crypto currency?*

   These donations are accepted, but organizations do not want restrictions on investment strategy or the ability to convert and use the asset.

Our 2023 **Reporters** are:

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- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;

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Heckerling 2023 – Report 12

Wednesday and Thursday, January 11th -12th Special Sessions

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This report covers the Wednesday Special Session not included in an earlier report and some of the Thursday Special Sessions. Report 13 will cover the final additional Thursday Special Session and the Friday General Sessions.

Wednesday, January 11th

Special Session # II-C:
So You Want a New Trustee?

Speakers: Craig M. Frankel, Michael H. Barker, and Jaclyn G. Feffer

ABA Reporter: Alexa Langweil

Takeaway: There are several techniques available for removing a recalcitrant trustee or modifying a trust to remove a trustee, including non-judicial settlement agreements, trust modification by consent of interested persons, court modification, and court removal.
There's likely to be an increase in attempts to remove trustees with the growing popularity of dynasty trusts, as well as increasing use of directed trusts (many individuals appointed as trust protectors may not be educated in what this role means and how to properly exercise their power).

First step if someone is dissatisfied is to consult with an attorney who can speak with a beneficiary, find out information from the trustee, and attempt to figure out a resolution with disclosure or looking at the powers. Alternatively, have an attorney read the trust agreement, and determine who has the right to do what. As a litigator, Mr. Frankel most frequently sees a failure to communicate or an outright refusal of the trustee to do something, regardless of what that something is. Hostility between a

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beneficiary and trustee, while a frequent issue, is not a legally sufficient reason, but it is generally the motivation.

Attorneys reading the trust agreement should read not only the appointment provisions, but the entire document, including the administrative provisions.

If all voluntary efforts fail, attorneys need to determine which state law applies. If subject to an unfavorable state law, see if it's possible to change states to obtain a more favorable state law. Most states have adopted the Uniform Trust Code provisions on removal, which provides seven methods for removal.

Nonjudicial Settlement Agreements (NJSAs): UTC § 111 authorizes binding, non-judicial settlement agreements by interested persons under certain circumstances.

Key questions to ask when evaluating whether this is a workable option:

- Who is an interested party? If a trustee is an interested party, as a general rule, their consent is needed and they may be unhappy giving someone the power to remove and replace them.
- What can you do? Is this administrative or substantive? Is it within the scope of a judicial settlement that can be done without court approval? Mr. Frankel takes the position, seen in the Restatement Third, that the concept of removal and replacement is administrative.
- Is the proposed solution inconsistent with a "material purpose" of the trust? Review case law to ensure that it does not violate a material purpose.

If an agreement is not a workable solution, trust modification may be a better option.

Trust Modification By Consent of Interested Persons: UTC § 411 and the Restatement (Third) of Trusts § 65 authorize the modification of non-charitable irrevocable trusts by consent under certain circumstances. Most states have adopted statutes or have case law permitting the modification of a trust by consent of its beneficiaries, trustees, and/or settlors, even if it violates a material purpose, so in essence an irrevocable trust can be converted to a revocable trust.

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Key questions to ask when evaluating whether this is a workable option:

- **Does state law require court approval for a modification?**
- **Whose consent is needed?** If settlor approves, modification is generally easy. Without the settlor's approval, all beneficiaries if they agree can modify a trust. There is a question of whether such approval is sufficient to amend the removal and replacement provisions. Some courts have said yes, but others have found that because removal provisions exist in the UTC, that is the exclusive way to remove a trustee and a trust cannot be modified to empower another to do so. Even if all of the beneficiaries do not agree, the court can still modify the trust agreement (i) if all of the beneficiaries had consented, the trust could have been modified or terminated under this section and (ii) the interests of a beneficiary who does not consent will be adequately protected. However, when the settlor does not agree, a discussion ensues as to what is a material purpose.

Court Modification Based on Unanticipated Circumstances: Many states have adopted statutes based on UTC § 412 or Restatement (Third) of Trusts § 66, both of which authorize a court to modify a trust if, due to circumstances not anticipated by the settlor, modification will further the purposes of the trust. *Cleary v. Cleary*, No. 1668 (Md. Ct. Spec. App. Dec. 21, 2020) provides an example of what is meant by circumstances not anticipated by the settlor. Changes in family structure, e.g., divorce from a spouse named as trustee, can qualify as unanticipated circumstances.

- If the settlor is living, they can speak to the unanticipated circumstances, but if deceased, who can speak to their anticipation (it can be administrative or substantive), so long as the modification furthers the purpose" of the trust, which Frankel comments sounds like a code word for "material purpose". The Court may also modify just the administrative terms if continuation of the trust on its existing terms would be "wasteful," "impractical," or "impair the trust's administration".
- Restatement (Third) of Trusts § 66 adds a slight twist, which may be particularly alarming for corporate trustees: if a trustee is aware or should have been aware of unanticipated circumstances, they have an affirmative duty to file a petition with the court to seek the modification.

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Even with a NJSA or when a trust can be modified on its own, most states still provide the right to receive court approval.

There are essentially four ways to remove a trustee:
Removal for cause (i.e., substantial non-compliance): The hardest, most expensive, most time-consuming form of court removal, this also creates an issue for how the trustee should administer the trust in the interim.

Lack of Cooperation by Co-Trustees: UTC § 706(b)(2) authorizes a court, either on motion or on its own, to remove a co-trustee(s) where "lack of cooperation among co-trustees substantially impairs the administration of the trust." This typically occurs when a trust agreement requires the co-trustees to act together (as is the norm) and the agreement does not include an impasse provision, or when an individual trustee deadlocks the other.

Failure of the Trustee to Administer the Trust Effectively: UTC § 706(b)(3) authorizes a court, either on motion or on its own, to remove a co-trustee(s) where "because of unfitness, unwillingness, or persistent failure of the trustee to administer the trust effectively, the court determines the removal of the trustee best serves the interests of the beneficiaries." This is extremely broad, but provides an easier route than removal for cause.

Substantial Change of Circumstances: UTC § 706(b)(4) provides for removal when "there has been a substantial change in circumstances or removal has been requested by all of the beneficiaries, the court finds that removal of the trustee best serves the interests of all of the beneficiaries, and is not inconsistent with a material purpose of the trust, and a suitable co-trustee or successor trustee is available."

The distinction here is the change in circumstances is not from the settlor's perspective, but from the perspective of the trust, wherever its being managed. Note the "or" contained in the above language, which allows for removal if it has been requested by all beneficiaries even if there has not been a material change in circumstances. In this scenario, the material purpose of the trust is relevant.

The speakers then provided illustrations and discussed best practice for handling recalcitrant trustees.

- The scenarios stressed that **court removal is a drastic remedy and may not be as easy as one hopes.**

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- A second theme was the **significance of state law**.
- A third theme was the importance of communication, as its not usually bad actors, but **a lack of communication** that creates discord.
- Lastly, **practical considerations** outside of these seven methods are available: attorneys can plan/draft better and seek cooperation from a corporate trustee (likely will require a release). The latter is more difficult when a settlor specifically designates a particular corporate trustee. Likewise, unhappy beneficiaries may want to consult with an attorney to determine what type of information they should ask for and how best to ask.

The speakers then discussed **common motivations** for beneficiaries seeking trustee removal.

- **Lack of communication and information** are common complaints. The law clearly describes what a beneficiary is entitled to receive; while a trustee may comply with a request for more information such as tax returns or spreadsheets, that's not required under the statute.
- **Distributions** are another source of beneficiary unhappiness.
- **Investment decisions** may also be a source of beneficiaries' unhappiness with a trustee.

Practice pointer: Discretion is the better part of valor. Intermediate methods, short of removal, may be enough to quell dissatisfaction. Ask for communication, ask questions, request additional distributions, if unhappy with investments, discuss and negotiate. Practical approaches can be very meaningful, but the seven methods outlined above are available if needed.

Drafting Tips:

- The speakers do not recommend pot trusts.
- **Create a mechanism for resignation of a trustee (do not rely on state law).**
- **Create a mechanism for removal and replacement of a trustee.**

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- Include precatory language or a separate letter of wishes (not always advisable) to allow greater understanding of the settlor's general vision/intentions for the trust.

Material Purpose: An amorphous concept, some courts have held that in determining a trust's material purpose, one is confined to the four corners of the document (i.e., traditional rule of grantor intent). The Restatement allows consideration of the surrounding circumstances (undefined). The speakers then debated the merits of explicitly including trust language regarding the settlor's "primary purpose" or their "intentions."

Thursday, January 12th

Special Session # IV-A
The Gift that Keeps on Giving: Ethics and Privilege Landmines with Gifts and Form 709

Speakers: Stephanie Loomis-Price and Christine S. Wakeman
ABA Reporter: Michael Sneeringer

One Big Thing: Let's be careful out there: communications in written, typed, or spoken form are forever.

Is there a gift-giving winner and loser? Each time there is a potential gift by a spouse in a joint representation, there is a potential conflict.

Gifting using spousal lifetime access trusts ("SLATs"). According to Christine, there are three schools of thought that attorneys have discussed at Heckerling this week when working with clients desiring the creation of a SLAT:

- One group of attorneys will only prepare one SLAT.
- One group of attorneys will prepare two SLATs: one for spouse #1 and one for spouse #2 (timing is not a factor).
- One crop of attorneys will prepare two SLATs but one SLAT must be in one tax year and the other SLAT must be in another tax year (timing is a factor).

Landmines for the attorney, not necessarily gifting related.

- Every representation involving a husband and wife joint grantor trust (what if the parties divorce?).

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- Inadvertently sharing confidential information (sending an e-mail to a person but meaning to send an e-mail to another person).
- Electronically stored information ("ESI") in discovery.
- Gift-splitting:
- Gift-splitting when one spouse is not faithful to the other.
- Wasting exemption by inadvertent gifts to non-spousal companions.
- Joint representation, specifically the potential termination of engagement if one spouse mentions divorce to the attorney outside of the presence of the other spouse.

What does the attorney client privilege not cover? There were a few examples given when the attorney client privilege will not apply, including turning over invoices, tax opinions, and dual-purpose advice (legal and business advice that is mostly business advice).

What is privilege? It is important to understand what is privileged and what is not. Privilege is confidential communications between a client and attorney related to the legal subject matter at hand, but more importantly, certain items destroy privilege:

a. Having other people in the room.
b. Having familial hangers-on around.

What can you if someone else wants to join the conversation? Consider an agency agreement under state law that your client would sign with his or her “agent” (that child, parent, sibling, or “friend” who wants to be a part of the conversation). In this same vein, a durable power of attorney could also be considered.

Letters contemporaneous to the transaction, good or bad? The panelists agreed that the traditional cover your rear letter may stave off penalties in a gift tax audit or tax litigation matter. Why? This is because you were providing the client with the pros and cons of entering into the transaction, as opposed to initiating a risky transaction on the client’s behalf with no warning.

Practice Tip: Write things in a way that explains the transaction but that does not hurt your client later if the transaction is audited and communications are discovered.

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The oops category: when there is an error in the transaction. When there is an actual measurable mistake (not a mistake in judgment), ask yourself four questions:

1. Who made the mistake? A scrivener or somebody else. Another law firm?

2. How material or serious is that mistake? Some of the case law in states only turns in favor of your client depending on how serious the mistake is.

3. Do your best to figure out what type of error it is:

a. Mistake of fact,

b. Mistake of law,

c. Unilateral mistake of fact or law or

d. Bilateral mistake of fact or law.

4. What remedies are available?

If a client begins a question with "can't we just", the answer is no. Tell your clients, subordinates, and law partners: we cannot take the low road and we cannot take a shortcut.

U.S. v. Kovel, 296 F.2d 918 (2d Cir. 1961) and attorney-client privilege discussion.

- Per Stephanie, if you are using this case to cloak your communications with appraisers in attorney-client privilege, you would be wrong.
- In communications between an attorney and a consulting-expert, privilege may apply.
- Attaching an appraisal to a gift tax return does not mean that there is privilege between the attorney that hired the appraiser and the appraiser.

Who engages the appraiser? Stephanie opined that she does not want anything but the engagement letter and logistics in writing when dealing with an appraiser. She opined that the attorney should engage the appraiser, not the client.

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Adequate disclosure. The words "but my appraisal is only a few years old" could jeopardize adequate disclosure. You should make sure that you comply with each of the adequate disclosure steps, but there is no need in return to specify to the IRS in advance how you complied with adequate disclosure.

Form 2848. Stephanie indicated that the IRS has everything single Form 2848 on file for attorneys. Attorneys may receive communications on clients whom they worked on many forms ago. Stephanie described CAF-77:

1. A CAF 77 listing is a complete listing of all clients for a given representative and may be obtained via a Freedom of Information ACT (FOIA) request.
2. Stephanie recommended that once you receive a list of all Forms 2848 on file, you should begin to remove yourself as the "attorney-of-record" (in the eyes of the IRS) for clients you no longer have contact with.

Keep your eventual future audience in mind. Everything you say or write may end up as evidence in tax court or other proceeding.

Thursday, January 12th

Special Session # IV-B:
From Take Off to Touch Down – A Comprehensive Look at Inbound Investments into U.S. Markets

Speakers: Scott A. Bowman, Michael Rosen-Prinz, and Dina Kapur Sanna
ABA Reporter: Katharine G. Griffiths

Key takeaway: Transfer tax planning for non-U.S. residents who invest in U.S. assets is complex and depends on the type of U.S. assets the client owns.

Investment in U.S. Financial Markets

Mr. Rosen-Prinz covered planning for non-residents who want to invest in U.S. financial markets.

<u>Estate tax blockers:</u>

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1. Foreign corporations set up for significant and legitimate non-tax reasons that hold US-situs assets can be used to prevent the non-domiciliary from paying estate tax.
2. It is important to ensure the client does not have any retained interest that would fall under IRC §§ 2035–2038).

<u>Basis step-up</u>

1. If you use a single foreign corporation as an estate tax blocker, IRC § 1014 does not apply to provide a basis step up.
    a. If a non-resident investor gives all assets to another non-resident, there is no basis issue, but if a non-resident gives to a resident, there is a basis issue.
    b. When a U.S. person inherits a foreign corporation, it will likely become a controlled foreign corporation. Gain within a controlled foreign corporation will be Subpart F income and will not receive a preferential rate.
2. How do we solve this issue?
    a. Single foreign corporation
        - Two solutions:
            - Churn the portfolio - sell and buy stocks all the time to ensure they have a high basis.
            - Sell assets immediately after death
                a. There is a formula for determining how much income from sale is Subpart F income based on when in the year the Decedent died. If the Decedent died on the 300th day of the year, only 1/300th of the gain is treated as Subpart F income.
    b. Triple blocker
        - Foreign grantor trust owns foreign holding company 1 and foreign holding company 2. Foreign holding companies 1 and 2 each own 50% of a foreign subsidiary that holds the U.S. assets.

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- The beneficiary makes a check the box election at the Decedent's death on the subsidiary. This allows for a step up in basis because there is a taxable liquidation of the subsidiary, and the assets are distributed to foreign holding companies 1 and 2.
  - If the non-resident dies in the first 75 days of the year, can treat the check the box election as being made before the year of death so the gain is pushed into the pre-death year.

c. Asset protection trust with single foreign corporation

- Use an irrevocable trust with these characteristics:
  - For the benefit of grantor/grantor's spouse.
  - Purely discretionary; and
  - Jurisdiction does not allow grantor's creditors to access the trust.
- Trust holds foreign corporation that holds U.S.-situs assets
- When grantor dies, make check the box election effective the day prior to grantor's death to get a step up in basis.

Investment in U.S. Real Property

Ms. Kapur Sanna covered planning for non-residents who want to invest in U.S. real property.

<u>Blockers:</u>

1. Foreign corporation
   a. Favorable for income tax purposes due to lower corporate tax rates.
      i. If income producing property, should make a net rent election under IRC § 871(d), which will allow it to take certain deductions that would not otherwise be available.
   b. Branch profits tax:

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i. Applies to after-tax proceeds from U.S. real property of foreign corporation that are not reinvested into U.S. business (30% tax; effective rate of 44.7% when included with 21% corporate tax).

ii. Can set up U.S. corporate subsidiary to hold the income-producing U.S. real estate to avoid this.

1. Dividends are subject to a 30% withholding tax, but now client has control of when tax incurred because it depends on when dividends are paid.

c. Personal use of the property without rent - could be constructive use of the property which will be treated as a dividend. Alternatively, could be imputed income to the corporation.

d. Using a corporate blocker and checking the box at death to get basis step up may create a FIRPTA withholding obligation, so this may not the best option for U.S. real property.

i. Could domesticate the company at death, which is a tax-free re-organization and then make an s corporation election.

2. Two-tiered partnership

a. Not as favorable as a foreign corporation due to lower corporate tax rate. Additionally, there is uncertainty on whether these are effective estate tax blockers.

3. Irrevocable Trust

a. Trust is the blocker and trust holds property directly or through single member LLC.

b. Use a U.S. trust, not foreign trust, otherwise IRC § 643 applies (rent-free use of property is a deemed distribution).

c. U.S. trust avoids FIRPTA withholding at 15% when property is sold.

d. Downside: Pays additional 3.8% tax on gain, but may be a small price to pay for a robust structure that doesn't need to be domesticated on shareholder's death.

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Investment in U.S. Tangible Personal Property

Mr. Bowman covered planning for non-resident clients who want to invest in U.S. tangible personal property.

1. Tangible property is treated similarly to financial assets for estate tax purposes.
    a. Nature of tangible property is different from financial assets from a non-tax perspective, though, which can create tax difficulties.
        i. Cannot churn it (typically not fungible).
        ii. Moving cash in and out of structure regularly to build up outside basis of subsidiary is not available because it does not produce income.
        iii. Using multiple holding companies and selling property back and forth likely does not look good from a step transaction and economic substance perspective. Additionally, sales tax may erode income tax savings.
        iv. Asset protection trust - if using trust property on regular basis, that cuts against idea that it is protected from creditor claims.
    b. If the property is substantial (over the $60,000 estate tax exemption), then could try a two-tiered partnership and hedge the risk of doing so with life insurance.

Our 2023 **Reporters** are:

- **Beth Anderson, Esq.**, an attorney with Wyatt, Tarrant & Combs, LLP in Louisville, Kentucky;
- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;
- **Katharine Griffiths, Esq**, an attorney with Holland & Knight in Tampa, Florida and

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- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank).
- **Alexa Langweil, Esq**., an attorney in Philadelphia, Pennsylvania
- **Michelle R. Mieras, J.D., LL.M., CTFA,** a Senior Vice President with BOK Financial Private Wealth in Denver, Colorado.
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Heckerling 2023 – Report 13

Thursday, January 12th Special Session

Friday, January 13th – General Sessions

As we have done for the last twenty-six years with the permission and cooperation of the University of Miami School of Law, we will be posting daily Reports to this list containing highlights of the proceedings of the 57th Annual Heckerling Institute on Estate Planning held in-person in Orlando at the Orlando World Center Marriott Resort & Convention Center and virtually on January 9 -13, 2023. The Institute's 2023 brochure is available at www.law.miami.edu/heckerling .

This Report 13 concludes our coverage of the 2023 Heckerling Institute on Estate Planning, covering the Friday General Sessions and the final Thursday Special Session.

Friday, January 13th

Down and Dirty Estate Planning for Retirement Benefits

Speakers: Natalie B. Choate
ABA Reporter: Michael Sneeringer

One Big Thing: Natalie's presentation focused on how to test a trust that is named as the beneficiary of a retirement account to determine how the RMD rules apply to the trust and its beneficiaries. She also included some tidbits about SECURE 2.0.

Why is Natalie not discussing Secure 2.0? Secure 2.0 has very little to do with estate planning.

2.0 Tidbit #1. Age 73 is now the age for retired minimum distributions.

Testing a trust to identify which beneficiaries count. Here are the first four steps necessary to test a trust in order to determine whether the trust qualifies as a Designated Beneficiary for purposes of the minimum distribution rules and who are the trust's countable beneficiaries.

1. Does the trust pass the four trust rules to make the trust a "see through trust".

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2. You make a list of all potential beneficiaries who could conceivably get money under the trust. You omit beneficiaries who are disregarded under the "disregard rules" (see below)

a. Disregard people who predeceased the participant.
b. Disregard people who are not born yet.
c. Disregard permissible appointees under a power of appointment UNLESS that power of appointment is actually exercised (death is the "exercise" of the power).

3. Divide the list of potential beneficiaries into 2 tiers (newest rule).

a. The IRS describes Tier 1 beneficiaries as something else. But, Tier 1 beneficiaries are people who can inherit once the participant dies.

These beneficiaries are entitled and eligible to get money from the trust; they do not have to wait for anybody else to die.

b. Tier 2 beneficiaries are everybody else who can inherit, regardless of whether there is a contingency or not. There is no such thing as "Tier 3".

4. You apply certain disregarded rules to get the countable beneficiaries. The three disregarded rules are:

a. The conduit trust rule. With a conduit trust, you disregard the entire Tier 2 described above.

- A Conduit trust is now an official term in the Treasury Regulations. A conduit trust must immediately pass out the distribution right away, for the life of the beneficiary.
- A conduit trust for the benefit of a surviving spouse allows the surviving spouse to use the recalculated life expectancy.
- Because in 2020, the RMD was 0 and interest rates were low, it was suggested that the Marital-conduit trust provide the trustee with the ability to make discretionary distributions for health, education, maintenance, and support (as opposed to a conduit trust mandating distributions of retirement benefit income only).

b. The age 31 rule. if you have a Tier 1 beneficiary under age 31 (or any younger age), you can disregard any Tier 2 beneficiary if that child dies before age 31.

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- A minor child as a participant gets a lifetime expectancy payout until he or she reaches age 21 (at which time the minor child is subject to the 10-year payout rule).

- With a minor child EDB, you do not need to have a conduit trust. You can accumulate distributions while the minor is slowly reaching age 31.

c. "Second choice-second tier guy" rule. If you do not have a conduit trust and instead have an accumulation trust, we disregard any second tier beneficiary who will inherit only if some other second tier beneficiary fails to survive such first tier beneficiary.

2.0 Tidbit #2. You can have a charity as a remainder beneficiary and not lose your government benefit qualification. There is a change in the law for qualified longevity annuity contracts (QLAC): a QLAC can have a return of premium guarantee. This type of annuity is not a countable asset for Medicaid purposes.

Testing a trust to identify which beneficiaries count. After you determine whether the trust qualifies as a Designated Beneficiary for purposes of the minimum distribution rules and who are the trust's countable beneficiaries, the applicable denominator period must be determined.

1. If any of the countable beneficiaries is a non-individual (an estate or charity), the trust is a non-designated beneficiary. The distribution period is the 5-year rule if the participant died before his or her RBD, otherwise the ghost life expectancy.

2. If the trust is a conduit trust, the distribution period for the trust is exactly the same as it would have been for the conduit beneficiary(ies) if they were named directly as beneficiaries.

3. If the trust is a Type 2 Applicable Multi-Beneficiary Trust, that is, there is a disabled or chronically ill beneficiary, no distributions from the retirement plan may be paid to anyone other than such disabled or chronically ill beneficiary.

4. If any countable beneficiary of the trust is a minor child of the participant, the trust is entitled to the life expectancy payout. Here Natalie noted that because the likelihood of having a minor child of the participant is low, attorneys should not go out of their way to draft a trust so as to qualify as a see-through trust.

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5. If all countable beneficiaries of the trust are EDBs, you get a payout based on the oldest EDB's life expectancy.

6. If none of the above applies, the 10-year rule applies. All benefits must be distributed before the end of the year of the tenth anniversary of the participant's death.

2.0 Tidbit #3. If 70.5 or older, a taxpayer can make a contribution directly to a charity (not a donor advised fund), up to $100,000 per year. Before Secure 2.0, that meant a distribution outright from the IRA to a charity. Now you can make a one-time split interest gift to a charitable gift annuity or charitable remainder trust, with limitations:

1. Maximum contribution amount of $50,000.
2. The payout must be to yourself or yourself and your spouse.
3. The one-time gift must start within a year (no deferred gift).
4. The annual payout must be at least 5% of the gift amount.
5. The charitable gift annuity must commence fixed payments of 5% or more than the contribution amount not later than 1 year from the date of funding.

What Natalie consider "Level 2": the "harder stuff"? Natalie indicated that the proposed regulations have generous provisions for post death changes in the trust. She noted that there was no such thing as decanting when the Regulations were originally written . Any possibility that the trust will be reformed or decanted after death is ignored until it happens after death.

If decanting, you must decant it before September 30 in the year after death. Amendments to a trust before this beneficiary finalization date are good. The IRS will give recognition to those changes. If decanted a year later, the IRS will test it at that time. In general, you cannot make post death reformations that improve results. Sometimes though the issue is the beneficiary designation form; can we reform the beneficiary designation form? Natalie indicated no. You can fix stuff only applicable to the trust instrument.

What is the worst rule in the Regulations? According to Natalie, the worst rule in the Regulations has to do with multiple trusts or subtrusts. Separate accounts: an IRA left to multiple beneficiaries and divided into separate accounts.

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- The IRS says that separate accounts will not be recognized for RMD purposes for determining the distribution period. Congress changed this for disabled and chronically ill beneficiaries:
- The statute says the separate trusts will be recognized as separate beneficiaries and each trust will get the deal it gets. Accordingly, if you leave your IRA to a trust dividing into subtrusts, it would be beneficial if one of them is disabled or chronically ill.
- Should trusts add toggles that apply to allow the use of the ghost life expectancy if produces a more favorable result? According to Natalie, while the generous treatment of post-death changes are helpful for assisting survivors clean up a trust to improve RMD outcomes, they also provide a path to allow "toggles" in the planning stage.
- She indicated that she has never seen a good toggle in a trust document. For example, a trust could give a beneficiary a limited power to appoint to charity. By exercising, disclaiming, or restricting that power, the beneficiary could facilitate a desired result such as qualifying for the "ghost life expectancy" payout (if that appears more favorable than what would otherwise apply).

Why is Natalie optimistic about Secure 1.0? According to Natalie, Secure 1.0 was great for her career.

Is long term deferral best? Natalie opined that for the younger generation, deferral in an IRA may not be as beneficial as the beneficiary withdrawing the IRA funds within the 10 years so that he or she can contribute that money to a Roth IRA or Roth 401(k), if eligible.

Friday, January 13th

Wrap-Up: It Ain't Over Till It's Over

Speakers Charles A. (Clary) Redd and Turney P. Berry

ABA Reporter: Michael Sneeringer

One Big Thing: 3,968 people attended Heckerling; about 3,000 on site and almost 1,000 virtually. For those who attended and those that did not attend, these were some of the more important points according to two luminaries in the estate planning field.

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Judge Maurice B. Foley. Judge Foley noted his judicial philosophy. Clary and Turney thought it gave valuable insight into the mind of a Tax Court judge.

Recent Developments 2022. Defined value clauses were discussed at length. Clary loves defined value clauses.

- He indicated that whenever you deal with the lifetime disposition of an asset that is difficult to value, the question is how to best draft the defined value clause. He indicated that what kind of value defined clause to use is key.
- He discussed *Wandry* type clauses and how those were addressed in the Sorensen case.
    - Attorneys and accountants should review *Sorensen* for its comments on *Wandry*.
    - In *Sorensen*, the IRS compared Wandry clauses to the clauses in *Petter*, *Hendrix*, *Christansen*, and *McCord* (charitable spill over cases).
    - Clary opined that charitable savings type clauses might be a good idea. He does not see a downside to using the charitable spillover (what are the odds that a return will be selected, he noted).

Not Too Rich, Not Too Poor: Goldilocks Planning for the Middle-Rich Clients Who Need Our Help. Turney indicated that planning does not need to consist of esoteric Heckerling-like techniques.

- Grantor trusts are the lifeblood of this type of client.
- The order in which you do planning is more important here.
- If a client is reluctant to start annual exclusion giving and basic marital deduction planning, more complex planning might be best avoided.

It's a Nice Place to Visit, but Do You Want to Live There? The panelists pointed out Amy Kanyuk's discussion on the mechanics for moving a trust and what types of clauses and items can go in a trust (an example of in terrorem clauses was discussed as most states have them, but each state's law on them varies).

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Upside Down with a Perfect View. The panelists highlighted Todd Flubacher's discussion of the state income tax consequences when taking actions. Specifically, Turney asked what "does principal place of administration" mean in comparing ministerial acts versus discretionary acts.

- He asked whether the purchasing of the product or thought process behind purchasing the product matters for principal place of administration.
- He wondered whether it is more important where the action is carried out at versus where the action was initially thought up.

Goblins Lamentation List: Unscrambling "Installment Obligations" (Paul Lee). Turney noted the intersection here of non-grantor trusts becoming taxable upon toggling off grantor trust status.

You're Fired! Whether, When, and How to Terminate Representation of a Client (Including Ethical Considerations). The panelists summarized Bruce Stone's examples of when it is appropriate to fire a client, such as when a client refuses to follow your advice.

- indicated that Bruce discussed that there are also situations when you are able to fire a client with diminished capacity.
- The panelists opined that attorneys should screen their clients better up front and decline the representation of a troubled prospect immediately.

"You're No Good, You're No Good, You're No Good, Baby, You're No Good " – Saying Goodbye to the Recalcitrant Trustee. What about a breakup with a trustee? The panelists gave a few examples from Craig Frankel's Tuesday talk.

They discussed how using a non-judicial settlement agreement requires all of the parties to consent: can you get ALL of the parties to agree to something? Or do you have to instead convince a court? Some topics discussed during the presentation according to the panelists were:

- Substantial changes of circumstances justifying removal of a trustee.
- An unfit trustee.
- An obvious breach of fiduciary duty
- Will the Trustee voluntary resign?

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- Should the Trustee have terms limits?

Current Trends in Special Needs and Elder Law. The panelists highlighted the planning tip of locating a special needs trust in a jurisdiction where accountings are not mandatory. Why? So that a nosey caregiver is not leafing through papers to find out how much money the disabled beneficiary has.

They discussed relying on the *Cristofani* case in order to issue withdrawal notices to remainder beneficiaries and not the disabled-primary beneficiary.

America the Gradual: An Update on How Anti-Money Laundering Initiatives Affect Estate Planners. Two major developments were discussed according to the panelists related to anti-money laundering initiatives:

1. Corporate Transparency Act. Establishes a central registry of reporting companies and company affiliates.

2. The increasing pressure put on lawyers potentially to act as financial intermediaries (a/k/a turning lawyers into "snitches").

Review of the Past Year's Significant, Curious, or Downright Fascinating Fiduciary Cases. The panelists discussed some of the cases from this presentation.

1. *In re Trust of Harrison*, 2022 Pa. Super. Unpub. LEXIS 16 (2022). Trustee's objections to beneficiary's lifestyle do not amount to a disability that allows trustee to withhold required age-based distribution of trust principal.

2. *In re Omega Trust*, 2022 N.H. LEXIS 60 (2022). Exchange of emails between settlor and attorney may constitute valid trust amendment.

3. Stalnaker v. Cupp, 2022 Cal. App. Unpub. LEXIS 1710 (2022). California court does not have personal jurisdiction over Tennessee trustee of credit shelter trust based on contacts with California attorney.

4. *Matter of Grossman*, 2022 N.Y. Misc. LEXIS 1352 (2022). Visceral shock and dismay that decedent chose a donee for her exercise of her power of appointment whose commitment to West Bengali folk music mirrored her own, a decision claimed would cause the deceased donor of the power great distress, and personal derision of the art form as merely

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"pleasing to Bengalis", are not grounds to contest exercise of power of appointment.

Split Dollar Is Still Alive and Kicking – Fundamentals and Intergenerational Update. The panelists noted that there was a discussion related to the *Levine* case and the *Morrissette* case (called "*Morrissette II*"). They noted that the *Levine* case was decided positively for split dollar life insurance because unlike *Morrissette II*, the decedent did not have the unilateral ability to unwind the split dollar arrangement.

Watch Your Steps--Don't Abuse Substance in Transfer Tax Transactions. The panelists described that in looking at a series of transactions, does each component have real life independent significance standing alone.

- If yes: off to a great start in being able to defend the transactions.
- If no: trouble.

In her presentation, Carol Harrington used the Smaldino case as the example for what not do to in planning.

Thursday, January 12th

Special Session IV-C
Take a Dive into the Sunshine State (Law) – The Essential Update on Florida Law

Speakers: Shane Kelley, Elaine M. Bucher, John C. Moran
ABA Reporter: Craig Dreyer

COMMUNITY PROPERTY TRUST ACT (NEW) - On July 1, 2021, Florida joined Alaska, South Dakota, Tennessee, and Kentucky as an opt-in community property trust state. There are five requirements for a trust to be a community property trust:

1. Must be in writing.
2. Provide it is a community property trust.
3. Must have FL resident trustee or corporate trustee in Florida.
4. Signed by both spouses.
5. Have required language in TRUST in bold letters.

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- Terms of the Florida Community property trust may be agreed upon by spouses and everything can be agreed upon by the parties, unless against public policy.
- Benefits:
    - Assets should receive a full step up in basis when one spouse passes, but the IRS has not addressed this directly.
    - Community property transferred to this trust will retain community property if acquired elsewhere.
- Risks:
    - May not get full step up if IRS challenges.
    - Community Property will lose the creditor protection of tenancy by the entireties status property.
    - Homestead Property will either need homestead waiver or property must be disposed of in a way that does not violate homestead laws.

HOMESTEAD

SB 1070, Homestead in Trusts

- The speakers gave an overview of the Florida Homestead laws in Florida before highlighting some new legislation and cases:
    - F.S. 736.1109: If a devise of homestead under a trust violates the limitation of the devise of homestead in S. 4(c) Art X of the State Constitution title shall pass as provided in F.S. 732.401, at the moment of death.
    - F.S. 736.1109(2) A power of sale or general direction to pay debts, expenses and claims within the trust instrument does not subject an interest in the protected homestead to the claims of decedent creditors, expenses of administration, and obligations of the decedent's estate as provided in 736.05053.
    - 736.0201(7), A proceeding to determine homestead status of real property owned by a trust may be filed in the probate proceeding for the settlor's estate if the

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settlor was treated as the owner of the interest held in the trust under section 732.4015. The proceeding shall be governed by Florida probate Rules. (Allows probate proceeding to determine homestead in probate matter for house in revocable trust).

- Feldman v. Shocket, So.3d, (Fla. 3d DCA 2022), Will directed sale of homestead, spouse claimed homestead. Personal Representative said spouse waived rights by signing mortgage waiving homestead rights, and spouse signed waiver after death, but did not do so knowingly. Court noted that F.S. 732.202 allows waiver of homestead rights, but there must be fair disclosure. Post death waiver did not apply since it was too late as the devise vested at the moment of death.
- Ballard v. Pritchard, 332 So.3d 570 (Fla 2d DCA 2022), you cannot leave a spouse a life estate, and the balance to one child (excluding another), since it is an invalid devise. Spouse gets a life estate and the balance goes to both children.
- Fitts, et al. v. Furst, et al., 283 So.3d 8333 (Fla. 3d DCA 2019), F.S. 196.031(6), a person who is receiving or claiming the benefit of ad-valorem tax exemption or tax credit in another state where permanent residency is required as a basis for the granting of that ad valorem tax exemption or tax credit, is not entitled to the Florida homestead exemption.

STATUTORY FEES FOR ATTORNEYS REPRESENTING FIDUCIARIES

If an attorney representing the personal representative intends to charge a fee based upon the schedule provided under section 733.6171(3) (the sliding scale), the attorney must make the following specific written disclosures to the personal representative:

- There is not a mandatory statutory attorney fee for estate administration.

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- The attorney fee is not required to be based on the size of the estate, and the presumed reasonable fee provided in subsection (3) may not be appropriate in all estate administrations.
- Fee is subject to negotiation between the personal representative and the attorney.
- The selection of the attorney is made at the discretion of the personal representative, who is not required to select the attorney who prepared the will.
- The personal representative shall be entitled to a summary of ordinary and extraordinary services rendered for the fees agreed upon at the conclusion of the representation.
    - The summary shall be provided by counsel and shall consist of the total hours devoted to the representation or a detailed summary of the services performed during the representation.

An attorney must obtain the personal representative's signature acknowledging the required disclosure. If an attorney fails to make the required disclosure, the attorney may not be paid for legal services without prior approval of the fees by the court or the written consent of all interested parties. Effective date for the disclosures is October 1, 2021.

DIRECTED TRUSTS

- Trust Director's Powers
    - F.S. Sec. 736.1406: Trust Director may exercise any power granted in trust agreement.
- Trust Director's Duties and Liabilities
    - F.S. Sec. 736.1408: Trust director has the same fiduciary duties and liability with respect to exercise or non-exercise of power of direction as a trustee in similar position.
    - F.S. Sec.736.1411: Unless otherwise provided in trust agreement, a trustee director does not have the duty to monitor trustee or another trust director, or inform or advise settlor, beneficiary, trustee or trust director about a situation in which the trust director would have acted differently than trustee or other trust director.

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  - Must provide, upon written request from beneficiary, information that is within the trust director's knowledge or control if information is related to powers or duties of trust director.
- Directed Trustee Duties and Liability
  - F.S. 736.1409: Directed trustee has duty to determine whether a trust director's exercise of a power is within the scope.
  - If directed trustee determines exercise of power is within scope, directed trustee must take reasonable action to comply and will not be liable for reasonable action
  - Directed trustee may be released from liability for trust director's breach of trust unless:
    - Breach involved directed trustee's willful misconduct.
    - Directed trustee induced release by improper conduct; and
    - Trust director was unaware of material facts related to breach at time of release.
  - F.S. Section 736.1411: Unless trust agreement provides otherwise, directed trustee does not have duty to monitor trust director or inform or advise settlor, beneficiary, trustee, or trust director about a situation in which the directed trustee would have acted differently than the trust director. Must provide information to trust director if information is related to powers or duties of trust director.

CLIENTS WITH DIMINISHED CAPACTIY

On March 2, 2022, the Florida Supreme Court approved changes to Rules Regulating the Florida Bar 4-1.14 regarding dealing with clients with diminished capacity. The Rule was rewritten, in part, to more closely align with the ABA model rule. The new rule focuses on maintaining a normal client-lawyer relationship, as much as reasonably possible, and encourages the attorney to exhaust all other remedies before applying for a guardianship for a client.

- Rule 4-1.14(b) as amended now provides that when a lawyer:

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  - Reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial, or other harm unless action is taken and cannot adequately act in the client's own interests

- Then lawyer may take reasonably necessary protective action, such as:
  - Consulting an individuals or entities that have the ability to act to protect the client and seek the appointment of a guardian ad litem or guardian.

- A lawyer must make reasonable efforts to exhaust all other available remedies to protect the client before seeking removal of any of the client's rights or the appointment of a guardian.

- New subsection 4-1.14(c)addresses lawyer confidentiality and provides that "the lawyer is impliedly authorized under the rule on confidentiality of the information to reveal information about the client, but only to the extent reasonably necessary to protect the client's interests."

ASSET PROTECTION

Homestead exemption is Florida's best asset protection method.

RULE AGAINST PERPETUTITES

Section 689.225(2) provides that for all trust crated on or after July 1, 2022, RAP is 1,000 years, unless trust elects to shorten this period.

REIMBURSEMENT OF INCOME TAX FROM GRANTOR TRUST

New F.S. 736.08145 was added to the Florida Trust Code:

- Authorizes but does not require, a trustee of certain trusts to reimburse the grantor of a trust for income tax attributed to the grantor.

- The trustee has the sole discretion to pay such tax reimbursement amount, determined without regard to any other distribution or payment made from trust assets, to the person directly or to the appropriate taxing authority.

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SLATS

F.S. 736.0505(1)(b) – General Rule in Florida with respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit.

- In 2010 legislature created exceptions for:
-
    - Trusts with a Life Estate with a power of appointment in Donee Spouse, and
    - QTIP trusts
- A third exception has been created for SLATS if the following three conditions are met:
    - Settlor's spouse is the beneficiary of income or principal during his/her lifetime;
    - At no time during the lifetime of the settlor's spouse is the settlor a permissible beneficiary; and
    - Transfers to the trust by the Settlor are completed gifts.

BEWARE: No Treasury Regs providing an exclusion from IRC 2036 or 2038, are available under this scenario, unlike the Inter Vivos QTIP regs under Sec. 25.2523(f)-1(f), ex.11.

FAMILY TRUST COMPANY ("FTC") LEGISLATION

- Exemption from Accounting Requirements
    - As of July 1, 2022, if terms of trust permit, FTCs may provide accountings to qualified trust beneficiaries only at:
        - Trust termination,
        - Removal or resignation of a trustee, or
        - Upon demand of qualified beneficiary.
    - FTC may elect to provide a summary statement in lieu of a comprehensive accounting, but the Trustee must make available detailed information.
- Confidentiality of Proceedings

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- As of July 1, 2022, in trust proceeding where FTC is a party, the identity of the settlor, trustees and beneficiaries, and any information regarding the trust is confidential.
- Court must seal such information but shall make it available for the settlor, trustee, beneficiaries, their attorneys, or other persons, if the court determines there is a compelling need.

DISINHERITING PERPETRATORS OF ELDER ABUSE OR EXPLOITATION

- Prior Florida Law:
  - Chapter 825 – criminalizes the abuse neglect or exploitation of elderly disabled adults, and provides injunctive relief for protection.
  - Chapter 415 – provides protective services for elderly and disabled adults.
  - Chapters 772 and 415 – contain civil remedies for abuse, neglect, or exploitation of elderly and disabled adults.
- NEW House Bill 1041(2021)
  - Addition to definition of exploitation:
    - A breach of fiduciary duty that results in kickback or receipt of improper benefit.
    - Obtaining a fiduciary appointment with the purpose and design of benefitting someone other than the principal or beneficiary.
    - Obtaining or using property through intentional modification, alteration, or fraudulent creation of a plan of distribution or disbursement expressed in a will, trust agreement or other testamentary devise without either a court order, a written instrument executed by the elderly disabled adult, or action of an agent under a valid power of attorney.
  - Persons convicted of abuse, neglect, exploitation or aggravated manslaughter of the decedent are treated as predeceased and a conviction creates a rebuttable presumption that the statute applies.

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    - Court may also determine by the greater weight of the evidence whether the decedent's death was caused by or contributed to by the wrongdoer's abuse, neglect, exploitation or aggravated manslaughter.
    - Notwithstanding the foregoing, the statute also proves a forgiveness provision, if properly documented to show intent, signed by testator and two witnesses.

AN UPDATE ON E-THINGS

- E-Wills - statute effective July 2020, but nobody is currently creating electronic wills. Statute is unworkable and nobody uses it, even after the 2021 glitch correction bill.
- Remote notarization- is alive and well for probate proceedings.
- Florida Rule Amendments:
    - Rule 2.530 Communications Technology – allows many court proceedings by Zoom.
    - Rule 1.310 allows communications technology for depositions.
    - Rule 1.700 Rules Common to Mediation and Arbitration, allows Zoom for mediations.

Our 2023 **Reporters** are:

- **Beth Anderson, Esq.**, an attorney with Wyatt, Tarrant & Combs, LLP in Louisville, Kentucky;
- **Kristin Dittus, Esq.**, an attorney with Life & Legacy Planning, Ltd. in Denver, Colorado;
- **Craig Dreyer, Esq.**, an attorney with the Dreyer Law Firm in Stuart, Florida;
- **Katharine Griffiths, Esq**, an attorney with Holland & Knight in Tampa, Florida and
- **Joanne Hindel, Esq.**, a Vice President with Fifth Third Bank in Cleveland, Ohio (not acting as an attorney for Fifth Third Bank).
- **Alexa Langweil, Esq**., an attorney in Philadelphia, Pennsylvania
- **Michelle R. Mieras, J.D., LL.M., CTFA,** a Senior Vice President with BOK Financial Private Wealth in Denver, Colorado.

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