

***51st Annual
Heckerling Institute
on Estate Planning Update***

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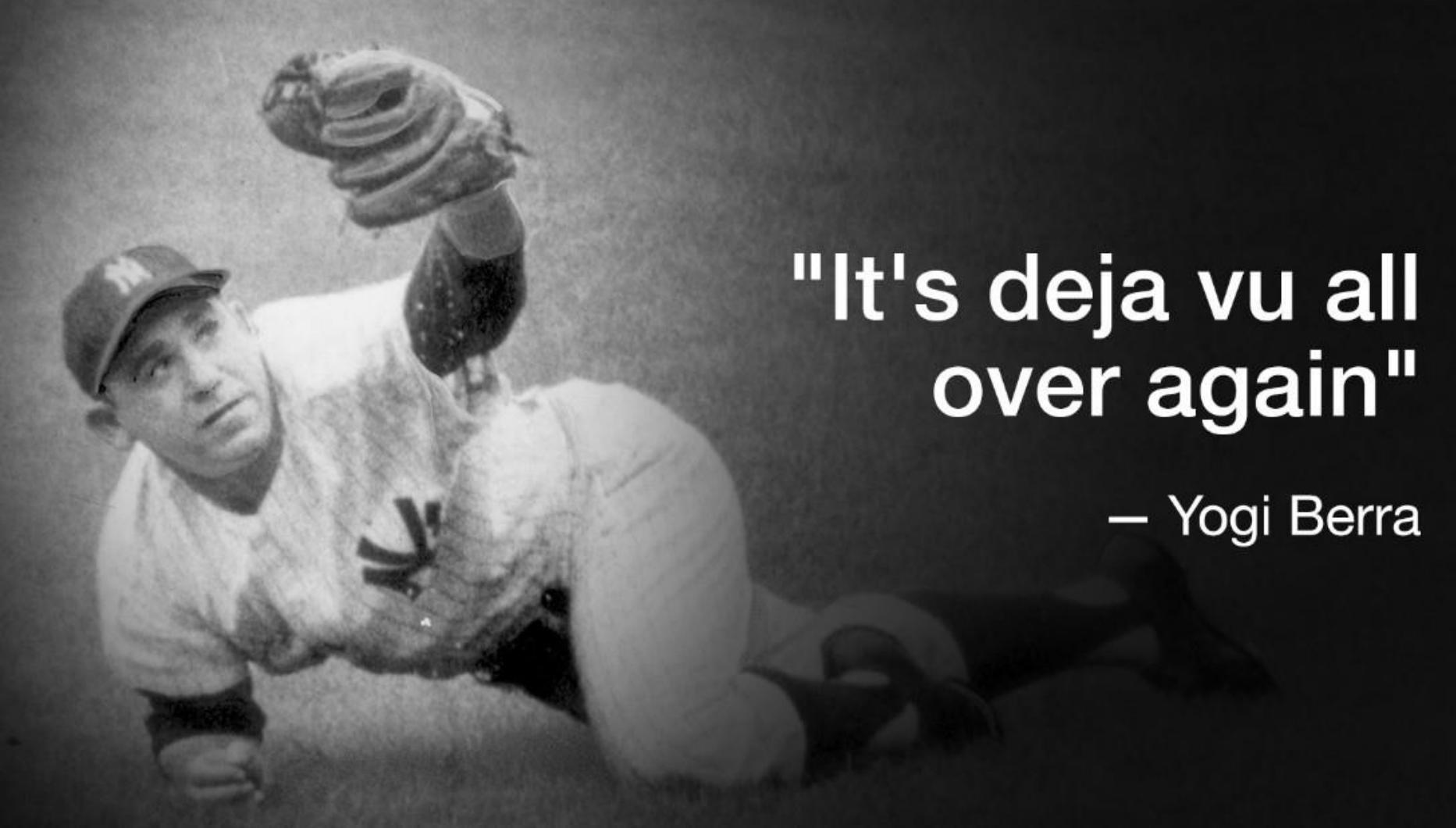
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A black and white photograph of Yogi Berra, a famous baseball player, kneeling on a baseball field. He is wearing a light-colored baseball uniform with a dark cap. His right hand is raised, holding a baseball glove. He has a serious expression on his face. The background is a dark, textured surface, likely the infield dirt.

**"It's deja vu all
over again"**

— Yogi Berra

Potential Impact of 2016 Election

The Death Tax Repeal Act of 2017:
(S. 205) (H.R. 63)

- Estate tax repealed
- GST tax repealed
- Gift tax retained, with indexed exemption and indexed annual exclusion; tax rate of 35%
- Chapter 14 retained
- Step-up in basis retained

Potential Impact of 2016 Election

(cont'd)

Trump/Pence website tax reform proposal:

“Repeal the death tax but capital gains held until death and valued over \$10 million will be subject to tax to exempt small businesses and family farms. To prevent abuse, contributions of appreciated assets into private charity established by the decedent or decedent’s relatives will be disallowed.”

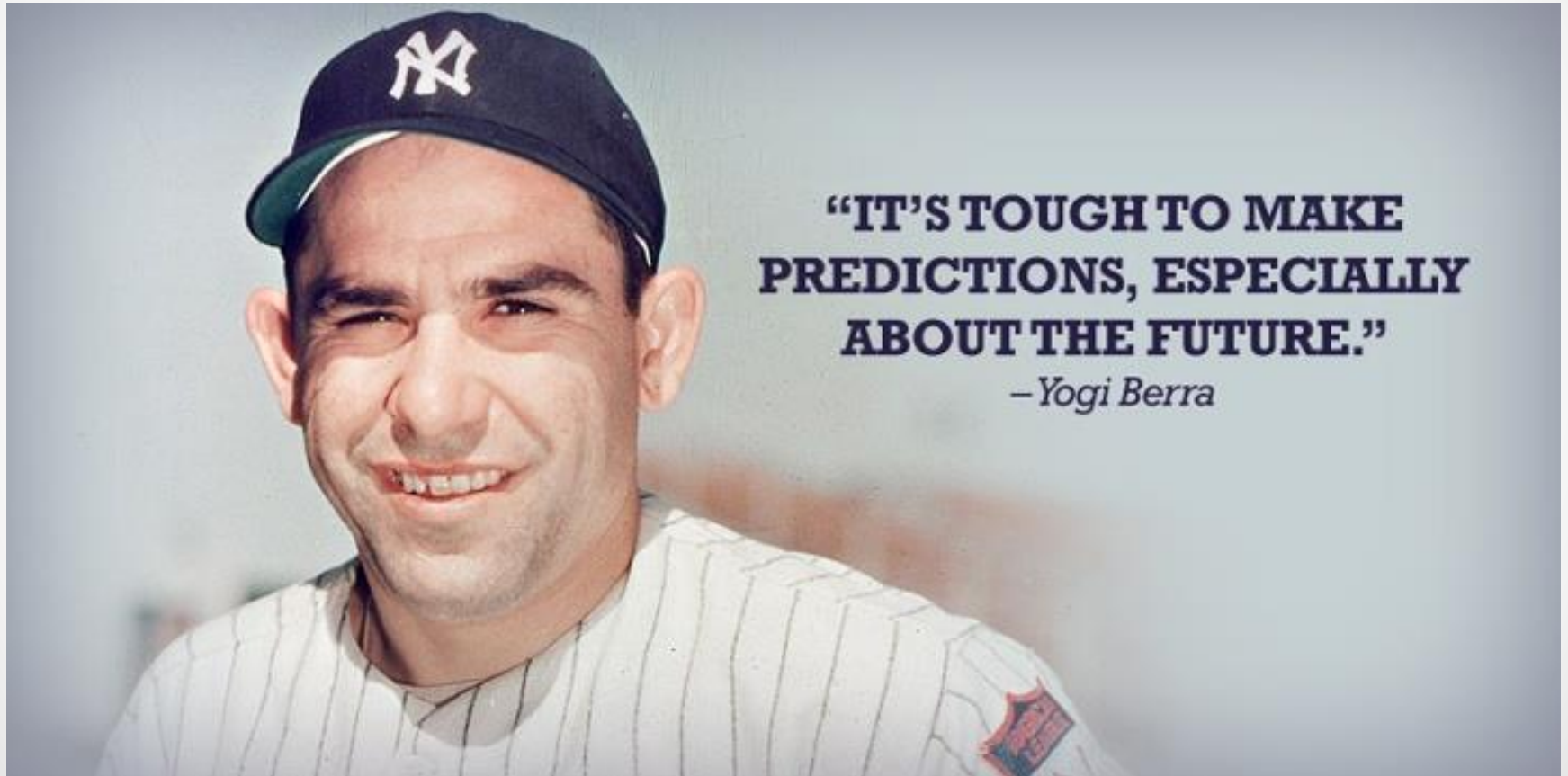
Potential Impact of 2016 Election

(cont'd)

Minnesota State Legislature:

- Repeal Minnesota estate tax (H.F. 85; S.F. 462)
- \$5 million Minnesota estate tax exemption amount; 16% tax on amount above \$5 million (H.F. 77; S.F. 8)

Potential Impact of 2016 Election



Potential Impact of 2016 Election

(cont'd)

Planning in times of legislative uncertainty:

1) **Build flexibility into estate planning documents**

- Formula clauses
- Disclaimer
- Clayton QTIPs

2) **Avoid paying gift tax**

- Defined value clauses
- Sale transactions

Potential Impact of 2016 Election

(cont'd)

Planning in times of legislative uncertainty:

- 3) **Consider giving a trust protector broad flexibility to modify an irrevocable trust due to changed circumstances (general power of appointment)**
- 4) **Keep it all in perspective**

Update on Section 2704 Proposed Regulations

Catherine Hughes of the Treasury Department's Office of Tax Policy gave the update on the Section 2704 proposed regulations:

- They received more than 10,000 comments; she has read about 400 of them
- More than 36 individuals delivered comments at the December 1, 2016 hearing on the proposed regulations; one in favor of the proposed regulations

Update on Section 2704 Proposed Regulations (cont'd)

- She assured us that it was not the IRS intent to eliminate all valuation discounts; no intent to create a deemed put right
- No intention to make the proposed regulations retroactive. (Transfers before effective date should be safe.)
- Will consider an exception for an active business in next revision of the proposed regulations

Update on Section 2704 Proposed Regulations (cont'd)

- Finalizing the proposed regulations in the near future appears remote as various bills were introduced in 2016 to negate the proposed regulations (H.R. 6042; H.R. 6100 and S.B. 3436)
- Proposed regulations are not dead yet
- Recommend disclose on gift tax return that position taken may be contrary to proposed regulations
- Don't rush to make gifts to avoid the proposed regulations

2016–2017 Priority Guidance Plan

- Guidance on definition of income for spousal support trusts under §682 (new)
- Guidance under §§2522 and 2055 on tax impact of certain irregularities in the administration of split-interest charitable trusts (new)
- Regulations under §2642 regarding allocation of GST to pour-over trust at end of ETIP (deleted)
- Final regulation under §2642(g) regarding extension of time to allocate GST exemption (deleted)

2016–2017 Priority Guidance Plan

(cont'd)

- Guidance under §2801 regarding gifts received from certain expatriates (not expected in near future)
- Guidance under §2053 regarding personal guarantees (may see these soon)
- Final regulations under §1022 regarding basis of property acquired from a decedent in 2010
- New comprehensive regulations under §6166, primarily dealing with the requirement of security
- New procedures for closing letters

Non-tax Recent Developments

1) **Electronic Wills Act**

- Adopted in Nevada; introduced in Florida
- Executed without physical presence of a witness or an attorney
- Watch for a uniform law governing electronic wills

Non-tax Recent Developments (cont'd)

- Issue: how to authenticate an electronic will
 - NV: requires electronic signature and at least one authentication characteristic (e.g. retinal scan, voice recognition, facial recognition, etc.)
 - FL: requires testator to electronically sign in the presence of a notary public or two witnesses; presence may be by live video and audio conference (e.g. Skype)

Non-tax Recent Developments (cont'd)

2) Transfers to trusts

- Real estate was effectively transferred to a revocable trust by listing the real estate on a schedule attached to the trust agreement

California law merely requires the transfer of real property by written instrument, naming the transferor and transferee and delivery to and acceptance by the transferee

Non-tax Recent Developments (cont'd)

- Ownership of real estate is a matter of delivery of the deed. Presumption of delivery may be rebutted by failure to record deed. (Estate of Mendelson, 48 N.E. 3rd 891 (Ill. Ct. App. 2016))

3) Co-trustee liability

- Individual co-trustees named to act with corporate trustees to provide knowledge of family

Non-tax Recent Developments (cont'd)

- Life tenant beneficiary served as a co-trustee with her husband and a corporate trustee. The husband was a private equity investor. He lost 90% of the value of the trust and defaulted on loans made to him by the corporate trustee secured by a pledge of trust assets. Life tenant co-trustee was found jointly and severally liable to remainder beneficiaries because she failed to exercise reasonable care in supervising the co-trustees. (In re Burton Trust, 2015 WL 7455910 (Mo. Cir. Ct.))

Non-tax Recent Developments (cont'd)

- Consider use of distribution advisors rather than co-trustees

4) **Fees**

- American Rule = each party pays own attorneys' fees
- Undue influence cases: fees shift to losing party if person in a fiduciary relationship "commits the pernicious tort of undue influence" (Niles Trust, 823 A. 2d 1 (N.J. 2003)). Fees do not shift to losing party if

Non-tax Recent Developments (cont'd)

person in a confidential relationship. (In re Estate of Folcher, 135 A. 3d 128 (N.J. 2016)).

(Presenters note that litigation is the fastest growing element in the estate and trust arena.)

- In some jurisdictions, an unsuccessful contestant might be charged with fees. It is difficult to sanction a contestant for frivolous litigation when at least some facts reasonably support the claim.

Estate Freezes – GRATs, Sales to Grantor Trusts & Preferred Partnerships

GRATs

- Continue to be popular planning devices, particularly if the estate tax – but not the gift tax – is repealed
- IRS has taken the position that the transfers to GRATs were fully taxable gifts if the administration of the GRAT fails to comply with regulatory requirements
 - watch deadline to make the annuity payment
 - watch inadvertent additions of property to the GRAT

Estate Freezes – GRATs, Sales to Grantor Trusts & Preferred Partnerships (cont'd)

- Use a formula to define the annuity
- Use a “zero’d out GRAT” to avoid economic risk if the GRAT fails to produce sufficient growth
- Use rolling short-term GRATs (e.g. 2-year GRATs) to reduce mortality risk
- Fund separate GRATs with separate investments, which may include fractional interests, leveraged assets and preferred interests

Estate Freezes – GRATs, Sales to Grantor Trusts & Preferred Partnerships (cont'd)

Sales to Grantor Trusts

- Continues to be very effective method of freezing value of appreciating assets for estate tax purposes
- IRS has argued that §2036 applies and assets sold to the trust are includible in seller's estate (Woelbing case)

Estate Freezes – GRATs, Sales to Grantor Trusts & Preferred Partnerships (cont'd)

- To defend against the §2036 argument, John Porter recommends:
 - partnership distributions should not be made at same time and in the same amount as the note payment
 - separate the gift and sale transactions so taxpayer can argue that the sale is for full and adequate consideration

Estate Freezes – GRATs, Sales to Grantor Trusts & Preferred Partnerships (cont'd)

Preferred Partnerships

- §2701 requires a qualified payment right for the senior interest that is annual, cumulative and fixed
- At least 10% of the gross must be dedicated to the junior interest
 - use preferred partnership for GST planning rather than GRATs
 - consider using preferred partnership in place of sales to trusts due to the lack of authority for sales to trusts

Planning Considerations for Foreign Person Owning U.S. Assets

- Financial Action Task Force (“FATF”) consisting of Canada, France, Germany, Italy, Japan, UK and USA, issued “40 Recommendations” in 1989 to combat money laundering and terrorist financial activities
 - Bank Secrecy Act
 - USA Patriot Act

Planning Considerations for Foreign Person Owning U.S. Assets (cont'd)

- FATF identified lawyers, accountants and trust companies as potential unwilling participants in money laundering and terrorist financing
- FATF has been pressuring its members to adopt laws requiring non-financial businesses and professionals to conduct formal and discoverable client due diligence and report suspicious activity
- ABA has resisted the adoption of mandatory due diligence and reporting

Planning Considerations for Foreign Person Owning U.S. Assets (cont'd)

- Instead, ABA has adopted the “Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing”

Key points:

1) Know your client

- Basic background information
- Type and location of assets
- Source of funds to be involved in the transaction

Planning Considerations for Foreign Person Owning U.S. Assets (cont'd)

2) Due diligence

- OFAC list
- Other internet searches
- Background checks depending on potential risk involved in representing client

Minimizing Fiduciary Risk

1) **Loans to beneficiaries**

- Does trust agreement authorize loans?
- Do it right: a loan is a trust investment
 - Due diligence
 - Document the loan
 - Security for loan

Minimizing Fiduciary Risk (cont'd)

- Guidelines for making loans to beneficiaries:
 - Loan would be considered prudent if it were made to a third party
 - With the loan in the trust portfolio, the duty to the beneficiaries is properly balanced with the duty to make prudent investments
 - If the trust agreement does not expressly authorize loans to beneficiaries and the loan would not be considered prudent if made to a third party, the other beneficiaries have consented in writing to the loan

Minimizing Fiduciary Risk (cont'd)

2) Pledging trust assets or guaranteeing beneficiary's loan to third party

- Authorized by the trust agreement?
- Watch duty of loyalty. If trustee has any relationship to the third party lender, obtain consent from other beneficiaries or court approval.

Minimizing Fiduciary Risk (cont'd)

3) Trustee should take care not to sign contracts on behalf of the trust in manner that binds trustee in an individual capacity

“not individually, but sole as trustee”

Minimizing Fiduciary Risk (cont'd)

4) **Real estate in the trust**

- Trustee has a duty to protect trust property from damage or destruction
- Requires active management
- Early on, take control of the trust property
- Develop a game plan for maintenance, repair or sale of the property

Minimizing Fiduciary Risk (cont'd)

5) Duty to diversify the trust portfolio

- Generally, trustee has a duty to diversify the trust portfolio
- Trustees must consider circumstances of the market and the beneficiaries even when the terms of the trust direct investment policy
- Mere authorization to retain a concentrated position may not be sufficient
- Trust agreement should expressly waive the duty of diversification

Basis Consistency

- §1014(f) provides that the basis for income tax purposes not exceed the value as finally determined for federal estate tax purposes
- Consistency of basis only applies if a federal estate tax return is required to be filed, except filings solely to elect portability
- §6035 requires that basis be reported by the estate to the IRS and the beneficiaries (Form 8971)

Basis Consistency (cont'd)

- Exclude cash, IRD, tangible personal property not appraised and property sold during administration
- Subsequent transfers of such property must be reported to the IRS and donee
- Property omitted from the estate tax return after statute of limitations has expired has a basis of zero