

Provided to you by the
Community Foundation for
Palm Beach and Martin Counties

Impressions from the 2012 Heckerling Conference

Boca Raton Estate and Tax Roundtable

Diana S.C. Zeydel

Greenberg Traurig, P.A.

333 S.E. 2nd Avenue

Miami, FL 22121

zeydeld@gtlaw.com

(305) 579-0575

February 9, 2012

Diana S.C. Zeydel, Shareholder

Greenberg Traurig, P.A.

333 S.E. 2nd Avenue

Miami, Florida 33131

Diana S.C. Zeydel is a shareholder of the law firm of Greenberg Traurig, P.A., in Miami, Florida, and a member of the Florida and New York Bars. She is a member of the Board of Regents and Chair of the Estate & Gift Tax Committee of ACTEC. Diana is a frequent lecturer on a variety of estate planning topics. She has authored several recent articles, including “The Impossible Has Happened: No Federal Estate Tax, No GST Tax, and Carryover Basis for 2010” with J. Blattmachr, M. Gans and H. Zaritsky, *Journal of Taxation* (February 2010); “Tax Effects of Decanting – Obtaining and Preserving the Benefits” with J. Blattmachr, *Journal of Taxation* (November 2009); “Estate Planning in a Low Interest Rate Environment” *Estate Planning* (July 2009); “Directed Trusts: The Statutory Approaches to Authority and Liability” with M. Clarke, *Estate Planning* (September 2008); “How to Create and Administer a Successful Irrevocable Life Insurance Trust,” and “A Complete Tax Guide for Irrevocable Life Insurance Trusts” *Estate Planning* (June/July 2007); “Gift-Splitting - A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules,” *Journal of Taxation* (June 2007); “Deemed Allocations of GST Exemption to Lifetime Transfers” and “Handling Affirmative and Deemed Allocations of GST Exemption,” *Estate Planning* (February/March 2007); “Estate Planning for Noncitizens and Nonresident Aliens: What Were Those Rules Again?” with G. Chung, *Journal of Taxation* (January 2007); “GRATs vs. Installment Sales to IDGTs: Which is the Panacea or Are They Both Pandemics?” with J. Blattmachr, *41st Annual Heckerling Institute on Estate Planning*, (2007); and “What Estate Planners Need to Know about the New Pension Protection Act,” with M. Gans and J. Blattmachr, *Journal of Taxation* (October 2006). Diana received her LL.M. in Taxation from New York University School of Law (1993), her J.D. from Yale Law School (1986), and her B.A., *summa cum laude*, from Yale University (1982), where she was elected to *Phi Beta Kappa*.

MIA 182,365,879v1 2-8-12

Asset Protection – Heckerling 2012

Bove/Rothschild

- I. Default law is that a power held by the beneficiary is not a fiduciary power
 - a. Nickels v. Eaton – dealing with spendthrift trusts – opinion based on UK law
 - b. McLean case in Missouri –
 - i. Facts: Young man injured in automobile accident and confined to wheelchair
 - ii. Award for \$2 million -- \$1.4 million left for young man – set up a special needs trust so would qualify for public benefits
 1. Initial trustee was corporate trustee – resigned
 2. Second trustee was a lawyer who made referral to personal injury lawyer
 3. Protector was the lawyer who handled the case
 4. Trust provided the Protector is a fiduciary
 - a. Question arose about his fiduciary duty
 - b. Only power of Protector was to remove and replace Trustee
 - c. Trustee could appoint a successor but Protector could override
 - d. Trustee squandered the trust – 18 months later trust was bankrupt
 - i. But some of expenditures were \$150,000 for stereo system
 - ii. \$50,000 for a fence
 - e. Trustee breach of duty and case was mishandled – and settled with trustee for almost nothing
 - f. Next new lawyer came in and sued the Protector – and should have monitored the trustee and removed him
 - i. Any duty to keep an eye on the trustee
 - ii. No commentator disagrees with notion that Protector knew something was wrong then has duty to act
 - iii. Evidence indicated that Protector knew and participated with the Trustee
 - g. What if no actual knowledge??
 - i. Suppose no accounting rendered in the short period of time
 - ii. Do you have a duty to monitor??
 - h. Got in touch with lawyers
 - i. Motion for summary judgment was filed
 - ii. No law in Protectors in Missouri
 - iii. How can you hold Protector liable with no law and grants motion for summary judgment

- iv. Appeals court granted a decision – only reason did not agree with the result –
 - 1. Yes, no law in Missouri
 - 2. Protector is a fiduciary but we do not know to whom he owes duty? – Trustee? Beneficiary? Trust?
 - 3. Wouldn't it be different if we had to say why we are giving the Protector a power??
 - 4. Enough unknowns, that the court send it back to District Court in order for court to establish the duties
 - 5. Lawyer for the defense made good points and made a motion to exclude his testimony because it would be new law when there is no law – so no expert witness testimony was permitted
 - 6. Granted directed verdict for the defendants
 - 7. Judge's order said – the Protector had a duty – if came to his attention that the Trustee was breaching his duty, then he could be liable
 - 8. The attitude of the court towards the Protector –no one thought to argue to the court that this is the same as an advisor and we have law on that
 - 9. Repeated reference to fact that trust did not refer to the Protector's duties
 - 10. Should we add purposes of why we gave the Protector this power?
 - 11. Case is on appeal
 - 12. Case did not state what the damages were
 - a. At what point did the Protector have a duty to step in?
- v. Put a provision in the trust that says at any time or from time to time X may appoint a Protector and X should consider giving the Protector one or more of the following powers – appoint temporarily and then let the Protector expire

II. Directed Trust Statutes

- a. Opposite of the Protector – the Advisor is directed the Trustee and the Trustee is absolved of fiduciary liability – unless manifestly contrary to intent of settlor or being directed in bad faith

- b. If trustee can be absolved of a fiduciary liability – then why is it that a Protector must have a fiduciary duty
 - c. Isn't it enough to have one person with a fiduciary duty
 - i. No absolute exculpation for a fiduciary – Fraud, dishonesty, but cannot absolute exculpate
 - 1. Warner case – trustee directed to do something and it should not have been done – Court said you should have known it was a bad instruction and so trustee was not exonerated
- III. Compensation etc. Alexander Bove drafting
- a. Protector is a fiduciary – in NY may be entitled to same compensation as a trustee
 - b. As a fiduciary Protector is entitled to reasonable compensation for services rendered
 - c. Protector as a fiduciary has a right to hire agents or whatever entitled to do to carry out duties
 - d. If Protector is not a fiduciary – then no entitlement to a fee – see NY law
- IV. Normal Protector powers
- a. Normally it is the power to remove and replace trustees
 - i. Two edged sword – if using to provide flexibility
 - ii. Client does not want children to be at the mercy of the trustee
 - 1. Name the beneficiary as the Protector with the power to remove and replace – does that mean no fiduciary duty at that point in time?
 - 2. Should the beneficiary have this power – eg what is improvident or influence of spouse etc. maybe the Protector should be an independent person
 - 3. Limit the beneficiary to only be able to appoint an institution or with a sufficient degree of distance
 - 4. Or have a committee of Protectors so that all can decide
 - iii. Bove – try to build in safeguards
 - 1. Totally against naming beneficiary or Grantor as Protector, but give them the power to remove and replace the Protector
 - 2. Like idea of a committee
 - 3. What is not a fiduciary – that may create a problem
 - b. How does the Protector signify acceptance of the role – but we never ask the Protector to sign an acceptance
 - i. Bove says should have a document of acceptance – cannot accept a fiduciary role without affirmative consent
 - ii. If not a fiduciary then maybe you do not need an acceptance
- V. Arbitration provisions in the trust?
- a. Can you require arbitration under all the laws of the States
 - b. Gideon and Bove say no they do not include it
 - c. Dispute among two trustees and give Protector a power to mediate the dispute
 - d. Would an arbitrator a fiduciary?

- e. Can you really enforce the clause??
- VI. Advising the Protector
 - a. Who is going to pay for D/O coverage
 - b. Now get to sue me – who would want to serve?
 - c. Lawyer’s D/O insurance does cover you probably as a Protector
 - d. Personal call – encourage client to sue trusted members of the family who might be professionals
 - e. There are professional Protectors out there
- VII. Comments
 - a. Arizona had Protector legislation – Protector needs to have a certain amount of fortitude
 - b. Arizona says subject to the terms of the trust, a Protector is not a fiduciary
 - c. CA is working on a statute
 - i. Situs competition on directed trusts do it by completely exculpating the trustee
 - ii. Whether the trustee in states with directed trusts can be exculpated with respect to the specific duties that the Protector has
 - d. If Protector is foreign and can remove and replace the trustee then you have a foreign trust

Chris Hoyt – Retirement accounts

- I. What is the required beginning date
 - a. Year you turn 70-1/2 then April 1st of following year
 - b. Beneficiary – designated beneficiary – is a human being
 - i. Leave ½ to daughter and ½ to charity
 1. Do not care who is beneficiary on DOD
 2. We care about the determination date – date is September 30th of the following year
 3. Get rid of problem beneficiaries
 - a. Disclaimer
 - b. Cash out – charity is tax exempt so do not need deferral
 - c. Separate accounts – divide after death by September 30th
 - c. Minimum Distributions required as of the Determination Date September 30th
 - i. But plan document may trump these rules
 - ii. If one of beneficiaries is an estate or trust – then if die before RBD then must liquidate within 5 years – if dies after RBD then can take over life expectancy of the participant
 - iii. Stretch if beneficiary is a human being
 - iv. Beneficiary is older than decedent, can use participant’s remaining life expectancy
 - v. What about a rollover? Spouses only
 - d. Work for company with policy of liquidating IRA in one year – but could move to an IRA – that would be an inherited IRA, not a rollover
 - e. Use the life expectancy of the oldest beneficiary – which is the problem with trusts
 - i. Trust is not a human being
 1. Look through trust and can use the life expectancy of the beneficiaries
 - f. Rollover by a Spouse
 - i. Rollover into her own IRA
 - ii. But sometimes should not do this –especially if young
 - iii. If take money out of your own IRA is under age 59-1/2 then you pay a penalty
 - iv. Inherited IRA get no 10% penalty
 - v. Leave in decedent’s account
 1. Spouse can recalculate her life expectancy so never run out of money
 2. Spouse can elect to treat as her own IRA
 - a. Life you did a rollover but without moving the money
 3. First spouse died young, surviving spouse can wait until participant would have been 70-1/2 to take out the money
 - g. Trust as beneficiaries
 - i. Trust is not a designated beneficiary
 - ii. When can look through the trust

1. IRA administrator must receive copy or certification of beneficiaries to designate a trust
 - iii. Accumulation Trust or Conduit Trust
 1. Conduit Trust – there is no accumulation, MRD goes to the beneficiary – have more years if spouse beneficiary because can recalculate
 2. Accumulation Trust – if spouse is beneficiary must liquidate over life expectancy of spouse with no recalculation
 3. Charitable Remainder Trust can be an attractive beneficiary of retirement account –
 - a. Two generation CRT – for older surviving spouses
 - b. Pay in lump sum to CRT and it will pay 5% to SS for life and then when she dies pay 5% to every child until every child dies
 - c. CRT is tax exempt so no need for stretch payments
 4. Page 17 – How many years have? See charts on the speed of payment. By far the rollover has the least of all in terms of required distributions.
 - iv. Portability and the effect on retirement accounts
 1. Physician dies second and spouse has no funds and all assets are retirement assets
 2. Allows the natural thing to be done which is to leave all the assets to the surviving spouse
 3. Majority of retirement assets payable to CST end up in spouse's estate because using a conduit trust
 4. CRT is the credit shelter trust for IRD – then pay to kids for their entire life and then goes to charity -- good for stock options, etc
 5. What about the grandkids – go to Family Foundation and use philanthropy for the grandkids – not an all or nothing proposition – also for second marriages
- II. Getting the money to a CRT
- a. Need an older spouse – over age of 70
 - b. Second generation needs all to be over age 40
 - c. Why? Need a minimum 10% remainder value

Blattmachr -- Heckerling Fundamentals Program – Powers of Appointment

- I. Powers of appointment are governed by the local property law
 - a. Is not per se a property right
 - b. And is not an interest in property – therefore initially it was not subject to estate, gift taxation
- II. Types of powers of appointment
 - a. Imperative power – one that must be exercised
 - i. Trustees must exercise the power
 - ii. If they refuse, then the Court will exercise the power on behalf and a Judge may disagree, and may oversee the exercise of the power by the fiduciaries
 - iii. You may wish to draft for this situation, so that your client determines how any dispute will be resolved
 - b. Non-imperative powers
 - i. Exclusive power – power to exclude people
 - ii. Non-exclusive power – you cannot exclude anyone eg each and every one of my nieces and nephews versus in favor of any one or more of my nieces and nephews
 - iii. Doctrine of elusive appointees –eg give each a \$1 – a peppercorn. How far can you go from what would be equal shares – could use a word formula to solve for it.
 - c. General and Non-general powers
 - i. General – tax purposes, self, estate, creditors and creditors of your estate
 1. Originated with the common law – eg property law principles were the same which creates a fair amount of law on this topic
 2. If not clear, the power will be deemed to be a general power – common law rule is reversed by Maryland
 3. Or say it is a non-general, special or limited power of appointment
 - ii. Non-general power – special or limited power
 - iii. What if say on powerholder's death exercisable in favor settlor's descendants
 1. Can you exercise in favor of yourself? Tax law says no. Illinois law is very clear
 2. Should say something –but if limit to living descendants – if say who survive the powerholder may exclude the future born descendants! Need to specifically exclude the powerholder's estate, creditors or creditors of the powerholder's estate instead.
 3. Life estate coupled with a power to exercise in favor of yourself is not the same as fee simple absolute
 - iv. Presently exercisable power
 1. Two types of powers may be granted. Could be presently exercisable but taking effect at a later time
 - d. Relation back doctrine

www.yourcommunityfoundation.org

- i. You are an agent of the donor
- ii. Can have important administration and jurisdictional consequences
 - 1. What happens to the interpretation
 - 2. Which court has jurisdiction on questions of construction?
 - 3. What about venue? You need to go back to the county where the Will was admitted to probate, except the rule was changed in NY
 - 4. You could override in the instrument
- iii. *Self* case
 - 1. Had a special power of appointment, but because had an income interest so this caused there to be a gift by the powerholder
 - 2. Ct of Claims disagreed – donee was nothing but an agent of the donor
 - 3. *Regester* is to the contrary Tax Court – exercise of special power of appointment during your lifetime is a gift to that extent
- e. Class of the appointees
 - i. A power may be invalid because of an indefinite class of appointees
 - 1. Result cannot be exercised – becomes invalid
 - ii. Other questions of construction
 - 1. Manner in which may exercise is not stated, cannot exercise except in a manner that would be same as if you owned the property
 - a. EG POA over real estate, you need a writing, witnessed and notarized, for example
 - iii. RAP
 - 1. Exercise may be invalid because it violates the RAP rule.
 - 2. What is the effect of a violation – do you simply reduce the term so it qualifies
 - 3. Probably relates back to the RAP that governs the original instrument
- f. Methods of Exercise
 - i. Requires intent and compliance with rules set forth by donor, and under local law
 - ii. Intent – What if dispose of the property but do not say you are exercising a power of appointment – generalized reference may be enough unless the donor’s instrument is more specific
 - iii. Implied exercise is probably the default rule so need to be very specific about what will constitute a valid exercise
 - iv. Substantial Compliance Doctrine – Will also save a less than perfect exercise
 - v. General residuary clauses – If have a GPOA then in most States will be deemed to exercise the power; therefore, the will should exclude the appointive property
 - vi. Blending exercise – residue and any property over which I have a GPOA – then blending the property with your general estate
 - 1. Preferable to have a specific exercise clause

- 2. Make sure on RAP etc
- vii. Specific reference requirement – you should be clear what you mean by this
 - 1. Specific and blanket non-exercise statements. Add “I am not exercising any other power of appointment that I may hold”
- viii. Could make a conditional exercise, If ____ then I exercise my POA etc., but cannot violate public policy with the conditions
- ix. Revocation of an exercise – generally cannot undo it
 - 1. Deemed to be irrevocable if exercisable during lifetime possibly so make sure the donor specifies that permitted to be revoked
- x. What if the appointee is deceased
 - 1. Probably saved by Anti-lapse unless you condition the exercise on survival
 - 2. Say the anti-lapse statute will or will not apply
- xi. Descendants of the deceased appointee may take even if the anti-lapse statute does not imply
- xii. Capacity to exercise
 - 1. Capacity may turn on whether I have capacity to dispose of the property under my local law
 - 2. Different level if property disposed of by Will – lower capacity for a Will than by lifetime writing
 - 3. Better do by Will if any concern about the donee of the power
 - 4. Which law applies to determine capacity – probably the law of the donee
 - 5. Who can exercise -- can it be done by the guardian – but which one – the guardian of the person or of the property? The law is not clear but probably the guardian of the person that has the power and probably a guardian of a minor may not exercise the power
 - 6. Attorney in fact may not be able to do it, unless you are permitted under state law or are permitted to modify the local law
- xiii. Exercise under a Will not admitted to probate
 - 1. Probably is validly exercised unless the Will is denied admission to probate
 - 2. Rule – Get all Wills admitted to probate – may not have standing with respect to tax matters, etc.
- g. Released and Disclaimers of powers of appointment
 - i. Can I later release – under the common law, the answer is yes
 - ii. Tax effects?
 - iii. Disclaimer – donee of the power can be disclaimed
 - 1. May have a very short period of time – NJ – 36 hours was too long a time
 - iv. Disclaimer of a power versus a disclaimer or property by a donee

1. Federal tax law – disclaim within nine-months of date the property transferred even if transferred to me by exercise of a power of appointment that is exercisable by instrument much, much later – relates back to the last owner of the property and its disposition
- h. Contracts to exercise a power of appointment
 - i. Will a contract to exercise a general power work – if real estate need formalities to transfer the underlying property, and also need consideration
 - ii. What if exercise of a non-general power of appointment – what if pay to exercise in favor of any person – you need consideration
- III. Takers in Default
 - a. No effective exercise
 - i. Takers in default
 - ii. Partially ineffectually exercised then the ineffective part is stricken
 - iii. General power of appointment with no taker in default – then goes back to powerholder’s estate, not the donor’s estate
 - iv. Rule is different if a non-general power, usually goes back to the estate of the donor
 - b. Description of Takers in Default
 - i. You need to state expressly
 - ii. Claims of donee’s creditors – generally not if a special power
- IV. Rights of Creditors of Donor or Donee
 - a. Non General powers assets generally not available to creditors
 - b. General power of appointment
 - i. Subject to claims of creditors of donee
 - ii. Donor created power – if presently exercisable subject to claims of my creditor even if restricted to health, education, maintenance and support – State law says that is a general power – *Matter of Flood* in NY
 1. It’s a creditor rights problem, not a tax problem because even 2041 excepts HEMS
 - iii. QTIP trusts do not need a general power
 - iv. Right of election
- V. Fiduciary Powers of Appointment
 - a. Contrast between fiduciary and non-fiduciary powers
 - i. Non-fiduciary power can be exercised arbitrarily and capricious
 - ii. Fiduciary must act in good faith – and maybe reasonably
 - iii. Fiduciary powers may be constrained by public policy, but not a personal power of appointment – including one exercisable only in favor of “boys” for example
 - b. Decanting powers
 - i. General rule on exercises in further trust
 1. Is now the default rule that a power of appointment is exercisable in further trust

- ii. *Phipps* – held that a fiduciary held power is a power of appointment and can be exercisable in further trust
- iii. State variations
 - 1. May not be able to eliminate an income interest
 - a. Marital Deduction issue?
 - b. Notice 2011-101
 - 2. Some States require that you go to court
 - 3. FL law, decant only if the power of invasion is absolute
- iv. New York Statute
 - 1. Why may you decant
 - a. Protect the tax treatment of a trust
 - b. Grant a beneficiary a power of appointment
 - c. Reduce administrative costs
 - d. Alter the trustee provisions –identity or manner of appointment
 - e. Extend the termination date of trust
 - f. Convert to a grantor trust or the reverse
 - g. Change the governing law of the trust
 - i. Go to Scott on Trusts saw rule that the powers of the trustee are not derived from place where the trust was created or its governing law, the powers of trustee are derived from the place the trust is administered
 - ii. Alaska and New York is specific
 - h. Divide property to create separate trustee
 - i. Reducing potential liability
 - j. Convert trust into a supplemental needs trust, and exception to eliminating an income interest under NY law – does not work in Arizona – local department says it will not respect
 - k. Make it non-spendthrift to allow a transfer of the interest
 - 2. Other common uses –
 - a. Make it into a directed trust
 - 3. Some Tax Issues of Decanting
 - a. Notice 2011-101
 - i. Asked for advice in 13 areas
 - 1. Beneficiaries changes
 - 2. Mere possibility of it being changed creates problems?
 - b. Income, gift, estate and GST tax effects
 - i. Grandfathered trusts
 - 1. Works if beneficiary power so long as within RAP

2. Trustee power must be in trust when created or State law must have been in effect when trust became irrevocable
 - a. What do you do – go to local court and get ruling that the decanting power there as of inception – Works in FL
 - b. Wait until trust about to terminate in beneficiary's favor anyway eg – have not worsened any tax effects
 - c. Give the beneficiary a special power of appointment that is testamentary so that no gift by the beneficiary by not objecting to the decanting
 - d. Exercisable only with consent of non-adverse trustee – require there to be one and if at any time there is none, the Court can consent
- c. *Bosch* issues
 - i. Whether beneficiary had a GPOA under local law
 1. Rev. Rul. 73-142 – construction occurs prior to the taxing event – binding upon the parties and therefore the IRS is also bound
- d. *Cottage Savings* issue
 - i. Worry about whether changing nature of the interest that you have a gain realization event – if change income interest to unitrust if not state law authority then have a gain realization event
4. Gift Tax Consequences
 - a. Does beneficiary experience gift tax ??
 - i. Probably should not if beneficiary cannot overcome the authority
 - ii. Should be the same under State law
 - iii. What if State grants the power later, does that cause a problem
 - b. If a beneficiary is denied the ability to reverse the decision
 - i. Rev Rul 84-105 says not a gift until the ability to object expires
5. Estate tax
 - a. Ascertainable standard
6. GST Tax

- a. Decanting can cause loss or grandfathering unless do not move the beneficial interests down or extend the duration
 - b. Do not have to use the family members as the measuring lives
 - c. Have the trustee distribute to the then youngest beneficiaries for a period of years to get the skip down as far as possibility
- VI. Importance of Powers of Appointment
 - a. Flexibility
 - b. Different Needs and Rewards
 - c. King Lear Effect
 - d. How broad the power of appointment should be
 - i. Limit the class
 - ii. Appointment to spouses but only an income interest
 - iii. Common Classes of Appointees
 - e. Method of exercise
 - i. Make it exercisable by Will or Deed
 - ii. Eligible to receive interest only if prenup or postnup adequate to protect financial interest
 - iii. Give the beneficiary a power of appointment to exclude the spouse
- VII. Some tax Issues Relating to Power of appointment
 - a. 2041 and 2514
 - i. How to get into the estate tax regime
 - 1. Spring the Delaware Tax Trap – Delaware had common law rule against perpetuities
 - a. If beneficiary exercises the power of appointment and grants a new power that allows beneficiary to extend the RAP – SPOA treated as general power if exercised in a manner that does not relate back to original trust RAP
 - i. Exercise SPOA to grant someone a presently exercisable general power of appointment
 - ii. That converts the exercise by the beneficiary into a GPOA and will be included in the powerholder’s gross estate
 - b. 678
 - i. What is you have power of withdrawal that goes away meaning that it lapses
 - 1. Seems not to be a partial release or modification
 - 2. Instead the power should convert to a HEMS withdrawal power
 - c. “Portability”
 - i. Had not simplified things
- VIII. Foiling Reciprocal Trust Doctrine with Special Powers of Appointment
 - a. Use the Shelter now

Blattmachr -- Heckerling Fundamentals Program – Powers of Appointment

- I. Powers of appointment are governed by the local property law
 - a. Is not per se a property right
 - b. And is not an interest in property – therefore initially it was not subject to estate, gift taxation
- II. Types of powers of appointment
 - a. Imperative power – one that must be exercised
 - i. Trustees must exercise the power
 - ii. If they refuse, then the Court will exercise the power on behalf and a Judge may disagree, and may oversee the exercise of the power by the fiduciaries
 - iii. You may wish to draft for this situation, so that your client determines how any dispute will be resolved
 - b. Non-imperative powers
 - i. Exclusive power – power to exclude people
 - ii. Non-exclusive power – you cannot exclude anyone eg each and every one of my nieces and nephews versus in favor of any one or more of my nieces and nephews
 - iii. Doctrine of elusive appointees –eg give each a \$1 – a peppercorn. How far can you go from what would be equal shares – could use a word formula to solve for it.
 - c. General and Non-general powers
 - i. General – tax purposes, self, estate, creditors and creditors of your estate
 - 1. Originated with the common law – eg property law principles were the same which creates a fair amount of law on this topic
 - 2. If not clear, the power will be deemed to be a general power – common law rule is reversed by Maryland
 - 3. Or say it is a non-general, special or limited power of appointment
 - ii. Non-general power – special or limited power
 - iii. What if say on powerholder’s death exercisable in favor settlor’s descendants
 - 1. Can you exercise in favor of yourself? Tax law says no. Illinois law is very clear
 - 2. Should say something –but if limit to living descendants – if say who survive the powerholder may exclude the future born descendants! Need to specifically exclude the powerholder’s estate, creditors or creditors of the powerholder’s estate instead.

3. Life estate coupled with a power to exercise in favor of yourself is not the same as fee simple absolute
- iv. Presently exercisable power
 1. Two types of powers may be granted. Could be presently exercisable but taking effect at a later time
- d. Relation back doctrine
 - i. You are an agent of the donor
 - ii. Can have important administration and jurisdictional consequences
 1. What happens to the interpretation
 2. Which court has jurisdiction on questions of construction?
 3. What about venue? You need to go back to the county where the Will was admitted to probate, except the rule was changed in NY
 4. You could override in the instrument
 - iii. *Self* case
 1. Had a special power of appointment, but because had an income interest so this caused there to be a gift by the powerholder
 2. Ct of Claims disagreed – donee was nothing but an agent of the donor
 3. *Regester* is to the contrary Tax Court – exercise of special power of appointment during your lifetime is a gift to that extent
- e. Class of the appointees
 - i. A power may be invalid because of an indefinite class of appointees
 1. Result cannot be exercised – becomes invalid
 - ii. Other questions of construction
 1. Manner in which may exercise is not stated, cannot exercise except in a manner that would be same as if you owned the property
 - a. EG POA over real estate, you need a writing, witnessed and notarized, for example
 - iii. RAP
 1. Exercise may be invalid because it violates the RAP rule.
 2. What is the effect of a violation – do you simply reduce the term so it qualifies
 3. Probably relates back to the RAP that governs the original instrument
- f. Methods of Exercise
 - i. Requires intent and compliance with rules set forth by donor, and under local law
 - ii. Intent – What if dispose of the property but do not say you are exercising a power of appointment – generalized reference may be enough unless the donor’s instrument is more specific
 - iii. Implied exercise is probably the default rule so need to be very specific about what will constitute a valid exercise
 - iv. Substantial Compliance Doctrine – Will also save a less than perfect exercise

- v. General residuary clauses – If have a GPOA then in most States will be deemed to exercise the power; therefore, the will should exclude the appointive property
- vi. Blending exercise – residue and any property over which I have a GPOA – then blending the property with your general estate
 - 1. Preferable to have a specific exercise clause
 - 2. Make sure on RAP etc
- vii. Specific reference requirement – you should be clear what you mean by this
 - 1. Specific and blanket non-exercise statements. Add “I am not exercising any other power of appointment that I may hold”
- viii. Could make a conditional exercise, If ____ then I exercise my POA etc., but cannot violate public policy with the conditions
- ix. Revocation of an exercise – generally cannot undo it
 - 1. Deemed to be irrevocable if exercisable during lifetime possibly so make sure the donor specifies that permitted to be revoked
- x. What if the appointee is deceased
 - 1. Probably saved by Anti-lapse unless you condition the exercise on survival
 - 2. Say the anti-lapse statute will or will not apply
- xi. Descendants of the deceased appointee may take even if the anti-lapse statute does not imply
- xii. Capacity to exercise
 - 1. Capacity may turn on whether I have capacity to dispose of the property under my local law
 - 2. Different level if property disposed of by Will – lower capacity for a Will than by lifetime writing
 - 3. Better do by Will if any concern about the donee of the power
 - 4. Which law applies to determine capacity – probably the law of the donee
 - 5. Who can exercise -- can it be done by the guardian – but which one – the guardian of the person or of the property? The law is not clear but probably the guardian of the person that has the power and probably a guardian of a minor may not exercise the power
 - 6. Attorney in fact may not be able to do it, unless you are permitted under state law or are permitted to modify the local law
- xiii. Exercise under a Will not admitted to probate
 - 1. Probably is validly exercised unless the Will is denied admission to probate
 - 2. Rule – Get all Wills admitted to probate – may not have standing with respect to tax matters, etc.
- g. Released and Disclaimers of powers of appointment

- i. Can I later release – under the common law, the answer is yes
 - ii. Tax effects?
 - iii. Disclaimer – donee of the power can be disclaimed
 - 1. May have a very short period of time – NJ – 36 hours was too long a time
 - iv. Disclaimer of a power versus a disclaimer of property by a donee
 - 1. Federal tax law – disclaim within nine-months of date the property transferred even if transferred to me by exercise of a power of appointment that is exercisable by instrument much, much later – relates back to the last owner of the property and its disposition
 - h. Contracts to exercise a power of appointment
 - i. Will a contract to exercise a general power work – if real estate need formalities to transfer the underlying property, and also need consideration
 - ii. What if exercise of a non-general power of appointment – what if pay to exercise in favor of any person – you need consideration
- III. Takers in Default
 - a. No effective exercise
 - i. Takers in default
 - ii. Partially ineffectually exercised then the ineffective part is stricken
 - iii. General power of appointment with no taker in default – then goes back to powerholder’s estate, not the donor’s estate
 - iv. Rule is different if a non-general power, usually goes back to the estate of the donor
 - b. Description of Takers in Default
 - i. You need to state expressly
 - ii. Claims of donee’s creditors – generally not if a special power
- IV. Rights of Creditors of Donor or Donee
 - a. Non General powers assets generally not available to creditors
 - b. General power of appointment
 - i. Subject to claims of creditors of donee
 - ii. Donor created power – if presently exercisable subject to claims of my creditor even if restricted to health, education, maintenance and support – State law says that is a general power – *Matter of Flood* in NY
 - 1. It’s a creditor rights problem, not a tax problem because even 2041 excepts HEMS
 - iii. QTIP trusts do not need a general power
 - iv. Right of election
- V. Fiduciary Powers of Appointment
 - a. Contrast between fiduciary and non-fiduciary powers
 - i. Non-fiduciary power can be exercised arbitrarily and capricious
 - ii. Fiduciary must act in good faith – and maybe reasonably

- iii. Fiduciary powers may be constrained by public policy, but not a personal power of appointment – including one exercisable only in favor of “boys” for example
- b. Decanting powers
 - i. General rule on exercises in further trust
 - 1. Is now the default rule that a power of appointment is exercisable in further trust
 - ii. *Phipps* – held that a fiduciary held power is a power of appointment and can be exercisable in further trust
 - iii. State variations
 - 1. May not be able to eliminate an income interest
 - a. Marital Deduction issue?
 - b. Notice 2011-101
 - 2. Some States require that you go to court
 - 3. FL law, decant only if the power of invasion is absolute
 - iv. New York Statute
 - 1. Why may you decant
 - a. Protect the tax treatment of a trust
 - b. Grant a beneficiary a power of appointment
 - c. Reduce administrative costs
 - d. Alter the trustee provisions –identity or manner of appointment
 - e. Extend the termination date of trust
 - f. Convert to a grantor trust or the reverse
 - g. Change the governing law of the trust
 - i. Go to Scott on Trusts saw rule that the powers of the trustee are not derived from place where the trust was created or its governing law, the powers of trustee are derived from the place the trust is administered
 - ii. Alaska and New York is specific
 - h. Divide property to create separate trustee
 - i. Reducing potential liability
 - j. Convert trust into a supplemental needs trust, and exception to eliminating an income interest under NY law – does not work in Arizona – local department says it will not respect
 - k. Make it non-spendthrift to allow a transfer of the interest
 - 2. Other common uses –
 - a. Make it into a directed trust
 - 3. Some Tax Issues of Decanting
 - a. Notice 2011-101
 - i. Asked for advice in 13 ares
 - 1. Beneficiaries changes

2. Mere possibility of it being changed creates problems?
- b. Income, gift, estate and GST tax effects
 - i. Grandfathered trusts
 1. Works if beneficiary power so long as within RAP
 2. Trustee power must be in trust when created or State law must have been in effect when trust became irrevocable
 - a. What do you do – go to local court and get ruling that the decanting power there as of inception – Works in FL
 - b. Wait until trust about to terminate in beneficiary's favor anyway eg – have not worsened any tax effects
 - c. Give the beneficiary a special power of appointment that is testamentary so that no gift by the beneficiary by not objecting to the decanting
 - d. Exercisable only with consent of non-adverse trustee – require there to be one and if at any time there is none, the Court can consent
 - c. *Bosch* issues
 - i. Whether beneficiary had a GPOA under local law
 1. Rev. Rul. 73-142 – construction occurs prior to the taxing event – binding upon the parties and therefore the IRS is also bound
 - d. *Cottage Savings* issue
 - i. Worry about whether changing nature of the interest that you have a gain realization event – if change income interest to unitrust if not state law authority then have a gain realization event
4. Gift Tax Consequences
 - a. Does beneficiary experience gift tax ??
 - i. Probably should not if beneficiary cannot overcome the authority
 - ii. Should be the same under State law
 - iii. What if State grants the power later, does that cause a problem
 - b. If a beneficiary is denied the ability to reverse the decision

- c. "Portability"
 - i. Had not simplified things
- VIII. Foiling Reciprocal Trust Doctrine with Special Powers of Appointment
 - a. Use the Shelter now

State Income Taxation of Trust

Dick Nenno

- I. Congress has power to regulate commerce among the States
 - a. Safe Deposit and Trust Co., Guaranty Trust Co, and
 - i. Safe Deposit
 - 1. State cannot tax a nonresident trustee because trust has resident beneficiarys
 - ii. Guaranty
 - 1. Can tax resident beneficiaries on trust distributions
 - iii. Greenall
 - 1. Can assess a resident property tax
- II. State court cases
 - a. Mercantile v. Murphy
 - i. Due process clause prohibits NY from taxing accumulated income of an inter vivos trust funding during life and by Will – no NY trustee and no NY source income but NY settlor
 - ii. McCullough
 - 1. CA could tax a resident co-trustee
 - iii. Taylor
 - 1. NY due process may not tax gain on sale on FL Real Property held in trust under Will of NY decedent – only non-resident trustees served w/r to FL real property because NY trustee was not qualified
 - b. North Dakota
 - i. Due Process minimum contacts test does not require the physical presence
 - ii. Commerce Clause substantial nexus test requires physical presence
 - c. Due process clause of 5th amendment
 - i. District tax case – founder trust
 - d. CT case on due process
 - i. Sole beneficiary was a CT resident
 - ii. Enough to tax the trust

- e. Probably unconstitutional for State to tax a trustee solely because the trustor was a resident, but different if subject to jurisdiction because trust under a Will
- III. Specific state jurisdiction
- a. Honors founder state approach to taxation of the trustees
 - b. NY follows all of Federal grantor trust rules
 - c. Rates up to 8.97%
 - d. For testamentary or inter vivos trust
 - i. Treat as nonresident trust if no NY trustees or trust income
 - ii. Intangibles follow residence of the trustee
 - iii. One dollar of NY source income destroys the exemption for a resident/non-resident trust – eg founder was a resident
 - iv. NY city tax
 - 1. Could be rates up to 12.846%
 - e. 2010 case
 - i. 1992 NY city resident created an irrevocable trust naming Manhattan attorney as trustee
 - ii. 1995 Trustee moves to FL
 - iii. Trustee kept paying taxes in NY
 - iv. Trustee files for refund but only for the open years
 - v. Refund for closed years denied
 - f. Silver TSC-A-00(2)(i)
 - i. NY resident creates Delaware LLC of which she is managing member
 - ii. Put the membership interest in trust
 - iii. Rules that not subject to NY income tax notwithstanding the management – would not have worked otherwise
 - g. PA resident trust – founder state trust approach
 - i. Nonresident resident trust if no PA assets, no resident fiduciary/beneficiary
 - ii. Avoid tax by transferring situs to another State
 - h. Georgia
 - i. GA honors all federal grantor trust rules
 - ii. 6.0% income tax on income over
 - iii. No GA trustee, no property in GA, no GA trustee, no GA beneficiaries
 - iv. Whether or not trustor in GA
 - i. Illinois
 - i. Only follows 671-678 of the IRC, but not 679
 - ii. Net income at 6.5%
 - iii. Illinois uses the founder state trust approach
 - j. California
 - i. Honors all federal grantor trust rules
 - ii. 10.30% on income over \$1 million
 - iii. Resident trust – resident fiduciaries or resident non-contingent beneficiaries

- iv. Resident individual fiduciaries can avoid tax is delegate duties to nonresident corporate trustee
 - v. Nonresident trustee with discretion to make payments to resident beneficiaries may postpone tax until payments are actually made
 - vi. CA collects tax from beneficiary if not paid by the trustee
 - vii. If resident and nonresident beneficiaries, fiduciary or source income gets complicated
- IV. Planning for new trusts
 - a. Consider State income tax considerations
 - b. Resident testator – see if you can fit into exception for Resident/Nonresident trust
 - c. If in founder state with no such exception
 - i. Then move or do not do it
- V. Planning for Existing trusts
 - a. Changes may require court involvement
 - b. Trustees in all States may have a duty to look at this in order to minimize tax
- VI. Reliance on availability of home state courts
 - a. Testator/trustor’s home state jurisdiction
 - i. But may move
 - b. Courts of state where trust administered should handle all questions concerning the administration of a trust
 - c. Trust state courts may not have to give full faith and credit to decisions of home state courts
- VII. Look at Source Income
 - a. Nonresident trusts are taxes on this – how can you avoid, such as putting the asset in an entity such as an LLC or FLP
 - b. Best chance of succeeding if have multiple contributors and lots of assets
 - c. Advisor will probably be treated as a trustee
 - d. Use of decanting power to exit the state
 - e. DING trust – IRS stopped issuing rulings for a while, but may again be willing to consider now
 - f. PLR 200944002
 - i. Allowed resident trust to avoid estate tax
 - ii. Mortensen case is being studied – IRS has declined to issue subsequent rulings similar to the PLR

Charitable Organizations – Heckerling

Alan Rothschild and Richard Fox

- I. Public Charity
 - a. Supporting Foundation -- Need public support and anyone who gives you more than 2% of donations does not count
 - b. Automatic public charity – schools, hospitals, churches
 - c. Operating Foundation
- II. Private Foundations
 - a. Would rather not be a PF
 - b. Most are confined to a grant making activity, are not running programs
 - c. Over 75,000 PFs in US today
 - d. It is type of 501(c)(3) so immediate deduction even though funds not immediately deductible
 - i. Donor retains control over the assets
 - 1. Investments
 - 2. Timing of disbursement
 - 3. Governance control
 - 4. Control the term
 - ii. Private Operating Foundation
 - 1. Funded by a single source
 - 2. Carries out a program – eg small museum
 - e. There is a complex tax regime that regulates PFs
 - i. Less flexibility with a corporation rather than a Trust
 - ii. Barnes case in Philadelphia – requirement that the building be on Mainline Philadelphia
 - iii. Trust are more easily modified these days
 - f. Page 12 – See the governing instrument requirements
 - g. Private Foundation must distribute 5% of its assets—program related investments and counts towards 5% requirement – loan to a museum for example and it counts
 - h. Page 16 – certain transactions between PF or family members are prohibited – disqualified persons
 - i. See Top of pae 16
 - ii. Sale, exchange or leasing of property to the PF is prohibited
 - iii. Payment of compensation reimbursement of expenses
 - iv. Transfer to or use by disqualified person of Foundation assets
 - 1. Personal pledge to local charity – prohibition for PF to fulfill the pledge if it is a binding agreement
 - 2. Cannot have PF pay the charitable portion of the Table at the Gala
 - 3. Say in the grant that shall not confer any benefit, no tickets etc.
 - v. Tickets generally considered personal

www.yourcommunityfoundation.org

- i. Taxable expenditure rule
 - i. Public charity can allocate small portion of funds to influence legislation
 - ii. PF its never
 - iii. Individual grants are a problem even indirectly to another private operating foundation – you need to exercise expenditure responsibility
 - iv. Penalty is 10% for every year or 200% if IRS finds before you turn yourself in and correct
 - j. Investment Excise Tax – 1 or 2% on their income – modest – public charity has no tax on a capital gain – could make grant with the appreciated stock with no realization event
 - k. Excise Business Holdings Tax
 - i. Aggregation rules – PF plus insiders hold more than 20% get in trouble
 - ii. Gifts or bequests have 5 years to get rid of tax avoid the tax
 - iii. Passive investment income through FLP is not a problem – must be an active business to be in trouble
 - l. Compensation
 - i. Rule 4941(d)(1)(D) -- self-dealing transaction if pay compensation from a PF to a disqualified person
 - ii. Exception -- Must be reasonable to carry out purposes of the PF
 - iii. Must be for personal services
 - 1. No definition of personal services
 - a. Legal
 - b. Investment management
 - c. Accounting?? – but not decorating, etc.
 - d. These are personal services
 - iv. Government Officials are disqualified persons and cannot pay them anything except reimburse for out of pocket – but not to travel outside the US
- III. Donor Advised Fund
- a. Donor retains right to recommend how grants are made
 - i. Local community foundations
 - ii. Fidelity Charitable Gift Fund – raised more money in 2010 other than United Way and Salvation Army -- \$270 million raised
 - iii. Donor Advised Fund can be used to terminate a PF
 - b. What are the difference between that an PF
 - i. Get immediate deduction
 - ii. Legal fiction that part of a whole, and the whole is a public charity
 - iii. No 5% payout requirement
 - c. They are not all the same – local one may have better advice on the activities of the community
 - d. Some may only recommend grants in the local area – many do not so limit
 - e. May not allow succession of advisors
 - f. Fidelity’s minimum is only \$5,000

- IV. Sponsor organization refused to follow the direction – Court held that was fine and you gave up control
 - V. Supporting organization
 - a. Public charity
 - b. Robertson – issues whether using for certain purposes
 - c. Put it into a trust – do not want to give them the funds
 - i. Same treatment as public charity
 - ii. Close knit relationship between supporting org and the public charity
 - iii. Founder cannot control –
 - iv. Milton Hershey school was the origin of this
 - d. Relationship test
 - i. Parent subsidiary – parent org appoints the board
 - ii. Type 1 supporting with community foundation – community foundation appoints your directors
 - iii. Type2 – majority of board comes from supported organization
 - iv. Responsiveness test
 - 1. Responsive – close and continuous working relationship with the supported organization
 - 2. Face to face meeting
 - a. Take advice on grants and investments
 - v. Charitable trust is not enough – so rule is gone
 - vi. Type 3 --Attentiveness test
 - 1. Must give at least 85% of your income
 - vii. Functional activity test?
 - viii. Excess benefit rule – cannot loan money back to yourself
- VI. 4947(a)(1) trust is wholly charitable set up under a Will or inter vivos so now
 - a. Treated PF even though not a 501(c)(3)
 - i. All interests held for charitable purposes
 - ii. Deemed to be a PF
 - iii. Received some type of charitable deduction – estate, gift etc
 - iv. Do get a charitable income tax deduction
 - v. Do not need an IRS determination
 - vi. Name charity to receive all distributions
 - vii. Even if not a 501(c)(3) – may be advantageous for income tax purposes because no permanent set aside deduction and 642(c)(3) deduction may not be available
 - b. (a)(2) deals with split interest trusts
- VII. Income tax deduction for charitable gifts
 - a. Entitlement to charitable income tax deduction
 - i. Type of entity that receives the gift
 - ii. Kinds of property give away
 - iii. Gift substantiation

1. Need the substantiation prior to filing your return claiming a deduction
2. Fact that appraiser failed to attach bio was enough to deny the entire deduction – and cannot fix retroactively
- iv. Amount of deduction
 1. Percent of adjusted gross income
- b. Contribution of appreciated capital assets are generally deductible at full FMV
 - i. Deduction ==FMV generally
 - ii. If any property when sold but does not produce L-T capital gain then can only deduct basis
 - iii. PFs – can only deduct cash at 30%
 1. Or qualified appreciated stock
 2. If contribute more than 10% no deduction and aggregate with family members
 - iv. Tangible personal property
 1. No FMV deduction unless used for related function or activity
 2. PPA – if charity sells in same year you give it, limited to basis
 3. Or if within 3 years of gift – recapture difference between basis and FMV as ordinary income unless charity certifies it intended and did use for related purpose, or became impossible
 4. Get a board resolution that will use for related purposes or get a grant agreement
 5. 8283 – get box checked
 6. Or say to charity cannot sell for 3 years – but that is a restriction that may create a problem at least in terms of negatively affect value
 7. Vehicles – legislation, when you donate then deduction for what sold it for by charity
- c. See chart in materials and checklist
- d. Retain rights need to be insubstantial
 - i. Exercise in fiduciary capacity then insubstantial
 - ii. Display rights may be such rights
- e. Remainder interest in property
- f. Fractional interests in property
 - i. Now no longer works – must give the remainder within 10 years

VIII. Individuals

- a. No charitable deduction for gifts to individuals
- b. Needs to be broad enough class
- c. No earmark for a particular individual – eg to a particular person to fund his research
- d. Conditions on gifts
 - i. Forfeiture versus return to donor
 - ii. Give alternate use or over to donor advised fund should work
 - iii. Have unnamings rights in the hands of the charity – eg donor becomes a criminal

- IX. Charitable Gift Agreement
 - a. It is a business transaction
 - b. Document the donor's intent is
 - c. Anticipate changes
 - i. That happens if School of Music is closed
 - ii. Make sure what you cy pres
 - iii. Is publicity or lack of publicity important
 - iv. Put your standard contract terms in there – eg paper supercedes the agreement, governing law, etc.
 - v. All income or only income means charity can exercise standard prudent standard under UPMIFA – then need to look at effects

Disposition of Art

Ralph Lerner

- I. Charitable Donation
 - a. Related Use Rule
 - i. Otherwise limited to basis
 - b. Gift from artist
 - i. Deduction limited to the cost of artist's materials
 - c. Qualified Appraiser
 - i. New definition – uniform standards of appraisal
 - d. Otherwise deduction for full fair market value
 - i. Five year carry over
 - ii. Full fair market value if for the related to the purposes of the charity
 - iii. Make sure that not sold within 3 years – get note from IRS
 1. Transfer could be to another charity – not just a sale
 - e. Section 170(a)(3)
 - i. Future interest rule – if any intervening interest, then do not get a charitable deduction
 - f. Fractional Interest in Artwork
 - i. Used to be could donate 20% and no discount for a fractional interest
 - ii. But now PLR 200223013 – can put restrictions on a fractional gift, but be careful
 - iii. Now whole new set of rules – fractional interest will not work anymore
 1. Deduction limited to original cost all the way through
 2. No longer works unless joint purchase between collector and charity
 - iv. 28% capital gains tax on sale of painting, and State and Local tax
 1. Solve with CRUT – charity 6% to beneficiary – named as remainder beneficiary, so really not paying \$10 million
 2. Had the painting reproduced so friends would not know
 - v. Art collector wanted to have its own museum Rev. Rul 74-6000 – was not enough, PLR 7824001 about how much public access you need
 1. 53.4942(b-2(a)(6) ... Example 4
 2. Closed off room from rest of the house and private entry way – operating foundation – put works on loan, when came back put back in storage and study center PLR200232036 agreement where private operating foundation enters into agreement and provide life insurance for the curator
 - vi. Value of fractional interest – do you get a discount because of old law that no discount for fractional interest in art work
 1. Stone case – based on evidence hypothetical seller of undivided interest in art would seek to have the entire painting and take 50% of the proceeds especially in light of the right to partition

2. 9th circuit affirms – the cost of a partition action would be your discount and no fractional interest discount on art
 3. Court consistently recognized that sum of all fraction is less than whole – but seems not to apply to art
 4. Skol case? Very small discount when it comes to art – no only wants art with a cloud over title, so any litigation negatively affects the value
 5. 2503(b) – no restrictions will be used if not real – Holman
 - a. What about FLP for art?
 - b. Does that work – no you cannot take a discount for the art
 - i. 2036(a)(2) problem if retain possession
 - ii. Lock in 28% discount
 6. Elkins case – said no discount on the art – and cannot really determine the rental value of artwork
 - a. Looking at 2703(b) – bona fide business arrangement, comparable arrangements and not a device. IRS says there are no comparables in the art world
 - b. Restriction was not on the fractional interest, but rather on the sale of the art itself, says taxpayer
 - c. Deduction only for cost of partition action
- II. Tax Code treats the copyright and the work of art as one property interest, not separate interest
- a. Simpler to give the art away to charity than to attempt estate planning for the family
 - b. There is a Revenue Procedure that you can get an advance ruling on the value of the art which is binding on the IRS but not on the taxpayer – estate tax is useful because get closer to DOD determination
 - c. Work of art and copyright are two different types of property – avoid inadvertent split interest transfer
- III. Gift is a lot cheaper and better for client than estate planning strategies with the art

GST Tax – Heckerling

Julie Kwon

I. Guidance at the end of last year

a. Notice 2011-66

- i. For purposes of Chapter 13, references to Chapter 11 assume estate tax was applicable, carryover basis election does not affect the applicable rules
- ii. Timely file 8939 is a timely allocation of GST exemption
- iii. Use schedule R for direct skips at death
- iv. Decedent has full increase in the GST exemption of \$5 million
- v. Zero percent tax rate is not the same as an exempt trust, the trust has an inclusion ratio of 1 unless you allocation exemption
- vi. Application of move down rule
- vii. Outright direct skip gifts
 1. Treated as electing out of automatic allocation
 - a. Option to make an Affirmative elect out
 - b. Or with lifetime direct skip transfers outright to a skip person treated as electing out
 2. But does not include a transfer in trust
 3. Does not apply to a transfer at death even if a direct skip
- viii. Schedule R will have immediate operative effect
 1. Direct skip must elect out of automatic allocation
 2. May occur as a result of disclaimer planning
- ix. 2010 Form 709 April 17th or October 17th
 1. Helpful automatic relief provision 301.9100-2 if corrective action taken within 6 months of a timely files return
- x. Due date of return – you may want to make late allocation of GST exemption
 1. Need to elect out of automatic allocation
 2. Do not do this with a direct skip

b. Sunset issues

- i. Various GST tax relief provisions enacted as part of EGTTRA
- ii. Here are provisions that will expire
 1. Increase in GST exemption amount we had are ignores
 - a. How to ameliorate
 - i. Should you bifurcate the use of your exemption
 - ii. \$1.36 million – part up to \$3.5 million
 - iii. Balance
 - iv. May need to create the trusts on different days and at different times
 - v. Use a direct skip trust to obtain the benefit of the move down rule?

- b. Trust are already exempt – should you decant to direct skip trusts to lock in an application of move down rule
 - c. Should you think about to make distributions to allow beneficiaries to use their tax benefits
 - 2. Automatic allocation to indirect skips disappear – or hopefully Treasury will respect the prior elections versus affirmative elections in or out
 - 3. Retroactive allocation
 - 4. Qualified Severance
 - a. Expiring
 - 5. Administrative provisions
- II. Qualified Severance Rules
 - a. Collateral aspects may survive even if 2642(g) expires
 - b. Used to be very narrow universe of splits recognized
 - i. Separate transferors
 - ii. Trusts included in your estate
 - c. Mandatory severances
 - i. General rule is that trusts are not treated as separate unless they were always separate
 - ii. New rule mandatory severance is recognized – Should survive even if sunset – what does it take to qualify
 - 1. Not within any person’s discretion
 - 2. Trusts must be separate under applicable law
 - 3. Does not change inclusion ratio
 - 4. But could administer distributions favorably
 - 5. May trigger an immediate GST tax
 - d. 642 regulation
 - i. Discretionary severance
 - 1. Trusts separate under applicable State law respected for GST purposes, but inclusion ratio is not changed
 - e. IRS does not like horizontal severances
 - i. What if you make an actuarial split
 - ii. If you split between child and grandchild then that would create a taxable termination unless you could do a qualified severance
 - iii. But the trusts are separate after the fact
 - f. Valuation rule for qualified severance
 - i. Can do this non pro rata
 - 1. No discounts
 - 2. Have only so many days to accomplish it
 - ii. Conflict between property law and the GST law
 - g. Income tax rule
 - i. Safe harbor for income tax purposes

1. State statute or governing instrument
 2. Then there is no income tax realization event
- III. Taxable Termination
- a. 2622 allows deduction in computing amount subject to tax on taxable termination
 - i. Can tax deductions similar to 2053
 - ii. What is the GST effect of the new rules
- IV. Drafting issues
- a. Page 41 – usually have a trustee’s power of severance
 - b. Typically limited to the original terms of single trust before severance continue to govern
 - i. May be able to vary terms so long as in the aggregate same succession of beneficial interest – so the normal language is too limiting
 - c. Formula clauses
 - i. Defined with reference to an exemption – do we want a ceiling
 - d. Drafting will be more simple because we need to be more flexible and probably will put it all in trust to avoid unexpected consequences – broad discretionary standard
 - e. State estate tax may make estate tax more expensive than GST tax
 - i. NY has its own GST tax regime
 - f. What are option with all of this uncertainty
 - i. Trustee to grant a power of appointment or grant with consent
 - ii. Deliberately trigger the Delaware Tax trap
 - iii. Default option like a formula shifting power
 1. Very hard to draft because it depends on how beneficiary disposes of the property – maybe is a GPOA if beneficiary can control whether has the power of not
- V. Timpen case – upheld the IRS regulation exempts special powers of appointment so if could may want to shift to a SPOA before the taxing event

Recent Development

- I. 2010 Decedents
 - a. 8939 must file timely – then you have the option within 9 months to adjust your elections – seems you can allocate additional basis increase, eg if you sold the asset
 - b. You cannot change from carryover basis to estate tax return
 - c. No automatic allocation for GST purposes if you elect into carryover basis
 - d. No formula allocation – according to Dennis, because you have no way to determine the adjustment
 - e. Have future accountant involved so that you can keep it straight
 - i. Allocate to certain parts of the block of stock, for example
 - ii. Can go back and allocate basis
 - f. Instructions 8939
- II. What will Congress do?
 - a. What could happen
 - i. Absolutely nothing could happen and that means Jan 1 we have a \$1million exemption
 - ii. Congress could repeal the estate tax
 1. Cannot rule that out
 2. So few people are subject to the tax
 3. Problem is basis
 - a. Very hard to give people a basis step up without an estate tax
 4. Capital gains tax at death – DB says unlikely
 5. When will Congress Act
 - a. Polled group – before or after 12/31 – seems exceptionally unlikely that it will before
 - i. Factors – election this year. Senate 51 Democrats and 2 independents, and Republicans 47.
 - ii. Number of seats up for reelection, but could see shift in power and control in Senate
 - iii. House 242 Republicans and Democrats balance
 1. Typical that out of power party will lose seats
 2. Swings greater
 3. Republicans defending more first term candidate
 - iv. Other factors
 1. Tea Party
 2. Occupy Wall Street
 - b. Congress Acts in first quarter 2013 – Congress could make retroactive without fear of challenge if more favorable
 - i. Do have a concern at IRS about that – increased exemption when shifts disposition

- ii. Issue not whether successful but whether filed because that would put system in turmoil
 - c. We don't know what will happen, when or whether retroactive
 - III. Recapture
 - a. Page 21 – There is no such thing as a clawback problem
 - i. Better move during lifetime, get a tax free deferral on the tax liability
 - ii. Who pays the estate tax on the additional amount?
 - 1. Really a tax apportionment issue
 - 2. Skew marital deduction reduce to zero planning
 - iii. Code says you get a credit for the “gift tax payable”
 - 1. Gift tax you would have paid if the law in year of gift had been the law applicable in the year of death
 - 2. Year of death law would have paid the appropriate amount of tax
 - 3. Therefore the clawback problem disappears
 - iv. Form 706 for a 2011 decedent gets the computation correct without any clawback problem
 - v. Page 27 – year of prior transfer the exclusion was \$1 million, so you pay 35% of the tax if give \$2 million. Line 10 shows credit for gift tax paid but if apply law is written the exclusion has gone up, not down, then you may not get credit for the prior gift tax paid previously, the credit should actually be zero. Like to think you get no additional tax due. Means you owe additional tax on the \$1 million. The real issue is a client who pays tax early, and incurs tax. Do you get credit for that payment. The exclusion will go up because of indexing in all events.
 - 1. You do get a credit at the higher rates
 - a. 55% rate and \$1 million exemption, then better off to pay gift tax
 - vi. Should we advise clients to pay gift tax?
 - 1. Probably not
 - 2. Make gifts with assets with the highest basis
 - a. DB ran numbers on zero basis gift as to what appreciation would have to be to overcome loss of basis step
 - i. Suppose asset stays at same value
 - ii. Asset needs to go to \$1.8 from \$1 million before the estate tax savings offsets the loss of basis step up
 - iii. And if children will not sell, then it will not matter
 - 3. What if the exemption is lost in the future
 - a. Use of exemption, means property could depreciate
 - b. Talk about techniques to use the \$5 million
- IV. Portability
 - a. Solves the problem for client with insufficient assets to fund the CST – eg only have a house or IRA to work with

- b. Put in for simplification
 - c. Page 30 – assume that may be permanent
 - i. Whenever a married individual dies must file an estate tax return
 - ii. Currently filing the return is deemed to make the election, otherwise need to make an affirmative election out
 - iii. Suppose the executor refuses to file 706, can the spouse file a 706 on behalf of the estate to make the election
 - d. Credit shelter trust is the right way for most wealthy clients
 - e. Marital Deduction can be a QTIP trust and reverse QTIP election for GST purposes and not lose the GST exemption – then rely on portability for the estate tax
 - f. Page 39 – Appreciation during the overlife of surviving spouse gets you a basis step up at the surviving spouse’s death, but if consumption exceeds appreciation, then portability is preferable because then have more left to shelter
 - i. Does the example take into account income taxation
- V. Tax Patents
- a. Congress enacted Sept 2011 that limits the ability to patent a tax strategy, but loophole for tax preparation software
 - b. So-GRAT patent is under review and may be invalidated
- VI. Revenue Proposals
- a. Greenbook
 - i. Page 49 – portability be made permanent
 - 1. JP thinks \$5 million and portability will be last
 - ii. Page 51 – wants to amend 2704 possible guidance – Regs have been drafted, Treasury knows not valid as the Code is currently drafted
 - 1. What is the effective date?
 - 2. Supposed to be effective as of 1990
 - a. Disallow discounts put into play since then??
 - b. Change to 2702 would impact short term GRATs would be prospective only
- VII. Family Office
- a. Have now issued rules that are now final, very expensive proposition under Dodd Frank
 - i. No de minimus rule. If you are an investment person – and being paid for that may be an investment advisor, and may have to register
 - ii. Big family office need to do the following
 - 1. Time to comply by March 2012 – must register
 - 2. Handling investments for the housekeeper
 - a. Any trusts that give annuity to a gardner or housekeeper, and automatically out of the box because not a family member, then must register
 - b. Family Foundation can kick out the non-family contributions
 - b. Private Trust Company gets you out of the registration rules

- i. Still no guidance on this rather complex situation
 - ii. Who should be acting as trustee
 - c. Alternate Valuation regs reissued
 - i. Look at this for estate and gift
 - ii. Distribution of a fractional interest would call acceleration
 - 1. May be denied a fractional interest discount – proposed an aggregation rule and take piece remains and prorate the value to the chunk that remains
 - 2. Page 87 – transaction in the ordinary course of business
 - 3. Same value transaction exception, with a 5% safe harbor if the change in value is not more than 5%.
 - 4. New approach is that the event triggers an earlier valuation date as if there were a disposition of the asset
 - 5. Disposition of fractional interests will also trigger acceleration – and you value as a pro rata share of the whole
- VIII. Revenue Ruling for Substituting Life Insurance Policies
- IX. Regs under 2053
 - a. Protective Claim for refund
 - i. Important item
 - 1. How do you go about making the claim
 - 2. Page 92 – Rev. Proc 2011-48
 - 3. Page 94 Notice 2009-84
 - 4. Page 95 CCA200848045
 - 5. Timing Issues
 - a. If the claim involved is less than \$500,000, none of the new rules apply, but must have a qualified appraisal to support it
 - b. Shapiro case – claimed that claim for \$30 million and settled for \$250,000
 - 6. Remind us that when you file a claim for refund after you pay, the statute of limitations does not apply. The claim for refund may go back to any item on return for addition to tax that may offset entitlement to refund – protective claim was to keep your opportunity to obtain a refund
 - 7. Notice says that will only look at items related to the refund item, unless there is fraud, malfeasance
 - 8. How do you perfect claim for refund
 - a. For returns for 2012 – there will be a new Schedule PC to file with the return
 - b. But otherwise use Form 843 that you use

- i. CCA says there is a standard by which Government will alert you that the claim on the form is deficient – then you get 45 days to cure, then the whole thing is waived
- ii. We might fail to tell you the claim is deficient, but you must notify us that we failed to notify you, and you have 30 days to tell them that you did not get the acknowledgment – and IRS should let you know within 180 or 60 days depending on what you filed, then you must within 30 days tell them that we did not receive your acknowledgment

X. Decanting

a. Page 98 – Notice 2011-101

- i. Service announced will no longer issue rulings
- ii. Asking comments about the following
 - 1. Is a beneficiary's right in income and principal changed
 - a. When the trust is split into two pieces have the interests changed
 - 2. Situs changed
 - 3. Adding a power of appointment
 - 4. Court order required?
 - 5. Are beneficiary's required to consent?
 - 6. What will the regs say?

XI. Estate of Riese and Van

a. Retention of enjoyment – 2036 issues

- i. Van -- taxpayer transferred the title of the property but still living and dwelling at the time of death; her daughter and husband ostensibly provided all the consideration for acquisition of the dwelling – transfer made for full and adequate consideration – may not have been raised or argued
- ii. Riese –Pulled out of his hat
 - 1. 3 year QPRT – at end of term donor she should have moved out or paid rent
 - a. But she did not and did not promptly get around to a lease, but planner said had time
 - b. Donor kept paying the carrying charges
 - c. Government argued 2036(a)(1) – taxpayer wins
 - d. Estate asks for a deduction for the rent under 2053 – the tax court allowed that as well (unreduced by the carrying charges)
 - e. But no deduction for post mortem rent
 - f. Add provision to QPRT that says if remainder beneficiary allows donor to reside in residence then agree to pay fair rental value?

iii. 2041 issue

1. HEMS standard – reasonable comfort, but not plain comfort
2. Surviving spouse was co-trustee of the Family Trust; principal was payable – sustenance and welfare used – Mississippi law had previously said comfort was ascertainable – and adding word welfare did not queer the standard
3. 1990 Judicially determined ascertainable standard – article that says what is an ascertainable standard
4. Gift tax rule – fixed or ascertainable standard – words are a little different
5. PLR state court reformation based upon scrivener’s error, and the IRS recognized it – but if an error, that may relate back – State court reformation

XII. Page 109

- a. Divorce property settlement arena
 - i. Avoiding gift tax liability
 1. Incorporated into the decree then not voluntary and not a gift
 2. Or make transfer while still married
 3. Or transfer for support is an exception
 4. 2516
 - a. PLR said that was not a gift as to the income interest but the remainder interest was a taxable gift of future interest in the remainder.
 5. Who is the donor if you are giving up support rights in exchange for the trust

XIII. Partnership interests

- a. Guistina case
 - i. Timber operation – two valuation methodologies
 1. Discounted cash flow 75% weight
 2. Liquidation value 25% weight
 - ii. Swing vote analysis – maybe back in play
- b. Gallagher
 - i. Appraisal done by CEO and President
 - ii. Obtained multiple appraisals
 - iii. TC resolution – was less than the 706 value claimed by the taxpayer
 - iv. Page 121 – when no tax effecting of cash flow of S corps – that should not be the case, there are certain benefits to own through entity, comparable companies pay regular income taxes, insufficient attention to benefits of owning interest in a passthrough entity
- c. Mitchell
 - i. Planning done within 1 week of D’s death

1. Murphy and Frank cases – whether near death planning will be respected
 2. Gov't challenging the value of the underlying property
 3. By stipulation that the Gov't agrees to the discount
 4. Taxpayer peels off a 4% interest
 - a. Get a fractional gift tax discount
 - b. Fractional interest discount on 95% -- 19 to 35% range
 5. Murphy and Frank – on whether the discounts are allowable and the outcome was split
 6. In Mitchell ask how to value the underlying properties – both were leased
 - a. Gov't's theory used a "lease-buy-out" method – which Tax Court does not adopt
- d. Adler
- i. 1100 acres in Carmel to 5 children and retained right to use the property, and paid all expenses
 - ii. The issue was not whether included in gross estate
 1. Only a valuation issue – 5 parcels or 1 parcel – cited Mellenger and there was no aggregation
 2. Here in Adler said had control of all and no discount
- e. Petter and defined value
- i. Christiansen, Petter decided, and affirmed on appeal to 9th circuit and Hendricks
 - ii. Petter is the more arms length case
 1. Neither court blessed the formula that was used
 2. Public policy argument could still be raised
 - iii. Hendricks went over to the donor advised fund
 1. Donor advised fund had independent counsel
 2. Independent appraiser
 3. Donor and spouse were not part of the arrangement
 4. Court cited Proctor – but followed McCord
 5. Rejected Proctor argument – said it encouraged gifts to charity
 6. Was very well thought out
 - iv. Look at defined value clauses
 1. Page 130 – the question is how do we use this to make large gifts?
 - a. Recommend consideration of a defined value clause
 - b. Use the confirmation clause – allow the parties to negotiate the allocation – or use finally determined for gift tax value method
 - c. Concern about increasing the audit risk if use the defined value clause – but with hard to value gift will be audited anyway

XIV. Alternate Valuation

- a. Government took position that could not make a late alternate valuation election – 2032 says election for alternative valuation if the return is filed within 1 year after the due date including extensions
 - i. Will grant request for relief if the Form 706 is filed within the one year tardy period of time
- XV. Step transaction situation – what if you wait a while
- a. If each step dependent on other steps will be valued all at once
 - b. Get around that – page 141 – Holman – Dell stock (6 days), Gross – publicly traded stock (11 days), Linton (later dated documents), Senda (same day)
 - i. Assuming do the documentation correctly and in the correct order. Need a period of time so that the assets can change in value or have potential for a change in value
 - ii. Footnote 9 in Linton – wait a period of time so have risk of change of valuation
 - 1. Closely held business interest may not change
 - 2. Levy case – real estate – 2 years after death was a good indication of value so do you need more for real estate??
 - 3. Declared a dividend to change the value
 - 4. Enter into a lease agreement to change the value of the real estate
 - 5. What is at risk is the discount applicable to the wrapper the property is in
 - 6. Must follow the formalities to get the paperwork right
- XVI. Estate of Jorgenson
- a. Bona fide non-tax reasons for formation
 - i. Had a trust before for management
 - ii. Financial education – children were never involved
 - iii. Had a buy and hold investment philosophy – requires no special skill
 - iv. No family unity so no one else contributed
 - v. No pooling of assets
 - vi. Creditor protection – could not identify any creditor problems
 - vii. Partnership formalities never adhered to
 - 1. Disproportionate distributions
 - 2. No meetings
- XVII. Turner
- a. Started out well
 - i. Formed and retained adequate assets to support themselves
 - b. Then went wrong
 - i. Disproportionate distributions
 - ii. Management fees without specification of duties undertaken as manager
 - iii. Amend partnership agreement for any reason
 - iv. Paid personal expenses and commingled assets
 - v. Reasons for formation not supported by the facts

- c. Crummey good news
 - i. Page 165 life insurance policies – premiums paid directly by the grantor
 - ii. No one was told about the rights to withdraw
 - iii. Lack of notice does not change the legal rights – citing Crummey – notice was not required – Howard case also says notice not required, and revenue ruling also supports it by saying withdrawal period too short AND no notice is given
- XVIII. Hawaii case
 - a. No valuation discounts permitted
- XIX. Circular 230
 - a. Amendments when participating in return preparation
 - i. Most important aspect – no ethics violation is reckless, willful and incompetent, and know return position cannot be supported
 - ii. Page 151 – reasonable basis standard – no longer a clear 1-3 likelihood of success
 - iii. Substantial authority lower than 50/50
 - iv. What counts as authority is what comes from a court or Treasury
- XX. 201120005
 - a. Various items of interest in this ruling
- XXI. Duncan case
 - a. Graegin loan case – Trust created for Vincent and had illiquid funds in the estate
 - i. Borrowed funds from another trust – Prepayment prohibited, etc. and interest deduction for the 15 years worth of interest
 - ii. Tax Court held that identical trustees with same beneficiaries are not the same entity, and State law treats these as separate – Estate does not have to sell the illiquid assets instead
 - iii. Economics of Graegin loans – But no prepayment requirement, could file refund claims instead year after year
 - iv. If file at the end of the 15 years take the deductions – get it treated same as if paid on the date of death
- XXII. Case on page 190
 - a. Van Heusen – woman volunteer for the animal shelter had 90 cats and IRS said cannot deduct the expenses – Tax Court ruled that could deduct but limited to evidence

Rubenstein – Modification and Reformation of Trusts

- I. Tax Rates Generally
 - a. Income taxes – everyone has to pay, and relatively low rates, deductions are not that generous
 - b. Transfer taxes do not raise that much revenue
 - i. Designed to motivate behavior – designed to be avoided – planning to leave to spouses or to charity
 - ii. GST taxes are either tax inclusive or exclusive
 - iii. Debts and claims are fully deductible
 - iv. Exclusions
 - v. Where to take the deductions and which tax benefit do you wish to take
 - vi. 2010 – Congress forgot how much fiduciary income tax would be lost because deductions shifted to the income tax return if there is no estate tax deduction for them – increased revenue estimate of cost to over \$100 Billion
- II. Retroactive Modification
 - a. Any number of different examples of statutorily permitted reformation proceeding
 - i. Split interest charitable gifts – can reform to qualified interest
 - ii. GST gifts – current reformation permitted
 - iii. QDOTs for non-citizen spouses – if botch it you can cure – but cannot cure for a QTIP
 - iv. MA has the ability to start a trial level proceeding in the Supreme Court so has a leg up – Bosch in absence of a determination by the highest court only need to give proper regard
 - v. Construction should you give you better argument because you are not changing anything
 1. Patent ambiguity and Latent ambiguity
 2. Facts and find an ambiguity that helps you to construe to made changes
 3. Tax clauses are usually construed to minimize taxes
 - a. Matter of Gordon – couple with no children, all to survivor and balance to his siblings, SS left everything to charity and tax apportionment from residuary as to everything including QTIP which would pay taxes from the charitable share – Executor went for a construction to avoid apportionment to charity, and not enough of intent to apportion QTIP taxes to residue
 - vi. Disclaimer
 1. Another way of rewriting things
 2. QTIP example – the wrong beneficiaries could disclaim
 3. Disclaimer of powers or tax clauses
 - a. Matter of Boyd – Tax apportionment to residue and outside asset to son – disclaim the tax apportionment provision benefit, and it is an interest in property that can be disclaimed

4. Non-qualified disclaimer may get the right disposition but with gift tax consequences
- III. Probate or Elective Share contest
 - a. Can substantially right the Will and without tax consequences
 - b. See what happens in Settlement of the contest
- IV. Conflicts in Agreements that trump Wills
 - a. Do those trump the Will or the Elective Share
 - b. What about a Shareholder's agreement
 - c. Interesting way to shoehorn into making changes
- V. Prospective changes to document
 - a. Decanting
 - i. Various ways to make changes
 - ii. Trust or State powers
 - iii. New York's new statute
 1. Addresses problem of less than absolute power to invade, but must carry over the restrictions
 2. What if no ability to invade at all, so long as there is an ability to accumulate or pay income, then still can decant even if cannot invade corpus
 - iv. Treasury concerned about tax impact of decanting
- VI. Modification or Reformation
 - a. By a beneficiary's power of appointment
- VII. Trustee Litigation
 - a. Prudent investor act has a right of contribution if gave someone too much money
 - b. Beneficiary needs more money – overweight to income to accommodate income beneficiary and then remainder beneficiaries sue
 - i. So maybe can force funds back into a GST exempt trust, for example
 - ii. Settle with the non-income producing property, for example

