

**Heckerling Institute 2006**

Reports from the event, as posted to the ABA-PTL List Serve

## Report #2

A complete listing of the proceedings and speakers is available on [the Institute's Web site](#)

As we have done in January for the last nine years, and again with the permission of the University of Miami School of Law Center for Continuing Legal Education, we will be posting daily Reports to this list containing highlights of the proceedings of the 40th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 9-13, 2006 at the Fontainebleau Hilton Resort and Towers in Miami Beach, Florida. A complete listing of the proceedings and speakers is available on the Institute's Web site. The URL for that site is <http://www.law.miami.edu/heckerling>.

=====  
This Report contains coverage of the Monday afternoon **Recent Developments Program**

=====  
Recent Developments in Estate, Gift and Income Tax Monday Afternoon, 1/9/06  
Presenters: Dennis Belcher [DB], Prof. Jeff Pennell [JP] and Carol Harrington [CH]

Reporter: Jeff Weiler Esq.

As required by regulations at Title 31, Part 10 of the Code of Federal Regulations which comprise Treasury Department Circular 230, the statement that follows is made pursuant to Section 10.35(b)(5)(ii) of Treasury Department Circular 230:

- (a) Any advice set forth in this email memorandum is not intended or was not written by the author to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;
- (b) The advice in this email memorandum was written to support the promotion or marketing of the transactions or matters addressed by this email memorandum; and
- (c) Any taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

DB: No one block buster development but practice has changed. Since we are mid way through the phase in of the 2001 tax act now need to address certain issues: state death tax deduction rather than credit; 4 years from 2010 cliff and what should be done. DB thinks repeal is unlikely but lower rates and higher exemption was proposed. Planning today is more difficult and challenging.

CH: In debate in Congress concerning transfer tax law changes, gift tax was not to be coordinated with the estate tax -- gift tax exemption was to be kept at \$1,000,000 and 45% rate. There was concern that liberalizing the gift tax would allow avoidance of income tax. There was to be no phase in of proposed changes as has occurred with prior changes in transfer tax laws. Immediate effective date was to be used -- a cliff.

DB: Chance of reform in 2006 but DB has been wrong many times before. As exemption goes up, fewer estate tax returns are being filed (Exemption>Returns: 1,000,000/60,000, 2,000,000/30, 3,500,000/less than 15,000). While only rates and exemptions are supposed to be modified, there could be "revenue raisers". The Joint Committee on Taxation has five proposals that Congress could consider: limit perpetual dynasty trusts, limit valuation discounts, curtail Crummey powers, require consisting reporting of basis on 709 and 1040, modify transfer tax provisions that apply to Section 529 plans. Suggests planning now for 2010 cliff. DB prefers gifts now and not waiting for developments.

JP: Treas Dept Business Plan provides predictor of what is coming concerning new Regs. Items on list include: Final Regs under 671 regarding reporting requirements for widely held fixed income trusts, guidance concerning transfer tax issues and use of family owned company as trustee of trust -- private trust company, Section 2053 and post death events, sample charitable lead trust forms, final Regs under 2642 for qualified severance of a trust, and guidance under Section 2704 regarding restriction on liquidation of an interest in a corporation or partnership.

DB: Thirty six pages of outline are devoted to state death tax provisions. There are wide variances state to state. It is now more difficult for persons to advise on estate planning matter in other states -- a good reason to avoid advising on law in states in which you are not licensed to practice. One problem area: client domiciled in state with a state death tax and owns real estate in state without death tax, e.g. Florida. In past we advised to avoid probate by having out of state real estate put into FLP or FLLC with result being nexus in state of domicile. This approach today could subject the real estate to state estate tax in state of domicile.

CH: Structuring estate plan document: planning now is more complex and this results in more complex documents. Family trust (by pass trust, Trust B) is now several layers to account for state death tax implications. As asset value is higher, more of the layers of trusts are funded. CH is using Clayton flips with an independent executor.

DB: Section 691 (c) deduction for estate tax on IRD is not applicable to state death taxes. An article by Gans/Blattmachr (citation not provided) suggests pre death planning should consider accelerating IRD e.g. withdrawing IRA to create pre death income tax liability that reduces federal estate tax.

JP: Section 67 (e) 2% floor for miscellaneous trust deductions, investment management fees. This issue applies to every trust that files a Form 1041. Tax Court decision in Rudkin, 124 TC 304 states a two part test: to avoid the 2% haircut. The expense must be proper for the entity and must be unique to the fiduciary administration (the problem "but for" test). Problem: corporate fiduciary fees are fully deductible but if individual fiduciary hires an investment advisor 2% haircut is imposed. This is one reason why there is an increase in use of family trust companies.

DB: Section 643, unitrust distributions and classification as ordinary income or capital gain. Must look at state law concerning unitrusts

JP: Section 664 Charitable Remainder Trust application of ordering rules. The Regs adopt first in first out, and worst in first out approach.

JP: Surviving Spouse's Right of Election, Rev Proc 2005-24. There has been much negative comments. The panel thinks there will be some moderation but not revocation of this Rev Proc. Since Rev Proc grants a safe harbor, the safe harbor must be retained. Problems with safe harbor: taxpayer may not be married at time of CRT so spouse can not waive rights, clients move to states that may create rights after CRT formed. There could be retroactive disqualification of the CRT. Suggestion: wait for the fix before doing a CRT. ACTEC comments: if surviving spouse does exercise right of election and assets in CRT become subject to election, then under Sections 4941 and 4945, self dealing and taxable expenditures, the surviving spouse may be subject on excise taxes. Speaker does not know what IRS will do with this Rev Proc.

JP: New Unitrust Forms, Rev Proc 2005-52 through 2005-59. Turn off state law if it is inconsistent with the form. If two life unitrust and second life is not spouse, you must find a source other than CRT to pay estate tax at death of first beneficiary. Even if calendar year used as taxable year for unitrust, the annual valuation date does not need to be Jan 1.

JP: Non prorata distributions of IRD to charitable beneficiary as part of residuary estate, PLR 200520004 and 200526010. Section 691(a)(2) acceleration event can be avoided if either state law or document authorizes non prorata fractional division.

JP: Section 691(c) deduction for income tax on IRD subject to federal estate tax. Who gets the deduction? The deduction follows the income. Problem: person paying the estate tax may not be the person receiving the income. Document could require an equitable adjustment for this situation.

DB: Noble decision, 89 TC 649, valuation and significance of post death sale. Sale of asset 15 months after death at price higher than used on 706 impacted the fmV at death. Lower pre death sales where disregard as not comparable to assets held at date of death. Five factors used by court for adjusting the fmV from earlier sales to value a date of death.

JP: State lottery payments. Not assignable and rights owned at death. Issue is whether Section 7520 tables apply or whether there should be a discount since payments are not assignable. Donovan, 95 AFTR 2d 2005-2131 (DC Mass) valued rights under Section 7520 tables.

DB: Undivided interests in real estate, award of fees under Section 7430. Baird 416 F3d 442 (CA 5) reversed Tax Court and allowed fees where IRS would allow only a 3% partition discount.

JP: IRA Proceeds, Kahn 125 TC \_\_ No 11, a reviewed decision. Gross estate value of assets in IRA is not reduced by anticipated income tax liability on distribution from them.

DB: Final Alternate Value Regs Section 2032. Planning suggestion: if partnership or corporation can make a distribution after date of death and before alternate valuation date, do it. If distribution is not made then value of interest in the entity owned by the estate is higher on alternate valuation date. Consider use of derivatives to protect economic position and risk of decrease in value. Estate bears 100% of risk after alternate valuation date.

DB: Several FLP cases in 2005. Observation: carefully formed and operated entities with significant business purpose with non financial assets should be OK. Post formation facts are important and are being reviewed by the courts. Courts are looking at the governing instrument for things that are out of the ordinary. Avoid personal use assets in entity and have client retain sufficient assets for

standard of living.. To avoid Section 2036(a), a significant non tax reason for entity is needed. Some taxpayers have won cases with bad facts and do not rely on such cases.

CH: Kelly, 90 TCM 369. Does not understand why Section 2036 was not raised in this decision. Entity formed 8 months before death with liquid assets. Tax Court allowed 12% lack of control and 20% marketability discounts.

CH: Bongard, 124 TC 95, Section 2036 to be avoided, need 1. Bona fide sale, and 2. full and adequate consideration -- two separate tests must be met. For bona fide sale, need legitimate and significant non tax reason with "objective" standard being applied by the court. Decision had multiple opinions. Status and result per speaker = chaos!

JP: Strangi, 417 F3d 468 (CA 5) aff'd Tax Court. To avoid Section 2036 application, two test approach (as above - Bongard) used and taxpayer failed the second test -- bona fide sale; lacked significant non tax reason or other business purpose (note use of "or"). JP does not know what is required concerning substantial business purpose, non tax reason. The "objective test" per court seems to be a subjective smell test to JP.

JP: Schutt, 89 TCM 1353. Taxpayer victory in Section 2036 case was attribution to good facts fully documented by the taxpayer.

DB: Senda, 88 TCM 8 (2004) on appeal to CA 5 concerning discounts for gifts of FLP interests. DB is troubled by Judge Cohen's position that what is valued is what is donor relinquished not what was received. This is not the current law and would be a major change if adopted.

JP: Smith, 2005-2 USTC Para 60,508 (DC Pa) dealt with application of Section 2702 to a partnership agreement. The facts failed the pre Section 2703 tests and contractual arrangement did not fix value. Taxpayer could unilaterally amend the contractual arrangement.

Panel: FLP what should you do now?

CH: Do not go to Tax Court if you can pay tax and go refund route. Restructuring: take control test seriously and give up control. Wind is not blowing in the right direction for taxpayers and concern about unresolved application of Section 2036 (a)(2). To avoid control, taxpayer could transfer control interest to an irrevocable trust with an independent trustee and to avoid taxable gift retain a power of appointment. This will not avoid estate tax on the assets in the trust but cuts off the control issue. Note the 3 year look back under Section 2035 (a) for giving up a Section 2036 right.

JP: Watch out if sale of interest to avoid Section 2035 3 year look back! Allen case (citation not provided) states that full and adequate consideration to avoid Section 2035 is measured by what would be in the gross estate under Section 2036. If this amount was paid, it could be a current gift since it would exceed fmv for gift tax purposes.

DB: Get rid of control. Do not create a new entity unless there is a significant business activity. Generic reasons used in the past will not be sufficient today. Watch the formalities.

DB: Greagin [56 TC 387 (1988)] loans, up front interest deduction on 709 for funds borrowed to pay estate tax. TAM 200513028 IRS would not allow interest deduction because partnership that loaned funds had liquid assets and was controlled by estate beneficiaries.

CH: Jackson, 2005-2 USTC para \_\_\_\_ (DC W. Va). Trust was not reformed, and at termination assets went directly to charity -- Section 2055 (e) not followed. Per court, charity got the funds so no problem and deduction allowed.

JP: Marital deduction and income requirement. Davis, 85 TCM 944 (2003) deduction denied because of restrictions on spouse's right to trust income, aff'd by CA 9. Survivorship requirement should be based on time and not closing of estate - Sowder, 2005-2 USTC para \_\_\_\_ (DC Wash).

DB: Qualified disclaimers, Section 2518, Rev Rul 2005-36. Beneficiary's acceptance of RMD after death of participant did not prevent disclaimer of balance of IRA.

CH: Final Reg under 2632(c)(5)(A)(i). Speaker humorously stated that she is one of the 5 persons who are guardians of the generation-skipping transfer tax rules. Regs give a lot of flexibility to electing out and electing in.

She suggests do not rely on automatic application. Attach statement to Form 709 stating what you are electing and identifying the applicable trust. Can be adoption by grandparent of grandchild if requirements met. Also, if a grandchild is adopted by a non lineal descendant (second spouse of deceased child), the adoption does not cut off lineal descendant relationship with grandparent.

JP: Blount, 87 TC 1303 (2004) affi'd by CA 11 (citation not provided) deals with valuation of corporation that owned life insurance on decedent's life and had obligation to purchase decedent's shares in the corporation. CA 11 reversed TC on valuation. CA 11: we conclude that the insurance proceeds are not the kind of ordinary nonoperating assets that should be included in the value of the corporation under the treasury regs.

DB: Chawla, 2005 US Dist. LEXIS 3473 (ED Va). Insurance company refused to pay death benefits alleging fraud in the life insurance application and lack of an insurable interest. Court held for insurance company on both arguments. Problem now: does trustee of an irrevocable insurance trust have an insurable interest (probably no if it is considered an entity and yes if there is look through to qualifying beneficiaries). Decision is on appeal to CA 4 which probably will affirm on fraud argument and not get to insurable interest argument. This issue creates problems in other states since many states have statutes similar to statute involved with this case.

NOTE: We are also suppose to receive a report on this session from Reporter Bruce Stone. In the interests of sending this one out as soon as possible, we are sending it now. When and if Bruce's report arrives, we will send it out separately at that time.

=====  
News From The Exhibit Hall  
=====

From WealthCounsel ([www.wealthcounsel.com](http://www.wealthcounsel.com)) comes the news that they are demonstrating the latest version of their document drafting system, WealthDocs 6.2, which is being released this

quarter at Heckerling. WealthDocs 6.2 is an upgrade of WealthDocs 6.1 that was first released at Heckerling in 2005. More details on this new release will be forthcoming later. The main reason for this announcement is to let you all know about the "Thriving in Estate Planning Practice Model" presentation that WealthCounsel is presenting on Wednesday, January 11th, from 6:00 to 7:00 p.m. in the Imperial I room of the Fontainebleau Hotel. To attend, contact the WealthCounsel booth at Heckerling (Nos 18 and 19) or fax your name and phone number to 1-888-292-6126. This presentation is going to be done by Stan Miller of Miller & Schrader, PA in Little Rock, AR. This is described as a simple yet exciting Practice Model for working more effectively as an attorney-advisor team using the power of collaboration between the attorney and financial advisors in together designing solution sets that can include both insurance and financial products as well as legal solutions. Sounds interesting.

Schumaker Publishing, Inc. has some Year 2006 specials currently going on. One, they are selling a value pack of 250 copies of one of their Quick-Read brochure of your choice for only \$212.50 plus \$20 s/h (a savings of \$49). Two, they are selling 250 copies of their Client Newsletter for \$212.50 plus \$20 s/h (a savings of \$49). Third, they are selling 100 of their brochures or newsletters free with every one of their Powerpoint Seminars that is purchased, a \$100 value. These offers are good until 1/31/06. For free samples and pricing information, visit [www.estateplanning.com/specials](http://www.estateplanning.com/specials).

---

Our on-site local reporters who are present in Miami this year are Gene Zuspann Esq. of Zuspann & Zuspann in Denver, Colorado, Bruce Stone of Goldman, Felcoski & Stone, PA in Coral Gables, Florida (a member of the Institute's Advisory Committee), Herb Braverman of Walter & Haverfield, LLP in Cleveland, Ohio, Jeff Weiler of Benesch, Friedlander, Coplan & Aronoff, LLP in Cleveland, Ohio, Merry Balson of Wade, Ash, Woods, Hill & Farley in Denver, Colorado, Barbara Dalvano of Isaacson & Rosenbaum, PC in Denver, Colorado, Paul Hood of Dickenson, Peatman & Fogarty in Napa, CA, and Joanne Hindel of Fifth Third Bank in Cleveland, Ohio. The editor again this year will be Joseph G. Hodges Jr. Esq, a solo practitioner in Denver, Colorado who is the Chief Moderator of the ABA-PTL List.

#### GENERAL INFORMATION ABOUT INSTITUTE

##### Inquiries/Registration

Philip E. Heckerling Institute on Estate Planning University of Miami School of Law Center for Continuing Legal Education P.O. Box 248087 Coral Gables, FL 33124-8087

Telephone 305-284-4762 / FAX 305-284-6752

Web site [www.law.miami.edu/heckerling](http://www.law.miami.edu/heckerling)

E-mail [heckerling@law.miami.edu](mailto:heckerling@law.miami.edu)

---

Brought to you by the ABA-PTL Discussion List Moderators