# 46th Annual Philip E. Heckerling Institute on Estate Planning January 9-13, 2012

# *Report No. 5 (Wed. 1/11 Cont. & Thur. 1/12)*

## Heckerling 2012

### University of Miami School of Law Center for Continuing Legal Education

Orlando World Center Marriott Resort and Convention Center
Orlando, Florida
http://www.law.miami.edu/heckerling

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NOTICE: Although audio tapes of all of the substantive session at the Miami Institute currently are only made available to Institute registrants for purchase, the entire proceeding of the Institute are published annually by Lexis/Nexis. For further information, go to their Web site at http://www.lexisnexis.com/productsandservices. The text of these proceedings is also available on CD ROM from Authority On-Demand by LexisNexis Matthew Bender. For further information, contact your sales representative, or call (800) 833-9844, or fax (518) 487-3584, or go to http://www.bender.com, or write to Matthew Bender & Co., Inc., Attn: Order Fulfillment Dept.,1275 Broadway, Albany, NY 12204.

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As we have done in January for the last fifteen years, and again with the permission of the University of Miami School of Law Center for Continuing Legal Education, we posted daily Reports to this list containing highlights of the proceedings of the 46th Annual Philip E. Heckerling Institute on Estate Planning that is being held on January 9-13, 2012 at the Orlando World Center Marriott Resort and Convention Center in Orlando, Florida, a new venue for the Institute starting in 2007. A complete listing of the proceedings and speakers is available at www.law.miami.edu/heckerling.

We also will be posting the full text of each of these Reports on the ABA RPTE Section's Web site, as we have since the 2000 Institute. Those Reports can now be found at URL http://www.americanbar.org/groups/real_property_trust_estate/events_cle/heckerling_reports.html.
In addition, each Report can also be accessed at any time from the ABA-PTL Discussion List's Web-based Archive that is now at URL http://mail.americanbar.org/archives/aba-ptl.html by registered subscribers to that List or by anyone at the List's public archive at http://home.ease.lsoft.com/scripts/wa.exe?A0=ABA-PTL-PUB.

Note that all ABA-PTL Reports are published with the prior permission and approval of the Heckerling Estate Planning Institute and only after they are reviewed for accuracy of content and proper formatting by the Editor and, where requested, by the Presenters

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# Announcements:

From Crescendo: The Board of Directors of the American Council on Gift Annuities (ACGA) announced that gift annuity rates changed again on January 1. 2012. The new rates will be 0.5% to 0.8% lower than the previous schedule. The primary factor in reducing the rates is a lower yield on ten-year Treasury bonds. To view these new rates, go to www.CrescendoInteractive.com.

From Mercer Capital: Complementary copies of enhanced editions of Buy-Sell Agreements for Closely Held and Family Business Owners and An Estate Planner's Guide to Revenue Ruling to Revenue Ruling 59-60 were released by them at this Institute and they are only available during the conference.

From BNA: Attendees are encouraged to stop by and learn more about their Estates, Gifts and Trusts Portfolios Library that are written by the nation's leading estate and gift tax experts.

From US Trust: Attendees are invited to stop by their booth and participate in a demonstration of their long-standing Practical Drafting publication and related products.

From the Exhibit Hall: The exhibit hall will be open Friday 8:00 AM until 12:00 Noon but be aware that many of the vendors will begin packing up to go home after the mid-day break from 10:40 to 10:50 AM.

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Content: This Report contains reports on some of the Wednesday Special including Using Annuities in Estate Plans, Planning for the New Medium Sized Estate ($5 MIL to $15 MIL), and the Thursday Special Session Elder Financial Abuse.

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Wednesday, January 11, 2012 –

# Special Sessions I

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2:00 - 3:30 p.m.

## Session I-F - Using Annuities in Estate Planning: Opportunities and Pitfalls (Financial Assets Series)

Presenters: Mary Ann Mancini, John L. Olsen and Melvin A. Warshaw
Reporter: Kimon Karas

Using commercial annuities in an estate plan has never been a very popular technique, but with the uncertainties in the economy and the new products out there, planners may be ignoring what could be a valuable tool to achieve important goals for the family. The panelists discussed how annuities work financially, what the tax ramifications are when dealing with these assets and the benefits (and drawbacks) they can provide to the estate plan. This report covers the more significant highlights of this presentation.

The topic addressed the concept of commercial nonqualified annuities in estate planning. In certain cases an annuity may be appropriate in lieu of a trust because of expense, trustee selection, and/or flexibility. Common situations where an annuity may be appropriate instead of a trust, where one desires a disposition to an employee, household help where the annuity will provide the person a stream of income. Alternatively one desires to make a gift to a person and for the gift to be confidential an annuity may be appropriate.

An annuity in a trust poses many problems. Do trust powers authorize the purchase of an annuity. If the trust must qualify for the marital deduction paying the spouse all the annuity income will not satisfy the all income requirement. In an all income trust, marital or nonmarital, distributing the annuity would probably be considered an impermissible distribution of principal.

The panel reviewed the income tax consequences of an annuity. All amounts distributed from an annuity, during life or death, are either (i) "amounts received as an annuity, or (ii) "amounts not received as an annuity."

Amounts received as an annuity are treated part as a return of investment and part as ordinary income. For annuities with an annuity starting date after 12/31/86, this treatment, exclusion ratio, applies only until all of the investment in the contract is received and thereafter all receipts are taxable income.

Amounts not received as an annuity are taxed depending on issuance date. Contracts issued prior to 8/14/82, return principal first and contracts issued after that date return income first.

Amounts received as an annuity include among others, withdrawals, loans, and pledges.

The tax deferred treatment of gain in an annuity is not granted by specific Code reference, but by implication. A deferred annuity does not enjoy tax-deferred treatment:

1. When held by a "non-natural person" Section 72(u);
2. Applies to extent of contributions after 2/28/86.

Exceptions to that treatment for:

a. Qualified contracts;
b. Qualified funding asset;
c. Immediate annuities;
d. Contracts acquired by estate by reason of death;
e. Where the holder is acting as "agent of a natural person"
    i. Corporation as holder;
    ii. Family limited partnership as holder;
    iii. Trust-most revocable trusts and many irrevocable trusts except where a trust beneficiary included a "non-natural person."

Distributions from an annuity can incur penalty tax10% of amount includable in income. Section 72(q). Exceptions are;

1. After person reaches age 591/2;
2. By reason of death of holder;
3. Taxpayer's disability;
4. Substantially equal periodic payments.

Taxation at death. If contract in payout status at least as rapidly as distributions were being made to decedent owner. However, if distributions are made to a beneficiary under a “refund feature” they are not taxable until all investment in the contract has been received.

If the contract was not in payout status, the entire value must be distributed within 5 years unless:

1. Contract is payable to or for the benefit of a designated beneficiary in which case contract may be distributed over no longer than beneficiary’s life expectancy; (Section 72(s)(2))
2. If beneficiary is surviving spouse, the spouse may treat the contract as spouse’s own contract-“spousal continuation.” Section 72(s)(3).

Death benefits should be paid to the owner/beneficiary who should be the same person. Complications arise if the contract is annuitant driven (death benefit paid upon death of annuitant), but since 1/18/85, all contracts are owner driven (death benefit paid upon death of owner). If the owner and beneficiary are the same the death of the owner will trigger distribution of the entire contract at owner’s death.

However, if the contract is annuitant driven and the non-annuitant owner dies, depends on contract terms, which can vary. For example an annuitant driven contract when the annuitant dies first. If the owner beneficiary is the spouse the spouse cannot do a spousal continuation; and if a third party is beneficiary, the death benefit is payable to a third party with spouse having no rights to the contract; the beneficiary will be liable for all gain in the contract, beneficiary may be liable for 10% penalty as the exception for distribution by reason of death of holder is not applicable, and owner spouse will be deemed to have made a gift of entire value of annuity to beneficiary.

Avoid at all costs a jointly owned annuity.

Annuities and trust. Where the trust owns and is the beneficiary of the annuity. Annuity must be distributed within 5 years of grantor’s death and trust must pay tax on annuity gain. Annuity owned by an irrevocable non-grantor trust will cause distributions during lifetime of annuitant to be subject to 10% penalty and if trust does not qualify as “agent of natural person” annuity gain will be taxable as earned. If the annuity is owned by an irrevocable grantor trust depends on the company some say the death of the grantor will trigger the distribution, others say the death of the annuitant.

If the trust is the beneficiary, a very common situation, where the annuity is payable to annuitant’s revocable trust. If contract is owned by a married individual and spouse is the beneficiary, the spouse has the following options;

1. Lump sum;
2. Distributions over 5 years;
3. Distributions over spouse’s life expectancy;
4. Spouse treats annuity as her own.

If the trust is the beneficiary, spouse forgoes options 3 and 4 above even if she is sole trustee and sole beneficiary of trust.

Summary

1. Read the contract;
2. Annuity is a tool not a magic bullet;
3. Annuitant and owner should be same person;
4. Don't make annuity payable to trust without good reason;
5. Don't name joint owners without good reason;
6. Be alert to tax triggers, taxation on gain by giving contract, pledging as collateral.

The panel then presented a number of power point examples [available from Mary Mancini upon request] and concluded with two scenarios. One example based on TAM 9825001 dealt with funding a NIMCRUT with a deferred annuity. The TAM held purchase of annuity was not self-dealing; it did not affect trust's qualification as a CRT, and the trust's right to receive either the cash value or the surrender value in the contract did not create trust accounting income under Code Section 643(b). However, all distributions to the beneficiary will be taxable ordinary income.

The last example was the use of a deferred annuity to fund a retirement benefit. The example used as a grandparent funding a trust for a grandchild with a deferred annuity with a payout not to arise until the grandchild attains age 65, unless the grandchild becomes disable. The panel recommended if one contemplates such a strategy make certain the trust has built in flexibility if for any reason the annuity does not perform as anticipated or any other unanticipated changed circumstances.

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Wednesday, January 11, 2012 –

# Special Sessions II

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3:50 – 5:20 p.m.

## Session II-A - Planning for the "New Medium Sized" Estate of $5 to $15 Million (Focus Series)

Presenters: Thomas W. Abendroth, Christopher R. Hoyt and Joshua S. Rubenstein
Reporter: Carol Sobczak

An examination of planning options for a class of wealthy taxpayers who suddenly find themselves in the sandwich generation – with enough wealth to be taxed but not enough to give away. There was an analysis of lifetime and testamentary wealth transfer strategies, as well as a focus on what happens to retirement assets that could be hit with a double-whammy of estate and income taxes.

This special session focused on fundamental planning principles for clients who have large enough estates to be concerned about planning, but are not at the top tier of wealth. Here are the more significant highlights of this session.

We may think that clients worth $15 million should just give away $5 million, but our clients would probably disagree. As with the $1 million to $5 million estates, they also are concerned with having enough to live on.

1. Lifetime Planning. The lifetime planning issues for these clients include making certain they have valid advance directives and durable powers of attorney in place. Find out if they have separation agreements or pre-nuptials.

Dynasty trusts may not be appropriate for these clients due to the value of the trusts. Be very careful with tax apportionment clauses. For example, leaving a specific gift of a $5 million painting to one child and the residue of $5 million to the other with taxes coming out of the residue will treat those children quite differently.

Avoid probate contests by not disinheriting one child completely, as that child would have no incentive not to contest.

Check the character of property of clients moving to or from community property states and draft marital property agreement to keep character of community property to keep the step-up in basis at the first death.

Check life insurance policies for conversion options. If proceeds would be includable in gross estate, it may be wise to pull out some cash value for the clients' use.

Make annual exclusion gifts and pay tuition and medical expenses which are excluded from gift tax.

It may be a very good time for private annuities as assets are devalued and the federal rate are low.

If clients have a small business that is less than 35% of their gross estate, they may want to transfer assets to the business to get it over 35% to qualify for small business treatment.

2. Testamentary planning. Testamentary planning can include making death-bed transfers in states that have a separate death tax with a lower threshold than the federal tax.

Check marital formula clauses. The optimum marital deduction may not be appropriate for these clients, especially in second marriages.

Also check GST formula clauses. In a $10 million estate, the maximum amount of GST exemption, which has increased from $2 million to $5 million, may not be the appropriate amount to pass to children in trust. Consider using percentages of the estate, or a formula that gives a specific amount "but not more than" a certain percentage of the estate.

3. Retirement Planning. Retirement planning issues can be complicated because of the interplay of income and estate taxes, and many clients in this bracket have a large percentage of their estates in retirement plans. Another issue is that you can't give these assets away during your lifetime.

If a client is ill, it is better to take the minimum distribution early in the year so the beneficiary doesn't get hit with both income and estate taxes. Another device is to convert to a Roth IRA to save estate taxes. See Rev. Rul. 94-27 and PLR 200336020. Remember that you can also reverse the Roth IRA conversion anytime before the client's income tax return is due in the following year.

Finally, consider a charitable bequest of a portion of retirement accounts since charities pay no taxes. Or name the charity as a contingent beneficiary and have the primary beneficiary disclaim all or a portion. Make certain the charity is a donor-advised fund so that the primary beneficiary can have the assets used for a purpose the beneficiary considers important.

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Thursday, January 12, 2012 –

# Special Sessions III

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2:00 - 3:30 p.m.

## Session III-E Elder Financial Abuse: Protecting the Aging Client from the Den of Thieves (litigation Series)

Presenters: Bruce S. Ross, Dana G. Fitzsimons, Jr.and Vivian L. Thoreen
Reporter: Joanne Hindel

This session discussed the legal and ethical issues involved in deterring, minimizing, and even avoiding elder abuse through: state laws; estate and elder law planning; use of powers of attorney, medical directives, and trusts; pre-death will contests; and other techniques. It also discussed strategies for litigating the elder financial abuse case, including: discovering abuse; adult guardianship litigation; the powers and limitations of the civil courts; multi-jurisdictional issues and judgment enforcement; and coordination with local, state, and federal authorities. Highlights from this session are reported here.

Bruce started out by saying that Elder abuse can be physical, emotional/psychological, sexual and financial. The largest number of cases reported involves family and friends and caregivers, loss to the elderly through commercial, financial abuse is the highest.

While definitions of the term elder financial abuse varies from state to state the central concept is the misuse of the elder's money or property.

He mentioned that he and Vivian represented Mickey Rooney who had personal experience with elder abuse at the hands of relatives.

Dana then discussed the initial ethical challenges lawyers face when representing the elderly.

When deciding whether to represent an elderly person who may have suffered financial abuse, the lawyer must first determine whether the client has the requisite capacity to enter into an attorney-client relationship. With an existing client, the lawyer's actions are somewhat different. When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment of for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.

If the lawyer believes that the client is at risk of substantial physical or financial harm the lawyer may take reasonably necessary protective action including the possible appointment of a guardian ad litem, conservator or guardian.

The lawyer will often have valuable information about the capacity of the client and must carefully consider the ethical duty of confidentiality when approached by family members for information or when contemplating the right course of action to protect a client with diminished capacity. One possibility is to have the client sign a release allowing the attorney to reveal confidences if necessary.

Dana emphasized, however, that the lawyer should not represent an elderly client in estate planning matters and in matters pertaining to a guardianship and should never bring an action against a client for a determination of competency.

Vivian then discussed forms of deterrence for elder abuse.

Litigation is a form of deterrence against financial elder abuse. Some states have enacted statutes that strip the inheritance rights of persons who commit financial elder abuse. She reviewed a few of the states that have partial disinheritance statutes and indicated that these could be improved upon for better protection of the elderly.

Vivian then covered another method of preserving an elderly person's assets through the use of pre-death probate. Another method is through the use of traditional will contests post death.

The advantage of the pre-death probate approach is greater certainty for the testator as well as the ability of the testator to testify as to intent and defend against challenges. The disadvantage to the process is the fact that the testator may still revoke a will so the action can be ultimately just a waste of judicial resources. The process may also damage family relations.

Another method to deter attempts at financial abuse is through the use of no contest clauses in wills which are available and enforced in most states.

The panelists then turned to the topic of punishing a thief and reviewed both civil and criminal statutes. Vivian said that actions against those who engage in financial elder abuse can be civil and/or criminal actions.
Generally, the burden of proof in civil actions is usually a preponderance of the evidence. In criminal actions, the burden is beyond a reasonable doubt. Damages in civil actions usually entail restitution while criminal actions may result in restitution as well as prison sentences.

She pointed out that in the case of Brook Aster whose son was convicted of engaging in financial elder abuse against his mother, he only got 1-3 years in prison despite having taken millions from his mother.

Vivian then discussed the pros and cons of jury versus bench trials in the actions against the thieves.

Dana concluded the discussion with a review of the Uniform Adult Guardianship and Protective Proceedings Jurisdiction Act (UAGPPJA) that was promulgated by NCCUSL in 2007 and deals with jurisdictional issues with respect to conservatorships and guardianships.

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Our on-site local reporters who are present in Orlando in 2012 are Joanne Hindel Esq. of Fifth Third Bank in Cleveland, Ohio; Kimon Karas Esq. of McCarthy, Lebit, Crystal and Liffman Co. LPA in Cleveland, Ohio; Craig Dreyer Esq., Attorney At Law, in Stuart, Florida; Mike Stiff Esq. of Stiff, Zisman & Ingraham, P.C. in Denver, Colorado; Herb Braverman Esq., Attorney At Law, in Orange Village, Ohio; John Warnick Esq. of Family Wealth Transitions & Solutions in Denver, Colorado; D. Scott Robinson Esq. of Long, Reimer & Winegar in Boulder, Colorado and Cheyenne, Wyoming; Jason E. Havens Esq. of Havens & Miller in Destin, Florida and Carol A. Sobczak of Favaro, Lavezzo, Gill, Caretti & Heppell, PC in St. Helena, California.

The compiler of periodic discussion threads from certain public and private e-mail discussion lists such as ABA-PTL, ABA-TAX, ACTEC-PRAC and WealthCounsel's WCLS is Stanbery (Stan) Foster Jr. Esq. of Williams, Kastner & Gibbs PLLC in Seattle, Washington.

The editor again in 2012 is Joseph G. Hodges Jr. Esq., a solo practitioner in Denver, Colorado, who is also the Chief Moderator of the ABA-PTL List.