50th Annual Philip E. Heckerling Institute on Estate Planning
January 22-26, 2018
Heckerling 2018 - Report No. 3
(Tuesday 1/23/18)

Heckerling 2018
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

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 E-mail: heckerling@law.miami.edu

Headquarters Hotel - Orlando World Center Marriott
8701 World Center Drive
Orlando, FL 32821
Telephone (407) 239-4200, FAX (407) 238-8777

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, other than the afternoon special sessions, 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

NOTICE: The content herein is to be used for information purposes only. Neither the Heckerling Institute nor the University of Miami represent or warrant the accuracy or completeness of the information contained in these Reports, and do not endorse the content. Moreover, the views expressed herein do not necessarily reflect the views of the Heckerling Institute or the University of Miami. In no event will the Heckerling Institute or the University of Miami be liable for any damages that might result from any use of or reliance on these Report.

This reporting service is brought to you by the ABA-PTL Discussion List Moderators. The URL for the ABA-PTL searchable Web-based Archives is: http://mail.americanbar.org/archives/aba-ptl.html.
Heckerling 2018 - Report No. 3

As we have done in January for the last twenty one 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 52nd Annual Philip E. Heckerling Institute on Estate Planning that is being held on January 22-26, 2018 at the Orlando World Center Marriott Resort and Convention Center in Florida. A complete listing of the proceedings and the Institute's 2018 brochure are available at www.law.miami.edu/heckering. Introduction Part 1 issued on 1/11/18 covered the Institute Opening Reception, its Scope, the Faculty, the Advisory Committee, the Sponsors and the Vendors, plus general information at the end about the Institute. Introduction Part 2 issued on 1/12/18 contained a complete listing of all of the proceedings of this Institute. This Report continues our coverage of the proceedings.

We also will be posting the full text of each of these Reports on the ABA RPTE Section's Heckerling Reports Website, as we have since the 2000 Institute. The Reports from 2000 to 2017 can now be found at URL http://www.americanbar.org/groups/real_property_trust_estate/events_cle/heckerling.html. In addition, each Report from 2006 to date can also be accessed at any time from the ABA-PTL Discussion List's Web-based Archive that now only goes as far back as January of 2006 and is located at URL http://mail.americanbar.org/archives/aba-ptl.html.

Announcement: The Real Property, Trust and Estate Law Section is among the exhibitors at this year's Institute. They are holding forth at Booths 225 and 227. In addition to special show prices on many of the Section's publications, information about the many activities and resources the Section offers is available there, as is information about how to become a member of the Section and how to subscribe to its ABA-PTL Discussion Listserv. Unfortunately you have already missed the chance to get a free ticket to their free breakfast that was held this morning.

Summary: This Report #3 continues our coverage of the general sessions that were held on Tuesday, those being managing tax basis, money in politics (Lloyd Leva Plaine lecture), buy-sell agreements and will drafting and contests.

The next Report #4 will begin our coverage of the Wednesday morning general sessions and afternoon special sessions 1 and 2.

Tuesday, January 23, 2018 (cont.)

9:00-9:50
Putting It On & Taking It Off: Managing Tax Basis
Today for Tomorrow [FIN]
Presenter: Paul S. Lee
Reporter: Kristin Dittus

This lecture refreshes us on the “free basing” methods introduced by Paul Lee at Heckerling in 2014 with “Venn Diagrams” and with “Modern Uses of Partnership” in 2016. In addition to highlighting how to effectively manage tax basis to avoid unnecessary capital gains tax or create basis in partnership assets, today’s lecture provides a foundation for deeper consideration in the small special session panel that will be held Wednesday January 24 at 2:00 pm. The power point used during the presentation is now available for download on the Heckerling App.

With the higher Applicable Exclusion Amounts (“AEA”) ushered in by ATRA starting in 2010 and doubled under the new Tax Cuts and Jobs Act of 2017 (“new Tax Act”), planners have a lot of room to maximize the step up in basis upon a client’s death to minimize income tax consequences on low basis assets.

Using the AEA during life. Mr. Lee advises caution in using available AEA during the client’s life. Be aware there could be a claw back under a new subsection of IRC §2001 once the higher AEA sunsets in 2026. Perhaps limit lifetime use to the $5M indexed for inflation from 2010 or use a GRAT to avoid the use of the AEA during life. A wait and see approach may be best.

Distinguishing Various Assets Classes: It is important to identify which assets will benefit most from a step up and organize the client’s estate to maximize this benefit. Using a chart to illustrate this, assets such as IRAs, cash or high basis stock would benefit the least from a step up, while a step up in depreciated commercial real estate, copyrights and low basis stock would offer significant benefits. Mr. Lee predicts an increase in the use of Qualified Small Business Stock (“QSBS”), discussed below.

Using Grantor Trust Swaps. Benefits under the new Tax Act include no change to the step-up in basis at death and grantor trust rules. Mr. Lee recommends using the Grantor's swap power to exchange high basis assets for low basis assets, cash for a loan, and to execute a promissory note for appreciated assets.

Use of a General Partnership. In an example where a senior partner holds a 40% interest and a younger partner has 60% interest, get low basis assets to the senior partner’s share. Contribute assets to an LLC Holding Company, then convert entity to a general partnership to maximize the step up in basis because we are no longer trying to achieve valuation discounts. Use a §754 Election to achieve a step up. For advanced planning, create a separate entity for assets benefiting the most from §754 election to minimize the administrative complexity.
Use Debt to Multiply the Step Up in Basis. Qualified liability results in an estate
deduction under §2053(a)(4); qualified debt can be created with zeroed-out transfers or
a private split-dollar loan.

Double Step Up. Suggestions to achieve a double step up, as enjoyed by those in
community property states, may be done with a Joint Exempt Step-Up Trust (JEST) or,
preferably, a Section 2038 Estate Marital Trust. This trust creates estate inclusion under
§2038 by allowing the deceased spouse to terminate and is also a completed gift
because assets do not go back to such spouse. However, inadvisable if divorce is a
potential risk.

QSBS (§1202) – the Tenfold Basis Option. Contribute the assets of an LLC for C-
Corporation stock, looking for attain high basis on the conversion. Be careful to avoid
capital gains tax on conversion if possible. Sec. §1202 allows the fair market value
(FMV) of the asset to become the new basis on the conversion. New §199A uses §1202
definitions so they work well together. Example: adjusted basis is $10; FMV is $100;
§1202 allows you to adopt $100 as the new basis upon conversion to C-corporation.

Contract Derivatives to Achieve Step Up. Sell the appreciation to a grantor trust (IDGT)
and retain the asset. There is a risk if the contact is not completed before the Grantor
dies, as the appreciation may be considered ordinary income. Consider the effect of
new §1061, but not yet fully understood.

Installment sale to IDGT and Outstanding Promissory Note. If Grantor sells an asset to
an IDGT ($50M), he holds a note and accrues interest over many years. Asset FMV
grows to $100M. Under §1001 (Crane v. Commissioner), there is a potential gain of
$50M when there is a conversion from a Grantor to a non-Grantor trust on death. To
avoid this result, create an LLC and contribute both the promissory note and the asset to
the LLC. If the LLC owns both the asset and the liability, the liability disappears. No
transfer tax because the Grantor owned both. See Rev. Rul. 99-5 regarding this kind of
transfer. Use a §754 election and a 743(b) adjustment to strengthen the transaction.

The Magic of Partnerships. The Wednesday special session will go in depth on how to
strip and shift basis among partnership assets. The ideal partnership has mixed basis
“old and cold” assets, being in the entity for more than 7 years. The partnership
distributes a high basis asset through an in kind distribution to a senior partner,
resulting in a zero basis to the partner and allowing allocation of the remaining basis to
the other partnership assets. This allows the partnership to change the basis of assets
without a taxable event.
Lloyd Leva Plaine Distinguished Lecture - Money in Politics: A Hydraulic or a Legal Issue?
Presenter: Trevor Potter
Reporter: Herb Braverman

For over a century federal law has attempted to regulate the sources and amounts of money in elections. The result proves to some that money is a hydraulic force: efforts to channel it only result in broken dikes and washed away dams. Others believe that the problem is inartful drafting, failed regulators, partisan greediness, the leveraging of the tax code to subvert the campaign finance laws, and a Supreme Court which has no understanding of how politics and the legislative system actually work. Which is it?

This presentation was this year's LLOYD LEVA PLAINE DISTINGUISHED LECTURE and was presented by Mr. Potter, the President of the Campaign Legal Center. He has had a great deal of experience with the subject matter, having served as a Commissioner and Chairman of the Federal Election Commission, among other related duties and positions, perhaps the most well known of which is his having been the advisor for Stephen Colbert and his Super PAC and his involvement with the Citizens United case during the last election cycle.

Mr. Potter reviewed the history of money in politics, beginning as far back as 1913 and tracing it through the current period, which I felt he clearly considers as a terrible blot on our democracy and a potential serious risk to its future survival. He provided a lengthy and detailed outline, and I would recommend your obtaining his materials if you are interested in this very important issue—if not as an estate planner or related professional, then perhaps at least as a concerned American.

The gist of the story here appears to be that money once had a role in our governing processes that was disclosed to the public and limited (by amount and by purpose) in various ways by various agencies, including the FEC, the IRS, the SEC and, of course, Congress. Unfortunately, while the process was already somewhat strained, it became “broken” when Justice Alito replaced Justice O’Connor on the US Supreme Court and the Court decided the well-known Citizens United case in 2010. Thereafter the cases have essentially removed any sense of limitations on political contributions, making undisclosed contributions in various USC 501 devices in unlimited amounts the basic fuel of the very expensive campaigns we are experiencing at the federal and state levels today. Hence the term “dark money” and Mr.
Potter’s concerns that this system will only get worse unless somebody (I think he meant us) stands up enough to get the foxes out of the hen house.

2:50-3:40

**Buy-Sell Agreements: A Critical Part of Any Business Formation [CHB]**

Presenter: Louis A. Mezzullo

Reporter: Kimon Karas

This session discussed the objectives and key tax and non-tax issues when drafting a buy-sell agreement for a closely-held business.

Reasons for such agreements include, setting value for estate/gift tax purposes, establishing where funds will come from to pay estate taxes, restrict lifetime/death transfer, income tax considerations, where will interest pass at death. Most often a CPA is the initial contact with clients regarding the need for such an agreement. The planning team will include CPA, attorney, insurance consultant, trust officer, investment adviser. Lou insists at formation stage that clients consider as part of engagement a buy/sell agreement.

I. Definition. Agreement between owners of a business, or owners and entity, to purchase and sell interests of the business at price determined upon future events arising. Events include death, disability, divorce, outside offer, bankruptcy, or termination of employment. Considerations will be the same irrespective of business form.

II. Items of significance regarding agreements.

A. Due to repeal of General Utilities increased use of S corporations and partnerships.

B. LLC as a preferred form of business entity.

C. Section 2703.

III. Objectives.

A. Avoid disputes among owners. From perspective of entity avoid termination for example of S corporation status.

B. Attorney must avoid conflicts of interest and advise that owners need to seek separate counsel.

IV. Buy/sell may be a cross purchase agreement between owners or a redemption agreement with the entity. If using a redemption agreement with a C corporation with a mandatory obligation to purchase make certain corporation is obligated party and not shareholders. If corporation purchases the shares that shareholders were obligated to purchase the shareholders will receive a constructive dividend.
V. If agreement is insurance funded a large number of shareholders may make cross purchase cumbersome requiring multiple policies. Consider use of partnership or trust to purchase and hold policies.

VI. Premium payments on life insurance policies used to finance the purchase are not deductible whether premiums are paid by the entity or owners.

VII. Watch transfer for value rule. Exceptions include policy transferred to an insured, a partner of the insured, a partnership in which insured is a partner, or a corporation in which insured is an officer or shareholder. A solution with a cross purchase agreement is to use the partnership. Caveat, IRS will no longer rule whether a transfer of a life insurance policy to an unincorporated entity will be exempt from transfer for value rule when substantially all of entity’s assets consist or will consist of life insurance policies. Rev. Proc. 2017-3. Lou suggests the transfer for value rule should not apply if the trust owns policies pursuant to a cross purchase arrangement.

VIII. With repeal of corporate alternative minimum tax, a C corporation owner of policy will not be subject to alternative minimum tax on receipt of life insurance proceeds. C corporation must be mindful of accumulated earnings tax exposure; however accumulating funds for purchase of minority shareholder may be considered reasonable needs of the business as well as accumulations in the year of death to redeem a shareholder under Section 303.

IX. Credit consideration may dictate who is the purchaser, entity or owners.

X. Capital gain treatment is assured in a cross purchase transaction and may not be due to family attribution rules when corporation is redeeming shares. If redemption by a C corporation fails to qualify as a capital gain the result is a dividend with the consequences the purchased party cannot use installment method of reporting gain and no basis offset.

XI. State law may restrict corporation’s ability to redeem shares. Consider if that is an issue that shareholders take action to make acquisition satisfy state law requirements or mandate shareholders be purchasers if corporation is prohibited from purchasing.

XII. In a redemption transaction the basis of remaining shareholders shares is not affected; whereas in a cross purchase the purchasing shareholders obtain cost basis in shares purchased. Basis is not an issue if the entity in question is a flow through since owners of flow through obtain basis regardless of the form of agreement.

XIII. In a C corporation interest paid on an installment obligation to purchase the shares under a cross purchase agreement will be treated as investment interest. If C corporation is redeeming the shares the interest is deductible; however, 2017 Tax Act limits interest deductibility. In the case of a flow through interest paid by owners on a cross purchase will need to run through interest tracing rules, either deductible as business interest, investment interest or passive interest.

XIV. Other considerations. Under a cross purchase if excess life insurance proceeds are received they are retained by the owners; however in a C corporation context in order for shareholders to get at excess proceeds requires most likely a dividend payment. In a buy sell scenario if other family members hold equity, consider in the agreement allowing the family to purchase the interest to retain its percentage ownership.
XV. Triggering events. Triggering events may include, death, retirement, disability, attempted sale to outside 3rd party, termination of employment, divorce, or bankruptcy. If employment termination is for cause or owner is associating with a competitor, consider a reduction in the price paid. In bankruptcy context a price that is not reflective of fair market value may not be enforceable.

XVI. Setting the price. Best is an outside appraisal. Others are fixed price (with automatic adjustment if price not fixed within identified time period, i.e. 1-year of triggering event), book value or adjusted book value, capitalization of earnings (but may need to adjust if earnings are not reflective of true earning capacity, i.e. high or low compensation paid to owner/employees), put & take (“Texas standoff”) works only if both sides have equal bargaining power. Be cognizant of price and impact on marital deduction. If price is not respected by IRS, marital can be reduced or denied. See Estate of Rinaldi (1997) QTIP did not qualify where son had right to purchase stock held by marital trust at less than FMV.

XVII. Payment terms generally if not sufficient cash to affect purchase will be evidenced by promissory note. Consider security for note, pledges.

XVIII. Whether purchase is mandatory or optional. What is agreement’s purpose? If ownership is limited to active owners, death, other departing event should trigger a mandatory obligation to sell. If withdrawing owner is a minority owner, will want a mandatory obligation to be purchased-will not want family to stay in a minority position. In the event of death to establish price for estate tax purposes there needs to be a mandatory obligation to purchase; if only an option price not likely to be accepted by IRS.

XIX. Restrictions should consider voluntary transfers during life to family, trusts for family.

XX. Pre-Section 2703, under regulations purchase price under agreement is respected to fix value if the i) price is fixed or determinable; ii) estate must be obligated to sell at fixed price; iii) restrictions apply both during life & death; iv) agreement must be bona fide and not device to pass interest to decedent’s natural bounty without full consideration.

XXI. TRA 1990 enacted Section 2703 intended to preclude related parties from depressing value in family controlled entities. Rule under Section 2703, for purposes of transfer taxes, value of property is determined without regard to any right or restriction relating to the property.

XXII. Exception to Section 2703’s application. A right/restriction is disregarded if: i) bona fide arrangement; ii) not a device to transfer to family (regulations expand family to include “natural objects of transferor’s bounty”); and iii) terms are comparable to similar arrangements entered into by persons in arms’ length transactions (regulations adding “at the time right/restriction is created”).

XXIII. Comparability considerations include: i) expected term of agreement, ii) current FMV of property; iii) anticipated changes in value during agreement term; and iv) adequacy of consideration given in exchange.

XXIV. Non family member exception. A right/restriction satisfied the 3 statutory tests if more than 50% by value of the property subject to right/restriction is owned by parties who are not members of transferor’s family.

XXV. A pre Section 2703 agreement will be subject to Section 2703 if it is substantially modified after 10/8/1990, the effective date of Section 2703. The regulations
The 1846 Last Will of John Sutton - What's Not So New in Will Drafting and Contests [LIT]
Presenter: Terrence M. Franklin
Reporter: Herb Braverman

Will drafting, the role of the attorney as counselor and witness, and pleading and the presentation of facts in a Will contest trial were addressed on the eve of the anniversary of the signing of the last will and testament of the speaker’s ancestor, a Florida slave owner whose Will emancipated the mother of his children and their offspring. Here is the story.

This is a very personal and poignant story told by an African-American litigator who took an interest in probate matters regarding his family and its origins in the Deep South before the Civil War. He brought the story to life with slides of documents and photos that cannot be reproduced here for you to appreciate.

The story involves a will contest in Florida, in which the plaintiff is trying to recover the property of his deceased brother—property which included a number of slaves, whom the deceased had freed by the terms of his Last Will, prepared in 1846, at a time when freeing a slave in Florida was not a simple matter. More specifically, this is the story of how John Sutton freed his “partner” Lucy and her offspring in his Will. Lucy is Mr. Franklin’s ancestor. After a will contest and a helpful decision by the local judge, the executor, Mr. Adams, took his fiduciary tasks very seriously and got Lucy and her family to Illinois, where being a freed slave was more easily accomplished at the time. For more details on the story and the documents and photos he showed, I suggest that you “google” Mr. Franklin and read the article(s) he has written on the subject...or you might wait for the novel he is writing to bring the story to life, a portion of which he read as a part of his presentation.

While, in many respects, the details of the story might not be important to those simply seeking a technical education at the Heckerling, Mr. Franklin did point out the importance of what we do when we prepare documents and administer estates, etc., because the process is a part of someone’s history.
and, more generally, our collective history. He hoped that in the end we would appreciate our tasks as well and what we are doing for others . . . making an effort to “bend the arc of history toward justice.”

The Reporters:

Our on-site local Reporters who are present in Orlando in 2018 are Joanne Hindel Esq., a Vice President with Fifth Third Bank in Cleveland, Ohio; Kimon Karas Esq., an attorney with McCarthy, Lebit, Crystal and Liffman Co. LPA in Cleveland, Ohio; Craig Dreyer Esq., an attorney with the Dreyer Law Firm in Stuart, Florida; Herb Braverman Esq., an attorney with Braverman & Associates in Orange Village, Ohio; Kristin Dittus Esq., a solo attorney with offices in Denver, Colorado, Michael Sneeringer Esq., an attorney with Porter, Wright, Morris and Arthur, LLP in Naples, Florida, Michelle R. Mieras, a Fiduciary Risk Manager with Bank of the West in Denver, Colorado, Beth Anderson Esq., an attorney with Wyatt, Tarrant & Combs, LLP in Louisville, Kentucky, Bruce A. Tannahill Esq., a Director of Estate and Business Planning in the Mass Mutual Financial Group in Phoenix, Arizona, and Patrick J, Duffey Esq., an attorney with Holland & Knight in Tampa, Florida.

The Report Editors in 2018 are Joseph G. Hodges Jr. Esq., a solo practitioner in Denver, Colorado, who is the Chief Moderator of the ABA-PTL discussion list. He is being ably assisted in those duties this year by Reporter Bruce A Tannahill Esq.