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Heckerling 2018 - Report No. 5
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University of Miami School of Law Center for Continuing Legal Education
Orlando World Center Marriott Resort and Convention Center
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http://www.law.miami.edu/heckerling

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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.htm1. 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: Stacey Eastland, in his opening remarks about the Question and Answer panel (see below re), paid tribute to attorney Dennis Belcher, who passed away at the height of his legal carrier in 2017. The American College of Trust and Estate Counsel has published a tribute to Dennis in Volume 43, No. 1 of the Fall 2017 issue of the ACTEC Law Journal. This entire issue is dedicated as a festschrift in his memory. As is pointed out in the Forward, a festschrift is a collected volume of scholarly essays or reflections on an individual's contributions to his or her field and are often used to honor the memory of a colleague who has died. This issue is divided into two parts. Part I is a transcription of Dennis's 2016 ACTEC Joseph Trachtman Memorial Lecture and his 2008 written testimony to the US Senate Committee on Finance regarding ways for simplifying estate planning, many of which still have vitality today. Part II includes professional and personal reflections from 20 different people who knew Dennis in a variety of capacities. Further information is available at www.actec.org.

Summary: This Report #5 continues our coverage of the general sessions that were held on Wednesday, the same being the Question and Answer session. In addition, the Fundamentals #2 session that was held concurrently with Special
Sessions 1 and 2 in the afternoon on Wednesday is also included.

The next Report #6 will begin our coverage of the Wednesday afternoon Special Sessions.

**Wednesday, January 23, 2018**

10:55-12:35

**Question and Answer Panel**

Presenters: Carol A. Harrington + Steve R. Akers + Jeffrey N. Pennell + Carlyn S. McCaffrey

Reporters: Michael Sneeringer and Bruce Tannahill

Stacy Eastland, a member of the Institute's Advisory Committee, introduced the panelists and then acknowledged the passing last year of his dear friend and our fellow trusts and estates attorney, Dennis Belcher of Richmond, Virginia. See our Announcement above about the *festschrift* that has recently been published by the ACTEC Law Journal in his memory.

Carol A. Harrington (“Carol”) moderated the panel question and answer session.

Steve R. Akers (“Steve”) discussed the ways the Tax Act continues the marriage penalty. These include the 37% tax bracket beginning at $400,000 for single taxpayers but $600,000 for joint returns (only 150% of the single amount) and the $10,000 limit on the state and local tax (SALT) deduction for all taxpayers, which allows two single taxpayers to claim a total of $20,000 in SALT deductions while a joint return is limited to $10,000.

Steve discussed the *Powell* case that he had addressed earlier in the week regarding incomplete gift analysis. He noted that he spoke to an attorney that indicated the judge vacated that opinion.

Carol explained she made a mistake earlier in the week discussing the home mortgage deduction. She discussed the new rules that limit the interest deduction on debt incurred after December 15, 2017 to the interest on $750,000 of acquisition indebtedness and suspends the deduction for interest on home equity debt from 2018-2025, regardless of when the home equity debt was incurred. Interest on acquisition indebtedness incurred before that date and refinanced loans up to the amount of the refinanced debt remain deductible.
Jeffrey Pennell (“Jeff”) discussed Clawback and who would pay the estate tax when the exclusion amount snaps back. He opined that state law and most estate planning documents do not address it.

Carlyn S. McCaffrey (“Carlyn”) discussed ESBTs and charitable deductions. The Tax Act provides that the charitable contribution for ESBTs will be determined under section 170, which governs charitable deductions for individuals, rather than section 642(c), which controls charitable deductions for trusts. This eliminates the governing instrument and distributions from current income requirements and allows deductions for gifts of property. This allows a deduction for unrealized appreciation. The potential downsides include applicability of the percentage limitations and the substantiation requirements.

Steve described a discussion with John W. Porter that Code Section 2036(a)(2) is being raised more frequently by the IRS in audits and how it is being applied by Tax Court Judges. Carol joked that Steve was hinting that clients should go to District Court.

Carol discussed re-charactering Roth conversions made in 2017, which is permitted until October 15, 2018. Roth IRA conversions occurring in 2018 or later cannot be recharacterized. She said QTIP elections should be made on Form 706 rather than sending the IRS a letter or some other way. She and the panel agreed that the IRS is set up to deal with IRS forms unless the form instructions or regulations provide for a different method.

Steve indicated the best estate planning going forward in 2018 may be a QTIP’able trust because it provides the most flexibility for clients. The decision on whether to make the QTIP election can be delayed until 15 months after death by extending the time to file the 706.

Jeff discussed Code Section 67, its amendment and how it affects fiduciary administration. Jeff noted that the legislative change was a shortcut approach, simply suspending the deductions through 2026. He discussed Code Section 67(e) and deductibility subject to the 2% floor. He opined on that most trust administrative fees are still fully deductible (including legal and fiduciary fees).

Carol opined that estate planning practitioners need to think through gift tax issues when transfers occur or changes are made to documents. Jeff reminded the audience that a gift tax applies to gratuitous transfers.
Carol discussed family offices, deductions and structuring investment management fees. She noted that it may be possible to turn investment management fees into Code Section 162 deductions.

Jeff discussed estate planning and taking advantage of the increased exclusion amount. He suggested that non-qualified disclaimers may be useful for gifting purposes. However, you must be careful because many states have laws designed to prevent inadvertent gifts arising from non-qualified disclaimers.

Steve answered a question on how long a Code Section 645 election can be kept opened. Section 645 provides that treatment of a revocable trust as part of an estate under the section 645 election applies until two years after the decedent’s date of death if no estate tax return is required to be filed. If an estate tax return is required to be filed, the election applies until six months after the date of the final determination of the estate tax.

Carlyn discussed Code Section 199A and whether it is available in certain employment fields, such as athletics (i.e., does it apply to ownership of a sports team as opposed to the athlete). She discussed its applicability to a sports team owner and someone in the field of the performing arts. She noted that with all the questions she is asking, that there are no clear answers.

Carlyn discussed the effective date rule and the alimony provisions. She noted the importance of signing a marital separation agreement before 2019 to qualify for the alimony deduction.

Jeff discussed portability and that Clawback probably should not apply to the DSUE if portability is used because the decedent’s estate tax exemption was available at the time of death.

Carol discussed GST and automatic allocation. She noted there are many problems with automatic allocation, including GRATs and irrevocable life insurance trusts and allocation, including trusts holding a joint and survivor life insurance policy. She discussed decanting and trust modification related to GST allocation and GST exempt status. She noted there are gift tax risks associated with decanting and trust modification. She believes that State common law is helpful.

Jeff discussed buying a dwelling inside a trust as opposed to a trust giving a child the money to buy the dwelling and other related trust tax issues.
Carlyn discussed non-resident aliens and foreign trusts. She discussed domestication of the trust and that the answer of domestication depends on the purpose of the trust (Is the trust going to end? Domesticate it. Is the trust a long-term dynasty trust? It may be best to keep the trust a foreign trust).

The panel closed with comments from Steve about some portability questions.

2:00-5:20  FUNDAMENTALS PROGRAM #2
(Runs concurrently with Special Sessions I and II)
Selected Subchapter J Subjects: From the Plumbing to the Planning, Preventing Pitfalls with Potential Payoffs [TRU]
Presenters: Alan S. Halperin + Amy E. Heller
Reporter: Kristin Dittus

Understanding the rules of Subchapter J is essential for every estate planner. The program provided an overview of Subchapter J, including the rules related to grantor trusts and non-grantor trusts. The panelists addressed potential pitfalls and planning opportunities that permeate this area.

Selected Subchapter J Subjects: From the plumbing to the planning, preventing pitfalls with potential payoffs. Presented by Alan Halperin and Amy Heller.

Reported by Kristin Dittus

This 3-hour class focused on developing a framework to assist in analyzing subchapter J of the Internal Revenue Code (IRC or “code”) §§641-685.

Purpose of Subchapter J and Tax on Trusts. The purpose of Subchapter J is to allocate the tax burden among the persons who receive an income benefit from the trust or estate. Gross income does not include gifts or bequests, however the income created by such gift or bequest is taxable income. The tax of trusts and estates is a hybrid system, sharing attributes of an entity and pass through or conduit tax. Distributable net income (“DNI”) calculates which distributions carry-out gross income and appropriately taxes such beneficiaries. DNI has both a (1) quantitative element which determines how much tax is allocated between the trust or estate and the
beneficiary, as well as a (2) qualitative element for the character of the tax. DNI is similar but different from fiduciary accounting income ("FAI"), which is based on state law concepts. It is important to distinguish between defined terms, such as these, because they affect the rights of the parties involved.

Under the old system, trustees were concerned about balancing benefits between current and future beneficiaries. Whereas with modern trust administration and the Uniform Prudent Investor Act 1994, trustees are more concerned with total return rather than the specific allocation of income and principal.

**Simple or Complex.** Trusts can be either simple (distributes all FAI to beneficiaries, no charitable contributions, and no distributions in excess of income) or complex (all non-grantor trust that are not simple or Charitable Remainder Trusts ("CRT")). It is possible for a trust to be simple one year and complex the next. Unsurprisingly, a simple trust has a simplified tax calculation.

**Tax Calculations.** Calculating the income tax of a non-grantor trust or estate involves taking deductions from gross income, determining the tax rate and applicable credits. Tax and other tax attributes can be applied at the entity level, or pass through to the beneficiary. For complex trusts there is a two-tier system, under Tier 1 income is required to be distributed currently and tier 2 includes any other amounts paid, credited or distributed. Tier 1 absorbs DNI to the extent of the distributions, and if any DNI is left it is proportioned among tier 2. Mr. Halperin then went into more detail regarding the specifics of DNI and FAI calculations, as well as the application of DNI among the tiers.

**Charitable Deductions.** Charitable contribution deductions are taken under §642(c). There is a 100% deduction up to the amount of taxable trust income. The trust should take this deduction if possible, since it is more generous than for an individual. Sec. 642(c) must be made out of income and done under the terms of the trust. There have been two recent developments concerning 642(c), a chief counsel memorandum, CCA 201747005 and the case of Green v. U.S. (10th Cir. Jan.12, 2018). The CCA was not favorable to the taxpayer and the presenters question process on the determination. The Green case considered the charitable deduction amount allowed for the
donation of appreciated property. After considering four points, the court allowed the appreciation as the deduction.

**Itemized Deductions of §67.** Miscellaneous itemized deductions, previously subject to the 2% haircut, are no longer deductible under the new tax act. The speakers agree the new §67(g) does not appear to affect §67(e) because §67(e) is no longer subject to the 2% rule (regarding the costs that would not otherwise be incurred if not for estate or trust specific work). To maximize deductions for a family office, Mr Halperin recommends using an entity that allows deductions at the entity level, rather having such deductions pass through to the individual who may be disallowed from taking certain deductions. There is less reason to be afraid of C Corps under the new tax regime. Under the new legislation, excessive deductions taken in the final year that exceed income or characterized as miscellaneous, carried out to beneficiaries cannot be deducted.

**Important Accounting Highlights.**

- DNI will not be carried out on gifts made under §667(a)(1), the distribution of a specific gift of assets or property, or under §663(a)(1), a gift or bequest that can be made in three payments or less.
- The 65 day rule allows income distributed in the first 65 days of the taxable year to be attributed back to the accounting of the previous year. This does not apply to simple trusts because such income must be distributed in the current year.
- The Separate Share Rule requires the allocation of tax among those who are the beneficiaries receiving the income.
- For distributions in kind, the beneficiary generally receives carryover basis which is the same basis the trust holds. The deduction to the trust is limited to the basis. Under §643(e) the deduction between the trust and the beneficiary cannot lead to a loss.
- Under §645, the Trust can be treated as part of the estate.

**Grantor Trusts**

Amy Heller took over to discuss grantor trust rules starting on the outline at page 32. Grantor trust rules were introduced in 1954 by Subpart E under Subchapter J part 1 (§§671 - 679).
Under the grantor trust rules, the grantor holds certain strings where she is deemed the owner for income tax purposes, but NOT for estate inclusion. Historically high-income taxpayers wanted to shift income to lower tax bracket family members through the use of trusts. It is easy to create a grantor trust because the IRS wanted to ensure individuals were not avoiding tax by using trusts. With an intentionally defective grantor trust (IDGT) the grantor generally pays the income tax on the growth of trust principal and such payment is essentially a tax free gift to the trust annually. This is a huge advantage to clients with large taxable Estates.

The Grantor Trust Rules. See pages 32 - 61 of the outline for more detail and highlighted sections are below.

1. Under §672(c), any related or subordinate party will link the grantor through the family attribution rules. An attorney is not considered linked to the grantor, however see the Wiley case where the attorney acted at the complete direction of the grantor may bring into this independence into question.

2. Under the spousal attribution rules of §672(e), a grantor trust will be created if the grantor's spouse serves as trustee, yet there is no risk of estate inclusion.

3. To avoid classification as a grantor trust under §674, the power to control beneficial enjoyment, do not have the spouse serve as trustee or allow the spouse to make distribution decisions.

4. The grantor's ability to swap assets of equal value, will not cause estate inclusion, even with the ability to reacquire life insurance under §675(4). See section §2042 and Rev. Rul. 2008 - 22. It is not advisable, however to allow the grantor to reacquire voting stock covered by §2036(b) because the guidance is unclear on this asset.

5. Under §676, if the grantor can revoke it will be a grantor trust but it will also be included in the grantor's estate, so to not use revocation for wealth transfers out of the estate.

6. Sec. 675(2), the grantor's ability to borrow trust assets creates grantor trust status. If the loan requires interest, but not collateral, it will avoid estate inclusion. If the grantor does borrow, the loan will trigger grantor trust status. This can be helpful to avoid capital gains tax if the grantor sells an asset to the trust but it's not a grantor Trust. Allowing a grantor to release the right will remove grantor trust status for this rule.
7. Grantor trusts generally do not include the grantor as a beneficiary, however it may be permissible under the laws of a domestic asset protection trust state. If the spouse is a beneficiary, this allows by assets to flow back to the marital unit for the grantor’s benefit.

8. Under §677(a)(3), the grantor's ability to pay life insurance premiums may create a grantor trust, but there is insufficient support to rely on this. Do not include if you are trying to avoid grantor trust status.

9. Sec. 678, discusses the creation of ownership to a beneficiary in the case of a 5x5 power or withdrawal rights. Guidance is unclear, so do not add crummy rights if you're concerned about this.

10. The new tax act repeals §682, which provided relief in the event of a divorce, so add provisions to your documents in the event of divorce.

Two important doctrines for grantor Trusts:

- Rev. Rul. 85 - 13 allows transactions between the deemed owner and grantor trust to be disregarded. This avoids the implication of tax on transfers.
- Rev. Rul. 2004 - 64 allows for reimbursement to the grantor for the payment of income tax. Avoid requiring reimbursement and review state specific law on this matter.

With the new high exemptions, grantors may want to turn off grantor trust status so they no longer have to pay the income tax. This conversion is not likely to generate tax, however if trust assets have liability in excess of basis there may be gain to the grantor. See page 59. Additionally, these rules may provide guidance for transfer taxes if a trust is decanted which the IRS has not addressed. See Pages 61 - 66 from for more on decanting.

Charitable Trusts

Mr. Halperin picked up the mic to cover charitable remainder Trusts (CRT) and charitable lead trusts (CLT).

CRT. There are various CRTs (CRAT, CRUT, NIMCRUT, NICRUT) where the lifetime beneficiary is an individual and the remainder beneficiary is a charity. Section 664 covers specific rules for CRTs. These trusts are generally tax exempt except for unrelated business transaction income (UBTI), which is important to avoid due to extremely negative tax
consequences. There is no tax at the CRT level, and tax passes to the beneficiary.

**CLT.** Rev. Proc. 2001-45 and 2001-46 are the bibles for drafting CLTs. Under §642(c), CLT can deduct 100% of the income to the extent of it passes to charity and the rules are not as draconian if you have UBTI. Be aware there may be recapture if the grantor dies before the term ends because the charity may not have received all assets they are entitled to under the code.

**QSSTs and ESBTs.**

Subchapter S corporations: have limitations on ownership by trusts, often limiting non-grantor trusts to only 2 years or less of ownership. QSSTs are similar to QTIPs, and the provisions were drafted in the code during the same time period. The similarities include having a single current beneficiary to whom all income is payable and the QSST election must be in effect. The QSST is treated as a grantor trust and deemed owned by its income beneficiary.

ELECTING SMALL BUSINESS TRUST (ESBT): An ESBT may only have certain types of beneficiaries, including individuals, estates, trusts and certain charitable organizations. The ESBT election must be in effect. ESBTs are subject to tax on allocable share of income from the S corporation and there is no distribution deduction. Major changes under the new Tax Act include allowing a trust to qualify as an ESBT even if there is a NR as a potential current beneficiary. If an S corporation makes a charitable contribution, the ESBT gets a charitable deduction under §170 rather than §642(c).

**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

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.