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Institute on Estate Planning
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Heckerling 2018 - Report No. 7
(Wednesday 1/24/18)

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

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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.htm. 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.

ERRATA Re Fundamentals #2 (Report #5): In the section on charitable deductions, it was reported regarding the recent (1/12/18) 10th Circuit Green case that the Court had allowed the appreciation in the property as a deduction. As has been pointed out by our PTL readers, Russ Willis, Ed Morrow and Phillip Jones, that was what the lower Court held. According to Russ, The 10th Circuit "emphatically did not allow a deduction for appreciation." Per Phil "the 10th Circuit ruled that the charitable fiduciary income tax deduction for in-kind contributions by a trust is limited to adjusted basis, thus the fair market value of the donated property could not be used as the deductible amount." We stand corrected.

Announcement: Ultimate Estate Planner announced today that the Heckerling promotions they were offering during Heckerling are available for those who could not attend the Institute if they are ordered by the end of the day today. These include their 2018 Tax Reform Survival Kit with downloadable education packages, a pre-sale of the 2018 Keebler Tax Planning Chart Bundle, and The Successor Trustee Manual. For more information, see www.ultimateestateplanner.com.

Summary: This Report #7 continues our coverage of the Special Sessions that
were held on Wednesday afternoon, the same being 1E on special needs planning, 1F on structuring philanthropy, 2A on dynasty trusts, and 2B on Family LPs and LLCs.

The next Report #8 will continue our coverage of the Wednesday afternoon Special Sessions.

Wednesday, January 24, 2018 (Cont.)

2:00-3:30  SPECIAL SESSIONS I (Cont.)

Session I-E
Beyond the Special Needs Trust: Essential New Developments in Special Needs Planning [ELD][TRU]
Presenters: Katherine N. Barr + Kristen M. Lewis + James M. McCarten
Reporter: Bruce Tannahill

This panel discussed new laws, regulations and options that estate planners must know to plan effectively for a secure quality of life for a person with a disability. This Report covers the more significant highlights of this session.

Special needs trusts are sometimes considered the planning tool for individuals with special needs. Because planning for those individuals involves much more than special needs trusts, this session was devoted primarily to special needs planning other than special needs trusts (SNTs). Each speaker focused on one aspect of special needs planning.

As an introduction, Ms. Barr noted that individuals with special needs are common – one in 6 children today have a disability. As an example, one in 48 boys are on the autism spectrum, while one in 189 girls are on the autism spectrum.

Katherine Barr – Recent Laws Affecting Special Needs Planning

ABLE Accounts

ABLE accounts started out in the public’s eyes to be a single solution for special needs planning. As enacted, they don’t replace good special needs plan with separate SNT.

Limitations on ABLE accounts mean they are not for everyone. These include:

1. Onset of disability must start before age 26
2. Annual contributions limited to gift tax annual exclusion amount
3. Account can’t hold more than $100,000 without excess being considered a resource for Medicaid
4. Subject to Medicaid payback, regardless of who funded the account
5. Payments for non-qualifying disability expenses are subject to income tax on the income and a 10% penalty tax.

Differences from SNTs include:

1. Inexpensive to set up and operate. In Alabama, the annual cost is $45.
2. Contributions must be made in cash.
3. A competent individual in control of the ABLE account can have autonomy over the account and it may be linked to a debit card.
4. Can’t be named beneficiary of retirement accounts or life insurance

**Disabled Military Child Protection Act**

Passed in December 2014, this Act allows a military retiree to designate a SNT established at death as the beneficiary of their military pension without the pension disqualifying the beneficiary for SSI. Although the trust must be a Medicaid payback trust, Ms. Barr said that this is not a problem because the money will be spent every month.

**Special Needs Fairness Act**

This Act allows a competent individual under 65 with special needs to create their own SNT and put their own money into it. The individual can’t be their own trustee.

**Uniform Decanting Act**

The Act includes a special section dealing with decanting to SNT. Whether it needs to go to a first-party or a third-party trust depends on trust provisions and state law.

Ms. Barr observed that the trend is to move away from guardianship/conservatorships and move to supported decision making.

**Kristen Lewis – Planning for Beneficiaries with Special Needs**

Doing a SNT is not comprehensive special needs planning, which requires a team of professionals.

Many benefits for individuals with special needs are conditioned on SSI eligibility and cannot be accessed otherwise. Many families want their family members to have access to those programs or services so eligibility for SSI is important, regardless of the family’s means.

Members of the Dream Team:

1. Special needs planning attorney. Most traditional estate planning attorneys aren’t familiar with special needs planning. Ms. Lewis recommended using a member of the Special Needs Alliance.
2. Trustee willing to serve as trustee of SNT. Not all professional trustees will take SNTs.
3. Accountant or CPA familiar with SNTs.
4. Government benefit advocate who assists family apply for government benefits cost effectively. Government is generally not the family’s friend and family may be encouraged to apply for benefits family member isn’t eligible for.

5. Care manager.

6. Life care planner – a professional who puts together objective, arms-length assessment of cost to fund individual’s lifetime costs. Should determine how much is needed in the SNT.

7. Special education planner or litigator -- helps family work with schools to get free and appropriate education.

8. Investment advisor. It’s not inherently obvious how you invest money for individuals with special needs. The individual may have a lower risk tolerance but a normal or substantially normal life expectancy. Many trustees have investment manager familiar with special needs planning.

9. Guardian. Either the guardian or attorney generally coordinates the team.

Clients generally need a network of SNTs:

1. Testamentary SNT. For clients under 60, normally use testamentary 3rd party SNT.
2. First party SNT, even if no money to go into it immediately, just in case something slips through the cracks.
3. Receptacle SNT designed to receive inheritance intended to benefit the person with special need. Once the trust is drafted, the attorney normally prepares letter to family members that provides assistance to them on how to make gifts or bequests to the individual with special needs.
4. Gifting SNT. Include secondary beneficiaries who have withdrawal right to avoid gift tax issues.
5. Divorce SNT. 90% of parents who have children with special needs end up in divorce. This trust is designed to receive anything set aside for an individual with special needs as part of the divorce.
6. Community SNT. Designed to receive community contributions for the individual.

Cardinal rule of SNT funding is DO NOT COMMINGLE first-party money and third-party money.

James McCarten

Mr. McCarten spoke from the perspective of a special needs planner who has an adult child with special needs. He said that special needs planning turns tax logic on its head.

Individuals with special needs are the same as everyone else – they want to do the same things that everyone else does.

He said that the most important part of helping families is helping them understand the need for financial planning. They often spend everything available to help child with special needs get help and don’t think about what happens in the future. A change in caregiver is most traumatic change a child with special needs will go through.

Individuals with special needs want to live independently if possible. The most important consideration is who is going to pay for it. Home and Community Based Services (HCBS) may be
available but availability may be limited and requires that the individual be in a group home with less than six residents.

There are ways to get children services and into the community. Funding the resources and understanding the rules, including tax and employment laws can be challenging.

Session I-F
Structuring Philanthropy: What Works When [CHR]

Presenters: Martin Hall + Erik Dryburgh + Michele A.W. McKinnon
Reporter: Herb Braverman

A critical question for philanthropic clients is what structure or combination of structures should be used to fulfill their goals. This session considered not only the more standard options of private foundations, private operating foundations, donor-advised fund accounts and supporting organizations, but also reviewed the use of section 501(c)(4) social welfare organizations and LLCs to meet the needs of different donor profiles. This session is a follow up to Mr. Hall's Tuesday morning General Session (Report #2). Here are some of the highlights from this session.

This panel of legal counsel presented a follow up to the general session presentation of Mr. Hall reported earlier. They took several vehicles, such as public charities, private foundations, private operating foundations, donor advised funds, supporting organizations and social welfare organizations and for each of these vehicles the panel discussed their respective (1) charitable contribution deduction limits for individuals, (2) qualified charitable distributions from IRAs, (3) controlled/prohibited activities subject to excise taxes, (4) entity level taxation, (5) distribution requirements, (6) disclosure of donor identity and (7) degree of donor control. The clear indication is that this field of activity has become far more complicated than it may have been in its past.

The panel then ran through several hypotheticals, which were not in the materials per se, but were available on the conference app, along with other supplemental materials. The overall message was that these vehicles would serve in each of the hypotheticals, but not with the same degree of satisfaction for the donors who, of course, have different objectives. Some are focused on having control and ownership of assets, so a donor advises fund may not be desirable. On the other hand, a private foundation would probably be better suited, but a supporting organization tied to a public charity may also suffice.

This type of analysis continued through several “hypos” and lead the panel to conclude that donor and advisor may well have to look at “all of the above” vehicles and, of course, make changes among the vehicles over time as objectives change. For example, the members of a donor family may change over time, mission creep may occur and, of
course, there may be (and have been) changes in the applicable tax and other laws that would suggest alterations.

The panel spent time on funding with closely held business interests and on income tax considerations. There was also a discussion of what was or was not a “charitable purpose”, noting for example that scholarships to individuals were not a charitable purpose for at least some of these vehicles. Of additional interest was the discussion about how other vehicles have been or could be created to solve problems, for example, the changes to Sec. 501(c)(4)s, once limited to “social welfare” purposes.

3:50-5:20  SPECIAL SESSIONS II

Session II-A
Show Me the Money! Settlors, Beneficiaries and the Dynasty Trust [TRU]
Presenters: Diana S.C. Zeydel + Todd A. Flubacher + Barry F. Spivey
Reporter: Joanne Hindel

Flexibility or no flexibility for dynasty trusts? Can we solve for settlor intentions, beneficiary predilections, tax considerations, and state law limitations without fiduciary litigation? This session examined the options. This session builds on Ms. Zeydel's General Session on the same topic (Report #2). Here are some of the significant highlights from this presentation.

Part I – Reasons for and advantages of dynasty trusts

Todd started the discussion by suggesting that the advantages of dynasty trusts are bigger and better than ever. He said that the drafting attorney should determine which states authorize dynasty trusts, that is: which states have abolished the rule against perpetuities. He said that there are 20 states that authorize perpetual trusts and 14 states that still have the rule against perpetuities. He said that the dynasty trust helps to prevent the dissolution of the settlor’s wealth. He said that these trusts provide for creditor protection, the protection against in-laws, the preservation of wealth, the ability to hold family businesses, the ability to restrict information about wealth, retain confidentiality and protect against future tax uncertainty.

Part II- Judicial changes to existing trusts in order to create dynasty trusts

Barry then talked about various aspects of petitioning a court for judicial modification or reformation of existing trusts. He addressed jurisdictional considerations such as is the forum state in which an action can or may be brought also the place of principal administration of the trust. He discussed the parties that should be joined in a court proceeding and discussed the concept of virtual representation and the UTC authority to have certain parties represent others...
as long as no conflict of interest exists in the representation. He described the types of judicial actions that can be brought under the UTC: Section 411 authorizing modification or termination upon consent of the settlor and all beneficiaries and the role of the court in those actions. If the settlor is unavailable, the beneficiaries can still seek modification or termination under Section 411 but then the court must determine that continuance of the trust is not necessary to achieve any material purpose of the trust.

Barry also reviewed judicial actions under Section 412, when a court may modify administrative or dispositive terms of a trust to terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination would further the purposes of the trust. Finally, Barry talked about Section 415 that provides for reformation of the terms of an irrevocable trust by a court due to unilateral mistake of law or fact that results in a misstatement of the settlor’s intent.

Part III- Nonjudicial Settlement Agreements

Diana discussed the increased use of non judicial settlement agreements (NJSA), made statutorily available in the states that have adopted the Uniform Trust Code. An NJSA is generally authorized by a statute that provides settlors, beneficiaries and fiduciaries with a tool for resolving matters arising with respect to the administration of a trust without the time and expense of court involvement. An NJSA is an extremely useful tool to address flexibility in changes and can be used for matters such as correcting errors or resolving ambiguities, dividing a pot trust or merging trusts, modernizing outdated trust provisions, ratifying trustee actions and even changing interests of beneficiaries. She did caution, however, that if non judicial changes to beneficial interests are undertaken there may be tax ramifications which should be understood before the changes are implemented.

Finally, the panelists discussed the statutory authority to decant now available in a number of states. They described decanting as a trustee power that often requires advance notice to trust beneficiaries before the decanting is undertaken. They also discussed whether the exercise of decanting by the trustee could run afoul of the trustee’s duty of impartiality to the trust beneficiaries. They also noted that the IRS has not issued any guidance on the tax ramifications of decanting.

Conclusion

The panelists concluded by reiterating that dynasty trusts are important planning tools for families and if discussed and drafted carefully will preserve family wealth for many generations.
This session examined the income tax issues that may be overlooked in unwinding a family LP or LLC, particularly if the advisor’s expertise is more concentrated on estate planning than income taxation. This session builds on Mr. Abendroth's Tuesday General Session presentation on business succession. This Report covers the more significant highlights from this session.

This breakout session examined the income tax consequences of different contributions and distributions from family limited partnerships and limited liability companies. The speakers used set a fact pattern and altered the facts through a series of examples.

The presentation started with a few necessary definitions and brief refresher of partnership tax terms include inside basis, outside basis, pre-contribution gain (the difference between the contributing partner’s basis in the assets and the assets fair market value), “step in the shoes” and capital accounts.

The key takeaway of the presentation is that knowledge of the history of the partnership is a must for avoiding tax traps. Good records are important to understanding the tax history and business history of the entity.

I. Gain recognition of formation

Generally contributions to a partnership on formation are nontaxable events, however, if the contribution is to an “investment company” and run afoul of the diversification rule, then the contributing partners will have to recognize the pre-contribution gain. But you can combat the diversification rule with a cash contribution by one of the contributing partners.

II. Non-liquidating Cash and Non-Cash Distributions

Generally distributions of cash do not cause gain recognition. Cash distribution reduces the partner’s outside basis (but not below zero) by the value of the cash distribution. Any cash in excess of the outside basis must be recognized.

If the distribution is of cash and other property, then first reduce basis by value of the cash, then the property receives a carry-over basis equal to the lesser of the partnership’s basis in the property or the partner’s remaining outside basis. When the property is later sold, the partner will recognize the gain but can tack the partnership’s holding period to determine the character of the gain (ordinary income, short term or long term cap. gain).

If the partnership distributes marketable securities, then must review Sec. 731(c) to determine whether the marketable securities are treated like cash or like property. If the partnership is an investment partnership and the partner receiving the marketable securities is an “eligible partner” then distribution is treated like property and typically no gain and carry over basis deferring gain recognition until the partner sells the assets. An investment partnership cannot have been engaged in a trade or business ever. The trade or business taint cannot be washed away not even on a technical termination. History of the partnership from formation to distribution is very important. For example, the partnership may have
been formed with commercial rental property that was subsequently sold and the proceeds were invested in marketable securities.

A partnership that is not an investment partnership and does distribute marketable securities must complete a before and after gain calculation to determine the amount of the asset that will be deemed cash and the amount treated as property. Cash distribution triggers a recognition of gain but that value is added to the outside basis and increases the basis of the securities so that there is not a double recognition of the gain when the property is later sold.

III. Seven Year Rule

If a partner contributes assets with pre-contribution gain to the partnership, the partner’s gain stays with the partner for seven years from the time the asset was contributed (not from the time the partnership was formed). If the asset is sold or distributed to another partner during the seven year period the contributing partner must recognize the pre-contribution gain. This may come to the surprise of the contributing partner because that partner will have a taxable event without receiving anything from the partnership. Most often the partnership agreement does not have a provision for mandatory tax distributions for pre-contribution gain recognition events. No expiration of the pre-contribution gain if the asset is sold within the partnership, and all the pre-contribution gain should stay with the contributing partner. Most partnership do not follow this rule, but the presentation panelists cautioned that with the new partnership tax rules there may be an increase in the partnership audits.

IV. Terminating/Liquidating Distribution

The presenters ran through several examples of typical ways to terminate and distribute all the partnership assets to the partners.

The first example was to sell all of the assets within the partnership and distribute the cash proceeds. Gain would be recognized on the sale, but that gain would increase the partners’ outside basis and then cash would be distributed thereby reducing the outside basis to zero. Only one level of gain recognition.

Another example was a distribution of property in kind, which the presenters cautioned against doing especially if the partnership is not an investment partnership but will be making distributions of marketable securities because there could be substantial immediate recognition of gain.

A third example discussed non-pro rata distributions of property. In this example, it is very important to set client expectations and an understanding that depending on the assets each partner receives, each partner may have very different tax consequences. Some partners may be able to defer gains and others may have an immediate recognition event.
The take home message of liquidating distributions are setting client expectations, knowledge of historical facts are necessary to determine whether a transfer is taxable or not, and managing the income tax liabilities with the transfer tax vehicles.

V. Partial Liquidating Distributions/Redemptions

When buying out or redeeming one partner it is important to discuss prior to the redemption that client expectations as to whether the buyout will occur at full value or a discounted value. Also, if assets must be sold to generate cash necessary to complete the buyout, then the other partners may have a recognition event and should those partners receive a distribution for tax purpose as part of the redemption. For example if the redemption value is $2 million but each non-redeeming partner is subject to $20,000 in taxes, then should the redeeming partner receive $2 million less (x*$20,000) where x is the number of non-redeeming partners.

If assets must be sold can more of the gain be shifted to the redeeming partner in an effort to increase and zero out that partner’s capital account? Yes, if the partnership agreement allows for it. Also yes if the partnership agreement doesn’t allow for it, but does have a savings provision referencing Sec. 704(c) because a partnership agreement may be amended up to the date the tax return is due.

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.