# Heckerling Institute Report
# Report #4 - The Tuesday Sessions

The following is Report #4 from our on-site reporters regarding some of the highlights from the events and presentations that are taking place at the 34th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 10-14, 1999 at the Fontainebleau Hilton in Miami Beach, Florida.

This Report covers **all the Tuesday sessions**. More in depth reports on the sessions that were done by Messrs Choate, Jansen and McCue can be found in Reports 3 and 5.

This report was filed by on-site reporter, and Miami resident, Bruce Stone. Bruce is also a member of the Institute's Advisory Committee.

The **second day of the Heckerling Institute** opened with a **Question and Answer** session. The questions were fielded by **Dick Covey, Mal Moore, Stacy Eastland, and Dave Cornfeld**.

The panel opened with a discussion of the overall state of the transfer tax system. Mal Moore thinks that repeal of the estate and gift tax is unlikely, but he said that the question is how do we advise clients in the current situation? Perhaps we counsel clients not to make large taxable gifts. How should we change the drafting of our documents? Stacy added that estate freezing techniques and discounting strategies are in favor in the current environment. The panel generally thought that the revenues that will be raised by the estate tax in the coming years are so large that if the system is repealed, it will have to be replaced with something that will generate a large amount of revenue in its place.

Dick addressed a question that asked if a surviving spouse's elective share really would attract DNI if it does not receive interest or any share of post-mortem income under state law. He said that the answer is clearly yes, it will attract DNI. Elective share amounts are not described in section 663 (a)(1), and therefore they will attract DNI even under the separate share rules.

Mal answered a question that asked if a simple statement that a sale to an intentionally defective trust is not a gift because it is for adequate and full consideration will be sufficient under the gift tax disclosure regulations. Mal thought that such a statement should suffice. Furthermore, if a gift tax return is filed even though not required, it should commence the statute of limitations.

In addressing another question, Stacy stated that he is now worried much less about section 2704(b) issues in family limited partnership transactions than he was several years ago. He does utilize gifts of limited partnership interests to public charities fairly frequently in his planning. Giving the charity a Class A preferred limited partner interest (with a coupon interest rate) allows clients to pass money to charities without regard to the percentage limits on charitable donations, AMT concerns, etc.

Dave said that a spouse can hold a $5,000 Crummey withdrawal right without estate tax problems as long as the spouse doesn't make a contribution to the trust. The period to disclaim a 5 and 5 withdrawal right would commence each time that a contribution was made to the trust subject to the withdrawal right, but he does not recommend disclaiming such a right because of a risk that the disclaimer might be regarded as a release of the right. It is better simply to allow each withdrawal right to lapse, if it is not to be exercised.

Mal said that an intentionally defective trust should not have Crummey withdrawal powers. It will become a grantor trust over time with respect to the Crummey beneficiaries. If the transaction is properly planned, no gifts should be involved with transfers to the trust (other than any initial seed gift of capital).

Stacy recommends the use of disclaimers of pecuniary amounts over $X where an estate has hard to value assets, and for the will to provide for those disclaimed interests to pass to charity. He described this as a poison pill that works. The downside is that you may have to negotiate with the charity or with the state attorney general over the value of the estate assets.

Stacy recommends a weighted appraisal approach which assigns a defined percentage of emphasis on asset valuations, and the balance of the percentage emphasis on going concern factors, and then applying minority discounts, etc. This gives guidance in how much discount to allow for built-in capital gains.

Dave said that a gift to a corporation qualifies for the annual exclusion, as a gift to the shareholders, as do gifts by analogy to LLCs and limited partnerships - subject to the facts and circumstances of each situation, of course.

Mal stated that a surviving spouse's disclaimer of an asset that would not receive a basis step adjustment because of section 1014(e) will result in the basis adjustment being allowed if the asset passes to someone other than the spouse (such as to a trust in which the spouse has a beneficial interest).

Mal said that if the beneficiary of a QPRT wants to buy a more expensive house than is held in the QPRT, the beneficiary can either contribute the additional cash needed (which must be spent within 3 months), or do a joint purchase with the QPRT on a fractional interest basis.

Stacy said that the most common drafting error in family limited partnerships that he encounters is giving the general partner too much wide open discretion that overrides the fiduciary duties that the general partner otherwise would owe to the limited partners.

Dave stated that no taxable gift will be caused if the donor/custodian of an UGMA account simply resigns as custodian of the account to avoid estate tax inclusion under section 2038. However, if the custodian dies within 3 years after the resignation, inclusion will still result because of sections 2035(d)(2) and 2038.

Dick repeated his comments from yesterday about the gradual increase in the lack of professionalism of the Service in the past few years. As an example, he referred to TAM 199935003, involving the consequences of a commutation clause in a common law GRIT, as an example of egregious abuse by the Service of its authority.

Following the opening Q&A session, **Natalie Choate** then spoke on **trusts as beneficiaries of qualified plans**.

She recommended putting on your estate administration checklist to give a copy of the client's trust to the plan administrator within the 9 month deadline, if the client dies before the required beginning date (RBD). (Note: the 9 month deadline is not the same date as the 706 due date.)

If the client dies after reaching the RBD, Natalie recommends sending a copy of the trust to the administrator, along with a statement that the client will notify the administrator of any later amendments to the trust. A copy of the trust should be sent to IRA administrators, even if they don't want it.

To avoid the IRS rule that an estate does not qualify as a designated beneficiary, the trust should contain language prohibiting payments back to the estate to pay taxes, administration expenses, claims, and unfunded bequests.

Natalie brought down the house when she picked up a copy of her book to answer a point about "designated beneficiaries" - she turned to a page and began to read the words "... she moaned softly as he ...." Natalie then said "oops, that's in the new edition!" She referred the audience to her website to receive an updated copy of her outline that will analyze Revenue Ruling 2000-2. Her website is www.ataxplan.com.

Following Natalie, **Don Jansen** then spoke on current developments on the **use of life insurance in estate planning**, and generally on family or private split dollar (PSD).

Don reviewed a number of rulings dealing with exceptions to the transfer for value rules, tax-free exchanges of policies, and modified endowment contract issues. He then turned to an analysis of PSD rulings, noting that no rulings have been issued since 1998 in any split dollar arrangement (not just PSD). Before then, there were only two private letter rulings on PSD arrangements.

If the noninsured spouse is a party to a PSD arrangement, care must be taken to address what happens if the noninsured spouse dies before the insured spouse. The noninsured spouse's interest in the arrangement should not pass to the insured spouse or to any trust in which the insured spouse is a beneficiary or trustee.

If the insured is a party to a PSD arrangement, there should be no right to borrow, and there should only be a barebones collateral assignment (a security interest in the contract), without any right to surrender, borrow, assign, change beneficiaries, etc.

Overall, due to the lack of much guidance, and due to the apparent attention being given by the Service, caution should be exercised in the use of PSD arrangements, especially if the insured is a party.

Following the lunch break, **Georgianna Slade** spoke on **inter vivos planning with generation skipping trusts**.

Clients should make GST trust grantor trusts for income tax purposes wherever feasible, and should fund the trusts with cash (full basis, with no possibility for valuation disputes and arguments over GST inclusion ratios). To the extent possible, the trust should be made a party to valuation shifting opportunities, such as allowing the trust to take advantage of business opportunities, or by making loans on arms length terms to allow the trust to make investments that might not otherwise be possible (such as hedge funds).

When charitable lead trusts are used, attention must be paid to the private foundation rules if closely held stock is used. Usually the excess business holding and jeopardy investment prohibited transaction rules will be involved, because ordinarily the charitable deduction will exceed 60%.

Georgianna discussed a technique that might possibly minimize GST tax ultimately payable, by planning with the generation assignment rules. A trust can be drafted for the benefit of great grandchildren (making no provisions for children or grandchildren), with a power in the trustee to add other descendants as beneficiaries. Following the initial transfer, the transferor's generation assignment should drop to the level immediately above the great grandchildren's level. If the trustee later adds children or grandchildren as beneficiaries, distributions to the grandchildren should not be subject to GST tax. This could be coupled with a power to divide the trust, and then add children or grandchildren as beneficiaries only for a separate trust after the division.

Following Georgianna, **Howard (Scott) McCue** spoke on **planning and drafting to influence the behavior of beneficiaries**.

He cited the trend of ultra-wealthy individuals such as Bill Gates and Warren Buffet not to leave their descendants enormous sums of money, coupled with a trend to create incentive trusts for clients who do want to leave their wealth in trust for their descendants.

Clients mostly want to encourage beneficiaries to receive an education, to work hard, to enter social service fields (such as teaching, although this is nowhere nearly as common as it was years ago), to provide stewardship of the family wealth for succeeding generations, and to engage in philanthropy. These purposes are encouraged almost exclusively through the use of trusts, including incentive trusts. However, incentive trusts have significant disadvantages - they lack flexibility, they cannot adapt easily over time to changing value systems, and they present problems of enforcement. Scott cited one example of a beneficiary who was required to undergo drug testing every month, which alienated her from her family members and made her forego her interest in the trust.

Scott also analyzed how entity structures that are now commonly used in estate planning (such as limited partnerships) may strip control away from individual family members, with planned or unplanned consequences on behavior, and which may provide wanted or unwanted insulation for managers of the family wealth.

Following Scott, **Maria Nunez** gave an overview of the **foreign trust rules** since enactment of the 1996 and 1997 tax legislation.

Maria cautioned practitioners on the importance of understanding what is and what is not a foreign trust under the new rules, and warned that common sense is often deceptive and wrong in this area. Generally speaking, a trust beneficiary is any person who could possibly benefit from the trust, including persons who could benefit if the trust were amended. In most trusts this cause a virtually unlimited class of beneficiaries, both domestic and foreign. It is easy for a trust to be foreign and not know it, if you do not have a familiarity with the new rules.

The closing speaker for Tuesday was **Bruce Ross**, whoi spoke on some **trends in the rules governing professional conduct in trusts and estates practice**.

Only six states now clearly require privity as a condition precedent to brining a claim for legal malpractice in estate planning: Ohio, Maryland, Nebraska, New York, Texas, and Virginia. The issue is in a case that will be decided by the Hawaii Supreme Court.

Liability to beneficiaries for attorneys who represent fiduciaries is a hot area now. Generally, privity is required to sue an attorney representing a fiduciary for negligence. However, if more than negligence is allegedly involved, such as aiding and abetting, privity requirements are being relaxed. This is certainly true in the Restatement of Law Governing Lawyers. The Ethics 2000 project also may make significant changes in the rules governing confidentiality of communications between lawyers and fiduciary clients.

Bruce advised that ACTEC has completed a multi-year project on publishing engagement letters in estate planning and administration matters. Those letters and the third edition of the ACTEC commentaries on the rules of professional conduct can be purchased from ACTEC by anyone at a nominal cost. [**Editor's Note:** In addition, they will soon be available in full text on the public side of the ACTEC Web site at http://www.actec.org under RESOURCES]

That's it for Report #4.

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