

Heckerling Institute Report

Report #4a - The Tuesday Sessions

The following is Report #4A 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 has been numbered 4A because it is a **clarifying post** about some remarks that were attributed to **Mal Moore** by our on-site reporter, Bruce Stone, as having been made by Mal during the **Tuesday morning Q&A session** that Mal and Messrs Covey, Cornfeld and Eastland presented.

First, here from Report #4 [NOT Report #6] (which Report was all about the software vendors) **is the remark in question** that Mal supposedly made as the same was reported to us by Bruce:

"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)."

In response to this, the following messages have been posted on the ABA-PTL list and are being republished here so all the subscribers to all of the lists to which these reports are being sent can read them and reach their own conclusions. **In addition**, should Mal wish to have us post a clarification of his remarks in this regard, if one is needed, we would be glad to do so, and perhaps one of our on-site reporters could raise this issue with him if he is still there in Miami.

<<Message One>>

Date: Wed, 12 Jan 2000 21:18:14 EST

From: "Dennis P. Williams" <TAXPLAYER@AOL.COM>

Subject: Re: [ABA-PTL] Miami Heckerling Institute 2000 - Report #6

[sic #4]

To: ABA-PTL@HOME.EASE.LSOFT.COM

Mal suggested that

"Do not use Crummey withdraw power for Trust that are to be "Defective" and

to which the Grantor will sell assets, because over time the Powerholders will be the beneficiaries of the Trust."

Correct me if I am wrong, if the Grantor trust rule under Code Section 671-677 are "violated" the Trust is "defective" with respect to the Grantor. If concurrently, a Beneficiary is a "substantial owner" of the Trust under Code Section 678, because of the lapsed withdraw power, the Code Section 671-677 power will supersede the Code Section 678 provisions, and the Grantor, and not the Powerholders, will be treated as if he/she owned the Trust property.

After the Grantor death (or should the Code Section 671-677 provisions removed, then the Powerholders will "spring" into being the "Substantial Owner, under Code Section 678.

Does anyone share Mal's concerns about having Crummey Powers in a Trust that is to be used by the Grantor for his/her Sale of a Defective Grantor Trust?

This is important to me, because I have a Crummey Trust that I am about to have the Grantor sell some Class B Non-voting stock (S-corporation) Stock, and I need it to be 100% defective, with respect to the Grantor (and not with respect to the Powerholders).

Any comments will be appreciated.

Please feel to e-mail me at work at "dwilliams@webersterlinglaw.com"

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<<Message Two>>

Date: Thu, 13 Jan 2000 10:06:05 -0500

From: "<Bruce D. Steiner>" <BSteiner@KKWC.COM>

Subject: Re: [ABA-PTL] Miami Heckerling Institute 2000 - Report #6

[sic #4]

To: ABA-PTL@HOME.EASE.LSOFT.COM

If Mal is correct, wouldn't this produce a *good* result? During the grantor's lifetime, the grantor pays the income tax, even though the trust

is not included in the grantor's estate. After the grantor's death, the beneficiary pays the income tax, even though the trust may not be included in the beneficiary's estate.

Bruce Steiner

<<Message Three>>

Date: Thu, 13 Jan 2000 12:36:30 -0500
From: Doug Delaney <delaneyhhi@HARGRAY.COM>
Subject: Re: [ABA-PTL] Miami Heckerling Institute 2000 - Report #6
[sic #4]
To: ABA-PTL@HOME.EASE.LSOFT.COM

Also, assuming the grantor has a larger marginal income tax bracket than the beneficiary, isn't the audit risk lower as we may have a sizable income tax refund due?

<<Message Four>>

Date: Thu, 13 Jan 2000 07:57:19 -0800
From: Steve Oshins <steveo@WIZARD.COM>
Subject: Re: [ABA-PTL] Miami Heckerling Institute 2000 - Report #6
[sic #4]
To: ABA-PTL@HOME.EASE.LSOFT.COM

Bruce-

I think Mal's comment was to NOT use Crummey powers. I will not make any comments on that. But there is at least one PLR out there on that (that David Handler brought to my attention a couple of years ago when he and I were discussing it).

However, with respect to the trust being grantor defective during life and then beneficiary defective after death, see the 1990 PLR on this which was later changed by a 1993 PLR. According to the 1993 PLR, it doesn't work. The cites to the PLRs are in the 1998 T&E article my father and I co-authored called "Protecting & Preserving Wealth into the Next Millenium" which I think you all know how to find on the Published Articles page at <http://www.oshins.com/>. Sorry, I'm too lazy this morning to look for the actual cites.

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<<Message Five>>

Date: Thu, 13 Jan 2000 11:24:19 -0500
From: Wes Yang <wyang@KLETTLIEBER.COM>
Subject: Re: [ABA-PTL] Miami Heckerling Institute 2000 - Report #6
[sic #4]
To: ABA-PTL@HOME.EASE.LSOFT.COM

Steve,

If one limited the withdrawal rights to a 5 & 5 standard, would this avoid the problem of beneficiaries being treated as the transferors? My understanding (perhaps erroneous) is that it is the lapse of the withdrawal power above the 5 & 5 amount that is treated as being transferred by the beneficiary. While this obviously is more limiting than a full annual exclusion Crummey withdrawal amount, it would at least provide use of some portion of the annual exclusion on gifts to the defective trust. I understand (or at least I think I do) that the exclusion is not available with respect to the GST, and therefore GST exemption must be allocated, if the trust is a GST trust. Is my understanding a misunderstanding? Thanks.

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<<Message Six>>

Date: Wed, 12 Jan 2000 21:25:05 EST
From: "Dennis P. Williams" <TAXPLAYER@AOL.COM>
Subject: Re: [ABA-PTL] Miami Heckerling Institute 2000 - Report #6
[sic #4]
To: ABA-PTL@HOME.EASE.LSOFT.COM

Oh, one final question.

If a Defective Grantor Trust has a provisions that obligates the Trustee to pay to the Grantor any income tax attributable to the Trust's income so long as it is defective, I believe there is a PLR that states there will be no Code Section 2036 or 2038 problem for the Grantor.

Would the same result apply if the Trust has such a provision that permits, but does not obligate, the Trustee to pay to the Grantor an amount equal to the income tax attributable to the Trust's income?

I believe Wealth Transfer Planning form use "may," and not "shall" in the provisions related to paying the grantor an amount equal to the income tax attributable to the Trust assets.

I would rather use "may!"

Thank you for you thoughts.

Dennis P. Williams, JD and CPA (inactive)

<<Message Seven>>

Date: Wed, 12 Jan 2000 22:14:01 -0500
From: Don Cairns <doncairns1@WORLDNET.ATT.NET>
Subject: Re: [ABA-PTL] Defective trusts - Report #6 [sic #4]
To: ABA-PTL@HOME.EASE.LSOFT.COM

Try to avoid needing the reimbursement clause - in non-GST trust you're returning value to the settlor - in GST context you're doing that and wasting the GSTT exemption. If settlor can't handle the income tax (a good way to reduce settlor's estate without transfer tax) consider giving the independent trustee authority to add the spouse as a beneficiary and move the income tax money out of the trust back to settlor/spouse. (Yeah, yeah, not always a spouse . . .) Using power in trustee to add beneficiaries such as spouse and charities is an excellent way to achieve grantor trust status.

<<Message Eight>>

Date: Wed, 12 Jan 2000 22:16:36 EST
From: "Dennis P. Williams" <TAXPLAYER@AOL.COM>

Subject: Re: [ABA-PTL] Defective trusts - Report #6 [sic #4]
To: ABA-PTL@HOME.EASE.LSOFT.COM

Good Comments:

I generally give a Disinterested Trustee the power to remove the defective provision (and add them back later) so prospectively the tax liability can be shift from the grantor to the trust and back!

I have not used the "reimbursement" provisions, because I do not like to rely on PLRs.

Dennis P. Williams, JD and CPA (inactive)

<<Message Nine>>

Date: Thu, 13 Jan 2000 12:41:44 -0600
From: "James A. Williams" <jwilliams@GDHM.COM>
Subject: [ABA-PTL] Crummey Powers in Defective Grantor Trusts
To: ABA-PTL@HOME.EASE.LSOFT.COM

One of the reports [#4, not #6] from the Heckerling Institute correctly attributed to Mal Moore (while serving on a question and answer panel) the flat footed comment that defective grantor trusts shouldn't have Crummey powers. I was in the audience. As Dennis Williams points out in his earlier post, Mal is dead wrong on this point. He overlooked the fact that grantor held powers under Sections 671-677 trump Sec. 678 powers. I think he was just going too fast and that what he meant to say was that it is generally best to have such powers lapse protected. Unfortunately the other panel members (Covey and Cornfield and Eastland) were preoccupied with their own questions and Mal's overstatement wasn't corrected. That wasn't the only wrong answer given by the question and answer panel during that session. It's unfortunate that the reporter passed the comment along without editorial comment about, at least, its questionability.

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<<Message Ten>>

Date: Thu, 13 Jan 2000 13:33:10 -0600
From: "Jay S. Goldenberg" <attyjsg@CHICPLAN.COM>
Subject: Re: [ABA-PTL] Crummey Powers in Defective Grantor Trusts
To: ABA-PTL@HOME.EASE.LSOFT.COM

[W] well, there is an alternative answer. While I consider the whole Service theory on Crummey powers making the holder the "owner", I point out that 678 was only *one* of the theories they've propounded. Another is that the power holder is treated as though they themselves had withdrawn the money and turned around and recontributed -- i.e., becoming the grantor! In fact, this theory was used to qualify trusts as S shareholders. In such case, 671 wouldn't be trumping 678, because it's not a 678 issue.

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<<Message Eleven>>

Date: Thu, 13 Jan 2000 14:37:05 EST
From: Nassaujim@AOL.COM
Subject: Re: [ABA-PTL] Crummey Powers in Defective Grantor Trusts
To: ABA-PTL@HOME.EASE.LSOFT.COM

Educate me: I thought that when a Crummey power (aka a General Power

of Appointment) is allowed to lapse, the beneficiary who allowed the lapse to occur is deemed to have taken the property and recontributed it to the trust for purposes of the grantor trust rules, thereby making that beneficiary a partial grantor. and in a typical defective trust arrangement, this dirties the diaper.

and unlike the transfer tax rules, these is no 5 or 5 safe harbor.

I have heard this conclusion from a number of sources other than Mal Moore.

if this is wrong, please enlighten me.

Jimmy

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<<Message Twelve>>

Date: Thu, 13 Jan 2000 15:29:50 -0600
From: "David A. Handler" <david_handler@CHICAGO.KIRKLAND.COM>
Subject: Re: [ABA-PTL] Crummey Powers in Defective Grantor Trusts
To: ABA-PTL@HOME.EASE.LSOFT.COM

Section 678(b) says that if the trust is a grantor trust as to the grantor under 671-677, then 678(a) (which makes it a grantor trust as to a beneficiary) doesn't apply. However, 678(b) says that in such circumstances 678(a) doesn't apply with respect to a power over income, but doesn't say anything about principal. So, one could argue that a crummey power over a grantor trust makes the beneficiary the owner of the principal and the grantor the owner of the income. Many commentators feel this is a drafting error and thus "read" 678(b) as if it says income and principal.

PLR 9141027 held that where the grantor was taxable on the income and

principal
under 677 and 674, the holders of withdrawal rights would not be treated
as the
owners of any part of the trust under 678. Thus, the IRS treats 678(b) as
if it
reads "income and principal." PLR 9309023 concurs. There are no rulings
in
which the IRS has held to the contrary.

David A. Handler
Kirkland & Ellis

<<Message Thirteen>>

Date: Thu, 13 Jan 2000 16:58:35 EST
From: "Daniel R. Ross" <DanRRoss@AOL.COM>
Subject: Re: [ABA-PTL] Crummey Powers in Defective Grantor Trusts
To: ABA-PTL@HOME.EASE.LSOFT.COM

To the best of my knowledge there is no definitive authority of the income
tax consequences of the lapse of a 5&5 power. A number of years ago I
was
involved in a panel at the Hartford Tax Institute discussing this issue. A
follow-up article appeared in the Journal of Taxation.

The IRS has argued, though I am not sure there are any published rulings,
that section 678, unlike sections 2041 and 2514, contains no 5&5
exception,
and that, therefore, the lapse of a withdrawal power, even if limited to the
5&5 level, is a release for purposes of section 678. However, I and the
other panelists concluded there was more to the analysis. Both sections
2041
and 2514 contain specific language providing that the lapse of a power
shall
be treated as the release of a power; the release of a power is, of course,
a
taxable event under section 2514 and, in specified circumstances, may be
a
tax trigger under section 2041. Section 678, like sections 2041 and 2514
specifies the circumstances when a release of a power is a taxable event,
but
unlike the estate and gift tax sections, section 678 contains no language
specifically stating that a lapse of a power shall be treated as a release.
Unless there is a common law concept that a lapse should be treated as a
release, this difference in statutory language would suggest that a lapse of
a power, whether or not limited to the 5&5 level, is not a tax trigger for

purposes of section 678.

It has been many years since I have researched this issue. If anyone on the list is aware of any authority that would contradict the above analysis, I would be most interested.

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_____ **The End**

That's it for Report #4A.
