HECKERLING INSTITUTE 2001
REPORT #4

As we did in January of the last four years, and again with the permission of the University of Miami School of Law Center for Continuing Legal Education, we will be posting to this list throughout the coming weeks highlights of the proceedings of the 35th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 8-12, 2001 at the Fontainebleau Hilton Resort and Towers in Miami Beach, Florida.

Our on-site local reporters there in Miami this year will include:

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Again this year a complete listing of the proceedings and speakers is available on the Institute's Web site. The new URL for that site is http://www.law.miami.edu/heckerling
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REPORT NO. 4 - Wednesday, January 10, 2001 and Thursday, January 11, 2001

First, somehow Gene Zuspann's report on Dennis I. Belcher's Tuesday morning session entitled "How to Tie a Tight Knot with Marital Agreements" was accidentally cut from Report No. 3 before it went out (sorry Dennis and Gene), so here it is:

Dennis questioned why anyone prepares these documents. It is a lose-break even situation. The best scenario is that you never hear about the agreement after it is completed. If the matter goes to litigation, the attorney preparing the document will be a witness, and maybe, a defendant. He first reviewed the issues. The first issue is what law will be applied to the agreement. It is best to be in a state that has adopted the Uniform Premarital Agreement Act. Agreements in these states are more likely to be enforceable. He then discussed the provisions of the Act.

The presentation and materials also addressed the requirements under ERISA.. The benefits may be waived by the spouse if all requirements are met, however the regs take the view that this can not be done in a premarital agreement because at that time, the person is not a spouse. Dennis discussed a number of cases and the procedures that should be taken. Next he covered planning for divorce and then planning for death. Some agreements do not provide for divorce, but almost every agreement covers death.

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Second, here is yet more news from the Exhibition Hall, this time courtesy of Reporter Gene Zuspann:

I have been after some kind of a breakdown of vendors, especially in software. Some or all of these have been mentioned in earlier Reports. I believe that this is all the Estate Planning Software vendors who are attending:

BNA - Estate Tax Spreadsheet

Brentmark - Estate Planning Tools

CCH - Viewplan's Vista, Factuary, Benequick, Beneview and Progeny

Crescendo - the programs are primarily for charitable planning

ProBATE - from Greeley Colorado, one of the integrated programs for administration, but includes estate planning as well

Pen 'd Calc - a customizable program (by the vendor) that allows the user to have the screens changed.

U.S. Trust - EPLAN

West - Intuitive Estate Planner, FATE, FET, FIT and FGT

zCalc - good, inexpensive software ($99 here) for illustration of a large number of plans

Power Presentation is also attending (written up by Joe yesterday) but I understand that this is not a full calculation program.

Drafting programs - those that generate estate planning documents:

Cowles Legal Systems

Lawgic Publishing Company

ProDoc

The Technology Group - Wealth Transfer Planning by Jonathan Blattmachr (the only one currently on the web)

West - Bob Wilkins' Drafting Wills and Trusts on Caps

Lexis also has a product that has clauses for estate planning. At the moment, this is not a generation system. They are working on that now that they have acquired HotDocs, but their representatives have no idea of the status of estate planning forms other than the state already out - California.

Another web based planning vendor for the sharing of the information among the various parties to the estate plan is Connect2A.com, located at www.connect2a.com on the web. The significant difference for this product is that everyone enters information into an on-line database (is this a real ethical problem) and the information is downloaded in a format that various programs can import to use in the planning and generation of the documents. This would save the attorney a lot time in recreating the data.

I question whether the attorney should not have the data loaded to the firm's web site and sent to the attorney via e-mail or downloaded from the web site database. Although there would be time to enter the data into the various programs, the data would not be out of the attorney's hands. Also, encryption of this data would be available depending upon the request of the client.

Finally, a new company is at the institute - U.S. Deeds. They will have a state specific deed prepared and recorded for any state. The cost is $150 + recording costs. Ted Atlass queried whether you would get any advice. The danger would be that they would prepare an adequate deed, but, especially where the laws of the state are not understood by the attorney, i.e. a deed for California property needed by an attorney unfamiliar with community property, no suggestion that there are other issues that need considered.

In that case, whose O&E policy will take the hit?

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Next, Reporter Julia Fisher reports the following about Carol Harrington's presentation Wednesday morning entitled "Grandfathered Generation-Skipping Trusts":

On Wednesday, Carol Harrington covered the final regulations regarding effective date grandfathered GST trusts. The regs, which were issued December 20, 2000, address two issues: the two recent case holdings on the effect of a general power of appointment, and the rules regarding additions to grandfathered trusts.

The two cases (Peterson v. Comm'r, 1996 and Simpson v. US, 1999) reached different results when a surviving spouse held a general power of appointment over a pre-1986 marital trust. In the Peterson case the court sided with the IRS and held that the lapse of a general power in favor of grandchildren resulted in a taxable direct skip. The court in Simpson found for the taxpayer where the surviving spouse exercised the general power in favor of grandchildren. The regulations resolve the issue by providing that any property remaining in trust after the release, exercise or lapse of a taxable power is treated as a constructive addition to the trust.

The second issue that the final regs address is the case of additions to the corpus of effective date grandfathered trusts. The transition rule provides that GST does not apply to an effective date grandfathered trust except to the extent of post effective date additions to the trust, but a definition of addition is not found in the effective date provisions, the legislative history or existing regulations. Numerous private letter rulings have been sought, and many have been issued, seeking clarification of the addition rule when changes are made to a grandfathered trust.

The final regs provide four safe harbors regarding changes to exempt trusts, generally approving changes that arise from:

1. Certain powers held by the trustee;

2. Court approved settlements;

3. Judicial constructions; and

4. Modifications that do not shift beneficial interests in the trust to a lower generation or extend the time for vesting beyond the period provided in the original trust.

Carol pointed out that the regulations do not make clear the actual effect of the loss of exempt status if a change to the trust is treated as an addition.

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Next, Reporter Gene Zuspann reports the following on Thursday morning's leadoff presentation entitled "Funding Marital Deduction (and other) Bequests: Only the Questions are the Same" by Prof. Jeff Pennell:

Some of Jeff's material comes from several of his publications - BNA Tax Management Portfolio, 843 Estate Tax Marital Deduction, and Casner and Pennell, Estate Planning, Chapter 13. Also, the footnotes indicate that many of the provisions in the material are adapted for forms originally copyrighted The Northern Trust Company, printed with permission.

Jeff started with a chart on the different alternatives to funding the marital trust. He pointed out that the planner needs to keep in mind the possibility that the estate tax is repealed and carryover basis comes back. In this scenario, pecuniary funding could case significant taxable gains on funding - much larger than now. Also, he indicated that each of the alternatives have a hickey. The object in funding is to avoid the hickey.

Jeff has 8 alternatives. His most important criteria is the flexibility of the alternative chosen.

He next discussed PLR 9143008. An attorney in California has allegedly been told that the Service will issue a Revenue Ruling on the facts of this case. The PLR used cascading funding, which Jeff feels is very useful.

The method of funding can be chosen at the time of funding, rather than when the instrument is drafted.

Jeff then discussed the Chenowith case. The planning technique is to fund the marital share with 51% of an entity, getting the control premium in the funding, and then using intervivos gifts to reduce the share to less than 50% by the date of death. Note that you "can screw this up," citing TAM 9403005.

The problems with the large amount of IRD in many estates often needs to be taken into account. Sometimes these should be allocated away from the Marital bequest. This can also be trust when funding with 2057 assets. This topic will be addressed by Steve Martin in a presentation on 2057 later today.

Funding with split interests was discussed using cash to fund, then buy a life estate in an asset with the remainder purchased by the nonmarital share. He cites Treas. Reg. 25-2702-2(d)(1) Ex. 3 has authority that this is allowable.

In some regions, the Service is waiting for the surviving spouse to die, to determine if there was adequate funding at the date of the funding of the marital share. If a funding problem exists, there are sometimes massive gift tax, along with interest and penalties that have run for a number of years. One alternative, at the end of funding, have the surviving spouse give the fiduciary a release (normally the gift starts at the time that the spouse cannot make a claim against the fiduciary), and then file a gift tax return. This can get the statute running.

With the separate share rule, pecuniary maritals have become as difficult as fractional share maritals. "Caution also is in order if state law provides that the recipient of a true worth pecuniary bequest is entitled to statutory interest in lieu of income." The regs provide that the interest distribution does not carry DNI and is not entitled to a deduction - the result is double taxation. The moral - emphasized several times in the presentation - is that each choice does have a hickey.

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Next, Reporter Julia Fisher reports the following about Keith Bilter's presentation Thursday morning entitled "Marital Deduction Formula Clauses":

On Thursday, following Professor Pennell's discussion of marital deduction funding formulas, D. Keith Bilter of San Francisco analyzed his approach to this question. His analysis is founded on the objective that the marital deduction not be overfunded. This goal can best be met in most circumstances he posited by the use of three shares, all funded at date of distribution values: a pecuniary marital formula, a pecuniary credit shelter amount equal to the balance of the assets of the estate at date of death fair market value and a residuary equal to any balance of the estate.

Keith's conclusion is that this method will freeze the value of the marital, and that all appreciation will be allocated to the third residuary share. If the assets depreciate prior to funding, the plan provides that the marital and credit shelter shares abate proportionately.

This approach mandates careful attention to the GST funding rules that apply to pecuniary bequests. His conclusion is that a true worth marital funded at date of distribution values, using assets fairly representative of appreciation and depreciation during the period of administration and bearing appropriate interest will satisfy the GST requirements.

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Next, Reporter Gene Zuspann reports the following on Steve Martin's Thursday morning presentation entitled "Practical Aspects for Qualified Family Owned Business Interests [QFOBIs]"

Both Berle Abbin, who introduced Steve, and a number of Steve's colleagues said they have no intention of reading or using 2057, or for that matter, 2032A.

The basic thrust, if you qualify, is to get an additional deduction of $675,000. However, this is deceiving. The actual benefit is the difference between the current applicable exclusion amount and $1,300,000. This is the maximum that can be used after the interaction of the applicable exclusion amount and 2057. There is great complexity. However, Steve pointed out that he comes from a small community and his clients are usually smaller. They care about the savings gained using 2057. Further, pairing 2032A and 2057 in an estate of a married couple, can shelter $4.2 million from tax.

Steve believes that 2057 may be expanded. This comes from his conversations with people in Treasury. The reason is that they are looking for targeted tax relief - relief that benefits taxpayers that engage in certain activities.

Steve discussed the eligibility requirements of 2057. He pointed out that some of the terms in the statute are not defined or clarified, and that some, such as present interest, have a different meaning than their definition in other sections (2503 in the instance of the term present interest). He also discussed events and repercussions of recapture caused by an early disposition of a QFOBI - a qualified family owned business interest. One scary thought is that, if a recapture tax is owed, the tax and interest could exceed the value of the interest.

[Author's note: Several years ago, Don Kelley, in his presentation on a related topic, said that he "papers the file" with instruction letters, warning letters, and other CYA letters to the parties signing the election - a VERY GOOD IDEA!]

Initially, Steve pointed out that 2057 is highly dependent upon 2032A, having 16 cross-references to that section. However, there are many differences, so the planner must be cognizant of these. Steve has found that there is no clear answer to which election is best. He talks with the family about the differences and the probable actions of the family in the recapture period. Also, there is no authority for a protective election under 2057 (there is under 2032A).

Another area where there is no authority is for a partial election. Steve has filed returns with partial elections, which have been audited and closed without problem.

Originally, when this section was passed as 2033A, there was concern about the type of martial formula. A pecuniary marital formula is best for using 2032A. Now, Steve believes that any marital formula works with 2057. He pointed out the Jeff Pennell's material indicates that a formula marital may not work.

Steve drafts with all of his QFOBI provisions in one place. This includes subtrusts and those provisions to help avoid triggering the recapture tax. Also, he sometimes includes provisions creating positions to assist with material participation by a qualified heir (a requirement to avoid recapture), such as appointing a qualified heir as a special trustee, or to hire a qualified heir as a manager. To avoid problems with persons not signing the election and recapture agreement, he sometimes modifies his tax clause to provide that if a beneficiary does not sign the agreement, that beneficiary's share will be burdened with the extra tax caused by the inability to elect 2057. This is often a problem where one heir is managing the business, and the other heir(s) are not around and not involved - those not involved are not willing to take the risk of a large recapture tax if something goes wrong.

Finally, he discussed the problems with buy-sell agreements and premarital agreements where QFOBI's are involved.

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That is it for Report No. 4. The full text of all the Reports will be posted on the ABA RPPT Web site at http://www.americanbar.org/groups/real_property_trust_estate.html beginning early next week.

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