Report #3

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The below Report was compiled by our on-site Reporter, Ted Atlass, who is a distinguished member of the Colorado Bar Association practicing in Denver, Colorado.

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SINGLE STOCK MONETIZATION AND DIVERSIFICATION TECHNIQUES

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I. INTRODUCTION

Discussed were tools for monetizing or diversifying concentrated stock holdings while delaying the imposition of income taxes. There is no one magic bullet - it is often necessary to combine the use several strategies.

II. WHY DIVERSIFY?

A properly diversified portfolio will both reduce the risk and enhance the expected return to be achieved.

III. NON-TAX FACTORS TO CONSIDER

Tax considerations cannot be considered in a vacuum. Business laws - such as state and federal securities laws, and the Hart-Scott-Rodino Act, need to be considered, as well as the client's non-tax objectives (e.g., generating immediate cash or ongoing cash flow, simplifying his or her investments, desires to get funds to family or charity in immediate or long term, desire to control the investments, unrelated business taxable income, and the market's sensitivity to the client's disposition of shares, etc.).

IV. SELECTED DIVERSIFICATION TECHNIQUES

A. Issues involving the use of traditional charitable remainder trusts were discussed, including CRATs, CRUTs, and NIMCRUTs - including their being non-amendable and irrevocable, the impact of inflation of a CRAT payments, the impact of raising and falling asset values on CRUTs, the tax disadvantages of CRTs (re the tier system under IRC Sec. 664, the problems re unrelated business income investments, etc.), and the risk of premature death causing a charitable windfall. Also discussed were the added advantages of traditional NIMCRUTs, especially their flexibility.

B. An innovative variation on the spigot NIMCRUT was discussed, involving the gifting of non-callable preferred limited partnership interests (representing perhaps 90% of all of the partnership's outstanding units) to a NIMCRUT. Management and growth units in the partnership would be kept in the family. An appreciated asset would first be given to a partnership, the partnership units then gifted to a NIMCRUT (structured to provide at least the minimum 10% charitable deduction), and the appreciated asset subsequently sold by the partnership. Such gifted non-voting preferred limited partnership units would provide that all payments be deferred for many years (perhaps 20 years) before becoming due shortly before the NIMCRUT is to end. Most of the gain from the sale of the asset would thus be deferred for 20 years under the tier rules of IRC Section 664.

C. Also discussed was a technique where appreciate property would be exchanged for an annuity from a partnership owned mostly by a public charity (perhaps a donor-advised fund) - where the partnership would subsequently sell its assets for a long-term note to a different limited partnership consisting of the donor's children, with interest at the AFR rate. Such note could be a SCIN if it were desired to eliminate the mortality risk associated with the early deaths of the donors.. The children would get the benefit of any investment return that beat the AFR rate, and the parents would get the favorable IRC Sec. 72 tax rules relating to annuity payments (rather than less favorable IRC Sec. 453 installment sale treatment). There were a lot of details and issues relating to this technique which were covered in detail in the outline.

D. Public or multi-client exchange funds were discussed as a means of diversifying one's stock holdings (although the stock ultimately received would not have a stepped-up basis). Such partnership must stay in existence for 7 years, and no cash can be received in the first two years, in order to avoid disguised sale rules. Also, such partnerships must be formed other than strictly with public securities.

E. A derivative technique, called a "collar", combines the purchase of a put option and the sale of a call option - where the price received and paid for such options offset each other (i.e., a "zero-cost" collar). Economic risk must exist, but is limited - and most of the owner's equity can thus be immediately borrowed out and redeployed in other investments, even though income taxation is postponed because the original stock has not yet been sold.

F. Another derivative technique, called a "prepaid variable rate forward", combines a collar structure with a loan in a single transaction - the shareholder's risk is limited, and the shareholder gets about 85% of his or her equity out up front - and, in 3 or so years, is obligated to tender an appropriate amount of stock to close out the deal (less shares need be tendered if the stock goes up, and income taxes are postponed until such stock is tendered).

G. Another technique, called the "mixing bowl example," involved the use of appreciated stock , a partnership, and a c corporation, was discussed that may allow a family to achieve results not unlike those obtained with a public exchange fund.

V. COMPARISON OF TECHNIQUES

Extensive spreadsheet were attached to the outline and compared the different diversification discussed diversification strategies with each other - and which indicated that there is no one technique which is always better than the others.

THE NEW MINIMUM DISTRIBUTION RULES

Marcia Chadwick Holt, Esq., of Davis Graham & Stubbs LLP, Denver, Colorado

I. THE 2001 PROPOSED REGULATIONS

Proposed regulations relating to minimum distributions were released on January 17, 2001, and issuance of final regulations is expected in the near future - possibly February. The required minimum distributions (RMDs) under the 2001 Regulations are generally smaller than those required by prior law,

II. CAVEAT RE BENEFICIARY DESIGNATIONS

The preemption of ERISA over state law was emphasized, and the need to designate a new beneficiary after becoming divorced was discussed - in the Engelhoff case, the state statute cutting out an ex-spouse from non-probate assets upon divorce was held inapplicable where the decedent had not changed the beneficiary designation that named his former spouse as beneficiary.

III. QUALIFIED PLAN DISTRIBUTION OPTIONS

Remember that ERISA requires that married participant in a pension plan, including a money purchase pension plan: (a) at retirement is required to take a qualified joint and survivor annuity, and (b) at death prior to retirement must take a qualified pre-retirement survivor annuity.

The plan may, but need not, offer optional benefit forms with spousal consent.

IV. DISTRIBUTIONS DURING LIFE OF PARTICIPANT OR OWNER

The required beginning date (RBD) is generally April 1st of the calendar year following the later of the year the participant attains age 70-1/2, or, unless a 5% owner or IRA owner, April 1st of the calendar year the participant retires.

The 2001 proposed regulations provide a new lifetime uniform table for determining required minimum distributions (RMDs) which must be taken after the RBD. Such tables can be used even where there is no Designated Beneficiary. No life expectancy recalculation is required. The participant's age is used to get the divisor. An exception to the new tables applies if the spouse is a designated beneficiary and is more than 10 years younger than the participant - and meets certain other requirements - in which case a "joint life and last survivor expectancy table" can be used to computed the MRD.

A controversial provision in the proposed 2001 regulations would require "IRA trustees, issuers, and custodians" to report RMDs annually to the IRS, the IRA owner and the IRA beneficiary. Many comments were made to the IRS regarding this requirement, and no effective date has yet been set for it. Additionally, new aggregation rules for multiple IRAs will now apply.

V. DESIGNATED BENEFICIARIES

The proposed 201 regulations provide that during the life of an IRA participant or owner, the new uniform table (or exception re 10 year younger spouse) applies - whether or not there is a Designated Beneficiary. The Designated Beneficiary's life expectancy only matters after the death of the participant or IRA owner.

The Designate Beneficiary is determined on December 31st of the calendar year following the calendar year of the participant's or IRA owner's death. The interim or shakeout period after death can thus be used to get rid of unwanted beneficiaries (i.e., cash them out, do disclaimers, eliminate beneficiaries who die in common disasters, etc. - although not all plan administrators will recognize disclaimers) - so that the remaining beneficiary qualifies for favorable stretched out RMDs.. Individuals, not estates or charities, can be Designated Beneficiaries. If there are multiple beneficiaries, use the factor for the beneficiary with the shortest life expectancy. Certain trusts can be designated beneficiaries.

VI. POST-DEATH DISTRIBUTIONS

There are two rules that may govern how quickly distributions must be made from a qualified plan and IRA where death is before the RBD or before distributions commence - (a) one allows use of the life expectancy of the Designated Beneficiary per Reg. Sec. 1.72-9, Table V), and, (b) the other requires that all distributions be made by the end of the calendar year in which occurs the 5th anniversary of the death of the participant or owner. The plan controls which applies - but if the plan is silent, then: (1) the life expectancy rule applies if there is a Designated Beneficiary, and (2) the five-year rule applies if there is no Designated Beneficiary. A special rule applies if the surviving spouse if the Designated Beneficiary and the sole beneficiary of the account. - and allows use of the surviving spouse's life expectancy, which is automatically recalculated. An "at least as rapidly" rule applies where death occurs after the RBD, or after distributions commence - and an exception applies where the deceased participant or IRA owner had no Designated Beneficiary.

VII. SUMMARY CHART FOR DETERMINING RMDs

A very useful summary chart for determining RMDs was provided in the outline.

VIII. SPOUSAL ROLLOVERS

It was pointed out that the proposed 2001 regulations require that a surviving spouse, who is age 70-1/2 or older, must first take the RMD for that year as owner - and only the balance may be rolled over. Also, it was pointed out that EGTRRA of 2001 expanded permitted spousal rollovers to be made to IRC Sec. 401(a) plans, Sec. 457 plans, and annuities under Sec. 401(a) and (b). Additionally, in certain circumstances, the Secretary can now waive the 60 day rollover requirement.

USE OF IRD FOR CHARITABLE BEQUESTS

Prof. Christopher R. Hoyt, University of Missouri School of Law, Kansas City, Missouri

I. GIFTS THAT PRODUCE THE BEST TAX RESULTS

Generally, the best tax results come from the lifetime gifts of appreciated long-term capital gain property to charity, as a charitable deduction for the full fair market value results, and the built-in capital gain is avoided. Reduced tax benefits apply to charitable gifts of ordinary income property, such as inventory, and to gifts of tangible personalty, such as paintings.

At death, it is best to give so-called "IRD" (income in respect of a decedent) assets to charity, as the estate is reduced for death tax purposes by the full amount of the IRD, the charity is not subject to being income taxed on receipt of the IRD (as would be a non-charitable beneficiary), and other assets (which will not be income taxable to non-charitable beneficiaries, and which will qualify for basis step-up, if appreciated) are thus freed to be gifted to non-charitable beneficiaries.

It was interesting to learn that of the roughly 2% of decedents who are required to file estate tax returns, only 17% to 19% of the estate tax returns filed in several selected years in 1986 to 1998 claimed a charitable deduction.

II. FUNDAMENTAL PLANNING POINTERS

Testamentary charitable gifts should be made from IRD assets. Even persons not inclined to make charitable bequests may consider gifting retirement plan assets to charity at death, due to the high double tax on such assets if such assets pass to individual beneficiaries. Also, naming a charitable remainder trust to be the testamentary beneficiary of a retirement plan or of other IRD assets at death is a way to defer the income taxation on such IRD.

III. OVERCOMING OBSTACLES

Ideally, IRD assets will go directly to charity at death - so that the IRD never hits the estate's income tax return (e.g., charity will be the direct beneficiary of the retirement plan or U.S. Savings Bonds having accrued but untaxed interest). Otherwise, if the estate collects the IRD, it is necessary that the state qualify for the charitable income tax deduction via a well-timed payment to charity, or via the permanent charitable set-aside deduction under IRC Sec. 642(c).

The executor/trustee should be given authority to make non-pro rata distributions (so IRD assets can be distributed to charity), and there should be language in the document (which, it is hoped - but not guaranteed - that the IRS will respect) that any charitable bequests are deemed funded first from IRD.

Additionally, under the 2001 proposed regulations dealing with required minimum IRA distributions (which provide that the Designate Beneficiary is determined on December 31st of the calendar year following the calendar year of the participant's or IRA owner's death - see summary of Marcia Holt's talk for more details) - it will be advisable, if charity and individual beneficiaries are to share an IRA, that the charity be paid in full by December 31st of the calendar year following the account owner's death, if a separate account is not established for the charity, so that the remaining individual beneficiary can get maximum deferral.

IV. LIFETIME CHARITABLE GIFTS FROM IRAs AND QUALIFIED PLANS

Lifetime gifts from retirement plans result in the participant having both income from a retirement plan distribution and an offsetting charitable income tax deduction - so contributing appreciated stock during life is a better deal, from income tax standpoint. But income tax savings can result from the lifetime charitable gift of a retirement plan distribution in certain circumstances involving lump sum distributions (either of employer stock, or which qualify for forward-averaging tax).

V. STRUCTURING CHARITABLE BEQUESTS UNDER THE 2001 PROPOSED REGULATIONS DEALING WITH RMDs

The outline contains a detailed analysis of how to structure charitable bequests under the 2001 proposed regulations dealing with required minimum distributions.

VI. LEGAL AUTHORITY ON POINT

Useful as a reference, a number of private letter rulings dealing are cited in the outline which deal with the issue of charitable gifts and IRD.

UNDERSTANDING YOUR CLIENT'S MONEY PERSONALITY

Jon J. Gallo, of Greenberg, Glusker, Fields, Clayman, Machtinger & Kinsella LLP, Los Angeles, California

I. IMPORTANCE OF CLIENT VALUES

Every client has values and desires, separate from saving taxes, that must be considered. We must humanize are approach to estate planning - i.e., be both "high tech" and "high touch."

II. REDUCTION OF STRESS

Planners don't realize how stressful the estate planning process is to clients - e.g., how stressful thoughts and discussions of his or her own death, the death of a spouse or child, divorce, financial calamity, disability, sale of one's business, etc., are to the client.

Client stress can be reduced by: (1) Listening (i.e., more human interaction, rather than mail and e-mail contacts, etc.), (2) Normalizing (i.e., explain the estate process and that most clients don't like to think about such things, have trouble making decisions, have to revisit the estate plan every few years, etc.); and (3) Reframing (i.e., rather than talking about death and taxes - instead focus on a family vision statement, goals, and values). It was suggested that the concept of the "ethical will"be looked at in this regard.

III RELATIONSHIP WITH MONEY

Estate planners must understand the client's relationship with money - i.e., how they feel, how they think and how they deal with it. Attitudes towards the acquisition of money (could they not care less about it, or would they do anything to get more of it), the use of money (is the client a miser, or do they spend everything they get), and the management of money (do they micro-manage every dime, or are they disorganized and hate being involved in money management).

CHOICE OF LAW IN TRUSTS: HOW BROAD IS THE POSSIBLE SPECTRUM?

Malcolm A. Moore, Esq., of Davis Wright Tremaine, Seattle, Washington

I. INTRODUCTION

The governing law with respect to the validity, construction, administration, and meaning and effect of a trust was reviewed. Due to policy reasons, a settlor has historically had the least amount of flexibility (re choice of laws) with reference to issues of validity. Section 403 of the new Uniform Trust Code would eliminate the traditionally differences in rules relating to trusts with land and trusts with other assets, relating to the determination of the trust's validity and meaning and effect - thus granting more authority re choice of law matters than has historically existed.

Questions of validity (e.g., public policy issues such as the rights of creditors or surviving spouses) involving trusts holding land have historically been governed by the law of the land's situs - at least while such land continued to be held by the trust. Questions dealing with the validity of other trusts have historically be decided by the law of the testator's (or settlor's domicile), or (if no public policy in the testator's or settlor's domicile is violated), by the law of the state with the most significant relationship with respect to the particular issue at hand.

Questions of construction, absent a choice of laws clause, seem to be less well-settled. They may be decided by the law of the settlor's (or decedent's) domicile, or where the trust is administered, or the law where the most significant relationship to the matter at issue exists, depending upon the circumstances. The key is that these are default rules that can generally be overridden by a specific choice of laws clause in the document. Such choice of laws clause may mandate what law is to apply, or may give the trustee (or trust protector) some flexibility to choose what law is to apply.

II. SITUS

Situs generally means the place of the trust's administration. Where the choice of law is tied to situs, moving the place where the trust is administered (typically where the trustee is located) may change applicable law as to the rights of creditors of settlors or beneficiaries, accounting requirements, availability of non-judicial settlement provisions, state income tax consequences, etc.

III. WHEN CAN A SETTLOR/TESTATOR CHOOSE THE APPLICABLE LAW?

Historically, there is little law re the ability of settlors and testators to choose what law governs the validity of a trust of land. The Uniform Trust Code will presumably create such an ability where there is some nexus between the trust and the jurisdiction whose law is chosen. Settlors and testators of trusts of movables have historically had broader rights to designate a choice of law governing the validity of a trust of movables,, at least provided that there is some nexus with the chosen jurisdiction and where no strong public policy of the settlor's or testator's law of domicile is violated.

Testators and settlors have long been able to make choice of state laws provisions re construction and administration (e.g., trustee powers , compensation, indeminficiation and succession; trust investments and termination; and principal and income issues). It was suggested that they should also be able, via incorporation by reference, to cause a uniform act (such as the Uniform Trust Code or Uniform Principal and Income Act) to govern a trust.

IV. MOVING A TRUST

Trustees may be given directly given the right to move a trust's situs or its principal place of administration to a different jurisdiction, or such a change of jurisdiction may happen indirectly by reason of a change of trustee occurring (via resignation, removal, or the exercise of a power of appointment), a trustee moving, etc.

V. WHY MOVE A TRUST

Moving a trust's situs to a different jurisdiction could be desirable for a number of reasons, including more favorable income tax consequences, to have different rules re the availability of court oversight or alternative dispute resolution, to allow the application of different principal and income rules (including a total return investment concept), etc.

VI. CHOICE OF LAWS FROM STATES OTHER THAN THE STATE OF SITUS

The trustee or a third party, such as a trust protector, could be given the power to adopt the laws of other jurisdictions (including the laws of different jurisdictions for different issues), so long as the chosen jurisdiction has some relationship to the trust where matters of validity are concerned), so long as the state whose laws are being adopted does not have limitations that have not been met (such as requiring that a trust's principal place of administration be in the state in order for such power to apply to a trust).

VII. LIMITATIONS MAY NEED TO EXIST

Trustees, protectors, and beneficiaries should not be given such broad discretion as will cause potential gift and estate tax problems (e.g., causing a taxable power of appointment to occur, etc.), or which could defeat the objectives of the settlor/trustor. Additional, attempts to grant powers which would violate strong public policy (encourage divorce, limit spousal rights, defeat creditors, etc.) would presumably be ineffective.

VII. DRAFTING CONSIDERATIONS

It was suggested that validity of the trust be covered by whatever applicable law would support such validity, and that the trustee be given broad authority to select what laws (including laws of jurisdictions and uniform acts) are to govern questions of construction, the meaning and effect of the trust's terms, and the administration of the trust - including moving the trust, or not exercising such powers. In default of such an exercise of discretion, the laws of the place of administration would apply. Additionally, the trustee would be prohibited from any exercise of discretion that would cause the trustee to be deemed to possess a general power of attorney for federal gift and estate tax purposes.

HECKERLING SPECIAL:

Stephan Leimberg <steve@leimbergservices.com> has recently informed us that his Company [Leimberg & LeClair] is willing to offer a Heckerling Special for anyone who sees this announcement and subscribes to his LISI Newsletter service during the time the Institute is taking place All you have to do is send an e-mail to service@leimbergservices.com and include the words HECKERLING DISCOUNT in the subject. Bob LeClair will get back to you and handle the sign-up. They will give those people a monthly price of $13.95 rather than the $14.95 regular price. They also can take a free look at the site and its many services by going to http://www.leimbergservices.com and clicking on the blue FREE TRIAL button on the top right.

NEWS FROM THE IRS:

>The IRS has just publishes the New Form SS-4, Application for Employer

>Identification Number

>(PDF). It is a Two-page PDF document. (Internal Revenue Service).

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>The instructions are also there in a separate file - iss4.pdf

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That is it for Report No. 3. 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.

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