Report #4a

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REPORT NO. 4A - The Vendors and Other Techie News

This report is a supplement to Report #4 that was sent out on Saturday, 1/12/01, as we have a couple of corrections we need to make in the information that is in Report #4 and a few additional tidbits of information to pass along.

FIRST, with regard to WealthCounsel and their special offer, which is good for the rest of this month, we had the pricing information wrong. The information below is official from their CEO, Lew Dymond.

The special offer pricing is $3,500 for the initial cost ($3,900 after the special offer pricing ends) plus $350 a month, which is the continuing monthly fee. The continuing monthly fee can be paid $3,000 in advance each year, for which the user receives a $500 discount. Also, and as was noted in Report #4, the initial fee and monthly maintenance can be paid for in a variety of ways, which are (a) $0 down plus $575 per month for 24 months (that's a total of $13,800), or (b) $1,500 down plus $575 per month for 12 months (that's a total of $8,400), or (c) $3,500 down plus $350 per month for 12 months (that's a total of $7,700), or (d) a one-time payment up front of $7,000, and all PROVIDED you mention that you heard about this offer on the ABA-PTL list (or, for those of you from Colorado, the CBA-TES list). Otherwise, and after 12/31/01 for all other customers, the total minimum initial cost has been increased to $8,150, with the monthly fee being $390.

SECOND, with regard to Schumacher & Co. [technically Schumacher Publishing, Inc.], we incorrectly listed the URL for their Web site as - www.estplanning.com. Actually, that URL belongs to the 6 lawyer San Antonio, Texas law firm of Bayern & Aycock. The correct URL for Schumacher is www.estateplanning.com. This Company, which used to be owned and managed by Jim and Vickie Schumacher, is now being run exclusively by Vickie, who was in Miami with her tech people taking orders for their books, pamphlets and lawyer Web sites.

The consumer side of their Web site lists links to such things as their own Directory of estate planning lawyers and related financial planners and service providers with user-posted (presumably unsolicited) 1 to 10 ratings and client reviews (we couldn't find any negative ones) of some of these lawyers, along with links to the CLE content and articles many of these lawyers have either written or placed on their Web sites, a schedule of client seminars across the country, information about the 5th Edition of their best-selling book, Understanding Living Trusts, and an order form for all of their books, Mini-Reports and Financial Organizer.

The professionals side of their Web site lists links to such things as pamphlets and PowerPoint presentations, Internet content (including how they can build a site for you [for $1,900 plus an $89 per month hosting fee for the Full Edition] or add their educational content to your existing site, resources for such professionals, access to their professional Directory where you can add your own name or firm listing for free, and a direct link to the International Genealogical Search Inc.

THIRD, for those of you who might be wondering if that special LISI Newsletters pricing offer from Leimberg & LeClair is really worth it, below is the full text of a sample issue.

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Steve Leimberg's Estate Planning Newsletter

Subject:PLR 200150020 Beware of Jointly-Held Powers Over Trusts

LISI Commentator Jerry Kasner uses PLR 200150020 to illustrate a "trap for the

unwary" in drafting or recommending trust provisions which give individuals who

may not even be named as beneficiaries of the trust a power to determine who

receives distributions from the trust.

Jerry warns that such powers could be classified as fatal general powers of

appointment.

KEEP READING IF:

You plan estates or review or draft wills and trusts

You advise clients who wish to structure multi-generational trusts

for their

descendants, and seek to give younger generation family members control

over the

distributions.

BUT FIRST, A LISI LawThreads® ALERT:

IRS RULING APPROVES CRT TO CGA EXCHANGE: A discussion on the GIFT-PL list

analyzes PLR 200152018 which approved a taxpayer's exchange of a life interest

in a charitable remainder trust for a gift annuity issued by the same

charity.

Our LawThreads review also links to a couple of articles on the Web discussing

the ruling.

HECKERLING INSTITUTE REPORTS BEGIN: As in past years, Moderator Joe Hodges and

his volunteer reporters attending the 2002 University of Miami Philip E.

Heckerling Institute on Estate Planning will post brief summaries of the

proceedings. LISI's LawThreads review will serve as a link to the reports
in the
list archives and also to the Reports as posted on the Web pages of the ABA
Real
Property, Probate and Trust Law Section. To read these and other recent
LawThreads items, log into LISI at http://www.leimbergservices.com, then
click on
the blue LawThreads tab under Special Services.

Remember that LawThreads also provides an easy way to sign up for ABA and other practical, highly informative, and well-run discussion groups. Once you are logged into LISI at http://www.leimbergservices.com, click on the blue LawThreads tab at the top right hand side of the page. Then click on List Resources. Scroll down and you'll find an easy way to sign up for one or more professional discussion groups.

NOW BACK TO JERRY KASNER'S CAUTIONARY TALE:

EXECUTIVE SUMMARY:

At some date prior to January 1, 1977, the decedent created a trust for his grandchildren and their descendants. The trust gave his two children the joint power to "close the class" of grandchildren who would be eligible
beneficiaries.

(This is legal jargon which means that the children can exercise their power to provide that any grandchildren born after a certain date are not eligible beneficiaries.) The children now propose to release that joint power, and are concerned that such a release will be a taxable gift by them. The IRS ruled it would not be so long as joint power holders have interests which are
adverse to
each other, they do not have general powers of appointment, and the release of

the joint non general power has no gift tax consequences.

FACTS

The decedent created an irrevocable trust. Only his grandchildren and their descendants were named as beneficiaries.

He gave his two children a power, which they could only exercise jointly while both are alive, to close the class, in which case grandchildren born after the date that power is exercised would not be beneficiaries. If one child dies, the survivor can exercise the power to close the class.

THE PLOT THICKENS:

However, there are no grandchildren, nor descendants of grandchildren! If the children exercised their joint power now, who would get the assets in the trust?

Under the trust terms, it will terminate on the death of the last child, and be distributed to the descendants of the decedent who created the trust. Outside of a small interest which might pass to a cousin, it appears the trust would be distributed to the grantor’s children, or surviving child, who are not even named beneficiaries, but who are the lineal descendants of the decedent.

IS THIS A GENERAL POWER OF APPOINTMENT?

So if the children exercise their joint power to close the class, then the trust will be distributed to the descendants of the decedent. In effect, the children could exercise their joint power and the trust assets would be distributed - to them! Since the effect of their joint power is to permit them to direct distribution of the assets to themselves, it would appear to be a general power of appointment over the trust. And if they release that power, that release would itself be a taxable gift.

However, as the ruling points out, Code Sections 2041(b)(1)(C)(ii) and 2514(c)(3)(B) provide that for gift and estate tax purposes, a jointly held power

is not deemed to be a general power of appointment so long as the joint owners must agree on the exercise, and each has a substantial interest in the trust property which could be defeated by the exercise of the power.

THE ADVERSE INTEREST ARGUMENT:

The taxpayers argued, and the IRS agreed, that under the terms of the joint power, if one child died, the other child could exercise the power and direct distribution of all or most of the trust to himself. Since either child might survive, each child has a chance of getting all of the trust. This creates an adverse interest. Therefore, the joint power is not a general power of appointment so long as both are alive. The release of a non-general power of appointment has no gift tax consequences, and that is the effect of the ruling.

Note the cousin who had a possible interest in the trust was permitted to disclaim that interest within 9 months of the date he became aware of the trust interest. Since the trust was created prior to January 1, 1977, IRC §2518 would

not apply which means the 9 month disclaimer period starts with the date the disclaimant first becomes aware of the interest in the trust, not the date of transfer to the trust under IRC §2518.

COMMENT:

Clearly, this is an unusual fact pattern. But the issue of joint powers does come up in practice. Some years ago, the author was consulting with an attorney who had been asked to review a multi-million dollar trust created years before in which the five children of the grantor who were the income beneficiaries could jointly agree to invade the trust for their own benefit. They were clearly adverse to each other, since any exercise of that power in favor of one would reduce or eliminate the interests of the others, and at the death of a child, the remaining children could exercise the power. At the termination of the trust, it would pass to their issue. It was clear that the intention here was that the trust would skip the generation of the children, and that the attorney who drafted the trust assured the parties that this would be the case. No problem, right?

Guess what? Four of the five had died. This left the sole remaining child with a general power of appointment over the entire trust. Fortunately for the heirs of the attorney who drafted the trust, he had died some years before, and could not be sued.

DON’T RELY ON ADVERSE INTEREST!

I feel the adverse interest rule that applies to joint powers should never be relied upon to avoid general powers of appointment. Further, it is important to remember that the mere fact a certain individual is not named as the beneficiary of a trust does not mean he or she could not have a general power of

appointment

over it. The most common example is where the person named as trustee has the

power to make trust distributions to satisfy his or her own legal obligations,

including the obligation to support dependents. That is why many states have

adopted statutes which prohibit a trustee from making such distributions.

Be careful out there!

HOPE THIS HELPS YOU HELP OTHERS!

Jerry Kasner

Edited by Steve Leimberg for Steve Leimberg's Estate Planning Newsletter

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page. Click on the grey box that says: CLICK IF YOU FORGOT PASSWORD. Follow

the instructions and we'll e-mail it to you almost instantly.

CITES:

PLR 200150020 ; IRC §2514, §2041 IRC §2041(b)(1)(C)(ii), §2514(c)(3)(B), IRC

§2518. See also the just released book, Tools and Techniques of Estate

Planning

(800 543 0874).

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FOURTH (AND LAST), here from the Weinberg Group is a sample of one of their

Current Developments e-mails, this one dealing with the Split-Dollar IRS

Notice 2002-8 that was issued on 1/3/02:

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Dear Current Developments Subscriber,

As you are probably aware, on January 3, 2002, the Treasury and IRS issued Notice 2002-8, the long-awaited new rules for taxing split-dollar life insurance. This new Notice radically changes the tax treatment of split-dollar for the future, subject to some very important transitional "grandfather" rules. On January 7th, AALU issued Washington Report No. 02-1 analyzing the new rules in detail. Rather than repeat that analysis, attached is the AALU Washington Report in its entirety. [Ed: This attachment is not attached to this Report]

The new Notice will have to be studied in the days ahead to fully understand its ramifications. In addition, the IRS solicits written comments on the Notice by April 28, 2002. After that, proposed regulations will be issued, comments will be solicited on the proposed regs., and then final regulations will be adopted. This process will take some time, and, obviously, the final rules on split-dollar may differ markedly from those of the Notice. Therefore, what I would like to do here is make some preliminary observations about Notice 2002-8.

1. The most important date for the moment is Jan. 28, 2002.

Split-dollar arrangements entered into before Jan. 28th are entitled to the limited grandfather protection provided for existing plans under the Notice's "safe harbor" rules. Thus, there remains a very limited period(less than three weeks) to implement new split-dollar plans that will have the same grandfathering provided for existing plans.

2. Existing split-dollar plans (pre-Jan. 28th plans) may continue in split-dollar mode and terminate before January 1, 2004, and the employee will not be taxed on then existing policy equity, i.e., on cash surrender value received in excess of basis. I think this grandfather provision will be meaningful for "matured" split-dollar plans, meaning plans near or at the time of rollout. However, for "unmatured" plans, where substantial future premium payments are yet to be made, I don't think it will be meaningful in most situations to be able to terminate the plan without adverse tax consequences.

3. Alternatively, for existing split dollar plans (pre-Jan. 28th plans), the plan may continue in split-dollar mode until 2004. Then, for all periods beginning on or after Jan. 1, 2004, the plan must be converted to a loan from employer to employee in order to avoid taxation of employee equity upon later termination of the plan. (It's not clear whether "all periods beginning on or after Jan. 1, 2004" refers to January 1, 2004, employer or employee taxable years beginning on or after that date, or the policy year that begins on or after that date.) All pre-2004 employer outlays for premiums must be picked up as the beginning loan balance, and subsequent premiums paid by the employer will be treated as additional loans. Presumably, the loan may be either interest-free and taxed as a "below-market" loan under IRC sec. 7872, or interest-bearing and taxed under the usual tax rules without the complexities of sec. 7872. (Interest-bearing loans at the appropriate AFR are not taxed under the imputed interest rules of sec. 7872.) I believe this will be the grandfather clause most used by existing split-dollar plans as a practical

matter. Questions remain to be answered, such as the effect of the different tax treatment between demand and term loans, the applicability of the Original Issue Discount (OID) rules, etc. These, as well as other possible issues, are identified in the Conclusion of the AALU Washington Report.

4. As indicated previously, new split-dollar plans entered into before Jan. 28, 2002, can be treated as existing plans and entitled to the grandfather protection offered existing plans. In my opinion, implementing a new plan before Jan. 28th will provide maximum future flexibility and preserve the most favorable options for the plan. To enter into a new split-dollar plan means clients and their advisers must move very quickly to comply with the Jan. 28th deadline. A logical question is what does "entered into" mean?" The Notice does not address this question. In my opinion, it means that the ILIT (or other entity that is to own the policy) must be in place, the policy must be issued and paid for, the split-dollar agreement and the collateral assignment must be signed (and, hopefully, the collateral assignment filed with the insurance company), all before Jan. 28, 2002! This is a tall order, and in many cases the Jan. 28th deadline will not be met.

5. For all existing plans (including new plans entered into before Jan. 28th), I would be very cautious about amending the terms of the plan if you want to preserve the limited grandfather protection provided by the Notice. In effect, we have been given a two-year grace period by the Treasury and IRS to figure out what to do with existing plans. Unfortunately, complete grandfathering of existing plans was not

forthcoming, although the insurance industry, and particularly AALU, worked very hard for that result.

6. For plans entered into on or after Jan. 28, 2002, it looks like the plan can be designed in two mutually exclusive ways. The plan can be structured as an endorsement split-dollar plan, where the employer owns the policy and the death benefit is endorsed to the employee (or his or her ILIT). The consequence will be the familiar annual economic benefit ("term cost") method of taxation. However, any rollout from policy values to end this continuing and increasing term cost will result in the entire policy equity being taxed at the time of rollout (for income tax purposes and also for gift-tax purposes if the policy is owned by an ILIT). Consequently, an endorsement split-dollar plan is a plan without an exit strategy, assuming the coverage is to continue for life. In this connection, the annual economic benefit cost will be measured by the new Table 2001 rates, or some other later-derived IRS term rates. However, existing insurance company alternative term rates can be used (apparently for the life of the plan) if the split-dollar plan (you guessed it) is entered into on or before Jan. 28, 2002. Otherwise, after 2003, carrier alternative term rates must meet tough new standards applicable to commonly-sold term policies in order for the alternative rates to be used instead of the table rates (assuming the IRS doesn't do away with alternative term rates altogether).

7. Alternatively, for post- Jan. 28th plans under which the employee or trust owns the policy, employer premium payments will be treated as loans, with the tax consequences discussed above. In other words, collateral-assignment split-dollar as we now know it will become extinct.

However, there is a question in my mind of whether some more favorable tax regime may apply for the period between Jan. 28, 2002, and the date final regulations are adopted. AALU seems to assume not, but I'm not so sure. We'll have to wait and see whether there are different rules during this transitional period.

8. There are a host of other questions left unanswered by the Notice. For example, the Notice states that the "same principles" will apply to split-dollar arrangements in non-employer/employee contexts, including private split-dollar and corporation/shareholder split-dollar, but it doesn't elaborate. The Notice says nothing about reverse split dollar, although it permits the continuing use of actual PS 58 costs to measure annual economic benefit for split-dollar arrangements entered into before Jan. 28, 2002, where the agreement provides that such rates will be used. Insofar as survivorship term rates are concerned, the Notice leaves it up to taxpayers to figure it out, based on the Table 2001 individual rates, for split-dollar arrangements entered into before the date of "future guidance" (whatever that means),. Hopefully, insurance companies will help us in determining the survivorship term rates to be used before future guidance.

9. As a practical matter, what are we doing at the present time about split-dollar plans? First, we're attempting to implement as many new plans as possible before the Jan. 28, 2002 deadline. Second, we're being very careful not to disturb the grandfather protection of existing plans. Finally, we're developing models that are aimed at minimizing income and gift taxes in the future, both for existing plans and for new plans.

10. A final caveat: the preceding comments are based on our

preliminary views of Notice 2002-8, compiled just a week after the Notice was issued. They reflect our own opinions, which may not turn out to be correct in all respects in light of later developments. I hope you found our comments useful.

Nothing contained in this communication is to be considered as legal or tax advice.

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That is it for Report No. 4A. 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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