Report #4 - Wed. a.m. 1/8/03

As we have done in January for the last six 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 week highlights of the proceedings of the 37th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 6-10, 2003 at the Fontainebleau Hilton Resort and Towers in Miami Beach, Florida.

A complete listing of the proceedings and speakers is available on the Institute's Web site.
The URL for that site is http://www.law.miami.edu/heckerling.
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REPORT NO. 4 - Wednesday 1/8/3

Worth the Effort Even Beyond the Grave - an Update of Post-mortem Tax Planning Strategies
Steve R. Akers 1/8/3

The emphasis of the presentation was on current events - Steve has a 145 page outline and did not try to cover any significant portion of his materials.

Effect of 2% floor on miscellaneous itemized deductions - §67. Scott case issued in 2002 was a Virginia case. The case held that because in Virginia a fiduciary could be protected by investing in certain statutorily approved investments, that there is no reason to hire an outside advisor. As such, in Virginia, any such expense would be subject to §67. There is still uncertainty in this area.

Steve discussed the new §645 regs. These were also discussed by Carlyn on Monday. He pointed out many of the differences between the proposed regs discussed in his materials, and the final regs.

Alternate valuation date - dealing with assets in a poor economy. Remember to consider an election under §2032. Also, consider making sufficient disclaimers or reducing the QTIP election to cause a small amount of tax to be payable. Remember the issue is different than several years ago because the estate may pay some tax now that would not be due at all if the estate tax is repealed.

Deduction of Administrative expenses attributable to QTIP trust or other non-probate assets. The Grant case (2d Cir, 2002) was discussed regarding the disallowance of administration expenses and personal representative fees on the decedent's estate tax return. Although the case seems to say these were not deductible due to the fact that the majority of the estate was in a revocable trust (11000 of 876000), the facts actually indicate that many of the expenses were not deductible anyway, i.e. expenses in selling the residence when the estate had adequate cash to pay the estate taxes. Also, the Maryland statutes limit the amount of both PR and trustee fees, and those charged substantially exceeded that amount.

Valuation of disputed claims in an estate. The cases continue to hold that post death events are not to be considered in determining the deduction - it is to be determined at the moment of death. Steve discussed the holding in the O'Neal case. The 11th Circuit held that the IRS cannot even admit into evidence the fact that the claim was settled for 1/17th of the amount claimed on the 706. A significant factor is that the IRS did not put on its own expert in determining the value of this claim, even though the parties had been ordered to put on evidence of their positions.

Transfer of an interest in a QTIP trust. This issue arises when the surviving spouse wants the QTIP assets to go to the children without waiting for his/her death. If they disclaim this extra amount in the decedent's estate there will be estate tax. An alternative is to leave the assets outright to or in a QTIP trust for the surviving spouse, who can assign an interest in the property or trust. This should not be a prearranged event. However, it uses the applicable exclusion amount of the surviving spouse rather than causing tax in the decedent's estate. A proposed reg was issued this year explaining the tax effects assigning an interest in a QTIP - Prop. Reg. §25.2511-2. Steve discussed the valuation issues regarding funding a marital deduction with assets subject to discounts, where the estate had control of such assets. The cases governing this issue are Chenowith, Bellinger, Disanto, etc. Possible methods suggested for avoiding the problem: Fund the marital bequest with a note, have someone purchase the minority interest from the estate within the first six months and elect the alternate valuation date, fund using a defined value formula conveyance or make these marital gifts during lifetime.

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From the Far Bank of the River Styx: Post-mortem Estate Planning with Limited Partnerships
Dan Markstein
1/8/3

Holding or investing in Limited Partnerships by Fiduciaries. Bogart on Trusts states that retention of such an interest, without express authority in the governing instrument, could expose the fiduciary to liability. This is enforced by a similar ruling by the U.S. Comptroller of the Currency. There are examples of language authorizing the investment in or retention of an LP interest in the materials.

There are funding problems associated with LP interests. The estate must engage an appraiser to determine the discounts, not only for the estate tax return but also for the funding of the trusts. Dan also further discussed the Chenoweth problem discussed by Steve Akers. This should usually not be a problem unless the discount on an interest used for funding is greater than that used for the entire interest on the estate tax return.

There are also potential problems with funding a trust with a limited partnership interest. One of these is reporting income from the partnership on the trust return where the cash distribution is less than the income. If the trust has to distribute all income, then it may not have enough cash left to pay the tax on the excess income it did not receive. An alternative is to sell the partnership interest for a note. The value of the note must be equal to the value of the interest sold. The materials set out different statutes, regs and cases on valuing a note. (See, Harper 83 TCM 1641 (2002) discounting a third-party secured note by 12% for estate tax purposes) Failure to do so may constitute a gift.

Another issue discussed is whether Regulation U issued by the Federal Reserve applies to the grant of a security interest in the limited partnership interest that is sold? Although staff opinions indicate that this is not true, there does not seem to be solid authority.

Solutions:

- Do not secure the note with the security interest (the LP)
- Enhance the note - maybe with a guarantee by some of the beneficiaries.
- Get a letter of credit

(This is a complex issue covering about 15 pages in the materials - get and read the materials)

Paying the estate tax. Dan does not like borrowing from the LP interest - it goes against the argument that the interest is illiquid used in the appraisal for the discount.

Possibility of elections under 6161 and 6166
Borrow from a bank - without using the LP as security
Variable rate demand note

He closed by discussing the post-mortem creation of a partnership. Funding of the marital and by-pass trusts should be completed before the creation of a partnership to avoid a reverse Chenoweth type problem. Another question is whether there is a 2519 issue if a QTIP trust is involved in the formation, but FSA 199920016 says not.

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