Preliminary Report

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Again this year 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. For those of you without access to the Web, here are the core parts of the schedule:

Scope of the Institute:

The Heckerling Institute on Estate Planning is the nation's leading conference for estate planners. It is designed for experienced attorneys, trust officers, accountants, insurance advisors, and wealth management professionals who are familiar with the principles of estate planning. As the largest such gathering of estate planning professionals in the country, the Institute has some of the better characteristics of a national convention, offering a unique opportunity to exchange ideas, to network, and to review the latest in technology, products, and services displayed by over 100 vendors in an exhibit hall dedicated entirely to the estate planning industry. With the addition of this year's new series on financial assets, the Institute offers something of interest to every member of the estate planning team.

· A recent developments panel on Monday afternoon, featuring three of the nation's foremost estate planning experts, will guide you through the year's developments on the tax front.

· Our general session lectures, which begin on Tuesday morning and continue throughout the week, provide in-depth analysis of topics of timely interest to experienced estate planners.

· Wednesday and Thursday afternoons offer a wide variety of workshops, panel discussions, and case studies that will examine and provide practical guidance on sophisticated estate planning techniques.

· New this year is a series of afternoon programs focusing on financial assets in estate planning. This series will provide a review of modern portfolio and financial theory, explore how tax considerations can be integrated with those principles, and examine some of the latest wealth management strategies.

· Finally, this year's Institute once again includes our popular Fundamentals Program, designed to be of interest to not only entry-level practitioners, but also to more experienced planners who would benefit from a thorough review of these three important topics. The programs will review the various types of charitable entities, explore planning and drafting for the marital deduction, and examine the preparation and filing of the Form 706

THE INSTITUTE 2004 FACULTY:

Steve R. Akers
Bessemer Trust
Dallas, Texas

Louis J. Chiavacci

Merrill Lynch
Coral Gables, Florida

Ronald D. Aucutt
McGuireWoods LLP
McLean, Virginia

Dennis I. Belcher
McGuireWoods LLP
Richmond, Virginia

Scot W. Boulton
U.S. Bank Private Client Group
St. Louis, Missouri

Michael V. Bourland
Bourland, Wall & Wenzel, P.C.
Fort Worth, Texas

Jeffrey L. Burr
Jeffrey L. Burr & Associates
Las Vegas, Nevada

Jeffrey Callender
Deloitte & Touche
New York, New York

Thomas Christensen, Jr.
Blackburn & Stoll, LC
Salt Lake City, Utah

Virginia F. Coleman
Ropes & Gray LLP
Boston, Massachusetts

Richard B. Covey
Carter, Ledyard & Milburn
New York, New York

Nicholas J. DeNovio
Senior Counsel to the Chief Counsel
Department of the Treasury
Internal Revenue Service
Washington, D.C.

S. Stacy Eastland
Goldman, Sachs & Co.
Houston, Texas

David M. English
University of Missouri School of Law
Columbia, Missouri

Mary Louise Fellows
University of Minnesota School of Law
Minneapolis, Minnesota

Charles D. Fox, IV
Schiff Hardin & Waite
Chicago, Illinois

Lawrence A. Frolik
University of Pittsburgh School of Law
Pittsburgh, Pennsylvania

T. Randall Grove
Landerholm, Memovich, Lansverk & Whitesides
Vancouver, Washington

Carol A. Harrington
McDermott, Will & Emery
Chicago, Illinois

Ellen K. Harrison
Shaw Pittman LLP
McLean, Virginia

Dan T. Hastings
Skadden, Arps, Slate, Meagher & Flom LLP
New York, New York

Jerome M. Hesch
Greenberg Traurig
Miami, Florida

Marcia Chadwick Holt
Davis, Graham & Stubbs LLP
Denver, Colorado

Donald O. Jansen
Fulbright & Jaworski L.L.P.
Houston, Texas

Marcus P. Johnson
Bourland, Wall & Wenzel
Fort Worth, Texas

Mary Louise Kennedy

Edwards & Angell, LLP
Providence, Rhode Island

Robert C. Lawrence, III
Cadwalader, Wickersham & Taft
New York, New York

Jonathan R. Macey
Cornell Law School
Ithaca, New York

Jerry J. McCoy
Law Office of Jerry J. McCoy
Washington, D.C. Howard M. McCue

Mayer, Brown, Rowe & Maw
Chicago, Illinois
Judith W. McCue

McDermott, Will & Emery
Chicago, Illinois
Kathryn W. Miree

Kathryn W. Miree & Associates, Inc.
Birmingham, Alabama

Donald J. Mulvihill
Goldman Sachs
Chicago, Illinois

Richard W. Nenno
Wilmington Trust Company
Wilmington, Delaware

Jeffrey N. Pennell
Emory University School of Law
Atlanta, Georgia

Lloyd Leva Plaine
Sutherland, Asbill & Brennan LLP
Washington, D.C.

Robert C. Pomeroy
Goodwin Proctor LLP
Boston, Massachusetts

John W. Porter
Baker & Botts, L.L.P.
Houston, Texas

A. Christopher Sega
Venable, Baetjer, Howard & Civiletti
Washington, D.C.

David G. Shaftel
Law Offices of David G. Shaftel, PC
Anchorage, Alaska

Barbara A. Sloan
McLaughlin & Stern, LLP
New York, New York

Conrad Teitell
Cummings & Lockwood LLC
Stamford, Connecticut

William J. Tyne
Bessemer Trust
London, England

Andrew H. Weinstein
Holland & Knight, LLC
Miami, Florida

Glen A. Yale
Oppenheimer, Blend, Harrison & Tate, Inc.
San Antonio, Texas

THE PROGRAM SCHEDULE:

Sunday, January 4
12:00 - 6:00 p.m.
Registration -
Fontainebleau Hilton Resort & Towers or Wyndham Miami Beach Resort

Monday, January 5
8:00 a.m.
Registration - Fontainebleau Hilton Resort & Towers or Wyndham Miami Beach Resort

8:00 - 9:00 a.m.
Complimentary Continental Breakfast

9:00 - 10:30 a.m.
OPTIONAL PRE-CONFERENCE FUNDAMENTALS PROGRAM -
Publicly Supported Charities, Private Foundations and Everything in Between:Talking - and Understanding- the Talk

10:45 a.m. - 12:15 p.m.

Conrad Teitell
The structural, practical and tax aspects of publicly supported charities, community foundations, donor-advised funds (maintained by both charitable and "commercial" entities), supporting organizations (three types) and private foundations (non-operating, operating, pass-through, and corporate). Choosing wisely among the donee-charities; plus the plethora of tax rules for outright and split-interest contributions to those entities.

10:30 - 10:45 a.m.
Break

2:00 - 2:10 p.m.
Introductory Remarks
Tina Portuondo, Institute Director

2:10 - 3:30 p.m.
Recent Developments in Estate, Gift and Income Taxation - 2003 Part One
Dennis I. Belcher
Carol A. Harrington
Jeffrey N. Pennell
Materials by Richard B. Covey and Dan T. Hastings

3:30 - 3:45 p.m.
Break

3:45 - 5:15 p.m.
Recent Developments in Estate, Gift and Income Taxation - 2003 Part Two

6:00 - 7:00 p.m.
Complimentary Reception for Registrants
Fontainebleau Hilton Resort & Towers

Tuesday, January 6
8:00 - 9:00 a.m.
Complimentary Continental Breakfast

9:00 - 9:45 a.m.
The Domestic Asset Protection Trust Comes of Age
Richard W. Nenno
This presentation will summarize the domestic asset protection trust laws, discuss their federal income and transfer tax implications, assess their asset protection effectiveness, describe possible uses of these trusts, and compare the domestic trust laws to one another and domestic trusts to offshore trusts.

9:45 - 10:30 a.m.
But I Just Wanted a Few Strings Over the Trust Assets for Me and My Family
Steve R. Akers
A discussion of the controls over distributions and administrative powers that may be retained by a donor or trust beneficiary without causing problems. Non-tax (including creditor effects) and tax factors are explored, including the gift, estate and income tax effects of various powers. The program

addresses the effects of various strategies that a donor may suggest to keep controls over trust assets, including removal and appointment powers.

10:30 - 10:45 a.m.
Break

10:45 - 11:30 a.m.
Cottage Savings is a Loss to Trust Beneficiaries
Lloyd Leva Plaine
This program will address how Internal Revenue Code Section 1001 gain realization and recognition rules and the Cottage Savings holding are applied to beneficiaries of trusts in the case of trust distributions, divisions, modifications, settlements and interpretations. This is especially relevant for trusts that are grandfathered from the GST tax and non-grandfathered trusts with a zero inclusion ratio.

11:30 - 12:15 p.m.
Old But Not Cold - Restructuring, Refocusing, and Retiring Irrevocable Trusts
Ronald D. Aucutt
Many old trusts are unwieldy, unproductive, or otherwise outdated. Distribution standards, fiduciary powers, and trustee succession plans all need to be rethought. Even termination is not always as simple as it sounds. This presentation will address these issues in light of both emerging law and practical constraints.

12:15 - 2:00 p.m.
Lunch Break

2:00 - 2:45 p.m.
Bulletproofing the Family Limited Partnership - Current Issues
John W. Porter
A discussion of current issues involving family limited partnerships and LLCs, including recent case law and IRS pronouncements. The discussion will also focus on the audit and litigation positions taken by the IRS, defenses to those positions, privilege issues, and practice tips to avoid or minimize the risk of dispute with the IRS regarding FLPs or LLCs.

2:45 - 3:30 p.m.
Taming the Tiger: Designing, Implementing and Operating the FLP to Avoid a Successful Section 2036 Attack
T. Randall Grove
Recent cases show that the IRS is having success in attacking family entities through the use of Internal Revenue Code Section 2036. Understanding client objectives and providing guidance before and after the establishment of the entity is very important in avoiding this hazard.

3:30 - 3:45 p.m.
Break

3:45 - 4:30 p.m.
Defined Value Clauses: How Much Do I Love Thee? This Much - No More, No Less A. Christopher Sega
A review of the issues involved in the transfer of "difficult to value" assets. This presentation will

compare so-called "defined value" and "price adjustment" clauses, review the Proctor case and the related public policy concerns, and address the government's attack on formula clauses.

4:30 - 5:15 p.m.
Funding Formulas Fail on Flexibility: Variations on Traditional Marital/Credit Shelter Funding Techniques Barbara A. Sloan
This session will explore how to create the flexibility so desirable in post-EGTRRA credit shelter/marital deduction planning and how to address control issues and combine techniques to provide maximum flexibility.

Wednesday, January 7
8:00 - 9:00 a.m.
Complimentary Continental Breakfast

9:00 - 9:45 a.m.
Charitable Trust Litigation: Enforcing Donor Intent When the Ties That Bind Become Frayed
Howard M. McCue
What happens when the donor's family becomes disenchanted with the charity that father selected? Who speaks for the charity? This program will examine some recent cases to seek guidance for planners and fiduciary litigators alike.

9:45 - 10:30 a.m.
The Rules of Engagement: Managing Liability for Nonprofit Boards
Kathryn W. Miree
How well do you advise your clients on the risk of assuming a board position at a public or private charity? In this era of accountability, this "how to" manual guides professionals through the process of advising clients on their roles and responsibilities as nonprofit board members, focusing on key areas of risk and best practices for liability management.

10:30 - 10:45 a.m.
Break

10:45 a.m. - 12:15 p.m.
Question & Answer Session
· Dennis I. Belcher
· Carol A. Harrington
· Jeffrey N. Pennell

12:15 - 2:00 p.m.
Lunch Break

2:00 - 3:30 p.m. / 3:45 - 5:15 p.m.
FUNDAMENTALS PROGRAM - Basic Estate Planning for Spouses: Drafting for the Marital Deduction Isn't Rocket Science - It Isn't That Precise (Runs concurrently with the Special Sessions)
Jeffrey N. Pennell
The marital deduction: a staple of virtually every estate planning practice. Its basic qualification rules also inform, and sometimes even transcend, other wealth transfer tax issues (e.g., reaching carryover basis, if that becomes a reality). This session will expand your knowledge of the essentials of this bedrock of everyday practice.

2:00 - 3:30 p.m.
Special Sessions I

I-A - CASE STUDY - But I Just Wanted a Few Strings Over the Trust Assets for Me and My Family
Steve R. Akers
This session will address the effects of the various strategies that a donor may suggest to keep controls over trust assets, including removal and appointment powers for the donor or for beneficiaries, and creditor effects of retained powers by donors or beneficiaries.

I-B - Bulletproofing the FLP - Current Issues
John W. Porter
T. Randall Grove
A discussion of current issues involving family limited partnerships and LLCs, including recent case law and IRS pronouncements, audit and litigation positions taken by the IRS, defenses to those positions, and practice tips to avoid or minimize the risk of dispute with the IRS regarding FLPs or LLCs.

I-C - Everything You Always Wanted To Know About Domestic Asset Protection Trusts, But Could Never Find Out
· Richard W. Nenno
· Mary Louise Kennedy
· Jeffrey L. Burr
· David G. Shaftel
· Thomas Christensen, Jr.
Will I be sued if my clients use domestic APTs? Will I be sued if my clients don't use domestic APTs? Is the full faith and credit clause really fatal to domestic APTs? Representatives of five domestic APT states tackle these and other hard questions about this recent technique.

I-D - Charitable Trust Administration: Enforcing Donor Intent When the Ties That Bind Become Frayed
Howard M. McCue
This session will examine some recent cases to seek guidance for planners and fiduciary litigators alike.

I-E - Satisfying Solutions and Practical Planning For S Corporations
Charles D. Fox, IV
This session will examine many of the recent developments with respect to S Corporations, including the new regulations on electing small business trusts and tax affecting valuation strategies, and will examine the important planning issues that arise when advising clients who have or who are considering S Corporations.

I-F - Financial Assets Series (See insert at bottom for program description)
3:30 - 3:45 p.m.

Break
3:45 - 5:15 p.m.

Special Sessions II
II-A - CASESTUDY- The Rules of Engagement for Nonprofit Boards: Case Studies and Cautionary

Tales Kathryn W. Miree Jerry J. McCoy
This session will take an in-depth look at several recent cases involving liability for nonprofit boards, and examine ways to protect nonprofit board members (and the charities they represent).

II-B - Bulletproofing the FLP- Current Issues (Repeat of Session I-B)
John W. Porter T. Randall Grove

II-C - The Future of the Transfer Tax System: Reform or Repeal?
· Dennis I. Belcher
· Lloyd Leva Plaine
· Mary Louise Fellows
The American Bar Association's Sections on Real Property, Probate and Trust Law and on Taxation, the American Bankers Association, the American College of Tax Counsel, the American College of Trust and Estate Counsel, and the American Institute of Certified Public Accountants formed a Task Force on Transfer Tax Reform to prepare a non-partisan, non-political report analyzing the administrability of the gift, estate, and GST tax law as changed by the 2001 Act and alternatives to the 2001 Act. The panel will discuss the Report, which focuses on the transitional period, the carry-over basis rules, the continuation of the gift tax notwithstanding repeal of the estate and GST taxes, proposed modifications to existing law, and alternative tax systems.

II-D - An Update on Retirement Benefit Planning Issues: Recent Developments and Practical Advice
Marcia Chadwick Holt
Virginia F. Coleman
The panelists will focus on the issues of creating separate accounts and naming trusts as beneficiaries. They will also offer some practical advice on resolving retirement issues.

II-E - Restructuring, Refocusing and Retiring Old Trusts
Ronald D. Aucutt
This interactive session, using examples drawn from actual cases, will examine ways to retool old irrevocable trusts or to soften the landing for terminating trusts.

II-F - Financial Assets Series (See insert for program description)

Thursday, January 8
8:00 - 9:00 a.m.
Complimentary Continental Breakfast

9:00 - 9:45 a.m.
Split Dollar Has Split - So How Do We Finance Premiums Now?
Donald O. Jansen
Despite the title, reports of the demise of split dollar have been exaggerated. However, after the final regulations, it is more expensive. The pros and cons of post-regulation split dollar and other premium funding techniques (such as third party financing, sales to defective trusts, GRATs and FLPs) will be reviewed.

9:45 - 10:30 a.m. When the Kids Won't Play Well Together: Tax-Free Corporate Divisions in Family Business Succession Planning
Michael V. Bourland
Effective planning of an estate with a significant family business component is difficult in a

dysfunctional second generation environment. This presentation will examine the necessary steps in a tax-free division and transfer of a family business in corporate form and other estate assets among members of the dysfunctional second generation.

10:30 - 10:45 a.m. Break 10:45 - 11:30 a.m.
Trust Classification Times Four
Robert C. Lawrence, III
This session will discuss the criteria used to classify a foreign (non-U.S.) entity for U.S. federal tax purposes as a trust, association taxable as a corporation, partnership, or disregarded entity. If the entity is a trust, then it is necessary to determine whether the trust is a non-U.S. or U.S. trust, grantor or non-grantor trust, or a complex or simple trust and the U.S. federal tax consequences thereof. The analysis will conclude with a comparison of foreign (non-U.S.) trusts to alternative vehicles used commonly in civil law jurisdictions.

11:30 a.m. - 12:15 p.m.
Tax Shelters - The Ethical Dilemma
Andrew H. Weinstein
What is a tax shelter; will you know it when you see it; dead or alive; what to do with it when you identify it; navigating the new rules; compliance; confidentiality agreements; professional risks, rewards, responsibilities and penalties. This session will address ethical obligations involving tax shelters and will review targeted issues affecting private client service.

12:15 - 2:00 p.m.
Lunch Break

2:00 - 3:30 p.m. / 3:45 - 5:15 p.m.
FUNDAMENTALS PROGRAM - Preparing and Filing the Form / 706: Who, What, How, When, and Where (Runs concurrently with the Special Sessions)
Glen A. Yale
For practitioners who have prepared no or few returns - the basics and not so basics of preparing the Form 706, including what needs to be reported and what does not, how various assets can be reported, making elections, what deductions are proper and which ones are not, engagement letters for preparing the return and retaining the appraiser, return attachments, assembling the return, and disclosures to the client and to the IRS (they are not the same!). Sample asset and deduction schedules will be critiqued. 2:00 - 3:30 p.m. Special Sessions III

III-A -CASE STUDY - Tax-Free Corporate Divisions in Family Business Succession Planning
Michael W. Bourland
Marcus P. Johnson
This session will present case study examples illustrating the role of family corporate business tax-free divisions in the estate planning process.

III-B - Planning and Drafting for Maximum Flexibility in Credit Shelter/Marital Deduction Planning
Barbara A. Sloan
A review of the many straightforward techniques (ceilings, floors, disclaimers, partial QTIPs, and Clayton trusts) and a discussion of some of the thorny issues that arise when meeting with the client and drafting for these alternatives.

III-C - Tax Shelters - The Ethical Dilemma

Andrew H. Weinstein
Nicholas J. DeNovio
A panel discussion on real life (and death) fact patterns involving the tax shelter dilemma and opportunities for ethical solutions thereto.

III-D - The Uniform Trust Code: Your State Might Be Next
· David M. English
· Judith W. McCue
· Scot W. Boulton
Completed in 2000, the Uniform Trust Code has been enacted in five states and is being considered in over 30 others. This program will review the Code, focusing on the most discussed provisions, including the sections dealing with notice, nonjudicial settlements, trust modification and termination, revocable trusts, and trustee removal. The panel consists of the Code's Reporter and other participants in the drafting and enactment process.

III-E - Premium Financing Techniques
Donald O. Jansen
This session will focus on income, gift and estate tax concerns with various examples of premium funding techniques such as split dollar, GRATs, FLPs, third party financing, and sales to defective trusts.

III-F - Financial Assets Series (See insert for program description)

3:30 - 3:45 p.m.
Break

3:45 - 5:15 p.m.
Special Sessions IV

IV-A - CASE STUDY- Planning for the Very Old Client: The Complex and Confused World of Anna G.
Lawrence A. Frolik
This session will confront the problem of estate and end of life planning for Anna G., an 85 year old widow, who may suffer from modest dementia, was married three times and has step-children, children, and grandchildren, and who lived for years in California, a community property state, but who now resides in a common law property state... and she wants to write a new will.

IV-B - Formulas, Fractions and Ratios - Oh My!
S. Stacy Eastland
A. Christopher Sega
An examination of the defined value and price adjustment clauses being used to limit transfer tax risk, with illustrations of the types of clauses that are sanctioned in the case of disclaimers, GRATs, CRUTs, and marital and charitable bequests, and why the government dislikes these clauses.

IV-C-Tax Shelters-The Ethical Dilemma (Repeat of Session III-C)
Andrew H. Weinstein
Nicholas J. DeNovio

IV-D - Foreign Trusts

Robert C. Lawrence, III
This session will examine the use of foreign (non-U.S.) trusts and alternative vehicles in tax planning.

IV-E- Financial Assets Series (See insert for program description)

Friday, January 9
8:00 - 9:00 a.m.
Complimentary Continental Breakfast

9:00 - 9:45 a.m.
State Death Tax Credit: Planning and Drafting in Light of Phase Out
Robert C. Pomeroy
EGTRRA's phase out of the state death tax credit has resulted in many states imposing an estate tax based on the pre-EGTRRA state death tax credit tables. This program will focus on the deathtime and lifetime planning issues that arise as a result thereof.

9:45 - 10:30 a.m.
Old Age With Fears and Ills: Planning for the Very Old Client
Lawrence A. Frolik
The very old client represents special planning challenges. With death a near reality, the next estate plan is likely the last. Planning is often complicated by client deficits in mental capacity and physical stamina, long-term care costs that threaten to erode the estate, and complex family relations that make it difficult for the client to decide how to distribute the estate. This program will address these and other problems raised by the very old client and will suggest appropriate and effective responses.

10:30 - 10:45 a.m.
Break

10:45 a.m. - 12:00 p.m.
CASE STUDY - Grand Finale - Implementing Bright Ideas
· Ellen K. Harrison
· Jerome M. Hesch
· S. Stacy Eastland
Each panelist will provide separate planning recommendations for different client hypotheticals. Financial projections, using a range of investment assumptions, will illustrate each panelist's recommendation. The objective is to illustrate the substantive and empirical analysis needed in order to choose the most appropriate technique for a client from the available alternatives.

GENERAL INFORMATION:
Inquiries/Registration:
Philip E. Heckerling Institute on Estate Planning
University of Miami School of Law
Center for Continuing Legal Education
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling

E-mail: heckerling@law.miami.edu
===
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
==

Introduction

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

As we have done in January for the last seven years, and again with the permission of the University of Miami School of Law Center for Continuing Legal Education, we will be posting daily Reports to this list containing highlights of the proceedings of the 38th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 5-9, 2004 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.

We also will be posting the full text of each of these Reports on the ABA RPPT Section's Web site, as we have since the 2000 Institute. Those Reports can be found at URL http://www.abanet.org/rppt/meetings_cle/heckerling. In addition, each Report can also be accessed at any time from the ABA-PTL Discussion List's Web-based Archive at URL http://mail.abanet.org/archives/aba-ptl.html.

Our on-site local reporters who are present in Miami this year are Gene Zuspann Esq. of Zuspann and Zuspann in Denver, Colorado, John Warnick Esq. of Holme, Roberts and Owen in Denver, Colorado, Carol Warnick Esq. of Holland & Hart in Denver, Colorado, and Jason Havens Esq. of Havens & Miller in Destin, Florida.

==

Scope of the Institute:

The Heckerling Institute on Estate Planning is the nation’s leading conference for estate planners. It is designed for experienced attorneys, trust officers, accountants, insurance advisors, and wealth management professionals who are familiar with the principles of estate planning. As the largest such gathering of estate planning professionals in the country, the Institute has some of the better characteristics of a national convention, offering a unique opportunity to exchange ideas, to network, and to review the latest in technology, products, and services displayed by over 100 vendors in an exhibit hall dedicated entirely to the estate planning industry. With the addition of this year’s new series on financial assets, the Institute offers something of interest to every member of the estate planning team.

· A recent developments panel on Monday afternoon, featuring three of the nation’s foremost estate planning experts, will guide you through the year’s developments on the tax front.

· The general session lectures, which begin on Tuesday morning and continue throughout the week, provide in-depth analysis of topics of timely interest to experienced estate planners.

· Wednesday and Thursday afternoons offer a wide variety of workshops, panel discussions, and case studies that will examine and provide practical guidance on sophisticated estate planning techniques.

· New this year is a series of afternoon programs focusing on financial assets in estate planning. This series will provide a review of modern portfolio and financial theory, explore how tax considerations can be integrated with those principles, and examine some of the latest wealth management strategies.

· Finally, this year's Institute once again includes the popular Fundamentals Programs, designed to be of interest to not only entry-level practitioners, but also to more experienced planners who would benefit from a thorough review of these three important topics. The programs will review the various types of charitable entities, explore planning and drafting for the marital deduction, and examine the preparation and filing of the Form 706

THE INSTITUTE 2004 FACULTY:

Steve R. Akers
Bessemer Trust

Louis J. Chiavacci
Merrill Lynch

Ronald D. Aucutt
McGuireWoods LLP

Dennis I. Belcher
McGuireWoods LLP

Scot W. Boulton
U.S. Bank Private Client Group

Michael V. Bourland
Bourland, Wall & Wenzel, P.C.

Jeffrey L. Burr
Jeffrey L. Burr & Associates

Jeffrey Callender
Deloitte & Touche

Thomas Christensen, Jr.
Blackburn & Stoll, LC

Virginia F. Coleman
Ropes & Gray LLP

Richard B. Covey
Carter, Ledyard & Milburn

Nicholas J. DeNovio
Senior Counsel to the Chief Counsel
Department of the Treasury
Internal Revenue Service

S. Stacy Eastland
Goldman, Sachs & Co.

David M. English
University of Missouri School of Law

Mary Louise Fellows
University of Minnesota School of Law

Charles D. Fox, IV
Schiff Hardin & Waite

Lawrence A. Frolik
University of Pittsburgh School of Law

T. Randall Grove
Landerholm, Memovich, Lansverk & Whitesides

Carol A. Harrington
McDermott, Will & Emery

Ellen K. Harrison
Shaw Pittman LLP

Dan T. Hastings
Skadden, Arps, Slate, Meagher & Flom LLP

Jerome M. Hesch
Greenberg Traurig

Marcia Chadwick Holt
Davis, Graham & Stubbs LLP

Donald O. Jansen
Fulbright & Jaworski L.L.P.

Marcus P. Johnson
Bourland, Wall & Wenzel

Mary Louise Kennedy
Edwards & Angell, LLP

Robert C. Lawrence, III
Cadwalader, Wickersham & Taft

Jonathan R. Macey
Cornell Law School

Jerry J. McCoy
Law Office of Jerry J. McCoy

Howard M. McCue
Mayer, Brown, Rowe & Maw

Judith W. McCue
McDermott, Will & Emery

Kathryn W. Miree
Kathryn W. Miree & Associates, Inc.
Birmingham, Alabama

Donald J. Mulvihill
Goldman Sachs

Richard W. Nenno
Wilmington Trust Company

Jeffrey N. Pennell
Emory University School of Law

Lloyd Leva Plaine
Sutherland, Asbill & Brennan LLP

Robert C. Pomeroy
Goodwin Proctor LLP

John W. Porter
Baker & Botts, L.L.P.

A. Christopher Sega
Venable, Baetjer, Howard & Civiletti

David G. Shaftel
Law Offices of David G. Shaftel, PC

Barbara A. Sloan
McLaughlin & Stern, LLP

Conrad Teitell
Cummings & Lockwood LLC

William J. Tyne
Bessemer Trust

Andrew H. Weinstein
Holland & Knight, LLC

Glen A. Yale
Oppenheimer, Blend, Harrison & Tate, Inc.

SUBSTANTIVE PROGRAM SCHEDULE AND HIGHLIGHTS:

Monday, January 5

9:00 a.m. - 12:15 p.m.
OPTIONAL PRE-CONFERENCE FUNDAMENTALS PROGRAM -
Publicly Supported Charities, Private Foundations and Everything in Between:Talking - and Understanding- the Talk
Conrad Teitell

2:00 - 2:10 p.m.
Introductory Remarks
Tina Portuondo, Institute Director

2:10 - 3:30 p.m.
Recent Developments in Estate, Gift and Income Taxation - 2003 Part One
Dennis I. Belcher
Carol A. Harrington
Jeffrey N. Pennell
Materials by Richard B. Covey and Dan T. Hastings

3:45 - 5:15 p.m.
Recent Developments in Estate, Gift and Income Taxation - 2003 Part Two

Tuesday, January 6

9:00 - 9:45 a.m.
The Domestic Asset Protection Trust Comes of Age
Richard W. Nenno

9:45 - 10:30 a.m.
But I Just Wanted a Few Strings Over the Trust Assets for Me and My Family
Steve R. Akers

10:45 - 11:30 a.m.
Cottage Savings is a Loss to Trust Beneficiaries

Lloyd Leva Plaine

11:30 - 12:15 p.m.
Old But Not Cold - Restructuring, Refocusing, and Retiring Irrevocable Trusts
Ronald D. Aucutt

2:00 - 2:45 p.m.
Bulletproofing the Family Limited Partnership - Current Issues
John W. Porter

2:45 - 3:30 p.m.
Taming the Tiger: Designing, Implementing and Operating the FLP to Avoid a Successful Section 2036 Attack
T. Randall Grove

3:45 - 4:30 p.m.
Defined Value Clauses: How Much Do I Love Thee? This Much - No More, No Less
A. Christopher Sega

4:30 - 5:15 p.m.
Funding Formulas Fail on Flexibility: Variations on Traditional Marital/Credit Shelter Funding Techniques
Barbara A. Sloan

Wednesday, January 7

9:00 - 9:45 a.m.
Charitable Trust Litigation: Enforcing Donor Intent When the Ties That Bind Become Frayed
Howard M. McCue

9:45 - 10:30 a.m.
The Rules of Engagement: Managing Liability for Nonprofit Boards
Kathryn W. Miree

10:45 a.m. - 12:15 p.m.
Question & Answer Session
Dennis I. Belcher
Carol A. Harrington
Jeffrey N. Pennell

2:00 - 3:30 p.m. / 3:45 - 5:15 p.m.
FUNDAMENTALS PROGRAM - Basic Estate Planning for Spouses: Drafting for the Marital Deduction Isn't Rocket Science - It Isn't That Precise (Runs concurrently with the Special Sessions)
Jeffrey N. Pennell

2:00 - 3:30 p.m.
Special Sessions I

I-A - CASE STUDY - But I Just Wanted a Few Strings Over the Trust Assets
for Me and My Family
Steve R. Akers

I-B - Bulletproofing the FLP - Current Issues
John W. Porter
T. Randall Grove

I-C - Everything You Always Wanted To Know About Domestic Asset Protection
Trusts, But Could Never Find Out
Richard W. Nenno
Mary Louise Kennedy
Jeffrey L. Burr
David G. Shaftel
Thomas Christensen, Jr.

I-D - Charitable Trust Administration: Enforcing Donor Intent When the Ties
That Bind Become Frayed
Howard M. McCue

I-E - Satisfying Solutions and Practical Planning For S Corporations
Charles D. Fox, IV

I-F - Financial Assets Series - Risky Business: A Guide to Modern Financial
Theory
Jonathan R. Macey

3:30 - 3:45 p.m.
Special Sessions II

II-A - CASESTUDY- The Rules of Engagement for Nonprofit Boards: Case
Studies and Cautionary Tales Kathryn W. Miree Jerry J. McCoy

II-B - Bulletproofing the FLP- Current Issues (Repeat of Session I-B)
John W. Porter
T. Randall Grove

II-C - The Future of the Transfer Tax System: Reform or Repeal?
Dennis I. Belcher
Lloyd Leva Plaine
Mary Louise Fellows

II-D - An Update on Retirement Benefit Planning Issues: Recent Developments
and Practical Advice
Marcia Chadwick Holt
Virginia F. Coleman

II-E - Restructuring, Refocusing and Retiring Old Trusts
Ronald D. Aucutt

II-F - Financial Assets Series - Working Together: Integrating Investment Management with Estate Planning
Donald J. Mulvihill

Thursday, January 8

9:00 - 9:45 a.m.
Split Dollar Has Split - So How Do We Finance Premiums Now?
Donald O. Jansen

9:45 - 10:30 a.m.
When the Kids Won't Play Well Together: Tax-Free Corporate Divisions in Family Business Succession Planning
Michael V. Bourland

10:45 - 11:30 a.m.
Trust Classification Times Four
Robert C. Lawrence, III

11:30 a.m. - 12:15 p.m.
Tax Shelters - The Ethical Dilemma
Andrew H. Weinstein

2:00 - 3:30 p.m. / 3:45 - 5:15 p.m.
FUNDAMENTALS PROGRAM - Preparing and Filing the Form / 706: Who, What, How, When, and Where (Runs concurrently with the Special Sessions)
Glen A. Yale

2:00 - 3:30 p.m.
Special Sessions III

III-A -CASE STUDY - Tax-Free Corporate Divisions in Family Business Succession Planning
Michael W. Bourland
Marcus P. Johnson

III-B - Planning and Drafting for Maximum Flexibility in Credit Shelter/Marital Deduction Planning
Barbara A. Sloan

III-C - Tax Shelters - The Ethical Dilemma
Andrew H. Weinstein
Nicholas J. DeNovio

III-D - The Uniform Trust Code: Your State Might Be Next
David M. English
Judith W. McCue
Scot W. Boulton

III-E - Premium Financing Techniques
Donald O. Jansen

III-F - Financial Assets Series - Keeping Them Rich: Legal, Tax, Diversification and Hedging Strategies for Families with Concentrated Stock Positions
Louis J. Chiavacci
Jeffery C. Callender

3:45 - 5:15 p.m.
Special Sessions IV

IV-A - CASE STUDY- Planning for the Very Old Client: The Complex and Confused World of Anna G.
Lawrence A. Frolik

IV-B - Formulas, Fractions and Ratios - Oh My!
S. Stacy Eastland
A. Christopher Sega

IV-C-Tax Shelters-The Ethical Dilemma (Repeat of Session III-C)
Andrew H. Weinstein
Nicholas J. DeNovio

IV-D - Foreign Trusts
Robert C. Lawrence, III

IV-E- Financial Assets Series - So What Are The Alternatives
William J Tyne

Friday, January 9

9:00 - 9:45 a.m.
State Death Tax Credit: Planning and Drafting in Light of Phase Out
Robert C. Pomeroy

9:45 - 10:30 a.m.
Old Age With Fears and Ills: Planning for the Very Old Client
Lawrence A. Frolik

10:45 a.m. - 12:00 p.m.
CASE STUDY - Grand Finale - Implementing Bright Ideas
Ellen K. Harrison
Jerome M. Hesch
S. Stacy Eastland

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:

Philip E. Heckerling Institute on Estate Planning
University of Miami School of Law
Center for Continuing Legal Education
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==

Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

Report 1A

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Monday, January 5
2:10 - 5:15 p.m.
Recent Developments in Estate, Gift and Income Taxation - 2003 Part One
Dennis I. Belcher
Carol A. Harrington
Jeffrey N. Pennell
Materials by Richard B. Covey and Dan T. Hastings

Reporter: Gene Zuzpann Esq.

IRC 643 Regulations:

Carol Harrington discussed the new 643 regs that were issued last week in T.D. 9102. Excellent summaries of these are available on the Leimberg LISI service (Archive Message 624 1/5/04 under Free Resources at http://www.leimberg.com) and in the RIA Newsstand for 1/6/04. As a bonus, a full text version of the LISI message will be posted as Report No. 1B

2056 now has a reference to 643 approving the use of income under 643 to qualify under a QTIP. There is no loss of GST if you switch from a straight income trust to a straight unitrust, however you may not do a greater of trust.

Much depends upon applicable state law. The authority must exist in the first place. Those states that have already passed a unitrust alternative are now in place to use the alternative without concern. Those that do not have one will either have to adopt the law of another state (allowed under UPIA but not sure about regs) or push forward to get a statute of their own.

A trustee may not "play with" capital gains - deciding to include them in income in one year and not the next because the trustee likes the income tax consequences. However, the decision to do so in one trust does not affect the same decision in a different trust.

15% Dividends:

Dennis Belcher discussed the new 15% rates on qualifying dividends. He indicated that some trusts may want to take C-corp e&p now because of the low rates and that trustees will have to wait for the 1099's to know what tax rates apply to a given dividend. He believes that some taxpayers are going to surprised at the results. Also, 15% income is deemed to be distributed last in a CRT.

Hess and Lappo and Perachio Cases:

Next the panel discussed the Hess and Lappo decisions. In each of these cases (TCM decisions) the courts determination of value is close to the average of the taxpayer's appraiser and the IRS appraiser. Dennis Belcher also discussed the Perachio case. In that case, the court did not like the work of either appraiser. The taxpayer's appraiser suggested 35-45% and the IRS suggested 5% to 25%. The court used the 25% number.

US E-Bonds:

U.S. E-bonds - the PLR cited stated that there is no discount for income tax due on the accrued interest.

Lottery Winnings:

Jeff discussed the lottery ticket cases. Gribauskas and Shakleford allowed the taxpayer to depart from the 7520 rates because the interest was not transferable. The Cook case held that this fact did not require departure from the tables. There is now a split among the circuits - Cook in the Fifth and the other two in the Ninth and Second Circuits.

Jeff also pointed out that none of the opinions discuss the relevance of 7520(b) for times in which the tables may not be used.

Net Gifts:

The next topic discussed net gifts - those in which the donee agrees to pay the gift tax and any additional estate tax. McCord held that the latter provision benefits the donor's estate and not the donor. Reduction of the value of the gift for possible estate tax is not "the type of tangible benefit required to invoke net gift principles."

Jeff and Dennis then discussed the need for tax clauses to cover potential tax liability due to the gross-up under 2035(b) and stated that this should be covered in the deed of gift.

Kimbell, Strangi II and Stone Cases:

The panel spent some time discussing Kimbell, Strangi II and Stone and the application of Byrum and 2036.The facts of Strangi support the finding that an implied agreement exists for retained possession or enjoyment of the assets - therefore 2036. Jeff discussed the application of 2043 as an anti-tracing rule.

The panel also discussed the dicta by Judge Cohen that 2036(a)(2) may also apply and that a business purpose is very important - both upon the formation and also in the operation of the partnership.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140

Telephone (305) 538-2000, FAX (305) 674-4607
===

Report 1B

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Monday, January 5
2:10 - 5:15 p.m.
Recent Developments in Estate, Gift and Income Taxation - 2003 Part One
Dennis I. Belcher
Carol A. Harrington
Jeffrey N. Pennell
Materials by Richard B. Covey and Dan T. Hastings

Reporter: Gene Zuzpann Esq.

IRC 643 Regulations:

Carol Harrington discussed the new 643 regs that were issued last week in T.D. 9102. Excellent summaries of these are available on the Leimberg LISI service (Archive Message 624 1/5/04 under Free Resources at http://www.leimberg.com) and in the RIA Newsstand for 1/6/04. As a bonus, a full text version of the LISI message is posted below.

Date: Mon, 05 Jan 2004 23:13:42 -0600
From: stevesletters@leimbergservices.com
Subject: T.D. 9102 - Definition of Income for Trust Purposes Steve Leimberg's Estate Planning Newsletter

Steve Leimberg's Estate Planning Email Newsletter - Archive Message #624
Date: 05-Jan-04 07:13 PM
From: Steve Leimberg's Estate Planning Newsletter
Subject: T.D. 9102 - Definition of Income for Trust Purposes

If you are involved in sophisticated trust planning (private or charitable), you'll be very interested in the following report from Bob Wolf of Tener, Van Kirk, Wolf & Moore, P.C. Pittsburgh, PA. It involves what in my opinion is one of the single most important income tax Regulations of the decade. And there's no question Bob Wolf is one of the most knowledgeable, creative, and forward-thinking minds in the country on the subject.

In a word, Bob says the new regulations are TRU-iffic! (To learn more about TRUs - total return unitrusts - and their pros and cons -
and the state laws recently enacted to enable conversion to TRUs - and a sample TRU document, go to our sister site, http://www.leimberg.com/ Look under FREE RESOURCES.)

TRU-iffic! That's how one might describe the very planning-positive Final Regulations issued December 30th, 2003 (effective January 2, 2004) governing the definition of income under Section 643(b), the composition of DNI under 643(a), a qualifying income interest for the estate tax marital and QDOT deductions under 2056(b)-7 and 2056A-5 and for the gift tax under 2523(e)(1).

The regulations alleviate concerns and protect the tax benefits under recent state law changes

providing for a unitrust definition of income and/or the power to adjust between principal and income.
In a very informal nutshell, these new rules make it clear that - if the transaction falls within the very reasonable parameters of the final regulations - a conversion of a classic trust into a TRU or a trustee's exercise of a power to adjust will NOT:

1. Cause a loss of the federal estate tax marital deduction,
2. Trigger a taxable transfer for gift tax purposes,
3. Result in a taxable sale or exchange (ala Cottage Savings), and
4. Undo GST grandfathering.

EXECUTIVE SUMMARY:
The Treasury has released Final Regulations that expand upon their Proposed Regulations issued February 15, 2001 allowing for conversion of existing trusts into unitrusts pursuant to state statute (available today in 17 states) or the use of the power to adjust between principal and income where such power is granted under state law (available today in 35 states plus D.C.). We are now free to use those statutes without worrying about our marital deduction, our GST grandfathered status, or that such use might be considered to be a sale or exchange under the Cottage Savings doctrine.

COMMENT:
WHY WE COULDN'T RELY ON PROPOSED REGS:
While the Proposed Regulations were very favorable and suggested that Treasury would look kindly on these new state laws adapting our trust income and principal rules to the modern investment era, the Proposed Regulations were not in effect, and we were not free to rely on them - since by their express terms, they were to go into effect the year after the Regulations were made final.
So in some regards, the ability to confidently employ the new state laws was still in the future. Well, the future is now!

WHY THE CONCERN?
A surprising amount of the income tax law turns on state law definitions of what is "income" and what is "principal". So when the Uniform Principal and Income Act was promulgated in 1997 (7B U.L.A. 131,141 (2000) ("UPAIA"), allowing the trustee to "adjust" from principal to income or income to principal, there was a lot of concern as to whether the IRS would allow the trustee to have or exercise that power, by which one might either increase or decrease accounting income, and still qualify for the marital deduction (you might reduce the spouse's income interest), whether the exercise of such a power might constitute a gift, or whether the grandfathered status of GST trusts might be jeopardized.

And when a number of states started to consider allowing trusts to be converted into unitrusts which paid out a set percentage of the trust value, without regard to the accounting income in the trust, a dialogue was started with Treasury through the New York Legislative Committee, requesting guidance from the Service prior to enacting its proposed new law allowing an alternative unitrust definition of income and the power to adjust as contained in the UPAIA.

PROPOSED REGS A VERY PROMPT AND POSITIVE START!
The Treasury responded promptly and helpfully with its Proposed Regulations, which resulted in a dozen states enacting unitrust conversion statutes in one 12 month period subsequent to the announcement of the Proposed Regulations. This trend continued at a slower pace thereafter despite the lack of Final Regulations and a severe three year bear market in stocks.

WHAT'S AHEAD?

It is quite likely that that issuance of these Final Regulations may prompt more state law changes, because it is now completely clear that the benefits of the new rules only apply to those states that have the newer more favorable statutes which grant trustees the power to adjust and the power to convert to a unitrust.

The Proposed Regulations, while extremely helpful guidance that was largely followed and expanded upon in the Final Regulations, were not law, and as such, many trustees and practitioners were not yet using the new laws that had been enacted in many states. This was particularly apparent in the case of Marital Trusts and GST Exempt trusts, where practitioners and trustees alike were afraid of losing the all-valuable GST grandfathering, or having a Marital Trust disqualified or a "transfer" having been made by the surviving spouse by converting the trust to a unitrust or exercising the power to adjust.

The issuance of PLR 200231011 added another fearsome concern where a trust modification into a 7% unitrust (along with many, many other changes to the trust) was held to be a "sale or exchange" under Cottage Savings. This caused other practitioners to draw back from exercising these new powers until the tax dust had cleared. That dust has now cleared.

THE GORY DETAILS OF THE NEW REGS:

Generally, federal tax law follows local state law with respect to the definition of income, with the anti-games proviso that trust provisions which depart fundamentally from traditional principles of income and principal will not be recognized.

State law definitions of income which provide for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year including ordinary income and tax exempt income, capital gains, and appreciation, will be respected.

SAFE PARAMETERS - AND UNCHARTED WATERS:

A state unitrust statute allowing the payout of no less than 3% nor more than 5% of the fair market value of the trust assets will be respected.

However, the final regulations expressly left open what would happen if the rate were less than 3% or more than 5%. Don't count on the same blessing if you draw outside of these lines, taking into account what trust interests are being protected by the choice of rate. For example, if the rate were less than 3%, the marital deduction might be in trouble because you may have reduced the spouse's interest. If you converted to an 8% rate, the marital deduction should be fine, but you may have a gift transfer from the remainder beneficiaries to the spouse.

The final regulations expressly allow for the use of a multi-year valuation method. Most of the unitrust statutes have a 3 year "smoothing rule" and this is O.K.

If a conversion is made to a unitrust under state law, without the benefit of an express unitrust definition of income by statute it is possible that you will qualify, but you will have to satisfy the standard under the Bosch (387 U.S. 456 (1967)) decision (requirement of a decision of the highest court of the state). In my opinion, that isn't likely.

And it's even more unlikely that you could obtain the benefits of the power to adjust principal to income or income to principal without enacting UPAIA Section 104. The state law background just isn't there. But if your state has adopted the power to adjust, variations in the exact requirements under state law should not present a problem from a tax perspective. So the lack of the word "Equitable" in a state statute, or the absence of an express requirement that the trustee be investing as a "prudent investor" does not create a tax problem. The trustee must meet whatever state law requirements are imposed; state laws are not required to be homogenized as a matter of tax policy.

Both the power to adjust and the power to convert to a unitrust can be applied to sprinkle or spray trusts, as well as the more traditional "hold the principal and pay the income" style trusts.

Where there are alternative methods of determining income under applicable state law, a change in method can be made in either direction without fear of a recognition event or the loss of grandfathering. Since there are currently a dozen states that expressly allow both the power to adjust and the unitrust as alternatives, this is important.

The Final Regulations governing the application of Chapter 13 (GST Tax) to trusts expressly provide that the conversion of a trust into a unitrust or using the power to adjust under a state statute specifically does not prejudice GST grandfathering.

SITUS SHOPPING MAKES SENSE!
Attention K Mart Shoppers! The Final Regulations do not stop at assuring us we lose no GST grandfathering, that there is no taxable sale or exchange, and that there is no gift: In two examples the final regs make clear that if the situs of a trust is moved to another state with a different state law in this regard, that is fine also. So if you are in Massachusetts or North Dakota, where you don't have a favorable total return trust law, you can move your trust next door to Maine or South Dakota, which have unitrust legislation, and take advantage of their laws to convert the trusts to unitrusts.

This should significantly increase the pressure on states which do not have total return legislation to put it on their agenda or suffer the financial consequences to their trust industry.

Portability has never been greater.

WHAT ELSE IS NEW?
In sync with the changes to the definition of income for trust purposes, the ability of trustees to include capital gains in Distributable Net Income has also changed from the traditional to allow ordering rules in state statutes and the power of the trustee to either allocate capital gains to a distribution to an "income" beneficiary or not, provided that the exercise of the power is done consistently. In some regards, this is the most complicated and least significant of the changes.

The Reg provides-"Gains from the sale or exchange of capital assets are included in distributable net income to the extent they are, pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary (in accordance with a power granted to the fiduciary by applicable local law or by the governing instrument if not prohibited by applicable local law).

(1) Allocated to income [but if discretionary for a unitrust, the power must be exercised consistently]. . .
(2) Allocated to corpus but treated consistently by the fiduciary on the trust's books, records, and tax returns as part of the distribution to a beneficiary; or
(3) Allocated to corpus but actually distributed to the beneficiary or utilized by the fiduciary in

determining the amount that is distributed or required to be distributed to a beneficiary."

SAY WHAT?
Part of the theory of total return trusts and total return investing is that the trustee will be free to invest for capital gains or interest or dividends, whichever will produce the most return. But if the income beneficiary is getting an increased payout because of the application of a unitrust statute or the power to adjust, it stands to reason that the recipient ought to pay the capital gains tax on the distribution, at least if there are capital gains to distribute.

But the hang-up is that capital gains are not traditionally a part of distributable net income unless the amount distributed is determined by the amount of capital gains, or let's say the capital gains are actually distributed (and this may not be obvious, since cash is, as they say, cash.)

WHY DOES THIS MATTER?
If the capital gains taxes are all paid by the trust, the trust cannot afford to pay out as much to the beneficiary as if the beneficiary were paying his or her fair share of the taxes. So if the trust is paying the tax freight, the value of the trust is more likely not to keep up with inflation than if capital gains can be distributed to the income beneficiary along with his or her increased income share. In addition, the beneficiary is more likely to be in a lower tax bracket than the trust, since the top tax bracket is reached in a trust or estate at only $9,550.

Also, if the capital gains taxes are paid by the trust, it produces a conflict between choices for achieving total return as between bonds and stocks more commonly than if it is allocated to the income beneficiary as much as possible, after the ordinary income after expenses is distributed (and for an equity oriented account, the net dividend income won't be much).

WHAT DOES IT MEAN?
If you live in a state that has an ordering rule as part of your total return legislation, such as in Alaska, Pennsylvania, Oregon and Washington, to name a few, then capital gains will come out of the trust first, with short term gains coming out before long term gains (the Regs don't expressly state that short term gains can be ordered out first, but Example 11 under 1.643(a)-3(e) includes such a statute without adverse comment).

So if you have a direction that requires the ordering in your trust document and applicable state law, the unitrust amount will include capital gains.

Other states, such as Delaware, give the trustee express discretion to decide whether to include capital gains in DNI, and there, for the unitrust, the exercise must be consistent, once the opportunity to exercise the discretion is presented. The Regs expressly allow this exercise if the trustee is given the power under state law, such as in Delaware, or by the trust instrument, if it is not prohibited by state law.

So if you do have discretion given to the trustee to make this determination, then the trustee can go either way. But the Regs clearly require that, as respects a unitrust, the exercise of discretion has to be consistent, since the allocation of the capital gains to a unitrust distribution does not affect the amount of the distribution.

WHAT ABOUT THE POWER TO ADJUST?
If the trustee has the discretion to decide whether to include capital gains in a distribution, it is likely

that the exercise will have to be consistent, unless the allocation of capital gains to a distribution actually determines the payout, which is not normally the case for the power to adjust. The power to adjust is not the power to distribute capital gains, but the power to adjust from principal to income and vice versa. It is not clear whether the Regulation writers understood this nuance.

DISTRIBUTIONS MADE IN KIND :
If distributions are made in kind to satisfy a unitrust payout, the property is deemed to have been sold for its fair market value on the date of distribution, just as if a distribution were made to satisfy an "income" obligation.

IMPACT ON POOLED INCOME TRUSTS AND NIM-CRUTS :
Here the news is not as favorable. For a pooled income trust, the charitable deduction is unavailable under 642(c)-2 if under the governing instrument and applicable state law, the income beneficiary's right to income may be satisfied by the payment of a unitrust amount or that takes into account unrealized appreciation in the value of the funds assets.

Strangely, the definition of a pooled income fund does not prohibit a unitrust definition of income or the power to adjust under applicable state law, but the Regulation requires that in exercising the power to adjust, the trustee has to allocate to principal the proceeds from the sale or exchange of any assets contributed or purchased in the fund to the extent of basis. This is an odd requirement, because to my knowledge, no state law has that provision in it. In fact, the UPAIA itself, and all of the state laws adopting it so far prohibit the use of the power to adjust to pay "(4) from any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside".

It would seem however, that one could retain the status of a pooled income trust, without the benefit of the charitable deduction for capital gains tax purposes, but only with the power to adjust, which does not seem to be available under the Uniform Act, unless state laws were changed to allow it.

And for the NICRUT and NIMCRUT twins to continue to qualify for their special tax treatment, they must have an alternative definition of income that is not a unitrust definition, either in the document or applicable state law. This seems reasonable, since the payout of a lesser of two unitrust amounts makes little conceptual sense. Post contribution gains may be defined to be part of income, and the Reg states that a discretionary power to determine that allocation of capital gains to income may be given to the trustee under the governing instrument, but only to the extent that the state statute permits the trustee to make adjustments between income and principal to treat beneficiaries impartially.

If state law would allow a unitrust definition of income which would disqualify the pooled income fund's charitable deduction, the trust will have 9 months to reform the governing instrument to eliminate this definition from applying the trust starting from January 2, 2004, or such later date of a state statute authorizing determination of income in such a manner. Since so far as I know, no state has such a law, that shouldn't be much of a problem, unless your faithful reporter is missing something!

Bob Wolf
Edited by Steve Leimberg
CITE AS:
Steve Leimberg's Estate Planning Newsletter # 623 at http://www.leimbergservices.com

CITES:
T.D. 9102 (To view the actual text of this ruling, click on Recent Entries and look under Actual Text for Final Regulations on Definition of Trust Income). Cottage Savings doctrine. (499 U.S. 554 (1991).

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Report 2

Tuesday, January 6

Reporter: Gene Zuspann Esq.
9:45 - 10:30 a.m.
But I Just Wanted a Few Strings Over the Trust Assets for Me and My Family

Steve R. Akers

Steve has a lengthy outline - 105 pages. He discussed 20 points in the outline.

He suggests that the attorney first talk with the client about the non-tax reasons for selecting a trustee. His outline sets out a number of non-tax factors - capacity, personal attributes of the trustee, impartiality investment sophistication, permanence, fees and others. He touched on several of these topics.

Steve then discussed tax issues in the selection of a trustee. This part of the presentation and outline are broken down into donor tax issues and beneficiary tax issues.

He discussed gift tax issues and retained rights and the problems caused by incorrect selection. The donor should not have a retained beneficial interest unless the donor is in a jurisdiction authorizing a self-settled trust.

He analyzed a situation where the donor transfers assets to a spouse with the potential of having the spouse appoint the assets back to the grantor. There is a timing issue - this should not occur quickly but should work if there is no arrangement.

The nature of the relationship with a 3rd party trustee to the donor can cause problems. There are also dispositive powers that can trigger negative tax effects under 2036 and 2038. If the distribution powers do not contain ascertainable standards, have an absolute prohibition of the donor becoming a trustee, even thought the event that could cause the donor to become a trustee is remote or impossible. The string causes inclusion, not the ability or intent to pull the string.

Certain administrative powers can cause inclusion in the estate. Generally, if the powers are subject to review by the court then there will not be a problem. Steve discussed and there is a large section of the outline analyzing the Byrum and Strange cases and the fiduciary duty exception under Byrum. See Rev Rul 81-15.

Two prohibited administrative powers are the power to vote stock and incidents of ownership over life insurance. Note that 2036(b)(2) has a different 3 year rule if at any time during the 3 years the donor had the right to vote the stock.

Trustee removal and appointment powers - some of these can cause inclusion. The power in the donor to appoint him or herself as trustee. The power to appoint additional trustees not including self should not cause inclusion. He briefly touched upon Rev Rul 79-353 and the Vak and the Wall cases regarding the power to remove and replace trustees.

Foreign trusts can have significant problems. These include reporting for foreign trust and selection of a trustee.

The outline includes a large section in Grantor trust status but Steve only commented on these rules for a moment.

The next section covered Beneficiary Tax issues.

These include discretionary beneficial interests and gifts by a beneficiary if the beneficiary fails to exercise rights. He emphasized that once a beneficiary becomes trustee and acquires a power that constitutes a general power of appointment there is a permanent taint that is difficult to shed. This can be overridden by inclusion of ascertainable standards. Some states also have laws that protect a trustee/beneficiary if the instrument does not include ascertainable standards.

The Upjohn case - the power of a trustee to satisfy the trustee's support obligations - can cause problems. Upjohn is a 2503 case, it is not a 2041 case.

Again, if the beneficiary can appoint him/herself as trustee and if there are no ascertainable standards then such a power will cause inclusion in the estate of the beneficiary.

Having the beneficiary as the sole trustee may cause application of the grantor trust rules under 678. It appears from the cases that an ascertainable standard exception exists but this law is case law and not in the statutes or regulations.

The attorney should determine if the appointment of a trustee in another state would cause income tax inclusion/exclusion in the other state. He also discussed resident vs nonresident trusts as determining which state will tax the trust. He listed four rules determining taxation - residency of the grantor, administration in the state, residency of the trustee and residency of the beneficiary.

The next section in the outline covered savings clauses. Steve said: "Use a savings clauses." He indicate that many attorneys do not use savings clauses. His response is why not use one. There is no downside.

Finally, he spent a couple of minutes on Creditor issues in trustee selection. He pointed out that despite "black-letter law," there is little authority that a spendthrift clause will protect a beneficiary acting as a trustee.

10:45 - 11:30 a.m.
Cottage Savings is a Loss to Trust Beneficiaries
Lloyd Leva Plaine

The issues addressed are the effect of Cottage Savings and Section 1001 on various actions effecting trusts.

Lloyd believes that a division or consolidation should not be a gain realization event. However, the IRS rulings sometimes do not reach this conclusion. The determination is whether there is a "material difference" for the purposes of §1001(a).

The IRS position has varied depending on whether the power to divide, consolidate or even a distribution exists in the trust. The Service has held that §1001 applies if the trust does not have such a provision even if the action is court approved.

Lloyd (and her materials) discuss a number of PLR's. The IRS's initial position was that a reformation or division would be subject to §1001 if the beneficiary's interest is materially different from the interest in the new trust.

The IRS now appears to recognize that a trust event authorized in the instrument will not constitute an exchange [under §1001]. There are a number of rulings in the last 3 years following this position. Now there are several rulings that also hold that a statutorily authorized action will not be an exchange. Also, most bona fide settlements conforming to the intent of the grantor have been held not to be exchanges.

She next discussed the grandfathered GST trusts. Lloyd does not believe that this should apply to such trusts. Cottage Savings should not apply to situations absent a sale or exchange of an interest in a trust. However, the Service seems to believe that there will be cases where no sale of exchange was involved that it does apply.

She discussed several situations and the effects of each. These include discretionary distributions of trust principal from an exempt trust to a new trust, court settlement of a bonafide dispute, judicial construction and some other actions.

Adoption of a unitrust approach or an adjustment under UPIA section 104 should not cause a problem. Her presentation and materials was based upon the proposed 643 regulations. The final regs do somewhat expand the GST effective date safe harbor. The final regs set out what state laws will be respected and give some examples. The final regs support the conclusion that an adjustment or conversion will not be a problem if the action is authorized by state statute. Lloyd emphasized that the regs say 'state statute,' not 'state law.'

There are two examples in the regs that authorize a conversion to a unitrust or an adjustment under state statute and conclude that there will not be a problem under GST. (Examples 11 and 12). If the client's state does not authorize one of these alternatives, then either the trust situs must be moved or such an action could cause problems with a grandfathered GST trust.

There are a number of rulings discussing a greater of a unitrust or an income approach but they do not discuss gain realization. Lloyd discussed good and bad rulings and the varying fact situations. One (PLR 200231011) of these concluded that gain recognition would occur. Lloyd believes that this ruling is fact driven and the result should not apply in most cases.

She does not believe that the adoption of a unitrust approach, an adjustment approach, or the greater of the two should be treated as a realization event. She analyzed different situations and discussed the reasons what there should not be gain recognition.

Where are we? If you have a state statute, you should be OK. If the instrument authorizes the actions, then you should be OK. If you go to court to authorize an action in a reformation of the trust to comply with the settlor's intent, you should be OK. Outside of these parameters, the law is not settled and you should probably be cautious.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Report 3A

Technology (pt.1)

First, an **IMPORTANT MESSAGE** from the Institute Staff:
At 10:45 AM 1/7/04 -0600, Ron Smith wrote:

January 6, 2004

Dear Registrants,

We have had a theft of registration records on a laptop which included the addresses and credit card information of our registrants. You may wish to contact your credit card company regarding your account. We regret this inconvenience and ask that you notify the Institute at www.law.miami.edu/heckerling of any unauthorized activity on your account.

- The Heckerling Institute on Estate Planning

Second, this Report will be the first of many on the various exhibitors who are present in Miami this year. These Reports will be prepared this year primarily by Jason Havens Esq., who is a practicing trusts and estates attorney in Destin, Florida and an LLM graduate in Estate Planning from the University of Miami Law School. In addition, Jason is the creator and Webmaster of the Legal Research for Estate Planners (LREP) Web site at www.jasonhavens.net.

The number of software and other vendors at the 2004 Institute has grown to 109. The software vendor list this year includes, in alphabetical order, although some of the other exhibitors who are not listed here may also provide software related services, such as forms on disk:

authoratative.net
BNA\Tax Management, Inc.
Brentmark Software, Inc.
CCH INCORPORATED
Connect2A
Eidelman Associates -- WINDRAFT
EstateDoc Systems, LLC
EstateWorks
Fast-Tax
FASTER Systems, LLC
Financial Data Service, Inc.
InterActive Legal Systems
The Lackner Group, Inc.
LAWGIC, LLC
LexisNexis
Power Presentations, L.L.C.

Practitioners Publishing Company (PPC)
ProDoc®, Inc.
Quick&Easy® by DataTech Software
RIA
Schumacher Publishing, Inc.
Selden Integrated Systems -- A ProBATE Software Company
WealthCounsel, LLC
West -- A Thomson Company
zCalc, LLC

Following are the highlights from the "first round" among the software and other vendors. These highlights are generally classified in categories that will hopefully prove helpful to list members. Additional "rounds" will follow.

A. CALCULATION SOFTWARE:

1. Brentmark (http://www.brentmark.com): Brentmark's Kugler Estate Analyzer (TM) (http://www.brentmark.com/kugler.htm) has received a warm welcome over the past year. The program uses three steps: client information, assets & liabilities, and techniques. The program combines Brentmark's Estate Planning QuickView and Estate Planning Tools capabilities in that the user can perform calculations and illustrate planning techniques, such as generation-skipping transfer trusts, qualified personal residence trusts, grantor-retained annuity trusts, charitable remainder trusts, charitable lead trusts, sales to grantor trusts, family limited partnerships, and testamentary charitable gifts, with flowcharts. The Kugler Estate Analyzer is advertised at a price of $595 for a single-user license (with a $199 annual maintenance fee). For those of us who prefer immediate gratification, you may download the Kugler Estate Analyzer at a discounted price of $570 (http://www.brentmark.com/orders.htm). You may demonstrate the Kugler Estate Analyzer via Brentmark's site (http://www.brentmark.com/download.htm#Kugler).

Brentmark also offers the Retirement Income Navigator (TM), the Pension & Roth IRA Analyzer, EPLAN (TM) (acquired from U.S. Trust), and many others. Brentmark introduced the Asset Transfers System, which tracks transferring and retitling assets for a client, in 2002. Brentmark recently introduced its Stock Options Risk Analyzer (8/2003) and its Savings Bond Toolkit (11/2003).

One of the best features of Brentmark's website is the inclusion of most product user manuals on the "Downloads" page: http://www.brentmark.com/download.htm. You can view each manual in your Adobe Acrobat Reader and decide whether you would like to purchase a particular product. Most products also feature a "demo" version, which are all included on the "Downloads" page and are available at the Brentmark booth as well.

2. CCH (http://tax.cchgroup.com): CCH's ViewPlan Advanced (TM) has also received a warm welcome from practitioners. This program integrates the features of the basic CCH ViewPlan, Beneview, and Factuary modules. You can calculate and illustrate more than twenty different asset transfer techniques including CRTs, NIMCRUTs, CLTs, GRTs, QPRTs, and SCINs. The graphical flowcharts are accompanied by built-in calculation logs. ViewPlan Advanced works seamlessly with other CCH products such as Enteract (TM) financial planning and Pro System fx (R) tax software programs, and uses Microsoft standards. ViewPlan Advanced is priced at $1,490 for a single-user license.

3. Thomson/West (TM) (http://west.thomson.com): Besides the Zane products and the RIA products, including Warren, Gorham & Lamont's superb treatises and the various journals of that group, Thomson/West has recently released the seventh version of its comprehensive program known as the Intuitive Estate Planner ("IEP") (http://west.thomson.com/customerservice/software/iep.asp). The IEP is authored by Donald H. Kelley and Konrad Schmidt, III. The IEP calculates and illustrates most estate planning techniques, from split interest trusts to non-resident spouse situations to gifts (even including calculation of the "gross-up" rule under Internal Revenue Code § 2035(b) for taxable gifts made within three years of death). The IEP coordinates a client's assets with the schedules of the federal estate tax return. The IEP offers the ability to produce customized presentations based on slides created from a client's illustration, pre-formatted slide shows, or your own customized slides. A slideshow demonstration and software patch files are available via the IEP page of the Thomson/West website. The IEP is priced at $900 for a single-user license.

4. Bureau of National Affairs (BNA) (http://www.bna.com): BNA has supported their Estate & Gift Tax (TM) Planner (http://www.bnasoftware.com/products/EGT/etplanner/?intProductID=4) for fifteen years. Like the Intuitive Estate Planner, the Estate & Gift Tax Planner performs numerous calculations and has a similar "spreadsheet" look and feel. The Estate & Gift Tax Planner also includes the ability to produce presentations. A "demo" version is available at the BNA booth. The Estate & Gift Tax Planner costs $995 for a single-user version.

5. zCalc (http://www.zcalc.com): zCalc's Tool Box illustrates most estate planning techniques. Unlike other programs, zCalc can be customized by changing the Tool Box templates or the actual functions in the function library. zCalc is still reasonably priced at $295 for the initial purchase of the Tool Box (a single-user license) and $150 per year thereafter.

zCalc has also introduced its Presentations program, which includes various presentations on seventeen estate planning topics. The difference between these presentations and the comprehensive programs (above) is that zCalc Presentations is a stand-alone program (i.e., the presentations are not coordinated with a specific client's calculations and concepts). zCalc Presentations costs $395 for the initial purchase (a single-user license) and $200 per year thereafter.

B. DRAFTING SOFTWARE:

1. epExpert (TM) (http://www.lawtech.com/WINDRAFT/EPEXPERT/): epExpert uses an underlying engine, WinDraft, to produce documents. You can basically build your own document assembly system with your own forms. This program also works with DOCS Open or iManage document assembly software. epExpert has several unique features, including an outline checklist interface to answer all applicable questions quickly and then produce a whole set of documents for both spouses. It then can automatically save each document in DOCS Open or iManage, and fill out each profile with names and descriptions. A particularly useful feature is the "drag-and-drop" interface, which lets a user enter contact information just once for husband, wife, children, and fiduciaries, and then drag-and-drop each person into various roles for the client's documents, e.g., associating a person with a fiduciary role such as trustee or personal representative, or designating the person as a beneficiary.
A number of large firms use epExpert to produce their custom forms based on their own language. Smaller firms can implement epExpert as well, although the pricing and level of complexity in implementing the system might deter some small firms from pursuing epExpert. WinDraft costs $495 for a 5-user license, and epExpert, the estate planning module, costs $4,500.

2. DataTech SoftWare, Inc.: DataTech's ThinkDOCS (http://www.thinkdocs.com) functions as an engine and allows you to build your own document assembly system. ThinkDOCS uses an integrated database that stores answers that users input in dialog boxes. Therefore, if a change is made (e.g., changing a client's name from "Bill" to "William"), the database can prompt the user that a change has occurred and can then apply the same change to all of the client's documents. You can also use templates to make ThinkDOCS more efficient and effective, similar to other drafting programs. The ThinkDOCS system is priced at under $700 for a two-user license.

3. Thomson/West (TM) (http://west.thomson.com): West has has consistently supported its Drafting Wills and Trust Agreements (http://west.thomson.com/product/13513114/product.asp), which was originally authored by Robert P. Wilkins and is now co-authored by Michael L.M. Jordan. Unlike other drafting systems, which are based on the HotDocs engine, this system is still based on CAPS (Capsoft). The drafting language is also somewhat cumbersome and not as "client-friendly" as other drafting systems. However, Drafting Wills and Trust Agreements is affordable, priced at $695. The form volumes (http://west.thomson.com/product/13513203/product.asp) can be purchased for $385.

4. ProDoc (http://www.prodoc.com): ProDoc offers Ronald Lipman's will and trust forms, the Florida Lawyer Support Services, Inc. (FLSSI) probate and guardianship forms, and probate management and accounting software as a part of its Estate Planning Library, which is advertised at $95 per month. Other practice systems are available. The newest feature of ProDoc is the Small Office Suite, which is essentially a case management program (somewhat similar to Amicus Attorney or PC Law) that affords contact management, calendaring, and time billing capabilities.

5. InterActive Legal Systems (http://www.ilsdocs.com): As noted in last year's final technology report, Jonathan G. Blattmachr, a distinguished estate planning attorney at Milbank, Tweed, Hadley & McCloy, LLP in New York and well-known author, has revived his Wealth Transfer Planning program. Wealth Transfer Planning, a "what-you-see-is-what-you-get" program, is now co-authored by Mr. Blattmachr and Michael L. Graham of Dallas, Texas. I reviewed this program several years ago and was impressed by (1) its numerous modules, which are similar in breadth of scope to Wealth Transfer Planning's "practice systems," and (2) its elegant language, but have not reviewed it after its recent "revival." I am currently doing so and will post a "post-review" excerpt in a subsequent report. Wealth Transfer Planning costs $2,995 for a single-user license.

6. WealthCounsel (http://www.wealthcounsel.com): WealthCounsel is again a popular booth. The WealthCounsel drafting system functions as a "what-you-see-is-what-you-get" program and includes various "practice systems" (or modules) built on the HotDocs (R) document assembly platform. WealthCounsel includes more "practice systems" than most other drafting systems, from various trusts to family limited partnerships to a comprehensive charitable system that even features private foundations.

WealthCounsel membership includes an extensive list serve with 1,800 participants (which is also free to non-members), continuing education, and an impressive knowledge base. As of October 2003, WealthCounsel was offering two payment options: (b) $3,900 down plus $390 per month for twelve months; or (c) $7,900 paid in full for the first year. However, please check with the WealthCounsel booth for special Heckerling Institute pricing.

WealthCounsel will again sponsor a post-Heckerling session to discuss topics and techniques presented at this year's Institute. According to distinguished practitioner and WealthCounsel co-author Lew Dymond, WealthCounsel will again implement updates to its practice systems based on selected ideas and techniques gleaned from the Institute presentations. WealthCounsel costs more than other drafting system, but you obviously receive additional services such as these types of post-program sessions and timely updates. You should remember that pricing is only one factor to consider in selecting a drafting system.

7. Lawgic (http://www.lawgic.com): Lawgic also functions as a "what-you-see-is-what-you-get" program. Lawgic was revived by Bruce Grewell, the new "captain" of Lawgic. The distinguished estate planning attorneys at the international law firm of Holland & Knight, LLP (http://www.hklaw.com) have been updating the Lawgic Wills & Trusts products, including Florida and Georgia, which they originally authored. Well-known co-authors John Arthur Jones, Edward F. Koren, Richard L. Stockton, and Bruce Stone have used their well-drafted, "plain English" provisions to provide updated, state-specific systems for California, Florida, and Georgia. Lawgic offers wills, disability planning documents, and a number of trusts (from revocable inter vivos trusts to insurance trusts to various grantor trusts), as well as ancillary documents and client letters. Lawgic is one of the only drafting systems that offers state-specific documents with state-specific legal commentary on various issues that arise from one state to another. According to representatives of Lawgic, they will release new Wills & Trusts products for Illinois, Maryland, Massachusetts, New York, Oregon, Virginia, and Washington in the near future. Notably, Carlyn S. McCaffrey, a distinguished estate planning practitioner at the international law firm of Weil, Gosthal & Manges, LLP (http://www.weil.com), has recently agreed to oversee Lawgic's New York Trusts & Estates product. Lawgic representatives are discussing the addition of other distinguished practitioners as they release Wills & Trusts products for other states.

A "Getting Started Guide" is available within the program and via the Lawgic website (http://www.lawgic.com/new/pdfs/GettingStartedGuide.pdf). Lawgic's website offers some excellent "Product Training Videos" in the "Support" portion of their site (under "Training"). Lawgic is priced at $1,500 for a full version (single-user license) or $995 for "Lawgic Lite" (single-user license), the latter of which does not feature certain trusts used in larger cases (but which can be converted at any time for $500).

This Report is continued in **Report 3B**.

____

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
===
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
==

Report 3B

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Technology (pt.2)

First, this Report 3B is a continuation of Report 3A, being Jason Havens' continuing report on the **Vendor's Exhibit Hall**.

C. TRUST ACCOUNTING & RELATED ADMINISTRATION SOFTWARE:

1. The Lackner Group, Inc. (http://www.lacknergroup.com): The Lackner Group, Inc. has consistently offered a single-entry estate administration program known as the 6-in-1 Estate Administration System. This system produces the 706, 1041, the accounting and inventory for the estate administration, and relevant state tax forms as well. The 6-in-1 Estate Administration System is a Windows- or Mac-based system that includes the latest tax preparation forms, including the updated Form 1041. Lackner has also updated its system to anticipate all known "decoupling" states (i.e., those states that are deviating from the "pick-up" tax, based on the state credit for federal estate taxes). Lackner is compatible with the well-known File Maker Pro database program. The Lackner modules are priced separately.

2. Thomson/West (TM) (http://west.thomson.com): Fast-Tax (http://www.fasttaxtrust.com) gives the trust administration user the ability to produce tax forms. Fast-Tax interacts with Zane fiduciary accounting software, which is also part of the Thomson group. Products are priced separately.

3. Bureau of National Affairs (BNA) (http://www.bna.com): BNA (http://www.bnasoftware.com) offers two automated systems: an updated 706 program that already incorporates the increased applicable exclusion amount and a newly-updated 709 program. The 709 program now allows you to move gifts easily within the return by highlighting and "right-clicking" on the particular gift that you want to move to a different part of the return. Navigation within the 709 is also improved. "Demo" versions for both products are available at the BNA booth.

4. Financial Data Service, Inc. (http://www.financialdata.com): This program produces the 706 and 709 transfer tax returns, as well as probate reports and other items.

5. Selden Integrated Systems/ProBATE (TM) Software (http://www.probate-software.com): ProBATE Software offers fiduciary accounting and tax compliance software, including the preparation of Forms 706, 709 and 1041, as well as estate planning software and a digital workflow program through iKE Office.

6. FASTER Systems, LLC (http://www.fastersystems.com): FASTER software offers a single-entry system for fiduciary accounting.

7. DataTech SoftWare, Inc.: DataTech's Quick & Easy (TM) (http://www.quickandeasy.com) (tax preparation) now offers a complete suite of estate administration tools called Estate.suite (TM) (http://www.estatesuite.com/). You may also purchase individual tax and fiduciary administration modules from the main Quick & Easy website.

8. EstateWorks (http://www.estateworks.com): EstateWorks is a web-based system that tracks and assists with the preparation of estate administration matters. Users can "click" through any part of the program and can see at a glance the status of cases and a checklist for each case. EstateWorks generates documents and merges data into word processing files and other formats.

D. APPRAISAL & VALUATION SOFTWARE:

1. Estate Valuations & Pricing (EVP) Systems, Inc. (http://www.evpsystems.com): EVP has released an updated version of its excellent stock and bond valuation software, and this software is now free for the asking, although you need to register as a user.

2. Other appraisal and valuation vendors abound, and will be featured later as time permits.

E. RESEARCH SOFTWARE & SERVICES:

1. Lexis-Nexis (http://www.lexis.com): Lexis features numerous estate planning titles in its Estate Practice and Elder Law Library, including the University of Miami Philip E. Heckerling Institute on Estate Planning materials. You may also purchase the presentation materials on CD-ROM this year for approximately $140.

2. Thomson/West (TM) (http://west.thomson.com): West offers a number of estate planning research tools as well.

3. Bureau of National Affairs (BNA) (http://www.bna.com): As most of you know, BNA offers excellent research tools, including the well-known Tax Management Portfolios (one of my favorite research tools) (http://www.bnatax.com/tm/tmil.htm). You might not know, however, that BNA now allows you to jump from the Portfolios to the primary sources and back again. Previously, users could "click" a footnote and view the primary source. Now, you can accomplish the reverse by determining where a primary source is discussed in the Portfolios. A "demo" is available on the BNA website (http://www.bnatax.com/tm/tmil.htm).

F. MISCELLANEOUS VENDORS:

1. Connect2A.com (http://www.connect2a.com): Connect2A.com allows estate planning professionals to track their clients' assets and estate planning techniques via an Internet-based service that is encrypted and more secure than almost all private law firms' internal servers. Connect2A offers excellent training, from their Internet-based presentations powered by WebEx technology (http://www.connect2a.com/C2Ademo.html), which cover basic aspects of Connect2A, setting up trust information in Connect2A, and the trust funding process of Connect2A, to their in-depth training sessions for the estate planning team. One of the most attractive aspects of Connect2A's service is the ability to track asset and beneficiary changes during the trust funding process. Connect2A's system is also compatible with HotDocs (R) and thus is compatible with other estate planning programs such as Financial Profiles and WealthCounsel. The Connect2A service costs $60 per month, billed quarterly.

2. The Capital Trust Company of Delaware (http://www.ctcdelaware.com): The Capital Trust Company of Delaware's site includes many useful Adobe Acrobat one-page summaries on basic and advanced estate planning techniques, which are excellent when explaining a concept to a client who would prefer a picture. Presentations are also available, as well as sample forms and provisions and

extensive information on the application of Delaware law. Most of the mentioned materials are located in the "Personal Trust Services" area under the "Trusts" heading on the top navigation bar.

Registration is no longer required to access these materials. Visitors may still register for a free e-newsletter, however, which contains planning discussions and recommendations from some of the helpful Capital Trust Company of Delaware team members.

3. Foundation Source (R) (http://www.foundationsources.com): Foundation Source offers administration services for private foundations. These services include maintenance of governing documents, tax filings, and grant processing and compliance. Investment services are not included and are not intended in the scope of the offered services.

4. Power Presentations (http://www.power-presentations.net): This company offers packaged presentations for estate planning seminars and client presentations.

5. Schumacher Publishing, Inc. (http://www.estateplanning.com): This company markets packaged websites for estate planning attorneys plus numerous printed materials.

If any vendors or any important developments were omitted that we should have mentioned, please stay tuned. We will attempt to cover all items of interest in future reports as time permits.

Second, here is an **ANNOUNCEMENT** of special interests to all estate planning attorneys about the upcoming ABA TechShow 2004:

The **2004 ABA TechShow**, which will be held in Chicago **March 25-27, 2004**, will feature for the first time an all-day Tract on Thursday, March 25, 2004 that is being co-sponsored and presented entirely by members of the ABA Real Property, Probate and Trust Law Section. The four panel presentations that will be held that day will be the following:

RP.01: Electronic Estates: Virtual Trips to the Courthouse
James Creamer, Donna Killoughey
Explore the current state of electronic filing in probate and surrogate courts. Learn about the special issues that are presented by e-filing
when the original wills, trusts and other documents are not in an electronic format that permits them to be proved-up as valid originals under current state and federal law. This program will also cover e-wills, e-trusts and related health care documents in light of UCITA and related state and federal legislation. Special focus will be given to the experience in Colorado, which two years ago became the first state in the nation to permit e-filing in every one of its trial courts.

RP.02: The Electronic Transaction from A to Z - Tools for Doing the Deal Online
Nancy Grekin, Gerald Hoenig, George Meyer
With e-mail you can put anything authored by one attorney on another attorney's desk instantly. The revised document can be returned by e-mail. What's next on the horizon? Soon you'll be using deal rooms and extranets to negotiate and to collaborate on the preparation of transactional documents. Are you still spending your days marking up the last document you

used in a similar deal with a pencil, looking for the letter from last week that contains critical information, or feeding paper into a fax machine? Find out how you can use document assembly to streamline document production, how to send and receive a fax without ever producing a piece of paper, and how to use document preparation and management technologies to make your transaction as paper-less as possible.

RP.03: The Electronic Transaction from A to Z - Closing the Deal Without Leaving Your Office
Nancy Grekin, Gerald Hoenig, George Meyer
Tired of getting on airplanes to close deals? Online electronic closings are now being done in many locales. Learn about the electronic signatures acts, how to obtain an electronic signature and how they are validated. Discover the advanced features of Adobe Acrobat which facilitate the creation of electronic closing binders and electronic signatures.

RP.04: Bits And Bytes Meet GRITs and GRATs Alphabetizing Estates By The Numbers
Roger Shumaker, Amy Mendelsohn
Long hand calculations of potential estate taxes and tax avoidance planning is a thing of the past. New software helps you easily determine how to effectively preserve assets and meet the distribution goals of the grantor. Learn how to accurately calculate estate planning alternatives, and then demonstrate the options to your clients with graphics. Once the choice is made, learn how to quickly and economically generate the plan documents, significantly reducing your document production time.

The normal registration fee for TechShow is $695 if paid for by 2/26/04, else $795. However, since the RPPT Section is a Program Promoter this year, and if you are a member of the RPPT Section, you qualify for a reduced registration fee of only $595 if paid for by 2/26/04, else $695. However, in order to be eligible for that reduced fee, you have to use the **Program Promoter Code #24** when you register.

You can also register for one day only for $295 if paid for by 2/26/04, else $345. Law students can register for all three days for $145 if paid for by 2/26/04, else $195. Admission to the Exhibit Hall only (which rivals the Heckerling Exhibit Hall in size and number of vendors) is free this year.

For more information and the details about all the programs that will be offered over the three days of the show, go to www.techshow.com, as there will be additional tracts for Litigation & Electronic Discovery, Wireless, Security & Privacy, Knowledge Management, General, Solo & Small Firm, Strategies & Best Practices, Advanced IT and (this is new) the Technology Training Institute.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087

Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

Report 4

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Tuesday, January 6 (Continued)

9:00 - 9:45 a.m.
The Domestic Asset Protection Trust Comes of Age
Richard W. Nenno, Wilmington Trust Company

Reporter: John Warnick Esq.

Dick Nenno used the "Biker Bob" family to illustrate at least seven different ways in which a domestic asset protection trust ("DAPT") can be utilized.

The worst possible candidate for asset protection planning is a client who has or is about to incur a large obligation and wants to hide assets to avoid satisfying this debt.

The "best candidate" for a domestic asset protection trust would be the client who:

1. has no current creditor problems (or at least assets substantially in excess of what is needed to cover current and foreseeable claims);

2. is worried about claims that might arise in the future;

3. has assets that aren't needed to meet current and foreseeable living expenses; and

4. does want frequent access to the assets which are to be protected.

Mr. Nenno noted that virtually all U.S. jurisdictions hold that trusts created for third parties are generally not reachable by the beneficiaries' creditors. Five states (Delaware, Alaska, Nevada, Rhode Island and Utah) now recognize irrevocable self-settled spendthrift trusts.

Mr. Nenno acknowledged a bias against DAPTs and questioned Professor Bogert's assertion that self-settled trusts are generally created with evil intent. After addressing the three reasons offered for refusing to recognize DAPTs, he gave nine reasons why domestic asset protection trusts should be recognized. He noted that all U.S. jurisdictions have rules to set aside fraudulent transfers and cited two recent cases illustrating the application of these rules: U.S. v. Engh, 330 F.3d 954 (7th Cir. 2003) and Nastro v. D'Onofrio, 263 F. Supp. 2d 446 (D. Conn. 2003). Since all five of the domestic asset protection trust states have fraudulent transfer rules, Mr. Nenno concludes that a creditor should be able to reach assets that were the subject of an improper transfer to a DAPT. However, domestic asset protection trusts that do not run afoul of the fraudulent transfer rules should be effective.

Mr. Nenno next reviewed the potential liability of an attorney who either assists or declines to assist a client to create a domestic asset protection trust. He noted that ethical opinions or cases involving the propriety of an attorney's participation in asset protection planning have come down in four states: California, Connecticut, Oregon and South Carolina. They indicate that an attorney might be engaging in an ethical violation if he or she helps a client defraud known or foreseeable creditors, but that there should be no ethical violation if the planning involves unknown and unforeseeable creditors. He also cautioned that the attorney cannot assume he or she will escape ethical problems simply by choosing not to participate in asset protection planning and noted commentators have suggested that it is only a matter of time before a case arises questioning whether an attorney has discharged the duty to represent a client zealously if he refuses to promote a client's lawful asset protection plan.

In his discussion of the tax consequences of domestic asset protection trusts, Mr. Nenno noted that the creator of a DAPT can choose to structure the trust as a completed gift for federal gift tax purposes while still excluding the trust principal from his or her gross estate for federal estate tax purposes if the settler can only receive distributions from the trust in the absolute discretion of an independent trustee. Conversely, the trustor of a DAPT can intentionally prevent a completed gift by retaining a special testamentary power of appointment.

From an income tax standpoint, the domestic asset protection trust will be treated as a grantor trust unless the distributions to the trustor must be approved by an adverse party such as a child who would receive the assets not distributed to the trustor. Mr. Nenno also pointed out that domestic asset protection trusts are being utilized to avoid state and local income and intangible taxes.
Mr. Nenno acknowledged that no case has yet upheld the effectiveness of domestic asset protection trusts. He noted that in early 2003 a rumor had circulated that an Alaska asset protection trust had been breached. In fact, the case in question involved a transfer from an Alaska resident to a foreign asset protection trust that was to be administered in Alaska and was probably fraudulent.

In his discussion of the full faith and credit clause, Mr. Nenno refuted the argument of offshore trust proponents that this constitutional provision and related issues are fatal to domestic asset protection trusts. He noted that the full faith and credit clause will only be relevant when a creditor obtains a judgment against the trustor of a domestic asset protection trust and tries to enforce it in the state where the trust was created or when a creditor seeks to obtain a judgment against a domestic asset protection trust in a jurisdiction that doesn't recognize such trusts.

The full faith and credit clause applies to the "acts" as well as to the "judgments" of another state. Citing *Franchise Tax Board of California v. Hyatt*, 123 S. Ct. 1683 (2003), he noted that the Supreme Court has held that the full faith and credit clause is exacting with respect to a final judgment rendered by a court with subject matter and personal jurisdiction but does not compel a state to adopt a statute adopted by another state. Mr. Nenno pointed out that the Supreme Court has also said "full faith and credit . . . does not mean that states must adopt the practices of other states regarding the time, manner and mechanisms for enforcing judgments." *Baker by Thomas v. General Motors Corp*., 522 U.S. 222, 235. And he cited *Phillips Petroleum Co. v. Shutts*, 105 S. Ct. 2965 (1985) for the proposition that a state court can't ignore statutes of other states.

Dick's conclusion is that the full faith and credit clause is more likely to protect trusts established in Delaware, Rhode Island, Nevada and Utah that have even-handed restrictions on the enforcement of foreign judgments than to be used as a tool to strike down such trusts. He also pointed out that the laws of foreign countries warrant no respect under the full faith and credit clause.

Mr. Nenno offered the following examples of possible uses of the domestic asset protection trusts:

1. to shield a gift or inheritance that is received outright rather than in trust;

2. to protect children who receive significant assets at the age of majority;

3. to protect officers and directors from heightened risks or to allow them to use "blind" domestic asset protection trusts to comply with security law restrictions while keeping the ability to benefit from the trust assets;

4. to avoid state income or intangible taxes;

5. to protect the assets of clients who are mentally, physically or financially vulnerable;

6. to protect assets from claims of future spouses and avoid providing the type of financial disclosure that is required to implement effective prenuptial agreements;

7. to protect personal injury awards (see In re Jordan, 914 F.2d 197 (9th Cir. 1990) for an example of where such a trust would have been helpful);

8. to protect CRTs and other estate planning vehicles such as GRATs, QPRTs, etc. Mr.Nenno pointed out that trustors may be more likely to engage in sophisticated estate planning transfers if they know that the funds might still be available to them in the event of an emergency;

9. nonresident aliens may use domestic asset protection trust before they immigrate to the US to remove assets from their estates while still retaining the ability to get funds back in the event of a future need or catastrophe; and

10. to provide protection for offshore or ineffective domestic self-settled trusts. Mr.Nenno noted that careful consideration must be taken to determine if such a move will causethe trustor/beneficiary to make a completed gift.

Mr. Nenno concluded with an abbreviated comparison of the relative benefits of some of the domestic asset protection trust jurisdictions. For the workshop Wednesday afternoon on domestic asset protection trusts, he has assembled a panel of lawyers from each of the five DAPT jurisdictions. We will report in greater detail on the comparative merits of these jurisdictions after we listen to all five of the panelists.

2:00 - 2:45 p.m.
Bulletproofing the Family Limited Partnership Current Issues.
John Porter

Reporter: Carol Warnick Esq.

For purposes of his discussion, the arguments used by the Service apply to both FLPs and LLCs, but he is going to refer to FLPs.

Various arguments have been used by the IRS to attack FLPs, and to varying degrees of success. Some are:

1. Entity designed solely to reduce transfer taxes. (this is really "lack of economic substance" argument.)

The IRS argument is missing a step. You must identity the property rights that are being transferred. What is being transferred in an interest in the partnership, either an assignee interest or an FLP interest. As appraisers will tell you, discounts apply for lack of control and lack of marketability.

Before you ever look at the gift, you have to see what rights were transferred, and was full and adequate consideration received. The partners have no rights to the underlying assets.

In both the *Lappo* and Peracchio cases discussed in the outline, the Service dropped this argument. This argument is continuing to be dropped out by the Service.

2. Section 2703 Argument.

Strangi addressed this issue. 2703 is not an estate or gift tax inclusion statute. It is a valuation statute, an exception to the willing buyer, willing seller test. It is getting to buy-sell agreements and other types of restrictions on transfer. This is what Judge Cohen said in *Strangi* I that was affirmed by the 5th Circuit. 2703(b) provides a safe harbor.

This argument is dropping out as well, but still being raised a little. Make sure the provisions in your agreement are commercially reasonable. Look to what kinds of restrictions are present in nonfamily partnerships.

3. Gift on formation argument.

Courts have said that where you have a pro-rata partnership and capital accounts are properly handled, there is no gift on formation.

He discussed the *Shepherd* case where a father gifted 25% of the partnership at formation to each son. In this case there was a gift.

The Service is trying to raise a similar argument (depletion of value) in a properly formed pro-rata partnership, but they are losing that argument. It may be raised at the audit level because examining agents often throw in the kitchen sink and expect that the real arguments will be sorted out as the case goes along.

Stone case was a case John Porter handled. He also just tried two other cases which have not been decided yet.

The 2036(a) argument. Elements are a transfer with a retention of interest or retention of the right to designate the persons who will enjoy the property.

(a)(1) involves respecting the entity. At issue here are bad facts such as commingling assets, failure to respect entity, contribution of personal assets (personal residence), insufficient assets outside the partnership upon which to live (helps Service argue there is an implied agreement.), paying taxes out of partnership.

The Service is also looking at what happens after death, even though they probably should not be considering after death actions. He suggests paying taxes through a borrowing arrangement with the partnership, rather then with a distribution or even a redemption because there are valuation issues involved there.

The bona fide sale exception. Do you have to have a bona fide sale **and** full and adequate consideration? In *Stone*, the children's attorneys had input into the terms of the partnership agreement. This is consistent with a commercial partnership.

There is no one fact that the courts have all hung their hats on.

He reviewed an audit letter he received from the IRS and suggests going through such letters as a way of thinking through everything prior to creation of the entity.

Make sure your files show nontax reasons for setting up this partnership.

Mentioned defined value clauses and noted that they just filed the appeal in *McCord* on Monday.

More specifics will be discussed at the break-out session tomorrow.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

Report 5

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Tuesday, January 6 (Continued)

Reporter: Carol Warnick Esq.

2:45 - 3:30 p.m.
Taming the Tiger: Designing, Implementing and Operating the FLP to avoid a Successful Section 2036 Attack.
T. Randall Grove

We should select with care the clients with whom we use entity planning. Many problems arise when entity planning is used where it does not really fit very well.

We should all ask these types of questions:

Is my client the right kind of client for entity planning?

What is the best strategy for this situation?

What is the right design for the overall entity plan?

What is the right guidance and assistance for the client with respect to the operation and creation of the entity? Look at full spectrum in order to counter the substance oriented arguments.

He believes that the Service is bringing up a sham argument couched as a 2036 argument.

Reminder: There is NOT a lot of certainty in this area...still a facts and circumstances issue.

2036 (a)(1) refers to a retained interest argument.
2036 (a)(2) refers to a transfer and then control over who receives the benefits.

Retention of Benefit by Donor.

First stage of cases looked at commingling, disproportional distributions, continuation of pre-entity benefit, etc. (*Schauerhamer, Reichart, Harper*.)

Second stage of cases focus on the entity having the characteristics of a testamentary device. (*Harper, Thompson, Kimbell, Strangi II*.) Courts discuss the purpose of 2036 to include transfers that are testamentary in nature. There is no practical effect of the entity until transferor's death. (Factors include a transfer of a majority of decedent's assets to the entity, minimal change in economic benefit of the assets from prior to the creation of the entity, donor advanced in age and has serious health conditions.).

Third stage cases such as *Stone*. Need non tax reasons for setting up the arrangement to be able to overcome the implied agreement issues.

Again, ask the question. Is my client the right client for entity planning. Should include both analyzing the client and listening to the client.

Will my client be able to make a successful transition from the sole proprietor mind set to an entity mind set?

This is also important to the client with regard to the long term satisfaction of the client. (will they be moaning in the future about the complicated nature of the plan?) What kind of articles will the client be sending you from the Wall Street Journal ten years from now?

What is the client's willingness to treat the entity as an on-going business with an unrelated third party (not family members). If they can do that, they will probably make the right decisions with the entity as they go along.

What about client's other relationships, i.e. with the CPA, etc. Will they help the client deal with the complexities? What is the relationship with at least one of the children who may have an easier time understanding the sophistication required?

Asset transfers are a huge issue. Will client pay to make sure that the attorney sweats the details on implementation? Have in writing what is attorney's role and what is the client's role.

Ethics rule 1.4 Communication with client. We must reasonably consult with the client to permit the client to make informed decisions. We need to communicate the material risks and the reasonable alternatives, as well as the risks of reasonable alternatives.

When discuss risks and disadvantages, discuss the fact that to do entity planning you are giving up other types of planning.

Be sure you have a good engagement letter.

Explain the opportunities and risks to the client in writing. Do not be viewed as the guarantor of the client's expectations without shaping those expectations.

What is the simplest way to accomplish the client's objectives. Will divided ownership in the property accomplish the same thing?

Balance low to high complexity versus high to low tax benefit.

Identify alternatives for client.

DESIGN ISSUES key issues

Look at the situation and build your design around it. *Stone* is a good example. The economics in *Stone* are a lot like the economics in *Strangi*, but there were other good facts in *Stone* that could be emphasized, i.e. negotiations among the parties, the kid's being involved in the terms of the partnership agreement, etc.

Then look to shore up any weaknesses.

Avoiding the implied agreement. There were 3 issues in *Strangi II* that sunk their ship.
1. Did not pay rent currently. Whenever personal use assets go into an entity, must have a high level of documentation and compliance with agreements. (In *Strangi*, no rent for use of personal residence was paid concurrently.)

2. Not retaining sufficient assets for use of donor. Only transfer assets that fit with the purpose of the entity. Have non tax reasons for that asset going in.

3. Not sufficient changes from after the entity was set up. If taxpayer is retaining a major part of the benefit, show significant changes in investments, how assets are invested, control, benefit, etc. Consider establishing an irrevocable trust like *Byrum* (helps for both 2036(a)(1) and 2036(a)(2) matters).

Issue of transfer: Whether any gratuitous transfer is needed or if you get into (a)(1) simply by funding the entity?

At this point, look at a "full and adequate consideration" design. He thinks that is the safest right now.

He provides in the outline eight design guidelines which will keep you on the right path both with implied agreement issues and full and adequate consideration issues.

1. Clarify the specific business (nontax) purpose.

2. Negotiate the decisions regarding design, implementation, and operation of entity between the donor and other parties.

3. Develop a business plan and pool the property and services from each of the partners.

4. Transfer to the entity only those asset6s that are appropriate to achieve the economic objectives and to satisfy other nontax goals. The donor should keep sufficient assets to comfortably provide for his/her personal needs and desires, including gifting.

5. Implement and operate the entity in a business-like manner as a joint enterprise for profit.

6. Utilize an active investment approach to accomplish the economic objectives of the entity.

7. Make significant changes in the benefit to be received from assets and in the management of assets (in order to avoid "implied agreement").

8. Continue to operate the entity after the death of the donor and invest assets according to economic objectives (rather than primarily using assets to pay estate taxes or liquidating the entity.)

There are two major design pitfalls dealing with 2036(a)(2). They are (1) joint action and (2) constraints on right to designate

1. Joint action - occurs only in situation where taxpayer does not already have the authority to make those kinds of decisions. In *Byrum*, joint action did not come up. There was an independent trustee utilized. Mr. Byrum could flood the trust with dividends because he supposedly could control the

directors, but did not have control to get the dividends all the way to the beneficiaries.

Mr. Gulig in *Strangi* had two fiduciary roles, manager of the entity and attorney in fact for Mr. Strangi under the power of attorney. The attorney in fact role helped create the joint action problem. Court did not believe he would exercise fiduciary duties to other shareholders if it conflicted with his fiduciary duties as attorney in fact for Mr. Strangi.

2. Constraints on right to designate, not just fiduciary constraints. But *Byrum* is a bit more involved than that. Mr. Byrum had tremendous management control. He could replace independent trustee, etc. But also had to deal with certain "realities of corporate life"(words used by opinion).

He thinks that utilizing an irrevocable trust with an independent trustee, as in *Byrum*, is very important.

Have an organization meeting that involves the key advisors. The appendix includes a checklist of various issues to address at that meeting.

Do not gift too much. (Look at gifting checklist, also in appendix.)

Key issues for annual review. (Exhibits 12 and 13 in appendix go through summary of operation of entity.)

3:45 - 4:30 p.m.
Defined Value Clauses: How Much Do I Love Thee? This Much No More, No Less.
A. Christopher Sega

Mr. Sega discussed that much of our clients' property is not subject to easy valuation, therefore lawyers have come up with two types of formula clauses, which he discusses at length.

1. Price adjustment clause I'm giving you Black acre, but if I'm wrong on value, you give part back to me or else pay me more. The price adjustment formula adjusts the amount transferred based upon the occurrence of a subsequent event (a "condition subsequent.") The subsequent event is typically a valuation redetermination. These formulas undo a portion of the gift and either return this portion to the donor, or increase the compensation paid to the transferor for this portion. These clauses do not work because of the *Procter* case.

In *Procter*, the Fourth Circuit ruled on four articulated public policy grounds.

1. If respected, the clause would inhibit efficient collection of tax by discouraging audits. (A successful challenge would not increase the amount of tax collected but would restore the property to the donor.)

2. The effect of the condition would be to requir4e the court to pass on a moot case. If the condition was valid and the gift held taxable, the only result would be to defeat the gift so that it would not be subject to tax. Thus the proceeding would become one of seeking the court's "declaratory judgment" that no gift occurred.

3. The provision should not be permitted to defeat a judgment of the court..

4. Because the trust beneficiaries were not party to the tax litigation between the donor and the Service, the beneficiaries might later seek to enforce the gift after the tax litigation concluded, even though the gift of the excess value was determined to have never been made.

In his analysis, *Procter* ignores the fact that the clause would return a portion of the transferred property to the settlor's estate, where it would be subject to estate tax. Furthermore, the Tax Court now has the authority to make a declaratory judgment as to the value of the gift. *Procter* also suffered from being an unsympathetic plaintiff.

Rev. Ruling 86-41 confirms that price adjustment clauses do not work.

2. Defined value clauses I'm giving you $5 worth of Black acre. It defines the amount transferred from the outset. Some consider this formula as involving a "condition precedent" or "condition concurrent." You cannot ignore the defined value formula, because you need the formula to determine the property transferred. Ignore the formula, and no property changes hands. What the Service may later do is irrelevant.

A Tale of Two Technical Advices. TAM 86-11-004 (November 15, 1985) the Service upheld a defined value formula gift and made no mention of Procter.

Fast forward to TAM 2002-45-053 (July 31, 2002). Service declined to give the defined value formula effect.

But Service does sanction the use of formulas in certain "Congressionally sanctioned" situations, i.e. marital deduction formulas, QTIP formulas, GRATSs, CRTs, formula disclaimers, etc.

We as practitioners use many non-congressionally sanctioned formulas such as savings clauses.

Less aggressive taxpayers may wish to limit their formula transfers to those types of gifts that Congress has "sanctioned". How can we creatively use these safe harbors in our planning? If the principal abuse perceived by the Service is the excess value (either in kind or additional consideration) going back to the donor, one might seek to avoid this result by transferring the excess value to a third party (the "gift over"). This third party might be a tax-advantaged donee, such as a charity, a marital deduction trust, a zeroed-out GRAT, or an incomplete gift trust, so that there is little or no transfer tax consequences to a revaluation.

He goes on to discuss at length the *McCord* case. This case involved a formula with the excess (the "gift over") going to a congressionally sanctioned beneficiary. A majority of the Tax Court would have respected the defined value clause it if had provided that the amounts allocated to each donee were to be determined using "fair market value of the gifted interest *as finally determined for Federal gift tax purposes*." This language was absent and the Tax Court found nothing in the formula or assignment that the gifted interests allocated among the donees would not be ascertained until the "final" determination was made. It is significant that the majority opinion did not mention *Procter* even though both parties briefed it extensively.

Consider having "gift over" go to an incomplete gift trust over which the donor retains a special power of appointment. (Any amt that may be subject to tax goes to a 2nd tier donee, an incomplete trust.

Example: If $1M gift intended, but upon valuation is valued at $2M, the first million still goes to the 1st tier trust and second million goes to the incomplete gift trust. Also discussed other potential "gift-over" donees such as a marital deduction trust or a zeroed out GRAT, (more leverage with the GRAT).

He also discussed that one common issue with the donor's deciding to gift is the lack of a step-up in basis with gifting. Caryln McCaffrey has previously discussed using a formula to return a gift to the donor's estate in the event the donee's income tax cost on a subsequent sale exceeds the donor's estate tax savings. (He calls his a Hedge Formula.) This might occur when low basis property is gifted, but fails to appreciate or declines in value. In that event, the donor may have saved estate taxes by having the property included in her estate at the lower value, with a basis adjustment at death. The donee could then dispose of the gift without incurring a capital gain. He indicated that such a formula should have no 2036 issues. What about 2038? No, because appreciation (or lack thereof) causes it to return to donor's estate. The donor cannot control the appreciation.

Steps he suggests to take if using a defined value clause. (More are discussed in the outline.)

1. Get a good appraisal up front. Do not do a quick and dirty appraisal up front and then call in the big guns if you get audited.

2. Know what the appraisal says before you make the gift.

3. Do not transfer all the donor's partnership interest

4. If using a hedge formula, make sure you have an independent trustee...

5. If it has a trigger provision, make sure that you pull it. Adjust the books based on the formula.

6. Report it as a dollar amount gift on the tax return, not a percentage of partnership interests.

7. Engage in similar transactions with nonfamily members

8. Include in your agreement that anytime within the gift tax statute of limitations, either party can request a third party appraisal to revalue the gift.

9. If you do a "gift-over" transaction, have part of the property go so that some tax will be paid, but do not make it just a "sliver." That takes away the public policy issue in Procter.

10. If doing a redemption by second tier donee, make sure second tier donee does an appraisal to determine what they got. Should be a separate appraisal.

4:30 - 5:15 p.m.
Funding Formulas Fail on Flexibility: Variations on Traditional Marital/Credit Shelter Funding Techniques.
Barbara A. Sloan

Ms. Sloan described 2 types of clients

1. The client who, absent tax planning, would leave entire estate to surviving spouse, outright. (sweetheart client). This client seeks to build in flexibility with a disclaimer.

2. Type of client who, absent tax planning, would leave entire estate to surviving spouse in trust. (all-in-trust client). This client seeks to build in flexibility with a partial QTIP election

In reality, most moderate to high net worth clients will use formula credit shelter bequests rather than the above. But then along comes EGTRRA and we do not know what to do. But even with EGTRRA, the likelihood of repeal seems so low and so far away, many practitioners have adopted a "wait and see" approach.

However, we want to provide as much flexibility as possible, and want to defer as many decisions to the death of first spouse to die since we do not have all the answers now due to the uncertainties of the tax code. Now is the time to consider taking the new tax law more seriously. We not only have the potential repeal of the estate tax, we have the possible advent of carry-over basis issues, etc.

She presented several ideas to consider.

1. Consider capping the exemption at some predetermined amount. The problem is that it does not increase flexibility, but it does increase certainty. This is especially helpful in jurisdictions where the state estate tax exemption amount now does not track the federal estate tax exemption amount. In doing this, be sure to consider where expenses should be paid from.

2. Use disclaimers. They are trickier than they appear to be, or else we would not continue to have cases on them. Especially tricky is the acceptance of benefits issue. Be sure to give a cash bequest to spouse so spouse will not be as apt to accept benefits of what is supposed to be disclaimed. Also look at successive disclaimers.

Remember, money in trust is not the same as money in hand.

3. Partial QTIPs. Provide a lot of flexibility...

4. Clayton (contingent income) trust - less well-known technique.
Named for the case which established its viability.

Starts as a trust for which a QTIP election could be make, but nonQTIP-elected portion flows to a completely different trust and does not even have to meet the requirements of the QTIP trust. The 6th and 8th Circuits and the Tax Court have all gone along, and now we even have a regulation. Reg. 20.2056(b)-7(d)(3). .

She calls it a powerhouse technique. A Clayton trust can include other family members as beneficiaries. She defines it as follows:

"A Clayton trust is a trust which starts life as a qualified trust for which a QTIP election could be made, but to the extent that the executor does not make the QTIP election, the non-elected portion flows to a separate trust which is not required to have terms identical to the QTIP trust and is not required to meet the definition of a QTIP trust."

In essence, it is a trust that can mutate from being a QTIPable trust (one than can be QTIPed) into a completely different trust that doesn't have to contain the requirements necessary to qualify as a QTIP.

She discussed making the Clayton election, which is really the absence of an affirmative QTIP election. It is not the same as making a disclaimer from a QTIP. In a QTIP, the spousal interest is a vested interest. In a Clayton trust, the spouses' portion remains contingent until election is made.

This is not easy drafting. We are really drafting for a non-event, i.e. the failure or refusal of the executor to make a QTIP election within the applicable time frame. She discussed several ways to draft such a clause.

One disadvantage of the nonmarital portion of Clayton trust is that you can not take advantage of the previously taxed property deduction as you can with a partial QTIP.

Another major unanswered question looming is whether the surviving spouse, who is the sole executor of the estate, will have adverse gift tax consequences in making the election. She suggests that you should not allow the surviving spouse to be the sole executor (have co-executors with the other executor designated to make the Clayton decisions) or use an independent executor to make those decisions and the QTIP election.

She spent a lot of time dealing with the Clayton trust, and her outline contains a good discussion of the main concept as well as its variations.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

Report 6

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Wednesday, January 7

10:45 a.m. - 12:15 p.m.
Question & Answer Session
Dennis I. Belcher
Carol A. Harrington
Prof. Jeffrey N. Pennell

Reporter: Gene Zuspann Esq.

They received 100+ questions

Impact of HIPPA
Sets privacy standards for medical information _ certain entities (health plans, providers and clearinghouses) may not disclose info to anyone other than patient or POA agent
How does this affect an EP practice
Removal of trustee for incapacity _ medical provider may not longer provide this without a separate authorization signed by that patient
HCPOA still allows agent to make decisions _ should specifically provide that agent should be personal representative under HIPPA (designating specific section of Act which I did not get)
Should execute a separate authorization to holder to get info from doctor and check with Dr and hospitals to see what they require

Strangi was appealed and will go to Fifth Circuit; ACTEC will file an amicus brief

Tax apportionment _ can you apportion tax to an inter vivos donee by a Will?
The issue could apply to the 3 year rule bringing back gift tax into an estate
Jeff only knows of 3 cases dealing with the issue _ 2 allocate the liability to the donees and one does not do so
What is the result under the Uniform Estate Tax Apportionment Act? They did not allocate this in the Act assuming that the gift tax liability was the donor's. Jeff is not sure this is correct. This should be addressed in your tax clause and in the deed of gift.
Jeff also addressed a difference in estate tax rates due to lifetime gifts causing additional tax in the estate but he would not try and draft for this issue
Dennis directed the audience to the Stone decision where the taxpayers tried to address the gift tax.

Question of basis and FLP's
Dennis discussed the difference in inside and outside basis due to a valuation discount and the §754 election.

§643 regulation issues (Carol)
§643 regs address §1001 issue. Although this is not 'clean' it was the best the Service could do given that the §643 project was already open.

The trustee must be consistent on allocation of capital gains to income and observe a duty of impartiality

Sometimes you can use Strangi to your advantage, for instance, if values went down. If you allow 2036 to apply, then all of the tax effects of including the asset in the estate. However, there are a number of issues involved with this.

Defined value clauses. You are looking at a method of limiting the estate tax payment. Consider the possibility of a disclaimer. The trust would provide that the interest would go to the child, but if he/she disclaimed, then it would go to the family foundation. The question submitted asked whether this is good - Dennis said that it depends on the family. Caveat: The person disclaiming must be careful of any problems that the disclaimer could cause for the FF and its operation and the potential excise tax issues.

Can a 5 year old trust with a 25% inclusion ratio be split into a trust with a zero inclusion ratio and a trust with an inclusion ratio of 1? Carol answered in the affirmative. This authority was granted in a 2001 change in the law. See the statute and regs for authority and requirements of the split. You can do this without court approval if your state law allows it. You need to notify the Cincinnati Service Center of the change. If the donor is alive do a gift tax return explaining the change in allocation. If not, mail a document to the IRS showing the change.

Jeff discussed a question on FLP's. He addressed judicial activism (a conclusion of the person submitting the question and adopted by the panel) as the courts have realized that the Service has lost all of its arguments but that the courts feel that the discounts are unsustainable. Jeff feels that the judges are saying that in the bad fact situations, the taxpayer should not succeed. He feels the Fifth Circuit in Strangi may do what they did in Church - exercise the smell test and leave the result alone, regardless of the problems with the lower court decision.

§2036 and the marital deduction (Dennis)
a problem exists if the decedent has used the applicable exclusion amount and a gift comes back under 2036. If there is no ability to get the money from the donees, the gift tax will affect the marital deduction and cause significant additional tax (a circular calculation)
It is wise not to fund your marital share until after you complete your audit

Defenses to Strangi (partially suggested by Stacy Eastland)
Make distributions from entity mandatory
Make power to liquidate in an entity not owned by the transferor
No investment authority in transferor
Reasonably definite external authority

Jeff suggests that you follow the same approach you would take to drafting a trust; Dennis also suggests following the business model (Stone). Jeff does not feel that you should rely on the Byrum defense. He feels this a litigation defense.

2:00 - 3:30 p.m. Special Sessions 1
Session 1-B - Bulletproofing the FLP - Current Issues
John W. Porter
T. Randall Grove

Reporter: Carol Warnick Esq.

John Porter and T. Randall Grove did most of the talking, although they noted that their Special Session Materials contained two relevant articles, which are listed below. They announced that they were providing microphones for the authors of those articles to make comments at any time during the presentation. They asked that all other comments or questions be put in writing and submitted to them in that fashion.

The articles were:

Strangi; A Critical Analysis and Planning Suggestions, BY Mitchell M. Gans and Jonathan G. Blattmachr, 2003 Mitchell M. Gans and Jonathan G. Blattmachr, Published in Tax Notes, September 1, 2003, pg 1153.

New Tax Court Cases: Developments in Planning with Family Limited Partnerships, by S. Stacy Eastland, 2003, Stacy Eastland, Published in ACTEC Journal, Fall 2003 Vol 29. No. 2, p. 69.

John Porter started out going over what he talked about yesterday. He again emphasized that we should work to make these entities commercially reasonable. Many things we like to include in partnerships, such a prohibiting withdrawal, only allowing withdrawal with a penalty, requiring a high number of affirmative votes before liquidation, etc. are also common in commercial deals.

He feels that 2703 was specifically set up to deal with abusive buy-sell arrangements. The Service has lost many of the other arguments against FLPs.

As he discussed yesterday, the gift on formation argument is really dropping out. In Strangi, they based the argument on the partnership's own appraisal. The Service felt that something had happened to the values, they disappeared somehow in the process therefore there must have been a gift on formation. The Tax Court threw that argument out and said that what Mr. Strangi received was worth about the same as what he put in, in spite of the valuation appraisal showing discounts.

The Jones case put the gift on formation argument to bed with the same analysis. If the capital accounts are properly credited and this is a pro rata partnership, there is no gift on formation. Contrast this with the Shepherd case, where 50% of what he contributed was credited to his two sons' capital accounts (25% to each son). Make sure that when the partnership is created and when a partner contributes property to the partnership, that the value of the property is appropriately credited to his or her capital account.

Strangi II T. Randall Grove says it is a testamentary devise case. He thinks that comment right out of the box in the opinion had a very significant impact on the rest of the opinion. Mr. Strangi retained the right to enjoyment of the assets in Strings. How did they get there? Mr. Gulig had power of attorney. This looks more like one man's estate plan than a joint enterprise. The fiduciary duty Mr. Gulig owed to Mr. Strangi allowed to court to come up with the retained right issue.

He discussed how Mr. Strangi continued to use his personal residence, how he did not have sufficient assets in his own name to continue to live the way he had been accustomed, and the most critical factor, which was that nothing really changed in the management, etc. of the assets. Mr. Gulig continued to manage afterwards, just as he did before. Grove thinks the court was greatly influenced by the fact that the whole arrangement looked like one man's testamentary devise.

2036(a)(2) issue Court said it distinguished Strangi from Byrum because Byrum had an independent trustee. Court also said they were ignoring the identity of the other shareholders. (Family members, with only a sliver of interest going to charity.) There was a high unlikelihood of the shareholders bringing any accountability into the mix, both terms of who they are but also in how small their interest was.

Porter This upsets him because the courts seem to think that family members will not enforce fiduciary obligations. We as practitioners know that family members do sue other family members. We see it all the time. Will this be a battleground in the appeal of Strangi II? Also make sure that the partnership agreement does not negate fiduciary duties as in Kimbell.

Question: What impact did Mr. Gulig's role as attorney in fact have on the court, given the other issues as well?

Answer: The Court never got beyond the fact that Mr. Gulig was the attorney in fact for Mr. Strangi, even though he had fiduciary duties to others under the FLP agreement.

Very broad discretionary powers to Gulig in partnership agreement. Maybe better off with ascertainable standards regarding distributions, which should avoid the 2036(a)(2) problem. We won't see that in Strangi because there are no ascertainable standards in the agreement.

Mitchell Gans asked whether or not ascertainable standards are really necessary? It was not in Byrum. It was a corporate fiduciary standard. Does Byrum stand for the proposition that corporate fiduciary duties are the same as what we term ascertainable standards?

Porter: He thinks you need both the fiduciary duties and ascertainable standards to avoid the (a)(2) problem.

Mitchell: Thinks that corporate fiduciary duty is analogous to the ascertainable standards in trust law.

Porter: In a partnership, if income is not distributed, it must be credited to the partner's capital accounts. The general partner may control when they get it, but can not decide to give it to some other partner's capital account.

Mitchell: Timing still an issue, even though it is in the capital account.

Stacy Eastland: 2036(a)(2) should not be applied. O'Malley case is wrong with all of its progeny. You cannot shift the income to another partner in a partnership. He agrees with Porter. Partners have the benefit of the past, present, and future income. This is language from the Harrison case.

Look at his article (Special Session Materials) He cites authority from Jennings v. Smith. He suggests putting in the partnership agreement specific amounts to be distributed with no discretion. They have used this in almost every single partnership. It never hurt them in getting discounts. Also helpful if you want annual exclusions. Solves the Hackl problem. Also helps on the 2036(a)(1) problem. Now there is a distribution that would be inconsistent with the retained interest argument. We have three years to amend partnership agreements and put Little Suzy or Little Bobby in charge. Now maybe defined value clauses may have an even greater importance. (He commented he will talk about defined value clauses in his special session tomorrow.)

Mitchell: Is not persuaded by idea that the value is in the capital account. He cited an Alexander case. Here, the interest could either go to the daughter or her estate. She could sell her interest as a vested remainder. The Tax Court held that the father's ability to move it between the daughter or her estate was all it took to bring the interest back to his estate.

Porter: He likes to see fiduciary duty PLUS ascertainable standards on distributions in the partnership agreement.

Mitchell: How does that avoid a 2036(a)(1) argument?

Eastland: It just needs to be a standard that can be defined.

Grove: What about transfer issues?

Eastland: A transfer must be the same thing for 2036 as it does for 25ll. He does not think the initial transfer to a partnership is a taxable transfer.

Mitchell: He agrees that you have to have a taxable transfer to get into 2036(a)(1). Thinks that in the recycling argument the courts have ignored the cases. Prior cases talked about bona fide sale did you really get the consideration not was it a family transfer? Cannot be a transfer for 2036 purposes if it is not a transfer for gift tax purposes. He thinks that the Tax Court got it wrong on both issues. He thinks the gift on formation issue is much more troubling. Is there a connection between gift on formation and bona fide sale? We say that there is. He things you should fund the partnerships in such a way as to avoid that argument. What are the appeals courts going to do?

Jones issue Is there a gift on formation when a child purchases or obtains general partnership interests and the father only gets limited partnership interests? The government argued a gift on formation. Despite the disproportionate control rights, the Tax Court found no gift on formation because the capital accounts were property accounting for the interests contributed. To avoid the issue completely, provide proportionate interests in both the general and limited partnership interests upon formation.

Grove: We need to talk about constraints on rights to designate, 2036(a)(2) planning issues. There was not an independent trustee in Strangi as in Byrum. There were also corporate realities on Byrum. Also the fiduciary duty in Strangi was owed to himself since he had 99.9% ownership, whereas in Byrum there was the possibility of enforcement from others. Byrum refers to the independent trustee who has the right and the duty to hold Mr. Byrum responsible. He thinks the idea of an irrevocable trust with an independent trustee is a powerful tool we can use for planning.

Looks at his materials, Exhibit 6-B. Three circles surrounding the designation of donees. First ring is the GPs fiduciary duty. Second ring is business objectives and economic realities. The partners should monitor the economic results of the partnership on an ongoing basis. If the family has had a business plan and evaluated performance based on the business plan, he thinks it would have helped in litigation.

Porter: The more it looks like a going concern, the better and the more likely it is to be respected by the Service. In the bad cases, the courts have felt like it was not a real deal. In Stone, the court found there was real business purpose.

Third circle: Distribution authority restrictions. Is the family lawyer or family accountant an independent trustee that would help? He thinks the family lawyer or accountant is more of a subordinate than an independent trustee. He also thinks expertise is critical as well. Also the facts are important. Look at the reality of the situation.

Porter: Looks at things backwards because he does not plan...he litigates. He likes the idea of someone more independent rather than anyone who could be considered subordinate.

Grove: In Byrum, the decedent had the power to remove the trustee but the court still liked it. The court said that if the successor trustee is going to succeed to the rights of the one removed, then it seems to be OK that you can remove the independent trustee.

Discussed what the IRS is alleging in its notice of deficiency on a 2036(a)(1) case. If they argue that you have a retained right, then the asset that corresponds to your percentage interest should go back to your estate. If they argue that an implied agreement exists with regard to all of the assets, (Harper, Thompson, Strangi), then everything is going to be included. in the estate. For a 2036(a)(2) argument, if there is the right to designate, then all assets are going to be includable.

Porter: Tried two cases recently (November 2003), Vassler and Bonguard. The Service tried to bring all the assets back to the estate. They backed out all the gifts made during life and backed out of the notice of deficiency the fair market value of the partnership interest. They looked at it as though no partnership was ever created and no gifts were ever made.

In essence, when 2036 is asserted, the value of the assets contributed by decedent are brought back in, gifts and partnership interest are backed out.

Porter: Look at the situation where the general partner has discretionary authority to distribute, but he is clean with regard to 2036(a)(1). First go to argument that there was no transfer, then get to full and adequate consideration, fully created capital accounts, the partners have received appropriate interests in the partnership, and satisfy the bona fide sale rule. With 2036(a)(2) he would take the position that they are subject to fiduciary duties and that those obligations are enforceable. They are real obligations because the capital accounts are required to be credited with partnership funds that are accrued but not distributed. Given a choice, he prefers to see some type of mandatory distribution if Mom or Dad is the general partner. He cannot go along with the Idea that just because Mom or Day can vote with others to liquidate the entity, they have a 2036 issue. He does not really think that can be the law of the land. If so, Bill Gates would have a 2036 problem with his Microsoft stock because he can vote with all the other owners of Microsoft stock regarding liquidation.

Grove: What about not making any changes to the way you are doing anything with respect to the 2036(a)(2) issues. There are very knowledgeable attorneys who are taking this position.

We do not want to be Chicken Little or the Ostrich with its head in the sand. Look at everything and make your best call.

2036(a)(2) issue assessment. Exhibit 7 from his materials. Helps you assess various factors from weak to strong in your situation. He goes through this analysis with clients and then makes a mutual decision as to what steps to take. Client may want to risk the 2036 issue rather than give something up.

Exhibit 8(a). Strangi II issues where 2036(a)(2) now seems to apply. Most of the interests have been gifted to already to the children. His next exhibit adds an independent trustee to the situation which arguably can take it out of the 2036(a)(2) problem. If the donor is old, worry about the three year rule because of possible lapsed or relinquished rights and donor dies within 3 years. His next exhibit is a different variation when kids enter into a transaction can either sell a significant interest or gift a significant interest to charity.

Recommends a Journal of Taxation article by Joe Kirpix where he discusses the issue of what is a de minimus amount? It is all relative.

Porter: From a litigation perspective, he likes to see more rather than less. A legitimate pooling of both assets and services is the best. In Stone, the children contributed much more in services. The more it looks like a real deal, a real pooling of assets and services, the better chance you have of surviving a 2036 attack. He likes to see children involved in the process regarding how the partnership is going to be structured. He has seen the government questioning witnesses in the Bonguard case right after Stone, and their questions went to the issue of negotiation in the partnership agreement. He thinks it does not have to be a fight, just give everyone the opportunity provide input.

Grove: References to other planning ideas in the Gans Blattmachr Article. It goes into some detail on an approach where there can be a restructuring of the FLP when all rights regarding distribution and liquidation are in the GP interest, and then there is a gift to an incomplete gift trust.

Porter: Wants to mention some of the IRS attacks on the sale to a defective trust. The Service ignores the promissory notes and argues 2701 and 2702. The Service has sought to ignore the transaction and ignore the notes. A recent case he is aware of settled nicely. The Service dropped most of their arguments. But the same things apply. The sales and promissory notes need to be structured as real deals. Page 51 of his outline discusses the facts and circumstances the Service will look at to see if they respect these deals for tr5ansfer tax purposes. He discusses some tips there as well.

Question: The entity is an LLC, and Mom or Dad gave most or all of their interest away already but want to stay on in an investment advisor capacity, but not with regard to distributions. Will that work?

Grove: Thinks that can be workable. It is only the right to designate income or property that is hooked by 2036(a)(2). One of the main arguments in Byrum was that Byrum's right to control the Board by virtue of his majority interest was tantamount to his right to retain or distribute income. The court said no, just because you have impact on investments, just because you can say do not sell the stock out of the trust, and just because indirectly you could affect the amount of income that came to the trust, since you do not have the right to make the distribution decision, you do not have a 2036(a)(2) issue.

Grove: 2038 issue right to amend or revoke. Also cannot not have the right to amend or revoke, but investment power is fine. Cannot have the right to amend or revoke, or to distribute or liquidate.

Grove read a note from Willamette Management Associates that said that having a minimum distribution right in the partnership agreement does not hurt your discount. This right is similar to rights contained in the commercial entities which are being used as comparables in the discount appraisals.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
===
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
==

Report 7

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Wednesday, January 7 (continued)

3:45 - 5:15 p.m. - Special Sessions II
Session II-C - The Future of the Transfer Tax System: Reform or Repeal?
Dennis I Belcher
Lloyd Leva Plaine
Mary Louise Fellows

Reporter: Carol Warnick Esq.

In discussing the original votes on the subject, Dennis noted that one Senator said this legislation is the biggest piece of nonsense. You could not put 10 people and a keg of beer in a room and come out with a worse proposal.

Where are we now? Last year, President Bush said he will continue to press Congress to make tax cuts, including the end of the death tax.

What has happened to the Bush tax cut packages? He has always had to deal. The White House may not get exactly what it wants, but they do get something done. What does that mean? Do not underestimate President Bush. He has not given up on the abolition of the death tax.

Dennis Belcher said that he had assumed that estate tax repeal was a dead issue in 2004, but will come up again in 2005, because that is after elections. However, he has now heard that the Republicans were concerned about their ability to hold on to a total repeal and so a deal was proposed in the fall to lower rates significantly and raise exemptions significantly and make the 2057 deduction unlimited. In his view, the closer the rates get to the capital gains tax, the less significant the estate tax will be. Something may come up this year after all.

What does it cost to repeal the estate tax? Over $200 BILLION in one year if it were done away with today. Can Congress afford it? Very costly to repeal.

However, we cannot underestimate the sentiment in the country on the death tax. Whenever you see a poll, think about who did it and what their motivation is. National Public Radio, Kaiser Family Foundation and the Kennedy School did a national survey in March of 2003 regarding Americans' views on taxes. Question: There is a federal estate tax. Do you favor or oppose keeping the estate tax? 54% said get rid of it. Then they asked the question in the death tax format (used the word "death tax" instead of "estate tax"). This time, 60% favored eliminating it. Reasons given: The money is already taxed once, it might force the sale of small businesses and family farms, and it might affect me or my family some day.

Then they asked specific questions to see how much the people know and understand. 56% said get rid of it if the exemption amount is $1M. 72% said eliminate it if the exemption amount were $5 million. 75% said eliminate it the estate tax if the exemption amount were $25M. The answers do not make sense and people obviously do not understand it. But there is a significant feeling among Americans that we should make significant changes to or eliminate the estate tax. Politicians listen to that.

They then discussed the Task Force on Transfer Tax Reform which is a multi-organizational group comprised of representatives from ACTEC, the Section on Real Property, Probate and Trust of the ABA, the ABA's Section on Taxation, the AICPA, The American College of Tax Counsel, and the American Bankers Association. The Task Force was charged with preparing a comprehensive report for submission to Congress, the Treasury and the public which analyzes technical and transitional consequences of the significant changes enacted in 2001 with respect to the gift, estate and generation skipping transfer taxes, and various alternative legislative measure that might be adopted to eliminate the substantial uncertainties that tax payer and their advisers now face under the existing transfer tax system.

The remainder of the session went through various discussions with regard to issues to be raised in this report, which is not yet finalized.

Second, here are some **follow up items** of news from the **Exhibit Hall** as reported by Gene Zuspann Esq. and Jason Havens Esq. and supplemented and edited by yours truly.

We took a closer look at the Faster fiduciary accounting program now that the West FATE program has been taken over by Fast-Tax (formerly Zane). While is seems very good, the making of entries takes some time and effort and is done by the selection of a type of transaction from the menu bar. All the Reports produced by their system comply with the National Fiduciary Accounting Standards (as do the Reports of most of these accounting programs). They do not yet have the ability to value securities on line through EVP or Appraise, but they are "working on that." The software itself is rather pricey, especially for a solo or small office, the same being $2,500 per year for the Web-based version (the client data stays on your PC) and $4,500 for the CD-ROM version, with a monthly maintenance fee after the first year. They offer on-site training for $750 per day plus expenses, but we feel such training should not be necessary for such a program if it is well designed and truly user friendly.

The ACTEC Fiduciary Accounting System that was developed by Fellows of the American College of Trust and Estate Counsel (www.actec.org) in 1995 and consists of templates and Report formats that are designed to work with all versions of Quicken, both DOS and Windows, is still alive and well and can be ordered from ACTEC for a mere $75 by going to the on-line order form on the public side of the ACTEC Web site at http://www.actec.org/public/quickenorder.asp. Note that, for reasons that are unknown to us, sales of this product outside the College currently are restricted only to attorneys, although we are personally aware of various other allied professionals who have been able to obtain and currently are using this program. Rumor has it consideration is being given to developing a version of this program that will function with Quick Books.

No official word yet on what Brentmark has done or plans to do with the former US Trust Form 706 software program, but we are trying to find out something for you.

Forms 1041 - what software are you using, going to use, etc. now that the West EPS From 1041 program is no more? The answer is far from clear, except people generally seem to be not happy with what they are currently using, and this includes such products as the FAST-TAX Form 1041 (formerly Zane), ProBATE's Form 1041, Kleinrock's ATX, etc. A lot of people were using and very much liked the Shepards/West Form 1041 DOS-based program, but that one disappeared a year ago, and the first West Windows version of the same for use last year that West issued to replace it was an absolute failure. Some people have moved over to Profx, but it is expensive and not for someone who only does a few returns each year.

Other tax preparation programs (Forms 706 and 709) - everyone is waiting to see what the fall out is going to be from the sale of the West EPS Form 706 and 709 products to FAST-TAX, as West issued the last version of its Form 706 product for decedents dying in 2003 in December of 2003, and none of the West DOS-based FET, FGT or FIT programs that many of us loved and used for so long exist any more.

ProDoc DAE software - currently they service Texas and Florida. They had a Colorado probate system at one time too, but abandoned that after a few years when Colorado moved to a new caption format that was designed to accommodate the electronic filing of all their probate pleadings through their state-wide Lexis-Nexis CourtLink system. ProDoc is considering moving into California too.

EstateDoc Systems - we are informed that this system has modules for all of the Returns (Forms 706, 709 and 1041) and that they are in the process of combining all of these into one system. They will also be including probate forms for select states in some of their systems. Sounds like this product might merit a closer look by some of us.

The preliminary consensus on document assembly for this year seems to be that, while it is nice that Wealth Transfer Planning and Lawgic are back and alive and well, the product that is currently generating the most interest is WealthDocs Version 6 from WealthCounsel, largely due to its integration with and use of HotDocs 6 vs. a proprietary engine. However, the Lawgic booth was generating quite a lot of interest with regard to its announcement of plans to develop a New York EP system that will be authored by Carlyn McCaffery of the New York City law firm of Weil, Gotshal & Manges, LLP, the immediate past president of ACTEC. Also, Jim Eidelman is in Miami demonstrating his WinDraft Word-based system that is in use by several firms across the United States.

Stand by for more technology news yet to come...................

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607

==

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Report 8

Tuesday, January 6 and Wednesday, Jan 7

Reporter: John Warnick Esq.

Tuesday, January 6

11:30 a.m. - 12:15 p.m.
Old But Not Cold - Restructuring, Refocusing and Retiring Irrevocable Trusts
Ronald D. Aucutt

Mr. Aucutt is the President of the American College of Trust and Estate Counsel (ACTEC) and has been a frequent lecturer at the Heckerling Institute.

Mr. Aucutt started his comments with a reference to the just issued final regulations defining net income under Section 643(b) and mentioned that in his opinion the final regulations have been drawn too narrowly and will put an undue amount of emphasis on state law. Existing trusts in states that do not have a unitrust statute will not have the planning flexibility that is afforded under the final regulations to trusts with a situs in states which do have a unitrust statute.

He then drew a distinction between "old" trusts which are grandfathered from the GST Tax because they were irrevocable prior to September 26, 1985 and those trusts established subsequently. He noted that there is a tremendous amount of wealth in these "old" trusts, and that there is a tendency to ignore them. He suggested that planners need to thoroughly comb these instruments and be sensitive to planning opportunities which may prove valuable to the administration of such trusts.

At the same time he suggested that there are a considerable number of "old" trusts that have been established or become irrevocable since September 25, 1985, and that planners also need to be aware that there have been significant developments in trust law, such as the UPIA and Prudent Investor Act, which alter the administration and planning landscape. This category of "old" irrevocable trust will become increasingly important in the years ahead.

What are some of the common problems facing long-term irrevocable trusts?

Many of these old trusts have beneficiaries in multiple generations who often disagree, even within generations, about the direction the trust is taking or should take. Often the trustee is caught in the middle of this crossfire.

The trustee of an "old" trust may be handcuffed by outdated boilerplate or by a less "trust friendly" situs. There may be interest in changing the situs of the trust to achieve greater privacy, a more favorable or cooperative environment of court supervision, clearer or more advantageous substantive rules, or a favorable income tax climate. Today the pressures produced by the trustees' duty of impartiality to successive beneficiaries, the prudent investor rule, new principal and income rules, and declining investment yields are combining in a "perfect storm" to suggest the superiority of a "unitrust" approach to balancing the interests of successive beneficiaries.

Another problem with "old" trusts can be the sheer multiplicity of trusts created over a number of years, often by different generations of grantors. This can lead to annoyingly different distribution and administrative provisions which compound the trustee's difficulties.
Outdated trustee succession regimes are frequent problems encountered with "old" trusts. Sometimes grantors depended on individual trustees and demonstrated an antagonism towards corporate fiduciaries. Individual trustees grow old, retire, die or become incapacitated. Family trustees may be succeeded by younger generation family members, but this is not always easy. The suitability and acceptability of corporate trustees can also change over time.

Another aspect of the unique planning challenges of the old trusts is termination. It is very ackward for a trust to distribute illiquid real estate to multiple generations of beneficiaries. Solutions such as contributing the illiquid assets to an entity may not be clearly authorized by the instrument.

Ron Aucutt next spent a significant amount of time reviewing the history and changes brought about by both the Uniform Prudent Investor Act and the Revised Uniform Principal and Income Act (1997). He noted that one of the stated purposes of the Revised Uniform Principal and Income Act (the "Act") is to ease the tension trustees face in satisfying both income and remainder beneficiaries while adopting the modern portfolio theory under the Uniform Prudent Investor Act. The power to adjust under the Act can be used to liberate the trustee to fully implement modern portfolio theory. It gives trustees the power to correct situations where the income or remainder beneficiaries are adversely impacted by the total return investment strategy. But the trustee does not have power to adjust under the Act unless the following three factors are satisfied:

1. the trustee invests and manages the trust as a prudent investor;

2. the terms of the trust describe the amount that may or must be distributed to the beneficiaries by referring to the trust's "income"; and

3. the trustee determines that it cannot administer the trust impartially based on what is fair and reasonable to all of the beneficiaries unless the trust clearly manifests an intention that the fiduciary favor one or more beneficiaries.

Thirty states and the District of Columbia have adopted the Uniform Prudent Investor Act so the first factor is going to be present in most trusts. Even in those states which haven't adopted the Uniform Prudent Investor Act or similar legislation, the prudent investor rule may be approved by the courts in that state or the trust instrument itself may require it be observed. Mr. Aucutt has concluded that this first factor will be satisfied in virtually all states except those where a trustee is permitted to invest only in assets set forth on a statutory "legal list".

If a trustee of an old trust determines that all of these factors are present, then the trustee must determine if it is appropriate to resolve the conflict between income and remainder beneficiaries by transferring principal to income in order to increase the payout to income beneficiaries each year. This can become a significant administrative chore and require significant record-keeping and documentation each time the trustee makes an adjustment under the Act.

To alleviate that administrative burden, Mr.Aucutt suggests that conversion to a private unitrust may be appropriate. By reforming the old trust to become a private unitrust the trustee is creating a "partnership" among the income beneficiaries, remaindermen, and the trustee that will enable the trustee to invest the assets for long-term growth for the benefit of all beneficiaries. This should give the trustee and investment team a greater focus.

What considerations should the trustee make in converting a traditional "income" trust to a private unitrust?

First, the trustee will need the consent of all affected parties.

Second, the trustee may want to consider using a rolling average to reduce potential fluctuations in unitrust distributions due to short-term market swings. The trustee may also want to consider placing a ceiling and/or floor on the distribution amount from the unitrust that will satisfy the needs of all beneficiaries and reduce the risk to the remaindermen.

Third, in the case of a trust with grandfathered IRS status, careful attention needs to be paid to protect that status, and it may be desirable to obtain an IRS ruling.

Fourth, the trustee should consider whether the conversion is also an appropriate opportunity to divide inter-generational trusts along family lines so as to allow individual families to invest as they see fit.

Finally, the trustee must carefully consider the income tax consequences of the unitrust distribution and conversion to a private unitrust. This requires careful attention to the regulations under Section 643(b) and navigating around the Cottage Savings problem which Lloyd Leva Plaine covered previously.

There are special considerations that trustees must give to the old trust that is about to terminate. Watch out for special powers of appointment and be alert to planning opportunities that may arise through careful exercise of these powers. In exercising a special power in further trust, attention should be paid to avoid the Delaware Tax Trap and to comply with applicable rule against perpetuities constraints. Non pro rata distributions upon termination may trigger a taxable exchange if neither the trust instrument nor local law give the trustee authority to distribute assets on a non pro rata basis.

Mr. Aucutt briefly touched upon some practical problems with dynasty trusts. He quips that a "pot" trust after a few centuries will resemble a publicly owned corporationor maybe even a public charity.

One practical problem is the record-keeping necessary to track who the descendants are of some common ancestor if a family line dies out 300 years from now. He promised that more of these practical issues will be dealt with in tomorrow's workshop.

Wednesday, January 7

Reporter: John Warnick Esq.

9:45 -10:30 a.m.
The Rules of Engagement:Managing Liability for Nonprofit Boards
Kathryn W. Miree

Ms. Miree is the author of *The Professional Advisors' Guide to Planned Giving* (Aspen Publishers, 2002) and the co-author with Jerry McCoy of *The Family Foundation Handbook* (Aspen Publishers, 2001).

Directors of nonprofit boards are facing incredible challenges as they struggle to operate charities at a time when funding is drying up, endowments are shrinking, criticism of nonprofit misfeasance and malfeasance is high, and demand for accountability is strident.
Nonprofit contributions are down in three areas: individual gifts, foundation grants and government grants. Note: individual contributions in 2002 were up .7% over 2001 but down .9% when adjusted for inflation.

Investment markets have ravaged the reserves of charities. Ms. Miree has seen the endowments of some charities shrink by as much as fifty percent. Particularly hard hit have been those charities whose boards weren't keeping a close eye on their investment policy and investments

New nonprofits are emerging and old nonprofits are soliciting funds for the first time. The number of traditional charities has grown from 558,745 to 909,574 between 1994 and 2002.

The Sarbanes-Oxley Act reflects heightened expectations of accountability for the corporate sector but these standards may eventually be imposed on the nonprofit community. Ms Miree suggests an excellent article on the Sarbanes-Oxley Act and its
implications for nonprofit management is found at
www.guidestar.org/news/newsletter/sarbanes_oxley.jsp

Ms. Miree uses the term "directors" to designate the individual with responsibility for oversight and management of a 501(c)(3) organization whether the charity's governing documents refer to them as trustees or directors. The key is the voting responsibility imposed upon the individual. Ms. Miree's analysis and guidelines are not intended to apply to "honorary" or "emeritus" directors that do not have any voting power. Citing *Black's Law Dictionary*, Ms Miree noted that directors are serving in fiduciary capacities, managing the assets of the charity for the public good. For the last several decades, the courts have made a distinction between the trust and corporate form or organization and have applied a less stringent standard for nonprofit directors than trustees. See *Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, et. al.*, 381 F. Supp. 1003 (D.D.C. 1974).

There are two basic categories of duties that apply to directors: codified and practical. The three primary codified duties are: 1) duty of care; 2) duty of loyalty; and 3) duty of obedience or adherence to the charity's governing documents and applicable law.

Examples of the exercise of the duty of care include:

participation in board and committee meetings;

familiarity with the board's business plan and strategic plan;

review of the charity's budget, fundraising results, financial statements and investment returns;

review of minutes (which should be requested if not produced);

review of agents appointed by the charity to carry out delegated duties and familiarity with policies governing the handling of money and donations, asset management, employee management, and other areas of risk; and

queries when necessary to clarify facts and form independent judgment about decisions to be made.

Directors are not liable for decisionseven if such decisions prove to be unwise in hindsightso long as the decisions are informed, made in good faith, and without a conflict of interest.

The duty of loyalty requires a director not to vote on matters affecting the nonprofit which in any way would benefit the director personally at the expense of the nonprofit, not to take excessive compensation, not to solicit or accept loans from the nonprofit, and to reveal all conflicts or personal benefits that may result from a vote of the nonprofit.

In addition to the duties imposed under state law, there are four other sets of rules which impact a director's duty of loyalty:

private foundation self-dealing rules under Internal Revenue Code § 4941;

IRS intermediate sanctions for private inurement under § 4958;

state law governing nonprofit directors; and

state law governing trustees.

There are also practical duties incumbent on directors of nonprofit organizations such as: 1) establishing the mission and purpose of the entity; 2) selecting and evaluating the executive officer (s); 3) ensuring continuity in operational and strategic planning as well as perpetuation of the governing body; 4) exercise of oversight of the organizational activities; 5) public relations; 6) ensure accountability to donors, the public and the IRS; and 7) manage the charity's assets to prevent theft, embezzlement or improper use of funds.

Ms Miree cited a recent article published in *The Exempt Organization Tax Review* by Marion R. Fremont-Smith and Andras Kosaras which compiled data regarding lawsuits and similar proceedings brought against nonprofit directors and managers for civil and criminal wrong-doing between 1995 and 2002. There were seven major categories or risk documented in this survey.

1. Employee lawsuits are among the most commonly filed against nonprofits. These suits ran the full gamut from ERISA, ADA, Equal Pay Act claims, age discrimination, OSHA, COBRA, civil rights claims, to Family Medical Leave Act violations.

2. Third-party liability for negligence or breaches of the duty of care, conflict of interest, libel, slander, etc.

3. Investment management breaches.

4. Private inurement the use of charitable assets for the personal benefit of directors.

5. State law violations such as failure to collect and submit sales tax, pay property tax, satisfy audit requirements, register under applicable charitable solication laws.

6. Failure to Comply with Federal Law such as IRS filings, meeting employee obligations, substantiating gifts in excess of $250 and complying federal postal laws.

7. Account for Funds. Directors are ultimately responsible for oversight of the use of the charity's funds and for compliance with the donors' instructions.

How can charities and their governing bodies manage these risks? Four avenues of protection are available to the charity and its directors: statutory protection; insurance, proper policies and procedures, and proper operation.

In terms of managing risk through proper policies and procedures, Kathryn suggested that nonprofits consider: 1) performing an annual risk assessment by reviewing its internal and external activities and exposure to list those activities creating the greatest risk;
2) ensuring that policies and procedures are in place to manage the identified risks; 3) adopt gift acceptance policies; 4) annually review investment management policies in terms of balancing risk and return, spending policies, asset allocation, and return objectives; reviewing financial management policies and controls on money movement; 5) adopting standards for the confidentiality of records.

In terms of managing risk through proper operation, perhaps the most important step is board structure. Kathryn thinks that too large a board is not only unwieldy but promotes sleeping through meetings. Reporting is also critical as is the director's ability to ask questions and obtain meaningful answers. If the charity is not willing to provide adequate information or reports, the director should likely resign.

What is the legal advisor's role in advising clients on the responsibilities for nonprofit management? The advisor should help the director in understanding what his or her potential liability is for serving on the board and assist in obtaining protection for that service. The legal advisor should also assess the liability, review policies, procedures and protections that are in place and then guide the charity in obtaining the necessary protection and safeguards to minimize the risks.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140

Telephone (305) 538-2000, FAX (305) 674-4607
==

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Report 9

Thursday, January 8

9:00 - 9:45 a.m.
Split Dollar Has Split - So How Do We Finance Premiums Now?
Donald O. Jansen

Reporter: Carol Warnick Esq.

If plans are entered into or significantly modified since September 18, 2003, they are now under the new regime.

There are 2 types of regimes the taxpayer can choose from.

(1) Economic benefit regime (old endorsement split dollar) Premium measures economic benefit, but cash value will be taxed

(2) Or can choose loan regime employee owns entire cash value. Must use higher applicable federal interest rate.

It has been implied there is a demise of split dollar but it is not dead, just more expensive.

Many ways of financing premium payments. Can be simple...just pay the premium out of your pocket., or maybe a family entity can pay the premiums. A trust might be a remaindermen in a GRAT remainder interest can give money to the trust to pay the premiums.

He is going to cover 3 other approaches to financing premium payments.

1. Loan approach -- by employer, by insured, by a third party

2. Using employer money, bonus plan, split dollar, undivided ownership of the policy between employer and employee

3. Sale to a defective trust where assets will produce enough to pay premium and pay back principal to the note

1. Employer loan

Employer has to comply with new split dollar loan regs. But he has to pass some initial hurdles.
1. split dollar arrangement
2. correct ownership of policy
3. have a real, bona fide loan (not a sham loan)

Applies if the employee is the owner or his trust is.

Exception.....page 7 special exceptions
if employer has all the cash value, regs treat it as if the employer owns the policy

Regs say if the employer is direct or indirect source of payment of interest on the loan, interest is disregarded. Example of indirect source of payment in regs. Employee was to pay back loan in a lump sum at maturity date, along with premiums. Also had a deferred comp plan which would pay out the amount of the interest at that same date. If you have an agreement to bonus the money annually, it is an interest free loan.

If no loan, all the money is income on the front end. If employer is going to be the source of the interest or the premium payments, be careful. Do not tie the deferred comp agreement to the loan in any way. Or make it subject to a substantial risk of forfeiture

If employee pays applicable federal interest rate, no consequences.

Demand loan AFR is the blended fed rate published in July of each yr. 1.52% in 2003 usually lowest interest rate but most volatile.

Term loan rates determined differently page 13 short, mid, long term. Higher than demand rate but can lock it in. Can be conditioned upon continued employment by the employee.

If do not charge it you have income and gift tax consequences. Page 13 On a demand loan these are annual.

Term loan pg 14 one-time income and one-time gift tax consequence in the month you enter into the loan.

Pg 15, #5 example in regs 15 yr interest free loan discounted back was a $64,000 dividend to that shareholder in the month which it was entered into.

Pg 15,16 and 17 Special rules tied to life expectancy or conditioned on employment, or a family loan figured as if it were a demand loan if to a life insurance trust would make a front end gift to the ILIT

A loan every time an employer pays a premium different AFRs, etc.

SECOND TYPE OF LOAN
pg 25

Insured loans money to ILIT to hold down the gift, he can loan the money to the trust.

Various loan formats separate loan each year using AFR but if he has the money on a universal life policy, do a single premium loan at the front end compounds the money interest free.

The fly in the ointment are the MEC (modified endowment contract) rules. If you put the premiums in the policy too fast, then for the lifetime of the insured it is taxed as if it were a tax deferred annuity. If you borrow, the income comes out first, basis stays in contract. (pg 26). If you do not need to borrow, or do not need to touch cash value, it is OK. When insured dies, it is still a life insurance policy.

Page 26 income tax consequences spit-dollar loan regime applies. Must pay APR also, when it is the insured loaning money to the trust make it a grantor trust insured pays interest to himself a non tax event.

In order to make it a grantor trust, choose a defect that will get you the right income tax consequences 3 most popular pgs 27, 28, 29

1. Nonadverse party has the ability to add a beneficiary to the trust other than an after born child likes to use a trust protector for this.

2. Power of any person to reacquire trust property and substitute with equivalent value. Must not be done in a non fiduciary capacity again he likes using a trust committee or a trust protector.

3. If the income of the trust maybe applied to pay premium on an insurance policy on the life of grantor or grantor's spouse, then you have a grantor trust. Can you trigger this defect if you have no income in the trust? He also uses another string as well.

What if grantor trust status ends while grantor alive? Tax consequences of outstanding loan? Pg 30 No direct authority. Probably treated as if the grantor transferred the trust assets to the trust on that date and any liabilities of the trust to a third party are treated as money received and will result in gain to the grantor to the extent that the discharge of indebtedness exceeds the basis of the assets in the trust.

What if the loan is to the insured? That is a worry.

What if grantor trust status ends because of death of grantor? Is that a sale or exchange? Do we get a step up in basis? Pg 31 he cites articles in this area opinions vary

Always plan to have the note paid off well within the life expectancy of the grantor so there is no issue.

Gift tax consequences of loaning money to the trust must charge the AFR and have a bona fide loan. Make it clear this is a valid loan with notes, etc. Pay interest each year to show it is a real loan, otherwise it could all be a gift at the front end.

Is inadequate security enough to cause IRS to discount the loan? One theory - 7872 rules. Other theory says 7872 is silent so if you do not have enough security, they might discount it. Frazee v. Commissioner, a 1992 case, took the 7872 approach

Try to have other assets in there to provide security, or have beneficiaries secure the note.

Estate Tax Consequences no problem under 2042 no incidence of ownership - what about 2036? Is it a transfer where the insured retained the right to the income? if you do not have enough security, could be an issue. He suggests maybe a 10% additional gift to the trust.

THIRD TYPE OF LOAN Third party financing

Trust borrows money to pay premiums usually balloon notes....most have interest being paid currently - some allow interest to be accumulated

Where to you get the loans? banks, or specialized institutions

AIG, Bank of Scotland - LIBOR plus a spread of 1 1/4 to 2 1/2 percent

Read your loan documents may say for 15 yrs but have a clause that renews every year and allows them to pull the plug.

3rd party lenders will demand security want the assets in the trust to exceed the loan by 10% - will require outside collateral or guarantees.

Income tax consequences of 3rd party loan. He does not think it is subject to 7872.

Should it be a grantor trust? Most of the time, no. Unless there are other reasons (other assets in the trust and want grantor to pay taxes or with crummey powers.)

If you do make it a grantor trust, same issues apply when it is no longer a grantor trust....aim to have it paid off before grantor dies.

Gift tax consequences. He does not think it is a gift, but if there is a lot of money involved he will have the trust pay a guarantee fee charge what a bank would change for a letter of credit.

He indicated he would go over the rest of his outline in the special session.

9:45 - 10:30 a.m.
When the Kids Won't Play Well Together: Tax-Free Corporate Divisions in Family Succession Planning
Michael V. Bourland

Reporter: Gene Zuspann Esq.

Family business succession planning often involves inter-generational conflicts between subsequent generations. These difficulties are compounded if the business entity form is a corporation. The goal of such divisions is to allow different family members or groups to own and control their own business without causing a tax on the division of the corporation.

Divisions of the family business can often be accomplished under IRC §355.

In his materials and presentation, the "distributing corporation" owns the "controlled corporation" and will distribute the stock of the controlled corporation in the §355 transaction.

Requirements of §355:

-The distribution to a shareholder is with respect to the shareholder's stock

-The distributing corporation must distribute stock in the controlled corporation which the distributing corporation controls immediately before the distribution (80% voting control and 80% of total shares of all other classes of stock)

-The plan cannot be a device for the distribution of earnings and profits of the distributing corporation, the controlled corporation or both

-There is no bright line test

-This is a facts and circumstances test

-Facts to be reviewed - whether the distribution is pro-rata, whether an sale occurs shortly after the distribution, and the nature of and use of the assets in the controlled corporation.

-There must have been an active trade or business for 5 year period ending on the date of distribution. The business must not have been acquired in the 5 year period.

-There must be a significant corporate business purpose. The purpose must be a non-federal tax purpose. It also must not be a shareholder purpose, however the shareholder purpose may be so nearly coextensive with the corporate purpose as to preclude any distinction.

-The dispute between the shareholders must be to such an extent that the corporations business will be affected negatively if the division of the corporation is not carried out.

-There must be a continuity of interest in the controlled corporation by the shareholders of the distributing corporation.

-There must be continuity of the business enterprise - the business enterprise that existed before the division must still exist after the division.

Tax effect of the division

-If §355 met then neither gain or loss are recognized.

-If the requirements are not met, the distributing corporation can recognize gain (but not loss)

-Disguised sale rules - intended to prevent the sale of a corporation carried out the pretext of a tax-free corporate division.

-Distributions part of a prohibited plan.

The controlled corporation will not recognize gain or loss, even if the tax-free corporate division provisions are not followed. The basis of assets in the controlled corporation are a substituted basis in the hands of the distributing corporation.

He then went back to page 5 of the outline to review some diagrams of the various transactions. These consist of one for a pre-succession division, in which the founder is still alive. Some children receive stock in one corporation (the controlled corporation) in exchange for all of their stock in the distributing corporation. The parents also receive part of the stock in the controlled corporation but give up no stock. The result is that the parents now own part of both corporations but the children each own stock in only one of the corporations.

He then reviewed a post-succession division. In this case, some children retain all of their stock in the distributing corporation and some children give up all of their stock in the distributing corporation for all of the stock in the controlled corporation.

Finally, he analyzed the two transactions using the various tests of §355 set out above.

In the past, PLR's were used in advance to protect against the negative results of failing the tests. However, in Rev Proc 2003-48, the Service indicated that it will not longer issue comfort rulings.

Estate Planners points to remember (The outline indicates that "the complex and voluminous nature of the tax law pertaining to tax-free corporate divisions renders an exhaustive understanding of it by estate planners quite impractical.")

-Corporate business purpose

-Be diligent

-Give diplomacy a chance - the cost of doing the division may outweigh the tax benefits of accomplishing it tax-free.

-The division should be incorporated in the current estate plan

The presentation was very well organized and given in a great deal of detail. He ended about 8 minutes early. Although the outline is not as long as many, he covered it in whole.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

Report 10

Thursday, January 8

2:00 - 5:15 p.m. FUNDAMENTALS PROGRAM
Preparing and Filing the Form 706: Who, What, How, When and Where
Glen A. Yale

Reporter: Jason Havens Esq.

REPORTER'S SUMMARY: This was an excellent presentation on preparing and filing the federal estate tax return, even for those who have prepared returns for many years. Glen was both entertaining and informative. His excellent outline guides you through the crucial preliminary steps and then through each part of the actual IRS Form 706. He pointed out several nuances of each schedule and the proper way to report common and uncommon property items. His materials also include several useful checklists, client letters, client memoranda, and a sample estate tax return.

REPORTER'S COMMENTS: References with only numerals are generally IRC citations. "GE" refers to "gross estate." "DOD" refers to "date of death." "FMV" refers to "fair market value." "IRD" refers to "income in respect of a decedent."

SECTION 1: GENERAL MATTERS:

1.03: Executor files 706 under penalty of perjury.

Preparer: Treas. Circular 230

1.04: Preparer/Client Relationship: Same for attorney or CPA. See *Bria v. U.S.* (D. Conn. 2002) (attorney representing executor and withdrawal; subpoena for attorney's records; standard to assert privilege; held that communications and NOT underlying facts covered). Therefore, PUT NOTHING IN FILE that do not want IRS to see.

Engagement letter: CHECKLIST. Identify client, confidentiality defined, scope of engagement (and maybe what is BEYOND scope, e.g., exclude opinion on documents used to prepare 706 such as other tax returns -- see ACTEC COMMENTARIES, which are available via Internet), financial terms, termination, and required disclosures.

Time table for preparing and filing 706: Key to prepare good draft 706 by 8 months after date of death because MIGHT NEED DISCLAIMERS (and might need to obtain court approval).

File ownership: Executor by default but may be changed by engagement

1.05: Filing threshold: Adjusted taxable gifts + specific exemption for post-9/8/1976 gifts + gross estate on DOD. Disregard: deductions, alternate valuation, special use valuation, and QFOBI.

1.06: Obtaining information: Checklist: income tax returns, checks/registers, balance sheets (see

Trompeter v. Comm., T.C. Memo. 1998-35), insurance policies, decedent's mail, previous estate tax returns (e.g., for SS or child), decedent's will, decedent's employer.

1.08: Where filed: Hand-delivered or mailed or private delivery service to Cincinnati (no electronic filing due to attachments); non-residents must file in Philadelphia.

1.09: Date of death: Refer to death certificate (or process to correct); time and date controls based on decedent's DOMICILE TIME ZONE (even if dies in another time zone), but foreign death is time zone where decedent actually dies. If presumptive death (e.g., 9/11/2001), IRS says 7 years of absence (PLR 8526007), but conflicts with some state laws (e.g., TX is based on court decree of death).

1.10: Responsibility for payment: Executor not responsible UNLESS distributions made and knowledge of insufficient estate assets. US v. First Midwest Bank/Ill., N.A., 1997 WL 675192 *13 (N.D. Ill. 1997).

1.11: Deadline: 9 months after DOD (same as disclaimers) but extension of six months. If late, lose 6166 extended payout and penalties but only election lost.

1.12: Extensions: Automatic 6 months (Form 4768) and no more unless regulatory extension (e.g., in Iraq). Extension to PAY generally allowed. See Treas. Reg. 20.6161-1. Longer-term payout available, e.g., for closely-held business (6166) or future reversion/remainder (6163), BUT bond required (sometimes twice value of estate tax) and difficult to obtain sometimes.

1.14: Penalties:

Undervaluation (6662(e)(2)) but avoided if substantial authority for tax treatment, disclosure of relevant facts, or reasonable reliance on appraisal (see, e.g., *Sammons v. Comm.*, 838 F.2d 330 (9th Cir. 1988)).

Civil Fraud: 6663: 75% of underpaid tax. See *Trompeter v. Comm.*, No. 99-70805 (9th Cir. 2002).

Criminal Fraud: 7201

1.15: Estate tax liens: 6324 (10 years)

1.16: Deficiencies: 6501 (generally three-year rule but exceptions for false/fraudulent return (no time limit), omissions (six-year period *but see Estate of Helen G. Williamson v. Comm.*, 72 TCM (CCH) 687 (1996)). Can obtain discharge from personal liability via 2204 (no increase re: audit probabilities or anything else).

1.17: Amending Return: No such thing, but "supplemental information" allowed. See Treas. Reg. 20.6081-1(d). Does NOT cure fraud. See *Badaracco v. Comm.*, 464 U.S. 386, 294 (1984). If audit, must disclose assets omitted in good faith; if no audit, NO NEED to disclose omitted assets if good faith. Claim for refund: 6511(a): Must be filed within 3 years of original 706 and prior to any court action. See Zeier v. US, 80 F.3d 1360, 1363-64 (9th Cir. 1996) (what NOT to do).

SECTION 2: VALUATION:

2.02: Defined: Treas. Reg. 20.2031-1(b): Hypothetical willing buyer-willing seller. Q of fact.

2.03: Date: Estate of *McClachey v. Comm.*, 147 F.3d 1089, 1091 (9th Cir. 1998).

2.04: Alternate valuation: 2032 (6 months)

2.05: Valuation and basis: 1014(a): FMV @ DOD unless IRD (691).

2.06: Valuation Discounts: Lack of marketability, FLPs, key-person, time-value of money

SECTION 3: REQUIRED INFORMATION:

3.08: Disclaimers: 2518: Refusal to accept transfer.

Required questions: gift tax returns (Q 7 -- reasonable inquiry re: unreported gifts)

SECTION 4: SCHEDULE A -- REAL ESTATE:

4.01: When completed: Generally only probate real property.

4.04: Required information: Describe with enough detail that IRS can locate. *See* Treas. Reg. 20.6018-3(a).

4.05: Valuation: Property tax value acceptable if FMV. See 20.2031-1(b). Can use appraisal or sale close to DOD. Appraiser engagement letter checklist (6.07(D)(3)). Appraisal report review checklist (4.05(C)(5)). Discounts (fractional interest, market absorption, catastrophic events).

4.07: Mortgages: Reported on Schedule K unless non-recourse (and then report net figure on Schedule A).

4.10: Alternate valuation: Rent prior to DOD included. Mineral production post-DOD included. Should UPDATE appraisals from DOD to AVD (include in engagement letter).

4.11: Attachments: Appraisals, ad valorem tax appraisal, and/or closing statement (if value based on sale).

SECTION 6: SCHEDULE B -- STOCKS/BONDS:

6.01: When completed: When GE includes ANY stocks or bonds

Three categories: closely held, publicly traded, or blocks of publicly traded.

6.03: Stocks: *See* 706 Instructions p. 12; Treas. Reg. 20.6018-3(c)(2). Dividends listed separately.

6.04: Bonds:

6.06: Valuation: 706 Instructions p. 13; Treas. Reg. 20.2031-2. Recommendation to use valuation services.

6.07: Closely held stock: Obtain appraisal. See Rev. Rul. 59-60.

6.15: Attachments: quotations, discount support, appraisals, more information for closely held stock.

SECTION 7: SCHEDULE C -- MORTGAGES/NOTES/CASH:

7.01: When completed: Self-explanatory.

7.02: How reported: Order to list items.

7.03: Mortgages: Valuation: *See* Treas. Reg. 20-2031-4. SCINs: S*ee Estate of Musgrove v. US*, 95-2 USTC para. 60,204 (Fed. Cl. 1995). Below-market loans: 7872.

7.05: Cash in possession: Cash on hand.

7.06: Cash in banks: *See* Treas. Reg. 20.6018-3(c)(3).

7.08: Attachments: Appraisals, copies of notes reported at less than remaining balance, but NOT bank statements (just indication that reviewed by preparer).

SECTION 8: SCHEDULE D -- INSURANCE ON DECEDENT'S LIFE:

8.01: Reporting life insurance: All insurance, even if not included in GE (explain if not includible). Obtain Form 712 from insurance companies; provides value.

8.02: Inclusion in GE: 2042

8.03: Policy held by corporation: Only included in valuing corporation and decedent's stock in corporation IF proceeds payable to corporation. If proceeds NOT payable to corporation and attributable to decedent (more than 50% of stock), then includible.
8.06: Insurance otherwise included: Listed on Schedule D, but reported on Schedule G (2035-38).

8.08: ILITs: List by describing trust and note no incidents of ownership held.

SECTION 9: SCHEDULE E JOINTLY-OWNED PROPERTY:

9.01: When completed: Joint tenancies WROS and tenancies by the entirety. Listed EVEN IF not includible in GE.

9.02: Qualified joint interests:

9.05: Disclaimer of joint interests: See Treas. Reg. 25-2518-1 & -2.

SECTION 10: SCHEDULE F -- OTHER MISC. PROPERTY:

10.01: When completed: Must answer three questions EVEN IF no property needs to be listed. Appraisals might be required.

10.02: Property reported: Checklist: Automobiles (http://www.kbb.com), coin collectibles (see

Trompeter v. Comm., T.C. Memo. 1998-35), contraband (see TAM 9207004 (amazing!)); *Sammons v. Comm.*, 838 F.2d 330 (9th Cir. 1988); Paul Adams, 50 TCM (CCH) 48 (1985)), personal effects (list required: Treas. Reg. 20.2031-6(a)), jewelry (get AUCTION HOUSE appraisal because approved by IRS), lawsuit (see Estate of Smith v. Comm.)

Marital/2044 property and duty of consistency required (*see Estate of Letts v. Comm.*, 190 TC 290 (1997)) but certain QTIP property not included if QTIP not required to reduce prior estate to zero (see Rev. Proc. 2001-38).

SECTION 11: SCHEDULE G -- TRANSFERS DURING DECEDENT'S LIFE:

Custodian on UTMA/UGMA account: Includible because allowed to discharge debt of decedent.

[SECTIONS 12, SCHEDULE H, through 23, SCHEDULE U, not discussed due to lack of time.]

2:00 - 3:30 p.m. Special Sessions III

Reporter: Carol Warnick Esq.

III-D The Uniform Trust Code: Your State Might Be Next
Prof. David M. English
Judith W. McCue
Scot W. Bouton

The Uniform Trust Code has been enacted to date in five states, Kansas, Arizona, Nebraska, New Mexico, and Wyoming. It is under consideration or study in over 30 other states.

Most American trust law developed prior to 1900. The world we live in is so different now. Two examples, (1) at that time there was no federal tax system and (2) marriages may not have been happy but they lasted longer. Trust are much more common now, yet trust law in many states is very thin. While much of the UTC codifies the common law, it does make some significant changes.

Remember, for the most part, the UTC contains default provisions which can be drafted around. When asked why not leave everything up to the draftsman, the reply was that because of the increased use of trusts, many trusts are being drafted by planners who do not really understand the law or the issues involved, or maybe even come out of a book or a trust kit. The feeling is that some protection should be provided by enacting these basic laws.

The most controversial issue that has come up so far has been the notice and reporting requirements to beneficiaries. Section 813 of the UTC fills out and adds detail to the trustee's duty to keep the beneficiaries informed of administration. When in doubt, the UTC favors disclosure to beneficiaries as being the better policy.

Section 103(12) defines a "qualified beneficiary" as a beneficiary who, on the date the beneficiary qualification is determined, (A) is a distributee or permissible distributee of trust income or principal; (B) would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (A) terminated on that date; or (C) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date. This definition essentially includes the remainder beneficiaries but leaves out alternative and contingent remaindermen.

Public policy issues permeated the notice discussions. Grantors generally expect to have more control in a trust environment than if their will was being probated, and many Grantors do not want the beneficiaries alerted to the trust until absolutely necessary. This must be balanced with the rights of the beneficiary to protect themselves. States are using a variety of approaches when they adopt the UTC. .

Article 3 deals with representation, and many feel this is the most valuable part of the UTC. It provides comprehensively for the representation of beneficiaries and others unable to represent themselves, both with respect to notices and consents, and without judicial intervention. Virtual representation (of minors, unborn beneficiaries, etc. is allowed.)

Modification and termination of trust provisions were discussed. Due to increasing use of long-term trusts, there is a need for greater flexibility in the rules about when a trust may be modified or terminated. Must also remember that the primary objective of trust law is to carry out the settlor's intent.

The beneficiaries and the settlor can get together and terminate a trust. This is a codification of well-settled common law. However, remember, the 643 final regs do not bless the termination of a trust. Also a potential Strangi issue. under 2036(a)(2). Section 411 of the UTC allows for the settlor and the beneficiaries to modify or terminate a trust. Is this a taxable power? 2038 regs say that if a power is based on state law it is not a taxable power under 2038. The 2036 regs do not say that. If the settlor participates in the modification or termination of a trust then are all irrevocable trust taxable a la Strangi?

One major change is to do away with the presumption that a spendthrift provision is a material purpose barring the beneficiaries from compelling termination of a trust. Used to be that a spendthrift clause was not in a trust unless it was a material purpose of the trust. Now they are almost boilerplate. (Spendthrift provisions did not originate in England like most of our trust law. They originated in Massachusetts.)

UTC also allows for termination of an uneconomic trust (a value of $50,000 or less) without a court order or any other special procedure.

3:45 - 5:15 p.m. Special Sessions IV

Reporter: Carol Warnick Esq.

IV-B Formulas, Fractions and Ratios - Oh My!
S. Stacy eastland
A Christopher Sega

Stacy Eastland began the presentation talking about the McCord case. He discussed his thinking in setting up the transaction and what he thinks can be gleaned from the case.

Possible "Bad News" from *McCord*:

1. Transactions with charities are not considered transactions with unrelated adverse parties for a

majority of the court.

2. This case is precedent for the proposition that a transferor may have to pay gift taxes based on a transaction over which the transferor had no control. (The kids negotiations with the charities to buy out the charities' interests.)

3. There appears to be an implication that defined formula clauses will only be recognized if the major words "as finally determined for Federal gift tax purposes" are included somewhere in the formula clause. (This would not be practical in commercial transactions between nonrelated parties.)

4. If a future Tax Court adopts the reasoning of the concurring opinion of Judge Swift, no charitable deduction would be allowed for any gifts of partnership interest to charities, unless under (i) the assignment documents, (ii) the partnership agreement, or (iii) the applicable state property law that charity is immediately admitted to the partnership as a full-fledged member.

Possible "Good News" from *McCord*:

1. If the assignment document provides that the donee is an assignee, and other surrounding facts are consistent with the assignment document, the Tax Court will recognize that what a hypothetical willing buyer will pay for the transferred interest is only based on assignee rights That recognition by the Court may have a profound effect on the amount of the marketability discount that is allowed.

2. It appears that all but two judges of the current Court will find a defined value formula clause is not against public policy when it involves a charity and will even allow a charitable deduction that may be substantially above what the charity actually receives. A majority of the Court allowed the donors a charitable deduction that was approximately 28% above that the charities ultimately received.

3. The case strongly suggest that a majority of the Court would be prepared to allow pecuniary defined value formula clauses, which incorporated the phrase "as finally determined for federal gift tax purposes." This seems especially so where the value as finally determined will be divided among the donees and be retained by them in the proportions provided by the formula, with no "buyout" by one donee of another prior to final valuation For instance, defined value formula clauses incorporating that phrase in which the excess value over a stated dollar amount goes to a grantor retained annuity trust, or to a marital deduction trust, appear to have the support of all but two of the judges on the Tax Court.

They discussed a possible technique where the next tier donee is a limited power of appointment trust. You can use the same trust that receives the first tier gift (a single trust with 2 sub-trusts - one trust representing the gift element over which you retained a limited power of appointment, and the other trust where the gift would be complete.) Make both trusts grantor trusts so if ever there is a change in the income interest, the grantor still pays the tax. If there are adjustments, no amended income tax returns will have to be filed. If the property is sold, the sale proceeds can be allocated between the two sub-trusts and adjustments made later if necessary.

Sega: He liked the fact that in McCord. Stacy used the donor advised fund of the community foundation...He asked Stacy if he thought that the fact it was a donor advised fund had anything to do with the decision in *McCord*? Stacy said he thinks that what made the court mad was the lack of an independent appraisal (even though they were instructed to obtain one, but chose not to.)

Stacy Eastland discussed another type of transaction discussed on page 19 of his special session materials, using a formula defined value clause so the gift element can go into a transaction where you minimize the taxable gift, such as a GRAT.

He briefly discussed GRATs in comparison with sales to defective trusts. GRATs have advantages in that there is a built in revaluation clause. GRATs have the disadvantage that you can die early before the term of the GRAT is up. You can do cascading GRATs to deal with that risk. The problem still remains that interest rates can go up. (His aside was that you never know when Jimmy Carter may be re-elected.)

The advantage to sales to defective trusts is that you can lock in today's low interest rates.

Example 4 in his materials uses a formula amount, a note coming back, the words "as finally determined for federal gift tax purposes", and if the value exceeds the dollar amount, the excess goes to a GRAT. Hopefully, the worst that can happen is that the donor does not end up selling as much to the kids as he had hoped.

Think of this in terms of the *Strangi* problem. If you are looking for an exit strategy, one might be to do this type of transaction, or do a redemption, and to the extent the value exceeds your dollar amount, the excess goes to the GRAT.

Example 5 places the whole partnership interest into a GRAT followed by a formula defined value transfer of the retained annuity in the GRAT to an Intentionally Defective Grantor Trust. Stacy said it was hard to see how you can get in trouble with this on a short term GRAT.

____

Report 11

A complete listing of the proceedings and speakers is available on **the Institute's Web site**

This Report, prepared by Reporter Jason Havens Esq., covers several sessions that involve the representation of charitable institutions and their donors. In addition, Reporter John Warnick Esq. previously reported in Report No. 8 on Kathryn Miree's Wednesday morning general session presentation entitled *"The Rules of Engagement: Managing Liability for Nonprofit Boards."*

Monday Morning, January 5, 2004 - Pre-Conference Fundamentals Session
Publicly Supported Charities, Private Foundations and Everything In Between: Talking - and Understanding - the Talk
(a study of the practical and tax aspects of these entities)
Conrad Teitell
Cummings & Lockwood LLP
Stamford, Connecticut

I. INTRODUCTION

Mr. Teitell began with a quote from Democracy in America (1835) by Alexis de Tocqueville: "These Americans are the most peculiar people in the world.... In a local community, in their country a citizen may conceive of some need, which is not being met. What does he do? He goes across the street and discusses it with his neighbor. Then what happens? A committee comes into existence and then the committee begins functioning on behalf of that need.... All of this is done by private citizens on their own initiative."

II. PUBLICLY SUPPORTED CHARITIES: See IRC § 170(b)(1)(A)(i)-(vi).
Churches or conventions of churches.
Tax-exempt educational organizations with a regular faculty/curriculum/body of students attending resident classes.
Tax-exempt hospitals and, under certain circumstances, organizations directly engaged in continuous medical research in conjunction with exempt hospitals.
Organizations operated exclusively to hold and administer property for state/municipal colleges/universities.
Governmental units.
Publicly supported organizations: Must meet either:
(1) More than one-third support test (support from public/governmental sources at least one-third of total support) or
(2) Facts and circumstances/10% test (substantial support -- at least 10% of total support -- from public, nature of publicly supported organization)

III. DONOR ADVISED FUNDS -- COMMUNITY FOUNDATIONS, CHARITABLE GIFT FUNDS CREATED BY FINANCIAL INSTITUTIONS AND FUNDS MAINTAINED BY UNIVERSITIES, ETC.

Must qualify as publicly supported organization (one of two tests above)
Key: ADVICE: Donor gives advice (not absolute direction)

IV. SUPPORTING ORGANIZATIONS

Three types: IRC § 509(a)(3) (very detailed and complex rules):

Type I: "parent-subsidiary" relationship: operated, supervised, or controlled by publicly supported charity, which designates majority of Type I's governing body

Type II: "brother-sister" relationship: supervised or controlled in connection with publicly supported organization

Type III: "kissing cousin" relationship: operated in connection with one or more publicly supported organization

See Nancy P. Marx, The Right Fit: Matching Client Goals with Charitable Entities, Tr. & Est. (Oct. 2003).

V. PRIVATE FOUNDATIONS

Any organization described in IRC § 501(c)(3) except organizations described in IRC § 509(a)(1), -(a)(2), -(a)(3), or -(a)(4). 501(c)(3) organizations basically divided into two classes: private foundations and public charities. Most private foundations are non-operating foundations, but other categories include operating foundations, exempt operating foundations, and pass-through (conduit) foundations.

VI. PRIVATE OPERATING FOUNDATIONS: spends at least 85% of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt activities (income test) and also meets the assets test, the endowment test, or the support test.

VII. EXEMPT OPERATING FOUNDATIONS

VIII. PASS-THROUGH (CONDUIT) FOUNDATIONS

IX. COMPANY FOUNDATIONS

X. TAXES ON SELF-DEALING -- IRC § 4941, TREAS. REG. 53.4941

Acts between private foundation and "disqualified person."

Examples of transactions that constitute self-dealing:

Sale, exchange, or leasing of property;
Lending money or other extensions of credit;
Providing goods, services, or facilities;
Paying compensation or reimbursing expenses to disqualified person;
Transferring foundation income or assets to, or for use/benefit of, disqualified person; and
Certain agreements to make payments of money or property to government officials.

Exceptions to self-dealing:

Compensation or reimbursement to disqualified person that is not excessive;
Providing goods, services, or facilities to disqualified person if made available to general public on at least as favorable a basis AND provision of same is functionally related to foundation's exempt purpose; and
Leasing of property to disqualified person if without charge.

XI. TAXES ON FAILURE TO DISTRIBUTE INCOME -- IRC § 4942, TREAS. REG. 53.4942

Distributable amount = minimum investment return of private foundation reduced by sum of any income taxes and tax on investment income, and increased by (1) amounts received or accrued as repayments of amounts taken into account as qualifying distributions for any tax year, (2) amounts received or accrued from sale or disposition of property to extent that property's acquisition was considered a qualifying disposition for any taxable year, and (3) any amount set aside for specific purpose to extent that amount set aside was not necessary for purpose set aside.

Minimum investment return = 5% of excess of combined FMV of all foundation assets, other than those used or held for use for exempt purposes, over amount of indebtedness incurred to buy these assets.

XII. TAXES ON EXCESS BUSINESS HOLDINGS -- IRC § 4943, TREAS. REG. 53.4943

XIII. TAXES ON INVESTMENTS WHICH JEOPARDIZE CHARITABLE PURPOSE -- IRC § 4944, TREAS. REG. 53.4944

Jeopardizing investment = investment that shows lack of reasonable business care and prudence in providing for long-term and short-term financial needs of foundation for it to carry out its exempt purpose.

XIV. TAXES ON TAXABLE EXPENDITURES -- IRC § 4945, TREAS. REG. 53.4945

Examples of expenditures normally not considered taxable expenditures include:

Expenditures to acquire investments that generate income to be used to further organization's purpose;
Reasonable expenses related to acquiring these investments;
Payment of taxes;
Expenses that qualify as allowable deductions in figuring tax on unrelated business income;
Any payment that is qualifying distribution;
Any deduction allowed in arriving at taxable net investment income;
Reasonable expenditures to evaluate, acquire, modify, and dispose of program-related investments; and
Business expenses of recipient of program-related investment.

XV. DISQUALIFIED PERSONS -- IRC § 4946, TREAS. REG. 53.4946

All substantial contributors to foundation;

All foundation managers;

Owner of more than 20% of (1) total combined voting power of a corporation, (2) profits' interest of a partnership, or (3) beneficial interest of trust or unincorporated enterprise, which is (during ownership) a substantial contributor to foundation;

Member of family of any of above;

Corporation of which more than 35% of total combined voting power is owned by persons described above;

Partnership of which more than 35% of profits interest is owned by persons described above; or

Trust, estate, or unincorporated enterprise of which more than 35% of beneficial interest is owned by persons described above.

XVI. PRIVATE FOUNDATIONS -- 10 PITFALS

Pledges: satisfying pledge made by disqualified person. Treas. Reg. § 53.4941(d)-2(f)(1).

$250-and-over substantiation requirement.

Tickets to fundraising events: purchasing such a ticket for a disqualified person ("rubber chicken"!). See PLR 8449008; PLR 9021066.

Disqualified person's purchase at auction.

Terminating CRTs and dividing proceeds between life beneficiary and charitable remainder organization (private foundation) based on respective interests at time of termination. See PLR 200310024; PLR 200314021; PLR 200225092.

"Qualified appreciated stock" to private foundation (generally deductible at cost basis only unless gift is truly "qualified appreciated stock").

IRA gift to private foundation -- 2% excise tax? See PLR 9838028; PLR 9341008. But see PLR 9633006.

Five-year carryover NOT available when lead trust for benefit of private foundation. PLR 8824039.

CLT benefiting private foundation. See PLR 200138018 (road map for avoiding inclusion of lead trust assets in donor's estate where lead trust beneficiary is donor's private foundation -- must relinquish ALL control of CLT).

Reformation to conform to donors' intent that private foundation is allowable remainder organization of CRUT (by trying to remove 170(b)(1)(A) reference to type of charity allowed to receive CRUT remainder).

XVII. TERMINATION OF PRIVATE FOUNDATION STATUS -- EXIT STRATEGIES

See Rev. Rul. 2003-13, 2003-4 IRB 1; Rev. Rul. 2002-28, 2002-20 IRB 94.

XVIII. HELPFUL IRS PUBLICATIONS AND FORMS

XIX. INCOME TAX CHARITABLE DEDUCTION REDUCES COST OF GIFT: ELEMENTARY (ELEEMOSYNARY) DEAR WATSON

XX. CHARITABLE DEDUCTION ENABLES DONOR TO MAKE BIGGER GIFT THAN ORIGINALLY PLANNED BY A GIFT OF TAX ADVANTAGE

XXI. "3% REDUCTION RULE"

XXII. AMOUNT OF CONTRIBUTION AND APPLICABLE INCOME TAX CEILING ON DEDUCTION DEPENDS ON TYPE OF GIFT, HOLDING PERIOD, TYPE OF DONEE, AND SOMETIMES ELECTION MADE BY DONOR

[Covered in IRS Pub. 526, "Charitable Contributions": http://www.irs.gov/pub/irs-pdf/p526.pdf.]

XXIII. GIFT AND ESTATE TAX CHARITABLE DEDUCTIONS

XXIV. PARTNERSHIPS: IRC § 702(a)(4); IRC § 703(a)(2)(E); TREAS. REG. 1.170A-1(b)(7)

XXV. CORPORATION GIFTS: IRC § 170(b)(2), -(d)(2), AND -(a)(2); TREAS. REG. 1.170A-1(b)(7)

XXVI. GIFT VS. BUSINESS EXPENSE

XXVII. SERVICES

XXVIII. UNREIMBURSED VOLUNTEER EXPENSES

XXIX. AVOIDING CAPITAL GAINS ON GIFT OF APPRECIATED SECURITIES

XXX. GIFT OF PROPERTY HAVING FAIR MARKET VALUE LOWER THAN COST BASIS

XXXI. BARGAIN SALE

XXXII. PLEDGES

XXXIII. GIFT OF UNDIVIDED PORTION OF DONOR'S ENTIRE INTEREST IN PROPERTY: IRC §§ 170(f)(3)(B), 2522(c)(2), 2055(e)(2); TREAS. REG. 1.170A-7(a)

XXXIV. SPLIT-INTEREST CHARITABLE GIFTS

Idea of QTIP/CRUT combination (besides discussion of overview of split-interest techniques from Mr. Teitell's other excellent charitable planning materials, which are also available for attendees of his Salvation Army presentation)

XXXV. SUBSTANTIATING INCOME TAX CHARITABLE DEDUCTIONS

XXXVI. THE APPRAISAL REQUIREMENTS

See Treas. Reg. 1.170A-13(c).

XXXVII. INFORMATION RETURN BY DONEES -- THE "TATTLETALE" RULE

XXXVIII. IRS'S PUBLIC LISTINGS OF TAX-EXEMPT ORGANIZATIONS

XXXIX. JEOPARDIZING TAX-EXEMPT STATUS

XXXX. INUREMENT TO INSIDERS

XXXXI. PRIVATE BENEFIT

XXXXII. INTERMEDIATE SANCTIONS -- IN BRIEF

XXXXIII. EXEMPT ORGANIZATIONS -- LEGISLATION AND ISSUES ON THE HORIZON

Mr. Teitell highlighted the importance of the passage of the CARE Act (HR 7) and encouraged everyone to continue supporting it.

XXXXIV. PRIVATE FOUNDATIONS -- PROPOSED LEGISLATION

XXXXV. ADVANTAGES AND DISADVANTAGES OF PUBLIC CHARITIES, PRIVATE FOUNDATIONS, AND EVERYTHING IN BETWEEN: ACCOMPLISHING CHARITABLE OBJECTIVES, TAX BENEFITS, CONTROL, FAMILY INVOLVEMENT, SIMPLICITY, COMPLEXITY, AND PERSONAL LIABILITY

XXXXVI. CONCLUSION -- THE AMERICAN PHILANTHROPIC TRADITION

Wednesday, January 7, 2004 @ 9:00 AM - 9:45 AM
Charitable Trust Litigation: Enforcing Donor Intent When the Ties That Bind Become Frayed
Howard M. McCue, III
Mayer, Brown, Rowe & Maw
Chicago, Illinois

Mr. McCue delivered a very good and timely session on charitable trust litigation. His materials walk you through the analysis of a charitable trust construction case, beginning with the principles of charitable trust construction and ending with the case's resolution. Some of the most helpful materials are contained in Scott's appendices, which summarize relevant charitable trust case law.

I. INTRODUCTION

II. HOW ARE THESE ISSUES ANALYZED?

A. First Principles.

B. The Role of Donor Intent.

Mr. McCue focused on the primary principle in construing charitable trusts (and mixed charitable and private trusts): "The controlling consideration in determining the meaning of a donative document is the donor's intention. The donor's intention is to be given effect to the maximum extent allowed by law" (quoting The Restatement of Property (Wills and Other Donor Transfers). Donor intent is determined from the text of the trust agreement, together with all relevant evidence.

Mr. McCue stated the "plain meaning rule," which is the traditional majority rule: Extrinsic evidence cannot be introduced to contradict the plain meaning of the words used in a trust. He explained the contrary position of the Restatement of Property, Donative Transfers, which allows extrinsic evidence to inform the text of the donative document. He cited Andrea Cornelison's article, "Dead Men Talking: Are Courts Ready to Listen? The Erosion of the Plain Meaning Rule," which traces the history of the plain meaning rule and its exceptions and was published in the American Bar Association Section of Real Property, Probate, and Trust Law's REAL PROPERTY PROBATE & TRUST JOURNAL in 2001.

C. Cy Pres.

Mr. McCue summarized the judicially applied principle of construction known as cy pres. Under the doctrine of cy pres, if property is placed in trust for a designated charitable purpose and that purpose becomes unlawful, impossible, or impractical to carry out, then, unless the terms of the trust provide otherwise, the charitable trust will not fail; rather, a court with proper jurisdiction will direction application of the property (or an appropriate share of such property) to a charitable purpose that nearly approximates the donor's designated purpose. The cy pres doctrine is also sometimes applied where enforcing the donor's designated purpose would result in a wasteful use of the entire charitable trust property. Mr. McCue used the "Hershey" cases to illustrate the principles and application of the cy pres doctrine.

D. Equitable Deviation.

Equitable deviation is another judicial remedy which, like cy pres, allows a court to change a charitable trust's purpose in a trust construction matter. However, unlike the cy pres doctrine, which is limited to cases where the donor's specific charitable purpose cannot be accomplished, equitable deviation has been applied in various cases. Mr. McCue noted that the cy pres doctrine and equitable deviation are often used interchangeably and are difficult to distinguish when reading case law. He used the Barnes Foundation litigation to discuss equitable deviation further.

E. Variance Power.

A "variance" power is sometimes included in trust agreements and allows the trustees to change the trust's terms when the trustees determine that the donor would not desire literal compliance with the terms of the trust agreement due to a substantial change in circumstances. Mr. McCue cited the New York Community Trust's invocation of a variance power to move a gift away from the Community Service Society of New York.

III. STANDING

Mr. McCue outlined the critical aspect of standing in the context of charitable trust litigation.

A. The Charitable Beneficiary.

The charitable trust beneficiary, which has an actual interest in the trust, has standing in all matters involving the construction of a charitable trust. Mr. McCue discussed the case involving the San Francisco Foundation and the Beryl Buck charitable trust.

B. The Attorney General.

Most charitable trust cases have held that the state attorney general also has standing to bring or participate in a construction case. Mr. McCue used the two Connecticut cases of Herzog and Blumenthal to illustrate the ability of a state attorney general in such circumstances.

C. The Donor.

Mr. McCue pointed out that the donor does not always have standing to enforce the charitable gift based on the inconsistent cases on this issue. Mr. McCue contrasted the Herzog and Smithers cases on the issue of a donor's standing. He also recommended that donors make explicit in their gift agreements a retained right to enforce the restrictions placed on a charitable gift.

D. The Donor's Family and Other Representatives of the Donor.

Mr. McCue highlighted the new trend of allowing -- or disallowing -- the donor's family (or other donor representatives) to challenge the use of charitable gifts. Mr. McCue used the Sybill Harrington and Avery Fisher family case involving the Lincoln Center and the New York Philharmonic to illustrate this new trend.

E. Third Parties.

Mr. McCue used the Hershey cases to describe situations where third parties have also sought standing to challenge the administration of charitable funds.

IV. HOW ARE THESE ISSUES RESOLVED?

A. Political Considerations.

Charitable trust cases are inherently political, often involving the attorney general, government officers and officials, lawyers, public charities, and others. Mr. McCue cited the Bishop cases involving the late Princess Bernice Pauahi Bishop, the last surviving member of the Royal Kamehameha (Hawaii) family.

B. Venue.

Mr. McCue underscored the importance of venue which, like political considerations, is very important when the impact of one conclusion may favor citizens of one community over the citizens of another.

C. Sometimes Legal Issues Get Lost.

Mr. McCue analyzed the relegation of legal issues in some of the high-profile cases, such as Hershey and Barnes, where the courts have relied more upon practical (or other) considerations.

D. Compromise Solutions.

As in most multi-party litigation situations, charitable trust disputes often result in compromises. Mr. McCue cited the Buck, Barnes, and Bishop cases to illustrate that these cases are complex multi-party disputes.

V. SOME LEGISLATIVE APPROACHES TO THESE PROBLEMS

A. The Uniform Trust Code.

The Uniform Trust Code (UTC) codifies the cy pres doctrine, grants broad authority to a court to apply the doctrine of equitable deviation, and expressly addresses the issue of standing. The UTC allows a donor to maintain a proceeding to enforce a charitable trust (section 405(c)).

B. The Uniform Management of Institutional Funds Act.

VI. PRACTICAL GUIDANCE IN DRAFTING

A. Recognizing the Practical Issues of Administration.

Mr. McCue urged drafters to articulate the donor's intent with clarity and with sufficient detail to permit the charitable donee and other interested parties to determine what is intended over the period of administration. Mr. McCue cautioned drafting to do anything "in perpetuity," as circumstances change over time.

B. Anticipate Enforcement Issues.

Mr. McCue recommended drafting for enforcement issues, but certainly not as a substitute for clarity as to donor intent. He also noted that providing for an alternative use of the gift property may be appropriate to consider, although that "gift-over" may not be recognized after a certain period of years.

C. Avoid the Predictably Dysfunctional.

Mr. McCue challenged the estate planner to discuss practical issues candidly with clients. He reminded us that we bring the benefit of our training and experience to the table. If a client's dispositive plan will not work, we should challenge the client and urge the client to reconsider the plan. He concluded with the Barnes case as an example of a plan that was impractical from the beginning.
SPECIAL SESSION I-D: charitable trust litigation: enforcing donor intent when the ties that bind become frayed:

****
Wednesday, January 7, 2004 @ 2:00 PM - 3:30 PM Special Sessions I
Session 1-D: Charitable Trust Administration: Enforcing Donor Intent When the Ties That Bind Become Frayed
Howard M. McCue, III

Mr. McCue's special session centered on a hypothetical case study involving entertainment lawyer

Louis Howe, his third wife Ilsa de Freshlinghoven, and Louis' two children from his first marriage, Hubert and Dewey. Louis had built a mansion home on a 300-acre island in the Florida Keys, where whooping cranes began to migrate. Louis and Ilsa developed a strong affection for the whooping cranes, and Louis decided to make his island a sanctuary and research center to be run by the University of Miami (UM). His sons were concerned about Louis' distraction from his "extraordinarily complex estate plan" that had been designed by a well-known estate planning attorney and would benefit the sons primarily. Louis approaches you and states that he wishes to protect (1) Ilsa, (2) whooping cranes in south Florida, and (3) Hubert and Dewey.

The attendees of the special session had a wonderful and entertaining exchange of ideas as to how to achieve his estate planning goals and how to represent UM. The consensus was that Louis would convey the property to UM during lifetime. The majority of attendees also agreed that a trust would probably not be appropriate here. One attendee suggested consideration of a supporting organization (SO), probably a Type I, to be governed by representatives from three other charitable organizations that are involved in the study of birds and two representatives from the family; however, there were strong concerns against involving Hubert and Dewey because of their lack of interest in Louis' donative intent.

We also discussed a more simplistic outright transfer with a retained life estate. Another attendee mentioned that UM would want the ability to change the use of the donated property if the circumstances changed substantially, e.g., if the whooping cranes decided not to migrate to Louis' island sanctuary. Attendees voicing concerns on behalf of Louis stated that they would want to retain the ability for Louis and/or Ilsa to enforce the agreement.

Then more facts were supplied. Louis decided to negotiate his own agreement with UM, donated the property with a retained life estate (the last-to-die of Ilsa and Louis), and provided a $20M endowment for the research institute. Louis provided that Ilsa and his sons serve on an advisory committee, but included no alternative "gift-over" of the property to another charitable organization. Later, after Louis' death, the cranes stop coming to the sanctuary and instead migrate to the Everglades. The chair of UM's Department of Biodiversity suggests that the facilities be converted to a research institute for red tilapia, which Ilsa does not like. The President of UM says that the endowment cannot support the research institute and that Ilsa should consider (1) contributing additional funds to continue the study of the whooping cranes or (2) selling the island, adding the proceeds to the endowment, and broadening the focus of the endowment. Ilsa also learns that Hubert and Dewey are proposing that a donor advised fund be created with the proceeds to benefit UM, but shift the focus of the benefit to the UM athletics program (as they are "serious football fans").

The attendees then analyzed the additional facts. We agreed that UM could assert the cy pres doctrine or pursue equitable deviation to devote the property and endowment to another purpose. One of the attendees emphasized that if the property is sold, the proceeds should be used to enforce Louis' specific purpose to study the whooping cranes. Thus, the research institute would need to continue in the Everglades.

One attendee noted that an additional contribution from Ilsa is inconsistent with the gift agreement. Another attendee stated that Ilsa can probably enforce the gift agreement, although Louis should have included language affording standing to her in the gift agreement. Lastly, we agreed that the alternative charitable organization and the "gift-over" probably should have been inserted in the gift agreement.

We concluded that we would recommend a 50-year supporting organization and then allow UM to take the property. The concern is that the family will "blow up" the plan. It is also not realistic to create a perpetual charitable vehicle in these circumstances, given the tenuous status of the whooping cranes.[Reposted from report #8 and reported by john warnick, esq.]

Wednesday, January 7, 2004 @ 9:45 AM - 10:30 AM
The Rules of Engagement: Managing Liability for Nonprofit Boards
Kathryn W. Miree

NOTE: This general session was previously reported on by John Warnick Esq. in Heckerling Report No. 8. Readers are referred to that Report for the details. The follow up Special Session on this topic that was held Wednesday afternoon is reported on below by reporter Jason Havens Esq.

Wednesday, January 7, 2004 @ 3:45 PM - 5:15 PM Special Sessions II
SESSION II-A: The Rules of Engagement: Managing Liability for Nonprofit Boards
Kathryn W. Miree
Kathryn W. Miree & Associates, Inc.
Birmingham, Alabama

Jerry J. McCoy
Attorney at Law
Washington, D.C.

Ms. Miree's and Mr. McCoy's special session also focused on case studies. We reviewed several problems and provided analysis. Following is a summary of those comments.

A. Problem 1:

In the first problem, Knowledge College has lost most of its students and its endowment over the past eight years. Knowledge College is governed by a Board of Trustees, which consists of fifteen prominent individuals, including one who is a president of a more successful college at the other end of the state. The Board has been unable to devise a successful solution to the declining enrollment and the decreasing endowment. At its next meeting, the Board will discuss whether to (a) close the college, sell the campus, and devote the remaining assets to educational purposes; (b) stay the course and keep the college going; or (c) seek a merger partner from among the other colleges in the area.

We discussed that the focus or purpose of Knowledge College is not very strategic as a "small liberal arts college." There is nothing to attract good candidates to the college. The Board needs to spend time refining the college's purpose.

We also questioned the reason for the eight-year decrease in the endowment. The Board could be facing liability, and has seemingly taken no action or even planning to correct this problem. The fact that the college is governed by a Board of Trustees means that the college is probably governed by a trust instrument, which should be analyzed (as the duty of care is generally higher than if the charitable organization were a non-profit corporation).

The main point of discussion centered on the lack of review and planning. Ms. Miree and Mr. McCoy noted that the planning process is crucial, even if the wrong decision is ultimately made. The fact that no planning or analysis has been done leaves this Board exposed to potential liability.

Mr. McCoy revealed that this hypothetical is based on Zehner v. Alexander (Wilson College) (Pa. Surrog. Ct. 1979 -- Judge Keller (citation unavailable)), which took the first option -- to close the college. However, the opposing trustees, faculty/alumni, and students enjoined the closure. Wilson College survived after the injunction and is evidently still running.

B. Problem 2:

In the second problem, the Friendly City Opera Company is encountering financial difficulties. Several large bequests have saved the organization in the past. The Board wants to pursue changes and address the need of a shortage of younger supporters.

We agreed that the Board should pursue a more structured system of planned giving and financial reporting. Other facts illustrated that the Board has not been kept fully informed by the Executive Director. The more structured Board and systems are crucial.

Then Mary Sunshine, an affluent socialite, proposes that she would like to join the Board. However, she does not want to become involved in meetings or functions of the Board. "That's just not [her] thing." Nevertheless, she promises to raise $1M in a year or else contribute it herself.

We discussed that the Board is justifiably concerned about Mary joining the Board. We concluded that the Board should create an advisory committee so that Mary can participate, but not on a full Board member level. The committee member status would insulate Mary and the Board from potential liability due to her lack of involvement.

Lastly, more facts express that the Board wants to divide its responsibilities among its members. Opponents argue that the Board should instead provide oversight and not simply delegate individual responsibilities to individual Board members. We agreed that the latter approach of providing oversight is the main function of the Board. While committees and subordinate processes can be used effectively, the Board itself must provide oversight and governance when it meets and acts.

Mr. McCoy revealed that this hypothetical is based on the Bishop case and the creation of "fiefdoms." Ms. Miree noted that the Board should function by committees, but it CANNOT shed its ultimate responsibility for making decisions.

C. Problem 3:

In the third problem, which we did not have much time to address, a situation similar to the National United Way case was discussed involving a Chief Executive Officer who had outstanding loans from the organization, advances on trips, and the like. Mr. McCoy noted the private inurement issues and also the oversight responsibilities of the organization. Ms. Miree noted that there was seemingly no fiscal policy in place for the organization.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087

Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
===
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
==

Report 12

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Thursday, January 8, 2004 (Continued)

Reporter: John Warnick Esq.

10:45 - 11:30 a.m.
Trust Classification Times Four
Robert C. Lawrence, III

Mr. Lawrence started out explaining that his talk will really be an overview, because of the time limitations, and that the real substance will be discussed during the workshop.

Reporter's Notes: The afternoon workshop really applied, in much greater detail, the rules which Mr. Lawrence touched on duriing his general session. Therefore, we are posting the afternoon session as part of these general session remarks.

Mr. Lawrence then asked why the foreign trust rules should be important to you if your practice is primarily a domestic practice. You may think it has no relevance to your practice. That is a mistake. The globalization trends are so strong that Mr. Lawrence believes in the coming years you will be faced with clients that have multinational holdings or multinational families.

Mr. Lawrence went back to the Roman empire to trace the development of "trusts" or entities similar to trusts. . He noted that these concepts have developed independently in Teutonic culture, Gallic culture and Anglo-Saxon culture. At the time of the French revolution they abolished their trust equivalent and when the Napoleonic code spread throughout Europe it contained no statutory form of trust. Instead the "usufruct" developed under French law. But starting in Liechtenstein after the First World War the trust concept has been recognized as the "treuhand".

So it is likely that when you first deal with the client that has an interest in one of these foreign trusts you will be dealing with a treuhand or some other hybrid arrangement. You will then have to put that foreign entity under the microscope of U.S. law and determine how it will be classified for U.S. tax law and apply our principles of law to tax them.

What is the U.S. tax definition of what is a "trust"? Under the Regulations the term "trust" refers to "an arrangement created under will or inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts." The emphasis here is on the function of the trustee in protecting or conserving the property for the benefit of the beneficiaries.

What happens if your foreign entity doesn't meet the definition of a trust. You need to go back to the check the box regulations. If
you don't check the box, when that entity is analyzed 10 or 15 years later and the foreign entity is not regarded as a trust, then the default provisions for entity classification become applicable and it would be treated as a partnership if it had more than one member and at least one member does not have limited liability, or as an association taxable as a corporation if all members have limited

liability, or disregarded as an entity separate from its owner, if it has a single owner that does not have limited liability.

The existence of associates and the objective to carry on a business are the two attributes which case law has identified as being present in associations and partnerships. The absence of either attribute will cause an entity to be classified as a trust for U.S. tax purposes.

Mr. Lawrence noted that it is unusual to see a trust drafted in the U.K. that won't have powers clauses that permit the carrying on of business and that it is there mere existence of the power rather than whether it is actually being used to conduct a business that matters.

Once we determine that we are dealing with a trust we have to move to the second classification: whether the trust is a foreign trust or a U.S. trust. That classification will depend on whether we are dealing with pre-1996 or post-1996 law. The pre-1996 law had a totally useless definition and the courts ended up using a facts and circumstances test.

The post-1996 law requires that a trust meet two requirements to qualify as a U.S. trust: (1) a court within the U.S. must be able to exercise primary supervision over the trust's administration (the "Court Test"); and (2) one or more U.S. persons must have the authority to control all substantial decisions of the trust (the "Control Test"). If a trust fails to meet either of these requirements, it is a foreign trust for U.S. tax purposes.

Mr. Lawrence pointed out that having an arbitration clause in your trust will result in the trust being classified as a foreign trust because the Court Test would not be satisfied if a U.S. court wouldn't be able to exercise primary jurisdiction.

The regulations provide a safe harbor for satisfying the Court Test. A trust will satisfy the Court Test if (i) the trust instrument does not direct the trust be administered outside the U.S.; (ii) the trust is in fact administered exclusively in the U.S. and (iii) the trust is not subject to a flee provision. Bob Lawrence also pointed out that the flee cause doesn't flunk the Court test if it is limited to a foreign invasion of the U.S. or widespread confiscation or nationalization of property in the U.S.

Mr. Lawrence pointed out that the regulations provide a list of substantial decisions for purposes of the Control Test. But that list doesn't include approvals of accountings, decisions to migrate, to borrow or lend, or to guarantee a loan to a beneficiary. And you have to be very careful that you don't lodge any substantial decision in anyone that isn't a U.S. person.

Mr. Lawrence feels this Control Test is a great thing from the U.S. point of view. The only problem is that the U.S. wanted an objective test and the Control Test can be very subjective. From a U.S. Trust company perspective this is a great marketing opportunity to foreign individuals because they can offer the stability and advantages of administration in the U.S. and so long as there is just one substantial decision lodged in a non U.S. person, the trust will be treated as a foreign trust for U.S. tax purposes.

Once the grantor dies, you may not want the trust to continue as a foreign trust. So if you have a U.S. trustee, you can easily migrate that trust into the U.S. upon the grantor's death if that is desirable. Bob Lawrence pointed out that there is a distinct advantage to having a U.S. trustee in these circumstances in terms of being able to migrate the trust into the U.S. His experience in transitioning a trust from a foreign trustee to a U.S. trustee indicates you need plenty of lead time to get this accomplished. He has seen it take up to two year time to migrate that trust into the U.S. upon the grantor's death. Since there are many potential tax consequences during this period, it may prove very advantageous to already have a U.S. trustee in place.

But Mr. Lawrence pointed out that out that what you need to take away from this is to be very careful of what powers you have in your trust instruments and to whom you give those powers, whether in a fiduciary capacity or in a non-fiduciary capacity. You have got to be very careful in drafting your domestic trusts and monitor the status of powerholders because they may leave the U.S. and it may change. You have a 12 month change in which you can cure an inadvertent change but if you don't cure that change then there may well be a change in the trust classification and the trust may become subject to the § 684 tax on transfers or there may be a different tax result.

The third area of classification is whether the trust is grantor or nongrantor. The grantor powers are found at § 673 to § 677. Prior to 1996, Rev. Rul. 69-70 provided that if you had a foreign grantor trust and there was no U.S. income in the trust, then the income of the trust would be taxable to the foreign grantor and there would be no tax on distributions to U.S. beneficiaries. The IRS didn't like this. The 1996 legislation changed all of this. We were successful in carving out a few exceptions. One of these is for a foreign trust that is revocable. The revocation has to be in the control of the foreign grantor and not in the control of the beneficiaries. The second exception is for a trust where the only distributions during the grantor's lifetime are to the grantor or the grantor's spouse. This exception permits an irrevocable trust and can provide assurances to the ultimate beneficiaries that the trust won't be subject to further change.

There is an important grandfather exception for trusts which were in existence in September 1995 but the trusts had to be classified as a grantor trust under § 676 and § 677(a)(1) and (2). There isn't symmetry between the grandfather provisions and what the current law is. To preserve grandfather status you have to be very careful about future contributions that are made to a grandfathered foreign grantor trust and make sure that is accounted for separately and in Mr. Lawrence's opinion segregated from the balance of the trust assets.

You also need to be aware of § 679 and 684. These will be covered in greater detail in the workshop.

Next he discussed the taxation of U.S. Beneficiaries of foreign non-grantor trusts. The beneficiary will be taxed on these distributions and there will need to be a return filed on Form 3520. One difference between the foreign non-grantor trust and domestic trust is that there is the possibility that the U.S. beneficiary will be taxed on realized capital gain in the foreign trust. DNI for the foreign grantor trust is enhanced by realized capital gains. If not all the income is distributed out in the year it is earned then we have UNI (undistributed net income). But it is important to note that the capital gain if it doesn't get completely distributed in the year of realization will be treated as UNI and there is a conversion of its character from capital gain to ordinary income so that in the year when it is distributed eventually to the U.S. beneficiary it will no longer be treated as capital gain but will be taxed as ordinary income to the U.S. beneficiary.

Mr. Lawrence also noted that in addition to the income tax imposed on UNI distributions made to a U.S. beneficiary, there is also a nondeductible interest charge imposed. A weighted average method is used to determine the period for which interest is charged with a different rate charged for accumulations through 1995 and a floating rate determined under § 6621 applied to accumulations after 1995.

Mr. Lawrence also noted that it is important to plan and draft for the possibility that the foreign trust could receive a step-up in basis upon its assets upon the death of its grantor. This will significantly reduce what the tax might be if that trust is converted to U.S. trust status after the grantor's death. Some people think that it is useful to keep the foreign trust offshore after the grantor's death. But it doesn't provide much flexibility if you don't have distributions for a long, long time. You have to be very careful if you have a client that is a beneficiary of a foreign trust and there are accumulations. You have to plan for the distribution of those accumulations. It is a rather complicated exercise because often these accumulations.

Mr. Lawrence mentioned that he wanted to briefly mention the problems associated with ownership of foreign corporations held by foreign trust. You have to look to see what your entity structure is and how you will migrate this trust and/or deal with the accumulations in the trust or the corporation.

Mr. Lawrence concluded with a summary of the usufruct, the treuhand, the stiftung and the anstalt. The treuhand is not a testamentary document. It has to be intervivos but it can extend beyond the death of the transferor. It is a third party beneficiary form of ownership. There is no third party beneficiary form of enforcement. The stiftung is primarily for charitable purposes. The anstalt is used for commercial purposes. You still have to go through the same classification routines with these entities where you will first have to determine if it is a trust or an association, then presuming you find it is a trust you will have to determine if it is foreign trust or a U.S. trust, then you will have to consider whether it is a grantor trust or a non-grantor trust. Finally, once you have identified what you are dealing with then you will have to analyze the income and transfer tax consequences of the arrangements and what reporting requirements it is subject to.

****

Special Sessions IV Workshop - Thursday afternoon.

Session IV-D - Foreign Trusts

Robert C. Lawrence, III
Jane Tse
Dina Kapur Sanns
Cadwalader, Wickersham & Taft

Note: The examples are shown in italics.

Ellen, a U.S. citizen, lives in London with her husband, Jean-Marc. Ellen and Jean-Marc have three adult children who are U.S. citizens. Ellen is the sole shareholder of a U.K. corpo*ration which is in the business of exporting textiles, El- Jean Holdings. On August 10, 1999, sells her El-Jean Holdings shares to Jean-Marc for cash. At the time of the sale the shares are valued by an independent appraiser at $100,000. On Sept. 19, 1999, Jean-Marc creates and funds a trust with the El-Jean Holdings shares known as the El-Jean Holdings Trust. On February 5, 2000, the El Jean Holdings Trust sells the shares to an unrelated corporation for $200,000. At the same time that Jean-Marc created the El Jean Holdings Trust he creates a second foreign trust, called the Last Resort Trust, with a nominal amount of cash from his personal bank account. The Last Resort Trust is an irrevocable, discretionary, sprinkle trust for the adult children. The El-Jean Holdings Trust is an irrevocable discretionary trust for the benefit of Ellen and Jean-Marc but it provides that upon the first to occur of the death of Jean-Marc or the divorce of Jean-Marc and Ellen, the trust will terminate and be distributed to the Last Resort Trust. Until such triggering events, however, the trustee may, in its sole and absolute discretion, pay or apply the income or principal of the El-Jean Holdings Trust to or for the benefit of Jean-Marc and/or Ellen, to the exclusion of either one of them.*

The trustee of both trusts is a foreign trust company but Jean-Marc may replace the trustee with any other trustee.

1 (A) *What is the classification of the El-Jean Holdings Trust and the Last Resort Trust for U.S. income tax purposes? Are they a grantor or non-grantor trust as to Jean-Marc or Ellen?*

Jane responded to this question by analyzing whether Jean-Marc would be treated as a grantor of the trust. Let's assume the August 10, 1999 sale was made for adequate and full consideration and that Jean-Marc is really the sole contributor of assets to the El-Jean Holdings Trust. Will Jean-Marc be treated as the owner of the El-Jean Holdings Trust for Subpart E of Subchapter J of the Internal Revenue Code. Jean-Marc won't be treated as a grantor/owner of the El-Jean Holdings Trust under § 672(f)(2) of the IRC because it doesn't fit within any of the three exceptions. Jean-Marc can't revoke and revest the assets of the trust in himself, either by himself or with anyone else's consent. It is also possible that income or principal could be distributed during Jean-Marc's lifetime to his children if he and Ellen divorced. Distributions from the trust won't be taxable as compensation to Jean-Marc. So none of the three exceptions apply and the trust isn't subject to the grandfathering rule either since it was executed after September 19, 1995.

Dina responded to this question by analyzing whether Ellen would be treated as a grantor of the trust. Ellen could be viewed as the grantor under IRC § 679 of the El-Jean Holdings Trust if she were viewed as having made an "indirect" contribution to the trust through Jean-Marc if the fair market value exception were not made. So if the shares were really worth $200,000 at the time Ellen sold her shares to Jean-Marc, then she would be treated as the owner of 50% of the El-Jean Holdings Trust because she will be viewed as having made an indirect contribution through Jean-Marc for the portion of the value for which she didn't receive adequate consideration. It should be pointed out that these transfers took place prior to August 8, 2000, the effective date of the regulations that introduced the intermediary rule under § 679. Those intermediary rules have a very broad application. They basically provide that if a U.S. person transfers property to a foreign trust through an intermediary with a tax avoidance purpose then § 679 applies. But because these transfers took place prior to August 8, 2000 the only way that Ellen can be deemed to be the grantor in our example would be if in fact the shares were worth more than the consideration she received from Jean-Marc.

Mr. Lawrence pointed out, however, that there was an independent appraisal. It would appear that this appraisal should hold up. But there could have been some intervening event between the initial sale and the second sale that is responsible for the appreciation. If that were the case, then Ellen would not be the grantor.

Mr. Lawrence pointed out that transfers between family members frequently take place informally and without the benefit of an independent appraisal which makes it troublesome to be able to rely on the adequate consideration exception.

1 (B) *Assume the same facts but with the modification that the transactions all take place a year later*.

Dina explained that in this variation of the facts the transfers have fallen on the other side of the effective date of the § 679 regulations which will bring the intermediary rules into play.

Mr. Lawrence asked Jane to explain why the $100,000 gift tax exclusion under 2503(b) as some bearing on the first example. Jane noted that there is an exception to § 672(f)(5) for gifts which are covered by the annual exclusion under 2503(b). Thus, if there was a gift transfer to Jean-Marc and the fair market value exception did not apply, this transaction still wouldn't be covered by § 672. Jane also pointed out that the annual exclusion is increased to $100,000 (adjusted for inflation now to $114,000 if I understood her correctly) if the donee spouse is not a U.S. citizen.

Dina, however, noted that the annual exclusion exception does not apply to § 679. So in the second variation where the transfer by
Jean-Marc took place after August 7,2000, the annual gift tax exclusion would not keep the transaction from being covered by the intermediary rules.

Mr. Lawrence: What are the U.S. income tax reporting requirements applicable to Jean Marc or Ellen upon the creation of the trust, if any?

Dina: Ellen would be the grantor/owner of 50% El-Jean Holding Trust. She would have to report the transfer to the trust on Form 3520. If the intermediary rule applied then she would be deemed to have made the transfer to the trust when Jean-Marc made the transfer. The Trust would also have to annually file a form 3520A and provide Ellen with a Foreign Grantor Trust statement so she could properly report 50% of the income from the trust on her income tax return. If she failed to do so, the penalty would be 5% of the assets deemed to be owned by her. She would also have to make sure that the trust provided each U.S. beneficiary with a Foreign Grantor Trust beneficiary statement so they could properly report as well.

Jane: On the other hand, if under the first set of facts Jean-Marc were treated as the sole contributor to the Foreign Trust there is no reporting requirement for Jean-Marc upon the formation and funding of this trust. However, if the trust subsequently makes distributions to Ellen the trust will have to furnish her with a Foreign Trust beneficiary statement and Ellen would have to report the income which she received as a result of the distributions to her. If she fails to report, there would be a penalty as to 35% of the gross distribution.

Mr. Lawrence: If the sale of the El-Jean Holding Company shares to Jean-Marc were for fair market value, there would have been no reporting requirement for Ellen in our first variation. Likewise, if But if Ellen were required to report the transfer to the trust on a Form 3520 and she failed to report, there is a penalty of 35% of the initial value of the assets transferred.

Mr. Lawrence: What the analysis change if Ellen sold the shares to Jean-Marc for a note payable in three years. This gets into the qualified obligation issues.

Jane: § 679(a)(3) But the regulations say that you take any obligation from a grantor/owner or beneficiary of the trust shall not be taken into consideration unless it is writing and the term is for less than five years and it is denominated in U.S. Dollars and the yield is not more than 130% of the AFR. If it meets the "qualified obligation" then it will be taken into consideration. Jane pointed out that if there is a valuation problem, the qualified obligation would only work as to 50% of the transaction and would still leave Jane being treated as the owner of 50% of the trust.

Question: In the example it states that Jean-Marc can remove and replace the trust. Isn't it conceivable that he could thereby appoint himself as trustee and make a distribution to himself or Ellen of all the assets of the trust. Wouldn't this cause a problem.
Jane: This is a very good question and you have picked up on one of the important points in our

example. However, as to a foreign person the revocation power has to be held by Jean-Marc. It isn't sufficient that he can remove and replace the trustee. Even if he holds the power and it is subject to the consent of an independent trustee, who he can remove and replace, that will not be enough. He must hold the power to revoke or hold it subject only to the consent of a related or subordinate party.

Mr. Lawrence: And who is in fact subservient to him.

Dina: The point here is that what is sufficient under 676 for domestic trusts doesn't work under 672 (f) for foreign trusts.

Question: If under governing law Jean-Marc's creditors could reach the trust, even that wouldn't be tantamount to a general power of appointment.

Panel: True.

Question: These penalties are quite severe and up until a year ago we had been successful in getting the IRS to abate these penalties where CPAs are overlooked the reporting requirements.

Mr. Lawrence: I haven't seen any change particularly. The IRS seems to be relatively understanding especially when there is an intent to comply and the taxpayer is coming forward voluntarily and saying Mea Culpa.

Question: What happens if the foreign spouse, because of laws in their own jurisdiction, gives property to the U.S. citizen who then contributes it to a foreign trust that was grandfathered.

Mr. Lawrence: First, the U.S. spouse will have certain reporting requirements once they receive a gift from their foreign spouse. Second, the U.S. spouse would be a grantor as to that portion of the foreign trust which is attributable to the contribution by the U.S. spouse. If that property were commingled and there isn't separate accounting, that would taint the trust and destroy the grandfather status of the foreign trust.

Question: If it was separately accounted for, could you preserve the grandfather status?

Mr. Lawrence: I would actually keep it separate. But you must account for it separately. But I would advise the trustee to keep it entirely separate.

Question: Would this be a U.S. trust or a foreign trust.

Dina: You are going to have to go back to the Court Test and the Control Test to make that determination.

Question: If the trust is amendable by the trustee during the lifetime of the U.S. citizen and the foreign spouse but by its express terms its income can only be paid to the U.S. citizen and the foreign spouse, is there a problem?

Mr. Lawrence: Yes, there is a problem. The second exception is a mandatory requirement. It doesn't permit any possibility of alternation.

Dina: The way to get around this problem is to limit the power to amend in the trustee's hands to provide that it can only be amended to benefit the U.S. citizen and the foreign spouse.

Jane: U.K. Trusts almost always have that power in the trustee.

Question: In Canada it is fairly typical to have the trust established not by the family itself but by a family friend who puts in $100. I feel that the family friend is merely a nominee.

Mr. Lawrence: The initial seed funding would leave that person as a grantor and owner as to their contribution but if the family then contributes $1,000, that person would not be grantor as to that additional contribution. This desire for confidentiality drives this. Sometimes the institution can be the grantor.

1 (C) *Assume the facts as above except that Ellen sells the shares to Jean Marc on August 10, 2000 and then Jean-Marc, rather than the trust, sells them on February 5, 2001 to a third party for $200,000. Jean-Marc then purchases marketable securities which he contributes to the El-Jean Holdings Trust two years later. Would there be any change in the outcome or analysis.*

Jane: It doesn't matter that Jean-Marc is contributing other assets to the trust other than the assets which were originally transferred to him by Ellen. The analysis under 679 doesn't change.

Mr. Lawrence: Another problem we might focus on is what happens if Jean-Marc purchases U.S. stocks with the proceeds of the sale of the El-Jean Holdings stock. That raises a very serious problem. Under § 2104 if the asset is situated in the U.S. at the time of transfer or time of death, then § 2036 or § 2038 applies and those assets will be taxable in the estate of Jean-Marc. If Jean-Marc contributes assets to the trust which are subject to § 2036 or § 2038, then that puts a taint on that trust as to those assets and if they grow to be worth $20,000,000 15 years later that $20,000,000 would be included in Jean-Marc's estate and § 2104(b) would apply. The only way around it is to terminate the trust and start over. I'm not aware of any other way to solve that problem.

1 (D) *Assume the same facts except that Ellen sells the shares to Jean-Marc on August 10, 2000 and he contributes them to the trust on September 19, 2000 and the trust sells them on February 5, 2001 for $100,000 rather than $200,000. Also, assume that Jean-Marc can revoke the trust but only with the consent of the trustee and the trustee would consent to the revocation because otherwise Jean-Marc would remove the trustee. Does the analysis change?*

Dina: Even though the transfer takes place after the effective date of the § 679 intermediary rules, we are assuming that the fair market value exception is met. So here it is clear that Ellen is not the grantor but that Jean-Marc is the grantor of the trust. The issue is whether the trust is a grantor trust as to Jean-Marc. As Jane explained earlier, there is a chance that the trust could terminate during Jean-Marc's lifetime and be distributed to the Last Resort Trust. So the question here is whether the revocable trust exception is met. Even though Jean-Marc can revoke the trust it is subject to the consent of the trustee and the trustee's powers are not attributed to Jean-Marc. Therefore, the revocable trust exception is not met.

The next example asks if the analysis would change if Jean-Marc removed the trustee and appointed a trustee who is related and subordinate to Jean-Marc. The answer is no because there is a special rule under the revocable trust exception regulations which says that once a trust is tainted for purposes of the revocable trust exception it is tainted for all other years. So even though now the trustee is related and subordinate it is still tainted and will continue to be tainted.

Mr. Lawrence The next example asks if the analysis would change if Jean-Marc names a related or subordinate trustee at the outset. And here the answer is yes, the analysis does change. Because in this example from the outset the trustee is a related or subordinate trustee so it would constitute a grantor trust as to Jean-Marc trust.

1 (E) *Assume the same facts as above except that Ellen sells the El Jean Holdings shares to Jean-Marc on August 10, 2000; he contributes them to the trust on September 19, 2000; and the trust sells them on February 5, 2001 for $100,000 (not $200,000). Assume further that the trustee of the El Jean Holdings Trust may exclude and add beneficiaries in its complete and absolute discretion. In 2004, Ellen and Jean-Marc move to New York City but leave their children behind. Prior to such move the trustee executes a deed excluding Jean-Marc and Ellen as beneficiaries of the El Jean Holdings Trust and adding their adult children as beneficiaries. October 30, 2004, Ellen and Jean-Marc move to New York City and in the process Jean-Marc obtains a green card.*

Jane: Here we are trying to illustrate the preimmigration rules of § 679(a)(4). Because Jean-Marc's immigration starting date is within five (5) years of the transfer to the El Jean Holdings Trust, he would be treated as the owner of the trust under § 679.

Mr. Lawrence. If there is accumulation income inside of this trust on the starting date of his immigration status, that income will be attributable to him and treated as being a portion of the trust owned by Jean-Marc but it would not be immediately taxable to him in that year.

Would the analysis change if the adult children were nonresident aliens?

Jane: It wouldn't change the analysis under these facts because the trustee still has the power to add beneficiaries and could add U.S. beneficiaries at any time.

Mr. Lawrence: There were a lot of abuses in this area. There would be an arrangement there would be no U.S. beneficiary during the lifetime of the grantor. Then miraculously after a year the trustee would add the grantor's children as beneficiaries. Mr. Lawrence was never comfortable with this but now it is absolutely clear this won't work.

Would the analysis change if the adult children were nonresident aliens and at the same time the trustee excluded Jean-Marc and Ellen as beneficiaries, it irrevocably released its powers to add future beneficiaries?
Would the analysis change if Ellen and Jean-Marc move to New York City on October 30, 2005?

Jane: Yes, the analysis would change because now the residency starting date would be more than five years after the transfer by Jean-Marc to the El Jean Holdings Trust.

1 (F) *Assume the same facts as in E except that after moving to New York City, Ellen and Jean-Marc stay for a period of time and then return to London on November 1, 2007.*

Would the analysis change if the trustee exercises its power to add Ellen and Jean-Marc as beneficiaries and exclude their adult children as beneficiaries and at the same time irrevocably releases it powers to add or exclude beneficiaries prior to Nov. 1, 2007?

Dina: This is illustrating the application of § 684. The only reason Jean-Marc was treated as the owner of this trust while he was in the U.S. was because § 679 applied. But when he moves out of the U.S. and becomes a foreign person again, § 679 will no longer apply. This would create a § 684 event and he would be treated as transferring all of the assets to the trust in a taxable sale immediately prior to becoming a foreign person.

Would the analysis change if the trustee distributes the trust fund to another trust which is created by Jean-Marc for the same beneficiaries but over which Jean-Marc retains the power to revoke prior to Nov. 1, 2007?

Dina: Yes, this would change the analysis because the second trust would meet the revocable trust exception and would be treated at all times as a grantor trust. Thus, when the transfer takes place prior to Jean-Marc leaving the U.S. we have a grantor trust to grantor trust transfer and this will avoid the § 684 problem. But note that this technique is only available before 2011. § 684 has now been amended for years starting after 2010 to only apply if the grantor/owner is a U.S. person.

Question: We have had a couple of sessions dealing with the five U.S. jurisdictions which offer asset protection. Do you feel there is a continuing advantage to going offshore strictly from an asset protection trust.

Mr. Lawrence: I think you are really talking about creditor protection trusts. I consider true asset protection trusts the types of trusts which were created to protect assets in the event of invasion such as those we created for Kuwaiti citizens before the Iraqis invaded Kuwait in the early 1990s. I find the idea of trying to avoid your creditors morally repugnant. But in terms of analysis, you have to look first at your local law. I don't think that there is any reason to take a domestic trust and tainting it "foreign". When you are dealing with a foreign jurisdiction there are more hurdles to overcome than when you are dealing with a domestic jurisdiction. You have the full faith and credit clause. You don't have those issues with a foreign jurisdiction.

The questioner responded to the moral issue by discussing what he perceived to be a "tort crisis" in the U.S. and pointed out the example of the Rhode Island nightclub fire where any deep pocket is being pulled into the litigation on a joint and several liability basis even though many of them have no moral culpability for the tragedy.

Mr. Lawrence agreed that the proliferation of contingent fee litigation has gotten out of hand.

Question: If you have a problem getting the form 3520A out of the foreign trustee, does the U.S. beneficiary have any standing to file a 3520A on their initiative to avoid the penalties. Bob Lawrence responded that you have a major problem on your hands and the IRS can determine that any distribution is all ordinary income. Jane pointed out that the penalty is actually imposed on the U.S. owner so ultimately the U.S. owner has significant incentives to cause the foreign trustee to act.

Dina: The 3520A is only relevant if you have a U.S. owned foreign grantor trust. If it is a true foreign grantor trust or foreign non-grantor trust then it doesn't have to file the 3520A but it does have to provide the U.S. beneficiary with a beneficiary statement.

II. After moving to the U.S. and obtaining a green card, Jean-Marc learns of the death of his aunt. At the same time Jean-Marc and his siblings learn of a Cook Islands trust established for their benefit by their deceased aunt during her lifetime. Assume that the trust is, and has always been, a foreign non-grantor trust which provides for the division of the trust funds into equal shares on a per stirpital basis for the grantor's nieces and nephews. Each share is held in a separate sub-trust for the individual for whom it was set apart and such individual's lineal descendants. The separate sub-

trusts are discretionary, sprinkle trusts and the trustee may, in its sole and absolute discretion, pay or apply the income and/or principal of the sub-trust to or for the benefit of any of all of the beneficiaries thereof to the exclusion of any one of them. Jean-Marc has a sister and a brother. The brother has been physically present in the U.S. for several years and is treated as a U.S. resident for U.S. federal income tax purposes. The sister is a French resident living in London. The brother has three children, who were born in the U.S. and are U.S. citizens. None of Jean-Marc nor any of his siblings were aware of the existence of the trust prior to their aunt's death. none of them of any of their issue have ever received distributions from this trust. The trust's sole asset is shares of a New Zealand holding company valued at $38 million and the trust has a $0 basis in those shares. The New Zealand holding company has accumulated earnings and profits of $12 million and has never declared a dividend. The New Zealand holding company declares a dividend of its accumulated earnings and profits.

(A). Analyze the U.S. federal income tax consequences and reporting requirements, if any, applicable to the U.S. beneficiaries of the trust as a result of the receipt by the trust of such dividend.

Jane: There is a two level analysis here. First we to determine if the New Zealand holding company is a CFC, a FPHC or a PFIC.
Here there are three separate trusts. Two of these trusts are for the benefit of U.S. persons: Jean-Marc and his brother. We reach that conclusion through attribution. But since 50% of either the vote or value of the New Zealand holding company is owned (through attribution) by U.S. shareholders, this company meets the definition of a CFC. The New Zealand holding company would also be a FPHC because more than 50%, by vote or value, of the outstanding stock is owned by or for not more than five individuals who are U.S. citizens or residents. Again by attribution we would have Jean-Marc and his brother both treated by attribution as owning more than 50% of the stock. The test for the PFIC doesn't look to ownership but rather to the source of the company's income. In our example we are assuming that all of the sources of income of this holding company are passive. Therefore, we meet all three of the definitions.

Mr. Lawrence: That is not a good result. Is there some sort of prioritizing.

Jane: In this case Jean-Marc and his brother don't own this stock directly but rather through discretionary trusts. The rules are not very clear on whether the beneficiaries are actually taxed on the income of the companies where there is a discretionary trust.

Dina: I think the CFC rules take precedence over the rules. Under the CFC rules you look not only to direct and indirect ownership but also to constructive ownership. But for CFC income purposes, the constructive ownership rules are ignore. For purposes of CFC income you look only at direct and indirect ownership. If we look at indirect ownership we have two trusts, each of which owns 33.3% of the New Zealand holding company. There are four beneficiaries of each trust. Each beneficiary would be deemed to own approximately 8.2% of the company through indirect ownership. However, that assumes that each of these beneficiaries have fixed entitlements under the trust. And as Jane pointed out these are fully discretionary trusts and there have been no distributions made to date. So it would be very hard to determine which of the beneficiaries is stuck with CFC income so we would argue that for income inclusion purposes it would be inequitable to tax any beneficiary until there has been a pattern of distributions established. But it isn't clear-cut how you allocate income when you are dealing with a discretionary trust.

Mr. Lawrence: If there is a fixed interest trust, on the other hand, I think there is a much more difficult argument to be made. Think about this. This is really unfair. The income that is being earned at the lower corporate level is being imputed up to the beneficiaries and taxed to them even they don't get the income nor have any right to the income. The position that our government is taking under the regulations is really unfair. I wonder if a court could be persuaded that the equities here are being overlooked and that the regulations should be upheld.

Question: This is more of a clarification but in the example it doesn't indicate that the New Zealand holding company has any related party "trading" or "service" income nor does indicate that it has personal holding company passive income, so we don't know whether the company has any so-called "bad" Subpart F income. The questioner pointed out that it is clear that it is a CFC. But if it doesn't have Subpart F income then you still have to deal with the PFIC rules. You do have the QEF election but my question is if this is a foreign nongrantor trust and there are no distributions, then how does the QEF election interface with the throwback rules when the trust finally makes a distribution?

Dina and Jane: The U.S. beneficiary, rather than the trust, makes the QEF election. Once the QEF election is made the company doesn't have to make a distribution the income is deemed to be distributed.

Jane: In our example it is to late to make a QEF election because that QEF election has to be made in the first year of the U.S. shareholder's holding period.

(1) *Assume the same facts as above except that the trust is a discretionary sprinkle trust for the grantor's nieces and nephews and their lineal descendants instead of three separate sub-trusts.*

Bob Lawrence: If you move from separate trusts to a pot trust, if you do have UNI up at the trust level you can make a stripping distribution to foreign beneficiaries of the UNI and then in later years make distributions in later years to the U.S. Beneficiaries. I see nothing in the regulations which would prohibit that.

Jane: In this variation we were trying to illustrate if the trust is a discretionary trust it is even more difficult to determine if the New Zealand holding company are a CFC, PFIC or FPHC. There would be better arguments that the New Zealand holding company is not a CFC or FPHC and there is no income inclusion.

(B) *Assume the same facts as above except that the New Zealand holding company does not declare a dividend and instead the trustee sells its shares to a third party.*

Dina: If we take the position that we have a 10% shareholder of a CFC, the sale to the third party would be an indirect disposition under the PFIC rules. But in our example the 10% ownership only through constructive ownership, so while the statute seems to capture this it isn't clear and even if PFIC did apply the similar facts and circumstances test is used to ascertain the ownership and we would argue it is not ascertainable.

1. *Would the analysis change if local law requires capital gains of the trust to be allocated to principal and the trust only provides for discretionary income distributions for the next one hundred years?*

Dina: The argument would be even more compelling if the capital gain were allocated to principal and the trust only provided for income distributions for the next 100 years because the beneficiaries would have no prospect for ever receiving any of the capital gains from that sale.

(C) *Assume the same facts as in (B) above except that after such sale, the trustee reinvests the sales proceeds of the trust through an underlying holding company*.

1. *Analyze the U.S. federal income tax consequences and reporting requirements, if any, applicable to the U.S. beneficiaries as a result of the trustee reinvesting the sales proceeds through another holding company wholly-owned by the trust.*

Jane: In (C) we are assuming that the CFC, PFHC and PFIC rules do not apply and that the beneficiaries are not subject to tax under those regimes. In this case the trust would realize the gain at the trust level and it would be DNI that year and in subsequent years if not distributed it will be UNI. If the trustee continues to reinvest the sales proceeds through an underlying holding company they will continue to be problems with CFC, PFHC and PFIC. So we don't recommend that. Instead, we would suggest the new holding company make an election to be a disregarded entity for U.S. tax purposes. In that case we would eliminate the problems with PFHC, PFIC and CFC. Nevertheless if not distributed there will still be a problem for the beneficiaries down the line. So we prepared these charts in the supplement to illustrate the difference between distributing 50% of the income annual with catch up distributions in year 10 and 20 versus making distributions of 100% of the income annually

Would the analysis change if the new holding company had an election in effect to be treated as a disregarded entity for U.S. tax purposes?

Would the analysis change if the holding company distributes 50% of its current earnings to the trust each year, and the trust in turn distributes the same to its beneficiaries an din years 10 and 20, the holding company distributes all of its current and accumulated earnings to the trust and the trust in turn distributes the same to the beneficiaries.

Jane: There is a rule under 665 that there can never be an accumulation distribution in a year where the distribution does not exceed fiduciary accounting income. If the company makes a distribution of $26.8 million to the trust in the tenth year, even though that amount exceeds the DNI for that year the beneficiary will not be treated as receiving an accumulation distribution but rather will only be taxable on the DNI distribution in that tenth year which is $5.8 million.

Dina: So this rule lets you transfer more than $26 million of value to the beneficiary with the beneficiary only being subject to tax on the $5.8 million of DNI.

Jane: What we are basically doing in this example is allowing the trust to accumulate income and then permitting the trustee to distribute that accumulated income to the beneficiaries without any tax consequences.

Mr. Lawrence: It is much more favorable then if there would general distributions of all DNI ever year. Obviously this foreign stuff is very complicated. It is like multi-dimensional chess.

Would the analysis change if the holding company distributes 100% of its current earnings to the trust each year, and the trust, in turn, distributes the same to the beneficiaries? The chart illustrates the superiority of the 50% distribution.

Analyze the U.S. Federal income tax and reporting requirements, if any, applicable to U.S. beneficiaries who receive distributions of the earnings (current and accumulated) of the holding company which are distributed to the trust. The panel ran out of time and didn't cover this.

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Report 13

Thursday, January 8, 2004

2:00 - 3:30 p.m. - Special Sessions III

Session III-A CASE STUDY - Tax-Free Corporate Divisions in Family Business Succession Planning
Michael W. Bourland
Marcus P. Johnson

Reporter: Gene Zuspann Esq.

The panel discussed a long fact situation and the possibilities of restructuring to accomplish the family goals.

The attorney must first determine if a division is necessary. The adversity among family members may be personal rather than problems with the business. Sometimes the business as a whole is worth more than the sum of the parts, and if so, the division would reduce the value of the business.

Following the division, will the different companies do business only with each other? If they do, there may be an issue that the
division had no real business purpose and that the only reason for the division was a shareholder purpose. Remember that there must be a valid business purpose and a shareholder purpose alone is not enough to qualify for §355.

Keep a mind the problem if one of the 3 businesses (in this example the panel was using a 3 way split-up) has not been in business for five years. One of the requirements is that the business must have existed for 5 years ending on the date of the distribution. You may be able to work this out, but care is needed.

If the value of each division is not identical, there are several alternatives to consider.

- If one shareholder receives cash to equalize the division, the cash will be taxed as boot. If no cash changes hands, there is a gift. If there is boot, consideration should be given to the tax impact.

- You could use non-business assets in the distributing corporation to try and equalize the values, but there is a risk that the new corporation is not in a trade or business after the division if the amount of the non-business assets are significant. Problem assets are those that are not functional assets in the trade or business. The risk in this case is that the entire transaction could be jeopardized.

Debt in excess of basis is not a problem because §355 uses a §368 reorganization and (if I understand correctly) the debt in excess of basis rules in §357 do not apply.

Session III-E Premium Financing Techniques
Donald O. Jansen

Reporter: John Warnick Esq.

Reporter's Note: Due to the time constraints imposed in the regular session, Mr. Jansen was unable to fully cover his topic in the general session that was reported in Report No. 9. He picked up in the afternoon at p. 43 of his outline of approximately 80 pages. You will note that he took questions from the audience at several points during his workshop presentation. These questions have been italicized for convenience of the reader. During the workshop Mr. Jansen did not address the case study examples which were included in the Special Session materials.

The Economic Benefit Regime is analogous to the old endorsement split dollar arrangement. It will apply to split dollar arrangements entered into after 9/18/2003.

What are the economic benefits of adopting the new Economic Benefit Regime:
1. the cost of current life insurance protection is based on the term tables provided by the IRS (see Notice 2002-8 for the most recent IRS announcement)
2. the amount of the policy cash value to which the non-owner has current access
3. the value of the economic benefit to the extent not taken into account by the non-owner in a prior tax year.

If the cash value is directly or indirectly accessible to the non-owner, he has constructive receipt and he will be taxed on the equity build-up. He is deemed to have access to the cash value if he can withdraw or borrow such amount.

The cash value must be accessible to the owner/employer. We have to build into the contact full access for the employer to the cash value while the employee is alive. Mr. Jansen suggests that in a family arrangement the IRS may look past the terms of the arrangement.

The cash value must be accessible to the general creditors of the owner/employer. There are some states which protect the cash value of a life insurance policy from the claims of creditors of the owner. Perhaps in those states the split dollar arrangement should expressly allow access to the creditors of the owner.

What about a policy in which there is no equity but which pays a dividend to the employee rather than the owner/employer? Under the economic benefit regime the employee will be taxed on economic benefits such as dividends or policy loans in the year that he receives them and those amounts will be treated and taxed to the employer under Section 72 and to the non-owner according to what his relationship is with the owner - employee (compensation) trust(gift), etc.

P. 51 - 7a. he thinks this is a stretch and will be challenged in court.

P. 52 - 8 Non-owner's basis - "surprise"

p. 54 - You may ask who in his right mind would use economic benefit regime? There are quite a few people and two broad categories where Mr. Jansen sees this will be used frequently:

1. Executive compensation where there is no trust involved.

2. Switch-dollar. Why not use an economic benefit arrangement with the life insurance contact is owned by a trust but the cash value is owned entirely by the employer. Just before you reach a cross-over point, you switch over to the Loan Regime. The conversion when there is no equity should cause no income tax problem. But by delaying the switch to the loan regime we get to take advantage of the lower term costs of the Economic Benefit regime.

P. 55 - Section 162 Executive Bonus Plans. Employer bonuses the premium to the employee who owns the policy and all the cash value. If this is a large policy the cash value build-up may become significant in a relatively short period of time. With employers viewing these benefits as primarily a retirement supplement, they may want to impose restrictions upon the executive's access to the cash surrender value before he reaches his anticipated retirement age.

Many restricted access executive bonus plans have been developed. What are the income tax problems with these arrangements? Could the IRS argue that the executive restricted bonus plan is really a compensatory split dollar life insurance arrangement governed by the loan regime? If the restricted executive bonus plan has a vesting schedule, the issue will be whether the last two parts of the three part definition are met. This is not clear. Is the "reasonable person would expect the payment to be repaid in full" test met if repayment to the employer can occur before the executive is vested. Is the repayment "to be made from the policy's ...cash surrender value" test met although the separate agreement does not require the executive to use cash value for payment if the triggering event occurs before vesting but the policy contains an endorsement that the executive cannot access cash value without employer consent?

If the restricted access executive bonus plan not a split dollar arrangement then the premium would be taxed to the executive under general income tax principles under either Section 61 or Section 83.

Mr. Jansen suggests avoiding the outside vesting schedule if at all possible? Maybe the vesting schedule really doesn't give that much to the employer. But if the employer suggests using a vesting schedule, Mr. Jansen raised the question of whether the executive should consider making a IRC Section 83(b) election?

Does ERISA apply to the restricted access executive bonus plan? Recent DOL advisory opinions indicate that single employee plans are covered by ERISA. DOL. Adv. Op. 75-09; DOL Adv. Op. 79-75. Since 1987 most cases in this area have been impacted by the Supreme Court's decision in Fort Halifax Packing Company v. Coyne, 482 U.S 1 (1987). Some courts have found a nonqualified deferred compensation or welfare benefit granted to a single employee have found the plan to be covered by ERISA but others have reached a contrary result. To strengthen the argument that there is no ERISA plan, each restricted access executive bonus arrangement should be individually negotiated and perhaps included in the employment contract. Certainly it would be advisable not to have a general document which applies to all executives who meet certain requirements.

Even if you find that the restricted access executive bonus plan is it a welfare plan under ERISA or a Pension Benefit Plan under ERISA?

To avoid treatment as a welfare plan, the executive should always be the owner of the life insurance arrangement.
ERISA applies to a plan which provides retirement income to employees or results in deferral of income by employees for periods extending to the termination of covered employment or beyond. ERISA Section 3(2)(A).

If the restricted access executive bonus is treated as an employee pension plan, any vesting schedule should be designed to lapse well short of normal retirement age. Mr. Jansen uses the example of a ten year restriction for a 35 year old executive as one which should avoid characterization as a pension benefit plan.

If the plan is considered to be an employee pension plan, then there are numerous ERISA requirements you must contend with. If you can succeed in characterizing this restricted access executive bonus as an "unfunded top hat" arrangement applying to a select group of management or highly compensated employees, only a written plan containing items such as designation of a named fiduciary and setting forth a claims procedure is required. The requirement of filing an annual Form 5500 can be avoided if a single alternative statement is filed with the DOL as provided in ERISA Reg. Section 2520.104-23(b). The penalties for failure to file the annual report is substantial so it is highly recommended that the alternative statement be filed. Mr. Jansen suggested that it might also be desire to file a protective alternative statement within 120 days of the implementation of the plan to anticipate the possibility that the DOL might determine that the restricted access executive bonus is an unfunded top hat pension plan. Such a protective alternative statement might state that the employer doesn't think the plan is subject to ERISA but in case it should subject to ERISA, the statement is being filed.

NOTE: Mr. Jansen cautions that the "top hat" exemption is not applicable if the DOL determines the executive bonus plan is a funded rather than unfunded plan. This would be the result if DOL determines that the restricted cash value of the policy constitutes a plan asset funding a retirement plan.

Audience Question on Section 677(a)(3) - income is or may be applied to pay insurance premiums on the life of the grantor. Do you feel that we can rely on that to establish grantor trust status?

There are some older cases that indicate that this doesn't result in a grantor trust if it is a "dry trust" - that is the trust holds no assets other than the insurance policy. It clearly would be a grantor trust for ordinary income but might not be for capital gain purposes. The cases don't reach that point. Therefore, Mr. Jansen strongly feels that

Audience Follow-Up Question on Section 677(a)(3) What about putting the premiums in early and let them generate some income before paying the premiums?

Mr. Jansen feels this might help some but questions just how helpful it would be if the amount of income generated is rather inconsequential in relationship to the premium.

Mr. Jansen then returned to his outline and a discussion of Employer/Employee Joint Ownership - what if you start out with a 60/40 ownership split and what if over time they increase the ownership percentage of the executive? This might be combined with an executive bonus plan. This plan offers some of the advantages of the restricted access executive bonus plan. It isn't quite as useful for wealth transfer purposes because of the gift tax element.

And there is a practical problem, particularly with a variable policy, of tracking what is owned by each party at each point in time.
What are the income tax consequences of this joint ownership plan? Is it a split dollar life insurance arrangement? The split dollar life insurance regulations state that each owner will be treated as the owner of a separate contract to the extent of such person's undivided interest. But there is a

disturbing comment in the regulations which states that each person must have, at all time, all the incidents of ownership with respect to an undivided interest in an contract.

You can't have an arrangement where the employee owns 40% of all incidents of ownership of one portion of the policy and a split dollar arrangement as to the remaining 60%.

As the employer transfers an interest to the employee each year, there will be income to the employee each year with a corresponding deduction to the employer.

The key issue in transferring a fractional interest in the policy each year is what is the value of that interest. The regulations state that it is the cash surrender value. Don't try to take a minority interest discount. Mr. Jansen sees some clouds on the horizon. The IRS is becoming increasing dissatisfied with using cash value as the measure of value. Mr. Jansen points out that the new split dollar life insurance regulations raise a question. The original proposed regulations use the term "cash surrender value" but in the final regulations they removed the word "surrender". Elsewhere in the final regulations (in the discussion of economic benefit) they state "policy cash value is determined disregarding surrender charges or other similar charges or reductions." Although that definition doesn't literally apply to policy cash value, is it possible the IRS will attempt to use this methodology to value the transfer of a split ownership policy. If the undivided ownership is not a split dollar life insurance arrangement, then Section 83 or Section 61 should apply and the use of cash surrender value should be permitted.

What are the gift tax consequences of the Joint Ownership life insurance arrangement? The valuation of gifts of life insurance policies is calculated differently than under Section 61 or Section 83. For gift tax purposes the value of a life insurance contract is its actual cost or replacement cost.

What is the effect of the new split dollar life insurance regulations is on private split dollar where the arrangement is between the insured and a trust? The final regulations make it clear that the loan regime and economic benefit regime apply to private split dollar. If it is a grantor trust you should avoid the income tax consequences of a loan regime but you still have to deal with the gift tax consequences. Mr. Jansen would avoid the economic benefit regime for private split dollar arrangements because of the Section 2042 problems.

Friday, January 9, 2004

9:00 - 9:45 a.m.
State Death Tax Credit: Planning and Drafting in Light of Phase Out
Robert C. Pomeroy

Reporter: Gene Zuspann Esq.

When congress started phasing out the estate tax, they compensated in the early years by phasing out the state death credit faster than the federal reductions. The result is that there is no loss to the federal fisc in the early years of the repeal. In fact, the collections by the federal government are now larger than they were before the phase out started.

This has caused a substantial loss to the states that has occurred very quickly. The materials include a table showing the current status of all 50 states. He noted that Oregon and Pennsylvania have since modified their laws.

He quickly discussed the differences in the laws in a number of the states that are decoupled. The different approaches vary widely,
are already in place in a number of states and other states either have or anticipate bills to change the law.

Planning for death-time transfers:

He does not think that the planning for a single person will change much - the estate is going to pay more tax. However, changes in the marital deduction planning will need to be considered. In decoupled states, the alternatives are to pay the state tax that arises for the difference between the federal and state exemptions, or to underfund the marital deduction. The client must consider the benefit of paying money to the state on the first death to avoid a higher federal tax in the second estate, as opposed to paying no tax at the first death and relying on continued changes in the law (or a complete repeal of the estate tax) that eliminates the tax on the second death.

He discussed 3 choices to consider and the decision will affect the formula clause for the marital deduction planning:

- Minimum total tax

- Minimum federal tax taking state death tax credit into account only to extent it does not increase state taxes. You must be careful with this kind of formula where there is property in multiple states and the laws in the states vary. He gave several examples. The result seems to be that you need to crunch the numbers to obtain an answer and advise the client that the results will change as assets and values in the various states change.

The basic issue/decision is how you fund your marital deduction amount.

- Minimum federal tax

Consideration of the effect of using the applicable exclusion amount during life to reduce the total tax. There are several alternatives that can accomplish this result, if the client will consent.

- Do an inter vivos stand-by credit shelter trust, funding such a trust shortly before the client's death. The trust would be funded with the client's applicable exclusion amount. This strategy is attractive in estates with pre-EGTRRA state death tax credit if the state does not have gift tax or tax gifts in contemplation of death.

This planning could be accomplished with a durable power of attorney (to a disinterested person) to make very sizable gifts to the objects of the client's bounty or a trust for their benefit. For example, a $10,000,000 gift (in 2007) made the week before the client's death might save $880,000 in taxes. If the assets are low basis assets, the agent could borrow on the assets and sell them after the death of the donor, repaying the loan.

- If the client does not believe repeal is really going to occur, or will not survive until 2010, gifts which incur federal gift tax continue to be attractive. The client will have to survive three years to keep the gift tax out of the estate.

- A client could consider a change of domicile if the state death taxes are very high. The materials contain an extensive appendix listing recommended actions for changing domicile to a new state.

If the assets are not portable, the assets in the former state may be put in an LLC or other entity form. The intangible should be taxable in the state of the domicile. He points out that this strategy may not be effective in all states. He does suggest filing something with the former state showing the change in domicile so that a large penalty and interest does not attach later in the event the former state determines that this approach does not work.

At the moment, the states are acting independently in dealing with the change in the state death tax credit. Because of these actions by the states, and the lack of a possibility that a unified approach can be adopted in the near term, the estate planner will have to take the different laws of the states into account in the planning.

9:45 - 10:30 a.m.
Old Age with Fears and Ills: Planning for the Very Old Client
Lawrence A. Frolik

Reporter: Gene Zuspann Esq.

He classifies old as 85. He also points out that most of these people are women. One-half of women alive at age 65 live to age 85. In men age 65, the anticipated expectancy of being alive at 85 is 30%.

In counseling, the attorney must realize that time is of the essence. Both the client and the attorney should put the estate plan on a fast track. The client may not only die, but has the potential for dementia. One problem with many clients is the fear of making a mistake and of making changes. The attorney has to work through this problem to complete the engagement.

The client also may have physical infirmities. There are many things that the attorney needs to keep in mind in working with the older client.

- Use a series of short meetings. It is often a strain on the client just to get to the office.

- Many clients are less sharp in the late afternoon (sundowning). Schedule meetings in the morning and early afternoon.

- Consider going to their home.

- Many have hearing problems. Do not have any background noise.

- Sit next to them at a small table - do not have the conference across your desk. Have firm chairs.

- Loss of vision often causes problems. Do not bother with demonstrations on your computer screen. It is often difficult for them to see and older clients are not comfortable with this method. Do it the old way (pencil and paper).

- Because of short-term memory problems, prepare a written outline or simple explanations of what was presented at prior meetings and what is to be addressed at the next meeting.

- Problems with financial realities. Example: Client suggests a generous gift of $5,000 when client is worth $5,000,000. You need to suggest this may not be seen as generous and point out the cost of things now - a basic car costs $20,000.

- Some clients will not be able to understand the concepts of a complex plan. Most clients to not understand the detail of such a plan, but they do understand the concepts. Be careful of a claim of undue influence.

Psychological barriers.

- Be alert to depression or dementia. The most common symptom of dementia is diminished short-term memory.

- Talk with other family members (who are almost always involved with a very old client) about depression.

- You may want to use a mini-competency test. Some attorneys use these much of the time with the statement "Let's clear this up so we have no problems." Who is the current president of the U.S.; count backwards from 100 by 7, etc.

- Realize that an physically disabled spouse may not have the same goals as the well spouse.

- What are the client's attitudes toward death - some are fatalistic and not protective enough about their own financial well-being.

- Some are too fearful of the details that they fail to make the large decisions, i.e. too concerned with dividing the personal effects.
Try to narrow the range of choices to 2 or 3 alternatives, execute the plan, and put off such detail decisions.

- Put the desires in a perspective that the client can understand - "You want to provide enough money for your 3 grandchildren to go to any college they want," rather than "you should set aside $337,000."

Older clients often use gentler terms to express their feelings. The older client says "I am frustrated with my son." A younger client might say "I am mad as hell at my son." You need to clarify the client's attitude.

The "hide the asset" game.

- Some clients hide or hoard cash, i.e. cash in books in the library.

- Some older clients have multiple bank accounts and multiple brokers. There is no intent to hide the asset, but finding all of the assets can be difficult when the client does not remember all of the assets. Get the income tax returns and if a spouse has died, get a copy of assets in the deceased spouse's estate.

- Are there assets with an emotional significance.

- Titling of assets can be a problem. Avoid devising a plan that is dependent upon the client taking steps to rearrange assets unless you are sure these actions can be completed.

Tangled Families.

- As the client grows older, their family may not resemble a tree, but rather a tangled bush.

- The very old client will have old children. The children are probably already between 50 and 65 and the grandchildren are often in their 30's. Is a plan, "all to my children" fair or equitable when you have "hard" data about the children.

- Be cognizant of the lifestyles of the lower generations - the faults and problems of the children and grandchildren. Often this information is not well known to the client, especially when the issue is the grandchildren. If there are controversial facts, should the client be told?

This presentation was enjoyable with a lot of dry humor - a good program at the end of a long week of information overload.

10:45 a.m. - 12:00 p.m.
CASE STUDY - Grand Finale - Implementing Bright Ideas
Ellen K. Harrison
Jerome M. Hesch
S. Stacy Eastland

Reporter: Jason Havens Esq.

Ellen gave some overview comments on the current estate planning environment, including potential repeal of the estate and GST taxes, techniques in a low interest rate environment, financing life insurance, the use of FLPs, Circular 230, and more.

Ellen highlighted the considerations involved in approaching estate planning (page 3 9 factors).

Stacy's problems:

Stacy emphasized the 15% tax as a "window of opportunity" for closely-held businesses. He suggested the use of a disproportionate redemption. The cash distributed would be taxed at 15%.

Sam and Sally Selfmade

Illustration A: Disproportionate redemption: Use a loan, distribute the cash after a recapitalization of the entity, redeem Sam's and Sally's non-voting shares, and then contribute the cash to an FLP.

Calculations (page 4): Roughly a $500M savings due to estate tax savings even though 15% income tax paid, and Sam and Sally are still in control. Risk: Defined-value clauses transferring non-voting shares and then gifting over any remaining amounts to GRATs (not "zeroed-out" in this situation). Tax risk: Could be mitigated with lesser discount (30% instead of 40%) still get major advantage with "freeze" (where real savings is).

Jerry's problems: Example 8 (page 10):

Family C corporation with marketable securities

Solution: Merge private C corporation into public corporation in a tax-free merger (A reorg.) (carry-over basis to public shares). Ross Perot did this with his company and was issued a special class of preferred stock (with a dividend) by General Motors. Could then engage in loans and reinvest in other investments.

Ellen's problems: Leveraged redemption with CLAT (page 14):

Susan owns limited partnership interest. Partnership borrows $2.7M and redeems 90% of Susan's interest for cash allocated to her so that basis used (by Susan's guarantee of loan). Then Susan has no gain. She can invest in other investments. Susan can then pursue further discount planning: a new FLP and a CLAT. (Corrections to Ellen's materials: Left with a 13% interest in the original partnership because 6% of a smaller partnership post-redemption; changes numbers through rest of example.)

Stacy's problems: Example 2: Simulated CRT:

Illustration B: Using a single-member LLC and giving 99% to public charity (or FL). Then exchange ownership interest for joint-and-survivor annuity. 514 requires 10% or more gift element or else "acquisition indebtedness." Also Rev. Rul. 98-15, where IRS imposes aggregate theory of partnerships; charitable deduction allowed if charities not in control of partnership.

Stacy and Jerry: Premium financing:

Create an FLP and a preferred interest to parents. Take some and give away. Take rest and sell for note. Partnership then buys insurance policy and uses cash to purchase that policy.

____

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Report 14

THURSDAY, JANUARY 8, 2004 (CONTINUED)

Reporter: John Warnick Esq.

11:30 a.m. - 12:15 p.m.
Tax Shelters - The Ethical Dilemma
Andrew H. Weinstein

He did not follow the outline but rather provided an overview of the new tax shelter regulations and the related enforcement provisions.

The outline materials were only up-to-date through November. There are significant developments which took place at the end of December. By January they will have updated materials which will be made available to all attendees who request the updated outline by e-mail [to Holland & Knight].

What is the ethical dilemma involving tax shelters? It has been suggested that there is no ethical dilemma because tax shelters are unethical per se or there is no ethics in the marketing of tax shelters.

When he first started looking at tax shelters in the 70's it was easy to spot a tax shelter. Anyone could look at the shelters and tell they were bogus. By the 1990's the IRS's focus was on collection and there were many strategies which technically didn't appear to be tax shelters. These new transactions were sophisticated and at least offered the appearance of being grounded within the code.

Now we all have to worry and what do we do about it?

He doesn't have a magic formula. But it starts with one simple premise: Please guide yourself appropriately.

The Office of Tax Shelter Analysis ("OTSA")is the focal point for the IRS' tax shelter compliance initiative. OTSA is headed by Nicholas J. DeNovio who will join me this afternoon in the workshop. He is responsible for planning and coordinating tax shelter initiatives. OTSA generally serves as a clearing house for information reported to or through the IRS through taxpayer and promoter disclosures.

In 2001 the IRS announced an anti-tax shelter initiative. This was focused on disclosure, guidance and perhaps most importantly increased tax shelter training for agents. This strategy was supplemented in 2003 with its continuing pursuit of promoters, targeted audits and litigation against taxpayers and its offering of settlement initiatives.

Mr. Weinstein noted that a meaningful discussion of whether the substance of a tax strategy will be respected by the IRS is beyond the scope of his presentation. He was going to discuss estate planning considerations, the tax shelter regulations and the consequences to taxpayers if the tax consequences of their strategy are not respected. He will also discuss list maintenance, penalties, and ethics. He will not cover registration of tax shelters.

What we need to understand is how the substantive law affects our clients:
1. Will the transaction trigger the tax shelter regulations;
2. Whether the taxpayer's tax position will be respected;
3. The consequences to the taxpayer if his position is not respected; and
4. Claims of privilege.

Second, we must understand how the substantive law affects us as advisors
1. Whether our advice on the tax advice of the transaction is correct;
2. Whether the transaction will trigger obligations for us as advisors under the tax shelter regulations;
3. Whether we will be subject to penalties under the regulations or under revised Circular 230; and
4. Claims of privilege.

Third, we must understand our ethical obligations. Tax shelter rules make our ethical duties more complicated. Especially if we are called upon to render an opinion.

Mr. Weinstein's hope is that after he has concluded his remarks that we will understand how the tax shelter regulations affect us and our clients and we will understand what we must do and should do to meet these new requirements.

Estate planning considerations

So far the focus of the IRS has been on the identification and dismantling of tax shelters. Designers and promoters of tax shelters are looking for uncharted territory. To date the IRS focus has been on income tax shelters. But logic suggests that we should see a growing number of transfer tax shelters promoted to our clients. Promoters will contact us as the closest advisors to high net worth individuals. They will present us with products, ideas and concepts and ask us to introduce them to our clients.

Eventually the IRS focus will reach estate and gift tax matters. The IRS is estimating that estate and gift tax matters will be the third highest area of growth for accounting firms.

The IRS focus on transfer tax shelters is in its infancy. But there are certain abusive trust strategies which the IRS has identified. The characteristics that the IRS is looking for include: reduction or elimination of tax; deductions for personal expenses paid by the trust; depreciation deductions of an owner's personal residence; stepped-up basis for property transferred to a trust; reduction or elimination of self-employment taxes; reduction or elimination of gift and/or estate taxes. While specific guidance has not been issued by the IRS, Mr. Weinstein feels we should anticipate the IRS to pay increasing attention to abusive trust and abusive insurance transactions which significantly reduce any type of tax.

Estate planners must be aware of what will trigger the tax shelter regulations.

The current IRS regulations are not triggered by most transfer tax strategies unless they are substantially similar to listed transactions or fit into one of the other five categories of reportable transactions. In the afternoon session we will be discussing with Nick what "substantial similarity" means.

What is a tax shelter? "It is a deal done by very smart people which absent tax considerations would be considered very stupid." The good tax shelters do have economic benefits. So those of us who thought that we only had to test a tax shelter for economic substance, need to realize that we have to learn how to ride our bikes again.

The final tax shelter regulations were issued in February 2003. Even the application of these regulations depends on whether a transaction is deemed a reportable transaction. The substantive merits of the taxpayer's position have nothing to do with whether the tax shelter regulations apply.

Think of tax shelters not as a definable term but as a concept. The concept is a transaction that complies with the black letter of the code but violates the spirit of the code.

For instance , § 6662 (the accuracy related penalties) defines "tax shelter" as basically any plan which has tax avoidance as a significant purpose. This could cover virtually anything the estate planner does.

The tax shelter disclosure regulations do not have a definition of tax shelter. Rather their application depends on whether the transaction is a "reportable transaction".

The List Maintenance regulations apply to "abusive tax shelters", a term which is defined as "confidential corporate transactions" and "reportable transactions." Neither of these terms are similar to the definition in § 6662.

Mr. Weinstein strongly suggested you look at the Winter 2002 issue of the Tax Law Review and particularly the article entitled "Ten Truths About Tax Shelters" by Professor David Weisback. The following are paraphrased highlights of comments from Professor Weisback as quoted by Mr. Weinstein in his talk.

"There is no constitutional right to engage in tax planning"

"The right to minimize taxes is not a basis principle of moral philosophy".

"Tax planning does not rank with freedom of thought, speech, association or religion."

"There is no social benefit to tax planning...tax planning is like polluting because polluters pollute too much."

"Tax advisors do, however, serve a few socially valuable functions in limited tax planning situations, in adversarial practice and in compliance."

"Tax planning deserves little or no protection. Disclosure is not enough. It just increases complexity, eliminates the tax shelter 'du jour' and makes the law even more unstable."

Treasury issued the final tax shelter regulations in February, 2003. The regulations basically require three things: disclosure by taxpayers, list maintenance by tax advisors and promoters, and registration by promoters and sellers. The regulations are intentionally overbroad.

A tax professional's failure to advise a client on the necessity of disclosure can have serious consequences. The tax advisor must be mindful of the fees received in order to comply with the list maintenance requirements. The tax advisor also needs to be aware of the limits on privilege. The regulations are clearly a trap for the unwary.

Disclosure statements (Form 8886) must be filed by taxpayers who participate in "reportable transactions".

There is a four prong analysis to determine if disclosure is necessary. (SEE 14-6) The critical date for this analysis is whether the transaction was entered into on or after February 28, 2003. Reporter's Note: in the materials at footnote 26 citing Treas. Reg. § 1.6011-4(b)(2) Mr. Weinstein offers this comment: "If a transaction involving estate or gift tax entered into on or after January 1, 2003 is identified as a listed transaction in published guidance, the transaction must be disclosed in the matter described in such published guidance."

If the answer to all four questions in this analysis is in the affirmative then the taxpayer must disclose.

Reportable transactions don't have any connection to whether the transaction has a defensible tax position.

There are six categories of reportable transactions: listed transactions; confidential transactions; transactions with contractual protection; loss transactions; transactions with a significant book-tax difference; and transactions involving a brief asset holding period. (SEE 14-7)

The IRS is going to give "green light notices" for transactions which the IRS determines are legitimate. The IRS is also going to try to give advance notice to taxpayers of transactions which it considers abusive. "Yellow flag" notices will be issued when the IRS determines it is likely to issue guidance in a particular area. "Red light" notices will be issued for transactions which the IRS considers abusive tax shelters, and will most likely include these strategies within the "Listed Transactions" category.

A "Listed transaction" is a transaction which is the *same or substantially similar* to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction. The most recent comprehensive publication of the transactions the IRS has identified as "listed transactions" is Notice 2003-76 which identified 24 transactions. The latest guidance is Notice 2004-8 dealing with abusive Roth IRA transactions. The IRS also posts a list on its web site.

The listed transactions cover a wide variety of fact patterns. Here is a list of some of these transactions that should be of particular interest to estate planners: 1) deductions for contributions to retirement plans; 2) allocation of income to tax different parties; 3) distributions from charitable remainder trusts; 4) artificial inflation of outside partnership basis; 5) Guam trusts; 6) selling corporate assets through an intermediary; 7) 351 contribution of high basis assets; 8) reinsurance arrangements; and 9) trusts for contested liabilities. The materials' list is current only through November, 2003. See 14-7 to 14-11.

The second category of reportable transactions is "confidential transactions." This has been the

subject of considerable controversy.
Under the original rule there were two situations where the definition of confidentiality was met: 1) if the taxpayer's disclosure of the tax treatment was limited in any way or 2) if the taxpayers knows or has reason to know that his use or disclosure of the information relating to the tax consequences is limited in any other manner for the benefit of any person who is making a statement about the potential tax consequences.

Under the original definition standard personal injury settlement agreements were caught if they contained language regarding tax effects or treatment of the payments.

Originally it was contemplated there would be a carve out of specific transactions.

Under the new rules which were issued in December 2003 (and which are not covered in the materials handed out at Heckerling) a "confidential transaction" is defined as a transaction offered to a taxpayer under conditions of confidentiality where the taxpayer has paid a minimum fee to an advisor. Conditions of confidentiality exist only when the advisor who receives the minimum fee imposes the limitation on disclosure to protect the advisor's tax strategies. The fact that the confidentiality is not legally binding on the taxpayer is not relevant. The new definition significantly narrows the breadth of the definition and should narrow the concern over the scope of this rule. .

Mr. Weinstein skipped the discussion of the last four categories of reportable transactions as they are adequately covered in the outline in order to focus on disclosure which he feels is very important.

What are the consequences of a taxpayer entering into a reportable transaction? The taxpayer must file a disclosure statement on Form 8886 to his tax return. The taxpayer must retain copies of all documents relating to the transaction until the expiration of the statute of limitations. If a transaction the taxpayer has entered into becomes a listed transaction after the taxpayer entered into the transaction, then the taxpayer must file a disclosure statement to his next tax return if the statute of limitations for the listed transaction has not yet expired.

If you are unsure, file a protective disclosure statement. Failing to disclose significantly increases the likelihood of penalties. Failure to disclose is a strong demonstration of a lack of good faith on the part of the taxpayer.

Disclosure may prompt some type of activity by the IRS such as audit. At this point we don't know exactly what type of IRS activity will occur upon disclosure as the regulations are new. Clients should expect the worst.

How should we advise our clients. Look to the proposed revisions to Circular 230. These are very important. As a tax advisor you should complete a substantive analysis of the tax consequences of the transaction. You should feel comfortable advising them on the substantive merits of the transaction.

The guidance issued by the IRS may serve as authority to invalidate the tax treatment.

The failure to disclose a reportable transaction significantly increases a taxpayer's penalty exposure. § 6662 imposes the accuracy related penalties. Substantial authority for the tax position is usually a defense to the accuracy related penalties. The taxpayer must have a reasonable believe that the tax treatment is "more likely than not".

Even in the case of a tax shelter, the understatement penalty is generally avoid when the taxpayer can demonstrate that there was reasonable cause for the underpayment and that he acted in good faith. Reasonable cause exists when a taxpayer reasonably and in good faith relies on an opinion basis on a professional tax advisor's analysis of the relevant law and facts if the advisor unambiguously concludes that there is a greater than 50% likelihood (the more likely than not standard) that the treatment of the item will be sustained by the IRS.

Under the rules proposed on December 29, 2003, a taxpayer's failure to disclose is a strong indication that the taxpayer failed to act in good faith. Thus the failure to disclose would generally make the taxpayer ineligible for the reasonable cause exception to the imposition of penalties.

Taxpayers should construe the regulations broadly in favor of disclosure.

In its release of the new rules the IRS has announced it will not accept, as evidence of good faith or reasonable cause, reliance on a tax shelter opinion from a tax adviser with a financial interest in the tax shelter or a pre-existing referral agreement with the tax shelter promoter.

Taxpayers engaging in reportable transactions may find themselves facing the fraud penalty and this would be especially so in the context of listed transactions. Mr. Weinstein mentions this by way of future caution because he has seen references to penalties up to 75% and that is the fraud penalty.

List Maintenance rules apply to advisors and promoters - have limited application because of the level of fees that must be received. The rules are discussed in detail in the outline. The fee threshold for advice provided to a non-corporate taxpayer is $50,000 but it is reduced to $10,000 in the case of a listed transaction. All fees for services or advice, whether or not tax advise, in the implementation of the transaction are taken into account. Failure to comply with the List Maintenance rules gives rise to penalties of up to $100,000 per year.

It is recommended that advisors who are subject to List Maintenance requirements fairly and openly advise their clients of this requirement prior to the client entering into the transaction. That warning must include details on what information will be on the list and that it must be given to the IRS upon request, and that if given to the IRS the client should expect an inquiry or audit from the IRS.

Privilege and Work Product Claims. We need to be honest with our clients and bring their expectations of privacy down to the new reality we face as a result of the expansion of the IRS summons power. For now we should assume the identity of a client participating in a tax shelter is not privileged. We need to proceed with caution until the privilege and the work product claims are resolved. We need to be honest with our clients and bring their expectations down to reality. This will reduce countless client conflicts down the line and once clients know what to expect they can act within those parameters. This will no doubt make our malpractice carriers happy as well.

Mr. Weinstein closed with a discussion of the ethical considerations. Circular 230 contains guidelines that an advisor must follow in practice before the IRS. It is obvious that the IRS is going in a certain direction and that is to beef up the best practices it expects from advisors representing taxpayers before it. It mandates disclosure of an advisor's referral agreement or financial interest in the transaction. Disclosure should also be made to the client that the client may not rely on the opinion of any non-independent advisor.

Revised Circular 230 adopts the broad definition of tax shelter contained in § 6662.

We now need to review Circular 230 whenever we are advising a client with respect to a tax shelter or whenever we are preparing a tax opinion. Violations of Circular 230 in connection with tax shelters are punishable by suspension or disbarment if the violation is reckless, willful or the result of gross incompetence.

Disciplinary action begins with the referral of professional misconduct to the Office of Professional Responsibility. The IRS has significantly beefed up their Office of Professional Responsibility. It conducts an informal review. Then it notifies the practitioner and provides the practitioner with an opportunity to respond to the allegations. If the Office of Professional Responsibility institutes a formal proceeding for suspension or disbarment that proceeding takes place before an administrative law judge, whose opinion can be appealed to the Secretary of The Treasury and ultimately to Federal District Court. Mr. Weinstein's advise is to "stay away".
Mr. Weinstein has personally watched through the Standards of Tax Practice Committee of the American Bar Association the evolution of the activity involving the IRS' Office of Professional Responsibility. He feels that we should look forward to substantial enforcement efforts. Until now IRS enforcement has been sporadic. That is now going to change.

He then quoted Commissioner Everson's attack on "fast and loose attorneys" as quoted in David K. Johnston's article in the December 29, 2003 issue of the New York Times

How do the Model Rules apply to us. We must provide timely and competent advice. We must learn and understand what transactions will trigger the tax shelter regulations. It is not an easy task. The sheer volume and technical difficulty involved in conducting a tax shelter analysis is something we now must do. Lawyers are not to assist a client in conduct the attorney knows is criminal or fraudulent. The commentary to Model Rule 1.2(d) explains that this rule applies whether or not the defrauded party (i.e., the IRS) is a party to the transaction, and specifically prohibits a lawyer's participation in a transaction which results in the criminal or fraudulent avoidance of tax liabilities.

Mr. Weinstein cautions that we must ask ourselves: 1) does this rule create an affirmative duty to third parties such as the IRS? 2) is a lawyer's ability to offer advice that falls short of being criminal or fraudulent restricted? Is the fact that the activity is not criminal or fraudulent adequate support for a favorable tax opinion.

Mr. Weinstein also raises the issue of what are the estate planning attorney's responsibilities in the context of the valuation of assets in connection with estate planning transactions. Can the attorney assist the appraiser? Can the attorney indicate to the appraiser that the client needs a low appraisal? Should the attorney recommend an appraiser that he knows will be more accommodating to the client's wishes?

Model Rule 1.4 explains the requirements for proper communications with a client. What type of information should a client know about a tax transaction to make an informed decision? Is the fact that the client may be required to file a disclosure statement with his tax return something the client should be informed of. Mr. Weinstein challenges us to think of what we consider to be "best practices" with regards to the level of disclosure to our clients.

As Mr. Weinstein concluded his remarks Thursday morning, he asked, "is it buyer beware or is it advisor beware?"

****

2:00 - 3:30 p.m. - Special Sessions III
Session III-C - Tax Shelters - The Ethical Dilemma
Andrew H. Weinstein
Nicholas J. DeNovio

[**Ed. Note:** These materials are still in the process of being prepared. If they become available in time, they will be sent as part of the Final Report, Report No. 15]

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Report 15

This is our Final Report from Heckerling 2004. We hope you have enjoyed these Reports again this year as much as we have enjoyed bringing them to you. As the Editor, I want to take this occasions to thank all of our hard working Reporters (whose names are listed immediately above) for all of their diligent work in attending so many sessions then staying up late at night or rising early in the morning in order to submit their reports to me in writing for final editing and publishing. This effort would not have been possible without all their help.

Perhaps the most important thing to report now are the dates for the 39th Annual Heckerling Institute in 2005. Those dates are January 10 -14, 2005, so mark your calendars now.

Next, here is the **final report** from the **Exhibit Hall** about all the software and other vendors who were present this year exhibiting their new and improved products. This report comes to you courtesy of Reporters Jason Havens Esq., Gene Zuspann Esq. and your's truly:

A. CALCULATION AND DRAFTING SOFTWARE:

1. **authoritative.net** (http://www.authoritative.net): Jeff Pickard, creator of zCalc, is in the process of providing a "one-stop shop" for estate planning attorneys. His new service, authoritative.net, will not only allow users to access the zCalc Suite, including the zCalc Toolbox and Presentations, but will also feature the following: (a) **Document Systems**, including an estate planning drafting system that is being authored by Professor Stanley D. Neeleman (J. Reuben Clark Law School at Brigham Young University and formerly a partner at Holme, Roberts & Owen, Denver, Colorado) and also a business entity formation drafting system, (b) **File Cabinet**, a document storage system, and (c) **File Backup**, an electronic "vault" for safe, secure storage of electronic data. More information is available via the authoritative.net toll-free telephone number: 888-552-4477. The estate planning drafting system is allegedly being built on a "next generation" document automation platform called Oban, but we do not know much about this platform or how it compares to HotDocs 6.0 at the present time.

2. **Brentmark** (http://www.brentmark.com): As previously mentioned, Brentmark will continue to support **EPLAN** (TM) (acquired from U.S. Trust). Those of you who have used EPLAN will recall that it is very robust and handles most estate planning calculations and illustrations. Brentmark has future plans to make EPLAN more user-friendly like other Brentmark products. However, Brentmark will await the status of potential legislative changes before it embarks on such development changes. The status of the former US Trust Form 706 program is not know at this time.

3. **WealthTec** (R) (http://www.wealthtec.com): Howard Eisenberg, who works with the zCalc/authoritative.net folks (who were distributing information sheets at Heckerling on Howard's behalf), has created several powerful programs under his WealthTec umbrella. First, **Dimensions** (TM) (http://www.wealthtec.com/wealthtec_dimensions.htm) is used to capture the client's asset and income information. Second, **WealthMaster** (TM) (http://www.wealthtec.com/wealthtec_wealthmaster.htm) can model numerous estate planning techniques, from A-B trusts to ILITs to numerous charitable trusts. Third,

Foundations (TM) (http://www.wealthtec.com/wealthtec_foundations.htm) augments WealthMaster to build highly-sophisticated financial and estate planning illustrations for affluent clients by comparing up to three plans side-by-side. All of these programs are included in the WealthTec one-year subscription at a price of $1,195 (see http://www.wealthtec.com/wealthtec_subscription.htm). This entitles the user to a one-year license, which must be renewed in order to continue using the product. Fully-functional demo versions are available for a free 45-day trial period: http://www.wealthtec.com/wealthtec_demo.htm.

B. JUST DRAFTING SOFTWARE:

1. **EstateDoc Systems** (http://www.EstateDocSystems.com): Brian Albee and EstateDoc Systems have introduced **TrustDocs** (TM). TrustDocs is endorsed and has been designed with Steve Oshins, Esq., a well-known, widely published estate planning attorney in Las Vegas, Nevada. TrustDocs operates on the HotDocs platform and is designed to produce an entire revocable living trusts estate plans, including the trusts, pour-over wills, and disability planning documents, in one single Microsoft Word document. Navigation within TrustDocs is very efficient, using "buttons" to move through each menu-driven level of the data input phase. Error messages alert the user if a question has not been answered. Binders and tabs for presenting the plan to clients are also available, so all the user has to do is print the entire Word file on hole-punch paper and then insert the pages and the tabs into the binders.

TrustDocs requires a one-time initial membership fee of $995 for a single firm license (with a 45-day trial period). The subscription plans are priced at $245 monthly, $698 quarterly (5% discount), $1,323 semi-annually (10% discount), or $2,499 annually (15% discount). TrustDocs requires HotDocs (R) version 6.1 (or more recent) and Microsoft (R) Word (TM) 2000 (or more recent).

(**ED NOTE**: We regret that EstateDoc Systems was erroneously reported to produce tax preparation software in Report #7, which is not the case. EstateDoc Systems only focuses on document production.)

2. **WealthDocs** by WealthCounsel (http://www.wealthcounsel.com): WealthCounsel was back at Heckerling for the third year in a row, this time marketing the latest Version 6 update of it's HotDocs based document assembly system called WealthDocs. WealthDocs actually consists of eight separate practice systems, those being for Wills, Living Trusts, Irrevocable Trusts, Charitable Planning, Family Limited Partnerships, Split-Interest Trusts, Special Needs Trusts and Retirement Trusts. This latest version of WealthDocs is designed to be used with the newest Version 6.0 of HotDocs, which can be ordered from WealthCounsel by members at a discount. The cost to join WealthCounsel and obtain their software and secure access to their Knowledge Base currently is either $3,900 down plus $390 per month for 12 months or a one-time discounted up-front fee of $7,900 for the first year.

3. **Wealth Transfer Planning** (WTP) by InterActive Legal Systems (ILS) (http://www.ilsdocs.com): After reviewing Wealth Transfer Planning (WTP), we are still impressed by its language and features. The updated WTP system includes a joint revocable trust (for use in community and separate property states), "anti-Strangi" amendments for FLPs and FLLCs, more charitable trusts than previously offered, and helpful "Practitioner Concept Memos." Although WTP is still built on the Smart Words document assembly engine and word processing system, Mr. Blattmachr commented that WTP might be offered on a different engine in the not-too-distant future. Rumor has it that engine could end up being either HotDocs or Ghost Fill. For those of you who are interested in subscribing to the current version of WTP, a basic subscription costs $2,995 for a single

seat or $3,595 for a single user network plus $295 for each additional network user. An enterprise-wide 4 office/30 user subscription is available for $19.995. An optional premium support package is also available for an additional cost of $1,295 for a single user and $1,595 for a network plus $99 per each additional network user.

In addition, ILS has recently announced a new product, called "Coping with Strangi," in which Jonathan Blattmachr discusses the recent Strangi II decision, its impact on estate planning, and strategies to employ to help avoid its impact. Through a unique multi-media presentation, Mr. Blattmachr delivers materials that will help you immediately apply his strategies to your estate planning practice. The Coping with Strangi module is a two-disk set (DVD video and CD-ROM) and includes:

· 30-minute substantive lecture by Jonathan Blattmachr (video on DVD-CD)
· 30-minute PowerPointTM slide presentation recapping the issues and providing specific recommendations
· Sample notification letter to your clients
· Sample notification letter to your advisors and other allied professionals
· Sample article for publication in your client newsletter
· Detailed substance outline, with cases and citations

The sample forms are in MS WordTM and Adobe AcrobatTM formats. In addition, this program has been approved for .5 CLE credit hours in New York and Florida, and credit is pending in other states. The product retails for $199.00, but ILS is distributing a copy free of charge to all Wealth Transfer Planning subscribers as their our way of thanking them for their business and continued support.

Lastly, your Editor had an opportunity to have a brief conversation with Natalie Choate today about the current status of her **DistribuGuide**(tm) program that the WTP folks used to sell when the WTP program was initially affiliated with and being supported by The Technology Group. She advised me that she had some discussions with Jonathan about ILS continuing to produce and support this program for her, but that no final decisions were ever reached, so she has recently licensed her employee benefit beneficiary forms to WealthCounsel to use as part of their WealthDocs Retirement Trusts system.

C. TRUST ACCOUNTING & RELATED ADMINISTRATION SOFTWARE:

1. **DataTech SoftWare, Inc.** (continued): As previously mentioned, DataTech's **Quick & Easy** (TM) (http://www.quickandeasy.com) (tax preparation) now offers a complete suite of estate administration tools called **Estate.suite** (TM) (http://www.estatesuite.com/). Estate.suite truly combines estate administration systems into one easy-to-use suite. The intuitive programming within Estate.suite intuitively allows you to enter more or less information, depending on your needs. Users can "drill down" into more detailed fields or, if more details are not necessary, remain on the top level. Users can easily create asset accounts, make partial or final distributions, use multi-value accounting (e.g., date-of-death, alternate valuation, current, or other values for a single asset), create joint ownership assets, and perform predefined or custom transactions. All of this occurs in a real-time relational data context. In other words, users do not need to worry about verifying that a transaction automatically changed the value of the remaining asset or account. Users can easily track parties, creditors, and fiduciaries. The MasterTicklers feature is very handy to remind users when tasks need to be accomplished and enables tracking of those ticklers and tasks.

The beauty of Estate.suite is the inclusion of every aspect of estate administration software: Quick & Easy Heritance Estate Administration System with Fiduciary Accounting and Probate, Quick & Easy State-Specific Estate/Inheritance/Probate Automated Forms, Quick & Easy Federal Estate Automated Forms (706, 709, and more), and Quick & Easy Federal 1041 Automated Forms. All of these systems can be tracked via the global reporting tools, which even track user activity within the Estate.suite system. These reports are exportable to a variety of formats including PDF, Microsoft (R) Excel (TM), text, rich text, Microsoft Word, HTML, or XML. For more information, please contact Crystal Lauver at crystal@thinkdocs.com.

2. **EstateWorks** (http://www.estateworks.com) (continued): EstateWorks has made several enhancements to its web-based estate administration system. A "favorites" area now allows users to store their bookmarks and create portals to other sites that he or she uses regularly. You can also customize team roles, which allows definitions inside or outside of the law firm context. Notes can be created throughout the system. Custom tasks can be assigned to individual cases, which can be tracked via reports. EstateWorks' document management program has been improved to promote a team-based, collaborative approach by allowing users to "check out" documents for use and modification. Templates are also available for reports, contacts, letters, and tax forms.

D. APPRAISAL & VALUATION SOFTWARE:

(See vendor report #3b)

E. RESEARCH SOFTWARE & SERVICES:

1. **Trusts & Estates Magazine** (http://www.trustsandestates.com): *Trusts & Estates* magazine announced the introduction of an on-line archive of the past 10 years of *Trusts & Estates* articles at the Heckerling Institute. The on-line archive will be available to subscribers at the web site above beginning January 20, 2004. A subscription to Trusts & Estates, including the on-line archive, is $199. Heckerling Institute attendees may subscribe for a special rate of $169. For more information, please contact Liz Airhart at eairhart@primediabusiness.com.

2. **LexisNexis** (TM) (http://www.lexis.com): Lexis now offers its own headnotes for cases, organized by legal topics, as well as three-part case summaries for each case: Procedural Posture, Overview, and Outcome. Users may also obtain and print their documents in one submission instead of proceeding through several steps. Document delivery methods include dual-column printing, PDF, e-mail attachments, facsimile, Microsoft Word, Corel WordPerfect, rich text format, and HTML. Lexis added a very helpful feature that allows users to copy a highlighted portion of a case and automatically generate a pinpoint legal citation for that selection, called "Copy with Cite." Finally, users can save their search histories for up to 30 days.

F. MISCELLANEOUS VENDORS:

1. **Alaska Trust Company** (http://www.alaskatrust.com): The Alaska Trust Company web site contains helpful information on the numerous estate planning developments in Alaska. One of the most helpful pages, Section 20. Selected Cases, Rulings & Commentary, which is available on the left-hand navigation pane, includes summaries and full-text versions of relevant cases, rulings, and portions of *Practical Drafting* and other resources. Section 16. Sample Trust Documents provides sample Alaska trusts in Adobe Acrobat or Microsoft Word format. Those who attended (or wanted to attend) the special session on domestic asset protection trusts will find this web site especially

informative.

2. **Connect2A** (http://www.connect2a.com): Connect2A has just announced that this is your last chance to take advantage of the low introductory Connect2A monthly membership fee of $60 per month prior to their first every price increase on February 1st for their new member monthly standard membership fee to $70.00 per month (for up to 250 clients for 1 advisor and up to 4 associates). If you are a member of one of their alliance partners (e.g., WealthCounsel), new member alliance partnership pricing will also be increasing on February 1st. If you complete your membership application by February 1st, they will include their Premium Service, Custom Connect (tm) at no additional monthly cost (normally it costs an additional $10 per month) although presumably the initial implementation fee that usually ranges from $250 to $1,000 still applies.

Well, that's it for Heckerling 2004. We've covered about all we can cover given our time and energy. If we have missed something important or something is in need of an errata, let us know and we will do what we can to add or correct it, at least in the Reports as they are posted on the RPPT Web site. See you in 2005.

The Reporters

GENERAL INFORMATION ABOUT INSTITUTE:
Inquiries/Registration:
University of Miami School of Law
P.O. Box 248087
Coral Gables, FL 33124-8087
Telephone: 305-284-4762 / FAX: 305-284-6752
Web site: www.law.miami.edu/heckerling
E-mail: heckerling@law.miami.edu
==
Headquarters Hotel - Fontainebleau Hilton
4441 Collins Avenue
Miami Beach, FL 33140
Telephone (305) 538-2000, FAX (305) 674-4607
===

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**