Report #11 (Wednesday, Cont'd)

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

==

This Report contains coverage of additional Wednesday sessions, including

==

Special Session I-D - Disunification of GSTT and Gift Tax Exemptions Wednesday Afternoon, 1/12/05
Presenter: Ellen K. Harrison Esq.

Reporter: Shelly D. Merritt

After EGGTRA, the GST tax exemption and the exemption from gift tax are no longer unified. The gift tax exemption remains at $1 million, while the GST exemption is currently at $1.5 million and is scheduled to increase until 2010 when the estate and GST tax are repealed. This dis-unification creates numerous issues with gift planning.

In addition, because gift tax exemption is automatically allocated to taxable gifts, whereas GST exemption is not, it is possible that a person will have differing amounts of gift tax exemption and GST tax exemption.

In this workshop, Ms. Harrison focused on some of the issues raised by dis-unification as well as how to postpone generation-skipping transfers.

Cascading Crummey Powers

When a Crummey power lapses, for GST tax purposes, the power holder becomes the transferor with respect to the excess of the greater of $5,000 or 5%.
This rule can be used to shift the "transferor" for GST tax purposes down a generation. However, if there has been a timely made GST allocation before the lapse, then the transferor will not shift down. As a result, if the automatic allocation rules apply, the grantor must elect out of the automatic allocation of exemption if the trust is a GST trust. If the grantor does not elect out, then a portion of his/her GST exemption will be wasted on that part that the child becomes the transferor. The allocation must be done after the lapse of the withdrawal right as to a late allocation.

To avoid possibly including the trust assets in a beneficiary's estate under IRC Section 2036 when using "cascading Crummey powers," it is advisable to:

1. Make the beneficial interest wholly discretionary so that no power holder has the "right" to any amount from the trust;

2. Use independent trustees so that no power holder has the right to control beneficiary enjoyment; and

3. Establish the trust in a jurisdiction that prevents creditors from reaching trust assets to satisfy the power holder's debts.

Late Allocation of GST Exemption

A late allocation of GST exemption to an existing trust that has an inclusion ratio of more than zero may be an effective way to use the excess amount of a person's GST exemption over the gift tax exemption. For example, an allocation at the close of the "Estate Tax Inclusion Period" (ETIP) for a trust, such as a GRAT, will not constitute a taxable gift and no gift tax exemption would be needed to make the allocation.

A late allocation of GST exemption does not relate back but instead is effective on the date the gift tax return making it is filed. As a result, if there has been a taxable distribution before the late allocation, it will not be covered.

A late allocation cannot be made on timely filed gift tax return. For this reason, it is important to note that an extension for the taxpayer's income tax return automatically extends the gift tax return due date.

If a trust is subject to the automatic allocation rules and the taxpayer wants to make a late allocation, two gift tax returns must be filed. One to elect out of the automatic allocation rules and another to make the late allocation.

The new automatic allocation rules could cause existing trusts to have inclusion ratios. A late allocation of GST exemption can be used to give the trust a zero inclusion ratio. For example, if a trust was established in 1998 and gifts made to it but no GST exemption was allocated, the trust would have an inclusion ratio of one. If the trust meets the definition of a GST Trust under the new rules and contributions are made after 2001, then GST exemption will automatically be allocated to the trust for each of these contributions. The trust will end up with an inclusion ratio other than zero or one. This ratio will change each year that gifts are made to the trust unless the trust elects out of the automatic allocation rules.
This can be resolved by making a late allocation.

Late allocation to term life insurance policies

Another planning option is to make a late allocation to an ILIT holding term insurance right before end of each year when the interpolated reserve value is almost zero rather than making the allocation when the premium is paid at the beginning of the year. So long as the insured doesn't die before the late allocation is made and is effective, this will leverage the use of the grantor's GST exemption. As long as the contribution to the trust is made during the first quarter of the year, there will always be a timely return yet due so there is little risk to doing this.

Qualified Severances

A qualified severance is any division of a single trust into two or more trusts if the division is permitted by the instrument or local law, the trust assets are divided on a fractional basis, and the terms of the new trusts provide, in the aggregate, for the same succession of interests of beneficiaries as are provided in the original trust.

Proposed Regulations 26.2642-6 dealing with Qualified Severances were issued on August 24, 2004. The regulations provide that if a trust is divided into two trusts, the new trusts will be treated as separate trusts for GST purposes only if the severance is a "qualified severance."

Requirements for a qualified severance:

1. The severance must be pursuant to the trust instrument or local law.

2. The severance must be effective under local law.

3. Each trust must receive a fraction of the total value of the trust (not a pecuniary amount).

4. The terms of the new trusts must provide, in the aggregate, for the same succession of interests of beneficiaries as the original trust.

5. The severance must be reported on a Form 706-GS(T) "Generation-Skipping Transfer Tax Return for Termination," and must write "Qualified Severance"
in red at the top of the form and attach a Notice of Qualified Severance to the Return.

The proposed regulations provide that they repeal Treas. Reg. 26.2654-1(b) which allows for the severance of trusts that are included in the transferor's estate or created under the transferor's Will when certain funding requirements are met. Ms. Harrison believes this is an error in the proposed regulations. For example, if D's revocable trust makes a gift to a trust for descendants of the largest pecuniary amount that can pass to the trust without incurring or increasing federal estate tax and the residue to a marital trust, under T.R. 26.2654-1(b), D's GST exemption may be allocated to the pecuniary gift to the trust for the descendants. However, under the proposed regulations, this gift would not qualify for severance because it is not a fractional share gift.

Non-Qualified Severances (i.e., by not giving notice to IRS)

For purposes of Chapter 13, separate trusts are not treated as separate for GST purposes unless the separate trusts exist from the inception of the trust.

For example, T creates a trust for T's children that provides the Trustee with the discretionary power to distribute income or corpus to T's children. When the youngest child reaches age 21, the trust is to be divided into separate trusts for each child which provides for income to the child during life, principal to child's children on child's death. The separate trusts created when the youngest child reaches age 21 do not qualify as separate trusts for GST purposes since the trusts did not exist from and at all times after the creation of the trust. Any allocation of GST exemption to the trust either before or after the youngest child reaches age 21, will apply to the entire trust.

If a qualified severance of a trust that distributes per stirpes occurs, the division of a discretionary trust will cause the new trusts to be separate for GST tax purposes and a taxable termination will occur on the death of each non-skip beneficiary (child). Planning can be done to postpone a taxable termination with such a trust by making a non-qualified severance. The taxpayer can take the position under this scenario that since there is no qualified severance, a taxable termination does not occur until the last child (non-skip person) dies instead of upon each child's death, even though each child has a separate trust since the separate trusts did not exist from inception.

It may be a good planning strategy to provide that on the taxpayer's death, the residuary estate passes to one discretionary trust for all of the decedent's children for a certain period of time, such as 2 years, and then divides into separate shares for the children.

Discretionary CLATs

Discretionary CLATs can also be used to postpone a generation skipping transfer. If a charitable lead annuity trust (CLAT) gives an independent trustee discretion to select the charities to whom distributions may be made, no person has an interest in the trust for GST tax purposes until the lead interest ends. A transfer to a discretionary CLAT is not a direct skip and even if only skip persons have interests in the trust when the lead interest terminates, a taxable termination will not occur because an interest in the trust, as defined for GST tax purposes, will not have terminated.

Transferring Remainder Interests

If a remainder beneficiary of a trust sells or gifts his or her remainder interest to skip persons, such as the beneficiary's children, it is arguable that the "transferor" of the remainder interest for GST tax purposes should be the remainder beneficiaries and not the donor. For example, grantor creates a GRAT which passes to the grantor's child at then end of the GRAT term. After funding the GRAT, child gives his remainder interest to a trust for the benefit of the child's children (grantor's grandchildren). When the GRAT term expires, if the child is the transferor for GST purposes, there will be no generation skipping transfer because the child's children are not skip persons as to the child transferor.

However, the IRS ruled in PLR 200107015 that where a remainder beneficiary of a charitable lead trust (CLAT) makes a gift of his remainder interest, the remainder beneficiary is the transferor for GST tax purposes only to the extent of the percentage that the value of the remainder interest bears to the value of the trust at the time of the beneficiary's transfer and the original grantor remains the transferor as to the balance. In Ms.
Harrison's opinion, the statutory analysis for the conclusion in the ruling is flawed and the application of the ruling to other types of trusts, such as GRATs and QPRTs, is uncertain.

Gift Splitting

The gift splitting rules differ for GST tax purposes than for gift tax purposes. For gift tax purposes, gifts to a spouse, including interests in trusts, cannot be gift split. For GST tax purposes, the electing spouse is treated as the transferor of one-half of the property transferred, regardless of the interest the electing spouse is deemed to have in the transferred property.

==

Special Session 1-E - Ethical Issues and Drafting Solutions in Medical Releases and Competency Determinations Wednesday Afternoon, 1/12/05
Presenters: Michael L. Graham Esq. and Gregory S. French Esq.

Michael L. Graham of Dallas and Gregory S. French of Cincinnati hosted a vibrant dialogue joined into by many of the attendees at this follow up session to Graham's HIPAA presentation on Tuesday at the Heckerling Institute. Based upon a case study prepared by French, the session attendees explored the Model Rules of Professional Conduct and the Aspirational Standards for the Practice of Elder Law

Of the National Academy of Elder Law Attorneys, the comments to the Rules and the ACTEC Commentaries to the Rules, as well as our mutual experiences, and struggled with the difficult questions involving individual capacity and family relationships that arise in our practices. The nuances of client identification, confidentiality, conflicts of interest, client capacity, fiduciary issues, long-term care planning and documentation dealing with health issues were examined in a lively session. The complexity of these issues is recognized by most attorneys who assist older clients and their families. The necessity of representation letters creating single or joint representation, even letters for multiple generations of a client family was agreed upon by the attendees. The proactivity of the attorney in connection with assessing client capacity, pursuing solutions for incapacitated clients and protecting client confidentiality was discussed. Attorneys should review the often counter-intuitive rules in their states and in the resources named above. There will be more and more circumstances facing us in the years ahead as our clients age and require different kinds of assistance than we have given them in the past. Embroiled in family relations gone "postal" and fueled by money -related issues, the attorney who wants to avoid liability while serving his/her client well will want to be familiar with the representation landscape and will be thankful that he/she has prepared for these issues as well as possible.
Although it is impossible to summarize the wide ranging discussions of this session, it is clear that every attorney is (or should be) well versed and well planned in this area.

The new 4th edition of the ACTEC Commentaries to the Model Rules will be published this year; get your copy and use it well, along with the other resources noted above.

==
Special Session II-D - Practical, Professional and (Perhaps) even Profitable Solutions to Every Day Ethical Dilemmas
Presenters:
Alan Rothschild (AR)
Stacey Cole (SC)
Chris Gadsden (CG)

Reporter: Eugene Zuspann Esq.

CG -
1. After the Model Rules were passed, the estate planning bar realized
that they were designed and promoted by trial lawyers and they were conformed to the needs of the trial bar.
2. The focus of this session is on the ABA Model Rules.
3. There are significant variations between the different states;
generally, the ABA rules are far more restrictive that those in the states.
4. He discussed the ACTEC commentaries and state hotlines that the
attorney can call for help.

Hypo #1

1. Originally, the clients were the deceased and the surviving spouse
(SS); you drafted the estate planning documents for them; a bank is the executor and trustee and it retained you to represent them in administration of the estate.
2. Whom do you represent? The fiduciary
3. Must you tell SS whom you represent? Yes - there must be no
question in the beneficiaries mind; in many situations you may also represent her if there is no

conflict
4. Must the SS be notified of her elective share rights? There is a
split here. CG believes that he should tell her and that she be advised to have separate counsel. It depends on her perception of your representation. She definitely needs to be advised that she has separate interests.
5. You may be regarded as the family lawyer because of your previous
relationship with the clients. See rule 4.3. If there is a conflict, you need to advise the family members that you do not represent them. If you can represent them, the engagement letter needs to clearly reflect this.
6. If the bank invests some of the estate's funds in the bank's
holding company stock, and it depreciates -
a. Do you raise this with the bank? Yes
b. Do you raise this with the SS? Not if they are the only client. See rule 1.6 but this rule is limited to bodily harm. Many states have broadened this. Look at your engagement letter. This answer changes if you are representing the family or if they believe you are protecting their interests. In that case, the attorney needs to withdraw.
c. One attorney puts the obligation into the will and trust so that the testator authorizes the waiver of confidentiality. He believes that with this waiver, counsel can disclose the breach of trust. If you cannot disclose and the bank will not consent, you have to resign.
7. Issue: If the H&W were long tern clients, must the spouse consent
to your representing the bank? - No clear answer.

Hypo #2
Client calls. He and his sister want you to update mom's estate plan

1. Who is the Client? Mom
2. At the interview, mom is capable of carrying on conversation but
always wants son to answer or confirm a decision. Son and Daughter want mom to give away most assets for gifting and Medicaid spend down
3. When Son suggests he leave so that you can discuss this with her
alone, she is not comfortable and asks that her son not leave
4. SC would not tape the execution - once you tape it, you are stuck
with it; If things do not go well, you are still stuck with the tape.
5. Mom dies and you receive a phone call from a third child (after you
prepared the documents)
a. She asks number of questions about the planning and her mother's
desires and asks whether you know about her
b. You should decline to answer anything and you should call you
carrier. At this point, if the existence of the child is unknown to the attorney, and the plan leaves the child out, then there is a problem.
c. The solution was in the planning. The attorney must set up an
office procedure and make sure it is followed. It should include a questionnaire and the questions should be asked and the answers noted.

Hypo #3 - Multi Jurisdictional Practice
A large client sells his business and moves to another state. The client returns to your office and asks you to prepare a new estate plan. You are not licensed in the second state.

1. Can you prepare the documents?
a. If you are competent to do the documents?

i. If so, and if the work you do for the client is in your state of
practice, then you may do the work. See rule 5.5 but this rule is only adopted in 11 states at this time.
ii. If not, you should either retain an attorney licensed in the second
state or send the client to such an attorney
b. The extent of contacts with the other state is relevant and you
must check the rules in your state and the rules of the other state. If the contacts are more than minimal, you should either refer this out or retain local counsel.
2. If you are the local counsel, you must define who is the
client? Is it the one that pays your fee. This needs to be clearly set out in the fee agreement and both the client and the referring attorney need to be clear.

Hypo #4
A client for whom you had previously done an estate plan (for he and his 3rd wife), approaches you to do a new plan for he and his new (MUCH) younger 4th wife. He does not seem to be willing to disclose all to his new wife and discretely suggests that he may want to make other gifts. At this point in time, you have no idea if there is a marital agreement. Client is a sizeable client, but had not done work with the firm for several years. You had referred him to another firm for the divorce from his 3rd wife.

Choices
a. Joint representation
b. You represent him and send his wife to another attorney
c. Separate representation. Few attorneys do separate
representations. (the priestly approach - each client has his own
confessional)
d. May want a termination letter for new spouse

The panel and the audience discussed the alternatives. Depending on the facts and further discussions with the spouse, the attorney (you) need to determine what is proper.

Hypo #5
You represent a large charity and a member of the board of the charity approaches you do to an estate plan that includes a CRT for the benefit of the charity. This fact situation is taken from Oregon formal opinion 91-116.

1. There needs to be a lot of care in this case.
2. Oregon decided that the attorney could not represent both the
Charity and the director unless you get written consent from both the charity and the individual.
3. AR believes the problem is that you have a continuing relationship
with the Charity.
4. AR cited a Maryland opinion where attorney was on the planned
giving committee of a church and was approached by a client to prepare a plan that involved the church. Maryland decided that he could not do estate plan for person desiring to give money to church. In Maryland this was complete bar.
5. In any state, at a minimum, you must disclose any conflict to the
client and review your state opinions and cases to see what may be done.

Hypo #6
Receipt of confidential materials intended for another.
This was at the end of the presentation. SC discussed the effect of this in several states and indicated

that it is not uncommon in litigation.

==

Care and Feeding of GRATS

Presenter: Carlyn S. McCaffrey Esq.

Reporter: Herbert L. Braverman Esq.

Our on-site local reporters who are present in Miami this year are Gene Zuspann Esq. of Zuspann & Zuspann in Denver, Colorado, Shelly Merritt Esq., a solo practitioner in Boulder, Colorado, Connie T. Eyster Esq. of Hutchinson, Black & Cook LLC in Boulder, Colorado, Jason Havens Esq. of Havens & Miller PLLC in Dustin, Florida, Bruce Stone of Goldman, Felcoski & Stone, PA of Coral Gables, Florida, Herbert L. Braverman Esq. of Walter & Haverfield LLP in Cleveland, Ohio, and Jeffry L. Weiler of Benesch, Friedlander, Coplan & Aronoff LLP of Cleveland, Ohio. The editor again this year will be Joseph G. Hodges Jr. Esq, a solo practitioner in Denver, Colorado who is the Chief Moderator of the ABA-PTL List.

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
Telephone305-284-4762 / FAX305-284-6752
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
==

Brought to you by the ABA-PTL Discussion List Moderators URL