Report #20 (Thur. and Fri - Final)

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

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This Report contains coverage of the Thursday afternoon Special Session involving Implementing Total Return Trusts and the final Friday morning General Session entitled Wrapping It Up.
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SOME ANNOUNCEMENTS:

This will be our last Report for the 2005 Institute. While we were unable to cover and report on every session as we had hoped in the beginning due to the limitation on the number of reporters we could have and the fact that on both Wednesday and Thursday afternoons there was a Fundamentals session running all afternoon concurrently with 14 different break out Special Sessions, a review of the sessions that were covered and reported on by us indicates we were fairly successful in accomplishing our mission again this year. Also, we normally would have ended these Reports before now, but this year we had a four-day e-mail crash that put a real wrench in our usual distribution and publishing process.

At this time, as your Editor again this year, I want to take this occasion to publicly thank all seven of our reporters for a job well done, especially considering that all but two of them had never been reporters for us before. They were loyal and dedicated to the task at hand in spite of some of the later evening and early morning hours they had to put in so their reports could be prepared and submitted in a timely fashion. Maybe by next year the Fontainebleau hotel will have installed high speed lines in all the sleeping rooms, making our job all that much easier.

And now for the last of our Reports for 2005..................

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Special Session IV-F - Implementing Total Return Trusts: Solving Three Variable Problems When You're Bad at Math (Part of the financial planning program series) Thursday Afternoon, January 13, 2005 at Wyndham Hotel

Presenter: Paul S. Lee of Bernstein Investment Research & Management

Reporter: Jeffry L. Weiler Esq.

The decline in interest rates and dividend yields makes it difficult to provide sufficient income to current income beneficiaries when the Trustee is limited to distributing fiduciary accounting income. States have enacted legislation that allow fiduciaries to invest for the highest total return but not hurt the current beneficiary in the process. These trusts are referred to a "Total Return Trusts". Implementation of these trusts requires an understanding of modern portfolio theory as well as tax and trust law. This speaker's presentation defines Total Return Trusts, reviews legislation and regulations, quantifies the decision making process and provides guidelines and a methodology for drafting and implementing Total Return Trusts.

A Total Return standard for investment performance encourages investors to seek the highest overall return without being restricted by how that return is created. This type of investing creates a conflict in traditional trusts between the income and remainder beneficiaries. A Total Return Trust allows the fiduciary to invest for Total Return and permits an adjustment of the amount to be distributed to the current beneficiary without regard to whether the source of the distribution (dividends, interest, capital gain, etc).

Framework for implementation involves solving a three variable problem:
* What is the appropriate investment strategy for the trust?
* What should the appropriate distribution policy for the trust be?
* What portion of the income taxes should be paid by the trust and by the current beneficiary?

The outline reviews the investment strategy under the provisions of the Uniform Prudent Investor Act including the duties of the trustee and circumstances and conditions the trustee should consider in making investment decisions. The primary consideration of the fiduciary is finding the appropriate risk and return tradeoff given the objectives of the trust.
Diversification of the investments is required (unless the fiduciary is relieved of this obligation). The applicable circumstances must be considered.

Applicable state law may allow the fiduciary to make equitable adjustments between principal and income. In exercising the power, the fiduciary should consider the nature, purpose, and expected duration of the trust; intent of the settler; identify and circumstances of the beneficiaries; needs for liquidity, regularity of income and preservation and appreciation of capital; assets in the trust; actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; anticipated tax consequences of an adjustment.

States have adopted three versions of distributions polices: only equitable adjustment power; dual approach – equitable adjustment power and option to convert of a unitrust; only conversion to a unitrust.

US Treas Regs under 643 (b) deals with the computation of distributable net income. Generally capital gain is excluded from DNI and is taxable to the trust rather than to the beneficiary receiving distributions. However, exceptions are provided in the Regs.

The current financial planning tools are not limited to historical averages and take into account the alternative returns and as well as the random and unpredictable nature of the markets. It is called stochastic or probabilistic modeling – Monte Carlo modeling. Frequently 10,000 simulated markets are produced to study possible outcomes.

Distribution policies:

An annuity permits the current beneficiary to avoid downside risk of a falling market. The portfolio risk is shifted to the remainder beneficiary.
A unitrust approach allows the fiduciary to invest for total return and eliminate the conflict between the current beneficiary and the remainder beneficiary. Studies indicate a 4% unitrust has an equal probability of maintaining the initial distribution over 10 and 30 years with a 60/40 stock/bond portfolio. However, due to market volatility the unitrust amount will go up and down. Smoothing rules will make the unitrust payments more uniform (reduce volatility). This is accomplished by calculating the unitrust distribution using a three year average of assets value. Another distribution approach is the greater of an annuity and a unitrust which can be favorable to the current beneficiary. Another approach is a collared unitrust which has fixed minimums (floors) and maximum (ceiling).

In regard to taxation, the allocation of tax by the fiduciary does not affect the trust assets but does have an impact on what is received by the current beneficiary and the remainder beneficiary.

The fiduciary must follow a process concerning trust investment policy. The process protects the fiduciary and is more important that the investment performance. The outline includes a sample total return investment policy statement.

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Wrapping It Up - a case study
Friday Morning - The Finale
Presenter: Louis A. Mezzullo

Reporter: Eugene Zuspann Esq.

Lou offered up an extensive fact situation. It addressed many of the issues included in the institute this week. Many of the topics apply to the fact situation.

Parents (Harry and Wilma) have 4 children David, Son, married, has 4 children. Joan, married and has children from a prior marriage.
Missy - gay, living in San Fran and has a partner. Ed, married, no children. Harry has a very successful defense software business in VA. The company is an S-Corp. They have always lived in VA, except for 10 years working for a company in CA. They have 3 residences (total value $2,500,000) in joint tenancy. Each separate own $5mm in stocks and bonds valued. Harry owns the S-Corp valued at $75mm. He has guaranteed $30mm of debt for the corp. The business generates $15mm per year in net income.
They have rental real estate valued at $5mm held in joint tenancy. He has a $1mm 401(k) and they each have a $100k IRA. He has life insurance of $2mm with a cash value of $400k and Wilma(Mom) has $750k with cash value of $100k. David, Joan and Joan''s husband are active in the business. Ed is a doctor and his wife, Carol, is a lawyer. Missy is half owner of a restaurant in San Francisco. Harry does have charitable desires. Harry has come in for help planning his estate and providing for the employees of the business. The facts do not mention that Wilma came in with Harry.

Lou started by explaining his practice in this classes about assumptions outside of the fact situations. If necessary facts are missing, the students are expected to make other necessary assumptions to complete the analysis of the estate.

First, who is the client? You need to determine this at the outset. Harry needs to define the scope. If the family gets along and Harry wants to do planning for the children, then Lou would represent the family. However, if something comes up that the family does not agree during the representation, he may have to withdraw from the representation of the entire family. When an in-law is a lawyer, Lou has also found that the person is always looking over his shoulder and ''knows'' all about estate planning. Given this fact, he may not be willing to represent the family.

Lou set out some immediate considerations:

1. Determine potential conflicts and who is the client 2. QPRT''s 3. Liquidity 4. Restructuring issues for the corporation 5. Employee''s financial future 6. Asset protection Next, get a comprehensive list of all assets and liabilities and have the client verify its accuracy. This summary is necessary to do the plan and helps avoid problems later when other assets or liabilities are identified. He has an outline about repeal of the estate tax.

What would attorneys continue to do if the estate tax is repealed?
1 plan for disposition of the clients assets at the client''s death 2. Asset protection planning 3. Planning for disability 4. Business succession planning 5. Planning for marital and other situations 6. Charitable giving 7. Life insurance planning 8. Fiduciary litigation 9. Planning to cope with carry-over basis. Lou feels this will be more complex than planning for the GST tax.
10. Retirement planning
11. Planning for the state death taxes where applicable 12. Planning to avoid gift taxes. The gift tax it will still be applicable for lifetime gifts over $1mm
13 Planning for business for non-tax objectives 14. Planning for children, spendthrift planning 15. Planning for clients with property in more than one state 16. Planning for clients with contacts in more that than one country 17. Planning for non-residents 18. Planning for reinstatement of death taxes; still may want dynasty trusts I missed two more - Lou''s list had 20 items

Only 4 issues would no longer be applicable 1. No planning for the estate tax 2. No using marital deduction planning 3. No planning for charitable gifts for federal estate taxes 4. No gifts at death to avoid death taxes

He discussed the various alternatives to the changes in the estate tax. How will the law change? Will there be a complete repeal? When? Will the repeal be immediate (this would be the easiest) or will it phased in?
Instead of complete repeal, will the exemption just be frozen or increased to some fixed amount? We may also see some reforms that we do not want to see? e.g. Crummey powers

He also raised other non-tax issues and questions that would be relevant after a complete repeal: We will still need to consider one or more trusts for the benefit of the children because one spouse may not need or want to give the other spouse full control of all of the assets. Steve Oshins and Jonathan Blattmachr both stated that almost everything should be left in trust.

Some preliminary ideas on planning the estate for Harry and Wilma 1. Create voting and non-voting stock (90% non-voting and 10% voting). He assumes the premium on the voting stock makes it worth $10mm. Using the
§§2701 subtraction rule, the non-voting stock is worth $65mm.
2. The company is operating company. He concluded that if the appraiser gives a total discount for the minority interest and lack of control, ""I would get another appraiser.""

A. Give one-half of the non-voting stock to Wilma
B. Sell $18mm of non-voting stock to a grantor trust for each of
the children involved in the business. This represents $36mm and a 50%
discount. (The reporter must have missed because this is not going to total
$75mm)
C. Lou would do this without an estate tax because it is good planning for the family and also for the gift tax.
D. Transfer balance of non-voting stock to a zero-ed out GRAT. Use
some small gift with a formula clause. Use a 10 year GRAT because he
thinks it would work. E. Now have 2 grantor trusts and a GRAT.

3. Transfer marketable securities to a zero-ed out CLAT. The beneficiaries are the other two children.
4. Have children with the interests in the CLAT sell to a GRAT for the benefit of the children. Make sure there is a non-skip person with an interest in the CLAT so that when the term of the CLAT or the GRAT ends, there will not have a taxable termination. You will have to file a gift tax return to start

the statute of limitations on the inclusion ratio.
5. FLP - read the Monday materials discussing the 2036(a) issue.
Lou then discussed the applicability of a number of other programs to this estate plan:

A. You may wish to consider the use of the Inheritor''s Trust if Harry and Wilma''s parents are going to be leaving assets to them. This is for both estate tax protection and for creditor protection if the software company goes down the drain. The trust would be a discretionary trust. He does not agree with Steve Oshins that the UTC good faith standard may cause a problem. Lou believes the good faith standard applied before the UTC.
B. He discussed the issues raised by several other programs - Chris Hoyt using retirement plan assets in Charitable remainder trusts, Mitchell Gans on deference, Dennis Belcher on liquidity and 6166.
C. May want to structure borrowing for any estate tax using a fixed payment arrangement so that the interest is deductible.
D. Could use Carlyn McCaffrey''s idea to buy a call from the GRAT. This makes a whole lot of sense. Make sure that the remaining payments that must go to the spouse so you are not back with the Walton problem. There should not be a merger with the remaining payments gong to the same place as the remaining assets.
E. He discussed most of the other sessions and the possibility of each topic affecting this estate.

THE END......................

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.

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