# Report #6 (Tuesday, Cont'd)

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

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This Report contains additional coverage of the Tuesday sessions. Since some of this relates to charitable planning, a copy of this Report is being sent to the GIFT-PL and Planned Giving lists.

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**Funding Bypass and QTIP Trusts with Retirement Plan Assets Prof. Christopher R. Hoyt**

Report by Herbert L. Braverman Esq.

Christopher Hoyt is a professor at the University of Missouri (Kansas City) School of Law, who presented a discussion on funding trusts with retirement plan assets. Professor Hoyt reviewed the strategies for estate tax and income tax planning that are available to us and to our clients under various circumstances with a particular focus on the use of stretch IRAs and of charitable remainder unitrusts (CRUTs).

He began by reviewing the minimum distribution rules for retirement accounts and he reminded us of the 10% penalty for most distributions taken before 59 1/2 and the odious 50% penalty imposed when an account owner does not take appropriately large distributions after attaining the age of 70 1/2 or retiring , whichever occurs later. Professor Hoyt noted that minimum distributions during lifetime are essentially the same, regardless of who or what is named as beneficiary. On the other hand, after the account owner's death and in particular as of September 30 of the year following death, the identification of the designated beneficiary's) is of prime importance. This is so because the decedent's IRA can be a stretch IRA with payments spread over the life expectancy of the designated beneficiary (DB). Using the government's Uniform Lifetime Distribution Table and the life expectancy table, Professor Hoyt illustrates the relative wisdom of naming a young DB and paying the tax favorable IRA over an extended period of DB life expectancy.

Professor Hoyt took the time to point out that the Japanese who eat no fat outlive Americans and the French who eat a lot of fat and drink a good bit also outlive us; so do the wine-drinking, fat -eating Italians--his conclusion is that it must be "speaking English that kills you!"

He then turned to the integration of income tax and estate tax planning. He presented some interesting statistics to illustrate how few 706's will be filed in the future under the current tax regime--perhaps as few as 200 per state in 2006--and , therefore, how much more important income tax planning for retirement funds will be.
He referred to Mrs. Sam Walton as one of the wealthiest woman in the world and suggested that Senator Kerry refers to her as "the one that got away."

Professor Hoyt reviewed the advantage a surviving spouse has as the DB, namely, the ability to do a rollover IRA and treat the new IRA as

her/his own. He noted 3 problem areas: (1) when the IRA owner is not
married and, of course, has no surviving spouse; (2) when the IRA owner is in a second marriage (with children from the first marriage); and (3) when the IRA owner and spouse is subject to estate tax. In these cases, after paying some attention to the use of other approaches that may be somewhat helpful in some circumstances, such as annuities and QTIP trusts, Hoyt demonstrates the income tax and estate tax advantages of using the two-generation CRUT arrangement, where possible. This CRUT is named as beneficiary of the retirement account and then pays a long stream of income payments to the account owner's spouse for life and then does so for their child(ren). For a more detailed treatment of the technical issues associated with using CRUTs as a bypass trust/QTIP trust for income in respect of a decedent, the Professor refers us to his article in TRUSTS AND ESTATES (May 2002), "When a Charitable Trust beats a Stretch IRA". A copy of the article is also attached to his outline, but a detailed discussion of the article is beyond the scope of this report.

Professor Hoyt also discussed basic tax planning strategies for married individuals. Where there are no estate tax concerns, a spousal rollover of retirement benefits, followed by a stretch IRA for the children should suffice.But what if there are estate tax concerns that would normally call for the use of a conventional bypass trust? First , try to fund the bypass trust with non-IRD assets. If these are insufficient, some retirement assets will have to fund the full credit shelter amount. Where there is sufficient wealth, Professor Hoyt suggests several strategies:

1. give some retirement assets to the
children in stretch IRAs or to other beneficiaries who are considerably younger than the spouse.

2. consider establishing a conduit bypass trust to reduce both the size of the required distributions and the income tax rate imposed on them.
A rollover to spouse is still better, if the surviving spouse lives a long life.

3. consider a 2-generation CRUT. This can result in estate tax and income tax advantages similar to a 2-generation IRA rollover.

4. for "young" surviving spouses, use an IRA rollover to achieve substantial income tax objectives, even though the assets will be in her/his estate in the distant future (who knows what the estate tax system will be then?)

Similar integrated estate and income tax planning strategies can be used when considering the use of retirement assets to fund QTIP trusts.

As for the unmarried individual with out estate tax issues, the use of the stretch IRA is probably the best alternative, but the use of a CRUT as a beneficiary would still be available. Where estate taxes are likely to be suffered, Professor Hoyt recommends a charitable bequest of retirement accounts and other IRD assets to avoid the "double whammy of estate and income taxes."

I think this is a full report of the session, but I recall the Professor quoting President Bush as saying that it is important to right 90% of the time and not worry "about the other 6%."

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Deference and the End of Tax Practice
Prof. Michael Gans

Report by Connie T. Eyster Esq.

This presentation addressed the issue of how much deference courts are apt to give to IRS regulations, rulings and other agency pronouncements when making decisions on tax court cases, and how the court decides the level of deference.

The speaker believes that a sea change on this question is happening in administrative law, which change could have a significant impact on how we advise clients, write opinions on tax issues, and litigate tax cases as this change begins to impact our area of the law.

Prof. Gans indicated that he believes the IRS has been publishing more guidance in recent years and will continue to do so in order to garner further support for the deference argument in the courts. It is not clear to what extent the IRS realizes their expanding power under this deference principle, but practitioners need to be aware of the arguments and take them into account.

There was a confluence of events that led Prof. Gans to believe that there was a dramatic change happening with regard to deference issues.

1. In 1996, the U.S. Supreme Court decided a case called Smiley v.
Citibank, 517 US. 735, which was a non tax case discussing the scope of an administrative deference case called Chevron, U.S.A., Inc. v.
Natural Res. Def. Council, Inc., 467 U.S. 837 (1984). This was a unanimous opinion, which, if applied in the tax area, will turn many of our notions of deference upside down.

Immediately before the Chevron case was decided, courts applied deference in two different ways. "Legislative regulations," which are regulations issued by the service out of an express direction in the legislation granting such authority, were given deference that was very hard to overcome. A legislative regulation would not be given deference only if the regulation was arbitrary and capricious. All other types of regulations, including those issued generally under IRC § 7805 (which generally allows the IRS to promulgate regulations interpreting the code called "interpretive regulations") were given "Skidmore deference." Whether the court decided to give deference to these non-legislative regulations would be determined based on a variety of factors such as whether the court thought the interpretation by the agency was correct, whether the statute was amended or reenacted after interpretation was issued, whether the agency was involved in litigation when the regulation was written, and whether the regulation was written contemporaneously with the passing of the statute.

Chevron purported to establish a new theory of deference, which was discussed in the case of U.S. v. Mead, 533 U.S. 218 (2001). Under this new deference standard, the court will first look to see if a statute is ambiguous or silent on the issue presented. If it is not silent or ambiguous, then the court will use the express language of the statute to determine the issue. If the statute is silent or ambiguous, then the courts will defer to the agency regulation issued on that question, if the regulation reasonably resolves the ambiguity.

Smiley tells us that this new standard will be used, even when the traditional Skidmore factors would have indicated that no deference should be given to the agency regulation. Smiley was a non tax case that was unanimously decided by the Supreme Court. In that case, the statute at issue was enacted 100 years before the regulation, but the fact that the regulation was not contemporaneous with the statute did not seem to impact the court's decision. Likewise, the regulation was issued after the transaction in the case had been consummated and after lower courts had issued rulings in the case. Nonetheless, although the agency issued the regulation while taking an adversarial position, the court still gave deference to the regulation. Further troubling was that the court upheld the regulation, despite the fact that the agency had previously taken contrary stances in other published notices.

Prof. Gans highlighted footnote 3 in Smiley case, in which the court said that even though the regulation applied retroactively to the transaction in that case, it was not, in fact, a retroactive application because the agency had not previously issued formal regulations on that issue (even though it had taken a position on the issue in other notices). This was the court's decision, even though, like the IRS, the agency in the Smiley case was prohibited from issuing retroactive regulations.

Under this analysis, Prof. Gans questioned why would the Supreme Court ever grant certiorari on a tax case? If the statute is ambiguous, all the IRS would need to do is issue a new regulation addressing the issue, which would be deferred to by the court.

2. Also making Prof. Gans aware of the deference issue was a 1997
decision in which the Supreme Court issued its decision in favor of a taxpayer by relying on the regulations. Three justices issued a concurrence which highlighted the issue raised in Smiley, that by giving the regulations so much deference, the courts have given the IRS the ability to change the outcome by simply issuing new regulations.

3. Finally affecting Prof. Gans's concern about the deference issue,
were new regulations on the GST issued in 1999 regarding IRC Â§ 2601.
There was a split in the circuits regarding how the lapse or exercise of a general power of appointment might affect the grandfathered status of a GST trust. Rather than appeal a case and request a grant of certiorari, the preamble to these regulations essentially stated that it was issuing new regulations to overrule the circuit decision that was favorable to the taxpayer (Simpson v. U.S., 183 F.3d 812 (8th Cir. 1999)) and affirm the decision favorable to the government (Peterson Marital Trust v. Comm'r, 78 F. 3d 795 (2nd Cir. 1996)).

Prof. Gans believes we will see more of this deference issue, which seems to be expanding the power of the IRS, rather than the courts, to decide tax issues.

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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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