Heckerling Institute 2006
Reports from the event, as posted to the ABA-PTL List Serve

Report #1

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 nine 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 40th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 9-13, 2006 at the Fontainebleau Hilton Resort and Towers in Miami Beach, Florida. A complete listing of the proceedings and speakers is available on the Institute's Web site. The URL for that site is http//www.law.miami.edu/heckerling.

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First, a news item of interest from Reporter Paul Hood - he has just joined the law firm of Dickenson, Peatman & Fogarty in Napa, CA. Congratulations Paul.

Next, since we are having to cover the vendors a little differently this year, reports from the exhibit hall will be included at the end of most of the Reports as information becomes available rather that as a separate Report just on that subject.

Lastly, some news from the Institute. About 2,650 people are registered this year. close to what it was in 2005, The staff is excited about the new Orlando, Florida venue for the 2007 Institute.

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This Report contains coverage of the Monday morning **Fundamentals Program #1 on the Anatomy of Plan Beneficiary Designations**

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Anatomy of Plan Beneficiary Designations Monday Morning, 1/9/06
Presenter: Natalie Choate

Reporter: Merry Balson Esq.

Natalie Choate was, as usual, a wonderful speaker. She turned the complicated subject of estate planning for retirement plan benefits into a straight-forward and interesting presentation, full of practical suggestions and examples.

Overview

Ms. Choate began by reviewing the chart entitled "Estate Planning for Retirement Benefits, in One Page" (pg. 74). The initial question is who should your client name as the plan beneficiary? This chart demonstrates that there are only 6 possible choices: 3 are tax favored and 3 are less tax favored. The tax favored options are: 1) young individuals (or a "see-through trust" for younger individual beneficiary), who can take advantage of long-term income tax deferral because payouts are based on the beneficiary's life expectancy; 2) surviving spouse, who can roll over an inherited IRA to her own IRA or other eligible plan; and 3) charity, because it is income tax-exempt and pays no income tax on the retirement plan benefits it receives. The less-tax favored options are: 1) older individuals (or a "see-through trust" for older individual beneficiaries), who have a shorter life expectancy; 2) trust for surviving spouse, which must take benefits over the single life expectancy of the spouse (at best), cannot roll over benefits, cannot defer distributions until spouse is 70 1/2, cannot use the Uniform Lifetime Table, and cannot extend deferral over the children's life expectancy after spouse's death; and 3) estate (or a non-see-through trust), which does not qualify for the life expectancy of beneficiary payout method, is not income tax exempt, and is often in a higher tax bracket than other family members.

Generally, Ms. Choate stated that estate planing for retirement benefits can generally be boiled down to this: 1) name the spouse as beneficiary, and 2) if the client is wealthy, name a charity as contingent beneficiary, and if they are not wealthy, name the children. However, she pointed out that there is no one-size-fits-all beneficiary designation, and that the appropriate designation will depend on many factors.

The MRD is determined by dividing the account balance by the beneficiary's life expectancy, then reducing the denominator by 1 each year. For example, if the beneficiary was a newborn baby, the first year MRD would be 1/80 of the account balance, the second year MRD would be 1/79, third year would be 1/78, etc.

Naming Minors as Beneficiaries (pg. 4)

There are 5 options when leaving retirement benefits to minors: 1) to the minor outright (not recommended, primarily because it subjects assets to guardianship, delays and fees); 2) to the UTMA custodian (recommended for some beneficiaries if the sum is relatively small, but not so good for larger sums because UTMA terminates at young age and parents often want to delay distributions beyond that age); 3) to "conduit trust" for the benefit of a minor (recommended where sum involved is large enough to justify a trustee's fee, where qualifying for life expectancy payout is a high priority, and the client is comfortable with all distributions from the plan being paid directly to the minor beneficiary); 4) to a see-through "accumulation trust" for the minor (recommended for larger sums, where the pass-through of a conduit trust is not acceptable and the life expectancy payout is important goal); and, 5) to a non-see-through "accumulation trust" for the minor (recommended for larger sums, where the client does not feel see-through status is worth the compromises, and/or the life expectancy payout is either not available or not suitable).

A trust will qualify as a "see-through" trust only if it complies with 5 IRS trust rules. Three of the rules are ministerial and easy to satisfy (the trust must be valid under state law and must be irrevocable when the plan owner dies, and certain documentation must be provided to the plan administrator). The tougher trust rules are that all trust beneficiaries must be individuals, and you must be able to identify the oldest beneficiary. As a "see-through" trust, the IRS will look through the trust and use the oldest beneficiary's life expectancy when determining the MRD.

Only two trusts clearly qualify as see-through trusts: a conduit trust (described on page 47); and an "accumulation trust" Ms. Choate calls an O/R-2-NLP Trust (described on page 49), which passes outright at the life beneficiary's death to one or more individuals who are living at the participant's death and not to a trust. The main advantage of a conduit trust is that it automatically qualifies under the trust rules, and remainder beneficiaries of the trust are disregarded. In "accumulation trusts" all beneficiaries must be individuals, the oldest life expectancy is used to calculate the MRD, and the IRS looks to all beneficiaries (including contingent beneficiaries) when determining whether all beneficiaries are individuals. The O/R-2-NLP Trust qualifies as a see-through trust because all beneficiaries who are counted by the IRS as trust beneficiaries are individuals. Trusts other than the conduit trust and O/R-2-NLP potentially qualify for see-through treatment, but that qualification is less certain.

Note that most 401(k) plans do not allow a life expectancy payout, and instead require the beneficiaries to take a lump sum distribution.

Naming Disabled Persons as Beneficiaries (pg. 13)

Those who need a special needs trust to preserve government benefits can not use a conduit trust, and must instead use the O/R-2-NLP trust that qualifies as a special needs trust. Those families who are wealthy and who are not concerned about qualification for government benefits can use conduit trust.

Naming Multiple Beneficiaries (pg. 9)

When naming multiple beneficiaries, the life expectancy of the oldest beneficiary is used to calculate the MRD for all beneficiaries named, unless the beneficiaries divide the IRA (i.e. establish separate accounts) post-death by the required deadline. If separate accounts are established, each beneficiary can use his or her own life expectancy.

Practical Tip: When a trust terminates owning an IRA, the trustee transfers the entire IRA in tact to the beneficiaries, and does not need to terminate the IRA. The trustee simply writes the IRA provider, as trustee of trust, instructing them to change the title to the IRA to the beneficiary with his social security number. The statute is clear that this is permissible, and there are letter rulings that allow this kind of transfer, but some providers are reluctant to change title in this manner. IRA providers that are willing to change title at trust termination are listed on Ms. Choate's website at www.ataxplan.com.

Naming Spouse or Trust for Spouse (pg. 15)

Naming the spouse is very tax favored, but naming a trust for the spouse is not at all tax favored. The difference in tax treatment is significant, particularly when you consider that when the spouse rolls over a plan, she can defer payments until age 70 1/2, and use the Uniform Life Table to calculate MRDs each year, which essentially means she will never run out of money (assuming she takes only the MRD). There is a very high cost for using a trust as opposed to naming the spouse outright and clients should be aware of this cost.

Note that if a trust is named as beneficiary, then any beneficiaries who take through that trust can not use the separate account procedure discussed above, and instead, the IRS requires the oldest beneficiary's life expectancy be used to calculate MRDs (pg. 13). If the client's goal is to use separate life expectancy tables for the beneficiaries, and you are using a trust as a beneficiary, name the trust "if the owner's spouse survives him," and if the spouse does not survive, name the children as direct beneficiaries.

GST Issues (pg. 26)

We briefly discussed how a trust for a child for life, and then to grandchildren becomes more difficult with retirement plans. Ms. Choate sets out 5 ways to deal with this when starting on page 27 of her outline. Her favored approach is number 4 (pg. 28), which gives the child a power during life to withdraw assets of trust with the consent of a nonadverse trustee (which is treated as a general power).

Miscellaneous Issues

Page 42 of the outline sets out 17 things you need to know if you're doing work in this field. Additionally, the client needs to understand the trust accounting treatment of retirement benefits (in UPAIA states that often means only 10% of the MRD is income), and you as an advisor need to know what the client intends when he/she says they want an IRA to be paid to a trust for the spouse in which the spouse will receive "all income."

Beneficiary Designation Form (pg. 70)

Ms. Choate included a Beneficiary Designation Form which starts on page 70.
The form includes a provision allowing the transfer of the account by the beneficiary, and requiring the plan administrator to provide information to the personal representative of the owner's estate.

Practice Tip: To gain cooperation from a plan administrator that refuses to provide information to the personal representative that is necessary for preparation of the estate tax return, send a letter stating that you have for the information, that the plan administrator refused to provide it, and notifying them that under section 6018(b) the obligation to file an estate tax return for this asset now shifts to the plan administrator.

New Developments and Trends

Ms. Choate discussed several new developments and trends that are so new they are not in the outline. PLR 2005-37055 deals with the possibility that a trust protector could switch between a conduit trust and an accumulation trust, and modify the trust to limit the remainder beneficiary to persons who were younger than the current beneficiary. While the IRS approved this transaction, and Ms. Choate believes the concept might work under certain circumstances, she believes the ruling was questionable.

Generally, the obligation to take the MRD for the year of death falls on the beneficiary (to the extent the owner had not taken the MRD for that year). In Rev. Rul. 2005-36, the IRS concluded that a surviving spouse named as beneficiary who took the MRD would not be prevented from later disclaiming the IRA account, because acceptance of the MRD did not constitute acceptance of benefits for purposes of Section 2518 disclaimer.
Note that once the beneficiary exercises investment control, she cannot disclaim.

One hot trend is the self-directed IRA that invests in real estate. Ms.
Choate sees potential future problems for the general public engaging in these self-directed IRAs given the numerous traps for the unwary in this area, including UBTI, and a myriad of potential prohibited transactions which could disqualify the plan.

Prior to 2002 there were no extensions of the 60 day period for rollovers given by the IRS. In 2003, the IRS began granting hardship waivers allowing an extension of time in any case that doesn't violate equity or good conscious. Although you can use your IRA as a source of short term financing, you must have the funds back in the IRA within 60 days, or the IRS is unlikely to give an extension of time for "hardship." PLRs give examples of permissible hardship waivers.

In several 2005 PLRs, the IRS allowed (for the first time) the post-death rollover of a pre-death distribution by persons other than the spouse (e.g., the personal representative). When you are administering estates, you need to look at whether the decedent took any distributions from his plan and determine whether you need to seek permission to complete an intended rollover.

The IRS dealt with abuses in the area of valuation of life insurance and annuity contracts by issuing Rev. Proc. 2005-25 setting out the formula for determining fair market value of a life insurance policy (premiums paid less earnings minus reasonable charges), and issuing final regulations that state that when a plan distributes or sells a policy, the value for income tax purposes or the value for the sale must be the fair market value.
Additionally, abuses with variable annuities held in IRAs led to Rev. Proc. 2006-13, which addresses valuation rules for conversions from IRAs to Roth IRAs when the plan holds variable annuities.

Clients holding variable annuity contracts with guaranteed death benefits that contain a "high water mark" guarantee should consider pulling out most of the cash value and converting the annuity to a Roth IRA. The death benefit would have to be actuarily valued, and income tax would be paid now, but the beneficiaries would receive the death benefit tax free.

Consider recommending to clients who are retired, and over 60 but under 70 1/2 that they use up their income brackets converting their IRAs to Roth IRAs. Future MRDs will be reduced, as will future taxable income, and the client will have a tax-free source of income from the Roth. Also consider an IRA conversion to a Roth if the client has a short life expectancy.

Roth 401(k) plans are available to high income workers in a 401(k) or 403(b) plan. Clients should check with their employer to set this up.
Clients (or surviving spouse of clients) with net operating losses from a business should also consider participating in Roth IRA or converting existing IRAs into Roth IRAs as the net operating loss could offset the cost of the conversion.

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News From The Exhibit Hall
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Wealth Transfer Planning is now being marketed by Interactive Legal Systems [info@ILSDocs.com] is here again, this time with a fully operational HotDocs version of their WTP assembly engine. In fact WTP has developed some special proprietary HotDocs functionality just for their program. They had a choice of going with HotDocs or GhostFill and chose HotDocs. The user can modify the language in the forms and the system now comes with community property forms that were developed by Michael Graham, a co-owner, who practices law in Dallas, Texas, a community property state. Nicole Splitter formerly of US Trust has now joined the WTP sales staff, and Patricia McLelland, who has been with WTP since its inception, is still with the Company and here in Miami.

The hot talk of the day is all about GEMS, the tax return and fiduciary accounting software that was

developed by Gillett Publishing, LLC www.gillettpublishing.com. Currently they have three programs, GEM706,
GEM709 and GEMAcct. Mark Gillett, the President of the Company, advises that they have decided not to do a GEM1041 program even though Mark produced one for years for Shepards, then West, so we will have to look elsewhere for such a program. Hopefully we can cover some of the available options in that regard in later Reports. People who have purchased the GEMS system (it is not sold in separate modules) have been very pleased with it and how user friendly it is, which is no surprise given how well Mark developed the comparable programs for Shepards, then West, in the past. This is one set of programs that are well worth a look-see if you do not have one or are using ones you do not like, and the company is offering a discount price of $895 during the Institute and until January 15th, including for our readers.

Trusts & Estates magazine has just announced the premier (1/9/06) issue of the "Trusts & Estates Newsletter" and is making it available on-line exclusively to subscribers to Trusts & Estates magazine and for free. More information about this new publication can be obtained from Prism Business Media at Booth #103 at Heckerling.

Cannon Financial Institute has just announced the lineup for its monthly Estate Planning Teleconference Series for 2006. This series starts off on, Tuesday, January 24th, with the topic "Understanding Beneficiaries' Rights Under Trust Documents and Local Law." The presenters are none other than Roy M. Adams and Charles ("Clary") A. Redd, both of Sonnenschein, Nath & Rosenthal, LLP. Both Roy and Clary are presenters at this year's Institute. Roy is doing the Friday morning session on Circular 230 and Clary is doing the Thursday afternoon Special Session 3-E on Circular 230. For more information about the Teleconference Series, go to www.cannonfinancial.com/telecong.htm.

Our on-site local reporters who are present in Miami this year are Gene Zuspann Esq. of Zuspann & Zuspann in Denver, Colorado, Bruce Stone of Goldman, Felcoski & Stone, PA in Coral Gables, Florida (a member of the Institute's Advisory Committee), Herb Braverman of Walter & Haverfield, LLP in Cleveland, Ohio, Jeff Weiler of Benesch, Friedlander, Coplan & Aronoff, LLP in Cleveland, Ohio, Merry Balson of Wade, Ash, Woods, Hill & Farley in Denver, Colorado, Barbara Dalvano of Isaacson & Rosenbaum, PC in Denver, Colorado, Paul Hood of Dickenson, Peatman & Fogarty in Napa, CA, and Joanne Hindel of Fifth Third Bank in 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.

We 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 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 mail.abanet.org/archives/aba-ptl.html

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