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

Report #10

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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This Report contains coverage of some of the Thursday afternoon Special Sessions #3 on **Changing Trust Situs, Section 409A and Circular 230**

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The Nuts and Bolts of Changing the Situs of a Trust Thursday afternoon Special Session III-B, 1/12/06
Presenters: Richard W. Nenno, Joshua S. Rubenstein, Carol A. Johnston and W. Donald Sparks II

Reporter: Joanne Hindel Esq.

Top ten reasons people want to move trusts

1. Unhappiness with the current trustee, not due to a breach of fiduciary duty but because beneficiaries want better treatment
2. Avoidance of home state's income tax
3. Investment performance and the belief that a new trustee will do a better job or the ability to segregate administrative and investment responsibilities
4. Lower fees and costs for such matters as court accountings
5. The ability to coordinate the management of different trusts in different locations
6. The ability to engage in trust reformation
7. The ability to move to a state allowing the conversion to a total return unitrust
8. Asset protection options
9. The ability to extend the trust terms or get away from the rule against perpetuities
10. In order to avoid excessive or burdensome state regulation – particularly in the charitable trust area

Some additional reasons might be:

1. Better virtual representation statute in another jurisdiction
2. More lenient standards to remove existing trustees – note that states vary from best interest of trust to malfeasance
3. Moving in order to qualify for federal diversity jurisdiction

Note that while family may have particular reasons to move, other reasons may have to be given to court having jurisdiction in order to have a successful move. Must be careful not to demean the local jurisdiction when asking for permission to move the situs.

Be careful when considering the move to another situs that grandfathered GST trusts are not adversely affected and their exempt status is lost.
Might want to obtain an IRS Private Letter Ruling on issue before seeking permission from local court to move.

Top ten roadblocks to moving trust situs

1. Conflict or lack of cooperation among beneficiaries, the current trustee and the successor trustee
2. Absence of appropriate language in the document
3. Court intervention that makes it expensive and time-consuming
4. Generally, fee concerns such as a termination fee or the new trustee's fee
5. Uncooperative fiduciaries
6. Accounting requirements and attendant receipts, releases and indemnifications
7. Choice of law issues involving the construction, administration or validity of testamentary or inter vivos trusts
8. Conflict of interest issues among multiple beneficiaries, trustees and even lawyers
9. Virtual representation issues such as the need to appoint a guardian ad litem and attendant notice issues
10. Tying up loose ends with the jurisdiction one is leaving

Case studies

1. From Joshua Rubenstein

Proposed change of situs was from New York to Delaware

Fourth generation wealth family members were beneficiaries of a large number of trusts created by prior generations, some testamentary, some inter vivos. New York law governed all. Different trusts had different trustees and state income taxes on trusts were payable to at least two different states.

Family wanted to achieve convenience, uniformity and cost savings by creating a private trust company in Delaware. About 75% of the trusts could be moved pursuant to a New York statute giving the trustees the ability to move them without court involvement. The plan was to create a private trust company and fund it with a number of the trusts at issue.
The court was asked to unify administration with other family trusts already in Delaware.

The factors used to request court approval, that did not offend the court, included convenience of administration, convenience to the beneficiaries, the fact that the documents had a change of situs provisions, the fact that there already were other trusts for the same beneficiaries in the new jurisdiction, that all the affected beneficiaries consented, that there would be a significant cost savings in addition to the tax savings and the new jurisdiction (Delaware) had already provisionally accepted the trusts.

The negative factors in the situation included disagreement among the beneficiaries, disagreement with the trustees because one did not trust his family, the inability to predict if the court would grant the relief requested and the fact that the court mandated judicial accountings.

In the end, the mandated judicial accountings caused the whole matter to fail because this family had never kept written records of trust administration and could not provide the necessary accountings to get the trustee's releases.

2. From W. Donald Sparks, II

Proposed change was from Delaware to New Jersey

This matter involved an inter vivos and testamentary trust. Different choice of law rules applied to the two different trusts but both trusts did specifically permit the movement.

The family wanted the move because of perceived poor investment performance by the corporate trustee of the closely held stock in the accounts and because they wanted to avoid state income taxes.

The primary problems in the matter revolved around unreasonable client expectations (one of the beneficiaries was a litigation attorney who just wanted to force the change and deal with the consequences later) and fees that were payable to the old trustee and the new trustee.

Ultimately, the move did take place but the outstanding trustee fee issues took more than a year to litigate and the trust ended up paying a 1% termination fee.

3. From Carol A. Johnston

Proposed change was from California to Nevada.

This matter involved the transfer of both a testamentary and an inter vivos trust for the same family. The transfers were primarily state income tax motivated and also involved a grandfathered GST exempt trust.

In this situation, the same trustee would continue to administer the trusts in the new jurisdiction because it was a corporate trustee that had an affiliate in Nevada.

The primary problem was in timing the court order so that a favorable IRS ruling could be obtained before the court order confirming that the grandfathered GST exempt trust would retain its favored status.

In the end, Carol Johnston was able to get both a favorable IRS ruling and a court order that allowed the transfer. In this case, the attorney did inform the court that the primary reason for the move was for tax savings and found that the judge was amenable to the move despite the loss of revenue to California because all the beneficiaries had consented.

Questions from the audience

At the conclusion of the case studies, the audience raised the following questions:

1. When these moves are contemplated, do the parties give any consideration to the original intentions of the settlor?
Panel indicated absolutely and mentioned that the courts usually first look to the language of the governing document to see whether the settlor contemplated a possible change by including a change of situs provision.
Generally, these are easier to do if the settlor is still alive and participate in the matter.

2. Had any of the panelists ever dealt with trusts in different jurisdictions and simply swapped assets within them in order to obtain better tax treatment of those assets? Answer – no.

3. If the change of situs matter is approached under a non-judicial settlement arrangement such as is available in UTC states, do the panelists worry about possible inclusion of the trust in the settlor's estate under 2036? Answer: usually it is not includable if state law permits the change of situs.

In addition, another approach might be to go to court and get approval for the change that way and have the settlor file a statement of non-objection.

4. If you have all the beneficiaries agree to the move by way of an amendment to the trust terms, do you have gift tax or sale issues for the beneficiaries? Answer: you might if you change the beneficial interests.

This reporter found the topic fascinating and the case studies very illuminating. One should certainly read Richard Nenno's separate outline on Trust Choice of Jurisdiction to obtain a more in-depth review of matters discussed at the beginning of the panel discussion.

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How Does 409A Work
Thursday afternoon Special Session No. III-D, 1/12/06
Presenter: Donald O. Jansen

Reporter: Gene Zuspann Esq.

Initially Donald Jansen set out 6 different stock based arrangements that the CEO has received and analyzed each of these to determine whether they were subject to 409A (i.e., are they grandfathered?) and then whether they are excluded from 409A.

The first two are vested stock options granted before 12/31/2004. The first is exercisable at the FMV of the stock at the date of the grant. This is not subject to 409A because it is vested and because it is granted before 2005.

The second are vested stock options exercisable at a 10% discount from the FMV at the time of grant. Again, these are not subject to 409A because it was vested before 2005.

The second set of stock options were subject to a substantial risk of forfeiture (not vested). The first of these is exercisable at FMV at the date of the grant and has dividend pass-through rights before exercise. These would be subject to a 409A exception if it were not for the dividend-rights. The answer to these is “maybe.” If the dividend-rights are part of the underlying grant, then these are subject to 409A. However, if the dividend rights are set forth in a separate arrangement, the separate arrangement is subject to 409A but the underlying stock option is not. p13-14 The non-vested options exercisable at a 10% discount are subject to 409A and are not subject to an exception.

The next restricted stock is not vested for another 4 years. These are covered by 409A but excluded because of the substantial risk of forfeiture.

Finally, (trick question at least to me) the taxpayer has restricted stock units with a dividend pass-through before vesting of the vesting. These are subject to 409A but are excluded because a unit is not property. A promise to pay under sec 83 is not property.

Because of 409A, many plans will have to be amended before 2007.

Non-vested rights exercisable at the FMV at the date of the grant are covered by 409A but are excluded. from its application. If there is a discount factor, the employer may substitute non-discounted options and avoid 409A. The FMV is at the date of the grant, not at the market price of the security at the exchange date.

Remember: the object is to avoid paying tax on the deferred comp, along with an additional 20% income tax and interest at 1% above the underpayment rate. The tax is due in the year that is the later of the date the employee’s deferred comp does not comply with the new constructive receipt rules or funding rules, or the date it is not subject to a substantial risk of forfeiture.

The preamble, but not the regs, suggests two remaining remedies to make the executive whole if the company does not want to amend. (There was a third, but it expired in 2005) 1. The company can give restricted stock with the same terms to the exec = in value to the 10% difference.
2 The company can set up a separate 409A def comp plan with 10%
difference in value in that plan.

The object is to come into compliance under 409A so the exec can avoid an early income tax, along with a tax penalty and interest.

Other features can cause compliance problems. The one Don discussed is the dividend pass-through.

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The Gathering Storm - Circular 230: What Does It Mean and What Do We Do?
Thursday afternoon Special Session No. III-E, 1/12/06
Presenter: Charles A. Redd

Reporter: Jeff Weiler Esq.

The speaker's outline has five components: 1. Decision tree in question and answer format without boxes and lines, 2. Glossary of Circ 230 terms with citations to Circ 230, 3. Summary of covered opinion requirements, 4. a hypo for discussion at workshop, 5. Circ 230. He states that the important sections of Circ 230 are 10.0, 10.2, 10.3, 10.22, 10.33, 10.35, 10.36, 10.37, 10.50, 10.51, and 10.52. Hereafter references to sections will be to sections of Circ 230.

The American Jobs Creation Act of 2004 authorized the Sec of Treas to issue rules concerning written opinions related to avoidance or evasion of federal tax. While the statute authorized imposing monetary fines as a sanction, the current rules do not include the imposition of monetary fines.

Government concern was that taxpayers, after losing controversies, were able to avoid penalties by maintaining that they relied on an opinion letter that stated that there was a reasonable basis for their position.
The way for the IRS to have an immediate and direct impact on the perceived problem was to proceed against tax practitioners. The new rules, Circ 230, are directed at written advice and written tax opinions. The IRS felt that opinion letters being used by taxpayers where deficient in many respects.

Section 10.35 states when a covered (one covered by Circ 230) arises. When one or more federal tax issues (a defined term) are involved with written advice from a practitioner (a defined term) and : 1. it is a listed transaction, or 2 principal purpose is avoidance or evasion of IRC tax, or 3. significant purpose is avoidance or evasion of IRC tax and it is a reliance opinion, marketed opinion, or subject to conditions of confidentiality.

Principal purpose arises if tax avoidance or evasion exceeds any other purpose. There is an important exception that removes the written advise from the formal requirement that must be met for a written covered opinion.
This is that the purpose of the claimed tax benefit is consistent with the statute and also with the Congressional purpose. This exception only applies to "principal purpose" transactions and does not apply to "significant purpose" transactions. Being consistent with the statute and Congressional purpose is of no help in avoiding a formal covered opinion for a "significant purpose" transaction. Most difficult part of Circ 230 - what is a principal purpose transaction and what is a significant purpose transaction.

Marketed opinion (under Circ 230) as applied to speeches and articles. Speaker believes that there are few instances where the Circ 230 disclosure (that eliminates the need for a formal covered opinion) is required on speeches and articles. He feels that such written material is like a treatise and is not giving advice. In his view, advice must be given before Circ 230 applies (Reporter: Your reporter is omitting a Circ 230 disclosure from this email because the subject is not federal tax advice.
However, your reporter will be putting a Circ 230 on emails that have a discussion of federal tax

issues notwithstanding this speaker's views until your reporter is convinced that Circ 230 does not apply).

Does Circ 230 apply to an attorney employed by a bank and not in private practice but having customer contact and providing written comments on federal tax matters? Speaker maintains that the statement that the bank does not give tax or legal advice is not relevant for purposes of Circ 230, and fact that the attorney is in a department other than the bank's tax department is not relevant. Speaker's analysis is based on the down side to the employee. If the employee is not practicing before the IRS, then if the IRS applies sanctions to the employee, it has little impact on the employee other than embarrassment. Note that monetary fines do not apply at this time.

Question asked about Crummey withdrawal rights and whether they are consistent with the statute and Congressional intent. Speaker thinks they are so consistent. An attendee at the session stated that a member of the IRS Office of Professional Responsibility speaking in Michigan had a view contrary to the speaker's views on this issue.

Again, speaker stated that Circ 230 is directed at advice and not merely statements.

In regard to reliance opinions, Circ 230 applies if the advice at a confidence level of more likely than not.

If a formal written covered opinion is required, the rules require attention in the written opinion to significant federal tax issues. What about issues that are not significant? The rules do not state how to handle issues that are not significant in the formal written opinion. The speaker speculates that may be issues that are not significant do not need to be addressed in the written opinion.

In the estate planning process, client may be given written a communication that reviews many estate planning techniques. This could be preliminary advice (a defined term) and would not be a covered opinion if the practitioner in good faith expects to provide a covered opinion at a future date. Even though good faith intent was to send a covered opinion at a future date, circumstances may arise thereafter that result in the covered opinion not being sent. This should not be problem if there was good faith intent up front.

One way to avoid the impact of Circ 230 is prominent disclosure that the opinion can not be relied on to avoid penalties.

A Power Point presentation can be a written opinion subject to Circ 230.

Note carefully the definition of a federal tax issue. It is narrower than anything having to do with federal taxation. For instance, a comment about a return already filed concerning adequate disclosure does not involve a federal tax issue, and excise tax issues, e.g. private foundation rules, appear to be outside the definition of federal tax issues, and late advice after action has been taken is outside the definition (speaker cites section 10.35 (b)(2)(ii) (C)).

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News From The Exhibit Hall

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Looking for CUSIP numbers? Here from a recent discussion on the PTL List are the latest suggestions for where to go.

http://www.cusip.com - not free
http://activequote.fidelity.com/mmnet/SymLookup.phtml
http://www.quantumonline.com/Index.cfm
http://www.nasdbondinfo.com/asp/bond_search.asp

DataTech Software - Heritance System [www.heritancesystem.com]

The Heritance System is a tax, probate and fiduciary accounting software system that has been developed by DataTech Software. The fiduciary accounting module seamlessly shares integrated information with the other modules in the system, including the federal and state forms, and fills out these forms from within the accounting program. The system is flexible and the individual modules can be used separately or together. Since Heckerling 2005, the new or enhanced features include the handling of community property, the ability to group asset and liability accounts together, handling for selling multiple lots, including on the FIFO method, and the addition of additional reports, all of which can be personalized and exported in a variety of formats. Additional additions and enhancements include such things as multiple year trusts and estates, the ability to specify a date range on the First and final Accounting, the option to manually calculate the number of stock shares, prices and totals, the ability to convert from principal to income and vice versa, and the ability to transfer selected accounts to a trust to create multiple trusts from one estate. In 2006 one of the additions will be of several new state modules, including appropriate state formats for the accounting reports. Heritance also provides periodic on-line Webinars of their system for anyone who might be interested in obtaining an overview of their system. These last 20 minutes plus Q&A. The link for signing up for these is www.heritancesystem.com/webinar [the next presentation will be 1/18/06]. The special show price for this software was $899 just to give you a rough idea of its retail price.

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.

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
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