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

Report #12

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 the Friday morning main sessions on **Interests in Trusts in Divorce, Circular 230, and Lou Mezzullo's Wrapping It Up.**

PLEASE NOTE that we are NOT wrapping it up with this Report. We still have several reports yet to come from sessions that were held earlier in the week and even though there were some sessions we were unable to cover for a variety of reasons. So stay tuned and we will let you know when we have filed our final report for 2006.

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First another errata in Report No. 11. The main session on Avoiding "Oops"
with Partnerships in Your Estate or Trust Administration was presented by Carol A. Cantrell, not M. Read Moore and Samuel A. Donaldson as was stated in the header for that Report. Your Editor, not the Reporter, goofed on that one. We have not yet received a report for the Moore-Donaldson main session.
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Interests in Trust in Divorce: What the Settlor Giveth the Divorce Court May Taketh Away Friday morning Main Session, 1/13/06
Presenter: Marc A. Chorney

Reporter: Herb Braverman Esq.

Mr. Chorney reviewed the status of the law in so far as it effects trust interests held by individuals who are also involved in the termination of their marriages. In some cases, the trust interest may be found to be separate, non-marital property that is not involved in the division of property between the future ex-spouses , whereas, in other cases, the trust interest may be treated as marital property and be counted as marital property for purposes of the divorce court. Mr. Chorney focused on Colorado, his home state, where he has extensive experience, but he also discussed other jurisdictions and, where he could, generalized about the status of trust interests in divorce courts in all jurisdictions.

He identified the "all property" approach by a minority of states where the courts pool all the property of the parties and proceed to divide it appropriately and the more common "separate" -v- "marital" property approach, in which the property divided by the courts is that acquired by the parties subsequent to marriage, except for property acquired by gift, inheritance or similar fashion. Some states have apparently adopted a hybrid approach, giving the court some equitable powers to mix and match according to statutory factors. There is continuing differences in the treatment states give to the appreciation of separate property that accrues during the marriage--some states treat that appreciation as part of the separate property and some treat that appreciation as part of the marital property to be divided. These issues also exist in community property states where there is a lack of uniformity in dealing with these issues, even within a state the available case law may be hard to reconcile and rely upon.

Interests in a third party settled trust have been impacted by the expanding "property" definition in divorce courts, but there are statutes in some states that seem to exclude them from the property division process. Mr. Chorney noted California, Washington, New York, Iowa and Florida, contrasting different treatment in each. The interest in trust must be "possessory" at the time of the divorce in order to be considered marital property. Mr. Chorney discussed several cases to illustrate this point, including Solomon -v- Solomon in Pennsylvania, Storm -v- Storm in Wyoming. Loeb-v-Loeb in Indiana. The interest that is merely a prospective expectancy (even a very likely one) is not part of the marital property to be divided by the court.

On the other hand, some courts have ruled that a remainder interest that will be fully distributable to a spouse at some point is subject to the court's dispositional powers even when the interest is subject to a survivorship provision or could be eliminated by a preceding beneficial interest in the trust. This approach is sometimes tempered by a notion of "vesting" but not in all courts.

In Trowbridge -v- Trowbridge (Wis.) and in Davidson -v- Davidson(Mass.), courts did not find a vested interest, but did include the interest in the property division process, presumably on their own equitable basis. Nevertheless, the "vested interest" concept has been(and is being) applied in divorce courts in various states. Mr. Chorney discussed Balanson in Colorado, where the Supreme Court of the state determined that one spouse had a "future, vested interest not within the discretion of the trustee to withhold" and that this interest was not a "mere expectancy"
even though there appeared to a number of circumstances that would have prevented the spouse from ever benefiting from the trust interest. The Court, in dicta, suggested that the presence of a general power of appointment in the trust may have taken the interest out of the "property" definition. This presents a planning point in this area perhaps. Mr.
Chorney did not suggest that a special power of appointment would be as
helpful. Furthermore, Mr. Chorney appeared to support the position of
some courts the "vested interest" approach should be replaced by a "facts and circumstances" evaluation on a case by case basis. This would require that the court look at the facts and circumstances to determine whether the interest in trust is too uncertain, remote or speculative to constitute "property" for this purpose.

Mr. Chorney also related Colorado cases suggesting that interests that were not fully distributable to a beneficiary/spouse would not be property in divorce courts for one of three reasons--the trust were discretionary, the interest in trust could not be reached by creditors or the interest was so uncertain that it could not be quantified at the time of the termination of the marriage.

As for income interests in trusts, the states predictably have gone in either direction, some states including these interests as property and other states excluding them. Check out your own state!

An interest in a third party revocable trust of a living settlor has be analogized to an expectancy in a will--neither is included as a property interest in divorce courts. Similarly, a limited power of appointment was held not to give rise to a property right in divorce court, except in one MA case that Mr. Chorney concluded actually stood for the proposition that "bad facts make bad law."

Mr. Chorney discussed the possible analogy between pensions and their treatment in divorce courts and trust interests, transfer tax valuation of temporal interests in trusts, valuation under elective share statutes in a number of states and attempts to join a trustee in a divorce action, all with interesting detail but no reliable conclusions. As he closed, he noted that what we have really learned is that, as planners, we must keep an eye on the issues that are being raised and dealt with in divorce courts in our states and, perhaps, in others.

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Circular 230: A Nine-Hundred Pound Gorilla Friday morning Main Session, 1/13/06
Presenter: Roy M. Adams

Reporter: Jeff Weiler Esq.

The speaker began with a history of Circular 230. The regulation of lawyers and agents who represent claimants before the United States Treasury Department began with the Horse Act of 1884. Apparently claims were permitted for the value of horses and other property lost during the Civil War. Some fraudulent claims are being filed and this Act permitted the Treasury Department to discipline attorneys who assisted with filing inappropriate claims. The American Jobs Creation Act of 2004 that became effective on October 22, 2004 permits the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction, plan or arrangement which is of the type the Secretary of Treasury determines as having a potential for tax avoidance or evasion. The Act also authorizes the imposition of monetary fines. On May 19, 2005 the Treasury Department issued final regulations on Circular 230 which became effective after June 20, 2005.

The speaker agreed with two other commentators, Howard Zaritsky and Jonathan Blattmachr that Circular 230 is a positive thing. It discourages practitioners from accepting assignments that they are not capable of doing. The need for covered opinions and the cost of the preparation of such opinions will prevent professionals from attending to some relatively modest value transactions and only very large transactions for wealthy taxpayers will be able to bear the economic costs of the complex, comprehensive covered opinions.

While the best practices for tax advisors set forth in Circular 230 Section
10.33 (hereinafter all references to Sections shall refer to Sections of Circular 230) are not mandatory, some respected commentators have stated that this Section could be used to form a basis for malpractice liability. The best practices include several requirements one of which is establishing facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law to the relevant facts and arriving at a conclusion supported by law and facts. Evaluating the reasonableness of any assumptions or representations will require work by the tax practitioners.

Section 10.35 deals with covered opinions. This refers to certain kinds of advice that, if provided by a practitioner, is subject to detailed requirements. A covered opinion arises if the advice is written (including electronic communications) and concerns one or more federal tax issues arising from: (1) a transaction that is a listed transaction, (2) a transaction where the principal purpose is the avoidance or evasion of tax, or (3) a transaction with a significant purpose of which is the avoidance or evasion of tax and the written advice is a (a) reliance opinion, (b) a marketed opinion, (c) subject to conditions of confidentiality, or (d) subject to contractual protection. A federal tax issue is a question concerning the federal tax treatment of an item of income, gain, loss, deduction or credit, the existence or absence of a taxable transfer of property or the value of property for federal tax purposes.

If the transaction is a principal purpose transaction, the detailed rules do not apply if the claiming of a tax benefit is in a manner consistent with the statute and Congressional purpose. If a transaction is a principal purpose transaction, there cannot be a Circular 230 disclosure to avoid the detailed covered opinion.

If a transaction is a significant purpose transaction, consistency with a statute and Congressional purpose will not avoid the detailed rules. However, with a significant purpose transaction, a Circular 230 disclosure can be made to avoid compliance with the detailed rules for a reliance opinion and a marketed opinion.

Preliminary advice will not be a covered opinion if the practitioner is reasonably expected to provide a subsequent written advice to the client that satisfies the requirements for covered opinions.

The speaker observes that there will be a lot of oral tax advice. There could be transcriptions of the oral advice prepared by the client and not by the practitioner.

A practitioner can provide a limited scope opinion. This is a written opinion that considers less than all of the significant federal tax issues and a practitioner and the taxpayer agree that the scope of the opinion and a taxpayer's potential reliance on the opinion for purposes of avoiding penalties that may be imposed on the taxpayer are limited to the federal tax issues addressed in the limited scope opinion.

At this point the speaker mentioned that he gave a limited scope opinion concerning unrelated business taxable income. Your reporter asked the speaker after his presentation whether he believes that the Circular 230 rules apply to excise taxes such as those that arise concerning private foundations. He responded that he was not sure that the Circular 230 rules do apply to such transactions. However, the instance in which he gave the limited scope opinion concerning unrelated business taxable income related to an income tax deduction and the deductibility of an expenditure for federal income tax purposes.

The speaker suggested that the most likely areas involved with estate planning that may require covered opinions are the creation of family limited partnerships and limited liability companies, an installment sale to an intentionally defective grantor trust, and Crummey withdrawal powers granted to individuals who have no significant interest in the trust beyond their withdrawal powers.

Section 10.52 enumerates the penalties that can be asserted against the practitioner. These include censure, suspension, or disbarment from practice before the IRS.

The speaker's outline states that whether a constitutional challenge against Circular 230 could succeed is questionable.

The speaker commented on unofficial guidance from IRS officials and the discussion of future regulations. One is IRS Chief Counsel Donald Korb who stated that the agency intends to “use a rule of reason or common sense in applying these rules”. OPR Deputy Director Stephen Whitlock has said that the IRS will be looking for patterns of behavior and repeated conduct before imposing Circular 230 penalties. OPR Director Cono Namorato has said that the IRS is not looking to penalize practitioners for inadvertent “foot faults” and would not try to be “hyper-technical”. Acting Secretary Tax Legislative Counsel Michael Desmond has stated that the government will be reasonable in enforcing Section 10.35 and that practitioners should use common sense when determining how to comply with that Section. The speaker concludes that most of these statements provide little help to practitioners as they struggle to comply with Circular 230. It appears that each of these IRS officials do not wish to provide clear guidance regarding Circular 230 through their own public statements and would rather have publications such as notices, revenue rulings and additional regulations meet this objective.

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Wrapping It Up
Friday morning Main Session, 1/13/06
Presenter: Louis A. Mezzullo

Reporter: Jeff Weiler Esq.

The speaker had a comprehensive and complex factual situation set forth in his outline. As he reviewed the hypothetical, he commented on presentations made by previous speakers at the seminar. The facts included three residences – a primary residence and two vacation residences. He suggested that consideration should be given to a qualified personal residence trust. The facts included a very valuable closely held business. He suggested getting an appraisal of the business because clients frequently think their businesses are worth much more than indicated by an appraisal. Rental real estate was owned and the speaker observed that this should be transferred to a limited liability company for a number of reasons.

In commenting on a designated beneficiary for a retirement plan death benefit, the speaker observed that a parent could name a child as the beneficiary and give the child a general power of appointment which if not exercised results in the death benefits going to the child’s estate. It was the speaker’s view that having the death benefits going to the estate of the deceased beneficiary (not the plan participant) should qualify as a distribution to a designated beneficiary (Reporter: the speaker did not cite authority for his position).

In regard to Circular 230, the speaker stated that he has a minority view. He does not use the Circular 230 disclosures in his written communications. He feels that the primary purpose of his estate planning work is to pass assets to younger family members and that there are not significant federal tax issues involved. In regard to his work on family limited partnerships, he thinks that the significant federal tax issues arise with Section 2036(a) and Section 2038 and he does not give any advice on the application of these provisions since there is a facts and circumstances test that applies. After documents have been signed and are being sent to his clients, he provides instructions concerning the operation of the entity but does not provide an opinion. Much of his advice is preliminary advice. If the client does not go through with the proposed estate planning techniques, he does not feel that there should be a problem. Since Circular 230 involves ethical rules, there are no bright lines and common sense should be used in determining the application of the rules. By the presence of a Circular 230 disclosure at the beginning [sic.
end] of this email, you may assume that your Reporter does not subscribe to the speaker’s minority

view on Circular 230 disclosures.

In regard to the application of the reciprocal trust doctrine to irrevocable life insurance trusts where a husband and wife currently establish reciprocal trusts, he observed that the only amount that may be subject to the reciprocal trust doctrine is the initial funds placed into the trust with the future life insurance proceeds not being subject to the doctrine. (Reporter: citation not provided).

He remarked that asset protection has received a boost from the new bankruptcy law The rollover of a plan participant's account in a qualified plan to an individual retirement account now will be exempt. In the past, the speaker was concerned about telling his physician clients to rollover their qualified retirement plan death benefits to an IRA because an IRA did not have the same protection from creditors that was available to the account in the qualified plan. Now the protection that was available to the account in the qualified plan is also available to the account in the rollover IRA.

The speaker's outline listed 21 items that will be unaffected by repeal or substantial increase in the applicable exclusion amount. He discussed each of the items. One of which was planning to cope with carryover basis. He observed that the statutory implementation of carryover basis in the past was terminated before it became effective. If no action is taken, the current laws provide that carryover basis will begin with the year 2010. He is concerned that the relationship between the Democrats and Republicans in Congress is so hostile that they may not be able to agree on a change in the tax laws before 2010. The result could be that the estate tax laws are actually repealed in 2010 and carryover basis actually becomes effective.

Several areas where reform could be made concerning the transfer tax laws were mentioned. These included eliminating the ability to use Crummey withdrawal rights, reducing the annual exclusion amount or the number of annual exclusions available per donor or both, providing for portable applicable exclusion amounts between spouses, eliminating discounts for family controlled entities, and eliminating dynasty trusts.

He observed that prior to the enactment of the generation-skipping transfer tax, few of his clients were concerned about dynasty trusts. After dynasty trusts became limited by the generation-skipping transfer tax rules, client then had an interest in implementing dynasty trusts. He had the same observation concerning the estate freeze rules and GRAT's. Prior to the enactment of the estate freeze rules, few of his clients had an interest in GRAT's. After the enactment of the estate freeze rules, his clients developed an interest in GRAT's.

Suggestions were offered for reviewing current estate plans. Because of the increase in the estate tax applicable exclusion amount, current estate plan should be reviewed to determine whether the additional amount that would be going to the credit shelter trust pursuant to a formula is appropriate to a particular situation.

He observed that the generation-skipping transfer tax automatic exemption allocation rules are giving him a headache. In many cases the client will not [want] the automatic allocation made. He feels that it is usually better practice to make an independent decision regarding the allocation of the generation-skipping transfer tax exemption on an annual basis unless it is certain that the allocation should either always automatically apply or never automatically apply with respect to certain trusts.

In regard to planning for repeal of the estate and generation-skipping transfer taxes, he observes that clients may want alternate dispositions depending on whether or not their estate plan is subject to the estate and generation-skipping transfer tax at the death of the client. Conditioning an alternate disposition upon the repeal of the estate and/or generation-skipping transfer tax is not the most effective way to deal with this uncertainty since the estate and/or generation-skipping transfer tax may not be repealed but simply may not be applicable to decedent's dying in a particular year. This is what will occur in 2010 if the law is not changed before then. The estate and generation-skipping transfer taxes will not apply although they are not repealed. In some cases the client may want assets passing outright. In other cases the client may want to have assets passing to one or more trusts that will be held for an indefinite period in such a way that if the estate and generation-skipping transfer tax are reinstated the assets of the trust will not be subject to the transfer tax. This would involve not permitting the beneficiaries to have a general power of appointment. If repeal does occur, there is concern about the meaning of terms in existing documents that refer to terms currently in the IRC that may no longer be there after repeal. Because the gift tax will presumably still apply, there will be a premium on using techniques that involve little or no taxable gifts.

In regard to removing assets from the transfer tax system, some practical considerations were offered. Techniques that the speakers feels should be used include GRAT's, CLAT's, as well as other techniques. He suggested a combination of techniques such as the purchase of assets from a GRAT by a grantor trust for a SCIN is something that should be considered.

In structuring short term grantor trusts, the speaker sometimes defines the annuity as the greater of the annuity amount or capital gains.

Comments were offered about recent decisions concerning family limited partnerships and family limited liability companies. He noted the Kelly decision. (Reporter: no citation provided). Two-thirds of the assets contributed to the partnership were cash and one-third was marketable securities. The taxpayer died five months after formation. A 53% discount was claimed. The IRS was willing to allow a 24% discount. The court allowed a 32% discount. IRC Section 2036, 2038 and 2703 were raised by the IRS and dropped. The taxpayer was in his 80's, had a physical shortly before he died, and had a holiday photo taken showing him in good health before he died. He had a pension that provided sufficient funds to maintain his standard of living. The facts in this case were good but not great.

The Keller decision (Reporter: citation not provided) involved a family limited partnership funded with marketable securities. The IRS was seeking summary judgment under IRC Section 2036. The District Court denied the summary judgment request because there were too many factual issues.

The speaker suggests that when a family limited partnership is formed, it should not be merely to save taxes. There should be many other non-tax reasons for formation. He noted that in the Shutt decision
(Reporter: citation not provided) there was not "business" reason for the formation of the entity. A main reason was to carry out and invest and hold investment philosophy.
This was the last speaker of the seminar. At the conclusion of his speech, the seminar director announced that the attendance at the seminar this year was 2,617 persons.

As required by regulations at Title 31, Part 10 of the Code of Federal Regulations which comprise Treasury Department Circular 230, the statement that follows is made pursuant to Section 10.35(b)(5)(ii) of Treasury Department Circular 230:
(a) Any advice set forth in this email memorandum is not intended or

was not written by the author to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;
(b) The advice in this email memorandum was written to support the
promotion or marketing of the transactions or matters addressed by this email memorandum; and
(c) Any taxpayer should seek advice based on the taxpayer’s
particular circumstances from an independent tax advisor.

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News From The Exhibit Hall
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ABA Real Property, Probate and Trust Law Section
[http://www.americanbar.org/groups/real_property_trust_estate.html]

The ABA RPPT Section was an exhibitor again this year, offering discounts on their numerous publications. Unfortunately you had to be three to partake of those discounts. One of those publications is the Section's flagship magazine. The latest issue for January/February 2006 contains an interesting article in its Technology - Property column by Gary Whittington about the eight blunders of trying to develop word processing document assembly documents. This is such good article that we thought we would list the eight blunders here as a way of peaking your interest. For in more depth treatment of these, we refer you to the article.

Blunder 1 - In The Swamp of Perfectionism Blunder 2 - Drafting by Programers Blunder 3 - The Grand Plan Blunder 4 - Taking Too Much Drafting Responsibility Away From Users Blunder 5 - Encouraging a Slave Mentality Blunder 6 - Forgetting the 80/20 Rule Blunder 7 - To Far Ahead of the Technology Curve With Web-Based Assembly of Complex Templates Blunder 8 - Too Few Documents

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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, 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.

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