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

Report #6

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 Wednesday afternoon **Special Session #1 Programs on Transfer Tax Audit Issues, Ethics and the Trustee's Duty to Provide Information to Beneficiaries**

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Transfer Tax Audit Issues: What's Hot
Wednesday Afternoon Special Session 1-B, 1/11/06
Presenter: Norman J. Benford, John W. Porter, Martin E. Basson and James L. Gulley

Reporter: Paul Hood Esq.

1. FLP-LLC/2036 cases.

John Porter led off with a discussion of FLP/2036. He feels that 2005 cases gave us clarification-but little guidance, in part because the cases were so fact-intensive cases. 2703 arguments are being resurrected. Can we ignore the buy-sell provisions? Blount.

Bongard: Every judge on Tax Court weighed in on this matter except Judge Cohen. Bongard partnership was not operated as a piggy-bank-no distributions to Bongard. 2036(a)(2) argument turned into a 2036(a)(1) argument. No real business purpose required, just a non-tax purpose.

Korby: Sr. Gen got all distributions-court found distributions to have been made as needed-and not as a managerial fee.

Porter noted the following bad facts that the IRS keeps litigating:
Personal use assets in entity; fiduciary duties negated in governance documents; percentage of assets contributed to the entity versus assets retained; commingling; non-pro rata distributions.

Basson stated the he feels sympathy for innocent taxpayers who have watched the facts and results change in this area of the caselaw over the past few years. Attorneys involved in the planning and now the audit clearly are under pressure, and his auditors see that. The IRS hasn't given up on 2001

guidance. Look for continued aggressive enforcement. Still looking at business purpose. Signed more summons lately than ever before. 73 cases in his inventory. Not every entity is being audited, though, as the audits consider matters on a coordinated case by case basis.

Gulley noted that there were 206 cases in Appeals. 74 cases docketed. Mary Lou Edelstein is telling Appellate conferees to give zero discounts in "strong 2036 cases." Per Basson: No meaningful average discounts for cases being settled," even after Benford pushed him on the recent caselaw. But then Basson said something about a 25-35% discount.

Had 100% discount case (multi-tiered entities). And a 90% case. Gulley said "you're going to get a discount, but its going to be fact-driven."

2. Impact of post-valuation events-Noble.

Post-death sale. Okerlund. Basson-"These cases prove that you can get any number you want out of the appraiser-even prominent appraisers." But then he took that statement back. Basson stated that the IRS will make an attempt to get a sale into evidence, no matter how pre- or post-valuation date it is.

3. Discount for Built-in capital gains-Jelke.

C corporation-lots of marketable securities. The IRS appraiser used a DCF approach to value the discount for built-in capital gains-but used net asset value approach for enterprise (entity) value. Taxpayer filed appellate brief three weeks ago. Government brief is due shortly.

4. Lottery winnings/stream of payments. Basson-IRS will continue to rely upon 7520.

5. Defined Value Transfers.

McCord-pending with Fifth Circuit for coming on two years. Defined value disclaimer case-stipulated to Tax Court for about a year-maybe awaiting McCord.

6. Forum shopping/taxpayers. The IRS noted that there seems to be some attempts to get cases moved around to affect appellate venue, which they don't believe works under the rules.

7. IRS Discovery-Enforcement.

Basson: IRS Enforcement budget is up from 25% of overall budget to 60%.
More summons enforcement in transfer tax matters. Call the manager if you're feeling overburdened. Porter chimed in not to forget privileges before just turning materials over-especially if the client has to waive that privilege first.

8. Graegin Notes.

Nothing going on per John Porter. IRS settling cases.

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Ethics - What's a Lawyer to Do?
Wednesday Afternoon Special Session 1-D, 1/11/06

Presenter: Frank A. Thomas III

Reporter: Gene Zuspann Esq.

Ethical Issues in Multigenerational Representation or Pork is a Four letter word

"Or fun with the dysfunctional family"

Frank starts with a lengthy fact situation, followed by a number of questions.

The patriarch, Bubba, is the sole owner of Hooo Pig, Inc., a successful distributor of pork rinds and chitlins. Drudge is his lawyer and was a childhood friend. He has always represented Bubba, Hooo Pig, and all of the family.

He has put into place a complex estate plan for Bubba, his wife and their children. He did obtain engagement letters allowing free sharing of all information. Part of the plan is to set up irrevocable trusts for their children and grandchildren funded with Hooo Pig stock. Later, Hooo Pig goes public and Bubba finds that his net worth and that of his family has increased substantially.

Many of the answers to the questions are straight forward. For instance, Bubba asks Drudge to change the beneficiary designation on his IRA to a long time paramour from the business, and not to tell his wife.

As to the issue of disclosure, Frank has 5 choices to the question - can he tell the wife about the paramour?

They range from yes because they are joint clients, yes because the action is detrimental to the wife, to no - the IRA was going to charity and does not effect the wife and no - it will be harmful to Bubba. Frank summarized that there is no right answer. The case law comes down across the board. He pointed out that a consent to disclose is revocable, and in the case law "confidence trumps loyalty almost every time." The choices are to get consent from all parties or to withdraw.

Other topics include: Representation of one former client when another one has a new attorney. The conclusion was that generally, an attorney cannot represent one client against another. An exception occurs if a substantial amount of time has passed, however, he also concludes that "you are a brave sole if you are going to try that one."

On one client wanting to take action against another's wishes - the attorney needs to stop the suggestion immediately and if the client in the office continues talking, then the attorney must disclose the conversation to the other client.

Frank suggested that the engagement letter in a case such as this should indicate that Bubba is the primary client, that he will continue to represent Bubba, and that anyone else choosing to have him represent them do so at their own peril.

In a situation where the representation is a successive relationship, and if something adverse happens, "cut the cord quickly and cleanly" and be as neutral as possible.

In a situation where a trustee intends to take some action adverse to the trust and the beneficiaries,

the attorney needs to immediately advise the trustees of the possible breach of trust. Conflict between two trustees, when the attorney has jointly represented them involving the trust, requires immediate withdrawal.

As to the question of incompetence of the client, an issue is to whom may the attorney make disclosure. Frank indicates that it is clear that Drudge could disclose Bubba's incompetence to his doctor. This varies from State to State.

Frank also has an outline with the materials. He pointed out that, when things go south, the first thing to go in the joint or mutual representation is consent to disclosure. If there is an issue, you must get a new, informed consent from all parties to continue, or withdraw.

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The Trustee's Duty to Provide Information to Beneficiaries: When Can the Settlor Say "Don't Ask, Won't Tell"?
Wednesday Afternoon Special Session 1-E, 1/11/06
Presenters: Anne J. O'Brien, Gail Cohen and Dennis I Belcher

Reporter: Joanne Hindel Esq.

Definitions under the UTC

Anne O'Brien started the discussion and explained that this would be an expanded discussion of the settlor's ability to keep information out of the hands of beneficiaries with a review of different state approaches to Section 105 of the Uniform Trust Code, the Duty to Inform and Report.

She reviewed the definitions of types of beneficiaries under the UTC Section 103:
- Beneficiary: a person that has a present or future
beneficial interest in a trust, vested or contingent or, in a capacity other than that of trustee, holds a power of appointment over trust property
- Qualified beneficiary: a beneficiary who, on the
date the beneficiary's qualification is determined:
- (A) is a distributee or permissible distributee of
trust income or principal
- (B) would be a distributee or permissible
distributee of trust income or principal if the interests of the distributees described in (A) terminated on that date without causing the trust to terminate; or
- (C) would be a distributee or permissible
distributee of trust income or principal if the trust terminated on that date.

Under Section 813 of the UTC, trustees are required to (I) notify "qualified beneficiaries" (current beneficiaries and first-line remainder
beneficiaries) who have attained age 25 of the existence of the trust, the identity of the trustee and the right to obtain copies of the trustee'
reports and (ii) to respond to the request of any beneficiary for trustee's reports and other information reasonably related to the administration of a trust.

The duty of a trustee under Sections 813 (b)(2) and (3) to provide notice and information to "qualified beneficiaries" is mandatory to the extent such beneficiaries are 25 years of age or older, regardless of whether the beneficiaries have requested any information from the trustee. Section 105(b)(8) ensures that any "qualified beneficiary" will learn of the trust's existence and have the ability to request further information about the trust no later than age 25. In contrast, a trustee's duty under Section 813(a) to provide "beneficiaries" with all information reasonably related to the trust's administration becomes mandatory only upon the request of a beneficiary.

The UTC protects trustee who abide by the Code's information and reporting requirements by providing that an action for breach of trust may not be commenced more than one year after the trustee provided a report that adequately disclosed the existence of a potential claim for breach of trust and informed the beneficiary of the one year time limitation. In the absence of a report that adequately discloses a claim, a five year statute of limitations period applies, and the five-year period does not begin to run until the trustee is removed, resigns, or dies; the beneficiary's interest in the trust terminates; or the trust itself terminates.

Case law addressing trustee reporting duties

Dennis Belcher then discussed the Fletcher v. Fletcher decision (480 S.E.2d
488) in which he represented the defendant and appellant. In that case, the settlor provided under the terms of her revocable trust that, upon her death, three separate trusts, one for her adult son and one for each of her two grandchildren, be established. The settlor appointed another son to serve as trustee of each of these trusts with a bank serving as co-trustee.
Apparently, the settlor, on her deathbed, had asked the trustee-son to not disclose any terms of the trust to the trust beneficiaries and the son had agreed. A year after the settlor died, the beneficiary son brought a proceeding against the trustee asserting that their refusal to comply with his request for a copy of the entire trust agreement precluded him from determining whether the trustees were fulfilling their duties as trustees.
The trustees had provided sections of the trust agreement, namely the section designating each beneficiary as such and the administrative provisions applicable to the trustees but the beneficiary-son wanted a copy of the entire trust agreement. The trial court ruled in favor of the beneficiary and the appellate court did also, stating in its opinion that the trustees had placed too much emphasis on the duties of the trustees and not enough on the rights of the beneficiaries. Dennis Belcher did mention, that, in hindsight, it might have been better to bring a separate action rather than a demurrer to the action brought by the beneficiary-son so that the trustees could have introduced testimony showing that the decedent had not wanted information conveyed to her beneficiaries.

Settlor flexibility under the UTC

Anne O'Brien then emphasized that like the Fletcher decision, the UTC requires a trustee under Section 813 to furnish a copy of the entire trust agreement. She suggested that drafting attorneys should therefore consider changing documents to clearly reflect the settlor's intention regarding the purposes of a trust, as well as the ability of a beneficiary to change the trust situs.

She also mentioned, however, that unlike Fletcher, most trustees will want to disclose information

about the trust in order to commence the one-year statute of limitations period for actions against the trustee for matters revealed to a beneficiary.

Situs shopping to avoid notice requirements

Gail Cohen then discussed some aspects of the reporting and notice issues from the perspective of the corporate trustee. She said that her institution had done an inventory of their trusts to see whether the documents identified what law governed administration of the trust. She said that under common law, settlors had broad discretion to determine the situs of trust administration.

She pointed out that under the UTC 107, the settlor is given the ability to select the jurisdiction for administration of the trust unless the law is contrary to the jurisdiction having the most significant relationship to the trust. She cautioned that if a settlor wanted to designate a jurisdiction more favorable to his or her trustee reporting choices, the settlor would have to be sure that the rules governing trustee situs and administration meshed or be sure that the trust had substantive contacts in the jurisdiction chosen.

Questions from the audience

The panel then took question from the audience that included the following:

- Whether UTC Sections 105 and 107 were in conflict
with each other since 105 seemed to require certain notices to beneficiaries but 107 would allow a settlor to choose a different trust situs that might not have such notice requirements (the panel agreed that this appeared to be internally inconsistent).
- Whether a purpose trust (used primarily with
off-shore trusts) would be subject to beneficiary notice requirements (the panel determination was that it might not)
- Whether personal information about a beneficiary
gathered by a trustee in the course of administration could be subjected to disclosure under the reporting rules (the panel consensus was that it could
not)
- Whether the beneficiary surrogate concept available
in some jurisdictions could serve as a substitute for problematic beneficiaries (the panel indicated yes but explained that the surrogate concept has undergone much criticism and cited a recent article in Trusts and Estates magazine)
- Whether a contingent beneficiary (alternate to the
named beneficiary if that beneficiary did not survive the trust term) could obtain trust information (the panel indicated no since this beneficiary did not fall within the qualified beneficiary category)

States responses to the UTC notice requirements

The panel mentioned the chart included in the outline that identifies each state's status regarding

adoption of the UTC and its position on the notice requirements.

By way of summarizing some aspects of the chart here is the following excerpted from Anne O'Brien's outline:

By the end of their 2004 legislative sessions, ten jurisdictions had enacted the UTC: D.C., Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, Tennessee, Utah and Wyoming. With the exception of New Hampshire and New Mexico, each had altered the mandatory notice and reporting provisions in some way.

During 2005, five additional states adopted the UTC: Arkansas, North Carolina, South Carolina, Oregon and Virginia.

Of these states, only New Hampshire and New Mexico have adopted UTC 105(b)(8) and (9); eight (Arkansas, Kansas, North Carolina, South Carolina, Tennessee, Utah, Virginia, Wyoming) have omitted these sections entirely.
Nebraska omitted (b)(8) but adopted (b)(9), and four others (D.C., Maine, Missouri, and Oregon) have retained both (b)(8) and (b)(9) but have changed them in some way.

D.C. and Maine have created a role for a "trust protector" to receive notice on behalf of "qualified beneficiaries."

Some jurisdictions have cut back the scope of the notice provisions by narrowing the definitions of "qualified beneficiary" which could be described as including current beneficiaries, secondary beneficiaries, and presumptive remaindermen.

In Kansas, the definition of "qualified beneficiary" does not include secondary beneficiaries but does include presumptive remaindermen. In Wyoming, however, "qualified beneficiary" excludes both secondary beneficiaries and presumptive remaindermen. Maine has adopted the definition of "qualified beneficiary" but has added a provision stating that it does not include a contingent distributee or a contingent permissible distributee of trust income or principal whose interest in the trust is not reasonably expected to vest.

This reporter found the panel discussion interesting and informative and was particularly appreciative of the fact that, unlike some of the other presenters, these speakers did not unfairly criticize corporate trustees and in fact, included a representative of a corporate trustee on the panel.

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News From The Exhibit Hall
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GEMS

Talk about timely technical support, take a look at this little GEM that hit the airwaves today:

Date: Thu, 12 Jan 2006 14:22:13 -0600 (CST)
From: "GEMS" <gems@neb.rr.com>
To: <Support@gillettpublishing.com>
Subject: GEMS UPDATE NOTIFICATION - GEMS 709

To all GEMS Users,

Yesterday afternoon we discovered a minor calculation issue in our newly released GEM709 program and have posted an update to our website this morning to correct the issue. The update makes a correction to the tax computations on the 709, page 1, lines 4 and 5 for amounts LESS than $10,000 on lines 2 and 3. We apologize for this inconvenience. Our corporate policy is to immediately update GEMS if an issue is discovered and to inform our users as quickly as possible. We appreciate your understanding and will continue to strive to give you the very best products and support.

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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