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

Report #8

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 #2 Programs on Marital Planning, Charitable Giving and Estate Tax Repeal**

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More Marital Planning
Wednesday Afternoon Special Sessions II-C, 1/11/06
Presenter: Eric A. Manterfield

Reporter: Barbara A. Dalvano, Esq.

This is a continuation of the general session program presented by Eric Manterfield on Tuesday, January 10, 2006 on Marital Deduction Planning in an Era of Transfer Tax Reform. The Workshop consisted of a series of fact patterns Mr. Manterfield developed and participant discussion on the planning issues presented. The fact patterns addressed a variety of fundamental estate planning issues.

Fact Pattern #1

Husband and wife are in first marriage. H is 43 and W is 42. They have 3 kids, 18, 15 and 12. Both work outside home and H earns $275,000 and W earns $85,000 annually. They travel frequently with kids. Goals include providing for well being of each other and assets thereafter distributed to kids in a thoughtful manner. Assets include residence with FMV net of mortgage of $450,000; cash and investments of $250,000 jointly owned (H also owns $35,000 and W also owns $15,000 individually). H has $1M life insurance and W has $500,000 of life insurance. H has retirement assets of $350,000 and W owns $200,000 of same type asset. Total joint owned is $700,000; H owns $1,385,000 and W owns $715,000.

Discussion/Observations: Is there sufficient life insurance if H died; would W’s income be sufficient for support of the family? Additional life insurance may be needed and ownership of the life insurance should be discussed with client, including ownership by an ILIT. Perhaps a disclaimer trust plan would be developed for this couple. Some lawyers think the couple is too young to have a mandatory credit shelter trust forced upon the surviving spouse notwithstanding the mix of assets and possible appreciation.

Fact Pattern #2

Husband and Wife are in second marriage that has lasted for 14 years. H is 62 and W is 58. H owns a tool and die shop in Ohio where he works with his two sons, ages 37 and 32. The eldest son is "heir apparent" for the business. The business is worth $4M. H also owns business real estate worth $1M and other assets. H's daughter is 28 years old. W has 37 year old son who is divorced and a 32 year old daughter with three kids of her own. No premarital agreement exists. H owns assets worth $6,175,000; W owns assets worth $75,000 and they jointly own assets worth $1.1M.

Discussion/Observations: Mr. Manterfield always worries about earnings and cash flow to surviving spouse at death of H who is the business owner. Also, if H wants control of the business to pass at his death to his son, conflicts of interest arise if that son is also a trustee of the credit shelter trust. Estate plan could be developed with $2M worth (1/2) of the business funding the credit shelter trust (the other portion of the business assets would be allocated to the QTIP trust for the W). However, if fund the QTIP with business assets, surviving spouse can force sale of the business interest to generate sufficient cash to pay surviving spouse income. This may not be what the H desires. If any portion of the business is held in the credit shelter trust, since it does not (and is not intended to) qualify for the marital deduction, surviving spouse won't have ability to force a sale of the business interest.

Perhaps can you give W a minority interest in the business with a "put" option so that the W can require son to buy her interest out and protect her cash flow. With some of the business interest in a credit shelter trust and some in a QTIP trust, there could be valuation discounts available on the later death of the W. Also, perhaps could recapitalize the business to create voting and non-voting stock, but still would need to give the holders of the non-voting interests a "put" option and/or also develop a "call" option for the voting stock holders to buy out the non-voting stockholders.

Also, H could leave 100% of the business interests to the active eldest son and H could buy life insurance to equalize the inheritance. Problem is that insurance could be very expensive for H and/or H could be uninsurable.

Some attorneys would call a family meeting and discuss exactly what the family wants with respect to the estate and whether the "heir apparent" actually wants the business. Also, does lawyer represent both H and W in the planning and what conflicts exist? W would have rights of election against estate that should be discussed. Some attorneys say that it is often difficult to represent both H and W. There are too many issues that present conflicts among H and W and the business. Some feel it is unlikely that there would be open discussions of the estate plan, so they would not proceed without W being represented by separate counsel. If H wanted to make some lifetime gifts of the business interest to the son and H asked W to consent to split gifts, W should get separate counsel to advise her on gift splitting in favor of her stepson.

Also, H owns the business real estate worth $1M and leases it to the business. If that asset is not handled separate from the residue of H's estate, the successor to the business will have to deal with spouse, siblings and/or step-siblings regarding the business real estate. To avoid the inevitable conflicts and problems that would arise, the business real estate could be contributed to an LLC and "puts" and "calls" in the LLC operating agreement established to enable the inactive owners to liquidate their interests and enable active owners to buy-out the inactive owners.

If W is not active in the business, but some portion of the business passes to the credit shelter trust, should W be designated as the trustee? If the asset funding the credit shelter trust is a debt position with respect to the business (rather than voting or non-voting stock), conflicts could be reduced; during H's life, some of H's business interest could be converted into a debt position which could then be used to fund the trusts.

Fact Pattern #3

Husband is 91 and Wife is 89. H and W has been married for 71 years. They live in the same home where W was born. Their health is good. They have one daughter, aged 69, who is divorced. Daughter has three kids of her own. Daughter visits H and W and stays in the residence when she does so. H and W are active supporters of the orchestra in their town and the orchestra has approached them about a gift of the home. Orchestra would also like a cash gift that could be used as an endowment to pay operating expenses of the home.

Discussion/Observations: H and W should talk to their daughter about the proposed gift of the house. If daughter wants the house, H and W could consider creating a life estate for the daughter in the house. H and W could form a CLAT for a term of years for the cash gift which would give the orchestra some period of time to raise endowment funds to fund the operation costs of the house.

Fact Pattern #4

Husband and Wife are young and have one young child. Both are employed outside the home and have modest earnings. They have student loans and other expenses to pay.

Discussion/Observations: This young couple should focus on acquiring life insurance to replace lost income if one of them dies prematurely. Also, this couple needs to start their retirement savings; with their income under $100,000 per year they would be eligible to establish Roth IRAs. This couple obviously needs to select a guardian for their minor child. If they name a couple as co-guardian, problems could arise. If the couple named as co-guardian subsequently divorce – a custody fight for the minor child could ensue. Also, it was pointed out that with a client of modest means and several children, if a trust for minor children is provided for in the wills of H and W and is funded as a result of the premature death of H and W, Mr. Manterfield commented that the instrument should provide guidance to the trustee of the trust regarding the extent to which the trustee can spend trust funds for the education of each child so that the trust is not depleted by the costs of educating the older children to the detriment of the younger children.

Also, consider whether the person named as guardian for the minor children should also be the trustee of the trust for the children – a lawyer remarked that there would be no oversight of the trustee actions. If a guardian takes custody of the children and purchases a new home to accommodate the additional children in its custody, the trust and guardian could take title to the new home as tenants in common to extent of costs that the trust pays for the new home.

Should guardians be paid? Some lawyers draft provisions so providing.

Fact Pattern #6 (skipped fact pattern #5)

Husband and Wife are in a first marriage. H is 57 and W is 55. They own a large farm in Kansas which they farm with their daughter (age 35) and son-in-law (age 35) and unmarried son age 32. They want to keep the farm in the family and desire their daughter to be in charge at their deaths. The farm real estate is valued at $8M, the farm house is valued at $250,000, the farm equipment is worth $750,000 and accounts receivable are worth $2M. Total estate, all of which is jointly owned, is $11,000,000.

Discussion/Observations: Assets are illiquid. H and W may need life insurance to equalize the distribution of the estate among the active and inactive children. H and W could contribute the farm to an entity and have an operating agreement that develops "put" and "call" rights to manage realization of inheritance and minimize conflicts among family for the operation of the farm. Perhaps there is an agricultural program to enable the family to retain "agricultural preservation rights'; this is a sale into perpetuity of development rights and could result in lower appraisal for valuation discounts for estate tax purposes. Would need a government entity involved. Could also consider conservation easement for valuation reduction. Also, family could consider a state partition action to equalize estate assets among family members.

It is clear that the illiquidity creates a problem for estate tax payment purposes. Valuation discounts will likely play a key role in the estate plan to reduce the tax burden. Others commented that H and W could fractionalize the interest in the farm between H and W to below 50% each and transfer a small interest to the daughter. The estate plan of H and W would then provide for a credit shelter and a QTIP marital trust so that the fractional interests would not be aggregated. Also, position the farm to qualify for section 2032A special valuation treatment and installment payment of estate tax liability.

Fact Pattern #7

Husband and Wife are in a first marriage. H is 58 and W is 54. They have four children who are all adults. H is a business owner and plans to retire in four years. H owns an IRA valued at $1,350,000 and other assets. H and W own jointly $1.6 M. Aggregate value of estate is approximately $3.6M.

Discussion/Observations: If H dies first, W is still young and if W rolls over the IRA and then starts withdrawing from it, the pre-59-1/2 penalty will apply due to W being under age 59-1/2; however W could treat the IRA as an inherited IRA rather than roll it over as her own and start taking withdrawals without the age 59-1/2 penalty applying. H and W need to consider re-titling their jointly owned assets, but if they resist doing so, they can consider a disclaimer plan coordinated with the IRA assets.

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Charitable Giving Exit Strategies
Wednesday Afternoon Special Session II-D, 1/11/06
Presenters: Jerry J. McCoy and Winton C. Smith Jr.

Reporter: Gene Zuspann Esq.

Jerry McCoy and Winton Smith presented a number of short scenarios in which there is a problem with an existing plan due to unforseen consequences. (The problem number below follows the order of the presentation rather than the order in the materials.

Problem 1 - the Overgenerous Charitable Lead Trust

A charitable lead trust is set up then the investments appreciate significantly (in the example, the investments were worth 3 times the initial value).

The Service allowed the payment to the charity of the undiscounted income stream that the charity would have received and to terminate the trust early.

Both Jerry and Winton pointed out that the current rulings regarding early termination, modification and other changes would not have been granted 10 years ago. This is a significant change in attitude by the IRS.
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Problem 2 [not covered]

Problem 3 - The disappointed donor

Donor (D) makes a gift to a university for the creation of a specific program without a gift agreement. Due to a change in the leadership of the school, the program is not considered appropriate for the university and the program is severely curtailed and modified. D wants the university to either make the university continue with her initial wishes or to give her money back.

The general rule is that donors do not have standing to bring suits against the charity, citing Herzog Foundation in the materials at 7-2. The attorney general is the only party with standing to sue the charity for compliance or remedies.

Jerry and Winton both suggest, that if the D wants to make a substantial gift of any kind, that a gift agreement be entered into with the terms of the gift and specifically giving the D the right to sue to enforce the agreement. The action to sue will be brought in contract. The contract may also wish to provide an alternate beneficiary in the event that the charity breaches to terms of the agreement.

Note that in some states, the AG is the only party with the right to sue, but this seems to be changing, and the gift agreement gives one more argument to the D that there is standing.

Problem 4 - CRT and the request for an immediate contribution

D creates a charitable remainder trust and the trust is operating as intended. It may have appreciation in the portfolio. The charity approaches D and asks for an immediate contribution for capital improvements and D wants to help.

They discussed the problems for a partial distribution or if D relinquishes an interest in the trust. The planner must be careful that the arrangement qualifies for both the income and the gift tax charitable deduction.

Accomplishing this goal depends on the amount of the gift. If the need is for a substantial amount and D does not need the income, D can simply assign the entire interest to the charity and the doctrine of merger will terminate the trust. D will get a charitable deduction for the present value of the remaining income stream.

Winton indicated that he has not done so, but would look at providing the power to make gifts from income or principal to his documents in the future. He would also add the power to make gifts for income in excess of distribution needs.

Problem 5 - a two life CRT and trouble in the marriage

Two married donors created a CRT and the remainder beneficiary is designated. One party wants to add a new beneficiary and the first objects.

The best way is to partition the trust into 2 trusts. State Law may have provisions aiding or rejecting this approach.

Problem 6 - Financial troubles of the Donor

D creates a CRT and afterwards, D's net worth decreases to the point that D needs more money to live.

D can sell the income interest to the remainder beneficiary. This has been approved. If there is an early termination, or if the remainder beneficiary is a private foundation, there may be a self dealing issue. Note that the beneficiary will have a capital gain without basis under IRC. Section 1001(e)(1).

There are a number of current PLR's on termination of the trust due to mistake. Often these involve 'scrivener error.' They allow the trust to be modified without self-dealing penalties and without loss of the CRT status. One of these occurred because the attorney used a sample form, and did not add some additional requested language. Jerry recommends that his charitable clients not send sample forms.

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Reinventing Yourself After Estate Tax Repeal or Higher Exemptions: Using Estate Planning Techniques for Income Tax Planning Wednesday Afternoon Special Session 1-F, 1/11/06
Presenters: Jerome M. Hesch and Neill G. McBryde

Reporter: Paul Hood Esq.

They began by reminding us that clients are still interested in income tax planning, and discussed the following methods in that vein:

1. Deferral of income tax: income shifting is still good to do.

2. Converting OI into CG.

3. Avoiding AMT. Shifting income to children can reduce/eliminate AMT phase-outs, even if they attract the "kiddie tax."

4. Deferral of CG.

The remainder of the talk was devoted to going through the use of estate planning techniques to achieve income tax planning objectives:

A. Inter-family installment sales to irrevocable, non-grantor trusts, followed two years later by a sale of the company stock.

B. CRT for income tax-free diversification.

C. Non-grantor charitable lead trusts to create income tax charitable contribution deduction to offset ordinary income.

D. Use IRA's to continue income tax-deferral after death.

E. Use life insurance to shelter income from taxation.

F. Use life insurance as an IRA substitute.

G. Create IRC Sec. 529 plans to create "educational dynasty trusts" with tax-deferred income.

H. Use partnerships/LLC's to create income tax-freeze for C corporations.

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News From The Exhibit Hall
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See Report No. 9, etc.

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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