Heckerling Institute 2007
Reports from the event, as posted to the ABA-PTL List Serve

Report #2

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 ten 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 41th Annual Philip E. Heckerling Institute on Estate Planning that is being held January 8-12, 2007 at the Orlando World Center Marriott Resort and Convention Center in Orlando, Florida, a new venue for the Institute this year. A complete listing of the proceedings and speakers will be published here later and is also available on the Institute's Web site at http://www.law.miami.edu/heckerling.

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This Report contains coverage of the Monday afternoon session on Recent Developments - 2006 and the Tuesday sessions on GRATS vs. Installment Sales to IDGTs, Yesterday's FLP, and Succession Planning

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Recent Developments - 2006 Monday afternoon, January 8, 2007 Presenters: Steve Akers , Carlyn McCaffery and Lou Mezzullo , again utilizing the materials prepared by Richard B. Covey of Carter, Ledyard and Milburn and Dan T. Hastings of Skadden, Arps, Slate, Meagher & Flom.

Reporter: Paul Hood Esq. of L. Paul Hood Jr. (APLC) in Mandeville, Louisiana

Akers led off with a statement that estate tax repeal "is as dead as dead can be." He reviewed the various reform bills that have been introduced during the past year. He expects to see little action until 2009 with exemptions in the $3.5-5 million range. Mezzullo predicted a rate of 35% and an exemption of $3.5-5 million range. McCaffery cautioned against defining bequests based upon definitions set out in the Code, which may well change substantially, and she reminded all to put property in trust as opposed to outright legacies because there may still be a gift tax without a substantial estate tax.

McCaffrey reviewed the 2006-2007 Treasury/IRS Priority Guidance Plan. She also reviewed the new private annuity trust proposed regulations under IRC Sec. 1001. She is anticipating comments to those proposed regulations that will suggest installment sale income tax treatment.

Mezzullo then reviewed the Pension Protection Act of 2006 provisions applicable to estate planning. The IRC Sec. 529 plan legislation has been made permanent. He also discussed the modified provisions pertaining to conservation easements under new Internal Revenue Code Sec. 170(h), which elevated the deduction limitation from 50% to 100% and that lengthened the carryforward period from five to 15 years for conservation easements.

He cautioned against making fractional interest gifts in artwork due to the limitation on the deduction of a retained interest in that artwork as well as the recapture provisions of the income and gift tax benefits.

Akers then discussed the Senda decision out of the Tax Court and the Eighth Circuit, principally the integrated transaction doctrine. In light of this decision, Akers cautioned against making gifts too soon after formation of the entity, but Mezzullo disagreed.

Akers then discussed the discount case: the district court decision in Temple v. U.S. He indicated various surveys, informal and formal, of discounts for FLP's with marketable securities that range from 25-40%, with discounts being curiously higher at the audit level as opposed to the appeals or trial level.

Akers then discussed the Rosen case, an IRC Sec. 2036(a)(1) decision. He cautioned all to make pro rata distributions. In Korby, there is an appeal to the U.S. Eighth Circuit in another FLP/IRC Sec. 2036 case in which the taxpayers lost.

The conversation then turned to the Fifth Circuit decision in McCord, which involved a gift of all of the senior generation's interests in the FLP. The panelists seemed to all be in agreement that transactions that look like the one in McCord will pass muster (although Mezzullo admitted that he has never used a defined value gift), despite the seeming lack of discussion of the public policy and other issues pertaining to defined value gifts. Mezzullo pointed out the new draft Form 706, which asks if the decedent ever owned or ever sold an interest in an FLP or LLC to essentially a grantor trust.

McCaffery then discussed the Focardi case, which held that the revocable spousal annuity was not a "qualified interest" for purposes of the GRAT rules under IRC Sec. 2702. She also discussed deferred payment GRATs and parallel GRATs as possible planning techniques, which, if drafted correctly, can provide GST Tax leveraging.

After the break, McCaffery then took up a discussion of the history of the GST Tax as well as some planning opportunities with respect to that tax, including using a GRAT, a sale of a GRAT remainder interest as well as a lifetime QTIP in connection with a GST Tax transfer to leverage the GST Tax exemption.

Akers then proceeded to discuss the few valuation cases there were in the past year, beginning with the Huber decision. In the Kohler decision, Akers pointed out that there was a $100 million difference between the value as stipulated by the taxpayer as opposed to that of the IRS. He emphasized how important it is to have a good appraisal and to shift the burden of proof to the IRS. Mezzullo then discussed the Amlie decision.

Mezzullo discussed new Rev. Rul. 2006-26 in the area of IRAs being made payable to QTIP trusts, which replaces Rev. Rul. 2000-2 and that obsoletes Rev. Rul. 89-89.

The panel concluded with a discussion of patents on estate planning techniques.

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GRATs vs. Installment Sales to IDGTs: Which is the Panacea or are They Both Pandemics? Tuesday morning, January 9, 2006 Presenter: Jonathan G. Blattmachr

Reporter: Reporter: Paul Hood Esq. of L. Paul Hood Jr. (APLC) in Mandeville, Louisiana

Blattmachr led off by pointing out that he had a co-author of his Heckerling materials: Diana S.C. Zeydel of the Miami office of Greenberg Traurig, P.A. He cautioned all at the outset that it is virtually impossible to make an "apples to apples" comparison in comparing GRATs to installment sales to intentionally defective grantor trusts (IDGTs).

His materials begin with some general gift tax valuation principles and an observation that the GRAT works when appreciation exceeds the IRC Sec. 7520 rate. However, Blattmachr highlighted three exceptions to that general rule: (1) where a special or disparate valuation factor such as a blockage discount comes into play, (2) where GRAT assets experience large losses before even larger gains and (3) parallel GRATs.

Blattmachr compared the complexities of the GRAT to those of the installment sale to the IDGT, noting that different people find each technique more complex than the other. He pointed out two "basic" questions about GRATs: namely, how small can the remainder in a GRAT be (despite the Walton decision, Blattmachr doesn't zero out a GRAT-he creates a gift equal to .001 of the fair market value of the GRAT property) and how short a GRAT may last. He included language to assist with both of these uncertainties that he referred to as the "Zeydel formula".

Blattmachr cautioned all to observe the formalities of a GRAT, e.g., timely making the annuity payments, in order to avoid an IRS argument that the GRAT is disqualified, which would result in a gift of the entire value of the property put into the GRAT. He indicated that his firm offers clients a GRAT compliance service to make sure that the GRAT stays qualified.

He discussed some remaining issues pertaining to the viability of installment sales to IDGTs, namely, the applicability of IRC Secs. 2701 or 2702 to the technique, whether the IDGT assets are includible in the grantor's estate if the grantor dies while the note is outstanding, the effect of the techniques if it is not administered in accordance with its terms and whether gain is recognized by an installment sale of appreciated assets (Blattmachr emphatically says no).

Blattmachr went on to compare and contrast the two techniques where the grantor dies during the term of the GRAT/installment sale as well as some GST Tax differences between the two techniques. He then discussed the risks of an inadvertent gift with each of the techniques, which he pointed out could be ameliorated through the use of a defined value formula, creation of a 10% remainder or a disclaimer. His materials suggest that the risk of a large inadvertent gift may be greater for the installment sale to an IDGT than for a GRAT. He pointed out that the installment sale offers a lower interest charge (IRC Sec. 7520 rate as opposed to the IRC Sec. 1274 rate for installment sales) as well as a greater opportunity for leverage.

He introduced the concept of using a Monte Carlo simulation to assist in the comparison and design of either technique. Blattmachr makes several conclusions. First, he believes that a direct gift may be better than either technique if very significant appreciation is expected. Second, the installment sale may produce better results than a GRAT if return exceeds the IRC Sec. 7520 rate. Third, the installment sale may be better adept at capturing outperformance as well as for mitigating the effects of underperformance. Fourth, Blattmachr observed that the short term GRAT utilizing the 105 day payment delay rule can be more beneficial than the installment sale in some instances.

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"Yesterday's 'FLP': 'Fabulously Locked-in Profits'? Or 'Finally Losing Pizzazz" Tuesday afternoon, January 9, 2007
Presenter: Ronald D. Aucutt

Reporter: Reporter: Paul Hood Esq. of L. Paul Hood Jr. (APLC) in Mandeville, Louisiana

Aucutt began with a fair market value of FLP hypothetical. He made brief mention of a possible revival of the step transaction doctrine in Senda v. Commissioner, T.C. Memo 2004-160, aff'd., 433 F. 3rd 1044 (8th Cir. 2006). Aucutt then went through the "dirty dozen" IRC Sec. 2036 cases.

He then discussed the factual timeline in Bongard v. Commissioner, 124 T.C. 95 (2005), which was not appealed. Aucutt highlighted Judge Laro's "checklist" for why the transfer of assets to the FLP was not a bona fide sale for adequate and full consideration for purposes of IRC Sec. 2036(a)(1) in his opinion in Rosen v. Commissioner, T.C. Memo 2006-115, which IRS examiners and reviewers have essentially begun using as an audit checklist.

Aucutt set out some lessons from Estate of Strangi v. Commissioner (often referred to as "Strangi II"), T.C. Memo 2003-145, and his outline contains a list of the "badges" of a kind of retained interest and control. He discussed the uncertainties that clients have relative to the applicability of IRC Sec. 2036, and he reviewed possible legislative and regulatory preemption. Aucutt believes that Treasury has enough legislative authority to successfully deal with FLP's in IRC Sec. 2704(b)(4).

As possible options for potentially problematic FLP's, he suggested termination (but he cautioned against ignoring the income tax consequences) as well as having clients give up control of the FLP.

Aucutt concluded with a discussion of the applicability of IRC Sec. 2035 to interests in FLP's. He suggested limiting distribution powers in FLP's/LLC's to an ascertainable standard as a possible way around IRC Secs. 2035/2036.

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Succession Planning - The Need For Both A Belt and Suspenders Coordinating the Estate Plan with the Corporate Documents Tuesday afternoon, January 9, 2007 Presenter: Jonathan C. Lurie

Reporter: Gene Zuspann Esq. of Zuspann & Zuspann in Denver, Colorado

Mr. Lurie's presentation concerns the integration of the client's estate plan with Buy-Sell agreements and other corporate documents. Many problems arise because the attorney preparing the corporate documents and the attorney preparing the estate plan do not consult with each other and the results can be confusing or disastrous.

Some of today's presentation set out questions and issues, the answers to be presented at the breakout session tomorrow.

He cautioned that where both a trust agreement or estate plan and a buy-sell agreement (BSA) are in place, that the BSA must anticipate changes in the trustee or the beneficiaries. The trust must be drafted to take into account permitted transferees - parties that may receive stock or ownership in the business approved by the BSA. The BSA may specify the terms under which a trustee may continue to hold the business interest after the death of one of the parties.

He then discussed some areas that are often not addressed in the documents.

- How with the burden of death taxes be handled?
- May the estate defer taxes? The BSA may cause acceleration of taxes under §6166 because of a forced sale of business interests.
- If the tax allocation clause is not considered, a person not receiving the business may be burdened with the estate tax.

Marriage and domestic partnerships:

- There are often issues about ownership of the business between spouses. The spouse who started and operates the business may not own all of the stock and is often indignant that the other spouse must be involved in the negotiation and drafting of the BSA.

- Divorce should be one of the triggering events in a BSA. If the asset is S-Corp stock, one alternative is to make the spouse's stock non-voting. This still meets the one class of stock requirement in the S-Corp laws.

- The client should also be cognizant of the impact of a post death divorce - a possibility in some states. In some cases, the family business is dealt with in a premarital agreement.

- In QTIP trusts, the spouse must be given the right to make the assets in the trust productive. The BSA may cause a loss of the marital deduction if this is not provided.

The BSA must meet the Chapter 14 requirements.

The agreement must be comparable to other agreements negotiated in an arms-length transaction, it must not be a device to transfer property to the decedent's family for less than full and adequate consideration in money or monies worth, and it must be a bona fide business arrangement. Some issues that arise are whether counsel was consulted during the negotiation of the agreement and whether an appraiser was used to determine the value of the business.

The BSA may use a formula to determine value, but these must also meet the Chapter 14 tests. John recommends that you must involve experts to determine the operation and design of the formula and the agreement must be arms-length.

The agreement must be drafted taking into consideration the estate tax apportionment provisions that are applicable, either in the governing instrument or by statute. These can impact a party to the agreement that is not an heir or beneficiary of the decedent. Mr. Lurie said that some people suggest giving the buyer the right to participate in the audit negotiations, however, he suggested a better solution is to create a fund for the purpose of paying the taxes, possibly funded with life insurance. Also, another issue involves of what happens if the BSA is disregarded for estate tax purposes. The attorney must remember that the purchaser may not be involved in the estate tax audit.

He discussed the use of a trust protector. The trust protector would not act in a fiduciary capacity. The trust protector would have powers to change the trust, change the jurisdiction of the trust or change the trustee. The trust must provide for the compensation of the trust protector, as well as issues involving removal of the protector and replacement on resignation. The desire is to give the trust protector the powers needed to accomplish the client's goals without giving too much power. The document needs to provide a system of checks and balances.

In drafting the BSA, consideration should be given to requiring arbitration or mediation.

All BSAs should include an exit strategy. John likes the Biblical method - one party divides the assets into two pools and the other party chooses which pool of assets it will receive.

The attorney should realize that some plans provide for continued control of the business when a prudent person would not.

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News From The Exhibit Hall

All of the major players are here and all seem to have their usual space and configuration.

Thomson West has much of the center of the room. They have a large area that has been decorated and includes a plush astro turf carpet. Don Kelly is here and is demonstrating his IEP program.

Mark Gillette is here with the GEMS product that does everything but the Form 1041.

Vince Lackner is here with his 6-in-1 full line of estate administration programs, including the Form 1041.

WTP has several bays and a pretty good staff. Nicole Splitter, (not her current name - she is remarried) is here and seems to be with WTP. She was with U.S. Trust until it abandoned (sold) its software products. Jonathan Blattmachr no doubt will be frequenting this boot to do demos of WTP, which is a HotDocs-based DAE.

Jane Shuck is still with Brentmark. Natalie Choate mentioned during her presentation that she would be at the Brentmark booth, presumably to push sales of her book, Life and Death Planning for Retirement Benefits (6th Edition).

A problem with the configuration this year is that the attendees have no reason to pass by the vendors unless they specifically go to the exhibition area. You arrive at the conference rooms before the exhibitor area and all refreshments are set up outside of the conference rooms. The advantage of the Fontaine Bleu was that almost everyone walked through the exhibitor area several times a day. We will be curious to see what the vendors have to say about this later this week.

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Our on-site local reporters who are present in Orlando this year are Gene Zuspann Esq. of Zuspann & Zuspann in

Denver, Colorado, Herb Braverman Esq. of Walter & Haverfield, LLP in Cleveland, Ohio, Merry Balson Esq.of Wade, Ash, Woods, Hill & Farley in Denver, Colorado, Paul Hood Esq. of L. Paul Hood Jr. (APLC) in Mandeville, Louisiana, Joanne Hindel Esq. of Fifth Third Bank in Cleveland, Ohio. Jason Havens Esq. of Havens & Miller PLLC in Destin, Florida. Alan Rothschild Esq. of Hatcher, Stubbs, Land, Hollis and Rothschild, LLP in Columbus, Georgia, and Kimon Karas Esq. of McCarthy, Lebit, Crystal and Liffman Co., LPA in Cleveland, Ohio. The editor again this year will be Joseph G. Hodges Jr. Esq, a solo practitioner in Denver, Colorado, who also is the Chief Moderator of the ABA-PTL List.

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