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

A complete listing of the proceedings and speakers is available on **[the Institute's Web site]**

Report #6

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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EDITOR'S COMMENT: For those of you who are counting, it is currently anticipated that there will be one more Report #12 that will be posted either later today or sometime tomorrow pending my receipt of the required reports.

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Eratta: At the end of this Report is an Eratta regarding the Thursday afternoon Special Session 4-B Report by Joanne Hindel that has just been submitted to us for publication by Gideon Rothschild, one of the Presenters.

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This Report contains coverage of Fundamentals Programs No. 2 and 3. No. 2 held on Wednesday afternoon dealt with the tax and non-tax considerations in drafting buy-sell agreements. No. 3 held Thursday afternoon dealt with making "friends" with Subchapter K. These Fundamentals Programs run all afternoon are concurrently with the Special Sessions that are held in the afternoons. This Report also contains coverage of the Wednesday afternoon Special Session 1-C Navigation without a Compass - Charitable Planning in 2007 presented by Kathryn Miree and Jerry McCoy Since that is a charitable session, we will be sending a copy of this Report to the GIFT-PL and PG lists too.

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Fundamentals Program #2 - The Blount Trust About the Family Business: The Tax and Non-Tax Considerations in Drafting Buy-Sell Agreements Wednesday afternoon, January10, 2007
Presenters: Howard Zaritsky and Farhad Aghdami

Reporter: Herb Braverman Esq. of Walter & Haverfield, LLP in Cleveland

Presented by Howard M. Zaritsky and Farhad Aghdami, Esqs. Reported by Herbert L. Braverman, Esq.

This was a fundamentals presentation at the Institute. It reflected that different presenters take on a task differently. There were 3 fundamentals programs at the Institute this year. Professor Pennell presented on the wealth transfer tax using a 49 page outline; Richard Robinson introduced Subchapter K, partnership taxation, in 36 pages; while Zaritsky and Aghdami produced a 261 page outline, which was substantially excerpted from prior publications by the presenters (with others). The materials are thorough, including some "sample" forms, and I recommend them to your attention, perhaps more so than the tape of the presentation itself.

Mr. Zaritsky explained that buy-sell agreements are used to (1) maintain closely-held status; (2) guarantee a market for the stock of a decedent; (3) freeze asset value for estate tax purposes; (4) consolidate control in a family; (5) protect S corp. status; (6) prevent deadlocks; and (7) restrict competition from former stockholders or family members. Although the buy-sell agreement was never defined per se, it was pointed out that it is a contract, should be in writing and should include a purchase price for corporate shares. Furthermore, the agreement should be reflected in other corporate documents, such as minutes, stock certificates, by-laws, etc.

The 3 basic forms of buy-sells were reviewed: (1) the redemption agreement between the corporation and the stockholders, in which the corporation agrees buy offered stock at specified terms; (2) the cross-purchase agreement between or among stockholders, in which the stockholders agree to purchase offered stock at specified terms; and (3) the hybrid agreement which contains elements of both (1) and (2) in various combinations and forms.

The estate planning advantages of buy-sells include (1) the estate tax value freeze; (2) simplicity to create and to maintain; (3) ease of elimination, if desired; and (4) liquidity through market creation. But, there are some disadvantages, (1) Chapter 14 issues that prevent freezing values; (2) older stockholders get the values included first, others may not benefit from the values sought; (3) funding costs and complications; and (4) difficulty obtaining favorable income tax treatment on redemption of decedent's interest.

Focusing on the estate value freeze objectives, the presenters covered the 6 requirements that must be met in order for a buy-sell agreement to set estate tax values. The first 4 requirements come from a variety of sources: (1) the estate must be obligated to offer the interest for sale at the decedent's death; (2) there must be a reasonable and ascertainable price for the interest; (3) there must be lifetime restrictions that preclude a transfer of the interest at a price higher than the agreement price at death; and (4) the so-called device test, to demonstrate that the agreement is not merely a device to transfer the interest to the natural objects of the decedent's bounty for less than full and adequate consideration. These requirements are discussed at length, with considerable citations throughout. Similarly, the 2 requirements added in 1990 by Section 2703 of Chapter 14 are covered in great detail--both (1) the bona fide business purpose requirement and (2) the comparability requirement, the terms of the agreement must be comparable to similar agreements entered into among unrelated persons. The important cases establishing the interpretation of these requirements are cited and fully discussed in the outline, including the cases whose names are used in the title of the presentation to whet the intellectual appetite. The cases include both taxpayer wins and losses, so a review of the outline and these cases is certainly recommended. For example, in the True case (Estate of True -v- Comm., T.C.Memo 2001-167), the Tax Court and subsequently the 10th Circuit, the agreement is discussed at length and found to be a "device" failing the test, whereas, in Estate of Amlie -v- Comm., T.C.Memo 2006-76, the agreement as found not to be a device. The requirement of arm's length comparability, added by Section 2703, is examined carefully in Estate of Blount -v- Comm., T.C.Memo 2004-116. The first taxpayer victory in a case decided under Section 2703 came in Estate of Amlie -v- Comm., T.C.Memo 2006-76.

The presenters touched on topics that are covered in depth in their lengthy outline. These topics include income tax planning with buy-sells, taking into consideration the form of corporation and the form of buy-sell agreement; funding a buy-sell, including a discussion of life insurance planning; the importance of certain non-tax buy-sell provisions; ethical considerations for attorneys representing parties in buy-sell negotiations; Circular 230 issues; and sample agreements for your consideration.

The subject was covered well in the materials; unfortunately these materials are only available to Institute Registrants. However, the Presenter's books on this subject are available for purchase though various legal publishers.

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Fundamentals Program #3 Making "Friends" with Subchapter K Thursday afternoon, January 11, 2007 Presenter: Richard Robinson

Reporter: Herb Braverman Esq. of Walter & Haverfield, LLP in Cleveland, Ohio

Mr. Robinson conceded that he could not teach the group Subchapter K in 3 hours and the group conceded that it could not learn Subchapter K in 3 hours either. However, he indicated that he would touch on a survey of issues, not really in depth, but to give the group some familiarity with Subchapter K, its intricacies and its importance to the estate planner.

He began with entity classification. A partnership includes a syndicate, a group, a pool, a joint venture or any other unincorporated organization in which any business, financial operation or venture is carried on...that is not a trust, an estate or a corporation. State law is not determinative for federal income tax purposes. Sections 761 and 7701.

An unincorporated entity with 2 or more owners may elect to be classified as an association (and thus a corporation) or a partnership; and an unincorporated entity with one owner may elect to be classified as an association or to be disregarded as an entity separate from its owner. Unless the entity elects otherwise, a domestic eligible entity is a partnership if it has 2 or more owners or is disregarded as an entity separate from its owner if it has a single owner. An eligible entity may elect to be classified as other than its default classification or to change its classification by filing Form 8832, "Entity Classification Election," or "check the box" with the service center. The Form may be filed any time during the year and may be made effective on the date of filing, one year after the filing or 75 days before the filing. This filing is automatic if the entity files Form 2553, electing a Sub S election for the entity. If a Sub S filing is made erroneously because of "substantial economic effects" issues, use the procedures of Rev. Proc. 2003-43 which allows for a 2 year extension for filing the correction; beyond that, you have to seek a ruling to correct.

Robinson used schematic drawings and tables to set forth problems and scenarios illustrating his points and it is recommended that his outline be reviewed in connection with the study of Subchapter K. Some portions of this summary may not be as clear as we would like without these items.

See Rev. Rul. 99-5 and 99-6, discussing income tax characterization for distributions from a single member to a multiple member entity or from a disregarded entity to a partnership; and vice-versa (99-6)

For example, Robinson distinguished between a partnership and a tenancy-in-common and suggested that Rev. Proc. 2002-22 is the guideline in this arena. Mere expense sharing, joint repairing, maintaining and leasing real property is not a partnership; he used a condominium rental pool arrangement to illustrate this point. If you have partnership status, there is a penalty for failure to file a partnership tax return of $50 per partner per month for up to 5 months. See Section 6698 of the Code. Similarly, a partnership interest cannot qualify for a tax-free exchange under Section 1031 of the Code--this possibility must be examined closely before attempting such a tax-free exchange.

No gain or loss is recognized when property is contributed to a partnership in exchange for a partnership interest, unless the partnership would be taxed as an investment company within the meaning of Section 351. See Section 721. A transferee entity is an investment company if more than 80% of the value of its assets are stock or securities and the transfer results in a diversification of stock or securities. Money, futures, contracts, precious metals, etc., are stock or securities for this purpose. However, diversification does not occur if no more than 25% of the assets are in one issuer and not more than 50% of the assets are in 5 or fewer issuers. This is why a large commercial hedge fund may have no problem avoiding the investment company issues, but a husband and wife may not do so when forming an FLP. Robinson suggested that the spouses make asset exchanges between themselves prior to contributing to an FLP to avoid the "diversification" complications.

Robinson then discussed contributions of property that is subject to liability to an entity and how this complicates gain recognition under Section 731. He reviewed the issues surrounding recourse and non-recourse liabilities and how they differ for partners who contribute or who assume such liabilities. See Section 752 and its proposed regs. Each year, partners have to look at their own personal liability at the beginning of the year versus at the end of the year to determine his/her gain from changes during the year from partnership contributions. Robinson made it quite clear that complexities abound in these areas that he was not covering in his presentation.

Also discussed were contributions and distributions treated as disguised sales under Subchapter K. If the distributions resulted from business operations, a disguised sale problem may not exist, but if the distribution is from borrowed monies, then a determination of whether or not a disguised sale has occurred is warranted. This analysis is impacted by the 2 year rule--transfers between a partnership and a partner more than 2 years apart are presumed not to be a sale unless circumstances clearly establish otherwise. See Section 707 and regs.

Robinson spent considerable time discussing partnership interests in exchange for services. The analysis varies depending on whether the persons involved in the transaction are related or not. The receipt of a vested capital interest in exchange for services is a taxable event. Compare receipt of a non-vested profits interest for services, which may not be a taxable event. See Rev. Procs. 93-27 and 2001-43. As a part of this analysis, Robinson suggested that a key employee wishing to avoid tax complications resulting from a liquidation within 2 years should file a Section 83 protective election using a "zero" value for the interest received.

Also, Robinson discussed the self-employment taxes issues in an LLC, since it is not clear whether a member of an LLC should be treated as a general partner or as a limited partner for purposes of self-employment taxes. He told the story of the proposed regs. That IRS prepared in this area in the '90's and noted that they were so controversial that Congress actually passed a bill prohibiting their publication. Nevertheless, he felt that the essence of these proposed regs that will never be finalized are still worthy of giving us proper direction. So, a limited partner is someone who has no personal liability for entity debts, who has no authority to bind the partnership and who does not do more than 500 hours of service per year. Of course, one could always go the limited partnership format or to the S corp format to deal with these issues. See PLR's 9432018 and 9452024 for LLC cases where self-employment taxes were enforced.

Robinson also had chapters in his outline for allocations of profits and losses, special allocations for LLC's, partnership sales and distributions, disguised sales of partnership interests, Section 752(b) relief of liabilities, distributions of property that was previously contributed (or not) and Section 754 elections.

The tape of this presentation is very helpful and recommended, as is the printed materials for the schematics and tables used by the presenter. Unfortunately these are only available to Institute attendees.

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Special Session 1-C Navigation without a Compass - Charitable Planning in 2007 Wednesday afternoon, January 10, 2007 Presenters: Kathryn Miree and Jerry McCoy

Reporter: Jason E. Havens, Esq. of Havens & Miller, P.L.L.C. in Destin, Florida

Kathryn W. Miree, Esq. and Jerry J. McCoy, Esq. continued Kathryn's discussion during her general session on charitable gift planning. They presented charitable gift planning options from the donor's perspective from less to more complicated.

First, Kathryn described her "kitchen table philanthropy" concept in the context of a family's outright/direct charitable giving. She recommended gathering children and/or grandchildren at the table and telling them that they could each give $1,000 or whatever amount to their favorite charitable causes. I have also seen this described in terms of giving younger family members a number of pennies (e.g., ten each) each year and allowing them to give as many as they desire to whatever organization(s). The family could donate a much greater amount (e.g., $100K per "representative penny"), but the concept still works well as a teaching tool.

Second, Jerry and Kathryn focused on the next level of giving in using gift agreements to provide conditions on an outright charitable gift. Gift agreements can define how a particular gift can be used and also a "gift over," which is a contingency that if triggered causes the gift to "migrate" from one exempt organization to another, e.g., to Harvard but if Harvard fails to abide by the express conditions of the gift, then to Yale. Jerry and Kathryn affirmed the usefulness of a "watchdog" to ensure that the gift is used as intended. Jerry recommended the excellent 2006 Probate & Property article of Alan Rothschild, Jr., Esq. (who was in attendance), "Planning and Documenting Charitable Gifts," which addresses the use of gift agreements; this article can be accessed freely online even by non-members (in HTML format -- with the PDF version only available to ABA RPPT members): http://www.abanet.org/rppt/publications/magazine/2006/ja/rothschild.shtml.

Third, Jerry highlighted the use of a charitable lead trust (CLT) to provide income to a charity for a specified period of time, with the remainder ultimately distributed to family members or other beneficiaries. He generally noted the income and estate tax benefits of using a CLT.

Fourth, Kathryn and Jerry noted the continuing use of donor advised funds (DAFs). However, they cautioned that the Pension Protection Act (PPA) has created a new regime of regulating DAFs that did not previously exist under the Internal Revenue Code or the Treasury Regulations. Kathryn had already covered much of the substance of the PPA's changes in the DAF context. She referred the attendees to her materials, which in the special session consist of Jerry's detailed summary of the PPA's charitable gift planning provisions.

Fifth, Kathryn and Jerry discussed the use of supporting organizations (SOs) and also the limitations created by the PPA. Both agreed that SOs might now be on par with private foundations (PFs) for many (if not most) donors who desire to be much more involved in terms of continuing control of their charitable gifts. Jerry discussed with one of the attendees the provisions of Notice 2006-109, which gives guidance to private foundations in determining the type of SO to which the PF is making grants. (The same rules of that notice apply to DAFs making grants to SOs.)

Jerry and Kathryn anticipate more changes from Congress to address perceived abuses in the charitable gift planning arena. Both highlighted a few of the other provisions contained in the PPA, such as changes impacting conservation easements and fractional interests in tangible personal property, which are covered extensively in the general and special session materials. Jerry noted the outcry of museums and other charitable organizations regarding the latter change, which could dramatically impact a gift of art (especially for estate tax inclusion purposes). They concluded that this has been quite an active year in charitable gift planning developments!

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Eratta for Special Session 4-B The Ethics of Asset Protection Planning Held Thursday afternoon, January 11, 2007 Presenters: Alexander Bove, Jay Adkisson, Mathew Mtiasevich and Gideon Rothschild. Eratta submitted by Gideon Rothschild - it is published here in full.

I believe that Joanne Hindel's reporting of our panel was not entirely accurate. Firstly, it was Matt Matiasevich who followed Alexander and discussed the ethics rules and it was Jay who followed Matt. I tried to note the corrections below in CAPS, including some of the substantive comments.

Alexander introduced the session by saying that the concept and the sub-specialty of asset protection planning in the law are generating more and more controversy and criticism, even angry criticism, most of it directed at asset protection trusts, and most of that directed against offshore asset protection trusts.

He said that it is puzzling that articles criticizing asset protection planning don't make an equally emotional attack on such things as limited liability companies, bankruptcy-remote entities, acquisition of exempt assets, and pre-bankruptcy planning in general.

He poses a typical scenario of a radiologist, who, as a result of a flawed X-Ray machine, has a rash of malpractice claims filed that are then all settled. Six months later, when no actions are pending, he is considering the establishment of a self-settled asset protection trust.

Alexander then turns over the discussion to Jay Adkisson (NOT JAY - IT IS MATT DISCUSSING THE FOLLOWING). Jay approaches the discussion from the perspective of a litigator and says that asset protection planning really boils down to two issues:

1. Is asset protection planning (APP) per se fraudulent?

2. Are attorneys who do this kind of work committing an ethical breach?

He points out that facing discipline in this area will involve questions of moral turpitude that will justify a lengthy review and stiff penalties if found liable. He also states that most malpractice insurance will not cover the lawyer if found liable in this area.

He says that some states, such as California, put this area under the category of interference with justice.

He says that a disciplinary tribunal will apply ethical principles but the law of fraudulent transfers may also be applied.

He differentiates between the states that follow the Model Rules and those that follow the Model Code and indicates that in the Model Rules states, practicing in the area of APP will not be found to be a violation of the ethical rules but in the states following the Model Code, APP will be considered a per se violation.(I DO NOT BELIEVE HE SAID APP WILL BE A PER SE VIOLATION. WHAT HE SAID WAS THAT ENGAGING IN A FRAUDULENT TRANSFER WILL BE A VIOLATION - A HUGE DISTINCTION)

He says that it is important to understand what a fraudulent transfer is and which ethical rules of your jurisdiction apply. He suggests that maintaining a disciplined case review and intake system can help in actions involving this area. He also suggests that the lawyer pay attention to the possibility that you are acting in a capacity other than just planner for your client, for instance when you are dealing directly with creditors of the client.

Matthew (THIS IS NOT JAY'S PRESENTATION) starts off by pointing out that many early Americans came to the U.S. in order to flee onerous creditor laws in other countries and were themselves debtors. He also mentions that Thomas Jefferson might have drafted the first Asset Protection trust when he set up a spendthrift trust for his daughter.

He points out that contrary to general belief, APP is meant to avoid fraudulent transfers and keep clients on the right side of the law.

He warns that the financial services industry has engaged in the creation of products to provide for asset protection and that APP is being productized with clients expecting standardized pricing for the service.

He analogizes APP to a swimming pool with the shallow end consisting of the safe methods of APP and the deep end having no bottom and containing mutant sharks otherwise known as litigators.

He continues this analogy by suggesting that the shallow end has statutes that are intended to let people protect and plan. His examples include state and federal exemption planning and corporate planning. He also says that spendthrift trusts are an example of traditional APP and that insurance products also represent a transfer of risk from the individual to the insurance company with the client having the ability to keep assets.

He does point out that laws have developed to limit the planning one can do in the shallow end of the pool such as the Bankruptcy Act and spendthrift protection limitations.

He then suggests that in the middle of the pool are the laws that are not intended to protect against creditors but have the effect of APP. His example is that of a charging order protection allowing the protection of partnership assets so that for instance, a partner can't force his other partners into an agreement that involves his own creditors. He also points to tax shelters as good examples of legislation in this area.

He warns that if the lawyer plans to practice in this area, you have to have an understanding of the laws so as not to inadvertently place your client or their assets in jeopardy.

He then describes the deepest end as the area where the legislation has prohibited APP. He says that all questions in this area will be resolved against you and it is fraught with high client risks such as losing their business and being subject to criminal sanctions.

He says this is where the fraudulent transfer laws exist and suggests that one should never even use the term: asset protection but instead refer to this area as the creation of self-settled spendthrift trusts.

Having said that he points out that most states do not allow these kinds of trusts to escape creditor access and that since there have been so few cases in this area, you don't know how courts might rule if a matter is litigated and it is best to not draft domestic asset protection trusts.

He says that if a foreign asset protection trust is challenged the court might order repatriation of the assets or throw the settler in jail.

He also mentions that most of the bad cases seem to deal with trusts created in the Cook Islands.

Gideon then agrees (AGREES WITH WHAT?) and suggests that the bad case law decisions in this area are similar to the FLP arena with bad facts making bad law. He also suggests that we all engage in APP when we draft LLCs. Gideon also suggests that you may actually be held liable for malpractice if you don't advise your clients about APP options and uses a tenancy by the entireties situation as an example.

He suggests that this area can be handled ethically if you conduct proper due diligence including the review of a client's financial records and the preparation and completion of an APP audit checklist. He also suggests that the lawyer should keep a record of the clients that have been rejected to show a court if necessary to substantiate the review and due diligence aspect.

He recommends conducting a solvency analysis: what will the client retain after the transfer of assets to an asset protection trust?

He reviews a few cases and points out that if legitimate reasons can be found, the courts will uphold self-settled trusts. He mentions some legitimate reasons for foreign asset protection trusts might be to engage in asset diversification, benefit foreign heirs or avoid forced heirship laws. He also points out that some laws, notably the bankruptcy laws, do allow self-settled trust that are older than 10 years.(ACTUALLY WHAT I SAID WAS THE UNDER THE NEW BANKRUPTCY CODE, IF A TRANSFER TO AN APT IS MADE MORE THAN 10 YEARS PRIOR TO FILING, IT WILL NOT BE DEEMED A FRAUDULENT TRANSFER, THUS SHOUDL NOT BE SUBJECT TO ETHICAL BREACH. BUT IT MAY STILL HAVE TO SATISFY THE REQUIREMENT THAT THE TRUST IS A VALID TRUST UNDER APPLICABLE LAW)

All the panelists did a great job of providing another perspective on asset protection planning and on dispelling the commonly held belief that this is done to defraud creditors.

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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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