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 #8

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 Thursday afternoon Special Sessions on The Ethics of Asset Protection, IRS Analysis of Gifts, Estate Planning for Real Estate Transfers, and a Holistic Approach to Analysis of Private Annuity Trusts to Defer Capital Gains

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Special Session 4-A - Simplified Trail Resolution from an Estate Planner's Point of View. Thursday afternoon, January 11, 2007 Presenters: Robert Goldman, John Rogers, Bridget Logstrom and Bruce Stone

The substance of this Special Session is covered by the similar Special Session 3-A that was presented on Thursday afternoon and the main Session that was presented on Thursday morning.

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Special Session 4-B The Ethics of Asset Protection Planning - An Oxymoron Thursday afternoon, January 11, 2007 Presenters: Alexander Bove, Jay Adkisson, Matthew Matiasevich and Gideon Rothschild

Reporter: Joanne Hindel Esq. of Fifth Third Bank in Cleveland, Ohio

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. 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.

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 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 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.

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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Special Session 4-C It is Better to Give and then Receive - is the IRS's Favorable Analysis Correct? Thursday afternoon, January 11, 2007 Presenters: John Bergner and Mitchell Gans

Reporter: Kimon Karas Esq. of McCarthy, Lebit, Crystal and Liffman Co., LPA in Cleveland, Ohio

This was a special session following up on the earlier presentation by Mr. Bergner of “Waste Not Want Not---Creative Use of General Powers of Appointment To Fund Tax-Advantaged Trusts.”

Basic fact pattern to the presentation. What is attempting to be solved is the situation between spouses of unequal wealth and the potential wasting of the poorer spouse’s unified credit.

Example: Assume richer spouse has $4M in assets, poorer spouse has assets of $200,000. First spouse dies when credit amount is $2M, and second spouse dies when credit is still $2M. If richer spouse dies first, typical A/B trust arrangement works well by funding the bypass trust and the balance to the marital trust. The bypass trust passes to heirs after surviving spouse's death at no tax and surviving spouse's estate pays tax on the amount in marital trust of $2M plus her own assets of $200,000, or $90,000. Family receives $4.1M after death of second spouse. Alternatively if poor spouse dies first only $200,000 of $2M of credit shelter trust is funded "wasting" $1.8M of credit. When surviving spouse dies with a taxable estate of $4M with an estate tax of $900,000, only $3.3M passes for the family.

Traditional solutions are:

* Rich spouse makes a lifetime outright gift to poorer spouse; or

* Lifetime QTIP.

Problem is oftentimes (or sometimes) the richer spouse is concerned with "control."

Solution based on PLRs 200101021,200210051,200403094, and 200604028. Generally they are the same with some variations with the exception the 2006 ruling the spouse had the right to disclaim.

Rulings.

* Richer spouse creates and funds a revocable trust;

* Richer spouse grants poorer spouse a general power of appointment by formula (so as to use poorer spouse's unused unified credit) exercisable during life or at death, creating a bypass trust for the surviving spouse or if the spouse does exercise the power of appointment that the assets pass to the bypass trust on the lapse of the power; Note-Richer spouse retains right of revocation over general power of appointment that lapses at the moment of death.

* Surviving, richer spouse, is granted rights in the bypass trust but does not have powers that would cause inclusion in richer spouse's estate.

IRS Holds:

* No taxable event occurs while both spouses are living so long as the general power of appointment is not an intervivos power that is exercised.

* Upon poorer spouse's death, richer spouse makes a completed gift to poorer spouse that is the subject to poorer spouse's general power of appointment.

* Gift from richer spouse to poorer spouse qualifies for the gift tax marital deduction.

* Property that is subject to the general power of appointment is includible in poorer spouse's estate.

* Poorer spouse is treated as transferor of all property that funds bypass trust, including property that passes through the e exercise or non-exercise of the general power of appointment.

* Richer spouse can be both beneficiary and trustee of bypass trust so long as the power to make distributions is limited by ascertainable standards and can have an intervivos and testamentary limited power of appointment over the trust property.

* Richer spouse's property probably does not receive a new income tax basis at poorer spouse's death, at least to the extent of richer spouse's interest in the property.

Mr. Gans addressed possible attacks with the strategy.

* The gift to the spouse must qualify for the marital deduction. IRS concludes it qualifies but there is no analysis associated with its conclusion. Mr. Gans cited Johnstone, 76 F2d 55 (9th Cir.) for the proposition that a general power of appointment that can be revoked at any time but that is extinguished if the donee dies causes Section 2041 inclusion for the donee. The gift is made at moment before death. An alternative argument is that the spouse is granted a limited power of appointment and because of that power the gift is incomplete.

* Is there is terminable interest?

Mr. Gans believes there is some risk but that can be addressed as follows:

* Spouse exerecises the power of appointment citing RR 82-184;

* The spouse's power if it lapses passes to spouse's estate;

* Create a QTIP. .

3. Sections 2038 (Skifter analysis) or Section 2036. Mr. Gans states Reg. Section 25.2523(f)-1(f), Ex.11, which provides a lifetime QTIP cannot be challenged by IRS under either Section 2036 or 2038.

4.Creditor argument under Section 2041. The limited power of appointment should foreclose that argument.

The presenters discussed other possible applications of this strategy between spouses and others where control is not an issue. For example special assets or even between non-spouses (same sex partners). For example in a married couple situation assume in husband and wife situation husband owns $2M of assets and wife has a $2M IRA. If wife dies first and has a general power of appointment she can direct the husband's other assets of $2M fully funds a credit shelter trust and her IRA is left directly to the husband qualifying for the marital deduction and also allowing the husband to rollover wife's IRA.

The presenters also suggested that in estates of less than $2M that spouses create a joint trust each having a general power of appointment. In the case posited the parties do not care about the marital deduction and leave everything to a credit shelter trust. This strategy is possible only if there is no separate state estate tax because the parties have intentionally not structured a marital disposition.

Mr. Gans discussed another alternative based on the fact pattern. Richer spouse creates a revocable QTIP for spouse, or just places assets in QTIP for spouse. Trust provides income to life for spouse, the revocation power terminates at spouse's death, at spouse's death the assets are split into a credit shelter/marital allocation with the bypass trust for the spouse who is granted a limited power of appointment and also has a veto power over distributions. Spouse has an invasion power subject to ascertainable standards. The QTIP election is made following spouse's death. The potential issue is filing a gift QTIP in the year of death. Mr. Gans posits that should be acceptable but if not the spouse has retained a special power of appointment making the transfer an incomplete gift.

Mr. Gans then reviewed a concept that he called "Supercharged Credit Shelter Trust" that will be the subject of an article that he and Jonathan Blattmachr have written. Comparing a conventional credit shelter trust with this concept assuming the trust earns 8@ and an effective tax rate of 25%. Assuming $2M in trust, after five years a conventional trust has $2.68M vs. $2.94M; after 20 years the spread is $6.41 vs. $9.32.

What is the concept. Husband creates QTIP for spouse. At spouse's death Section 2044 inclusion in spouse's estate. Husband is a permissible income beneficiary of by pass trust. Under Ex. 11 Sections 2036/2038 do not apply at husband's death. The credit shelter trust for income tax purposes is treated as a grantor trust under Reg. Section 671-2 because husband funded the trust. For estate tax purposes a trust that is included in the spouse's estate but for income tax purposes a trust deemed created by the husband. The income tax paid by the husband for the trust allows the trust to grow without income tax consequences. There is no gift under RR 2004-64 when a grantor pays tax for his grantor trust there is no gift. There is a possibility of basis step up also in this trust. Husband can swap assets income tax free or alternatively under Reg. Section 1001, Ex 5, when grantor trust status ends it is deemed as if grantor transferred assets at that time (again for income tax purposes).

The presenters also discussed the concept has merit even if portability of unified credit becomes the law.

The presenters' outline included a number of various forms that may be of interest. Included in the forms is an "Inheritance Trust" form--designed to create a trust for a person that can receive property inherited from others as well as a series of 12 other forms dealing with grants of testamentary and inter vivos general powers of appointment, commentary regarding the non-exercise of general powers of appointment, and exercises of testamentary general powers of appointment.

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Special Session 4-D Death, Dirt and Duties: Estate Planning for Real Estate Transfers Thursday afternoon, January 11, 2007 Presenters: Wendy Goffe and Scott Osborne

Reporter: Merry Balson Esq.of Wade, Ash, Woods, Hill & Farley in Denver, Colorado

This session reviewed selected real estate issues, including §1031 exchanges.

Title Insurance and Deeds. Mr. Osborne, a real estate attorney, began by addressing the preferred type of deed to use. While this will inherently be a state law issue, the issues to be considered are the same regardless of the jurisdiction. The first question is what kind of warranties do you want to convey with the property, and whether you want to convey the same warranties you received when you took title. If the passage of warranties is important, generally you should not use a quitclaim deed, because in many states, that will destroy the ability to claim under prior warranties (e.g., the warranties possessed by the grantor). Many people use trustee deeds, which are essentially limited warranty or special warranty deeds, which tend to limit the warranties conveyed to those things created or suffered by the grantor during the grantor's ownership only, and not to acts occurring prior to ownership. His position was that generally speaking you do want those warranties to pass to the donee. He suggests obtaining a copy of the deed the grantor received originally (i.e., the vesting deed) from either a title insurance company or from the courthouse.

In the West, no one relies on warranties contained in the deed because most rely on protections contained in the title insurance policy purchased at the time the grantor acquired the property. Note that if you convey title to an entity (including an LLC, or trust) the title insurance may not cover the entity as an insured in many inter vivos transactions. The ATLA policy contained a rather limited definition of insured for many years, and did not include many entities even when they are used in estate planning transactions. Owners policies are not assignable, and claims can be made only by the covered "insured" while they own the policy. The definition of "insured" in most homeowners policies since 1998 has been expanded to contemplate transfers to trusts with continuation of coverage, but that definition remains limited and does not include all entities used in the estate planning context. If you are aware of a potential transfer to an entity at the time of purchase, Mr. Osborne suggests obtaining a "Fairway" endorsement (based on Fairway Development Co. v. Title Insurance Co. of MN, 621 f. supp 120 (ND Ohio 1985)) an example of which is contained in the materials, to ensure that the policy coverage will continue even if there is a change in the members of an entity.   See also, Gebhardt Family Restaurant LLC v. Nation's Title Ins Co. of NY, 132 Md. App. 457 (2000) for example of attempt by grantors to obtain coverage when property was transferred to an LLC. A deed conveying warranties may create rights in the grantee to claim through the grantor, but many states limit the damages/claim to the amount the grantee paid for the property, which may be a problem where family members contribute to the LLC and no payment is actually made. See e.g., Point of Rocks Ranch, LLC v. Sun Valley Title Ins. Co., 146 P.3d 377 (Idaho 2006) where LLC claimed title company had an obligation to defend title under warranties by grantor. The claim was denied there because the deed contained language that the transfer was subject to all easements of record, and the claim related to an easement not covered in the title policy, but that was of record, therefore, there was no breach of warranty.

Options to preserve title policy coverage include:

(1) obtaining a "Fairway" endorsement on the front end;

(2) purchase an additional or successor insured endorsement for the policy; or

(3) obtain a new owners policy, which is less expensive if done in connection with a refinance of the property.

Note that the new 2006 ALTA policy adopted in most states has a significantly broader definition of the named insured, and includes transfers to other entities, even if no consideration is actually paid if the entity is wholly owned by insured/grantor. The policy is reproduced in the materials.

If residential real property is transferred with a mortgage it is not subject to the due on sale or due on transfer provisions of the mortgage under federal law. However, commercial properties are not protected in the same manner, and if a right to transfer is not contained in the mortgage, you must obtain permission from the lender to make the transfer or the note may be accelerated.

Ms. Goffe addressed IRC §121 which permits an exclusion of gain up to $250,000 per person, or $500,000 for a married couple, when the residence is used as a principal residence for a period of 2 out of 5 years, and the ownership and use tests are satisfied. So long as one spouse meets the ownership requirement and both meet the use requirement, the full $500,000 exclusion is available. The $250,000 per person exclusion can also be applied to separately owned residences if the ownership and use tests are met. Section 121 contains some exceptions for shortened use and fractional reductions, including

(1) a change of employment where the new place of employment is at least 50 miles from the old place of employment,

(2) certain health issues;

(3) unforseen circumstances regarding involuntary conversion, disasters, unemployment, divorce or separation, multiple births from the same pregnancy and other facts and circumstances (such as an adoption requiring an additional bedroom in the house, spouse moving to hospice, and need to parent/in-law); or

(4) a sale due to a move to the nursing home.

The safe harbor applies if a qualifying individual (i.e., taxpayer, spouse, co-owner or person who lives in the same house, or persons related to these individuals) applies to the IRS. The reduction is based on a fraction stated in the Code. Tacking of ownership and use periods is available in some limited circumstances, including for certain military personnel and overseas spies. The gain exclusion is available once every two years, and the taxpayer can opt not to apply it to a transaction. The gain exclusion is not available where the residence is owned by an irrevocable trust, but does apply to any grantor trust, life estate, coop and sale of a remainder interest in the residence if the sale is to an unrelated party. If a taxpayer has multiple residences a facts and circumstances test applies, where the IRS looks at which home is used the majority of the year, where the taxpayer is employed, the address used for tax returns, automobile and voter registration, where the taxpayer has a driver's licence and where he/she banks.

Mr. Osborne then addressed §1031 exchanges. The materials discuss the mechanics and requirements so he did not review those in detail. With the increased personal residence gain exclusion, the §1031 exchanges have become less common. Traditionally these are used for rental property, where the taxpayer trades property throughout his/her life without gain recognition, then dies owning the property and receives a step up in basis. Usually the taxpayers who use the §1031 exchange are "pathological tax avoiders." The personal residence gain exclusion provides some additional flexibility when using the 1031 exchange because a taxpayer can exchange a property, then live in it for the required time, sell it and exclude much of the gain.

Mr. Osborne then addressed reverse exchanges which is not in the materials and is a misnomer. It is not actually a reverse. Instead, it is a method of parking property you want to acquire prior to the time you sell property you want to exchange. You should analyze the transaction, and the potential tax benefits and the expenses involved to ensure it makes sense before automatically entering into §1031 exchanges. 1031s have been available since 1979, but in 2000 Revenue Procedure 2000-37 (effective September 15, 2000) set out safe harbors for these transactions. The safe harbor contains strict time limits to identify the relinquished property (45 days) and to complete the transaction (180 days), so the client needs to have the property in mind at the outset. If the safe harbor time limits are not followed there are general rules that may still protect you, but keeping within the safe harbor is certainly better.

Exchanges of mature property for property under construction presents unique problems. Identification of the property can be difficult if it has not yet been built, but you can reference plans and specs or provide a general description of the project. The easiest way to deal with construction problems is to wait to exchange property until the property under construction is far enough along to have sufficient value to soak up all proceeds from the relinquished property, and then do a simultaneous transaction (i.e., delay the closing until the construction is complete). If this is not possible, then close within 180 days after the trade. There can be difficult issues surrounding the use of sales proceeds by the intermediary. Sales proceeds (from exchange property) cannot be used to pay for the construction. Monitoring and participating generally in construction is permitted, but be mindful of the constructive receipt issues.

Common §1031 problems/issues include: compliance with the strict safe harbor timing rules; ensuring that the new investment is at least as expensive as what is being sold; creation of unintended tax when cash is taken out of the sales proceeds (e.g., refunds of security or other deposits) or when sales proceeds are used to fund non-property related acquisition costs (these can usually be funded separately); using a §1031 exchange where there is personal property involved (e.g., these exchanges do not usually work for hotels and apartments for this reason); using an entity to sell and individual to purchase or vice versa (the same entity that acquires the property must do the exchange); ensuring you have a good intermediary/qualified facilitator sot that the transaction works properly (most states have these available); and attempting to use §1031s on second homes/vacation rentals.

Ms. Goffe reviewed the many charitable giving issues that can arise with real estate. The materials on this topic are in her main outline on estate planning for the second home. Valuation and substantiation rules must be followed when donating real estate to charity. The general rule is that the asset must be valued at fair market value. A qualified appraisal by a qualified appraisal is required to obtain the charitable deduction if the asset is valued at more than more than $5,000. Additionally, if the value is in excess of $500,000 an appraisal summary must be filed so the IRS can determine whether the value is inflated. If the charity disposes of the property within 3 years (formerly 2 years), the charity must file a Form 8282 showing the amount they received on the sale of the property. The Pension Protection Act ("PPA") also increased the penalties for overvaluation. Note that if the value of a CRT remainder is less than $5,000 there is no appraisal requirement.

Prearranged sales are not permitted. If the donor enters into a binding contract to sell prior to the transfer to the charity, no deduction will be allowed.

Ms. Goffe then discussed the unrelated business taxable income (UBTI) issues. Generally, if income from a trade or business is not substantially related to the exempt purpose, it will be UBTI and subject to income tax. However, most passive income is subject to UBTI only to the extent that it is derived from debt financed property. The Tax Relief and Health Care Act of 2006 (enacted in December 2006) changed the UBTI rules with respect to CRTs. Rather than disqualifying the CRT for the entire year if it had any UBTI, under §424 only the UBTI is taxed and the CRT is not tainted.

Transferring mortgaged property to a charity creates UBTI to the recipient because it will be considered debt financed income. However, if the transfer occurs through a devise on the death of a donor, the first 10 years of ownership are not treated as debt financed. Additionally, the charity can own property for 10 years if the donor had the debt for at least 5 years before the transfer to the charity.

Close attention must be paid to the self dealing rules when transferring real property to a private foundation, CRT or CLT. For example, if a mortgage was placed on the property within 10 years prior to the transfer. If the donor is personally liable on the mortgage, the CRT can be treated as a grantor trust and will lose its benefits and the donor will be liable for the capital gains tax. With few exceptions, the self-dealing rules prohibit any transaction between a "disqualified person" and a foundation, CLT or CRT. The disqualified person cannot continue to reside in a residence (even if rent is paid) where a home is transferred to a charity.

Fewer traps exist with outright gifts of real estate to charities. The deduction value will be the fair market value only if the donor is not a dealer in the property. A dealer's deduction is limited to basis. When a donor makes a gift of real property to her foundation the deduction is also limited. However, the donor may not receive any benefit in exchange for the transfer (e.g., if donor obtains favorable zoning on property for development of adjacent property).

A charity can purchase property for a bargain sale. In that case, there must be an allocation between a gift and a sale, and the donor will recognize gain only on the sale portion.

The self-dealing rules present problems for CLTs funded with commercial real estate. The lease of real estate to the grantor or persons related to the grantor will give rise to self-dealing tax, but you can plan around this, usually with a $0 rent. Foundations, CLTs, and CRTs are subject to the excess business holdings rule, and must dispose of those holdings within 5 years to avoid the excise tax. Ms. Goffe noted that a disposition back to the grantor or a related party is prohibited. The Code authorizes 5 year extensions under certain circumstances.

Ms. Goffe mentioned that you need to be mindful of the self-dealing rules with disclaimers of real estate that pass to a private foundation. The disclaimant who is also a disqualified person should not be in control of the real estate in the private foundation for management or distribution purposes to avoid the self-dealing rules.

If real estate owned by an S corporation is contributed to a CLT, the CLT would be a permitted shareholder as an S corporation, and a nongrantor trust could elect ESBT treatment, but the CLT will be taxed on income at the highest rate and under §642(c) it is denied the charitable deduction, so it loses its tax benefit.

Ms. Goffe noted that fractional gifts of real estate are addressed in the material so she would not discuss this today.

Charitable gift annuities can be funded with unmortgaged real estate but are a type of bargain sale. Note that under the new private annuity proposed regulations the amount realized is going to be taxed at the fair market value of the contract and immediately subject to capital gain tax. Charitable annuities are not currently subject to that rule, but Senator Carl Levin suggested this might be coming in future legislation.

Mr. Osborne reviewed conservation easement issues. A conservation easement is a permanent restriction on privately owned land that creates a charitable deduction for the value passing to the holder of the easement (a charity). The value of the easement is the difference between the fair market value before the transaction, and the value after the easement is imposed. Conservation easements can be made at death in a will or by election in the estate. The concept is that this will preserve open space and limit development. Conservation easements have become increasingly popular, with approximately 1700 private land trusts in the U.S., and 37 million acres of land subject to conservation easements. The PPA contained a number of provisions affecting conservation easements mostly as a result of abuses with the charitable deductions. The new provisions included: (1) the amount of the available deduction was increased; (2) the carryforward was stretched to 15 years; and (3) the penalties were increased on appraisers. Under Notice 2006-96, the IRS issued some transitional guidance including new appraiser guidelines. Generally the appraiser now needs a designation of some kind.

When a client wants a conservation easement, you need to consider several principal issues. Form documentation for a conservation easement is included in the materials. Consider the rights retained (which should not be so expansive as to destroy the conservation purpose) and the sufficiency of enforcement mechanisms in place for the land trust (which should include a cash gift for monitoring and enforcement). Keep in mind this is a permanent arrangement whether or not it turns out as the taxpayer might have hoped. The client's primary motive should be to conserve property, and the easement needs to further some conservation purpose. The appraiser needs to be reliable and believable. Finally, the statutory requirements must be fulfilled (e.g., any debt must be subordinated by the easement, and a land trust must accept the easement). Mr. Osborne commends to our reading the following cases in this area: Turner v. Comm'r, 126 T.C. No. 16 (May 16, 2006); and Glass v. Comm'r, 2006 U.S. APP Lexis 31387, 2006 Fed App 0464P (6th cir, Dec. 21, 2006).

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Special Session 4-E A Holistic Approach to Analysis of Private Annuity Trusts to Defer Capital Gains, Including Exit Strategies Thursday afternoon, January 11, 2007 Presenters: Jerome Hesch and Kevin McGrath

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

Hesch led off with a description of the benefits of private annuities over installment sales, at least prior to the promulgation of the proposed regulations that pertain to private annuities. He then described the new proposed regulations, which now cause recognition of all of the gain immediately (rather than over the life expectancy of the annuitant). He reminded everyone that pre-October 18, 2006 private annuities are grandfathered.

He then went over an example that was in his materials in which a private annuity could do for clients something that a GRAT could not do. Hesch underscored the importance of remembering to include a "switch" in a trust document to "turn off" grantor trust status since that status can be a bad thing if the trust property and income significantly grows in value.

McGrath then described the exhaustion test under the IRC Sec. 7520 regulations (and formerly under Rev.

Rul. 77-454). He reminded everyone that failure to meet the exhaustion test out to age 110 will cause an inadvertent gift. McGrath gave some potential solutions to the gift problem, which ranged from making a larger gift, beneficiary guarantees to spousal guarantees to funding the trust with a seed gift to using a self-cancelling installment note instead of a private annuity.

Hesch then discussed the advantages and disadvantages of the private annuity as far as the income tax consequences go. He reminded all that the income tax disadvantages of private annuities have always outweighed their advantages. Hesch suggested buying back the private annuity as an exit strategy.

The panel concluded with a guest, who discussed the ABA comment process relative to the proposed private annuity regulations. The ABA is likely to recommend application of the installment sales rules and the OID rules to private annuities in lieu of the draconian rule contained in the proposed regulations.

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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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