2017 Heckerling Highlights

Washington, D.C. Estate Planning Council Webinar

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Disclosure

IMPORTANT: This presentation is designed to provide general information about ideas and strategies. It is for discussion purposes only since the availability and effectiveness of any strategy are dependent upon your individual facts and circumstances. Always consult with your independent attorney, tax advisor, investment manager, and insurance agent for final recommendations and before changing or implementing any financial, tax, or estate planning strategy.

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Overview

- Largest estate planning conference in the country, reportedly with over 4,000 registrants this year
  - U.S. Trust among largest sponsors and participants
- 46 total sessions during the week, led by 86 faculty members
  - 3 Fundamental sessions
  - 20 General sessions
  - 23 Special sessions
- We will cover only a portion of the topics presented, and only in summary fashion

Heckerling Highlights - 2017

Charitable Planning Related Topics – Ramsay Slugg

- 7 charitable planning related topics
    - Giving to foreign charities (general session)
    - Charitable giving by business owners (special session)
    - Basics of private foundations (general session)
    - Impact investing (general session)
    - Private foundation governance and grantmaking, practical problems and solutions (special session)
    - Charitable lead trusts/impact investing (special session)
    - …CLT remainder planning (special session)

Art Planning Topic

- Combined update of legal developments and industry practices for trust & estate attorneys not used to dealing with this area

Recent Developments

- Estate Tax Repeal?
- Section 2704 Regulations
- Sale to Grantor Trust/Defined Value Clause/SCIN
- Family Limited Partnerships

Recent Developments
Estate Tax Repeal?

- As a result of the **2016 election**, Republicans control the Presidency, and retain control of the House and Senate.
  - It is expected that **significant tax changes** will be enacted in 2017.
  - In addition to income tax changes, there will **likely be transfer tax changes**.
- **Trump plan**
  - Trump campaign plan includes **repeal of the estate tax**.
  - However, **capital gains at death** would be subject to tax, subject to a $10 million exemption.
    - Unclear if $10 million exemption is for each decedent, or is the combined exemption for a married couple
    - Unclear if deemed sale at death, or carryover basis and tax when asset is actually sold
  - Silent on **gift tax**
    - Gift tax may be viewed as supporting the estate tax and also the income tax.
- **House Republican blueprint**
  - Released in June 2016
  - **Repeals estate and GST tax**
  - Silent on **gift tax**
- **Permanent or temporary**
  - In order to avoid a filibuster in the Senate (need 60 votes, and Republicans only have 52 votes), Republicans can use a procedure known as **budget reconciliation.**
    - If the tax changes would produce deficits, it is required that such tax changes be **temporary - sunset** after the budget window period (for example, after 10 years).
    - Even if "permanent" changes are enacted, they could still be changed by new legislation in the future.

Recent Developments
Estate Tax Repeal Acts of 2017

- Various **estate tax repeal acts** have been introduced since the election, including:
- **H.R. 631** (introduced in House on January 24, 2017)
  - **Estate tax repealed** for decedents dying on or after date of enactment.
  - QDOTs with respect to a surviving spouse of a decedent dying before date of enactment will be subject to tax for 10 years after date of enactment.
  - **GST tax repealed** for generation-skipping transfers on or after the date of enactment.
  - Gift tax remains
    - Top rate of 35%
    - Exemption of $5 million, with inflation adjustment after 2011
  - No reference to any deemed capital gains tax at death or carryover basis
    - If section 1014 is not changed, may continue to be a step-up in basis for certain property in estate (other than property referenced by estate tax inclusion, such as a QTIP trust)
- **S. 205** (introduced in Senate on January 24, 2017)
  - Same as above, except it **also reinstates section 2511(c).**
    - Section 2511(c) was contained in the Economic Growth and Tax Relief Reconciliation Act of 2001. It was repealed by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and that repeal was made permanent by the American Taxpayer Relief Act of 2012.
    - This section essentially provides (in cryptic language) that a transfer to a non-grantor trust is treated as a completed gift.
      - This would effectively eliminate ING trusts, since it would then be impossible to make an incomplete transfer to a non-grantor trust.

Recent Developments
2704 Regulations

- **Proposed regulations under section 2704** were released on August 2, 2016.
  - The regulations are not effective until after they are published as final regulations.
  - The regulations were controversial, and there was uncertainty how they would be interpreted, and what effect they would have on valuation discounts for family-controlled entities.
  - As a result of the November 2016 election, there was speculation that the regulations would be withdrawn, particularly if there is estate tax repeal.
  - However, if the estate tax is repealed but the gift tax remains, the 2704 regulations may still be relevant.
- **IRS public hearing** on 2704 proposed regulations on December 1, 2016
  - Although practically all the commentators who spoke advocated for a complete withdrawal of the regulations, the IRS did not say they would be withdrawn.
  - **Disregarded restrictions and deemed put right?**
    - Almost every commentator expressed concern over what some have read to be a deemed put right.
    - Catherine Hughes (Advisor in Treasury Department's Office of Tax Policy) stated it was not the intention of Treasury or the IRS to imply a deemed put right. Ms. Hughes reiterated this at Heckerling.
    - Nevertheless, many commentators requested the panel to clarify the language to negate any interpretation that a deemed put right exists – even if no concern as to what Treasury intended, still a concern what interpretation a court might make.
  - **Retroactive application of 3-year rule?**
    - Many commentators were concerned the 3-year rule relating to lapsed liquidation rights could apply to certain transfers made before the effective date, if the transferor died after the effective date and within 3 years of the transfer.
    - Catherine Hughes stated that it would be clarified that there would be no retroactive application of the 3-year rule. She also reiterated this at Heckerling.
- On January 20, 2017, the Trump administration instructed federal agencies to **stop all pending regulations** until a legal and policy review can be conducted.

Recent Developments
Sale to Grantor Trust/Defined Value Clause/SCIN

- ***Woelbing*** **– Settlement in Tax Court (March 2016)**
  - Sale of stock to grantor trust for interest-bearing promissory note
  - **Defined value clause** used to determine the number of shares sold, which would be equal to the face amount of the note
  - Trust has financial capability (greater than 10% of face value of note) to repay loan
  - IRS views note as a retained interest
    - Valued at zero under 2702 – therefore sale viewed as a gift
    - Estate inclusion under 2036 – does not qualify as a bona fide sale for adequate and full consideration
  - Case settled on favorable terms for taxpayer
    - Appears IRS effectively agrees to operation of defined value clause
- ***True*** **– Pending in Tax Court**
  - Gift and sale of business interests to children and a trust
  - **Defined-value/price adjustment clause** – if value of gift increased, then donee treated as having purchased excess (increase in purchase price)
  - When IRS non-acquiesced in *Wandry* (defined value clause), speculation that IRS would continue to oppose such clauses
- ***Johnson*** **– Pending in Tax Court**
  - In *Davidson (*stipulated decision entered July 6, 2015), the decedent had engaged in various estate planning transactions, including SCINs. The IRS, in a Chief Counsel Advice, took the position the SCINs should be valued, not under section 7520, but under a willing-buyer willing- seller standard that took account of the decedent's health. As a result of settlement in 2015, there is continued uncertainty as to the valuation of SCINs.
  - *Johnson*, filed in 2016 and pending in Tax Court, also involves valuation of a SCIN

Recent Developments
Family Limited Partnerships

- ***Purdue* – Tax Court (December 28, 2015)**
  - First FLP/LLC 2036 case since 2012
  - Tax Court agrees with the estate that transfers to LLC were **bona fide sales for adequate and full consideration** – therefore 2036 does not apply
    - Court agrees with IRS that gift-giving alone is not an acceptable nontax motive, but finds that decedent's desire to have securities and other property managed as a family asset, with consolidated management and investment strategy, constitutes a **legitimate nontax motive.** No significant negotiations, but formation of LLC still an arm's length transaction**.**
    - Court holds that transfers by decedent **to the LLC** in exchange for membership interests were a bona fide sale for adequate consideration, due to legitimate and significant nontax reason.
- ***Holliday* – Tax Court (March 2016)**
  - Marketable securities and cash transferred to limited partnership
  - Court finds that decedent retained income because partnership agreement provides that periodic distributions were to be made to partners
  - Court holds **not a bona fide sale for adequate and full consideration**, because there is **no significant non-tax reason** for creating the partnership. Court rejects each of three non-tax reasons claimed by estate:
    - Protection of assets from personal injury claims
    - Protection from undue influence of caregivers
    - Preservation of assets for heirs
    - Court also finds no meaningful negotiation associated with formation of partnership
- ***Beyer* – Tax Court (September 2016**)
  - Stock and other marketable securities transferred to limited partnership, and then sold to grantor trust for note
  - Court denies discounts for value of assets in estate
    - Implied agreement that decedent would retain enjoyment – continued use of assets and failure to retain sufficient assets outside partnership
    - **Not a bona fide sale for adequate and full consideration – no valid legitimate and significant non-tax reason** for partnership

Placebo Planning by Professor Jeffrey Pennell (22 pages).

- His last Heckerling presentation. I believe he said 41 years!
- Two stated goals that inter-mix:
  1. Planning that is "common but maybe not so intuitive."
  2. Illustrate a "single concept" that applies to many techniques, but it's "not what most planners believe it to be."
- For both
  - many times we don't really understand the technique and what makes it "tick"
  - the question becomes whether it ends up being not useful but also no harmful (a placebo), or whether there could also be harm resulting from the lack of fully understanding.
- I will share some of the #1s and my understanding of #2.
- High-level. If you want more detail, there's the full Heckerling outline.

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Placebo Planning by Professor Jeffrey Pennell
"Sole and absolute discretion."

- Many trusts grant to the trustee(s) "absolute" or "unfettered" discretion.
- If that were literally true, there would be no trust.
    1. If the trustee is truly unaccountable, there is no trust to enforce.
- So, it's usually interpreted not literally. For example, it can be interpreted to mean only that the trustee cannot be forced to exercise discretion.
- Is it a placebo?
    1. Does it really do what it says? No.
    2. Does it cause any harm? Who knows; Pennell offers potential "harm." For example, a trustee might indeed read it literally and act as if there is no accountability. Beneficiaries might believe there is no ability to question a trustee.

Placebo Planning by Professor Jeffrey Pennell
"5-and-5 powers"

- Usually these lapse and there are no gift/estate tax consequences.
- If death occurs while the current year's power is exercisable, there is estate tax inclusion. It's a GPOA.
- To minimize that risk, many drafters say the 5-and-5 can be exercised only on one day of the year, if alive.
- "There is no case law establishing that this is viable planning, but is there any down-side to its use? This may be placebo planning, or better – in the sense that it can't hurt to try, and it may work."
- So what day do drafters often pick? Common choices are 12/31 and 1/1.
    1. What are the highest mortality days of the year? Could you pick two worse days, given the goal of limiting the power in this manner?
    2. One wag (and close friend) suggests the day when we go on daylight savings time — because there are only 23 hours in that day! My point is: think about the goal and select an intuitive date.

Placebo Planning by Professor Jeffrey Pennell
Mandatory distributions

- Often there are step outs, such as 1/3 at ages 25, 30 and 35. The "rationale" is to allow a child to receive a portion, learn a few life-lessons, and not squander the entire inheritance
- Odds are most are well beyond age 35 when parents die, meaning there are no multiple-stage step outs.
- This is placebo planning, in the sense that the multiple-stage plan likely appeals to parents who want the life-lesson learning to occur, but worthless in terms of how the events likely will occur.
- Proposed answer is simple. Just make the steps outs occur "upon the last to occur of the child being age X and Y days/months/years after the death of the surviving parent."

Placebo Planning by Professor Jeffrey Pennell
The "single concept"

- He offers his thoughts on what makes several techniques "click"
- The recurring theme can be expressed as follows (my paraphrase)
  1. If the tax liability is going to increase annually at X%, and if the cash (called "cold cash") used to pay the tax will be increasing less, pay the tax sooner.
  2. From the paper: "payment of tax with assets that will not appreciate in value, in order to protect the growth in assets that will appreciate."
- This "simple" idea is used to describe the benefit of several techniques
  1. Gifts
  2. ILITs
  3. Roth conversions, paying the tax with "outside" funds
  4. Others
  5. Easier said than done! *(to know which assets will outperform)*

Placebo Planning by Professor Jeffrey Pennell

- He then offers some comments/issues/critiques of several other techniques
  1. IDGTS
  2. SLATs (and in particular the issue of reciprocity)
  3. Remainder Purchase Marital Trusts
  4. Beneficiary Defective Inheritor's Trust

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When to Claim Social Security Benefits, later is Usually, But not Always, Better by Lawrence Frolik of U Pitt School of Law

- There is no new ground broken here. That's OK; that just makes it a valuable review of a topic that hits clients of all levels of wealth.
- We have Wealth Strategy Reports summarizing these rules; I'll give an overview
- Focus is on retirement benefits (not disability)
- Eligibility. Must have "paid into the system" (have "covered quarters")
- Choosing a payout option
  1. You have a benefit that will get paid at your "Full Retirement Age" (FRA)
     - age 66 or 67, or in between, depending on year of birth
  2. You can elect to take your benefit early (reducing the annual benefit) or late (increasing the annual benefit)

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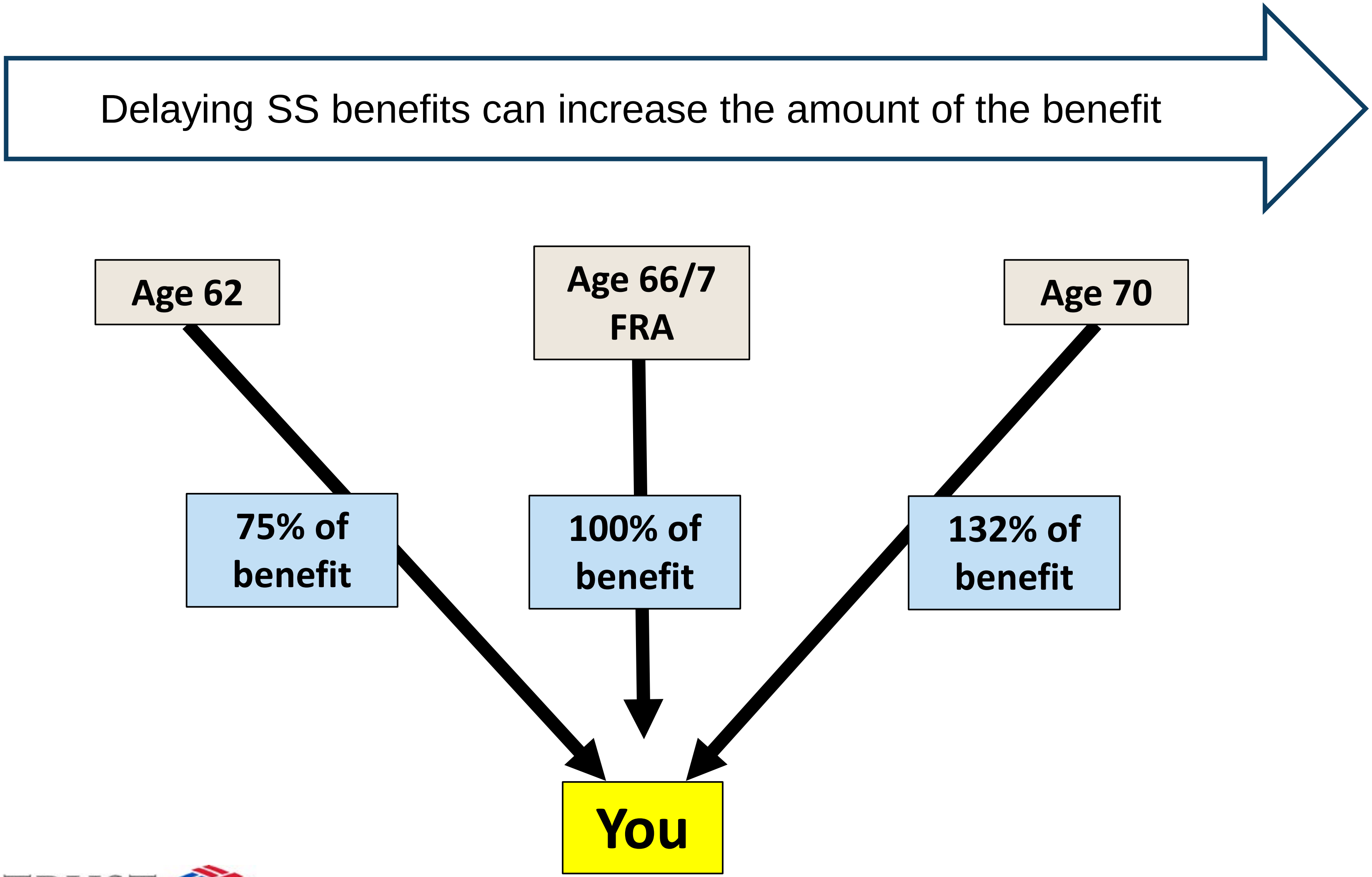

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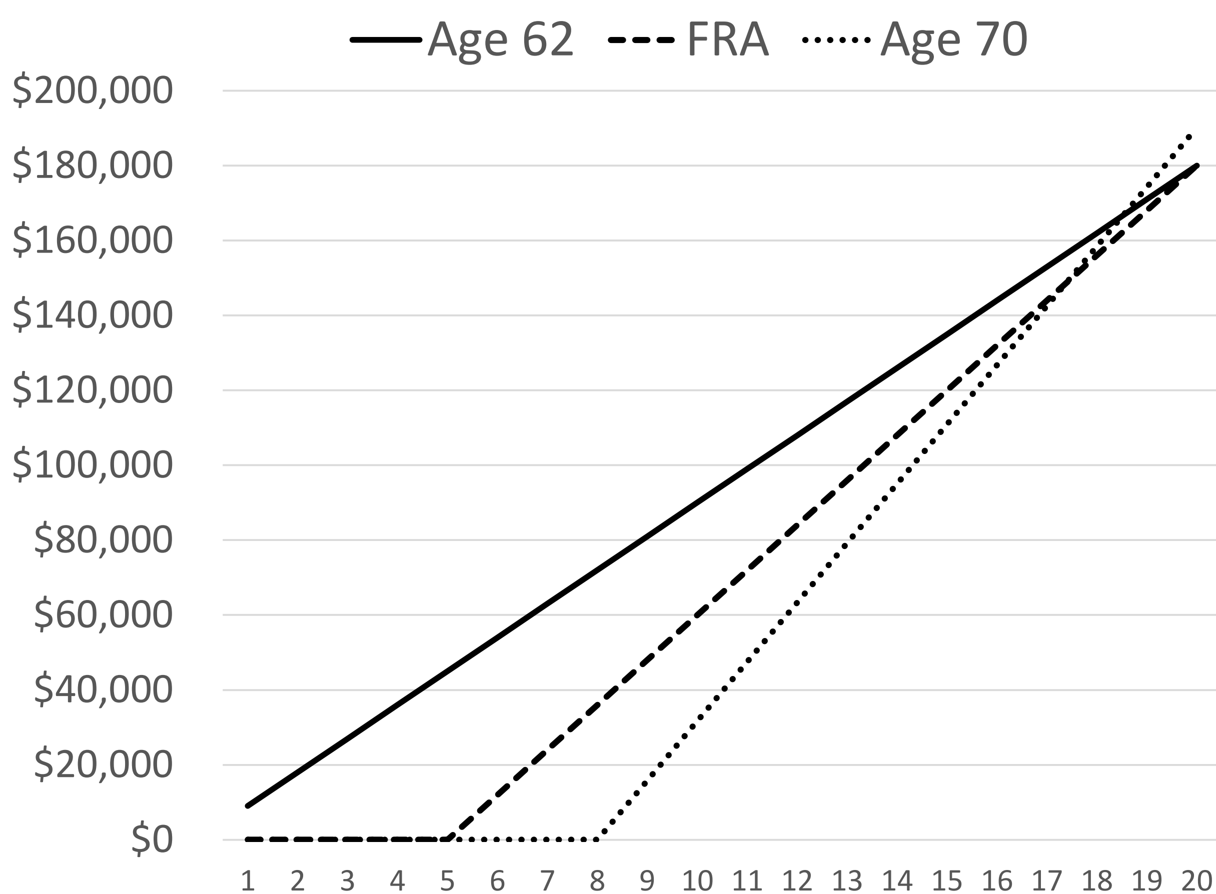
This is a horse race; you tell me when you are going to die and I'll tell you which payout to choose.

	Annual $
Full monthly benefit at FRA	$12,000
At age 62	$9,000
At age 70	$15,840



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When to Claim Social Security Benefits, later is Usually, But not Always, Better by Lawrence Frolik of U Pitt School of Law

1. For all (single and married)
   - Cash flow needs!
   - Earnings Test
     - Having earned income can reduce your benefit
     - N/A after FRA
   - Income Taxation of Social Security benefits
   - Time Value of Money
2. For Married
   - Spousal Derivative Benefit
   - Spousal Survivor Benefit
   - Filing strategies
     - File and Restrict (if born > 1/1/54)
     - File and suspend (will now suspend all derivative benefits)

When to Claim Social Security

1. How to put it all together?

Calculators (**but make sure the software is updated to reflect the Bipartisan Budget Act of 2015**!)

socialsecurity.gov/estimator

sscalc.net

analyzenow.com

State Taxation of Trust Income

Overview – (Richard W. Nenno)

1. Patterns of state income taxation of trust
2. Constitutional limitations of taxation.
3. Focus on certain states.
4. Planning (new and existing trusts)
5. Appendix – state survey

Basics

- *Resident trusts* – state taxes <u>ALL</u> the income of resident trusts
    - Problem: Resident is defined in many different ways. Possible inconsistent and overlapping treatment. There are constitutional limitations. There are planning opportunities.
- *Non-Resident trusts* – state taxes only the source income

Planning Opportunity

- Grantor trusts –taxed to grantor wherever located – not all states recognize
- Distributed income generally taxed to the recipient-beneficiary
- Source income – taxed to the state where the property is situated or the activity occurs.
- Planning opportunity – accumulated nonsource income of nongrantor trusts

State Taxation of Trust Income

Patterns of state income taxation of trust

1. 8 states - do not tax income of trusts
2. 42 states and D.C. look to one or more of the following to determine "Residence"
   i. Created by Will of resident testator (16 states) – (e.g., CT, D.C., IL, MD, PA, VA)
   ii. Created during lifetime by in state resident (12 states) – (e.g., D.C., IL, MD, PA, VA)
   iii. Administered in the state (14 states) – (e.g., CO, KS, LA, MD, SC, VA)
   iv. One or more trustees in the state (7 states) – (e.g., AZ, CA, OR, VA)
   v. One or more beneficiaries in the state (5 states) – (e.g., CA, GA, NC, TN)

State Taxation of Trust Income

Constitutional Limitations

- Due Process Clause
  - Linn v. Department of Revenue (IL)
- Commerce Clause
  - McNeil v. Commonwealth (PA)
- Pendulum swinging away from taxation based on residency
- Nenno: *"The commerce clause should preclude state income taxation of a trust based solely on the domicile of the testator or trustor … though the Due Process Clause may not preclude such taxation with respect to testamentary trusts."*

Planning - New Trusts

- Consider state income taxation when planning
- Move to another state?
- Avoid testamentary trusts – create and fund revocable trust in another state during lifetime.

Planning - Existing Trusts

- Can tax be eliminated / move trusts?
- Avoid additions to certain existing trusts after trustor moves to another state.

Other Main Session Topics

- Retirement Accounts in 1st & 2nd Marriages: The Fun Begins
- Estate Planning Through an Asset Protection Lens—It's Not Just Self-Settled Trusts
- Warming Up to Preferred Partnership Freezes Multiple Planning Applications with This Versatile Technique
- With Great Power Comes Great Liability: Helping Trustees Avoid Pitfalls in Common Transactions
- I Have it Because Mom Liked Me the Best: How to Help Protect Vulnerable Seniors from Financial Exploitation
- Tax and Estate Planning Considerations for Foreign Persons Owning U.S. Assets
- Knowing the Ropes and Binding the IRS When Fiduciaries Are Involved in Settlements and Modifications: Income and Transfer Tax Issues Every Fiduciary Should Know About
- The Executor's Job Gets Tougher: Basis Consistency and Selected Other Income Tax Issues Facing Executors
- Wrap-Up: The 2012 Tax Act in the Context of a Technologically Advancing World—A Tsunami for the Estate Practitioner

Fundamentals Program Sessions

- Portability: Lots of Questions, Few Easy Answers
- Just Enough to Be Dangerous: Partnership Income Tax Fundamentals for the Estate Planner/Administrator
- GST Tax: Math, Mistakes & Mitigation