ACTEC 2014 Summer Meeting Musings

June 2014

The American College of Trust and Estate Counsel is a national organization of approximately 2,600 lawyers elected to membership. One of its central purposes is to study and improve trust, estate and tax laws, procedures and professional responsibility. Learn more about ACTEC and access the roster of ACTEC Fellows at www.actec.org.

This summary reflects the individual observations of Steve Akers from the seminars at the 2014 Annual Meeting and does not purport to represent the views of ACTEC as to any particular issues.

Steve R. Akers

Senior Fiduciary Counsel — Southwest Region, Bessemer Trust
300 Crescent Court, Suite 800
Dallas, TX 75201
214-981-9407
akers@bessemer.com
www.bessemer.com

BESSEMER TRUST

TABLE OF CONTENTS

August 6, 2014

Introduction

Some of my observations from the 2014 ACTEC Summer Meeting Seminars in Dana Point, California on June 19-21, 2014 are summarized below. (At the request of ACTEC, the summary does not include any discussions at Committee meetings.) This summary does not contain all of the excellent information from the seminars, but merely selected issues from the seminars that I attended. (Recordings of all of the seminars are not yet available.) The summary is based on the presentations at the seminars, but the specific speakers making particular comments typically are not identified.

Items 1-53 come from the "Stand Alone" program titled Alpha to Omega: Life Cycle of an Estate Plan. Items 54-68 come from seminars with the general title—Planning for Clients Who HATE Taxes: Is There a Magic Wand?

Items 1-5 are observations from a Session by R. Hal Moorman, Jeanne L. Newlon, and Jason S. Ornduff—Beyond the Wonder Years: Advising Clients at the Beginning of the Journey

1. Significance to Young Clients of Estate Planning

a. ***Significance.*** Young adults think they are invincible. 18-25 year-olds do not even understand why they need to talk about estate planning. The estate planning discussion is often with the young adults' parents who want to talk about estate planning for their children.

   Even though young adults may not have a lot of money does not mean that they don't have challenges or that they don't need assistance.

b. ***Basic Needs.*** Young clients generally need the basic documents: wills or revocable trusts, advance directives, health care powers of attorney, and financial powers of attorney. For wills, intestacy may not be terrible, but parents who have transferred assets to their children may want the assets to pass to siblings rather than back to the parents. The most important assets for young adults may be their "stuff" rather than financial assets.

   The young client may have financial assets and not know it. One panelist had a client who found out in his 40s that millions of dollars had accumulated for him in custodial accounts.

   Health care issues are important for young clients as well as older clients. Terry Schiavo went on life support at age 26 and was not disconnected from life support until age 41. One panelist uses this issue as a marketing strategy. He had a client who knew that his son had been in an accident but was unable to find out where he was because of HIPAA. When the son came home, the client had him immediately sign HIPAA forms. That panelist keeps track of the birthdates of clients' children. As they get close to college age, he contacts them and suggests that they talk about HIPAA forms. That is a way to re-connect with clients, and other issues typically arise as well.

2. PREMARITAL AGREEMENTS

a. ***Generally***. Young clients sometimes want to address premarital agreements, but premarital agreements often arise for second marriages rather than for young adults. Advising clients about premarital agreements is somewhat like giving divorce advice, but this planning is more fun for the attorney because the attorney is trying to keep the marriage together.

   The attorney must be sensitive to potential conflicts of interest between the parent and the parent's young adult-child. If the parent wants the child to sign a premarital agreement before getting married but the child is reluctant to do so, the attorney should respond to the parent: "I represent you; I cannot represent her."

   One of the panelists does not favor premarital agreements, especially for first marriages, feeling that they often do more harm than good and other strategies can better protect family wealth. He reasons that young adults often have little financial assets—why go to the trouble of a premarital agreement?

b. ***Portability***. The written materials include sample portability provisions for premarital agreements (prepared by George Karibjanian and Lester Law). The form requires the spouses direct their executors to make the portability election, appoints the other spouse as the portability executor, requires the surviving spouse to pay the cost of filing the Form 706 if it would not have been required except to make the portability election, requires that supporting documentation should be provided to the surviving spouse, and acknowledges that the provision is an enforceable contract to make a will.

c. ***Targeted Provisions.*** Consider tailoring the agreement to protect just the important family assets. All of the normal marital property rules would apply to the remaining assets.

d. ***Contest of Premarital Agreement***. Consider drafting the agreement to provide that the "poorer" spouse will receive different assets if the marital agreement is contested than what the spouse will receive if it is not contested.

e. ***Process, Process, Process.*** Pound into clients that following the proper process is a necessity with premarital agreements (including full disclosure of assets, separate counsel, not signing on the altar steps, etc.) Beware that the attorney for the "poorer" spouse may drag his or her feet—to hinder the proper processing procedures.

f. ***Should Estate Planning Attorneys Do Them?*** The panelists varied widely as to whether they do premarital agreements. One panelist likes doing them, another is reluctant to do them for first time marriages, and another does not do them at all (but refers clients who want premarital agreements to divorce lawyers).

g. ***Ethical Issues.*** If the attorney represents one spouse in a premarital agreement and the married couple later wants the attorney to represent both of them in preparing their wills, one panelist is comfortable doing that and another panelist is not.

3. Duty to Inform and Report as Trust Beneficiary Reaches Age 18

Even if trusts terminate long after age 18, state law may require giving adult beneficiaries information about the trust. Children are more often continuing to live with parents until their late 20s. Parents sometimes do not understand that certain legal rights exist when their children reach age 18.

Trust provisions may be able to relieve the trustee from some of the information reporting requirements at age 18, but some statutes require that the trustee give information to trust beneficiaries (including informing them of the existence of the trust) after reaching some age designated in the statute (for example, at age 25 in the District of Columbia).

The beneficiary typically can waive the right to receive information about the trust (after reaching majority).

It is in the trustee's interest to provide the beneficiary with accountings and information about the trust as soon as possible (so that the statute of limitations on any breach of fiduciary duty claims will begin to run).

The panelists were generally of the viewpoint that we do a disservice to clients when we help them hide the ball from their children. If a parent does not want the children to know about assets in a trust the parent should not make the gift to the trust. That is an indicator of bigger underlying problems.

4. Termination of Trust or UTMA Account When Not in Best Interest of Beneficiary

A trust or custodial account may terminate when a young adult reaches a certain age, at a time when the distribution would not be in that person's best interest (such as when creditor or divorce problems are looming).

One panelist told of an actual situation in which a minor was to receive $250,000 upon reaching age 18. The panelist suggested that the assets be placed in further trust with a trusted advisor after a long conversation about the perils of property management. The minor refused—he dropped out of high school within a month of graduation, bought motorcycles for his friends, bought a $30,000 stereo for his pickup, started using and selling drugs, and ended up in prison.

The states have varying laws as to whether UTMA custodianships terminate at age 18 or at age 21.

Consider a discussion with the beneficiary about what the beneficiary would do with the money, the advantage of proper management, etc. In particular, the parent can use this approach: "It's not that mom and dad don't trust you. We just don't trust everyone around you."

One strategy is to transfer the assets to a partnership or LLC, so that an interest in the partnership or LLC would be distributed at the termination date rather than cash or other hard assets. Check with local law to verify that a custodian can transfer assets to an LLC or other entity, and check whether such a transfer to delay the receipt of hard assets by the beneficiary might arguably violate a trustee's fiduciary duties.

A trust modification might be possible. (A judicial modification typically is based on changed circumstances, but one panelist asked tongue in cheek "how 'unforeseen' is it that the beneficiary turns out to be an idiot?") State law may permit a nonjudicial modification by agreement. Decanting to a trust with a longer term may be permissible under the decanting laws of some states. (If the state decanting statute does not permit that, consider moving the situs (perhaps in a judicial proceeding-- "the best place to do it is in a small town") to another state that grants broad decanting authority to trustees.)

One panelist had a situation in which a child was approached by a friend for an investment. The child had placed his money in a revocable trust for management assistance. The panelist told the third party "I would like to help you but the money is in trust" (without mentioning that the child could revoke it at any time).

5. Ethical Issues

Inherent conflict of interest issues may arise for the attorney who represents the parents and their young adult children.

- It is the child's estate plan, not the parents' plan. The attorney cannot write the will as dictated by the parents if the child does not want it.
- The initial engagement letter may address potential conflicts, but conflict issues may change over time as the relationship progresses.
- If the child asks, "what am I receiving from my parents?", the attorney may have to respond that he or she is not authorized to disclose that information.
- If the parents are paying the bill for the child's estate planning (a common occurrence), the attorney must document clearly that the child is the client even though the parent is paying the bill.
- If a trust created by the parent gives the child a power of appointment, how can the attorney do effective estate planning for the child without disclosing the power of appointment? Encourage the parent that the child needs to be told about the power of appointment.
- If buy-sell agreements restrict who can receive interests in a closely held business, the attorney can discuss those restrictions generally without divulging detailed information about the business.

Items 6-15 are observations from a Session by Kelly S. Henry and Robert K. Kirkland—Stay Linked with Your Younger Clients (and Your Younger Colleagues) by Forever Friending the Latest Digital and Social Media Technology

6. Social Media Channels

a. ***Social Networks.*** Social network sites allow users to make connections with each other. These include Facebook, LinkedIn (the largest professional network), Foursquare (app to discover great places and share information about them), Google+, Bebo and MySpace).

b. ***Micro Blogs.*** Micro blogs include brief updates about the users' lives that can easily be shared with friends. These include Tumblr, and Twitter.

c. ***Video/Photo Sharing***. Applications to facilitate the sharing of videos or photos include YouTube, Pinterest, Flickr, and Instagram.

d. ***Blogs***. A blog (short for "web log") is a web site with observations by the writer. These include WordPress and Blogger.

e. ***Presentation Sharing***. Scribd is a digital library with a huge collection of written works, including court filings and academic papers. SlideShare is the "world's largest community" for sharing presentations.

f. ***Social Bookmarks.*** Online services enable users to share bookmarks (links) of web documents.

7. Interesting Facts About Users of Social Media

- 73% of online adults use at least one social media site. 42% use more than one. Women use more than men.
- 30 million Facebook accounts belong to dead people.
- 72 hours of video are uploaded to YouTube every minute.
- There are 500 million Tweets per day.
- The IRS is on Facebook; while it does not currently post content, it invites users to "like" the IRS Facebook page (see Publication 5102).

8. Differences in Generational Communication Styles

The Silent Generation and Baby Boomers like to communicate in person or by telephone. Generation X (born between 1965 and 1980) communicate more through email and to some extent social media.

Millennials (born after 1980) communicate in the most succinct manner possible, mostly by texting. They will not answer the telephone and may not respond by email. They are technologically savvy, and multi-tasking is a way of life. They want to be constantly entertained and feel the need to share their opinions on everything. They are losing the ability to communicate verbally, as described by Rick Pitino (the University of Louisville basketball coach):

> They are far more emotional and willing to communicate those emotions through text or instant messages. A player will think nothing of texting "Luv u coach" to me nowadays, when we would never have said that kind of thing when I was young. But put the same player in a one-on-one setting with me, and he's awkward, uncomfortable, and not sure how to look at the person across the desk or how to address him."

9. Pervasive Existence of Digital Assets

Digital assets including the following: Airline rewards, hotel points, email accounts, social networking account, information stored on computers or mobile telephones, voicemail, online photos and videos, photo or video sharing accounts, I-tunes or other electronically recorded music, financial information accounts, web pages and blogs, online purchasing accounts (such as Amazon), domain names, online sales accounts (such as eBay), and real estate security systems. All of the above have usernames and passwords.

Digital property can have substantial monetary value and tremendous sentimental value. A major risk for digital property is security, especially when the user becomes disabled or dies.

10. Helping Clients Identify Digital Property

Planners should motivate clients to create a digital inventory, with usernames and passwords. The written materials include a form that one panelist uses to assist clients. The form includes sections to collect information about hard copy file locations, default information (usernames, passwords and security question answers), electronic devices access information, income taxes, banking, stock, retirement, insurance, credit cards, debts, businesses (including airlines and hotel accounts), utilities, and social media. For each, the client can list the website, username, password, and other information.

There are differences of opinion as to where that list should be located. It could be housed in a safe deposit box, but it needs to be updated about every 6 months and that would be awkward if it is in the safe deposit box. There are several free services to store the digital inventory secured by a single password. Services available for the storage of passwords include Last Pass, Roboform, 1 Password, Dashlane, Kee Pass, and Keeper.

11. Access (or Restrictions on Access) After Death or Disability

A growing problem is how family members or fiduciaries gain access to the owner's digital property after death or disability (or how owners can assure that certain accounts are kept secret after death or disability). Examples of services to assist in this regard are Deathswitch or Google Inactive Account Manager. After a designated period of time when the owner does not respond, these services can either cause data to be deleted or allow selected contacts to receive the data.

Being able to access digital information after an individual's death or disability is very important, not only to obtain the information in that account, but because the information may lead to valuable information about other accounts or assets.

12. Drafting Suggestions

a. ***Wills and Revocable Trusts.*** Planners are beginning to include digital property powers and authorizations in clients' wills. The following is an example of a relatively short clause used by Jeanne Newlon in revocable trusts:

Power over Digital Property and Digital Accounts. The Trustee shall have the power to access, take control of, conduct, continue, modify, and terminate the Settlor's Digital Accounts or otherwise exercise any rights or powers over such accounts as the Settlor would have if the Settlor were living. Further, the Trustee may properly access, take control of, handle, conduct, continue, distribute, dispose or, or terminate the interests the Settlor or the Settlor's estate has in Digital Property unless such actions are contrary to the terms of this Trust Agreement. Pursuant to the foregoing, the Trustee is authorized to take any step necessary to terminate any personal website over which the Settlor had control at the time of the Settlor's death. The Settlor intends to give the Trustee the powers and rights described in this paragraph notwithstanding the terms of services, terms of use, or other terms governing such accounts, websites or services. All such websites, services and providers may release the Settlor's log-on credentials, including the Settlor's username and password, to the Trustee and shall be indemnified and held harmless from any damages, causes of action or claims that may result from this disclosure or permitting the Trustee to exercise the rights and powers described in this paragraph.

A longer sample provision (drafted by Jim Lamm) is available at Item 37.j of the Heckerling Musings 2013 found here and available at www.Bessemer.com/Advisor.

b. ***Trustee.*** If the estate has significant digital property, consider using a digital property trustee who is tech-savvy.

c. ***Location.*** Where should these authorizations be contained? One panelist says the best place is the client's will. **Practical Pointer**: That panelist's client had over a million airline miles, and the airline just wanted to see a *will* with a provision saying where the airline awards passed.

d. ***Direction to Destroy Certain Digital Property***. Can a will include a direction that the fiduciary destroy certain digital property? The drafting committee for the Fiduciary Access to Digital Assets Act concluded that should be allowed. Nevertheless, the executor may be reluctant to destroy estate assets that may have substantial value. What if creditors or family members want the fiduciary to preserve the value represented by such digital property? One panelist would probably get court authorization before destroying valuable digital property information, even if the will directs the fiduciary to destroy the information.

e. ***Separate Digital Property Authorization.*** The panelists recommend using a separate one-page digital authorization form, in addition to the digital property access provision that is included in the will. An example is in the written materials. A sample authorization form (drafted by Jim Lamm) is available at Item 37.i of the Heckerling Musings 2013 found here and available at www.Bessemer.com/Advisor.

13. ASSISTING FIDUCIARIES WITH DIGITAL PROPERTY

Attorneys will need to assist fiduciaries in obtaining access to digital property, including online accounts, and information stored on computers, smart phones and iPads.

The fiduciary should make an inventory of digital property.

Make a backup of digital information before tinkering with it.

Consider hiring a consultant who specializes in data recovery.

Be aware of state and federal privacy laws (such as the Electronic Communications Privacy Act, Stored Communications Act, and Computer Fraud and Abuse Act). Accessing digital information may potentially be a criminal activity. The fiduciary is in a quandary—the fiduciary has the responsibility to marshal assets but doing so might violate privacy laws. The best practice is to have the account owner sign a written digital property access form. If that is not done, get a court order if needed to access digital assets.

Review the terms of service agreement; they are all very different. The Yahoo agreement provides that Yahoo terminates all emails as soon as Yahoo is aware of the customer's death.

Marriott and Starwood allow reward points to be transferred at the death of the account owner; Hilton does not.

The Fiduciary Access to Digital Assets Act was approved by the Uniform Laws Commission on July 16, 2014, shortly after the ACTEC Summer Meeting. Passage of the Uniform Act by states will provide clarification regarding the rights of fiduciaries to access digital property.

14. Ethical Issues With Social Media

Ethical issues that may arise with social media include the following:

- Inadvertently creating an attorney-client relationship (Rule 1.18)
- Advertising and solicitation (Rule 7.3; whether social media sites rise to the level of "in person" solicitation depends on the particular state)
- Advertising (Rules 7.1 and 7.2; the Florida bar in April 2013 issued rules subjecting all websites to the ethics rules)
- Endorsements and ratings (Rule 7.4; for example, issues arise with LinkedIn as to whether attorneys can list "Specialties" and regarding endorsements)
- Breach of client confidentiality (Rule 1.6; be wary of disclosing too much detail on personal pages about professional activities; in the *Pelshek* case in Illinois, the attorney referred to her clients by their first name or by the jail ID number and referred to one judge as "a total ass----" and another judge as "Judge Clueless" or "That Evil Witch"; in another Illinois action (*Tsamis)*, an attorney responded in too much detail responding to criticisms from a client on a social media site; issues can also arise regarding computer maintenance companies having access to confidential files or for using online data storage managed by third party vendors to store confidential documents)
- Giving legal advice outside the jurisdiction (Rule 5.5; provide only general legal information and do not answer fact specific questions especially regarding laws of a different jurisdiction)

- Cloud computing, in which software is provided via the Web rather than being installed on the attorney's computer and confidential information is stored on remote servers beyond the attorney's control; the ABA and New York bars have issued guidelines regarding the proper use of cloud computing (Rules 1.1 Competence, 1.3 Diligence, & 5.3 Responsibilities Regarding Nonlawyer Assistance))
- Use of social media in litigation (Rule 8.4; "Friending" witnesses and parties, accessing jurors through social media, and creating online relationships with judges present issues; accessing public pages of another party's social network site and reviewing a juror's Internet presence is allowed if the attorney does not communicate directly with the juror; a lawyer (or paralegals in the office) should not make a "friend" request to witnesses or other involved persons without disclosing the purpose of the request)
- Extrajudicial statements (Rules 3.6 & 8.4; remarks on social media during pending litigation may be improper)
- Evidence (Rule 3.4; preserving favorable texts and messages while destroying others that were not helpful constitutes spoliation of evidence)
- Ex parte communications (Rule 3.5; some decisions say that attorneys can be "friends" with judges on Facebook, but that is not allowed in Florida)

15. Practical Traps

a. ***LinkedIn Invitations.*** Invitations to join LinkedIn are an easy way for hackers to get into a network. To accept an invitation, sign in to LinkedIn; do not just click "Accept" inside the email invitation message.

b. ***Privacy***. Private account settings (for example, in Facebook) are not the same as privacy. They are still public sites and information can be re-shared. If you don't want something potentially to be re-shared, don't post it in the first place.

c. ***Photos***. Photos of children posted on social media (or photos posted by children) can pose security issues.

d. ***Prenuptial Agreements.*** Some prenuptial agreements restrict posting inappropriate photos on social media sites.

e. ***Personal Social Media Sites.*** Be sensitive to what is posted on one's personal social media sites. Clients or prospective clients who are intrigued by the attorney's professional Facebook page will look at his or her personal pages as well. (For example, be careful about political postings.)

f. ***Facebook as a Marketing Tool***. One panelist, having obtained several substantial clients through Facebook, recommends that attorneys have professional Facebook pages.

Items 16-29 are observations from a Session by Dennis I. Belcher and Rhonda H. Brink—Until Divorce Do Us Part

16. When Do Divorce Considerations Impact the Planning Process?

Divorce-related issues can arise in the first written communications with the clients, for example, relaying that the discussions will include the characterization of property as marital or non-marital property. Even those general warnings may not be sufficient. If a conflict arises after extensive intake disclosing "skeletons in the closet," the attorney may have to withdraw from the representation.

One panelist, upon finding out in the initial contact with a prospect that one spouse has substantially more wealth than the other spouse, generally suggests first meeting with that spouse alone (and clients generally agree).

Attorneys constantly have to make judgment calls about clients (their capacity, commitment to the estate planning process, etc), and one of those judgments is the client's commitment to his or her marriage. Various issues turn on that judgment.

17. Written Engagement Letters; Scope of Engagement and Waiver of Confidences

Written engagement letters should detail the scope of the engagement and clarify whether the representation is a joint representation with full disclosure of information or is a separate representation. The attorney should also be sensitive to conflicts that may arise during the course of the representation (for example, partitioning assets that may later be used to fund GRATs).

Can the attorney rely on the waiver of confidences if a divorce later occurs? Do not turn over information without following proper *process.* One participant recommends that unless a waiver can be obtained from both clients during the pending divorce, do not release any information without forcing a subpoena request allowing the attorney to tell the judge that the attorney wants to make sure that he or she is following ethical obligations.

18. "The Divorce Lawyer Will not be Your Friend"

Dennis Belcher's words of wisdom: (1) Put the client's interest first. (2) Watch out for your own interest. Spouses as clients may be friendly today, but if they later go through a divorce, "the divorce lawyer will not be your friend."

19. Defining "Spouse" in Documents

Trust documents may refer to a beneficiary as "Jane Doe," "my wife, Jane Doe," or "the spouse to whom I am married at the time." Consider with clients using the more generic description when the estate planning documents are prepared and there is no fight. Clients can consider the benefits that may thereby inure to their children in the event of a later divorce. The panelists can recall various situations in which they wished they had been more general in defining the spouse who is a beneficiary of a trust.

20. POST-DIVORCE REPRESENTATION

One spouse may call the estate planning attorney after the divorce and want to revise the will to delete the spouse as a beneficiary or as agent under a power of attorney. Recommendation: not without a waiver from the other party. (The other spouse may call several days later asking the same thing. Sometimes they will not give consent, even though they both want the estate planner to change their wills.) The reality is that the documents are on the estate planning attorney's computer and changes can be made efficiently by that attorney. **Practical Pointer**: One panelist adds in the initial engagement letter a provision to the effect that "to avoid any misunderstanding about revising documents after a divorce, you authorize me to revise the documents of either of you without notice to the other after a divorce. There would no longer be a joint representation of the spouses and any information that I might gain in a separate future representation of either of you would be kept confidential."

During the pendency of a divorce, be careful about changing revocable documents too quickly. Negating all property rights of the other spouse may be overkill. Target what rights and assets the client particularly wants to protect.

21. DIVORCE STATISTICS

The number of divorces per million in the U.S. has declined from 2000 to 2011, but the rate of marriages per million has dropped even more. 40% of first marriages, 60% of second marriages, and 70% of third marriages end in divorce. Persons less likely to get divorced are those over age 25, those who went to college, those who live in a Blue state, and those who have children. (Statistics are a sample of a large group; when dealing with a particular person, statistics don't matter.) Some suggest that the odds of divorce decline to 10-20% for affluent and more educated clients, especially depending on how long they have been married. (However, one panelist has two partners who were married over 35 years and divorced after age 70.)

One of the states with a low divorce rate is Massachusetts. Massachusetts is a state where interests in trusts are considered in determining equitable distributions and spousal support; perhaps the divorce rate there is so low because it costs so much to get divorced there.

22. ESTATE PLANNER'S ROLE IN DIVORCE ACTIONS

Involvement in divorce actions may be a growth area for estate planning practices. One panelist has an active practice in divorce matters, but always in connection with a divorce lawyers. (The panelist notes that "our part of it is a lot harder to learn than their part.") In many ways divorces are similar to beneficiaries fighting over assets after the death of a parent, and involve many of the same relationship issues and require similar attorney skills (such as dealing with valuation, business assets, human relationships, etc). Estate planning attorneys have skills in drafting clear detailed provisions (that are often much clearer than settlement agreements drafted by divorce lawyers). It's all about the money eventually—but a difference is that in divorces the people are fighting over their own money and in trust litigation they are fighting over somebody else's money. A common theme in both types of actions is that one party asks "how much is it going to cost to get past this" and another party says "here's all the bad things the other party has done and why they should not get anything." The counselor responds, "I understand, I understand," but eventually brings the parties to the realization that it is just about money.

With respect to custody disputes, the panelist reminds the couple that "five years from now, this is not going to matter a lot because your children are not going to want to spend much time with either of you."

Many divorce lawyers are having a tough time economically. The number of litigated divorces seems to be decreasing, perhaps because of hard times. Often couples cannot afford to divorce; the cost of two people living separately significantly exceeds the cost of living together, even if the couple lives in separate bedrooms.

Estate planning attorneys may also get involved in addressing income, gift and estate tax issues that arise in the divorce (for example, whether payments qualify as alimony for tax purposes). Divorce lawyers often seek the advice of estate planning attorneys with respect to trust issues.

23. Same-Sex Couples

A common divorce concern for same-sex couples is that if the couple was married in a recognition state but live in a non-recognition state, the couple probably will not be able to get a divorce in their state of domicile (for example, that is the case in Texas). The couple will not get a paper that is the equivalent of a divorce decree to say whether the marriage is on or off. A cohabitation agreement is needed to govern the couple's relationship—and ending the relationship.

24. Premarital Agreements

Be especially careful with the recitals in premarital agreements. If the recitals are incorrect, does that impact the validity of the agreement? Perhaps, that negates having consideration for the agreement. Use brief recitals—for example, the couple plans to get married, they each have assets, and they want to keep their assets separate.

25. Forum Shopping

We must be sensitive that the laws of another state (i.e., the state where a beneficiary lives at the time of a divorce) may govern with respect to state property rights. Forum shopping may be important. In preparing trusts, realize that attorneys cannot give absolutes regarding how protective the trust will be at a beneficiary's divorce—because that depends on where the beneficiaries may be living.

26. Changing Family Law

There has been a tension between trust/property law and family law—and the family lawyers are winning.

- Traditionally, courts had no authority in divorce to move assets from one spouse to another.
- Later, many states adopted equitable distribution concepts. States began to adopt concepts of couples having separate property and marital property (i.e., property acquired during marriage regardless of whose name was on the title to the property). This was a major breakthrough, providing substantial equity.
- Later, impingements were made on separate property—efforts during marriage that increased the value of separate property may transmute the separate property to having marital property rights.
- Some states take the position that the appreciation in separate property is also marital property.
- Colorado has case law saying that appreciation in trust assets is marital property. Massachusetts considers the interests that one spouse may have in trusts in making an equitable distribution of assets.
- The clear trend is to give courts more equitable powers in divorce matters.

27. Trust Beneficiary Interest- Impact on Divorce

a. ***Tension in Providing Divorce Protection for Beneficiaries***. Estate planning attorneys typically spend as much time discussing protecting beneficiaries from creditors generally as planning for protection from a spouse in a divorce action. That is ironic because relatively few beneficiaries have experienced creditor attacks on their trusts, but divorce actions are common. Planners should spend more time discussing how to protect beneficiaries from divorce claims. Traditional trust drafting does not do that. Planners often focus on providing control, flexibility and tax savings for the beneficiary. Those provisions hurt with respect to divorce claims. The more control/interest the beneficiary has in the trust, the more likely it will be treated as marital property.

   If the beneficiary (i) has a special power of appointment, (ii) is the trustee, (iii) can make distributions to himself for health, education, support and maintenance, and (iv) can appoint an independent trustee who can make distributions for any reason, the beneficiary has a great deal of flexibility and control while still having the trust assets omitted from the beneficiary's gross estate. But a divorce judge will likely view the trust assets as the beneficiary's "property" for purposes of the division on divorce. The attorney can argue the importance of fiduciary duty, but the judge will just view that as an attempt to cheat the divorced spouse.

   On the other hand, if there is an independent trustee and the trustee has total discretion in making distributions without any requirement to make support distributions, that interest is more likely to be viewed as not constituting property of the beneficiary for purposes of the divorce action.

   Planners should have more detailed discussions with clients about priorities, and whether "divorce-proofing" the trust is more important than giving the beneficiaries control and flexibility.

b. ***Traditional Rule***. The traditional rule has been that a beneficiary's interest in a trust with a spendthrift clause that is a purely discretionary interest (in the trustee's sole discretion) is treated as that person's separate property for purposes of the divorce action.

c. ***Massachusetts.*** In Massachusetts, courts look at all assets, including interests that a spouse may have in trusts, and make equitable distributions considering all of those interests.

d. ***South Dakota and Nevada—Most Protective.*** The laws of South Dakota and Nevada are the most protective of beneficiaries' interests against attacks by a spouse or former spouse or child of the beneficiary. The South Dakota statute is the most protective of a beneficiary's interest in a trust. Creditors cannot "reach" assets in a discretionary trust, and the statute provides a very broad definition of "reach," including by garnishment or attachment. South Dakota Codified Laws § 55-1-24(6). If the trust contains a spendthrift provision, no creditor may force a distribution (even for a mandatory or support interest). South Dakota Codified Laws §55-1-42. A support interest does not rise to the level of a property interest. *Id.*

   Nevada specifically disallows claims of spouses, former spouses, children, or dependents. "No spouse, former spouse, child or dependent shall be a beneficiary unless named or clearly referred to as a beneficiary in the writing." Nevada Revised Statutes §166.080. Section 163.417 provides that a creditor may not exercise and a court may not order the exercise of a power of appointment, any power held by a trust protector, or a trustee's discretion to make distributions or take any other authorized action in a specific way.

e. ***Governing Law Issue.*** Even if the trust instrument says that it is governed by South Dakota law (for example), the court where the divorce is located will decide what is "property" for purposes of the equitable distribution in a divorce. It is likely that a Massachusetts court (which generally considers a beneficiary's trust interests as property) would rule that the interest in the South Dakota trust should be considered as the beneficiary's property in the equitable distribution.

   There have been cases in which courts directed a trustee to make distributions to a beneficiary and then from that beneficiary to the divorced spouse. The situs of the trust is not determinative; also look at what the trustee is doing and the extent of the beneficiary's interest, and examine under the law of the domicile whether that is considered "property" of the beneficiary-spouse.

f. ***"Divorce-Proof."*** Because of the uncertainties about where married beneficiaries will live and about the effectiveness of governing law provisions in trusts, planners cannot give assurances that trusts are "divorce-proof." They can discuss the issues and strategies used to provide as much protection as possible, but cannot give divorce-proofing assurances.

28. Modifying Trusts

a. ***Overview.*** If a beneficiary is nearing the age at which a trust terminates and the beneficiary is going through a divorce, the beneficiary may look for ways to extend the trust so that it does not terminate during the divorce.

   If both spouses end up with interests in a trust, to the extent possible divide the trust interests so that the spouses are not involved with each other in the future (for example divide a single charitable remainder trust for the spouses into two separate trusts for each of the spouses). The divorce negotiations may result in agreements to delete the divorced spouse from having interests or powers in the trust (for example, beneficial interests or trustee appointments), and trust modifications may be necessary to accomplish that result.

b. ***Decanting.*** The state decanting statute may permit distributing the trust to a trust with the desired provisions. If the law of the domicile does not have such a decanting statute, consider moving the situs of the trust (perhaps in a judicial proceeding) to a state that has a broad decanting statute that allows the change.

c. ***Nonjudicial Modification.*** Nonjudicial modifications are allowed in Uniform Trust Code states. The modification agreement would be included in the divorce documents. For example, this might be used to remove a divorced spouse as a beneficiary, successor beneficiary, trustee, or successor trustee.

d. ***Judicial Settlements.*** Judicial trust modifications are generally based on changed circumstances. That can be a hard standard to meet.

e. ***Leverage in Negotiations.*** The need to negotiate desired changes in trusts may provide the other spouse with substantial leverage in the divorce negotiations. For example, if a successful GRAT is terminating, at which time the soon-to-be-divorced spouse will become trustee over the trust holding substantial interests in a closely-held business, that spouse will have significant leverage in the negotiations.

29. Character of Distributions to Trusts From Business Interests

In making equitable distribution decisions, the divorce court may consider trust income as marital property that can be considered in the distribution decision, but not trust principal. For distributions to a trust from a business entity, partial liquidation distributions are treated as principal, but distributions other than liquidation distributions typically are treated as trust income. The business manager's characterization of the distribution will likely be respected.

Items 30-37 are observations from a Session by Richard L. English and Joshua S. Rubenstein—Haute Cuisinart-Estate Planning for the Blended Family

30. Blended Family Often Arises From Remarriage Following Divorce

Many blended families arise following the divorce of one or both spouses, so the planning will involve divorce issues. Reviewing the spouses' prior divorce documents, property settlement agreements, and any premarital agreements is important. Furthermore, review beneficiary designations to make sure that the prior divorced spouse is not still listed as a beneficiary of insurance or retirement plans. (Get a writing from the insurance carrier or plan provider confirming the beneficiary designation.)

The planner must be sensitive to the conflicting priorities of the spouses, including: (1) one spouse may have substantially more wealth than the other, (2) there may be children by prior marriages, and (3) age differences.

31. General Planning Considerations

a. ***Beware of "Simple Estate Plan."*** The simple "all to spouse" plan will become more prevalent with the $5 million indexed estate tax exemption and portability. But that allows the surviving spouse to cut out the decedent's children by a prior marriage. The planner should document that this issue has been discussed.

b. ***Separate Economic Interests of Surviving Spouse and Children by Prior Marriage***. To the extent possible, separate the economic interests of the surviving spouse and the decedent's children by a prior marriage. For example, leave some assets to the surviving spouse and some assets to the children (either outright or in trusts). Children from a prior marriage may be unhappy having to wait until the surviving spouse's subsequent death before receiving any economic benefits from their deceased parent.

c. ***Consider Using Independent Fiduciary.*** Consider using an independent fiduciary—someone other than the surviving spouse. A client may be aware that his or her spouse thinks that the client's children are lazy, not working hard enough, etc. Does the client want the spouse to be the person making decisions about distributions to the children when the spouse comes to the fiduciary position with that bias? Is that going to be a healthy relationship between the surviving spouse and the children?

d. ***Overview of Ways to Provide for Surviving Spouse.*** (1) Outright transfer (but no protection from the surviving spouse diverting assets); (2) QTIP trust (but the children of the prior marriage may be waiting a long time before receiving any benefits); (3) Unitrust (this may align the interests of the spouse and children better-both will want trust growth); (4) Credit shelter trust with both the surviving spouse and children as discretionary beneficiaries.

   For retirement plans, alternatives include naming the spouse as primary beneficiary, or designating a QTIP trust (which is complicated but the panelist has done it based on guidance in rulings). A simpler option may be to leave part of the plan to the surviving spouse and part to the children (or trusts for them). Monitor this split over time; as the spouse gets older, a smaller percentage may be left to the spouse.

32. USE OF BASIC EXCLUSION AMOUNT

a. ***Credit Shelter Trust vs. Portability.*** Portability provides alternatives in using the first decedent-spouse's basic estate tax exclusion amount. With portability, assets could be left outright to the spouse or into a QTIP trust (or general power of appointment trust) and still use the deceased spouse's DSUE amount. Alternatively, assets could be left to a standard credit shelter trust with the spouse and children as discretionary beneficiaries. This decision is particularly poignant for blended families. Leaving assets outright to the surviving spouse or into a general power of appointment trust allows the surviving spouse to divert the assets away from the decedent's children. Using a QTIP trust can assure that assets remaining at the spouse's subsequent death pass to the first decedent-spouse's children, but under §2207A the trust will bear a proportionate part of any estate taxes paid at the spouse's death (absent a waiver in the surviving spouse's will), raising various complications that can be avoided by using a credit shelter trust. See a detailed discussion of this issue at Item 18.f of the Estate Planning: Current Developments and Hot Topics Summary (July 2014) found here and available at www.Bessemer.com/Advisor.

   Portability is also helpful as a strategy for using the decedent's exemption if the less wealthy spouse dies first.

b. ***Lifetime QTIP.*** Lifetime QTIPs provide a way to fund the less wealthy spouse. Lifetime QTIP trust planning is addressed in detail in articles discussing the "Supercharged Credit Shelter Trust" (see Gans, Blattmachr & Zeydel, *Supercharged Credit Shelter Trusts*[sm], 21 PROB. & PROP. 52 (July/August 2007); Blattmachr, *Planning for the Unknown in 2010 and Beyond: Carryover Basis and No Estate Tax or a Revised Wealth Transfer System?*, 43RD ANN. HECKERLING INST. ON ESTATE PLANNING (2009).

c. ***Large Split Gift.*** A split gift is one way to use the less wealthy spouse's exclusion amount. Negotiations with the less wealthy spouse may be appropriate to determine if and how much the wealthy spouse should pay to the less wealthy spouse to use his or her exclusion amount.

d. **"Pay It Forward."** Consider making gifts to the less wealthy spouse, who might subsequently make gifts to the children of the wealthy spouse. There is a risk that the IRS may attempt to collapse the transaction as a step transaction; allow time to lapse before the donee-spouse elects to make subsequent gifts.

33. PORTABILITY AND FILING FORM 706

This is a commonly recurring issue, especially if the decedent's executor has no real interest in preserving the exclusion amount for the surviving spouse's family.

Consider addressing whether the will should dictate that a Form 706 will be filed to make the portability election if there is a surviving spouse. Having a named executor is important; if there is no named executor, any person in possession of property has the authority (and responsibility) of filing an estate tax return-and either making or not making the portability election.

Walton v. Estate of Swisher, 3 N.E.3d 1088 (Ind. App. 2014) is an example of negotiations that may arise regarding the portability decision. In that case the surviving husband agreed with the decedent's daughter to pay some of the deceased wife's medical expenses and to pay her estate $5,000. The husband died the following year. When the daughter learned of the estate tax savings that resulted from the use of the wife's unused exclusion amount, she sued his estate for $500,000 under an unjust enrichment theory. The court concluded that no additional amount was owed, and the original agreement with the daughter was unambiguous and did not result in unjust enrichment.

The fact that this claim was even made raises interesting issues for planners:

- The importance of covering the filing/ portability issue in the couple's estate planning documents or marital agreement, including who pays for the cost of filing the return if it will be filed just to make the portability election;
- The possibility of opening a probate estate for the purpose of having an executor who can negotiate for the preparation of an estate tax return;
- Whether the surviving spouse is the appropriate person to serve as executor;
- The value of the right to file the estate tax return and make the portability election and whether the executor should negotiate to receive payment for making the election; and
- The importance of the surviving spouse disclosing the potential benefits of portability when negotiating a payment for filing the return.

34. Same-Sex Marriage

Blended families may arise in a same-sex marriage situation.

Same-sex unmarried couples are not able to take advantage of various benefits afforded married couples under state law including no intestacy benefits, no elective share, no community property, no presumption of survivorship, no tenancy by the entireties, and no automatic revocation of will benefits or beneficiary designations on divorce. Federal benefits may be available but only on an agency-by-agency basis (for example, there has been no guidance as to whether same-sex couples who were legally married but live in a state where the marriage is not recognized are entitled to Federal Disaster Benefits). Same-sex couples face an increased likelihood of a will contest.

35. Transfer Taxes for Unmarried Couples

a. ***Estate Tax***. Obviously, no marital deduction is available at the first spouse's death. Federal estate tax concerns for many clients are diminished with a $5 million indexed exclusion amount and portability. The estate tax situation can be particularly unfair for unmarried couples with large estates. A possible alternative is to enter into a contract to receive death benefits in return for pooling assets. An estate tax debt deduction was allowed under §2053 in *Carlson v. U.S.*, 54 AFTR 2d 84-6451 (DC Minn. 1983), but the payment would be income if it is in return for a promise to provide services.

Life insurance may be appropriate to pay the federal estate tax that will apply at the death of the first party.

b. ***Gift Tax***. The gift tax is a bigger concern for unmarried couples because of the lack of a marital deduction. (Transfers may be made within the annual exclusion amount or for tuition or medical expenses without gift tax concerns.) There is no gift splitting. A non-taxable gift cannot be made to a cohabitant who may make a subsequent gift. Section 2516 is not available to protect transfers incident to divorce.

Every time a transfer is made between the couple, arguably a taxable gift results (for example, hosting a party, buying cars, going on vacation, paying rent, paying mortgages, etc.) One panelist has never seen the IRS attack those transfers as the sole issue in an audit, but he has had the issue arise in audits along with other issues (when the IRS goes through the check book and identifies many such possible gifts).

c. ***GST Tax***. The GST tax may apply in few situations, but it is extremely harsh when it applies. If one of the parties is 37½ years younger than the other, any transfer to the younger partner will be taxed the same as a gift to a grandchild, potentially being subject to payment of both gift tax and GST tax.

d. ***Opportunities Not Available to Married Couples***. Opportunities that unmarried couples have that are not available to married couples include the following.

- QPRTs—The prohibition of repurchasing the residence from the QPRT prior to termination would not apply.
- GRIT—Congress closed GRITs, but only for "applicable family members."
- FLPs—If spouses are limited and general partners there is a fiduciary duty between them as spouses which may reduce the valuation discount.
- Charitable split interest trusts and foundations—The self dealing prohibitions that apply to spouses would not apply to the unmarried couple.
- Income splitting—Income splitting with a trust is not possible for spouses because having a spouse as a potential beneficiary causes the grantor trust rules to apply.
- Retirement plan assets—ERISA provides assured benefits for spouses.

36. Will Contests

Will contests may be more likely for same-sex marriages, unmarried couples or blended families.

a. ***Improper Execution.*** The easiest way to attack a will is for improper execution. Having clients come to the attorney's office to oversee the execution of estate planning documents is especially important for unmarried couples or same-sex marriages.

b. ***Lack of Capacity***. Set aside 15 minutes in the execution ceremony for the couple to briefly describe to the witnesses their goals and the basic disposition in the documents. Consider having the witnesses prepare a contemporaneous memo. Do not videotape the execution ceremony. People "act" when they know they are being filmed, and the parties will appear uncomfortable and stilted on tape in front of the jury. Relying on the memories of the witness is much preferable.

c. ***Undue Influence.*** Successful contests are based on undue influence more than any other reason. Consider having the couple use separate counsel to prepare separate wills.

d. ***Multiple Wills***. The client might sign multiple wills, doing substantially the same thing. The contestant would then need to contest all of the wills.

e. ***Capacity Standard for Wills vs. Trusts.*** A very low standard of capacity applies for wills, but the higher contractual capacity standard generally applies for irrevocable inter vivos trusts. The Uniform Trust Code requires the settlor of a revocable trust to have the same capacity as is required for a will.

f. ***Testamentary Substitutes.*** Life insurance, jointly held property, retirement plans, or other property that passes by beneficiary designation may be a testamentary substitute that would not be affected by a will contest.

g. ***Agreements***. Other agreements may create contract rights that override wills, such as marital agreements, domestic partnership agreements, contracts to make wills, shareholder agreements, and buy sell agreements.

37. Posthumous Use of Genetic Material

a. ***Ability to Control Genetic Material***. Body parts are generally not considered property except to the extent that a person has an interest in control over decision making over health care decisions. An individual cannot give his body parts to someone. However, some cases have allowed wives to obtain frozen sperm from deceased husbands. (That is not allowed in the U.K. without consent.) Frozen embryos seem to be in a category between persons and property.

b. ***Ability to Inherit.*** This issue did not arise at common law because there was no way to have posthumous children. Now, insemination can occur years after the sperm provider dies. This is an emerging area of the law. Statutes include the Uniform Parentage Act (1987, amended in 2000 and 2002), the Uniform Status of Children of Assisted Conception Act (1998), and the Uniform Probate Code (2008 amendment providing in §2-120 that a posthumously conceived child will be considered "in gestation" at the deceased parent's death if that child is in utero within 36 months after the parent's death or is born no later than 45 months after the parent's death). This is a growing issue as a result of the increase in the amount of frozen genetic material. For an excellent summary of inheritance rights of assisted reproduction children, see Sheldon F. Kurtz & Lawrence W. Waggoner, *The UPC Addresses the Class-Gift and Intestacy Rights of Children of Assisted Reproduction Technologies*, 35 ACTEC J. 30 (Summer 2009).

c. ***Ask Clients***. Ask clients how they want to treat their issue by assisted reproduction in estate planning documents. See a detailed discussion of this issue at Item 37 of the Heckerling Musings 2013 found here and available at www.Bessemer.com/Advisor.

Items 38-43 are observations from a Session by Robert B. Fleming, Adam F. Streisand, and John Mazziotta, M.D. Ph.D (Chair, Neurology, David Geffen School of Medicine, UCLA and Director, UCLA Brain Mapping Center, Los Angeles, California)—Modern Day Magellans: The Brain Mappers

38. Imaging Can Show What Parts of the Brain Engage For Specific Activities

The brain is comprised of neurons. A CAT scan shows brain structure, but not function. "Function" is what parts of the brain are working at a given moment. MRI imaging shows what parts of the brain are working during certain activities. (An MRI makes an image every 1/30th of a second; it looks at brain activity over a period of time.)

As an example of this imaging process to isolate parts of the brain involved in specific activities, a person would be instructed to look at a pattern. A few minutes later the person would look at the same pattern but without color. The differences between the images would show what part of the brain controls color in the opposite side of the visual world (because the right side of the brain controls the left side of the body and vice versa.) Another example is that an individual might be shown a pattern and minutes later shown the same pattern with motion; the differences in the brain images would show what parts of the brain perceive movement in the visual world.

39. Stroke

There are two major disorders of the elderly—stroke and Alzheimer's disease.

Stroke used to be the 4th leading cause of death. That is now decreasing because of better treatments.

Strokes have severe results. One-third of patients die within 6 months. Among survivors, 1/3 require daily assistance, 1/5 need help walking, and 3/4 do not return to full time employment.

Strokes can result from clots (ischemic strokes, about 87% of strokes) or from bleeding from a blood vessel rupture in the brain (hemorrhagic strokes, often caused by high blood pressure).

Getting immediate treatment for a stroke is imperative. With immediate treatment, the patient not only often returns home but has a normal life. There is a window of only about four hours (this used to be three hours) for appropriate treatment.

Stroke symptoms can be remembered with the acronym FAST—**F**ace drooping, **A**rm weakness (inability to raise both arms and keep them raised), **S**peech difficulty (slurred speech, inability to repeat a simple sentence), **T**ime to call 9-1-1. Other symptoms include: sudden numbness or weakness of the leg, arm or face; sudden confusion; sudden trouble seeing in one of both eyes; sudden trouble walking, dizziness, loss of balance or coordination; or sudden severe headache with no known cause.

When someone is suspected of having a stroke, immediately call 9-1-1. The patient is taken to a stroke center, available in most community hospitals, where the patient's brain will be scanned and given medications to dissolve clots. If the clot is not dissolved, the patients may be taken to more sophisticated stroke centers to remove the clot surgically (a catheter is inserted in the femoral artery, and sent through the aorta toward the brain where it grabs and removes the clot).

Typically a stroke causes some core damage where the brain is dead. Around that may be part of the brain that is damaged but can be salvaged if blood flow and oxygen can be restored to those damaged peripheral areas.

40. ALZHEIMER'S DISEASE

a. ***Rapidly Increasing.*** Alzheimer's disease typically occurs in patients in their 70s or 80s. Alzheimer's disease is becoming more prevalent, as people are living longer and as the ability to identify the disorder increases.

   About 5.2 million Americans have Alzheimer's disease in 2014. By 2050, the number of people age 65 and older with Alzheimer's disease may nearly triple from 5 million to as many as 16 million, barring the developments of medical breakthroughs to prevent, slow, or stop the disease. Deaths from Alzheimer's disease increased 68% from 2000 to 2010 while deaths from other major diseases decreased. One in three seniors dies with Alzheimer's or another dementia.

   Women are more likely to get Alzheimer's than men (about 2/3rds of Americans with Alzheimer's are women). A woman's estimated lifetime risk of developing Alzheimer's disease at age 65 is 1 in 6, compared with nearly 1 in 11 for men.

   The focus is on finding ways to delay the onset of the disease. If the onset can be delayed 5 years, that will result in 50% fewer patients; a 10 year delay in onset will result in 75% fewer Alzheimer's disease patients. That is achievable.

b. ***Impact on Economy.*** Alzheimer's disease is the most expensive condition in the nation. Direct costs in America of caring for Alzheimer's patients are an estimated $214 billion (including $150 billion to Medicare and Medicaid). (In addition, 15.5 billion caregivers provided an estimated 17.7 billion hours of unpaid care in 2013, valued at more than $220 billion.) Estimates are that Alzheimer's disease will cost an estimated $1.0 trillion annually (in today's dollars) in 2040 and $1.2 trillion in 2050. **That is an unsustainable cost to the national economy**; research to find ways to treat or delay the onset of Alzheimer's disease is imperative to the economies of the U.S. (and the world).

c. ***Impact on Brain.*** Alzheimer's disease cause brain neurons to degenerate in certain areas, and the degeneration spreads. As the brain dissolves, the fluid spaces in the brain get bigger and folds on the outside of the brain get larger; in addition a protein associated with Alzheimer's accumulates in the brain (although the protein accumulation does not necessarily predict the onset of Alzheimer's).

d. ***Tools to Diagnose Alzheimer's.*** Brain scans can identify the increased fluid-filled parts of the brain and the proteins associated with Alzheimer's. Scanning to identify Alzheimer's is only done for research purposes. Genetic testing can also identify a certain gene that carries an increased risk of Alzheimer's (but that gene is neither necessary nor sufficient to cause Alzheimer's, so the genetic testing is not conclusive).

e. ***Research for Tools to Delay Onset***. About 2% of Alzheimer's patients have an inherited form of the disease that is quite predictable; onset in these individuals often occurs in the 50s. (Protein accumulation in these individuals may be indentified even in their young 30s.) Experimental therapies are studied in these individuals to determine if the therapies delay the onset of the disease.

Other research activities focus on slowing the progression of the disease once it arrives; that research seems to result in very small incremental successes. It is more likely that a major breakthrough will come in treatments to delay the initial onset of the disease, rather than in treating the disease once it occurs. (Treating people who are already symptomatic is not the best strategy. In effect, we are taking someone who is already demented and keeping them demented longer. A better goal is to delay people from getting the disease.)

For clients interested in contributing to these causes, research is conducted by the National Institute of Health. Most major medical centers are performing Alzheimer's research; the research is occurring primarily at academic medical centers.

f. ***Medications.*** There are medications that slow the rate of degeneration. There are no medications to prevent or reverse the disease.

g. ***Possible Detrimental Use of Predictive Tests.*** Medical ethicists are debating the issue of how Alzheimer's tests might be misused by insurance companies, employers, etc. At this point, scans and studies are only done on a research basis and they are blind studies in which participants are not identified. When these tests are publicly available, there is significant uncertainty as to how the results might be used or misused.

41. Legal Capacity

Legal capacity is a legal determination. The diagnosis of dementia does not mean that the individual is incapable of doing any legal acts. The issue is whether the individual can understand the significance of actions. The California Probate Code makes clear that a person with a mental disorder may still be capable of performing legal actions (§810(a)) and the issue is the ability to perform mental *functions* rather than a diagnosis of a mental *disorder*. (§810(c)).

Testamentary capacity requires generally that the testator understand his relations, the nature of his property, and the effects of testamentary acts. For example, the California Probate Code (§§810-813) focuses on whether the person is *able* to understand the probable consequences of decisions and alternatives to those decisions. A higher level of capacity (contractual capacity) is required for other actions. California cases have indicated that trust amendments making simple changes in the trust disposition may just require the lower level of testamentary capacity, but that more complex trust changes (addressing tax issues, the characterization of property, powers of appointments, etc.) will require the higher contractual level of capacity.

Brain scans currently cannot determine the capacity to make decisions. The best tool for determining capacity is the patient interview (to determine the ability to retain information on a short and long term basis and to understand simple and complicated logic). Discussions with family members also helps provide factual information over the long term, but their bias may make their comments untrustworthy. One of the attorney-panelists said that he prefers using a neurologist rather than a psychiatrist to perform these tests.

Others suggest that estate planning attorneys may be as equipped as anyone to determine an individual's capacity to deal with the estate. (One Fellow reported getting a report about an individual's capacity from three different doctors—getting three very different results.)

To assist in making a determination about a client's capacity, the attorney should ask questions in different and complex ways, and should ask open ended questions eliciting conversation. Don't always ask questions expecting a "yes" answer. (How will the attorney be able to convince a jury that the client really understood what was being done when the attorney is just able to testify that the client answered yes to all of the attorney's questions?)

42. Meet With Clients Alone

One panelist advises always to have the initial estate planning meeting with the client alone. He sends a confirming letter to prospective clients saying that he is happy for relatives to bring the client to the office, but he will meet with the client alone in the conference room. Upon arriving, if the relative wants to follow to the conference room, say "I want to meet with your father alone for a few minutes first." As the client leaves the office, tell the waiting-relative: "It turns out that we didn't need to talk any further; Mr. __ agrees that I can share the documents with you once they are prepared. Will you be bringing your parent to the next meeting when he signs the documents?" Reasons for this approach – (1) He wants to be able to testify that he always does that. (2) He had a situation in which the daughter met with her father and him in the client conference, telling him how the father wanted to change his will. Mr. Fleming then said he wanted to talk to father alone for a few minutes. Father got close to him and whispered "don't change the will." What does he do at that point with the daughter? He resolved that day he would never let children in the conference room in the initial meeting with aging clients. Thereafter, he has had two clients leave because of this approach; the children bolted into the conference room five minutes after the conference began and said they did not want to use him as the attorney. That confirmed for him that he was using the right approach.

43. Attorney's Duty to Ascertain Capacity or Whether Client Is Unduly Influenced

Determining a client's capacity to make a will or whether undue influence exists can be difficult. Attorneys have a duty to act competently and with loyalty to the client. The attorney must attempt to determine if the client has capacity or is unduly influenced. It is not enough for an attorney to say that the client may or may not have capacity, but that is an issue for the jury to determine later if there is a contest. Attorneys have an affirmative duty to determine, in the attorney's judgment, that the client has capacity. (That does not mean, however, that the attorney is liable for damages if the attorney's good faith determination turns out to be wrong.) The attorney cannot be held liable for refusing to draft estate planning documents if the attorney, in his or her judgment, does not think the client has capacity.

In *Borianian v. Clark,* 123 Cal.App.4th 2012 (2004), the trial court held that an attorney was liable to beneficiaries under an existing will for preparing a new will for a woman, based on information and directions from her boyfriend. The woman was terminally ill and was on morphine and deteriorating rapidly on the day the revised will was signed. She died three days later. The appellate court reversed, holding that the lawyer's duty was only to the woman, and that "he did not owe a duty to [the] beneficiaries to evaluate or ascertain his client's capacity to make a new will." The court reasoned that the attorney's liability to an "intended beneficiary" depends on various factors, including "the likelihood that imposition of liability might interfere with the attorney's ethical duties to the client, and … whether the imposition of liability would impose an undue burden on the profession." The court's reasoning suggests that if the duty extended to beneficiaries under a new will, that might cause the attorney to exert pressure on the client to complete the estate planning documents summarily. Or if the attorney's duty extends to beneficiaries under a prior will, that might create an incentive for the attorney not to prepare a new will to carry out the client's intent.

Items 44-53 are observations from a Session by Peggy Sheahan Knee and Bernard A. Krooks—Eleventh Hour Action Items for the Client Who Is Approaching the Journey's End Modern Day

44. Motivation to Address Estate Planning; Changed Perspective

Getting younger clients motivated to address estate planning issues can be quite difficult, but not so for clients "in the bottom of the 9th." The "Journey's End" can be a day or a year, but the client may have opportunities during the Journey's End to make adjustments, with the perspective that the decisions being made will likely be the final decisions.

The client may bring a different perspective to issues when the client is facing his or her own death. An old Mexican saying is "the bull looks a lot different when you are in the ring."

45. Growing Elder Population

Planning for these clients is quite significant to estate planning practices in light of the growing elder population. There are 40 million Americans over age 65, and by 2030 that will be 88.5 million (which will represent 20% of the population). Older clients are more likely to contract an illness and to need end of life services.

46. Increased Emphasis on Counselor Role

The client's focus may be more on seeking guidance from the attorney in the role of a counselor rather than just for pure legal issues. Some of the important decisions will be about selecting the best fiduciaries, selecting health care decision makers, leaving a family legacy, etc. Everyone has special circumstances among family members (descendants with special needs, dependency problems, bad marriages, creditor issues, same-sex marriage issues, etc.) The client in this phase of life will be focused on making decisions to deal best with these special circumstances, and will want the counselor's judgment with respect to these specific situations.

47. Cost of End of Life and Health Care Concerns

The client will want to be able to leave some kind of economic legacy to his family, and the biggest impediment to that for most people is not estate taxes, but the cost of end of life and health care.

Most people want to live at home in their finals days, but that is not attainable for many. Be aware of elder abuse if a deteriorating client is living at home; clients living at home are much easier prey for someone to exploit.

"Late stage" clients should carefully consider who is named as agent to make health care and end of life decisions. As an example, one client did not trust his daughter or friends to carry out his intent regarding end of life decisions. He told the attorney he was willing to pay someone $100,000 to make the end of life health care decisions for him when he was not competent to make decisions (and he ended up entering into a contract with the nurse that provided his care to pay her $100,000 to make these decisions for him).

The client should give serious thought to and give guidance regarding what priority to place on the cost of care. For example, one child may want mom to live in the nicest nursing home (at $22,000 a month) and another may want mom to live in an assisted living facility that costs $6,000 a month. The client should give guidance on these types of decisions before the issue arises (while the client is still competent to express his or her desires). If guidance is not given, who the client names as agent to make health care decisions would have a substantial impact on the cost of end of life care for the client.

Possible funding sources for end of life care can be from various sources, including long-term care insurance, reverse mortgages, or from acceleration of death benefits from life insurance policies. Most clients are not impoverished enough to receive benefits from Medicaid and there is only limited funding from Medicare for end of life care.

48. General Estate Planning Issues

a. ***Wills and Trust Disposition***. This may be the last opportunity to make adjustments regarding the disposition of the estate. Estate plans are often drafted building in a great deal of flexibility to be able to adjust to changing circumstances. (Bad marriages may have become stable [or vice versa], grandchildren with spendthrift or dependency problems may have "grown up" [or vice versa], etc.) The client will have a more informed knowledge of assets likely to be in the estate and may be in a better position to decide how specific assets or amounts should pass to specific individuals. The client can now take into account circumstances as they exist and make appropriate adjustments.

b. ***Beneficiary Designations.*** Review beneficiary designations to make sure they are consistent with the estate plan.

c. ***Fiduciary Appointments.*** The client should make the tough decisions about who is best able to serve as fiduciary under the client's estate plan and make appropriate adjustments. Has the asset mix or family dynamics changed? Are trust protectors needed for some issues?

d. ***Client Serving As Fiduciary.*** The late stage client may be serving as a fiduciary under other trust documents. If so, consider appropriate succession of the fiduciary position. (At a minimum, contact the successor fiduciary to notify him or her about the looming change.)

e. ***Power of Attorney.*** Is the appropriate person named as agent? If the power of attorney is a "springing" power, consider changing to an immediately effective power. Does the client want to add or delete the power of the agent to make gifts?

f. ***Health Care Powers of Attorney***. As discussed above, the client should have detailed discussions with persons who will be agents under health care powers of attorney documents and be comfortable that the agent will actually carry out his desires. One panelist told of a client situation in which the wife agreed to carry out her husband's intentions regarding his advance directive, but minutes later told the attorney separately that she would never be able to make the decision to "pull the plug." The ABA has a good iPhone App called "ABA My Health Care Wishes" that assists clients in making these decisions. The ABA Commission on Law and Aging has produced a consumer toolkit for advanced health care planning that has a list of powerful questions to consider in making these decisions. Another resource is at www.everplans.com.

g. ***Powers of Appointment.*** If the client has any powers of appointment, the client should carefully consider whether and how they should be exercised.

49. Family Legacy

For many clients, the most important issues will not be about money but will be about relationships and values. Robert De Niro recently told Esquire magazine his biggest regret:

> I always wanted to chronicle the family history with my mother. She was always interested in that. I wanted some researchers I'd worked with to talk to my mother, but my mother was a little antsy about it. I know she would've gotten into it…. But I wasn't forceful, and I didn't make it happen. That's one regret I have. I didn't get as much of the family history as I could have for the kids.

The last stage client may want to consider an ethical will or legacy letter to relay strongly held values to family members. The attorney might suggest insightful questions of issues for the client to address [what's important to you? biggest regrets? things the children did for the client that were important, the best and worst day of your life, most influential people, words of wisdom learned from parents and grandparents, lessons learned the hard way, things on your bucket list you never did, etc.]. The attorney might assist with a videotape for the client to describe values that were of prime importance when a family foundation was created or setting out values and aspirations for a closely held business. The client may want to digitize personal artifacts such as photos, birth certificates, etc.

Appendix A (courtesy of John Warnick, Denver Colorado) is a summary of nuggets of wisdom that one individual placed in his will. It is a wonderful example of a concise listing of 20 nuggets of wisdom to the settlor's family.

50. Guidance Letter Regarding Trust Distributions

There is a growing use of long-term trusts for non-tax reasons. The successor trustee may have never met the settlor. One panelist sees a growing trend of settlors providing a "Statement of Wishes" to the help the trustee in making discretionary decisions under the instrument. For example, the trust may authorize discretionary distributions for "education" and the settlor might provide additional guidance as to aspirations for the education of the beneficiaries and what types of educational expenses should be preferred over others. Corporate trustees generally welcome such guidelines to provide additional insight regarding the settlor's desires.

Should such a statement be included in the trust instrument itself? Some fiduciary litigators suggest the wisdom of that approach. The trustee cannot rely on a separate statement from the settlor. Other attorneys prefer keeping such a statement in a more informal separate letter—just to provide guidance. The attorney should review the statement closely to assure that it is not contradictory of provisions in the trust agreement.

Such statements may raise various issues. Does the trustee have an obligation to make the statement available to beneficiaries? (It is probably discoverable in litigation.) What if the settlor really wants to change the distribution standards (perhaps based on lifestyle/spending choices the beneficiary has made that seem inappropriate to the settlor)? That cannot be done. If the settlor attempts to do so, might the IRS possibly raise a §2038 claim to include the trust assets in the settlor's gross estate?

These kinds of guidance letters are common in other parts of the world.

51. Digital Assets

The late stage client should prepare as detailed a list as possible of all digital assets, usernames, passwords, etc. Make sure the fiduciary has access to digital assets. Consider naming a digital fiduciary who is technically savvy.

52. Income Tax Issues

The decedent's last year is generally the last opportunity to take advantage of carryovers.

The client may want to take steps to diminish valuation discounts or to cause inclusion of trust assets in the gross estate in order to achieve a large basis step-up at death.

Third parties may consider making transfers to the client in poor health so that the basis of the assets can be stepped up at the client's death (and perhaps to take advantage of the client's GST exemption). Section 1014(e) denies a basis increase if the gift property is returned to the original donor within one year. One participant suggested that several donees might make gifts and the gift properties might be left back to the donees, but each donee would not receive the property that he or she transferred (being aware of the possible application of the step transaction theory).

53. Checklist for Dying Client

Peggy Sheahan Knee discussed the following very practical checklist of issues to consider for the dying client. (This is a terrific checklist. Most such checklists focus on tax planning issues, but this checklist has a myriad of very practical every day matters that should be addressed by a dying client.) This list is included with her permission.

- List all medications (This may seem silly, but when dealing with seniors, they may be taking 15-20 mediations per day. Missing one could easily happen.)
- Employer contact information—for employee benefits (At least identify the last employer.)
- Personal insurance information (Determine whether long-term care insurance is in effect.)
- Time sensitive bills (including credit cards)
- Contact information for guardians for minor children (Reconsider who is the proper guardian; meet with the guardian and discuss care plan; is appropriate funding available? Also consider those things for adult children who are dependent on the client.)
- If the person is serving as a fiduciary, consider succession
- Care plan for pets
- Locate important documents (social security card, birth certificate, marriage certificates, etc.)
- User names and passwords for laptops
- Contact online service providers to give access to personal representative for digital assets
- If military veteran, location of discharge papers (The facility that stored those documents burned.)
- Location of safe deposit box, including box number and keys (Consider what is in the box; is the box still needed?)
- Location of storage facility sites and entry code information (If fees are not paid, the assets will be auctioned.)
- Location of secret hiding places (As one client reasoned--"I put it in the freezer. Why the freezer? It's the last place to burn.")
- Review health care directives to determine if they reflect current wishes. Stop being polite about who will be offended. It's time to be blunt and do what is best.
- Consider whether a POLST ("Physician Orders for Life Sustaining Treatment") is appropriate. It is very helpful for end of life planning.
- Organ and tissue donation preferences
- Hospice-preferred provider—in home or in a facility
- Preferred disposition of remains (Fights among family members are not uncommon.)
- Name and address of funeral home
- Cemetery deeds
- Name of church
- Description of memorial service
- Family tree (including names and last known addresses for heirs)
- Compile information for death certificate—father's name, mother's maiden name, correct name for death certificate
- Updated list of professional contacts

- Detailed asset list
- List of contracts—IRAs, life insurance policies, annuity contracts, retirement accounts; Look at beneficiary designations
- Review the last will and testament to determine if it comports with wishes
- Consider domicile change for transfer tax purposes
- Consider large gifts in states where there is no gift tax but large estate tax and no "clawback"
- Is genetic material stored? What consents or restrictions should be place on its use?
- Safeguard valuables

Items 54-63 are observations from a Session by Nancy G. Henderson, M. Read Moore, and Diana S.C. Zeydel—Balancing the Income and Transfer Tax Aspects of Traditional (and Not So Traditional) Estate Planning Techniques

54. Flexibility is a Key Mantra to Planning; No "Permanence" in Tax Laws; California Property Tax

The estate tax law became "permanent" on January 1, 2013, but "as long as Congress is in session, the law is not permanent."

Other taxes may also change. For example, a higher California income tax rate (now 13.3% for taxable incomes over $1 million) was passed in November 2012, retroactive to January 1, 2012.

California Property Tax. The California property tax is also substantial and planning to avoid a reassessment of property tax value is a substantial factor in estate planning decisions in California. A change of ownership can trigger a substantial revaluation of the property for California property tax purposes. Under Proposition 13 (which was passed in 1978), the maximum amount of property tax on real estate that can be charged by counties is limited to 1% of the assessed value, and the assessed value of the property cannot increase more than 2% per year. The base year value (which could go back to 1975) can be reassessed in cases of (a) a change in ownership, or (b) completion of new constriction. For real estate that has been owned for several decades (even back to 1975), the increase in assessed value on a change of ownership can be quite substantial—with an *annual* additional property tax thereafter of 1% of that substantial increase in assessed value. There are other exemptions as well; under the homestead program, homeowners who live in their homes as their principal residence qualify for a $7,000 reduction in the taxable value of their property.

A change of ownership generally includes transfers by reason of gift, death of the owner, or transfers to entities, but there are important exceptions including (1) transfers to a spouse or domestic partner (including transfers to a trust for the spouse or domestic partner), and (2) transfers from a parent to a child (but limited to $1.0 million for property other than a principal residence). As an example of planning considerations, if a decedent leaves property outright to a spouse, the first decedent-spouse's ability to transfer up to $1 million to a child is lost, and the surviving spouse only has his or her own $1 million parent-child exception. In contrast, a transfer at the first spouse's death to a credit shelter trust or to a QTIP trust qualifies for the spousal exception and a transfer from that trust to children at the surviving spouse's subsequent death also qualifies for the original decedent-spouse's $1 million exception for parent-child transfers. Thus, the parents could make $2 million of parent-child transfers before triggering a change of ownership.

Strategies are also available for lifetime transfers involving entities. A transfer by various co-tenants of their interests in a piece of real estate to an entity does not result in a change of ownership if they receive proportional interests in the entity. When a cumulative change of the property owners exceeds 50% of the interest in the entity, the full value of the real estate is reassessed (not just the proportional amount attributable to the transfer). A possible strategy is to transfer undivided interests to children within the parents' collective $2 million exception for parent-child transfers and have the children and parents contribute their interests to an entity in which the children own more than 50%. When the parents die and transfer their interests in the entity, their entity transfers will be less than 50% and therefore will not trigger the property value reassessment.

55. Transfer Planning vs. Holding Assets for Basis Step-Up

Realize that the possible donees often would rather receive property now and pay income tax when it is sold rather than wait for 30 years until the parent dies to receive the property.

With many decisions, the planner must realize there is no absolute RIGHT answer—and sometimes the decision will turn out wrong. To the extent possible, building in flexibility is helpful.

a. ***Reasons to Opt for Transfer Planning***. Reasons for engaging in transfer planning include: (i) the estate tax is due regardless of liquidity, whereas the capital gains tax is due only after a voluntary sale when sale proceeds are typically available to pay the tax; (ii) pressure on businesses to pay estate tax, even if it is deferred; (iii) restrictions on business transfers under §6166 if an extension is allowed; (iv) depreciation deductions are a deferred benefit; even though they are available every year, a present value analysis may show that many years of depreciation deductions are necessary to exceed the transfer tax savings from transfer planning; (v) transferee liability and estate tax liens on property; (vi) state estate tax; (vii) property tax strategies (in California there are amazing strategies available in life that are not possible after death, see Item 54); and (viii) donees get to enjoy the property immediately.

b. ***Reasons to Prefer Retaining Assets for Basis Step-Up at Death***. Reasons for preferring basis step-up planning include: (i) life insurance is available to pay estate tax (term insurance may be acquired during the time frame for transfer tax savings to overcome the loss of basis step-up); (ii) client maintains control and access over the property; (iii) flexibility to change ultimate recipients of property if the client's views change; (iv) avoid expenses and complexity; (v) avoid property tax change of ownership; (v) for certain assets, there is more than just a capital gains tax rate advantage to a basis step-up (for copyrights, patents, trademarks, artwork, or for "negative basis" assets).

c. ***Likely Approaches in Specific Types of Client Situations.***

   Low Basis Stock Portfolio. As discussed below, stock with a zero basis would have to appreciate by 247% before the 40% federal estate tax savings on the appreciation would outweigh the loss of a basis step-up on the full value of the asset (at a 23.8% federal rate). That may take a number of years to occur. If transfer planning is used, make transfers to grantor trusts with a power of substitution so the grantor can re-acquire the low basis assets before death. Rolling GRATs are also a possible strategy because the client will be receiving back the current value of the assets and only the appreciation will be losing a basis step-up.

Real Estate Investor. The client owns low basis (fully depreciated) real property with a low property tax valuation. The planner must know the family's plan for the real estate—will it be sold? transferred in a §1031 exchange? retained for income? If it will likely be retained long-term, that is strong factor favoring basis step-up. **Interesting Observation:** If the real estate is transferred to children and the parents would like the children to keep the real estate long-term, the parents might like that a decision by the children to sell the real estate (and trigger an income tax) will be painful.

High-Tech Entrepreneur. The entrepreneur owning very low basis stock will have to weigh the likely future appreciation. If the business may appreciate substantially in the future (in excess of the 247% "cross-over" point), transfer planning will be favored. If the company is likely to be bought in the near future, that also favors transfer planning (no basis step-up will apply anyway and the sale price may represent substantial appreciation over the discounted value of the stock that is removed from the transfer tax base).

d. ***Numerical Analysis.*** The advantage of making a gift is that the appreciation is not subject to estate tax; but the disadvantage is that there is no step-up in basis for that asset at death. Stated differently, there may be have to be a substantial amount of appreciation in order for the 40% estate tax savings on that appreciation to offset the loss of basis step-up on the full value of the asset. For a zero basis asset, assuming a 40% estate tax rate and a 23.8% capital gains rate, the asset would have to appreciate 247% in order for the estate tax savings on the appreciation to offset the loss of basis step-up on the entire value of the asset. For example, assume a $1.0 million asset with zero basis is transferred. If it appreciates to $2.47 million (really $2,469,135) , the 40% estate tax savings on the appreciation will equal 23.8% times the full value for which there would be no basis step-up (*i.e.*, $1,469,135 post-death appreciation x 0.40 = 2,469,135 total gain (assuming zero basis) x 0.238).

An analysis based on the probability of achieving this breakeven point taking into account market volatility suggests an even more troubling result. For example, if a concentrated asset is assumed to have an expected return of 8.59% but with expected volatility of 28.17%, the probability of reaching the breakeven point 30 years out is only 66.53% (whereas a straight-line return of 8.59% would reach the breakeven point in 11 years). The basis of the asset, time horizon for appreciation to be removed from the estate, and asset allocation are all important factors.

Furthermore, there is the possibility that the asset will actually decline in value, in which event the client would have been better off not making the gift even without considering the basis step-up issue.

e. ***Client Decision***. The attorney can advise the client of the tax effects and economic risks of the transfer decision, but make sure the client is ultimately making the decision and assuming responsibility for the decision of whether to engage in transfer planning or to retain the assets to achieve a basis step-up at death. Transfer decisions involve economic decisions somewhat like the decision of whether to buy or sell assets at a given time.

56. Flexibility for Engaging in Transfer Planning and Also Getting Basis Step-Up at Death

If the transfer is made to a grantor trust, the grantor could re-purchase the assets for cash or other high basis property before the grantor's death. Any appreciation will have been removed from the grantor's gross estate. This can be advantageous even if the grantor must borrow money from a bank to make the purchase (but consider pre-arranging the loan so that it could be finalized quickly if need be). **Practical Suggestion:** Have the trust assets held in an entity (such as an LLC) so the transfer could be implemented very quickly (with a one-page LLC member interest assignment document).

Another way of dealing with the issue of having enough time for the future appreciation to reach the breakeven point is to have term insurance to make up the difference of the loss of the basis step-up during the transition period.

There are also ways of structuring transfer planning and keeping the possibility of causing estate inclusion to achieve a basis step-up, but that approach would unwind all of the transfer tax advantage by causing inclusion of the full asset value (whereas the repurchase from a grantor trust does result in removing the post-transfer appreciation from the grantor's estate). Such strategies include:

- Independent third party exercise of authority to grant the donor a testamentary limited power of appointment, which would cause estate inclusion under §§2036(a)(2) and 2038 and result in a basis adjustment under §1014(b)(9);
- Donor use of the property in some way that would reflect an implied agreement of retained enjoyment to cause estate inclusion under §2036 (such as using property without paying adequate rent); or
- If the donor is a discretionary beneficiary of the trust, move to the trust situs to a state that does not have domestic asset protection provisions.

57. Importance of Transfer Planning With Grantor Trusts

An analysis of planning scenarios, taking into consideration estimated market performance of given portfolios (considering expected returns, yields and volatility) highlights the importance to making transfers using grantor trusts. The assets transferred to a grantor trust grow tax-free because the grantor pays the income taxes each year on the trust income. Making a $10.5 million gift to grantor trusts with 0% discount has about the same effect (median transfer of $32.5 million in 20 years) as making $10.5 million gifts to a nongrantor trust with an upfront 20% discount (median transfer of $33.4 million in 20 years). The grantor trust effect is continuing, and results in further advantages over time. Conclusion: you do not need to be "off the charts" in pressuring the appraiser for very high discounts if grantor trusts are used. Of course, using grantor trusts with upfront discounts result in even larger wealth transfer.

58. Portability and Grantor Trusts

One of the advantages of a portability-oriented plan is that the spouse can make gifts using the DSUE amount to a trust that is a grantor trust as to the surviving spouse. The tax advantage of grantor trust planning can continue for the surviving spouse's lifetime. A concern is whether the spouse will make the gift; pulling the trigger on making a large ($5.25 million) gift soon after the personal traumatic experience of going through the first-decedent spouse's death is difficult. The spouse gives up the flexibility to change the ultimate disposition of the assets, and the spouse must also give up having a beneficial interest in the assets unless the trust is governed under the laws of a self-settled trust state. (Consider PLR 200944002 and *Huber.)* There is some degree of inherent uncertainty regarding the effectiveness of such DAPT provisions if the spouse does not reside in a DAPT state and inherent uncertainty regarding the estate tax treatment of the trust if the spouse is a discretionary beneficiary. The §2036 issue is discussed in more detail in Item 17 of the Estate Planning: Current Developments and Hot Topics Summary (December 2013) found here and available at www.Bessemer.com/Advisor. The effectiveness of selecting the law of a DAPT state to govern the trust that is created in a non-DAPT state is address in Item 54 of the ACTEC 2014 Annual Meeting Musings found here and available at www.bessemer.com/Advisor.

A possible strategy is for the spouse to make the gift to a trust for children and give a trust protector after some period of time the power to include the spouse as a discretionary beneficiary (if the trust is in a self-settled trust state). That might provide a stronger argument that §2036 does not apply (by an implied agreement of retained enjoyment).

Using Both Spouses' GST Exemptions. A better strategy is to have the first spouse to die create a "reverse QTIP" (allocating the first spouse's GST exemption to the trust) and have the surviving spouse create two trusts, one using the DSUE amount and one using his or her own gift and GST exemptions.

In any event, using these strategies for large gifts by the surviving spouse to create a trust that is a grantor trust as to the surviving spouse is often available only to "mega estates."

59. Supercharged Credit Trust^SM^ As Another Way to Cause Grantor Trust Treatment for Surviving Spouse Using Decedent's Estate Exemption

The Supercharged Credit Shelter Trust[sm] was originally described in Mitchell M. Gans, Jonathan G. Blattmachr, & Diana Zeydel, *Supercharged Credit Shelter Trust*[sm], Prob. & Prop. 52 (June/July 2007). For more detailed discussions of the Supercharged Credit Shelter Trust[sm] in connection with portability see Jonathan G. Blattmachr, Austin W. Bramwell and Diana S.C. Zeydel, *Portability or No: The Death of the Credit-Shelter Trust?*, 118 J. Tax'n 232 (May 2013). The Supercharged Credit Shelter Trust[sm] involves the creation of an inter vivos QTIP trust by a client for his or her spouse. At the donee-spouse's death, the assets would pass into a "bypass trust" for the surviving client-spouse's benefit. The transfer would be treated as being made from the decedent spouse (the original donee-spouse) for estate tax purposes (so the surviving spouse could be a discretionary beneficiary and trustee), but is treated as having been created by the surviving spouse (the original donor-spouse) for purposes of the grantor trust rules pursuant to Reg. §1.671-2(e)(5)(first sentence).

For a more detailed discussion of the Supercharged Credit Shelter Trust[sm], see paragraph 2(e) of the summary of the seminar by Diana Zeydel and Robert Weiss in the ACTEC 2011 Summer Meeting Musings found here and available at www.bessemer.com/advisor.

60. Expected Timing Between Deaths of Spouses

The expected time between the deaths of two spouses obviously depends on the ages of the spouses, but on average the "overlife" is about 10 years. (For example, based on actuarial tables from the Office of the Actuary of the Social Security Administration's website, the expected overlife for a 55 year old husband and a wife ranging from age 55 to 70 is about 12 years, and the overlife for a 70 year old husband with a 70 year old wife is about 9 years.)

Accordingly, using optimal strategies during the surviving spouse's subsequent lifetime after the first spouse dies is quite significant; there will likely be a substantial period of overlife.

61. Getting Basis Step-Up Regardless Which Spouse Dies First

a. ***Gift to Dying Spouse.*** One approach is for the "well" spouse to give property to the dying spouse. The concern is that §1014(e) provides that if the donee spouse dies within one year and the property returns to the donor spouse, there no basis step-up. There is little authority under §1014(e); there are no cases, no regulations, and no published rulings.

   If the property passes to a QTIP trust rather than directly to the surviving spouse, PLR 9026036 (reissued as 9321050) provides some support for disallowing a basis step-up only for the proportional part of the property attributable to the surviving spouse's mandatory income interest. This proportional analysis is further described in Item 8c of Estate Planning: Current Developments and Hot Topics (July 2014) found here and available at www.bessemer.com/advisor.

   Another strategy may be for the donee-spouse to leave the property to a third person, not the surviving spouse. However, that may not be the intent, and if that amount exceeds the decedent-spouse's estate tax exclusion amount, a 40% estate tax would be generated at the first spouse's death in order to avoid a 23.8% capital gains tax avoided by the basis step-up—not a good trade-off.

   For an excellent analysis of §1014(e) and planning ramifications, see Jeff Scroggin, *Understanding Section 1014(e) & Tax Basis Planning,* LEIMBERG EST. PL. EMAIL NEWSLETTER #2192 (Feb. 6, 2014).

b. ***Community Property***. The rationale of the basis step-up for both halves of community property goes back to 1948 when the marital deduction was instituted. The general thinking was that husbands would likely own all of the marital assets and husbands were likely to die first, so a full basis step-up would be available for all marital assets for most couples at the first spouse's death. If only the decedent's one-half of community property received a basis step-up, community property states would be disadvantaged compared to common law states. The rule for community property is now based on outdated assumptions, but it continues.

Spouses in community property states get a basis step-up on all community property regardless of which spouse dies first. Any separate property could be converted to community property (through a "transmutation agreement"). Query whether the spouses need separate counsel for a transmutation agreement; one panelist said yes and another said it depends on whether the amount is small or large and whether it is a long marriage. But a question arises as to whether that is a transfer that might trigger §1014(e) if the "recipient" spouse dies within one year.

For couples that do not live in community property states, the spouses might create community property by conveying assets to a "Community Property Trust" under Alaska or Tennessee law. See the discussion in Item 1.I of the ACTEC 2013 Fall Meeting Musings found here and available at www.bessemer.com/advisor.

Owning assets as community property vs. separate property has real life consequences, including (1) ownership and disposition on death or divorce, (2) management rights, and (3) what property is liable for debts of a spouse.

c. ***Other Strategies.*** Other strategies for causing estate inclusion at the first spouse's death are discussed in Item 8 of the Estate Planning: Current Developments and Hot Topics Summary (July 2014) found here and available at www.bessemer.com/advisor.

62. Planning for Surviving Spouses

Assets received by the surviving spouse from the decedent would have received a basis step-up at the spouse's death and would be excellent assets for transfer planning. If the spouse owns assets outright (or in a general power of appointment trust with a withdrawal power), the spouse has no difficulty making gifts.

If substantial assets are in a QTIP trust for the surviving spouse, a variety of issues may arise when the surviving spouse attempts to engage in transfer planning strategies, including the following:

- Can distributions be made to the spouse in accordance with the trust's principal distribution standard (so that the spouse can employ transfer planning strategies with those assets)?
- If distributions cannot be justified within the standard for distributions, can distributions to the spouse be made anyway?
- Can the trust be modified to permit distributions to the spouse?
- Can the spouse trigger a gift under §2519 by assigning or releasing some or all of the income interest?
- If the spouse releases the income interest as a gift, does §2036 apply to the remaining assets in the trust if the spouse is a discretionary principal beneficiary? (Presumably §2036 would not apply if the spouse sells the income interest for full consideration.)

- Does the spendthrift clause in the trust allow the spouse to release his or her income interest?
- Can the QTIP trust contribute assets to entities in return for interests that might be discounted for valuation purposes without triggering §2519?
- The spouse's ability to make gifts may be simplified if the trust is drafted to give the surviving spouse a delayed power of withdrawal over some or all of the trust (with or without the consent of non-adverse parties).
- Consider whether a bequest outright to the surviving spouse is preferable to leaving assets to a QTIP trust if the couple anticipates that the surviving spouse will employ sophisticated estate planning strategies during his or her lifetime. (If there is a concern that the spouse would might dispose of the assets in a way the decedent would not have wanted, consider using a QTIP trust with a delayed withdrawal power with the approval of a non-adverse party or with restrictions on how much could be withdrawn.)

These issues are discussed in Item 12 of the Heckerling 2010 Musings (summarizing a presentation by Read Moore) found here and available at www.bessemer.com/advisor. For an outstanding analysis of these issues, see M. Read Moore, Neil T. Kawashima, & Joy M. Miyasaki, *Estate Planning for QTIP Trust Assets,*44TH ANN. HECKERLING INST. ON EST. PL. ch. 12 (2010).

63. DE-GRANTORIZING GRANTOR TRUSTS

A settlor may wish to convert a grantor trust to a non-grantor trust for various reasons: (i) the increase of the estate exemption to $5 million indexed together with portability may mean that the client no longer has estate tax concerns, (ii) the grantor may have transferred as much value as desired and no longer wants to keep paying income taxes on the trust's income, or (iii) having items of trust income continuing to appear on the settlor's income tax return may raise questions about the trust in an estate tax audit.

Merely having a trustee start to reimburse the grantor for such income taxes under a discretionary reimbursement power in the trust instrument may raise an issue as to whether an implied agreement existed that the trustee would do that when desired, thus causing the trust to be in the grantor's estate as a result of the implied retained control over the trust.

Conversion to a non-grantor trust may occur in various possible ways, depending on the terms of the trust, such as by relinquishing a beneficial interest of the grantor's spouse, a third party exercising a power to remove "trigger powers" that cause grantor trust status, changing trustees so that half or less are related or subordinate parties if the trust allows distributions without an ascertainable standard, or the grantor's release of a substitution power (among other possible methods). Very careful navigation of the grantor trust rules will be required.

Before relinquishing grantor trust status, carefully consider that keeping grantor trust status may be very helpful if the client wishes to substitute illiquid assets into the trust in return for liquid assets for living expenses or to reacquire low-basis assets before the grantor's death.

Items 64-68 are observations from a Session by Lawrence Brody and Mary Ann Mancini—The Inevitable Reality of Taxes: Providing the Liquidity to Pay Estate Taxes Due

64. Basic Life Insurance Concepts—Investment and Credit Risk

a. ***Investment Risk***. All permanent policies have some level of investment risk (perhaps other than traditional, non-participating whole life policies or no-lapse guaranteed universal life policies). Some policies give the owner control over investment risk and others do not. Life insurance policies (perhaps other than term, non-participating whole life or no-lapse guaranteed universal life) are not "buy and hold" assets but are "buy and manage" assets. A common problem is that agents are willing for a fee to *sell* policies but few are willing, even for a fee, to *manage* policies.

b. ***Credit Risk***. Every policy has credit risk—the risk that the life insurance company "expires" before the insured. This is a state regulated industry with no federal guidelines or reserve funds. State funds to protect against the failure of insurance companies can cover only small policies.

   Most policies are subject to the general creditors of the company. The exception is that for "separate account policies" (*e.g.,* variable universal life and private placement insurance) the cash value is not subject to the carrier's creditors. All other policies are "general account policies" and their cash values are subject to the carrier's creditors.

65. Policy Pricing and Illustration of Permanent Policies

a. ***Policy Pricing***. Three elements affect pricing inany non-term policy. (1) Mortality charge (generally based on mortality tables that assume all insureds die by age 100). In most policies there is no guaranteed cost of insurance and the carrier can increase the cost of insurance at any time to reflect its current mortality experience. That is a risk that is hard to identify. (2) Expense loading, including sale commissions, underwriting expenses, and administrative expenses. (3) Investment return on the savings element of the policy. Another pricing effect is policy persistence, and policies have persistence built into the pricing of the policy (in effect, part of the expense loading element). Policies are expensive for carriers to place and early lapses prevent the carrier from recouping its losses sustained in the early years of the policy. If a carrier has a bad lapse experience, their illustrations will not look as good as those who policies remain in force a long time. (On the other hand, lapses in later years, after the early year costs have been recovered and the carrier has received years of additional premiums, are profitable for the carrier. Some policies are priced assuming some level of profitable lapses [called "lapse supported pricing"].)

b. ***Policy Illustrations***. Policy illustrations are nothing more than "what if" illustrations. They are based on various assumptions (some of which are disclosed and others that are not). The illustration estimates the financial experience of the policy at age 120, but it is not possible for a carrier to know the cash surrender value in 80 years. Potential buyers, however, think of illustrations as being guarantees.

A consideration in reviewing a policy is the policy illustration, but make sure the agent provides a worst-case-scenario illustration (showing the maximum policy cost and the lowest possible investment return). The purchaser should review the worst-case illustration and understand that nothing else is guaranteed.

The planner should make sure that the owner receives a new illustration every year to see how the policy is performing as compared to the projection. Premiums may need to increase to keep the policy in force as long as the client lives.

A famous quote about policy illustrations is paraphrased as follows: these are financial illustrations of what might happen if certain disclosed undisclosed assumptions proved to be true most of which will not. For any other financial instrument, could someone legally show you what it would be worth 80 years from now, and if they did would you believe them?

"A life insurance policy illustration says 'here's what the policy will be worth when the insured is 125—believe or don't.' I think the answer is—don't."

Practical Pointer: Larry Brody observes that we can point clients to the real life example of Executive Life illustrations.

> Clients should probably be reminded about how, at the time, the illustrations from now defunct Executive Life looked much better than those of other, more conservative, carriers. This may be a place where the "cheapest" product (i.e., the one with the lowest projected annual premium) may not necessarily be the "best" one. This is counter-intuitive, and is therefore very difficult for many clients and their advisers.

66. Policy Selection and Management

Clients should look for a policy from a financially sound carrier, with reasonable illustrated results, taking into account the investment return, expenses, and mortality charges, which, based on reasonable assumptions, is projected to last well past actuarial life expectancy (perhaps to 110 or 120). Clients should diversify by choosing multiple carriers with multiple policy types (in large cases) as a hedge against carrier insolvency and to diversify potential investment risks. Look for a policy series the carrier will continue to support in the future – one that is central to its sales strategy.

The newer forms of policies (discussed below) offer premium flexibility and potentially higher investment returns, but they place more (or all) investment risk on the policy owner.

Adding a term insurance rider to a permanent policy potentially lowers the premiums but may make the policy less stable by magnifying the risk of poor investment performance or increased expenses, because the policy values are intended to help pay premiums in the future.

67. Universal Life (Flexible Premium) Policies

a. ***Universal Life Policies Generally***. Universal life policies have a risk element (death benefit) and accumulation element (the cash value) with flexible premium amounts.

General Account Policy. These are "general account policies" that are not protected from the carrier's creditors (but variable universal life policies have separate accounts that are protected, as discussed below).

Death Benefit Choice. The death benefit can either be a level benefit or a base amount plus an accumulation element (which is most typical).

Accumulation Account. The investment "accumulation element" is key to the success of these policies. Too often, policy owners elect to pay as low amount as possible in premiums in the early years, but this leads to low accumulation amounts. If there is not enough value in the accumulation account to cover the carrying charges for the policy, it will lose face amount at death or the policy may lapse unless the owner pays added premiums (unless is the policy has a no lapse guarantee, in which event there is much less flexibility in the amount of premium payments).

Traditional universal life credits returns to the accumulation value based on the carrier's *interest* rate in its portfolio of investments. (This was very favorable when universal life became popular in the 1970s because prior whole life policies credited low yields based on the prior periods of low interest rates as compared to the new-money rates in the 1970s.) The decline in interest rates in later years led to lower performance than anticipated (and ultimately led to the development of equity indexed policies and variable policies, described below, offering the possibility of higher returns keyed to the long-term performance of equities rather than interest earned in the fixed income market).

"Opens the Black Box." Universal life policies "open the black box" of insurance because the carrier reports the expenses charged against the accumulation value and the mortality charges. The carrier has an incentive to keep these expenses reasonable (or well advised insureds would exchange policies for more competitive policies issued by other carriers). The owner will get more information every month than the owner wants to see—the information can be overwhelming.

Trade-Off. The trade-off of universal life is that the owner has full information, has flexibility on premiums, has the ability to withdraw from the policy without the carrier's consent (if it is not a "modified endowment contract"), and has the possibility of higher returns—but the owner is at risk and it is up to the owner to do what needs to be done to maintain the policy (which may call for paying higher levels of premiums)

Premium Management. The carrier will suggest a premium that is anticipated to keep the policy alive. The initial planned premium is used to determine the commission that is paid to the agent (which reduces the accumulation amount). The best strategy is to use the low planned premium and voluntarily make higher premium payments. The accumulation account is then not reduced by a commission on the higher voluntary payments.

For many owners, the flexibility with respect to premiums has hurt more than it helped—because owners opted to pay low premium,s which resulted in depleted accumulation values.

An owner's ability to make large catch-up premiums at one time may be limited. Section 7702 limits the amounts of premiums that can be paid (to keep policies from becoming primarily tax-free savings vehicles), and the carrier will not allow the owner to violate §7702. The owner may be prevented from saving a universal life policy if the owner waits too long to add needed premiums.

b. ***Equity Indexed Universal Life***. Many carriers offer equity indexed universal life policies, for which the crediting rate to the accumulation value is based not on interest earned by the carrier but by reference to an equity index (perhaps the S&P 500, excluding the dividend component) but with a minimum and maximum crediting rate. To provide the floor and ceiling on the crediting rate, the insurer uses part of the policy account (perhaps as much as 10%) to invest in an index straddle. For example, if the market return is negative, the floor may be zero, but if the market returns 25% the policy may only get credited with 10%. These are not variable universal life products because the owner has no discretion about how the cash value is invested and cannot change investment strategies. Like variable policies, they are expensive policies to administer because of the hedging required to provide the floor and ceiling on returns.

These policies are often illustrated at high assumed return rates, such as 8 percent. To get a more realistic view of the policy (with all its built-in relatively high expenses), policyholders should ask for an illustration assuming a 4.5 or 5 percent rate of return.

These are fairly popular types of policies; policyholders may be enamored with the ability to participate in equity market returns with a floor of zero without giving thought to the huge impact over a long period of time of the annual ceiling on returns.

c. ***No Lapse Guaranteed Universal Life***. One of the primary advantages of universal life is flexibility without respect to premium amounts. That flexibility is lost if the owner wants a guarantee that the policy will not lapse before the death benefit is paid. In older policies, the premiums had to be paid by the due date (no grace period) or the guarantee lapsed (even though additional amounts had been paid for the guarantee).

To avoid that harsh result, carriers developed universal products with a "shadow account." Part of the policy is supported by a shadow account (that is not part of the policy) in addition to the accumulation value. Extra premiums were placed in these shadow account reserves that are credited with higher return rates than the accumulation values in universal policies. The shadow account is not part of the policy, however—if there is a tax-free exchange of policies or if the owner wants to withdraw values from the policy, only the accumulation value is available; the shadow account is lost, and it is owned by the carrier. The shadow account concept can result in huge valuation surprises; even though a policy may have nominal accumulation value the shadow account is taken into consideration in valuing the policy if the owner wants to give or sell the policy.

d. ***Variable Universal Life (VUL).*** A variable universal life policy has all the other attributes of universal life policies, with the added feature of giving the owner the choice of how to invest the cash values among what look like (but are not) mutual funds. The traditional universal policies had one fund choice; VUL policies now have a mind-boggling 50-80 funds that may be available for the accumulation account. (Larry Brody asks—"How many Argentinean debt funds do I really need to choose from?") Transfers are allowed within the carrier's family of funds without fees or tax consequences (in some policies, as often as daily).

VUL adds more owner control regarding investments (though not unlimited as described below), but VUL moves all of the investment risk from the carrier to the policy owner. With whole life insurance, *all* of the investment risk was on the carrier and that is why the crediting rates were so low. Traditional universal life has a floor on the investment return, so there is some sharing of investment risk. The investment return for a VUL policy is 100% determined by the owner's choice of funds and the investment performance of that fund.

Death Benefit. The death benefit may vary with the policy's investment performance but in most VUL policies not below a guaranteed amount. Because of the guaranteed minimum, the owner will be obligated to pay ongoing mortality costs for life, reducing the investment accounts by what is essentially a term charge.

Separate Account Policies Not Subject to Carrier's Creditors. VUL policies (and private placement policies, discussed below) are the only types of policies that are separate account policies that are not subject to claims of the carrier's creditors. (All other policies are general account policies.)

Not Appropriate Unless Owner Wants Equity Investments. VUL is not appropriate for a client who wants interest returns as the investment choice for the policy. VUL policies are expensive policies to create and maintain. Unless the owner is willing to be in equity markets, VUL is too expensive of a way to own insurance. Even if a client generally has equities as part of his overall portfolio, the client may view life insurance as part of his fixed income portfolio, in which event traditional universal life will be preferable to VUL.

SEC Requirements. Because the owner has an investment choice among funds, the policy itself is a security for federal security law purposes. The owner will receive a lengthy prospectus "best used as a doorstop because no one reads it." This is the only federal regulation of insurance policies—and only the sales process is regulated by SEC restrictions in how policies can be illustrated. The illustration may be based on returns as high as 12% straight line appreciation, or as low as zero. (Private placement VUL policies, described below, are not publicly offered and do not have to register with the SEC.)

Diversification and Investor Control Rules. Complex diversification and investor control rules apply to VUL policies under §817 regulations and a series of private letter rulings to assure that the owner does not directly control investments within the policy. (These are described in more detail below.)

Alternative to Non-Deductible IRA Account. VUL can be an attractive alternative to a non-deductible IRA. The assets grow tax-free as long as the §7702 and §817 requirements are met (as discussed below), but (1) there are no penalties or distribution requirements, (2) the owner can make tax-free withdrawals (as long as the policy is not a modified endowment contract ["MEC"]), and (3) the death proceeds are not taxable (contrasted with an IRA in which the withdrawals in excess of the non-deductible contribution amount are taxable even if withdrawn after the death of the owner. These advantages come at the cost of paying mortality costs, surrender fees, investment management and other carrier charges.

e. ***Private Placement Life Insurance***. Private placement life insurance is an individually tailored variable universal life (VUL) policy that is offered only to high net worth individuals who are willing to make a substantial cash investment in the policy at its inception. Private placement policies can be either "offshore" policies sold outside the United States (but a U.S. policyholder will still want a U.S. compliant product), and "onshore" policies that are sold in the United States.

Investment Options. The key feature of private placement policies is that they have very customized investment options, including hedge funds, private equity, stock portfolios and other alternative investments. Offshore private placement policies have an even greater range of permissible investments. However, the degree of control that the policyholder can have over the investments is still limited (discussed below regarding the diversification and investor control requirements).

Negotiation of Expenses. All of the pricing elements of private placement insurance are negotiable. The agent commission, as well as company expense charges may be negotiated to a minimum level. That allows greater portions of the premiums to remain in investment accounts, with greater opportunities for growth to support the policy and the death benefit.

f. ***Requirements For Tax-Free Build-up***. As long as a policy constitutes a "life insurance contract" under local law, the death benefits will generally be received tax free under §101. There are significant additional requirements, however, to avoid current income taxation on the annual accretions within the policy. These include (1) requirements under §7702(a), (2) diversification requirements under §817, and (3) investor control limitations (arguably referenced in §817 regulations but applied by various cases and public rulings and a large number of private letter rulings).

Section 7702. Section 7702(a) has two different tests, either of which can be satisfied to prevent future policy build-up in value from being subject to current income taxation. These are (1) the cash accumulation test (under which the cash surrender value cannot exceed the net single premium that would have to be paid at any time to fund future policy benefits) and (2) the guideline premium test (under which the ratio of policy death benefit to cash value must fall with the cash value "corridor" established in the table contained in §7702(d)). (Policies typically meet both tests, even though meeting just one of the tests is sufficient.) These are difficult mechanical tests, but as a practical matter the policy owner relies on the carrier to establish and maintain the policy in a way that satisfies §7702(a). If those requirements are not met, §7702(g) describes in detail how the annual increase in value will be subject to taxation at ordinary income tax rates.

Offshore private placement insurance may adopt the concept of a "frozen cash" in which the cash values never increase above the premiums paid so that there will be no current ordinary income. This type of policy is acquired for its death benefit and not for lifetime access to the growth in cash value due to the policy investments; the owner cannot access the excess value in excess of premiums paid through loans or partial surrenders.

Section 817. Section 817 has detailed diversification requirements for variable policies. The purpose is to discourage the use of variable annuities and variable life insurance "primarily as investment vehicles." In addition, while §817 and the regulations focus on diversification requirements, the §817 final regulations incorporate by reference certain aspects of prior published rulings placing restrictions on investor control. If the diversification requirements of §817 are not met, §7702(g) dictates how the annual build-up in value will be subject to current income taxation.

If the policy investments in a variable product (which includes private placement products) are not adequately diversified, any income on the contract must be included by the policyholder as ordinary income received or accrued by the policyholder during such year. Treas. §1.817-5.

The detailed diversification requirements in Reg. §1.817-5 have very objective tests (for example, no more than 55% in any one investment, 70% in two investments, 80% in three investments, and 90% in four investments). (There are also several other possible alternative tests.) The investment manager of each account should certify that the diversification rules are satisfied.

Investor Control Rules. The investor control rules were crafted by cases and published rulings before the adoption of §817. They are much more difficult than the objective diversification tests. The concept adopted in some court cases and published rulings is that if the owner keeps too much control over the investment of policy assets, the owner will be treated as the owner of the underlying assets under constructive receipt principles and therefore subject to current taxation on income realized each year. There have been four published rulings (Rev. Ruls. 82-54, 81-225, 80-274, and 77-85) and a large number of private letter rulings detailing various limitations on the degree of control that policyholders can have over policy investments. These include no legally binding right to require particular investments, no prearranged plan to invest in particular investments, the ability to choose among investment strategies but no control over specific investments, no ability even to communicate directly with the investment manager, no ability to recommend specific investments, and no ability even to have any current knowledge of a fund's specific assets. One private ruling required that the owner could not even know the investment techniques of the investment manager. The investments offered cannot be available to the general public, but only through the policies offered by the insurance company.

There has been some debate about whether the investor control rules apply in addition to the diversification rules in §817, but probably so. The IRS *clearly* imposes the investor control requirements before granting a favorable ruling.

68. Premium Financing

There are separate excellent detailed written materials regarding methods of funding premium payments and premium financing techniques.

69. Interesting Quotations and Gems of Wisdom

a. *Invincibility Complex*. "Young men especially have a sense they will never die. That's ok—they are allowed not to grow up as fast as women." --Jeanne Newlon

b. *Community Property*. "Community property is like cancer. It will infect all of the separate property if the spouses are not careful." --Hal Moorman

c. *Reality Check*. Dialogue from a Cosby show—Theodore: "We're rich." Cosby: "No son. Mom and I are rich. You're broke." --Jason Ornduff

d. *Premarital Agreements*. A client told Jeanne Newlon: "I'm going to Jamaica. It will either be a bachelor party or a "Newly Single Party" depending on whether my fiancée signs the prenup." (Jeanne says it was a "Newly Single Party.")

e. *Profitable Practice Paradox*. "Don't represent the crazy people or the poor people—but how many rich people are there who are not crazy?" --Hal Moorman and Jason Ornduff

f. *Technology and Changing Times*. "In 2004, Facebook didn't exist; Twitter was a sound; the cloud was in the sky; 4G was a parking space; LinkedIn was a prison; applications were what you sent to college; and Skype for most people was typo." --Thomas Friedman, as quoted by Bob Kirkland

g. *Passwords*. "Treat passwords like your toothbrush. Change them every 6 months and don't let anyone else have them." --Bob Kirkland.

h. *Friendly Divorce Lawyers.* Dennis Belcher's words of wisdom: (1) Put the client's interest first. (2) Watch out for your own interest. Spouses as clients may be friendly today, but if they later go through a divorce, "the divorce lawyer will not be your friend."

i. *Remarriage in Later Years of Life.* Dennis Belcher asked his mom if she would remarry after his father died. She said no. When asked why she said "at my age, a new spouse is just looking for one of two things—a nurse or a purse. I don't want to be either." --Dennis Belcher

j. *That's Why They're Rich*. Dennis Belcher observes that rich people may view their spouse's gift and GST exemptions as assets (worth up to 40% of the $5 million exemption). Dennis Belcher reports that he has seen clients in divorce actions negotiate to pay the spouse 30% of the spouse's gift and GST exemption amount to be able to use it prior to the divorce. "The rich view that as an asset. The rich are different. We don't think like that. That's why the rich are rich—they don't think like I do." --Dennis Belcher

k. *Marriage Benefits*. "There are over 1,000 advantages at the federal level of being married. Those of us who have been married know there are some disadvantages of being married as well." –Josh Rubenstein

l. *Motivating Clients*. "Motivating clients to do estate planning is difficult. It is like a root canal. 'I know I need to do it, but it will be painful and I don't want to do it.'" --Josh Rubenstein

m. *Younger Partner*. Unmarried committed couples may have GST concerns. The age brackets apply, and the GST tax will apply to transfers if one partner is 37½ years younger than the other. "Besides being the envy of all his friends at the country club, transfers will be treated the same as making gifts to a grandchild." --Josh Rubenstein

n. *Professions*. In Mrs. Wilson's third grade class, each student described what his parent did for a living and spelled the profession.

Mary: My mom's a banker, B-A-N-K-E-R. If she were her today she'd give you a dollar.

John: My dad's a baker, B-A-K-E-R. If he were here today he'd give you a cookie.

Dan: My mom's a neurologist. N-U-R …   N-E-R … After trying several times to spell it, Mrs. Wilson put her arm around Dan and said she would come back to him at the end of class and he would get it right.

Ann: My dad's a bookie, B-O-O-K-I-E. If my dad were here today, he'd give you 8 to 5 that Dan will not be able to spell neurologist."   --John Mazziotta, M.D. (Chair of Neurology at UCLA)

o. *"Half Plus Seven" Rule*. A rule of thumb suggested by some for when the difference in age of spouses is "inappropriate" is the "half plus seven" rule—a rule applied by children of a parent who has remarried. For example, if dad is age 60, half of 60 plus 7 is 37. If dad marries a 40 year old that is acceptable but marrying a 35 year old is not.   --Josh Rubenstein

p. *Divorce Expert*. "I should have been a panelist in the last session about divorce. I'm a relative expert about that topic."   --John Mazziotta, M.D.

q. *Humor and Young Children*. "Paradox is perceived as humor by adults, and is a key to entertainment and humor. Before age 4, children just get frustrated by paradox—they don't laugh."   --John Mazziotta, M.D.

r. *Life Insurance Policy Illustrations*. "A famous quote about policy illustrations is paraphrased as follows: these are financial illustrations of what might happen if certain disclosed undisclosed assumptions proved to be true most of which will not. For any other financial instrument, could someone legally show you what it would be worth 80 years from now, and if they did would you believe them?

A life insurance policy illustration says 'here's what the policy will be worth when the insured is 125—believe or don't.' I think the answer is—don't." --Larry Brody

Appendix A

NUGGETS OF WISDOM FROM PARENTS TO CHILDREN

John Warnick (Denver) addressed drafting methods to clearly express the testator's values and wishes at the ACTEC 2007 Annual Meeting. The following Guidelines (from Warnick & Holmes Roberts & Owen LLP, *The Power of Integrating Our Client's Values into Wealth Transfer and Business Succession Documents*, quoted with permission) read as a wonderful intimate dialogue between parent and child. These Guidelines appeared in an actual trust agreement; they could also be the basis of a heartfelt letter from parents to children to pass on deeply felt family and financial values. DON'T MISS THIS!! THIS IS WONDERFUL—THESE ARE REAL PEARLS OF WISDOM (*except for Item 19!; how could anybody possibly think that??*).

"Specific Guidelines for the Trustees and Beneficiary: I feel it would be valuable to share with the beneficiary as well as the Trustees some principles and core values which have assisted our family in achieving a level of financial success that affords us many opportunities.

Since the assets which have been or will be contributed to this trust have either come directly from my parents or from investments or investment opportunities with which they have had some significant connection, it is also appropriate to achieve to summarize the values which have guided our family in the successes we have achieved. Here are the nuggets of wisdom, which I have mined from my own life experiences and from my parents and which I hope will provide positive direction and encouragement to the beneficiary as she faces the theory of challenges that lie ahead of her:

1. Money you have earned is much more satisfying than money you have been given, but you should not feel guilty about the money you inherit or are given by your family. Remember the pleasure it gives us to provide you with certain things. Your obligation is to use it wisely and honorably, and not squander it. My intent is to give you a "leg up" in your pursuits, not to eliminate your obligation to become a productive and self-sufficient person. View the distributions you receive as a "hand up" rather than a handout.
2. Make certain that you can always take care of yourself. Do not depend on someone else to support you. Even if you choose not to work, you should have a set of skills that will enable you to support yourself and your dependents should circumstances make it necessary.
3. Be honest in your business and personal life.
4. Don't borrow money if you can possibly avoid it. If you must borrow money, make repaying the loan your first priority.
5. Using a credit card is the dumbest form of borrowing money. Pay off your entire balance every month.
6. If you cannot afford to pay cash for a luxury item (vacation, fancy car, jewelry), you cannot afford it. Borrowing money for an item you cannot afford is stupid.

7. Wealth is about relationships and friends. It is not about dollars and cents.
8. Don't ever try to control anyone with money.
9. Don't risk what you can't afford to lose.
10. Take some risks, if you can't afford to lose your investment. Gamble on someone or something you believe in. If your gamble does not pay off, walk away with what you have learned.
11. Don't try to squeeze the last dollar out of a deal. When you make a deal, neither you nor the person you're dealing with should feel "shafted."
12. Be generous, but do not give money away because you feel guilty about what you have or to garner to kudos.
13. In making a charitable contribution, consider doing it anonymously. If you can get a tax benefit from a charitable contribution, that is good, but it should not be the primary motivation for your alms. Also, don't be content to merely be a charitable check-writer. Don't expect or seek to be at the head table or on the Board of Directors of the high-profile charities in your community. You will get much more than a tax deduction and a name in the program when you roll up your sleeves and serve people rather than burn your time in committee meetings.
14. Our Uncle John is perhaps the finest example I've seen as someone who moves quietly, without any regard for recognition or appreciation, to assist the poorest of poor. He won't talk about it, but he could have been appointed to the U.S. Senate. It would have forced him to give up his privacy as well as the opportunities to teach and to organize like-minded and compassionate people at a grass-roots level. He chose to work in the trenches rather than walk the halls of Congress. There is nothing wrong with public service, and if you feel drawn to that pursue it. But never forget our roots, and our family's tradition of working hard, but sharing generously and quietly.
15. When making investments, keep it simple. Unless you become a professional in that field, you should avoid the complicated investment vehicles. You can make money with your money with a few simple principles. Do not get greedy and do not believe you can predict markets – if it was that easy, everyone would be rich. Use common sense to adopt a logical long-term investment philosophy and stick to it, making changes as appropriate as circumstances change (e.g., your age, your need for income, market forces, etc.).
16. Don't underestimate the value of objective, professional advice in any phase of life, including investments and financial planning. You know how important my professional relationship and friendship with our family's CPA has been. I would never dream of making a major move without Pyles' advice.
17. If you choose a job in a field you love, you won't work a day the rest of your life. So be sure you find a career that you like – maybe even love. Do not be afraid to change your position if you find yourself dissatisfied. Do a great job at whatever you decide to do – be it waiting tables or brain surgery.
18. Make sure you can always look yourself in the eye. If you do something in your life of which you are ashamed or embarrassed, do not hide – make it right, apologize, make

amends. Get up every morning and look in the mirror and see a happy person, without having to avert your eyes, and then set about doing the things you are passionate about.

19. Father always told me never to trust anyone from Dallas or Salt Lake City. He was right!!!!

20. Follow your dreams. I do not expect you to follow my dreams – either by entering the drilling business or by living in New Mexico. I do expect you to find a life that is as satisfying to you as mine has been to me."