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# Estate Planning: Current Developments and Hot Topics (Including Highlights from ACTEC 2012 Summer Meeting)

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# ACTEC 2012 Summer Meeting: Counseling Family Businesses and Business Families

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- Panels addressing (1) Toughest issues, (2) Ethics, (3) Communication
- Summary of issues arising in life cycle of family business (organized in “Days 1-7”)
  - Day 1: Beginning of the family business
  - Day 2: Expansion of the family business (new locations/services; key employees)
  - Day 3: Transition toward founder’s retirement
  - Day 4: Transition of leadership to next generation (daughter successful in family business, son not successful but wants to lead the business)
  - Day 5: Founder’s death
  - Day 6: Blow-up in the founder’s family
  - Day 7: Sale of the family business

# Counseling Family Businesses and Business Families

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- Example of judgment calls: Attorney becoming embroiled in family conflict situation – Opportunity vs. Tipping Point (p. 20-21)
- Another example: Sale of business (p. 24-26)
  - Can be a long process
  - Employee retention
  - Investment banker involvement?
  - Sales process
  - Periodically get founder's advice about sale
  - Caution about retaining real estate

# Counseling Family Businesses and Business Families — Communication, Key Lessons Learned

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- **Communication is key.** “Research shows that succession failures occur because of a breakdown in communication between generations. Finances matter and business matters, but communication is key.” (p. 17)
- **Structure.** Family Council and Family Assembly (p. 15-16). These structures provide a forum and rules for decision making. “Family conflict typically is not about personalities. It is about a lack of structure and preparation for change.”
- **Values.** “Values are discussed, infused, and perpetuated by families being able to get together and talk through the Family Council.”
- **Ten Years.** “Generational transitions are perilous – plan for a 10-year window.”
- Forced communication will not work.

# Counseling Family Businesses and Business Families — Gems of Wisdom

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Various gems of wisdom are on pgs. 65-68.

- Fundamental principles
- 35% vs. 55%
- Too smart too soon
- Fairness
- What comes around...
- Bloodsucker and parasites
- Timing and risk
- Whose problem?
- Tradition
- Who will feed the elephant?
- Listening and anatomy
- Lawyer's keenest eye

# Counseling Family Businesses and Business Families — Gems of Wisdom (continued)

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- Two straws, one soda
- Five-year rule
- Heir-conditioning
- Pilot/owner analogy
- Teleconference from “toughest issues” panel: American Law Institute and ACTEC, September 11, 2012 (Dennis Belcher, Ann Burns, Lou Mezzullo)

## ACTEC 2012 Summer Meeting: Other Panels

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- Recent cases addressing Uniform Trust Code
- Nonjudicial methods of modifying irrevocable trusts
- Trust situs and governing law



# Legislative Uncertainty

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- Tax Policy Center, July 2012:
  - If \$1 million exemption: 115,000 706s, 52,500 pay tax of \$40.5 billion
  - If \$5 million exemption: 10,000 706s, 4,000 pay tax of \$13.5 billion
- Possibilities: Do nothing in December, Repeal, Obama administration approach (\$3.5 million/\$1 million exemptions and 45% rate); Continue 2012 system; S. 3393 (Middle Class Tax Cut Act introduced 7/17/12 by Sen. Reid) provides \$3.5 million estate and gift exemption for one year with a 45% top bracket (the transfer tax provisions were subsequently removed)
- When will Congress act? December? April? Later?
- Portability will likely be made permanent

## Legislative Uncertainty (continued)

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- Sensible Estate Tax Act of 2011
  - Clawback fix
  - “Example 3” fix (no privity requirement for portability)
  - Consistency of basis (value “as finally determined”)
  - Generation-skipping exemption limited to 90 years

# Administration's Fiscal Year 2013 Revenue Proposals

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- New bombshell: Grantor trusts would be included in gross estate
  - Effective for grantor trusts created after or to the extent of funding after date of enactment
  - There could still be sale transactions with “grandfathered” grantor trusts without risking estate inclusion
  - Transition relief for “automatic periodic contributions to grantor trusts” is merely a transition rule
  - The IRS is serious about this

# Planning Approaches to Utilize Increased \$5 Million Gift Exemption

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- Cushion effect of \$5.12 million gift exemption is huge
- Clawback issue if given \$5 million and estate tax exclusion later reduced below \$5 million
  - Most believe the “clawback” will not occur (and was not intended)
  - Even if it does, not additional tax (but may be a concern with *who* pays the tax)
  - 2011 Form 706 instructions would apply clawback; but the IRS was not contemplating an estate tax exemption lower than prior gift exemptions
  - Legislation will likely fix this so there is no clawback
    - Sensible Estate Tax Act of 2011 approach (elegantly simple)
    - S. 3393 (an initial version of “Middle Class Tax Cut Act”) approach is more complicated

# Planning Approaches to Utilize Increased \$5 Million Gift Exemption (continued)

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- Basis — loss of basis step-up is more important as the capital gains tax rate and estate tax rate get closer (p. 11)
- Example: Gift of \$1 million zero-basis asset
  - Asset must appreciate 75% for estate tax savings on appreciation removed from gross estate to equal capital gains tax if asset is sold soon after death
- Document discussion of basis issue with clients making large gifts

# Planning Approaches to Utilize Increased \$5 Million Gift Exemption (continued)

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- “Rainy day” concerns
  - Donor borrow from trust if liquidity crunch (p. 12)
  - Lifetime credit shelter trust for donor’s spouse (p. 13-17)
    - Ideal arrangement: Spouse can be discretionary beneficiary, trustee and have limited power of appointment
    - Asset protection for both spouses
    - Could include testamentary power for spouse to appoint back to donor
    - Could require consent of non-adverse third party to exercise
    - 2036?
    - Likely a grantor trust under §677
  - Lifetime credit shelter trusts for each other (but not reciprocal)? (p. 18-20)

# Planning Approaches to Utilize Increased \$5 Million Gift Exemption (continued)

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- Discretionary trust in self-settled trust state (p. 20-22)
  - PLR 2009 44 002, but IRS is no longer issuing these rulings
  - Perhaps safest in Alaska or Nevada, but inherent uncertainty re-implied agreement under §2036
- Sales vs. gifts (sales achieve almost all gift advantages and leave stream of note payments) (p. 22)

# Portability — Temporary and Proposed Regulations

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- Effective date: Decedents dying on or after 1/1/2011. Regulations expire in 3 years if not finalized. (p. 31)
- Overview: Incredibly creative construction — but achieves laudable taxpayer-favorable results for implementation of portability
- Making election. Election made by executor filing timely and complete Form 706, but if return not otherwise required, no need to list values of assets passing to spouse or charity in most cases. Still must estimate FMV of gross estate. (p. 32-34)
- Many of major favorable positions evolve around the regulation's construction of the meaning of "DSUE amount"
- DSUE amount, defined in §2010(c)(4), was (we thought): Lesser of (1) basic exclusion amount or (2) [last deceased spouse's basic exclusion amount] *minus* [taxable estate plus adjusted taxable gifts]



## Portability (continued)

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- Overview of regulation’s definition of “DSUE amount” (the italicized words have been added or changed in the regulations as compared to the statute) (p. 35)
  - “... The DSUE amount of a decedent with a surviving spouse is the lesser of the following amounts –
    - (i) The basic exclusion amount *in effect in the year of the death of the decedent*;or
    - (ii) The excess of –
      - (A) The decedent’s *applicable exclusion amount*; over
      - (B) The sum of the amount of the taxable estate and the amount of the adjusted taxable gifts of the decedent [*reduced by the amount, if any, on which gift taxes were paid for the calendar year of the gift(s)*], which together is the amount on which the tentative tax on the decedent’s estate is determined under §2001(b)(1).”
- Temp. Reg. §20.2010-2T(c)(1) [bracketed phrase added by §20.2010-2T(c)(2) ].
- In addition, the DSUE amount is increased by
  - “*[t]he DSUE amount of each other deceased spouse of the surviving spouse, to the extent that such amount was applied to one or more taxable gifts of the surviving spouse.*”
- Temp. Reg. §20.2010-3T(b), 25.2505-2T(c).

## Portability (continued)

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- Basic exclusion amount limitation in §2010(c)(4)(A) refers to basic exclusion amount at predeceasing spouse's death (p. 35)
- Adoption of “Example 3 Approach” by construing “basic exclusion amount” in §2010(c)(4)(B) to mean “applicable exclusion amount” (p. 37)
- Omit adjusted taxable gifts on which gift taxes were previously paid (p. 38)
- DSUE amount can be used any time after first decedent's death (as long as Form 706 is eventually filed making the portability election) (p. 39)
- Ordering rule — first apply DSUE amount to taxable gifts by surviving spouse before using spouse's own exclusion amount (p. 40)
- Utilizing DSUE amount from multiple deceased spouses is permitted (p. 41). There is no gift tax on transfers covered by multiple DSUE amounts and no estate tax “clawback” if the taxable estate plus adjusted taxable gifts exceeds the estate exclusion. (Ex: No clawback if \$20 million of gifts, or make gifts and remarry and last deceased spouse has less unused exclusion)

## Portability (continued)

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- QDOT: If the decedent leaves assets to a QDOT, spouse cannot use DSUE amount until surviving spouse's subsequent death or until QDOT has been totally distributed.  
(p. 42)

# Estate Planning for Large Estates

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- Outstanding panel discussion at 2012 Heckerling Institute by Ann Burns, John Bergner, and David Handler (p. 49-63)
- This summary is an excellent overview of wide variety of estate planning strategies in developing an overall estate planning approach for a particular client situation. There is an excellent discussion of judgment calls in deciding which strategies are appropriate.

# Qualified Plan and IRA Minimum Required Distributions — Proposal for 5-Year Payout Requirement

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- Amendment to S. 1813 (2012 transportation bill) approved by Senate Finance Committee on Feb. 7, 2012 (p. 63)
- Funding provision (estimated to raise \$4.68 billion) requires that inherited qualified plans and IRAs generally must be distributed within 5 years. (Exceptions include plans payable to a surviving spouse, minor beneficiaries, and disabled beneficiaries).
- Dropped the next day, but this will be considered again
- Senator Kyl (R-Az): “an issue that both parties recognize”
- Senator Baucus (D-Mt) believes the purpose of retirement plans is not to allow wealth to accumulate generation to generation.
- This could be bargaining chip in ultimate agreement regarding transfer taxes.

## FLP and LLC §2036 Issues

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- Three government victories in 2011: *Jorgensen, Turner* and *Liljestrand* (p. 67-70)
- Two taxpayer victories in 2012: *Stone, Kelly*
- “Marital Deduction Mismatch:” *Turner II* (p. 78-89)
  - IRS agent did not make mismatch argument regarding the 28% LP interest retained by decedent
  - Court’s reasoning regarding lack of marital deduction of LP interest previously given to children might be interpreted as supporting IRS position for LP interests owned by the decedent’s death at death:

“Allowing a marital deduction for the transferred partnership interest *or the assets* would allow them to leave the marital unit without a transfer tax either at the death of the first spouse or upon the transfer by gift or at the death of the second spouse.” (p. 87)
- §2036 Exception: Listing of nontax reasons recognized by courts (p. 89)

# FLP Interest Gifts: Qualification for Annual Exclusion

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- *Wimmer* allowed annual exclusion (p. 93-100)
- *Hackl, Price, and Fischer* refused to allow annual exclusion (p. 100-107)
- Test: “substantial present economic benefit by reason of use, possession, or enjoyment (1) of property or (2) income from the property.”
- *Wimmer* concluded:
  - No right to present enjoyment of “property” (i.e., the LP interest) because of significant transfer restrictions
  - Present enjoyment of income from the property requires:
    - (1) Partnership expected to generate income
    - (2) Some portion of income flows steadily to donees
    - (3) That portion of income can readily be ascertained
  - Full annual exclusion allowed even though in first two years only “tax distributions” were made — not all partnership net income

# Defined Value Clause Structuring In Light of *Wandry*

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- Simple formula transfer clause: “I give that number of LLC Units equal to \$5.0 million”
- But *Procter* (4<sup>th</sup> Cir. 1944): “excess property that is decreed by the court to be subject to gift tax shall automatically be deemed not to be included in the conveyance and shall remain the property of the donor.” (p. 113)
- To avoid “taking back” argument, planners have used **formula allocation clauses**. All of a block of property is conveyed and a formula describes how much passes to a trust for the family and how much passes to charity. Nothing remains with donor. Four cases have approved that type of clause (*McCord, Christiansen, Petter, and Hendrix*) (p. 117)



## Planning in Light of *Wandry* (continued)

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- *Wandry*: “I hereby assign and transfer as gifts ... a sufficient number of my Units in [the family LLC] so that the fair market value of such Units for federal gift tax purposes shall be as follows [a list describes dollar amounts for various donees totaling \$1.0 million plus annual exclusions]” (p. 110)
  - Court did not view this as taking property back but transferring a “fixed set of rights with uncertain value.”
  - Court relied on reasoning of 9<sup>th</sup> Circuit in *Petter* (p. 113-114)
  - Summary re: “Taking Back” (p. 114):

“It is inconsequential that the adjustment clause reallocates membership units among petitioners and the donees rather than a charitable organization because the reallocations do not alter the transfers. On January 1, 2004, each donee was entitled to a predefined ... percentage interest expressed through a formula. The gift documents do not allow for petitioners to ‘take property back.’ Rather, the gift documents correct the allocation of ... membership units among petitioners and the donees because the K&W report understated [the LLC’s] value. The clauses at issue are valid formula clauses.”

## Planning in Light of *Wandry* (continued)

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- Public Policy: (p. 114-115)
  - Public policy exceptions are recognized for tax purposes only for “severe and immediate” public policy concerns. *Commissioner v. Tellier*, 383 U.S. 687, 694 (1966).
  - IRS role is to enforce the tax laws, not just maximize tax receipts
  - There are other mechanism outside of IRS audits to ensure accurate valuation reporting. (This rationale seems weak in this context.)
  - Charity involvement not critical to satisfying public policy concern (p. 115):

“In *Estate of Petter* we cited Congress’ overall policy of encouraging gifts to charitable organizations. This factor contributed to our conclusion, but it was not determinative. The lack of charitable component in the cases at hand does not result in a ‘severe and immediate’ public policy concern.”

## Planning in Light of *Wandry* (continued)

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- Should Planners Use Simple *Wandry*-Clauses Rather Than Allocation Clauses Involving Charity?
  - Just a Tax Court Memo case (Judge Haines)
  - Important changes since *Procter* (formulas sanctioned in various regulations, *Tellier* limiting public policy exceptions)
  - If appealed, appeal would lie with 10<sup>th</sup> Circuit
  - 10<sup>th</sup> Circuit approved *King v. U.S.* (1976) (formula adjustment of purchase price if IRS determined fair market value was different than sale price)
  - More conservative approach is to use allocation clause involving charity (4 cases approving)
  - If client not willing to do that, consider using simple *Wandry*-type clause

# Using Testamentary Power of Appointment to Avoid Completed Gift — ILM 201208026

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- **Facts:** Donors made gifts to trust providing that trustee could make distributions to various individuals for any purposes. The trust lasted for the donors' lives. The donors retained testamentary limited powers of appointment.
- Incomplete gift?
  - The retained testamentary power of appointment caused the *remainder* interest to be an incomplete gift because the donors could shift benefits.
  - The gift of the term interest was complete because the donors kept no ability to shift who would receive benefits during the term of the trust.
  - While the remainder interest was incomplete, it was valued at zero under §2702 because it was not a “qualified interest,” so the full value transferred to the trust was a completed gift.
- **Conclusion:** Be wary of relying on retained testamentary limited power of appointment to cause incomplete gift treatment if the donor does not retain a veto power over distributions to beneficiaries during the trust term.

# Website for Trust & Estate Attorneys

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### FEATURED VIEWPOINT

July 13, 2012

## ACTEC 2012 Summer Meeting Musings

Seminars at the ACTEC 2012 Summer Meeting are summarized. A special extended seminar about counseling family businesses and business families is summarized. Other seminars addressed various issues regarding trusts, including (1) recent cases under the Uniform Trust Code, (2) modifying trusts without going to court, and (3) situs and governing law issues....

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### OTHER INSIGHTS

#### Tax Update: The Supreme Court, Healthcare, and Taxmageddon

July 2012

With the Supreme Court's upholding of healthcare reform in June and the expiration of the Bush-era tax cuts at year-end, higher-income taxpayers can expect a decidedly harsher tax environment in 2013. In this Tax Update, we discuss how clients can begin to prepare for this convergence of tax increases, or "Taxmageddon."

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### UPCOMING EVENTS

#### Estate Planning Update

August 13, 2012

Steve R. Akers, Fiduciary Counsel – Southwest Region, will discuss current estate planning developments, including observations from the ACTEC Summer Meeting.

[> WATCH THE WEBCAST](#)

### EVENT RECAP

#### Investment Management Conference Call & Webcast Replay: Looking Ahead

July 18, 2012

Bessemer Trust hosted a conference call and webcast featuring Rebecca H. Patterson, chief investment officer, and Peter J. Langas, head of investment strategies

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