ACTEC 2011 Annual Meeting Musings

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(A number of other summaries prepared by Steve Akers and other resource information for professional advisors is available at www.bessemer.com/advisor.)

Items 31-34 are observations from a symposium by Dennis Belcher, Prof. Jeff Pennell, Susan Snyder, and Bruce Stone: Report of the Estate Planning in the 21st Century Task Force. The symposium summarizes the result of a survey of ACTEC Fellows about practice issues and implications of various societal and tax law changes on estate planning for clients.

Items 35-45 are observations from a symposium by Dr. Susan Shapiro and Dr. Linda Emanuel, moderated by Kathy Sherby: The Role of the Living Will, Advanced Medical Directive and Health Care Surrogates. The symposium focuses on the real life effects of these documents and what planners can do to guide clients in giving helpful information to their health care decision makers.

Items 46-55 are observations from a seminar by Peter R. Afrasiabi and Alan S. Watenmaker: Why Superman and Copyright Matter to You. The seminar provides an overview of copyright fundamentals that estate planners need to know — including the importance of the automatic reversion rights the copyright owners or their family members may have if the rights have previously been transferred.

Items 56-61 are observations from a seminar by Bob Kirkland, Anita Siegel and Harry Wolff, Jr.: They Don't Call Me Counselor For Nothing — Adding Value Your Product and Strengthening Your Client Relationships. The seminar addresses a variety of topics including: planning family meetings; long-term care insurance; ethical wills; letters of wishes for executors, trustees and guardians; disposition of remains and funeral planning; and interfacing with charitable donees.

Items 62-70 are observations from a seminar by James M. Maddox, William L. Harbison, and Margaret G. Lodise: Dealing with the Overlapping Roles of Individual Fiduciary, Business Manager and Beneficiary (What do you do when big sister says to little brother: "That is why Daddy named me President AND Sole Trustee!"). The seminar focuses on dealing with family conflicts in business succession planning situations.

Items 71-77 are observations from a seminar by Louis A. Mezzullo and Milford B. Hatcher, Jr.: 2701, a Trap for the Unwary. The seminar provides an overview discussion of section 2701 and focuses particularly on ways that multi-class partnership interests can be used.

Items 78-80 are observations from a seminar by Lauren Y. Detzel, Laird A. Lile, and Glen A. Yale: Something Old, Something New, Tax Forms and More, What's in it for You? The seminar addresses a variety of issues regarding estate, gift, and GST tax returns. Discussions from the seminar about planning issues under the Tax Relief... Act of 2010 are included in discussions of the topic above in Items 2 and 3.

Items 81-88 are observations from a seminar by Michelle Graham, Marilyn Piccini Roy, PhD, and Jean-Marc Tirard: How to Hold the Title to that Ski Chalet in Switzerland and that Bank Account in France: Nuts and bolts Issues in International Estate Planning. The seminar focuses on cross border estate planning issues with France, Canada, Mexico, and the UK.

Items 89-102 are observations from a seminar by Michele A.W. McKinnon, Prof. Anne-Marie Rhodes, and Jeffrey C. Thede: Family Foundation Case Studies. The seminar provides an overview of family foundations and addresses ways of achieving goals, creation and administration of the foundation, and termination issue.

Items 103-112 are observations from a seminar by Turney P. Berry, Jonathan G. Blattmachr, and Prof. Ray D. Madoff: Immortality and the Law. The seminar addresses the wisdom of the trend in the various states toward repealing or greatly extending the Rule Against Perpetuities.

Item 113 consists of interesting quotations from throughout the seminars.

Introduction

Some of my observations from the 2011 ACTEC Annual Meeting Seminars in Phoenix, Arizona on March 10-13, 2011 are summarized below. (At the request of ACTEC, the summary does not include any discussions at Committee meetings at the ACTEC Annual Meeting. The summary generally also does not include issues that I have discussed in prior "Musings.") I do not take credit for the many interesting ideas discussed below. I attribute all the good ideas to the many speakers at the seminars. I have not researched the various issues to confirm the correctness of or to endorse all of the ideas presented by the various speakers. I often have not identified individual speakers who made each of the comments (primarily in case I have misinterpreted any of their comments).

Items 1-17 come from the Hot Topics seminar by Sam Donaldson, Carlyn McCaffrey, and Steve Akers (as well as comments by various individuals at other seminars on the topics addressed below). The Program Committee asked the panel to focus on planning issues in light of the Tax Relief... Act of 2010 as well as other hot topics.

1. General Overview of Estate Planning Implications of Tax Relief... Act of 2011.

This summary does not contain a general overview of the Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010. A separate outline entitled *Estate Planning Effects and Strategies Under the "Tax Relief... Act of 2010"* discusses the Act in detail. An outline entitled *Heckerling Musings 2011* discusses planning ideas from a number of speakers at the 2011 University of Miami Heckerling Institute in light of the Act. Both of these outlines are available at www.bessemer.com/advisor, and the discussion in those outlines is not repeated here. Highlights of a few of the planning ideas and some creative suggestions and recent developments are summarized below.

2. Carryover Basis Election and Reporting Issues

a. *Estate Tax Regime Is Default System.* The default rule is that the estate tax applies to estates of decedents dying in 2010. An election is available for estates that prefer not to be subject to estate tax but to be subject to carryover basis instead. By far, most of the decedents dying in 2010 had estates well under $5 million and have no estate tax concerns in any event. Those estates do not have to file anything in order to be able to take advantage of the pre-2010 traditional basis step-up rules.

b. *Procedures for Making Carryover Basis Election to Avoid Estate Tax Regime.* Section 301(c) says the election is to be made "at such time and in such manner" as prescribed by the Secretary of the Treasury or his delegate (interestingly, not requiring regulations). An IRS Release on February 16, 2011, available at http://www.irs.gov/pub/irs-pdf/f8939.pdf, gave the first official preliminary guidance regarding procedures and filing dates for the Form 8939. An announcement on March 2, 2011, available at http://www.irs.gov/formspubs/article/0,,id=236791,00.html, described similar information regarding Publication 4895. These Releases give the following guidance:

- The IRS will issue, in order, (1) Form 8939, and shortly thereafter (2) instructions for Form 8939, followed by (3) Publication 4895, Treatment of Property Acquired From a Decedent Dying in 2010.
- The final Form 8939 will be posted at least 90 days before it is required to be filed.
- The Form 8939 *should not* be filed with the decedent's final income tax return (emphasis in original). (OBSERVATION: This is despite the literal wording of § 6075(a) providing that "[t]he return required by section 6018 with respect to a

decedent shall be filed *with* the return of tax imposed by chapter 1 for the decedent's last taxable year" [(i.e., the decedent's final income tax return] (emphasis added).

- The carryover basis election under § 301(c) of TRA 2010 *should not* be made on the decedent's final income tax return (emphasis in original).
- Instructions on how to make the carryover basis elections under § 301(c) will be described on the Form 8939, in the instructions to Form 8939, and in Publication 4895. The March 2, 2011 Release says that "[t]he election is made by filing Form 8939."
- The March 2, 2011 Release says that Publication 4895 is only relevant for estates that file the Form 8939.
- The latest information on these issues can be found at www.irs.gov/form8939.

A summary of a conversation between Robert Chapman, of the IRS Tax Forms & Publications Desk, and Carol Cantrell on February 3, 2011 (in response to comments filed by the American Bar Association Tax and Real Property, Trust and Estates Law Sections on January 31, 2011) was published by Leimberg Information Services on Feb 8, 2011. Mr. Chapman's comments included the following:

- The Form 8939, Instructions to the Form 8939 and the Publication 4895 are expected to be released by May 2011.
- The IRS will issue guidance regarding whether appraisals are required and whether group and de minimis rules will be allowed.
- There is no place to report the surviving spouse's one-half of community property on the Form 8939 and the IRS will give guidance; he was asked to clarify that the surviving spouse's one-half would be eligible for the step-up and as well as a step-down in basis and he hinted that it is, by noting that the question of whether both halves of community property is adjusted is the same for both § 1014 and § 1022.
- The estate would be shown as the recipient of property not yet transferred by the time the Form 8939 is filed.
- An amendment would not be required to report subsequent transfers or distributions by the estate.
- Property that is sold by the estate cannot qualify for the $3.0 million spousal basis adjustment, even if the sale proceeds are distributed to the surviving spouse.
- The IRS may add Schedule R from Form 706 (for reporting generation-skipping transfers and exemption allocations) to the Form 8939 so that executors who need to report generation-skipping transfers or exemption allocations will not have to file both the Form 8939 and Form 706.
- The IRS prefers to make the mere act of filing the Form 8939 as the affirmative election under § 301(c) of the Tax Relief... Act of 2010 out of the estate tax regime and into carryover basis, rather than providing a box to check. He agrees that the Form 8939 should contain a statement to the effect that filing the form constitutes the election.
- The IRS is likely disinclined to allow a "protective election" out of the estate tax regime in the event an IRS audit adjustment makes the election more advantageous.

On March 1, 2011, the IRS filed another request for comments regarding the Form 8939, stating that comments should be received by May 6, 2011 to be assured of consideration (suggesting that the Form 8939 will not be released before that date).

c. *Process for Determining Whether to Make Carryover Basis Election.* For many estates, the decision will be easy whether to be subject to the estate tax or carryover basis (if the taxable estate is either well under $5 million or well over $5 million). However, the executor should carefully document and retain the analysis of the rationale for what ever decision is made regarding the carryover basis election. Consideration of the detailed tax effects of carryover basis is particularly sensitive for real estate or other depreciable property, especially if the property has a "negative basis" due to refinancing or other reasons.

d. *Who Makes Carryover Basis Election?* The IRS has indicated informally that it will give guidance regarding who makes the election if multiple persons are in possession of property where there is no court appointed executor.

e. *No Spousal Basis Adjustment for Assets Sold During Administration.* The IRS indicates that the $3 million spousal basis adjustment cannot be allocated to any assets sold during this administration, because they do not pass to the surviving spouse. If the IRS does not change that position, there will be a lot of "constructive receipts" by spouses before sales took place.

f. *Attach or Keep Documentation Basis and Values Listed on Form 8939.* There is no statute of limitations as to values described on the Form 8939. Attach documentation or at least keep documentation of basis and values listed on the form.

g. *Extended Time for Filing Estate Tax Return.* The act extends the time for filing estate tax returns of decedents dying before the date of enactment to nine months after that date (i.e., to September 19, 2011). Is a further extension available beyond that? We are not sure. The estate of the decedent who dies on December 17 can get an automatic 6-month extension beyond September 19. It would seem that automatic extension should also be available for the decedent died before December 17.

3. Portability Planning Issues

a. *Last Deceased Spouse's Unused Exclusion Amount.* To deal with the issue of accumulating multiple "deceased spousal unused exclusion amounts" (or "DESUEAs") from multiple deceased spouses, prior portability proposals have limited the spousal unused exclusion to one additional exclusion. The 2010 Act retains that limitation but also adds an additional limitation that only the last deceased spouse's unused exclusion amount is available to the surviving spouse. This additional requirement creates various complexities, and it has been criticized.

b. *Timely Filed Return Requirement.* The Act continues the position of prior portability bills that the executor of the first spouse's estate must file an estate tax return on a timely basis and make an election to permit the surviving spouse to utilize the unused exclusion amount. § 2010(c)(5)(A), as amended by TRA 2010 § 303(a). (Therefore, even small estates of married persons must consider whether to file an estate tax return for the first deceased spouse's estate.)

It is possible that the IRS will develop something like a "Form 706-EZ" if the estate is filing only for the purpose of making the portability election. In any event, it will be important for the executor to maintain documentation regarding the values and amounts of the unused exclusion amount. The IRS may examine the return of a predeceased spouse at any time for purposes of determining the DESUEA available for use by the surviving spouse. I.R.C. § 2010(c)(5)(B), as amended by TRA 2010 § 303(a).

c. *Applies for Gift Tax Purposes*. Portability applies for the gift exemption as well as the estate exemption. A surviving spouse may consider using the DESUEA with gifts as soon as possible (particularly if she remarries) so that she does not lose it if the new spouse predeceases or if the basic exclusion amount is decreased (the DESUEA is the lesser of the basic exclusion amount or the amount from the unused exclusion calculation).

The recapture/clawback issue (discussed below) can also arise in the context of gifts using the surviving spouse's DESUEA for making gifts. If the spouse later remarries and the subsequent spouse dies, with less unused exclusion, the spouse will not have as much deceased spousal unused exclusion for estate tax purposes as when the gifts were made, so the exclusion amount for estate tax purposes will be less than for gift tax purposes when the gifts were made. This issue is different than the general recapture/clawback issue discussed below because it potentially applies under current law even if Congress does not later reduce the exemption amount. Also, the statute indicates that the unused exclusion amount can be decreased if the basic exemption amount is decreased by the time of the surviving spouse's death, perhaps suggesting legislative intent to apply the recapture tax in the somewhat analogous situation of lifetime gifts exceeding the total exclusion amount available at the surviving spouse's death. *See* Evans, *Problems With Portability, Part 2*, LEIMBERG INFOR. SERVICES EST. PL. NEWSLETTER 1777 (Feb. 16, 2011). This may result in additional estate taxes being due at the donor's death. The clawback issue in this context may be resolved differently than in the context of making gifts under a larger gift exemption than the estate exemption that exists at the donor's death.

d. *Unused Exclusion Reduced By All Adjusted Taxable Gifts of Predeceased Spouse, Even If Gift Taxes Were Paid On Some of Those Gifts*. If an individual makes lifetime gifts in excess of the gift exclusion amount, the excess reduces the DESUEA for that individual's surviving spouse, even though the individual had to pay gift tax on that excess gift amount. (This is because the DESUEA is (i) the basic exclusion amount, minus (ii) the sum of the individual's taxable estate and adjusted taxable gifts. There is no distinction for adjusted taxable gifts that were subject to actual payment of gift tax.) *See* Evans, *Problems With Portability, Part 2*, LEIMBERG INFOR. SERVICES EST. PL. NEWSLETTER 1777 (Feb. 16, 2011).

e. *Not Available For Non-Resident Aliens*. If a non-resident alien ("NRA") spouse dies first survived by a citizen spouse, there is no DESUEA because the NRA is merely entitled to a unified credit of $13,000 under § 2102 and does not have a "basic exclusion amount" that could be partly unused. If the citizen spouse dies first, the surviving NRA is not entitled to an exclusion under § 2101(c)(2) that includes the DESUEA, but is merely entitled to a unified credit of $13,000 under § 2102.

f. *Priority for Treasury Guidance*. Portability is not on the Treasury priority guidance plan. However, there are informal indications that the Treasury will issue guidance on portability and that it will be a priority, right behind providing guidance for 2010 decedents' estates.

g. *Reasons for Using Trusts Even With Portability*. There are various reasons for continuing to use bypass trusts at the first spouse's death and not rely on the portability provision including, (a) there is no assurance that portability will apply after 2012, (b) the deceased spousal unused exclusion amount is not indexed, (c) the unused exclusion from a particular predeceased spouse will be lost if the surviving spouse remarries and survives his or her next spouse, (d) growth in the assets are not excluded from the gross estate of the surviving spouse unlike the growth in a bypass trust which is excluded, (e) there is no portability of the GST exemption, and (f) there are other standard benefits of trusts, including asset protection, providing management, and restricting transfers of assets by the surviving spouse. On the other hand, leaving everything to the surviving spouse and relying on portability offers the advantages of simplicity and a stepped-up basis at the surviving spouse's death.

h. *Drafting Changes in Light of Portability*. Various uncertainties will arise regarding the portability issue. Who pays the cost of filing the estate tax return for the first decedent's estate? What if there is an audit and previously unreported gifts are now taxed? Should the surviving spouse indemnify the estate of the first spouse with respect to transfer tax issues that arise by reason of filing the return? Should the executor be exonerated if it does not file a return for the first spouse's estate? Wills should cover all of those issues. Furthermore, prenuptial agreements may begin covering those issues as well.

4. Testamentary Planning Issues

a. *Increased Focus on Client's Individual Goals and Customized Drafting to Meet Those Goals in Light of Inherent Uncertainty While Leaving Flexibility to Accelerate or Defer Estate Taxes at the First Spouse's Death*. In the future, it will be imperative to focus on client goals in light of very unpredictable tax changes, rather than just tweaking the standard tax planning structure around the client's goals.

As an example, assume wife has a $15 million estate that she wants to leave one-third to her husband and two-thirds to children by prior marriage. If she leaves $10 million directly to the children, that would cost approximately $2.4 million in federal and state estate taxes, but if the children receive $5 million currently, and receive the second $5 million when the husband subsequently died, the taxes payable at her death would drop to about $400,000 (the state estate taxes [e.g., New York state taxes] on the $5 million bequest to the children).

In this situation, the will might make a formula bequest to the children equal to the lesser of the estate tax exemption amount or two-thirds of the estate, and provide that if two-thirds of the estate exceeds the estate tax exemption amount, the difference passes to a QTIPable trust that would eventually pass to the two children. The other one-third of the estate would pass directly to the surviving spouse or to a QTIP trust for the spouse.

Carlyn McCaffrey suggested ways to provide flexibility as to whether estate taxes would be paid at the first spouse's death or deferred until the surviving husband's death.

Surviving Spouse with Flexibility to Make Deferral Decision. One possibility is that the clause could give the surviving husband the right to disclaim his interest in the QTIP trust, (and provide in the trust that any disclaimed assets would pass directly to the children or to trusts for them). The surviving husband might disclaim, for example, if the transfer tax rates were expected to increase in subsequent years.

Children with Flexibility to Make Deferral Decision. Another alternative would be to leave the flexibility of whether to defer estate tax until the surviving husband's death in the hands of the children. For example, there might be a formula bequest to a trust for each of the children equal to one-half of an amount equal to the difference between two-thirds of the residuary estate and the applicable exclusion amount. The terms of each trust would give the child the right to receive income from the trust for the surviving spouse's lifetime, with remainder to a discretionary trust for the child and his or her descendants. If the child thought that deferring estate taxes would be preferable, the child could disclaim the income interest, and the trust would provide that if the income interest is disclaimed by the child, it would pass to the surviving husband in a QTIPable format. (The disclaimer of the income interest by the children should be a qualified disclaimer, because the income interest was a severable interest created in the original document.)

Independent Party with Flexibility to Make Deferral Decision. Yet another alternative is to give an independent advisor or trustee the flexibility to make the choice of whether to defer estate tax until the surviving husband's death. Under this approach, there would be a formula bequest to a trust for the benefit of the surviving husband and children that would convert into a QTIP trust just for the surviving husband if the independent party (who would be the executor) made a QTIP election (the so-called Clayton election). If the QTIP election were not made, the trust would be a discretionary trust for the benefit of the surviving husband and children, but estate taxes would be due at the wife's death. The independent advisor and the family could make that decision at the time of the wife's death, with greater knowledge of the estate tax exemption amount at the time of the wife's death, and perhaps with better knowledge of what the law might look like when the husband subsequently dies than the parties know at the time the document is drafted.

b. *Building Flexibility to Cause Basis Step Up at Surviving Spouse's Subsequent Death.* Following the first spouse's death, leave the flexibility for causing assets to be included in the surviving spouse's estate to obtain a basis step up at his or her death if there are no estate tax concerns (generally by permitting distributions to the spouse under a very broad distribution standard or by granting someone the power to cause the spouse to have a general power of appointment).

Basis Step-Up Flexibility; Broad Distribution Powers. One method of causing estate inclusion if the surviving spouse has no estate tax concerns is to give the independent trustee broad authority to make distributions to the surviving spouse, in the absolute discretion of the trustee. (Even a "best interests" standard for a particular beneficiary might limit distributions for the purpose of allowing the beneficiary to make gifts.)

Basis Step-Up Flexibility; Independent Party with Power to Grant General Power of Appointment. The trust agreement could give an independent party the power to grant a testamentary general power of appointment to the surviving spouse. It could be a power exercisable only with the consent of a non-adverse party if the settlor wishes to place some controls over the surviving spouse's unbridled ability to redirect where the assets will pass. The power could be limited to the ability to appoint the assets to the surviving spouse's creditors.

5. Strategic Uses of $5 Million Gift Exemption

a. *Advantages/Disadvantages of Gifts*. In deciding whether to take advantage of the significantly increased gift exclusion amount, bear in mind the advantages and disadvantages of gifts. Many of the tax advantages of making gifts can also be secured by less drastic transfers such as sales or GRATs (which may leave the donor feeling more comfortable that assets would be available if needed in case of severe financial reversals).

Gifts are not removed from the base for calculating estate tax, but making gifts does not result in increasing the aggregate combined transfer taxes.

Advantages. Despite the fact that gifts are included in the base for calculating the estate tax, tax advantages of making gifts include

- removal of appreciation/income of gift assets from the gross estate,
- utilizing fractionalization discounts,
- paying income taxes on income from grantor trusts to further "burn" the donor's gross estate,
- removing gift taxes paid from the gross estate if the donor lives three years, and
- the ability to allocate GST exemption so that the same advantages apply for generation-skipping purposes as well.

An obvious but important non-tax advantage is the ability to shift assets to other persons so they can enjoy, consume or otherwise use the assets currently.

Disadvantages. Gifts can be disadvantageous from an overall tax cost perspective if

- the gift asset declines in value after making the gift (which uses up gift exclusion based on the date of gift value), or
- if the loss of a basis step-up more than offsets the estate tax savings as a result of removing appreciation/income from the asset and the other advantages of gifts listed above.

b. *Current Gift Tax Effects*. A donor can make gifts of the full additional gift exemption amount without paying gift tax.

c. *Clawback Issue*. If an individual makes a gift of the $5 million gift exemption amount, and later dies after the estate tax exemption has been reduced to a lower amount, will estate tax be payable on the "excess" amount? There is no clear answer, but staffers on the Joint Committee on Taxation indicate that was not intended, and suggest that this will be clarified by future legislation.

Clients should be aware of the possibility of the additional estate tax. But clients should also realize that the combined estate/gift tax would not be greater than if no gift were made in the first place. Even if the "clawback" applies, the estate will not pay more taxes as a result of making the gift than if the gift assets had been retained (unless the gift assets were to decline in value or unless gift taxes are actually paid at higher rates than the estate tax rate). An issue that may be of concern arises if the gift was made to persons different from the residuary beneficiaries. In that case, the residuary beneficiaries may end up paying the additional estate taxes with respect to assets that have passed to the donees.

If the estate would otherwise pass to a surviving spouse or charity, the additional tax expands because the tax itself does not qualify for the marital/charitable deduction and an interrelated calculation dramatically increases the tax hit. Even in that case, while there may be estate taxes payable at the first spouse's death, those same taxes would have been payable if the gift assets had been transferred to the gift donees at the first spouse's death.

Carlyn McCaffrey points out that an approach to avoid this estate tax at the first spouse's death if clawback applies is to include provisions in the trust agreement of the trust that receives the gift (1) that give an independent party the right to grant the settlor a testamentary limited power of appointment over the trust (which would cause estate inclusion under § 2038 because § 2038 merely looks to powers existing at the date of death rather than focusing on powers that were retained at the time of a prior transfer), and (2) that cause any trust property included in the settlor's gross estate to pass to a QTIPable trust if there is a surviving spouse at the settlor's death.

d. *"Rainy Day" Concerns*. If the client has concerns that making a $5 million (or $10 million for a couple) gift could someday leave the donor in a vulnerable position in case of severe financial reversals or changed circumstances, consider having one spouse create a "lifetime credit shelter trust" for the other spouse, or having each of the spouses do the same thing but with differences to avoid being treated as reciprocal trusts. Making gifts to a trust of which the donor is a discretionary beneficiary may be possible in "self-settled trust states" although there would be the inherently factual question of whether there was an implied agreement of retained enjoyment under § 2036 in the event the donor ever needed access to the funds.

Also, sales or GRATs may achieve most of the tax advantages of gifts while leaving the donor in a more comfortable position that the retained note or annuity payments would still belong to the donor.

Carlyn McCaffrey suggests that another possible alternative is to sell assets to an "old and cold" trust for a lifetime annuity to assure that assets are available for the donor's lifetime. An "old and cold" trust should be used to build the best arguing position that the transfer is made for full consideration so that § 2036 should not apply. The trust would have to contain sufficient assets to satisfy the "exhaustion" test described in Reg. §§ 25.7520-3(b)(2)(i), 20.7520-3(b)(2)(i) and 1.7520-3(b)(2)(i), which assumes that the measuring life will live to age 110. If the trust does not have sufficient assets to cover all of the exhaustion test, it may be possible for individuals to guarantee the annuity to avoid the impact of the exhaustion test.

e. *GRATs; Planning Strategy to Minimize Valuation Risk on Distributions to Satisfy Annuity Amounts*. The $5 million gift exemption opens up the possibility of another strategy that would minimize the valuation risks in making annuity payments. For example, a client might give some of the $5 million gift exemption amount to the grantor trust that will be the remainder beneficiary of a GRAT. When the annuity payment is due, the grantor trust might loan funds to the GRAT which it could use to make the annuity payment, without having to make an in-kind distribution. There would be no gift valuation risk with respect to annuity payments that could be funded with such loan proceeds.

6. GST Issues — Sunset Rule Uncertainties

The sunset rule changes of the Tax Relief.. Act of 2010 remove many of the uncertainties about the GST tax for 2010 and make clear that the GST relief provisions in EGTRRA (increased GST exemptions, automatic allocation, qualified severances, "9100 relief" for late allocations, etc.) are still given effect after 2010. Unfortunately, the relief under TRA 2010 only lasts for two years, and all the uncertainty will arise again following 2012. However, TRA 2010 shows how the EGTRRA adverse effects can easily be solved by a legislative change, and making that change is not controversial at all. The sunset as to those favorable provisions will likely be further extended following 2012, and the various estate, gift and GST changes in EGTRRA (other than the repeal of the estate tax with carryover basis and the repeal of GST tax) also will likely be extended permanently. But with Congress, nothing can be certain; the extension assumes that Congress can agree to pass at least some legislation that deals with the estate tax — which by no means is a given, as we saw in December 2009.

Do Not Rely on Automatic Allocations. One planning pointer in light of this uncertainty is that planners should not rely on automatic GST exemption allocations under the automatic allocation provisions added in EGTRRA, but instead should file returns making affirmative exemption allocations until the sunset uncertainties of the EGTRRA provisions are resolved.

Possible Planning Consideration in Late 2012. At the end of 2012, if it appears that the sunset uncertainties of EGTRRA and of TRA 2010 will not be resolved and that there is a possibility that GST exemption allocations in excess of those that would have been allowed under pre-EGTRRA law would no longer be respected so that the inclusion ratio of the trust would no longer be zero, Carlyn McCaffrey suggests the following. Consider decanting the trust assets to a trust that only benefits grandchildren. The decanting distribution would not be subject to GST tax in that year (assuming the inclusion ratio of the trust is still zero in late 2012), and the distribution would cause the move-down rule of § 2653 to apply so that later distributions to grandchildren from the trust would not be subject to the GST tax. (This is similar to strategies that were used for non-exempt trusts in late 2010 to take advantage of the ability to make distributions from non-exempt trusts without paying GST taxes.)

7. Administration's Fiscal Year 2012 Revenue Proposals

a. *Overview*. The Treasury on February 14, 2011 released the General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals (often referred to as the "Greenbook") to provide details of the administration's budget proposals. The President's Budget Proposal for Fiscal Year 2012 includes three repeated transfer tax related items from the prior two years and two new items dealing with estate and gift taxes. In addition, the proposal modifies the "Pay-As-You-Go (PAYGO)" baseline to assume that the 2009 estate tax system will be made permanent after the expiration of the Tax Relief … Act of 2010 provisions (at an estimated revenue cost of $270.21 billion from 2012 to 2021).

The first three items below are repeats from the prior two years. The items after that are new.

b. *Require Consistency in Value for Transfer and Income Tax Purposes*. This continues the approach from prior Budget Proposals of requiring that the basis for income tax purposes be the same "as determined for estate or gift tax purposes (subject to subsequent adjustments)." The proposal does *not* adopt the approach suggested in a Joint Committee on Taxation report to require that the income tax basis be consistent with values as reported on gift or estate tax returns, even if the transfer tax values were subsequently adjusted on audit. (Estimated 10-year revenue: $2.095 billion)

c. *Modify Rules on Valuation Discounts*. This continues the proposal from prior years to revise § 2704 to add a new category of "disregarded restrictions" that would be ignored for transfer tax valuation purposes in valuing an interest in a family-controlled entity transferred to a member of the family if, after the transfer, the restriction will lapse or may be removed by the transferor and/or the transferor's family. While this same provision has been in the Budget Proposal the last two years, it has not been included in a single statutory proposal. (Estimated 10-year revenue: $18.166 billion).

d. *Require Minimum Term for GRATs*. The proposal imposes three additional requirements on GRATs: (a) a 10-year minimum term would be required for GRATs, (b) the remainder interest must have a value greater than zero, and (c) the annuity amount could not decrease in any year during the annuity term. (Estimated 10-year revenue: $2.959 billion)

e. *Make Portability Permanent*. This proposal would permanently extend the provisions in the Tax Relief… Act of 2010 regarding the portability of unused exemption between spouses. (Estimated 10-year *cost*: $3.681 billion)

f. *Limit Duration of GST Exemption*. The proposal would limit the GST exemption to 90 years after a trust is created. At least 25 states have extended their perpetuities provisions far beyond the traditional lives in being plus 21 years. This would be accomplished by increasing the inclusion ratio of any trust to one on the 90th anniversary of the creation of the trust. Contributions to a trust by separate grantors are treated as separate trusts for GST purposes. For each such separate trust, the 90-year period would be measured from the date of the first contribution by the grantor of that separate trust. If an existing trust pours over or is decanted into another trust, the 90-year period would be based on the creation date of the initial trust unless the assets pass to a single beneficiary-"vested" trust (this exception permits an incapacitated beneficiary's distribution to continue to be held in trust without incurring GST tax on distributions to the beneficiary). The proposal would apply to trusts created after the date of enactment and to the portion of preexisting trusts attributable to additions after that date. (Estimated 10-year revenue impact: Negligible)

Planning: This year is a doubly good year to create long term trusts: (1) $5 million of GST exemption is available this year (and next); and (2) Trusts created before the effective date of this legislation (if it is enacted) would not be subject to the 90-year limitation.

8. Deference to Regulations: Mayo Foundation Supreme Court Case

a. *Significance*. Regulations sometime seem suspect as to whether they are authorized by the relevant statutory provisions. (An example is the regulation providing a trust would not qualify for the § 2702 QPRT exception unless the trust instrument contained a provision prohibiting the grantor or grantor's spouse from buying the house from the QPRT or from any grantor trust that received the house at the end of the QPRT.) However, the courts have given great deference to regulations. The Supreme Court reconfirmed that deference in the recent *Mayo Foundation* case.

b. *Mayo Foundation; Supreme Court Analysis*. The Supreme Court addressed the deference issue in the *Mayo Foundation* case, issued January 11, 2011. *Mayo Foundation for Medical Education & Research v. U.S.*, 131 S. Ct. 704, 107 AFTR 2d 2011-341. In an 8-0 decision (Justice Kagan did not participate in the "consideration or decision of the case"), the Court resolved a challenge to a Treasury regulation defining the term "student" for purposes of the FICA rules. It upheld the regulation. The reasoning eliminated two possible grounds for future challenges of regulations.

Chevron As Exclusive Test; Rejection of National Muffler Factors. First, the Court appears to have adopted the doctrine of the *Chevron* case [467 U.S. 837 (1984)] as the exclusive test for determining the validity of a Treasury regulation. The *Chevron* test involves two steps. First, if there is a statutory ambiguity, did Congress address the precise question at issue? Second, if not, is the regulation arbitrary or capricious or manifestly contrary to the statute? The *Chevron* decision said that the regulation should be upheld if it is based upon any permissible construction of the Code.

The taxpayers in *Mayo* were relying on an earlier case than *Chevron*, the *National Muffler* case [440 U.S. 472 (1979)], which had suggested a much more elaborate approach in the second step. The *National Muffler* case said there would be heightened scrutiny (1) if Treasury had not been consistent over time in its interpretation of the particular regulation, (2) if the regulation was enacted years after the relevant statute was enacted, or (3) because of the way the regulation evolved, including whether the regulation had been promulgated after an adverse judicial decision (as happened in the *Gerson* case [507 F.3d 435 (6th Cir. 2007)] involving the validity of the GST effective date regulations which were revised after IRS losses in *Simpson* [183 F.3d 812 (8th Cir. 1999) and *Bachler* [281 F.3d 1078 (9th Cir. 2002)]). The Supreme Court appears to totally reject applying the *National Muffler* factors to tax regulations going forward:

> The Government... contends that the *National Muffler* standard has been superseded by *Chevron*…
>
> . . .
>
> Under *National Muffler*, for example, a court may view an agency's interpretation of a statute with heightened skepticism when it has not been consistent over time, when it was promulgated years after the relevant statute was enacted, or because of the way in which the regulation evolved…
>
> Under *Chevron*, in contrast, deference to an agency's interpretation of an ambiguous statute does not turn on such considerations…
>
> Aside from our past citation of *National Muffler,* Mayo has not advanced any justification for applying a less deferential standard of review to Treasury Department regulations than we apply to the rules of any other agency. In the absence of such justification, we are not inclined to carve out an approach to administrative review good for tax law only.

Rejection of Distinction for Interpretive vs. Legislative Regulations. In addition, the Court also eliminated the theory that regulations are entitled to less deference if they are an interpretation of statutes than if they are regulations that are promulgated pursuant to a specific direction by Congress to enact regulations. Even though interpretive regulations may be entitled to the same degree of deference, they do require something that the so-called legislative regulations do not. They require an ambiguity in the statute before the second step is applied.

c. *Application to Several Prior Estate Tax Related Cases Involving Deference.*

Cartwright [411 U.S. 546 (1973)]. This 1973 Supreme Court case, which predates *Chevron*, struck down a regulation that said the fair market value of a mutual fund share had to include the premium the buyer had to pay when investing in an open end mutual fund even though the estate could not redeem the shares for the same price. The Supreme Court invalidated the regulation because it imposes an unrealistic and unreasonable measure of value that conflicts with the basic notions of valuation. The case would likely be decided the same today.

Walton [115 T.C. 589 (2000)]. A regulation [Reg. §25.2702-3(e)(Ex. 5)] provided that the transferor could not treat as part of her retained value of property contributed to a GRAT the value of the contingent right of her estate to receive the remaining annuity payments if she died before the end of the term. The Tax Court did a *Chevron* analysis, and concluded that the regulation was invalid under *Chevron* as well as *National Muffler*. It recognized that § 2702 did not address the permissible term of a qualified annuity, then determined Congressional objectives from the legislative history, and based on an understanding of that objective the court determined that the regulation was an unreasonable interpretation of § 2702 and was invalid. *Mayo* does not appear to change the *Walton* result.

9. Deductibility of Palimony Claim; Estate of Shapiro v. U.S. (9th Cir. Feb. 22, 2011)

An unmarried couple lived together 22 years in Nevada. "After learning that Shapiro was involved with another woman," the cohabitant brought a palimony claim, which was outstanding when the decedent died. His estate claimed a §2053 deduction for the value of the palimony claim, and estimated the claim at $8 million. The palimony case settled the next year for $1 million. The IRS denied any deduction. The lower court granted summary judgment disallowing a deduction for the palimony claim, because the woman paid no consideration that was valid to support a contract under Nevada law. In a 2-1 decision, the Ninth Circuit reversed the summary judgment that disallowed the palimony deduction, saying that "twenty-two years of cooking, cleaning and other homemaking services" does in fact constitute consideration that is good enough to support a contract under Nevada law. It noted that the lower court never reached the issue of whether those services constituted "adequate and full consideration in money or money's worth," which is necessary to support a deduction under § 2053. It remanded the case for the lower court to consider that question, and if it determined that it did meet that standard, to determine the value of the claim as of the date of death. *Estate of Shapiro v. Comm'r*, 107 AFTR 2d 2011-942 (9th Cir. February 2, 2011)

One speaker was of the opinion that the dissent's approach may be correct in reasoning that § 2053 requires consideration "in money or money's worth," that other regulations and cases define that term to exclude love and affection, and that there were no allegations that the cohabitant had enhanced the value of the estate in money or money's worth. While "she cooked, cleaned and provided emotional support to Shapiro, the Estate presented no evidence that these services have a cash value or what that cash value would be."

10. Tax Patents Invalidated Under Senate Version of Patent Reform Act.

The Senate passed the Patent Reform Act, which it renamed the "America Invests Act" by a vote of 95-5 on March 8, 2011. Section 14 of that Act provides that tax strategy patents are not patentable because they are deemed prior art (not novel and non-obvious) since they require the Tax Code in order for the patent to work. The issue of tax strategy patents has been under study for several years, and the approach of this legislation was suggested by the Patent and Trademark Office staff in conjunction with the Senate Finance Committee and Senate Judiciary Committee staff as a way to deal with tax strategy patents that would not set a blanket exemption precedent that might apply to other types of patents.

This provision applies to any patent pending and any patent issued after the date of enactment. Therefore, for example, it would not invalidate the SO-GRAT patent.

A floor statement by Sen. Grassley specifically noted a letter sent from a coalition of 15 groups (one of which is ACTEC) describing why tax strategy patents are bad for taxpayers.

11. Aggregation of Various Undivided Interests Included in Estate Under § 2036; Adler v. Comm'r, T.C. Memo. 2011-28

Decedent had made gifts of undivided one-fifth interests in property to his five children, retaining a life estate. Those transfers were brought back into the estate under § 2036. The court concluded that they should be aggregated for valuation purposes, and no undivided interest discount was allowed. The court distinguished the *Mellinger* case, which did not require aggregating undivided interests included in the estate under § 2044 (QTIP property) and § 2033, because in this case the donor/decedent was able to control the disposition of all of the interests.

12. Transfer of Residence With Continued Occupancy by Donor Without Paying Rent Resulted in § 2036 Inclusion; Van v. Comm'r, T.C. Memo. 2011-22

In a rather involved (and comical) fact situation, the court ultimately determined that the decedent had acquired a beneficial interest in a residence and later gave the residence to a trust but continued to live there as the exclusive occupant for the rest of her life without paying rent. The court concluded that § 2036 applied. The court's reasoning seems to focus on the fact that the decedent never paid any rent, and cited two prior cases (*Disbrow* and *Trotter*) that had applied § 2036 where the decedent either paid no rent or made irregular rent payments for less than the amount stated in a lease agreement.

13. Continued Use of Residence Following End of QPRT Term Where Decedent Intended to Pay Rent But Died Suddenly Before Fair Market Rental Was Determined and Before Payments Were Made Did Not Result in §2036 Inclusion; Estate of Riese v. Comm'r, T.C. Memo. 2011-60

This case was decided after the ACTEC Meeting. The decedent remained in a residence following the end of the QPRT term and died unexpectedly before any rent was paid. The IRS argued that § 2036 applied.

When the QPRT was being considered, there had been discussions between the attorney and the decedent and the decedent's daughter (who assisted the decedent with her financial matters) that she would have to pay rent if she remained in the residence following the end of the QPRT term. Following the end of the QPRT term on April 19, 2003, the daughter discussed with the attorney how to determine the fair market rent. The attorney advised that the rent could be determined and paid by the end of that calendar year. The decedent had a stroke and died unexpectedly in October, 2003 before the fair market rent had been determined and before any rent payments had been made.

The IRS argued that there was an implied agreement of retained enjoyment in light of the fact that the decedent continued living in the residence without paying rent. The court disagreed, pointing to various facts suggesting that there was not an implied agreement of retained enjoyment. Some of these facts included that the necessity of paying rent was discussed on multiple occasions with the decedent and her daughter before the QPRT was created, and that the daughter discussed with the attorney how to determine fair market rent following the decedent's death.

> "While counsel's advice to determine rent by the end of the year was not the most prudent course of action, i.e., executing a lease and determining rent before the QPRT terminated would have been the ideal, we accept the parties' good faith testimony that they intended to determine rent by the end of the year... The Secretary had not issued any regulations or guidance as to how and when rent should be paid upon the termination of a QPRT. We believe that doing so by the end of the calendar year in which the QPRT expired would have been reasonable under the circumstances."

The underlying premise of the reasoning is that § 2036 is not triggered if a donor must pay fair market rent for continued use of the property. Interestingly, that underlying premise was never discussed, and it seemed well enough established that the court assumed § 2036 would not apply if the donor intended to pay rent following the end of the QPRT term.

14. Step Transaction Doctrine; Transfers to LLC and Transfers of Interests in LLC; Ninth Circuit Reversal of Linton v. U.S., (9th Cir. 2011)

a. *Background.* When assets are contributed to an FLP or LLC and interests are conveyed the same day or soon thereafter, the IRS argues that the step transaction should be applied to treat the transaction as if there were a transfer of the those actual assets to the donees without any discount. The step transaction doctrine was suggested in the *Shepherd* case, and in dictum by the Eighth Circuit in the *Senda* case supported the IRS's argument (the case referred to "integrated steps in a single transaction"). Two Tax Court memorandum cases (*Holman* and *Gross*) addressed the step transaction doctrine in this context, but held that the doctrine did *not* apply where the entity interest transfers were made long enough after the date of funding (6 days and 11 days, respectively) that there was a "real economic risk of a change in value." In two subsequent cases where the funding and transfers of interests in the entity occurred on the same day, a federal district court had applied the step transaction doctrine (*Heckerman* and *Linton*). The district court in *Linton* had granted summary judgment in favor of the IRS as to the step transaction doctrine (as well as another issue).

b. *Ninth Circuit Reversal.* The Ninth Circuit has reversed the *Linton* case. *Linton v. U.S.,* 630 F.3d 1211 (9th Cir. January 21, 2011). The facts in *Linton* were messy (and the court remanded the case for further factual determinations), but the contributions to an LLC and transfers of interests in the LLC may have occurred on the same day. The IRS argued that even if the funding of assets to the LLC clearly occurred before the transfers of interests in the LLC, the gifts should still be characterized as gifts of the assets to the donees (without a discount) under the step transaction doctrine, which collapses "formally distinct steps in an integrated transaction" in order to assess federal tax liability on the basis of a "realistic view of the entire transaction."

The court considered the three alternative tests for the step transaction doctrine (which have been applied mostly in income tax cases). The district court concluded that all three of the alternative tests applied. The Ninth Circuit held that none of them applied.

(1) The *end result test* did not apply because the end result sought was for the trust to end up with the LLC interest (not specific assets).

(2) The *interdependence test* requires that the steps are so interdependent that legal relations created by one transaction would have been fruitless without a completion of the series of transactions. The court concluded that putting assets in LLCs was a reasonable activity that made sense whether or not there was a gift, so the various steps have independence.

(3) The *binding commitment test* requires that there be a binding commitment to enter into the later steps of the transaction. The court concluded that test only applies to transactions spanning several years.

c. *The Dreaded Footnote — Economic Risk of Changed Value Test Still Applies.* The Ninth Circuit concluded specifically that the step transaction doctrine did not apply, and reversed the lower court's grant of summary judgment in favor of the IRS. However, in footnote 9 the court said that there are "timing requirements" between the funding of the LLC and the transfer of interests in the LLC "for the same reason that they apply the step transaction doctrine: to ensure that the two transactions are adequately distinct that the second transaction merits independent, and more favorable tax treatment" (pointing to *Holman* and *Gross* and quoting the "real economic risk" test of those cases). The court suspects that the timing requirements are "in essence a working out of the step transaction doctrine in a particular set of circumstances," and that once the lower court subsequently determines the timing facts and the effects of those facts, "there would be no need to apply the three traditional step transaction doctrine tests."

However, the court reiterates that on remand the court will apply the timing test issues that have been raised by *Holman* and *Gross*:

> To obtain favorable tax treatment, the Lintons needed to transfer assets to the LLC and then wait at least some amount of time before they gifted the LLC interest to their children. The waiting period would subject the gifted assets to some risk of changed valuation before they were transferred, through the LLC, to the children's trusts. That would make the two transactions distinct for tax purposes. (The government has not challenged that the nine days between January 22 and January 31 is a sufficiently long to make the transactions distinct, notwithstanding that some of the value transferred to the LLC was cash.)

15. Failure to Pay Penalty Applied Despite Reliance on CPA; Baccei v. U.S. (9th Cir. 2011)

In *Baccei v. U.S.*, 107 AFTR 2d 2011-898 (9th Cir. February 16, 2011), the Ninth Circuit affirmed the lower court decision applying a failure to file penalty. The CPA filed a Form 4768 extension request for an estate tax return, but forgot to indicate the date for the extended request and also did not check the box for extension of time to pay the tax. There was a cover letter sent with the incomplete form that indicated there was no ability to pay the tax and that was the reason for seeking the extension. The IRS denied the request because those items were left blank. The taxpayer made three arguments: substantial compliance, affirmative misconduct by the IRS, and reasonable cause. The court rejected all three.

As to substantial compliance, the court determined that the regulation was clear that the request for an extension of time to pay estate tax must state the period of the extension requested, and there was no substantial compliance.

Furthermore the court also determined that the IRS's inaction, namely failing to notify the executor that the payment extension request was deficient, was not affirmative misconduct.

Perhaps most important from a legal standpoint, the court noted the rule recognized in a number of cases that reliance on professionals is not "reasonable cause" to excuse the failure to *file* penalty, and the court extended that reasoning to the failure to *pay* penalty:

> "Although we have found no cases evaluating whether a taxpayer's reliance on an accountant to obtain an extension of time to pay taxes owed constitutes 'reasonable cause' under § 6651(a)(2), we draw guidance from *United States v. Boyle, 469 U.S. 241* [which held that reliance on an agent] is not 'reasonable cause' for a late filing under § 6651(a)(1)...
>
> . . .
>
> We extend these determinations of reasonable cause under § 6651(a)(1) [failure to file penalty] to determinations of reasonable cause under § 6651(a)(2) [failure to pay penalty]. There is no reason to distinguish between reasonable cause for a failure to timely *file* an estate tax return and reasonable cause for a failure to timely *pay* an estate tax, and we refuse to do so.

16. No FLP Discount Allowed; Jury Determined Value Based on Sale Price of Partnership Interest About Two Years After Estate Valuation Date; Levy v. U.S., (5th Cir. 2010)(per curiam)

The Fifth Circuit affirmed a jury finding at the district court setting the value of a partnership interest at $25 million without allowing any discount for lack of control and marketability due to partnership ownership. *Levy v. U.S.*, 106 AFTR2d 2010-7205 (5th Cir. 2010)(*per curiam*).

The facts are not well developed in the appellate opinion. The estate owned an interest in a limited partnership that owned undeveloped land, and apparently, the partnership sold the land about two years after the estate valuation date, resulting in the estate receiving $25 million.

The jury determined that the value of the estate's interest was $25 million, without a discount for lack of control and marketability due to partnership ownership. The court rejected the estate's various arguments for setting aside the jury verdict.

The trial court did not abuse its discretion in admitting evidence of the sale two years after the valuation date. ("The estate's expert testified that the Plano real estate market was relatively flat--increasing approximately 3%-- so the sales price would be an accurate comparator.")

As to the jury verdict allowing no discounts, the court concluded that "[t]he jury could have rationally found that no discounts for lack of control or marketability were merited because the estate controlled the general partnership interest, which has nearly unfettered control over the Partnership's assets."

A confusing final footnote stated that while the appellate court "declined to set aside the jury's verdict of zero discount, we note that the actual discount applied in taxing the Estate was thirty percent. Given the valuation found by the jury, it would have had to find a discount of larger than thirty percent for the verdict to have made a difference to the judgment in this case."

Practical Lesson: Actual subsequent sales are highly persuasive absent changed economic conditions. That may be particularly true for jury trials. In this case, the jury refused to allow any discount and set the value at the amount of the actual sale proceeds received by the estate.

17. Collection Action Against Transferees Under Transferee Liability Allowed 17 Years After Date of Death, U.S. v. Kulhanek; No Necessity for Assessment Against Transferee, Mangiardi v. Comm'r

a. *Collection Action Against Transferees 17 Years After Date of Death*; *U.S. v. Kulhanek,* 106 AFTR2d 2010-7263 (W.D. Pa. 2010). In this case, the IRS "came knocking on the door" of the recipients of retirement benefits and life insurance and collected estate taxes from them 17 years after the decedent's death!

Facts. The defendants were recipients of a $300,000 retirement account and a $10,000 life insurance policy. Each of them received distributions shortly after the decedent's death. The estate tax return was filed in 1992, making a § 6166 election. The stock of the business interest was sold in 1999. Over nine years later, the IRS filed an action against the defendants pursuant to § 6324(a)(2), which addresses transferee liability, to collect unpaid estate taxes of about $200,000 plus statutory interest.

Analysis. Under § 6324(a)(1) there is an absolute 10-year limit on the special automatic estate tax lien, without extensions or tolling. However, the court said that the IRS was not proceeding under that section but under the transferee liability provision of §6324(a)(2), which does not contain the absolute 10-year limitation by its terms. Because transferee liability is derivative of the transferor's liability, courts addressing the limitations applicable to § 6324(a)(2) have looked at the generally applicable statutes of limitations created under §§ 6501-6502.

Section 6501 requires that the IRS assess tax within three years after the return was filed. Section 6502 requires that an action to collect tax must be commenced within 10 years after the assessment of the tax, and that period can be suspended or extended. There was a tolling of the statute of limitations in this case under §6503(d) during the § 6166 deferral period. Because the § 6166 election preceded the assessment of tax liability, the assessment did not trigger the running of the statute of limitations until the end of the § 6166 extension period. The collection action was filed almost 9 1/2 years after the §6166 deferral period ended by reason of the sale of the stock — so it was filed within the allowed 10-year period.

Planning Concerns. (1) Transferees are personally liable up to the value they received at the date of the original transfer to them (in this case the date of death), even if they do not have that much value still remaining from those assets at the time of the later collection action. Recipients of gifts and recipients of assets following an individual's death must understand that this potential personal liability exists, and that it could arise well over a decade later without notice.

(2) There is no indication in this case that the IRS ever made an assessment against the defendants personally under the transferee liability provision, despite the fact that § 6901(c) provides that the period of limitations for assessment of transferee liability against an initial transferee is one year after the expiration of the period of limitation for assessment against the transferor. The IRS must assess tax against the estate within three years of filing the estate tax return (§ 6501(a)), so § 6901(c) requires assessment against the transferee within four years after the return was filed. The case did not discuss whether the IRS made an assessment against the recipients of the retirement accounts and life insurance policy within four years (which would be unusual), and did not address the effect of a failure to make such an assessment. Again, this raises the concern that transferees may conceivably first get notice of an unpaid estate tax liability when a Complaint is filed many years (in this case 17 years) after the date of death. (In this case, presumably the defendants had notice that an estate tax liability was unpaid, because they were the decedent's daughters, although the case did not indicate whether they were also the executors of the estate.) The potential injustice of this possibility, without prior assessment against the transferees, was raised in the recent *Mangiardi* case, discussed immediately below.

b. *No Necessity for Assessment Against Transferee, Estate of Mangiardi v. Comm'r, T.C. Memo. 2001-24*. In this case, the IRS proceeded to collect estate taxes from an IRA beneficiary eight years after the IRA owner's death, without ever having assessed tax against the beneficiary — and the IRS won.

Facts. The decedent's estate consisted almost entirely of nonprobate assets, a revocable trust valued at \$4.6 million and IRAs valued at \$3.4 million. The IRAs passed to the decedent's nine children. The decedent died in April, 2000 and the estate tax return was filed in July, 2001. The IRS granted six extensions for payment of the estate tax under § 6161. The extensions ended in December, 2004. The letter granting the last extension said that it could not be extended past December, 2004, because "we must ensure that the transferee assessments are made prior to the assessment expiration date to make those assessments." (The four-year period for making assessments against transferee would end four years after filing of the estate tax return, or in April, 2004.) However, assessments were never made against the IRA beneficiaries.

About 1 ½ years after the last extension expired (in July 2006), the IRS gave notice of intent to levy to collect tax. Maureen Mangiardi, a co-trustee of the revocable trust and statutory executor (perhaps one of the decedent's children) timely submitted a hearing request, arguing that the IRS was precluded from collecting estate tax liability from the IRA beneficiaries because the time for making a transferee assessment against them under

§ 6901 had expired. That proceeding was ultimately concluded in January, 2008 when the IRS sent a notice of determination that it could collect the estate tax liabilities either from the executor or from the beneficiaries without a prior assessment against the transferees under § 6901.

Analysis. The issue is whether a § 6901(c) assessment against transferees (which would have been required in this case within four years of filing the estate tax return) is required before the initiation of a collection action under the transferee liability provisions of § 6324(a)(2). The court held that it was not, and allowed the collection action to continue. The court's reasoning was rather terse, acknowledging that "[f]ew courts have considered this issue directly; however the Courts of Appeals for the Third Circuit and Tenth Circuit have held that respondent may collect estate tax from a transferee pursuant to section 6324(a)(2) without a prior assessment against the transferee under section 6901. United States v. Geniviva, 16 F.3d 522, 525 (3d Cir. 1994); United States v. Russell, 461 F.2d 605, 607 (10th Cir., 1972)," and that it found those cases persuasive.

The court also upheld the IRS's denial to accept $700,000 as an offer-in-compromise. The court reiterated that the IRS could proceed against the IRA beneficiaries in the amount of the IRA distributions, and the IRS had determined that the reasonable collection potential "was at least $3 million given that the beneficiaries received $3,433,007 in IRA distributions." The court agreed that the IRS did not abuse its discretion in refusing the offer-in-compromise because the petitioner did not offer an acceptable amount.

Reasoning That § 6901(c) Assessment is Not Required. The *Geniviva* case reasons that § 6901(c) and § 6324(a)(2) are "cumulative and alternative — not exclusive or mandatory" (quoting *Russell*). The *Geniviva* case relies on a Supreme Court case for this result:

> Before 1926, when section 6901 was enacted, the only means by which the Government could impose liability against the transferee was a bill in equity or an action at law brought under the precursor to section 6324 [citation omitted]. Section 6901 did not eliminate or limit such an action; rather, it provided an ADDITIONAL means by which the Government could enforce the collection of taxes. Leighton v. United States, 289 U.S. 506, 507-08 (1933). Thus, in Leighton the Supreme Court held that a failure by the Government to personally assess the shareholders of a defunct corporation did not bar an action to impose transferee liability against them… Leighton has never been overruled, either by the Court or by statute, and is binding upon us.

At least one district court opinion refused to go along with this reasoning. *United States v. Schneider, 92-2 U.S.T.C.* ¶60,119 (D.N.D. 1992). *Geniviva* distinguished that case, but noted the extreme unfairness of not requiring assessment against the transferees:

> [W]e express a certain sorrow that what seems inherently unfair is also quite in accordance with the law, and note a compassion for the equitable position of the appellants. They received their inheritance apparently believing that the affairs of their late mother's estate had been competently represented both professionally and personally, and handled in accordance with the law. Years later they found out that the estate had been poorly advised and represented, and had an unresolved, serious tax problem. Now they find themselves defendants in a lawsuit for the collection of those taxes, and under circumstances amounting to a forfeiture of their entire inheritance.

Planning Concerns. (1) The *Geniviva* court was correct that the result seems “inherently unfair.” In a case where there is a § 6166 deferral (like the *Kulhanek* situation), it is conceivable that the IRS could first contact IRA or life insurance beneficiaries up to 24 years (the § 6166 14-year deferral period plus the additional 10 years allowed under § 6324(a)(2), by reference to § 6502) after the decedent’s death that there are unpaid estate taxes, and that they are personally liable for the unpaid taxes (plus accrued interest over 24 years!) up to the amount of the benefits they received from the decedent 24 years earlier, without ever having had prior notice from the IRS of an assessment against them. Yes, that seems “inherently unfair.”

(2) This concern is exacerbated with respect to IRA beneficiaries or beneficiaries of other retirement accounts. For example, in *Kulhanek* the IRS concluded that a reasonable offer-in-compromise “was at least $3 million given that the beneficiaries received $3,433,007 in IRA distributions.” That simple conclusion ignores that the IRA beneficiaries will owe income taxes at ordinary income tax rates on the IRA receipts. For example, using the *Kulhanek* facts assume that beneficiaries of the $3,433,0 IRA were in the 35% income tax bracket when they received their distributions years earlier. They would have paid income taxes of $1,201,552, leaving them net proceeds of $2,231,454. That does not matter; they are still personally liable under § 6324(a)(2) for the full $3,433,007 that they received from the decedent. Even assuming they still have the $2,231,454 net proceeds many years later, they would still have to cough up the additional $1,201,552 out of their other assets. Yes, there is a § 691(c) deduction against the income tax for estate tax attributable to the IRD asset, but the statute of limitations for getting a refund of those income taxes has long passed. Hello bankruptcy!

(3) I have been under the misimpression for lo these many years that the transferees’ concern about liability lasted for four years after the estate return was filed because of the limitations period for assessment under § 6901(c). *That is flat wrong* under the reasoning of these cases, and transferees may have potential liability for estate tax many years beyond that. In many ways, the § 6901(c) time limit is meaningless.

Items 18-30 are observations from the Trachtman Lecture, by Ron Aucutt: “Creed or Code: The Calling of the Counselor in Advising Families.” The lecture focuses on the role of the estate planning attorney as a “counselor” and “true family lawyer” and ways that fulfilling a creed of professionalism to the good of the family (“for no other reason than because it is right”) may run into problems with the current ethical rules. Ron has a way with words like no one else that I know. Much of this summary is taken directly from his lecture — word for word — with articulate and moving words that only Ron could craft. This is merely a highly excerpted summary of Ron’s lecture. The entire lecture will be published in an upcoming issue of the *ACTEC Law Journal.* Read the entire lecture. It’s well worth the time.

18. Background About Joseph Trachtman and ACTEC.

Joseph Trachtman became President of ACTEC in 1966, when the membership of the ACPC rose above 1,000 for the first time, and he is said to have done more than anyone to institutionalize strict membership standards of expertise and professional conduct of ACTEC Fellows. As a past chairman of the ABA Real Property, Probate and Trust Law Section, Joe Trachtman followed up that commitment to quality by recruiting many outstanding members of the Council of that Section, as well as from his legendary New York Chapter.

19. Role of Estate Planning Attorneys as "Counselor"

Many families are identified to the world *by their last name*. ACTEC's last name is "Counsel."

a. *"True Family Lawyers."* Roberta Cooper Ramo's Trachtman lecture in 1996 inspired us with the challenge that trust and estate lawyers are the true "family law" lawyers, and it's a shame that that title has become largely associated with the *breakup* of families. Carefully consider our role as "counsel" and our calling as the true "family lawyers" – not for the breakup of families, but for the fostering, feeding, fortification, and fulfillment of families.

b. *"Advice For Architects From a Fireman."* Ron admits that his practice has largely involved the settlement of family disputes and minimizing tax costs. He says that he has mostly seen the results of failure – when members of families of substantial wealth have not been able to get along, when the best that can be done is to find a settlement that leaves everyone unhappy, or formalizes a split-up, like the partition or reformation or termination of a long-term trust, that ensures that family members will never see each other again. His experience usually relates to the tax treatment of settlements.

   He says the subtitle of this lecture might as well have been "Advice for Architects from a Fireman." But architects better listen to firemen.

c. *Ron's Thesis.* "In this fireman's experience," it is very rare to see a family completely disintegrate that has maintained a tradition of regular, honest, and wide-ranging communication.

   Ron's thesis is that the counselor can and must encourage and enable that fostering, feeding, fortification, and fulfillment of families.

   That's it. Just that one critical point. The number one duty of the counselor to a family is not the estate plan, not asset protection, not taxes. **It is to use all reasonable means to insist on or otherwise encourage the fullest and freest dialogue within the family for the sake of the survival and strength of the family.**

   Dialogue about the existing estate plan, changes to the estate plan, the family business, the business succession plan, trustees, the trustee succession plan, dreams and aspirations, disappointments, restoration. Dialogue about everything that is important.

   Even if we help eliminate all the taxes a client might otherwise pay, all we have done is to permit the client to keep something. We have not added one dollar to the client's balance sheet – in fact, we probably have taken some dollars away. But the counselor who helps foster, feed, fortify, and fulfill the family by encouraging and facilitating constructive dialogue – that counselor adds something that is precious.

20. Attributes of the Counselor

a. *Trust*. First, "trust" because it is first. But come back to that.

b. *Understanding (Which Requires Listening)*. The next attribute is understanding the family's values, objectives, and priorities. But those things must come from within the family itself. The lawyer cannot pull them out of a form book like a NIMCRUT or a QPRT.

   A family often doesn't even know what its values, objectives, and priorities are. The senior generation might be too busy or too driven – too occupied with *what* they are doing to have ever paused to ask *why* they do it.

The rules of healthy dialogue will involve a consensus of a set of principles greater than the dialogue itself that judges the relevance, usefulness, and appropriateness of everything that might be said. Those rules are the values of the family. Some experts urge every family to write a Mission Statement. All right, you tell that to some families, and their eyes will glaze over. "Mission statement? Why?" Don't press it. Just ask what their shared values are. Get them talking about shared values, and they will come up with something very close to a Mission Statement without even meaning to.

Sometimes – maybe usually – the place to start has to be with the senior generation alone, especially in a family of only young children. Here the focus is not as much shared values as it is transferable values.

Because the direction and bond of a family grows out of the family's values, not the counselor's values, the counselor must listen. Listening is more than just not talking. Listening means actively and curiously searching in the words you hear that reveals the makeup and passions of the client. Not just listening for what I need to fill in a blank in a document or craft the design of the next project or even ask the next follow-up question. Listening not just for the rational (which is our comfort zone), but for the emotional – even the irrational. Just listening for whatever there is to hear.

The framework of the dialogue in which to process the things that are said must be the client's, not the counselor's preconceived template.

Just because the values that form the framework for all action must be the family's values doesn't mean that the counselor personally should have no values or should play no role besides listening. Indeed, a counselor should help family members identify what is really important to them by prompting them with questions that are usually best when they are sharpened by the counselor's own values journey.

c. *Back to Trust.* Understanding, gained by listening – and prompting – is just the second requirement of an effective facilitator. The first is trust. Trust was mentioned first because it *is* first. But Ron explores trust second because trust, like understanding, is gained, in a larger way than we might think, by listening. That is because trust must grow – or, if you will, be earned. The attorney can bring to an engagement expertise, experience, even some ideas, but can't bring trust. Honesty is necessary for trust, and the attorney can bring honesty – the attorney better bring honesty – but can't bring trust.

Trust must grow *in the client*. Listening is a good incubator because true listening demonstrates a client-focus – it's about the client, not about me. There are two reasons why that is important. First, listening is informative — to learn the client's values, objectives, and priorities. Second, listening is affirming – only by truly listening and being truly committed to dealing with the family's concerns before promoting any agenda will the counselor demonstrate that the family is first. And that is essential to real trust.

Earning trust will usually also need follow-up. Trust is earned by making commitments and keeping them. The tougher the commitment, the greater the risk of failing to keep it, the easier trust comes when the commitment is kept.

And we will respect the importance of trust as we should only if we regard it like a 4.0 average – it is hard to earn, harder to keep, easy to lose, and impossible to get back.

As trust grows from listening – and from follow-up – so listening is enriched by trust, because the client is more willing to open up, and so forth.

d. *Judgment and Wisdom Born of Experience.* Judgment and wisdom born of experience are the third attribute of a good counselor.

21. Time and Billing

The problem is that these things take *time*. Especially the listening required to learn the client's non-technical framework in which the family's values, mission, and bonds must be built. And that may be the best explanation why some lawyers are so bad at it. Either we don't have time, or think we don't – or we do have time and want to bill for it.

There are two critical junctures in helping a family where it is hard to bill for our time. The initial listening is the first. The effect of turning off the clock on a client's willingness to talk can be miraculous. But here is a nifty secret. The counselor, the lawyer, the ACTEC Fellow who gains trust and understanding and fosters comfort by the time spent in listening off the clock can charge a higher hourly rate for work done on the clock. It doesn't always happen, but it happens often enough to be no accident, that we can bill a lot of hours, as long as we don't bill all of them.

22. Family Meetings

a. *How Often*? It varies, but probably two or three or four times a year. The family that is more geographically dispersed and therefore may be more distant might actually need to schedule such meetings more often.

b. *Where?* Once a year this should probably be more of a "retreat" and be scheduled offsite, perhaps even at a vacation spot and should span two or three days, with a liberal portion of free time or "nonbusiness" activities.

c. *Who should attend?* Families must figure out their own preferences.

Spouses. Because of the potential for divorce or other reasons the participation of spouses could be awkward. But a spouse is usually the person who is most influential in the family member's life. So Ron ordinarily likes to see spouses there.

Family members' lawyers. Now a word about individual family members' lawyers. No. Ron's bias would almost always be to exclude separate counsel, or to have a separate meeting or portion of the meeting specially for them. He observes — Good luck with that!

d. *Agenda*. Keep the agenda as non-technical as possible without misstating or glossing over material information. Make the information understandable, yet provide reasoning – better still, lead the family in their own reasoning. For example, "here's one answer; can you think of any others?" Include – even emphasize – the "soft" stuff: how the kids are, how school is going, sports, and so forth. At every meeting try to feature some tribute to an older family member – or remembrance of a deceased family member. Use photos, videos, writings, memorabilia, or, if nothing else is available, just good stories. This will remind participants of what they have in common. There should be candor about where wealth came from, as well as where it goes.

e. *Ground Rules*. There should be a commitment to rules of civility. For example, everyone should promise to try to say "I disagree"; not "You're wrong." Every participant is entitled to a voice and entitled to respect.

f. *Explaining Estate Plans*. Explain basic estate plans of the senior family members to the whole family. Use dollar amounts only in age-restricted meetings. For handouts, stick with summaries of estate plans, not actual documents. But don't omit anything that might materially affect a beneficiary just because it's part of the "boilerplate" – for example, trustee succession, treatment of adoptions, "spendthrift" protection, and no-contest and other forfeiture provisions.

Information about the estate plan should be updated whenever there is a material change. Like communication in general, it should not wait for a quarterly or bi-annual meeting. The communication the counselor seeks to encourage is ongoing – it is a mindset.

23. Special Considerations for Family Businesses.

Most experts recommend measures such as a family council separate from the business, the reality check of outside directors for all but the most simple businesses, and clear succession planning.

Statistics about the failure of the succession to future generations of family businesses can be exaggerated and misleading, if they do not appropriately define "failure." Merely closing a business, and certainly selling a business, is not necessarily a failure. Especially if the family gets proceeds from an orderly sale, the family business could by any standard have been a great success.

Business succession is the second occasion in which it might be prudent to offer to meet with the client without billing time. The biggest challenge in business succession is usually just getting the senior-generation CEO to consider letting go. Often the problem is one of two fears: What if my successors don't do as well? Or what if they do better? Or think about this: If my work is my life, what does that make my retirement?

One solution might be to urge the CEO to envision reasonably likely scenarios and "walk through" them. What if the founder and current CEO dies? Or becomes ill? Or incapacitated" Or missing? What if a certain son takes over? What will the daughter do? What if she takes over? What will her brother do? Does the company even need both of them anyway? Can they even work together? What would that look like? How would that work? Who would break ties? What if the rest of the family had voting stock? How would they react? What if they had nonvoting stock? Who wants to work hard just to benefit their inactive or absent siblings or cousins? Would they do that? Would they try to buy them out? How? With what? Would they succeed? And so forth.

Then factor in the possibility of outside managers, and go through it all again. How would the daughter like that? What would the son do then? And on and on.

The CEO's self-esteem can get a boost from such walk-throughs – it's being in control. And real problems and even solutions can be identified and addressed or scheduled to be addressed. Again, though, the commitment of the CEO to spend that kind of time – tough enough in ideal conditions – is invariably encouraged by the simple expedient of removing the billable hour concern.

The counselor needs to be available to take the time both to learn the family's values in the first place and then as needed to feed back to the family the input it needs to follow up on those values, including not letting egos get in the way of sound planning.

24. Ethical Rules

a. "*Chaos.*" In the Summer 2009 issue of the *ACTEC Law Journal* (then it was the *ACTEC Journal*), Professor Mary Radford published an article entitled "Ethical Challenges in Representing Families in Family Limited Partnerships." Mary's article, describes the state of the ethical rules relating to multiple representation as – "chaos."

b. *Roots Grounded in Adversarial Representation.* The current ethical rules in the *ABA Model Rules of Professional Conduct* and the Comments on those Rules, as well as the Model Code of Professional Responsibility that preceded them, and the 32 Canons of Professional Ethics that preceded that are all clearly grounded in the needs and limitations of litigation and other adversarial representation.

c. *ACTEC Commentaries.* The ACTEC Commentaries are one of the great success stories of ACTEC over the last two decades. When the Fifth Edition is published, we expect it to address with even more specificity many of the issues addressed below in the context of the family counselor's role.

25. Conflicts of Interest

a. *Easiest Issue "The First Time Around."* The easiest issue the first time around is the issue of conflicts of interest. (It is easiest because without consent, the attorney merely withdraws before the representation begins.)

b. *Model Rule 1.7.* Model Rule 1.7 flatly prohibits "the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal." In other cases, without "informed consent, confirmed in writing… the representation of one client [may not be] directly adverse to another client."

Another type of conflict arises under Model Rule 1.7 when "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client…"

c. *Joint Representations Between Spouses.* Estate planners are generally experienced in writing engagement letters to cover joint representations between spouses. It is not unusual for those engagement letters to provide that if a conflict arises – that is, if the interests of one spouse diverge from those of the other spouse – it might be necessary for the lawyer to withdraw from representing one or both of them.

d. *ACTEC's Model Engagement Letters. ACTEC's Model Engagement Letters* include the helpful addition that when there is a "conflict of interest" or "difference of opinion," the lawyer "can point out the pros and cons of [the] respective positions or differing opinions," without "advocating one of [the] positions over the other." The Model Engagement Letters are essentially the same in this respect where multiple generations, not just spouses, are involved.

e. *Specifying Surviving Client If Conflict Arises. S*ometimes it is desirable to limit the obligation to withdraw by designating in the engagement letter the client who will get dropped and the client who will survive. Not surprisingly, in the context of multiple generations, it's usually the senior generation that survives as clients.

f. *The Problem With Prospective Waivers in the Family Representation.* The ACTEC Commentaries state that "[a] client who is adequately informed may waive some conflicts that might otherwise prevent the lawyer from representing another person in connection with the same or a related matter." The problem is that under a Comment to the Model Rules "[i]nformed consent requires that each affected client be aware of the relevant circumstances and of the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client." In California, the Rules of Professional Conduct require written consent following written disclosure "of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client…"

The attorney must spell out the worst-case foreseeable scenarios. Now I happen to believe we almost never do that – or all our clients would be scared off! They certainly wouldn't consent. Conclusion: Most prospective waivers may be inadequate. At least they are risky.

26. Information Flow

a. *Model Rule 1.6*. Conflicts of interest are the easy issue – the first time around. The really vexing issue is the flow of information. The basic rule – Model Rule 1.6 – is pretty simple:

> A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent [or] the disclosure is impliedly authorized in order to carry out the representation…

b. *Information Flow With Joint Representation*. A joint meeting is no problem, because everyone is there. But what about a joint representation with occasional separate meetings?

Comment 31 to Rule 1.7 (the conflict of interest rule):

> The lawyer should, at the outset of the common representation and *as part of the process of obtaining each client's informed consent, advise each client that information will be shared* and that *the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other*.

Now that is why this subject is "chaos." So the lawyer "advise[s] each client that information will be shared. Later, one of them "decides that some matter material to the representation should be kept from the other." Wait, wait, don't tell that! But there is an agreement that the lawyer must tell that. So the lawyer follows the agreement and tells – right? No, "the lawyer will have to withdraw." This fundamental schizophrenia of the Model Rules and the failure of the commentators to come down on one side or the other of this issue make the Model Rules unworkable in the context of serving as a counselor to families. The ACTEC Commentaries are much more accommodating of joint representations, and they offer this advice:

> When the lawyer is first consulted by the multiple potential clients, the lawyer should review with them the terms upon which the lawyer will undertake the representation, including the extent to which information will be shared among them… The better practice in all cases is to memorialize the clients' instructions in writing and give a copy of the writing to the client[s].

But even this advice is not entirely helpful, for four reasons.

(1) Of course, it cannot eliminate the tension in the ABA Model Rules and Comments.

(2) It can stifle family participation in such discussions to present them with what amounts to a "waiver" at the beginning of the discussion. (It's like going on a tour and first signing the paper that says it's okay if you don't make it back!)

(3) It does not easily fit the model of the family advisor. If the model is a kind of "representation" of the family from generation to generation, then there really is no time that "the lawyer is first consulted by the multiple potential clients" and no

convenient way "to memorialize the [new] clients' instructions in writing and give [them] a copy of the writing." It is just not practical to expect an 18-year-old who comes of age in a family used to a kind of multiple representation to give a solitary "informed consent" under the obvious pressure to fit in to the model of the surrounding family members. By far the preferable approach is to just let it go so far as group meetings are concerned, until the new "client" actually wants to "*do*" something, such as sign a will or other document affecting legal rights or seek specific legal advice apart from the group.

(4) Sometimes the flow of information just takes us back to conflict issues. The issue of conflicts of interest is the easiest issue the first time around? Now we go around again, and it's not so easy. Unfortunately, no matter what the arrangement on confidentiality, it is obvious that someone might blurt out something that could affect the counselor's ability to represent someone else who is a client. Rule 1.7 states that "[a] … conflict of interest exists if … "there is a *significant risk* that the representation of one or more clients will be *materially limited* by the lawyer's responsibilities to another client, a former client, *or a third person*…

27. Secrecy Versus Loyalty

What do you do if you have a duty, for example, to the parents, and one of the children, to whom you promised secrecy, says something about the parents that creates "a significant risk" that your representation of one or both parents will be "materially limited"? The first time around conflicts of interest are the easy issue, because they can almost always be resolved by complete withdrawal. But is withdrawal good for the client? Is it good for the family, if the family then must do without the counselor, or another counselor must start all over building trust and gaining understanding?

The duty of withdrawal stemming from secrecy concerns creates a situation that is impossible. Chaos! But we can't accept impossibility.

28. Reconciliation Within the Family

From the perspective of a fireman speaking to an audience of architects, what's critically important is saving and preserving the family.

When there are conflicts, even direct conflicts, the family should be the place the conflicts are resolved and reconciliation is achieved, if at all possible, and that reconciliation should be facilitated by the lawyer as counselor, not the lawyer as lawyer. From Abraham Lincoln:

> Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser — in fees, expenses, and waste of time. As a peacemaker the lawyer has a superior opportunity of being a good man. There will still be business enough.

Lincoln continued, in a somewhat different vein:

> Never stir up litigation. A worse man can scarcely be found than one who does this. Who can be more nearly a fiend than he who habitually overhauls the register of deeds in search of defects in titles, whereon to stir up strife, and put money in his pocket? [Ron quips: Now there's a practice tip!] A moral tone ought to be infused into the profession which should drive such men out of it.

Sometimes, of course, there must be litigation, because sometimes even the most well- meaning and effective peacemaker cannot produce peace without justice. Even Lincoln litigated, 175 times all the way to the Illinois Supreme Court, 51 times as sole counsel.

If the adversity is viewed as a conflict that causes the lawyer to withdraw, the family loses the services of the trusted, understanding, and wise counselor at the very time those services are needed most. We must resist such a monstrous result.

29. Creed Over Code

Many state bars have adopted what they call "A Lawyers Creed of Professionalism." The Texas Lawyer's Creed, mandated in 1989 by the Supreme Court of Texas, in its preamble proclaims: "I am committed to this Creed for no other reason than it is right." But the "Creeds" seem to merely summarize the Model Rules, not transcend them.

So we must find that Creed within us, in the principle of simply *putting the client first* and in a commitment to that principle "for no other reason than it is right."

Arguably, the Model Rules themselves admit of subjection to higher principles. The Preamble to the Model Rules states:

> Within the framework of the Rules… many difficult issues of professional discretion can arise. Such issues must be resolved through the exercise of sensitive professional and moral judgment guided by the basic principles underlying the Rules.

And under the heading of "Scope," we read:

> The Rules of Professional Conduct are rules of reason. They should be interpreted with reference to the purposes of legal representation and of the law itself.

But the Model Rules fall short in this regard. Rule 2.4 permits a lawyer to serve as a third-party neutral, but Rule 1.12 would then bar that lawyer from an advocacy role. Rule 5.7 permits a lawyer to step out of a lawyer role, but appears to contemplate distinct "businesses" of delivering "law-related services." The examples given include psychological counseling. Assuming that "psychological counseling" implies the practice of a trained and credentialed professional and not the psychological counseling we all do every day without admitting it, this list is not encouraging. But I still see the "law-related services" of Rule 5.7 as the most convenient role for dealing with a family conflict for example (although with no attorney-client privilege), while still maintaining an attorney-client relationship with some or all of the family members. And of course, we truly will be giving advice that is by no means legal advice, including the personal advice and business judgment that the counselor of the Twenty-First Century cannot avoid.

Rule 5.7 might be read to require elaborate disclosures. If so, then the counselor must ask whether that very disclosure would likely widen the gap between disagreeing factions and therefore aggravate the conflict. It is certainly not in the family's best interest to aggravate the conflict, and the counselor in such a case might have to consider whether such a reading of Rule 5.7 must yield to the higher Creed of placing the client first.

The maxim that "I should not make the client's problem my problem" has a place. But if the choices are avoiding my problem at the risk of aggravating the client's problem or continuing to seek a solution for the client's problem at the risk of stretching ethical rules that otherwise don't work anyway, how can I possibly justify not putting the clients' interests first?

It will be obvious when trust has deteriorated to the point that the counselor's own participation can no longer be helpful. Then, hanging in there to seek reconciliation may actually have increased the likelihood that the only option for the counselor is to withdraw from representing everyone, even the presumed "favored" client.

30. Call to Action

Look for opportunities to try doing this. Those of you that accept this challenge, you are unique, but you are not alone, and you should not be alone. Share your victories and challenges. Seek affirmation and wisdom – even correction – from your partners. Reach out to other ACTEC Fellows. ACTEC Fellows, especially more experienced Fellows, be prepared to mentor others.

We champion the counselor who is committed to the Creed of placing the client's interest first above all else – including self-interest, maybe even especially self-interest. The counselor who would proclaim without reservation "I am committed to this Creed for no other reason than it is right."

Items 31-34 are observations from a symposium by Dennis Belcher, Prof. Jeff Pennell, Susan Snyder, and Bruce Stone: Report of the Estate Planning in the 21st Century Task Force. The symposium summarizes the result of a survey of ACTEC Fellows about practice issues and implications of various societal and tax law changes on estate planning for clients.

31. Overview of Areas Addressed by Task Force

Some of the areas addressed by the Task Force include the following: (1) Transition and succession planning for estate planning law practices; (2) Ancillary services performed by estate planners; (3) Development of state law impacting estate planning (e.g., the "new biology"); and (4) Delivery of client services (including online "do it yourself" estate planning which may lead to more litigation in the future).

32. Summary of ACTEC Fellow Survey Regarding Practice Issues

a. *Response*. The survey was completed by 800 Fellows, or about a one-third response rate.

b. *Years of Practice*. Of those responding, 47% had practiced 35 years or more. Only about 16% had practiced 25 years or less, and only 3.1% had practiced 15 years or less. Jeff Pennell notes, "there is a lot of gray hair or no-hair in the room."

c. *Sizes of Trust and Estate Practices*. Almost 70% of the Fellows are in practices with 10 or fewer T&E attorneys. Fifty-eight Fellows (7.1% of the respondents) are in firms with 25 or more T&E attorneys. There seems to be a growing chasm among lawyers who are in the mega firms with many estate planners and all the rest of the Fellows.

d. *Who Does Work for Mega Clients?* The statistics about the numbers of T&E practitioners in firms raises the interesting question of who does work for the mega wealth clients. Jeff Pennell speculates that there is a bifurcation between the mega firms that represent the ultra high net worth clients and all the rest of the Fellows.

e. *Geographical Centers*. Over half of the Fellows practice in areas with a population of more than 1 million, and 75% of the Fellows practice in areas with a population of more than 250,000.

f. *Billable Hours*. About 60% of the Fellows bill less than 1500 hours per year. Most of the Fellows with very high billable hours practice in the very large firms.

g. *Ancillary Work Other Than Pure Estate Planning*. Almost 60% of the Fellows receive no revenue from ancillary activities. This raises the question that if the estate tax exemption increase remains at $5 million, will estate planning practices be able to charge the same in the future? If not, will estate planning attorneys replace the revenue with ancillary business (such as serving as a fiduciary, investment management, paying bills, family office services, etc.)?

h. *Estate Planning Tasks Other Than Pure Basic Estate Planning*. A predominant number of Fellows (77%) receive between 25%-75% of their revenues from trust and estate administration. (That may be expected to increase. Even non-taxable estates can have significant post-mortem work.)

The Fellows who derive up to 25% of their revenue from other related areas are as follows: (1) Charitable planning – 77%; (2) Business planning – 62%; (3) Fiduciary litigation – 50%; (4) Asset protection – 51%; and (5) Elder law – 34%.

Quite interestingly, 56% of the Fellows derive *zero* revenue from the elder law practice and 40% derive *zero* revenue from asset protection planning. We hear a lot about each of those two substantive areas, but Jeff observes "you ain't doin' it."

i. *Revenue from Clients of Under $5/10 Million and Over $5/10 Million Net Worth*. About 60% of the Fellows get 75% or more of their revenues from clients with less than $5 million net worth. Only about 20% of the Fellows get 50% or more of their revenues from clients with a net worth of $5 million or more.

Only about 12½% of Fellows derive 50% or more of their revenue from clients with a net worth of more than $10 million.

The vast majority of Fellows are representing clients who became non-taxable in December 2010.

j. *Repeal Predictions*. Most Fellows thought the estate exemption would remain at $5 million or increase. Only about 3% thought there would be estate tax repeal. More of the academic Fellows thought the estate tax will be repealed. Jeff thinks there is a significant likelihood of repeal.

k. *Law School Courses*. About 80% of the academic Fellows thought that the enrollment in the basic trust and estates course would remain constant. (Jeff agrees.) However about two-thirds of the academic Fellows thought that enrollment would decrease in the more advanced wealth transfer tax course. Jeff is recommending that the advanced transfer tax course not be taught at Emory Law School at the JD level in the future.

33. Various Significant Changes Impacting Estate Planning Practices

a. *Aging Population*. The population over age 65 was 8% in 1950, 13% in 2010, and is estimated to be 20% in 2050 (Stanford Center for Longevity.)

b. *Decrease in Numbers of Estate Tax Returns and Estate Tax Collections*. The number of estate tax returns has decreased dramatically in recent years. There were 120,000 estate tax returns in 2001 compared to 35,000 in 2009. All of the decrease was in estates of less than $5 million. The number of returns for estates over $5 million increased, and the number of returns of estates over $20 million almost doubled from 2001 to 2009. (Keep in mind that represents estates of people who died in 2008 before the market crash in 2009.)

Estate tax collections decreased by $22.8 billion in 2009 as compared to 2000. Collections from estates under $5 million decreased by $66 billion, and there were substantial increases in collections from estates with more than $5 million.

c. *Numbers of Gift Tax Returns Increased*. There were about 184,000 gift tax returns, paying $32.3 billion, in 1997. There were about 235,000 gift tax returns, paying $40.15 billion in gift taxes, in 2009. Interestingly, there were many more gift tax returns even though the annual exclusion was higher. This suggests that a lot of transfer planning was occurring.

d. *Golden Age of Estate Planning*. Dennis Belcher thinks this is a golden age of estate planning. Clients come to see estate planning attorneys for several reasons: (1) Changes of circumstances (deaths, marriages, births, etc.); (2) Transfer tax changes; and (3) Changes in asset values (there have been dramatic changes, up and down, over the last three years).

Of course, there have been dramatic transfer tax changes. "We all say we need certainty. We need certainty. We need certainty. Thank G-d we haven't got certainty… Once there is certainty, you will see fewer needs to make changes." Despite the effects on attorneys' practices, Dennis reiterated that we know that our clients need some certainty regarding transfer taxes and that ACTEC will continue to push for Congress to provide some certainty.

After two years, he is concerned the level of people coming for estate planning will drop dramatically.

e. *Emphasis on Attracting Students*. The emphasis on attracting law students to the estate planning area is somewhat ironic. That is somewhat like Ford Motor Company encouraging the training of more mechanics instead of encouraging people to buy cars. It would seem that the focus should be more on educating people about the need for trusted advisors rather than training more "mechanics."

f. *Statistics Income Bulletin from IRS*. This Bulletin summarizes asset values from estate tax returns over a ten-year period. There are some surprising results.

Residences. On average, the value of the primary dwelling in an estate is less than 10%, in a very big state, just 2.5%, and about 11% in estates of under $5 million.

Life Insurance. The highest percentage that life insurance has represented in estates of over $20 million over a 10 year period is only 1/7th of 1%, and was just 2.5% for estates under 5 million. (Perhaps this number is skewed by life insurance owned in irrevocable life insurance trusts that are not reported on estate tax returns.)

Retirement Plan Benefits. In big estates, the largest percentage in any year represented by retirement benefits was 0.7%, and in smaller estates, the largest percentage in the last 10 years was just 7%.

Publicly Traded Stock. In the 2008 meltdown, the percentage of estates that was publicly traded stock declined from 27% to 25%. However, in retirement plans, the percentage dropped more dramatically from 7.5% to under 5%. This would suggest that managers of retirement funds were much less flexible than individuals or other portfolio managers. (Another explanation is that retirement plans had a larger allocation to equities than estates generally.)

These results are surprising. One would have assumed that residences, life insurance, and retirement plan benefits would represent a very substantial portion of most estates.

34. Impact on Estate Planning Practices; Planning For the Future

a. *Repeal Has Occurred Already For Most Estates*. At a $5 million exemption amount ($10 million for couples with portability) effectively there has already been estate tax repeal for most clients. While the estate exemption may be reduced to $1 million on January 1, 2013, it is extremely unlikely that it will remain at $1 million. Will planners adjust their practices in response to this change?

b. *Commoditization of Estate Planning*. A primary concern is that people can go online and draft their own wills. This may lead to increased litigation in the future, but it may result in a drop in planning.

c. *Globalization*. Firms needing to maintain their IT systems can hire people in India who have PhDs in IT matters at 1/10 the cost of hiring people in the United States. Perhaps lawyers will likewise be able to outsource basic document drafting.

d. *Simplification of Documents*. Documents may become simpler because they will be freed of the shackles of tax planning. However, perhaps they should be more complicated because of the need to react to other changes (discussed below), but can attorneys collect for that?

e. *Ancillary Services*. Estate planning attorneys may get more involved in ancillary services, such as acting as a fiduciary, investment management, paying bills, providing family office services, etc. What are the ethical implications of providing services in these new areas? If the attorney becomes a registered investment advisor, the attorney will have to deal with the SEC looking at the attorney's books.

f. *Application of Economic Principles*. Dennis Belcher attended a weeklong program for management of professional services organizations at Harvard Business School. One maxim that he learned is that there is very little competition for complex planning, but much competition for routine work. Furthermore, all complex planning becomes routine work over time. (For example, GRATs used to be sophisticated strategies and they are now fairly commonplace.) The revenue can be satisfactory for either complex or routine work as long as it is priced correctly. Complex planning involves little leverage with high billable work. Routine work requires lots of staff with technology efficiencies billed at a low fixed fee or else the work will be priced out of the market.

g. *Trusted Advisor*. The most satisfying legal work is being the "trusted advisor." There are the fewest complaints about bills, less malpractice claims, and the most planner satisfaction. We should strive to push the "trusted advisor" concept with clients.

h. *Dispute Resolution*. "Thank goodness for greed, sibling rivalry, and jealousy. Those things will not go away." There is a growing trend toward resolving disputes out of the court system.

i. *Drafting Changes*. We are experiencing significant demographic changes including longer life expectancy, more generations living at the same time, first marriages later in life, children being born later in life, increases in the divorce rate, more blended families, more families where there is no marriage at all, and assisted reproductive technology. However, many of the drafting assumptions were for the "Greatest Generation" and have not changed.

   Termination Ages. Many documents have provided that the age of financial maturity (i.e., the termination date) was 25, 30, and 35. (Question: Who was drafting those documents?

Answer: A 35-year-old."). Attorneys have started to include withdrawal powers rather than stated termination dates. There is also a trend toward discretionary trusts and giving trustee guidance about distributions at specified ages.

Per Stirpes vs. Per Capita. Bruce Stone asked one of his colleagues (who happened to be a grandparent) to review his documents. She asked why he always used a per stirpes distribution, which would result in grandchildren receiving varying amounts. She said "I'm a grandparent and I would never draft a document that way." For the next six months, Bruce explained the per stirpes/per capita difference to every client and asked what the client wanted. He was shocked — almost unanimously the clients wanted the per capita approach, so he changed his standard form to the per capita approach.

Spouses of Children. Most documents exclude spouses of children. Three weeks ago Bruce had a client couple who wanted to provide for their daughter-in-law. Bruce did not ask the question; the client brought up the issue.

Assisted Reproductive Technologies. Bruce recently met with a client whose adult son came with them to the estate planning conference. Bruce pointed out in passing his form language that deals with descendants born as a result of assisted reproductive technology. That prompted the son to tell his parents that he and his wife were using assisted reproduction alternatives, and that he wanted any children of his born after his death to receive what his parents would have left him. The parents were dumbfounded but agreed to do so. Bruce realized that because the son had no children currently, if he predeceased his parents before having any children, there would be no provisions for any of his children born after his death because the couple's estate would be divided per stirpes among their descendants upon their death. Bruce's language did not deal with that situation, and without the son's fortuitous involvement, a whole class of future born grandchildren would have been cut out of the plan. To deal with this issue, assets cannot be divided at the death of the surviving parent, but the class must be left open for several years in case there is a post-death birth. Bruce assumed that most clients will not want to leave their estates open for this possibility, but without asking the question, how do we know?

Items 35-45 are observations from a symposium by Dr. Susan Shapiro and Dr. Linda Emanuel, moderated by Kathy Sherby: The Role of the Living Will, Advanced Medical Directive and Health Care Surrogates. The symposium focuses on the real life effects of these documents and what planners can do to guide clients in giving helpful information to their health care decision makers.

35. Definitions of Health Care Documents and Roles

a. *Advance Directive.* An advance directive is an agreement to give directions for health care decisions if the patient loses the ability to decide. There are three possibilities. (1) Proxy directives (often called durable powers of attorney for health care) that name persons to make health care decisions; (2) Instructional directives (often called living wills) that give guidance as to the patent's wishes; and (3) Combination directives that do both.

b. *Default Surrogate Statutes*. If a patient has not named a health care decision maker, statutes provide priority among decision-makers, such as the guardian, spouse, adult children, adult siblings, etc.

36. Results of Study of 2,000 Patients

a. *Multi-Year Study*. Susan Shapiro described a study of more than 2,000 patients in ICUs from 2007-2009 of a large urban teaching hospital in Illinois. Dr. Shapirio (a sociologist) and a research assistant made observations of more than 1,000 interactions and meetings between health care providers and patients families and friends regarding 205 incompetent patients. She has "an inside view of advance directives on the ground."

Her conclusion: Our best laid plans are often not realized at the end of life and legal solutions are limited in this particular context.

b. *Prevalence of Health Care Directives*. Only about 36% of the patients in the ICUs said they had an advance directive or completed one during hospitalization, and of those, powers of attorney (proxy directives) are the most common. However, only about 1/10th of the patients ever produced documents at the hospital. Even when documents show up, many physicians never read them, and often do not know where to find them in hospital records.

c. *Advance Directives' Often Not Discussed With Family*. Many decision makers said they had never discussed the advanced directives with the patient. When that happens, the advanced directive may make matters worse – if it is not specific enough and the decision-maker is clueless about what the patient really wanted.

d. *Decision Maker Named in Proxy Directive Does Not Always Make Medical Decisions*. There are many medical decisions made throughout the ICU stay. For about 70% of the patients, the designated decision-maker made the big medical decisions; 3% of the decision-makers made no decisions. In the balance of the cases, the decision-makers made some but not all medical decisions.

The designated decision-maker is most likely to be excluded if he or she is not at the hospital, hard to find, does not speak English, if other family members are constantly available at the hospital, and if he or she is not a member of the nuclear family (such as a recent spouse, romantic partner, distant relative, etc.). Physicians often have not read the documents, so they talk to the nuclear family. If the decision maker is more vulnerable (elderly or does not speak English), they are often shut out of the decision making process.

e. *Practical Impact of Advance Directive on Medical Decisions*. In a third of the situations where there were copies of advance directives in the medical records, the subject of the advance directive never came up in discussions. Discussions about advance directives never occurred in 75% of the situations in which the patient claimed to have an advance directive at home but not at the hospital.

There was one situation in the entire study in which the advance directive was critical in carrying out the patient's intent — the decision-maker made a different decision than the default surrogate makers (her children) would have made.

In less than 25% of the cases, the advance directive probably helped ensure that the patient's wishes were realized. The decision makers wanted to honor the patient's wishes and referred to the advance directive to affirm their understanding and provide closure.

For 45% of the patients, the advance directive made no difference. It was never mentioned or the family said that it knew the patient's wishes, "end of story."

f. *Advance Directive Failed to Help or Made the Situation Worse In Many Situations*. "Advance directives probably or certainly failed to help honor the patient's wishes or actually undermined the patient's wishes at least as often as and slightly more often than it probably or certainly helped to honor the patient's wishes."

In some situations the patient's wishes were just ignored. One transcript: After the patient had spent days in ICU, the physician asked the decision maker if she knew what the patient would have wanted. "Oh yes, he would not be here. I know that for sure. I don't care though. I just don't care. I know it's selfish, but I don't want to let him go. I know I'm not being rational right now, I just can't imagine not having him."

Another situation is where the directive does not represent the patient's preferences. That can happen if the form is filled out by someone else, or if the form uses terms the patient misunderstood, or uses terms that mean something different to the family than to the physician. (For example, the terms "coma," "machine," and "vegetable" are bad words. Doctors view them very differently than patients.) Finally, sometimes patients' preferences may change but they do not change their advanced directive.

The directive may make the situation worse. The existence of the advance directive itself may stand in the way of making the right decision for several reasons. (1) The directive may be misinterpreted by the physician or the family. (2) The decision-maker may hide behind the document and refuse to make any decision at all. For example, there was a situation where painful chest compressions were periodically being repeated. The doctor said that the hope of any neurological functioning after further resuscitation was low. The sister-in-law said to "let her go." The decision maker (the husband) said "It's all on the paper. It's out of my control." He took the advance directive and shoved it in the doctor's face saying "just read it — is she going to be brain-dead?" The doctor said "I can't definitively tell you."

For three-quarters of the patients, the advance directive made no difference or it made matters worse.

g. *If No Directive, Physicians Often Follow Direction to Withdraw Life Support Even Though Default Surrogate Statute Does Not Give Decision Maker The Right to Withdraw Life Support.* It was very rare for default decision-makers to be refused the option of withdrawing life support, even though state statutes do not give default surrogates that authority. About 40% of the families for whom patients had no advance directives ended up withdrawing life support. A default decision-maker's direction to withdraw life support was refused only once in her three-year study.

Why does this happen? There are various reasons. Physicians look the other way because the patient's condition is so devastating, even if it does not meet the requirements of the statute. They may not know the law and the difference between a power of attorney and a default surrogate maker. In many cases it is because the doctor does not insist on seeing the directive; they just do what the family wants. Mainly, physicians do not want to stand in the way of the grieving family's decision.

It is tragic when that happens; for this reason alone, it is wise to have a power of attorney for health care.

h. *Difficulties of Making Decisions in ICUs Can Lead to Conflicts Among Family Members.* There are mixed messages from dozens of health care providers. Some doctors are unwilling to offer prognostic information about the likelihood that the patient will recover. Given that differences among people in their ability to deal with uncertainties and risk depend on judgment calls, ability to see the forest from the trees, and personality traits, it is not surprising that members of the same family may come to different decisions on how to proceed, even if they agree on the ultimate goal. Although conflict is relatively rare among families in an ICU, there are differences about judgment and information processing. Some family members want to wait until an uncertain prognosis becomes more certain. Waiting often happens even if the decision-maker has come to a decision, to wait until the rest of the family can come to resolution with the issue. Frequently the family reaches some semblance of consensus. Significant conflict is more the exception than the rule. That's not the main concern. The main concern is the difficulty that the families are facing in making decisions.

i. *Example of Attorney Experiencing Extreme Burden on Decision Maker*. One of the decision makers in her study was a lawyer who counseled with her clients about these issues. "This is so difficult. I tell people to do powers of attorney all the time. I didn't know how difficult this is. I don't want to kill her but I'm flummoxed. It's what keeps me up at night. We've been talking about this pretty much nonstop since this happened. This is pretty much all we talk about. I'm really struggling with this. I know her wishes. This is my responsibility to advocate for her. That is my job. I must speak for her. I never realized what a burden it is to be on the power of attorney."

j. *Conclusion.* "Decision-making in a hospital setting is not easily subject to control, either legally or otherwise. To believe that it is provides a false sense of security and probably increases the likelihood that a client's wishes will be undermined. The impulse should be to have less law, less formality, less specificity."

37. Physicians Perspectives and What Planners Can Do to Assist With End of Life Care Decision.

a. *Traditional Perspective*. Traditionally, the medical profession has been quite reluctant to use advanced care planning documents and for a number of years had said "why do advanced care planning, it doesn't work." However, Dr. Emanuel thinks we should continue to do advanced care planning not despite the observations in Dr. Shapiro's study, but because of them.

b. *Goal*. "Dying affords the chance to complete one's life with as close to a perfect ending as human beings can muster. And human beings can muster a lot when they are dying. It's possible to do this without suffering. Before palliative care became very sophisticated, I used to say that there is no easy way out of this world; we all suffer as we exit this world. That's not true anymore. That's not necessary. So we are looking for a suitable transition for family and friends as the patient makes his or her own critical transition out of life."

c. *Most Die in Hospitals; Families Financially Devastated Through Dying Process*. "Most people die in hospitals, not at home where they want to. There are massive amounts of needless suffering and the very tragically wasted precious time even though suffering is no longer really necessary. Furthermore, in the US, 40% of families sink to poverty until they can recover, and for many households it takes more than six years to recover their assets to their previous level."

d. *Attorney's Role is to Facilitate Teamwork*. Advanced care planning is about teamwork between the attorney, the client, the family, and the health care team. The attorney's role is to facilitate that teamwork.

e. *Advanced Care Planning Process*. Advance care planning is a process of planning for future medical care — not a document. Values and goals are explored and documented. A proxy decision-maker is determined. It is a process by which the patient and family meet a settled understanding, relative peace with the reality that we are mortal and that these things happen and we have some ability to navigate the last chapters of life as well as possible. It is a process that permits peace of mind, what Dr. Emanuel calls "existential maturity."

f. *Primary Focus is Not Autonomy of Patient But Consideration of Loved Ones and Overall Situation*. An important goal is to reduce the difficulty of the decision making proxy role. The autonomy of the patient is important, but it is not the primary focus. Autonomy has previously undergirded the advance care effort and that has been the focus of our activities with clients. "We've broadened the scope of our view. We are not just looking at the patient with autonomous choices that need to be honored. We're looking at the patient in the context of his and her loved ones. In the context of the household economics. In the context of the health care team and the care that is being delivered, whether it's in the ICU or in the home hospice setting. So we're much broader and much more realistic and we're trying to go for something more intangible and much more important."

g. *Recommend Both Proxy and Instructional Directives*. Dr. Emanuel teaches physicians in medical school and in continuing practice. She always recommends that people have both proxies and stated wishes. We emphasize that the proxy burden is less if there's some comfort available from knowing that the patient's wishes are there and honoring them is their task. It still burdensome, but less burdensome.

   There are very few people who can't say anything about what they want and there are very few people who can't choose a proxy. It happens, but it's maybe one in 100,000.

h. *Tell Proxy*. She strongly recommends that the patient tell the proxy they have been named.

38. Worksheet to Determine "Personal Threshold"

a. *Include Proxy in Discussion and Have Medical Care Provider Check Results for Medical Reasonableness*. Dr. Emanuel uses a worksheet that can be completed in five minutes. It is very important to include the proxy in a structured discussion. (Dr. Emanuel refuses to be a proxy unless she was involved in this kind of a discussion; otherwise she does not have enough information.) The worksheet describes various health scenarios, and provides alternative options for care that the patient would desire in those scenarios. A nurse or doctor should check the results for medical reasonableness. (For example, someone might indicate that he does not want artificial hydration but wants to be on a ventilator; if the patient is on a ventilator, artificial hydration will be necessary.)

b. *"Validated Advisor Document*." The end result should be a "validated advisor document." (This means a document that empirical research indicates is a valid representation of what the patient meant to say and reproducible over time and that can be applied in a fashion that is relevant in a medical setting.) The signed document should be entered into the medical records. Statutory documents are recommended to ensure portability.

c. *"Personal Threshold."* The "personal threshold" is the point in a mounting prognosis where the patient's desire for treatment would change from (1) curative to (2) comfort and quality of life. Dr. Emanuel describes this as the point at which "I'd rather be a portrait on the wall then a burden to my family."

d. *Worksheet Description*. 96% of people in clinics can complete the worksheet in less than 15 minutes. There are two exceptions — lawyers and doctors. Preferably, the scenarios and various alternative treatments should be reviewed quickly for first impressions without a great deal of focus.

The worksheet describes six different health care situations, and the individual gives guidance as to specific types of medical treatments that would be desired and describes the overall goal of medical care in that situation. The following example is Situation (B): "If, in the opinion of my physician and two consultants, I am in a coma, with a small and uncertain chance of regaining higher mental functions, and a greater chance of recovering with some residual damage, and a much greater chance of not recovering at all, my wishes, if medically reasonable, for this and any additional illness would be:" A table then lists six general types of treatment (such as, resuscitation, mechanical breathing, blood transfusion, artificial nutrition and fluids, antibiotics, and pain medication even if indirectly shortening life). For each treatment, the individual selects either "want, don't want, unsure, treatment trial; stop for no improvement." Finally, the individual would check which of the following goals of medical care should apply in that situation:

- prolong life; treat everything
- attempt cure but reevaluate often
- life quality over longevity
- comfort care only
- other (specify)

This process is helpful for both the patient and the proxy. The patient gets self-knowledge, and the proxy gets detailed information to guide him or her in the decision-making process.

39. Artificial Nutrition and Hydration

Question: Some people suggest that one should never allow withholding hydration, thinking that would intensify suffering, but should allow withholding of nutrition.

Response: Hunger and dehydration are very real for those who are healthy. It is different for those who are near the end of life. Near the end of life, the body manages water in a different way. Most of the water in a dying body leaks out into the tissues and can cause very painful edema, resulting in puffy open wounds. It is better to keep a person dry near the end of life.

A person who is extremely ill is not hungry. You know that from having the flu. Family members will sometimes try to feed dying persons because they love them, but the patient ends up using the patient's last strength to keep the spoon from entering his or her mouth.

Family members should express their love to dying patients other than by feeding them or forcing them to drink. The side effects of dryness are dry mouth or dry eyes; manage those with mouth swabs and artificial tears.

Dr. Emanuel believes that insisting on artificial nutrition and hydration is wrong.

40. Who Should Receive the Proxy and Instructional Advance Directive (Living Will)?

Question: Some people advise that the hospital should only be given the proxy document that appoints the person, but not the living will with instructional provisions. The theory is that the process will be slowed and that the hospital we be concerned about its own liability and more likely to consult its own counsel and ethics committee to interpret the living will.

Response: Ethics committees are not involved in these issues. Dr. Shapiro said that in all of the 200 patients in her study, the ethics committee showed up in only one case (where the patient was brain-dead and the family would not believe it.) Doctors want to make the family happy and they are not concerned with liability.

41. Changing Patient Wishes

Question: It is not unusual that a patient makes his or her wishes moderately clear before a serious illness. As the situation gets worse and the patient's mental capacity deteriorates, the patient gets scared of dying and wants more aggressive treatment than desired when totally rational. What is the attorney's role in that situation?

Response: This is a thorny issue that arises often. Patients do change their minds. However, it is very hard to do anything other than what the patient said to do "this morning." The surviving family survivors must be able to live with themselves. That is a very important part of this overall process.

42. Medical Insurance Reimbursements

Question: There is a general belief that medical insurance policies will not cover these discussions. Will the doctor be surprised when the patient shows up with an advance directive and hears that the attorney told the patient to discuss it with the doctor?

Response: Insurance reimbursements are allowed for consultations for advance planning. The doctor's role in the process can be minimal — just to make sure that the patient's wishes are medically reasonable and not conflicting. Dr. Emanuel agrees that the appropriate role of the lawyer would be to suggest reaching out and communicating with the physician.

43. Multiple Proxies

Question: Attorneys have been told by doctors that they only want one designated decision-maker and will not accept a medical directive if more than one proxy is listed. Is that correct? (Another attorney indicated that some facilities will not accept a committee of decision-makers, and some hospitals will only accept their particular form.)

Response: This comes up often. Dr. Emanuel believes that most medical care providers would be satisfied if the proxy lists the names of all of the children but simultaneously identifies who is the final decision-maker in the case of a conflict. The medical team wants a spokesperson. The goal is not to prevent a consensus among the children.

44. Ethics Committee Can Assist If Family Is Bombarded With Varying Opinions

Question: An attorney was recently called by a wife whose husband was in critical condition. "Ten medical people are telling me unclear things. I don't know where to get direction." What can be done?

Response: This is a very difficult situation. One alternative is to ask for a consultation with the Ethics Committee of the hospital. This may force getting the doctors together. Ultimately, the family has to pick who to trust. This is especially difficult in the ICU situation because there usually has not been prior contact with the ICU doctors. Remind the proxy that it is the attending physician who writes the final orders. The proxy should make sure that he or she is communicating with that physician.

45. Who Should Receive Advance Directives?

Advance directives should be given to the proxy and family members who care about the person's well-being. In addition, the attending physician and primary care physician should receive a copy. If the individual is a chronic kidney or cancer patient, there may be a specialist. Whoever takes care of the patient on a day-to-day basis should have a copy. If the copy is just delivered to the hospital ahead of time, you have no assurance of knowing where it will end up.

Dr. Shapiro said that she would be reluctant to bring all of the worksheets and instructional information to the hospital. Some doctor will point to one answer and say that it conflicts with a decision being made. "Doctors don't read carefully. They become very literal about things that were not meant to be literal."

Items 46-55 are observations from a seminar by Peter R. Afrasiabi and Alan S. Watenmaker: Why Superman and Copyright Matter to You. The seminar provides an overview of copyright fundamentals that estate planners need to know — including the importance of the automatic reversion rights the copyright owners or their family members may have if the rights have previously been transferred.

46. Overview of Significance of Copyright Law to Estate Planners

a. *Identifying Assets*. In identifying a client's assets, it is easy to overlook copyright rights that may exist. Even copyrights that had been previously assigned may still constitute assets that the author or the author's family members have valuable rights to in various situations. For example, as discussed below, the Superman copyright was transferred in 1938 for $130, but family members have recently reacquired the copyright, which will result in a massive wealth shift. There are only limited windows of time that the copyright may be required in most of these situations, so it is important that the planner recognize those opportunities.

b. *Transfers of Copyrights to Family Members*. Special things may be done to assure that transfers that a client desires to make will be respected (by making the transfers in a will). The transfer of a copyright other than by will (including a transfer to a revocable trust or other trust) is not protected against future attacks by a federally described class of beneficiaries who will have the right to terminate the grant at designated times.

c. *Sample Forms*. Alan Watenmaker's materials have various estate planning forms that may be helpful for copyright owners.

47. What is Copyright?

a. *Generally*. Copyright is the exclusive right to copy, exhibit, distribute, adapt (which means to create derivative works), perform or display any original work of authorship fixed in a tangible medium of expression. For example, if a song is reduced to a tangible medium, the creator has the right to perform it, control performances, and create derivatives, such as creating a play out of the song.

b. *Original Work of Authorship*. Only a minimum amount of creativity is required (as compared to patents). Even doodles on a page are copyrighted. Copyright only applies to the expression of ideas, not the ideas themselves. For example, Einstein could not copyright the theory of relativity, but he could copyright his description of it as reduced to tangible form. Facts are not subject to copyright, but a particular description of those facts can be copyrighted.

A massive exception is the "work for hire" doctrine. Under this doctrine, the person who actually created the work is not the author, but the employer is the author.

c. *Fixed in a Tangible Medium or Expression*. An idea alone cannot be copyrighted; it must be reduced to a permanent physical rendering (including typing something in a computer).

d. *Types*. Things that can be copyrighted include books and other writings, music, film, photographs, artwork, software source code, and architectural works (as of 1990).

e. *When Does Copyright Exist*? A key date in copyright law is January 1, 1978. The 1976 Copyright Act overhauled copyright law, and it became effective January 1, 1978. The law regarding copyrights varies dramatically depending on whether the copyright was created before or after that date.

For works created on or after 1/1/78, copyright exists at the moment of creation irrespective of any registration or publication. (There are various good reasons to register a copyright with the copyright office, but it is not required to create a valid copyright.)

For works created before 1/1/78, copyright exists at the moment of publication, as provided in the 1909 Copyright Act. If something is created but not published with appropriate formalities, a copyright did not exist under prior law.

f. *Duration of a Copyright*. The duration depends upon whether the copyright was created on or before 1/1/78.

Pre 1/1/78 Work. Under prior law, there was a dual-term policy. Purpose: The bargaining rights of authors and publishers are very different. The work may become very valuable after the fact, so the policy was to give authors a "second bite at the apple." If an assignment was made of a work, after a certain number of years, the author could go back to the publisher and renegotiate. Initially, the first term was only 14 years. That was later extended to a 28 year first-term and a renewal term of 28 years, for a 56 year life of the copyright. After 56 years the work would enter the public domain.

The 1976 Act extended that another 19 years to a single term of 75 years.

The 1998 Mickey Mouse Law extended the duration again for another 20 years, to a single 95 year term. (Mickey Mouse was on the verge of entering the public domain and Disney lobbied Congress to extend the copyright. There is now a trend toward trademarking things, because trademarks last forever.)

Works Created On or After 1/1/78. The 1976 Act changed the law to be more consistent with the rest of the world. Under the 1976 Act, a copyright lasts for the life of the author plus 70 years.

g. *Copyright Reversion*. The Copyright Act allows copyright grants made by authors or even by authors' heirs to be taken back, notwithstanding the nature of the assignment and even if the assignment purported to give up all reversionary rights. These "termination rights" are discussed in detail below.

h. *Works For Hire*. As a general default rule, works created by an employee belong to the employer. But whether someone is an employee for this purpose can be very unclear; it is not governed by federal income tax principles. Works created by an independent contractor, on the other hand, belong to the creator. There are no termination rights for works for hire.

48. Termination Rights

a. *What is the Termination Right for Pre- 1978 Assignments?*

There is a termination right of a statutorily defined class of family members to terminate a pre-1978 copyright grant that was made by the author or heirs (for a copyright published before 1978) to get back the copyright for the renewal terms (i.e., the additional 19 years [from years 57-75] under the 1976 Act extension, and the additional 20 years [from years 76-95] under the 1998 Mickey Mouse Law).

In addition, if the author died during the initial 28-year term, the designated class of the author's family members has the right to reclaim the copyright, cutting off the rights of persons named in the author's will and cutting off rights of the publisher to which the author had previously assigned the rights. (See the discussion of the Saroyan *Cave Dwellers* case below.)

Will Exception. The major exception is that a grant by a will cannot be terminated (unless the "Saroyan *Cave Dwellers*" exception applies [if the author died during the initial 28 year term of a pre-1978 copyright], as discussed below). A bequest in a will governs the copyright, and eliminates the right of family persons designated in the statute to terminate the renewal terms.

The will must specifically mention "copyrights" to qualify for this exception; general transfers under the residuary clause will not suffice for this purpose. However, for purposes of whether copyright rights pass under the will generally (not for purposes of this particular exception), Mr. Watenmaker said that he has had no problem reregistering a copyright into the names of residuary beneficiaries under a will.

When: Window For Terminating Prior Grant. The termination of a grant of rights made before 1978 (for a pre-1978 work) can be triggered by the author or heirs between the 56th and 61st year of when the copyright was originally secured to recapture the additional 39 years. Even if the 19-year renewal (from the 57th to the 75th year) is missed, the final 20 year term (from year 76 to year 95) can be recaptured if triggered between the 75th and 80th year if the author or successor have not previously exercised the termination right. For example, works created in 1954 are eligible for termination in 2011, because the 56 year waiting period expired at the end of 2010.

Exception to Will Exception. Under the "Saroyan *Cave Dwellers*" exception, where the author died in the first 28 year term of a copyright published pre-1978, the class of people entitled to claim termination rights triggered the second 28 year term (from years 29-56) and the extension term of 39 years (from years 57-95), notwithstanding the author's will to the contrary. (This exception to the will exception was probably not intended, but it is clearly in the literal terms of the 1909 Copyright Act. It applies only if the author dies during the first 28 year term for a copyright published before 1978.) This "exception to the will exception" is discussed in more detail below.

b. *What is the Termination Right for Works Assigned On or After 1/1/78?*

What: An assignment of a work that is granted on or after 1/1/78 by the author [but not by the author's heirs] (whether the work was created before or after 1978) can be terminated by a federally defined class of family members beginning 35 years after the grant of the copyright (not 35 years after the copyright was originally acquired), unless the grant was made by will. This right is a contingent expectancy; the author cannot assign or bequeath the termination right. As discussed below, the termination right exists for persons defined in a statutory class of people who are in existence at the time the termination right exists.

When: A work assigned on or after 1/1/78 may be terminated in a five-year period beginning at the end of the 35th year of the date of execution of the grant. Notice of intent to terminate must be given between 2 and 10 years before the 35th year of the grant of the copyright.)

For example, assume Madonna assigned record rights to a record label in 1980. Thirty-five years later (in 2015), Madonna can terminate that copyright grant. She can give notice as early as 2005 that she will exercise this right beginning in 2015. (As a matter of fact, Madonna has already bought back her copyright rights. In the 1980s, Michael Jackson bought the copyrights to the Beatles music and sound recordings. That started with Michael asking Paul McCartney what he should do with all his money. Paul McCartney told him to buy music, and Michael Jackson went out and bought the Beatles' music! Paul McCartney was not happy about it, but told the press that it's not a big deal because he would get it back one day. That day is about here.)

c. *Any Lifetime Agreement to the Contrary is Void*. The 1909 Act said that any contrary lifetime agreement taking away termination rights would be void. A U.S. Supreme Court case (*Fred Fisher Music Co. v. M. Witmark & Sons*, 318 U.S. 643 (1943)) held to the contrary, but the 1976 Copyright Act confirmed that any attempt to assign away termination rights would indeed be void.

Publishers are still making attempts to find a way around that, but courts typically rebuff them. (For example, in the *Captain America* case the owner assigned rights to the copyright and the agreement stated that it was a "work for hire," which meant that no termination rights existed. However, he was later able to reclaim the rights, with the court concluding that whether the work was actually a "work for hire" depends on the actual facts and not the terms of an assignment agreement.)

Conclusion: The right to terminate copyright rights granted before 1978 for the last 35 years after the creation of the copyright and the right to terminate copyright rights granted on or after 1/1/78 as of 35 years after the grant are simply not assignable during life. The only way to assure that a grant is respected indefinitely is to make the grant by will (and even that does not work for pre-1978 copyrights if the author died during the first 28 year term of the copyright, as discussed below regarding the Saroyan *Cave Dwellers* case).

d. *Who Can Exercise Termination Rights?* There is a federally defined statutory class of persons who can exercise the termination right, determined at the time a termination right can be exercised. This class is (1) the author if alive; (2) the author's surviving spouse (even if he or she has remarried) if there are no descendants; (3) if there is a surviving spouse and surviving descendants, 50% to the surviving spouse and 50% to descendants *per stirpes*; (4) surviving descendants *per* stirpes if there is no surviving spouse; and (5) the author's estate.

Greater than 50% of the class (again determined during the window of the time that termination rights may be exercised) must agree to exercise the termination rights, or else the grant of the copyright will not be terminated. [Observation: A bequest of copyrights to a surviving spouse should qualify for the marital deduction. It should not be a terminable interest despite the termination rights because of the will exception to termination rights, and even without the will exception, the spouse would be able to block the exercise of the termination rights even if there are descendants that comprise 50% of the class that can exercise termination rights.]

The new owners are tenants in common of the copyright rights.

e. *How Are Termination Rights Exercised?* The mechanism to trigger the termination rights is a "complicated and byzantine maze of procedural morass."

f. *What Rights Do The Terminating Class Reclaim*? All of the assignee's rights revert to the terminators except derivative works created pre-termination, which may continue to be exploited, but no new derivative works may be created by the assignee.

49. Superman Case

a. *Siegel and Shuster*. In 1938, Siegel and Shuster sold their ideas for Supermen to DC Comics for $130.00. If they had known anything about copyright law, they would have fairly thought in 1938 that in 1966 (at the end of the initial 28 year term) they could get back the renewal term and renegotiate. However, in the meantime, the *Fred Fisher* US Supreme Court case held to the contrary. Siegel and Shuster were both penniless in their later years, but after an expose by the New York Times, Warner Brothers (who owned the rights to the Superman movies) gave them a lifetime pension.

The 1976 Act reversed the effect of the Fisher case and gave the renewal term back to the author and heirs.

b. *Exercise of Termination Rights by Siegel's Widow and Daughter*. For pre- 1/1/78 grants, the termination right can be exercised any time in the five-year window from the 56th to the 61st year after the publication of the copyright, which was 1994-1999 for the Superman copyright. Mr. Siegel's widow and daughter exercised their termination right in 1997. When a termination is exercised a termination date must be specified. Anything published more than 61 years before that date is not recaptured. The family can choose any date within that five-year window and they recapture rights for anything published up to 61 years before that date. They chose April 16, 1999, because the initial grant to DC Comics was April 16, 1938. (They figured nothing could have been published before that date because they had been trying to publish it but had been unsuccessful.) Warner Brothers found a few elements of Superman that had been published in an advance sheet publication on April 10, before the April 16 grant date. It was a black and white picture of a man in leotards. Warner Brothers tried to say that the work was published more than 61 years earlier, so the widow and heirs could not claim rights as to that April 10, 1938 publication. The court concluded that the April 10, 1938 publication was a black and white picture of a man in leotards without an "S" on his chest, and they could make all the movies they wanted about that (without the derivatives of Superman, Krypton, Lois Lane and all the other elements of the franchise). Warner Brothers can continue to sell the already-created derivative works (i.e., the Christopher Reeves movies), but no new works. That's why no Superman movie has been made in the meantime. The family will likely re-negotiate with Warner Brothers to keep alive the Superman movie franchise.

This is a good example of the massive volume of works created in the 30s-60s that will be coming up for the families to reclaim their copyright renewal terms.

50. John Steinbeck Case

John Steinbeck assigned his works in 1938. He had children by his first marriage, remarried, and died in 1968 leaving his estate to his second wife who had children of her own by a prior marriage.

The termination window arose 56 years later (1994-1999). The widow was 50% of the class of persons who could exercise the termination rights, and she refused to terminate (because she did not want Steinbeck's children by his first marriage to receive any of the rights). She then entered into an agreement with the publisher, Penguine Books, as the successor in interest to Steinbeck under his will, to rescind the 1938 agreement and re-enter a new agreement to reallocate rights, responsibilities and money. The widow died in 2003. By the time of the 75th year, when the termination right arose to get back the last 20 years, the children were the only surviving members of the statutory class so they exercised their termination rights. Penguine said they could not terminate the 1938 assignment, because it did not exist anymore — it was rescinded in 1994 by the successor to the agreement. They said there is just a 1994 agreement, signed by Steinbeck's widow, and that it could not be "undone" because one of the quirks in the Code is that any assignment made after 1/1/78 could only be undone in the 35th year if the assignment was made by the author. They argued there was no pre-1978 agreement to undo, because it was rescinded. The only existing agreement postdated 1/1/78, but it was not made by the author, so it could not be terminated.

The children argued that was a classic "agreement to the contrary" that should be void under the Act. Ultimately, the Second Circuit sided with the publisher and held that it was not a prohibited "agreement to the contrary."

Lesson: There are possible creative ways of getting around the "no agreements to the contrary" provision. They typically are unsuccessful, but at least this one worked in the Second Circuit. (The speaker says this is a very poor decision and it is a wrongly decided case that has been roundly criticized by copyright law experts.)

51. William Saroyan Works, Including *Cave Dwellers*; Assignment Pre-1978 and Author Dies in First 28-Year Term

The Cave Dwellers was published in 1958. Saroyan died in 1981, leaving all of his copyrights to the Saroyan Foundation in his will. The renewal term began 28 years after 1958, in 1986. The statutory class consisted of his children, who claimed the renewal rights for the next 28 years and the additional 39 years, or 67 years total. The Foundation challenged the termination, because it had inherited the rights under Saroyan's will during the first term. The court held that the renewal term belongs to the statutory class irrespective of any pre-existing grant, and that there is an exception to the "by will" exception if the author died in the initial 28-year term. Saroyan had wanted the Foundation to receive the rights and thought that he was irrevocably granting them the rights by bequeathing the rights to the Foundation in his will. However, the Foundation lost the rights, and his children reclaimed them.

Lesson: In this situation of copyright that was published before 1978, but where the author died in the initial 28-year term of the copyright, the federal class owns the rights today, not the assignee. The federal class owners can reclaim them at any time, not constrained by any windows or specific time periods.

52. Foreign Rights

The termination rights only apply to domestic rights. For example, when Siegel's widow and daughter got back the copyright rights that had been granted to DC Comics, they only got back domestic rights. Warner Brothers still has any foreign rights that it had.

53. Estate Planning Conclusions

a. *Transfers to Trusts Not Protected.* Transfers to a trust (including a revocable trust) will be subject to attack at a later time by the federal class of persons holding termination rights. For this reason, do not transfer copyright rights to a revocable trust. If the estate plan is a revocable trust-based plan, allow copyrights to pass to the revocable trust under the owner's pourover will. A bequest in the will of all rights still owned by the testator at his death to the revocable trust is effective to transfer copyrights into the revocable trust. (However, as discussed above, a bequest that does not specifically mention "copyrights" may not satisfy the "will exception" to the automatic termination rights. For that reason, it would be best to specifically mention copyrights in a will bequest where the testator owns valuable copyright interests.)

b. *Assignments to Revocable Trust.* As discussed immediately above, in an assignment of assets to a revocable trust, *s*pecifically exclude copyrights. That may require a probate proceeding, depending on state law.

c. *Incompetent Owner.* Revocable trusts are the classic tool to deal with management for incompetent persons. Does that mean that only powers of attorney or guardianships could be used to manage copyrights of an incompetent owner?

d. *Centralized Management.* Owners of copyrights typically like to provide for centralized management of the copyrights. One approach would be to assign all assets owned by the client other than copyrights to a revocable trust before death and allow the copyrights to pass to the revocable trust by will. There would then be centralized management of all the rights.

e. *In Terrorem Clause.* Can a trust provide that if the beneficiary exercises termination rights, the beneficiary would lose all other rights under the trust? There is no clear answer regarding the effectiveness of such an in terrorem clause, but it is unlikely that it would be effective under the "no agreements to the contrary" doctrine.

f. *Offset Other Trust Benefits.* One speaker's office has used a trust provision saying that if a beneficiary exercises termination rights, any royalties received would offset other benefits that the beneficiary might be entitled to receive under the trust. That at least would permit the owner to manage the total assets and income that pass to a beneficiary. But it has not been tested.

g. *Prevent Termination Right From Arising At All — Work for Hire.* There are no termination rights if a copyright is created under a work for hire. But this is the "atom bomb" approach — the author would not have termination rights either.

h. *Use Professional Appraiser to Value Copyrights.* There is no rule of thumb for multiplying prior royalties times a factor for estimating the value of a copyright. There are a wide variety of variables that affect the valuation. Use an appraiser experienced in valuing copyrights. A big factor is the expected time frame of the royalty stream. For example, compare the value of the copyright for "Silver Bells" vs. Britney Spears' latest hit. Silver Bells was written in the 1950s. It produces a steady royalty stream in the hundreds of thousands of dollars every year. The latest Britney Spears hit will produce big royalties initially but there will likely be a big drop off.

54. Income Tax Issues Affecting Copyrights

a. *General Rule — Ordinary Income Treatment, But Capital Gain Treatment at Death*. The sale of copyrights generally triggers ordinary income, but once the original owner dies, the ordinary income rule vanishes and the copyright is then a capital asset with a stepped up basis. I.R.C. § 1221(a)(3). This would permit future amortization deductions, and a later sale or exchange of the copyright would qualify for capital gains treatment.

b. *Musical Copyrights Exception*. There is a specific exception to the general rule in § 1221(b)(3), which provides that the sale or exchange of musical copyrights qualifies for capital gain treatment.

55. Consult a Specialist

Perhaps the most important takeaway from the presentation is to consult a copyright specialist if a client has valuable copyright issues.

Items 56-61 are observations from a seminar by Bob Kirkland, Anita Siegel and Harry Wolff, Jr.: They Don't Call Me Counselor For Nothing — Adding Value to Your Product and Strengthening Your Client Relationships. The seminar addresses a variety of topics including: planning family meetings; long-term care insurance; ethical wills; letters of wishes for executors, trustees and guardians; disposition of remains and funeral planning; and interfacing with charitable donees.

56. Planning Family Meetings

a. *Who Is the Client*? Before planning the meeting, confirm whether the client is the senior family member or the entire family. If the entire family, there must be consent of all parties for multiple party representation. This would require a careful assessment of issues and possibly interviews of the parties to see if there will be potential conflicts. If a dispute arises, the attorney may have send the parties to separate counsel. One speaker related an example of how this can happen. Mother loaned money to a child to buy a house. The child later divorced and was late on payments. The mother wanted to foreclose against the child. The attorney said that the mother must get someone else to do the foreclosure because the attorney represented the child also. The mother replied "but I pay all the bills."

b. *Who Should Attend the Meeting*? Usually only adults (say age 25 or 30 and above) attend the family meetings. It is rare to bring young children into the meetings. Spouses of children are sometimes included if they are also involved in the family business or managing investment assets.

   Consider having just one attorney attend the initial meeting. Otherwise, the family may feel overwhelmed with these. One speaker also includes the trust officer or trust advisor in the family meetings.

c. *Meeting Location*. An off-site meeting (other than at the family business office, attorney's office, or home) is typically best to avoid distractions.

d. *Topics*. Potential topics include: review of the estate plan; possible changes to the estate plan; goals (tax and non-tax); family business continuation planning and succession planning; equalization issues if the family business is passing just to certain active children;

coordination with children's estate plans; asset protection strategies ("you can do for your children what they cannot do for themselves"); and dealing with in-laws, stepchildren and divorced spouses. Provide an agenda before the meeting.

e. *Length of Meeting*. The initial meeting should not last beyond three hours. Provide food and drink. The meeting could perhaps be a weekend retreat. Subsequent meetings may be needed for implementation and updates on how the plan is developing.

f. *Communication*. Open communication is a key to avoiding festering family problems.

57. Long-Term Care Insurance

a. *Significance*. The speaker has not found that his clients are very interested in long-term care insurance. However, a show of hands reflected that many in the audience have clients who do own long-term care insurance.

There are about 8 million long-term care policies in the country today. Someone age 65 in 2007 had a life expectancy of 18.7 years. The bad news is that 70% of people who are age 65 will need long-term care before they die. The Alzheimer's Association estimates that 10 million baby boomers will develop Alzheimer's disease.

b. *Financing Long-Term Care*. The cost of long-term care is dramatic. The average annual cost of a private nursing home room is $77,380. In-home care typically costs $20 an hour, or $480 per day. Individuals pay about 18% of long-term care out of their own pockets. About 16% is paid by Medicare (it only pays for limited things, generally including health care but not long-term care), and about 48.9% of long-term care spending is paid by Medicaid. About 7.2% of long-term care spending is covered by long-term care insurance.

c. *Tax Treatment of Long-Term Care Insurance*. The 1996 HIPAA laws relaxed the tax treatment of long-term care insurance. Premiums paid for long-term care insurance can be deducted as a medical expense, but the deduction is limited to the "eligible long-term care premium," which is based on the insured's age. I.R.C. § 213 (d)(10)(A). Medical expenses can be deducted to the extent they exceed 7.5% of adjusted gross income (10% for years beginning after 2012). I.R.C. § 213(a). Benefits received under long-term care policies are excluded from gross income, except that if an indemnity contract that pays a per day benefit in excess of the per diem limit under §7702B(d) ($300 per day in 2011), the excess is taxable to the extent it exceeds actual long-term care expenses. I.R.C. §§7702B(a)(2) & 104(a)(3). There are special rules regarding the tax treatment of long-term care coverage provided by sole proprietors, partnerships, and C corporations.

The Pension Protection Act of 2006 added that life insurance policies may be exchanged for qualified long-term care insurance policies tax-free under §1035, and that life insurance and annuity contracts may include a long-term care insurance rider on a tax favored basis. I.R.C. §§7702B(e)(1) & 7702B(b). Beginning January 1, 2010, premium charges associated with long-term care insurance that are distributed from the cash value of a life insurance or annuity contract are entitled to tax favored treatment under §72(e)(11).

d. *Other Federal Programs*. The Deficit Reduction Act of 2005 makes provisions for state programs for long-term care insurance partnerships. Benefits paid under these programs may be disregarded in determining an individual's assets for purposes of Medicare qualification.

Under the Community Living Assistance Services and Supports Act ("CLASS") enacted March 23, 2010, a national voluntary long-term care insurance program is established that is funded through payroll deductions for active employees. Only persons who are "actively employed" and receive wages or earn self-employment income may enroll in CLASS, and premiums are paid exclusively by the enrollee/employee.

e. *Structure of Long-Term Care Insurance*. I.R.C. §7702B(b) has a detailed definition of a "qualified long-term care insurance contract." Policies are designed around the requirements of that Code section, but include many variables.

Trigger of Benefits. Payments are triggered when an individual is not able to meet a certain level of "activities of daily living" (described in I.R.C. §7702B(c)(2)(B)) for a certain period of time.

Amount of Benefits. The policy will pay a maximum amount, based on a per day or monthly limit. The maximum is typically three to five years of expenses. There are now products that pay for an unlimited time.

Premium Payments. Once an individual starts receiving benefits, premium payments are no longer required.

Pre-existing Conditions. Even under the new Health Care Reform Law, pre-existing conditions can be considered in denying coverage under long-term care policies.

Elimination Period. Many contracts have an elimination period. Even after the triggering conditions are satisfied, the policy does not start paying benefits for a certain number of days.

Institutional and Home Care. Address whether the policy covers both institutional care as well as home care (most do).

Renewability. The policy may be automatically renewable to a certain age, for a term of years, or for life.

Conditions Covered. Does the policy cover Alzheimer's and dementia?

Hospitalization Requirement. Older policies require hospitalization for a certain number of days even though the individual could not care for himself or herself.

Premiums Increase. Premiums generally cannot be raised later unless the carrier goes back to the state regulator and gets permission to increase the rate structure.

Important Riders For Consideration. Policies may offer an inflation adjustment. A recent phenomenon is a return of premium on death rider, which returns the total of all premiums paid less benefits paid under the policy, if the insured dies while the policy is in force. This rider approximately doubles the cost of the contract, but some carriers are aggressively pushing this rider, suggesting that an ILIT own the long-term care policy (the benefit would be paid income tax-free and pass to beneficiaries transfer tax-free).

f. *Underwriting*. Underwriting of long-term care policies will include extensive cognitive exams in addition to normal blood tests.

g. *Covering Both Spouses*? Many carriers will reduce the premiums significantly if both spouses are covered under a long-term care policy.

h. *Cost*. The cost of a "Cadillac" policy for a 55-year-old male with the refund of premium option is $7,779 annually, or $21,175 with a "10 Pay Option" (where premiums are paid for just the first 10 years).

i. *What Age*? Insurance carriers push people to get long-term care coverage at age 55. It gets more expensive as it is bought at later ages.

58. Ethical Wills

a. *Description.* An ethical will is a gift of words – a vehicle to share values, hopes, aspirations, life lessons, love, forgiveness, exhortation's etc. Zoe Hicks wrote an excellent article about Ethical Wills, describing planning considerations for them. Hicks, Zoe, Is Your (Ethical) Will in Order?, 33 ACTEC J. 154 (Winter 2007). The speaker described one individual who wrote a 150 page "life story" with pictures. It can also be a series of letters. The article by Zoe Hicks described a situation in which an individual gave letters to the trustee to deliver to his daughters as they reached various ages. The attorney who prepared the trust reports that the daughters looked forward to the letters their father wrote them much more than the money they received from the trust.

Encourage clients to tell the truth in the letters. Don't revise family history or reality.

Historically, ethical will language was put in last wills and testaments. The speaker encourages a separate ethical will.

b. *Example of Start of a Letter*. "Dear Children: Somewhere among these papers is a Will made out by a lawyer. Its purpose is to dispose of the material things which I may possess at the time of my departure from this world to the unknown adventure beyond. I hope its terms will cause no ill-will among you. It seemed sensible when I made it. After all, it refers only to material things which we enjoy only temporarily. I am more concerned with having you inherit something that is vastly more important…"

c. *Example Contents*. Possible contents of an ethical will may include: sharing of a set of values or beliefs; moral directives or hopes; reminders of family heritage and family stories; encouragement to carry on for-profit or not-for-profit efforts; reasons for certain actions taken during life; expressions of gratitude.

Bob Kirkland lists the following possible themes:

"a. Is there a loved one who needs your forgiveness, or from whom you want forgiveness?

b. Is there someone you need to tell that you love them?

c. Is there something you will regret not saying if you were to die tomorrow?

d. What values, beliefs, etc. do you wish to share, and with whom?"

d. *Why Consider Ethical Wills*. From the planner's standpoint, addressing ethical wills really helps connect with clients personally. From the client standpoint, the content may be the best gift that their children will receive. It can provide a sense of completion of the maker's life.

e. *Attorney's Role.* The speaker gives examples to his clients. Some attorneys get much more involved in the discussion of ethical wills with their clients, but he does not.

f. *Resources*. Resources include *The Wealth of Your Life, a Step-By-Step Guide for Creating Your Ethical Will,* by Susan B. Turnbull, *Grandmother's Memories to her Grandchild,* by Candy Paull and Thomas Kinkade, and *Ethical Wills: Putting Your Values on Paper,* by Barry K. Baines, M.D. An informative website is www.ethicalwill.com.

59. Letters of Wishes for Executors, Personal Representatives, Trustees and Guardians

a. *Overview*. These are letters that describe personal issues important to the grantor. The letters can be to beneficiaries or fiduciaries. The letters are typically separate from the will or trust agreement and are often informal, covering feelings and desires not appropriate for the formal legal (and sometimes public) document.

They are typically delivered after the death of the decedent. Sometimes they are delivered to fiduciaries during the individual's lifetime to see how the trustees will respond. They may be given to family members during lifetime to have an impact on their behavior.

b. *Instructions to Executor*. The letter may include guidance (not a mandate) as to what assets to retain and what assets to sell. It may address the desires as to how active the executor should be regarding the management of assets versus the mere preservation of assets during the estate administration. If there are multiple executors, it may address which executor's views should be given priority regarding specific issues. The letter may also discuss the preferred split of executor commissions.

c. *Instructions to Trustees*. The letter may give guidance (not a mandate) regarding investment issues, such as whether to prefer growth or income.

Instructions may give more detailed guidance regarding discretionary distributions than just standard ascertainable standards. For example, it may address whether improvement of a residence or vacation home would be permitted or whether to allow distributions for pursuing a business opportunity or professional practice. Incentive provisions may be addressed. The speaker told of one $100 million client who included guidance that distributions "be used for heat, light and rent in a reasonable way, but not for stupidity."

The letter may also address health issues, such as whether expensive in-patient clinics that are not covered by insurance should be included. It might address infertility or adoption expenses or payment of health insurance premiums.

As to education expenses, the guidance may discuss whether only tuition should be covered or also living expenses and what levels of education should be funded and whether re-education for someone who has been out of the workforce or is changing careers should be covered.

The guidance may address differences in treatment of children if there is a big disparity in ages or if some children have significantly more assets or opportunities than others.

The guidance may address factors to consider (perhaps beyond just tax factors) if the fiduciary has the ability to revoke or grant powers of appointment.

If the fiduciary has the authority to delay the times of distributions, the guidance could discuss factors that should be considered, such as mental or physical illness, emotional problems, unstable marriages, etc.

The guidance may address how multiple co-trustees should work together.

d. *Instructions to Guardian*. The guidance will generally provide that the person wants the child raised the same as if the decedent were alive to do it him or herself. Issues that may be addressed include education, religious affiliation, extra curricular activities, discipline guidance, and continued contact with other family members (aunts, uncles, etc.). If the child is disabled, there may be guidance regarding desired living conditions and what kind of services the child should have. The individual may be able to give detailed guidance regarding doctors and resources that are available for a disabled child.

e. *Trust Document versus Separate Letter of Wishes*. The speaker likes to keep the trust document language fairly standard, and use a separate letter of instructions to explain what is meant by those standards. One speaker expressed concern with standards beyond clearly recognized ascertainable standards. He observed that he is a tax lawyer first, and he has some concern that something in an informal letter my later surface to cause tax problems.

f. *Discoverability*. Any qualified beneficiary can probably request and receive a copy of the letter.

60. Disposition of Remains and Funeral Planning

a. *If Planner is First Person Contacted After an Individual's Death*. Call 911 to notify appropriate state authorities. If an individual dies in a hospital or nursing home, they take care of that. The first responder will put into place the legal things that need to happen when someone dies.

Call the personal physician if the attorney knows who it is. If an individual dies outside his or her home jurisdiction, deal with moving the body out of the state or out of another country. If the individual was an organ donor, make sure the hospital or paramedics know that. Notify next of kin (in accident situations, the authorities may do that). Contact the decedent's clergy if you know who that is. Make sure that any dependents in care of the deceased individual (including children, pets, and livestock) are taken care of. Take steps to protect property that may spoil or that need immediate attention.

b. *Funeral Planning*. Hopefully the individual has made pre-arrangements including a burial plot. The numbers of decisions that must be made at the funeral home are mind-boggling. There may be a dispute among family members about decisions to be made. State law provides who is in charge of the disposition of remains. The individual may have signed a statement appointing an agent to control the disposition of remains. (For an example of such a form, see §711.002 of the Texas Health & Safety Code.)

61. Interfacing with Client's Charitable Donees

The attorney's involvement with potential charitable donees may allow the client to remain anonymous. This may allow the client to avoid feeling pressured or being oversold.

A "Declaration of Intent" with the charity may be sufficient to include the donor on the charity's donor list even though it is not a binding pledge.

A Donor Advised Fund may result in lower legal fees. The attorney's real world experience with that fund is valuable to the client.

Communities Foundations have lawyers on staff. They can be intimidating to clients, and interfacing with them can add value to our clients.

Items 62-70 are observations from a seminar by James M. Maddox, William L. Harbison, and Margaret G. Lodise: Dealing with the Overlapping Roles of Individual Fiduciary, Business Manager and Beneficiary (What do you do when big sister says to little brother: "That is why Daddy named <u>me</u> President AND Sole Trustee!"). The seminar focuses on dealing with family conflicts in business succession planning situations.

62. Overview of Business Succession Planning Significance

a. *Job Security For Planners*. Sibling rivalry and greed will always be with us. This is job security personified. An issue is how planners can motivate clients to pay for the planner to deal with their lack of parenting success.

b. *Reduced Need To Sell Business For Liquidity*. In light of the increases in the estate tax exemption amount, there will probably be reduced need to sell closely held businesses for liquidity to pay transfer taxes. This could lead to leaving more entities in place with a greater likelihood of potential family conflict issues.

c. *Emotional Baggage*. Often the issues are not based on an objective evaluation of business and fiduciary principles, but may have more to do with "the sand the siblings threw in each others face on the beach when they were youngsters."

d. *Case Studies*. Three case studies are explored. These are based on actual fact situations.

63. Case 1: Issues Including Demand for Accounting and Information by Children Not Active in the Business, Funding, Effect of Trust Clauses Giving Trustee Broad Power Over Business Decisions and Waiving Conflicts, and Trustee Removal

a. *Case 1 Fact Summary*. The spouses lived in a community property state with four adult children. At the husband's death, the surviving wife's one-half passed to a grantor trust for her, and the husband's one-half was divided among a QTIP Trust, and Credit Shelter Trust. Eventually, two sons each received one-third, and two daughters shared a one-third portion. Following the deaths of both parents, the sons received their shares outright, but the daughters' interests in the family business were retained in a long-term trust with the sons serving as trustees. One of the daughters is very concerned about how the brothers are managing the assets. There is specific trust language that allows self-dealing and permits retaining closely held business interests.

b. *Sample Clause — Conflict of Interest, Self-Dealing, Exculpation Provision Regarding Business Interests in Trust.* The following clause prepared by Ted Calleton (Pasadena, California), in the materials by Meg Lodise, is reproduced with his permission:

> *Conflict of Interest: Self Dealing: Exculpation.* The Settlors privately own property in common with their sons and/or are partners with their sons and intend to become partners with other family members. It is Settlors' belief that their sons, who have assisted them with the management of their assets (and the trust estate), are best equipped to make decisions regarding management and sale of the trust estate for the benefit of all the Settlors' children and grandchildren, even if such decisions encompass the sale of trust assets to themselves individually or as partners, or encompass loans from them individually or as partners to themselves as Trustee for trust purposes. Accordingly, it is the intention of the Settlors that their sons, or either of them, while acting as Trustee be given maximum flexibility to deal with and manage the trust estate, notwithstanding the fact that under other circumstances their actions would be deemed to be self-dealing or would place them in a position where their personal interests conflict with their obligations as Trustee. Thus, for so long as Son 1 or Son 2 is acting as Trustee and acts in good faith, he shall not be liable to any beneficiary for any loss, real or alleged, suffered by such beneficiary because the Trustee made or decided not to make any tax election or allocation of tax benefits (including use of the exemption from the generation-skipping transfer tax), or made or decided not to make any investment,

or for any allocation of assets prorata or non-prorata him between trusts, or for having made or decided not to make any discretionary distribution of principal or income. Neither of Son 1 or Son 2, shall be liable for acting with respect to shares of stock, corporate obligations, partnerships, joint ventures, business enterprises or any other property now or later constituting the trust estate, regardless of any interest that either of them has in such properties or entities, either as an individual or as a fiduciary of any estate or trust. Similarly, no liability shall exist by reason of any claim by or on behalf of anyone who may be interested in the trust estate or any trust established by this agreement arising out of, or claimed to arise out of, any possible conflict of interest based on the interest of either Son 1 or Son 2, individually, as a partner or as Trustee, in any property that is or may become a part of the trust estate or of any trust established by this agreement. It is the intention of the Settlors that the provisions of this Section 6.6 be liberally construed to the end that Son 1 or Son 2 acting in an individual or fiduciary capacity or as fiduciary of another estate or trust may deal with himself as Trustee and matters pertaining to any property that is or may become a part of the trust estate or of any trust established by this agreement.

Without limiting the generality of the foregoing, Son 1 and Son 2, or either of them, while acting as Trustee may exercise all rights and powers accorded the Trustee by law or by this agreement even if, at the time of exercise, either or both of them is (i) an officer, director, employee or shareholder of any corporation the securities of which are at any time a part of the trust estate or any trust established by this agreement, (ii) a partner, participant or employee of any partnership, joint venture or business interest in which the trust estate or any trust established by this agreement has an interest, or (iii) a fiduciary of any estate or trust having an interest in any corporation, partnership, joint venture or business enterprise in which the trust estate or any trust established by this agreement has an interest. Son 1 and Son 2, or either of them, while acting as Trustee are specifically authorized to make loans to, purchase or exchange assets with themselves individually or as a partner provided that if any such transaction the trust estate shall receive fair and adequate consideration in money or money's worth.

c. *Accounting*. Following their father's death, the sons provided an accounting to the other beneficiaries of the father's assets, but only provided an accounting with respect to their mother's one-half of the assets following her death. It would have been better if the sons had provided accountings from the date of the father's death. That would have started the statute of limitations running and might have helped the daughters' understanding and may have avoided any contest, if the daughters realized that the sons were doing what the parents (and their surviving mother) really wanted. (Under California law, if the mother was incompetent, an accounting would be required from the time the revocable trust was created.)

There may be no right to an accounting during the surviving mother's lifetime regarding the father's assets passing into trusts if the surviving mother has a general or limited power of appointment. Nothing vests until the mother decides not to exercise the power of appointment. Adding a power of appointment for the surviving spouse is a good way to maximize the control of trustees during the spouse's lifetime (except that the spouse may change the plan that was put into place to control the family business).

d. *Demand for Records*. The daughter demanded all books and records related to the accounting, salaries, and all business activities. Under California law, trustees must keep the beneficiaries reasonably informed, and upon a reasonable request by the beneficiary, must provide information relevant to the beneficiary's interest.

The sons resisted turning over information, but it might be better to disclose the information upon request (unless they have done something wrong). Refusing to turn over information makes the daughters suspicious. However, the sons may have concerns that information about the business might become public if it is released. They may rationalize "if I give them this information, they'll just ask for more and will have to spend lots of time providing information."

If the daughters go to court and ask for information, the court is likely to say "what's the harm" and require that the information be released.

e. *Funding*. One reason that might justify a release of information to the daughters is to provide sufficient information to determine if the funding is made fairly and in good faith.

f. *Trust Clause Maximizing Trustee's Powers Regarding Business Interests*. The trust clauses give the trustee maximum flexibility even if there would otherwise be self dealing. The sons will have an easier time defending their actions in light of the existence of these clauses. The daughters would argue that they are still entitled to information to determine good faith; for example, if there is contemplation that the business may go public in two years, the daughters would want to know that in determining the reasonableness of the funding decisions.

g. *Removal*. The daughters will have their brothers as trustees for the rest of their lives. They may prefer having an independent party as trustee. The sons will argue that the parents wanted them to continue the management of the family business as evidenced by the specific clause in the trust agreement. Courts will generally defer to business judgment decisions, especially where this type of specific waiver is included. Without that, courts may be more inclined to look behind the business judgments of the trustee. For example, *Rubin v. Goldman*, 48 Md. App. 59 (1981), although vacated, has a long discussion of conflicts issues of fiduciaries and the potential waiver of inherent conflicts in the trust documents.

64. Case 2: Daughter/Trustee Without Business Experience Names Herself as President With Big Salary; Business Declining In Value; No Potential Buyers Other than a Son Who Wants to Buy at a Discount; Fair Rental of Building to Business

a. *Case 2 Fact Summary*. The trust agreement has no clauses regarding conflicts of interest or specifically authorizing retention of business interests. A single man with three children dies owning a business. One son, Sam, has business experience but is not involved. Another son is a beach bum who needs cash. A daughter was an excellent receptionist with no business experience, but she was named as the sole executor and she causes herself and to be elected as the president with a $100,000 per year salary (high for that business). Real estate owned outside the business but that is used by the company vests equally in the three children. The daughter causes the company to rent the real estate at a high rental rate, and makes distributions to the three children. She appears to be running the business into the ground, and Sam (the son with business experience) would like to buy the business, but at a significant discount because one customer represents 90% of the revenue the company. No outsider is interested in purchasing the business because of its instability. The estate is illiquid and all cash was used to pay estate taxes.

b. *Obtaining Information*. Sam wants financial reporting, at least monthly. The daughter responds that he is not a shareholder, but the estate is the shareholder so he is not entitled to information. After he sued to obtain the information, she agreed to provide it.

c. *Executor Removal*. Sam's best argument to remove his sister is because of her conflict of interest as executor, beneficiary, and president (at a high salary). An independent executor would be more likely to explore other alternatives including selling the business (even to Sam if he is the only buyer). Arguably, she used her fiduciary powers to put herself in an advantaged position with the big salary. However, even without a conflict waiver provision in the will, the fact that decedent appointed her as the executor probably precludes removal on conflict grounds if she has not taken steps to exacerbate the conflict.

d. *Court Action Timing Difficulties*. A court action would require an evidentiary hearing with discovery, which would take at least a year. A court action is not a good alternative for Sam. His sister's salary is $100,000 per year, and the litigation costs would likely be another $100,000 or more. Litigating a case like this has severe economic risks.

e. *Doubling on Fiduciary Compensation and as President of Company*. There are significant issues about double dipping on compensation. In this actual case, the daughter did go to court and request interim executor fees. She did not tell the court that she was receiving a big salary from the business. When the court found out, it put her fee request on hold.

f. *Fair Rental*. Sam could argue in court that the rental was unreasonably high, but that is hard to prove as well. Sam might also request a partition proceeding and purchase the property at a partition sale, but that would likely take a year as well.

65. Case 3: Non-Active Children's Rights vs. Active Child in Control; Retaining All Profits For Growing Business; Court Modification of Trust; Attorneys Fees in Fiduciary Litigation

a. *Case 3 Fact Summary*. Parents are killed in a plane crash owning a business; they have three children. Hillary runs the business and has no children. Mary is married to a litigator and has children. John is a ski lift operator with limited ambition and cash needs. Each of the three children owned 20% of the business outright, and 10% is owned by a dynasty trust for the grandchildren. The parents' 30% passed under their wills to a long-term trust for all three children. Hillary is trustee of the dynasty trust and of the trust for the children. The trust contains good language about business continuity, but Hillary sold the estate's 30% interest to an ILIT that does not have specific business continuity language. After the parents' deaths, Hillary runs the business successfully, and in an effort to grow the business, she makes no distributions but plows all profits back into the business. John is upset; he has no way to get cash.

b. *Control*. Hillary has 60% control (20% directly, 10% as trustee of the dynasty trust, and 30% as trustee of the parents' trust for children).

c. *Classic Precarious Situation for Non-Active Children*. John's situation is illustrative of the classic non-active child situation. He receives no cash flow from the business and cannot enjoy what he received from his parents. The stock is controlled by Hillary. John is in a difficult situation, and it will be difficult to do anything for him.

d. *Conflict Between the Non-Active Children*. In this case, John has no children, but Mary has children who benefit from the growth of the business through their interest in the dynasty trust. It would be problematic to represent John and Mary together. John should not use Mary's husband to represent him and Mary.

e. *Change in Distributions*. John's best argument is that his parents made distributions from the company, and Hillary changed that prior pattern. There are fiduciary cases that have given deference to how the business was run in the past. *See Shear v. Gabovitch*, 685 N.E.2d 1168 (Mass. 1997) (no duty to make property productive after trustor deceased when asset was not made productive during his life). John will argue that he would not receive benefits for the rest of his life. However, courts are likely to defer to the business judgment of the fiduciary.

f. *Benefit of Preferable Business Continuity Language*. The parents' wills contain good business continuity language, but the executors sold the estate's stock to an old ILIT that did not have business continuity language. Hillary might request the court to give her the benefit of the better language. However, it is unlikely that the court will impose a different intent than contained in the terms of the ILIT just because later estate planning with other trusts was different. This problem could have been avoided if the estate had borrowed money from the ILIT to pay taxes rather than selling the stock to the ILIT.

g. *Purchase of John's Interest*. John might kick up dust by demanding accountings and information about the business. A possible settlement would be to purchase his trust interest. That would require modifying the trust, but in many states trust modifications can be achieved with very little changed circumstances. The courts see it as beneficial to the trust – and beneficial to their court calendars. In some states, there may be a requirement to show that the change would not impair a material purpose of the trust, and that may be hard to show unless John can be bought out with assets other than the business interests. A complicating factor is that his interest as a trust beneficiary is completely discretionary so it is hard to value.

66. Payment of Fees in Fiduciary Litigation

Trust assets can generally be used to pay the attorneys fees of the fiduciary. How does the attorney for the beneficiary get paid? The attorney must discuss with a potential client how expensive a court action will be. Even when representing trustees, other beneficiaries may get court restrictions on how much of the fees the trustee can pay. For example, in *Donahue v. Donahue,* 182 Cal. App. 4th 259 (2010), even after the trustee was successful in his defense, the beneficiaries objected to payment of the fees on the grounds that they were too high. The court questioned whether the trustee had demanded a "Rolls-Royce defense when a prudent trustee could have arrived at the same destination in a Buick, Chrysler or Taurus?"

In Tennessee, the court has the ability to shift the fees of all parties in trust litigation, requiring that the trust pay all, the beneficiaries pay all, or anywhere in between. California does not have an outright fee shifting provision. However, the court can shift fees if an accounting is defended in bad faith. In addition, a beneficiary who successfully brings a claim against a trustee may argue that it was for the benefit of the trust and that the fees should be paid from the trust.

One speaker's engagement letter for trustees always provides that if the trustee cannot pay fees out of the trust, the trustee will be personally liable for the fees.

67. Consider Litigation Alternatives For Family Disputes

There may be a family rift when the dispute starts, but after several years the schism will be irreparable. Consider alternative dispute resolution alternatives even before a lawsuit is filed. Even after litigation is pending, consider ADR as well, but a more flexible remedy may be possible if ADR is pursued before court litigation.

68. Damages Difficult to Prove

Damages in these types of disputes about control over business entities may be difficult to prove. For example, in Case 3 the fiduciary will argue that she is pouring all income back into the business to grow it, but there are no damages. A court may not view damages as sufficiently certain or even likely to occur. *Bastys v. Rothschild*, 2000 WL 1810107 (S.D.N.Y. 2000) (alleged damages too speculative), *Benedict v. Amaducci*, 1993 WL 87937 (S.D.N.Y. 1993). However, a court may loosen the damages proof requirements where sufficiently convinced of the breach of a fiduciary duty.

69. Representing a Party in Fiduciary and Individual Roles

A person may need separate counsel with respect to the different roles that the person has. However, clients may resist engaging two attorneys.

70. Planning to Avoid Future Family Confect Problems Later in Business Succession Situations

a. *Advise Client of Conflict Potential; Exit Strategy*. Discuss with clients how difficult the situation may become if individuals serve in multiple roles, for example as trustee for other family members, president, owner of the company, etc. Try to achieve upfront separation if possible by funding the interests of non-active children with assets other than business assets. Doing so before death is best, or an alternative is to build in legally binding options to purchase interests following the owner's death.

b. *Choice of Fiduciary*. Clients often want to use children as fiduciaries in business situations. They don't want to see past their perception that their children can get along and handle these conflict situations. But when one sibling is in charge of another sibling's interest, it is a prime source of conflict and litigation no matter how well the documents are prepared. An important discussion with clients is to consider having independent executors and trustees in these situations.

c. *Trust Language About Business Retention and Conflict Waivers*. Be as specific as possible with business retention and conflict waiver clauses. It is not very helpful just to say that conflicts of interest are waived. Instead say "I realize this may result in no distributions to John..." Generic waivers are not as effective as waivers that address specific conflict situations.

d. *Pre-Planning to Avoid Future Expense*. Explain how expensive litigation is on the back-end and that paying expenses upfront can be cost productive.

e. *No-Contest Clauses*. No-contest clauses help discourage litigation.

f. *Trust Language is No Cure-All*. Even excellent trust language regarding business interests and conflicts of waivers cannot solve all the problems.

Items 71-77 are observations from a seminar by Louis A. Mezzullo and Milford B. Hatcher, Jr.: 2701, a Trap for the Unwary. The seminar provides an overview discussion of section 2701 and focuses particularly on ways that multi-class partnership interests can be used.

71. Section 2701 Overview (Greatly Simplified)

a. *Significance and Example*. Section 2701 was enacted in 1990 as part of Chapter 14. The intent was to avoid perceived abuses of corporate recapitalizations. However, § 2701 can arise inadvertently. Lou was expert witness in a case where an individual created a partnership with preferred interests. The corporate attorney said that the individual should have his estate planning attorney review the partnership, but that was not done. A subsequent law firm discovered the problem and there were unpaid millions of dollars of taxes. A settlement was reached in the malpractice action.

Example: Father contributes $1 million and son contributes $10,000 to a partnership in which father and son will own 50% interests. Father will eventually get his $1 million back (but with no guarantee of getting it back at any particular time), so thinks that no gift is involved in the creation of the partnership. Under § 2701, father makes a gift of $495,000 to the son, because the right to get the $1.0 million back is valued at zero (because it is a put right or liquidation right, which is an extraordinary payment right valued at zero under § 2701. (To avoid valuing the right to receive back the million dollars at zero, there would have to be a fixed payment date, and the present value of the payment right would be determined as of the date.)

b. *Applies Only if Separate Classes of Equity.* Section 2701 only applies if there are separate classes of equity. Therefore, transfers of interests in an S corporation will never be subject to § 2701, and a partnership or LLC with "straight-up" allocations will never be subject to § 2701. There can be differences in voting rights, management rights, and limitations on liability. They are not treated as separate classes of equity.

c. *Triggering Events Under § 2701.* Section 2701 imposes special rules for valuing gifts of certain interests in corporations or partnerships that are transferred to family members. The special valuation rule applies if there is a *transfer* by the transferor of an interest in a corporation or partnership to a "member of the family" (generally the transferor's spouse and descendants and their spouses) and if an "applicable retained interest" [what we typically think of as a preferred interest] is retained by an "applicable family member" (generally the transferor and his or her spouse and ancestors).

d. *Applicable Retained Interest.* An applicable retained interest is either an (i) "extraordinary payment right" (a liquidation, put, call, or conversion right) or a (ii) "distribution right" if the transferor and certain members of the transferor's family control the corporation or partnership.

Any extraordinary payment right or distribution right (other than a "qualified payment right") is valued at zero, except that a mandatory payment right at some date can be given value.

A qualified payment right is a right to receive distributions from the entity that are fixed and cumulative. For example, this could be a 10% cumulative dividend right. (If cumulative dividends have not been paid when the person dies, they will be included in the person's estate assuming the corporation has enough value to pay them.)

e. *Only Used With Partnerships and LLCs.* As a practical matter, preferred interests are used only with partnerships and LLC's, because the "double tax" on corporate dividends makes them very inefficient for C corporations. (The speakers say that they have not seen a preferred interest with a C corporation in a family setting in over 25 years, because of the requirement under § 2701 of having cumulative dividends that ultimately must be paid.)

f. *Failure to Pay Cumulative Dividends.* If cumulative dividends are not paid, when the stock is later transferred or when the owner dies, there will be an increase in the taxable gifts or estate value equal to the dividends that have not been paid, compounded based on the same interest rate that was used for purposes of valuing the preferred interest. There is a cap on the amount that will be added — the amount of appreciation in the residual interests from the time that the two classes of interest were created until the date of death.

g. *Little Law Other Than Code and Regulations.* There has been no case law regarding § 2701, and only a few private letter rulings that are not very instructive.

h. *Combination of Liquidation Right and Preferred Return.* If father retains both an extraordinary payment right (such as a liquidation or put right) and a right to receive fixed preferred distributions (i.e., qualified payment right), in that case the *lower* of the value of the liquidation right or the preferred return is deemed to be the value of the retained interest to determine the value of the transferred residual interest.

Moral: Never have an extraordinary payment connected with a qualified payment right. If the extraordinary payment right is worth less than the qualified payment right, the lower of those two values will be the value of the retained interest for purposes of determining the value of the transferred interest.

i. *Subtraction Method to Determine Value of Transferred Interest.* The subtraction method is applied in several steps.

(1) *Value of Family Interest in Entity.* Determine the value of the family-owned interest in the entity. Unfortunately, the regulations say to treat all of the family-owned interests as being owned by one person. For example, if five family members collectively own 80% of an entity, the family interest would not be entitled to a lack of control discount. However, the § 2701 regulations were issued before Revenue Ruling 93-12, where the IRS agreed that transfers of minority interests to each of five children would be entitled to a lack of control discount even though the family controlled the entity. Therefore, the speakers think that it would be appropriate to apply appropriate lack of control discounts to the interest owned by each of the respective family members in determining the value of the interest in the entity owned by the family in this first step.

(2) *Subtract Certain Applicable Retained Interests.* Subtract the applicable retained interests retained by the transferor or applicable family members, after applying section 2701 in valuing those interests. (If there is a preferred interest that is a qualified payment right, an appraiser would determine the value of the preferred distribution rights, based on market conditions.)

(3) *Apply Balance to Residual Interests.* Apply the balance to the value of the residual interests. The value of the residual interests retained by the transferor is not treated as a gift. (In the simple example above [and ignoring the $10,000 contributed by the son], where father contributed $1 million to a partnership and received 50% of the interest in the partnership, the liquidation right to receive the $1 million at liquidation is valued at zero, so the deemed value of the residual interest is $1 million, but the father owned one-half of that, so only $500,000 is attributed to the gift of the 50% interest in the son.)

(4) *Determine Gift Amount.* Several other adjustments are made in determining the value of the gift. One of the adjustments is to adjust for minority interest discounts among the common interests on a proportionate basis. Treas. Reg. § 25.2701-3(b)(4)(ii). The regulations confirm that discounts may be appropriate in determining the value of the residual common interests.

(The outline is one of the best discussions anywhere of the technical details of the subtraction method process.)

j. *Ten Percent Minimum Value Rule*. The residual interests, regardless of the result under the subtraction method, must be worth at least 10% of the value of the enterprise including loans from the transferor to the enterprise. (The 10% value rule cannot be avoided by having low equity but a lot of debt.)

k. *Practical Effect*. Transactions should be structured either to have a qualified preferred return or else avoid § 2701 entirely. Mil: "Section 2701 is not the most frequently used provision, but it is not something to be afraid of. It's something that you can use for your own benefit. There is a great deal of technical detail, but the bottom line effect is that if there is economic substance to the preferred interests (with cumulative preferred returns payable at least annually, and without playing games with put, call, or conversion rights to try to bolster the value) the transaction can satisfy § 2701."

72. Structuring Preferred Partnership Interests

a. *Valuing the Preferred Interest*. There is no fixed objective method of valuing the preferred interest. There must be an appraisal, as a practical matter, based on market indicia. Rev. Rul. 83-120 is the bible in this area. Appraisers will use highly rated publicly traded preferred stock as a comparable, but make a qualitative adjustment because the family company is likely not a highly rated publicly traded entity.

The preferred rate is generally based on the riskiness of the underlying assets of the entity. The more likely it is that the preferred return can be paid, the lower the rate will be. If it is really unlikely that the preferred return can be paid, do not use a preferred partnership in that situation. If distributions depend on profits, it may be more likely that there will not be enough cash flow to make the preferred distributions.

The required preferential return rate floats with market conditions. For example, in 2007, about a 7 ½ to 8 ½% preferred return was appropriate. That was not still appropriate in 2009 after the market crash. Mil Hatcher sees 8 to 12% in the market based on current conditions (and that has been slipping upward a little). Five to six months ago, he thinks the appropriate rates were approximately 7 ½% to 12%. (The high-end [about 12%] is level because if it goes over that, this is probably not an appropriate vehicle.)

Keep in mind that a higher preferred rate means that there will be more value coming back into the transferor's estate, or if not paid, a higher compounded amount to be added to the transferor's estate. A lower rate is generally preferred, unless the parent specifically wants to receive a higher rate in order to satisfy his or her living expenses (or wants to make a transfer of the preferred interest in a reverse partnership freeze).

There can be a substantial range in the rates that are deemed appropriate by the various appraisers. Mil often uses 4-5 appraisers, and finds that the rates may vary in the same situation from 8% to 10 or 11%. "I'm not kidding. You will really see that much discrepancy among appraisers."

b. *Weighting Preferred to Common*. If preferred interests are more than 50% of the capital contributions to the partnership, the rates will be very high. As a practical matter, the preferred interest should not exceed about 80% of the capital in any event, because of the 10% test. (The maximum should be 80% rather than 90%, because the higher the weighting of the preferred, the more discounted the value of the common residual interest would be; therefore, 20% may equal only 10% after the discount.) But that is an 80% leverage; "only the housing market is above that."

Lack of marketability is a factor. To offset lack of marketability of the preferred interest, increase the preferred return. If a preferred return without any marketability discount may have been 7%, that may equate to an 8 ½% to 9% yield that would be expected if dealing with a closely held preferred interest.

Emphasis on Distributions. The emphasis should not be on preferred rate as much as on the ability to make distributions to satisfy the preferred interest. If the appraiser indicates that the applicable rate is 10 to 11%, and the entity will not support that high of distributions for the preferred interest, just issue less preferred. Allocate the appropriate amount to the preferred to get to the amount of desired distribution. The weighting between preferred and common will offset the differential between rates typically. When structuring the transactions, it is of utmost importance that there be discussions with the appraiser up front because that's when it must be structured appropriately.

c. *Voting Control In the Preferred Interest.* Voting control is also a factor. Revenue Ruling 83-120 says there is not much discount for lack of voting control, especially if there are fiduciary concepts under state law applicable to those in control. Mil generally prefers not to have voting control in the preferred interest. A primary reason is that if the owner ever decides to give away a majority of the voting control there is a special provision under § 2704 that may result in a deemed gift with respect to the diminution in value of the common interest.

73. When to Use Preferred Partnership Interests

a. *Disadvantage in Many Situations: Higher Preferential Return Than For Sales.* The preferential return is typically higher than the AFR rate that would be used in an installment sale transaction. Still, preferred partnership interests can be helpful for transfer planning purposes in appropriate circumstances.

b. *Discounts of Residual Interest May be Greater With Preferred Partnership Interests.* Assume that the appropriate discount for assets in a regular partnership would be 30%. If the same assets are held in a preferred partnership, the preferred interest has priority, so the common interest will be worth less. As opposed to a 30% discount hypothetically for a regular partnership, the common interest discount in a preferred partnership will be 35%-40% (realistically, it probably ought to be even higher than that.) The speaker typically sees discounts in the 35 to 40% range for residual interests.

However, bear in mind that the overall aggregate interest may be less with a preferred partnership than just making a gift of a standard FLP interest. Suppose a preferred interest is worth $800,000 and the company is worth $1 million. If client gives the common stock to the children, and if a 40% discount is justified there will be a 40% discount on the $200,000, which would be $80,000. On the other hand, if the client did not have a preferred interest the father can make a gift of the full $1 million partnership interest and get a discount on full $1 million value.

c. *Traditional Use of Preferred Interests in Family Situations.* Preferred interests may be used to provide assurance to the senior generation of getting cash from a family business. The first available cash flow passes to the preferred interest holder. This can incentivize children who are active in the business to grow the business. After the preferred return is paid all further growth builds the value of the common interest. Traditionally, this was used as a way to transition a business to future generations.

d. *Desire to Do Transfer Planning But Keep Specified Cash Flow*. Assume someone has $20 million of assets (in addition to the residence). The individual needs $400,000 pretax for living expenses. But the individual also wants to provide for the future and realizes that inflation is a possibility and wants to make sure that the total earning power is still about $800,000 per year. The investment advisor indicates that the individual should be able to receive $800,000 per year from the $20 million of assets. The individual will be reluctant to make a gift of $10 million of income producing assets that produces $400,000 of that cash flow. Instead, consider having the individual retain $10 million in the assets, and contribute the other $10 million of assets to a preferred partnership. Assume that half of that $10 million capital interest would be allocated to the preferred. If there is an 8% rate of return on that $5 million capital interest, that would produce $400,000 cash flow. That plus the $400,000 of annual cash flow from the outside assets produces the desired $800,000 of cash flow. The individual can consider making a gift of the $5 million capital interest attributable to the common partnership interest. Furthermore, the individual would only be making a taxable gift of the discounted value of the $5 million of capital attributable to the common interest. That is more likely to have a value of about $3 million.

Bottom line: The person has been able to maintain the amount of cash flow desired, and the individual has also been able to take advantage of discounts on the common interest that is given to save even more taxes ultimately. The preferred partnership can dramatically assist a giving program. (This is not particularly important to someone that has $100 million-$200 million of assets. But for someone in the $15-$30 million range, that is clearly a market where this kind of discussion can be very important.)

e. *Not Simple to Administer*. Preferred partnerships are not simple to administer. "I will tell you that have never seen a preferred partnership administered correctly in the first year." Mil has learned to quote up front that part of his role will be to administer the administration and the initial income tax return for the first two years because he wants to make sure that it is being done properly. (It is not long-term complexity after the family has become accustomed to administering the preferred partnership.)

Mil's rule of thumb is to use preferred partnerships only if at least $10 million is being contributed. As a practical matter, it is not appropriate to use a preferred partnership for a $1 million transaction.

f. *Carried Interests*. When representing real estate investors, hedge fund managers, or investment managers with investment partnerships, there will often be carried interests. Investors with them typically have a right to get their money back plus a non-cumulative return of, say, 8% before the manager's carried interest kicks in. The carried interest is incentive pay for the manager. The problem is that a gift of the carried interest probably triggers § 2701. However, if the client transfers both his carried interest and investment interest into an umbrella partnership for the family, that partnership can be a § 2701 compliant entity with preferred and common interests. (Some planners have questioned whether that qualifies under § 2701, but Mil thinks that it does. It has been implemented many number of times, but with a larger transaction, the planner might consider seeking a private letter ruling.)

In this situation, the "standard preferred freeze" works well. Effectively, the underlying investment beforehand is being mimicked. The preferred interest mimics the investment interest, and the common interest mimics the carried interest.

74. Non-Tax Reasons

Some planners maintain that a preferred partnership automatically has a business/non-tax purpose — because it allocates risk. However, Mil encourages planners to run the same type of analysis as to a legitimate and significant nontax reason that is typically used for setting up a partnership. For example, incentivizing a child who is in the business or incentivizing a child who's taking over investment management is a valid non-tax reason.

Using a partnership subject to § 2701 may assist in avoiding a § 2036 argument. Section 2701 was designed to avoid abuses in the gift tax area, and that may take some of the focus off of the estate tax § 2036 issue.

75. Reverse Preferred Partnerships

a. *Significance*. The 8 to 12% preferred return is an interest that the children may prefer as compared to any other type of investment they have seen for some years. Perhaps the children would make a contribution to the partnership in return for the preferred interest and the parents contribute money for the common interest. This approach would provide a steady income stream, or at least a safer interest, for the children.

   There are two problems with this standard reverse partnership. (1) The children typically don't have that much money they're willing to contribute. (2) Technically there is no need to comply with § 2701 if the preferred interest is passing to the younger generation, but the parents' common interests have a way of ending up with the grandchildren, and then they would be noncomplying interests (because their parents hold the preferred interest). It is not that difficult to comply with §2701; generally structure the transaction to comply even in a standard reverse freeze where the children get the preferred interest with the parents retaining the common.

b. *Leveraged Reverse Freeze*. This solves the problem of the children not having resources to contribute to the partnership. Parents set up a standard preferred partnership. For example, assume parent contributes $15 million, with $7.5 million dollars being allocated to the preferred and $7.5 million being allocated to the common. The appraiser says that an 8 ½% percent preferred return is appropriate for the preferred interest. That yields $637,500 per year of distributions. Let the partnership settle for a period of time before making further transfers (the same as with other partnership interest transfers). Later, consider a sale of the preferred interest to a grantor trust. The parent had been receiving $637,500 each year. If the sale was made for a long-term note with a 4.15% interest rate, or $311,000 per year of interest, there is net cash flow to the grantor trust of $326,000 per year without any transfer tax implications. This is purely an arbitrage-type play. The grantor trust receives 8½% and pays out 4.15%, leaving over 400 basis points of leverage.

   If a nine-year note is used (the parents are willing to shift value for a period of time, but then wants the value to come back to the parent because it may be needed at that point), a 2.33% interest rate might apply, or $174,000 per year of interest, leaving $462,000 per year of net cash flow to the grantor trust.

c. *Uses*. Possible applications of this strategy include:

(1) *Living Expenses*. Shift cash flow to children for their living expenses.

(2) *Pay Life Insurance Premiums*. Sell the preferred interest to an ILIT and the interest produces cash flow for an ILIT to pay substantial life insurance premiums for a large insurance policy (without the need for future gifts, Crummey notice letters, etc.).

(3) *Use In Connection With Standard FLP*. For someone considering creating an FLP for other reasons who wants to do other gifting, combine the reverse leverage preferred interest to facilitate the other gifting.

(4) *Deferred Gratification Use*. Use the excess cash flow from the arbitrage to pay the note (i.e., the trust's acquisition cost) so that the trust would end up owning the preferred interest outright after some period of time.

(5) *"Pacman" Gobbling of More Discounted Interests*. Use the cash flow (which is not discounted) to buy other discounted interests if the trust does not need to make distributions to the trust beneficiaries. For example, the excess cash flow might be used to purchase the common interest at a steeply discounted value. Or the excess cash flow might be used to buy an existing family limited partnership interest or interest in a family business.

d. *More Assurance of Success*. There is more assurance that value will eventually end up with the trust than with just making a transfer of a standard limited partnership interest.

76. Balloon Reverse Preferred Partnership.

If no payments are made on the preferred interest for 10, 15, or 17 years, and then there is a lump-sum payment, the preference return will have to be significantly higher to support that the preferred return is equal in value to its liquidation value. "This will not be a hot selling item. This is right up there with 'toxic assets.'" The preference return required on the long-term preferred balloon interest might be approximately 12%.

Section 2701 generally requires annual payments in order to avoid applying the subtraction method of § 2701. However, if there is a mandatory payment of a specific amount any specific time, that interest is excepted from § 2701. The difference between a 12% preference return and the AFR on the note given by the grantor trust in purchase of the interest is a huge arbitrage spread.

If a balloon preferred interest is sold to a grantor trust, Mil also "staples" a small common interest to the preferred interest to reduce an income tax risk.

Observation: With such a large preference return over a long term there would seem to be a significant risk that the entity would not be able to produce sufficient value to fully satisfy the preference return at the end of the specified term.

77. Loan as Compared to Section 2701 Structure.

If the client does not want to contribute $1 million to a partnership for the family to avoid the complexity of §2701, the client might consider just lending to the partnership and charge the AFR rate, which will be much lower than any preferred partnership rate. The issue will be whether the IRS could recharacterize the debt as equity.

Another possible complexity is that if parent contributes most of the capital to a child's startup entity, that may arguably violate the 10% value rule in § 2701. For example, if parent loans $1 million to a total startup entity, this may result in the common being deemed to be worth at least $100,000 rather than having negligible value. If the debt is reclassified as equity, §2701 would seem to apply. Counter: section 2701 might not apply to that transaction at all. Section 2701 does not apply to debt generally. Counter to that: the 10% minimum value rule says that the value of the common must be equal to at least 10% of the value of all equity interests plus debt from family members to the entity. Counter to that: if § 2701 does not apply to begin with, then the subtraction method and the 10% rule would not apply. (As is apparent from this dialogue, the speakers differ regarding this issue.)

If father wants to contribute an asset to be used in the business rather than just supplying startup cash capital, it may be possible for father to lease the asset to the entity.

Items 78-80 are observations from a seminar by Lauren Y. Detzel, Laird A. Lile, and Glen A. Yale: Something Old, Something New, Tax Forms and More, What's in it for You? The seminar addresses a variety of issues regarding estate, gift, and GST tax returns. Discussions from the seminar about planning issues under the Tax Relief... Act of 2010 are included in discussions of the topic above in Items 2 and 3.

78. Estate Tax Return Issues

a. *Multiple Executors*. What if the executors disagreeing cannot join in signing one return? Each executor or should file a return disclosing all of the information that executor has. There is no established procedure by which the IRS resolves the conflict between the returns.

b. *Notice to Executors*. Various cases have held that a notice of deficiency mailed to only one of multiple co-executors was sufficient notice. The speakers recommend filing a Form 2848, power of attorney form, listing all of the co-executors. One of the speakers lists the executor's address on the first page of the return as being in care of the attorney's address so that the Notice of Deficiency will get sent to him. He has had the experience of executors receiving a closing letter without realizing the significance of the letter; he would prefer that the closing letter comes to his office.

c. *Attorney Client Privilege Regarding Estates Tax Return Matters*. The privilege applies to advice and not facts.

"Not all communications between an attorney and his client are privileged. Particularly in the case of an attorney preparing a tax return... a good deal of information transmitted to an attorney by the client is not intended to be confidential, but rather is given for transmittal by the attorney to others – for example, for inclusion in the tax return. Such information is, of course, not privileged." *Colton v. United States*, 306 F.2d 633, 638 (2nd Cir. 1962), *cert. denied¸371 U.S. 951 (1963)*

While there have been a variety of cases addressing privilege with respect to tax returns, most of them are involving income tax returns, which are typically viewed more as just raising number crunching issues. *Bria v. U.S.,* 2002 TNT 78-13 (D. Conn. 2002) addressed privilege issues with respect to estate tax returns; it listed various items that were privileged and various items that were not.

Drafts of the estate tax return might be covered by the privilege but they might not be. For this reason, sensitive issues should not be included on draft returns that are sent to the client. Those issues should be discussed with the client separately.

d. *Privilege Regarding Appraiser's Information*. The *Ritchie* Ninth Circuit case this year (an income tax case involving the value of an easement) concluded that backup material in the appraiser's file was not privileged, was not covered by the work product doctrine, and was all discoverable. One speaker said that is troubling. Even though the attorney hires the appraiser, the attorney has no control of what is in the appraiser's files such as prior drafts or communications with others in the appraiser's office.

e. *Requesting Income and Gift Tax Returns*. Form 4506-T can be used to request a transcript of tax returns that have been filed, and Form 4506 can be used to request tax returns. Attach a Form 2848 Power of Attorney to these forms so the attorney can contact the IRS if the IRS is not fully responsive to the request. "This is not an expedited process, so start early." (Even though gift tax returns are shown on the transcript, the IRS may respond that they have no records of the actual gift tax returns.)

f. *Certified Mail vs. FedEx*. For returns that are sent by certified mail, get the stamped receipt from the post office and make sure that the date on the receipt can be read. One speaker uses FedEx, for fear that the receipt from the post office will get lost. FedEx has an incredible tracking system that does not just depend on a white slip.

g. *Time of Death*. The time of death is based on the time at the decedent's place of residence in the United States. For example, if a U.S. resident individual dies in Paris France at 3:00 AM on January 1, 2011, the decedent is treated as having died in 2010.

If the time of death is uncertain because the body cannot be discovered, the individual will have to be declared dead in a state court action. The planner has some flexibility with timing. A speaker indicated that in one case, the court proceeding was delayed for five years (and the estate received the benefit of increased exemptions), and in another case the court determination happened very quickly when that was advantageous.

h. *Effect of Late Filing on Elections*. Late filing causes the loss of the §6166 extended payout election and timely allocation of GST exemption. The QTIP, QDOT, alternate valuation date, and special use valuation elections may be made on late returns (but the alternate valuation date election may be made only if a return was filed within one year of the due date including extensions, I.R.C. § 2032(d)(2)).

i. *Amending or Filing Supplemental Returns*. Be wary of filing amended or supplemental returns. One speaker was involved in a case where the estate had received a closing letter. The executor filed a supplemental return, and 15 years later the estate is still in litigation. The attorney who filed the supplemental return had a malpractice action filed against him. That attorney's conclusion: do *not* file supplemental returns. If all of the information is not available when the estate tax return is filed, clearly disclose the information that is not available. It is then the IRS's responsibility to follow up on obtaining that information. *See Estate of Helen G. Williamson v. Commissioner,* 72 TCM 687 (1996).

79. Gift Tax Returns

a. *When Does Gift Occur?* There is no obvious trigger for when a gift occurs; gifts may be indirect and may be nebulous. (For example, is the payment for a wedding for a daughter or payment for children to join parents on a cruise a gift?) *Dickman v. Commissioner,* 465 U.S. 330 (1984) made clear that donative intent is not required, and a gift may result from allowing the use of property.

b. *Basis Information*. Supply basis information to the extent possible. One speaker filed a Form 709 20 years ago that did not include basis information, and the IRS returned the form as being incomplete. However, the speakers do not spend much effort trying to figure out the basis to list on the gift tax return.

c. *Advice Not to File Return?* What if an individual's estate is well under $5 million and the individual will never have transfer tax issues. If the client makes a taxable gift this year, do you have to advise the client to file a gift tax return? (Realize this is a cost to the client. Milton Friedman refers to the cost of compliance as itself being a tax.)

Section 10.51 of Circular 230 says that "disreputable conduct for which a practitioner may be sanctioned under § 10.50 includes... (7) Willfully assisting, counseling, encouraging a client or prospect of client in violating, or suggesting to a client or prospect of client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospect of client and illegal plan to evade Federal taxes or payment thereon."

One speaker suggests that we cannot counsel a client not to file a return that is due, even though the client will not have to pay estate or gift tax regardless whether the transfer is reported.

d. *Nontaxable Transfers That Do Not Have to Be Reported*. The Form 709 instructions say that a Form 709 does not need to be filed to report nontaxable transfers, and that they should not be listed on Schedule A even if a Form 709 is filed.

Annual Exclusion Gifts. Annual exclusion gifts do not have to be reported. However, one speaker does routinely report all gifts, including cash annual exclusion gifts, to assist in keeping track of GST exemption allocations. Furthermore, reporting the gift begins the running of the statute of limitations, both as to the valuation issue and as to whether the gift constitutes a present interest that qualifies for the exclusion.

Education Exclusion. Even if a gift tax return is filed, transfers for tuition at a qualified domestic or foreign educational organization do not have to be reported. One speaker received a ruling several years ago that prepayment of educational expenses qualified for the education exclusion. The speaker later asked the IRS person who granted the ruling whether the transfer should be reported. The IRS agent said that there is no place to report it on the return.

Medical Exclusion. Similarly, payment of medical care that is paid directly to the medical care provider is a nontaxable transfer and is not reported.

Transfers to Political Organizations. Contributions to political organizations, as defined in I.R.C. §527(e)(1), formed to elect a person to public office, are nontaxable transfers. (However, transfers to political organizations formed to influence a ballot initiative or referendum are taxable transfers.)

e. *Spousal Gifts That Do Not Have to be Reported*. Gifts to spouses that qualify for the gift tax marital deduction do not have to be reported unless they are qualified terminable interests (for which a return must be filed in order to make the election). Treas. Reg. §25.6019-1.

The QTIP election for an inter vivos gift must be made on a timely filed gift tax return. No 9100 relief is available for a late inter vivos QTIP election. PLR 201109012 (revoking PLR 201025021).

f. *When Charitable Gifts Must be Reported.* The Form 709 instructions state that if the only gifts made during the year are deductible as gifts to charities, a return need not be filed as long as the owner's entire interest in the property was transferred to charities. However, the instructions state that "[i]f you are required to file a return to report noncharitable gifts and you made gifts to charities, you must include all of your gifts to charities on the return." In light of the fact that annual exclusion gifts need not be reported, one speaker concludes that "this would appear to not require reporting outright transfers to charities unless they exceeded the annual exclusion."

g. *Disclaimers.* A properly executed disclaimer need not be reported on the gift tax return.

80. GST Returns

There are five different returns that directly implicate GST reporting: (a) Form 706, Schedule R (estate tax return); (b) Form 709, Schedule A Part 2 and Schedule C (gift tax return); (c) Form 706-GS(T) (generation-skipping transfer tax return for terminations); (d) Form 706-GS(D-1) (notification of distribution from a generation-skipping trust); (e) Form 706-GS(D) (generation-skipping transfer tax return for distributions). The last three "GS" forms are prefaced "706" but are not part of the estate tax return. The "GS" forms may be required when an estate tax return is not required and even independent of any death.

a. *Gift and Estate Tax Returns.* Direct skips are reported on gift tax returns and estate tax returns. In addition, information regarding transfers to trusts that are not direct skips is reported on gift or estate tax returns for purposes of allocation of GST exemption.

b. *Form 706-GS(T), Generation-Skipping Transfer Tax Return for Terminations.* The trustee of the trust that has a taxable termination is required to file this form. If the death of the child results in a taxable termination of the trust, this form is due whether or not the child is required to file a Form 706. Even if no tax is due because of a zero inclusion ratio, the return is still required to be filed. The return is due by April 15 of the year following the calendar year in which the taxable termination occurred. An automatic six-month extension is available by timely filing a Form 7004. The trustee may elect alternate valuation for purposes of determining the value of the taxable termination. I.R.C. § 2624(c); Treas. Reg. § 2662-1(d)(2)(describing time period for filing Form 706-GS(T) to make the election). The value of the taxable termination is determined after consideration of expenses, indebtedness and taxes that would be deductible under I.R.C. §2053 for determining estate tax. I.R.C. § 2622(b).

The trustee is personally liable for the tax. (There are two exceptions to personal liability: (i) where a gift tax return was not filed for a gift to the trust, and (ii) where the inclusion ratio on the gift tax return was understated. If the trustee does not know or should not have known the information was erroneous, the trustee will not be personally liable. I.R.C. § 2664(d).) Unlike estate tax returns, no closing letter is issued. Therefore, the trustee will not receive any comfort that the proper amount of GST tax has been paid, so the trustee should consider creating a reserve for paying any additional GST tax that may be due. (See paragraph e below regarding the statute of limitations.)

c. *Form 706-GS(D-1), Notification of Distribution From a Generation-Skipping Trust.* A trust that makes a taxable distribution is required to file this information return, similar to a K-1, to give information to the beneficiary that there has been a taxable distribution. The trustee is required to file this form but there is no tax due. (If the trustee pays the GST tax on the taxable distribution, that payment is treated as an additional taxable distribution, which would also have to be reported on a Form 706-GS(D-1). I.R.C. § 2621(b).) The return is due on April 15 of the year following the calendar year in which the distribution occurred. The filing requirement exists even if the trust has a zero inclusion ratio. The copy must be provided to the distributee, and the form includes specific instructions to the distributee about filing Form 706-GS(D) to report the taxable distribution and pay GST tax.

d. *Form 706-GS(D), Generation-Skipping Transfer Tax Return for Distributions.* The recipient of a taxable distribution is responsible for filing this form to report the taxable distribution. Unlike the other two "GS" Forms, this return is not required if the inclusion ratio is zero. The return is due by April 15 of the year following the calendar year in which the distribution occurred, but an automatic six-month extension is available by filing Form 7004. The amount of the taxable distribution can be reduced by a deduction for the cost of compliance, but the deduction is diluted proportionately if the inclusion ratio is less than one. I.R.C. § 2621(a)(2).

e. *GST Tax Valuation Statute of Limitations.* The GST regulations provide that the inclusion ratio does not become final until the *later* of (i) the period of assessment with respect to the first generation-skipping transfer reported on a GST return using that inclusion ratio and (ii) the period for assessing estate tax on the transferor's estate. Treas. Reg. §26.2642-5. This could leave the statute of limitations open for decades, even after the period for assessing estate or gift tax with respect to the transfer.

The 2001 Act modified I.R.C. §2642(b) (which is subject to the general sunset rule in § 901(a)(2) of EGTRRA, which has been extended through 2012) to provide that for any transfer that is reported on a timely filed gift or estate tax return, or for a gift subject to the automatic allocation rules, the value as finally determined for federal gift or estate tax purposes will control for determining the inclusion ratio of the trust. Therefore generally, the statute of limitations would run three years after the relevant gift or estate tax return was filed. I.R.C. § 6501(a).

However the change made by the 2001 Act was not retroactive, and the valuation of transfers to trusts before 2001 are still governed by the regulation described above. As an example, for pre-2001 transfers to a trust, the statute of limitations on the value of the transfer does not run generally until three years after the estate tax return has been filed following the transferor's death. However, the statue limitations could be accelerated by making a taxable distribution from the trust that is reported on a Form 706-GS(D). The statute of limitations would generally run three years after filing that return, I.R.C. § 6501(a), and the inclusion ratio would become final as of that time.

Items 81-88 are observations from a seminar by Michelle B. Graham, Marilyn Piccini Roy, PhD, and Jean-Marc Tirard: How to Hold the Title to that Ski Chalet in Switzerland and that Bank Account in France: Nuts and bolts Issues in International Estate Planning. The seminar focuses on cross border estate planning issues with France, Canada, Mexico, and the UK.

81. Overview

Always reach out to local counsel. Things are not always what they seem.

The various issues are addressed under the laws of France, Canada (Quebec in particular), Mexico and the UK. The presentation addresses (1) title and ownership issues; (2) tax issues, (3) holding vehicles (companies and trusts), and (4) recommendations of the best ways of holding foreign assets.

82. Title and Ownership

a. *Limits on Foreign Ownership*.

France. French property cannot be directly owned by trust, but shares of the company owning French real property can be held in trust. (However, the use of trusts to hold French assets may give rise tax complexities.)

Canada. Nine of the provinces and three territories in Canada are common law jurisdictions. However, Québec evolved from the Napoleonic code and it is a mixed civil and common law jurisdiction. There are no restrictions on foreign ownership of real estate or opening bank accounts. (The prairie provinces limit the amount of land that a nonresident can purchase, but that would not impact someone wanting to buy a vacation home in Canada.)

Mexico. Mexico does restrict the foreign ownership of certain property. In the "restricted zone" (100 km from the border and 50 km along the coast line) there are restrictions. In the unrestricted areas, foreigners can own property in their own names.

In the restricted zone, property is owned by foreigners through a "fideicomiso." It operates much like a trust agreement. The settlor is the seller of the property. The trustee must be a Mexico financial institution. The beneficiary is the client-foreign owner. The trust is typically irrevocable. It lasts for 50 years but can be renewed indefinitely. There are two ways to sell the property that is owned by a fideicomiso: (1) a beneficial interest in the fideicomiso can be assigned, or (2) it can be extinguished and the new owner can set up a new one. (Assigning the existing interest is less expensive, but the new owner just has the remaining number of years.) The beneficiary of the fideicomiso can be an individual, or there can be succession provisions, or it can name a US trust or LLC as the beneficiary. The trust cannot hold any other assets. The trustee acts at the direction of the beneficiary. If the property is leased, any rental income goes into a separate bank account, not into the fideicomiso directly.

The IRS so far takes the position that the trustee has the obligation to report the ownership on Form 3520 and 3520-A.

An exception to the rule that foreigners cannot own property in the restricted zone is that a commercial activity can hold title to a Mexico property. There is a lot of US investment in resorts in this manner.

b. *Foreign Bank Accounts*. None of the four countries restricts foreigners from owning bank accounts in the country. However, if the US person holds a foreign bank account or mutual fund, the individual must report them each year if the accounts exceed $10,000 at any time. The Foreign Bank Account Report (FBAR) is due on June 30 of each year and no extensions are possible.

c. *Joint Ownership*. In France and Quebec, there is no concept of joint ownership with right of survivorship. Joint ownership is treated as a tenancy in common. UK recognizes joint ownership with right of survivorship like the US. Bank accounts and real estate tend to be titled that way between spouses even though it is often not the best result for tax planning.

d. *Forced Heirship in France*. Forced heirship rules apply in France. For example, if an individual has two children, they are entitled to two-thirds of the French property and the owner is free to dispose of the other one-third. Children from prior marriages must also benefit. This applies even to non-French residents who own property in France directly in their own name. There are some methods of mitigating forced heirship rules. Ownership through a company (even a French company) will avoid forced heirship, and the law of succession of the deceased's last domicile will apply. In addition, spouses can own property in a manner that operates with the same result as joint ownership with survivorship.

Canada. The provinces and territories other than Québec are common law jurisdictions do not recognize forced heirship. Furthermore, unlike most civil law jurisdictions, Québec did not retain forced heirship.

83. Conflict of Laws for Succession Laws Regarding Movables and Immovables

France, Canada, Mexico, and the UK all recognize the general rule that succession law of the situs applies to immovables (i.e., real estate) but the law of the donor's domicile applies to movables. However, in Mexico, if real estate is held in a fideicomiso, the property will pass pursuant to the terms of that contractual arrangement.

Some civil law countries (Italy is an example) do not follow the movables/immovables distinction.

84. Situs Power of Attorney.

France. They are not commonly used, but they do make sense.

Canada. The notaries in Canada have a legal education and law degree. They are public officers and handle all real estate transactions. They act impartially on behalf of all parties. If a US resident-wife wants to sell property owned by her and her incompetent husband under a US power of attorney, the notary will likely refuse to proceed because the notary is not familiar with it. If you're able to get over that, the notary will want an expressed power to sell and will require that the power of attorney is "homologated" (a procedure before a Québec court of confirmation for an incompetent person that would recognize the power of attorney). Accordingly, having a situs power of attorney by a Canadian notary is strongly advised.

Mexico. Situs powers of attorney are used frequently. They are typically prepared in both languages and before a notary public. The speaker does not think that a US power of attorney would be recognized.

85. Situs Will

France. A US will is valid, but it is much easier and efficient to have a French will for French real property. A notary usually drafts wills in France. However, it is not a common practice to have wills in France because the Civil Code disposes of practically everything. One person out of eight or nine in France has a will. It is best to own property to a corporation and have the shares of the Corporation pass under the US will.

Canada. Canada recognizes holographic and regular wills. A situs will is not obligatory but highly recommended, and it should be prepared by notary. Probate fees are levied in all common-law provinces of Canada but not in Québec even for a witnessed or holographic will. The probate procedure is simple and inexpensive in Québec. Québec will recognize a foreign probated will without an ancillary probate by having the form will deposited in the foreign deed records of Québec.

Mexico. For property in the restricted zone, there is no will, but the asset passes pursuant to the terms of the fideicomiso. For property in the unrestricted zone, the will controls if the property is owned in an individual's name. For a US will, probate proceedings in Mexico will be required that are longer and more cumbersome than US probate. It is highly recommended to have a situs will in Mexico.

UK. The UK has similar probate procedures as the US, and generally will admit a US will. It is generally advised to have a separate situs will, but that is mostly for tax planning purposes. For merely transferring title, a US will works.

Authority to Deal with Foreign Assets. If property is owned in any foreign jurisdiction, the US will should have a clause specifically enabling the US executor or to deal with foreign property. Authorities in a foreign country will look to make sure that the executor has authority to deal with foreign assets.

86. Tax Issues

a. *French Income Tax Issues*. A French resident is taxed on worldwide income. Nonresidents are taxed on French source income (such as rental income from French property). Citizenship and domicile at common law are not relevant. There is a "domicile" concept but it is not the same as the common-law concept.

   Capital gains taxes apply, but the treatment differs based on whether the property is held directly or through an entity. There are various special rules that apply.

b. *French Annual Wealth Tax*. An annual wealth tax applies that is a trap for the unwary. The tax is generally payable by any nonresident individual owning directly or indirectly French real properties with the value (after deduction of debts) in excess of €800,000. The rate ranges from 0.55% to 1.8% according to the net taxable value of the property. It does not give rise to a credit in the United States, because the income tax treaty between France and the US does not treat it as an income tax.

c. *French Transfer Taxes*. France has an inheritance tax, payable by the recipient, and rates vary according to the relationship between the heir and the decedent. The rates vary from 5% to 40% for direct family members and they increase to 60% in the absence of the family relationship. There is a complete exemption for assets passing to surviving spouse, regardless of the citizenship or country of residence of the spouse. Same-sex partners benefit from the spouse exemption. Unless a tax treaty provides otherwise, the tax is due on the entire estate if the decedent was a resident in France at the time of death, whether or not the heir is resident in France.

   There is also a French gift tax.

d. *Canadian Income Tax Issues*. Nonresidents are taxed on Canadian source income. There is a tax on net taxable capital gains on the disposition of taxable Canadian property including real estate. There is also a tax on passive payments including dividends, interest and trust or estate income. There is a flat withholding rate of 25% unless reduced by a treaty (and they are reduced by the US treaty). For vacation property, nonresidents will recognize taxable capital gains on the disposition the same as a Canadian resident. One-half of the capital gains are included in income.

   The transfer of property to a trust is treated as if the donor disposed of the property at fair market value and is subject to a capital gains tax. Therefore, it is better to use a trust to acquire a property at the outset rather than to transfer property into a trust.

e. *Canadian Deemed Disposition at Death*. In the year of death, the owner is deemed to have disposed of all taxable Canadian property immediately before death. Canada normally allows a tax-free rollover to the spouse or a spousal trust (and for this purpose US spouses are deemed to be Canadian residents). The Canadian deemed disposition tax is treated under the US/ Canada treaty as if it were a death tax so it may be credited against the US estate tax.

f. *Canadian Deemed Disposition Rule for Trusts*. There is a significant landmine for trusts. Trusts are deemed to dispose of assets and reacquire them at fair market value every 21 years. The impact of this rule may be reduced by having a special-purpose trust that is only available to Canadian residents. For a spousal trust, the first deemed disposition is on the death of the surviving spouse, then every 21 years after that. A solution to reduce the impact of this rule is to dissolve the trust prior to the 21st anniversary. It is important that the terms of the trust be drafted to permit encroachment on capital without restriction or to provide a final distribution date that is less than 21 years after the date of creation. In the absence of that, court authorization will be necessary, and the courts will give primacy to the settlor's intent and an early termination may be contrary to the intent.

g. *Mexico Taxes*. For clients with vacation homes in Mexico, there are various taxes that apply.

Acquisition tax. This tax is 2-4% depending on where the property is located. It applies every time the property is transferred.

Capital gains tax. A capital gains tax applies when the property is sold. The basis gets adjusted every year for inflation. Income tax returns are required in both the United States and Mexico. The United States allows a foreign tax credit for tax paid to Mexico, but in differing amounts.

Property tax. Very low property tax payments (0.1%) are due quarterly.

Income tax. Rental income will be subject to an income tax in Mexico (and it will also be reported in the US).

Transfer Taxes. There is no estate tax in Mexico. There is a gift tax, but most familial transactions (for example, with spouses and children) are exempt.

h. *UK Tax Issues*.

Treaties. The UK has income tax treaties with many countries to eliminate double tax. However, make sure that the timing of the income recognition event matches. For example, a deemed disposition in the UK may not be treated as a disposition in the US.

Income Tax. The income tax is generally based on residency, based on whether the individual is physically in the UK at least 183 days during the year. A UK resident who is not domiciled in the UK is taxed on UK source income and capital gains on gains from the disposition of UK situs assets. He or she is subject to income tax on foreign source income and capital gains tax on foreign situs assets if and when they are "remitted" the UK (i.e., actually transferred to or deemed to be received in the UK). Prior to 2008, all UK residents who had a non-UK domicile were taxed on a remitting basis (only when income was "remitted" to the UK) as opposed to being taxed on an arising basis (when the gains or income were realized). New rules were imposed in 2008 so that UK non-domiciliaries who have been resident in the UK for seven out of nine years preceding the year in question must pay an annual charge of £30,000 in addition to all other tax liabilities in order to be taxed on a remitting basis. The £30,000 charge is merely a price for deferring tax, it is not normally creditable against future tax payable on income and gains remitted to the UK.

The UK tax year runs from April 6-April 5, unlike the calendar tax year that is used in the US.

Estate and Gift Tax. There is an exemption of £325,000 (roughly $525,000) (referred to as the "nil rate band"). The nil rate band applies to nonresidents as well as UK residents. UK has had a portability system for a number of years. The inheritance tax rate is 40% and gift tax rate is 20%.

There is no gift tax on outright gifts unless the individual dies within seven years of the transfers (referred to as "potentially exempt transfers"). If the individual dies during the seven-year term, a prorated portion of the 20% rate is applied, and it uses some of the "nil rate band."

For spousal transfers, there is a marital exemption if the domiciles of the spouses match. If there is a domicile mismatch (for example, a UK national married to a US citizen) there is no marital deduction. However, there is a limited marital exemption of £55,000 for transfers from the UK domiciled spouse to a non-UK domiciled spouse.

Special Tax on Trust Contributions, Distributions and on Trust Assets Every 10 Years. There is a 20% tax on assets passing into a trust, and a 6% charge every 10 years on the trust or on distributions from the trust (prorated, for example if there is a distribution in year five, there is a 3% charge).

87. Vehicles For Owning Real Estate in Foreign Countries

a. *France*. Using a legal entity to own French property offers no tax benefits, but for local succession purposes, shares of a corporation are treated as movable assets (governed by the law of the owner's domicile). Holding a personal residence inside a corporation has adverse tax consequences, because rent-free use by the shareholders is a taxable benefit in kind. The best entity for holding French property is a "fiscally transparent" entity known as an "SCI" (*a societe civiles immobilieres*). Real estate held in companies other than French companies or companies in countries having a signed tax treaty with France incur an almost unavoidable 3% annual tax and also suffer extremely heavy taxation of capital gains upon resale.

b. *Canada*. Joint ownership is the simplest form for owning Canadian situs real property. The most common alternative form is a trust vehicle. A nonresident trust can own immovable property in Québec because of a conflict of laws rule stating that the settlor may choose any law as the applicable law of the trust without the need for any objective connection between the trust and the designated law.

There is a substantial pitfall of using standard revocable inter vivos trusts for owning Canadian real estate. Funding the revocable trust during life will be treated as a deemed disposition giving rise to deemed realization of the capital gain in Canada, even though it is not a taxable transaction in the US. Furthermore, pour over wills to revocable trusts can be problematic in Canada, because there is no Canadian legislation recognizing the validity of testamentary transfers to revocable trusts like there is in most US jurisdictions.

One possible tax efficient estate planning alternative is for a nonresident to hold Canadian real estate in a "qualifying disposition trust." The contribution of property to such trust will not be considered a deemed disposition, but one of the requirements of such trust is that the assets revert to the grantor's estate at the grantor's death.

It is generally not advisable to hold vacation property inside a corporation, because use of the property by the shareholder is a taxable benefit.

c. *Mexico*. Foreign ownership of real estate in a restricted zone must be in a fideicomiso. Individuals are typically named as the beneficial owners, and the owner's children are named as successor beneficial owners. The speaker has run into problems when trying to name a trust as the beneficiary. (The notary required a US court order stating that the US trustee had the authority to act; the planner is at the mercy of the notary as to what he or she will require if a US trust is named as the beneficiary.)

Real estate in unrestricted zones can be held in individual names or in the name of the US trust or US LLC.

d. *UK*. The UK effectively has closed most of the tax "schemes" that shelter property from any of the UK taxes. One important planning strategy for persons moving to the UK is to use an excluded property trust (known as a "drop off trust"). For example, a US person may drop non-UK situs assets into the trust before the person arrives in the UK. If that person subsequently becomes domiciled in the UK, the trust assets may still not be subject to UK inheritance tax. The trust can qualify as an excluded property trust even if the settlor has a power of revocation.

VERY IMPORTANT FOR REVOCABLE TRUSTS: If a US person has a revocable trust and plans to move to the UK, the US person should resign as trustee and allow a US resident to act as trustee prior to when the person enters the UK (at a minimum, at least one US resident trustee should be appointed). Otherwise, the trust will be a UK tax resident for UK income tax and capital gains tax purposes on an "arising basis" with very low exemptions and flat rates of tax of 50% on income and 28% on gains. Further, if the settlor leaves the UK there will be a deemed disposal of the trust assets and a tax charge of 28% on unrealized appreciation on the exit of the trust assets from the UK. Winding up the trust is not a solution since this would also incur the capital gain charge.

88. US Tax Compliance Laws

a. *FBAR*. The US is on a campaign to identify foreign accounts to make sure they are properly reported and that US income taxes are paid. Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts) is commonly referred to as the FBAR. This report must be filed annually by US persons with a financial interest in or signatory authority over one or more financial accounts (including mutual funds) in one or more foreign countries with an aggregate value exceeding $10,000 at any time during the calendar year. The FBAR must be filed on a calendar year basis, reporting the maximum value of each account during the calendar year, and it is due June 30 of the succeeding calendar year. There are substantial civil penalties and criminal penalties for failure to file the reports.

The US adopted a voluntary disclosure program from March 23, 2009 through September 23, 2009, and that program was so successful that a second voluntary program has been adopted through August 2011. However, there is a mandatory 20% penalty that applies whether or not there was a willful failure to file. This is a trap for the unwary. Clients who went through the voluntary program were taxed at 20% of the highest account balance over the prior six-year period. When the program was announced, the IRS said that it had discretion to assess a penalty between 5 and 25%, but no one received the benefit of the 5% penalty.

b. *HIRE/FATCA Acts Reporting Requirement*. The 2010 Hire Incentives to Restore Employment (HIRE) Act (enacted March 18, 2010) is primarily aimed at providing businesses with tax incentives to help finance the hiring and retention of new employees. Part of the funding provision was a system to detect offshore tax evasion under the Foreign Account Tax Compliance Act ("FATCA"). US persons who have an interest in a "specified foreign financial asset" must attach an information statement to their income tax return if the aggregate value of all such assets exceeds $50,000. The FATCA reporting requirements are in addition to the information required at Part III of Schedule B of Form 1040 and in addition to filing the FBAR.

c. *Form 3520(Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts)*. US persons must file a Form 3520 if at any time during the tax year certain transactions occurred, including receiving more than $100,000 in gifts or bequests from a nonresident alien or if the person engaged in a "reportable event" with a foreign trust (including contributions to or distributions from the trust). The form is due on the same date as the taxpayer's US income tax return.

The penalty for failure to file the form reporting the receipt of gifts or bequests is equal to 5% of the value of the gift or bequest for each month the Form remains unfiled with a maximum penalty of 25% of the value of the gift or bequest. The penalty for failing to report a contribution or distribution from the foreign trust is equal to 35% of the gross value of the property transferred or distributed. There is also a penalty for failure to file in any year in which US person is treated as the owner of the foreign trust equal to 5% of the gross value of the trust assets.

d. *Form 3520-A (Annual Information Return of Foreign Trust with a US Owner)*. The trustee of a foreign trust with a US owner must annually file this form. For this purpose, a US "owner" is a US person who transfers property to a foreign trust if the trust has any possible US beneficiaries during the year or if the trust agreement can be amended to add or benefit a US person during the year. The form is due on March 15 of the succeeding calendar year.

The penalty for failure to file the Form is imposed on the US owner of the trust rather than the trustee, unless the owner can prove that the failure to file was due to reasonable cause. The penalty is 5% of the value of the trust assets.

e. *Others*. A variety of other forms may also be required with respect to certain foreign interests. These include Form 5471, Form 1040 Line 21, Form 926, Form 8621, Form 8832, Form 8858, and Form 8865.

Items 89-102 are observations from a seminar by Michele A.W. McKinnon, Prof. Anne-Marie Rhodes, and Jeffrey C. Thede: Family Foundation Case Studies. The seminar provides an overview of family foundations and addresses ways of achieving goals, creation and administration of the foundation, and termination issue.

89. What Type of Entity Makes Sense in Light of Client's Goals

a. *How Large? T*here are not fixed guidelines. One speaker has created $200,000 foundations that worked and has terminated multi-million dollars foundations that did not. Other factors are more important than the mere size of the foundation.

b. *Control.* A key factor in deciding to use a foundation rather than other vehicles is the client's desire for control. With the foundation, the client can control both distributions and investments. Under the changes made in the 2006 Pension Protection Act, the family can no longer keep control with a supporting organization. With a donor advised fund, the family has no control but can merely give suggestions regarding distributions.

The spectrum ranges from outright gifts with no control (although a gift agreement could be used to provide assurance that the gift would be used for a particular purpose) to private foundations with absolute control, subject to the pesky rules for private foundations.

c. *Training Tool.* The private foundation can work well as a training tool to involve younger generations. There is less family involvement with the other alternatives.

d. *Employing Family Members*. Private foundations can employ family members to provide "personal services" for reasonable compensation. Supporting organizations and donor advised funds cannot.

e. *Involving Future Generations*. If the client wants the entity to remain in existence long term, the private foundation or supporting organization works best. Many (but not all) donor advised funds limit the advisory involvement to several generations, so that would not be perpetual.

f. *Publicity*. Some clients want publicity regarding charitable contributions (for example, wanting their names on buildings), and others are more shy, and some want total anonymity. The private foundation is not good if the client desires anonymity because the annual Form 990 PF is publicly available.

g. *Perpetuate Philanthropic Traditions of the Family*. The private foundation works well for this goal.

h. *How Long Will It Continue?* If the arrangement is intended to be perpetual, creating a new entity is appropriate. If it is only temporary, an outright gift with a gift agreement may be more appropriate. A donor advised fund may work as well for many years.

Some families may think the arrangement will last in perpetuity, but after several generations that is often no longer workable.

i. *Private Foundation Is Just a Tax Classification.* A private foundation is not a legal entity. It is merely a tax classification of a certain type of exempt organization that does not qualify as a public charity. The legal entity is a charitable trust or non-profit corporation.

90. Deduction Limitations For Differing Types of Gifts to Differing Types of Charities

a. *Cash to Public Charity*. 50% of the adjusted gross income limit (it is really the "contribution base," which is adjusted gross income with a few adjustments; this is just referred over to below as the "AGI limit" for simplicity).

b. *Appreciated Property to Public Charity*. 30% of AGI limit. (However, the taxpayer has an election to deduct only the basis of the appreciated property, in which event the 50% of AGI limit applies. I.R.C. § 170(b)(1)(C)(iii).)

c. *Cash to Private Foundation.* 30% of AGI limit.

d. *Appreciated Property to Private Foundation.* 20% of AGI limit, but the deductible amount is not fair market value but the donor's basis in the property. That is a significant limitation, for example, in making gifts of real estate or business interests to the private foundation. There is an exception for "qualified appreciated stock" (stock for which market quotations are readily available on an established securities market), which can be deducted at full fair market value up to the 20% of AGI limit. Most listed public stock qualifies for this exception.

e. *Tangible Personal Property*. The Pension Protection Act made the rules even stricter for tangible personal property. A fair market value deduction is available for gifts of "related use" tangible personal property. The Pension Protection Act has a cumbersome process to confirm the related use and provides for recapture if the property is not so used or is disposed of within a certain period of time by the charity. (Even a related use contribution to a private foundation is subject to the capital gain limitation described above, limiting the deduction to basis in the property.)

   If there is not a related use, the deduction is limited to basis.

f. *Carryover Period.* There is a five-year carryover period for contributions that exceed the percentage imitations.

g. *Estate and Gift Tax Deduction.* The above limitations apply for income tax deduction purposes. There is no distinction for the type of gift or type of charity for the estate and gift tax deduction; a full deduction is available.

91. Substantiation Requirements

The normal rule is that for a gift of more than $250 the donor must receive a contemporaneous written acknowledgment, and the receipt must state that no goods or services were provided by the charity or it must include the charity's good faith estimate of the value of those goods or services. Those rules apply to private foundations even in the case of a gift from a donor to a charitable trust of which the donor is the sole trustee. If there is an audit, the donor still has to have a receipt. The IRS is extremely strict about the substantiation requirements.

92. Choosing Between Trust and Corporation For Private Foundation Entity

a. *Flexibility of Moving Jurisdictions*. One advantage of trusts is the ease of moving the trust to be governed by the laws of another state, particularly if the trust agreement permits moving the situs of the trust and allowing laws of the new jurisdiction to apply. It is much harder to move a corporation, generally requiring formal merger documents or the creation of a new entity in another state. An interesting question arises as to whether a trust foundation can be moved to another state to avoid interference of a particular state's attorney general. The recent *Maddox* case was a fight between two state attorney general offices when the trust was moved.

b. *Fixing Stated Purposes or Other Provisions That Are Difficult to Change*. Some donors they may feel strongly that they want the foundation to exist just for a single stated purpose indefinitely into the future, which a future trustee cannot change. Most nonprofit corporation statutes make it easy for boards of directors to make changes. That is not the case with charitable trusts.

   In family foundations, one speaker's view is that donors typically would want future generations to be able to change with the times.

c. *Ease of Drafting*. One speaker had a client who converted a corporate foundation to a trust foundation to lockup the purpose. In doing so, the speaker realized that a lot more administrative detail must be described in a trust, much of which is automatically provided in state statutes for corporations.

d. *Compliance Costs*. One speaker sees little difference. With both, a Form 1023 and Form 990 PF must be filed. Most states require some sort of annual filings for corporations with a nominal fee. For a foundation operating in multiple states, a certificate of authority to operate in multiple jurisdictions may be required, which would require multiple state corporate filings each year.

If a trust is being established under a will, under some states that may require expensive court supervised accountings.

e. *Fiduciary Duties and the Liabilities of Trustees versus Directors*. Trustees have the highest fiduciary duty. A key difference between trusts and corporations is the protection from liability for trustees (for trusts) and directors and officers (of corporations). Most state corporate statutes limit the liability of directors of nonprofit organizations, especially if they are not compensated. There are not similar provisions for trustees of charitable trusts. If the foundation is an active organization conducting activities, a corporate form may be preferable for liability protection purposes. There is some flexibility to draft around the liability issue for trustees, but there are state law limits in most states on the extent to which a trustee may be released from liability.

f. *Trend Toward Trust Form?* One speaker indicated he creates about twice as many corporations as trusts for exempt entities, but he is creating many more trust foundations than in prior years. A show-of-hands survey of the audience showed that about half of audience generally preferred corporate form and about half generally preferred the trust form.

93. Unrelated Business Taxable Income (UBTI) Issues and Differences of UBTI Treatment for Trusts and Corporations

a. *UBTI From S Corporations*. Since 1998, charitable organizations can hold S corporation stock but under § 512 all of the foundation's share of the S corporation income is treated automatically as UBTI, even if those items inside the corporation are passive and would otherwise not be UBTI. One result is that if the donor is looking at a gift of the stock followed by a liquidation event, on a net-net basis, the parties can sometimes be better off having the donor sell the stock directly, pay the capital gains tax, and donate the net proceeds of sale to the charity.

b. *UBTI From Partnerships and LLCs*. With partnerships and LLC's, the determination of whether the charitable organization's share of the pass-through income is unrelated is based on the actual activities of the partnership or LLC.

c. *Differences in Effect of UBTI on Trust vs. Corporate Foundations*. UBTI is taxable based on the usual rates for a taxable entity. For a corporate foundation, the normal C corporation rates apply, which can be better for ordinary income and generally worse for capital gain income. For a trust foundation, on the other hand, the trust reaches the top income tax rate more quickly than a corporation, but a trust that is taxable on UBTI is entitled to the same top rate of 15% on capital gains and qualifying dividends as applies to individuals. Therefore, there can be some real savings with the trust format.

Sometimes a tax situs can be established in a state with no income tax. For example, Oregon has a high income tax, and Portland is 15 minutes away from Washington which has no income tax. Sometimes a trust foundation will purposely be sited across the state line. The Oregon statute says that the situs of the trust is based on the residency of any trustee, but with a corporate trustee doing business in multiple states, the statue says the tax jurisdiction is based on the principal place of administration. Therefore, Oregon planners can create a trust form private foundation with a large bank as trustee and make sure that the trust is administered in the desired state.

Another distinction is that a trust foundation is entitled to a deduction against its UBTI for charitable distributions. Under § 512(b)(11), tax-exempt trusts having UBTI are eligible for the same income tax charitable deduction afforded individuals, which in the case of a cash gift is a limit of 50% of AGI. Therefore, if the trust makes sufficiently large distributions, it effectively reduces the overall income tax rate by 50% (which would be 7½% federal income tax on long-term capital gains and qualifying dividends and approximately 18% on ordinary income). That requires that during the year in which there is a large event (whether the receipt of ordinary income or capital gain) the foundation can distribute enough money to take advantage of that deduction. That works easily for a "pass-through" private foundation, but if the family wants more of an "endowment" foundation they will be hard-pressed to receive a $1 million capital gain in the foundation and give it all away in the same year. One strategy in that circumstance is for the foundation to make the large distribution in the same year to a donor advised fund for the foundation, with the idea that the money would be distributed out of the donor advised fund over the course of several years.

If a corporate foundation wants to hold substantial S stock, one alternative is to have the corporate foundation create an ESBT to hold the S stock. The donation would have to be made to the foundation and the foundation would fund its own ESBT. Under § 640(1)(c) the ESBT is taxed at 35%, but it is entitled to the 15% rate on capital gains and qualified dividends. But if the plan is for a foundation to receive S stock, it would seem to be better to simply set up a trust foundation to take advantage of the deduction rules described above.

d. *Creation of Trust-Form Supporting Organization by Public Charity to Receive Contributions of S Stock or Business Interests*. A great strategy for a public charity is to create a trust-form supporting organization (Type I, fully controlled by the public charity) as a tool for receiving S stock or business interests that generate UBTI. The trust organization would be entitled to the benefit of the 50% deduction described above for trust exempt entities. The public charity would use that entity is a vehicle to receive and hold, and if appropriate liquidate, those types of assets.

94. When to Fund Foundation, During Life or at Death?

a. *Client Specific.* This question is dependent on the client's specific situation and goals.

b. *Income Tax Deduction for Lifetime Gifts*. A lifetime contribution gets an income tax deduction. However, sometimes the income tax deduction for a gift to the foundation is so limited that this is not a particularly significant factor.

c. *Depends on Type of Asset.*

Closely Held Business Interest. For a contribution of a closely held business interest, the deduction is limited to basis. Therefore, the current income tax deduction for a lifetime gift may not be very important.

S Corporation Stock. If the stock is contributed during lifetime, there is no step up in basis. If the stock is subsequently sold, the gain will be UBTI. If the donor retains the stock until death there would be a stepped-up basis. A testamentary gift of the stock, followed by a subsequent sale, would not generate UBTI based on the pre-death appreciation.

Art. For a contribution of art, the income tax deduction is limited to basis (suggesting that the deduction may not very significant), but if the art collection is a key factor in what the donor wants to do with the foundation, the income tax deduction may not be a significant factor.

IRA. The IRA charitable rollover rules do not apply to contributions to private foundations. A contribution of the IRA would be treated as if the owner had withdrawn the assets from the IRA first with taxable income.

d. *Self-Dealing Rules and Estate Administration Exception.* The self-dealing rules effectively prohibit any transaction between a private foundation and a donor, member of the donor's family, members of the board, plus the ancestors, descendants, and spouses of those. Although it is defined as an excise tax, it is effectively a prohibition. The donor cannot repurchase assets contributed to the foundation because that would be a prohibited act of self-dealing. A current contribution during life would subject the assets to the self-dealing rules from that time going forward. If the donor may want to enter into prohibited transactions regarding a particular asset, waiting to make the contribution after the donor's death may be preferable.

Furthermore, an exception applies for assets that will be contributed to a private foundation under a donor's will. In that situation, the children could repurchase the asset from the estate before it is distributed to the foundation under the estate administration exception from the self-dealing rules, if certain requirements are met. Those requirements are:

(1) Assets paid to the estate in exchange for the asset have to be at least as liquid as the purchased asset (that is not a problem for cash sale);

(2) The sale must be at fair market value (approval by the probate court is not sufficient, and while there is no procedure for assuring that the sale is for fair market value, the speaker typically relies on reputable appraisals);

(3) The sale must be approved by the probate court; and

(4) It has to be concluded before the estate administration is terminated (once an asset has been distributed out of the estate, the estate administration exception no longer replies).

The estate exception is a very helpful estate planning tool to be able to make adjustments, particularly for closely held business interests, real estate and tangible personal property. This exception is very important to consider when planning a private foundation if there are assets that the family may want to repurchase.

95. Private Foundation Problems Regarding Illiquid Assets, Art, Stock With Securities Law Transfer Restrictions, Scholarships, and Overseas Grants

a. *Illiquid Assets*. If any illiquid asset is contributed, such as non-income producing real estate, the foundation may have trouble meeting the 5% distribution requirement, without distributing a fractional interest in the real estate itself.

One alternative to be able to meet the minimum distribution requirement would be for the foundation to sell an asset. Keep in mind that foundations pay a tax on net investment income. The capital gain on the sale of appreciated property would be subject to the 2% (sometimes reduced to 1%) tax on net investment income.

b. *Art*. A contribution of art may present the same problems described above regarding illiquid assets of how to meet minimum distribution requirements. Distributing a piece of art from the foundation to a museum is a possibility.

Applying the self-dealing rules gets murky with non-financial transactions, such as with art. Who will enjoy the artwork? What degree of public access must there be? The IRS has ruled that if the foundation owns artwork and it is exhibited at the donor's residence, that is an act of self-dealing. If there is an act of self dealing, it must be corrected within the taxable period and there is a 10% penalty. If it is not corrected, there is a 200% penalty. How would that penalty be calculated in the situation of an impermissible use of art by donor? (The IRS would like to say it is the value of the art as opposed to the right to use that property.)

There is no reasonable cause exception. In addition to paying a penalty tax, the transaction must be undone.

Bottom line: Don't do potentially self-dealing transactions involving art.

c. *Listed Publicly Traded Stock With Securities Laws Transfer Restrictions*. Donors of publicly traded stock may be executives or managers of the company subject to securities law restrictions on stock that can be sold. Those limitations carry over to the foundation. If the foundation cannot sell the stock when it receives it, it is not "qualified appreciated stock" that qualifies for the full fair market value-based deduction. If there are volume limitations, the donor could agree that the foundation could exercise to sell the stock first before the donor could sell.

If the stock is sold inside the foundation, it will pay the 2% tax on net investment income on the sale of stock.

d. *Scholarships*. There must be advance approval of the grant making procedures for scholarships. It is fairly easy to do and can be done on the exemption application. If the exemption application is filed without listing a procedure, that approval can be obtained from the IRS later, but beginning in 2011, the IRS is now charging for that. If the donors know that a scholarship program will be implemented when the foundation is created, described the scholarship procedures in the initial application form in order to avoid the additional user fee.

It is difficult but not impossible to make scholarships. Some large foundations have a hard and fast rule against have a scholarship program, but the rules are fairly straightforward.

e. *Overseas Grants*. If the foreign organizations have "friends of" organizations in the United States, contributions can be made to them. If a foundation makes distributions directly to the foreign organization, there are special rules that must be followed. The foreign organization must have an equivalency determination (that it would be a § 501(c)(3) exempt organization if it were in the United States), or the foundation must exercise expenditure responsibility that requires additional recordkeeping, but the expenditure responsibility rules are not overly onerous.

Some large foundations have a policy against making contributions to overseas organizations, but if the foundation is willing to follow the fairly straightforward rules of expenditure responsibility, it is not hard to do.

96. Distributions From Foundation to Supporting Organizations

When the foundation makes grants to local charities, it must consider whether they are publicly supported charities or supporting organizations. There are two critical impacts that result if the distribution is made to a Type-III "nonfunctionally integrated" supporting organization.

a. *Not Qualify for Minimum Distribution Requirements*. If the private foundation makes a grant to a Type III supporting organization, it does not count as a qualified distribution for purposes of the 5% annual minimum distribution requirement.

b. *Taxable Expenditure Rules*. The taxable expenditure rules are more complicated because of Pension Protection Act changes surrounding supporting organizations.

   A distribution from a foundation to a Type III supporting organization is a prohibited "taxable expenditure" for a private foundation unless the foundation exercises expenditure responsibility over the use of funds by the supporting organization. That is easy to miss, because there are numbers of supporting organizations that are affiliated with various public charities, such as art museums, colleges and universities, etc. It is very important to understand the exact type of the supporting organization. Some public charities still don't understand the importance and will not even know what type of supporting organization they have.

   The penalty is so large now (20%, with additional huge taxes on the foundation and foundation managers if the taxable expenditure is not corrected) that it is very important for private foundations to understand the importance of knowing what type of supporting organization they are making distributions to.

   Clients need to understand these limitations from the beginning.

97. Private Foundation Problems With Closely Held Business Interests

There are a variety of potential problems with making contributions of closely held business interests to private foundations, both for donors and donees.

a. *Donor Problems*. The donor problems described below apply to gifts of closely held business interests to any charity (whether a private foundation or public charity).

   (1) *Phantom Income*. Is there something inside the entity that would cause the owner to have phantom income upon a contribution of the business interest? These could be things in the business interest, such as unrealized receivables, appreciated inventory, investment tax credits subject to recapture, installment notes, etc. A gift of an interest in the entity could cause the donor to recognize phantom income.

   (2) *Bargain Sale Rules For Gift of Encumbered Property*. A charitable gift of encumbered property is treated as part sale, part gift. Worse yet, the donor's basis must be apportioned between those elements. Donors are very unhappy to find when contributing encumbered property that they have to report capital gain and have no cash with which to pay that tax.

For flow-through entities, the bargain sale rules apply to gifts of partnership or LLC interests where there is encumbered property within the entity. It is determined on a look-through basis and the calculations can be very complicated.

(3) *Valuation Difficulties, Substantiation Requirements and Discounts May Apply*. Valuation penalties apply if the deduction is overstated. I.R.C. §§ 6662-6664. The substantiation requirements require a qualified appraisal for gifts of most noncash property valued at more than $5,000 for the year. Treas. Reg. § 1.170A-13(c). Appropriate valuation discounts must be taken into consideration to determine the amount of charitable deduction for a contribution of a closely held business interest. Donors invariably want to ignore that.

(4) *Prearranged Sales*. Prearranged sales can result in treating the donor as having sold the asset before the contribution. What if there is a gift of an interest in an LLC holding an asset with respect to which there is a prearranged sale? For very large publicly traded partnerships where the donor has no role in management, why should the fact that there is a pending sale inside the partnership have an effect? But the counter and more compelling argument is that the prearranged sale rules must apply to prearranged sales of assets within the partnership or LLC or else someone who wants to make a prearranged sale could merely first drop the asset into an entity and when the sale was arranged, give the interest in the entity to the charity.

b. *Donee Problems*.

(1) *Unrelated Business Taxable Income*. For S corporation stock owned by a charity, the charity's entire share of S corporation earnings is UBTI (even if the income within the corporation is passive income that would not otherwise by UBTI). I.R.C. § 512(e). However, for partnerships and LLCs, a look-through approach is applied, and only income attributable to unrelated trade or business activities carried on by the entity is UBTI. I.R.C. § 512(c).

(2) *Debt-Financed Income*. One of the classes of UBTI is income derived from debt-financed property, for which there is acquisition indebtedness. If the foundation operates or sells debt-financed property, a portion of the income or gain is taxable. The same rule applies if the debt-financed property is inside a pass-through entity.

(3) *Payments of Income Tax*. To the extent there might be UBTI, one of the practical concerns of the charities is to make sure that under the partnership agreement or LLC there is the typical kind of tax withdrawal provision so that the charity can be assured that it will have cash that it can use to pay the phantom UBIT liability.

(4) *Capital Assessments*. Confirm that the charity would not be subject to a capital call.

(5) *Seek Indemnity From Donor*. If a charity receives closely held business interests that may have any of these potential problems listed above, the charity may want to seek an indemnity from the donor so that if any of those liabilities arise, the donor is responsible for paying them.

(6) *Excess Business Holdings*.

General Rule. The excess business holdings rule prevents a private foundation from holding a large interest in a business. I.R.C. § 4943. The purpose of the rule, like the UBTI rules, is to prevent tax-exempt organizations from competing unfairly with taxable businesses. The general rule is that a private foundation and all disqualified persons together may not own more than 20% of the voting stock in a corporation (this limit can be raised to 35% if a third person has effective control of the business). Nonvoting stock is permitted but only if all disqualified persons together do not own more than 20% of the voting stock. There is often no way around the excess business holding problem, unless the family members are willing to convert their stock to nonvoting stock.

Exceptions. There are two important exceptions where the excess business holdings rule does not apply: (i) if the business enterprise is related to the purpose of the organization; and (ii) if at least 95% of gross income of the trade or business is derived from passive sources. There is also a de minimis exception if the foundation at all times during the year owned 2% or less of the business.

Five-Year Grace Period. There is a five-year grace period for excess business holdings. If the family contemplates a sale in the relatively near future, the gift could be made to the foundation and it can be held with impunity within the foundation for five years. Hopefully the sale will occur within time, but if not, it is surprisingly easy to get an extension from the IRS. There is an even longer-term grace period for excess business holdings by donor advised funds.

98. Hiring Family Members and Sharing of Office Space by Foundations Under Self-Dealing Rules

a. *Employment of Family Members*. The foundation can pay reasonable compensation to family members. The speakers' preferences are that the family not be compensated, but that is sometimes what the client wants. There is an exception to the self-dealing rules for reasonable compensation for "personal services" that are reasonable and necessary to carry out the exempt organizations purposes. Be able to document the actual services provided by the family member. The Council on Foundations provides information regarding reasonable compensation for various types of services. If the compensation is not reasonable, the self-dealing excise tax would be imposed on the portion that is not reasonable. If the client insists on paying compensation to family members, don't let them be greedy.

Personal service means "sweat of the brow" services. For example, the foundation could not hire a disqualified person's janitorial service or construction company, because both of those involve supplies and activities beyond just personal services.

The 1996 Pension Protection Act provides that compensation cannot be paid to the donor or donor's family from a donor advised fund. It makes no sense to treat a donor advised fund more harshly than a private foundation. One speaker thinks that this might suggest a trend toward someday changing the rules so that a private foundation cannot pay any compensation to disqualified persons.

b. *Sharing of Staff and Office Space*. Sharing of expenses is possible as long as services are actually being provided to the foundation and the compensation is reasonable. The best practice is to have the foundation pay its share directly. If office space is leased, ideally the family office would have a lease and the foundation would have a separate lease, but that might not be possible if it is one office. It is not permissible for the foundation to lease the space and then be reimbursed by the family for its use of the office. Technically, that would be a prohibited extension of credit. It is satisfactory for the foundation to reimburse the family for those types of shared expenses. There are a variety of rulings that discuss all types of shared expenses. However, one speaker acknowledges that while rulings have allowed reimbursement of expenses by a foundation (for example, of utility costs), he would rely on them purely in a defensive mode but not in planning mode. Where an office is shared for family office purposes and for the foundation, always "round down," so if there is any question the family pays more than its pro rata share of the expenses.

The problem with these arrangements is that at some point there will be a mistake, and all the reimbursements must be very closely monitored.

99. Outside Advisors, Including Accountants

The donor may want to continue working with their current advisors. It is critically important that advisors understand the private foundation rules, particularly in light of the fact that all the excise taxes were doubled in the Pension Protection Act.

a. *Accountant*. Use an accountant who is very familiar with private foundations and the private foundation rules. Problems can arise very unintentionally. For example, a private foundation cannot satisfy a donor's individual charitable pledge. If the minimum distribution amount is determined wrong in an early year, it can perpetuate itself over time, and eventually result in a huge penalty.

b. *Investment Manager*. The investment manager should understand that there is a tax on net investment income, and that churning the portfolio account can result in unnecessary taxes for the foundation. The investment manager also must understand the UBTI rules. For example, margin investments are debt-financed assets subject to UBIT at ordinary income tax rates. Alternative investments can produce significant problems with respect to the valuation rules and the calculation of the 5% minimum distribution requirement. There is often a lag in getting values for those types of investments.

100. The Gala Problem and the Self-Dealing Rules

If there is a $25,000 sponsorship for attending a gala, clearly if the private foundation just pays the amount and disqualified persons attend the gala, that is an act of self-dealing. Can the disqualified persons pay the fair value of attending the gala itself? Some commentators have suggested that if there is a legitimate reason for representatives of the foundation to be present at the function, it is probably permissible. However, if that is not the case, it is more likely to be an act of self-dealing. Exercise caution. The speaker's clear preference is not to pay for gala sponsorships out of the foundation or, if the foundation does pay a sponsorship, do not accept tickets to the event.

101. Art Appraisal Uncertainties

The Art Advisory Committee, within the last couple of months, has indicated that more than half of the values that they see are wrong, even with appraisals.

102. Termination Issues

Future generations may not wish to operate together anymore as a single foundation with a single purpose, single investment philosophy, etc. Under § 507 there is tax on termination of a private foundation, but the tax can be avoided with planning.

a. *Termination*. If all of the members want to transfer assets to public charities, the foundation will be terminated. There are three basic ways to terminate the foundation.

(1) Transfer all of the assets to one of more public charities. If the transfer is made to public charities that have been in existence five years, the termination tax does not apply. Rev. Rul. 2003-13 addresses tax treatment of a foundation that distributes all of its assets to another public charity.

(2) Transfer all the assets to one or more other private foundations, and then terminate the foundation. This is a voluntary termination to which § 507 applies, but the termination tax is based on the assets at termination, which would be zero.

(3) Convert to the public charities. Have the foundation convert to either a support organization or a publicly supported organization.

b. *Division*. If one or more of the members would like to continue the foundation with respect to a portion of the assets, there would be a division. This is very common after several generations when interests have diverged and the parties live in different parts of the country and support different charities. Some family members may hate dealing with the foundation and want to avoid it altogether. It is easy to divide a foundation without running afoul of any tax rules.

Revenue Ruling 2002–28 describes the tax issues on divisions. It addresses the tax consequences of transfers from a foundation to one or more other foundations that are effectively controlled by the same persons who control the transferor foundation.

There is a great deal of flexibility. For example, a foundation with three family members with divergent interests could be divided into three separate foundations, could be divided among other foundations or donor advised funds or a portion could be distributed directly to a public charity. If some of the assets are distributed to a new foundation, tax attributes carry over to the new foundation. Substantial contributors to the prior foundation are treated as substantial contributors to the new one. Any chapter 42 tax liabilities carry over.

If a single foundation will be split into three separate foundations, one speaker will typically terminate the old foundation and create three new ones other than creating two new foundations and having the existing foundation continue as the third. If distributions are made from the existing foundation to two new foundations, the existing foundation would have to exercise expenditure authority over the new foundations, which is not what the family would want.

Items 103-112 are observations from a seminar by Turney P. Berry, Jonathan G. Blattmachr, and Prof. Ray D. Madoff: Immortality and the Law. The seminar addresses the wisdom of the trend in the various states toward repealing or greatly extending the Rule Against Perpetuities.

103. General Advantages of Trusts.

Jonathan Blattmachr reported that for the last 35 years he has represented only clients who left substantially all of their assets in trusts that last as long as possible under the applicable rule against perpetuities. Advantages of trusts include protection against creditors and spousal claims, providing management protection (how do you know that a future descendant will not have some kind of disability requiring management?), and potential tax savings. Why would a client not want to make those same advantages available for his or her descendants beyond just the immediate descendants? Just like toothpaste cannot be put back in the tube, the potential advantages of trusts cannot be reclaimed once the trust distributes its assets to the beneficiaries.

104. Potential Concerns With Perpetual Trusts

If there are huge advantages to the beneficiaries of having assets in trust, are there concerns for the rest of society as a result of those beneficiaries being so advantaged? Put another way, is there a societal concern with these "ever growing tubes" of societal assets parked in perpetual trusts?

a. *General Control Issue*. The rationale of the common-law rule against perpetuities is to allow people to exert control for the lifetime of the people who are living at the same time as the donor plus the term of minority of the next generation. That was the rationale for "lives in being plus 21 years." The general thinking is that people can make intelligent decisions about the control of property with respect to people they know. (Jonathan Blattmachr said he understood that the rationale of the common-law rule against perpetuities was for a tax purpose – to enable the king to collect transfer taxes.)

   There will be tremendous changes 100 years from today, and how can someone intelligently place controls over property that would make sense hundreds of years from now?

   Good planners advise their clients to give future generations the ability to change the trust provisions (through powers of appointment), but the perpetual trust state laws do not require that.

b. *Societal Concerns*. The American Law Institute has recommended legislation to limit perpetual trusts because of societal problems.

   Trust protections can be incredibly valuable, convincing planners like Jonathan to suggest that all clients should leave their assets in perpetual trusts to provide those huge advantages for their future descendants. However, is it good for society to have some people in the society who are not subject to claims of creditors, who do not have to pay taxes or live by the general rules of the society because of what their forefathers did generations ago? This social divide is a real problem for our society that we should not encourage. That kind of aristocracy does not work in a democracy over time.

   One speaker puts it this way: "It is not intuitively obvious to me why the Rockefellers should be permanently insulated from liability if they run a school bus off the road."

c. *Concerns for Beneficiaries*. If the trust does not give future generations a limited power of appointment to change the trust terms, that prevents future generations from deciding what is best for their offspring. Some clients are concerned with providing their children access to too much wealth. The trust might prevent future parents from being able to provide for their children in the way that they think best.

d. *Concerns for Donors*. Future generations will not necessarily revere great-great-great-great-grandparent for setting up the trust and mandating a set of family aspirations.

e. *Huge Values Held By Professional Trustees Without Controls*. Over time, huge amounts of societal wealth could be tied up in these trusts managed by professional trustees, with no one having the ability to "mind the store." On the average, 250 years later, there would be 114,500 beneficiaries of a family's trust. How do any of them have enough interest to exercise any control over the trustee? (We have seen examples of trustee abuse with some of the very large long-term charitable trusts – such as the Bishop estate litigation.)

Some states (New Hampshire, as an example) provide that there is no need to notify beneficiaries that they are beneficiaries of trusts. Under that system, there will be no effective controls on trustees.

Counterargument: One study showed that after three or four generations, the trust becomes like a mutual fund for the family. They are like passive investors with professional managers. That doesn't seem so bad. There are professional trustees who have a good reputation for handling large trusts in a professional manner.

Another Counterargument: Put curbs on how trusts are administered. Allow the removal of trustees who act appropriately.

Another Counterargument: Class-action plaintiffs' attorneys will gladly take up the challenge to address out of control trustees.

f. *Encouragement to Beneficiaries to Avoid Responsibility?* How is it good for society to have arrangements that encourage beneficiaries to avoid accepting responsibility (for their debts or management of their assets)?

g. *Tying Up Seed Capital for Investments in New Enterprises*. How likely is it that a professional trustee will be willing to invest in some beneficiary's idea of creating a new company that will be called "Google?" If vast amounts of society's wealth ends up being tied up in these trusts, will that discourage the American spirit of entrepreneurship?

Counterargument: The trust can provide that the trustees are permitted and encouraged to take steps to encourage entrepreneurial spirit, even though many of those investments will fail. The trust can provide that the trustee can break off part of the trust and allow a particular beneficiary to be the investment trustee of that particular pool of assets.

105. Appropriate Time Frame For Control

Why is it proper for a parent to set up a trust with these advantages for children, but not to be able to do that for grandchildren or great-grandchildren? At what time frame is the ability to provide these advantages no longer appropriate? If you think a trust is good for the next generation, why not the next?

The rationale of "lives in being plus 21 years" is that the individual knows those people and can make intelligent decisions about providing for them, but after that "they are off the stage."

Society routinely imposes limits. For example, one can vote during life but cannot leave votes behind after death. (Turney Berry remarks: "That's just a theory." Prof. Madoff acknowledges: "There is Chicago.")

Why limit the duration of trusts to a particular number of years — such as 90 years? Why not 100? Or 110? What is magical about 90? Counter: Even though any particular limit is arbitrary, we still have limits in society. That's why we have speed limits. We can say "what's the difference between 65 MPH and 67MPH?" — but with no limits people would drive 150-200 MPH.

As an example of the usefulness of allowing someone to keep a trust intact, Jonathan told of a case where a 29-year-old beneficiary was addicted to cocaine and was out of control. A trust worth $50 million was going to end on her 30th birthday. (The trust was extended for her life under a decanting provision.) "The $50 million would have been 'put up her nose.'"

106. "It's a Matter of Balance" — Meat Cleaver Approach Limiting All Trusts vs. Targeted Revisions For Problematic Issues

As opposed to restricting the duration of all trusts, another approach would be for the law to be revised to require desired elements of control for future generations. What if a state statute allowed perpetual trusts as long as someone in each generation had a broad power of appointment to change the control element? Or what if the law had a rule against perpetuities but allowed future generations to extend the perpetuities limit if it so desired? That would satisfy the dead hand control issue (but would not solve all of the other issues raised).

Jonathan said that he would not be opposed to a rule that said that if you want a trust of any kind there has to be an ability in someone, whether it's the court (and he thinks it exists under the law of every state) or a trustee or someone to have the ability to terminate it.

107. Balancing — Personal Freedom of Disposition vs. Societal Concerns

John Locke said "The purpose of government is to protect life, liberty, and property." There is a strong policy of protecting an individual's right to dispose of property as he or she sees fit without government interference.

This is a matter of balancing that strong policy of protecting individual freedoms vs. societal concerns with protecting against inappropriate ways of exercising that freedom that are so damaging to society that they must be limited.

108. Destroying Motivation of Beneficiaries

Teddy Roosevelt felt that inheritances were the worst things imaginable. He wanted an estate tax rate of almost 100%, because he grew up with wealthy young man who sat around doing nothing because they were waiting for their inheritance. We have all seen family situations where the family wealth destroyed the motivation of younger generations.

Jonathan makes all clients create a Family Creed. Ultimately they all come to the same conclusion, something like this. "I want my wealth, whether it's $100,000 or $100 million, to be used to allow my descendants to achieve their potential in life – whether that's in teaching school, medicine, law, business, or charitable, or whatever it happens to be. I do not want it to be used to create idle and useless and harmful lifestyles."

109. Accumulated Wealth Allows Creating Societal Benefits

As an example, the Grand Teton National Park is the most heavily visited national park. John Rockefeller bought the property and Congress refused to accept it from him. He had to hire lobbyists to convince Congress to accept it as a national park. Counterargument: how likely is it that a trustee will use the massive accumulated wealth for purposes like that?

110. Building Protection With Long-Term Trusts In Light of Flawed Legal System vs. Incentives to Improve the Legal System

Consider asset protection planning advantages of trusts. Twenty-four million lawsuits are filed each year. The U.S. is virtually the only country in the world that permits contingent fees and where "the loser doesn't have to pay." It is much easier to commence a frivolous lawsuit then to defend one. "I feel my responsibility for my clients, even for money that they earn, is to structure it in ways that will be immunized from their creditors in light of our legal system that encourages litigation."

Counter: One Fellow has been troubled since law school why the $1 million that a beneficiary receives outright can be reached by his creditors, but the $1 million that another beneficiary receives in trust cannot be reached by creditors. That dichotomy is exacerbated by using extremely long-term trusts. He is sensitive to the argument that if there were a better legal system, clients would not have to opt out of it. However, the greater an opportunity we create for the wealthy to opt out a legal system they don't like, the less incentive there is to improve the system for everybody. Isn't the answer to do something about frivolous lawsuits against everyone, rather than just protecting the wealthy from those suits and have other people subject to them?

111. Rockefeller Trusts Will Soon Terminate

The Rockefeller trust was created under a "two-life" rule that New York used to have. It will not be long before the Rockefeller trusts terminate and massive amounts of property will be distributed outright. Even though there are now 400 descendants of John Rockefeller and the massive wealth will be divided, one wonders how the next generation that receives that property outright will do with their newfound wealth.

112. Concern With Pressure That Attorneys Feel to Create Long-Term Trusts

One Fellow expressed that there are too many lawyers who think it's almost malpractice not to opt out of the rule against perpetuities. Bill Gates Sr. particularly took issue with the trend to having dynasty trusts. "I would rather not have the option to opt out. One hundred to 150 years is long enough."

Item 113 consists of interesting quotations from throughout the seminars.

113. Quotations

a. *Will They Pay For Their Shortcomings?* "How do we motivate clients to pay us to deal with their lack of parenting success?" – Jim Maddox

b. *Oh, Those Lawyers and Doctors.* "96% of people in clinics could complete the personal threshold questionnaire in less than 15 minutes. There were two exceptions — lawyers and doctors." – Dr. Linda Emanuel

c. *Time to Check Out.* The "personal threshold" is the point in a mounting prognosis where the patient's desire for treatment would change from (1) curative to (2) comfort and quality of life. Dr. Emanuel describes this as the point at which "I'd rather be a portrait on the wall than a burden to my family." – Dr. Linda Emanuel

d. *Fungible Attorneys.* Many clients see their estate planning attorneys as being fungible. It's like saying "I manage the best restaurant in this hospital." – Bob Kirkland

e. *The Secret to Being Heard.* "Funny how you're dead when people start listening." Country & Western song mentioned by Bob Kirkland

f. *Insensitivity.* "I attended one funeral where the minister started with, 'Joe Blow — G-d has thinned the herd.' I scratched him as a possible officiate for my funeral." – Bob Kirkland

g. *ACTEC Demographics.* "There's a lot of grey hair or no hair in the room." – Jeff Pennell

h. *Job Security.* "Thank goodness for greed, sibling rivalry, and jealously. Those things will not go away." – Bruce Stone

i. *Turbo Estate Planning?* "Will there be a TurboTax Form 706EZ?" – Jeff Pennell in discussing the filing requirement at the first spouse's death to use portability

j. *CYA.* “Everyone knows what CYA stands for — check your actions.” – Glen Yale

k. *It’s All In Your Perspective.* Many documents have provided that the age of financial maturity (i.e., the termination date) was 25, 30, and 35. Question: Who was drafting those documents?

Answer: A 35-year-old.” – Bruce Stone

l. *Listening.* “My wife will tell you I do all my listening at the office. My secretary knows I do all my listening at home. I’ll tell you I’m the best listener in the world – am I not here lecturing about it?” – Ron Aucutt

m. *An ACTEC First.* “I did promise Karen that my first four words, words no Trachtman Lecturer has ever been able to utter, would be magnificent: ‘Madam President. Madam President-Elect…’” – Ron Aucutt

n. *Preconceptions.*

“ATTORNEY: Before you signed the death certificate, had you taken the pulse?

CORONER: No.

ATTORNEY: Did you listen to the heart?

CORONER: No.

ATTORNEY: Did you check for breathing?

CORONER: No.

ATTORNEY: So, when you signed the death certificate, you weren’t sure the man was dead, were you?

CORONER: Well, let me put it this way. The man’s brain was sitting in a jar on my desk. But I guess it’s possible he could be out there practicing law somewhere.” – Ron Aucutt

o. *The Entire Estate Planning Professional Community Is SO Thankful For THAT Doctor.* “I can only speak from second-hand hearsay, for example, about the obstetric and pediatric team that worked with incredible resolve over the baby who would not breathe on his own for about 20 minutes after he was born, or about the nurse who told *my mother* that any other doctor would have given up. While committed to “first do no harm,” he defied the risk of harm for the possibility of a good outcome. – Ron Aucutt

p. *The Real “Lincoln Lawyer.”* “Even Lincoln litigated, 175 times all the way to the Illinois Supreme Court, 51 times as sole counsel.” – Ron Aucutt

q. *Lawyers as Peacemakers.* “Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser — in fees, expenses, and waste of time. As a peacemaker the lawyer has a superior opportunity of being a good man. There will still be business enough.” – Abraham Lincoln (as quoted by Ron Aucutt)

r. *Discretionary Assets.* “I remember when I was practicing in the mid-Georgia area, and a client came in wearing bib overalls. I asked what his net worth was (back in the mid-1980s) and the individual said: ‘bout 20.’ I was thinking $20,000 at that point, but it was $20 million.

I then asked ‘what do you live off of.’

He said ‘before tax or after-tax?’

I said 'You tell me after-tax and I'll do the conversion.'

He said: '4.'

I said, 'You mean 4 million?'

He replied 'no, $4.000'

I said, 'you mean per month?'

The response: 'No. Per year.'

I found out the guy lived in a shack with dirt floors — and had an estate of $20 million. That guy had a lot of discretionary assets." – Mil Hatcher

s. *The Best Generation*. George Orwell said "every generation thinks itself to be more intelligent than the one that went before it and wiser than the one that comes after it." – Prof. Ray Madoff

t. *Teddy and Estate Taxes*. Teddy Roosevelt felt that inheritances were the worst things imaginable. He wanted an estate tax rate of almost 100%, because he grew up with young man who sat around doing nothing because they were waiting for their inheritance." – Jonathan Blattmachr

u. *Purpose of Governments*. "The purpose of governments is to protect life, liberty, and property." – John Locke (as quoted by Jonathan Blattmachr)

v. *Jonathan's Discussion With His Father About Long-Term Trusts*. My father once asked me, "When your mother dies, when do you want your inheritance?"

I said, "Don't you love me?"

He said, "Of course I love you, that's why I'm asking."

I said, "So my wife can take it in a divorce? So when I'm 93 in rubber pants in the nursing home, some pretty young nurse can take it away from me? So some client can sue me? If you love me, you will put it in trust for as long as the law permits."

I was 23 years old, and I will tell you I haven't changed my mind. – Jonathan Blattmachr

w. *Gifts and Money Flushing*. "If you can't flush the money down the toilets, you shouldn't be giving it away." – Lou Mezzullo

x. *Our Expanding Universe Except …* "I'm reminded of a wonderful Woody Allen scene in which a young Woody Allen is complaining to a psychiatrist that he can't sleep, he can't eat, and he can't do his schoolwork because he's read that the universe is expanding and everyone is going to die. His mother said 'You live in Brooklyn, and Brooklyn is not expanding.'" – Turney Berry

y. *Mortality Ending in 2045?* "Ray Kurzweil, the highly respected futurist, has predicted that in 2045, the concept of mortality for human beings will end. The essence of one's brain can be downloaded the same way that a hard drive can be downloaded to a memory stick." – Jonathan Blattmachr "So now all I have to worry about is who is going to lose my essence." – Turney Berry

z. *Divorce Probabilities*. "Over 50% of American marriages end by divorce before the 25th anniversary. If your clients have two children, the odds are very high that at least one of them will be divorced. If they have four grandchildren, the odds are over 90% that at least one of them will be divorced." – Jonathan Blattmachr aa. *There Are Limits to Limits*. "Society routinely imposes limits. For example, one can vote during life but cannot leave votes behind after death." – Prof. Ray Madoff

Turney Berry remarks: "That's just a theory." (Prof. Madoff acknowledges: "There is Chicago.")

bb. *Our Litigious Society*. "There are 24 million new lawsuits each year in the US. The United States has 4% of the world's population and over half the world's lawyers. We have more lawsuits commenced each year in this country than in all the rest of the world combined." – Jonathan Blattmachr

cc. *Congressional Wisdom*. "The Administration's Fiscal Year 2012 Revenue Proposals include modifying the PAYGO baseline to assume that the 2009 transfer tax system will be made permanent after 2012, with an estimated revenue cost of $270 billion dollars over ten years. We would have wasted it any way, so what the heck. That just makes sense." – Sam Donaldson

dd. *Nevada Rules*. "In the *Shapiro case,* the decedent cheated on his 22-year cohabitant (which I thought was legal in Nevada, but maybe this was in Clark County.)" – Sam Donaldson

ee. *Forget the Friendly Advice*. "We want your millions, but not your two cents." – Joe Paterno (as quoted by Glen Yale)