BESSEMER TRUST

ACTEC 2016 Annual Meeting Musings

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

This summary reflects brief highlighted individual observations of Steve Akers from the seminars at the 2016 Annual Meeting and does not purport to represent the views of ACTEC as to any particular issues.

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Important Information Regarding This Summary
This summary is for your general information. The discussion of any estate planning alternatives and other observations herein are not intended as legal or tax advice and do not take into account the particular estate planning objectives, financial situation or needs of individual clients. This summary is based upon information obtained from various sources that Bessemer believes to be reliable, but Bessemer makes no representation or warranty with respect to the accuracy or completeness of such information. Views expressed herein are current only as of the date indicated, and are subject to change without notice. Forecasts may not be realized due to a variety of factors, including changes in law, regulation, interest rates, and inflation.

Introduction

Some of my brief observations from the 2016 ACTEC Annual Meeting Seminars in Las Vegas, Nevada on March 17-20, 2016, are summarized below. (At the request of ACTEC, the summary does not include any discussions at Committee meetings.) This summary does not contain all of the excellent information from the seminars, but merely a few selected issues. The summary is based on the presentations at the seminars, but the specific speakers making particular comments typically are not identified. Much more than in the past, this summary really is meant as "musings" on the various seminars, focusing on a few items from each seminar.

Items 1-4 Items 1-12 are observations from a seminar by Sarah S. Butters, Charles A. Redd, and Steven E. Trytten, Hot Topics

1. Basis Consistency

An oft-discussed topic throughout the 2016 Annual Meeting was the new basis consistency and reporting requirements. A full discussion of these developments is available in a summary titled "Basis Consistency Temporary and Proposed Regulations" found **here** and available at **www.Bessemer.com/Advisor**.

The following are some of the provisions in the proposed regulations that are rather surprising and that have received a great deal of attention.

a. **Zero-Basis Rule for After-Discovered Property**. In an extension of the basis consistency statute, if after-discovered or omitted property is not reported on a supplemental estate tax return before the limitation period expires (generally three years from the filing date, §6501(a)), the basis of such property is *zero*. Prop. Reg. §1.1014-10(c)(3)(i)(B). Planners generally believe that no duty exists to report after-discovered property if the estate tax return was filed in good faith. *See Badaracco v. Commissioner*, 464 U.S. 386 (1984). Accordingly, if a preparer determines that no obligation to amend a return exists to report omitted property, the failure to report the property may result in a 40% estate tax savings, but that savings may be offset by a 23.8% federal capital gains tax (plus any state capital gains tax) or an even higher income tax attributable to the inability to depreciate the property. That mere math analysis suggests that the after-discovered asset typically would not be reported (40% is greater than 23.8%), but if the recipient of the after-discovered asset is not the party responsible for paying estate tax with respect to that asset, the executor may be put in an inherent conflict situation. The party who bears estate taxes will not want the property reported, but the party who receives the asset will want it reported to have a basis equal to the date of death value of the asset.

   The zero basis rules rule raises particularly interesting issues with respect to after-discovered cash. What is the impact of cash having a zero basis?

b. **Subsequent Transfers.** If a beneficiary later transfers an asset from the estate in a non-recognition transaction to a "related transferee," the beneficiary has reporting requirements. No time limit applies; subsequent gifts many years later of estate assets to related individuals could trigger reporting requirements (with penalties for the failure to do so). "Eventually every asset in the U.S. will be in the IRS computer system somewhere"–that's an exaggeration, but the point is interesting regarding the massive amount of basis information that the IRS will be collecting (and conspiracy theorists will wring their hands over what the IRS might do with that information).

The proposed regulations curiously require that subsequent gift transfers to grantor trust be reported, but not transfers to non-grantor trusts.

c. **Funded Revocable Trusts.** A major area needing IRS clarification is how funded revocable trusts will be reported. The answer is unclear, but many think that the executor (or the trustee if there is no appointed executor) will deliver the information statements to the beneficiaries of the revocable trust (which may, in turn, be the trustees of other trusts (such as a marital trust or bypass trust)). For transfers from a probate estate to a revocable trust, the information statement is given to the trustee of the revocable trust, and apparently, a distribution from the revocable trust to its beneficiaries would not have to be reported as a subsequent transfer because the beneficiary would not be "related" to the trustee in its capacity as trustee.

2. Section 2704 Regulations

One of the speakers believes the current statutory authorization of additional regulations does not support regulations that would impose substantial new restrictions on valuation discounts under §2704 and in particular do not support adopting by regulations the "Greenbook proposals" (for Fiscal Years 2009-2012) to modify §2704 legislatively.

3. Same-Sex Marriage Retroactivity Issues

Following the U.S. Supreme Court decisions of *Windsor* and *Obergefell*, we now know that federal and state restrictions on same sex marriage are unconstitutional. The next round of litigation will be over the retroactivity issue–how far back will the unconstitutionality be applied to upset prior determinations. Federal tax refunds are allowed to the extent that past returns can still be amended (Rev. Rul. 2013-17), and Social Security claims that were pending on the date of the *Obergefell* decision will be allowed (under an August 20, 2015 announcement from the Justice Department). A wide variety of other issues arise, such as state inheritance tax refunds (at least that is painful only to a state and does not upset another individual's rights), in-state tuition claims, heirship determinations, elective share rights, spousal support rights, and homestead rights. Many of those issues involve upsetting what was thought to be settled title to assets.

Some common exceptions to retroactive recognition are for (1) bona fide purchasers, and (2) public policy issues if the retroactive recognition would cause "too much" hardship. For example, similar issues have arisen with respect to giving inheritance rights to nonmarital children (under the *Trimble v. Gordon* U.S. Supreme Court case); the Supreme Court dealt with the retroactivity issue in *Reed v. Campbell*, suggesting that claims that were filed after *Trimble* when the decedent's estate remained open should be recognized. Under that approach, the surviving spouse should be able to claim spousal inheritance rights for "open" probates (but in some states, estates are typically not formally closed).

A "statute of repose," allowing claims to be filed within a set time frame from when the statute is passed, is one method of dealing with these retroactivity issues. Mississippi adopted such a statute with respect to nonmarital children claims; Florida is now considering such a statute, which might provide, for example, that retroactive spousal inheritance claims would have to be brought within three years of when the statute passes.

4. Be Cautious About Transferring §1202 (Originally Issued) Stock

One of the changes in the Protecting Americans from Tax Hikes (PATH) Act of 2015 (the "tax extenders" legislation in mid-December, 2015) is to extend permanently the 100% gain exclusion (for both regular and AMT purposes) for §1202 stock. Section 1202 stock is "qualified small business stock" that was originally issued by a corporation that meets a gross assets limitation and certain other requirements. Before transferring a client's stock that was originally issued by a corporation, inquire to determine if the stock qualifies as §1202 stock. If so, the client should understand that transferring the stock may give up the favorable gain exclusion advantage when the stock is later sold.

5. Settlor Intent vs. Benefit the Beneficiary

The Uniform Trust Code and Restatement (Third) of Trusts have both endorsed and codified the "benefit of the beneficiary" rule as a mandatory, non-waivable requirement that a "trust and its terms must be for the benefit of its beneficiaries." Section 105 of the Uniform Trust Code contains "the requirement that a trust and its terms be for the benefit of the beneficiaries." Prior law generally provided that settlor intent would be honored in recognizing trust terms unless the terms are illegal or violate public policy. A growing trend of fiduciary litigation makes allegations that trust terms are capricious and do not benefit the beneficiary and therefore should not be enforced and should be modified. For example, retention of asset requirements and waivers of diversification may be challenged as not being for the benefit of beneficiaries. Some states have opted out of the mandatory "benefit the beneficiary" language in adopting the Uniform Trust Code.

Items 6-10 are observations from the Annual Joseph Trachtman Lecture by Dennis I. Belcher: Changes in Estate Planning Professional Practices—Do We Need a Canary or Did the Canary Stop Singing and We Missed It? (Many of the observations in this summary come directly from Dennis Belcher's materials. His thoughtfulness in making these materials available is greatly appreciated.)

6. Financial Services Industry Is Growing

The financial services industry includes estate planning, investment management, tax planning, business planning, insurance planning, and charitable planning. Financial service providers include lawyers, accountants, financial institutions, investment managers, insurance professionals, and charitable advisors. Interest in the financial services industry, insofar as it impacts estate planning practices, is growing.

7. Change Factors Impacting Estate Planning Professional Practices

a. **Has the Canary Stopped Singing?** The estate planning practice may be analogized to an intellectual coal mine. Canaries were used in mines to warn of dangerous gas leaks. Have there been significant changes in practices that we have missed?

b. **Despair.com on "Change**." **"**Change – Politicians are like diapers. They need to be changed often and for the same reason."

c. **Transfer Taxes.** Very significant changes to the federal transfer tax system occurred in 2001, 2010, and 2012. Transfer taxes are impacting far fewer numbers of individuals. While the number of gift tax returns has constantly hovered around 250,000-300,000 (with a spike above 350,000 in 2012 reporting 2015 gifts), the number of estate tax returns has plummeted from 120,000 in 2001 to 12,000 in 2014 (this is total estate tax returns, including returns for which no taxes are due). Federal transfer taxes have significantly decreased significance in estate planning practices; factors include increased exemption amounts, decreased rates, the stability of the transfer taxes and less need to changing estate planning documents, and portability and the resulting reduced amount of marital and credit shelter trust planning.

   Lessons learned from the transfer tax changes: less estate planning work for clients with less than $5 million; more estate planning work for the ultra-high net worth population; significant planning opportunity still exists for the large population with $5-$10 million of wealth.

   We are always "one election away" from significant changes in the transfer tax environment.

d. **Money in Motion**. A significant transfer of wealth is occurring. $12 trillion has been transferred from individuals born between 1928-1949. There will be an additional transfer of $30-$41 trillion between 2001 and 2048. This represents a substantial opportunity to build or lose client base.

e. **Changing Demographics**. The population is becoming older and children are remaining financially dependent longer on their parents. Children are marrying later and having children later. These changing demographics create opportunity.

   Wealth demographics are also changing. Marketable securities wealth has grown substantially, but residential housing has not yet returned to 2006 values. The wealth of 99% of the population (who are often not represented by estate planning attorneys) consists primarily of their residence and Social Security benefits.

   The demographics of estate sizes for estate tax returns filed in 2014 are interesting. About 56% (6.735 of 11,932) represent estates between $5 and $10 million. Estates under $10 million represent about 70% of all of the returns filed. (About 19.1% are between $10 - $20 million, 7.9% are between $20 - $50 million, and 2.9% are over $50 million.)

f. **Clients Are Better Educated**. A Google search for "estate planning" ends up with 11,100,000 results (including Legal Zoom and financial institutions). "The most informed client does not always hire the best lawyer."

g. **Life Is More Complicated**. Clients face more complicated situations at an older stage in life when they are less able to deal with complications. Clients need more advice on more subjects. But – will clients pay for the advice that they need?

8. Adapting Estate Planing Practices to Changing Times

a. **Darwin on Adapting**. "It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is most adaptable to change." -Charles Darwin.

b. **Growth Areas**. Potential growth areas include planning for the ultra-high net worth, income tax planning, fiduciary litigation, business planning, charitable planning, elder law planning, and international planning.

Business planning opportunities for estate planning practices include: transfer tax planning; income tax planning; governance issues; shareholder disputes; and sales, mergers, and acquisitions of businesses.

Charitable planning may grow for the ultra-high net worth client base, with a focus on transferring family values. However, charitable giving may decrease at the "affluent" level (with less tax incentives). Private foundations and donor advised funds will remain popular.

c. **Independence**. A distinguishing feature for most ACTEC Fellows is that they do not sell products, giving the Fellow the ability to give independent advice as compared to other advisors that sell products.

d. **SWOT Analysis**.

- **S**trengths (independence)
- **W**eaknesses (billable hours)
- **O**pportunities (transfer of wealth)
- **T**hreats (transfer tax is not as significant, threat of becoming a scrivener rather than a trusted advisor)

e. **Analyze Current Clientele.** Determine the net worth of all clients served during the last 36 months (under $5 million, $5-$10 million, $10-50 million, and over $50 million). What revenue has been generated by each of these categories of clients? Determine the type of work performed for clients during the last 36 months (planning, estate administration, litigation, business planning, charitable).

f. **Changes Needed**? Are the current clients the right clients for your firm? If not, what clients do you want?

9. Beverly Hillbillies vs. Star Trek Clients

a. **Beverly Hillbillies and Star Trek Television Series**. The Beverly Hillbillies ranked among the top 20 most watched programs on television for eight of its nine seasons, twice ranking as the number one series of the year. It survived nine seasons and 274 episodes.

Star Trek had low Nielsen ratings and was canceled after three seasons and only 79 episodes.

b. **Post- Cancellation Experience**. After the series' respective cancellations, the Beverly Hillbillies did nothing, but Star Trek played repeatedly in syndication and spun off the

Star Trek-The Generation television series that ran from 1987-1994, and a series of six feature movies.

Strategic planning looks for ways to achieve results with long-term growth and success prospects.

c. **Beverly Hillbillies Clientele.** A "Beverly Hillbillies clientele" is easy to develop and profitable in the short-term, but is not memorable in the long-term and develops little spin off work. The clientele generates a practice with simple matters, one shop relationships, and price-sensitive commodity clients that pay the overhead.

d. **Star Trek Lawyer/Clientele**. Star Trek had complicated plots, and required substantial investment before building its growth opportunities. The Star Trek clientele entails more complex matters (assets and beneficiaries) and less price-sensitive clients with multiple contacts. The lawyer becomes the trusted advisor. Building a Star Trek clientele takes significant investment in clients – it takes time to become a trusted advisor, and generally requires a team because of the client's needs.

10. Trusted Advisor

a. **Advantages.** A trusted advisor gets more legal work, more sophisticated work, more lucrative work, and produces attractive work for training younger lawyers.

b. **How to Be a Trusted Advisor**. Build credibility (such as with the ACTEC designation). Invest in knowing more about each individual client. Spend time with the client without charging for the time. Schedule regular meetings with the client. Get to know the client's family. (A client can have more than one trusted advisor.)

c. **Complex Work Becomes Commodity Work Over Time**. The trusted advisor who handles complex matters needs to stay "ahead of the curve." Complex transactions being done today will become fairly ordinary in five years.

Items 11-16 are observations from a Symposium by David A. Baker, Kristen E. Caverly, and The Honorable C. Jean Stewart—You Can Take It With You–Assuring Compliance With Decedents' Wishes In An Era of Litigation and Flexibility. The Symposium addresses a variety of things that can be done to make more likely that the client's wishes expressed in estate and trust documents will be honored. The Symposium materials include 50-state surveys with respect to the state laws impacting a variety to related issues including in terrorem clauses, intentional interference with testamentary expectancy, the admissibility of videotaped execution conferences as evidence, decanting, nonjudicial settlement agreements, total return trust conversion, and post-death psychiatric autopsies as evidence of capacity.

11. Balance With Desired Flexibility

The general assumption is that the client's wishes should be honored as expressed in estate planning documents unless there is a compelling reason not to do so. That goal, however, must always be balanced with the need for desired flexibility to react to changing circumstances.

12. Videotaping

a. **More Harm Than Good**? Videotaping often does more harm than good. The judge panelist typically did not find videotapes useful. They have an influence in trials, but not the overwhelming impact that attorneys might think. Videotaped conferences in hospitals are particularly problematic, because the person probably will not look good in the hospital.

b. **Certified Videographer**. If a videotape will be made, use a certified videographer.

c. **Scripted and Managed**. The most effective videotaped conferences are scripted and managed. The judge responds – "the ones that were effective looked scripted and managed." That does not leave the judge comfortable that the person really had any knowledge or depth of understanding about the documents being signed.

d. **Do Not Ask Why**. The biggest mistake is asking the testator why he or she is doing things. Even if the answer is coherent, it opens up issues about whether the testator was informed, whether the belief was the consequence of some abuse, or whether there was a mistake of fact. There is no need to know *why* the testator is doing the things he or she is doing– just that the testator understands *what* is being done.

13. Arbitration

Planners have widely varying views regarding arbitration. The litigator on the panel is a big fan of mediation but not arbitration. It is expensive because the parties must pay for a private judge. The discovery time is still the same. A significant difference is that there are no rights to appeal following arbitration.

Arbitration is unpredictable because the typical rules of evidence do not apply. For example, hearsay testimony or the testimony of someone not previously listed as a witness will be admissible. A huge factor in fiduciary litigation is the Dead Man's Statute (which generally prohibits an interested party in litigation from testifying about communications or transactions with the decedent). In arbitration, the Dead Man's Statute does not apply and the arbitration panel will hear anything that anyone wants to say.

14. Psychiatric Examinations

a. **Forensic Psychiatrist**. If the planning attorney thinks that someone may possibly raise a capacity issue in the future, consider using a forensic psychiatrist to examine the individual. Do not use the client's treating physician. Someone who has experience testifying is preferable. This is expensive, and the process may cost $20,000-$30,000 to get an evaluation that is admissible and helpful.

b. **Judge's Reaction**. The judge did not find the testimony of psychiatrists as compelling as other testimony including nurses or other medical personnel who may have had detailed conversations with the decedent. In addition, the estate planning attorney can talk about the client's background and desires, discussions with the client about various ways to accomplish the client's desires, discussions about drafts of documents, knowledge about family members, etc. That is all powerful testimony and much more persuasive than clinical testimony.

If an attorney thinks there is a possibility of a future contest, spending significant time with the client to discuss in detail the client's desires and working together to develop a plan that works and accomplishes what the client wants is important. Pay particular attention to the file itself– having a good clean file is important. Ideal would be to have a transmittal letter together with charts explaining documents.

15. Opting Out of Modification Alternatives

a. **Decanting and Unitrust Conversion**. Various state law alternatives are available for modifying documents, including decanting, nonjudicial settlement agreements, and unitrust conversions. State law typically permits a settlor to opt out of decanting and unitrust conversions. That may be important if a client feels strongly that the plan should not be revised, but do not include "opt-out" language as boilerplate. Modification methods provide significant flexibility for adapting to changing circumstances. (Indeed, one panelist questions whether someone might bring a malpractice claim because the attorney walked the client into a situation in which the trust cannot react to changes.) Particularly for lifetime irrevocable trusts, donors often like the flexibility for the trustee or a designated third-party to be able to make adjustments as circumstances change.

b. **Consider Situs.** If a client wants to include opt-out provisions, add a "no change of situs" provision. The planner needs to know what state law applies and what flexibility is allowable under that state's laws.

c. **Nonjudicial Settlement Agreements**. Nonjudicial settlement agreements, in connection with virtual representation statutes, may modify interests in wills or trusts without court action. The enabling statutes are essentially civil practice provisions and often do not contain opt out provisions. Express provisions in a trust may not be effective to block the applicability of nonjudicial settlement agreement and virtual representation statutes. However, courts will generally enforce limitations on modification expressly stated in a trust document, unless they violate public policy. There is little authority on whether such an opt out provision is effective, but there is no harm in including such a provision if finality is desired by the testator/settlor.

   Choice of law selection will be critically important for the client who wishes to limit nonjudicial settlement agreements, because some states do not have these provisions at all and some states that recognize nonjudicial settlement agreements have much more limited availability and applicability than others.

16. In Terrorem Clauses

a. **Generally Recognized; Powerful**. In terrorem clauses are now generally enforced. They are perhaps the most effective means of locking in a client's plan and curtailing post-death litigation. They have a tremendous impact on mediation proceedings.

b. **Not Boilerplate; Placement**. These clauses are not boilerplate. The attorney must discuss them carefully with a client who is concerned about disruption of the plan. If an in terrorem clause is used, consider placing the clause with the dispositive provisions rather than buried in the back of the will or trust document. In a court proceeding, this will suggest that the client felt strongly about discouraging contest actions.

c. **Probable Cause Exception**. In terrorem clauses are typically enforced unless the contestant had probable cause for the challenge. This is typically an objective belief that the contestant was reasonably likely to prevail based on facts and the law available at the time of bringing the action. Some states also apply a good-faith requirement, which is a subjective belief in the bona fides of the claim. Steps that the planner takes to bolster the enforceability of the plan (evidence of capacity, etc.) will increase the difficulty of the contestant being able to establish probable cause.

d. **Spousal Challenge and Marital Deduction**. There is little law as to whether the mere presence of an in terrorem clause in an estate planning document affects the marital deduction. If the estate tax marital deduction is important in a particular situation, consider providing that the clause does not apply to the surviving spouse, or that it would apply only three or four years after the date of death.

Items 17-23 are observations from a Symposium by Linda M. Doyle, Stephen P. Magowan, and Elizabeth Quinn—Personal Assistants, Nannies, Caregivers, House Managers, Gardeners and Drivers: 21st Century Household Employee Issues

17. Significance of Diligently Addressing Employment and Immigration Law Matters

Mistakes in employment and immigration law matters with domestic help can end up costing clients a lot of money. Failure to comply with these rules creates a significant hidden liability problem that can complicate insurance issues when a liability is asserted and can create a windfall for plaintiffs' attorneys. Disgruntled domestic employees (even employees who are dismissed for stealing) can raise issues regarding overtime rights, etc.–and win! Information is readily available on the Internet helping domestic employees understand their rights, and disgruntled employees can be aggressive in pursuing their rights. (As an example, see **http://www.domesticworkers.org**.) In addition, failure to comply with these rules may create reputation risks (remember when Supreme Court nominees were at risk because they had violated nanny tax rules). Exercising diligence with respect to domestic employees is critical– treat the hiring of a domestic employee as one would expect a corporation to treat the hiring of a business-related employee.

18. Waiver of Rights Not Possible

A common misconception is that domestic help can agree to waive rights under employment-related laws and regulations. That is not true, and significant fines and penalties apply for employers endeavoring to do so. For example, the right to overtime pay cannot be waived.

19. Pre-Employment Issues

a. **Job Application; Background Check; Personal Interview**. The domestic employee should complete a job application. A lie on the resume can help in defending a later lawsuit. What a person chooses to list as experience and what they view as important is insightful about the individual. Applications are available online. Check personal and professional references, asking good penetrating questions.

Job applications are a critical step in performing background checks (credit report, reference check, drug screen and arrest records search), which should be used for each domestic employee. Background checks are perhaps even more important for domestic employees than general business employees because of the close personal nature of the relationship with the family.

In the interview, one panelist says a favorite technique is to observe that the person listed three references, and ask for a fourth (to get someone the person thinks of immediately rather than a screened planned reference). In the personal interview, asking if the person plans to have a baby soon is illegal in the U.S. (but is legal in international maritime law–because having a baby on the ship at sea would obviously be a problem).

b. **Authorization to Work in U.S**. In the interview, the employer can ask if the person is legally authorized for employment in the U.S., but cannot ask where the employee is from or if he or she has a green card. Pursuant to the Immigration Reform and Control Act, employers must verify every newly hired employee's authorization to work in the U.S., by virtue of U.S. citizenship, a green card, or a visa that allows the individual to work in the U.S.

A Department of Homeland Security Form I-9 is required for any employee hired on or after11/6/86 (including those who provide services on a regular but inrequent basis, e.g., once a week). Significant fines apply if the Form I-9 is not secured and retained by the employer (fines may apply for paperwork violations even if the employee is authorized to work). The employer is not allowed to question the veracity of the form.

Three key aspects for the Form I-9 are: (i) Employee information-the employee provides personal information and attests to the status of employment eligibility (this first part of the Form must be completed by the employee, not the employer); (ii) Employer Review-the employer reviews original documentation (such as a green card, Social Security card, driver's license, etc.) in the employee's physical presence to verify identity and employment eligibility and must properly document and certify this review (the speaker recommends that the employer *not* keep copies of these documents); and (iii) Reverification and Updates-timely updates to extensions of work authorization and personal information are required (the employer should keep a tickler system for the dates that work documents expire). The employer must retain the I-9s, but they should be kept separate from employee personnel and performance records.

Any employee not legally authorized to work must be terminated immediately. Be particularly careful about domestic employees hired by a third party. (Umbrella liability policies often state that there is no coverage for people illegally employed in the United States under the insured's direction.)

c. **Employment Agreement**. Use an employment agreement for each employee to avoid misunderstandings.

- Set expectations (job duties, hours, compensation/benefits, payroll frequency, tax treatment).
- Clarify that the employment is at will.

- Include a strict confidentiality agreement covering the entire family that applies indefinitely and prohibits direct or indirect disclosure with penalties for breach of the agreement (the penalties have a “chilling” effect on the employee).
- Address any house rules (guests, smoking, no illegal acts on premises, etc.)

20. Employment Issues

a. **Employment Policies**. Employment policies are typically covered in the employment agreement.

b. **Confidentiality Agreement**. Confidentiality agreements are very important for domestic employees because of the close access to information the employee will have. (The confidentiality agreement may be a part of the employment agreement.)

c. **Working Time Monitoring System**. Federal and state wage and hour laws apply to domestic employees. Wage and hour issues are frequently litigated by domestic employees in the event of any dispute with an employer (including allegations of employee theft). Using a formal mechanism to record time for each employee to establish compliance with federal and state minimum wage and overtime regulations is critical.

d. **Performance Reviews**. Set a timetable for formal reviews to manage employees’ expectations and if necessary, provide a defense to employment-related litigation.

e. **Required Postings**. All employers must post certain federal and state wage and hour and other employment-related laws in a conspicuous location. Laminated posters may be obtained from the Department of Labor.

f. **Personnel Files.** The employer should maintain personnel files for each employee with the pre-hire documents, performance reviews, and other employment-related documents.

21. Employee vs. Independent Contractor

a. **Most Are Employees**. Almost all domestic workers are employees, not independent contractors, though many are classified incorrectly. Employees cannot merely agree to be independent contractors and waive rights as employees.

b. **General Distinctions**.

Employee. Elements of an employee relationship include: (i) open-ended, and indefinite relationship; (ii) the employer exerts some control over what the person will do and over how the person does it; and (iii) the worker does not work for other individuals or entities.

Contractor. A contractor is generally a person with a special skill engaged for a specific project related to that skill and over whom the client exercises no control (such as a house painter). Nannies (as well as most domestic workers) are not independent contractors.

22. Compliance Requirements for Employees

a. **Tax**. For all employees, the employer must comply with tax law and pay Social Security, Medicare (FICA and FUTA), federal and state income tax withholding, and unemployment compensation insurance. The employer can control the overall compensation cost (including taxes) by taking all of these costs into consideration. Any advantage of not treating a worker as an employee benefits the worker, not the employer.

b. **Workers' Compensation Insurance**. One of the advantages of the worker being an employee is that the employer may obtain workers' compensation insurance. The employee's exclusive remedy for workplace injury is then the workers' compensation insurance. If the employer does not obtain workers' compensation insurance, or if the worker is a contractor rather than an employee, the worker may sue in tort for a workplace injury and have the claim resolved by a jury trial. (The employer may be sued for millions of dollars, even for someone getting hurt due to their own negligence.) In addition, the homeowners insurance and umbrella liability policy may exclude coverage if the worker is not an employee.

c. **Minimum Wage; Overtime**. The employer must pay minimum wage for all hours worked (state and federal requirements) and overtime to all non-exempt employees. Overtime generally applies after 40 hours in a workweek (or in California, after eight hours per day). Most domestic employees are non-exempt and are thus entitled to 1.5 times the hourly rate for overtime work.

   Having an accurate record of time worked, with employees attesting to the hours in each pay period, is critical. (A number of famous people have been sued for not paying overtime, and they have no records to rebut the claim. The Department of Labor will generally believe the employee, not the employer.)

   In determining if overtime applies, travel time and "on-call" time must be included to determine if the 40 hour limit has been exceeded (but a different hourly rate can apply for "on-call" time when the worker is not called for duty). For live-in arrangements in which certain requirements are met (five consecutive days or at least 120 hours a week in residence), the employer can avoid paying overtime but must still pay a minimum wage for all hours worked.

23. Liability for Domestic Employees' Activities

The employer is liable for employees' negligence, including negligent entrustment of automobiles. (The employer should check automobile insurance policies to make sure they cover domestic employees' driving activities.) Having domestic workers hired by an LLC may be a way of shielding personal assets of family members from potential employee liabilities. The LLC would secure liability insurance. The LLC also provides a structure for managing employment relationships.

Items 24-37 are observations from a seminar by Farhad Aghdami, M. Patricia Culler, and Nancy G. Henderson—Understanding and Avoiding Tax Penalties

24. Failure to File and Failure to Pay Penalties

a. **General Penalty Amounts**. The *failure to file* penalty is 5% per month of the amount of tax required to be shown on the return (reduced by any tax payments prior to the due date and credits against the tax) for each month or fraction of the month the return is late, up to a 25% maximum. §6651(b)(1). For example, if a return is due April 15 but is filed on April 30, the failure to file penalty is 5%, but if is filed on May 16, a two-month penalty (10%) applies. For any month in which both the failure to file penalty and failure to pay penalties are imposed, the 5% failure to file penalty is reduced by the amount of the failure to pay penalty (0.5% per month, as discussed below), so that the combined penalties for the month do not exceed 5%. §6651(c)(1). Therefore, if both penalties are imposed for at least five months, the maximum failure to file penalty is 22.5%, and the maximum total combined failure to file and pay penalty is 47.5%.

   A *fraudulent* failure to file penalty applies if the failure to file the return is fraudulent, in which event the 5% per month penalty increases to 15%, and the overall aggregate penalty increases from 25% to 75%. §6651(f).

   The *failure to pay* penalty is 0.5% of the amount due for each month the payment is late up to a maximum of 25%, calculated based on the tax due for each month the penalty is imposed. §6651(a)(2).

b. **Defenses.** A taxpayer may avoid the failure to file and failure to pay penalties if the failure was due to reasonable cause and not willful neglect (both of those elements must be met). The burden is on the taxpayer to establish the defense. The cases are fact intensive inquiries, and facts that are relevant are those that exist on the due date.

   For the *failure to file* penalty, reliance on a tax advisor for *substantive* advice may constitute reasonable cause, but not for ascertaining the due date (unless the law concerning the filing deadline is unclear) or reliance upon the professional for filing the return itself. *United States v. Boyle,* 469 U.S. 241 (1985). Reasonable cause may avoid the failure to file penalty but does not extend the time to make elections. Other possible facts that may constitute reasonable cause (such as death, serious illness, or unavoidable absence) are discussed in the Internal Revenue Manual in ¶20.1.1.3.2.

   The *failure to pay* reasonable cause defense is based on whether the taxpayer exercised ordinary business care and prudence in providing payment but nevertheless was unable to pay, or payment would have resulted in an undue hardship. For example, is the failure to pay based upon a market crash or an executor who gambled away liquid cash?

c. **First Time Penalty Waiver Abatement Program.** The IRS has a first-time penalty abatement waiver program. Accountants use this program regularly and it seems to work for fiduciary and partnership tax returns and similar returns. The program can work for income tax returns, but does not apply to the estate tax return, because of the nonrecurring nature of the estate tax return.

25. Deductibility of Failure to File and Failure to Pay Penalties

Penalties are in fact "additions to the tax;" therefore, penalties in connection with gift or income taxes incurred during lifetime and unpaid at the date of death are deductible as claims against the estate. Penalties accruing post-death on a decedent's income and gift taxes may also be deductible as administration expenses. Penalties imposed in connection with the estate tax, however, are not deductible for estate tax purposes.

26. Information Returns

Failure to timely file required information returns is also subject to penalties. Familiar information returns are Forms K-1, 1098, and 1099. Other information returns that may be relevant in the estate planning context are (i) the Form 706-GS (D-1) (for reporting taxable distributions by trust to a skip person, even if the trust has an inclusion ratio of zero); and (ii) Form 8971 and associated Schedule(s) A for property acquired from a decedent.

There are several exceptions to the filing requirement for the Form 706-GS (D-1): (i) grandfathered trusts; (ii) distributions for qualified tuition or medical expenses; or (iii) distributions of property that was already subject to the GST tax if the distributee is not a skip person as to the last transferee.

27. What is a "Return"?

Determining whether a "return" has been filed can be significant for a variety of reasons– the civil failure to file penalty, a criminal failure to file penalty, the validity of tax elections required to be made on a timely filed return, the period of limitations on assessment of tax, and the limitations period on claims for a refund.

Section 6011(a) provides that "[e]very person required to make a return or statement shall include therein the information required by such forms or regulations." To be a return, the document must be filed on the required form, should provide the information necessary for the IRS to determine the tax liability, and must be signed under penalties of perjury.

The signature requirement may be satisfied by an agent for income tax returns if the taxpayer is unable by disease or injury to make the return or is continuously absent in the United States for a period of 60 days prior to the due date of the return. An agent may sign a gift tax return because of the donor's illness, absence, or nonresidence but not mere inconvenience. An estate tax return must be signed by an executor (or all of the executors if there is more than one-but *Doriss v. Commissioner* held that a return signed by only one of the joint fiduciaries is a valid return), or if there is no executor, it must be signed by any person in actual or constructive possession of any property of the decedent.

There is no authority for any person other than a duly appointed executor to sign an income or gift tax return of a deceased individual, except that the surviving spouse may sign a joint return if no personal representative has been appointed. The President's Budget proposal would extend the executor definition rule (i.e., for persons in possession of property of the decedent) to income and gift tax purposes, as well.

28. No "Mail Box Rule" For Late Filed Returns or Late Payments

The postmark date for a return or payment controls if the return or payment is actually properly mailed on or before the due date. §7502. The mailbox rule does not apply, however, for purposes of determining the amount of any penalty for late filing or late payment, and the date of filing or payment will be the date of actual delivery to the IRS.

29. Accuracy Related Penalties

a. **General Categories**. Eight possible accuracy related penalties apply under §6662 including: (i) negligence or disregard of rules or regulations; (ii) substantial understatement of income tax; (iii) substantial valuation misstatement for income tax purposes; and (iv) substantial estate or gift tax valuation understatement. The IRS bears the initial burden to prove that an accuracy related penalty is warranted, but the taxpayer then has the burden to prove that an understatement was due to reasonable cause, substantial authority, or other defenses. The penalty is generally 20% of the portion of the underpayment attributable to one of the listed categories of activities.

b. **Negligence or Disregard of Rules or Regulations**.

Negligence includes a failure to make a reasonable attempt to comply with the Internal Revenue Code including the failure to keep adequate books or records or substantiate items properly or do what a reasonable and prudent person would do under similar circumstances. It also includes taking a position on a return that lacks a "reasonable basis." A "reasonable basis" is based on one or more of the authorities set forth in Reg. §1.6662-4(d)(3)(ii) considering the relevance and persuasiveness of the authorities and subsequent developments.

Disregard of rules or regulations includes any careless, reckless or intentional disregard of rules or regulations. Regulations give more detail regarding each of those possibilities.

c. **Substantial Estate or Gift Tax Valuation Misstatement**. This is an objective mathematical determination. If the value reported is 65% or less of the final value, a 20% substantial understatement penalty applies. If the value reported is 40% or less of the amount determined to be correct, a 40% gross valuation misstatement penalty applies. This penalty is applied on an item by item basis rather than on an aggregate basis (i.e., an overvaluation reported for one asset will not offset an undervaluation of another asset).

30. Defenses to Accuracy Related Penalties

a. **Adequate Disclosure as Defense to Negligence or Disregard for Rules or Regulations**. If the taxpayer has a reasonable basis for a position that is disclosed on Form 8275 (for rules) or Form 8275R (for regulations) and if the position is made in good faith, the penalty will not apply. Does disclosure raise a red flag highlighting the issue to increase audit risks? Many planners believe that filing the Form 8275 does not raise a much higher audit risk.

b. "**Substantial Authority" or "Reasonable Authority With Disclosure" Defenses to Substantial Understatement Penalty (for Income Tax)**. The substantial understatement penalty does not apply if the taxpayer had "substantial authority" for the tax treatment or if the taxpayer has "reasonable authority" and the relevant facts affecting the tax treatment are adequately disclosed in Form 8275 or Form 8725R §6662(d)(2)(B); Reg. §1.6662-4(f)(1). Substantial authority requires that the weight of authority supporting the treatment is substantial in relation to the weight of authority supporting a contrary treatment. The weight accorded an authority depends on its relevance, persuasiveness and the type of document providing the authority. Reg. §1.6662-4(d)(3).

c. **Good Faith and Reasonable Cause Defense to All Accuracy Related Penalties**. An accuracy related penalty will not apply if the taxpayer's failure to properly compute tax liability is due to reasonable cause and the taxpayer acted in good faith (except for the penalty for valuation overstatements for charitable deduction purposes, for which a qualified appraisal and good faith investigation are needed for this defense). §6664(c). All facts and circumstances are considered, but the most important factor is the extent of the effort of the taxpayer to determine the proper tax liability. Past consistent compliance without more is not sufficient evidence with regard to a current accuracy related penalty.

Reliance on a tax professional requires three elements to satisfy the good faith and reasonable cause defense exception. (1) The advice must have been rendered by a competent professional. (2) The taxpayer must have provided necessary and accurate information to the advisor regarding the advice sought. (3) The taxpayer must have relied in good faith on the competent professional's judgment. A very important caveat in relying on professional advice as a defense is that the taxpayer must provide the advice that was given, which waives the attorney-client privilege. That might allow the government to expand the scope of the audit.

The reasonableness of *reliance on an appraiser* is evaluated based on a consideration of four factors: (i) the methodology and assumptions used in formulating the opinion of value; (ii) the actual appraised value; (iii) the circumstances under which the appraisal was obtained; and (iv) the independence of the appraiser. In *Richmond v. Commissioner*, the reasonable reliance defense failed in a situation in which the CPA had no appraisal certifications and the appraisal was never finalized but a draft was submitted with the return.

31. Fraud Penalty

A penalty of 75% of any underpayment due to fraud applies under §6663(a). Both the fraudulent failure to file penalty under §6651(f) and the 75% fraud penalty under §6663 can apply to the same late-filed return.

The fraud penalty can apply in the estate and gift tax context. For example, a taxpayer who willfully fails to report taxable transfers on a gift tax return and the executor who knowingly perpetuates that failure in calculating the deceased taxpayer's adjusted taxable gifts on Form 706 are both subject to fraud penalties. The fraud penalty was applied in *Heyen v. U.S.,* 945 F.2d 359 (10th Cir. 1991) to a series of gifts followed by planned re-gifts intended to qualify for the annual exclusion.

32. Multiple Penalties Applicable to Same Transaction

The accuracy related penalties are not cumulative. If more than one accuracy related penalty would apply to the same transaction, only the higher penalty will apply. Similarly, if the 75% fraud penalty is applicable, only it will apply and not accuracy related penalties.

33. Frivilous Positions

The penalty for frivolous positions has been applied most commonly in the tax protester cases. §6673.

34. Return Preparer Penalties

a. **Penalty Based on Unreasonableness Standard**. A return preparer penalty applies if the return understates the tax liability due to a position taken that the tax preparer knew or reasonably should have known was unreasonable. A position is considered unreasonable unless it is supported by (i) substantial authority (if not adequately disclosed) or (ii) a reasonable basis (but only if adequately disclosed–typically on Form 8275 or 8275R, but sometimes if simply disclosed on the return itself). §6694. In addition, the preparer must have acted in good faith to avoid the penalty. The penalty is the greater of $1,000 (increased to $5,000 for willful or reckless conduct) or 50% of the income derived by the tax return preparer with respect to the return or claim at issue.

Observe that preparers have a higher threshold than taxpayers for avoiding penalties. Taxpayers have a reasonable cause and good faith defense to all of the accuracy related penalties, even without disclosure (see Item 30.a above). A taxpayer may be unhappy with disclosing a problematic issue merely so the preparer can avoid penalties if the taxpayer believes it is acting reasonably and in good faith with respect to the issue (the §6664(c) defense).

b. **Preparer**. The return preparer penalties can apply to non-signing preparers as well as signing preparers who are involved with a substantial portion of the return. A nonsigning preparer is anyone other than a signing preparer who prepared a substantial portion of the return. In addition, it includes anyone who provides advice to a taxpayer (oral or written) that leads to a position that constitutes a substantial portion of the return, which advice was given after the transaction was completed.

35. Ethical Restrictions on Tax Advisors Under Circular 230

Circular 230 governs any person engaged in practice before the IRS. It imposes various responsibilities on tax practitioners.

With respect to tax returns, §10.34(a) provides that a practitioner may not advise a client to take a position on a return or claim for refund containing a position that lacks a reasonable basis or is an unreasonable position as described in §6694 (a)(2). In addition, a practitioner must inform a client of any penalties that are reasonably likely to apply with respect to a position on a return if (1) the practitioner advised the client with respect to the position or (2) the practitioner prepared or signed the tax return, and must also inform the client of any opportunity to avoid such penalties by disclosure, if relevant, and of the requirements for adequate disclosure. §10.34(c).

36. Reasonable Basis; Substantial Authority; Other Standards

Appendix A, prepared by Nancy Henderson (San Diego, California) and attached to this summary of the ACTEC 2016 Annual Meeting, has an excellent comparison of the various standards of conduct that have been addressed throughout the discussions above about defenses under the various penalty provisions.

37. Criminal Penalties

The Code includes four criminal tax penalty provisions. These obviously are quite important both to advisers and clients. "I will not wear a jumpsuit for you or give you advice that will cause you to wear a jumpsuit."

a. **Intentional Failure to File or Pay Tax.** The intentional failure to file a return or pay a tax is a misdemeanor that can be punished with a fine up to $25,000 ($100,000 for corporations) and/or up to one year in prison. §7203.

b. **Intentional Material Misstatement**. Intentionally filing a return verified under penalty of perjury that contains a material misstatement is a crime under §7206(1). Similarly, willfully aiding or assisting in the preparation of such a false return is a crime even if the taxpayer did not realize there was a material misstatement. This is a felony that can be punished with a fine of up to $100,000 ($500,000 for corporations) and/or up to three years in prison.

c. **Obstruction**. Intimidating or impeding any officer or employee of the U.S. government, or in any other way corruptly obstructing or impeding the due administration of the tax law, is a felony punishable with a fine of up to $5,000 and/or up to three years in prison. §7212(a). d. **Willful Evasion.** Tax evasion and conspiracy to evade tax are two of the most serious tax crimes. The "willful attempt in any manner to evade or defeat any tax imposed… or the payment thereof" is a felony punishable with a fine of up to $100,000 ($500,000 for corporations) and/or up to five years in prison. In addition, a similar provision applies to any person required to collect, account for, and pay over any tax who willfully fails to do so. §7202. Conspiracy occurs when two or more persons conspire to commit a tax crime or defraud the U.S. government if one or more of the conspirators take steps to effect the object of the conspiracy. 18 U.S.C. §371.

Items 38-44 are observations from a Seminar by Stuart C. Bear, Katharine M. Davidson, Mary F. Radford, and Francis J. Rondoni—Middle of the Night Calls: What Do You Do When You Get the Urgent Call?

38. Elderly Father Arrested for DUI

The planner receives a call from a client that the client's elderly father has been arrested for DUI.

- As with many of these "urgent call" situations, contact an attorney who has expertise in dealing with the situation.
- An individual who is arrested for the first time for DUI should take a Breathalyzer test. The penalties for not taking the test are usually worse than the consequences of a failed test.

- A bail bondsman will be able to get the individual out of jail, usually after he or she has sobered up.
- A strategy that has been used by some attorneys for clients who think that their parents should no longer be driving is to call the police and tell them of the concern and advise them of the parent's driving patterns (going every morning for coffee at the same place). The police can follow and observe the driver. If concerned, the police can pull the driver over and require that he or she retake the drivers test. If the individual cannot pass the test, "it was the police who took the license away."

39. Elder Financial Abuse

A child moves in with elderly mom to take care of her. The child assists mom in preparing a new will leaving all of the assets to the child, and changes the accounts into the child's name.

a. **Testamentary Capacity**. A "George Carlin paraphrase" of the testamentary capacity tests: (1) Know your stuff? (2) Know who's going to receive your stuff? (3) Have intent for stuff to pass at death to desired beneficiaries?

If the child downloads a will form from the Internet and assists mom in filling out the form, the will is much more susceptible to a successful attack than if mom talked with a lawyer who prepared a will. The lawyer will testify that he or she thought mom had capacity.

b. **Undue Influence**. Undue influence is generally more difficult to establish than a lack of capacity. A presumption of undue influence may apply, however, if a person is in a confidential relationship with the testator, the new plan results in an unnatural split, and the individual in question is involved in the preparation of new will.

c. **Civil and Criminal Remedies**. There has been a trend of strong state statutes addressing financial exploitation of vulnerable adults. Many states used to have exceptions for persons holding a power of attorney and for family members. We now know that they are the most likely abusers, and those exceptions have disappeared from state statutes.

d. **Act Quickly**. Act quickly in potential financial abuse situations. In these cases, the abusing individual typically "goes dark" and will not discuss the situation with family members. If the family waits too long, all of the assets may be dissipated.

e. **Retirement Plans**. One of the largest financial assets for most individuals is a retirement plan, which merely takes a beneficiary designation change to upset the estate plan. There are no notarization or execution requirements. The level of capacity for changing a beneficiary designation (a contract), however, is higher than the level of capacity to execute will.

40. Health Issues During Foreign Travel

a. **Travel Medical Insurance**. Will a person's medical insurance apply abroad? Medicare will not be accepted abroad. The individual may need travel medical insurance. Read the fine print; is there a pre-existing condition exception?

b. **Medical Evacuation Plan**. A number of insurance companies offer medical evacuation plans. These are cost-effective. Transporting a critically ill individual from a foreign country can cost over $100,000 (but may be necessary to save the individual's life).

c. **U. S Consulate**. If an individual dies abroad, the family should consult with the U.S. Consulate who can assist in the process of obtaining a local death certificate, and in assembling documentation that would be required to ship the remains back to the United States.

   The Consular Officer can provide guidance to the family regarding how to forward funds to cover costs. The officer can assist with locating a local funeral home to assist with funeral arrangements. The Consular Office will send executed copies of the Consular Report of Death of a U.S. Citizen Abroad to the next of kin or legal representative for use in settling the decedent's U.S. estate matters. This report describes the essential facts regarding the death, disposition of remains, and custody of the personal estate that will be used in any U.S. legal proceedings as proof of death. The Report cannot be completed until the foreign death certificate is issued by the local authorities, and this may take up to 4 to 6 weeks depending upon the country involved.

d. **Cardboard Box For Shipping Body**. One of the speakers has heard that transferring a body in a special cardboard box is much less expensive than transporting the body in a coffin.

41. Health Care Decisions

a. **End of Life Wishes**. If a dispute arises over end-of-life decisions, having as much information as possible about the patient's wishes will be critical. That would be the most impactful information for a court. Did the patient tell various people he or she would never want life artificially prolonged?

b. **Location of Health Care Documents**. The worst place to keep healthcare documents is in a safe deposit box.

   Medical Records. Give a copy of the documents to physicians as a part of the individual's medical records.

   Motor Vehicle. Put a copy of healthcare documents (including HIPAA releases) in the glove box of motor vehicles. (An individual is more likely to be taken to an emergency room in his or her own motor vehicle than in an ambulance.)

   Cell Phones. Send healthcare documents electronically to healthcare agents (often the patient's children), so they will always have them available on their cell phones.

   Refrigerator. Put a copy of healthcare documents in the refrigerator. EMTs, when going into the house of a critically ill individual, know to look in the refrigerator for healthcare documents.

42. Artificial Reproduction Emergencies

a. **Sperm Harvesting**. Sperm harvesting, after a male individual's death, generally must be completed within 24 hours of death, but there have been viable extractions as much as 30 hours after death.

b. **Adopting Frozen Embryos**. A cottage industry has developed for adopting frozen embryos. Couples often will not want to use remaining frozen embryos after they had been successful in having a child. This situation generally requires a second adoption after the baby is born. The frozen embryos are referred to as "snowflakes" – they are all different and they are all frozen.

43. Granny Snatching

One child moves an elderly parent away from his or her home to live with that child in another state. Family members suspect that the purpose will be to assume total control of the elderly person's financial assets.

a. **Jurisdictional Issues**. These multi-jurisdiction situations typically become jurisdictional nightmares. Forty-three states have enacted the Uniform Adult Guardianship and Protective Proceedings Jurisdiction Act. This Act provides a good blueprint for addressing jurisdictional issues.

b. **Act Quickly**. If there is a long delay in bringing a legal action, maintaining that the original home state is still the home state becomes more difficult. Act quickly if a parent is removed and the family believes the move is not in the parent's best interest. Associate with an attorney in the other state.

44. Overseas Kidnapping

Kidnapping has become a huge problem in some overseas countries. For example, in Brazil wealthy local individuals live behind walls and travel with armed guards in bulletproof cars. Kidnappers have turned to tourists. The majority of kidnappings are unreported; unscrupulous police may be involved, and families fear retribution. The key to saving these people's lives is through negotiations; the kidnappers merely want a huge ransom.

a. **Kidnap and Ransom Insurance**. Kidnapped and ransom (K&R) insurance exists. There are kidnapping fund transfer experts.

   High net worth individuals who travel in these types of dangerous places should consider securing K&R insurance. Do not tell anyone about the insurance, however. Kidnappers love this insurance, and it changes the negotiations dynamics if the kidnapper is aware that it is in place.

b. **Social Media**. Do not publicize foreign travel plans in social media.

c. **Fly Commercial**. Fly commercial and not by private jet—kidnappers monitor airports.

d. **Local Transportation**. Do not take limousines or expensive cars or hail cabs off the street. If a driver is picking up a traveler at the airport, do not list the traveler's name on a plaque at the airport for the individual to locate the driver. Instead, have the driver list his or her own name, and the traveler will look for that driver's name at the airport.

e. **Be On Alert**. Do not go to unsafe areas of town. Vary the daily routine including routes, restaurants, etc.

f. **Low Profile**. American citizenship may make one more of a target. Maintain a low profile and do not advertise wealth or status (leave your Rolex at home).

Items 45-51 are observations from a seminar by Karen E. Box, Christopher H. Gadsden, Peter T. Mott, and John T. Rogers, Jr.—Preview of Issues Encountered in the Upcoming New Edition of the ACTEC Commentaries on the Model Rules of Professional Conduct

45. Change in Format

The ACTEC Commentaries on the Model Rules of Professional Conduct, first published in 1993, are intended to provide guidance regarding ethics issues faced by trusts and estates lawyers. A new Fifth Edition will be published in 2016.

Prior additions have been print-based. The Fourth Edition was issued with annotations. An annual update on the annotations have been added to the ACTEC website beginning in 2010. For the new Fifth Edition, a digital separate document will include all of the cases in the annotations. It will be a searchable digital document on the ACTEC website that will be organized by jurisdiction rather than by Model Rule number because many cases involve multiple rules, but searches can still be performed by Rule number. This format will be easier to research, particularly if someone is looking for cases in a particular jurisdiction.

46. Multijurisdictional Choice of Law Issues

Under Model Rule 8.5, a lawyer licensed in a jurisdiction is subject to the disciplinary authority of that jurisdiction no matter where the lawyer's conduct occurred. In addition, lawyers not generally admitted in a jurisdiction are also subject to that jurisdiction's disciplinary authority to the extent that the attorney offers to provide legal services in that jurisdiction. For legal matters before a court, the rules of the jurisdiction in which the court sits applies. For any other conduct, the rules of the jurisdiction in which the lawyer's conduct occurred applies, or if the predominant effect of the conduct is in a different jurisdiction, the rules of that jurisdiction apply.

For example, if a client has a vacation home in another state, and the estate planning attorney prepares a deed transferring the vacation home into a revocable living trust, the State Bar in the other state would likely have the authority to discipline the attorney if any disciplinary rule violations occur. Therefore, attorneys involved with multi-state matters must be concerned with the ethics rules in the other states that are involved.

47. Joint and Separate Representation of Spouses

Prior editions of the Commentaries have approved attorneys representing spouses simultaneously but separately, treating them as separate clients and keeping information received from one spouse confidential from the other spouse. That has been very controversial, however, and the Fifth Edition no longer endorses that practice.

The Fifth Edition address joint and separate representation of spouses in its discussion of Model Rule 1.7 as follows:

> As indicated in the ACTEC Commentary on MRPC 1.6 (Confidentiality of Information), a lawyer usually represents multiple clients jointly. Representing a husband and wife is the most common situation. In that context, attempting to represent a husband and wife separately while simultaneously doing estate planning for each, is generally inconsistent with the lawyer's duty of loyalty to each client. Either the lawyer should represent them jointly or the lawyer should represent only one of them. See generally PRICE ON CONTEMPORARY ESTATE PLANNING, section 1.6.6 at page 1059 (2014 ed). In other contexts, however, some experienced estate planners undertake to represent related clients separately with respect to related matters. Such representation should only be taken if the lawyer reasonably believes it will be possible to provide impartial, competent and diligent representation to each client and even then, only with the informed consent of each client, confirmed in writing….
>
> Example 1.7-1. Lawyer (*L*) was asked to represent Husband (*H*) and Wife (*W*) in connection with estate planning matters. *L* had previously not represented either *H* or *W*. At the outset *L* should discuss with *H* and *W* their estate planning goals and the terms upon which *L* would represent them, including the extent to which confidentiality would be maintained with respect to communications by each. Assuming that the lawyer reasonably concludes that there is no actual or potential conflict between the spouses, it is permissible to represent a husband and wife as joint clients. Before undertaking such a representation, the lawyer should elicit from the spouses an informed agreement in writing that the lawyer may share any information disclosed by one of them with the other. See ACTEC Commentary on MRPC 1.6 (Confidentiality of Information).

48. Multi-Party Representation of Parents and Children

The prior edition as well as the new Fifth Edition of the Commentaries discuss the general nonadversarial character of the trusts and estates practice, and that representing multiple family members may be in the clients' best interests. The Fifth Edition's discussion of Model Rule 1.7 provides:

> It is often appropriate for a lawyer to represent more than one member of the same family in connection with their estate plans…. In some instances the clients may actually be better served by such a representation, which can result in more economical and better coordinated estate plans prepared by counsel who has a better overall understanding of all of the relevant family and property considerations. The fact that the estate planning goals of the clients are not entirely consistent does not necessarily preclude the lawyer from representing them. Advising related clients who have somewhat differing goals may be consistent with their interests and the lawyer's traditional role as the lawyer for the "family." Multiple representation is also generally appropriate because the interests of the clients in cooperation, including obtaining cost-effective representation and achieving common objectives, often clearly predominate over their limited inconsistent interests. Recognition should be given to the fact that estate planning is fundamentally nonadversarial in nature and estate administration is usually nonadversarial.

With respect to representing both parents and their children with respect to their estate planning issues, the attorney should specifically discuss how much information should be exchanged with the various clients. Is the representation a joint representation with free flow of information or separate representation of the parents and children? The attorney should have that discussion with both generations. For example, if the younger generation wants a separate representation, let them know that the attorney cannot tell them if the parents decide to disinherit them. If a joint representation is desired, with free flow of information, that should be confirmed in writing. The attorney should be sensitive to the fact that conflict situations can develop. For example, if a parent wants to simplify the plan and leave all of the assets outright to the children, but the attorney knows that a child has marital problems, can that be disclosed? Or if the attorney knows that a child has substance abuse issues, can that be disclosed? A new example in the Commentaries specifically addresses doing estate planning for both parents and children:

> Example 1.7-1a. Lawyer (*L*) is was asked to represent Father (F) and (S) in connection with the estate planning matters. *L* had previously not represented either F or S. At the outset *L* should discuss with F and S their estate planning goals and the terms upon which *L* would represent them, including the extent to which confidentiality would be maintained with respect to communications made by each. If the prospective clients have common estate planning objectives and coordination is important to them, and there do not appear to be any prohibitive conflicts, the best practice would be for the lawyer to undertake the representation of the two clients jointly with an agreement that information can be shared. Depending on the circumstances, however, a lawyer may be able to represent the father and son as separate clients between whom information communicated by one client will not be shared with the other. Even then, the circumstances may be such that the lawyer knows or should know that their estate plans are interconnected. In this situation, separate representation may be appropriate, provided that there is no obvious conflict of interest between the clients. But even so the lawyer will need to make a conflict determination and may need to obtain the informed consent of each client if there is a "significant risk" that the representation of one might be materially limited by the representation of the other. In such a case, each client must give his or her informed consent confirmed in writing. The same requirements apply to the representation of others as joint or separate multiple clients, such as the representation of other family members, business associates, etc.

49. Dual Capacity Representation

The new Fifth Edition of the Commentaries adds significant new discussion with respect to the representation of someone in both a fiduciary and individual capacity. The Commentary to Model Rule 1.7 of the new Fifth Edition treats this as a judgment call for the attorney, based on the potential for conflicts of interest, and observes that waivers from other beneficiaries generally are not necessary:

> *Representation of Fiduciary in Representative and Individual Capacities*. Frequently a lawyer will be asked to represent a person in both an individual and a fiduciary capacity. A surviving spouse or adult child, for example, may be both an executor and a beneficiary of the estate, and may want the lawyer to represent him or her in both capacities. So long as there is no risk that the decisions being or to be made by the client as fiduciary would be compromised by the client's personal interest, such a "dual capacity representation" poses no ethical problem. The easiest case would be where the client is the sole beneficiary of the estate as to which the client is the fiduciary. But even there, since the fiduciary owes duties to creditors of the estate, it is possible for a conflict to emerge. Given the potential for such conflicts, a lawyer asked to undertake such a dual capacity representation should explain to the client the nature of the fiduciary role and insist that the client execute an informed waiver of any right to have the lawyer advocate for the client's personal interest in a way that is inconsistent with the client's fiduciary duty. If the client is not willing to do this, the lawyer should decline to undertake the dual capacity representation. If such a dual capacity representation has been undertaken and no such waiver has been obtained, and such a conflict arises, the lawyer should withdraw from representing the client in both capacities.
>
> In this situation, the question arises whether it is also necessary to obtain waivers from beneficiaries or others who are interested in the estate, but who are not the lawyer's clients.… Waivers from beneficiaries and other third parties do not seem called for by the rules, nor do they seem necessary or

appropriate. First, MRPC 1.7(b)(4) only contemplates waivers from "affected client[s]." Second, as long as the lawyer has explained to the client his or her responsibilities to third persons, such as non-client beneficiaries were creditors, and obtained the requisite client waivers, this should allow the lawyer to honor those responsibilities consistent with representation of the client.

> Example 1.7.4 *X* dies leaving a will in which *X* left his entire estate in trust for to his spouse *A* for life, remainder to daughter *B*, and appointed *A* as executor. *A* asked *L* to represent her both as executor and as beneficiary and to advise her on implications both to her and to the estate of certain tax elections and plans of division and distribution. *L* explained to *A* the duties *A* would have as personal representative, including the duty of impartiality toward the beneficiaries. *L* also described to *A* the implications of the common representation, to which *A* consented, including an informed agreement to forgo any right to have the *L* advocate for *A*'s personal interest insofar is it conflicts with *A*'s duties as executor. *L* may properly represent *A* in both capacities. However, *L* should inform *B* of the dual representation and indicate that *B* may, at his or her own expense, retain independent counsel. In addition, *L* should maintain separate records with respect to the individual representation of *A*, who should be charged a separate fee (payable by *A* individually) for that representation. *L* may properly counsel *A* with respect to her interests as beneficiary. However, *L* may not assert *A*'s individual rights on *A*'s behalf in a way that conflicts with *A*'s duties as personal representative. If a conflict develops that materially limits *L*'s ability to function as *A*'s lawyer in both capacities, *L* should withdraw from representing *A* in both capacities. See MRPC 1.7 (Conflict of Interest: Current Clients) and MRPC 1.16 (Declining or Terminating Representation).

> Example 1.7.5 X dies, leaving a will giving X's estate equally to his three children. Child A was appointed executor. A engages L to represent her as executor. A dispute arises among the three children over distribution of X's tangible personal property, and A asks L to represent her in resolving the dispute with her siblings. Depending on how the dispute progresses, L may need to advise A to obtain independent counsel to represent her in the dispute. In addition, L may need to advise A to resign as executor if the dispute gives rise to an actual conflict with her fiduciary duties.

50. Client With Diminished Capacity and Reporting Elder Abuse

The Commentaries to Model Rule 1.14 continue the approach of the prior edition in providing that an attorney representing a client with diminished capacity has the implied authority to disclose otherwise confidential information and take protective action to protect the client, considering the risk and substantiality of harm (which generally would be heightened by the client's diminished capacity). While the lawyer may consult with family members, trusted friends and other advisors, "the lawyer should consider the impact a particular course of action could have on the client, including the client's right to privacy in the client's physical, mental and emotional well-being. In appropriate cases, the lawyer may seek the appointment of a guardian ad litem, conservator or guardian or take other protective action."

The Fifth Edition adds a new discussion about reporting elder abuse to its Commentary on Model Rule 1.14. The states vary significantly regarding an attorney's ability to report suspected elder abuse, from California which is the most restrictive, to other states in which mandatory reporting is required. Among other things, the Commentary cautions the attorney to consider the effect of consulting other professionals about whether the client has diminished capacity, because some professionals are required to report incapacity situations:

> *Reporting Elder Abuse*. Elder abuse has been labeled "the crime of the 21st century," Kristen Lewis, *The Crime of the 21st Century: Elder Financial Abuse*, PROB. & PROP. Vol. 28 No 4 (Jul./Aug. 2014), and the federal and state governments are responding with legislation and programs to prevent and penalize

the abuse. The role and obligations of lawyers with respect to elder abuse vary significantly among the states. Some states have made lawyers mandatory reporters of elder abuse [citing statutes in Texas, Mississippi, Ohio, Arizona, and Montana]. Other states have broad mandatory reporting rules that do not exclude lawyers [citing a Delaware statute]. The exception to the duty of confidentiality in MRPC 1.6(b)(6), which allows disclosure to comply with other law, should apply, but disclosure would be limited to what the lawyer reasonably believes is necessary to comply. In states where there is no mandatory reporting duty of lawyers, a lawyer's ability to report elder abuse where MRPC 1.6 may restrict disclosure of confidentiality would be governed by MRPC 1.14 in addition to any other exception to MRPC 1.6 (such as when there is a risk of death or substantial bodily harm). In order to rely on MRPC 1.14 to disclose confidential information to report elder abuse, the lawyer must first determine that the client has diminished capacity. If the lawyer consults with other professionals on that issue, the lawyer must be aware of the potential mandatory reporting duties of such professional and whether such consultation will result in reporting that the client opposes or that would create undesirable disruptions in the client's living situation. The lawyer is also required under MRPC 1.14 to gather sufficient information before concluding that reporting is necessary to protect the client [citing a New Hampshire ethics committee advisory opinion]. In cases where the scope of representation has been limited pursuant to Rule 1.2, the limitation of scope does not limit the lawyer's obligation or discretion to address signs of abuse or exploitation (consistent with Rules 1.14 and 1.6 and state elder abuse law) in any aspect of the client's affairs of which the lawyer becomes aware, even if beyond the agreed-upon scope of representation.

51. Engagement Letters Dealing With Resonding to Subpoenas

Some estate planning attorneys are spending significant time responding to subpoenas (often in subsequent divorce litigation). Some firms are providing in their engagement letters that the client will be responsible for billings with respect to the time in responding to subpoenas. This issue is not addressed in the Commentaries. The ACTEC Committee on Professional Responsibility has spent a lot of time dealing with that issue, and the majority view is that there are no ethical constraints as long as the provision is discussed with the client and the attorney explains why the provision is included. However, the issue is not without controversy.

Items 52-56 are observations from a seminar by Tami Conetta, Margaret G. Lodise, and Thomas L. Overbey—Are you Rolling the Dice on Trustee Fees? Drafting, Understanding, and Enforcing Reasonable Compensation for Trustees

52. Measurement Standards

a. **Restatement (Third) of Trusts**. Under the Restatement (Third) of Trusts (§38), a trustee is entitled to reasonable compensation unless the terms of the trust provide otherwise or the trustee agrees to forego compensation.

b. **Uniform Trust Code**. Under §708 of the Uniform Trust Code, if the terms of a trust do no address trustee compensation, the trustee is entitled to reasonable compensation under the circumstances, subject to adjustment (as discussed in subparagraph d below).

c. **Other State Statutory Approaches**. A 50-state survey of the trustee compensation statutes is provided in the materials. Most states provide for reasonable compensation.

Some of the States list factors that the court may consider in determining the reasonableness of the compensation. Other states (such as Georgia and New York) include fee schedules.

d. **Terms of the Trust.** The Uniform Trust Code (§708) allows the trust instrument to override the statutory standard in the terms of the trust, subject to adjustment if the duties are substantially different than those contemplated or if the fee provided in the trust would be unreasonably low or high. Most states similarly allow the terms of the trust to control with respect to trustee fees, subject to equitable adjustment by the court.

e. **Agreement With Beneficiaries**. Many state statutes also recognize that an agreement among the trustee and beneficiaries will control over the terms of the trust instrument or statutory default provisions regarding trustee fees. An issue arises with respect to the ability to bind minors or incapacitated beneficiaries, but virtual representation statutes may apply.

53. Defining "Reasonable"

a. **Uniform Trust Code and Restatement**. The comment to §708 of the Uniform Trust Code, citing the Restatement, lists the following factors as relevant in determining the reasonableness of compensation: custom of the community; trustee's skill, experience, and facilities; time devoted to trust duties; amount and character of the trust property; degree of difficulty, responsibility and risk assumed administering the trust, including in making discretionary distributions; nature and costs of services rendered by others; and quality of the trustee's performance.

b. **Other Statutory Provisions**. Various other state statutes list factors that can be considered in determining the reasonableness of trustees fees. For example, various mandatory factors are listed in the North Dakota and Tennessee statutes, and various permissive factors that the court may consider are listed in the Maine statute.

c. **Common Law**. Many courts have identified their own "laundry list" of factors that may be considered in setting reasonable compensation. For example, the Florida Supreme Court identified 11 factors in *West Coast Hospital Association v. Florida National Bank of Jacksonville*, 100 So.2d 807 (Fla. 1958). These factors were analyzed and applied in detail in a pending Florida case involving a trust created by the iconic artist, Robert Rauschenberg, and in which the trial court ultimately awarded $24.6 million to the trustees, to be divided among three co-trustees. (This case is discussed in Item 56 below.)

d. **Multiple Trustees**. Some state statutes address trustee fees for multiple trustees, typically recognizing that the fee may be more than the fee that would ordinarily be paid to a single trustee. Some statutes award a full fee to each of two trustees, but require apportionment when there are three or more trustees. Some allow only a marginal increase in a single trustee fee and direct apportionment of the total amount among all trustees. Some institutions charge an additional fee when a co-trustee is serving with the corporate fiduciary. The issue of reasonable compensation for multiple trustees will become a more significant issue with the increasing trend to dividing trustee responsibilities among trustees.

e. **Attorney as Trustee**. There are no ethical or legal prohibitions on an attorney serving as trustee, and it is often done in some locations such as Boston and Philadelphia. The ACTEC Commentaries to the ABA Model Rules of Professional Conduct provide that the lawyer as a fiduciary may be compensated for work done in both capacities but may not receive double compensation for the same work (Commentary to Model Rule 1.5). Including a provision in the trust instrument authorizing removal and replacement of the trustee helps alleviate concerns that the attorney might take advantage of its fiduciary position. A few states have specific statutory provisions that either allow or restrict dual compensation as attorney and trustee. (Examples are California, North Carolina, and Florida, as well as ethics opinions in Arizona and Georgia).

54. Waiver of Trustee Fee

Two issues arise with respect to whether a waiver of a trustee fee will be recognized: (1) whether the income will be includible in income even though not received, under the constructive receipt doctrine; and (2) whether the waiver will be treated as a gift to trust beneficiaries. The primary factor is whether the commissions are waived early in the trust administration. Rev. Rul. 64-225, 1964-2 C.B. 15. A waiver should be formalized within six months of appointment. If commissions are not waived within the first six months, an intention to serve on a gratuitous basis may still be shown if the fiduciary fails to claim fees "and if all of the other attendant facts and circumstances are consistent with a fixed and continuing intention to serve gratuitously." Rev. Rul. 66-167, 1966-1 C.B. 20.

55. Drafting Considerations

a. **Measurement of Fee**. A standard approach used in most trust documents is to provide for a reasonable fee. A client may want more specificity, in which event other approaches could be considered, such as a set dollar amount, a percentage of the value of assets, or minimum or maximum fee limitations. The trustee fee for individual trustees typically does not include investment services, and the trust will pay an expense for investment services in addition to the trustee fee.

If a percentage of the value of assets approach is used, address how asset values will be determined, and the valuation date.

b. **Time of Payment.** The agreement could address the time of payment. Special provisions may be needed to address values that are not known immediately. Using set times provides objectivity. "A fee delayed is a fee that gets annoying."

c. **Post-Death Administrative Services.** If a funded revocable trust is used, address the "administrative fee" that will be paid for post-death administrative services (that typically would be performed by an executor). Address whether special fees may be paid for special services such as the sales of trust assets, the sale of business assets, accounting, tax return preparation, and legal services (if the fiduciary is an attorney).

d. **Multiple Trustees.** The agreement can address how multiple trustees will be compensated. One possibility is to rely upon an agreement of co-trustees, but to use a 50-50 split if there is no agreement. Corporate trustees are typically paid more than individual trustees (because they end up doing most of the work).

e. **Family Members**. The trust instrument may provide that family members do not receive a fee, but just reimbursement of expenses. Alternatively, a tailored arrangement may specify whether some individuals may receive higher fees than others.

56. Defending Trustee Fees; Rauschenberg Foundation Case

A notable Florida case addressed the amount of trustee fees for a revocable trust created by the iconic artist, Robert Rauschenberg. Trust assets included interests in corporations that owned real estate and art that he had collected. Prior to his death he selected three persons to act as co-trustees (an artist, his long-term accountant, and his business partner; they were selected because of their special skills). Those three individuals also served as directors of the corporations that were owned by the trust (and received compensation as directors). The trust assets passed to a Foundation. The decedent died in 2008, and in 2010 the trustees estimated that the trustees fee would be between $36 -$54 million. In 2011, the first accounting revealed that the trustees had paid themselves interim payments of $8 million and stated that the total fee would be $51-$55 million. The Foundation challenged the fee and said the fee should be determined using a lodestar analysis (generally an hourly-rate approach), and the fee should be $375,000 to be shared by all three trustees.

The date of death value (in 2008) was approximately $605 million, and the trust increased in value to over $2 billion by the time the trust administration was completed.

The trial court ultimately awarded a fee of $24.6 million to the trustees, to be divided among them (the court did not address how the fee would be divided). The court cited a lack of precedent for using a lodestar analysis and found that using a lodestar analysis would be unreasonable under the particular facts and circumstances of the case. The court reviewed each of the 11 factors that had been identified by the Florida Supreme Court in the *West Coast Hospital* case. The major legal issue was whether to apply the lodestar approach or the 11-factor approach. The trial court's order was affirmed by the appellate court in January, 2016. *Robert Rauschenberg Foundation v. Grutman*, et al., __ So.3d __ (Fla. 2d DCA January 6, 2016). (Whether the Foundation will appeal is unknown.)

Items 57-59 are observations from a seminar by Reynolds T. Cafferata, Stephanie B. Casteel, and Michele A.W. McKinnon— What is the Donor's Best Charitable Game?

57. Private Foundations

a. **Primary Activity–Grantmaking**. The primary activity of a private foundation is making grants to other charitable organizations (but the private foundation can also give scholarships if certain steps are taken).

b. **Control**. A major factor in choosing to use a private foundation is whether the family wishes to control the board, including not wanting any outsiders on the board. To some families, the control element is critical; it does not want to serve in a mere advisory role. Private foundations can also be used to involve younger family members and can serve as a training ground.

c. **Presumed Classification as Private Foundation**. There are four general types of §501(c)(3) exempt organizations: (1) private foundations; (2) organizations engaging in inherently public activity; (3) publicly supported organizations; and (4) supporting organizations. A charitable organization is presumed to be a private foundation unless it can establish that it meets one of the categories of public charities. §509(a).

d. **Limitations on Income Tax Deductions for Contributions to Private Foundations**. Various limitations apply on the deductibility of contributions to private foundations that do not exist for gifts to public charities. Income tax deductions are generally limited to a specified percentage of the donors' contribution base (essentially adjusted gross income). Gifts of cash or unappreciated property is subject to a 30% limitation for gifts to private foundations (compared to a 50% limitation for gifts to public charities). Gifts of capital gain property to a private foundation are subject to a 20% limitation (compared to 30% limitation for public charities). Furthermore the deduction for gifts of appreciated capital gain property to a private foundation is limited to the lesser of the property's basis or fair market value, except for a contribution of "qualified appreciated stock" (generally, publicly traded stock, for which the deduction is based on the property's fair market value).

In many situations, however, the ability of the donor to avoid paying capital gains tax on an asset that would otherwise be sold is more important than the income tax deduction for a contribution of that asset to a private foundation.

For testamentary funding of a private foundation, the income tax deduction is irrelevant.

e. **Tax on Net Investment Income**. The foundation pays a 2% tax each year on the net investment income (which may be reduced to 1% for certain years in which the foundation's payout rate is increased). §4940.

e. **Self-Dealing Restrictions**. Section 4941 imposes very strict prohibitions on direct or indirect self-dealing between a private foundation and disqualified persons. Whether the self-dealing benefits the foundation is irrelevant. Self-dealing is defined very broadly to include sales, leases, lending, any furnishing of goods, services or facilities, or the payment of compensation (except that an exception applies for reasonable compensation).

The Code authorizes several exceptions to the self-dealing prohibitions, the most important of which are the ability to pay reasonable compensation for certain services, the estate administration exception, and the corporate redemption exception. The estate administration exception is particularly important. It has been applied very liberally by the IRS, but only applies to transactions with assets in an estate (or revocable trust) that are approved by the probate court and that occur before the estate is terminated for which the estate (or revocable trust) receives fair market value that is at least as liquid as the asset that has been given up (an alternative to the liquidity requirement is that the transaction is done pursuant to a binding option). Reg. §53.4941(d)-1(b)(3).

f. **Excess Business Holdings**. A private foundation is limited on the interests it can hold in a "business enterprise" other than a functionally related business or a business with at least 95% of its income being derived from passive sources. §4943. A private foundation can hold up to 20% of the voting stock of business enterprises, reduced by the percentage of voting stock owned by all disqualified persons. A de minimis exception allows the foundation to hold no more than 2% of the voting stock and not more than 2% in value of all outstanding shares of the business. The foundation generally has five years to dispose of sufficient holdings to eliminate the excess business holdings. The five-year period can be extended for an additional five years at the discretion of the IRS in certain circumstances.

Alternatives for avoiding the excess business holdings rule include making a sale of sufficient interests, having the foundation distribute business interests to a public charity, converting a private foundation to a public charity, or arranging sales within the estate administration or corporate redemption exceptions. Another common strategy is to delay funding the foundation, because the five years does not start running until the business asset has been distributed to the foundation.

g. **Minimum Distribution Requirements.** Private foundations must make minimum distributions annually to avoid an excise tax. §4942. The distribution requirement is 5% of the average fair market value of its noncharitable use assets each year. The distribution must be made by the end of the following tax year, and any excess may be carried forward for five additional years. Distributions to other private foundations or controlled organizations generally do not count. Furthermore, distributions to non-functionally integrated Type III supporting organizations (or to Type I or Type II supporting organizations if controlled by disqualified persons) do not count.

58. Supporting Organizations

a. **General Description.** A supporting organization (SO) is operated exclusively for the benefit of one or more "supported" public charities, and is itself treated as a public charity. SOs are not subject to as many prohibitions as private foundations, and generally qualify for the more favorable percentage limitations for income tax deductions that apply to public charities. Perceived abuses arose because many SO's made few distributions. Abusive situations were reported in the Wall Street Journal, and ultimately the Pension Protection Act of 2006 included provisions aimed at SOs.

b. **Types I, II and III SOs.** Supporting organizations are classified into three major types: Type I (a majority of the board is appointed by the supported organization); Type II (a majority of the board overlaps with the board of the supported organization); and Type III (the board is not controlled by public charities or the same persons that control public charities). Type III SOs must demonstrate a close relationship with supported public charities by satisfying a responsiveness test and an integral part test [which is further broken down into distinctions for functionally integrated organizations and non-functionally integrated organizations]).

c. **Type III SOs Under Severe Scrutiny**. The Type III SOs (which are not controlled by or in connection with supported public charities) are perceived as the most susceptible of abuse, and received significant attention in the Pension Protection Act of 2006. The IRS subjects exemption applications for Type III SOs to a great deal of scrutiny. They are complicated to operate because of the tests they must continue to satisfy. Satisfying the responsiveness test and integral part test requires an extremely detailed analysis. Type III SOs are further categorized under the integral part test as being either functionally integrated or non-functionally integrated organizations.

The restrictions under the Pensions Protection Act and regulations are particularly harsh for non-functionally integrated Type III SOs (in light of the fact that the donor or family members may exercise control). Type III non-functionally integrated SOs:

- cannot support foreign charities;
- may not hold "excess business holdings";
- are required to make annual minimum distributions;
- cannot support an organization that is controlled by a donor either directly or indirectly or by a relative of a donor; and
- may not accept the gift or contribution from a person who, alone or together with certain related persons, directly or indirectly controlled the governing body of a supported organization.

There are also restrictions on grants to Type III non-functionally integrated SOs:

- if a private foundation makes a grant to the SO, it will not be a qualifying distribution for purposes of the foundation's minimum distributions;
- a grant by a private foundation to the SO is a taxable expenditure unless the foundation exercises expenditure responsibility; and
- if a donor advised fund makes a grant to the SO, the donor advised fund will be subject to an excise tax.

Some, but not all, of these restrictions also apply to other types of SOs.

The Type I SO is generally the best alternative to a private foundation for a donor who wants some degree of control/influence but is not willing to be subject to all of the private foundation restrictions.

59. Donor Advised Funds

a. **Benefits.** The donor advised fund is relatively simple compared to the operations and restrictions applicable to private foundations or SOs. Other advantages include the following.

- Although the donor has no control over distributions, the donor can give advice as the "donor advisor" (which the fund typically follows).
- Income tax deduction limitations are the same as for contributions to public charities.
- Minimum distribution requirements are not applicable.
- Disclaimers to donor advised funds are allowed. PLR 200518012
- Anonymous giving is possible.
- The lack of legal ownership and control may be helpful in other contexts such as securities law restrictions.

- Grants to foreign charities are allowed if the fund engages in an equivalency determination analysis, and certain community funds are set up to make grants in certain geographic areas of the world.

b. **Limitations.** Various perceived abuses of donor advised funds were also addressed by the Pension Protection Act of 2006. Some of the restrictions on donor advised funds include the following:

- no grants to non-functionally integrated Type III SOs;
- no grants to any Type I, Type II, or functionally integrated Type III SO in which the donor or donor advisor (and any related parties) directly or indirectly controls a supported organization of the SO;
- prohibited incidental benefit rules impose a 125% excise tax on distributions that result in a donor, donor advisor, or related person who receives more than an "incidental benefit";
- excess benefit transactions rules prohibit any grant, loan, compensation, or other similar payment from a fund to a donor, donor advisor, or related person (subject to a 25% excise tax on the fund and a separate 10% excise tax on a fund manager who agreed to the distribution knowing it would confer an excess benefit);
- excess business holding rules applicable to private foundations also apply (with the same five-year exception); and
- cannot receive an IRA rollover.

Items 60-65 are observations from a seminar by Lynne K. Green, Herbert A. Stroh, and Harry W. Wolff, Jr.— Setting Up Your Estate Planning and Probate Practice So You Can Retire With Ease

60. Personal Aspects of Retirement

An attorney's retirement has been described as "going from 'who's who' to 'who are you?'" The attorney must realize that his or her spouse may be busy with other activities. One Fellow's wife told him "I married you for better or worse, but not for lunch."

Some attorneys are miserable in retirement, because their total identity has been wrapped up in being a lawyer. Do not assume you will "find your bliss" in retirement. Start looking for it before you retire, developing interests and activities that can be pursued in retirement.

An interesting side effect of retirement is that one attorney nearing retirement observed that when he told people that he was no longer taking any new clients, he couldn't believe how much that increased the demand for his services.

61. Checklist for Closing a Law Practice

A 30-item checklist for closing a law practice appeared in an article published in the May/June 2011 issue of Law Practice Magazine. Some of the items include:

- attempt to get accounts receivable paid as much as possible before announcing plans to close the practice
- inform the staff of closing plans (try to foster a relationship so that the staff will remain throughout the closing process, otherwise, the process will be much more difficult);
- inform clients of closing plans (if an attorney is retiring from an ongoing practice, let the client know if others in the firm can still take care of the client and try to arrange meetings to introduce clients to the new attorney);
- return files to clients (or make arrangements for transferring files to another attorney); the majority rule in the United States is that clients are presumptively entitled to their entire files including any electronic matter; tidy up files to the extent possible, realizing that there may be notes in the files that would be embarrassing to persons who may see the file (particularly if the file is being delivered to family members of a deceased client);
- deal with the disposition of closed files and files containing original wills; notify insurance carriers such as malpractice, professional liability and premises liability carriers; and
- shut down the computer system.

62. Ethical Obligations to Notify Clients

Ethical rules generally require written notice to clients upon of ceasing an active law practice unless the client has consented to assumption of responsibility by another attorney. *E.g.*, Texas Rules of Disciplinary Procedure §13.01. Satisfying this ethical requirement to give written notice to clients will require (i) having a list of active client matters, and (ii) knowing who is the client in each of those matters.

Engagement letters may help clarify specifically who was being engaged in each engagement, the scope of the engagement, and when the engagement would terminate.

Hundreds or thousands of letters may be required. How do you find all of their current addresses? Some attorneys provide in engagement letters that the client will keep the attorney advised of any address changes, and to the extent the attorney has not been advised otherwise, the attorney can use the last address on file for any communications.

63. Document Retention and Destruction Policy

Risk managers for malpractice insurance firms say that one of the most common questions is what to do with old, closed client files. ABA Commission on Ethics and Professional Responsibility Informal Opinion 1384 (1977) states that dealing with the storing of inactive files is primarily a question of business management not of ethics or professional responsibility. It says that "[a] lawyer does not have a general duty to preserve all of his files permanently" in light of the substantial storage costs involved. "But clients (and former clients) reasonably expect from their lawyers that valuable and useful information in the lawyer's files, and not otherwise readily available to the clients, will not be prematurely and carelessly destroyed to the client's detriment." The Informal Opinion makes several practical suggestions:

> 1. Unless a client consents, a lawyer should not destroy or discard items that clearly or probably belong to the client. Such items include those furnished to the lawyer by or on behalf of the client, the return of which could reasonably be expected by the client, and original documents (especially when not filed or recorded in the public records).
>
> 2. A lawyer should use care not to destroy or discard information that the lawyer knows or should know may still be necessary or useful in the assertion or defense of the client's position in a matter for which the applicable statute of limitations period has not expired.
>
> 3. A lawyer should use care not to destroy or discard information that the client may need, has not previously been given to the client, and it is not otherwise readily available to the client, and which the client may reasonably expect will be preserved by the lawyer.
>
> 4. In determining the length of time for retention or disposition of a file, a lawyer should exercise discretion. The nature and contents of some files may indicate a need for longer retention than do the nature and contents of other files, based upon their obvious relevance and materiality to matters that can be expected to arise.
>
> 5. A lawyer should take special care to preserve, indefinitely, accurate and complete records of the lawyer's receipt and disbursement of trust funds.
>
> 6. In disposing of the file, a lawyer should protect the confidentiality of the contents.
>
> 7. A lawyer should not destroy or dispose of a file without screening it in order to determine that consideration be given to the matters discussed above.
>
> 8. A lawyer should preserve, perhaps for an extended time, an index or identification of the files that the lawyer destroyed or disposed of.

Before any files are destroyed, the firm must have a document retention and destruction policy. The retention and destruction policy should be described in the engagement letter. Some of the considerations for such a policy include:

- when a file is closed, the lawyer who handled the matter should determine the retention period based on the policy;
- staff members should index the file when it is closed and verified that all of the file is present and that original documents have been returned to the client (with a copy added to the closed file);
- based on the closed file index, when the destruction date arrives the file should be destroyed in a fashion consistent with protecting client confidentiality;
- the closed file index should reflect the date and manner of destruction;
- the same procedure should be applied to electronic files. For a comprehensive discussion including forms of policy schedules and letters, see Lee R. Nemchek, Records *Retention in the Private Legal Environment: Annotated Bibliography and Program Implementation Tools*, 93 LAW LIBRARY J. 1 (2001).

64. Planning For Sudden Retirement (Such as by Death or Disability)

Special problems arise in dealing with a sudden unplanned retirement because all of the tasks must be performed when the attorney is not there to supervise the process.

a. **Tasks**

- Secure the premises, files and accounts.
- Secure the staff (they need to know they will continue to be paid; they will be uncomfortable staying around if no one is in charge).
- Protect client interests. Triage to determine what must be done urgently to protect client interests.
- Protect law practice interests.
  - o Return client funds in trust accounts.
  - o Arrange for the collection of accounts receivable (make sure the bills get sent out and accounts receivable are collected; the longer payment is delayed the harder collection will become; also address getting paid for the work already done for work in progress).
  - o Arrange payment of accounts payable and review and terminate as appropriate all contracts for continuing obligations (equipment leases, library subscriptions, etc.).
  - o Retain the office space as needed to close the practice, and then terminate the office space lease.
  - o Make sure that insurance remains active; the successor attorney will be very interested in seeing that tail coverage exists.
  - o Make provisions for accessing computers, computer passwords, and digital assets (this will be essential to be able to close the practice).
- Handle physical files long term (see the discussion above regarding a document retention and destruction policy). Originally signed documents should be returned to the client. If the client cannot be located, all such physical files may be turned over to one attorney, and notice to be given to the state bar so that clients can find the files by going to that attorney. Determining what documents are essential can be time-consuming.

b. **Practice Administrator Concept**. California has adopted the concept of a Practice Administrator for closing a practice on the death or disability of an attorney. See *Practice Makes Perfect: Practical Issues for the Practice Administrator*, 13 CALIF. TRUST AND ESTATES QUARTERLY (Issue 3 Fall 2007).

A contract between the planning attorney and proposed successor attorney (the "practice administrator") outlines a course of action upon the attorney's death or disability. An example form includes terms addressing: the implementation date; determining when death, disability, or incapacity occurs; general powers of the practice administrator; specific powers (with a wide variety of very specific powers enumerated);, commitment that the practice administrator will preserve the attorney-client privilege and confidences; sale of the attorney's practice (including the authority of the practice administrator to purchase the practice provided the price is fair market value as determined by an appraiser and that the terms of sale are approved by the planning attorney's personal representative); compensation of the practice administrator; resignation and appointment of a successor practice administrator; liability and indemnification of the practice administrator; and terms for revoking or amending the agreement.

c. **Black Box of Key Information.** Assemble a "black box" of key documents (leases, equipment contracts, etc.), and a list of key things a successor needs to know to administer the practice. This would include things such as how to access client lists, billing records, who does the billing, accessing bank records (with passwords), accessing cloud-based storage, where employee files are located, etc. A practical suggestion is to keep a notebook readily available and make notes of things that are done over a several month period of time. This is a lot of work to develop "but nothing is impossible if I can make someone else do it." To the extent possible, assign tasks to other staff persons in developing the black box.

65. Malpractice Insurance and Asset Protection For Retiring Partner

a. **Malpractice Insurance**. Malpractice policies are claims-made policies covering claims made during the coverage year, even though the work was done before that. Can a retiring attorney buy insurance to cover work done during prior periods? Obtaining such insurance by a retiring attorney to cover prior periods is difficult and very expensive.

b. **Asset Protection**. The retiring attorney should be concerned with asset protection. For example, in a community property jurisdiction, community property assets might be partitioned so that the non-attorney spouse's one half of the assets would be protected from claims that might later be asserted against the attorney. Consider contributing assets to LLC's for their asset protection features. Address personal asset protection long before a claim is made because insurance protection is not what the retiring attorney might think that it is.

Items 66-71 are observations from a seminar by Thomas W. Abendroth and Charles D. Fox, IV — The ABC's of Estate Planning Acronyms and Service Marks

66. GRATs—Grantor Retained Annuity Trust

- Private investment funds (and private entities) can be good vehicles for GRATs, but valuation is a concern.
- Should liquid assets be contributed to the GRAT in addition to hard-to-value assets in order to make annuity payments for the first year or two?
- Advise the client that there will be some payments in kind and that valuation will be an issue for those payments.

- A flow-through entity that makes "tax distributions" is an excellent vehicle for a GRAT, because the cash distributions could be used in making annuity payments to the grantor (who will use the cash to pay income tax with respect to the flow-through income to the GRAT).
- Grantor trust status should continue until the final payment is made from the trust, but to provide more certainty, trust instruments should clarify that grantor trust triggers remain in place until the last payment is made.
- Toward the end of the GRAT term, the client may want to substitute cash for appreciated assets, so that low basis assets will be in the grantor's estate (to benefit from a basis adjustment at the grantor's death).

67. CLATs—Charitable Lead to Annuity Trust

- Getting clients interested in creating CLATs is difficult.
- The grantor does not get in income tax deduction for contributions to a CLAT (unless it is structured as a grantor trust, which generally is not best). Contributions do qualify for the gift tax charitable deduction (and testamentary bequests to a CLAT qualify for the estate tax charitable deduction).
- From an income tax standpoint, the CLAT is somewhat equivalent to an income tax deduction each year because income that the grantor would have otherwise received is earned by the trust instead.
- Testamentary CLATs can be very useful because only the value of the remainder interest is subject to estate tax. The trust terms can be structured to minimize the value of the remainder interest.
- The loss of the use of the trust assets during the term of the CLAT may be a significant detriment to the family, which might potentially outweigh any estate tax savings.

68. Sale to Grantor Trusts

- Most estate planning attorneys do not remember doing taxable installment sales between family members. Installment sales to grantor trust have now replaced intrafamily sales.
- Major risks: (1) valuation of the property that is sold; (2) valuation of the note (is it valued at its face value and is it treated as bona fide debt?); (3) uncertain income tax effects of the grantor's death; and (4) poor investment performance of the assets (which potentially could wipe out all of the value in the trust prior to the sale transaction).
- The planner will need to recommend whether to report the sale on a gift tax return to start the statute of limitations period on assessments in case the evaluation is wrong. At least one of the speakers generally prefers to report the sale. Valuation adjustment clauses are often used in sale transactions–either a *Wandry*-type clause (adjusting the number of units that are sold) or a *King*-type price adjustment clause (adjusting the note amount). The speakers believe these clauses are often used in arms-length

transactions (for example, granting "tag along" rights if a company is sold within several years, which would require that an adjustment will be made in the purchase price).

- Valuation of the promissory note will depend upon having significant equity in the trust prior to the sale. In addition, having equity in the trust impacts whether the debt is true bona fide debt rather than a retained equity interest that would trigger estate inclusion under §§2036 or 2038.
- If the trust is underfunded, can guarantees be used? In isolation, the answer may be yes, but using guarantees intensifies IRS scrutiny regarding the valuation of the note and whether it is a retained equity interest. Some planners who use guarantees advise that the trust should pay the guarantor a fee for providing the guarantee in response to letter ruling 9113009, which ruled that the agreement to provide a guarantee constituted a gift to the benefited party if there was no consideration. (That ruling was later withdrawn in letter ruling 9409018, but may nevertheless reflect possible IRS thinking.)
- If the grantor dies with a note outstanding, future payments will have income tax consequences. Providing for payments during the grantor's life is far preferable (and should also eliminate the §2036 risk).
- Summary: sales to grantor trusts have fewer assurances than GRATs– with more law uncertainty and valuation risk. Sales to grantor trusts are preferable, however, for generation-skipping purposes.

69. QPRTs—Qualified Personal Residence Trust

- The biggest issue to discuss with clients is what happens at the end of the trust term if the grantor wishes to continue living in his or her own house.
- If the grantor is married, the house could be left in trust for the benefit of the grantor's spouse. The grantor could then continue living in the house as long as he or she remains married. The trust might alternatively provide that the house can be used by the grantor's spouse, whoever that might be from time to time (which may be difficult to explain in a conference with the spouses).
- One alternative is for the grantor to rent the residence from the trust following the end of the QPRT term. Determining a fair rental value may be difficult. The grantor may be unpleasantly surprised with how high the monthly rental rate might be (even though a high rental rate is able to shift more value from the grantor's estate).

70. BDIT –Beneficiary Defective Inheritors Trust; BING—Beneficiary Irrevocable Grantor Trust

- The BDIT (referred to as a BING by some planners) is a trust for which all contributions qualify for Crummey withdrawal powers, so that the trust is likely a grantor trust as to the beneficiary. The beneficiary can subsequently sell assets to the trust that would be excluded from the beneficiary's estate even though the beneficiary might be a discretionary beneficiary or even the trustee of the trust.

- The biggest risk is that the trust is often modestly funded (with lapsing Crummey powers), and the IRS will question how the trust went from having thousands of dollars to having millions of dollars.
- Guarantees are often used to support sales to the trust. Will the IRS and courts respect them? Does a guarantee fee have to be paid? What is an appropriate amount of the guaranty fee?

71. Low Interest or Interest Free Loans

- Low-interest or interest-free loans are simple transactions that clients can understand.
- While this is a simple transaction, it can result in substantial wealth transfer over a period of time.
- If an interest-free loan is made to a Crummey trust, with the trust providing that beneficiaries can withdraw the amount of any gift from other funds in the trust, the gift element of the interest-free loan probably qualifies for the gift tax annual exclusion.

Items 72-75 are observations from a seminar by Judith W. McCue and Kathleen Nalty — What You Don't Know Can Hurt You: Unconscious Bias in Law Practice – How to Recognize and Interrupt It (Elimination of Bias)

72. Overview and Significance of Unconscious Bias

Researchers believe that as much as 80% or more of our thought processes are at the unconscious implicit level, controlled by the automatic intuitive part of our brain. Conscious thinking takes an immense amount of energy. To save energy, most of our routine thinking is in the unconscious mind.

Our unconscious mind are influenced by many things from the time that we were young children. The biggest of these is cultural influences.

Our conscious minds generally cannot control our unconscious minds. Conscious thinking has difficulty accessing what our unconscious minds are up to. There are no filters as to what might be embedded in the backs of our minds. Certain techniques, however, can help us become aware of what we keep in unconscious biases. To some extent, we are able to re-script what might be in the backs of our minds.

Unconscious biases are not inherently bad; indeed, we could not function without them. But they may encompass attitudes and stereotypes that we may not be endorse as appropriate if we become aware of them.

73. Types of Unconscious Biases That Interfere With Good Decision Making

a. **Illusion of Objectivity**. This bias keeps us from fully acknowledging that we have biases. In fact, studies show that assuming we are not biased makes us even more biased. Despite our best efforts, at the unconscious level we cannot be gender blind, colorblind, etc.

As an example, recruiters believe they do not have racial biases. Over 10 years ago, researchers sent 5,000 identical resumes in response to actual employment ads. The only differences were that half the ads had a name signaling the person was African-American, and the others had a name signaling a white individual. The white person received 50% more callbacks. Another test in 2012 tested gender bias among research scientists–who generally think they are not gender biased. Identical resumes were sent to 127 research scientists in university labs responding to employment ads for a lab manager position, except that on one-half of the resumes the applicant's name was Jennifer and the other one-half the applicant's name was John. Jennifer was viewed as less competent and her starting offering salary would have been significantly less than John. Most interestingly, there was no significant statistical difference between the male and female reviewers; the female reviewers demonstrated just as much implicit bias against the female applicant.

b. **Attribution Bias**. Attribution bias attributes characteristics based upon a person's group, with group stereotypes. People in the "out-group" are judged negatively by group stereotypes and are not given the benefit of doubt.

c. **Availability Bias**. People frequently fill in the blanks in a situation with what is more available to them (e.g., their in-group).

d. **Anchoring Bias**. The unconscious mind gets anchored to something it is exposed to, which then influences a later decision. For example, in a research study involving 167 U.S. Magistrate judges, the judges were given a fictitious case study and were asked to decide for the plaintiff or defense and award damages as appropriate. Half of the judges had no anchor. The other half saw the same case study but also saw a jurisdictional motion involving a $75,000 limit. The judges who saw the jurisdictional motion awarded 50% less in damages than the group of judges who never saw the motion.

e. **Confirmation Bias**. Confirmation bias causes people to pay more attention to information that confirms their belief system and pay little attention to information that contradicts their beliefs. An example is the recent series of automobile television advertisements for Buicks. Young persons are surprised that the luxury automobile in the advertisement is a Buick, because of their perception that "only old people buy Buicks." Buick is spending a lot of money on advertisements in an attempt to break that stereotype.

f. **Affinity Bias**. Affinity bias causes us to gravitate toward people who are like us and share similar interests and backgrounds. This type of bias is particularly pervasive.

74. Diversity and Inclusion in Legal Practice and How Bias Interferes

a. **Diversity vs. Inclusiveness**. *Diversity* focuses on recruiting; it is about diversity in the workplace. *Inclusiveness* focuses on retention and advancement within the firm. Inclusiveness involves everyone in the firm, not just the recruiters. Inclusiveness is all about creating an environment in which everyone has what they need to do their best work for the organization.

In sum— "diversity is about counting people, and inclusiveness is about making people count."

b. **Critical Opportunities**. According to research studies, certain groups (female, LGBTQ, disabled, and racially/ethnically diverse attorneys) have disproportionately less access to the following critical career-enhancing opportunities: networking (informal and formal), insider information, access to decision-makers, mentors and sponsors, meaningful work assignments, candid and frequent feedback, social integration, training and development, client contact, and promotions.

c. **Unconscious Bias and Affinity Bias**. Unconscious biases, and in particular affinity bias (which is a bias in favor of others who are more like you) are primarily responsible for these disparate opportunities. "When senior attorneys (the vast majority of whom are white and male) gravitate toward and share opportunities with others who are like themselves, they unintentionally but disproportionately leave out female, LGBTQ, disabled, and racially/ethnically diverse attorneys." If you are not intentionally including everyone, you are unintentionally excluding some.

75. Strategies For Interrupting Implicit Bias

a. **Awareness**.

Be Aware of Implicit Bias. The starting point of interrupting implicit bias is to recognize that it exists. The Implicit Association Test (available at **www.ProjectImplicit.org**) takes about 5-10 minutes to complete. It is based on how fast or slow a person is in reacting to association questions – the unconscious results come more quickly but concepts in the conscious mind are slower. It gives an indication of one's implicit biases with respect to various categories.

Pay Attention to Surprises. Pay attention to situations in which assumptions or expectations about a person or group turn out to be wrong. The gap between expectation (stereotype) and reality is where implicit bias lies. Even consider keeping a "Surprise Journal."

b. **Behavior Change**. Various bias-breaking activities will help keep biases from translating into behaviors.

- Actively doubt your objectivity.
- Increase your motivation to be objective and fair.
- Expose yourself to counter-stereotypic examples.
- Shift perspectives (put yourself in someone else support issues).
- Find commonalities with others.
- Reduce stress, fatigue, cognitive overload, and snap decisions (implicit bias leaks into decision-making more readily when people are stressed).
- Decrease exposure to stereotype-inducing stimuli.

c. **Structural Change**. Individual behavior changes often have to be supported and encouraged by structural changes in an organizations in order to have the greatest impact on interrupting implicit biases.

- Increase accountability.
- Make decisions collectively in diversified decision-making groups.
- Build support systems.
- Institute continuous education opportunities.
- Develop clear guidelines and criteria for evaluation and promotion decisions.
- Institutionalize programs that provide exposure to diverse exemplars.

APPENDIX A

Penalty Avoidance: Standards of Conduct Compared

By Nancy A. Henderson (San Diego, California) (included with her permission)

Not Frivolous

Treas. Reg. §1.6694-2(c)

A return position that is not patently improper.

Reasonable Basis

Treas. Reg. §1.6662-3(b)(3)

A return position reasonably based on one or more of the authorities set forth in Treas. Reg. §1.6662-4(d)(3)(ii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments).

Realistic Possibility

Treas. Reg. §1.6694-2(b)

A reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on the merits.

Substantial Authority

Treas. Reg. §1.6662-4(d)(3)

The weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting contrary treatment. The weight accorded an authority depends on its relevance, persuasiveness and the type of document providing the authority.

More Likely Than Not

Notice 2008-13 and Treas. Reg. §1.6662-4(g)((4)(i)(A)

The preparer has analyzed all of the pertinent facts and authorities described in Treas. Reg. §1.6662-4(d)(3)(ii) and, in reliance upon that analysis, reasonably concludes in good faith that there is a greater than 50% likelihood that the tax treatment of the item will be upheld if challenged by the IRS.

Citable Authorities

Treas. Reg. §1.6662-4(d)(3)(ii)

Authorities that may be considered to determine whether the above standards have been met include:

- Applicable provisions of the Internal Revenue Code and other statutory provisions;
- Proposed, temporary and final regulations construing such statutes;
- Revenue rulings and revenue procedures;
- Tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties;
- Court cases;
- Congressional intent as reflected in committee reports;
- Joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers;
- General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book);
- Private letter rulings and technical advice memoranda issued after October 31, 1976;
- Actions on decisions and General Counsel memoranda issued after March 12, 1981 (as well as General Council memoranda published in pre--1955 volumes of the Cumulative Bulletin);
- Internal Revenue Service information or press releases;
- Notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin.

Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals are not authority. The authorities underlying such expressions of opinion where applicable to the facts of a particular case, however, may give rise to substantial authority for the tax treatment of an item.