Trusts: 2019-2020 Planning Roadmap Part 2

Planning for Larger Estates, Additional Trust Planning; Practice Safer

ChronicIllnessPlanning.org

Trusts: 2019-2020 Planning Roadmap Part 2

Planning for Larger Estates, Additional Trust Planning; Practice Safer

By: Martin M. Shenkman, Jonathan G. Blattmachr, Sandra D. Glazier, and Joy Matak

A KEY ESTATE PLANNING GUIDE

Law Easy

General Disclaimer

- The information and/or the materials provided as part of this program are intended and provided solely for informational and educational purposes and is not intended to create a standard of practice. None of the information and/or materials provided as part of this power point or ancillary materials are intended to be, nor should they be construed to be the basis of any investment, legal, tax or other professional advice. Under no circumstances should the audio, power point or other materials be considered to be, or used as independent legal, tax, investment or other professional advice. The discussions are general in nature and not person specific. Laws vary by state and are subject to constant change. Economic developments could dramatically alter the illustrations or recommendations offered in the program or materials.

Thank you to our sponsors

- InterActive Legal
  - Vanessa Kanaga
  - (321) 252-0100
  - sales@interactivelegal.com

InterActive Legal

Thank you to our sponsors

- Peak Trust Company
  - Brandon Cintula
  - (888) 544-6775
  - bcintula@peaktrust.com

Trusts: 2019-2020 Planning Roadmap

Do GRATs Make Sense?

Do GRATs Make Sense? - 1

- For many if not most only wealthy (not uber wealthy) clients GRATs are not an optimal tool in the current environment because they do not use temporary exemption.
- For uber wealthy clients that have used all of their exemption, GRATs may be an appropriate tool to freeze value, lock in discounts, etc. before a possible 2020 Dem change. However, GRATs perhaps should not be planned in the traditional or historic application of the technique.

Do GRATs Make Sense? - 2

- If GRATs do make sense for the particular client consider that the Dem proposals emasculate GRATs so that the traditional application of GRATs as rolling or cascading GRATs may not be possible. Don't count on being able to roll a GRAT as that may be eliminated. Make sure the plan works even under that scenario.
- Might longer term GRATs make more sense to be part of a plan if rolling them may be eliminated by future legislation?
- If longer term GRATs are used consider the impact on GRAT immunization. Cash may not be a viable immunization agent in a longer term GRAT.
- Consider very long term say 99-year GRATs as an interest play. That may be a useful application for wealthy clients that have no remaining exemption.

Trusts: 2019-2020 Planning Roadmap

Community Property Trust

Community Property Trust for Basis Step-up on First Death

- Consider planning to use community property rules to obtain a full basis step up on the death of the first spouse to die (subject to the normal exceptions, such as for income in respect of a decedent).
- While there are 11 states with community property laws, three of the states provide elective community property laws that anyone can avail themselves of: Alaska, Tennessee and South Dakota, with others contemplating adding such provisions to their statutes.
- Some commentators have different views as to the effectiveness of these statutes for non-residents of those states.
- Residents of non-community property states, for example, might create a community property trust in Alaska in an attempt to obtain a full basis step up on the first spouse's death on all assets held in that community property trust. In reality, it is not a step up but more akin to a market to market regime as basis can be stepped down as well.

Trusts: 2019-2020 Planning Roadmap

Limiting 2519 Risks

Limiting 2519 Risks Generally

- The longer the time period between a distribution from a QTIP to the surviving spouse and a subsequent transfer the better.
- Have legal documentation, e.g. amended and restated Shareholders Agreement, signed after distribution.
- An independent economic event during the intervening period may be helpful, e.g. a dividend.
- Differentiate from bad facts, such as those in the Kite case, which involved a distribution from a QTIP followed by a contribution to a deferred CLAT and the spouse/beneficiary/transferor dying before receiving any payments under the plan.

Limiting 2519 Risks – Bifurcate QTIP

- Consider a division of marital trust proactively to insulate against a Section 2519 attack if the QTIP trust is selling an asset.
- Assume, for example, that an irrevocable trust that qualifies as a QTIP trust (e.g. a failed GRAT structured to qualify for a marital deduction) is, pursuant to the terms of the governing instrument, to be combined or poured into the primary QTIP trust. If that first trust is to engage in a sale or transaction that might produce a 2519 argument, perhaps the two QTIPs can be bifurcated to prevent a 2519 attack from reaching the second QTIP.
- In other words, one might wish to take steps to prevent a combination of the two QTIP trusts (e.g. the failed GRAT/QTIP merging into the primary QTIP at the end of the term of that failed GRAT).
- The same governing instrument might include powers to divide trusts and even not to merge trusts.

Trusts: 2019-2020 Planning Roadmap

Hart-Scott-Rodino

Hart-Scott-Rodino

- Practitioners should be mindful that large estate planning transactions may trigger reporting requirements under Hart-Scott-Rodino Antitrust Improvements Act ("HSR").
- HSR imposes an obligation to file a premerger notification report form with the Federal Trade Commission ("FTC"). This may all be counter-intuitive since a sale of interests in a closely held or family business to a trust created by the family can hardly be viewed as negatively impacting competition, but meeting the filing requirements, or finding an exemption, may be necessary to avoid potentially onerous penalty provisions.
- There could be an impact on the HSR determination based on trustee and trust protector provisions included in the trust instrument, and, specifically, who has the ability to remove and replace trustees.

Hart-Scott-Rodino

- A settlor's retention of the ability to remove and replace the trustee, or the right of a trust protector to do so, in an irrevocable trust, might cause the trust's voting securities to be treated as part of the settlor's ownership share of an entity for purposes of HSR testing.
- If the trust protector of a trust has the contractual power to remove and replace 50% or more of the trustees, the protector may be considered a control person.
- In testing HSR filing requirements, holdings of spouses are considered to be the holdings of each them.
- The company is its own Ultimate Parent Entity ("UPE").
- Inquiry might be appropriate as to whether an investment advisor (investment trustee) in a directed trust, who can vote the equity interests, might also be classified as a UPE.

Hart-Scott-Rodino

- An informal opinion might be obtained from the FTC as to whether a proposed transaction (e.g. a note sale transaction to a grantor trust) is exempt even though the transfer would meet the HSR size of transaction and size of person tests.
- The FTC may not dispute the proposition that essentially internal, estate-planning-driven transfers of family businesses to a trust should be exempt, while acquisitions by a trust from third parties should not.
- Any time a large transaction is contemplated, it may be advisable to have a mergers and acquisition specialist to parse through the HSR exceptions to confirm that no filing is needed.

Trusts: 2019-2020 Planning Roadmap

Differentiate Collateral; Differentiate Guarantee

Differentiate Collateral on Sale to Old Trust

- When selling assets to an existing irrevocable trust that has significant assets from prior planning, consider using assets other than the assets being sold in the current transaction as collateral.
- **Example**: ABC, LLC interests were sold to a trust years ago and that transaction has been completed and any note repaid. Now, the taxpayer is contemplating selling XYZ, LLC interests to the same trust. Instead of using XYZ, LLC interests as collateral on the note the trust gives the selling taxpayer, what if instead ABC, LLC interests are used as collateral for the note? Might that reduce the potential strings attached to the asset sold that the IRS might use to argue for estate tax inclusion?

Different Application of Guarantee

- What if a guarantee is used and the terms require that the seller/lender/donor must first proceed against the guarantor before proceeding against the collateral? While unconventional, might that create more distance from the asset sold if there is no collateral in the trust other than the original asset? How would the guarantee fee have to be adjusted to reflect this increased risk?
- Since the guarantor would be first “in line” before the collateral, the fee to be charged would have to be greater than in a traditional guarantee arrangements. In such instances, it might be prudent to have an independent appraiser evaluate what a fair guarantee fee might be for the transaction.

Defined Value Mechanisms

Drafting Wandry Clauses Post-Powell and Using Other Techniques

Non-Wandry Defined Value Mechanisms

- Non-Wandry types of mechanisms are based on the entirety of the intended value being transferred away from the transferor.
- If there is an excess value over what the buyer in the transaction is paying, as a result of an IRS audit adjustment, that excess value is poured into a non-taxable receptacle such as:
  - Charity (but, be cautious if a private foundation is used since this may not be a feasible mechanism).
  - A grantor retained annuity trust ("GRAT").
  - Marital trust (other than a "QTIP" which requires the election to be made on the gift tax return by the due date for the year the gift was deemed to have been made).
  - An incomplete gift trust.
- There is little agreement amongst practitioners as to which spillover or structure is best.

Wandry Clause

- In W*andry* the tax court upheld an approach that relied on the transfer of a fixed value of assets to a trust rather than a specified portion of equity.
- **Example**: “Taxpayer hereby transfers $100 worth of stock to XYZ trust.”
- While many practitioners prefer a *Wandry* approach over a *King* approach, the IRS has non-acquiesced to the *Wandry* decision.
- Another variation of a *Wandry* approach is for the beneficiaries to execute a disclaimer of any value in excess of the specified value. The concept behind this approach is that this would make it difficult for the IRS to argue more was transferred if the recipient trust is prohibited by the disclaimer from accepting the incremental value. This idea is attributable to Stacy Eastland.

Wandry Post-Powell

- Should we reconsider classic Wandry clauses in light of Powell?
- Many practitioners believe a Wandry clause provides security to deflect a valuation challenge by the IRS of a transfer to, for example, an irrevocable trust. Other practitioners might view the protection as less secure
- A response to this uncertain and potentially expansive view of Code Sec. 2036(a)(2) under Powell/Cahill might be to reconsider the traditional Wandry adjustment mechanism and use a different approach to avoid any equity remaining with the transferor in order to assure that the transferor cannot act “in conjunction with” to control any of the entity interests transferred.
- Consider a secondary sale of any interests remaining with the seller as a result of the Wandry clause effective on the date of the primary sale, at a price pegged to the gift tax value as finally determined. Consider signing a secondary purchase agreement to govern this.

King Price Adjustment

- The *King* case might provide a planning option to consider for a price adjustment clause. *J. King*, CA-10, 76-2 USTC ¶13,165.
- **Example**: "Taxpayer hereby transfers $100 worth of stock to XYZ trust for a note. If the value of the stock is finally determined for gift tax purposes to be greater than $100 the face amount of the note shall be adjusted accordingly." Some practitioners report what they described as favorable results on audits using this approach.
- Other practitioners are less optimistic and are simply not comfortable with a *King* type approach. Some object to *King* based on the structure of the adjustment. For example, might the adjustment of the note be viewed as an impermissible condition subsequent under a *Procter* analysis? On the other hand, some view *King* as an "outlier" not to be relied upon because it is only a 10th circuit case.
- King might require a business purpose or motive in addition to estate planning.

King Price Adjustment

- The *Ward* case rained a bit on the *King* parade according to some. *C. Ward*, 87 TC 78, CCH Dec. 43,178.
- A variation of a traditional *King* type approach might be for the note's face value to be defined as being the gift tax value as finally determined. This idea is attributed to Steven Gorin, Esq.

Be Careful with S Corp Stock

- **Example**: On March 1, 2019, Jack transfers all of his shares in his S corporation with an aggregate fair market value of $1 million to the Jack Family Trust, which is a valid S corporation shareholder (it is either an ESBT, QSST, or grantor trust). Jack believes that he has transferred all of his S corporation shares but, if it turns out that the aggregate value of all of Jack's shares were worth more than $1 million, Jack will be deemed to have sold the excess shares to the Jack and Jill Trust, which is a non-grantor trust. The Jack and Jill trust does not own any S corporation shares. In 2022, the IRS picks up Jack's gift tax return for audit and determines that the value of the shares transferred to the Jack Family Trust was $1.2 million. As a result, Jack is deemed to have sold $200,000 worth of shares of S corporation stock to the Jack and Jill Trust on March 1, 2019. However, the time for the Jack and Jill trust to make an ESBT election or otherwise qualify as a valid S corporation shareholder has long since passed. As a result, the entity itself could be deemed to have lost its S corporation status.

Be Careful with S Corp Stock and BDOTs

- What if a sale is made of S corporation stock by a non-GST exempt ESBT to a GST exempt BDOT?
- If all stock is sold the selling ESBT's status as an ESBT ends.
- If the BDOT is grantor to the ESBT, does the ESBT election cover and apply to the BDOT and the stock the BDOT purchased?
- If one share of stock is retained in the ESBT that may assure ESBT status remains intact.
- The new BDOT could make an ESBT election as well but if it is the grantor, then grantor trust status supersedes the ESBT election.

Sale to Non-Grantor Trust – 2 Tier Defined Value Mechanism - 1

- In some instances, use of a non-grantor trust might be advantageous as the buyer in a note sale or other transaction, even if unusual. The basis step-up on the death of the first spouse's might permit avoiding capital gain on a sale. Also, an old no-longer grantor trust may have substantial assets and avoid the need for seed gifts or guarantees and make the perceived risk of the transaction lower.
- How should a defined value mechanism be structured for such a transaction?
- A two-tier defined value mechanism would be necessary to address both income tax as well as gift tax audit results, since a sale to a non-grantor trust could trigger both income and gift tax audit adjustments.

Sale to Non-Grantor Trust – 2 Tier Defined Value Mechanism - 2

- The income tax audit adjustment could be based on an IRS argument that the value of the asset (e.g., stock in a closely held corporation) was understated so that the transaction is in reality part gift/part sale with less shares having been sold.
- This adjustment could be independent from a later gift tax audit that argues that the valuation was low, and hence a gift made. Thus, in contrast to the economic adjustment clause previously illustrated for a sale to a grantor trust, a two-tier adjustment might be necessary to conform the economics to the ultimate result of the transaction.

Consider Economic Adjustment Provisions

- Inherent to many defined value mechanisms is that an adjustment might be made at a future date and affect which taxpayer owns the LLC interests from the inception of the transaction.
- While defined value mechanisms routinely address the allocation of these equity interests, how are the economic implications of the adjustment provided for? If five years pass from the date of a transaction until the interests sold are determined definitively, how will the economic consequences of that five-year period addressed?
- The consequences might include dividends or distributions that need to be repaid from the recipient to the correct party, e.g., the seller.
- Also, what mechanism will be used to assure that the equity interests are properly adjusted? Will merely providing for an adjustment clause alone suffice?

Consider Economic Adjustment Provisions

- Sample Clause: "….. the Buyer [trust] and the GRAT have determined the number of Shares to be sold to the Buyer (i.e., the Actual Sale Shares) and the number of Shares to be gifted to the GRAT (i.e., the Actual Gift Shares") and …. It is understood that the CPA Report will corroborate the amount of dividends, other distributions, or other economic benefits that accrued to the Buyer prior to the Distribution Date (as defined in the Transfer Agreement), and that are properly allocable to the GRAT, if any. The Escrow Agent shall not submit the Existing Stock Certificate, the Sale Stock Power or the Gift Stock Power to the Corporation (or its transfer agent) pursuant to Section X until after the Escrow Agent receives written notice signed by the Buyer and the GRAT, in form and substance satisfactory to the Escrow Agent, that the Buyer has reimbursed the GRAT, or made adequate arrangements to reimburse the GRAT as permitted under the Transfer Agreement, for any amounts payable to the GRAT pursuant to the CPA Report."

Use an Escrow Agent - 1

- If a sale occurs subject to a defined value mechanism and/or a deferred payout supporting the note, who holds the collateral for the note? Who holds what documentation pending the resolution of the defined value mechanism? In most cases these documents are held by the estate. Might there be a better option?
- The *Ward* court noted: "Furthermore, since there is no assurance that the petitioners will either recover the excess shares or, at the time of their deaths, possess the power to recover such shares, and since the shares are not worthless, the petitioners' estates may be reduced by the transfer of the shares."

Use an Escrow Agent - 2

- Might having title documents held in the hands of an independent escrow agent, who assures that necessary adjustments are made, deflect this concern? Using an independent law firm, not a firm otherwise involved in the transaction, with a detailed escrow agreement specifying which documents are to be held, and how they should be handled, might add additional credibility to the arrangement and negate the issue raised by the *Ward* court. Endeavoring to adhere to all relevant formalities could be important.

Loans

Stepping/Deferring Interest Payments under a Note

- Assume a client is going to engage in a note sale to a grantor dynasty trust (a so-called Intentionally Defective Irrevocable Grantor Trust or "IDIGT"). But the entity whose interests are being sold has current cash flow needs for business research and development. As a result, distributions will be difficult/limited for several years.
- Can the purchasing trust backload the scheduled payment dates of the interest that accrues under the term of the note? During the first X years of the note, the purchaser pays interest every year at a rate of say 1%. The remaining and unpaid 2% interest (assuming a 3% AFR) will compound at the same 3% AFR rate until it is paid. Thus, the note will have negative amortization during the first X years of its term. After the first X years, the purchasing trust will pay the full interest that accrues every year on a current basis (or if advisable from a cash flow perspective another "step" in rate can be used). During the remaining term of the note, the purchaser also will pay the compounded shortfalls in interest payments that arose during the first X years of the note.

Stepping/Deferring Interest Payments under a Note

- The delayed payments of interest that accrued during the first X years of the note should not, by itself, cause the note that the purchaser gives to the seller to be recharacterized (e.g. as an invalid indebtedness, a gift, as equity instead of debt, etc.).
- Code Sec. 7872 provides rules for the tax treatment of loans with below-market interest rates. Code Sec. 7872(a)(1) recharacterizes the below-market-rate demand loan as a two-step transaction: (1) The lender treated as having transferred on the last day of the calendar year an amount equal to the forgone interest (the prevailing federal rate of interest less the loan's actual interest rate) to the borrower; and (2) The borrower/trust is then treated as retransferring that amount back to the lender as imputed interest.
- If interest accrues and is not paid the original issue discount (OID) rules will apply. The OID rules would have the taxpayer report a pro rata amount of the overall amount of the OID over the life of the loan using a constant yield method under the Regulations under Code Sec. 1272. But on a sale to a grantor trust the OID complications appear to be obviated. So, while these rules should apply, they may have no income tax significance.

Trusts: 2019-2020 Planning Roadmap

Administer Trusts Properly

Administer Trusts Properly

- The *SEC v. Wyly* case continues to serve as a reminder about the importance of proper trust operation. In *Wyly* there were trust protectors for each of 17 inter-vivos trusts. None of the persons serving as trust protectors were related or subordinate. Nonetheless the trustees followed all investment recommendations made by the protectors including with regard to collectibles, etc. The conduct of the trust protectors and settlors was such that the court imputed all actions of the trust protectors to the settlors since there was a pattern of action. *SEC v. Wyly et al*, No. 1:2010cv05760 - Document 622 (S.D.N.Y. 2015).

Administer Trusts Properly

- Have annual trust meetings.
- An Investment Policy Statement (“IPS”) might be created for each trust.
- Consider having power holders, fiduciaries and others (e.g., non-fiduciaries) sign written acknowledgement of their actions and roles.
- Prepare a trust balance sheet.
- Confirm all payments (note interest, GRAT annuity payments, etc. are made timely).
- Adhere to all formalities. Be certain deposits and payments are made from correct trust accounts.
- Be certain assets are properly titled in the name of the trust. Consider bank truncation of trust names and impact.

Trusts: 2019-2020 Planning Roadmap

Safer Practices

Safer Practice Habits

Safer Practice Habits

- Document risks. Almost every planning step, technique or transaction has risks and down sides. Identify those honestly for the client.
- Consider documenting risks in writing.
- Don’t oversell a technique (or yourself).
- Offer client options for every plan, if possible, so that the client makes an informed decision of which approach or option to use or not.
- Write letters and memorandum.
- Have follow up procedures in place.
- Clarify what you will and will not be responsible for. E.g. if you will not monitor note or GRAT payments, say so. If you do not have the expertise to review insurance policies or structures, say so.

Safer Practice Habits

- State in communications to the client that the matter you were working on is concluded. Many practitioners are worried about making statements to the effect "your file is closed." But, whatever negative perception you fear can be offset with language to the effect that "We would be pleased to again assist you should you wish our assistance in the future," etc.
- Communicate with clients – use email blasts, newsletters, letters to particular types of clients, customized letters to specific clients and more.
- Provide clients with checklists or instructions as to how to operate plans.
- Send clients draft documents in advance of signing meetings and document that you did so.

What Else to Consider Putting in Engagement Letters

Provisions to Consider

Basic Billing Provisions

- It is helpful to have an engagement letter that reflects the scope of the engagement and your billing practices.
- If billing on a flat fee or project basis, indicate the fee and what it will (and won't) cover and how extraneous matters will be billed.
- If billing on an hourly basis, indicate your hourly rate.
- Remember to indicate when payment will be expected.
- It can be helpful to indicate that your fee schedule changes from time to time.
- Address that you will bill if called as a witness.

Account Stated

- Consider including language that will help establish a claim premised upon an "account stated":

  > "It is our expectation that you will review all monthly invoices issued to you and immediately contact us if you have any questions or concerns regarding the invoice. In the absence of hearing from you within 30 days from the issuance date of any invoice, we agree that you have reviewed the invoice and have no objections."

Client Responsibilities

- Full and accurate client disclosure may be important to your ability to render advice and create a cohesive plan.
- Consider including a provision in the engagement letter that reflects it is the client's responsibility to provide complete and accurate disclosure of financial matters and intentions regarding disposition of their estate.

Scope of Engagement

Consider addressing:

- The documents you've been asked to review (or not).
- The documents you will be drafting (or not).
- If this a limited engagement (e.g. only to modify a limited provision).
- Who will be responsible for funding trusts/entities.
- Whether you evaluate and provide advice regarding insurance policies that are part of the plan.
- Re-affirming the scope of engagement (especially if it has changed) when you send the draft documents to the client.

Post-Mortem Representation

- It can be helpful to discuss what might happen after disability and death.
- A surviving spouse, child or nominated fiduciary may request the drafting lawyer to act as attorney for a beneficiary or fiduciary. Discuss whether this is desired by the client and the extent to which disclosures can be made.
- In an incapacity situation, representing a beneficiary or fiduciary may result in positions that are adverse to those of the former client – what then?

Document Retention

- Consider addressing:
  - Who will be responsible for retention of original documents.
  - Whether there will be a charge for additional copies of documents requested after engagement is completed.
  - How long the contents of a file will be retained.
- Despite having a file destruction policy, remember if you become aware of litigation before destruction occurs, you may have a duty to take steps to safe-guard documentation.

No Guarantees

- If you provide estate or tax planning services, you may wish to include language in your engagement letter which reflects you don't guarantee the plan will work as hoped.
- Tax regimes change.
- A client's failure to properly title assets, change of beneficiary, or other changes can adversely impact the plan.

No Guarantees – Sample Language

- "Many aspects of many if not most estate and related plans are not only uncertain, but subject to a wide spectrum of different views by other advisers, the courts, the IRS, and other authorities. Even many common strategies, techniques and transactions are subject to tax, legal, financial, and other risks and uncertainties. While we endeavor to identify some of the risks of a plan, all risks and issues with each component of a plan are not possible to identify or communicate. Creating a collaborative team will help identify more issues with your plan. Further, the fact that we communicate verbally or in writing certain risks should never be interpreted as an indication that any such listing or communication is a comprehensive listing or communication of every risk involved. The risks of any transaction can be further compounded by improper administration of the plan, failure to meet periodically to review and update the plan, changes in the tax and other laws. Such events may reduce hoped for benefits or even result in more costly results then had no planning been pursued. Periodic meetings with a collaborative advisor team may identify existing or new risks, help modify the plan to address changes in the law, mitigate risks, but still cannot provide certainty."

Text Messages

- Maintaining a record of communications with the client can be important should future litigation ensue.
- Consider a provision in the retainer agreement that says “It is not possible for the firm to maintain a record of text messages. You should assume that any text message directed to personnel of this firm will not be received and will not be read.” If texts are received, noting the gist of the text message in the billing system may serve to document the communication. Be mindful, however, that in many jurisdictions, bills aren’t considered privileged communication.

Client Payment/Allocation of Fees

- "How you allocate legal fees, to various persons, entities or trusts could affect whether the payment is tax deductible. It is important that you use checks drawn on the appropriate accounts for the appropriate entities or persons when paying legal fees. Paying personal expenses from a business entity could be argued by a claimant or tax authority as evidence of your disregarding the independence and legal integrity of the entity. If you personally, or another entity, pays for legal fees for the services rendered to that trust, the IRS might argue that the payment is equivalent to an impermissible additional gift and that the tax position of the trust should not be respected."

Ancillary Documentation

Additional Precautions

- Don’t sell a technique or plan. Give a balanced view of pros and cons so that the client can make an informed decision (yes this was stated earlier but it is so important).
- Document risks and concerns.
- Clarify who (client, another adviser, you) will be responsible for which follow up items (or not).
- Caution/warning at the beginning of every memorandum.
- Risk factors memo/listing.

Ancillary Documentation

- Consider ancillary documentation that backstops/supports the provisions of your engagement letter/retainer agreement.
- Intake sheet. Gather information before the engagement starts.
- Disclaimer/caveat on balance sheet client signs.
- Footers on bills.
- Emails/letters during the engagement clarifying the scope.

Ancillary Documentation

- Estate planning questionnaire.
  - If you send out a written questionnaire as part of the engagement process, remember that use of such forms does not eliminate the need to ask questions at the time of devising the plan as well as at the time of execution, to assure that the client has the requisite capacity to engage in the plan.

Document End of Engagement

- Consider sending written confirmation that engagement has ended or been completed when the executed documents are provided to the client.
- If you find that the engagement stalls because the client becomes unresponsive, you may wish to consider sending written confirmation that you consider the engagement ended and your file closed.
- When a client returns do not "reopen" their file, open a new file as this might support the position that the statute of limitations ran on the prior representation.

Malpractice

Recent Case Might Suggest Practice Changes

Malpractice – The Case

- A recent malpractice complaint filed in New Jersey has implications for estate planners in all disciplines.
- https.1/www.law.cornlnjlawjouma/12019/02/04//lowenstein-faces-malpractice-lawsuit over-creation-of-dynasty-trustl.
- The case involves a malpractice claim against a well-respected law firm, and national CPA firm, for using what appears to be from the descriptions in the complaint, common estate planning techniques such as GRATs, gifts, and note sales to dynasty trusts, etc. to reduce the potential estate tax obligations.
- We have little information on the case, the facts and how it will develop, but nonetheless there are important lessons practitioners might learn from the case regardless of outcome.

Malpractice – The Complaint

- Merely because the planning techniques are commonly used does not necessarily make those techniques appropriate for a particular client. Practitioners should exercise caution in applying common planning techniques without first understanding each client's unique situation and circumstances.
- Consider alerting the potential for increased income tax consequences to the beneficiaries of the plan due to the loss of a potential step-up in basis on assets transferred out of the estate, and the income tax cost on negative basis real estate assets if the grantor trust to which they were transferred becomes non-grantor.
- Discuss the income tax consequences that may be experienced when grantor trust status is lost or toggled off.

Malpractice – Time to Reconsider Practice Policies?

- How might practitioners modify how they practice to perhaps reduce liability exposure?
  - Should different or additional language be added to retainer agreements?
  - Might different approaches be worthy of consideration to apprise clients of the risks inherent in many estate planning transactions? What approaches might be useful? What approaches might be counter-productive?
  - Is it time for rules of professional conduct governing attorneys to be reconsidered as to restrictions on liability limitations given the current planning environment?
  - How do other allied professionals address liability limitations and what might that mean to estate planning attorneys?
  - Might mandatory arbitration provisions be beneficial? If beneficial are they permissible if attorney ethics rules proscribe their use?

Malpractice – Time to Reconsider Practice Policies?

- Every estate plan is subject to a myriad of variables and options.
- Every form of tax planning is always subject to risks that the law may change, economic assumptions underlying the planning may change, client goals may evolve, family dynamics can transform, and any of the myriad of other assumptions underlying any plan can change. A change in interest rates can have a dramatic impact on the ultimate tax consequences of a GRAT. If the donor/settlor of a GRAT dies during the term of the GRAT the plan is often presumed to fail. To the contrary, if the value of the assets inside the GRAT and interest rates have risen sufficiently, less than all the GRAT assets will have to be included in the donor/settlor's estate. Yet what control does any practitioner have over the value of the assets or interest rates?
- At high levels of wealth planning, when polling nationally known practitioners on the best approach or technique to use as part of a plan, it is likely none will provide you with the identical answer.
- In fact, on many seemingly commonly used planning points practitioners will disagree vehemently.

Malpractice – Possible Implications

- The reality is that estate planning is at best an art, not an exact science, and no practitioner should be held to an impossible standard. All any estate planner can do is a reasonable job based on the practitioner's perception of the facts, the overall goals expressed by the client, and guestimates as to the future, and so on.

Malpractice – Time to Reconsider Practice Policies? Risk Listing

- Create and use additional procedures to disclose risk factors.
- In the heyday of the tax shelter syndication days of the 1980s every private placement memo had a long risk factors section in the front of the document. While many of these points were boilerplate in most deals, better crafted private placement memorandum also had customized risks associated with the particular transaction.
- Perhaps some practitioners might consider the use of a somewhat generic, somewhat customized, list of risk factors. Sending a "Listing of Some Risk Factors that May Affect Your Plan" prophylactically to clients who wish to engage in various estate planning endeavors (such as DAPTs, SLATs, IDGTs, GRATs, etc.) might prove helpful in explaining some of the risks involved in a proposed plan.
- Such a step could also communicate to the client that there are risks involved in every estate plan.

Malpractice – Time to Reconsider Practice Policies? Risk Listing

- This is not presently standard practice nor required.
- While nothing requires a practitioner to lay out all issues in writing, and in fact there may be reasons not to provide the IRS (and perhaps other creditors) with a roadmap as to the purposes and intentions behind an estate plan, later proving the advice and cautionary comments provided by the professional to the client (after the client has died or become incapacitated) may be difficult without some level of contemporaneously created documentary evidence.

Malpractice – Time to Reconsider Practice Policies? – Safe Writing

- Perhaps practitioners might consider being [phraseology intentional] more attentive to the choice of words used in letters and memorandum.
- In the case the Plaintiff's allege: "In this memorandum, Mr. Weinstock stated that the recommendations "are designed to achieve the following planning goals to the **maximum** possible extent [highlight added]."
- Given the nature of the litigious environment, perhaps practitioners should consider language like: "……may achieve some of the following planning goals………"
- Perhaps banish the use words like "assured," "will," "optimal," "maximum," and instead only use words suggestive of possible results. While clients no doubt prefer shorter and clearer language, is it worth the risk? Certainly, if we state that net tax savings "might" be achieved that suggests that they also might not be.

Malpractice – Time to Reconsider Practice Policies? – Retainer Agr.

- "Audit and other Risks: To the extent that you engage us, or engaged us in the past, to perform tax, estate, asset protection and other planning, which may include, or may have included, estate, gift, wealth preservation and/or wealth transfer planning and other services, we may have suggested a number of strategies, and may have assisted in implementing strategies, that the IRS or state tax authorities, or others, could challenge. Possible challenges could be asserted even though we communicated several of the risks associated with such strategies. Possible challenges could be asserted also for risks that were not discussed, including challenges by the government that could cause inclusion of assets previously transferred out of your estate in your estate. Assets that had been transferred out of the estate as part of the recommended strategies will most likely not be adjusted to their date of death value, which could result in a capital gains tax liability, possibly a depreciation recapture tax liability, and/or a negative capital account recapture liability. You agree that we shall not be liable, to any extent, for any assessments of tax, interest, or penalties resulting from recommended strategies or previously implemented strategies."

Malpractice – Time to Reconsider Practice Policies? – Retainer Agr.

- Consider
- Rule: 1.8 Conflict of Interest: Prohibited Transactions
- (h) A lawyer shall not:
- (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented in making the agreement;
- The comment to the Michigan Rules of Professional Liability supply this clarification:
  - LIMITING LIABILITY
  - Paragraph (h) is not intended to apply to customary qualifications and limitations in legal opinions and memoranda.

Malpractice – Time to Reconsider Practice Policies? - Billing

- Many common billing programs permit adding standard text, e.g. footers, to certain types of bills or even to all bills.
- Consider adding some variation of the previously discussed “no guarantee” and “audit” provisions as a standard footer to all bills.
- Clients reminded of these limitations on each bill may have a more difficult time maintaining that they were not aware of these risks and limitations on what the practitioner can provide.

Malpractice – Reconsider Practice Policies? – Caveat to Memos

- Has any financial firm, trust company wealth adviser, or life insurance firm ever issued a forecast, memorandum or other client specific communication without cautionary language?
- Why is the same procedure not routinely used by estate planning attorneys and CPAs? Perhaps it should be.
- No client has ever authorized an unlimited budget for a memorandum, so every memorandum is necessarily constrained by the time and budget limitations. That assuredly has to limit the issues that can be identified and the research that can be done.
- Given the inherent uncertainties of the estate planning process, many memoranda can simply not provide assurance on some or many of the points addressed.

Malpractice – Reconsider Practice Policies? – Caveat to Letters

- Perhaps practitioners might add a paragraph on risks and issues to cover letters used to transmit wills, trusts and other significant estate planning documents. That paragraph might address:
  - Estate planning is inherently complex, subject to varying interpretations, and laws that frequently change.
  - Ongoing review and maintenance of every plan and document is essential.
  - There is no assurance that any particular result will be realized.
  - There are risks and negative consequences to every planning step and technique, all of which have not been enumerated in this letter or other communications.
  - By proceeding with this plan, you accept these risks.

Malpractice – Consider What Allied Professions Provide

- Assume that an estate planning attorney is involved in a complex estate plan for a large client. What are the respective liability exposures of each of these professionals? The attorney cannot limit his or her liability as that would violate rules governing attorney ethics.
- The CPA and appraiser may include stringent limitations on their liability on the matter. They may limit the dollar value of their liability to their fees earned. They might also limit the time period during which a claim can be brought, providing further protection.
- The wealth adviser may limit its liability by stating clearly that it does not provide legal or tax advice thereby perhaps shifting the burden back to the attorney and CPA .
- Assuming a trust company is involved in a directed trustee capacity. This is common in planning transactions for closely held business interests, real estate and other private equity type assets. As a directed trustee the institutional trustee may have liability that is subject to a willful misconduct standard. Willful misconduct is more than no liability as the absence of liability might negate the existence of a valid trust.

Conclusion and Additional Information

Planning for Large Estates in 2019 and 2020

Conclusion

- Wealthy clients should consider planning aggressively now. It is not worth the risk, however it is estimated, that Dems may win in 2020 and dramatically alter the transfer tax system.
- Make gifts between spouses in 2019 and then plan in 2020 to reduce the risk of a step transaction challenge.
- Set up new irrevocable trusts and make seed gifts in 2019 followed by note sales or similar transactions in 2020 to reduce step transaction risks.
- If non-reciprocal SLATs (or variants) are to be used consider setting up one SLAT in 2019 and another in 2020.

Additional information

- Sandra D. Glazier sglazier@lipsonneilson.com
- Joy Matak joy.matak@cohnreznick.com
- Jonathan G. Blattmachr jblattmachr@Hotmail.com
- Martin M. Shenkman shenkman@shenkmanlaw.com
- Interactive Legal sales@interactivelegal.com
- Peak Trust Company bcintula@peaktrust.com

A KEY ESTATE PLANNING GUIDE

Law Easy

ChronicIllnessPlanning.org

CLE Credits

- For more information about earning CLE credit for this program or other Martin Shenkman programs please contact Simcha Dornbush at NACLE. 212-776-4943 Ext. 110 or email sdornbush@nacle.com