**Steve Leimberg's Estate Planning Email Newsletter - Archive Message #3178**

**Date:** **05-Feb-25**

**From:** **Steve Leimberg's Estate Planning Newsletter**

**Subject:** **Thomas Tietz, Joy Matak, Martin Shenkman & Jonathan Blattmachr: Notes from the 59th Heckerling Institute on Estate Planning**

The **59th Heckerling Institute on Estate Planning** was held January 13 through January 17, at Marriott World Center in Orlando, Florida. Members should click this link to review the meeting agenda: Heckerling. The Heckerling Institute on Estate Planning covers a range of topics for estate planning professionals, including practical pointers that will assist practitioners whether their clients are high net worth individuals or more moderate net worth clients. **Thomas Tietz**, **Joy Matak**, **Martin M. Shenkman** and **Jonathan Blattmachr** attended the Heckerling Institute on Estate Planning and agreed to share their notes.

**Thomas Tietz, JD,** has lectured at the Notre Dame Tax & Estate Planning Institute and for the New Jersey Bar and Institute of Continuing Legal Education. He has published articles in the American Bar Association E-Report, Wealthmanagement.com and Trusts & Estate Magazine. He is a member of the American Bar Association, Real Property, Trust and Estate Law and Business Law sections, the New York State Bar Association, the New Jersey State Bar Association and the Bergen County Estate Planning Council.

**Joy Matak, JD, LLM** is a **Partner** at **Avelino Law.** She has more than 20 years of diversified experience as a wealth transfer strategist with an extensive background in recommending and implementing advantageous tax strategies for multi-generational wealth families, owners of closely-held businesses, and high-net-worth individuals including complex trust and estate planning. Joy provides clients with wealth transfer strategy planning to accomplish estate and business succession goals. She also performs tax compliance including gift tax, estate tax, and income tax returns for trusts and estates as well as consulting services related to generation skipping including transfer tax planning, asset protection, life insurance structuring, and post-mortem planning. Joy presents at numerous events on topics relevant to wealth transfer strategists including engagements for the ABA Real Property, Trust and Estate Law Section; Wealth Management Magazine; the Estate Planning Council of Northern New Jersey; and the Society of Financial Service Professionals. Joy has authored and co-authored articles for the Tax Management Estates, Gifts and Trusts (BNA) Journal; Leimberg Information Services, Inc. (LISI); and Estate Planning Review The CCH Journal, among others, on a variety of topics including wealth transfer strategies, income taxation of trusts and estates, and business succession planning. Joy recently co-authored a book on the new tax reform law.

**Martin M. Shenkman** is an attorney in private practice in New Jersey and New York who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of dozens of books and hundreds of articles and has won many professional awards.

**Jonathan G. Blattmachr** is director of estate planning for **Peak Trust Company** (formerly Alaska Trust Company), a director at **Pioneer Wealth Partners LLC**, a boutique wealth management firm, and co-developer with Michael L. Graham, Esq., of Dallas, Texas of Wealth Transfer Planning, a software system for lawyers, published by Interactive Legal LLC (www.interactivelegal.com).

Contents

1. Aging Clients

2. Arbitration

3. Artificial Intelligence

4. Basis Step-Up

5. Bonus Exemption

6. Charity Donor Agreements

7. Checklists and planning 2025 work

8. Community Property

9. Deceased Spouse Unused Exemption ("DSUE")

10. Deference

11. Defined Value Mechanisms (Valuation Adjustment Mechanism)

12. Discounts on FLPs

13. Dispositive Plan: Protecting Testator's/Trustor's Intent

14. Divorce

15. Doctrines, Tax Generally

16. Email, Other Communications and Internet Searches

17. Ethics

18. Fiduciary Liability

19. Foreign trusts, proposed regulations

20. Foreign businesses

21. Guarantee Fees: Are They Required

22. Income Tax Residency of Trusts

23. Litigation, Protecting Client's Dispositive Plan

24. Loan - is it bona fide

25. Purpose Trust

26. QTIP Considerations

27. Reciprocal Trust Doctrine

28. Religious Considerations

29. Risk Evaluation

30. Spousal Lifetime Access Trusts ("SLATs")

31. Step-Transaction Doctrine

32. Succession Planning

33. Trust Modification

34. Trust Property, Use of

35. Vacation Home to SLAT

The following is a discussion of some of the many topics addressed at the recent Heckerling Institute. Given the extensive coverage of the Institute, the following discussions are barely the tip of the proverbial iceberg. As we all seek to absorb the information gleaned from this year's institute, we outline ideas to extend and vary opportunities identified in the Institute presentations that might be helpful to readers. Though the concepts discussed might have been inspired by Institute presenters, many of the ideas expressed in this article are not entirely based on the comments from speakers, and some are quite different.

The discussions have been organized topically for ease of use. One or more of the topics may contain points raised in several different presentations and a broader topic from a presentation may be divided into different topical sections. Because of the change in organization and significant additional comments, presentation titles and speaker names have not always been listed. That was not done to in any way to disrespect speakers or not give credit to those presenting a particular idea but in an effort to make information more digestible for readers.

1. **Aging Clients**.

a. Estate planners regularly work with aging clients, and not uncommonly encounter clients with cognitive issues. Those situations will occur with greater frequency as recent dementia studies have identified increasing incidence of dementia:[i]

i. Older studies estimated that about 14% of men and 23% of women would develop dementia in their lifetimes. The new study puts that estimate higher, at around 42% for both men and women.

ii. Between ages 55 and 75, the average person's risk of developing dementia was 4%, according to the study. By the time someone turned 85, their risk was about 20%. Risk didn't reach 42% until a person's 95th birthday.

b. When working with elderly clients, and similarly clients with chronic illnesses, disabilities and perhaps other challenges, consider when it might be appropriate or advisable to take steps to assess the client's capacity, and corroborate that they have capacity. have the client obtain an evaluation from a geriatric psychiatrist. In many instances it can be difficult to ascertain the extent or impact of a client's age or health related challenges. For example, a client with Parkinsonian masked faces may not exhibit the anticipated facial responses to a conversation with counsel but nonetheless may be competent. It may make it challenging for the client to communicate emotions effectively. In the opposite situation, clients with other cognitive challenges may appear and present as anticipated, but may have significant cognitive issues. It's estimated that 96% of people with chronic illnesses experience what are known as invisible disabilities.[ii] Practitioners should be cautious as what they see may not correlate with the client's capacity.

c. Have the evaluation done close in time to the document signing. This would permit the geriatric psychiatrist to assess the client's state of mind at the time of the signing. Speakers suggested having the evaluation done either the day of the signing, or the days right before or after.

d. Also, consider obtaining a report from the client's neurologist or general physician to be aware of medications, physical ailments that may affect cognition, etc.

e. Engaging an expert to evaluate the testator could rule out capacity issues and preempt litigation over the questions about the testator's capacity. To the extent that capacity is an issue, an evaluation could identify the problem and help the practitioner determine how best to proceed.

f. As practitioners are aware, testamentary capacity is a low standard. Even a testator who does not appear perfectly intact may still meet the requirements for testamentary capacity: knowing the natural objects of their bounty, understanding the testamentary nature of transaction, understanding the nature of their property. The practitioner should endeavor to corroborate and substantiate testamentary capacity, regardless of whether or not a geriatric psychiatrist evaluates the testator.

g. If a challenge occurs that implicates the status of the testator's capacity and some or none of the above steps were taken, consider hiring a geriatric psychiatrist to review the record and create a report based on that record. In these instances, the expert may not have examined testator directly, or if they had, perhaps in at a different time or in a different context. In these instances, the expert will analyze the medical and other records of events to evaluate cognitive status of the testator at the approximate time of the will execution. They may review points that may or may not indicate capacity. This is a relatively new concept, and some states do not yet permit this.

h. **Example**: In one case, the nursing records for a hospital stay just prior to the will execution contained detailed notes about the patient's desire to know the scores and details of recent Yankee games and the discussions with medical staff. The medical record also reflected that the patient was alert and oriented in all three spheres at discharge. This means:

i. Person: They know who they are and can recognize others.

ii. Place: They know where they are, including the specific location, city, or building.

iii. Time: They can identify the current date, time, and season, or have a general sense of time.

i. When meeting with a client that may have cognitive issues, practitioners should be alert and try to identify indications of the client's cognitive status. Struggles with executive functioning are often an early and important sign of difficulties. Executive functioning is the ability to formulate plan, identify the steps to implement that plan, the implementation of the plan, and thereafter the understanding of what was done. This could involve balancing a checkbook or even cooking.

2. **Arbitration**.

a. What about including a mandatory arbitration clause in an estate document?

b. David A. Baker indicated that six states have considered such provisions and that five have concluded that they were valid.

c. If mandatory arbitration will be used, might it be advantageous to have those to be subject to the mandatory arbitration provision sign a separate agreement acknowledging that they agree to be so bound with the advice of independent counsel?

d. Other steps such as pre-mortem probate may be safer options.

3. **Artificial Intelligence**.

a. **ABA Formal Opinion 512**[iii] addresses ethical considerations on the use of generative artificial intelligence ("AI" or "GAI") tools in law practice.

i. Competence.

1. Opinion 512 notes that "…*Model Rule 1.1 obligates lawyers to provide competent representation to clients*." The opinion states that attorneys need to have a "…*reasonable understanding of the capabilities and limitations of the specific GAI technology that the lawyer might use*…"

2. With the speed at which AI is evolving, what level of research and review is sufficient to have a "reasonable understanding"? Opinion 512 acknowledges the speed of change, and recommends that attorneys keep abreast of developments, reading materials on AI products designed for the legal profession, and consult with individuals proficient in AI technologies.

3. Practitioners may consider having a consultation with an IT individual with expertise in AI, and have that consultant communicate regarding the actions the practitioner and their firm is taking regarding AI, as well as any further suggestions the consultant may have. The practitioner can then have periodic update meetings with a consultant. If further communications (email for example) are provided this could create a record of the actions the firm has taken, and the implementation (or not) of any recommendations the IT consultant provided.

ii. Hallucination.

1. AI technology is subject to the risk of "hallucinations," which means AI may create incomplete or outright false results when prompted for information.

2. Practitioners should review and fact check information provided by AI, and determine if the sources cited in the materials provided are legitimate.

iii. Confidentiality.

1. Model RPC 1.6 requires attorneys to protect their clients' information.

2. AI uses "machine learning" to improve the AI and create more comprehensive responses to queries. This is done through retaining any information provided to the AI model. For a non-subscription-based service, it is likely all information provided is included in an online database for machine learning purposes. So, if an attorney were to use a free AI, and included confidential client information in the query, that would potentially violate their ethical obligations under RPC 1.6.

3. As a result of the above attorneys may wish to avoid using any AI they have not paid a subscription for. In addition, practitioners should consider reviewing the provider's terms of service ("TOS") to determine if the practitioner believes, based on their "reasonable understanding," that client data will be protected. Alternatively, or in addition, it may be worthwhile having a tech consultant confirm that data is safe and save that communication to corroborate in the future the reasonableness of the practitioner's actions.

4. Practitioners should understand that some/many AI models not only search the internet for information but scour the firm's own database/network for information. That can be incredibly powerful especially for a larger or older firm that has massive files that would be impractical to search efficiently for information by other means. But that access of the firm's confidential data is a potential exposure point many are not aware of.

iv. Communicating with Clients.

1. Some commentators have suggested getting informed consent from clients before using AI that includes the client's confidential information. This might be done by adding a provision to law firm's standard engagement letter or retainer agreement.

2. Practitioners may consider disclosing to clients how, if at all, they will be using AI as part of their representation of the client. This may include disclosing what work the AI will be used on, for example if it is simply used to create the first draft of letters and memoranda, or used for document generation, drafting emails, etc.

3. One option practitioners may consider is incorporating their discussion of AI into their representation agreement. If clients sign a written agreement providing informed consent to the use of AI, it may be protective for the practitioner. Perhaps the following clause might be helpful "We will use artificial intelligence ("AI"), e.g. Microsoft Copilot, in performing research, summarizing meetings and emails, transcribing meetings, and in other ways. We believe that we have taken reasonable precautions to assure that these applications do not compromise your confidentiality but there is no absolute guarantee."

v. Firm Websites and Advertising.

1. Many businesses have incorporated "chatbots" on their websites, which automatically respond to queries from prospects or clients. This may be a particularly nettlesome issue for law firms if they choose to incorporate a chatbot on their website. If AI is used in the chatbot, the risk of hallucination could cause inaccurate information to be provided. If an individual visitor to the website, even a person the practitioner believes is a nonclient, relies on that information, the practitioner and their firm may have ethical and liability exposure.

2. The website might also inform the prospect or client that they are communicating with an AI chatbot, and perhaps even some of the limitations of what that means. For example, using the chatbot does not create an attorney client relationship, and does not constitute rendering legal advise and no decisions or actions should be made based on chatbot comments.

3. Practitioners may wish to review the rules of professional conduct for their licensed states to determine if they are comfortable incorporating a chatbot.

vi. Legal Fees.

1. Model Rule 1.5 addresses compensation for fees and expenses.

2. Rule 1.5(a) requires that the attorney's fees are reasonable. Rule1.5(b) requires the attorney to communicate to clients the basis for the fees charged.

3. Before a client is charged for the use of AI, the client should be informed of what they are being charged for. Attorneys may consider updating their representation agreement to reflect the use of AI, and how it will be charged.

4. As the use of AI proliferates the practice of law, traditional methods of compensation may need to be reconsidered. Opinion 512 notes that if the attorney charges clients on an hourly basis, that attorney can only charge for the time spent with the use of AI. So, if drafting a document without AI traditionally took 4 hours of work, but the use of AI reduced that time to 2 hours, the attorney would be permitted to charge for 2 hours of time.

5. For attorneys that traditionally use flat fees, Opinion 512 noted that "…*if using a GAI tool enables a lawyer to complete tasks much more quickly than without the tool, it may be unreasonable under Rule 1.5 for the lawyer to charge the same flat fee when using the GAI tool as when not using it*…"

6. How should attorneys charge for providing legal services as AI continues to proliferate more of the daily tasks performed in a firm? Speakers noted that creating a reasonable compensation method is complicated and may change based on how AI evolves in the future.

7. The aforementioned may not be the only interpretation about billing but the authors did not research this point further for this article. But the point made that fees may have to be reconsidered is valid and important to consider.

b. **Florida Bar Provides Guidance on Use of AI**.

i. The Florida Bar recently released a guide on getting started with AI.[iv] This information is valuable for practitioners in all jurisdictions to read as we all try to digest the rapidly changing AI environment.

ii. The information provided includes a list of current AI models that exist, a glossary of certain AI terms, a discussion on how to craft prompts for queries to receive more concise answers, the kinds of tasks AI can currently assist with, and more.

iii. The guide notes that Florida practitioners should not use free AI software, "*…Free General AI models may use your questions and uploaded documents to train future models. To maintain client confidentiality, you will need a paid subscription…*"

iv. For any practitioner that has not researched AI before, this guide can be used as a starting point to determine if they wish to begin implementing AI, which kinds of models they wish to look further into, and provides more comprehensive resources to review for further research.

4. **Basis Step-Up**.

a. Probably, the vast majority of business entities that are not proprietorships or single member disregarded limited liability companies (LLCs) are partnerships or treated as partnerships for Federal income tax purposes. Paul Lee's presentation at Heckerling essentially went through the nuts and bolts of the taxation of partners and partnership interests for estate and income tax purposes. It may be appropriate to keep in mind that the taxation of partners and partnerships is largely set forth in subchapter K of the Code and other provisions of the Code come into play as do many special tax rules.

b. The partnership tax rules are far from logical or intuitive. They represent a combination of what might be viewed as (1) the logical treatment, from an accounting perspective, of income and ownership of partners and partnerships and (2) tax rules attempting to prevent what may be viewed as abusive tax treatment of such interests. This seems to be even more significant when considered in the context of lifetime estate planning and the administration of such interest when and after a partner dies.

c. As Paul points out repeatedly, a key to understanding the basics of the income taxation of partners and partnerships is to realize how important basis is in income taxation and how these interests are specially treated. It seems that basis is one of the most critical factors in all of income taxation. It is used to determine how much depreciation is allowed for income tax purposes, how much gain is recognized for income tax purposes when a partnership interest is sold or disposed of in any other income taxable transaction. Basis seems to be determined in one of three ways (by purchase under Section 1012, a gifted basis determined initially under Section 1015 and by "inheritance" determined initially under Section 1014). However, regardless which of these three basic basis rules at least initially applies, there are exceptions and special rules. And when the property involved in a partnership interest is considered for estate planning purposes, the complications skyrocket.

d. To begin, one must understand that there will be two bases with respect to a partnership interest: (1) the partner's own basis in his, her or its partnership interest and this is called the "outside" basis, and (2) the partnership's own basis in the assets it owns commonly called the "inside" basis. This might seem somewhat surprising since (with rare exception) virtually all income tax attributes of the partnership are attributed to the partners. This is critically important in estate

planning because whether the partnership interest is transferred by gift, or to a grantor trust (being one whose assets are treated as owned by the grantor) or at death, the outside basis may (or may not) change and, in turn, the inside basis may (or may not) change.

e. Let's take a simple example. A partnership is formed and individual X is a partner. When X dies, his or her interest will be included in his or her gross estate. As a general rule, under Section 1014(a), the basis of the partnership interest upon death will equal the fair market value at death (or, if elected pursuant to Section 2032 on the alternative valuation date). That may seem simple enough but the partnership's own "inside" basis will not change. One complication that often will arise for any partnership that is a business is that part of the partnership interest may represent goodwill or accounts receivable which will not have a basis change under Section 1014 because they represent income in respect of a decedent (commonly referred to as IRD) largely treated for income tax purposes under Section 691.

f. A further complication arises when there is debt on the partnership interest or the partnership assets and whether the indebtedness is recourse (meaning the partnership is personally liable for the debt) or non-recourse meaning collection of the debt can only be taken from the partnership assets (or those assets made liable for the debt).

g. Paul spent considerable effort in explaining how unitary basis is determined (that is, the basis of all interests held in the partnership) especially where part is owned by a grantor trust which is ignored pursuant to Rev. Rul. 85-13 for income tax purposes.

h. As mentioned above, except to the extent of IRD, the basis of an inherited partnership interest will be its estate tax value. Paul points out that this likely will result in the inheritor of the partnership interest having a different income tax basis than the basis of the underlying assets in the hands of the partnership itself. This, of course, may mean recognition of gain upon the disposition of the underlying partnership assets, which may not be offset in whole or in part by reason of the higher basis in the hands of the inheritor of the inherited partnership interest. Paul points out the importance of the election permitted under Section 754 to have the bases of the partnership's assets adjusted (increased) by reason of this disparity. And clearly this must be considered both in estate planning with respect to the partnership interest and the administration of the estate (or revocable trust used essentially in lieu of the estate).

i. Paul points out that a type of conflict may arise in trying, where appropriate and proper, to have a lower value of the partnership interest (which value, except for the right to IRD, will determine basis) for estate tax purposes and desiring a higher basis for income tax purposes. He makes suggestions on how to avoid that conflict in some cases.

j. One of the main tools used in estate planning is the grantor trust (which as mentioned above is ignored for Federal income tax purposes). But the trust will no longer be ignored for income tax purposes when the grantor dies. Paul spends considerable time explaining what that effect will be.

k. Paul explained the so-called "mixing bowl" rules by which a taxpayer attempts to avoid (or reduce) gain by having the bases of other assets attributed to what the taxpayer contributed to the partnership. He pointed out the limitations of attempting to use such a mixing bowl for such an asset.

l. Paul discussed the position of the IRS that no basis adjustment under Section1014 occurs at death for assets in a grantor trust that are not included in the grantor's gross estate citing to Rev. Rul. 2023-2. He did not mention that Gans and Blattmachr have taken a contrary view and that the IRS has limited its position so as not to apply to a situation where there is indebtedness outstanding between the grantor and the trust at death as there often is when an installment sale has been made by the grantor to the trust (or a borrowing has otherwise occurred and is outstanding at death).[v]

*m*. He also said, "*if an IDGT holds assets that collateralize a liability that is greater than the basis of those assets, upon the death of the grantor, the deemed transfer will cause the recognition of gain to the extent of the debt. In this circumstance, the transfer would be considered a taxable sale or exchange that would cause a mandatory inside basis adjustment if the partnership had a 'substantial built loss.*'" It may be anticipated that some practitioners may disagree with that but it would be worthwhile to consider it in planning.

n. Paul also presented other basis adjustment concepts as in Section 743 and 731. Practitioners need to be aware of these, or work with a practitioner who is. Indeed, it makes sense to get such a practitioner involved at the beginning of the administration of the estate.

o. Paul also reviewed a number of important but typically not well-known areas, including the application of Section 2043 where the underlying assets of a partnership are included in the estate and their value is different from the value of the partnership itself. See E*state of Powell v. Commissioner* and *Estate of Moore*.

p. Paul's discussion involving negative basis property in a partnership and negative capital accounts is well written and worth reading by any estate planning practitioner who is not fully aware of these concepts. Also worth reading is Paul's discussion of the consequences of death causing the conversion of a disregarded entity to a regarded one such as when a partner in a partnership dies and the other partner was a grantor trust. The grantor trust's existence will then no longer be disregarded as a partnership will spring into existence

5. **Bonus Exemption**.

a. **What will happen**?

i. There is no certainty that the bonus exemption will be extended beyond 2025, or if it will instead be allowed to disappear at the end of 2025, as is provided for under current law. While the Republican sweep made it more possible that the bonus exemption will be extended, there are many issues that may prevent that from occurring: Byrd rule, deficits, promised tax breaks on tips and Social Security, etc.

ii. Many speakers pondered this point, often in reasoned detail but the bottom line is that no one can predict what might actually happen.

iii. The question for practitioners is not whether the exemption will be extended but when the exemption might be extended and how to manage clients who likely want to wait until there's more certainty.

iv. There are many clients who won't take action until there is certainty. If the bonus exemption does not decline, some clients may choose to do nothing. That is likely a mistake for many of those clients and if there is no certainty until late in 2025, the crush of work will create the same problems that happened in 2012. In 2012, many estate planners were so inundated with work that they stopped taking clients in the latter portion of the year. Some of those clients retained general practice attorneys and in many instances the level of sophistication of the work done was not optimal for clients. Either way, making rushed decisions is never optimal.

v. Clients should be educated that many estate planning steps, even non-reciprocal SLATs, have important non-estate tax benefits that justify the planning regardless of what happens with the bonus exemption. Other suggested steps are discussed below.

b. **Donor remorse from pre-2026 gifts**.

i. Practitioners who were practicing during the 2012 tax year saw many clients making late in the year gifts to use most or all of their $5 million inflation adjusted exemption as the exemption was scheduled to decline to only $1 million in 2013. The exemption didn't drop in 2013 and some, perhaps many, clients regretted the planning they had done at the end of 2012. That regret was dubbed "buyer's remorse."

ii. Similar to 2012, 2025 may be another year of buyer's remorse by clients who implement plans to secure their exemption, especially if it turns out that the bonus exemption is extended. What can be done to give those clients more palatable options?

iii. In addition, offering a client options, whether used or not, may also potentially help deflect a later challenge by the disgruntled gift giving client claiming that their practitioner encouraged or pushed the plan. However, practitioners may wish to communicate to clients that waiting until there is certainty about whether the bonus exemption may be extended they might miss the boat. If the tax legislation affecting the bonus exemption is not enacted until December, how will planning be done if the extension does not happen? Taking some action now may be more prudent for clients.

c. **Standby Trust Plan**.

i. For those who practiced in 2012, before the scheduled reduction in the estate tax exemption from $5 million inflation adjusted to a mere $1 million inflation adjusted in 2013 (which wasn't allowed to happen), planning as it became later in the year was at first difficult and then impossible. Many practitioners stopped taking on new clients as early as September of 2012. As it grew later in 2012, it become difficult to obtain appraisals. Initially, some appraisal firms agreed to provide a valuation number before the end of the year, but that the report would only be provided later in 2013. Later still it became impossible to even retain an appraiser. Simply put, clients who waited too long had planning done on a rushed basis with less than optimal steps, which was never ideal. Other clients had to retain general practice attorneys to do sophisticated estate planning as there were no estate planners with the bandwidth to undertake more planning. The lessons of all this should be considered in responding to the client who feels that they only want to make a large gift if the bonus exemption is really going to be allowed to

sunset. They should not defer to the last minute. But what planning option might be offered to a client who feels that way? Perhaps the standby trust plan will feel comfortable to them.

ii. Evaluate planning options as soon as possible so there is time to thoughtfully explore options and decisions. Draft the irrevocable trust that would suit the client's needs as if the exemption will in fact be reduced. Consider whether it is advantageous to execute the trust and fund a trust account with a nominal transfer to ensure everything is operational. For example, set up a brokerage account now to be certain all bank or investment firm requirements are met and that the account is fully operative. The trust is thus in "standby" mode. If it appears that the Republicans can't or won't prevent the sunset, the client has a trust ready to fund easily at the last minute.

iii. The client can make plans now, obtain brokerage paperwork and requirements, so that they can then fund the trust in late December 2025 without the need to involve their professional advisers (who may be too busy) as the foundation and protocols are established well in advance. If the Republicans extend the bonus exemption and the client doesn't want to proceed with the plan (a mistake perhaps from an asset protection perspective) the modest initial gift can be paid out to a trust beneficiary and the plan closed down.

iv. If the client is likely to fund the trust with entity interests, counsel could complete transfer/assignment documents now (e.g., membership interest assignments for LLC interests, stock powers and assignments for corporate entity interests, etc.). The documentation can remain unsigned. If the client opts to proceed, they can sign the documentation as late as New Year's eve and have the transfer effective before the January 1, 2026 reduction in the exemption.

v. Remember, however, the lesson from the Smaldino case[vi]; the practitioner should be certain to have "date" lines by each signature regardless of whether an effective date is provided for in the documents. Again, this permits the client to complete planning as close to the deadline as possible because it has been "teed up" in advance. Consider suggesting in such instances that the client has the transfer documentation notarized to give it more credibility if it is questioned by the IRS.

vi. Also, if entity interests might be transferred near the deadline it will be impossible to obtain appraisals to plan the quantum of those interests. Consider using *Wandry*[vii] or *King*[viii] type provisions in the transfer documents for quick transfers as late-date transfers will not be likely to have appraisals completed. In a *Wandry* transfer a specified dollar value of entity interests, not a percentage is transferred. In a *King* approach a sale may be consummated and the face value of the note the trust gives back to the client/seller will adjust if there is a gift tax value as finally determined that is greater than the initial estimated value.

vii. Consider in this type of planning whether a two-tier adjustment mechanism may be useful since an appraisal will be unlikely. Using this type of approach, the first-tier adjustment is made when the independent qualified appraisal is obtained (probably well into 2026), and the second adjustment, if any, would be made after a valuation is established on a gift tax audit as finally determined, i.e., the "traditional" *Wandy* or *Petter*[ix] type adjustment for gift tax value as finally determined.

viii. The standby trust plan could also be prepared more simply and at lower cost than a typical robust trust plan for a wealthy client if that makes the client more comfortable taking this precautionary approach. Consider creating the trust in the client's home state rather than one of the trust-friendly jurisdictions (e.g. one of the states that permit DAPTs). That may lower the cost (no need for local co-counsel, or an institutional trustee in that state). Perhaps, a family member or friend could be named as trustee. Give a trust protector the power to change trustees, situs and governing law. If the bonus exemption is permitted to sunset and the client funds the trust then the trust protector can "pull the trigger" and move the trust to a better jurisdiction, name an institutional trustee, and if advisable the trust can be decanted into a more robust trust.

ix. The point is that a client who is on the fence about whether they want to make a gift to use their exemption can have a simpler less costly trust created as a standby to secure the exemption and then make a bigger commitment if the use their exemption and then know that the plan will in fact be maintained long-term.

x. The most important point of the standby trust plan is to offer an option to clients who would otherwise "wait and see," who will likely find that they will be shut out of planning as advisers will be inundated if this becomes a late 2025 development.

d. **QTIP disclaimer, 2519 Gift**.

i. A disclaimer of some of the income interest in a qualified terminable interest property trust ("QTIP") to trigger a gift under Sec. 2519 of the principal of the QTIP can be used to secure bonus exemption.

ii. In some instances, it may be advantageous to divide an existing QTIP trust to separate the QTIP that will not be subject to a 2519 disclaimer from the QTIP that will be subject to the disclaimer. That may prevent any taint of assets held in what might be a much larger QTIP. The IRS has sanctioned the division of a QTIP trust for these purposes.[x]

iii. The anti-abuse regulations don't appear to prevent this type of planning.

iv. The client must be a beneficiary of a QTIP marital trust and as the beneficiary spouse she must have the ability to assign her QTIP income interest. If the spouse assigns any portion of her income interest in the QTIP that triggers a deemed gift of all principal under the QTIP under Code Sec. 2519.[xi] That will lock in, to the extent of the QTIP assets, her base exemption, and then her bonus exemption. A number of observations:

1. Psychologically, a gift of part or all of the income interests in the QTIP may be easier for a surviving spouse to make than a gift of her own assets as the assets in a trust may be viewed differently.

2. How much of the income interest must be disclaimed? While it arguably may be any portion of that interest might it be safer to disclaim a material portion or all of the income interest?

3. Depending on the terms of the QTIP instrument the surviving spouse may continue to have access to principal if she was also named as a principal beneficiary. So, she may still potentially benefit from the QTIP even after disclaiming the entire income interest in the trust.

4. Code Sec. 2036 should not cause inclusion of the retained interest (e.g., as a principal beneficiary) since the QTIP is a third-party trust created by the now deceased spouse, not by the spouse making a disclaimer and potentially retaining the status as a principal beneficiary.

e. **Create a QTIP'able Trust Now**.

i. Some clients may be uncomfortable making a completed gift to an irrevocable trust before knowing that the bonus exemption will expire. These clients may be able to make a gift to an irrevocable trust and defer the decision as to that trust's tax implications and future until the law is known.

ii. The QTIP'able trust plan is another approach to offer married clients who are not certain whether they want to make a large gift to secure some of the bonus exemption. A large gift, perhaps up to the exemption amount of $13,990,000 in 2025 could be made to an inter-vivos trust that meets the requirements to qualify by election as a QTIP under Section 2523(f). This is an approach that gives the client the benefit of hindsight to determine whether they will in fact commit to a plan.

iii. For a QTIP'able trust created in 2025, the client will have until October 15, 2026, to determine whether to elect QTIP treatment on the gift tax return. This gives an extended period of time, by which it would be anticipated that the status of the bonus exemption would be known. If the client in fact wishes to use their exemption, the gift tax return would not reflect a marital or QTIP election to cover the trust. Specifically, the trust would not be covered by the QTIP election available on form 709. The client must file a gift tax return to make the QTIP election as there are no other means to qualify (merely having a trust that meets the QTIP requirements alone is insufficient). The election is made by listing the QTIP on the gift tax return, and deducting its value. Note that the gift tax return Form 709 has been revised.

iv. Taxpayers may not make the election on a late-filed Form 709. This is important. Practitioners that create these types of trusts should assure that the client and one of their advisers (whoever will assume responsibility to file the Form 709) has calendared the requirement to file and to make, or not make, the necessary election.

v. If QTIP treatment is not elected, then the client's bonus and regular gift (and presumably GST) exemptions would be used as the transfer would not be protected by the marital deduction. This is why the trust is referred to as "QTIP'able" as it meets the requirements for a QTIP marital deduction. But it is not intended at the outset to assuredly be a QTIP as the decision whether to make the election is deferred.

vi. When the status of the bonus exemption is known, the planning can be reviewed and a decision made as to how to handle the QTIP election.

f. **Make a Gift Now to An Irrevocable Trust with a Disclaimer Mechanism**.

i. Another approach for a client who wants to plan, but is reluctant to commit to planning before knowing with certainty that the bonus exemption will not be extended, might be to plan a gift to an irrevocable trust that meets the client's goals, but add a disclaimer mechanism to that trust.

ii. If a qualified disclaimer, as defined in Code. Sec. 2518, can be exercised for the assets given to the trust, might that transfer be unwound by a disclaimer? If so, the client can use their bonus exemption now with the possibility of the plan being unwound at a future date. If the client makes a completed gift to a trust with this mechanism, there may be the ability to use hindsight to unwind the plan. So, for a client who appreciates the importance of planning and using bonus exemption, but who feels hesitancy because of the election outcome (e.g., the possible extension of the bonus exemption or even the repeal of the estate tax) this may provide a viable approach to consider.

iii. In order to proceed with a disclaimer plan, the practitioner should add a disclaimer provision to the trust agreement. This plan is potentially adaptable to many of the plans that would otherwise be pursued and can reasonably be integrated into a trust plan that is in process, but which is being reconsidered in light of the election results.

iv. Evaluate adding a disclaimer provision into the trust document that, if triggered, would unravel gifts to the trust. One suggested approach is to name a person who as the primary beneficiary of the trust would be granted the power to disclaim trust assets on behalf of the entire trust thereby unwinding gifts made to the trust. This is not the typical disclaimer in which a person disclaims so that they are treated as if they predeceased the transfer. Rather, this disclaimant is given the express power to disclaim on behalf of all beneficiaries, i.e., the entire trust. Further, as a result of this disclaimer being exercised the assets would not remain in the trust for the other beneficiaries, rather the assets would be effectively rejected by the trust and return to the settlor/donor as if no transfer had ever been made.

v. As with so many advanced estate planning techniques, there is disagreement amongst some commentators as to whether this technique is effective, and even if effective what approach to use in implementing the mechanism. One of the questions raised is whether you can merely designate a beneficiary to serve as a "primary" beneficiary to be vested with this power to disclaim on behalf of all beneficiaries. It is not clear why, if that is what the trust instrument provides for, such a provision would not be respected. But if that is a concern, the draftsperson could create an initial sub-trust for which that person named as "primary" beneficiary, is the only named beneficiary during the period the asses can be disclaimed, so that the person holding power is the sole beneficiary, not just designated as the "primary," beneficiary. In addition, limited powers of appointment might be incorporated so that at a future time the assets could be shifted through that to a different trust.

vi. Others might prefer to give the power to disclaim to the trustee, but that may raise issues as to how the trustee can disclaim without violating the trustee's fiduciary duty to the beneficiaries. Perhaps expressly providing the power in the trust instrument and stating that the trustee may exercise it without regard to a fiduciary duty to trust beneficiaries might help. Others might prefer to give a power to disclaim to both a primary beneficiary and trustee.

6. **Charity Donor Agreements**.

a. A presentation by Brad Bedingfield and Alan F. Rothschild, Jr. provided a lesson in how important it is for charitable planning to flexibly address the potential for changes. Changes can come in a myriad of ways such as law changes, changes in social or societal norms, etc. For example, a court case involving Students for Fair Admissions, Inc. changed the ability to consider race and gender, among other factors, in application of charitable gifts. This has created considerable issues for donors and charities.[xii]

b. But practitioners may be able to plan charitable gifts to address foreseeable changes and to build in some flexibility to evolve the gift for unforeseeable changes.

c. Anticipate changes of circumstances and include changes in law applicable to your gift. A variance provision could be included in a gift agreement. A broad variance clause might provide the charitable donee with the right to modify the gift agreement for changes in law or circumstances that as closely as then feasible maintain the intent of the initial gift. Perhaps the gift agreement could require that the charity make reasonable efforts to consult with the donor, or a specified person if the donor is not then competent or living.

d. Who are parties to the agreement? Clients often are not clear on the correct legal name of a charity or which specific charity or entity to name to accomplish the goals for the donation. Recommend that clients confirm the exact legal name and which entity to name (many charities have a variety of different entities for different purposes) so that the appropriate one can be correctly named.

e. **Example:** A client wanted to make a gift to the music department at a particular public university. Naming the university directly would not direct the funds to the music department. Instead, there was a particular fund that had to be used to accomplish that goal.

f. What if the charity restructures, merges, or terminates? That may, or may not, result in a change in the charitable objective the client wanted pursued. So, the mere change itself may not be an issue if the purpose can continue.

g. What if the purpose for the gift no longer exists? Example: A donor planned a gift to fund research on Parkinson's disease. What if a cure was found and Parkinson's disease research was no longer in need of funding? Might the funds be shifted to Lewy body (Lewy body dementia), research? Or perhaps for research on brain disease generally?

h. What if the gift paid for a named room in a building, e.g., the waiting room in a hospital? If the building housing that room is demolished because it was too old to modernize, what happens? The charity might be unwilling to carry over the naming to the comparable room in the replacement building as that may impede the ability to raise new funds for that new facility. Perhaps an alternative use or naming can be agreed to.

i. If a program, room or building is named after the donor, the donor may want to specify how and where that naming will appear. Example: Donor donates the funds for a new hospital building and wants the building to bear their name and to have that name used in all letterhead, on the

outside of the building, etc. The charity may insist on a morality clause so that if the donor is convicted of a felony (or other specified infractions) the name can be removed.

j. What if the gift produces more income than needed for the designated purpose? What should be done with the excess? What if the opposite situation arises, in which the gift produces insufficient funds for the stated purpose? Can the charity solicit another donor who can then share the naming rights for the program or facility involved?

k. Can or should the gift be announced publicly? Are there any limitations the donor may wish to have on publicity for personal security or other reasons? The donor's desire for publicity or anonymity should be considered when preparing the agreement.

l. Can management fees be assessed against the gift fund and if so at what rate?

m. Who will have standing to enforce the gift agreement if the charity is not following its terms?

n. What if the donor only partially fulfills their pledge? If 80% of the funds committed were donated, what should happen to the naming rights or other aspects of the gift agreement? What if only 25% of the funds were actually donated? Can the charity re-direct the funds to a gift commensurate with that actual donation?

7. **Checklists and planning 2025 work**.

a. Sarah Moore Johnson recommended using checklists on complex planning. This is an idea that deserves more attention from practitioners. The materials included a sample: "Checklist Of Open Estate Planning Items."

b. Practitioners might find even broader checklists that encompass the entire plan helpful.

c. The trust checklist can be used to identify ways to backstop, refine and administer the client's estate and trust plans, and could be reviewed and updated at each periodic meeting as circumstances require. If the checklist includes a list of documents, those documents can be organized into an electronic "binder."

d. The term binder is in quotation marks as it is not completed at the closing as a traditional real estate or corporate closing binder would, instead it would continue to grow as the client's planning evolves. In addition, for practitioners who are predominantly paperless, in most instances the documents will be organized electronically and no longer as a physical binder (absent a specific client request).

e. Given the complexity of estate planning, where even a "simple" irrevocable life insurance trust can include over a dozen different documents, perhaps dozens, practitioners might find this a useful tool in planning, creating, implementing and maintaining those plans. Cases such as *Smaldino* and *Sorensen* have highlighted the importance of observing formalities and proper administration.[xiii]

f. Practitioners might wish to consider the strategy for maintaining order when addressing 2025 planning suggested by Sarah Moore Johnson. Specifically, a practitioner should tally up how much time they have throughout the year to work on estate plans and divide by the approximate number of hours each plan might take. The result is the number of new engagements the practitioner can

take on. Practitioners should consider whether it is practical and reasonable to assume more engagements beyond that initial determination. For many practitioner's this is not feasible based on the uncertainty of engagements and the impossibility of predicting what efforts will be required for each engagement.

g. It could be risky for practitioners to take on more work than what they can reasonably assume they can handle as 2025 wanes on. But that is often really tough to evaluate.

8. **Community Property**.

a. **Introduction to Community Property**.

i. If married clients wish to make gifts (to use bonus exemption or otherwise) assets may have to be retitled between spouses, e.g., a gift from the wealthy spouse to the poor spouse, or jointly held assets may have to be divided into individual names. This shuffling of asset title can raise a host of issues: if a gift by the donee spouse to a trust is consummated might that be recast by a step-transaction challenge? What ethical obligations do the advisers have, as changing title to assets might change the results of equitable division if there is a future divorce?

ii. Laura A. Zwicker provided helpful insight into the community property rules, especially useful to practitioners in non-community property states who are not fully familiar with the nuances of community property. Some knowledge of community property rules is important as married clients move states and clients living in non-community property states may well have community property assets. Also, the possible use of community property trusts by married couples living in non-community property states is a planning option that may be useful in appropriate circumstances.

iii. Each spouse owes the other the highest fiduciary responsibility as to community property.

iv. The community asset is an indivisible asset during marriage and only becomes 50/50 on divorce. So, it is similar to the tenants by the entirety ownership structure, which is also not divisible. Neither spouse can gift their ½ of a community property asset to a third party.

b. **Transmutation of Community Property**.

i. So how do you change a community property asset so one or both spouses can gift it? The first step may be for them to formally change the nature of the community property by transmuting the community property into separate property. The transmutation must be documented in writing and must contain an express declaration of the transmutation of property. If the community asset is real property, it must be recorded like a deed.

ii. Practitioners should consider advising clients, preferably in writing, to obtain separate counsel before a transmutation is concluded as it could have material adverse impact on their interests in the event of a later divorce. That same letter might caution that there is a risk of losing a double step up in basis on the first spouse's death if community property is divided to use in SLAT or other planning?

iii. If clients transmute property, is there a potential step transaction issue if each spouse immediately gifts the post-transmuted property to a SLAT? Out of caution, should time and independent economic events occur between transmutation and a gift?

iv. Can you transmute an asset from community property to just the property of a single spouse? But if you do that, wouldn't that seem to change the answer as to time and events of independent economic significance between the transmutation and the gift?

c. **Community property trust**.

i. AK, SD, TN, KY and FL permit the creation of opt in community property trusts.

ii. This can permit clients to obtain a full or double basis step up on both "halves" of the asset owned by each spouse contributed to such a trust. This concept is similar to the use of DAPTs by a resident of a non-DAPT state. If you have property in a community property trust in a state with such legislation the argument is that it should be characterized as community property. There is, as of yet, no authority that these trusts will succeed in terms of securing the double basis step up.

9. **Deceased Spouse Unused Exemption ("DSUE")**.

a. The Deceased Spouse Unused Exemption (DSUE) is an important component of planning for married couples, having been introduced in 2010 and made permanent in 2012. In 2017 the *Vose* case[xiv] addressed the impact of a prenuptial agreement and issues presented by an executor not willing to cooperate with the DSUE election. That was eight years ago and the panel discussion on "Planning Tips (and Traps) for Married Couples" provided a valuable reminder of the case and some of the planning considerations.

b. A lesson of Vose is that prenuptial and post-nuptial agreements should specifically address whether the surviving spouse should be permitted to benefit from the DSUE. A generic broad waiver under a prenuptial agreement did not waive the right to the DSUE.

10. **Deference**.

a. The *Loper Bright* case[xv], decided by SCOTUS at the beginning of July 2023 overruled its 1984 decision in *Chevron*.[xvi]

b. Loper represents a generational change in the importance of all Federal regulations from those issued under antitrust legislation to those under the Internal Revenue Code. The importance of this decision cannot be overemphasized.

c. The decision reclaims for the courts the authority to determine what statutes mean, rather than have to give deference to what a Federal agency (such as the IRS) claims what they mean by the issuance of regulations. This enhances the power of taxpayers to challenge the IRS on many fronts. If, prior to *Loper Bright* (i.e., under *Chevron*) the court determined the Code was ambiguous, it was required to accept as "force of law" any reasonable resolution in a Treasury regulation. The agency's interpretation did not even need to be what the court considered the best

interpretation of the statue – but was instead required to uphold any reasonable one. The court was required to defer to the Regulations less than "best" interpretation.

d. Section 7805 confers authority to issue regulations that interpret the Internal Revenue Code.

e. What about a Code section that confers discretion? See, e.g., Code Sec 469(l) which provides: "*The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out provisions of this section, including regulations*..." For such a Regulation the courts may still have to give deference. However, how can practitioners identify all such Regulations? And what language precisely might be necessary in that provision to give the Treasury Regulation deference?

f. Practitioners need to be aware of what they need to do in light of *Loper Bright*. It may be advisable to file claims for refund on prior returns. Which Regulations might be affected? What are the issues practitioners will face with this new development?

g. Might Treasury's Approach to Regs Change? Another impact of the *Loper Bright* case might be that the IRS's approach to drafting and issuing tax Regulations may change. Since the agency cannot assume courts will give its Regulations deference, there may be a greater pressure or incentive for the IRS to solicit comments from taxpayers on proposed Regulations and give more consideration to reasonable comments from taxpayers. So, might the impact over time be more reasonable or even taxpayer-friendly interpretations of tax laws? The IRS might actively seek that so that if a Regulation interpreting the tax laws is challenged by a taxpayer in court, the IRS can demonstrate how their interpretation of that law was reasonable.

h. Consider:

i. To what extent should practitioners (including tax preparers) consider filing claims for a refund where a regulation has a particular adverse consequence for the client?

ii. Should practitioners regularly advise clients that an adverse regulation, not previously upheld, should be reconsidered?

iii. What if only one (lower) court has upheld the regulation?

iv. Could a practitioner be held liable for not advising a client to file a protective claim for refund?

11. **Defined Value Mechanisms (Valuation Adjustment Mechanism)**.

a. A key point to address in endeavoring to enhance the likelihood of a defined value mechanism used to protect a transfer from an unintended gift tax is not merely the selection and design of the mechanism, but the proper implementation of the mechanism. If the client does not respect and follow the formalities and requirement of the mechanism, the IRS and courts are not going to respect it either. An example of this was in the Sorensen case.[xvii]

b. Respecting the formalities of a defined value mechanism might include having an agreement between the parties involved in the transfer as to an economic adjustment mechanism if the percentage equity interest is adjusted by a gift tax audit as finally determined.

c. All governing documents, tax returns, trustee records, etc. should all consistently reflect that a dollar value of equity interests, not a fixed percentage of equity interests was transferred. With a closely held corporation the stock certificates should indicate that they are for a dollar value of interests subject to the agreement that incorporates the defined value mechanism, the stock ledger and shareholders agreement should all reflect that as well.

d. If a transfer was made to a trust the trustee's records should similarly reflect the dollar value interest. Tax returns should be consistent. In many, if not most, cases adhering to the formalities can be a daunting task as the concepts of a dollar value of interests is quite perplexing to non-estate planners and varies significantly from the typical manner in which equity ownership is handled. But it can be done.

e. However, in some instances compliance with the defined value mechanism terms may be made even more difficult or impossible. For example, the entity itself may have owners that are not willing to leave open ended unspecified interests as between two equity owners. If such a situation arises how can the defined value mechanism be respected? Perhaps using a very clever ideas suggested by the panel below.

f. During the fundamentals course on "Prudent Planning Pointers for 2025…," after pointing out that the IRS can only object to the value but not necessarily the percentage interests that were conveyed, Austin Bramwell suggested a clever idea that could be very helpful to supporting a defined value mechanism. That is, in the right circumstances, practitioners might be able to use a tenancy in common arrangement as a twist on formula adjustments. In such an arrangement, the donor makes a gift to two or more persons, as tenants in common. One of the tenants would be a completed gift trust which receives a gift of interests worth a specific dollar amount worth of interests (the "Gift Tenant"). The transfer to the Gift Tenant would be structured to use the transferor's lifetime exemption. The co-tenant would be a person to whom the transfer would not be a taxable gift, such as a spouse, a marital trust eligible for the unlimited marital deduction, a QTIP trust, charitable beneficiary, or incomplete gift trust. When values are finally determined for federal gift tax purposes, the tenancy in common agreement would dictate how the interests were allocated between the co-tenants. By using a tenancy-in-common (TIC) agreement, closely held family businesses might be able to reflect the arrangement more easily within the entity records. That is, instead of including language about the adjustment mechanism within the entity records, the entity can merely reference the TIC as the owner of a specific number of shares. in that way, the co-tenants own the referenced equity but sort out which of them owns what in accordance with the TIC agreement between them. This approach removes the third-party business entity from having to book two owners each with an open-ended (at least until the statute of limitations or audit ends) ownership interest.

g. Clients frequently transfer difficult to value assets. Clients want to use all of their exemption, but they do not want to trigger gift tax. Possible solutions to this common estate planning dilemma might include:

i. Use of a defined value mechanism like a *Wandry* clause, *Petter* structure, *King* arrangement, etc.

ii. Another option may be to design a SLAT as QTIP-able trust, and then make a formula QTIP election as the smallest amount of marital deduction that is necessary so that the gift does not exceed the remaining exemption.

iii. Create a discretionary SLAT with a backup QTIP provision. The donee spouse may then make a disclaimer, and any disclaimed property falls into the QTIP trust. The disclaimer instrument would disclaim the smallest amount necessary so that the gift to the SLAT will not create a gift tax.

h. *Wandry* was a full Tax Court case, but *King* was merely a 10th circuit case. However, many feel *King* type clauses are used commonly in non-tax transactions and should be respected because of that. Others disagree and prefer the comfort of a full Tax Court case.

12. **Discounts on FLPs**.

a. Wrapping assets in a family limited partnership (FLP) or limited liability company (LLC) to endeavor to obtain valuation discounts is a common strategy. But when such an arrangement is consummated close to the client's death, implemented by an attorney in fact or other fiduciary (particularly one who benefits from the transaction), lacks business purpose, etc., the IRS and the courts are not likely to view the discounts claimed as favorable. The Estate of *Fields*[xviii] seems to be yet another one of such cases.

b. The IRS views that some discounts are abusive if assets are put into a FLP just to get discounts. While the IRS may not succeed in its challenge just on that basis, the Service has been successful in asserting Code Sec. 2036 arguments. 35 cases have applied this 2036 analysis. The previous case was the *Moore* case[xix] almost five years ago. Now, *Fields* follows.

c. In *Fields*, the decedent was fond of a great nephew and granted him a very broad power of attorney. As the decedent's health declined precipitously, her great nephew formed a family limited partnership into which he contributed $1,000 in exchange for a general partnership interest (the "GP interest"). The great nephew, acting as attorney-in-fact on behalf of the decedent, then transferred $17 million worth of her assets into a family limited partnership, granting to her a 99.9941% limited partnership interest (the "LP interest"). Because the great nephew owned the GP interest which controlled the entity and restricted the rights of the LP interest to vote or liquidate, the great nephew sought a significant valuation discount for the LP interest retained by the decedent. The great nephew, who served as the executor of the decedent's estate, was able to obtain a valuation of the LP interest retained by the decedent which included a 25% valuation discount, reducing the value of her LP interest from $17 million to about $10.6 million.

d. The Court noted that the transfers by the decedent were completed ten days prior to her death, and also pointed out that the great nephew was the primary beneficiary of the transfers and resulting valuation discount. The Court appeared particularly skeptical of the transaction since the great nephew was on all sides of it: as the decedent's attorney-in-fact, the executor of her estate, the owner of the GP interest, and the primary beneficiary of her estate. As a result, the *Fields* Court determined that the FLP should be wholly disregarded and disallowed the valuation discounts.

e. The *Fields* Court found express retention of income under Code Sec. 2036(a)(1) since the decedent's agent was also the owner of the GP interest, with the power to declare distributions

from the FLP. The *Fields* Court also found implied retention of income because the decedent did not retain sufficient assets to pay her anticipated estate tax and the cash bequests under her will, even though the decedent had retained sufficient assets to pay her lifetime living expenses. Specifically, the decedent was left with only $2.15 million of assets outside the FLP, yet her will provided for bequests totaling $1.45 million and that left little to pay what was an obvious estate tax liability.

f. Under Code Sec. 2036(a)(2) the *Fields* Court considered the reasoning in the *Powell* case[xx] and found that the decedent in *Fields*, "*in conjunction with others*" controlled the partnership. The bona fide sale exception to Code Sec. 2036(a)(2) was held not to apply. The Court analyzed different factors as to why the bona fide sale exception was inapplicable. The estate claimed that succession of management, reducing the risk of elder abuse, etc. were all non-tax factors justifying the transfer of assets to the partnership, but the Court was not swayed. The Court also indicated that contemporaneous evidence was important, but the only contemporaneous evidence was an email discussing discounts.

13. **Dispositive Plan: Protecting Testator's/Trustor's Intent**.

a. Many clients are concerned about securing their dispositive intent, whether that be to favor a particular heir, avoid bequests to a specified person, or other wishes. David A. Baker presented a thought-provoking discussion on this topic. One of the categories of comments he addressed was using an in terrorem clause. See a discussion below on "In Terrorem Clauses."

b. Another concept he presented provides a consideration that is the opposite of what much of the profession has focused on for many years. Modern trust drafting has and continues to develop techniques to integrate flexibility into planning. This approach has arisen in part out of the trend for long term or perpetual trusts, and in consideration of the constantly changing tax environment. Flexibility can provide the means to address changes in circumstances and goals over a long period of time. Flexibility may provide the ability to react to tax changes.

c. However, as Baker points out, flexibility for some clients may have a negative impact. For some clients each potential point of flexibility may also provide the potential to undermine their intended dispositive plan. Thus, for some clients, practitioners may want to intentionally preclude the use of some of the more common and popular drafting techniques. Baker's insight warrants integrating into client planning discussions. Some of these points are noted below:

i. Many trusts and wills include a mechanism for a change in the situs and choice of law. But depending on where a trust might be moved the new state's laws may be less conducive to accomplishing the testator's goals. Perhaps changing situs and governing law should not always be incorporated.

ii. Decanting is allowed by statute in 23 states and some other states believe it's part of their common law. It is common to include a decanting power in trust instruments. But is this the correct approach? What changes may be effected in the new trust instrument? Consider that those changes, even perhaps administrative ones, may undermine the testator/settlor's intent. Decanting presents possibility of changing the plan in a way that the testator would not approve of if alive. Consider in appropriate circumstances prohibiting decanting

in the governing instrument and expressly opting out of state law decanting by specifically referencing the statutory or case law authority for it. A less Draconian approach might be to only permit decanting to address tax law changes. But that could be nettlesome. What type of tax law change might suffice to permit decanting? What types of changes to address tax changes should be permitted under this limited decanting provision?

iii. Should you similarly address and perhaps limit powers of appointment too?

iv. What about a unitrust election/conversion or a power to adjust? A unitrust election may permit the trustee, or in some instances a beneficiary, to convert the beneficiary's income interest (state law accounting income, FAI) to a percentage of total trust asset values to be distributed each year (e.g., 3-6%). But what happens if with such a conversion the trust starts to pay out principal that the testator may not have contemplated or wanted?

v. Modern trusts might have an array of fiduciary and non-fiduciary positions apart from just the trustee. There may be people given powers to remove the trustee or other powerholders, appointers given the power to add beneficiaries or appoint trust assets to specified persons (e.g., a special power of appointment trust, or "SPAT"), etc. In light of Baker's insight, practitioners might consider how these persons may impact the trust. In some instances, as with the decanting power discussed above, the client might wish to opt out some of these positions, or narrowly craft them, and perhaps even to expressly state that certain powers or positions should not be included or added to the instrument.

14. **Divorce**.

a. Many, perhaps most, clients are concerned about protecting their heirs and beneficiaries of trusts they create from such beneficiary's ex-spouse in a divorce. Following is a list of some of the many steps that might be considered:

i. Include an ascertainable standard, i.e., health, education, maintenance and support ("HEMS") standard in the trust if the beneficiary is, or may become, a trustee. While that may provide a measure of protection against general creditors and estate inclusion, could a HEMS standard enable the ex-spouse of a beneficiary to reach trust assets? Might child support or alimony be argued to be part of the beneficiary's/trustee's maintenance and support? It would likely be safer for the trust not to name the beneficiary as a trustee at all.

ii. Include a trust protector provision, so that if a beneficiary's divorce occurs in the future, the trust protector can remove the beneficiary as trustee (and change situs and governing law) so that the beneficiary is passive in regard to those steps. That might deflect a challenge by the beneficiary's divorcing spouse that those steps were pre-divorce planning by the beneficiary.

iii. The trust should have no required income or other distributions mandated.

iv. All distributions should be solely discretionary by an independent trustee.

v. Name an institutional trustee.

vi. Have the trust, from inception if feasible, have governing law and situs in a trust friendly jurisdiction that has laws that are protective of claims by a beneficiary's divorcing spouse.

vii. Having a trust governed by the laws of a different jurisdiction then the beneficiary's state of residence may also make attacking the trust in a divorce more costly and time consuming. That may dissuade the attack.

viii. Disclose the trust in any prenuptial or post-nuptial agreement and have the beneficiary's spouse acknowledge that the property in the trust is immune separate property.

ix. Be certain a seed gift, at minimum, is made to the trust by the donor and not by a beneficiary. For example, elsewhere in these materials the concept of selling an asset to an empty trust for a note was discussed. That approach, assuming a guarantee or other steps are taken to make the transaction supportable, is dangerous from a matrimonial perspective as well. If a parent/settlor gave even $100 to the trust the argument is that the only capital put into the trust was separate gift property and not the property of the beneficiary who may divorce.

x. If a beneficiary themselves is creating a trust, consider a beneficiary defective inheritance trust ("BDIT") that is seeded by a parent or other benefactor so that the trust is arguably characterized as a separate property asset.

15. **Doctrines, Tax Generally**.

a. Many comments were made about two of the tax doctrines that could undermine planning: the step transaction doctrine referencing the *Smaldino* case, and the reciprocal trust doctrine referencing the *Grace* case.[xxi] But consider that both *Grace* and *Smaldino* are bad fact cases and that the conclusions many practitioners draw from either case as to the reciprocal trust doctrine and step transaction doctrine may not be as severe as thought. There may be a different perspective.

b. In *Grace*:

i. "*The relevant factor was whether the trusts created by the settlors placed each other in approximately the same objective economic position as they would have been in if each had created his own trust with himself, rather than the other…*" The differences that can be integrated into each SLAT, e.g., one with broader access and one with lesser access (status as beneficiary, distribution standards, 5/5 power in one trust, powers of appointment, etc.) would seem to suffice under the *Grace* standard. Making one trust a domestic asset protection trust ("DAPT"), hybrid DAPT or SPAT, and the other a more traditional SLAT, would seem better still. Using different institutional trustees in different states might further address *Grace* issues.

ii. The husband gave wife all assets she contributed to the trust, albeit over a long period of time, but after the transfer the husband continued to control all assets.

iii. For example, the wife had no interest or involvement in the trust or its assets and merely signed whatever documents the husband gave her. "*She took no interest and no part in business affairs and relied upon her husband's judgment. Whenever some formal action was required regarding property in her name, decedent would have the appropriate instrument prepared and she would execute it*." So, his continued control was clear to the *Grace* Court.

iv. The key point in the *Grace* Court's concluding the trusts were reciprocal was the parties being in a different economic positions after the creation of the trusts, which the *Grace* Court did not feel was the cast in the facts before it. In *Grace*, the taxpayers remained one of the trustees, which seems to be another bad fact.

v. "*The trust instruments were prepared by one of decedent's employees in accordance with a plan devised by decedent to create additional trusts before the advent of a new gift tax expected to be enacted the next year.*" The taxpayers were not represented by counsel who would have had ethical obligations to each spouse.

vi. "*Grace, acting in accordance with this plan, executed her trust instrument at decedent's request*."

c. *Smaldino*:

i. The *Smaldino* case was mentioned by several speakers in the context of the step transaction doctrine. One speaker even referred to *Smaldino* as "scary." But *Smaldino*, like *Grace*, perhaps even more so, is a bad fact case. In *Smaldino*, the taxpayers did almost everything wrong:

1. Husband gave assets to wife, and she held them only for one day. That time frame was too short.

2. Wife did nothing to show control over the asset.

3. Legal documentation was wrong, no amended and restated operating agreement was prepared reflecting wife as a member.

4. The prerequisites in the operating agreement to transfer interests were not complied with.

5. No K-1 issued to wife for the day she owned it.

6. The transfer documents contained no dates of signature just effective dates.

7. Wife gave the identical interest she received to the trust (circular transaction).

8. Wife testified that she knew the asset wasn't hers.

ii. Yes, *Smaldino* should be viewed as a caution about the step-transaction doctrine. The case provides a checklist of steps not to do, and by implication, of steps to affirmatively take to deflect a step-transaction challenge.

d. A common cord between *Grace* and *Smaldino* is bad planning and worse implementation. Perhaps to avoid the negative impact of the application of any of the various tax doctrines is

planning, structuring and administering plans that make sense, that pass the common-sense tests of reasonableness and legitimacy, etc.

16. **Email, Other Communications and Internet Searches**.

a. Some of the most important gems are sometimes the simplest and said in passing. The Fundamentals panel "Practical, Prudent Planning Pointers for 2025 and Beyond" discussed dangers of emails and other communications that can undermine planning. We cannot control it. Clients, their family friends and other advisers too often engage in emails that unintentionally undermine planning.

b. It might be worthwhile to discuss with all clients that they should assume that every email or other communication could be discoverable and that if they are not certain whether something is appropriate to email or not it is preferable they call and ask before memorializing statements that could be problematic.

17. **Ethics**.

a. There are tough issues which are tricky to identify in real time. They can include conflicts of interest, diminished capacity, etc.

b. Lauren Wolven argued in her presentation that **all** advisers – regardless of discipline - should heed the ethics rules by which attorneys are required to be bound, since a client, beneficiary, or heir might ostensibly name every adviser related to the matter as a defendant in the suit.

c. To elaborate on her point, advisers should recognize that it often happens that someone on the advisory team tells the client what the client wishes to hear, or makes suggestions that would otherwise be inadvisable (e.g., like telling the attorney what to draft in a document). Perhaps advisers in these situations feel as though they are not in harm's way because they are not the professional who is directly responsible for the subject of their comments (i.e. they don't draft documents, prepare the tax returns, or design the insurance or investment plan). This could wind up a dangerous gambit for that person, the entire team, and especially the client. When a plan blows up, everyone who had even limited involvement can be hurt.

d. One court gave a stern warning to all attorneys, summarizing prior case law as follows: "*A conflict of interest, moreover, need not be obvious or actual to create an ethical impropriety. The mere possibility of such a conflict at the outset of the relationship is sufficient to establish an ethical breach on the part of the attorney.*"[xxii]

e. Model Rule 1.7 regarding Conflict of Interest: "*Current Clients: (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: The representation of one client will be directly adverse to another client; or There is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person, or by a personal interest of the lawyer*."

i. Applying the above rule can be challenging in situations estate planners commonly encounter. If counsel is representing an entity, even if 100% owned, that entity

is a separate entity from the owner. Single member disregarded LLCs are commonly used in planning or otherwise encountered in practice. Caution should be exercised.

ii. When representing an estate there are potentially many parties involved, some of whom may be involved in different roles. Consider sending a letter to all of the beneficiaries saying that you represent the personal administrator and not the beneficiaries, if that is in fact the case.

iii. If you represent an entity, do you write all directors and officers and tell them who you represent? Should you inform them that you will not share information unless expressly authorized to do so?

f. Duties to a former client.

i. Model Rule 1.9 regarding Duties to Former Clients: "*(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing....*"

ii. The status or determination as to whether a client is a current or former client can be tricky and may depend on what communications were sent to the client and what administrative steps the attorney has taken.

iii. It can also be challenging to differentiate a client that is inactive from one that is a former client. If work on a matter is concluded that should be confirmed in writing and if the attorney has other matters ongoing for that client or opens a new matter in the future, create a new billing matter to support the fact that the prior matter was concluded.

iv. If the client is terminated a formal termination communication should be sent that makes clear that status. Consider including in the communication:

1. Clearly state that the attorney-client relationship is being terminated.

2. The letter may, if appropriate, provide a reason for the termination.

3. It could summarize work completed and outstanding work so the client being terminated is informed of the status of their matter.

4. It should address the status of the client file and perhaps return the contents of the client file if the client does not already have them.

5. Send a final invoice that is the final billing and which confirms that the file is closed.

v. The status of the client must be ascertained to confirm the ethical obligations the attorney has to that client.

1. An attorney cannot represent one client directly adverse to another, or a client where there is significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person, or by the lawyer's personal interest.

a. The inclusion of not only a former client, but a third person or the attorney's own interests makes this rule quite broad.

2. An attorney cannot represent a client with interests materially adverse to the interests of a former client relative to a substantially related matter.

a. How is "substantially related" defined? Model Rule 1.9 Comments: [3] "*Matters are "substantially related" for purposes of this Rule if they involve the same transaction or legal dispute or if there otherwise is a substantial risk that confidential factual information as would normally have been obtained in the prior representation would materially advance the client's position in the subsequent matter. For example, a lawyer who has represented a businessperson and learned extensive private financial information about that person may not then represent that person's spouse in seeking a divorce…*"

g. Professionals most commonly have to navigate situations where their married clients wind up divorcing. In these situations, the safest course of action would be to obtain the ex-spouse's permission to work with the other ex-spouse.

h. Can an attorney draft an instrument appointing the attorney in a fiduciary position? The ABA ethics rules do not prohibit an attorney from being named to a fiduciary position, but such appointments are subject to the general conflict of interest rules if there is a significant risk that the lawyer's interest in obtaining the appointment will limit the lawyer's professional judgment in advising the client on choosing a fiduciary.[xxiii]

18. **Fiduciary Liability**.

a. In the *Miller* case[xxiv] one of the decedent's children was named fiduciary and treated the trust with informality benefiting himself, and he gave little or no information to his other siblings. They sued and the fiduciary/sibling argued protection under the trust indemnification provisions. Indemnification provisions cannot protect a fiduciary from violating the basic and fundamental obligations the fiduciary has.

b. When a client makes a suggestion of fiduciaries that seems potentially nettlesome, perhaps the advisers can guide the client to make a safer choice less fraught with potential problems.

c. Regular and complete communication with beneficiaries is often an approach to defuse potential mistrust and suspicion. Advisers can guide and assist fiduciaries in making those disclosures.

19. **Foreign trusts, proposed regulations**.

a. If a foreign person has the ability to make substantial decisions related to the trust, including the right to remove or replace the trustee, then the trust will be characterized as a foreign trust.

b. Where a U.S. person receives a gift from foreign person of $100,000 or more, the U.S. person will have disclosure obligations. This $100,000 threshold was a fixed amount, but the proposed regulations would extend cost-of-living adjustments to the threshold of $100,000.

c. Under the current rules, a U.S. person is not required to disclose the identity of the foreign person who made the gift of more than $100,000. Under the proposed regulations, the name of the foreign donor will be required to be reported on the Form 3520.

d. The proposed regulations clarify that where a beneficiary of a foreign trust resides in property owned by that foreign trust without paying rent, the fair market value of rent will be treated as a distribution. This distribution from the foreign trust must be disclosed on a Form 3520 and could result in income to the beneficiary flowing from the foreign trust.

e. An accumulation distribution from a foreign trust will be subject to a throwback tax, which is essentially an additional tax in the form of interest and penalties from the date when the income deemed to have been distributed was earned by the trust. The interest is charged pursuant to IRC Sect. 6621, often considered to be a punitive rate. As a result, most practitioners try to avoid the throwback tax whenever possible. If the proposed regulations are adopted, practitioners should consider the effect of the throwback tax and whether there are alternatives available. Perhaps it would be preferable for a beneficiary to pay fair market value rent for the use of a property owned by the foreign trust rather than pay a throwback tax on formerly undistributed net income. Can a trust be bifurcated so that the property is owned by a sub-trust that has substantial income producing property?

f. During the final presentation of the conference, Amy Kanyuk and Stephanie Loomis-Price pointed out that the proposed regulation that would treat a beneficiary of a foreign trust as having received a distribution does not apply to domestic trusts that allow beneficiaries to reside rent-free in trust properties. The income tax implications for the beneficiary and the domestic trust in such a circumstance is still unclear.

20. **Foreign businesses**.

a. The classification of an entity as a Controlled Foreign Corporation (a "CFC") or a Passive Foreign Investment Corporation ("PFIC") will subject the entity to complex tax rules. A corporation that only has one owner may be able to avoid classification as a CFC or PFIC, if the entity checks the box to be treated for U.S. tax purposes as a disregarded entity. Similarly, a corporation owned by two or more individuals may be able to elect to be treated as a partnership for U.S. tax law, in order to avoid the anti-deferral rules. Certain entities cannot avoid CFC or PFIC treatment, if they are considered a "per se" corporation.[xxv]

b. In general, the CFC and PFIC rules are draconian and not very straightforward. It is important to run through the rules to confirm what kind of entity is involved before proceeding. Practitioners should note that complex attribution rules apply and could result in constructive ownership that would render a different tax result than might have been expected.

21. **Guarantee Fees: Are They Required**?

a. Intra-family loans are one of the most common audit targets. Clients too often ignore the formalities of loans which may make the transactions vulnerable. That is often compounded by clients failing to pay interest and principal as required under the terms of the loan agreement. In addition to loan documentation and administration, the reasonableness of each loan should be reviewed. Who is the borrower? Who is the lender? Does the borrower have adequate resources?

Would a guarantee bolster the financial position of the borrower to make the transaction more defensible? Should a fee be paid for the guarantee if one is used? If so, what is the appropriate way to determine a fee?

b. It may be helpful to have all family loans recorded on a single table to have a broad overview of all the various trusts, entities and parties involved. Even if specific loans have been handled property the overview might help identify other issues or opportunities to simplify and consolidate loan transactions.

c. Do you have to pay fees for guarantees?[xxvi]

d. The guarantor should negotiate a guarantee fee from the debtor.

i. If the guarantor is an heir (e.g., child) of the seller, a motivation to use a guarantee fee is to avoid the possibility that a gift potentially will be triggered by a gratuitous guarantee, even though there appears to be authority that the gift would occur only if and when the guarantee is called on. The Service has ruled that the provision of a guarantee is a gift, measured by the donee's reduction in borrowing costs. The Service further stated in Ltr. Rul. 9113009 that any payment of the guarantee would be an additional gift. This ruling, however, was withdrawn in Ltr. Rul. 9409018 on other grounds concerning the marital deduction.

ii. If the guarantor is another family trust or family entity, payment of a fee for the guarantee may be necessary to demonstrate that the fiduciaries of the trust providing the guarantee are meeting their fiduciary obligations. If the guarantor is a family entity, payment of a fee may be essential to maintaining the independence of the entity involved. This could be critical from an asset protection perspective.

e. The fee, according to some practitioners, should be determined by an independent appraiser. Some practitioners compare to the fees charged for a "letter of credit" as a benchmark. Others reject the letter of credit paradigm based on the circumstances that often accompany their issue (e.g., an ongoing commercial banking relationship, security, etc.).

f. According to some practitioners, the person providing the guarantee should also have separate counsel to assure that he or she has been fully appraised of the risks involved, that the guarantee is real, and will be called on to be paid if the borrower defaults on the note. For example, an adult child who is making a guarantee may believe that the family estate planning attorney is also representing him or her. If separate counsel is not used, at a minimum, a conflict letter should be considered.

22. **Income Tax Residency of Trusts**.

a. A trust will be considered to be a domestic trust so long as it satisfies both the “court,” and the “control” tests set forth in Treas. Reg. Sect. 7701(a)(30)(E):

i. The trust will satisfy the court test if any court within the United States can exercise jurisdiction over the administration of the trust.

ii. The trust will satisfy the control test so long as one or more U.S. persons have authority to control all of the substantial decisions related to the administration of the

trust. Generally, a trust will satisfy the control test so long as all of the fiduciaries of the trust are U.S. persons.

iii. If a trust fails the court or the control test, it will be a foreign trust.

b. The rules set forth in IRC Sects. 673-679 will govern whether any foreign trust will be taxed as a grantor or non-grantor trust.

c. Termination of the grantor trust status of a foreign grantor trust will trigger gain. That is to say, the conversion of a grantor trust into a non-grantor trust will be treated as a taxable sale for income tax purposes.

i. Upon the conversion of the foreign grantor trust to a non-grantor trust, the assets in the trust will get a step up in basis under Sect. 1014.

23. **Litigation, Protecting Client's Dispositive Plan**.

a. **In-Terrorem Clause**.

i. One of the many steps that might be considered to protect the testator's dispositive plan is to integrate an in terrorem clause into a will, trust or perhaps other instrument. An in terrorem, or no-contest, clause, is a provision designed to discourage someone from contesting the will or trust by imposing a penalty for doing so, such as disinheritance.

ii. David A. Baker suggested using a tough in terrorem clause. He suggested covering specific tort and defense fees.

iii. However, consider potential unintended effects of how an In Terrorem Clause is drafted. In the *Shelton* case,[xxvii] after 10 years of the trust being in place, the court found that a dispute between a beneficiary and the investment trustee rose to the level of the beneficiary challenging the validity of the trust and held that the beneficiary was disinherited. Was this the Grantor's intent?

b. **Mandatory arbitration clause**.

i. Arbitration = ADR, which is private and the parties by contract agree to decide who wins or loses in a non-judicial arrangement. Usually done by contract. However, a will is not a contract.

ii. Six states have reviewed the legality of incorporating an ADR clause in a will and 5 said it was valid to include. California stated if you accepted any benefits under the will, you are bound by the arbitration clause.

iii. What if the parties who may be affected (e.g., spouse, heirs, testator) all signed a separate agreement acknowledging their agreement to a mandatory arbitration provision contained in a will? Would that bolster the clause?

c. **Videotaping conference**.

i. Speakers stated that videotaping a signing is a good idea, if you do it right. However, if you do it wrong it's a disaster.

ii. If the potential plaintiffs see a good video it should disincentivize the contest. If they file a contest, the video could potentially make the case.

iii. What do you do to do it right?

1. Employ a court reporter that does video-taped presentations to organize and conduct the signing.

2. Thoroughly rehearse it.

3. No one enters or leaves during the filming.

4. Only use the basics you need to sign the documents.

5. Do not have the testator go through a detailed discussion of why they cut someone out. You don't need a reason to disinherit in any state except LA.

6. Keep to the minimum necessary to prove a valid will.

iv. Watch the chain of evidence for the video tape after the recording. There are 2 states that have admitted a video tape as evidence and 5 or 6 have admitted the tape as hearsay. Hearsay = any statement out of court not made by the witness which is the testator.

v. Put the tape in a marked bag with a witness watching you do so and store it securely until the testator dies.

vi. Another view of the videotaping, with deference to Baker.

1. If the process is rehearsed as recommended, won't that fact become known if there is a trial? Does that negate any of the benefit of the videotape?

2. Unless videotaping is used somewhat regularly the question may be posed as to why a video tape was made of that particular will signing. If the answer will be that it was done because of questions over the client's capacity, might that not be problematic?

3. Clients may well freeze or act nervous and unnatural knowing that they are being recorded. Might that undermine the benefits of the recording?

4. Finally, the "tape" would likely be an electronic file. How is the chain of evidence preserved for that? Is there a suggestion that in a paperless office videotapes should be copied on to a particular medium?

24. **Loan - is it bona fide**?

a. A common estate planning transaction is the intra-family loan (whether from a parent to a child, a trust to a beneficiary, family entity to a family trust or family member, etc.).

b. In the *Estate of Bolles* case, [xxviii] the question was whether the payments were loans or gifts? The taxpayer made loans to all of her children but made larger loans to one child. The mother's practice each year was to forgive each child's outstanding debt due to her in the amount of the federal gift tax annual exclusion. IRS said the amounts transferred were gifts. The estate claimed that they were loans. The *Bolles* Court's conclusion was somewhat in the middle of these two

positions, as the Court found that initially the transfers were loans, but at some point the transfers became or were converted to gifts when it became apparent that the son/purported borrower could not repay the loans because of his lack of assets. When the mother and son agreed that the "loans" would reduce his inheritance they were converted to gifts. That occurred in 1989 when the mother revised her revocable trust and had her son/borrower Peter sign an acknowledgement that the funds would be treated as an advancement of his inheritance.

c. In *Bolles* there were no loan agreements or efforts to collect payments. Despite that, the Court still concluded that the mother expected Peter to repay the loans. While those two bad facts did not lose the case for the taxpayer, those are not factors that should be accepted in planning any intended loan transaction.

d. Characteristics of a loan include:

i. The borrower must have an intent to repay the funds as a loan.

ii. The parties must record/characterize the transaction as a loan.

iii. There must be a bona fide creditor-debtor relationship.

iv. There should be a written signed loan document.

v. There should be a reasonable expectation that loan will be repaid. That might require financial information from the borrower, and if that is insufficient to support the loan, perhaps a guarantee from another family member or trust might be warranted.

vi. The loan document should include a fixed repayment date.

vii. Payments in accordance with the terms of the loan agreement should be made.

viii. Secure the loan if possible.

e. Other considerations.

i. If the borrower overpays interest above a market rate of interest that may be construed as an indirect gift.

ii. If the grantor of a trust borrows from the trust, and the loan agreement is not at arm's length, the grantor could be argued to be receiving benefits from the trust creating a Code Sec. 2036 risk that the entire trust could be included in the grantor's estate.

f. The Applicable Federal Rate (AFR) may not be a safe harbor against the risks of the transaction being recharacterized. Code Sec. 7872 creates a safe harbor that there will not be imputed interest for income and gift tax purposes if the lender charges the borrower an interest rate of the AFR. But this is a narrow area and pointedly it does not apply to negate whether there was a retained estate tax string.

g. A key case addressing the criteria to differentiate loans from gifts was *Miller*:[xxix]

i. Written promissory note evidencing the debt.

ii. Borrowers have reasonable ability to repay the loan.

iii. Books and records of the lender and borrower reflect the transfers as loans.

iv. Interest charged on the note.

v. Reasonable security or collateral for the note.

vi. Demand for repayment made if a default occurred.

vii. Required payments were actually made on the note.

viii. The transaction was reported for federal tax purposes consistent with it being a loan.

ix. The note has a fixed maturity date.

25. **Purpose Trust**.

a. See succession planning.

26. **QTIP Considerations**.

a. How can funds be withdrawn from a QTIP:

i. QTIP trusts may be rigid, and it could be limiting as to what money or assets can be distributed out to the spouse.

ii. What standard of distribution applies to the surviving spouse during her lifetime? If there is an independent trustee a totally discretionary principal distribution standard can be provided to that trustee that would give latitude in determining distributions.

iii. Will the standard used legitimately permit surviving spouse to make gifts?

iv. The surviving spouse could be given a 5% annual withdrawal right, which would permit the spouse to withdraw those funds annually and use them for planning.

v. Permit a non-spouse independent trustee to make distributions to the spouse beneficiary to facilitate her making gifts. But that provision should confirm that the surviving spouse has no obligation whatsoever to make gifts. If that is not done there is a possibility that those distributions may undermine trust qualifying as a QTIP.

vi. While these and other steps might facilitate future estate planning, they also give the surviving spouse control over QTIP assets that may exceed what the decedent spouse wanted.

b. 2519 Risk.

i. Under Code Sec. 2519, if the surviving spouse disposes of all or any part of her income interest in the QTIP, she is deemed to make a transfer of all interests in the

QTIP. The spouse is deemed to have gifted the QTIP income interest under Code Sec. 2511 and all other interests in the QTIP under Code Sec. 2519.

c. Surviving Spouse wants to take assets out of QTIP and make gifts.

i. Will the removal of assets from the QTIP trust trigger a 2519 gift of the QTIP corpus?

ii. There is a legal fiction that the surviving spouse had already effectively owned the assets in the QTIP. Under Treas. Reg. 25.2523(f)-1(f) Example 11, the surviving spouse is the owner for gift and estate tax purposes. If that is so, how can there be a tax if the assets pass to the surviving spouse?

iii. In *McDougall*[xxx] the QTIP was terminated by a non-judicial settlement agreement ("NJSA") and its assets distributed to surviving husband. The court found that there was a gift made to the father by the children on the termination of the QTIP. In *McDougall*, the father had a limited power of appointment ("LPOA") and could have exercised it in favor of any of the beneficiaries so that no beneficiary had an expectancy from the QTIP at its natural termination.

iv. *Annenberg*.[xxxi]

1. Mr. and Mrs. Anenberg created a trust that included interests in the family business. After the husband's death, the property held in the family trust passed to marital trusts, with Mrs. Anenberg being the beneficiary of an income interest for her. Mr. Anenberg's husband's children were the contingent remaindermen. A QTIP election was made.

2. With the consent of the children and Mrs. Anenberg, in 2012 a local court terminated the QTIP, and all assets were distributed to her. Then Mrs. Anenberg made a gift of some of the interests in the family business to the children, and she sold the remaining shares to them for promissory notes.

3. The IRS argued that the termination of the QTIP and sale of the shares resulted in gift tax liability under section 2519.

4. The Tax Court held that the estate was not liable for gift tax under section 2501 for the termination of the QTIP. The Court determined that there was no gratuitous transfer under Code Sec. 2519 as a result of Mrs. Anenberg's qualifying income interest for life in the QTIP terminated.

5. In contrast to *McDougal*l below the IRS did not assert that the children as remainder beneficiaries made a gift.

v. *McDougall*.

1. The *McDougall* case involved the gift tax implications of a commutation of a QTIP marital trust.

2. Decedent died in 2011, and her residuary estate passed to a QTIP marital trust for her husband. Their two children were the remainder beneficiaries. A QTIP election was made. Then, in 2016, the husband as the surviving spouse and QTIP income beneficiary, and the two children as remainder beneficiaries, agreed to commute the marital trust, distributing all its assets to the

surviving spouse. The surviving spouse then sold some of the assets received from the marital trust to other trusts established for the benefit of the children and their children, in exchange for promissory notes. The goal was to facilitate the surviving spouse moving assets out of the QTIP that would be taxed on his death to other trusts outside his estate.

3. The IRS argued that the commutation of the QTIP triggered gifts from the surviving spouse to the children under Code Sec. 2519, and gifts from the children to the surviving spouse of their remainder interests in the QTIP trust under section 2511.

4. The taxpayers made a novel argument that the termination of the QTIP did result in a deemed gift by the surviving spouse under Code Sec. 2519. However, they argued the children gave an offsetting gift to the husband of all of the trust assets.

5. The Tax Court held that the surviving spouse was not liable for gift tax because no gratuitous transfers were made. However, the agreement to commute the marital trust resulted in gifts to the surviving spouse by the children under section 2511. The difference between *McDougall* and *Anenberg* is that in *Anenberg* the IRS failed to raise the issue of the remainder beneficiaries making a gift of their remainder interest to the spouse. The IRS asserted that argument in *McDougall*. The Court rejected the taxpayer's argument of offsetting gifts. The most difficult question is what value should be attributed to the imputed gift by the children to their father? The Court did not address that issue.

27. **Reciprocal Trust Doctrine**.

a. See discussion also of "SLATs" below.

b. The reciprocal trust doctrine has been discussed in several prior sections. The following are some comments made about SLATs with additional thoughts/comments.

c. Each spouse creates a SLAT for the other. The couple wants to use each of their entire gift tax exemptions, but they are not wealthy enough to let assets go completely. This is a common perspective but how wealthy must a couple be to use all of their exemption? If a couple is worth $50 million can they gift approximately $14 million x 2 = $28 million? Perhaps. That depends on age, health, life expectancy, lifestyle expenses and more. What about tax burn? How can that be projected? What if there is an economic setback? That analysis has to consider the couple's asset base, cash flow sources, and other factors. What if there is a medical issue? Might that suggest for many with $50 million gifting both of their exemptions might not be feasible?

d. For those concerned about the application of the reciprocal trust doctrine how do you way those risks against the risk of an unanticipated event putting the clients in financial difficulties? Is it worth the financial risk to recommend one SLAT and one dynasty trust the other spouse cannot access? Even if the probability of such a financial setback is low, the consequences could be devastating. These are not only the results of financial modeling where it might be demonstrated that there is some risk of a portfolio shrinking and undermining the clients' financial security. This is also black swan events to consider. How many wealthy people may have their financial security undermined by the California wildfires? That is only one example.

e. Financial modeling to identify financial risks can be very insightful, but the other types of risk need to be evaluated, even if subjectively, as well. Why would a practitioner prefer accepting that risk in lieu of the risk created by preserving access to the second trust (which need not be a SLAT, it could be hybrid DAPT, a DAPT or a SPAT)?

f. Consider what will happen if a court rules that the trusts are reciprocal. Each trust would thereafter be a self-settled trust, would be considered a 2036(a) transfer and cause full estate inclusion trust if the trusts are uncrossed.

g. If the SLATs are created in two different DAPT jurisdictions, and if a reciprocal trust challenge succeeded, the result is the trusts are "uncrossed" will be as if the husband created his trust and the wife created hers. In that scenario having the trusts in a state that permit self-settled trusts provide a backstop to secure creditor and estate tax benefits even if the reciprocal trust challenge succeeded?

h. Meaningful time between.

i. This is great advice and certainly an important factor. But one of the problems with having time between the creation is that there is no bright line rule as to how much time is necessary.

ii. In addition, the time between the creation or funding of SLATs is only one factor, what of all the other differences that are designed into the plan? Should the time between the creation of each SLAT be affected by the magnitude of other changes?

iii. Another practical problem with time between each SLAT is clients almost never plan when they should. So many clients wait for a life scare or tax development to stimulate them to address planning. If the bonus exemption is not extended, and if that only becomes a certainty in November or December 2025 there will be little or no time between the creation of both spouse's SLATs.

i. Different trustee successions.

i. That seems like a worthwhile difference but how does this cause the economic positions of each spouse to be different than it was at inception?

ii. Perhaps another perspective on trustee selection is to favor independent institutional or professional trustees over spouses and other family members that could be subject to an implied agreement.

iii. Perhaps selecting institutional trustees in different DAPT jurisdictions incorporates into the differences between the two trusts all the differences in each state's law. That may add further differences to the economic rights of each of the spouses.

j. Different beneficiaries of each SLAT.

i. This could be a very material difference, but it should include differences in beneficiaries during the lifetimes of the spouses so that it could affect the economic rights of the spouses for purposes of addressing the litmus test from *Grace* on different economic positions after creation of the trusts.

ii. Some commentators have suggested that the remainder beneficiaries can be different, but how does that affect the respective economic interests of the spouses? Also, if a different beneficiary is to be added, perhaps an elderly or infirm beneficiary could be added which also provides an opportunity for basis step-up planning.

k. Different assets.

l. Different powers of appointment.

m. Etc.

28. **Religious Considerations**.

a. Many estate planners do not address religious issues affecting estate and related planning unless a client specifically requests that a point be addressed. The presentation made the point that we all should endeavor to address religious issues that affect client planning. If we as estate planners don't ask (in our estate planning questionnaires, initial estate planning meetings, etc.) clients may not even realize that estate planning can reflect their religious wishes. But this should only be one component of addressing the range of personal planning issues.

b. But can estate planners practically expand their cultural competency by learning about different religious and cultural traditions around death and disposition of remains? Consider how many different religions there are, and how many different branches are within each religion. Further, death and disposition of remains is only one aspect of how religion may affect planning.

c. Religious beliefs affect every estate planning document and transaction.

i. Several faiths prohibit or restrict charging interest. That might affect provisions in durable powers of attorney and revocable trusts. Do rules on interest affect how a note sale transaction might be structured? There are many other potential ramifications.

ii. What about the complex medical decision-making process? That is more involved and complex than just the death and disposition or remains considerations.

iii. What about investment provisions? Many religions might have adherents that want to modify investment provisions in all documents. How can that be addressed without violating the Prudent Investor Act?

iv. What about a family vacation home or cabin? How can religious considerations be addressed in the context of that type of arrangement? Should rules and regulations be integrated into an operating agreement for an LLC owning the property to address religious considerations? This might include dietary restrictions for the kitchen, a prohibition of smoking, gambling or drinking on the premises.

d. The are so many faiths, variations, implications, and ripple effects of faith-based considerations that it may be practically impossible to suggest that practitioners gain cultural competency to address religious considerations.

e. This is all on top complex and constantly changing tax and property laws. Perhaps it may be more practical to heighten sensitivity to these issues and address them with all clients to determine what the particular client wishes.

f. If a client has religious preferences, then counsel can gain the relevant information from the client or the client's religious advisers. The field is just incredibly complex and massive to master.

g. In addition, religion is just one of a myriad of human aspects of planning. Other common considerations include addiction issues, mental health issues, chronic diseases and disability, varying lifestyle decisions, and so much more. Practically, we need to all be sensitive to the myriads of personal issues clients might want to or need to address. But we can never become culturally competent in such voluminous content.

h. Caution clients to address in specifics their religious considerations in their documents, especially if they do not want religious dictates to apply or if they want something different.

i. Caution clients to be careful using form documents provided by religious organizations. While they will comply with the dictates of that faith, and practitioners can and should consult them for that purpose, many are designed to be simple to use and acceptable in most states, and those goals may result in the documents not addressing points that could be quite important.

29. **Risk Evaluation**.

a. When you get so many incredibly smart people speaking at a conference, it is interesting to observe the spectrum of opinions on evaluating risk. Many of the presentations addressed, often indirectly, the evaluation or weighing of risk associated with different planning techniques. It is interesting how different national experts attach different planning techniques.

b. The bottom line seems to be that there is no way to quantify the risk associated with much of the planning we as estate planners engage in. In the end, all we can do is present the non-quantifiable risks to clients and let them choose which path they wish to take. But understanding that uncertainty is part of the fabric of estate planning is a point all advisers should communicate.

c. For example, it is likely SLATs have been so talked about, the subject of so many consumer articles and video clips that no doubt many clients come to estate planners not for a complete plan, but with the request for a specific technique like SLATs without beginning to understand the many decisions, options and risks involved in planning.

d. Clearly, purpose trusts are a creative and interesting planning technique that might in the right circumstances be the answer to an otherwise unsolvable estate and succession planning dilemma. However, other practitioners are concerned about the risks of a new technique, the classification as a trust, etc.

e. Some believe that it is feasible to give a beneficiary of a trust the power to disclaim on behalf of all trust beneficiaries to unwind a plan. Others feel that technique is quite risky and perhaps ineffective. But what of a middle ground of having an interim trust of which that beneficiary is the sole beneficiary? Might that convert some of the naysayers to being comfortable with the technique? Also, it is not only the unmeasurable risk of the disclaimer technique or variations of it

to be measured, but how do you compare that risk to the risk of a really unhappy client who has planning remorse and wants a plan unwound?

f. Upstream basis planning seems to be widely accepted, yet some practitioners have expressed concerns about some of the applications of the technique while others view it is so certain that they don't mention risks or uncertainties that it may involve, yet they express great hesitancy about non-reciprocal SLATs.

g. Powers of appointment are routinely used in planning, yet some who have no qualms about using powers of appointment in a wide array of planning situations are not comfortable using the SPAT technique which is an application of a limited power of appointment. How do we weigh the risk of a power of appointment being exercised in a manner contrary to what person granting the power might have wanted?

h. Most practitioners do not feel that there is any position to claim a basis step up on assets in a grantor trust outside the settlor's estate. Yet some practitioners still take that position.

i. Consider the different assessment of risk by different practitioners on what might be necessary to avoid a step-transaction doctrine. While case law has held 6-11 days is enough for discounts on marketable securities,[xxxii] few would seem to be comfortable with that time frame. Others grow more comfortable with 30 days. Consider the different interpretations of the import of risk assessment based on the *Smaldino* case.

j. While each practitioner must make their own judgements on these and so many other uncertainties, in the end we should all inform clients of the uncertainty and let them make their own decisions.

30. **Spousal Lifetime Access Trusts ("SLATs").**

a. **SLATs and The Reciprocal Trust Doctrine – A Different View**.

i. Practitioners are wary of a non-reciprocal SLAT plan running afoul of the reciprocal trust doctrine, as they should be. But the panel discussion on "For Richer For Poorer: A Potpourri of Planning Tips (and Traps) for Married Couples" may have impliedly suggested a different form of analysis of this issue.

ii. Laura A. Zwicker discussed the concern that the spouse who is beneficiary of the SLAT with lesser access might sue the practitioner if there is a later divorce. That is a real risk that practitioners should take heed of. But it is not only limited to divorce. The spouse with beneficiary status in the less accessible SLAT could find that lesser access a frustration in the event of the death of the other spouse or for any other reason. Zwicker's comment might be addressed by informing the couple of the differences in the planning and then documenting that, and the fact that the economic consequences of the differences can be material, in a written communication. This is an important point that practitioners should consider building into their standard communication templates.

iii. As noted above, the real essence of the *Grace* case was: "*It is also clear that the transfers in trust left each party, to the extent of mutual value, in the* ***same objective economic position as before***. [underlining added]"

iv. So, if the practitioner is worried (and all should be as Zwicker's worry is valid) how can the spouses be in the "*same objective economic position as before*?" They cannot be. So, if the provisions providing access for each spouse as beneficiary of the other trust are worrisome enough for the practitioner to document the effect of those differences in a CYA letter to the client, those same SLATs would seem to be different enough to not violate the reciprocal trust doctrine. That does not mean letting one's guard down or not taking reasonable steps to differentiate the SLATs as there is no clear line as to what quantum of differences are required, but perhaps a somewhat different view of the reciprocal trust doctrine might be appropriate.

b. **Other Considerations**.

i. Consider advising each spouse to have a separate spousal bank account. Perhaps they should not have joint accounts so they cannot inadvertently make a deposit from wife's SLAT distribution into a joint bank account with husband, and vice versa. Consider if the wife creates a SLAT for husband, husband gets a distribution from the SLAT, deposits it into a joint bank account, then the wife purchases herself a new car paying for it from the joint account. Has she just obtained benefit from the SLAT she created for her husband that she was not a beneficiary of?

ii. Caution clients of economic risks and that they cannot always be forecasted, e.g., California fires, retail tenants closing in a shopping center they own because of online commerce, etc.

iii. Coordinate SLATs with an insurance plan. Consider life insurance to address the premature death of the other spouse. Evaluate the need for disability and long-term care coverage as well.

c. **Loan Power**.

i. The panelists favor including the grantor trust trigger of permitting loans to the grantor without adequate security.

ii. They caution that there should always be adequate interest paid by the grantor (not just the AFR) to avoid a potential Section 2036 inclusion argument.

d. **Dueling SLATs**.

i. The panel did not like "dueling" SLATs. They suggested one spouse create one irrevocable trust for descendants and the other a more traditional SLAT. But that is not what most clients are comfortable doing.

ii. The real essence of the *Grace* case was: "*It is also clear that the transfers in trust left each party, to the extent of mutual value, in the same objective economic position as before*." The key criteria is the spouses or parties being in the same economic position as before funding the trusts. See comments and analysis of this point in earlier discussions.

iii. SLATs are an ideal technique for those rich enough to be concerned about exclusion being cut in half but they are not rich enough to let go of economic

benefits of gifted assets. It enables married clients in this group to fully utilize their exemption. SLATs do not appear to get caught by the anti-abuse rules. See the discussion above.

e. **Implied Agreements/Understandings.**

i. Understandings can undermine a SLAT plan.

ii. This could include an understanding that settlor has with their spouse, with a trustee or even with a trust protector.

iii. Consider the following situations:

1. An understanding that any distributions from the trust to the spouse she will give to the settlor.

2. Understanding settlor has with trustee that when settlor becomes beneficiary on death of spouse that settlor can command trustee to make distributions.

3. Understanding that income taxes will be reimbursed.

4. An understanding that the spouse will exercise a power of appointment to bring the settlor as a beneficiary on spouse's death.

5. Understanding that settlor has with trust protector will exercise power to bring in settlor as beneficiary, or that trust protector will confer a power on spouse so she can do that.

iv. A provable understanding can undermine the plan.

v. What could prove or indicate an understanding? This would be a facts and circumstances analysis. See the discussion under "Email, Other Communications and Internet Searches" above.

vi. Other considerations:

1. If the settlor's spouse is not named as a trustee, there can be no understanding between spouses in that position, so why do it?

2. Better yet include an institutional trustee. How can you have an implied agreement with an institution?

3. Have financial models prepared that show a 50% likelihood of success to table age expectancy that the settlor has no need to access SLAT assets.

f. **Marital Stability**.

i. Implementing SLATs can work well if done well in solid, long-term marriages. If the client's marriage appears somewhat shaky you might advise them to consider alternative strategies. It is important to know that divorce rates are lower with higher wealth clients.[xxxiii]

ii. What if divorce is anticipated at outset with incorporation of a floating spouse provision?

iii. Consider including a provision triggering a division of the SLAT on divorce with ½ of the assets passing to a trust incorporating a floating spouse clause.

iv. Address income taxes, i.e., the grantor tax burn, in the marital settlement agreement.

31. **Step-Transaction Doctrine**.

a. Have a reasonable amount of time pass between gifts from wealthy spouse to poor spouse.

b. Don't have the amount of the gift to poor spouse equal the exact amount that is then gifted by the poor spouse to the trust.

c. Don't have the asset gifted to the poor spouse be the same asset as gifted to the trust.

d. Document that donee spouse understands that he is the recipient of the gift and as recipient of the gift can use the property. Have donee spouse sign acknowledgement on transfer document acknowledging receipt and that she can do what she wants with the gifts.

32. **Succession Planning**.

a. General lessons. Natalie Reitman-White gave a presentation largely on the use of purpose trusts for business succession planning. There were several critical points in her presentation apart from the discussion of purpose trusts, some implicit, that warrant emphasis:

i. Most businesses have no succession plan. 2.9 million business enterprises have owners age 55+ (is that old?). 83% of those business owners have no succession plan. 64% of business owners do not believe that their children will be able to run the business. The take home point of this is that all practitioners in all disciplines should make a concerted effort to bring up succession planning for all business clients.

ii. Natalie reviewed many different options leading up to her primary topic of purpose trusts. She discussed the pros/cons of using a variety of techniques to provide succession for a business: ESOP, sale to a third party, sale to insiders, etc. She made it quite clear that the very topic she was focused on, purpose trusts for succession planning, was not a universal solution. Her approach is a model for how all practitioners should present planning to clients to both empower the client and to protect themselves as practitioners. Too often we all lapse into suggestion or encouraging a solution we might believe best for the client. But the approach modeled in the presentation of presenting options with pros and cons is protective of the advisers because the client then makes the decision, and that decision is based on a balanced explanation, including negative aspects of the recommended plan. With malpractice claims rising, this is an approach all should employ.[xxxiv]

iii. Another key point: there are many options to consider for the succession of a business. Practitioners should think out of the box, adapt options, even new concepts like a purpose trust, in trying to meet the particular client's unique goals and circumstances.

b. Questions, Comments, and Considerations on Using a Purpose Trust.

i. It is not fully clear that a purpose trust will be respected as a trust for tax purposes. If that is so, then how can the risks of utilizing this technique be assessed? If the status of the purpose trust as a trust is successfully challenged, will the entire plan fail? Might it be safer to try molding existing planning structures to fit the objectives rather than using a newer more uncertain technique?

ii. How do you get from current ownership to a purpose trust? Ellen Harrison suggested using a sale of the business interests to an intentionally defective grantor trust to shift the equity into the trust. In other words, use a typical IDIT/note sale plan as the initial step, and once the sale is completed, pour the business interests into a purpose trust.

iii. An IDIT can have charitable and non-charitable beneficiaries and be perpetual. The IDIT can include perpetual management decisions with a special purpose entity named as investment adviser or investment trustee. Considering that, what incremental benefit will be received from the shifting equity from a perpetual grantor trust to a purpose trust?

iv. The above IDIT construct can utilize both entity law governing entity structures, e.g. a single member LLC owned by the IDIT, in coordination with modern trust drafting provisions, to endeavor to tailor the legal structures to the client's goals. But in this approach the plan is built on the foundation of more certain and commonly used trust instruments and drafting techniques, as well as business entity law and drafting techniques. Tailored operating agreement provisions, management succession, etc. can be incorporated into the plan.

v. How do you draft, in detail, the management function with the Succession Committee? Who serves on that committee? How are they removed and replaced? Does that negate the profit motive and other incentives that motivated the growth of the business? The devil in this is completely in details.

vi. Succession planning challenges remain even with purpose trusts. It could be difficult to recruit or retain talent without traditional equity compensation. What are the policies and practices that will allow the purpose trust to interact with the board? The trust provisions will need to facilitate change over future decades so that change in the entity/business is not inhibited.

vii. Might this be done with creating a board of directors or managers in a special purpose LLC (or other entity) held by the IDIT? That would then be based on LLC law which has a wealth of precedents and guidance. Might that be more certain then what might be custom crafted governance provisions for a succession committee? In what document is the succession committee's governance contained?

viii. A board of managers of an LLC serving as investment advisor could by terms of the operating agreement consist of a specified number of "directors" or managers from business, the community, charities, etc. with a mandate that every X years the existing board (or some other mechanism) would have to replace one member in each specified category of managers.

ix. The IDIT can be a non-charitable trust with charitable beneficiaries and can provide great flexibility. So, using a modern trust can be robust and may

provide adequate options for the perpetual management or control over a business. That may be comparable to what a stewardship committee might do for its succession, but with the possible advantage being based on a large existing body of law.

x. The concept of a "golden share" was suggested as a small slice of equity ownership that could prevent a sale of the business to a third party. Is this conceptually similar to the *Powell* planning construct of creating a special voting interest that controls distribution and liquidation decisions and transferring it to a trust? If so, that may provide a template for an approach that has more history and documentation to base it on.

33. **Trust Modification**.

a. CCA 202352018.

i. Rev. Rul. 2004-64 provided that when the grantor pays the income tax on the income of a grantor trust, that payment is not a gift to the trust. If the trustee is required to reimburse the grantor, that is a retained interest that will cause inclusion in the grantor's estate. If the trustee only has the discretion to reimburse, not a requirement to do so, that will not alone cause inclusion in the settlor's estate, but other factors added to that could result in estate inclusion (e.g., the finding of an implied agreement).

ii. In the CCA, a discretionary trust is to distribute income to the child and, on death, distribute to the child's issue per stirpes. The grantor retained a power that characterized the trust as a grantor trust. Neither the trust nor state law authorized the reimbursement of taxes to the grantor.

iii. A modification agreement added a tax reimbursement clause to the trust. Pursuant to state law, the grantor's child and that child's issue consented to the modification. Based on these facts the IRS concluded that there was a taxable gift by the remainder beneficiary to the grantor/father.

iv. The CCA stated that the result would be the same in a modification where pursuant to a state statute beneficiaries were permitted to non-object.

v. The CCA did not address a critical issue, how to value the imputed gift. The IRS' view on this was that even if it was hard to measure the value of the gift those challenges should not detract from the fact, in their view, that there was a gift. But estimating a value for a right that is this immeasurable is akin to estimating how many angels can dance on a pinhead. How do you estimate income in each future year? How long will the trust last? What tax rates will apply to each type of income of the trust in every future year? How do you estimate the tax to be due in each of those years? How can you determine whether a discretionary power will be exercised? Even if you can do all the above, how do you apportion the gift value among the various current and future beneficiaries? What if the grantor could relinquish the power? What if the grantor relinquishes power to make it a non-grantor trust? What if trustee and beneficiaries agreed to permit a tax reimbursement power in exchange for grantor not relinquishing the power? No clarity on any of these points was provided in the CCA.

vi. Consider one planning option: can you move the trust to Florida? Florida law permits the trustee to reimburse the grantor for taxes regardless of what the trust provides. No clarity was provided on the result of what this would be because in this situation there would be no beneficiary consent.

vii. How do you deal with gift tax returns that have not been filed for years in which a tax reimbursement clause may have been added back to a grantor trust? What if you file a gift tax return for each beneficiary and remainderman and guesstimate the value of the purported gift? That puts the onus on the IRS to produce a different value.

viii. Regardless of the impossibility of estimating the value of such a gift, practitioners should consider cautioning any client that modifies a trust in any manner about the potential risks of a broad reading of the CCA.

ix. Many trust companies insist on beneficiaries signing off on any action or push the family to instead effectuate a non-judicial modification agreement if feasible, to avoid the trustee having to be involved, such as through taking the actions to decant a trust, because of concerns about potential liability. Now CCA 202353018 may make the provision of beneficiary approval potentially problematic in that the IRS may argue for an imputed gift (or some other challenge). But will trustees be willing to just proceed without those sign offs?

x. If not, if there is a trust protector or other mechanism to change trustees in the trust document, the family might just change trustees to one that will proceed without a sign off.

xi. If that change is accomplished by an independent trust protector in an action, from one independent trustee to another, there would seem to be no issue. But what if the trust protector is a family member or even a beneficiary? What if the change of trustee mechanism gives the beneficiaries by majority vote the right to change trustees? Will changing trustees in those latter situations be argued by the IRS to be equivalent to the beneficiaries approving the decanting? What if a corporate trustee is removed and a family member appointed to effectuate the desired modification then sometime later the trust protector removes the family member as trustee and reappoints the institutional trustee again?

xii. There is another facet to all of this. Let's say that after CCA 202353018 the trustee is willing to decant the trust without any approval or even advance notice to beneficiaries. What about the professionals advising on the decanting? The sign offs by the beneficiaries in the past would also seem to have negated a beneficiary later objecting to the transaction. After all, they had notice and either agreed or did not object. Without that consent, might this increase the risks of beneficiaries suing the advisers?

xiii. In light of CCA would you decant a GST exempt trust that had outright distribution at age 40 to a new trust that continues for beneficiaries lifetime and new trust would have RAP based on old GST exempt trust. GST issue in this scenario. Consider a situation where a trust is GST exempt and decanted into a new long term or perpetual trust, and the old trust would have terminated when the beneficiary reached age 40. Based upon the CCA, could the IRS

argue the beneficiary made a gift to the trust? Would that argument by the IRS be weakened if state law had a decanting statute in place when the trust became irrevocable?

xiv. A gift tax issue is raised by the CCA.

1. Under Florida law, trustees who can decant can do so without consent of beneficiaries.

2. On the facts of the CCA consent of beneficiaries was required, but in this situation only notice was required. Is there a distinction between notice and consent?

3. The CCA says if beneficiary is required to get state notice under state law and fails to object the beneficiary has also made a gift. Consent by a beneficiary is very different then notice to a beneficiary who fails to object.

4. There may be no practical reason for beneficiaries to object because if the trustee made a decision to modify a trust in a reasonable exercise of fiduciary discretion the beneficiary will not likely be successful in objecting to trustee's reasonable exercise of fiduciary discretion. Even if this reasoning doesn't apply in the context of adding a tax reimbursement clause, it may apply to other modifications.

xv. How have you modified your practice to address CCA 202352018? Consider carefully if a beneficiary has a basis to object to a proposed modification or decanting. Recommend that each beneficiary retain separate counsel to determine if that beneficiary can or should object. Counsel might inform the beneficiary it would be a waste of money. If that happens how can IRS argue gift?

xvi. Is there greater concern over the CCA arguments after the *McDougall* case?

xvii. The commentators pointed out that a CCA is mostly just the internal legal memoranda of the IRS. Practitioners should learn from the CCA and incorporate its lessons into their planning, but the conclusions set forth by the Chief Counsel are not binding on clients.

34. **Trust Property, Use of**.

a. It is very common for trusts to own residences and other personal use property which the trust then permits a beneficiary to use. Is the beneficiary's use of a residence owned by a trust required imputed income to the beneficiary? Does it draw out distributable net income ("DNI") from the trust to that beneficiary equal to the fair value use of the property?

b. President Biden's 2024 Green Book tax proposal included a provision that would have taxed a beneficiary's use of trust property. The proposal would have treated loans to a beneficiary, or a trust giving a beneficiary the right to use trust property, as a distribution for income tax purposes. This would have meant that the use of trust property by a beneficiary would be considered a taxable event, resulting in DNI carrying out to the borrowing beneficiary. Some would interpret the need to enact new legislation to tax a beneficiary's use of trust property as confirming that it would otherwise not be taxed.

c. Similarly, the use of a residence or other property by a beneficiary of a foreign trust is taxable. Some argue that would similarly suggest that if an express statute is needed to make the use of property of a foreign trust taxable that in the absence of such a statute applicable to a domestic trust that use cannot be taxable.

35. **Vacation Home to SLAT**.

a. Many clients have very valuable houses and QPRT is a one option to transfer the asset via gifting. However, you have an anti-clawback risk with QPRTs if the grantor dies during the initial term of the trust. Specifically, the anti-clawback rule exception will apply to QPRTs under Code. Sec. 2702 if the technique used the bonus temporary exclusion amount, that bonus exemption will be lost.

b. Clients that want to retain their liquid assets, but still secure their bonus exemption might be interested in gifting a personal residence, either their primary home or a vacation home, to a SLAT.

c. There is concern that the continued use of a residence that has been gifted to a SLAT could be characterized as a retained interest, giving rise to Code. Sec. 2036 estate inclusion.

i. But what if the SLAT purchases a residence that had not theretofore been owned by the couple? Wouldn't that seem to negate this concern?

ii. Also, while not downplaying the 2036 concern, if an investment portfolio is gifted to a SLAT and the beneficiary spouse receives distributions, does that create avoidance of a 2036 estate inclusion? Perhaps, perhaps not.

iii. See the discussion above under the caption: "Trust Property, Use of." A beneficiary's use of a residence held in a domestic trust does not impute income to that beneficiary (nor carry out DNI).

iv. If the wife is a beneficiary of the SLAT that the husband created, to which the husband gifted 100% of the ownership of a residence, should the wife have to sign a lease and pay rent if she did not own the residence previously? There should not be a 2036 issue as the wife never owned the house in which she lives. If the husband, by virtue of his marriage to the wife is permitted to live in the house, does that re-trigger a 2036 concern?

v. Is the above scenario so different from the husband contributing his one-half interest in a residence to a SLAT for wife, and wife's contributing her one-half interest in the residence to a SLAT she created for husband? Is it unreasonable to state that the wife is using the husband's asset in the SLAT he created and funded, and vice versa? Leaving aside reciprocal trust challenges that may be exacerbated by having a material portion of each SLAT consist of the same assets and the consistency of the parties' economic positions to that extent, do the gifts to the SLATs assuredly create a 2036 issue?

vi. If husband and wife own the residence jointly and divide the property into tenants in common before each contributes their half to the SLAT they form, is that a step-transaction concern perhaps instead of a 2036 concern?

vii. Should a lease be signed for use of the residence? What type of rent should be paid and how should that be determined? But is that necessary? Consider if a lease is signed and it is agreed that the occupants will pay property taxes, insurance and repairs in lieu of rent. Will that suffice? It certainly seems safer than not having a lease and not memorializing the relationship, but how do those payments correlate with a fair market rental price? The agreement should perhaps state that the parties believe that the cost of maintenance, property taxes and insurance (or whatever the list of expenses the spouses are paying), is believed to approximate a fair rent. The lease should not be for life as that would imply a life estate. Ideally, the lease should be for a term that is consistent with arm's length leases in the area.

viii. Often the types of neighborhoods clients engaging in this type of planning reside in are not the types of neighborhoods for which there are many, if any, residences rented, or the residences are so different that determining a comparable rent may not be accurate or easy.

ix. If rent is paid is that a gift to the trust?

x. Short-term rentals on platforms like Airbnb and VRBO typically charge nightly or weekly rates, which can be significantly higher than the fixed monthly rent of long-term leases. If rent is paid based on these kinds of short-term rentals and if it is in excess of fair value, would that be a gift to the trust?

xi. If there is a corporate trustee how can the settlor or settlor's spouse be assured that the trustee will continue to permit uncompensated use of the property? What if the trust is also a sprinkle trust, as many SLATs are, and includes not only the spouse as a current beneficiary but also all descendants, and perhaps other family members? The trustee has a financial responsibility to the other trust beneficiaries. Might that present less of a 2036 concern then if the spouse or a family member were the trustee of a trust for which only the spouse was a beneficiary?

xii. What can be done to avoid an implied agreement between the trust and the settlor or spouse using the asset? If the trustee is an institutional trustee, can there be an implied agreement? It would certainly seem more difficult to infer than if the other spouse or another family member were the trustee. But that analysis will also be quite dependent on who has control over decisions to hold a residence in the trust and permit use of it. If the investment trustee is named and has that power, and the investment trustee is the settlor or a spouse, that could implicate 2036. If, however, the authority over a personal use asset is under the purview of an institutional trustee and within their discretion, finding an implied agreement should be difficult, or perhaps unfounded.

xiii. In the Riese case,[xxxv] the grantor of a QPRT failed to pay rent following the QPRT term for a period of six months, then died. However, her attorney had advised of the need to pay rent, how to determine that rent, and to document the grantor's continued use of the property with a lease. After the grantor's death, the personal representatives calculated the unpaid rent and paid it. While this case was a taxpayer victory, is its comparison to a SLAT plan reasonable?

1. Following the term of a QPRT the grantor has no right to use or live in the residence that had been transferred to the QPRT. The residence at that time belongs solely to the remainder beneficiaries of the QPRT (children or trust for them).

2. In contrast, during the term of a SLAT, the spousal beneficiary of the SLAT should have the right to live in the house. If the grantor spouse uses that house it is not because of a right but rather because of the marital relationship with the beneficiary spouse.

3. If the couple divorced and the beneficiary spouse married someone else, that new spouse would presumably have the right to reside in the residence, absent the use of a floating spouse clause. Are the situations really comparable?

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

Thomas Tietz

Joy Matak

Martin M. Shenkman

Jonathan Blattmachr

**CITE AS:**

**LISI** Estate Planning Newsletter #3178 (February 5, 2025) at http://www.leimbergservices.com 

**CITATIONS:**

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[iii] ABA Standing Committee on Ethics and Professional Responsibility Formal Opinion 512, released July 29, 2024, viewed at https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/ethics-opinions/aba-formal-opinion-512.pdf, accessed January 21, 2025.

[iv] “The Florida Bar Guide to Getting Started with AI,” released January 7, 2025, viewable at https://www.legalfuel.com/guide-to-getting-started-with-ai/, accessed on January 21, 2025.

[v] See Gans & Blattmachr, “Grantor Trust Assets and Section 1014: New IRS Ruling Doesn't Solve the Problem,” Jl of Taxn (Sept. 2023).

[vi] Smaldino v. Comr., T.C. Memo. 2021-127 (November 10, 2021).

[vii] Wandry, Joanne M., et al. v. Comm (103 TCM 1472 (2002).

[viii] King v. United States, 545 F.2d 700 (10th Cir. 1976).

[ix] Petter v. Commissioner, T.C. Memo. 2009-280.

[x] Private Letter Rulings 201447008 and 201834011.

[xi] IRC Sec. 2519(a) states: “*...any disposition of all or part of a qualifying income interest for life in any property to which this section applies shall be treated as a transfer of all interests in such property other than the qualifying income interest*”

[xii] Students for Fair Admissions, Inc. v. Pres. and Fellows of Harvard College, 600 U.S. 181 (2023).

[xiii] For an article discussing the planning checklist concept further, including a sample checklist with comments, see “*The Need for Trust Compilations - Organizing Planning for Clients*,” co-authored by Sahar Pouyanrad, Martin M. Shenkman and Thomas A. Tietz, Steve Leimberg's Estate Planning Email Newsletter - Archive Message 3032 (April 24, 2023).

[xiv] Estate of Vose v. Lee, 390 P.3d. 238 (Okla. 2017).

[xv] Loper Bright Enterprises v. Raimondo, 603 U.S. 369 (2024).

[xvi] Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

[xvii] Sorensen v. Commissioner, Dkt. Nos. 24797-18, 24798-18, 20284-19, 20285-19 (T.C. 2022).

[xviii] The Estate of Fields v. Commissioner, T.C. Memo. 2024-90 (September 26, 2024).

[xix] Moore v. Comm'r, T.C. Memo. 2020-40 (U.S.T.C. Apr. 7, 2020)

[xx] Estate of Powell v. Commissioner, 148 T.C. No. 18 (May 18, 2017).

[xxi] United States v. Estate of Grace, 395 U.S. 316 (1969)

[xxii] Haynes v. First Nat. Bank of New Jersey, 432 A.2d 890 (N.J. 1981) at 900.

[xxiii] ABA Model Rule of Professional Conduct 1.8, Comment 8.

[xxiv] Miller v. Miller, Case No. 125,952 (Kan. Ct. App., October 18, 2024).

[xxv] See Treas. Reg. Sect. 301.7701-2(b)(8) and Form 8832.

[xxvi] See Shenkman, "Role of Guarantees and Seed Gifts in Family Installment Sales," Estate Planning, Nov 2010, VOL 37/NO 11, pg 3.

[xxvii] Shelton v. Tamposi, 62 A.3d 741 (N.H. 2013).

[xxviii] Estate of Bolles v. Commissioner, T.C. Memo. 2020-71.

[xxix] Miller v. Commissioner - 71 T.C.M. 1674 (1996).

[xxx] McDougall v. Commissioner, 163 T.C. No. 5 (September 17, 2024).

[xxxi] Estate of Anenberg v. Commissioner, 162 T.C. No. 9 (May 20, 2024).

[xxxii] See, for example, Holman v. Comm'r of Internal Revenue, 130 T.C. 170 (2008), where the Court found 6 days between transfer from one spouse to the other and transfer to an FLP was sufficient for volatile Dell stock.

[xxxiii] "Wealth and Divorce," Alexandra Killewald; Angela Lee; Paula England Demography (2023) 60 (1): 147–171. https://read.dukeupress.edu/demography/article/60/1/147/342803/Wealth-and-Divorce accessed January 19, 2025.

[xxxiv] "*...trusts and estates claims have also been steadily rising over the last 30 years, from just shy of 7 percent of all malpractice claims in 1985 to 12.05 percent in 2015. Although these may appear to be small numbers at first blush, this represents a nearly a 75 percent increase*." https://insurancefocus.usiaffinity.com/2018/02/brace-for-impact-the-rise-in-trusts-estate-claims-against-attorneys.html accessed Jan,. 18, 2025,

[xxxv] Estate of Riese v. Commissioner, T.C. Memo 2011-60.