Subject: Mary Vandenack's Notes from the Notre Dame® Tax & Estate Planning Institute – Part 1

The **50th Annual Notre Dame Tax & Estate Planning Institute** was held September 25 through September 27,2024, at Century Center in South Bend, Indiana. Members should click the below link to review the meeting agenda:

https://law.nd.edu/assets/572581/nd_taxestate_sept2024_062024_0621_01_booklet.pdf

The Notre Dame Tax & Estate Planning Institute 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. Noteworthy was a session on how to use financial modeling to help clients understand their planning.

As usual, **Jerry Hesch** did a superb job putting together an excellent line-up of topics and presenters. The two-track conference included topics for every practitioner.

The Institute provided topics focused on income tax planning, estate tax planning, trust administration, creative uses of charitable remainder trusts, supported decision-making, too much value in GST trusts, artificial intelligence and the Corporate Transparency Act.

Mary E. Vandenack attended the Notre Dame Tax & Estate Planning Institute and agreed to share her notes. Because of the length of the notes, these notes will be published as Part 1 and Part 2.

Mary E. Vandenack, J.D., ACTEC, CAP®, COLPM®, is a partner at DUGGAN BERTSCH, LLC in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, trusts and estates, private wealth planning, asset protection planning, executive compensation, business, business exit, and business succession planning, tax dispute resolution, and tax-exempt entities. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax-exempt organizations. Mary is also an adjunct professor at Creighton University, where she teaches trusts and estates.

Mary is active in ACTEC serving on the asset protection and technology committees. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves as a Delegate. Mary has been named to ABA LTRC Distinguished Women of Legal Tech, received the James Keane Award for e-lawyering, and serves on ABA Standing Committee on Information and Technology Systems. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law and process automation. Mary hosts a podcast called Legal Visionaries. More information can be found at https://maryvandenack.com.

Contents

HOW TO USE FINANCIAL MODELLING TO HELP YOUR CLIENTS AND YOURSELF 7

The Factors Designed to Shift Value to a Trust That is Not Exposed to Estate Tax Without Having to Use the Gift or Estate Tax Exemptions 7

Illustrating Estate Planning Techniques and the Grantor Trust Burn 7

Modelling the Burn From Installment Sales 8

Strategies to Reduce the Burn 8

AVOIDING MISTAKES IN ESTATE ADMINISTRATION 10

Introduction to Trust Administration 10

Cases 10

Common Errors in Trust Administration 11

Create a Compilation of the Trust and all aspects of the Plan and update the same annually. 12

Annotating and Analyzing the Trust Document 13

Beneficiaries with Mental Health Issues, Substance Abuse Issues 13

CURRENT DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS 14

Estimated 2024 Numbers 14

Moore case 14

Consistent Basis 14

Federal Rulings, Cases And Other Developments 15

Grantor Trust Rules 16

Marital Deduction 16

GST Regulations 18

PRACTICAL INCOME TAX PLANNING WITH YOUR ESTATE PLANNING FAMILY LIMITED PARTNERSHIP 19

Discounting Limited Partnership Interests 19

Income vs. Estate Tax Benefits of an Estate Plan 19

Impact of Valuation Discount 20

Avoiding Income Tax Trap At Death Caused by Valuation Discounts of FLP Interests 20

Section 754 20

Taxable Installment Sale of a Partnership Interest 20

Recent Anti-Basis Shifting Proposals 21

CHARITABLE GIFT ANNUITY PRIMER 22

Basics 22

Differences Between CGA and a CRT 22

Gift Annuity Rates ... 23
Things You Can Do With a CGA that You Can't Do with a CRAT ... 23
Step Annuities ... 24
Termination of Annuity ... 24
Estate and Gift Tax Rules ... 24
CREATIVE USES OF CHARITABLE REMAINDER TRUSTS ... 25
Charitable Remainder Trust Basics ... 25
Defer Gain on Sale of Appreciated Asset ... 26
Flip NIMCRUT ... 26
Can you pay deductible or rent to a Flip NIMCRUT? ... 26
Increase Valuation Discounts by gifting or selling annuity or unitrust interests or ownership interests in entities that own such interests ... 27
Consider Taking Trustees Fees out ... 27
Put a Value on the Benefit to the Family From Having Control Over the Charitable Remainder Entity. 27
S Corp Transfers Assets to Charitable Remainder Unitrust Before Sale ... 27
Convert a C corporation to an S corporation and Avoid the Unrecognized Built in Gains Tax ... 27
Stretch IRA's to 20 years or a Lifetime ... 28
IRA Disclaimer to Charitable Remainder Trust p 51 ... 28
Make Large IRA and Pension Accounts Payable to a Standby CRUT with Blocker LLC for Funding on Death Can be Used for This ... 28
Spray the Income to Lower Bracket Beneficiaries or Charities ... 28
Diversify – Form Both a CRUT and a CRAT ... 28
Asset Protection and Divorce ... 29
Avoid Paying Annual Distributions From a Private Foundation By Using a Short Term NIMCRUT That Pays to Charity After a Short Term of Years ... 29
SUBSTITUTE VS. SUPPORTIVE DECISION-MAKING OPTIONS AND POTENTIAL CONSEQUENCES FOR CLIENTS WITH DIMINISHED CAPACITY ... 30
Supported Decision-making ... 30
Importance of a Good Fiduciary ... 30
Medical Surrogate Decision-making ... 30
Designation of Patient Advocate ... 31
Accommodating Party Accounts by Individuals as Amenisis ... 31
Trusts ... 31
Court Protective Proceedings ... 32

TRUST MODIFICATIONS AND TRUST TERMINATIONS: UNINTENDED CONSEQUENCES AND HOW TO AVOID THEM 33
Introduction 33
Gift/Estate Tax Effect of Beneficiary Procurement or Acquiescence to Amendment 34
Impact of the GST Tax and State Trust Law Reactions 35
Potential Income Tax Effects of Commutations Generally 35
MOVING TIME: OVERCOMING TOO MUCH VALUE IN GST VULNERABLE TRUSTS 37
GSTT-vulnerable Trusts 37
Unique Issues with QTIP trusts 37
Shaping the Environment for Planning 37
Who Should be the Income Tax Owner? 38
When a GSTT-vulnerable trust owns a GSTT-Exempt Trust 38
Transactions Between Trusts 39
A VIEW FROM THE TRENCHES: CURRENT ISSUES IN TRANSFER TAX AUDITS AND LITIGATION 41
Anticipate the Dispute 41
Prepare for Audit 41
Relevant Valuation Decisions 42
Formula Transfers 42
Formula Language – It Matters 42
Potential Donees of the Excess Amount Under Petter Style Formula Clause 43
QTIP Termination 43
Statute of Limitations 44
Statute of Limitations – Donee Liability 44
Promissory Notes 45
Installment Sales 45
GRATs 46
Most Litigated Issue – Section 2036 46
Retained Right to Designate Persons Who Will Possess or Enjoy Assets Contributed or Income From Assets 47
Valuation Penalties 47
ARTIFICIAL INTELLIGENCE IN THE T&e PRACTICE: UNAUTHORIZED PRACTICE AND OTHER ETHICAL CONSIDERATIONS 48
Artificial Intelligence 48
Uses of AI in Estate Planning 48

Ethical Rules 49
What Should You Know 49
Confidentiality Rule 1.6 50
Courts Are Requiring Disclosure of Use 50
Supervision 50
Additional Items with AI 51
Our Comments on the AI World 51
CYBER SECURITY: NAVIGATING THE BRAVE NEW WORLD OF CYBERSECURITY, PRIVACY AND ETHICS 53
Protection of Information is Protection of People 53
Technological Competence 53
Duty of Confidentiality 53
What Are Reasonable Efforts? 54
ABA Formal Opinion 477R 54
ABA Formal Opinion 483: Lawyers' Obligations After an Electronic Data Breach 55
ABA Formal Opinion 512: Artificial Intelligence 55
OF SWIFTIES AND SKIPPIES: A MODERN TAKE ON THE GST TAX STRAIGHT FROM THE (NOT SO) TORTURED PLANNERS DEPARTMENT 56
Generation Skipping Tax 56
Key Concepts: 56
§2032 and §2624 do not mirror each other when it comes to the timing of the election 57
GST Exemption is the antidote to the GST tax. 58

NOTES:

HOW TO USE FINANCIAL MODELLING TO HELP YOUR CLIENTS AND YOURSELF

Presenters: Brad Dillon and Brandon Ketron. Brad Dillon is a partner on the a16z Perennial Team. Brandon Ketron is a partner at the law firm of Gassman, Crotty & Denicolo, P.A., in Clearwater, Florida.

The Factors Designed to Shift Value to a Trust That is Not Exposed to Estate Tax Without Having to Use the Gift or Estate Tax Exemptions

- Valuation Discounts – Financial modelling can illustrate the long-term effect of discounting a gift as well as other valuation factors.
- Freezing the Current Value of Assets – The concept of an estate freeze is to freeze the value of the client's assets within the estate and to move the growth outside the estate.
- Financial Leverage – A common strategy is to sell the assets in exchange for a promissory note. The promissory note value held in the estate does not increase in value.
- Using Grantor Trust and the Grantor Trust Burn - If the Grantor Trust Burn is well illustrated, the plan can be designed in a way that allows the planner and the client to consider alternatives that can reduce the impact of the Grantor Trust burn.

Illustrating Estate Planning Techniques and the Grantor Trust Burn

- Clients often dislike the fact that they pay the taxes on money that they have given away.
- When modelling the burn, you may want to assume that life expectancy of client is longer than that provided in the mortality tables.
    - The "new" tables are already almost 15 years old.
    - Life expectancies stopped increasing with the Covid-19 pandemic.
    - Tables are gender neutral.
    - Wealthy clients have better access to healthcare.
    - Using a longer expectation can be more realistic with respect to illustrating the burn.

  - Model burn to determine whether exemption should be used prior to possible reduction of the exemption. While many practitioners are recommending that the exemption be used while we have it, we don't want to rely on intuition to determine whether it makes sense for a client.
  - Good modelling reflects the current and long-term income tax results of the proposed transaction.
  - Modelling should take into account life expectancy of client, income, taxes, cost of burn, and client spend. Such an analysis could show that a client will burn through the entirety of their assets as a result of the estate planning strategy.
  - Rather than just getting excited about the ability to reduce estate taxes, we want to make sure that our planning will have good long-term results. Modelling can help the practitioner analyze whether the idea the practitioner is presenting actually makes sense.

Modelling the Burn From Installment Sales

- Even the ultra-wealthy are not immune from possible estate depletion resulting from the burn.
- Presenters used an example of an age 60 client with $100m of assets in an LLC. Senior gifted a 28.57% interest in the LLC with a $20m capital account to a grantor trust and then sold 71.43% in exchange for a note. Client annual spend is $1.5m. In this scenario, which involved a freeze of the entire estate, the burn resulted in total depletion of grantor's estate. Presenters' suggestion on this approach was that it illustrates that freezing the entire estate is likely not a good idea.

Strategies to Reduce the Burn

- Reduce the size of the initial discount taken.
- Tax Reimbursement Clauses – Tax reimbursement clauses allow the trustee to reimburse the grantor for income taxes paid. Do note that Chief Counsel Advisory Opinion (CCA 202352018) indicates that we cannot decant or otherwise modify a trust to add tax reimbursement without risking a gift back to the grantor.
  - Reimbursement provisions must be discretionary. Routine use of a tax reimbursement clause could be deemed to be an

    - agreement between the trustee and the grantor regarding reimbursement, which could result in estate inclusion for grantor.
    - Using reimbursement clauses are not always practical even if included in trust.
    - Presenters opposed relying on reimbursement clauses to reduce the burn.
- Terminate grantor trust status so that trust is a non-grantor trust and pays its own taxes. Grantor trust status should not be turned off while there is a note outstanding between the trust and the grantor. Doing so could trigger income taxes.
    - Grantor's spouse cannot be a beneficiary without adverse party consent to distributions.
    - No one can have the power to add beneficiaries.
    - Trustee cannot have power to use income to pay premiums.
    - Non-fiduciaries cannot have the power to vote stock or control investments when corporate holdings are significant.
    - Toggling off grantor trust status may raise fiduciary duty issues for the trustee. This may particularly be an issue where there is a trustee duty solely to the beneficiaries.
- Consider the structure of the promissory note to the grantor. The interest rate could be increased. To avoid fiduciary duty issues for the trustee, consideration can be given to initially using a shorter term for the note allowing for renegotiation of interest rate.
- Invest some of trust assets in assets that generate less income.
- Consider the use of Private Placement Life Insurance.
- Distribute some of the assets out to the beneficiaries.
- SLATs – Spousal access trusts allow the spouse to take out income.
- Allow grantor to be or to become a beneficiary.
- Prepay the note before its maturity date.
- Use self-cancelling installment notes.

AVOIDING MISTAKES IN ESTATE ADMINISTRATION

Presenter: Martin Shenkman, CPA, MBA, PFS, AEP (distinguished), JD. Martin is an attorney with Shenkman Law in private practice in New York. Marty was unable to attend personally but presented virtually.

Introduction to Trust Administration

- Trustee has a duty of loyalty to trust and beneficiaries.
- Proper trust administration has a variety of purposes in terms of protecting the asset protection features of the trust as well as the income and estate tax consequences of trust.
- Malpractice environment in estate planning is getting worse. Far too many mistakes are made in trust administration.
    - One issue is clients complaining that they don't understand the plan. Using a checklist summarizing all aspects of the trust and related documents and everything required is protective of the practitioner and makes it easier for the client to understand.
- Every advisor should have a copy of the client trust and understand the trust.

Cases

- *Smaldino* case – In this case, husband transferred an interest in an LLC to spouse and spouse transferred the units to trust. Documents were signed in August with April effective dates. Husband filed a gift tax return but did not treat the gift to trust as a split gift. The wife admitted that she had committed to transfer units to trust before she received them. The court said she never really owned the units and treated the gift to trust as coming from the husband. This is a case that illustrates that documentation and order of the process matters.
- *Levine* case – The Tax Court addressed Code Section 2036(a)(2) and whether the estate tax should apply to include cash surrender value of life insurance in decedent's estate. Code Section 2036(a)(2) includes in the value of the taxpayer's gross estate the value of all property that the decedent had transferred during lifetime for less than full and adequate consideration in money or money's worth not in a bona fide sale or exchange, over which the decedent retained for life the right, alone or in conjunction with another person, to designate the person or persons who shall possess or enjoy the property or the

income therefrom. An important fact in this case was that the irrevocable insurance trusts had always owned the life insurance policies. Another important fact was that the trustees of the insurance trust were independent. While the case is a split dollar case, it more represents proper handling of the formalities. The court praised the taxpayer for doing things right. Every practitioner should read the case from that perspective.

- *Connelly* case – Holding was that value of life insurance for buy/sell purposes had to be included in the value of the company. Two brothers that owned the stock didn't follow the provisions of their own agreement.

Common Errors in Trust Administration

- Wrong tax identification numbers may be used regarding a trust. One practical solution to avoid this is to write the identification number on a copy of the trust document.
- Wrong name of the trust appears. Trust name should be descriptive enough to identify the trust. The issue sometimes arises with reference to an account titled in the trust. Financial company might have limited number of spaces to enter trust name and it may be truncated in a way that makes it difficult to identify.
- Ignoring Defined Value Mechanism. A defined value clause establishes the value of assets being transferred as a gift or by sale, usually to an irrevocable trust. A defined value clause establishes the value so it is important to implement them correctly.
- An incorrectly filed tax return could result in the transaction being undone. If a Wandry clause was used, then the return should reflect estimated ownership. See *Wandry* case.
- Once the SOL runs for gift tax return then use the correct percentage of ownership versus the estimated.
- In an incomplete gift trust, there may be a mechanism to backstop the defined value clause. Using a re-run of the original gift letter can result in failure of the gift and estate tax inclusion.
- Wrong tax filings may be made. For example, there may be a marital trust and a credit shelter trust and all the income gets reported to the spouse. Attorney should coordinate with accountant on the structure of the trusts.

- Crummey Notices are often done incorrectly or not done at all. Gifts may not qualify for the annual exclusion because other gifts may have been made prior to the gift to Crummey.
- There are numerous options to make changes to irrevocable trusts to improve state income tax consequences.
- Deeds are often done incorrectly or not recorded. As part of the planning process, deeds should be reviewed and a record kept of the recordation process. At the administration phase, a review of all deeds should be effectuated early on in the process to identify any potential issues.
- Care should be exercised about titling of real estate when client has asset protection trust in same state as real estate. Title real estate in an LLC. Real estate titled in the client's name could result in the client having a presence in the state that will undermine the asset protection provided by trust.
- Corporate Transparency Act – Failure to file can affect trusts. Deadline is end of 2024. Penalties for failure to file are significant.
- There may be multiple powers of appointment in an estate plan that are not being exercised. Create a list of powers of appointment and review the list routinely to determine whether any have or should be exercised.
- SLATs – Reciprocal Trust Doctrine – Does typical family trustee understand the various differences that were built into the documents to address the reciprocal trust doctrine? What happens in the administration process? Does trustee realize that there are different beneficiaries of each trust? The compilation of trust documents helps identify these issues to facilitate administration.
- Trust can't pay personal expenses of client. This sometimes occurs when an irrevocable trust creates an entity and the entity pays personal estate planning expenses.

Create a Compilation of the Trust and all aspects of the Plan and update the same annually.

- When you create this type of compilation, the steps to administer the estate become apparent.

- Additionally, your annual meeting agenda becomes clear. An annual meeting to review an estate plan and collaborate with other advisors is the best prevention for issues in the later administration.

Annotating and Analyzing the Trust Document

- Go through trust and make notes directly in trust in varying colors for various advisors.
- Investment advisors should have an investment policy for each trust.
- Accountants should have copy of trust and coordinate with tax preparation.
- Include:
  - Name of Trust.
  - How was Trust Created? Date of trust agreement.
  - Trust Tax Identification Number. This can be noted on trust.
  - Current Trustees.
  - Successor Trustees.
  - Powerholders.
  - Trust Assets.
  - Trust Distribution Provisions.
  - Letters of Trusteeship.
  - Identify Beneficiaries. This is not as simple as it might appear. Consider artificial reproductive technology. Trust might include a significant other or floating trust provision.
  - Summary of selected trust provisions.

Beneficiaries with Mental Health Issues, Substance Abuse Issues

- These issues are more prevalent in wealth families than in non-wealthy families.
- Consider how trust should be administered when these issues are present.
- This is a more detailed subject that merits a full presentation.

CURRENT DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

Presenters: Turney Berry and Charles "Clary" Redd. Turney is a partner at Wyant, Tarrant & Combs LLP. Charles is a partner at Stinson LLP.

Estimated 2024 Numbers

- Estate and Gift Tax Exclusion $13,990,000
- Annual Gift Tax Exclusion $19,000
- Gifts to Non-citizen spouses $190,000
- §6166 estate tax deferral $1,900,000
- Threshold maximum federal income for non-grantor trusts and estates at which maximum tax applies$15,650

Moore case

- *Moore v. United States*, 36 F.4th 930 (9th Cir. 2022)
    - Tax was challenged as an unconstitutional direct tax. The challenge was specifically to the Mandatory Repatriation Tax.
    - Supreme Court ruled that repatriation tax was not a tax on property but rather a tax on income. Although income was not realized by the Moore's but by the company, the income was attributed to the Moore's.
    - This case makes it more difficult to challenge the power of Congress to impose taxes.
- Court did not say that realization is necessary, which is an issue tax planners likely should keep in mind.

Consistent Basis

- The final regulations on consistent basis were issued on September 17, 2024 and are based on Code Secs. 1014 and 6035.
- The final regulations regarding the statutory consistent basis requirement affect recipients of property acquired from a decedent if the inclusion of the value of the property in the decedent's gross estate increases the federal estate tax liability.
- The final regulations regarding the statutory basis reporting requirements affect executors and other persons required to file an estate tax return based on the value of the decedent's gross estate and the amount of decedent's lifetime adjusted taxable gifts, as well as trustees making in-kind distributions of property initially acquired

from a decedent that was subject to the statutory basis reporting requirements.

- Treasury Regulations Section 1.1014-1(a) provides that “the purpose of section 1014 is, in general, to provide a basis for property acquired from a decedent that is equal to the value placed upon such property for purposes of the federal estate tax.”
- Zero basis rule for unreported property was dropped in final regulations.
- Reporting of basis is required after assets distributed.
- The final regulations adopt a suggested interpretation of the term "acquiring" under Sec. 6035(a)(1) for reporting purposes.
- The final regs eliminate a reporting requirement for subsequent transfers of property for all beneficiaries other than trustees.
- The final regs except additional types of property interests from the consistent-basis and Sec. 6035 reporting requirements.
- Recognition event occurs upon sale of property even if there is no gain/loss on sale. Recognition event removes asset from basis reporting system. Presenter suggested that a practitioner could effectuate a recognition event immediately following death to remove the assets from the system. One reporting would still be required by the executor but additional reporting would not be required.

Federal Rulings, Cases And Other Developments

- Charitable and Tax Exempt Matters
  - *Buckelew Farm v. Commissioner*, T.C. Memo. 2024-52 – This case related to a syndicated conservation easement. Taxpayer won the legal arguments but lost the valuation argument. Issue related to highest and best use of property before the easement. Appraiser didn’t have sufficient information to take the position that was taken regarding highest and best use of property. This case reflects the need for taxpayers to comply with the multitude of requirements under Section 170 and the regulations thereunder in connection with claiming a charitable deduction.
  - Proposed regulations regarding Donor advised funds
    - Regulations provide that an investment advisor to a DAF can not be paid by the DAF unless the investment advisor

provides investment services to the sponsoring organization as a whole. The effect of this rule would be to penalize community foundations and privilege commercial investment houses that operate DAFs for investment purposes.
    - Distributions from a DAF other than to charitable recipients or to pay investment fees would be prohibited.

- *Connelly* case
  - Two brothers owned all the stock in a corporation. They had a buy/sell agreement that allowed the survivor to buy out the other. If survivor does not buy out, the company will redeem. The agreement provided for a certificate of agreed value or an appraisal. The company funded the buy/sell agreement with life insurance. Michael died. Instead of following the agreement, the surviving owner entered into an agreement with the surviving son to buy out the shares for $3,000,000.
  - Supreme Court ruled that value of the life insurance is includible in the value of the company. Value without insurance is $3.8 million. When $3,000,000 is added, value is $6.8 million.

Grantor Trust Rules

- CCA 202352018 – Decanting to add a tax reimbursement clause is a gift by the beneficiaries to the grantor.
  - One issue with this is what the value of the gift is.
  - This CCA raises the concern as to whether there will be additional efforts to characterize trust modifications as gifts by the beneficiaries.

Marital Deduction

- *Anenberg v. Commissioner* –
  - Sally J. Anenberg and her husband Alvin established the Anenberg Family Trust. When Alvin died, marital trusts were funded, with a QTIP election made, granting Sally a lifetime income interest and Alvin's children contingent remainder interests.
  - In 2012, the marital trusts were terminated with the consent of all parties, and the property was distributed to Sally. Sally made

a gift of shares to Alvin's children and sold the remaining shares to them for promissory notes.
  - Sally's 2012 gift tax return reported tax only for the gift of shares, not the sale.
  - The IRS issued a Notice of Deficiency, asserting that the termination and sale constituted a taxable disposition under §2519, subjecting the estate to gift tax and an accuracy-related penalty.
  - The Tax Court ruled that termination of the marital trusts and the subsequent sale of the shares did not result in a taxable gift under § 2519.
- *McDougall* – 163 T.C. No. 5 (September 17, 2024)
  - Upon decedent's death, estate residue passed to a marital trust. Her surviving spouse had an income interest in the trust and their two children had remainder interests. A QTIP election was made on decedent's estate tax return with respect to the property that passed to the marital trust. Later, the surviving spouse and children entered into an agreement where marital trust assets were distributed to spouse. Spouse then sold some of the assets to other trust created for the benefit of the two children and their children in exchange for promissory notes. Gift tax returns were filed reporting transactions as offsetting reciprocal gifts.
  - IRS took position that the commutation was a gift from surviving spouse to children and the agreement resulted in gifts from the children to surviving spouse of the remainder interests in the marital trust.
  - The Tax Court held that assuming there was a transfer of property under section 2519 when the marital trust was commuted, the surviving spouse is not liable for gift tax under section 2501 because the surviving spouse made no gratuitous transfers, and the transfer of the marital trust property in exchange for promissory notes also did not result in gifts from the surviving spouse to the children. However, the agreement to commute the marital trust resulted in gifts to the surviving spouse by the children under section 2511.

GST Regulations

- Extensions
  - Extension may be allowed if during the time prior to seeking the extension, taxpayer acted reasonably and in good faith.
  - Will the extension being sought prejudice the government's interest?

PRACTICAL INCOME TAX PLANNING WITH YOUR ESTATE PLANNING FAMILY LIMITED PARTNERSHIP

Presenter: Robert Robes. Bob Robes is the Director of Wealth Strategists at Baird Private Wealth Management and is based out of Baird's office in Charleston, South Carolina.

Why Limited partnerships are used in estate planning

- Creditor and asset protection planning
- Centralized control over family wealth
- Pooling of family investment opportunities
- Diversification of risk
- Vehicle for gifting to family members
  - Value can be transferred to family members while retaining control.
  - Discounting is available.

Discounting Limited Partnership Interests

- Typical discounts are for lack of marketability and minority interest.
- Partnership agreement should include the provisions that support discounts.
- Partnership must be established for valid business reasons.

Income vs. Estate Tax Benefits of an Estate Plan

- Basis planning is a goal, particularly for the majority of estates that are not subject to estate tax. Maximize the basis of any asset that is anticipated to be sold.
- Consider potential transfer tax cost against the income tax savings.
- The valuation discount applicable to a partnership interest in the estate of a partner may result in unintended income tax consequences at death.
- A Section 754 election allows a step up of inside basis of partnership assets to fair market value.
- When Section 754 election is not made, in a case where the FMV of LP exceeds basis, an estate could end up with a capital loss, which might or might not be useable. When Section 754 election is made, if discounting was used at time of gift, estate may have a gain.

Impact of Valuation Discount

- Discount applicable to FLP interest included in estate reduces the amount of the step up in outside basis.
- If you use discount at time of gift, when time has passed, reconsider structure so that you can get a greater value (and basis) at time of death. This approach would typically be most appropriate for consideration when there is no estate tax at death. If estate is subject to estate tax, discount may still be preferable.

Avoiding Income Tax Trap At Death Caused by Valuation Discounts of FLP Interests

- An income tax trap may occur upon the death of a partner where a discounted limited partnership interest is an asset included in the deceased partner's gross estate and there has been little or no appreciation in the value of the partnership's assets.
  - Example presented included a partnership that owns an actively managed portfolio where gain is routinely being realized and recognized. Discounted value of partnership interest might be lower than basis of assets in partnership. Tax trap could occur if partnership has Section 754 basis election already in place.
- Interplay between use of valuation discount and Section 754 electin must be considered.

Section 754

- When Section 754 election is made, it remains in effect for term of partnership.
- A Section 754 election applies to all property distributions and transfers of partnership interests taking place in the partnership taxable year for which election is made and all subsequent taxable years.

Taxable Installment Sale of a Partnership Interest

- The idea behind doing a taxable installment sale is that character of gain recognized by seller is capital and purchaser takes a cost basis in partnership interest.
- Not all assets are eligible for installment sale treatment.

    - 453(k)(2) prohibits use for sale of marketable securities.
    - 453(i) prohibits use for avoidance or recapture of gain.
- Capital account remains unchanged in hands of purchaser.
- If no Section 754 election is in place, adjusted basis of partnership assets is not impacted by sale of partnership interest. If 754 is in place, then adjusted basis is purchase price.
- Effect of 754 is to provide purchasing partner a cost basis in assets. Discounted sale could result in purchasing partner not having adjusted basis.
- It is important to be mindful of the anticipatory assignment of income doctrine.

Recent Anti-Basis Shifting Proposals

- Guidance on basis-shifting was issued on June 17, 2024. The guidance addresses basis shifting where partnerships and related parties are involved.

CHARITABLE GIFT ANNUITY PRIMER

Presenter: Lawrence P. Katzenstein. Lawrence is a partner at Thompson Coburn, LLP in St. Louis, Missouri.

Basics

- A charitable gift annuity is essentially a bargain sale. Donor transfers cash or property to charity in exchange for consideration less than the property transferred receives charitable deduction for difference.
- A charitable gift annuity is a contract between a charity and a donor.
- Donor to charitable annuity receives an annuity, which is an annual fixed sum.
- The remainder interest, the amount that will go to the charity, results in the charitable deduction.
- Benefits:
    - There is an income tax deduction during life. A lifetime charitable deduction is of more value than one at death for client's not subject to estate tax.
    - Donor receives income during life.
- Donor is relying on an unsecured promise to pay so donor should be comfortable with likely solvency of charity. Will the charity be around to pay the annuity? A CGA with a brand new charity may not be a great idea. Donor should ask whether entire amount of gift is set aside during term of annuity.
- Charity should make sure it will have enough funds to pay annuity. Another risk for charity is to seek to avoid having one donor being a significant part of the annuity pool.

Differences Between CGA and a CRT

- Part of every annuity payment is likely to be tax free.
- CGAs are simpler to set up and maintain.
- If annuitant of CGA dies before life expectancy and has not recovered full investment in contract, the remaining unrecovered basis is allowed as a charitable deduction on final return.
- The 10% rule of the CGA is different than the CRT. The CGA test does not affect the donor but only the charity.
- A 5% exhaustion rule applies to CRTs.
- Remainder beneficiary cannot be changed with a CGA.
- CGA is limited to one or two lives.
- CGA can hold S corporation stock.

- Donor cannot control investments in CGA but can in a CRT.
- Most of the private foundation rules apply to CRT.

Gift Annuity Rates

- American Council on Gift Annuities recommend maximum annuity rates.
    - Rates are maximum rates. Charity can always offer a lower rate and allow donor a higher charitable contribution.
- Rates are set so that if charity has sufficient annuitants, amount remaining at end of annuity will be half the value of original contribution.
    - Annuity rates assume 50% male and 50% female.
    - 1% is assumed annual expense rate and earnings rate assumption is 5%.
- Charities should talk with clients regarding whether or not they itemize. If they do not itemize, they may be better off with more income and less charitable deduction.
    - 10% test – Value of annuity must be less than 90% of the value of the property.
    - Charity cannot guarantee a minimum or maximum amount of payments.
    - Annuity contract cannot provide for adjustment of annuity based on income received from property.

Things You Can Do With a CGA that You Can't Do with a CRAT

- Payments from charitable annuities can be deferred. The rates for deferred annuities are higher than the rates for immediate annuities.
- Flexible deferred gift annuities can leave the start date open. The longer the annuity is deferred, the larger the annuity payment will be.
- One technique being used is the surrender of a deferred annuity interest in exchange for tuition.
- Donor could contribute a painting to a museum in exchange for a charitable gift annuity.
- A donor could give a musical instrument to symphony orchestra for use by a player in exchange for a gift annuity.
- Donor could give an office building and continue to maintain an office in the building in exchange for a charitable gift annuity. This would not

be possible with a charitable remainder trust due to the self dealing rules, which do not apply to a public charity (which the annuity provider must be for this example to work).
- Closely held stock can be given to a charity in exchange for a CGA. A family member could later purchase the shares at fair market value. Self dealing rules would prevent that in a CRT.
- Gift of marketable securities can be made in exchange for CGA in a case where 10% test might be satisfied but the 5% exhaustion text applicable to CRTs would not be met.

Step Annuities

- A CGA can be structure so that it increases annually. A deferred step annuity can combine and a deferral of the payment along with a step increasing annuity.

Termination of Annuity

- Annuitant can assign annuity interest to charity. Income tax charitable deduction is limited to annuitant's unrecovered basis in contract.

Estate and Gift Tax Rules

- The remainder interest to charity of a one life immediate gift annuity qualifies for the gift tax charitable deduction.
- The purchaser of an annuity for the donor's life followed by a second life makes a gift that qualifies for the gift tax charitable deduction as well as a gift to the person who receives the second life interest.
- If donor's spouse is the only annuitant, the gift qualifies for gift tax marital deduction. If annuity is donor for life and then spouse for lie, marital deduction availability is not clear.
- Death of an annuitant of a one life annuity ends all rights in the annuity so there is no estate inclusion.

CREATIVE USES OF CHARITABLE REMAINDER TRUSTS

Presenter: Alan S. Glassman. Alan is a partner at Gassman, Crotty and Denicolo, P.A., in Clearwater, Florida. Alan shared an "away" poem at the start of his presentation:

Good luck everyone in the path of Hurricane Helene,

Including me, while at this conference in South Bend / Notre Dame.

Professor Hesch's amazing programs include a storm of electrifying stuff,

So just keeping up for some of us may be somewhat rough.

My all-weather assistant, Reilly, at reilly@gassmanpa.com,

Will be available, as always, to help you without a qualm.

Let's all stay dry - except for the humor,

Because unfortunately this storm is no rumor.

Here's hoping the storm is both gentle and kind,

And once I get to a computer, a response to your email you may soon find.

So sorry for the low quality of this rushed poem,

But if you have boats and paddles, it may now be time to roam.

Charitable Remainder Trust Basics

- Three types:
  - CRAT – a charitable remainder annuity trust pays noncharitable beneficiary a fixed percent or amount for a term of years or the lifetime of one or more beneficiaries.
    - Minimum Annual payment
    - 5% probability of exhaustion test
    - 10% minimum remainder requirement

- CRUT - a charitable remainder unitrust pays noncharitable beneficiary a percent of value of the trust recalculated annually. A unitrust may permit certain variations on the standard percentage calculation.
    - Pays Greater Amount if Values Increase
    - Annual Valuations Required
    - 5% probability of exhaustion test
    - 10% minimum remainder requirement
- Flip-NIMCRUT – Such unitrusts start out as a NICRUT or NIMCRUT and then “flip” into a regular unitrust payment upon the occurrence of a triggering event.
    - Pays Greater Amount if Values Increase
    - Annual valuations required
    - Payments can be Deferred
    - 10% minimum remainder requirement

- When charitable remainder trusts work well:
    - For clients who have charitable intent.
    - For Clients Who have Appreciated Assets

Defer Gain on Sale of Appreciated Asset

- Consider a CRUT when appreciated assets will be sold in order to defer capital gains taxes and avoid or defer the 3.8% NIT tax.
- Transfer the assets to the CRUT before there is a binding obligation or solidly negotiated understanding as to the sale to facilitate deferral of income tax.
- This can be coupled with Estate Tax reduction, and a SLAT/Dynasty Trust Installment Sale, as mentioned below.

Flip NIMCRUT

- Durable Power of Attorney

Can you pay deductible or rent to a Flip NIMCRUT?

- A SLAT or Dynasty Trust that has the authority to form and fund a Charitable Remainder Trust may do so with the remainder interest charity being defined to possibly include a Cemetery Association or Police or Fireman Benevolent Society. The CRT transfer will not be considered to be a gift for gift tax purposes and the remainder interest will not qualify for an income tax deduction.

- In such event, Internal Revenue Code Section 4947(b)(3) indicates that the Self-dealing rules, will not apply, so it should be possible for family members and entities to borrow money from the CRUT at market rates, and to pay deductible interest to the CRUT.
- Please note that the IRS will no longer rule on such arrangements, but it is in the Internal Revenue Code.

Increase Valuation Discounts by gifting or selling annuity or unitrust interests or ownership interests in entities that own such interests

- Establish the CRUT or CRAT and then value the payment rights. Gift or sell the payment rights to a Grantor Trust in exchange for a promissory note.

Consider Taking Trustees Fees out

- Consider allowing the client and/or one or more family members to serve as a Trustee or Co-Trustee of the CRT in order to maximize the return provided to the family, even though these will be an after tax dollars, if the client wants to maximize what the family receives.

Put a Value on the Benefit to the Family From Having Control Over the Charitable Remainder Entity.

- Ask the family if it is worth perhaps 5% of the day one value of the entity to have a remainder interest charity that will benefit the community

S Corp Transfers Assets to Charitable Remainder Unitrust Before Sale

- S corp can transfer assets to a CRUT as long as it is not substantially all of the assets.
- F Reorganization – You form a parent corp and transfer S corp to parent corp. S corp becomes a QSST. Subsidiary continues to own assets.
- New Parent S corporation forms a Flip NIMCRUT. There is a blocker LLC between Flip NIMCRUT and Old company.

Convert a C corporation to an S corporation and Avoid the Unrecognized Built in Gains Tax

- An S Corporation that may have unrecognized built-in gains from having converted from being a C Corporation may transfer appreciated assets to a Charitable Remainder Trust that then sells

them. This needs to be a transfer of less than "substantially all" of the S Corporation assets in order to not trigger gain on the transfer.

Stretch IRA's to 20 years or a Lifetime

- Make a 20 year or lifetime CRT the beneficiary or contingent beneficiary of one or more IRA accounts. The IRA account assets can empty into the CRT without causing income tax until the Trust makes distributions. Trust can begin to earn capital gains and qualify dividends that would be paid out after the ordinary income has been used to reduce overall taxation and to simply/eliminate the

IRA Disclaimer to Charitable Remainder Trust p 51

- IRA can be made payable to accumulation trust that allows for Trustee of beneficiary to disclaim IRA in whole or in part.
- Contingent beneficiary is Charitable Remainder Unitrust.

Make Large IRA and Pension Accounts Payable to a Standby CRUT with Blocker LLC for Funding on Death Can be Used for This

- Set up dedicated revocable trust.
- Revocable trust owns LLC.
- IRA pays to LLC on death. LLC is a blocker. IRA proceeds goes to LLC.
- The income recognized by the LLC may not be considered to be Fiduciary Accounting Income of the Flip NIMCRUT until dollars or assets are actually transferred from the LLC to the Flip NIMCRUT if situated in a proper state. A 20 year Flip NIMCRUT could have 19 years of postponed income.

Spray the Income to Lower Bracket Beneficiaries or Charities

- When forming a Charitable Remainder Unitrustor Annuity Trust draft to allow an independent Trustee to spray/distribute the payments as between one or more individuals, including individuals who may be in lower tax brackets.

Diversify – Form Both a CRUT and a CRAT

- When retirement planning is considered, a fixed payment CRAT can help assure that the Donor will receive a fixed amount of payment until the term ends or the Trust assets run out, while a CRUT can help assure that growth in value and inflation result in payments that

may grow in value as compared to what a CRAT would pay. A CRAT with 60% bonds and 40% equities and a CRUT with 40% bonds and 60% equities may work best.

Asset Protection and Divorce

- Creditors typically cannot reach what is locked in for charity. In some states, annuity payments are exempt from creditor claims.

Avoid Paying Annual Distributions From a Private Foundation By Using a Short Term NIMCRUT That Pays to Charity After a Short Term of Years

- If client would like to make contribution to a private foundation or a private operating foundation but not have to make distributions in the first one, two or three years, then a Flip NIMCRUT that receives the contribution and will pay a unitrust or annuity trust payment eventually and surely before the distribution of remaining assets to a private foundation or a private operating foundation may be an appropriate fit.

SUBSTITUTE VS. SUPPORTIVE DECISION-MAKING OPTIONS AND POTENTIAL CONSEQUENCES FOR CLIENTS WITH DIMINISHED CAPACITY

Presenter: Sandra Glazier. Sandra is a partner at Lipson Neilson, P.C. in Bloomfield Hills, Michigan.

Supported Decision-making

- Supported decision-making creates options for the person who needs support, which may allow them to be able to make a decision rather than having a surrogate making the decision for them.
- Supports for a client could be personal or technology based.
- Some states officially recognize supported decision-making.
- Capacity is a fluid state rather than a static condition.
- See Assessment of Older Adults With Diminished Capacities, 2nd Edition, Handbook for Lawyers, ABA Commission on Law and Aging and American Psychological Assn.

Importance of a Good Fiduciary

- Great documents may not be helpful if the client has a bad acting fiduciary. Rather than bad acting, you might simply have a negligent fiduciary.
- Encourage clients to give significant thought to selection of a fiduciary.

Medical Surrogate Decision-making

- The majority of states have statutes providing for some form of surrogate medical decision-making. In many states, such laws allow a surrogate to act on behalf of a patient if a patient has no patient advocate or guardian.
- Medical surrogate decision-making refers to the process by which a a medical surrogate or proxy makes healthcare decisions on behalf of another individual who is unable to do so as a result of incapacity or serious illness. This can occur when a patient is unconscious, mentally incapacitated, or otherwise unable to communicate their wishes regarding medical treatment.

Designation of Patient Advocate

- Pursuant to a valid DPA, principal can select a surrogate decisionmaker. This may avoid the need for a court-appointed guardian.
- DPA may establish who can make a determination triggering the need for an “Agent to act. Determination may require a panel of persons familiar with the principal’s capacity, a treating physician, or a combination of various people who have assessed the principal’s capacity.
- Statements of intents and desires in a DPA may specify the degree to which the principal may wish to limit interaction with particular family members.
- Even when an excellent fiduciary is selected, there may be instances where a court process is preferable. A court process might provide protection to a fiduciary that might not be provided under a power of attorney.

Accommodating Party Accounts by Individuals as Amenisis

- Joint accounts may subject assets to creditors and result in unintended presumptions about grantor’s dispositive intent.
- Consider using an accommodating party account where someone is named just to assist with the payment of depositor’s obligations. The account allows designation of a limited agent who can access the account for the benefit of the owner but not the agent’s own benefit.

Trusts

- Even small estates can benefit from a trust because you can implement much better guardrails in the event of incapacity.
- Trust may assist with Representative Payee appointment given that the social security administration has its own set of rules as to who is permitted to receive, manage and account for benefits.
- Grantor may be the initial trustee of the trust. Grantor can choose to have a co-trustee immediately or simply name a successor.
- Trust provides standards and process for succession from grantor as trustee.
- Trust can help provide privacy while still requiring accountings on behalf of an incapacitated grantor.

- Powers and authority granted to a trust protector, advisor or director can help avoid need for a court proceeding.
- Trust can include automatic or optional provisions for removal or replacement of a trustee. Circumstances can be specified.
- Persons and institutions are more likely to accept an appointment as a trustee than as an attorney in fact under a POA.
- A Ulysses clause can be included in a trust. Such a clause prevents the grantor from overruling previous direction when the grantor meets criteria of being incapacitated.
- Different fiduciaries may hold different powers. This provides flexibility and can provide accountability.
- A trust can provide options regarding distributions that are not otherwise available. The grantor may want to avoid having significant gifts made while the grantor is alive but incapacitated. Alternatively, the grantor might want to be assured that there are sufficient distributions made for a spouse or other beneficiaries.

Court Protective Proceedings

- The goal is to use the least restrictive option and to provide client autonomy.
- Protective Orders – A protective order is a legal document issued by a court to protect the interests and well-being of an individual who is deemed incapacitated and unable to manage their own personal, medical, or financial affairs.
- Guardianship – Guardianship is a legal arrangement in which a court appoints a guardian to make decisions on behalf of an individual who can't make decisions for themselves due to incapacity. Such individual is known as a ward.
- Conservatorship – A conservatorship is a legal arrangement in which a court appoints a person or organization to manage the financial affairs and/or personal well-being of an individual who is unable to do so on their own due to incapacity.

TRUST MODIFICATIONS AND TRUST TERMINATIONS: UNINTENDED CONSEQUENCES AND HOW TO AVOID THEM

Presenter: Ed Morrow and Paul Hood. Ed Morrow is Co-Chair of the Estate Planning and Trust Administration Groups at Kelleher + Hollan, LLC, based in Chicago, Illinois. Paul is an author, speaker and consultant on tax, estate and charitable planning and business valuation.

Introduction

- There may be a false sense of security about decanting as to whether you have the fiduciary power to do what you are seeking to do.
- Why Terminate Trusts Early?
  - Trust may no longer be needed.
  - Concern about creditors/divorce/bankruptcy doesn't exist.
  - Lifetime distributions or investment choices may be hampered.
  - Testamentary distributions/planning may be hampered.
  - Federal income tax drawbacks once grantor trust status is turned off.
  - Costs.
  - Disputes with trustee or other trust advisors.
  - Disputes with current beneficiaries.
  - Disputes between beneficiaries.
  - Disputes between current and remainder beneficiaries.
  - Disputes between current and remainder beneficiaries.
- If trust is changed, a retroactive change likely does not need to be respected. Exception might be true scrivenor's error.
  - *American Nurseryman Pub. V. Comr*. – "Not even judicial reformation can operate to change the federal tax consequences of a completed transaction."
  - *Harvey C. Hubbel Trust v. Comr*., T. C. Op. 2016-67, the Tax Court denied the income tax effect of a Hamilton County, Ohio probate court-ordered retroactive reformation.
- A prospective change should be different.
  - Rev. Rul 73-142 – Grantor went to court years prior to his death to have court determine that trust had him mistakenly retaining a power. IRS ruled that the court order had tax effect.

Gift/Estate Tax Effect of Beneficiary Procurement or Acquiescence to Amendment

- Treas. Reg. Sec. 25.2511-1 has a broad definition of gift for gift tax purposes.
- Donative intent is considered very important.
- Gift tax is an excise tax on the privilege of transferring property during lifetime.
- If act is completely involuntary, arguably no taxable gift occurs. The lines are more blurred if a putative donor could have prevented a transfer. Failure to preserve one's rights by inaction could be considered a transfer. See e.g. Rev. Rul 81-264 and GCM 38584 and Rev. Rul 84-105.
    - An example might be that my kid steals money from me. I don't intend a gift at the time but if I let my kid keep the money by inaction, then I may have made a gift.
- Rev. Rul 86-39. A transaction shifted value from one trust to another. One trust had testamentary general power of appointment to one that did not. This was considered release of a general power of appointment. The release is considered a gift.
- *Sexton v. U.S.*, 300 F. 2d 490 (7th Cir. 1962) cert denied 371 US 820 (1962) – Kids got together and extended terms of trust. Acquiescence to extension was a transfer into the trust, a section 2036 issue. Court said that had beneficiary not consented, their argument that the amendment was a relinquishment that had no tax effect might have been persuasive.
- *Brooks v. Welch* – Exercising the rights is not a contribution to trust but more along the line of a power of appointment. It's not a transfer of property.
- PLR 9451049 – Removing a hems standard might be a transfer.
- Procurement or active acquiescence to creating a GPOA or even LPOA that could divest a beneficiary of the ability to appoint is likely a transfer that is a gift.
- The closer you get to being able to quantify how much a reformation or amendment increases or decreases value, the more likely you are to have a gift.

- Avoiding beneficiary involvement in any action that substantially changes beneficial interest is safer. Use an independent trustee or independent holder of a collateral lifetime limited power of appointment.
- McDougall v. Comr, 163 T.C. No. 5 – Children surrendered QTIP remainder interests leaving dad as sole owner of property in terminated QTIP. Court followed Annenberg as to the 2519 issue; however, the court concluded that release by children was a gift to dad.
    - Dad had a testamentary limited power of appointment among their descendants. If you were a buyer of the remainder, what would you pay knowing that interest could be divested.
- The IRS has put decanting on no ruling list with respect to changes in beneficial interests. The area is under study.
- Asset Protection Effect – any change can impact the asset protection features of the trust.

Impact of the GST Tax and State Trust Law Reactions

- Not every modification will be respected.
- CCA 202352018 – Modification that added tax reimbursement clause was a gift by the beneficiaries to the grantor.
- Consider the exercise by the trustee of the tax reimbursement clause. Is the trustee taking money that belongs to the beneficiary and giving it to the grantor? Does the settlor have the right to sue the trustee for failing to exercise discretion to reimburse the grantor. v

Potential Income Tax Effects of Commutations Generally

- A commutation is simply an early termination that involves trustee giving each beneficiary the current actuarial value of their share.
- PLR 201932001-10 – Parties agreed to terminate trust. Court agreed that there was no gift. For income tax purposes, the IRS said, “this is in substance a sale or exchange.”
- There is no clear authority that IRS is correct or incorrect. IRS cites 69-486.
- Likely the best authority is the Cottage Savings case addressing when you have the sale or exchange of property interests.

- PLR 200723014 – If under local law, the trustee is authorized to terminate Marital Trust B and distribute its assets to the remainder and life beneficiaries, the proposed termination and distribution will be by operation of law and will not be a sale or disposition.
- A commutation is a disposition when parties are receiving entirely different interests.
- Consider CYA letter that addresses possible income tax consequences of a trust termination.

MOVING TIME: OVERCOMING TOO MUCH VALUE IN GST VULNERABLE TRUSTS

Presenter: Chris Siegle. Chris is the Senior Wealth Advisor and a Managing Director in the Phoenix office of J.P. Morgan Private Bank.

GSTT-vulnerable Trusts

- QTIP Trust
- GRAT remainder trust
- Portion of survivor's trust not covered by GSTT exemption

Unique Issues with QTIP trusts

- Qualifying Income Interest and IRC 2519 – *Annenberg* case – Termination of QTIP was not a gift to spouse because nothing changed from transfer tax perspective. Assets of QTIP were includable in surviving spouse's estate while in QTIP and includable in estate after termination of trust.
- All Net Income From Trust
- Fiduciary accounting income under 643(b)
- IRC 651, 652 – All income is distributed. Trust gets a deduction. Spouse includes the income on her return.
- How can we expand the use of the QTIP Trust with these limitations?

Shaping the Environment for Planning

- Create grantor-like income tax owners of trusts, by individuals or trusts.
- IRC 678(a)(1) – This section is about when someone other than the trust creator is treated as the income tax owner of the assets.
  - A person other than the grantor shall be treated as the owner of any portion of the trust with respect to which such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself.
    - Vesting corpus can be a substantial risk of estate tax inclusion of the entire trust. We want to avoid this.
    - Income is more common as the target but what is income?

        - Consider adding capital gain to the definition of income or more broadly to include all elements of IRC 61. When this is done, then the withdrawal includes all income. You can use “taxable income” to bring in capital gain.

Who Should be the Income Tax Owner?

- Income tax owner could be the beneficiary of the trust.
    - If trust is a QTIP trust, then the beneficiary of the trust should be the income tax owner. Again, we are using a definition that includes “all of the income.”
    - Withdrawal right at the outset of the trust.
    - Withdrawal right springing from the actions of an independent trustee.
    - Added by state sanctioned decanting trust modification. CCM 2023252018.
        - This now raises the issue of how to avoid beneficiary consent when decanting?
- *Loper Bright Enterprises* case – This case overruled the *Chevron* doctrine. No longer are courts required to pay deference to agency decisions when it comes to interpretive regulations. This case gave power back to courts to come up with its view of the best interpretation rather than being held to the agency interpretation.
- Another irrevocable trust could be the income tax owner of another irrevocable trust.
    - PLR 201603321 – Trust 1 was modified to become income tax owner of Trust 2.
    - Treas. Reg 1. 671-2(e)(6). Example 8.
    - It could be a GSTT-vulnerable trust that owns a GSTT-exempt trust.
- 678 must be overlaid onto a non-grantor trust. This may make sense when trust is in the highest tax rate.
    - All income and gains flows to another trust.

When a GSTT-vulnerable trust owns a GSTT-Exempt Trust

- Goal is to get income tax free growth in GSTT trust.
- GSTT-exempt trust grows income tax free.
- GSTT-vulnerable trust is grantor like as to the GSTT-exempt trust.

- GSTT-vulnerable trust pays tax on all income and gain from GSTT-exempt trust (plus all of its income and gains.)
- Growth assets should be concentrated in GSTT exempt trust.
- Vulnerable trust owns exempt trust.
- Income tax ownership is significant because of what you can do with it.

Transactions Between Trusts

- Assets can be sold from grantor trust to GSTT exempt trust in exchange for a promissory note.
    - Exempt trust is owned by vulnerable trust.
- Installment sale for promissory notes.
    - Sale should look like an installment sale. When structuring, security interest should be taken in the assets.
    - Give consideration to the length of the installment note with an eye on the length of the GSTT exempt trust.
    - Promissory interest note payments needs to look like the income interest of the surviving spouse.
- Care should be exercised to avoid making a disposition of the income interest of the QTIP trust.
    - Definition of Income might need to include all receipts.
- Consider How to Use the Promissory Note
    - Promissory notes are still an asset to one trust and a liability to the other.
    - Note could possibly be exchanged for non-performing assets in GSTT-exempt trust.
    - When promissory note is in GSTT-exempt trust, the doctrine of merger will apply to cancel the promissory note.
        - When merger occurs, there could be capital gain recognition; however this is not clear.
- Exchanging Assets of Equivalent Value
    - GSTT-exempt trust has both the obligation for the note, and possession of the note.
    - GSTT-exempt trust transfers assets, including promissory note, with the GSTT-exempt trust.
    - GSTT-exempt trust transfers assets to the GSTT-vulnerable trust.

    - GSTT-vulnerable trust pays tax on all income, gain from the GSTT-exempt trust (plus all of its income and gain)
    - Exchange must be someone in a non-fiduciary role.
- If beneficiaries are the same for both trusts, shifting is fairly easy.
- A GSTT-vulnerable trust and GSTT-exempt trust could create a preferred partnership.
    - GSTT-exempt trust contributes assets and receives common interest (growth).
    - GSTT-vulnerable trust contributes assets, receives preferred and maybe some common interest.

A VIEW FROM THE TRENCHES: CURRENT ISSUES IN TRANSFER TAX AUDITS AND LITIGATION

Presenter: John Porter. John W. Porter is a partner at Baker Botts L.L.P. in Houston, Texas.

Anticipate the Dispute

- Prepare for the dispute at the planning state.
- IRS is staffing up on estate and gift issues.
  - They have specialists in various areas such as valuation.
- Common IRS challenges
  - Valuation
  - Formula Transfers
  - QTIP Termination
  - Promissory Notes
  - Installment sales to intentionally defective grantor trusts
  - GRATs
  - Penalties
  - Section 2036
  - Split dollar life insurance

Prepare for Audit

- Anticipate your potential audience at the planning stage.
- IRS issues broad request
- Understand and preserve privileges.
  - Attorney-client privilege
  - Work product – This typically applies to documents prepared in anticipation of litigation.
  - Tax practitioner's privilege
- Make sure your client understands privilege. Any waiver is by the client, not by the attorney.
- Your files can be subpoenaed. Subpoena could include emails.
- Estate planning lawyer may have to testify.
  - When this happens, privilege is waived.
- Best evidence of non-tax reasons comes from contemporaneous correspondence (See *Stone, Schutt*)

- It is okay to talk about tax attributes but also talk about non tax reasons also.

Relevant Valuation Decisions

- John keeps cases in his outline to create a list that offers alternative cases.
- John's advice is to get a good appraiser.
- *Cecil* case addressed tax affecting when valuing under a discounted cash flow approach. Court said tax affecting was appropriate in this case. Other issue in *Cecil* case was how to value company. IRS took position that appropriate valuation was based on assets. Court said entity was an operating entity versus just a holding company owning assets.
- Cases are all over the board. Consider formula transfers.

Formula Transfers

- Potential Benefit – Allows transferor to define the dollar value of hard to value assets passing to taxable transferees.
- Types of formula clauses
  - Defined value clause based on values "as finally determined for estate/gift tax purposes" (*Christiansen, Petter, Wandry*)
  - Defined value clause (*McCord, Hendrix*)
  - Price adjustment clause (*King*)
  - Reversion clauses don't work (*Procter*)

Formula Language – It Matters

- *Wandry* – "I hereby transfer to ___ that number of shares of the Company with the fair market value as finally determined for federal estate tax purposes equal to $[specific dollar amount].
  - IRS is hostile to *Wandry* clauses.
- *Petter* – "I hereby transfer 100 shares of Company to Transferee and charity/QTIP/GRAT to be allocated between the transferees as follows: (1) that number of shares with a fair market value as finally determined for federal gift tax purposes equal to $specific dollar amount to transferee and (2) the remainder of the shares to charity/QTIP/GRAT.
- *King* – "I hereby sell shares of Company in exchange for a promissory note with a principal amount of $ [x] (which that parties

believe to be equal to the fair market value of the shares). The term of the promissory note shall be ___. If the fair market value of the shares as finally determined for gift tax purposes is is greater than $[X], the principal amount of the note shall be adjusted to the finally determined value effective as of the date of the transfer. The parties intend for the sale to be at fair market value and that no gift result from the sale."

  - If you have a sale, consider using a King type clause.

- *Nelson* – "Mrs. Nelsen desires to make a gift and to assign to *** Trust her right, title, and interest in a limited partner interest having a FMV of $X.00 as of December 31, 2008 as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.
  - Adjustment is based on appraisal within 90 days rather than "finally determined value".

Potential Donees of the Excess Amount Under Petter Style Formula Clause

- Public Charity/Donor Advised Fund
  - Charity should get some real substance when using this clause.
- Private Foundation
  - This approach is more cumbersome due to self dealing and excess business holding rules.
- Lifetime QTIP
  - There is not case law supporting this.
  - If you use this, use a different trustee than you use for the IDGT
- GRAT
- None? – Wandry
- Consideration Adjustment

QTIP Termination

- CCA 202118008
  - Chief Counsel asserts that termination and distribution of QTIP results in two gifts: one from surviving spouse under 2519 and one from remainder beneficiaries to spouse.
- Treas. Reg. 25-2519-1(a)
  - If a done spouse makes a disposition of all or part of a qualifying income interest for life in any property for which a

deduction was allowed under section 2056(b)(7) or section 2523(f), the done spouse is treated for purposes of chapters 11 and 12 … as transferring all interests in property other than qualifying income interest.

- Rev. Rule 98-8 – Surviving spouse's purchase of remainder interest is a gift from surviving spouse to remainder beneficiaries.
- Treas. Reg. 25-2519-1(e). Exercise of power to appoint QTIP to done spouse is not a disposition under 2519.
- *Anenberg v. Commissioner*
    - Judicial termination of QTIP trust and distribution to surviving spouse is not a gift by surviving spouse.
    - Bona fide sale of the assets that surviving spouse received upon termination of QTIP is not a gift.
- *McDougall* Case
    - Tax Court followed Anenberg on there being no gift to surviving spouse upon termination of QTIP.
    - Tax Court said remainder beneficiaries made a gift to surviving spouse.
    - Issue is how can remainder beneficiaries make a gift of something of which the spouse is already the deemed owner? This is an issue that will go up on appeal.
    - Valuation issue in this area will be interesting.
- IRS is a dog with a bone regarding terminations of QTIPs so consider avoiding using this strategy.

Statute of Limitations

- Statute of Limitations doesn't run absent adequate disclosure.
- Treas. Reg. 301.6501(c)-1(f)(2) provide for adequate disclosure.
- Schlapfer v. Commissioner, T.C. Memo (May 22, 2023)
    - This case required substantial compliance rather than strict compliance with adequate disclosure rules but taxpayers must substantially comply with each requirement of the regulations, not substantially comply with the regulations overall.

Statute of Limitations – Donee Liability

- Donee's SOL does not expire until one year after the donor's statute of limitations expires.

- Clients often don't want to report a sale transaction on a gift tax return but this should be discussed in the light of disclosure rules.
- U.S. v. Marshall
- There is a split in the circuits on whether donee liability for gift tax is limited to value of gift received or includes unlimited liability for interest.

Promissory Notes

- This really comes down to whether this is a bona fide loan. Is there a reasonable expectation of repayment at the time the loan is made?
- IRS is looking at promissory notes more and more.
- Factors in determining whether bona fide loan or gift
  - Note
  - Interest
  - Repayment schedule
  - Collateral
  - Demand for Repayment
  - Records Reflecting Debt
  - Actual Repayment
  - Borrower Solvency

Installment Sales

- Gift Tax Issues
  - FMV of interest sold
    - Pierre case – step transaction issue.
    - Put some time between date of sale and gift. 30 days should be minimum.
  - FMV of consideration received
    - Presenter believes that 7872 is a safe harbor.
- Estate Tax Issues
  - 2036/2038 with respect to interest sold
    - Pierre issue – adequate and full consideration
    - Payment of note.
      - Avoid having note payments and distributions at the same time. This sets up IRS argument that grantor retained income interest.
      - Pay the note in times and amounts that are different from distributions from your entity.

- Trust should have some liquidity.

GRATs

- Typical audits are compliance audits.
- *Atkinson* issue – CCA 2022152018
  - Regs already provide for annuity adjustment based on a FMV change.
- Valuation
  - Grieve v. Commr – value of the initial transfer of assets
  - Exercise of power of substitution
  - Use of hard to value asset to pay annuity
  - Consider Wandry or King provisions
- *Baty* case
  - IRS argued that merger negotiations should be considered.
  - Taxpayer argued that regs allow valuation using high/low/mean.
  - IRS conceded the case.
- IRS is looking closely at GRATs. Once again, attach a great appraisal to your return by a qualified appraiser.

Most Litigated Issue – Section 2036

- Section 2036:
  - General Rule —The value of the gross estate shall include the value of all property to the extent of anyinterest therein of which *the decedent has at any time made a transfer* (except in case of *a bona fide sale for an adequate and full consideration* in money or money's worth), by trust or otherwise, *under which he has retained* . . .
    - (1) *the possession or enjoyment of, or the right to the income from, the property*, or
    - (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.
- When IRS is successful, all assets can be brought back into the estate.
  - Even if interests in partnership transferred during life -- *Harper, Korby* –
  - Marital or charitable deduction may not be applicable - *Turner*
  - Double counting - *Powell* Bona Fide Sale Test

Retained Right to Designate Persons Who Will Possess or Enjoy Assets Contributed or Income From Assets

- If senior family member is partner/manager, agreement should require distribution of available cash and define available cash to avoid the 2036(a)(2) issue.
- Co-general partner works better. Involve junior family members. It is a good non-tax reason and allows senior family member to remain involved.
- Estate of *Powell v. Commissioner*
  - Holding: Section 2036(a)(2) applied because (1) the decedent, in conjunction with the other partners, could dissolve the partnership, and (2) the decedent, through her son as the GP and as her agent, could control the timing and amount of distributions
  - Potential Ways to Avoid Powell 2036(a)(2) holding:
    - Satisfy bona fide sale test.
    - Create two classes of interest:
      - One with vote on dissolution/amendment.
      - One without vote on dissolution/amendment.
    - Senior family member disposes of all interest in equity more than three years before death.
    - Terminate entity more than three years before death.

Valuation Penalties

- There is a reasonable cause exception under 6664(c).
  - Presenter suggests that having attached a qualified appraisal by a qualified appraiser to your return should meet the criteria of this exception.
- *Estate of Richmond v. Comm'r* – Relying on appraisal may or may not be reasonable.
- *Morrissette*
  - Legal advice is a defense. Using this defense waived by asserting attorney client privilege.

ARTIFICIAL INTELLIGENCE IN THE T&E PRACTICE: UNAUTHORIZED PRACTICE AND OTHER ETHICAL CONSIDERATIONS

Presenter: Gerry Beyer

Artificial Intelligence

- Computers use sophisticated algorithms to complete tasks and even learn to enhance performance accuracy.
- Reactive AI
    - This is most basic and common type of AI.
    - Reactive AI provides predictable outcomes based on input.
    - Same response will be provided in identical situations.
    - No learning is involved.
    - Examples include suggestions when typing emails and documents, spam filters for emails and amazon recommendations.
- Limited Memory or Generative AI
    - This type of AI learns as it receives more data.
    - This type of AI is trained on a specific set of data.
    - When user enters new data, AI responds.
    - Examples: ChatGPT, Gemini, Commercial AI
- Anticipate Future AI's
    - Theory of Mind AI
    - Self-Awareness

Uses of AI in Estate Planning

- Automated Drafting
    - AI can increase the speed of document drafting.
    - AI can improve accuracy by acting as a super proofreader.
- Document Analysis
    - AI can review and analyze documents including locating provisions that need updating due to law changes, identifying inconsistencies, and creating summaries.
    - AI can review hundreds of existing documents manually.
- Predictive Analysis and Decision Support
    - AI can quickly provide predictions of outcomes of strategies including investments and tax results.

- AI can assist attorneys and clients in making more informed decisions.
- Automation of Estate and Trust Administration
    - Organize all of the steps of administration.
    - Assist with Trust Administration
- Client Onboarding
    - Chatbots

Ethical Rules

- ABA Model Rule 1.1 – Competence
    - Comment 8 requires a lawyer to keep abreast of changes including technology.
    - ABA Ethics Formal Opinion 510 states that lawyers need not become AI experts but must have a reasonable understanding of the technology that the lawyer might use.

What Should You Know

- Reactive AI Warnings
    - Be aware of AI insertions of email addresses or words. Avoid unintended insertions or corrections.
    - Another is the reply to all email rather than sender or email sent before it is ready.
- Limited Memory or Generative AI Operations
    - These operate on “large language models”.
    - They are trained on data sets and user input information.
    - There are sophisticated algorithms that result in generating a reply.
    - AI is simply providing sophisticated guessing.
    - As a result, AI may “hallucinate”. The generated reply may have no connection to the truth.
        - See cases of Steven Schwartz – Cases submitted were fake cases in a brief.
        - And Thomas Neusom
- Competence requires that you verify whatever AI generates.
- How you Can Improve Results – Prompt Recommendations
    - Be specific and include details.
    - Use examples.
    - Avoid ambiguity.

    - Use clear language.
    - Stay on topic.
    - Be open ended. Avoid asking questions that result in yes/no answer.
    - Provide context (audience, goals, etc.)

Confidentiality Rule 1.6

- Rule 1.6 requires that lawyers not reveal information relating to representation of clients. Lawyers also need to make reasonable efforts to prevent inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.
- Applied to AI
    - AI remembers the information you include in your conversation. All queries should be generic and avoid revealing any client information.
    - Consider purchasing AI systems which do not send information off-site and which have stringent security.
- Client should be informed of the attorney use of AI.
    - Disclose in the engagement letter even if not legally required.
- Is client consent required to use AI?
    - Florida bar has said that consent is not required if AI does not involve the disclosure of confidential information to a third party.
    - Currently, no consent is needed to use legal tools such as Westlaw and Lexis.

Courts Are Requiring Disclosure of Use

- Courts are starting to require attorneys to disclose whether AI was used in preparing pleadings or briefs.
- Court disclosure should specify that all legal assertions and cases have been independently verified and are accurate.

Supervision

- Rules 5.1 and 5.3 require that attorneys train and supervise associates and staff.
- Staff should be trained not to input client information in an AI program that is accessible to anyone outside the firm.
- How to Enforce:

    - Use software that tracks the use of AI.
    - Review output for evidence of AI writing style.
- Supervision of AI itself
    - This is beyond the control of an end user but you can impact the AI favorably by inputting accurate and unbiased data, using the most current version with all updates and patches and reporting inaccurate or unbiased data.

Additional Items with AI

- Billing
    - Attorneys cannot charge for time saved by use of AI.
    - It is okay to charge for time it takes to use AI and review results.
    - Clients may try to say our fees are unreasonable if we don't use AI.
- Advertising
    - It may be appropriate to market firm's use of AI.
- AI shortcomings
    - AI has difficulty with interpersonal relationship issues and moral judgments.
    - Responses can show bias based on training data.
    - Estate planning has a lot of data available.

Our Comments on the AI World

- Attorneyless Estate Plans
    - Willing
    - Quicken Willmaker Plus
    - Rocket Lawyer
    - Law Depot
    - Legal Zoom
    - DoYourOwnWill
    - Total Legal
    - U.S. Legal Wills
- What Do You Add?
    - Personal attention
    - Personal advice
    - Customized provisions beyond what AI can create.
    - Recognizing potential of contents and taking appropriate steps.

- Openly acknowledge AI options but you may want to provide examples of challenges seen with AI plans.
- AI can listen to a person’s typing and decode what is typed.
- AI can mimic someone’s voice with only a sample that is a few seconds long. Consider having a code word to verify your identity.

CYBER SECURITY: NAVIGATING THE BRAVE NEW WORLD OF CYBERSECURITY, PRIVACY AND ETHICS

Presenters: Lisa Vandesteeg and Stuart Kohn. Lisa is a partner in the Financial Services & Restructuring Group at Levenfeld Pearlstein LLC. Stuart is a partner in the Trusts & Estates Group at Levenfeld Pearlstein LLC.

Protection of Information is Protection of People

- Estate planners have a lot of information regarding people and their financial situations.
- Protecting the information of clients is protecting the clients as people.
- Hacking has become big business. It's everywhere. Data is big money and there are bad actors everywhere pursuing data.
- It is important to keep in mind that each of us might just be a conduit. A bad actor might hack one person and then use that person's information to create a deep fake and communicate with the person's clients or contacts.
- Attacks can come from a lot of different directions that you might not be aware of.

Technological Competence

- ABA Model Rule 1.1 Competence
- Comment 8, added in 2012, provides that lawyers must keep abreast of developments including those in technology.

Duty of Confidentiality

- ABA Model Rule 1.6.
- Requirement pursuant to comment is that a lawyer shall make reasonable efforts to prevent unauthorized disclosure or unauthorized access to client information.
- Factors from comments:
    - Sensitivity of information.
    - Likelihood of disclosure if additional safeguards are not employed.
    - The cost of additional safeguards.
    - Difficulty of implementing safeguards.

- A client may require the lawyer to implement special security measures not required by the rule.

What Are Reasonable Efforts?

- Be aware of what the risks and issues are.
- Take Steps to prevent issues.
- Ethical Rules apply to supervisory roles.
- See the discussions from the opinions below.

ABA Formal Opinion 477R

- This opinion dealt with securing information when transmitting.
- Lawyers must understand the nature of the threat.
- An attorney should understand how their firm's electronic communications are created, where the client data resides, and what avenues exist to access that information.
- Understand and use reasonable security measures.
- Attorney should understand enough about electronic communications methods to make a determination as to when an email requires additional security.
- Avoid using public wifi.
- Model Rule 4.4(b) obligates lawyers who know or reasonably should know that they have received an inadvertently sent communication relating to the opposing party to promptly notify the sending lawyer.
- ABA Model Rule 1.15 requires attorneys to provide appropriate safeguards to any property they hold on a client's behalf.
- Establish policies and procedures and periodically train employees, subordinates, in the use of reasonably secure methods of electronic communications with clients.
- Conduct due diligence on vendors who provide technology services.
    - ABA Opinion 08-451lays out the factors to consider with respect to vendors.
    - Use confidentiality agreements.
    - Go through conflict checks.
    - Determine whether they have an auditing faction.
- Law firm should have an Information Security Policy.
    - You may want to share policy with vendors and have them agree to meet or exceed your security protocols.

ABA Formal Opinion 483: Lawyers' Obligations After an Electronic Data Breach

- Data breach defined: "a data event where material client information is misappropriated
- Lawyers must take steps to proactively monitor for data breaches and cyber attacks.
- If a breach occurs, lawyers must be able to take steps to stopn it, restore affected systems and notify current and former clients about the breach and any damage.
- Attorneys should adopt best practices including an incident response plan and procedures for data breach response, as well as reasonable data security issues.

ABA Formal Opinion 512: Artificial Intelligence

- Data breach defined: "a data event where material client information is misappropriated.
- Lawyers must **either:**
  - acquire a reasonable understanding of the benefits and risks of the GAI tools that they employ in their practices; or,
  - draw on the expertise of others who can provide guidance about the relevant GAI tools capabilities and limitations.
- Lawyers cannot uncritically rely on content created by a GAI tool. AI is subject to hallucinations. Lawyers are responsible for independent verification.

OF SWIFTIES AND SKIPPIES: A MODERN TAKE ON THE GST TAX STRAIGHT FROM THE (NOT SO) TORTURED PLANNERS DEPARTMENT

Presenter: Steven M. Bonneau. Stephen is Senior Vice President & Tax Counsel for Northern Trust Company, Chicago.

Generation Skipping Tax

- Generation-skipping tax: A separate wealth transfer tax imposed on any generation-skipping transfers in addition to any estate or gift tax imposed on such transfers.
- Purpose: Impose a tax on transfers of wealth that skip a generation with respect to the estate or gift tax at the skipped generation's level.
  - Goal of the tax was to prevent erosion of estate and gift tax base.
  - Key issue was related to trusts.
- GST tax applies to transfers after 10/22/86.
- Tax was retroactively repealed and reinstated in the 1986 Tax Act.

Key Concepts:

- Transferor
  - Transferor is the center of the Chapter 13 universe.
  - Transferor is last person who during life or upon death makes a transfer (donor during life; decedent if upon death)
- Generation Assignment
  - Lineal descendant – count number of generations.
  - Non-lineal descendant – look at years of age difference.
- Skip Person & Non-Skip Person
  - Generation skipping transfers only occur when there is a skip person.
  - Skip person can be a trust.
- Interest
- Direct Skip
- Taxable Termination
- Taxable Distribution

Provisions not Unique to Chapter 13 (shared with some of the other chapters)

- Gift splitting
  - 2513 – Gift by husband and wife to a third party. If donor transfers only to third parties, one half is transferred by donor and one half by donor's spouse.
  - What if gift is made to a trust with spousal access? Will the transfer be eligible for gift splitting?
    - Amount is not ascertainable for purposes of gift split.
  - A split gift election makes a shift in transferor.
- Annual Exclusion
  - There is no term "GST Annual Exclusion" in the Code even though this term gets used.
  - The correct question might be whether the transfer qualifies under 2503b and 2642(c).
  - When interest is made to a trust, the beneficiary has to have some sort of immediate right for the transfer to qualify as an annual exclusion gift. Typically, some form or crummey withdrawal power is given.
  - Trust must have a skip person to qualify for GST. Typically, this is accomplished by providing a special testamentary power of appointment.
- Alternate Valuation
  - Section 2624 – can be taken in the GST universe only if there is a taxable termination as a result of the death of an individual.

§2032 and §2624 do not mirror each other when it comes to the timing of the election

- Estate Tax – Executors wishing to make an alternate valuation election must do so no later than one year after the time prescribed by law (including extensions) for filing such return.
- GST Tax – For taxable termination caused by an individual's death, the election on Form 706-GS(T) must be filed "on or before the 15th day of the 4th month after the close of the calendar year in which the taxable termination occurred, or on or before the 10th month following the month in which the death that resulted in the taxable termination occurred, whichever is later. Reg. 26.2662-1(d)(2).

GST Exemption is the antidote to the GST tax.

- §2631(a) – An important part of GST tax is your inclusion ratio. This is 1 minus the applicable fraction. Numerator is amount of GST exemption that has been allocated to a transfer and denominator will be the fair market value of the property transferred. You are typically trying to get an inclusion ratio of 1.
- Inclusion ratio determines effective rate of GST.
- §2631(b) – Any allocation under section (a), once made, is irrevocable.
    - There are actually some ways to “revoke” an election.
    - Regulations on out of order death – When there is an out of order death, you can make a retroactive allocation and have election be effective before the out of order death.
    - §2632 – Manual/Affirmative Allocation.
- §2632 Rules for allocating exemption
    - Automatic allocation rules for GST exemption for lifetime transfers apply to:
        - Direct Skip Transfers, unless elected otherwise;
        - Indirect Skips – Transfers (other than direct skips) made after 12-31-00 to a GST trust. 2632(c)(3)(A).
        - GST Trust –
        - There are six exceptions – If an exception applies, then the trust is not a GST Trust for purposes of the automatic allocation rules.
            - There is an exception to the estate inclusion exception.
            - To avoid this issue, elect to always have the rules apply or never have them apply.
        - If not a GST trust, there is not automatic allocation of GST exemption.
        - Not so tortured planners make election under 2632(c)(5).
        - Automatic Allocation Rules for Transfers at Death
            - First, GST exemption is allocated pro rata to direct skips occurring at death. 2632(e)(1)(A).
            - Second, any remaining GST exemption will be allocated pro rata to any and all trusts which the decedent is the transferor and from which a taxable

distribution or taxable termination might occur at or after decedent's death.
        - Pro rata allocations made to nonexempt portions of such properties or trusts.
        - Automatic allocation at death is effective as of the date of death.
    - Regulations suggest that a trust has GST potential even if possibility of a GST is so remote as to be negligible. Reg. 26-2632-1(d).
- Mechanics of a Timely Allocation Made During Lifetime
    - Made on gift tax return filed on or before due date for reporting a taxable gift for year at issue.
    - Effective Date: Relates Back to Gift.
    - Valuation Date: Uses gift tax value to determine applicable fraction.
    - Finality of Inclusion Ratio: 3 years from date of filing.
    - For transfers made during lifetime, be aware of ETIP issues.
- Late allocations
    - Made on a return filed after due date for filing a return for the year of the transfer.
    - •Made on Form 709
    - •Effective Date: Date of allocation (i.e., date of filing)
    - •Valuation Date: Date of allocation or first day of the month during which late allocation is being made; must make election pursuant to Reg. §26.2642-2(a)(2)
    - •Special Valuation Rule: Only for valuation purposes only
    - •Finality of Inclusion Ratio: Allocation not final for gift tax purposes. Not *out of the woods*[14] three years from the date of filing! See Reg. §26.2642-5 for applicable limitations period.

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

Mary Vandenack

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