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Heckerling 2017 - Report No. 10 (Thursday 1/12/17)

Below are the “deeper dive" on Tax Considerations for Foreign Persons With US Assets (the deeper dive was purportedly in a prior report, but instead the report on the basic one was accidentally inserted again) and the Fundamentals Program on GST Tax.

Michelle’s co-panelists were Josh, a former chair of ACTEC’s Internal Estate Planning Committee and a frequent Heckerling speaker, and Marnin, an American sent to Switzerland by his firm who is now a Swiss citizen and is an expert in international reporting of foreign assets (in addition to tax issues). To add to or reiterate some points:

- Consider that the timing of recognizing income might not match. For example, Code § 1031 exchanges allow income to be deferred in the US, but other countries might not have a counterpart. Matching can be important, because one jurisdiction might give credit for tax paid in another jurisdiction. The tax credit for foreign taxes paid might offset most of the US income tax, resulting in a low cost to get full basis in the new property (with resulting depreciation deductions or lower future capital gain tax). So always consider matching timing of US and foreign income taxation. (I’m not saying that matching always wins out – just that it should be considered.)

- Associating with local counsel is important to make sure all issues are considered. Consider seeking the help of a member of ACTEC’s International Estate Planning Committee (which another ACTEC fellow or I could find) or one of the huge worldwide CPA firms (in other countries, CPA firms might also have in-house lawyers).

- Other countries often do not recognize attorney-client privilege the way we do. They also may have local ways of doing business that do not mesh with our ways (or might even be illegal under US law).

Generation-skipping transfer (GST) basics serve as a good introduction. Additional points:

- What constitutes a GST trust that attracts automatic allocation of GST exemption as an indirect skip can be confusing – even according to those who drafted the language that Congress adopted! I file a gift tax return reporting the gift and then affirmatively opt into or out of automatic allocation as an indirect skip for all future transfers, reserving the right to timely change the election prospectively.

- The gift tax return does not run the statute of limitations except to the extent that a direct skip is made. For a trust receiving an allocation that is not a skip person, one needs to make a small distribution to a skip person, filing IRS Forms 706-GS(D-1) and 706-GS(D).

Steve

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From: Joseph G. Hodges Jr.
Sent: Sunday, January 15, 2017 4:38 PM
Subject: Heckerling 2017 - Report No. 10 (Thursday 1/12/17)

As we have done in January for the last twenty years, and again with the permission of the University of Miami School of Law Center for Continuing Legal Education, we will be posting daily Reports to this list containing highlights of the proceedings of the 51st Annual Philip E. Heckerling Institute on Estate Planning that is being held on January 9-13, 2017 at the Orlando World Center Marriott Resort and Convention Center in Florida. A complete listing of the proceedings and the Institute's 2017 brochure are available at www.law.miami.edu/heckerling and the listing of the proceedings was also published as part of **Introduction Part 2** that was distributed on 1/4/17.

We also will be posting the full text of each of these Reports on the ABA RPTE Section's Heckerling Reports Website, as we have since the 2000 Institute. Those Reports from 2000 to 2016 can now be found at URL http://www.americanbar.org/groups/real_property_trust_estate/events_cle/heckerling_reports.html . In addition, each Report from 2006 to date can also be accessed at any time from the ABA-PTL Discussion List's Web-based Archive that now only goes as far back as January of 2006 and is located at URL http://mail.americanbar.org/archives/aba-ptl.html .

Editor's Errata: In our haste to send out two Reports, #s 8 and 9, on Saturday, 1/14, we mistakenly included the text of the Wednesday morning Main Session report on Tax Considerations for Foreign Persons With US Assets that was in Report #5 also as the text of the "deeper dive" Special Session 2-E Report on the same subject that was in the Report #8. Accordingly, the full text of the correct Wednesday afternoon Special Session 2-E Report is included immediately below. As luck would have it, both sessions were correctly reported on by the same Reporter, so you only have your Editor to blame for this particular oversight in his haste to review, edit and publish some 50 2017 Heckerling Session Reports as quickly as possible this week. We thank our loyal and meticulous Report reader, Steve Gorin, and especially afternoon Co-Presenter, Marnin Michaels, for graciously taking the time to point out this error to us.

Editor's Comments : This Report #10 included the corrected version of the Report on the Wednesday afternoon Special Session 2-E "deeper dive" on the Wednesday morning Main Session on Tax Considerations for Foreign Persons With US Assets (see Reports #5 and #8) and the Thursday afternoon Fundamentals Program #3 all about the GST Tax.

Now for the news of the day: Back on December 30, 2016, we received an e-mail Notice from Steve Leimberg via his LISI Estate Planning Newsletter that, starting in 2017, all the future LISI Newsletters would be published in PDF format. This change builds on their earlier new features, like their Podcasts and 60 Second Planners publications. They say this PDF change is designed to try and lessen the problems with the many different ways their Newsletters render themselves to their readers depending on which browser or e-mail client each reader is using. Readers of those Newsletters are invited to share their reactions to this new display format c/o steve@LeimbergServices.com. Our thanks to Steve, a former ABA-PTL Heckerling Reporter, for sending us this information and LISI for publishing the week long *Marty Shenkman's Meeting Notes from Heckerling 2017.* Similarly, the ABA-PTL List 2017 Heckerling Reporters and Editor welcome your comments and suggestions about our reporting this year - send those to jghodges@jghlaw.com.

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Wednesday, January 11th, 3:50 to 5:20 pm
Tax and Estate Planning Considerations for Foreign Persons Owning U.S. Assets: A Deeper Dive [INT]
Presenters: Michelle B. Graham, Marnin J. Michaels and Joshua S. Rubenstein
Reporter: Michael Sneeringer

This panel session took a deeper dive into the tax and estate planning considerations for non-U.S. persons contemplating purchasing U.S. assets or having already owned U.S. assets. This session provided practical advice to practitioners on tax and estate planning considerations for non-U.S. persons investing in the U.S., including a discussion on how best to hold title to U.S. assets. This Special Session builds on the earlier Wednesday morning Main Session on the same subject (see Report #5).

The panelists educated the audience on tax and estate planning considerations for non-U.S. persons investing in the U.S.

The panelists used a PowerPoint presentation which was not part of the Heckerling materials. The materials did not have an outline and attendees were directed to rely upon Ms. Graham's outline from her Wednesday morning presentation.

Ms. Graham began by introducing the other two panelists. She discussed portions of her Wednesday morning presentation, including due diligence best practices. She indicated that at the outset, the goal is to figure out the rules applicable to the foreign client's jurisdiction of residence. She noted that attorney's need to figure out how asset ownership works in the foreign jurisdiction (Is there a marital regime? Was an election made?). She discussed the importance of obtaining an asset list during the initial client intake process.

Mr. Michaels discussed that there are basic principles to abide by when clients are foreigners but have assets in the U.S. He indicated that just because the U.S. treats an asset in one way does not mean that a foreign jurisdiction treats it that way (for example, limited liability companies ("LLC")). He discussed another example to illustrate: the Code Section 1031 exchange is purely a U.S. concept; these are not respected outside of the U.S. (i.e., zero tax result in the U.S., but not elsewhere). He noted the nuances of recourse and non-recourse debt in other foreign countries.

Mr. Michaels also discussed that in most continental countries, real estate outside of the jurisdiction of residence is outside the tax regime in that country when owned by an individual (i.e., if a Switzerland resident owns property in Israel, the Swiss do not tax said resident on that property; thus, not subject to tax upon sale). However, putting an asset in an entity (instead of outright) would subject the same property to tax in Switzerland, as well as tax on sale in Switzerland (in addition to a third tax when the money comes out of the entity). He noted that in some jurisdictions trust are not recognized, or business entities are used in business transactions but not recognized in certain civil law countries (for example, using a trust to open a bank account; the jurisdiction may not recognize this).

Mr. Rubenstein then discussed certain non-tax considerations. He indicated that these interests come up when: (1) non-U.S. clients do not move but invest in the U.S. or have children in the U.S.; and (2) when the non-U.S. family moves or leaves open the possibility that they might move to the U.S.

Mr. Rubenstein also discussed why community property is important to the discussion. He noted the three (3) ways of acquiring community property throughout the world. He touched on the Uniform Disposition of Community Property Rights at Death Act. He discussed community property regimes at the U.S. federal level, such as bankruptcy, ERISA and copyrights.

Mr. Rubenstein indicated that attorneys need to figure out the right laws to apply to property when clients come to the U.S. He described how to potentially defeat forced heirship. Mr. Michaels interjected with a discussion on the issue of compulsory share rights.

Mr. Rubenstein next discussed taxation with regards to picking up half of the income on community property pre 1976 and post. He indicated that Code Section 879 closed this loophole. Mr. Michaels interjected with a brief discussion on Islamic Property Law. He noted that different jurisdictions have different interpretations of this type of law.

Mr. Rubenstein noted that matrimonial agreements are enforceable in other states if done properly in the U.S.; in other foreign jurisdictions, this is not the case (other countries may not find these enforceable; however, may be guided by them). He indicated that in certain Asian countries, prenuptial agreements are enforceable; however, postnuptial agreements are not.

Next Ms. Graham read the first case study. Mr. Michaels took the first shot at discussing the issues. He noted that for lawyer communications with clients, there are different interpretations of issues such as conflicts of interest and ethical rules across the various foreign jurisdictions (the U.S. attorney might have to give special thought to the issue). Mr. Rubenstein and Mr. Michaels discussed the issues of cohabitation and marital rights and the conflicting issues present. The hypothetical discussed the necessity of a global probate and the choice of law (between Miami, Florida and Guatemala). The discussion touched on estate tax issues present based on the situs of the assets. Mr. Michaels noted that foreign families often have all of their assets in the U.S. (or at least outside of their home jurisdiction) where there is political friction in their home country.

Mr. Michaels indicated here that there is a growing concern of clients fathering children overseas or having secondary spouses overseas. Ms. Graham echoed these considerations. Mr. Michaels brought up the issues of the treatment of same-sex marriages and children (as it pertains to foreign jurisdictions), as well as artificial reproduction technology (“ART”) children. Mr. Rubenstein noted that in certain jurisdictions, children must be “legitimate children” (conceived during life and through the marriage), as opposed to ART children, in order to inherit property and/or have inheritance rights in general.

Ms. Graham then read the second case study dealing with a $5 million U.S. property purchased for daughter going to college in the U.S. How should title be taken: directly, with a trust, an entity, two-tier partnership? Mr. Michaels touched on direct ownership. He indicated that the goal is often to avoid U.S. estate tax; however, it may be simplest to have direct ownership with life insurance to cover the tax (i.e., a large $100,000 home in Georgia probably does not need a complicated ownership structure or super sophisticated planning). Mr. Rubenstein noted that the starting point in planning with property is the $60,000 exemption amount; provided, however, if a treaty applies, this is not the starting point (the exemption may be greater). Mr. Michaels noted that an offshore company is the classic structure for holding this particular asset. He indicated that the non-U.S. corporation avoids U.S. estate tax. He noted that attorneys should want to plan for their clients to avoid the branch profits tax. Mr. Rubenstein noted that attorneys need to understand the client's likely intentions with regards to the property.

At this juncture Mr. Michaels discussed the <u>benefits of the two-tier partnership structure</u>. He indicated that this planning will be preserved within the home countries. He indicated that no cases have analyzed this particular fact pattern. He stressed that he liked the structure because of the transparency and the ability to check-the-box upon the owner's death. He believes it solves a lot of home country problems. Mr. Rubenstein noted that this takes at a minimum about $40,000 a year to maintain.

Mr. Rubenstein followed this up with a discussion of the use of irrevocable, discretionary trusts. Mr. Michaels noted uncertainty by relying upon a Private Letter Ruling from the 1990s for trusts.

Ms. Graham concluded this session by introducing the wrap-up slide which provided other considerations that attorneys should consider. Mr. Michaels noted that there are all sorts of other techniques to consider which were not mentioned during the presentation.

At one point in the presentation, it is important to note that Mr. Rubenstein stressed the importance of reaching out to local counsel when dealing with foreign clients as U.S. attorneys generally hold licenses only in the U.S. and are not able to realistically know the property regimes and taxation rules in other countries.

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Thursday, January 12th, 2:00 to 5:20 am
FUNDAMENTALS PROGRAM #3 [FS]
(Ran concurrently with Special Sessions III and IV)
GST Tax: Math, Mistakes & Mitigation
Presenters: Julie Miraglia Kwon and Carol A. Harrington
Reporter: Kristin Dittus

This program reviewed practical basics of GST tax planning and compliance, including automatic allocations of GST exemption, reporting and elections on gift and estate tax returns, inclusion ratios, common snafus, and options to address prior mistakes. These concepts were explained with very helpful concrete examples.Here are the significant highlights from this three hour long session

The presenters, who followed a concise outline similar to their BNA chapter on the same topic, discussed key concepts in understanding how to plan with, apply, allocate and avoid pitfalls when using GST. Being two of the fastest speaking presenters at Heckerling, they packed a lot of information into this 3 hour lecture.

The Tax Reform Act of 1986 enacted the current GST tax as chapter 13 of the Internal Revenue Code, with the most recent modification in 2010 making GST tax permanent.

Definitions and Rules:

Determine who the transferor is. This can change over time depending on how assets are held. It is important not to waste GST exemption, which can happen if the transferor changes in the future. In gift splitting each spouse is deemed to have given half of the gift for GST purposes.

GST tax applies to a skip person. This includes a relative who is at least two generations younger than the transferor, a non-family member that is 37.5 years younger, or a trust with only skip persons as beneficiaries. Family members are defined by relationship and not by age.

A non-skip person (such as a child) is one generation down from the transferor and cannot be a skip person. There is no tax for non-skip transfers.

The predeceased ancestor exception allows a skip person to be treated as a non-skip person due to the death of an ancestor within 90 days of the transferor.

Assets that qualify for the marital deduction when the property is subject to estate and gift tax will shift the transferor to the surviving spouse. Under §2652(a)(3), a reverse QTIP election can be made to avoid this, but it must be made as to all of the QTIP property in a trust. To avoid wasting any GST exemption, a separate trust can be created. A spouse can also use his or her own GST exemption on a QTIP trust. It is important to identify the QTIP or reverse Q-tip election on schedule R of the tax return.

Interests cover the present right to receive.

There are three GSTs: direct skips, taxable terminations and taxable distributions.

The presenters also touched on the transferor move down rule (the transferor remains the same person but the generation gets reassigned to that same person), multiple skips (each skip person is treated the same, regardless of which younger generation the skip person is in), and tax base (there is gift tax on GST tax).

The inclusion ratio, determined by the applicable fraction, applies to the entire trust. Practitioners often separate trusts based on the inclusion ratio to simplify the tax on distributions. A qualified severance can be used to separate assets in trust with an inclusion ratio greater than 0 but less than 1.

Rules for Allocating GST Exemption: Allocation at death can correct previous problems if it is done timely, but if not, it often creates problems. If done timely, the taxpayer gets the full benefit of allocation from the date of the transfer. Reallocations done after the timely filed return must use values at the time of the allocation rather than at the time of transfer, which can be useful if values go down. In granting 9100 relief, the IRS is generally looking for good intentions effected by an innocent mistake, rather than who is trying to benefit from hindsight.

<u>Automatic Allocations</u>: The IRS does an automatic allocation if you make a transfer to a direct skip, assuming you want to defer or avoid the tax, or does not apply GST if the transfer is to non-skip person or a trust with 25% or more non-skip people. In a complex trust with hanging powers, the automatic allocation rules may not get the right result. For this reason it is important to affirmatively elect in or out of the auto allocation rules on the 709. Automatic allocations are irrevocable and cannot be amended.

<u>Retroactive Allocations</u>: If there is a death of a non-skip beneficiary while the transferor is living there is a one-time chance to allocate GST exemption. Must be timely filed to use this highly advantageous rule.

<u>ETIP Issues and Rules</u>: These rules apply when there is a completed gift for gift tax purposes, but such assets are also included in the donor's gross estate because of a retained right or power. The IRS wants to ensure the allowed GST exemption is applied to the appreciated assets and not on the date of transfer. This is often seen with GRATS.

Determining the purpose of a successive trust will often control how the auto allocation rules should be elected for the existing trust. Practitioners should calendar a reminder to help them file the proper election at the end of the ETIP period.

<u>Applying GST Exemption to Trusts</u>: Crummey trusts must elect to have the GST exemption applied to funding assets. Such trusts may allow spray distributions to kids and grandkids. To avoid wasting GST exempt assets passing to non-skip persons, Julie Kwon suggests having distributions for children pass to them first from a non-exempt trust (with an inclusion rate above 0), and leave them as beneficiaries of the GST tax exempt trust (with a 0 inclusion rate) as well. Having separate shares for each beneficiary also makes it easier to track the inclusion ratio applied to each trust. Keep in mind, hanging powers in a trust can change who the transferor is, creating complexity if that beneficiary dies.

The presenters also discussed how life insurance trusts and trusts with charitable beneficiaries are affected by GST.

<u>Qualified Severances</u>. Before the qualified severance rule of section 2642(a)(3) began in 2000, a trust could not be split. This resulted in a trust with an inclusion ratio between 1 and 0 wasting GST exemption on non-skip people and having to determine the tax on distributions to skip people. A qualified severance allows for the division of a single trust into two or more trusts if the division is done on a fractional basis and the terms of the new trust in the aggregate provide for the same succession of interest of beneficiaries as provided for in the original trust. Including trust provisions that do not require identical terms but follow the required statute to preserve succession can be very helpful. The practitioners should be careful not to change marital or QTIP provisions that would be problematic to the deduction benefits.

Additionally, exercise caution when using this severance technique because it can create a taxable event and income tax consequences.

<u>Finally - A Few Miscellaneous issues</u>:

Be careful when decanting not to alter tax attributes of a trust that is grandfathered in as GST tax exempt because it was created before the GST tax was created.

Triggering the Delaware tax trap may be advantageous for estate tax inclusion with the large applicable exclusion amount, but may be problematic for GST purposes.

If concerned you have lost an advantageous GST status, the presenters say they would not concede this kind of issue.

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The Reporters

Our on-site local reporters who will be present in Orlando in 2017 are **Joanne Hindel Esq** ., a Vice President with Fifth Third Bank in Cleveland, Ohio; **Kimon Karas Esq** ., an attorney with McCarthy, Lebit, Crystal and Liffman Co. LPA in Cleveland, Ohio; **Craig Dreyer Esq** ., an attorney with Clark Skatoff, PA in Palm Beach Gardens, Florida; **Herb Braverman Esq** ., an attorney with Braverman & Associates in Orange Village, Ohio; **Kristin Dittus Esq** . a solo attorney in Denver, Colorado, **Michael Sneeringer Esq** ., an attorney with Akermn, LLP in Naples, Florida, **Michelle R. Mieras** , a Fiduciary Risk Manager with Bank of the West in Denver, Colorado, **Beth Anderson Esq** , an attorney with Wyatt, Trrant & Combs, LLP in Louisville, Kentucky, **Bruce A. Tannahill Esq** , a Director of Estate and Business Planning in the Mass Mutual Financial Group in Phoenix, Arizona, and **Patrick J, Duffey Esq** , an attorney with Holland & Knight in Tampa, Florida.

The **Report Editor** again in 2017 will be **Joseph G. Hodges Jr. Esq** ., a solo practitioner in Denver, Colorado. He is also the Chief Moderator of the ABA-PTL discussion list.

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NOTICE : Although audio tapes of all of the substantive session at the Miami Institute currently are only made available to Institute registrants for purchase, the entire proceeding of the Institute, other than the afternoon special sessions, are published annually by Lexis/Nexis. For further information, go to their Web site at http://www.lexisnexis.com/productsandservices . The text of these proceedings is also available on CD ROM from Authority On-Demand by LexisNexis Matthew Bender. For further information, contact your sales representative, or call (800) 833-9844, or fax (518) 487-3584, or go to http://www.bender.com , or write to Matthew Bender & Co., Inc., Attn: Order Fulfillment Dept.,1275 Broadway, Albany, NY 12204.

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