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Heckerling 2017 - Report No. 2 (Monday 1/9/17)

After discussing the proposed regulations under Code § 2704, the report describes planning in light of tax reform and then discusses certain current developments.

A speaker suggested that tax reform most likely will be done through budget reconciliation, which starts in March, takes shape somewhat in May, and would be enacted by the August recess.

Steve

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From: Joseph G. Hodges Jr.
Sent: Tuesday, January 10, 2017 1:52 PM
Subject: Heckerling 2017 - Report No. 2 (Monday 1/9/17)

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 Comments: Report #1 officially kicked off our reporting of the proceedings at Heckerling 2017. Included in this Report #2 are the Monday afternoon Introductory Remarks from Tina Portuondo, the Institute Director, and Patricia White, the Dean of the University of Miami School of Law, that officially opened the Institute. This was followed by an extended traditional session called Recent Developments 2016 which was presented in two parts so that the recently Proposed Section 2704 Regulations could be adequately covered.

The next few Reports will contain our coverage of the all-day Tuesday, January 10th, main sessions.

One of the Exhibitors this year is InterActive Legal (https://interactivelegal.com), Booths 436 and 537. They are hosting a full agenda of activities, including a chance to win an Amazon Echo, various times from Tuesday through Thursday when you can meet with several "Experts" in person, including authors Natalie Choate and Howard Zaritsky, an ability to download various articles from their on-line Knowledge Base, including one on Turning Off Grantor Status, and a hosted Lunch Reception on Wednesday. Be sure to pay them a visit in person or on line and learn more about their various document assembly software offerings, including their very popular and robust Wealth Transfer Planning program.

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Monday, January 9th, 1:20 to 1:30 pm
Introductory Remarks
Presenters: Dean Patricia White and Director Tina Portuondo
Reporter: Bruce Tannahill

University of Miami School of Law Dean Patricia White opened the 51st Heckerling Institute by welcoming all attendees, sponsors, and the Law School staff. She noted that Heckerling is the largest continuing education program in the U.S., with approximately 3100 people attending the program this year, including nearly 600 first-timers.

Tina Portuondo, the Institute's Director, welcomed everyone to the nation's largest gathering of estate planning, highlighted the variety of topics that will be covered, and recommended taking advantage of the many networking opportunities it and the sponsors provide.

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Monday, January 9th, 1:30 to 3:30 pm
Recent Developments 2016 - Part 1
Presenters: Dennis I. Belcher, Ronald D. Aucutt, Catherine Veihmeyer Hughes and John W. Porter
Reporter: Bruce Tannahill

The first half of this program was dedicated to the potential impact of the 2016 election and an update on the recently issued Section 2704 Proposed Regulations.

Dennis started out by citing the Yiddish proverb of "Man plans and God laughs," referring to the Panel's initial planning that occurred before the Proposed Section 2704 Regulations were released on August 2, 2106 and the election of Donald Trump on November 8, 2016. These events led the Institute to divide the Recent Developments program into two sessions. The first session focused on the Proposed Section 2704 Regulations and possible changes resulting from Donald Trump's election. The second session covered other significant developments.

Proposed Section 2704 Regulations

Since these regulations were issued, numerous articles and summaries have discussed their provisions and their planning impact. The discussion here did not delve into the details of the regulations, focusing instead on why Treasury believed they were needed, aspects that have read as producing unintended results, and what planners should be doing.

The panel started its discussion of the Proposed Section 2704 Regulations by noting that the issues addressed by the regulations have been around for years. The problem is real – the IRS is bothered by the taxpayer's ability to create a family limited partnership, have a significant interest and control during life, and to have the control lapse at the taxpayer's death without transfer taxation because nothing transferred. The issue will continue as long as there is an estate tax.

Even if there is no estate tax, the issue may still exist – we may still have a gift tax. In addition, estate tax repeal is tied to what happens with basis.

Cathy Hughes, the Estate and Gift Tax Attorney-Advisor in the Office of Tax Policy of the U.S. Department of the Treasury, and a principal author of the proposed regulations said that Section 2704 had, for all practical purposes, been written out of the law. She reviewed some of the developments since the current Section 2704 regulations were issued in 1992 that led to this condition. These changes are detailed in the preamble to the Proposed Regulations. She said that the Proposed Regulations were designed to make section 2704 applicable again so it would achieve its intended purpose.

Important points about the proposed regulations from Ms. Hughes:

1) Final regulations will not be issued by January 20th.

2) There was no intent to eliminate all minority discounts. They will not totally disappear and treasury will make that clear in the final regulations.

3) There is no intention that when you disregard a restriction, you have to assume something that isn't there (put right). They did not intend to require a put right and will make that clear.

4) There was no intention to make the three-year rule retroactive and will make that clear. The regulations will have no retroactive effect.

5) Applicable restrictions under the current regulations apply to the entity as a whole while the disregarded restrictions under the Proposed Regulations apply to one owner's interest.

6) The regulations do not distinguish between operating and non-operating businesses. After reviewing the various definitions of active or operating businesses in the Code, including Section 6166, they decided not to attempt to make a distinction in the proposed regulations. They will look at suggestions for a workable distinction.

7) They don't distinguish between functional and dysfunctional families.

8) For a non-family owners' interest to be considered, it must be significant to the family, to the holder of the interest, and acquired well in advance of the transfer. They weren't sure if they drew the lines in the right place.

9) Because LLCs weren't common when the 1992 regulations were issued, they added provisions describing what it means to have control of an entity that isn't a corporation or partnership.
The regulations focus on how a business is organized, not on how it is taxed.

10) If you can overrule the statute or choose another statute, that statutory provision is not required.

<u>Effective dates</u>:

a) General Section 2704(a) and (b) provisions – effective the date regulations are published

b) Disregarded restrictions – 30 days after final regulations are issued. This part of the regulations is considered to be legislative regulations. By law, legislative regulations must become effective at least 30 days after the regulations are published.

<u>Public Comments and Hearing</u>:

During the 90-day comment period, in excess of 10,000 comments were submitted. To date, she's read about 400 but will read all of them and all will be considered in drafting the final regulations.

On December 1, IRS and Treasury held a 6½ hour hearing with 36 witnesses, including lawyers, CPAs, business owners, and appraisers.

Ms. Hughes said that various proposed alternatives were discussed, sometimes with more clarity than the written comments.

Only one speaker spoke in favor of the regulations and said it was a big loophole that needed to be changed

<u>Mr. Belcher, Mr. Aucutt, and Mr. Porter all testified. Their comments included</u>:

A) The regulations seem drafted for something that is not an active trade or business. Treasury could have written their own rules on the difference between active and passive.

B) There was a disconnect between witnesses and what Treasury said they were intended to deal with. Mr. Porter said that his experience, in dealing with IRS agents and appellate conferees, is that ambiguity is resolved in favor of the government.

C) Similarly, Mr. Aucutt said what matters is what the Estate & Gift Tax attorney, appeals examiner, or judge says. Ms. Hughes has said these questions will be resolved in the final regulations. This is what proposed regulations and the notice and comment period are designed to identify.

<u>What does this mean for appraisers</u>:

Mr. Porter said that there is nothing for appraisers to do now. If chapter 14 is applicable, it should be discussed with the attorney. For someone filing a gift or estate tax return reporting a transfer that occurred after 8/2/16, you must disclose if a position contrary to the Proposed Regulations is being taken. On gift tax returns, this is a requirement to start the statute of limitations for gift tax return purposes. It is better to have taken the expansive view that it may be contrary to Proposed Regulations.

If and when the Proposed Regulations become final, there will be some issues.

Ultimately, it is a standard of value consideration. Appraisers, attorneys, and CPAs should work closely together.

<u>Related Legislation</u>:

On September 21 and September 28, legislation was introduced in Senate and House providing that the Proposed Regulations will have no force and effect and that no funds can be used to finalize them. The same bills were reintroduced on January 3 of this year. The bills have had legs and gotten attention.

If the Proposed Regulations are killed, we still have valuation issues and uncertainty that will continue without providing guidance for planners. Somewhere along the line we can expect these issues to come back. The panel believes it would be better to have them resolved now.

Mr. Porter concluded by advising attendees to not let the tail wag the dog. There are other issues that will really guide our planning. There is no rush to make significant transfers, especially those that generate gift tax. He doesn't think we'll see the regulations finalized in the Trump Administrations.

<u>Other Potential Tax Reform</u>:

The panel noted that President-elect Trump's proposed transfer tax change plan has very simple statements that are very difficult to predict how they will be implemented.
He has stated his top three priorities are:

Repeal Obamacare

Invest in infrastructure

Immigration reform

Tax reform is not one of them. For this reason and the lack of specificity in his tax proposals, the Republican leadership's blueprint has new life. Many observers, including Mr. Aucutt, think this will be the basis for tax reform legislation this year. It focuses on:

a) Fueling job creation and delivering economic growth

b) Simplifying the tax code, and

c) Transforming IRS into a customer-service focused organization.

A panelist noted that simplicity always conflicts with fairness and that no one is going to file a tax return on a postcard.

Income tax reform. The Republican plan's priorities for individuals are to preserve:

a) Mortgage interest deduction

b) Charitable contributions, and

c) Retirement benefits. This may mean that discussion about eliminating stretch IRAs may subside.

For businesses, the priorities are:

a) Lower tax rates

b) More emphasis on expensing (immediate write off) of business investments

c) No business deduction for net interest expense. Interest expenses could be deducted against interest income but nothing else. This proposal probably has legs and needs to be watched. If enacted, it will affect the corporate bond market

d) NOLs can only shelter 90% of income, not 100%

Transfer tax and basis proposals. The GOP blueprint discusses repeal of estate and GST taxes but does not mention repeal of the gift tax. The gift tax ensures the integrity of income tax by preventing the shifting of income to lower-bracket tax taxpayers. The compression of tax rates proposed in the blueprint may reduce the need to backstop the income tax with the gift tax. People can do income shifting now with the higher exemption, so the need for backstop may not be that important.

Mr. Belcher repeated that estate tax repeal is tied to basis. If Congress repeals the estate tax and allows carryover basis, it will produce a tax increase on the middle class.

Mr. Aucutt noted that the income tax was enacted in 1913 and the estate tax in 1916. Neither said anything about basis of inherited assets. The first law addressing it was enacted in 1921, followed by a 1930 Supreme Court case and subsequent new laws. There is no real linkage between the estate tax and stepped-up basis and it feeds the notion that only a person who owns property when appreciation occurs is taxed on it. Estate tax step-up gives everyone a fresh start.

Alternatives to stepped-up basis:

A) Carryover basis. Defers revenue until sale or exchange of the property

B) Capital gains tax at death. Many economists think it is the best answer, eliminates death as investment planning strategy. It doesn't play well with the public, perhaps especially those who supported Trump

With the fiscal projections for nothing but deficits, it may be hard for Congress to go back to their constituents with tax reform that totally exempts appreciation from tax.

Repeal of the Death Tax under both the Trump and GOP plans has strings attached – income tax under one and gift tax under the other.

Transfer taxes do generate revenue (about $20 billion annually) that would need to be replaced.

<u>What to expect</u>:

Mr. Belcher stated that tax reform is coming but first emphasis will be on businesses and getting their tax rate below 30%. It would result in limits on deductions. There would likely be concern about the optics – Cabinet made up of several billionaires who would benefit significantly.

Mr. Aucutt stated that it is likely the GOP leadership will try to get tax reform completed by the August recess using the budget reconciliation process. It may not happen because GOP may try to wait until 2018 when they think they may have 60 votes in the Senate. We will probably know by May what's going to happen. The attractive political path is budget reconciliation with a few Democratic votes in each house. Budget reconciliation process is complicated. If nothing passed by April, probably nothing will happen. He expects some tax changes, some benefiting individuals but repeal of the estate tax will require political capital that the GOP will decide to spend elsewhere.

The consensus was that this is déjà vu all over again. We're in the same situation we were in in 2009.

<u>The panel's recommendations on how to plan for it included</u>:

1) Tell clients you never know (but clients won't like that)

2) Wait and see. Better off if clients can wait until we know what's going on. This may result in missed opportunities to shift appreciation

3) Don't want to trigger payment of gift tax so use techniques that don't generate taxable gifts

4) Consider GRATs, sales to intentionally defective grantor trusts

5) Mr. Porter strongly recommends the use of formula clause where you're selling or gifting a dollar value of units, not a specific number of units

6) Flexibility

7) Limited powers of appointment

8) Use QTIP trusts and don't make the election (Clayton trust)

Remember that estate tax rate and income tax rate are fairly close. If no estate tax, may not want to generate income rate

Mr. Belcher concluded this portion of the session by reminding the attendees that "[T]hings are never as good as they seem to be or as bad as they seem to be" and predicted we will probably be having this discussion again next year.

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Monday, January 9th, 3:30 to 5:30 pm
Recent Developments 2016 - Part 2
Presenters: Dennis I. Belcher, Samuel A. Donaldson, Amy E. Heller and Catherine Veihmeyer Hughes
Reporter: Bruce Tannahill

The second half of this program provided coverage of the other significant developments of 2016. Prof. Samuel Donaldson and Amy Heller replaced Ron Aucutt and John Porter as speakers.

This reporter will not attempt to repeat any of Prof. Donaldson's humorous, sometimes hilarious, comments. They alone were almost worth the price of admission.

Consistency of Basis Rules with Estate Tax Value:

New Section 1014(f) provides that step-up basis is limited to the finally determined value of property for estate tax purposes. It was enacted to prevent whipsaw of using discounts for estate tax valuation and beneficiary selling property after the statute of limitations has run using a value without discounts. There was no requirement that beneficiary use date of death value. Courts only required the executor to use consistent basis.

The rule only applies to property that generates an estate tax, so it only applies to taxable estates. It doesn't apply to property qualifying for marital deduction or charitable deduction.

Section 6035 requires all executors required to file estate tax return to file a notice with beneficiaries and IRS within 30 days of estate tax return due date or date actually filed, if earlier. If the only reason an estate tax return is filed is for portability, it's not a required return. Penalty is $250 per failure. Failure is per property, not per notice. Willful failure is effectively 10% of amount that should be shown on the information return. Disregarding it is not a viable option.

Proposed regulations – Ms. Hughes said that they tried to plug some holes in the statute with the proposed and temporary regulations. Including:

Final estate tax value caps the recipient's initial basis. It can still be increased by things such as capital repairs to real property.

Consistency requirements continues to apply until holder's basis doesn't rely on date of death value

Gross number must be shown, not net of debt

Section 1014(f) is only taxable property. If estate tax due, regulations provide that if tax is due, every asset contributes to the tax liability, with certain exceptions:

Marital/charitable deduction property

Tangible personal property that doesn't have a marked artistic or intrinsic value over $3,000

Not sure how they'll address after-discovered property because they think statute requires its value to be $0.

Some commentators suggested flexibility on who receives Schedule A. If which recipient will receive property is unknown, each potential recipient is to get list of all potential assets that could be used to fund their bequest. If anything happens to make the information incorrect or incomplete, must make a supplemental filing.

Ms. Hughes said they are struggling with alternative ways to interpret filing due date.

One concern raised by commentators is the rule on subsequent transfers. It requires a recipient of Schedule A who disposes of property in a carryover basis transaction to provide Schedule A to the new recipient and the IRS. IRS has received a ton of comments and is looking at alternative ways to handle it.

She said they will have the opportunity to revise regulations before final regulations are issued and suggested people keep track of suggested changes to the forms and submit them to her or the Chief Counsel's office. Efforts are being made to lobby Congress to change the date the report is required.

Ms. Heller said that the executor could include a letter to the beneficiaries explaining the form and that they are required to send the form. If a trust is to receive property but hasn't been created at the time notice is sent, the executor can't fully complete the form. Ms. Hughes said this will be addressed but doesn't know who should receive the form.

State Taxation:

Even if the federal estate tax is repealed, we will still have state law issues. In addition to approximately 18 states having an estate or inheritance tax, these will include income tax issues. These are especially daunting when a trust is involved because different states determine residency of trusts in different ways. Mr. Belcher recommended Richard Nenno's Wilmington Trust material on state income taxation that can be obtained from Wilmington Trust or found on the internet. Your reporter seconds that recommendation. He has found that material to be very useful. **See also 2017 Heckerling materials from Special Session IV-B, Thursday afternoon, January 12th.**

Treasury Priority Guidance Plan:

The Priority Guidance Plan Identifies the priorities and how the IRS/Treasury is allocating its resources. Typically, projects listed are expected to be completed by next June 30th. Some have already been completed.

Ms. Hughes suggested that people who have something that they want addressed in proposed regulations to let them know before regulations are proposed. Comments after proposed regulations are released may not be included in final regulations if they are outside the scope of the proposed regulations.

<u>Highlights of transfer tax issues</u>:

Gift tax effect of defined value clauses – IRS will try to provide some clarity.

Definition of income under spousal support trusts. Added due to request from California bar.

Section 2053 – what to do with loan guarantees and present value in determining amount of expenses and claims against the estate. Expect regulations to be out soon.

Security requirements under 6166. A complete revision of current regulations issued under prior 6166

Some projects have been dropped from the plan because they don't expect to complete them by June 30 but are still being worked on.

<u>Other Developments</u>:

Other developments discussed by the panel included:

<u>Estate of Daniel Woelbing v. Com'r</u> and *<u>Estate of Marion Woelbing v. Com'r</u>* – IRS conceded all taxes and penalties in cases dealing with a defined value installment sale to a grantor trust. The settlement for no additional tax indicates that the IRS accepted the defined value clause and the number of shares transferred was adjusted to reflect the increased value. In some cases, Ms. Heller was involved in, the auditor ignored Woelbing. It appears that the defined value clause worked. IRS had the opportunity to nail it and didn't. A panelist stated that the settlement is a positive development.

<u>*True v. Commissioner* cases</u> – show that the IRS is not giving up on defined value clauses without a fight. There is reason to be optimistic in this case because the facts don't paint the picture that the IRS wants.

<u>Family Limited Partnerships</u> – 2016 saw the first FLP cases since 2012. The cases show that FLPs are still the subject of IRS attention and careful planning is crucial.

<u>Rev. Proc. 2016-49</u> – IRS said that QTIP elections will be disregarded if it is made on an estate tax return filed only to elect portability. QTIP treatment may be elected to get a step-up in basis at the surviving spouse's death. Prof. Donaldson thinks Clayton QTIP trust will become the dominant estate planning technique. If you make a portability election, you can't void the QTIP election.

<u>Estate tax closing letters</u> – The IRS doesn't want them requested unless absolutely needed. They suggest the use of a transcript instead. On January 6, IRS issued Notice 2017-12, which provides guidance on the methods available to confirm the closing of an estate tax return audit. It also announces that an account transcript with a transaction code of "421" and explanation "Closed examination of estate tax return" can serve as the functional equivalent of an estate tax closing letter in confirming the closing of an examination.

<u>Electronic signatures on wills</u> – Recently introduced Florida S. B. 206 allows persons to execute wills electronically and without the physical presence of witnesses or an attorney. Similar legislation has been introduced in a few other states and Nevada enacted a similar law in 2001

(See NRS Section 133.085). E.g., see Hodges, "Electronic Wills - Are They Valid and Enforceable," CCH Estate Planning Review - The Journal - Technology Update Column (December 2016, pp. 279-280).

Recent Development Materials by: Steve R. Akers, Samuel A. Donaldson, Charles D. “Skip” Fox, IV, Jeffrey N. Pennell, and Howard M. Zaritsky
Edited by: Ronald D. Aucutt

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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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