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Estate Planning Workshop

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Estate Planning Workshop

Panelists: **Stephen R. Akers, Dallas**
Ronald D. Aucutt, McLean, Virginia
Lora G. Davis, Dallas
Mickey Davis, Houston
Jerome M. Hesch, Aventura, Florida
Pamela Orsak, Victoria, Texas
Jordan Ware, Austin

Moderator: **Stanley Johanson, Austin**

A. Account transcripts in lieu of closing letters. You heard what **I** said in the Recent Developments outline (p. 1). Do you have anything to add?

B. Should bypass trusts include "comfort" stations? For years (make that decades), in drafting bypass trusts to benefit a spouse or children we have always stayed within the parameters of an ascertainable standard relating to health, education, maintenance and support. "Comfortable" as an adjective modifying the permissible standard is OK, but "comfort" as the standard is to be strenuously avoided—right? That would give the beneficiary a general power of appointment, leading to a gross estate inclusion. The objective, of course, was to insure that the value of the trust assets would bypass the beneficiary's estate for estate tax purposes.

But in today's world, with a $5.45 million estate tax exemption (effectively $10.9 million for married couples), the vast majority of clients, and their beneficiaries, don't have to worry about the estate tax. (It is different if the client—or the beneficiary—lives in a state that has an estate tax; *e.g.,* Oregon, with a $1 million exemption, but that is not a concern in Texas and most states.) Instead, in most cases inclusion of the trust assets in the beneficiary's gross estate would be beneficial—the assets would receive a new basis for income tax purposes under §1014.

1. Consider a community estate of more than $10 million, a reasonably harmonious marriage, and three children. If the bypass trust for W in H's will (and vice versa) gives the spouse an invasion power, it would likely be advisable to stay with the HEMS standard, as W has assets that will count against if not "use up" her $5.45+ million exemption.

    a. For the three children, separate trusts (likely to be funded in the range of $3 million) are strongly indicated—to give spendthrift protection, divorce protection, in-law protection, and (in later years) avoidance of a guardianship in the event of declining capacity. Over the years, the trust assets will inevitably increase in value due to inflation if from no other cause. Inclusion of the assets in each child's gross estate, securing a basis step-up, is likely to be of much greater value to the successors than avoidance of an estate tax with its then-$7 million or so exemption—and that assumes that there is still an estate tax. Should the terms "comfort" and "benefit" enter the equation?

2. Would it be sufficient to rely on the Delaware Tax Trap—giving W a special power of appointment that can be exercised so as to give the donee a presently exercisable general power of appointment?

   a. Who is going to advise W down the road (perhaps many years from now), in explaining how to implement this relatively sophisticated (for lay persons) transaction? I expect, that in most situations, a continuing attorney-client relationship with a retainer fee will not be involved when you draft H and W's wills. What do you say to that? Is this a negative factor in relying on the Delaware Tax Trap?

3. Would it be appropriate (or possible) to give a Trust Protector the authority to expand the beneficiary's invasion power to include "comfort and benefit"?

4. Could we seek a judicial modification of a trust under Texas Trust Code §112.054(a)(4) on the ground that "the order is necessary or appropriate to achieve the settlor's tax objectives and is not contrary to the settlor's tax objectives"?

   a. Perhaps in drafting the trust's terms the settlor's tax objectives could be set out, with specific reference to concerns about taking steps to secure a new basis for trust assets where appropriate.

C. Installment sale to defective grantor trust—*Estate of Woelbing v. Commissioner* settled. The Recent Developments outline (p. 6) notes that *Estate of Woelbing* was settled shortly before the Tax Court trial date of February 29, 2016. As a result, several important issues regarding the DIGIT transaction, which would have been addressed, remain unsettled. What are your comments on these three key features of the *Woelbing* transaction?

1. Use of personal guarantees, given by two sons who were trust beneficiaries, to partially seed the purchasing trust, so as to make the trust a viable entity in the DIGIT transaction.

2. The basic validity of a DIGIT transaction, and whether the §2702 special valuation rule should apply.

3. With respect to the note paid as consideration, whether the AFR interest rate rather than the much higher §7520 interest rate could be employed in valuing the transaction.

D. More on defective grantor trusts—exercise of the substitution power with a promissory note. One of the most widely used mechanisms for making an irrevocable trust a grantor trust is to give the grantor a §675(4)(C) nonfiduciary power to reacquire trust assets by substituting assets of equivalent value. A situation in which the substitution power might be exercised is where the assets sold to the trust have appreciated substantially in value. The grantor may want to reacquire ownership so that the assets will secure a §1014 step-up in basis at the grantor's death. The substitution power would likely be exercised by exchanging the trust's assets for the grantor's promissory note of equivalent value. In Estate Planning 45 (Nov. 2016), Howard Zaritsky has written an article titled "Courts Split on Substitution of Note for Assets Under Section 675(41(0." In the article, Zaritsky discusses two recent cases:

1. *In re The Mark Vance Candiotti Irrevocable GST Trust,* No. 14CA0969 (Colo. App. 2015) (unpub. op.): In 2000, grantor C created an irrevocable trust for the benefit of his wife and son. The trust named the wife as trustee, and later a bank was appointed co-trustee. The trust gave C a substitution power exercisable in a nonfiduciary capacity and