Presentation

HUSCH BLACKWELL

Ten of the Top Estate Planning Traps for the Unwary Planner

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Trap No. 1 - Failure to Properly Draft Tax Apportionment Clauses

Introduction

Tax apportionment clauses in estate plans are very important and present a significant trap for the unwary planner. These clauses dictate which beneficiaries will bear taxes imposed by reason of a client's death. To adequately prepare such clauses, the planner must ask the right questions and gather sufficient information regarding the client's property interests, family history and estate planning goals. For example, the planner should determine the following:

- Whether the recipient of a legacy or specific gift should bear any death tax imposed with respect to the gift, or whether the residue of the client's estate or revocable trust should bear such tax; and
- Whether the client has an interest in, or power of appointment over, any assets that will pass outside the client's probate estate and revocable trusts at death.

The client may believe, for example, that beneficial interests in irrevocable trusts established by others will not be included in the client's estate or disposed of by the client's estate plan. By educating the client and asking the right questions, the planner will gather the information needed to prepare an appropriate tax apportionment clause.

The discussion below focuses on the transfer tax system currently in effect. It does not take into account the possible repeal of the federal estate tax.

Recent Cases

Recent cases highlight the importance of tax apportionment clauses.

- *Estate of Lurie*, 87 TCM 830 (2004) (holding that the apportionment clause in a decedent's revocable trust, which provided for the payment of all death taxes if the probate estate was insufficient, required the trustee to pay the estate tax imposed on assets of 20 other inter vivos trusts created by the decedent);
- *Estate of Green*, 86 TCM 758 (2003) (holding that a state's equitable apportionment rules prevented a residual charitable bequest from bearing estate tax because the tax apportionment clause in the decedent's will, which provided that death taxes be paid from the estate, gave no guidance as to how the residue was to bear the estate tax burden).
- *Estate of Kuralt*, 315 Mont 177; 68 P3d 662 (2003) (holding that a handwritten codicil prepared by former television personality Charles Kuralt, which failed to address the payment of death tax associated with the devise of a Montana ranch to a long-time companion, did not create an ambiguity with respect to the original

will's tax apportionment clause that directed the payment of all death taxes from the residue).

For additional case law, see Berek, *Recent Decisions Indicate a Review of Tax Apportionment Clauses*, 32 EST. PLAN. 3 (2005).

Failure to Provide for "Inside Apportionment"

The *Green* case above involved a common situation where the testator wants death taxes paid "off the top" but fails to make clear in the governing instrument how different residual interests will bear the tax. Here is a typical payment clause that fails to provide for apportionment inside the class of residuary beneficiaries:

Payment of Charges. *I direct my personal representative to pay the following items from the residue of my estate:*

(a) My legally enforceable debts (other than debts secured by real or tangible property, which property shall pass subject to those obligations);

(b) Funeral expenses;

(c) Expenses of administering my estate; and

(d) Taxes, including any interest and penalties, imposed by reason of my death upon any transfer of property.

Depending on the number and character of the residuary beneficiaries, local law may have to be applied to construe this clause (i.e., to carry out the decedent's probable intent through "*rules of construction*"). Suppose, for example, that a pre-tax, net estate of $3 million passes under a will containing the Payment of Charges provision above to two residuary beneficiaries, charity *C* and the testator's daughter *D*. *C* gets 1/3 of the residue, *D* gets the rest. With the estate tax charitable deduction for *C*'s interest, the estate tax is $225,000. The personal representative has paid the tax and is now ready to distribute the after-tax residue. How much does *C* get?

The point is that the Payment of Charges provision above does not answer that question, because it does not tell the personal representative how to treat the deductibility of *C*'s interest for distribution purposes. The Michigan Estates and Protected Individuals code ("EPIC") provides an answer in default. EPIC Section 3920(1) says that death tax paid under this clause will be apportioned pro rata among the residuary beneficiaries "based on the value of the residuary interests *generating the tax*," and Section 3921(2) says that for purposes of Section 3920(1), "interests generating a tax do not include property or interests . . . to the extent [they are] . . . deductible from the gross estate."

So, EPIC allocates the benefit of the charitable deduction entirely to *C*: *C* gets $1 million, and *D* gets $1,775,000. That may be what the testator intends, in which case the Payment of Charges provision above is fine. But if the testatrix wants *C* and *D* to share the benefit of the deduction, the provision had better be something like:

Payment of Charges. *I direct my personal representative to pay the following items from the residue of my estate* ***without apportionment among my beneficiaries****:*

...

> (d) Taxes, including any interest and penalties, imposed by reason of my death upon any transfer of property.

In that case, EPIC's rules and the deductibility of *C*'s interest are ignored for distribution purposes: *C* gets $925,000, and *D* gets $1,850,000.

Failure to Direct the Client's Revocable Trusts to Pay Death Tax

A client's will may require the personal representative to pay "from the residue of my estate without apportionment among my beneficiaries all taxes imposed by reason of death upon any transfer of property whether made under this will or otherwise." The will may fail to direct the trustees of revocable trusts established by the client to contribute toward the payment of those death taxes. If those trusts have tax apportionment clauses requiring the trustees to pay a proportionate amount of the client's death taxes, will those clauses control over the will's apportionment clause, or vice versa? The answer to this question matters if the beneficiaries under the will are different than the beneficiaries under the trusts.

Section 3921(4) of EPIC states: "If there is a conflict between directions in a will to allocate and pay tax and the terms of another governing instrument, the directions in the will control." The conflict between the will and trust apportionment clauses can be addressed by adding the following language to the Payment of Charges provision quoted above:

- *If the residue is insufficient or contains assets that my personal representative concludes cannot or should not be liquidated, my personal representative may direct the trustee of any trust then in existence that I established as a revocable trust to pay debts, transfer taxes, and expenses for which the residue of my estate otherwise is liable. The burden of payments made by the trustee shall be allocated as specified in the trust. Debts, transfer taxes, and expenses incurred because of my death that are treated as estate transmission expenses for federal tax purposes, whether paid by my personal representative or by a trustee at my personal representative's discretion, shall be paid from principal. Other estate expenses may be paid from income or principal, but an expense shall not be paid* *from income on property that qualifies for an estate tax marital or charitable deduction if the expense is attributable to other property or if a deduction for the expense is taken on my federal estate tax return.*

Failure to Apportion Death Taxes to Property Passing Outside the Will and Revocable Trusts

Property passing outside a client's will and revocable trusts may be included in the estate for death tax purposes. If the death tax on such property is significant, as it was in the *Lurie* case above, the client may want to apportion the death tax to that property. This type of apportionment is often referred to as "outside apportionment." Apportioning death tax to assets passing outside the client's will and revocable trusts can be done in various ways.

Apportionment based on Internal Revenue Code reimbursement and apportionment provisions

The Internal Revenue Code ("Code") has reimbursement and apportionment provisions that cause certain property to bear federal transfer taxes. To utilize those provisions, clause (d) in the Payment of Charges provision above could be replaced with the following language:

> *(d) Taxes, including any interest and penalties attributable to those taxes, imposed by reason of my death upon the transfer of property, excluding the following:*
>
> > *(i) Taxes for which sources of payment are provided under Code Sections 2206 (relating to life insurance payable to a beneficiary other than my personal representative), 2207 (relating to property subject to a general power of appointment), 2207A (relating to qualified terminable interest property), 2207B (relating to property subject to a retained interest), and 2603 (relating to property subject to generation-skipping transfer tax); and*
> >
> > *(ii) Any additional estate taxes imposed under Code Sections 2032A(c) (relating to qualified real property) and 2057(f) (relating to a qualified family-owned business interest).*

Each excluded tax shall be apportioned to the transfers or interests generating that tax in a manner that reflects any reimbursement rights or apportionment obligations under the Code with respect to that tax. If the Code does not provide for reimbursement or apportionment of that tax, then such tax shall be apportioned pro rata among the transfers or interests generating that tax, based on the value of the transfers or interests involved (reduced by any debts secured by those transfers or interests) as finally determined for that tax. Any interest and penalties attributable to an excluded tax shall be apportioned in the same manner as the tax.

One benefit of basing apportionment on the Code reimbursement and apportionment rules is that the reimbursement right for marital deduction property under Code section 2207A is the marginal increase in estate tax resulting from the inclusion of marital deduction property in the surviving spouse's gross estate. Thus, if the inclusion of the marital deduction property pushes the taxable estate of the surviving spouse into a higher estate tax bracket, that property bears the burden of the higher tax rate.

The Code does not provide reimbursement or apportionment rules for all possible inclusions. For example, the language above does not apportion any tax to the following inclusions:

- Gift tax paid on gifts made within three years of death (Code section 2035(b));
- Transfers taking effect at death (Code section 2037);
- Revocable transfers (Code section 2038);
- Annuities and employee benefits (Code section 2039);
- The unused portion of the five year annual exclusion amount with respect to "Section 529 plans," for amounts properly allocable to periods after the death of the donor (Code section 529(c)(4)(C)); and
- Property not qualifying for the marital deduction or disclaimed by the surviving spouse.

Clause (d) above could be expanded to cover, for example, property not qualifying for the marital deduction or property disclaimed by the surviving spouse in the following manner:

> *(iii) Taxes imposed upon transfers of property to or in trust for my spouse that do not qualify for the marital deduction; and*
>
> *(iv)Taxes imposed upon transfers of property as a result of a qualified disclaimer made by my spouse.*

The client and planner must carefully consider whether apportionment should occur with respect to employee benefits and contributions to Section 529 plans. Factors to consider include the following:

- A client may want to take advantage of the minimum distribution rules with respect to employee benefits in qualified retirement plans or individual retirement accounts. The minimum distribution rules can be used if certain requirements are met. One requirement is that there be a "designated beneficiary." An estate does not qualify as a designated beneficiary, and if an estate is a beneficiary of a qualified retirement plan or individual retirement account, the plan participant is treated as having no designated beneficiaries for minimum distribution purposes. Treas. Reg. §1.401(a)(9)-4, A-3. If a client's estate plan provides that transfer taxes will be apportioned to benefits in those plans or accounts, the possibility exists that the Internal Revenue Service may treat the estate as a beneficiary. To avoid this result, one commentator recommends that the estate plan should either prohibit the use of those benefits to pay death taxes or require that death taxes be paid from those benefits before September 30th of the year following the year of the client's death. *See* Choate, LIFE AND DEATH PLANNING FOR RETIREMENT BENEFITS, 6.2.12 and 6.2.13 (2003).

Thus, the following language might be added to the client's revocable trust if any benefits are payable to a trust beneficiary:

> *To the extent that other assets are available, Trustee shall not use for payment of debts, transfer taxes, or expenses of administration any benefits payable to the Trust under a retirement plan for which a trust beneficiary is treated as the designated beneficiary.*

The term "retirement plan" for this purpose would be defined elsewhere in the trust instrument.

- A withdrawal from a qualified retirement plan, individual retirement account or a Section 529 plan to pay death taxes will be subject to income tax in whole or in part. Thus, the ability to accumulate assets on a tax-deferred basis in a qualified retirement plan or individual retirement account (assuming no lump sum payout), or on a tax-exempt basis in a Section 529 plan, will be hindered by a tax apportionment.

Apportionment of taxes proportionately to all taxable transfers

Another alternative for apportioning taxes to property passing outside the client's will or revocable trusts is to apportion only to transfers generating tax. An example of this alternative is as follows:

Payment of Charges. *I direct my personal representative to pay the following items from the residue of my estate, without apportionment among my beneficiaries:*

> *(a) My legally enforceable debts (other than debts secured by real or tangible property, which property shall pass subject to those obligations);*
>
> *(b) Funeral expenses; and*
>
> *(c) Expenses of administering my estate.*

If the residue is insufficient or contains assets that my personal representative concludes cannot or should not be liquidated, my personal representative may direct *the trustee of any trust then in existence that I established as a revocable trust to pay debts and expenses for which the residue of my estate otherwise is liable. The burden of payments made by the trustee shall be allocated as specified in the trust. Debts and expenses incurred because of my death that are treated as estate transmission expenses for federal tax purposes, whether paid by my personal representative or by a trustee at my personal representative's discretion, shall be paid from principal. Other estate expenses may be paid from income or principal, but an expense shall not be paid from income on property that qualifies for an estate tax marital or charitable deduction if the expense is attributable to other property or if a deduction for the expense is taken on my federal estate tax return.*

I further direct that transfer taxes be paid as follows:

(d) A transfer tax shall be apportioned pro rata among and paid from the transfers generating that tax, whether made under this will or otherwise;

(e) Contrary to anything above:

(i) Any additional estate tax imposed under Code Section 2032A(c) (relating to qualified real property) or Code Section 2057(/) (relating to a qualified family-owned business interest) shall be paid in the manner provided in the Code or if the Code does not provide, shall be apportioned pro rata among and paid from the transfers or interests generating that tax;

(ii) Any estate or inheritance tax imposed on transfers of tangible personal property and gifts of a specific dollar amount made under this will or any revocable trust established by me shall be apportioned pro rata among and paid from the other transfers generating that tax;

(iii) Any generation-skipping transfer tax imposed under Chapter 13 of the Code or any other law on transfers of tangible personal property made under this will or any revocable trust established by me shall be apportioned pro rata among and paid from the other transfers generating that tax;

(f) A transfer tax shall be apportioned based on the value of each transfer or interest involved, reduced by debts secured by that transfer or interest, as finally determined for that tax. Any interest and penalties attributable to that tax shall be apportioned in the same manner as that tax; and

(g) Any credit, deduction, exemption, exclusion, tax rate reduction or differential, or similar tax benefit permitted in computing any transfer tax, which is directly attributable to an identifiable transfer; shall inure to the recipient of that transfer for apportionment purposes; and

(h) All transfer taxes shall be paid from principal.

Clause (d) above will apply to a state's GST tax but not to the federal GST tax because Code section 2603(b) provides that a tax apportionment clause will be ineffective for federal GST tax purposes unless it makes "specific reference to the tax imposed by this chapter...." Code section 2603(b) imposes its own equitable apportionment rules for the federal GST tax by providing that "the tax imposed by this chapter on a generation-skipping transfer shall be charged to the property constituting such transfer." Furthermore, Code section 2603(a) designates the person responsible for paying the federal GST tax. The apportionment language above assumes that the client wants the apportionment rules in Code section 2603(b) to apply with one exception. That exception pertains to transfers of tangible personal property under the client's will or revocable trusts, which is found in clause (e)(iii) of the apportionment language above.

If an unwary planner were to draft clause (d) in a limited manner so that it would apply to certain transfer taxes *other than* a GST tax, it appears that any Michigan GST tax would be apportioned under EPIC Section 3920. Section 42 of the Michigan estate tax act, MCL 205.231 et. seq., provides that the generation-skipping transfer tax imposed by Section 33 of that act shall be apportioned in the manner provided under the Michigan uniform estate tax apportionment act, Public Act 144 of 1963, and any successor act. The Michigan uniform estate tax apportionment act was repealed and EPIC Section 3920 appears to be the qualifying successor act. Assuming EPIC Section 3920 qualifies as a successor act for that purpose, it will apportion the Michigan GST tax first to the *residuary* beneficiaries under a client's will or revocable trusts unless the "governing instrument" provides otherwise. Thus, if a generation-skipping transfer under a client's will or revocable trusts is a *nonresiduary* gift, the Michigan GST tax imposed on that transfer would be borne by the residue of the estate or revocable trust, as the case may be, unless the governing instrument provides otherwise. That apportionment may not carry out the client's wishes. To avoid that result, clause (d) above was drafted so that it would cover the Michigan GST tax and apportion that tax to the transfers generating that tax.

Clause (e)(ii) above does not apportion estate and inheritance taxes to transfers of tangible personal property nor to bequests of a specific dollar amount made under the will or revocable trusts. However, if the aggregate value of those transfers and bequests is significant, the client may want to apportion estate or inheritance tax to those transfers and bequests.

Clause (e)(iii) above does not apportion generation-skipping transfer taxes to transfers of tangible personal property made under the will or revocable trusts, but does apportion such taxes to bequests of a specific dollar amount. If the aggregate value of those transfers is significant, the client may want to apportion generation-skipping transfer taxes to those transfers.

Clause (g) above provides that certain tax benefits used in computing a transfer tax will inure to the benefit of the recipient:

- Any tax rate differential in computing a state inheritance tax based on the relation between the decedent and the transferee will inure to the benefit of the transferee. For example, the tax rates under the old Michigan inheritance tax act for transfers to close relatives of the decedent ranged from 2 to 10 percent, and the tax rates for persons falling outside that group ranged from 12 to 17 percent. Clause (g) allows transferees who are close relatives of the decedent to benefit from any inheritance tax reduction due to that relationship. (The apportionment rules under EPIC Section 3921(2) do the same.)
- Clause (g) reasserts the position that a transfer tax will be apportioned only to transfers generating tax. Thus, a marital or charitable deduction, for example, inures to the benefit of the person for whose benefit the deductible transfer was made.

Clause (h) above directs the payment of transfer taxes from principal, which causes tax imposed on a temporary interest (e.g., an interest in income or an estate for a term of years or life) to be paid from principal rather than from the temporary interest. The client may or may not want this result (which is the same result provided in EPIC Section 3920), so it is important to raise the subject during the estate plan conference with respect to the temporary interest. According to one commentator, if the client wants to apportion death tax to a temporary interest, such tax could be paid from corpus and amortized over the respective interests based on their respective values, or the apportionment could occur through a loan repayable from the temporary interest. *See* Pennell, *Transfer Tax Payment and Apportionment*, NOTRE DAME TAX & EST. PLAN. INST. 21-1, 21-86, 21-87 and 21-130 (2004).

Apportionment of taxes to all transfers

A third alternative is to apportion transfer taxes to all transfers regardless of whether they generate tax. This alternative can be used, for example, when a client wants charitable and noncharitable gifts to bear transfer taxes. This alternative can be implemented by simply modifying paragraph (d) in the tax apportionment provision immediately above, omitting paragraph (g) from that provision, and relettering the balance accordingly:

I further direct that transfer taxes be paid as follows:

> *(d) A transfer tax shall be apportioned pro rata among and paid from all transfers made under this will or otherwise, regardless of whether those transfers generate the tax.*
>
> *(e) Contrary to anything above...*

(g) All transfer taxes shall be paid from principal.

Clause (d) of the apportionment language above applies to all transfers at death. Thus, it might not apply to any estate tax inclusions that do not constitute transfers at death such as lifetime gifts to Section 529 plans or gift tax paid within three years of death.

The apportionment language above allows all transfers to benefit from any credit, deduction, exemption, exclusion, tax rate reduction or differential, or similar tax benefit permitted in computing the transfer tax.

Failure to Apportion Transfer Taxes Away from a GST Exempt Marital Trust Included in the Surviving Spouse's Gross Estate

When a deceased spouse's estate plan establishes two or more qualified terminable interest trusts ("QTIP trusts") for the surviving spouse and the fiduciaries of the deceased spouse's estate allocate the deceased spouse's GST exemption to one QTIP trust (the "exempt trust") but not to the other QTIP trusts (the "non-exempt trusts"), the fiduciaries are likely to make an election under Code Section 2652(a)(3) to treat the exempt trust as if no QTIP election was made for that trust. When that "reverse QTIP" election is made, the deceased spouse is treated as the transferor of the exempt trust for GST tax purposes even though the remaining assets in that trust are included in the surviving spouse's gross estate for estate tax purposes.

Under Code section 2207A, the surviving spouse has a right to recover from the exempt trust the federal estate tax imposed with respect to that trust by reason of its inclusion in the surviving spouse's gross estate. However, the surviving spouse may not want to recover any estate tax from the exempt trust because the entire value of that trust can pass to grandchildren or lower generations free of the federal GST tax. (Any recovery of estate tax from that trust diminishes the amount of assets that will ultimately pass to those grandchildren or lower generations.) In that case, the surviving spouse's estate plan should waive any right of recovery with respect to the exempt trust and apportion estate tax imposed with respect to the exempt trust to the non-exempt trusts or to other assets in the surviving spouse's gross estate.

For drafting purposes, the planner should determine who the beneficiaries of the exempt and non-exempt trusts are. If the beneficiaries are descendants of the marriage of the deceased spouse and the surviving spouse, the surviving spouse may want the estate tax imposed with respect to the exempt trust to be paid from the non-exempt trusts or, if those trusts are insufficient, from the surviving spouse's estate. The tax apportionment clause in that event could read as follows:

***Payment of Charges**. I direct that all transfer taxes attributable to the inclusion in my estate of the marital trust for which a special election was made in my deceased* *spouse's estate under Code Section 2652(a)(3), together with all transfer taxes attributable to any other marital trusts established by my spouse for my benefit, plus any interest and penalties attributable to those taxes, be paid proportionately from those other marital trusts (and for this limited purpose I exercise any general power of appointment I may have over those other marital trusts), or, if there are no other marital trusts or to the extent they are insufficient to satisfy those obligations, be paid from the residue of my estate. I specifically waive the right of my estate under Code Section 2207A to recover estate taxes and any interest and penalties attributable to those taxes from the marital trust for which the special election was made. The transfer taxes to be borne by the other marital trusts or the residue of my estate shall be the increase in those taxes caused by the inclusion of all marital trusts in the tax base.*

I direct my personal representative to pay the following items from the residue of my estate, without apportionment among my beneficiaries:

> *(a) My legally enforceable debts (other than debts secured by real or tangible property, which property shall pass subject to those obligations);*
>
> *(b) Funeral expenses;*
>
> *(c) Expenses of administering my estate; and*
>
> *(d) All other taxes, including any interest and penalties attributable to those taxes, imposed by reason of my death upon any transfer of property, excluding the following:*
>
> > *(i)Taxes for which sources of payment are provided under Code Sections 2206 (relating to life insurance payable to a beneficiary other than my personal representative), 2207 (relating to property subject to a general power of appointment), 2207B (relating to property subject to a retained interest), and 2603 (relating to property subject to generation-skipping transfer tax); and*
> >
> > *(ii)Any additional taxes imposed under Code Sections 2032A(c) (relating to qualified real property) and 2057(f) (relating to a qualified family-owned business interest.*

Each excluded tax shall be apportioned to the transfers or interests generating that tax in a manner that reflects any reimbursement rights or apportionment obligations under the Code with respect to that tax. If the Code does not provide for reimbursement or apportionment of that tax-T-then-such tax shall be-apportioned pro rata-among the transfers or interests generating that tax, based on the value of the transfers or interests involved (reduced by any debts secured by those transfers or interests) as finally determined for that tax. Any interest and penalties attributable to an excluded tax shall be apportioned in the same manner as the tax.

If the residue is insufficient or contains assets that my personal representative concludes cannot or should not be liquidated, my personal representative may direct the trustee of any trust then in existence that I established as a revocable trust to pay debts, transfer taxes, and expenses for which the residue of my estate otherwise is liable. The burden of payments made by the trustee shall be allocated as specified in the trust. Debts, transfer taxes, and expenses incurred because of my death that are treated as estate transmission expenses for federal tax purposes, whether paid by my personal representative or by a trustee at my personal representative's discretion, shall be paid from principal. Other estate expenses may be paid from income or principal, but an expense shall not be paid from income on property that qualifies for an estate tax marital or charitable deduction if the expense is attributable to other property or if a deduction for the expense is taken on my federal estate tax return.

Alternatively, if the beneficiaries of the exempt and non-exempt trusts are descendants of a prior marriage of the deceased spouse, the surviving spouse may want the estate tax imposed with respect to the exempt trust to be paid from the non-exempt trusts or, if those trusts are insufficient, from the exempt trust. In that event, the first paragraph of the tax apportionment clause would read as follows:

Payment of Charges. *I direct that all transfer taxes attributable to the inclusion in my estate of the marital trust for which a special election was made in my deceased spouse's estate under Code Section 2652(a)(3), together with all transfer taxes attributable to any other marital trusts established by my spouse for my benefit, plus any interest and penalties attributable to those taxes, be paid proportionately from those other marital trusts (and for this limited purpose I exercise any general power of appointment I may have over those other marital trusts). I specifically waive the right of my estate under Code Section 2207A to recover estate taxes and any interest and penalties attributable to those taxes from the marital trust for which the special election was made, to the extent such taxes, interest, and penalties are paid from those other marital trusts. The transfer taxes to be borne by the other marital trusts shall be the increase in those taxes caused by the inclusion of all marital trusts in the tax base.*

Conclusion

A tax apportionment clause can be as important as the dispositive provisions in a client's estate plan. What the dispositive provisions give, tax apportionment may take away. The effectiveness of a tax apportionment clause is directly related to the planner's knowledge of the client's assets, family history and estate planning goals. A carefully drafted clause will carry out the client's intent, facilitate estate administration, and pay dividends to the objects of the client's bounty.

Trap No. 2 - Failure to Assist the Client in Making ERISA Plan Beneficiary Designations Consistent with a Prenuptial or Postnuptial Agreement or with a Divorce Decree

Introduction

A client may have interests in retirement plans that are qualified under the Employee Retirement Income Security Act of 1974 ("ERISA"). ERISA plans fall generally into two categories: employee pension benefit plans and employee welfare benefit plans.

Employee pension benefit plans defer income for retirement and are subdivided into categories called defined benefit plans and defined contribution plans. Defined benefit plans include pension and cash balance plans, while defined contribution plans include profit-sharing, 401(k), target benefit, stock bonus, savings and thrift, and ESOP plans.

Employee welfare benefit plans provide for the well being of an employee. They often provide life insurance, health, vision, dental and other immediate benefits.

Planning associated with ERISA plan benefits typically focuses on income and estate tax planning. For example, income tax planning often deals with how a client can maximize the income tax deferral through the so-called "minimum distribution rules." However, planning associated with divorce is often overlooked. That oversight could be very costly in the long run.

Divorce and Related Planning Issues

More than half of all marriages in the United States end in divorce. Consequently, the client may have a prenuptial or postnuptial agreement that plans for divorce or may have a divorce decree or property settlement agreement with respect to a prior marriage. Any of those instruments may have a provision similar to the following:

> The parties each waive any interest or claim in and to any retirement, pension, profit sharing and/or annuity plans resulting from the employment of the other party.

Another general provision often found in those instruments provides that the property division is in full satisfaction of all claims that each party may have in any property that the other party owns or has any interest in, either currently or in the future.

When a client enters into a prenuptial or postnuptial agreement or obtains a final judgment of divorce, the client may believe that all matters pertaining to the property division have been properly handled. Such confidence is likely to cause the client to pay little or no attention to changing a beneficiary designation on an ERISA plan so that it is consistent with the agreement or judgment.

When a client enters into a prenuptial or postnuptial agreement and fails to update a beneficiary designation for an ERISA plan that is consistent with the agreement, a dispute can occur as to whether the terms of the agreement or the beneficiary designation/ERISA plan will control the devolution of plan benefits at the client's death. Similarly, if a divorced client fails to update a beneficiary designation that is inconsistent with the divorce decree or court-approved property settlement agreement, a dispute can occur as to whether the terms of those documents or the beneficiary designation/ERISA plan will control the devolution of plan benefits at the client's death. In other words, state law property rights under a prenuptial or post-nuptial agreement or divorce decree often clash with property rights under a beneficiary designation/ERISA plan. An issue arises in that instance as to which law is supreme in defining those rights - ERISA or state law?

Judicial Struggle with ERISA Pre-Emption and Anti-Alienation Statutes

For decades courts have been called upon to determine whether ERISA pre-empts certain state law. Judicial pre-emption analysis often focuses upon the ERISA preemption statute and the ERISA anti-alienation statute.

ERISA pre-emption statute

The ERISA pre-emption statute, 29 USC § 1144(a), expressly preempts all state laws that "relate to" an ERISA plan. This preemption applies to all state law, whether legislative or judge-made. *Central States, Southeast & Southwest Areas Pension Fund v. Howell*, 227 F3d 672, 676 (CA6 2000).

The courts struggle in determining whether ERISA pre-empts state law because such law does not always clearly "relate to" an ERISA plan. Consequently, courts also apply jurisprudence relating to "conflict pre-emption" and "field pre-emption" to resolve ERISA pre-emption issues.

Justices Scalia and Breyer of the United States Supreme Court have recognized the judicial struggle in the area of ERISA pre-emption. Both Justices contend that the struggle is largely due to the fact that the ERISA pre-emption statute lacks any "discernable content" that can be applied by the courts. Justice Scalia asserts that some coherence will come to this area only if ordinary conflict and field pre-emption principles are applied. Similarly, Justice Breyer contends that the failure to endorse normal conflict pre-emption principles instead of ERISA's pre-emption statute will continue to produce an avalanche of litigation. *See Egelhoff v. Egelhoff*, 532 US 141, 152-55 (2001) (Scalia, J., concurring and Breyer, J., dissenting).

ERISA anti-alienation statute

The ERISA anti-alienation statute, 29 USC §1156(d)(1), which provides that "each pension plan shall provide that benefits provided under the plan may not be assigned or alienated," is also applied in ERISA pre-emption cases. An "assignment or alienation" has been defined, with certain exceptions, as "any direct or indirect arrangement whereby a party acquires from a participant or beneficiary" an interest enforceable against a plan to "all or any part of a plan benefit payment which is, or may become, payable to the participant or beneficiary." 26 CFR §1.401(a)-13(c)(1)(ii).

In *Boggs v. Boggs*, 520 US 833, 851-52 (1997), the United States Supreme Court highlighted the importance of the ERISA anti-alienation provision in pre-emption analysis. Using conflict pre-emption principles, the United States Supreme Court held that ERISA pre-empted a state community property law permitting the testamentary transfer of an interest in a spouse's pension plan benefits and further pre-empted all state-law claims based on that community property law. 520 US 833 at 853-54. Instrumental in the Supreme Court's pre-emption analysis was the ERISA anti-alienation statute. According to the Supreme Court, that statute (i) gives specific and powerful reinforcement to the conclusion that Congress intended to pre-empt nonbeneficiary, nonparticipant interests in retirement plans, (ii) reflects a considered congressional policy to safeguard a stream of income for pensioners and their dependents, and (iii) exists along with other protective tools such as minimum funding standards and pension plan termination insurance to guarantee that retirement funds are there when a plan's participants and beneficiaries expect them. 520 US 833 at 851-52.

A significant exception to the ERISA anti-alienation provision is a qualified domestic relations order (QDRO) issued under a state domestic relations law, which creates for or assigns to an alternate payee the right to receive part or all of a participant's benefits under certain ERISA plans. 29 USC §1056(d)(3); Code sections 401(a)(13)(B) and 414(p). A domestic relations order may relate to the provision of child support, alimony payments or marital property rights to a spouse, former spouse, child or other dependent of the participant. 29 USC § 1056(d)(3).

Case Law Applicable to the Michigan Planner

If a client fails to update a beneficiary designation consistent with a prenuptial or postnuptial agreement or divorce decree, the planner will have to advise the client or the client's estate as to whether the terms of the agreement or decree can be enforced to control the devolution of plan benefits.

Case law regarding pre-distribution pre-emption

ERISA pre-empts any attempt to redirect plan benefits prior to distribution through the enforcement of a prenuptial agreement, postnuptial agreement or divorce decree against a plan. For example, the Sixth Circuit Court of Appeals has repeatedly held that state court divorce decrees purporting to affect benefits payable from an ERISA plan (by means other than a QDRO) are preempted. *Central States, Southeast & Southwest Areas Pension Fund v. Howell*, 227 F3d 672, 676 (CA6 2000). In other words, if a deceased spouse fails to change a beneficiary designation naming the ex-spouse as beneficiary, the ERISA plan administrator must pay the ex-spouse even though the ex-spouse waived the right to receive plan benefits in the divorce settlement.

Although Michigan case law is developing in this area, existing case law appears to follow the Howell decision with respect to pre-distribution pre-emption. See *MacInnes v. MacInnes*, 260 Mich App 280, 290-98; 677 NW2d 889 (2004) (Murphy, J., concurring), which relied upon *Egelhoff v. Egelhoff*, 532 US 141 (2001) in determining that a plan administrator should follow plan documents for distribution purposes and has no legal obligation to look outside plan documents in determining beneficiary status.

Case law regarding post-distribution redirection of plan benefits

Recent Federal and Michigan court decisions applicable to the planner show a trend toward allowing plan benefits to be redirected after they are paid in accordance with the plan documents:

- *Central States, Southeast & Southwest Areas Pension Fund v. Howell*, 227 F3d 672, 676 (CA6 2000) held that a constructive trust can be imposed on ERISA employee welfare benefit plan benefits after they have been paid to the employee participant. In support of its holding, the Sixth Circuit Court of Appeals relied upon the Tenth Circuit Court of Appeal's decision in *Guidry v. Sheet Metal Workers Nat'l Pension Fund*, 39 F3d 1078, 1081-83 (CA 10 1994) (*"Guidry II"*), which determined with respect to an ERISA employee pension benefit plan that ERISA does not prevent the imposition of a constructive trust after plan benefits are paid to the beneficiary.
- *Ford Motor Co. v. Ross*, 129 F Supp 2d 1070 (ED Mich 2001) held that (i) 29 USC § 1055 and its surviving spouse annuity benefits and spousal waiver requirements preempted a premarital agreement that precluded the surviving spouse from obtaining and retaining any benefits from the deceased spouse's ERISA plan, and (ii) the preemption precluded the court from imposing a constructive trust on benefits distributed to the surviving spouse. The Federal District Court for the Eastern District of Michigan relied-upon the *Boggs* decision above and distinguished it from the *Howell* decision above as follows:

> "Howell did not address ERISA pension plan benefits subject to the spousal consent and waiver requirements set forth in § 1055 and addressed in Boggs. Rather than benefits paid to a surviving spouse under an ERISA pension plan, the Court in Howell addressed life insurance benefits under an ERISA employee welfare benefit plan. Section 1055's spousal waiver requirements and objectives do not apply in that context. The critical distinction in Boggs and Howell is the distinction between ERISA benefits that are subject to ERISA's spousal waiver requirements and those that are not."

129 F. Supp 2d 1070 at 1073-74 (emphasis added). By reconciling *Boggs* and *Howell* in that manner, Ross appears to permit the imposition of a constructive trust on ERISA benefits payable to a non-spouse beneficiary.

- *State Treasurer v. Abbott*, 468 Mich 143; 660 NW2d 714 (2003) held that (i) a court order directing that a prisoner's pension benefits be sent to the prisoner at his prison address and deposited in his own account did not violate ERISA's anti-alienation statute; (ii) ERISA does not protect pension funds after the beneficiary receives them, and (iii) the state may distribute the funds after they are deposited in the inmate's account to the extent permitted under the State Correctional Facility Reimbursement Act (SCFRA), MCL 800.401 et. seq. Similar to the *Howell* decision above, the Michigan Supreme Court relied upon *Guidry II* and cases following that decision. Consequently, the holding here is similar to the holdings in *Howell* and *Ross*; that is, plan benefits are not protected after they are paid to a non-spouse beneficiary. In addition, the Michigan Supreme Court noted in *Abbott* that, despite the trial court's reference to the warden as a receiver of the pension benefits there, the warden did not act as a receiver because he did not have the power to manage, control or preserve the benefits. Rather, the warden was only obligated to place the pension benefits in the prisoner's account. 468 Mich 143 at 153.

The impact of Boggs on case law permitting post-distribution redirection of plan benefits

Although a growing body of case law allows the redirection of plan benefits after they are paid to the beneficiary, the *Ross* case above highlights the importance of the *Boggs* decision on pre-emption analysis. Generally speaking, the United States Supreme Court in *Boggs* determined that pre-emption of a community property law was effective both *before* and after the payment of plan benefits. The Supreme Court realized that preempted state law is ineffective if pre-emption applies only to undistributed plan benefits. According to the Supreme Court:

> "If state law is not pre-empted, the diversion of retirement benefits will occur regardless of whether the interest in the pension plan is enforced against the plan *or the recipient of the pension plan*.

...

> "It does not matter that respondents have sought to enforce their rights only after the retirement benefits have been distributed since their asserted rights are based on the theory that they had an interest in the undistributed pension plan benefits. *Their state law claims are pre-empted*."

520 US 833 at 853-54 (emphasis added). According to *Boggs*, a pre-empted state law includes claims based on that law. If state law claims are pre-empted, then pre-emption effectively applies after plan benefits are paid. Nevertheless, the *Howell*, *Ross* and *Abbott* decisions were issued after the *Boggs* decision, so it will probably take another United States Supreme Court decision to resolve the issue whether ERISA pre-empts the redirection of *distributed* plan benefits based upon state law claims.

Boggs, however, dealt with a statute that granted rights to persons who were neither beneficiaries nor plan participants. That situation differs from instances where a designated beneficiary intentionally waives his or her plan benefits.

Waiver of plan benefits

ERISA does not expressly prohibit a waiver of plan benefits. Furthermore, ERISA allows a spouse to waive his or her interest in a survivor annuity benefit for the purpose of allowing the other spouse, as participant, to name another beneficiary. *See* 29 USC §1055(c).

In *MacInnes v. MacInnes*, 260 Mich App 280; 677 NW2d 889 (2004), the Michigan Court of Appeals adopted the majority view in the United States that a beneficiary's waiver of plan benefits is permissible under ERISA. Under the majority view, "even where ERISA prempts state law with respect to determining beneficiary status under an ERISA-regulated benefits plan, ERISA does not preempt an explicit waiver of interest by a nonparticipant beneficiary of such a plan." 260 Mich App 280 at 892 (quoting *Melton v. Melton*, 324 F3d 941, 945 (CA7 2003)). In *MacInnes*, the decedent was a participant in an employee welfare benefit plan that provided a life insurance benefit. The decedent designated her spouse as beneficiary of the plan benefits and subsequently divorced. The decedent did not change the beneficiary designation prior to death and the insurer paid the insurance proceeds to the ex-spouse. The Michigan Court of Appeals ordered the return of those benefits on the grounds that the ex-spouse had waived his interest in those benefits.

Planning Tips

Significant value can be provided to a client during the estate planning process when a planner considers the client's ERISA plan benefits in conjunction with any prenuptial or postnuptial agreement or divorce decree that the client may have.

- The planner should determine if the client has a prenuptial or postnuptial agreement or a divorce decree. If so, advise the client to update beneficiary designations for those plans so that they are consistent with the agreement or decree.
- The planner should determine if the client has the ability to recommend or implement amendments to the ERISA plans in which the client is a participant. If so, then one commentator contends that the following provision could be inserted into the plan as a means of dealing with the former-spouse-as-designated-beneficiary problem:

  > *"If there is no designated Beneficiary alive at the death of a Participant, any death benefit provided shall be payable to the Participant's surviving Spouse, or if none, equally to the Participant's children who survive the Participant or, if none, to the Participant's estate. For purposes of determining the existence of a designated Beneficiary if a divorce, annulment, or other dissolution of the marriage between the Participant and the Participant's Spouse occurs, the Participant shall be deemed to have revoked any designation of such Spouse as the Participant's Beneficiary effective as of the date of such divorce, annulment, or other marital dissolution unless otherwise provided in a order constituting a Qualified Domestic Relations Order as defined in Sections 206(d)(3) of ERISA and 414(p) of the Internal Revenue Code. Nothing in this Section shall prohibit the Participant from naming such former Spouse as the Participant's Beneficiary in a new designation of Beneficiary filed with the Plan Administrator after such divorce, annulment, or other marital dissolution."* Urda, *Death, Divorce and Retirement Plans*, NOTRE DAME TAX & EST. PLAN. INST. 30-1, 30-21 (2003).

- If the client fails to update ERISA plan beneficiary designations prior to death and the planner is retained to pursue plan benefits by enforcing a prenuptial or postnuptial agreement or a divorce decree, the planner should act in a manner that will avoid ERISA pre-emption issues. To that end, do not attempt to enforce the agreement or decree directly against the plan. Rather, attempt to redirect plan benefits away from the designated beneficiary *after* the plan benefits have been distributed to the beneficiary. To the extent possible, assert that the beneficiary who received the plan benefits *waived* his or her interests in those benefits under a prenuptial or postnuptial agreement or a divorce decree. The waiver argument may overcome any pre-emption challenge regarding post-distribution redirection of plan benefits based on the *Boggs* decision. Remember, though, that the *Boggs* and *Ross* decisions do not allow plan benefits paid to a *surviving spouse* under a qualified joint and survivor annuity benefit or a qualified preretirement survivor annuity benefit to be redirected after receipt if the spouse did not satisfy applicable federal waiver requirements.

- If a waiver theory is pursued, the planner should consider Justice Murphy's procedural analysis in *MacInnes v. MacInnes*, 260 Mich App 280, 297-98; 677 NW2d 889 (2004) when pursuing plan benefits:

  > *"To summarize my analysis, the actions and obligations of a plan administrator should be solely controlled by the plan documents, and plan proceeds should be paid accordingly, without the need to determine if a waiver occurred. When multiple claims are made, the plan administrator could simply distribute proceeds pursuant to the plan documents or the administrator, if desired, could commence an interpleader action. The judgment-designated beneficiary could proceed under a waiver theory to seek recovery from a paid plan-designated beneficiary or from proceeds deposited with a court or trust account pursuant to an interpleader action. The judgment-designated beneficiary, however, could not legally force a plan administrator to make direct payment to the beneficiary contrary to the plan documents under a waiver theory, nor could the judgment-designated beneficiary sue the administer for making a distribution to a plan-designated beneficiary."*

Trap No. 3 - Failure to Avoid "Substitute Gifts"

Introduction: Construction and Interpretation

EPIC's anti-lapse provisions create "substitute gifts" to the descendants of predeceased beneficiaries in certain situations involving wills, beneficiary designations and trust agreements. These provisions are generally rules of "construction," i.e., rules designed to supply a plausible intent when "interpretation" comes up empty-handed, but they incorporate the surprising interpretive rule that an explicit reference to the beneficiary's survival does not in itself imply that a gift will fail if the beneficiary fails to survive. With respect to wills, for instance, EPIC section 2602(1) provides:

> In the absence of a finding of a contrary intention, the rules of construction in [EPIC Part 6, Rules of Construction Applicable Only to Wills] control the construction of a will.

But section 2603(1)(c) provides:

> For the purposes of section 2602(1), words of survivorship, such as in a devise to an individual "if he survives me" or in a devise to "my surviving children", are not, in the absence of additional evidence, a sufficient indication of an intent contrary to the application of [the anti-lapse provisions of] this section.

There are analogous provisions in EPIC section 2709(c) with respect to beneficiary designations and section 2714(c) with respect to future interests under trust provisions.

Scope

The respective anti-lapse provisions for wills, beneficiary designations and future interests under trust provisions differ in scope.

- With respect to wills, the statute creates substitute gifts in favor of the descendants of deceased devisees who are grandparents, descendants of grandparents or stepchildren of the testator or the donor of a power of appointment exercised by the testator's will.
- With respect to beneficiary designations, the statute creates substitute gifts in favor of the descendants of deceased beneficiaries who are grandparents, descendants of grandparents or stepchildren of the decedent.
- And with respect future interests under trust provisions, the statute creates substitute gifts in favor of the descendants of any deceased beneficiary.

Sufficiently Indicating a Contrary Intent

In a "pour-over" will, there may be no gifts to individuals other than gifts of tangible personal property. In that case, it may be convenient to express intent contrary to the anti-lapse statute in the provision that disposes of such property.

- ***Tangible Personal Property.*** *My personal representative shall distribute my tangible personal property in accordance with one or more written statements or lists in existence at the time of my death, which I may have prepared or altered before or after the execution of this will. Any such property not disposed of by a statement or list shall be distributed to my children who survive me [(but not to the descendants of a deceased child)], to be divided among them as they agree. Any such property my children do not want or on the division of which they cannot agree . . . .*

In other situations, the threat of "substitute gifts" is more general, in which case, a separate declaration may be in order;

- ***Conditions of Survival.*** *A gift fails if a beneficiary does not satisfy a condition of survival and there is no substitute beneficiary indicated in this document who satisfies the conditions for taking. The provisions of an anti-lapse statute shall not apply to preserve a gift for a person or persons who are not identified as a substitute or substitutes in this document.*

The point is that without something like either the bracketed, bolded parenthetical in the tangible personal property provision or the separate declaration regarding conditions of survival, a will containing the former provision potentially involves grandchildren and remoter descendants of the testator in the division of tangible personal property, the reference to "children who survive me" notwithstanding.

Substitute Appointees

Provisions (in wills, trust agreements and beneficiary designations) that create powers of appointment also implicate "substitute gifts." EPIC section 2603(1)(e) provides:

> Unless the language creating a power of appointment expressly excludes the substitution of the appointee's descendants for the appointee, a surviving descendant of a deceased appointee of a power of appointment can be substituted for the appointee under this section, whether or not the descendant is an object of the power.

Consider the following provision creating a special power of appointment:

> ***Distribution of Remainder***. *Settlor's spouse shall have the power to appoint any portion of the principal and undistributed income of the trust among Settlor's siblings who survive Settlor's spouse, by a will admitted to probate that specifically refers to this power* ***[, but this power shall not be construed to yield any substitute appointment to a descendant of a deceased sibling of Settlor]****. Any principal and undistributed income not effectively appointed Settlor's spouse shall be distributed outright to . . . .*

And suppose "Settlor's spouse" makes a will exercising the power as follows:

> ***Exercise of Special Power of Appointment***. *I possess a special power of appointment under Section ____ of the _____ trust established for my benefit by my deceased husband under an agreement dated __________, _____. I hereby exercise that power by directing that the principal and undistributed income of that trust be distributed outright in equal shares to those of my deceased husband's siblings who survive me* ***[(but not to the descendants of a deceased sibling of any deceased husband)]****. If none of my deceased husband's siblings survives me . . . .*

Presumably, the bracketed, bolded parenthetical in either of these provisions would avert a "substitute" distribution of trust assets to any descendant of a deceased sibling of Settlor, but failure to include the relevant parenthetical in either provision makes its presence in the other provision crucial.

Disinheriting the State

EPIC may also create a "substitute gift" in favor to the State of Michigan when the term "heir" is used in dispositively. The confluence of EPIC sections 1104 (general definitions), 2105 (on escheat) and 2720 (general, donative, dispositions rule of construction for references to "heirs") is that the State of Michigan is an heir of every Michigan resident. Thus, without the bolded language in brackets, the following, provision would be self-frustrating (in a Michigan resident's "governing instrument" governed by Michigan law).

> ***If No Family Member Survives.*** *If a member of the class comprising Settlor, Settlor's spouse and Settlor's descendants dies, and no other member of that class survives, Trustee shall distribute the remaining assets not effectively appointed or disposed of pursuant to any other provision in this Agreement outright:*
>
> *(a) in the manner then provided under Michigan law to those persons [other than the state] who would be the Settlor's heirs if Settlor had died immediately after the last survivor of the class; or*
>
> *(b) if no one described in (a) then survives, to the __________ School, or, if the School is not then in existence . . . .*

The same is true of the following:

> **Absence of Beneficiaries.** If, at any time, there is no one to take under the other provisions of this Agreement, Trustee shall distribute the trust assets one-half to those who would inherit Senior's estate and the other one-half to those who would inherit Settlor's wile's estate in each case as if Settlor and Settlor's wife had then died intestate under Michigan law then in effect with the shares and proportions determined by that law. If there is no one to take one of the halves because the person (Settlor or Settlor's wife) to whose heirs that half would otherwise be distributed has no surviving heir, but the other person (Settlor or Settlor's wife) has at least one surviving heir, all of the assets shall be distributed to the heir(s) of the other person, **[and for purposes of this section, a governmental entity is not an heir of either Settlor or Settlor's wife].**

Trap No. 4 - Failure to Specially Allocate IRD

Introduction

Income in respect of a decedent ("IRD") is liable to be accelerated if used to fund general pecuniary bequests, whereas a specific bequest of an item of IRD will *not* accelerate income. *See* IRC § 691(a)(2). Thus, failure to specially allocate IRD in funding *non*-charitable transfers is liable to have untoward income tax consequences. And failure to specially allocate IRD to distributions *deductible* in determining the taxable estate is liable to cause part of the effective exclusion of the unified credit to be wasted in sheltering income taxes.

Marital-Deduction Planning

The concern about acceleration comes up whenever a so-called "true worth" pecuniary marital funding approach is used, but, because a specific bequest of an item of IRD will not accelerate income, the concern can usually be handled by a specific bequest to (or designation in favor of) the surviving spouse or marital deduction trust. The more difficult problem is deciding whether to allocate IRD *to or away from* the portion of the gross estate intended to qualify for the estate tax marital deduction.[1]

The basic objective is to allocate assets so that the portion of the taxable estate protected by the effective exclusion of the unified credit (and the portion, if any, on which estate tax is actually paid on the death of the first spouse to die) *appreciates* and the portion deductible as a marital transfer *depreciates* in the interval between the two deaths (assuming there will be an estate tax in effect on the death of the surviving spouse).

Thus, where the right to payments is expected to be exhausted during the surviving spouse's lifetime, the item of IRD can generally be treated as a wasting asset presumptively to be allocated to the marital-deduction pot.

> ***Allocation Between Credit and Marital Portions.*** *Trustee shall not allocate to the Credit Portion assets that represent income in respect of a decedent unless there are insufficient other assets to fund the Credit Portion completely and, in that event, Trustee is given discretion to allocate assets that represent income in respect of a decedent to the Credit Portion.*

But if the expected stream of payments goes on well beyond the surviving spouse's life expectancy (as may be the case, for instance, with a long-term installment agreement) or if the amount or regularity of payments will become more certain over time (ditto when the agreement concerns the sale of a going business), the rate at which the stream of payments is discounted for funding purposes may be greater than the expected rate of income taxation, in which case, the asset is likely to appreciate during the surviving spouse's remaining lifetime, and that recommends an allocation *away from* the marital-deduction pot.

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[1] With respect to benefits, maximum income tax deferral will usually depend on the surviving spouse's receiving the right to the IRD in question, because the spouse will be entitled to the most favorable minimum distribution schedule. Through the use of disclaimer trust provisions, though, the question whether the spouse's interest in the benefits will or will not qualify for the marital deduction can be kept open.

One also has to consider that a distribution of an item of IRD will *not* carry out distributable net income ("DNI") of the estate/trust if either the item is specifically bequeathed (because of Code section 663(a)(1)) or basis in the item is low (because of Code section 643(e)(2)). Consequently, the opportunity to deplete the marital-deduction pot by the amount of income taxes on IRD payable over the surviving spouse's remaining lifetime may have to be weighed against the opportunity to deplete the marital-deduction pot by the amount of income taxes on estate/trust DNI that could be carried out in the year of funding if other assets are distributed.

Charitable Gifts

Compared to the complexities associated with marital deduction planning, charitable deduction planning with IRD is a no-brainer: failure to specially allocate IRD to charitable gifts effectively reduces the value of distributions to non-charitable beneficiaries. Suppose, for instance, the decedent's assets comprise only an IRA and marketable securities; decedent's daughter *D* is designated as the primary beneficiary of the IRA; the contingent beneficiary is decedent's ex-husband; decedent's will/trust agreement provides a substantial gift to charity *C*, everything else to decedent's daughter, or; if the daughter does not survive, to decedent's ex-husband; there is considerably more in the IRA than the amount of the charitable gift; and the decedent had no basis in the IRA.

In that case, failure to make the charitable gift in the beneficiary designation is liable to reduce the value of *D*'s inheritance by the present value of the income tax to be paid on minimum distributions over *D*'s life expectancy. *D* cannot get the IRA to the charity by disclaiming (because of the contingent beneficiary designation), and without a disclaimer (under current legislation), an improvised substitution of the IRA for marketable securities would constitute a distribution of the entire account to *D*.[2]

On the other hand, making the charitable gift in the beneficiary designation avoids recognition of income in the amount of the charitable gift, and, provided *C*'s interest is distributed before September 30 of the year following the decedent's death, the minimum distribution schedule for the balance of the account will be unaffected.

On our hypothetical facts, the same result is also obtained if the estate/trust is the primary beneficiary of the IRA and the will/trust agreement has a provision like the following.

[2] The best construction in the hypothetical might yield D a charitable deduction, but the amount of the charitable gift is less than the entire account balance and the deduction would be in lieu of the estate tax deduction and subject to the percentage-of-AGI limitation as well as the 3% overall limit on itemized deductions.

> ***Payment of Charitable Gifts.*** *Unless otherwise specified, Trustee, in satisfying gifts to charitable organizations, shall first use assets that represent income in respect of a decedent. If retirement plan benefits are used to satisfy gifts to charitable organizations, distribution must be made prior to September 30 of the calendar year following the participant's death or such other date established by the Internal Revenue Code or treasury regulations to ascertain the identity of a retirement plan designated beneficiary.*

Though the result is the same, the analysis is a little different: in this case, the estate/trust has gross income when it uses a distribution from the IRA to pay the charity, but it is entitled to an offsetting deduction under Code section 642(c), which allows a charitable deduction (in of a section 170(a) charitable deduction) to trusts and estates for charitable distributions lieu that are (1) paid "pursuant to the terms of the governing instrument" and (2) paid out of the estate/trust's gross income.

On the hypothetical facts, the estate/trust's income tax deduction under section 642(c) is *in addition to* the estate tax charitable deduction, because the "disallowance of double deductions" in section 642(g) pertains only to payments deductible for estate tax purposes under sections 2053 (expenses, debts and taxes) and 2054 (losses), whereas the estate tax charitable deduction is allowed under section 2055. So, on these facts, the choice between making the charity a designated beneficiary of the IRA and designating the estate/trust instead is indifferent.

Trap No. 5 - Failure to Plan for Charitable Pledges

Introduction

Suppose that in the same charitable-gift situation above there is at the time of the decedent's death an outstanding charitable pledge to the same charity mentioned in the will/trust agreement or beneficiary designation. If charity *C* is a designated beneficiary of the IRA and the pledge is *enforceable*, one might expect the estate would have to recognize income to the extent of the unfulfilled pledge—because the decedent has effectively assigned a right to receive taxable income to one of her creditors. Happily, though, the Service has ruled that an enforceable charitable pledge is not treated as a debt for federal income tax purposes. Rev. Rul. 64-240, 1964-2 C.B. 172.

But suppose the amount of the pledge is *greater* than the charity's share under the IRA's beneficiary-designation. If the personal representative/trustee pays the difference out of estate/trust income, will the estate/trust be entitled to an income tax charitable deduction?

"Pursuant to the Terms of the Governing Instrument"

Again, Code section 642(c) allows a charitable deduction (in lieu of a section 170(a) charitable deduction) to trusts and estates for charitable distributions paid out of the estate/trust's gross income "pursuant to the terms of the governing instrument." So the question is whether the will/trust agreement *contemplates* the payment.

If the beneficiary designation is the *only* charitable provision in the plan, the will/trust agreement may say nothing whatever about payments to charities. In that case, a direction to pay the decedent's enforceable debts will probably not suffice to make the payment "pursuant to the terms of the governing instrument" since, as already noted, an enforceable charitable pledge is not treated as a debt for federal income tax purposes. (Rev. Rul. 64-240, 1964-2 C.B. 172.) Thus, the section 642(c) deduction may depend on the will/trust agreement's containing something like the following:

> ***Charitable Pledges.*** *Trustee shall have the power to satisfy written charitable pledges of Settlor irrespective of whether the pledges constituted binding obligations of Settlor or were properly presented as claims, if in the judgment of Trustee, Settlor would have wanted the pledges completed under the circumstances.*

Apart from income tax deductibility, the personal representative/trustee might be grateful for such language if it is unclear whether the pledge is enforceable (and the personal representative/trustee has a fairly clear idea that the settlor would or would not want the pledge paid). The personal representative/trust might also be grateful for it when considering a question implicit on the hypothetical facts and, indeed, in any situation in which there is a provision for a charitable gift and no mention of an unfulfilled pledge: Should *C* get the sum of the amount of the distribution and the amount of the outstanding pledge balance or only the greater of the two amounts?

The Exclusivity of Section 642(c)

Suppose, again, that the distribution to charity C is provided in the will/trust agreement, the estate/trust is the primary beneficiary of the IRA and the will/trust agreement has a provision like the following (already introduced above).

> ***Payment of Charitable Gifts.*** *Unless otherwise specified, Trustee, in satisfying gifts to charitable organizations, shall first use assets that represent income in respect of a decedent. If retirement plan benefits are used to satisfy gifts to charitable organizations, distribution must be made prior to September 30 of the calendar year following the participant's death or such other date established by the Internal Revenue Code or treasury regulations to ascertain the identity of a retirement plan designated beneficiary.*

But suppose too that there is at the time of the decedent's death an outstanding charitable pledge to *C*, the amount of the outstanding pledge balance is *greater* than the amount of the provided distribution, and the personal representative/trustee pays the full amount of the pledge balance with a distribution from the IRA.

If the will/trust agreement says nothing about payment of the pledge or any other amount to *C* beyond the provided distribution, the section 642(c) deduction will be unavailable for so much of the outstanding pledge balance as exceeds the provided distribution (because to that extent the payment to *C* is not "pursuant to the terms of the governing instrument").

On these facts, the partial unavailability of the section 642(c) deduction might be indifferent *if* the distribution to the charity could carry out the estate/trust's DNI: the Treasury regulations suggest that a specific allocation of IRD to one beneficiary's share will be respected without regard to economic effect (*See* Treas. Reg. § 1.663(c)-5, Ex. 9), so if the "payment of charitable *gifts*" provision applied to the whole payment to the charity and the distribution carried out DNI, the portion of the distribution that did not qualify for the section 642(c) deduction could be covered by a distributions deduction under section 661. Unfortunately, the Treasury regulations provide that charitable contributions "are deductible by estates and trusts only as provided in [section] 642(c)." Treas. Reg. § 1.663(a)-2. And (although that rule clearly goes beyond the statutory provision the regulation purports to interpret) the courts have upheld the regulations. *See*, e.g., *U.S. Trust v. Internal Revenue Service*, 803 F.2d 1363 (5th Cir. 1986).

So, deduction of an amount paid to satisfy a charitable pledge depends on the application of section 642(c), and that depends on there being direction, or at least permission, to pay such a pledge in the governing instrument and on the payment being made out of income.

Trap No. 6 - Failure to Coordinate Planning Documents with HIPAA

Patient Advocate

The State of Michigan allows a competent adult to designate another individual as a patient advocate empowered to make medical treatment decisions and anatomical gifts. These provisions are found in the Estates and Protected Individuals Code (EPIC) Public Act 386 of 1998 MCL 700.5506-5512. The law provides:

> *Section 5506(1) An individual 18 years or older who is of sound mind at the time a patient advocate designation is made may designate in writing another individual who is 18 years of age or older to exercise powers concerning cars,*

custody and medical or mental health treatment decisions for the person making the patient advocate designation....

A patient advocate may only act on behalf of principal when the patient is unable to act on their own behalf.

Section 5508(1) ... the authority under a patient advocate designation is exercisable by a patient advocate only when the patient is unable to participate in medical treatment or, as applicable, mental health treatment decisions. The patient's attending physician and another physician or licensed psychologist shall determine upon examination of the patient whether the patient is unable to participate in medical treatment decisions....

Section 5508(2) allows a court determination of the patient's ability to make health care decisions if a dispute arises over that question.

In most circumstances, a well drafted Patient Advocate Form will be readily accepted and will allow the Patient Advocate to step in on the individual behalf with very little difficulty. Doctors and medical facilities encourage and welcome the use of the Patient Advocate designation. However in cases where problems regarding the authority of the Patient Advocate arise it is important that the wary estate planner take into account the interplay of the Health Insurance Portability and Accountability Act of 1996 (45 CFR 164) or "HIPAA".

HIPAA

HIPAA prevents disclosure of "Protected Health Information" (PHI). The law was intended to protect a patient's right to privacy. These privacy rules limit the disclosure of PHI. Section 164.502(a)(1) and (2) divide the privacy rules into "required disclosures" and "permitted disclosures". The disclosures may be given to the patient or that patient's personal representative. To qualify as a personal representative under HIPAA an individual must be described in the standards set forth in Section 164.502(g) (see attached **Exhibit A**). The key provision is found in Section 164.502(g)(2) which provides:

Implementation Specification: adults and emancipated minors. If under applicable law a person has authority to act on behalf of an individual who is an adult or an emancipated minor in making decisions related to health care, a covered entity must treat such person as a personal representative under this subchapter, with respect to protected health information relevant to such personal representative.

To obtain the PHI the individual or that individuals personal representative must sign an authorization which meets the core standards provided in Section 164.508(c) (see attached Exhibit). The obvious problem is whether a Patient Advocate may sign an authorization to release PHI necessary to determine a patient's ability to make medical decisions before a determination has been made that the patient is indeed incompetent. In a disputed situation the medical entity is prohibited from releasing the information until the Patient Advocate has qualified as a personal representative but the Patient Advocate does not have that authority until the medical determination of incompetency has been made. Michigan's Patient Advocate law creates a springing power of attorney which only takes effect upon the determination of incompetency. A nominated advocate or other family member may resolve this difficulty by petitioning the court for a determination of competency, but that is time consuming and costly. A wary planner may wish to draft documents which eliminate or reduce this problem.

A good way to analyze the problem is to break down the question in two parts. First, who has the **appointment** as personal representative (who may make the request)? Second, does the request for PHI satisfy the HIPAA requirements (**authorization**)?

This outline will present two possible solutions to this dilemma. The first is to name a personal representative for PHI in a non-springing durable power of attorney. Obviously the power of attorney would have to be non-springing or else we are back to the same conundrum we have with the Patient Advocate form. But at the same time the document must be durable in order to have continuing effect if the patient is in fact incompetent. A paragraph could be added to a General Durable Power of Attorney, or a Special Durable Power of Attorney could be drafted to include language similar to the following:

> *Designation of Personal Representative: This power of attorney authorizes my agent to serve as my personal representative for all purposes relating to my Protected Health Information (PHI) as provided in 45 CFR 164.502(g)(2).*

A second possible solution is the preparation of a release, separate from the Patient Advocate form, appointing persons to whom PHI may be released. A release form must satisfy the requirements of an **authorization** under Section 164.508(c). See **Exhibit B**. A suggested Release is included as **Exhibit C**.

Application to Trust Planning

When an individual trustee is designated in a trust, the same problem may arise. Frequently, the trust will provide that a trustee will serve until that individual's death, resignation, removal or incompetency. In many instances the determination of incompetency includes language identical or similar to the patient advocate physician's determination. If questions arise regarding the continued capacity of an individual trustee, how do the heirs or successor trustee obtain a physicians diagnosis necessary to replace the Trustee? The physician's diagnosis is PHI under

HIPAA and the physician is prohibited from releasing the information except to the patient or the patient's personal representative. A possible solution would be to require that any trustee appointed under the trust must execute a valid **release** as a condition of appointment. The failure to execute or maintain the release could be grounds for removal by the beneficiaries or successor trustee. A possible provision might read:

> *Trustee qualification. As a condition of appointment any individual acting as trustee must execute and maintain a valid release authorizing the disclosure of Protected Health Information as defined in the Health Insurance Portability and Accountability Act of 1996. This release must allow the next successor trustee to authorize the disclosure of medical information necessary for a determination that the trustee is competent to perform the duties required. Failure to execute or maintain the release shall result in the disqualification of the individual as trustee and the next successor trustee shall succeed to all of the powers and duties of the trustee.*

The trust could in the alternative provide for a release in favor of a trust protector or beneficiary.

HIPAA Saving Clause

In a situation where it is impossible to obtain a release, a planner may be able to avoid going to court for a determination of incompetency by use of the HIPAA Savings Clause. Section 164.510(a)(3):

> *(3) Emergency circumstances. (i) If the opportunity to object to uses or disclosures required by paragraph (a)(2) of this section cannot practicably be provided because of the individual's incapacity or an emergency treatment circumstance, a covered health care provider may use or disclose some or all of the protected health information permitted by paragraph (a)(1) of this section for the facility's directory, if such disclosure is:*
>
> > *(A) Consistent with a prior expressed preference of the individual, if any, that is known to the covered health care provide, and*
> >
> > *(B) In the individual's best interest as determined by the covered health care provider, in the exercise of professional judgment.*

While disclosure is not mandatory this does provide the planner with a basis for a discretionary disclosure from the covered entity. Especially in the case of an emergency or where competency is pretty straight forward, a reference to this provision may work. It gives the unwary planner an opportunity to discover just how golden tongued they really are.

Trap No. 7 - Failure to Plan for Uncertainty

Introduction

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRA) made estate planning much more difficult by adding significant uncertainty to the planning process. EGTRA increases the Exemption Amount from $1,000,000 to $3,500,000 between 2002 -2009; repeals the Estate Tax and Generation Skipping Transfer Tax for 2010; brings back carryover basis in 2010; and reinstates the pre-EGTRA law for 2011 and following. President Bush has pledged to seek permanent repeal of the Estate Tax and many experts believe there is sufficient support in Congress to accomplish repeal or at least a further revision.

Estate Tax Exemption Amounts Under EGTRA

2002	$1,000,000
2003	$1,000,000
2004	$1,500,000
2005	$1,500,000
2006	$2,000,000
2007	$2,000,000
2008	$2,000,000
2009	$3,500,000
2010	Repealed
2011	$1,000,000

When planning for potentially taxable estates many planners use marital deduction formulas to minimize tax by utilizing the Unified Credit available for each spouse. Some estate planners have not updated their trusts to account for the uncertainty occasioned by EGTRA. A few updates for consideration will be presented in this outline.

The IRS Statistics of Income Division has released information regarding the estate tax returns filed in 2003. It reported that 30,626 returns were filed in that year. Of those returns 27,140 were for taxpayers with gross estate less than $5,000,000, or 88.6%. For most planners a majority of their estate planning involves estates of less than $5,000,000. Until planners learn how the estate tax will be changed it is important to build into existing plans flexibility in order to accomplish as much for the client as possible. This outline will focus on possible changes for married couples whose gross estates are between $1,000,000 and $5,000,000.

Revise the Marital Deduction Formula

Most of the common Marital Deduction Formula's are designed to "reduce to zero." The aim is to fully utilize the Unified Credit of the first spouse to die by funding the Credit Shelter Trust with the largest amount (or percentage) that can pass free of Federal Estate Tax. Several formulas are additionally designed to throw as much appreciation pre-funding into the Credit Shelter Trust. (True worth marital will throw all appreciation into the Credit Shelter Trust. If the estate is depreciating, a minimum worth Credit Shelter will place all of the estate reduction, during administration, in the Marital Trust.) The increasing Exemption Amount means that a larger percentage of a decedent's estate is going to be in the Credit Shelter Trust. If a planner determines that it is unlikely that the client will face a federal estate tax she may wish to adopt a formula which allow the funding decision to be made after the death of the first spouse. This could be accomplished by creating a Disclaimer Trust; a Marital QTIP Trust that allows for a partial QTIP election; or a Clayton QTIP Marital Trust.

In a Disclaimer trust all of the decedent's trust assets are placed into the Marital Trust except for those assets timely disclaimed by the surviving spouse. It is important that the survivor be willing and able to make a disclaimer. There are times either due to grief or greed that timely disclaimers are not filed and the decedent's Unified Credit is lost. If a Disclaimer Trust is used it is important to remove any limited power of appointment that the surviving spouse may have in the Credit Shelter Trust over any assets disclaimed to that trust. It may also be an excellent idea to have a Durable Power of Attorney naming someone who can make the Disclaimer on the surviving spouse's behalf in the event the survivor is incapable.

In a Marital Partial QTIP Trust all of the assets are funded into a single QTIP Trust. The trust is divisible. The trustee can elect to make a QTIP election for the assets deemed necessary with the remaining assets available to utilize the decedent's Unified Credit.

A Clayton QTIP Trust is designed to allow the surviving spouse's income rights to be dependent on the fiduciary's QTIP election. Assets for which no election is made can be placed in decedent's credit shelter trust. Both the Partial QTIP and the Clayton QTIP allow a fiduciary to make the necessary choices and avoids the grief or greed problems of the Disclaimer Trust.

All three of these techniques allow a decision to be made after the death of the first spouse, giving the fiduciary or surviving spouse the ability to make the tax decisions based upon the law in effect at that time.

Creating a Trust Protector

A number of commentators have recommended empowering an independent fiduciary, as Trust Protector, granting that fiduciary the authority to adjust the estate plan in the event of repeal or significant increase in the Estate Tax Exemption Amount. The powers that could be granted the Trust Protector in the event or permanent repeal, could include; the power to terminate or reduce the Credit Shelter Trust; the power to reallocate the assets between the Marital Trust and Credit Shelter Trust to take advantage of any available basis adjustment if carryover basis remains a part repeal; or could broadly grant the Trust Protector the authority to terminate the entire Trust or any sub-trusts established by the document. It is important to match the authority granted a Trust Protector to the goals of the Grantor. For example, a Grantor with children from more than one marriage may not want to grant a Trust Protector the authority to terminate the Trust, in the event of permanent repeal, transferring all trust assets to a surviving spouse, if that termination may result in the potential disinheritance of children from an earlier marriage. Because we are trying to plan for uncertainty, it is best to make the Trust Protector an independent trustee to avoid any beneficiary having a general power of appointment in the event that repeal is less permanent than planned. A sample Trust Protector paragraph designed to protect a second spouse and children from more than one marriage could be written as follows:

> ***TRUST PROTECTOR****: I name Very Good Bank, a national banking corporation of Metropolis, Michigan, as Trust Protector. It is my purpose to have an independent trustee with the authority to carry out the powers enumerated in this section, without creating a transfer tax liability to the trustee. In the event the Trust Protector determines that any trust created by this agreement is no longer necessary due to the repeal of the Federal Estate Tax or Generation Skipping Transfer Tax; or the increase in the Exemption Amount or decrease in the size of my gross estate and the gross estate of my spouse to the extent that transfer tax liability is unlikely, then the Trust Protector may, completely or partially, terminate that trust and distribute it's assets to the primary beneficiaries of that trust. In making a termination that Trust Protector must take into consideration that it is my intent that the trust created for my spouse continue for my spouse's entire lifetime. It is also my intent that the distributions from my trust for my children treat the children from both of my marriages equally. Action by the Trust Protector may be requested by the current trustee of any trust created by this agreement or by a current adult competent beneficiary. The decision of the Trust Protector shall be final. The Trust Protector shall have no liability for exercising, or deciding not to exercise, the powers granted in this section, and may as a condition of making a decision require all of the beneficiaries to release it and hold it harmless.*

This language is merely intended as an example, and a careful planner will want to determine if it is appropriate for a particular client and how it should be modified to protect that client's planning goals.

Bases and Caps

If it seems apparent that transfer tax is unlikely, other benefits can be obtained for the client by adding a base or cap to a marital deduction formula. There are several reasons why a client may wish to have a Marital Trust and a Credit Shelter Trust even though the federal estate tax has been repealed or is unlikely in that client's circumstances. The client may have different distribution patterns to be accomplished. For example, the client may wish to create a lifetime QTIP for a second spouse with some portion of the trust, giving the remainder, either outright or in trust, to children of a previous marriage. Some clients want to keep property that they have inherited in their family by giving it to their children and not their spouse. Maximizing the ability to allocate stepped up basis will become very important if carry over basis goes into effect. A careful planner can accommodate these concerns by modifying the Marital Deduction formula with a base or a cap. A "base" would provide that either the Marital Trust or Credit Shelter Trust will not be less than a designated amount. A "cap" would place a maximum distribution into either trust.

EXAMPLE: Assume the federal estate tax is permanently repealed but carry over basis remains as currently set out in EGTRA. EGTRA allows a basis adjustment of $3,000,000 for a surviving spouse and $1,300,000 for non spousal beneficiaries. If an estate plan provide for an elimination of the Credit Shelter Trust in the event of repeal, placing all of the assets into a Marital Trust the $1,300,000 basis step up would be lost. This could be avoided by adding a provision that in the event of estate tax repeal the Credit Shelter Trust is reduced to the smallest amount that can utilize the $1,300,000 basis step up. Even with capital gains taxes as low as 15% this could save $195,000 in tax liability.

Withdrawal Rights

A final possibility, to consider, is to build withdrawal rights into the Marital and Credit Shelter Trust in the event of permanent repeal. This solution would most likely be useful for clients that are likely to have the same beneficiaries, such as where the clients are in a stable long term marriage with all of the issue, for both clients, from that marriage. It would also be more appropriate in situations where the gross estate is smaller than the available spousal step up for basis adjustment.

SAMPLE WITHDRAWAL LANGUAGE: A sample withdrawal clause in the Credit Shelter Trust might read as follows:

> ***Withdrawal Right****: In the event the Federal Estate Tax is permanently repealed, my spouse may withdraw all or any part of the assets from this trust by an instrument in writing delivered to my trustee. If all of the assets are withdrawn, this Credit Shelter Trust shall terminate.*

If the client wanted continued trust protection the following alternate language could be used.

> ***Withdrawal Right:*** *In the event the Federal Estate Tax is permanently repealed, my spouse may withdraw all or any part of the assets from this trust by an instrument in writing delivered to my trustee: All withdrawn assets shall be held and administered under the terms and conditions of the Marital Trust. If all of the assets are withdrawn, this Credit Shelter Trust shall terminate.*

Chart

Exhibit D is a chart comparing the options presented and when each option is most suitable.

Trap No. 8 - Failure to Comply with Circular 230

Final Regulations

On December 17, 2004 the Final Regulations for Circular 230 (Regulations Governing Practice Before the Internal Revenue Service) were published with an effective date of June 20, 2005. These regulations cover several topics beyond the scope of this outline including "best practices" for overseeing a firm's tax practice; issuing municipal bond opinions or marketed opinions. This outline will focus on written opinions prepared for a client regarding tax matters. The Final Regulations can be found at: http://www.irs.gov/pub/irsutl/final_rule_covered_opinion_standards.pdf

Covered Opinion

Circular 230 provides standards which must be followed when a tax advisor issues a "covered-opinion". -Section 10,35 defines a "covered opinion" as written advice-regarding- (i) "listed" transactions, (Section 10.35(a)(2)(A)) (ii) a transaction which has a "...**principal purpose** of which is the avoidance or evasion of any tax..."(Section 10.35(a)(2)(B)) and (iii) a transaction with a "...**significant purpose** is avoidance or evasion of any tax..." if the written advice —(1) Is a reliance opinion; (2) Is a marketed opinion; (3) Is subject to conditions of confidentiality; or (4) Is subject to contractual protection.(Section 10.35(a)(2)(C) (emphasis added).

"Listed" transactions may be found at the following webpage: http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html.

These transactions and those substantially similar are normally regarded as tax avoidance transactions.

A **reliance opinion** (emphasis added) is defined as "Written advice ...if the advice concludes at a confidence level of more likely than not (a greater than 50 percent likelihood) that one or more significant Federal Tax issues would be resolved in the taxpayer's favor.

A Federal tax issue is defined in Section 10.35(b)(3) as a "...question concerning Federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property for Federal tax purpose. It appears that a written opinion regarding a valuation discounts, or any planning involving split gifts, irrevocable trust planning and many other techniques could be included.

Requirements for Covered Opinions

If an opinion is a "covered opinion" Circular 230 places significant requirements to bring that opinion into compliance. These requirements are found in Section 10.35(c). The practitioner must:

- Make "reasonable efforts" to identify and ascertain factual matters.
- Relevant matters must be identified.
- The practitioner must not make any "unreasonable factual assumptions."
- Any factual assumptions made must be identified.
- The practitioner must not base the opinion on the client's "unreasonable factual representations."
- The client's representations, statements or findings if relied upon by the practitioner must be identified.

In addition the letter must consider all "significant Federal tax issues" and set out the practitioner's conclusions regarding the likelihood that the taxpayer will prevail on the merits for each issue. The opinion must include:

- "the reasons for the conclusions, including the facts and analysis supporting the conclusions."
- The opinion must not take into account the likelihood of audit or the possibility that the issue might not be raised in the event of audit.

If an opinion cannot be given that reaches a confidence level of more likely than not, on any of the significant Federal tax issues, it must prominently disclose that fact and the taxpayer cannot use the opinion to avoid tax penalties.

All written opinions are included including emails; however verbal advice is not subject to Section 10.35

An opinion is described as a "reliance opinion" if the practitioner and client regard the opinion as one that the taxpayer can rely on to avoid the imposition of IRS tax penalties.

Opting Out

A practitioner can, by disclosure, avoid the compliance rules if the practitioner "prominently discloses" in the written advice, that the written opinion was not intended or written by the practitioner to be used and cannot be used by the taxpayer to avoid IRS penalties. Section 10.35(b)(4)(ii). Prominent disclosure requires that the statement be set forth at the beginning of the written advice in boldface type using a larger typeface than any other used in the written advice. At a minimum the statement would have to say at least:

This Opinion is NOT a Reliance Opinion. It is NOT intended by the writer that this opinion be followed. If this opinion is followed it CANNOT be relied upon as professional advice to avoid the imposition of tax penalties.

In the spirit of Circular 230, I ought to disclose that **my sample prominent disclosure has not been approved by the IRS and should not be relied upon. A careful practitioner should read Circular 230 and determine what statement will satisfy the "prominent disclosure requirement.**

Trap No. 9 - Failure to Watch for Gallenstein Applications

Introduction

The Tax Reform Act of 1976 (TRA) changed Section 2040 of the Internal Revenue Code. That law added Subsection (b) which revised the treatment of joint property between spouses. Under TRA property held jointly between spouses was to be included at 50% of the total property value at the time of death of the first spouse, regardless of the amount of consideration provided for the acquisition of that asset. TRA allowed taxpayers to elect to treat joint property acquired prior to 1977 as subsection (b) 50% property. Under section 2040 prior to TRA joint property between spouses was subject to the same treatment as joint property between unmarried individuals. This, so called "contribution rule" measure the contribution of each co-owner divided by the total contribution for the acquisition of the asset. At death, the resulting percentage was multiplied by the Federal Estate Tax value to determine the amount includible in a decedent's gross estate.

Contribution Rule Example

In 1975, Joseph Imgard and Thomas Lightly bought Blackacre as joint tenants with right of survivorship. Joseph provided $150,000 of the $200,000 purchase price. Thomas contributed the remaining $50,000. Ten years later Joseph died. Blackacre is appraised at $650,000. On Joseph's Federal Estate Tax Return 75% ($150,000/$200,000) of the appraised value would be included as part of Joseph's gross estate.

$650,000 x 75% =$487,500

Section 2040(b) Example

In 1982 Joseph Imgard and his wife Hilda acquired Whiteacre for $200,000. Hilda provided all of the consideration. When Joseph died in 1985 Whiteacre was appraised at $450,000. Section 2040(b) would require that one-half ($225,000) the value of Whiteacre be included as part of Joseph's gross estate even though he did not provide any of the consideration.

The Economic Recovery Act of 1981 (ERTA) provided an unlimited marital deduction for gift tax and estate tax for transfers to one's spouse.

Gallenstein

The Gallenstein Case (*Gallenstein v. United States*, 975 F2d 286 (6th Cir. 1992) addressed how property made joint between spouses before 1977 should be treated. In this case Mr. and Mrs. Gallenstein acquired a farm in Kentucky in 1955 for $38,500. Mr. Gallenstein provided all of the consideration. He died in 1987. At that time the farm was worth $3,600,000. Mrs. Gallenstein reported the entire $3,600,000 on her husband's Federal Estate Tax Return. Because of the unlimited Marital Deduction provided by ERTA no estate taxes were due on this asset. Less than seven months after her husband's death Mrs. Gallenstein sold the farm for $3,600,000. She claimed a full step-up in basis and reported no capital gains tax liability. Both the Kentucky District Court (91-2 USTC 60.088 (D.D.Ky) and the Sixth Circuit Court of Appeals found in Mrs. Gallenstein's favor. The Courts rejected the IRS position that TRA and ERTA had revoked the prior law. Subsequent cases have reached the same result and the IRS has acquiesced in the decision.

Gallenstein only applies to married U.S. citizens. In every decedent's estate it is vital to determine when the property was acquired and who provided the consideration. Because there is no Federal Estate Tax on assets joint between husband and wife the Federal Estate Tax value is meaningless from a transfer tax perspective. An increased FET value by use of the Contribution Rule allowed by Gallenstein can provide significant Capital Gains Tax savings where the decedent provided more than one half the acquisition prices.

Gallenstein Example

Gretta Gotbucks and her husband Jacques acquired Blackacre as joint tenants by the entireties. Gretta provided the entire $38,500 purchase price. Gretta died January 10, 2005. Jacques sold Blackacre April 16, 2005 for $3,600,000. Both Gretta and Jacques are U.S. citizens.

Assume Gretta purchased Blackacre Dec. 15, 1976: Gallenstein applies

- Jacques reports Blackacre has a $3,600,000 FET value
- Jacques qualifies for Marital Deduction
- For Sale Jacques has a $3,600,000 basis
- No Capital gain

Assume Gretta purchased Blackacre Jan. 15, 1977

- Jacques reports Blackacre has a $3,600,000 FET value
- Jacques qualifies for Marital Deduction
- For Sale Jacques has a $1,819,250 basis
    - Gretta one-half stepped up to FET value (50% of $3,600,000) = $1,800,000
    - Jacques basis is one-half purchase price (50% of $38,500) = $19,250
    - Total stepped up basis = $1,819,250

Sales Price	$3,600,000.00
Basis	$1,819,250.00
Capital Gain	$1,780,750.00
Tax Rate	15%
Tax	$ 267,112.50

Trap No. 10 - Failures in Trust Funding

Introduction

Trusts govern assets owned by the trust. Many excellent plans have less than optimal results because they are unfunded or incorrectly funded. Part of the difficulty is the estate planners' inability to complete some of the transfers. It is not too difficult for the estate planning attorney to do deeds and beneficiary designations. Some planners have excellent checklists; directions; sample forms and letters to assist the client complete the transfer of assets to the trust. Some items may only be transferred by the client. The attorney cannot, and in almost every case would not want to assume the responsibility to, transfer assets such as bank accounts, and publicly traded stocks. This short outline will explore three possible funding methods and discuss when each might be appropriate.

Declaration of Trust Ownership

Fred Keydel suggested a "magic wand" for trust funding through the use of a Declaration of Trust Ownership. This concept was presented in *Probate & Property*, January/February 1989 in an article entitled "The Magic Wand of Estate Planning." This technique is designed to allow a husband and wife who own joint property to declare that the ownership belongs one-half to each spouse's revocable trust as tenants in common. The article identifies three components which would be necessary for the declaration to be effective. Those requirements are:

- Each spouse must be the trustee of their own trust
- The trust must allow the trustee to hold property without disclosing that the owner is a fiduciary
- The couple must execute a document declaring that property presently owned and acquired in the future belongs one-half to each trust. Keydel believes the Declaration should be recordable.

The primary advantage of this declaration is that it allows many items to be funded without having to reregister each individual asset. There are at least two significant problems. First, the parties may own or acquire assets which they do not want in the trust, for creditor, Medicaid or other reasons. These concerns can be discussed with the client when the declaration is prepared but-the client may blithely acquire other subsequent assets without determining the suitability of trust funding. A significant second problem could be the willingness of third parties to accept the declaration. The document could be enforced against either of the spouses but if trustee must litigate ownership issue the transfer problem has not been solved, it has merely been postponed.

A sample Declaration is attached as Exhibit F.

Specific Assignment

A "specific assignment" is a transfer document for an identified asset. A typical example would be an "Assignment Separate from Certificate" to transfer stock:

ASSIGNMENT SEPARATE FROM CERTIFICATE

FOR VALUE RECEIVED, Daddy Bigbucks hereby sells, assigns and transfers unto THE DADDY BIGBUCKS LIVING TRUST dated March 17, 2005, one thousand shares of the Capital Stock of Really Big Industries, Inc., standing in his name on the books of said Corporation, and does hereby irrevocably constitute and appoint the secretary of the *corporation Wanna B. Rich, as attorney to transfer said stock on the books of the named Corporation with full power of substitution in the premises.*

Dated: March 17, 2005

____

Daddy Bigbucks

IN THE PRESENCE OF

____

____

These forms can be very effective for transferring stock in closely held corporations. The format can be easily modified for limited liability companies, and partnerships. Where there is some question regarding the extent of ownership, the assignment can be prepared for "all of my shares" or "all of my interest in" the assets to be transferred.

Whenever possible the underlying documents should be examined to determine whether the transfer is allowed and that the specific assignment will be effective to transfer the ownership interest. Some entities have strict "buy-sell" provisions which provide that no attempted transfer is effective unless it complies with the particular rules of that agreement. For a careful estate planner, the opportunity to review the buy-sell agreement, operating agreement, and/or partnership agreement may provide an opportunity to discover and remedy many other issues which may impact the client's planning.

For publicly traded investments a "specific assignment" will be ineffective unless it meets the requirements of the transfer agent. The transfer of individual stocks, brokerage accounts and mutual funds almost always requires that the transferor's signature be guaranteed. In my experience, most companies want transfers to be completed using that company's form. It may be possible to convince a company to recognize a "specific assignment," but relying on these instruments as documents for trust funding will, in many instances, just defer the problem of funding. If the estate planner and client rely on a "specific assignment to place an asset in trust and no further efforts are made to register that transfer until the client's death, it is difficult to know if the transfer will work. If, after the client's death, a conflict arises concerning the efficacy of the transfer the opportunity to complete the funding without probate involvement is lost.

General Assignments

In a "general assignment" a planner attempts to transfer all of a client's assets, or all assets of a certain class to the client's trust without specifically identifying those assets. The following is a typical "general assignment":

ASSIGNMENT

I, JOHN Q. DOE of Lansing, Michigan, hereby assign and transfer to the Trustee of the John Q. Doe Trust dated December 11, 2003, as amended from time to time, my interest in all property owned by me (i) in my individual name alone or (ii) as a tenant in common, including, but not limited to, the following described types of properly so owned by me:

1. *Real Estate (including any oil, gas and mineral rights), land contracts and mortgages;*
2. *Accounts and all evidences of indebtedness, investment or deposit, issued by any person, corporation, bank, savings and loan, building and loan, credit union, stock brokerage or other entity;*
3. *Policies of insurance upon the life of persons other than myself;*
4. *Stocks, bonds and other securities, and interests therein;*
5. *Partnerships, joint ventures, sole proprietorships and other business entities;*
6. *Royalties, patents, trademarks, copyrights and assumed names;*
7. *Leases between myself and any lessee and any lessor;*
8. *Tangible and intangible personal property of any kind or nature whatsoever and wherever located (including, but not limited to, jewelry, clothing, automobiles, furniture, furnishings, silver, books, pictures, diamonds, coins, heirlooms, art, crystal, collectibles, and all other similar items, personal items and household possessions); and*
9. *All property of any other kind or nature, now owned or hereafter owned by me.*

I intend that all of my property (except any property I hold as a joint tenant or as a tenant by the entireties with one or more other individuals) pass by and through the John Q. Doe Trust dated December 11, 2003, as amended and thereby avoid probate upon my death.

WITNESSES:

___________________________ ________________________________

JOHN Q. DOE

____

State of Michigan

County of:

On ____________________, before me a Notary Public in and for said County, personally appeared JOHN Q. DOE, to me known to be the same person described in and who executed the within instrument, and who acknowledged the same to be her free act and deed.

____

Notary Public

___________________________*County, Michigan*

*My Commission Expires:*____________________

This form taken from "Douglas A. Mielock, "Funding Trusts", *ICLE Planning for the Taxable Estate*, December 2004 (used with permission).

These assignments are most effective for closely held business interests, investments clubs and similar assets. A "general assignment" presents the same difficulties discussed in paragraph C. Specific Assignments. Obtaining the recognition of a third party to the transfer may be even more difficult because the assets are not specifically identified. There is an obvious problem when the purported transfer is not in the form necessary to accomplish that transfer. For example the "typical general assignment" included above purports to transfer real estate but is not in recordable form.

There is a significant additional problem. The "general assignment" claims to cover "all property of any other kind or nature, now owned or hereafter owned by me." The concerns discussed thus far have focused on the difficulty in getting assignments recognized as effective. However with a broad statement covering "all property", if effective, the planner may be bringing assets into the trust which should not be included. For example, qualified plans should be handled by beneficiary designation and not by transferring the plan into the client's trust.

The Ravitz Case

Unfortunately there have not been many published cases regarding assignments to trust, however an unpublished case was released November 16, 2004, which while not precedent, may assist estate planners. That case, *Constance H. Ravitz v. Comerica Bank* may be found in the Michigan Bar e-Journal in the Case Summary Cumulative in Archived e-Journals. Click the connection to "Court Opinions" and enter either "Ravitz" in the litigant box or select opinions for November 2004 and select the *Ravitz* case. In this case, arising out of the Oakland County Probate Court, a determination had to be made regarding the validity of assignments that a decedent had made to his trust. The Probate Court found the assignment to be effective and the Court of Appeals affirmed. What is especially interesting in this case is that the assignments were found to be valid even though they did not accurately describe the property to be transferred. The assignment referred to "partnership" interests. The Court found the assignment sufficient to transfer decedent's business interest even though it was not a partnership.

The Court of Appeals opinion stated:

> *Finally, the petitioner argues that the interests that the decedent transferred to the trust were not actually partnerships, and that accordingly, the assignments were legally invalid. As noted previously, that the trial court properly found, on the basis of petitioner's clearly expressed intent, that the assignments validly conveyed the interests in the listed properties to the trust, whether the interests were partnerships or not.*

This decision removed the business interests from decedent's probate estate which defeated the survivor's efforts to include the interests as part of a spousal election. The decision provides some comfort that at least a specific assignment will be recognized when the transferor's intent is clear. The court focused on the fact that the decedent attached the properties in question to the assignment documents. For the best results an assignment should be as specific as possible and should exclude those assets that would be inappropriate.

Exhibit A

Authorization Requirements

Section 164.568

(c) *Implementation specifications: Core elements and requirements—(1) Core elements.* A valid authorization under this section must contain at least the following elements:

(i) A description of the information to be used or disclosed that identifies the information in a specific and meaningful fashion.

(ii) The name or other specific identification of the person(s), or class of persons, authorized to make the requested use or disclosure.

(iii) The name or other specific identification of the person(s), or class of persons, to whom the covered entity may make the requested use or disclosure.

(iv) A description of each purpose of the requested use or disclosure. The statement "at the request of the individual" is a sufficient description of the purpose when an individual initiates the authorization and does not, or elects not to, provide a statement of the purpose.

(v) An expiration date or an expiration event that relates to the individual or the purpose of the use or disclosure. The statement "end of the research study," "none," or similar language is sufficient if the authorization is for a use or disclosure of protected health information for research, including for the creation and maintenance of a research database or research repository.

(vi) Signature of the individual and date. If the authorization is signed by a personal representative of the individual, a description of such representative's authority to act for the individual must also be provided.

(2) *Required statements.* In addition to the core elements, the authorization must contain statements adequate to place the individual on notice of all of the following:

(i) The individual's right to revoke the authorization in writing, and either:

(A) The exceptions to the right to revoke and a description of how the individual may revoke the authorization; or

(B) To the extent that the information in paragraph (c)(2)(i)(A) of this section is included in the notice required by Section 164.520, a reference to the covered entity's notice.

(ii) The ability or inability to condition treatment, payment, enrollment or eligibility for benefits on the authorization, by stating either:

(A) The covered entity may not condition treatment, payment, enrollment or eligibility for benefits on whether the individual signs the authorization when the prohibition on conditioning of authorizations in paragraph (b)(4) of this section applies: or

(B) The consequences to the individual of a refusal to sign the authorization when, in accordance with paragraph (b)(4) of this section, the covered entity can condition treatment, enrollment n the health plan, or eligibility for benefits on failure to obtain such authorization.

(iii) The potential for information disclosed pursuant to the authorization to be subject to re-disclosure by the recipient and no longer be protected by this subpart.

(3) Plain language requirement. The authorization must be written in plain language.

(4) Copy to the individual. If a covered entity seeks an authorization from an individual for a use or disclosure of protected health information, the covered entity must provide the individual with a copy of the signed authorization.

Exhibit B

Personal Representative

Section 164.502

(g)(1) *Standard: Personal representatives.* As specified in this paragraph, a covered entity must, except as provided in paragraphs (g)(3) and (g)(5) of this section, treat a personal representative as the individual for purposes of this subchapter.

(2) *Implementation specification: adults and emancipated minors.* If under applicable law a person has authority to act on behalf of an individual who is an adult or an emancipated minor in making decisions related to health care, a covered entity must treat such person as a personal representative under this subchapter, with respect to protected health information relevant to such personal representation.

(3)(i) *Implementation specification: unemancipated minors.* If under applicable law a parent, guardian, or other person acting *in loco parentis* has authority to act on behalf of an individual who is an unemancipated minor in making decisions related to health care, covered entity must treat such person as a personal representative under this subchapter, with respect to protected health information relevant to such personal representation, except that such person may not be a personal representative of an unemancipated minor, and the minor has the authority to act as an individual, with respect to protected health information pertaining to a health care service, if:

(A) The minor consents to such health care service; no other consent to such health care service is required by law, regardless of whether the consent of another person has also been obtained; and the minor has not requested that such person be treated as the personal representative;

(B) The minor may lawfully obtain such health care service without the consent of a parent, guardian, or other person acting *in loco parentis,* and the minor, a court, or another person authorized by law consents to such health care service; or

(C) A parent, guardian, or other person acting *in loco parentis* assents to an agreement of confidentiality between a covered health care provider and the minor with respect to such health care service.

(iii) Notwithstanding the provisions of paragraph (g)(3)(i) of this section:

(A) If, and to the extent, permitted or required by an applicable provision of State or other law, including applicable case law, a covered entity may disclose, or provide access in accordance with Section 164.524 to, protected health information about an unemancipated minor to a parent, guardian, or other person acting *in loco parentis;*

(B) If, and to the extent, prohibited by an applicable provision of State or other law, including applicable case law, a covered entity may not disclose, or provide access in accordance with Section 164.524 to, protected health information about an unemancipated minor to a parent, guardian, or other person acting *in loco parentis;* and

(C) Where the parent, guardian, or other person acting *in loco parentis,* is not the personal representative under paragraphs (g)(3)(i)(A), (B), or (C) of this section and where there is no applicable access provision under State or other law, including case law, a covered entity may provide or deny access under Section 164.524 to a parent, guardian, or other person acting *in loco parentis,* if such action is consistent with State or other applicable law, provided that such decision must be made by a licensed health care professional, in the exercise of professional judgment.

(4) *Implementation specification: Deceased individuals.* If under applicable law an executor, administrator, or other person has authority to act on behalf of a deceased individual or of the individual's estate, a covered entity must treat such person as a personal representative under this subchapter, with respect to protected health information relevant to such personal representation.

(5) *Implementation specification: Abuse, neglect, endangerment situations.* Notwithstanding a State law or any requirement of this paragraph to the contrary, a covered entity may elect not to treat a person as the personal representative of an individual if:

(i) The covered entity has a reasonable belief that:

(A) The individual has been or may be subjected to domestic violence, abuse, or neglect by such person; or

(B) Treating such person as a personal representative could endanger the individual; and

(ii) The covered entity, in the exercise of professional judgment, decides that it is not in the best interest of the individual to treat the person as the individual's personal representative.

Exhibit C

Health Information Release

1. **Date**: March 17, 2005
2. **Patient**: William M. Wright

   Address: 123 Main St., Metropolis, Michigan 49999

   Date of Birth: March 7, 1948

   Social Security Number: 123-45-6789
3. **Personal Representative**: Laura K. Knapp

   Address: 456 Oak Blvd., Smalltown, Michigan 49888

   OPTIONAL ALTERNATIVE:

   > ***Personal Representative****: My spouse, any adult descendant and any individual designated, now or in the future as my Trustee or Patient Advocate.*
4. **Purpose**: This document is intended to designate the individual who may act as my Personal Representative and is intended to grant to that Personal Representative the same access and authority that I possess regarding my Protected Health Information.
5. **Applicable Law**: This document is intended to comply with and should be interpreted in accordance to the Health Insurance Portability and Accountability Act of 1996 (commonly known as HIPAA). Words and phrases such as Personal Representative, Protected Health Information, release, authorization, covered entity and disclosure shall be as defined in that act. This document is also intended to qualify as a Durable Power of Attorney pursuant to MCL 700.5501-5505 and shall not be affected by my subsequent disability.
6. **Covered Entities**: The parties which may be required to disclose my Protected Health Information are those parties defined as "covered entities" in HIPAA and shall include but not be limited to all health care providers.
7. **Disclosure**: I authorize all covered entities to disclose to any person designated as my Personal Representative all health care information, reports and records. I intend that my Personal Representative be allowed to discuss my Protected Health Information with the entity in possession of that information. It is my express intention to give full authorization to any person designated as my Personal Representative in this document. I expressly authorize my Personal Representative to have the right to receive disclosure relating to my ability or inability to make medical decisions or financial decisions.

   OPTIONAL SENTENCE FOR TRUSTEES:

   > *This Release is specifically intended but not limited to allowing my Personal Representative to obtain such information from any covered entity to be able to determine whether I am capable of serving as Trustee of the Gretta Imgard Trust Agreement Dated July 5, 2004.*
8. **Termination**: This authorization shall terminate on the earliest of:

   a. one year following my death

   b. written revocation by me

   c. **OPTIONAL FOR TRUSTS** *when I cease to serve as Trustee of the Gretta Imgard Trust Agreement dated July 5, 2004*
9. **Re-disclosure**: I understand that information made available to my Personal Representative will no longer be protected by HIPAA. No covered entity may require my Personal Representative to indemnify that entity as a condition of the requested disclosure.

10. **Treatment**: I understand that a covered entity may not condition my treatment on my execution or refusal to execute this document. I am signing this agreement voluntarily. I have been advised that I may refuse to sign this Release if I choose.
11. **Enforcement**: My Personal Representative may commence legal action to require covered entities to recognize and honor this Release.
12. **Revocation**: This document may be revoked by me at any time by an instrument in writing.
13. **Copies**: A covered entity may rely on a copy or facsimile of this document as an original.
14. **Release**: I release any covered entity which, in reliance on this document, releases Protected Health Information to my Personal Representative from any liability arising from that disclosure

____

Name: William M. Wright

State of Michigan) ss.
County of)

On______________ , this instrument was acknowledged before me by William M. Wright, who is personally known to me.

____ Notary Public, County, Michigan

My commission expires:

THIS INSTRUMENT PREPARED BY:
William M. Wright
1605 Pinecone Road
Hastings, MI 49058
(269) 945-6325 Office
(269) 948-4495 Fax
wrightatwork@provide.net Email

Exhibit D

Options

Circumstance	Disclaimer Trust	Trust Protector	Clayton QTIP	Partial QTEP	Base and Cap	Withdrawal Right
Second marriage		X	X	X	X	
Greatest power to surviving spouse	X					X
Professional assistance		X	X	X		
Protection for specific assets or beneficiaries					X	
Stepped up basis		X	X	X	X	
Requires surviving spouse to act	X					X
Smaller estate (less than $3,000,000)					X	X
Larger estate (more than $3,000,000)		X	X	X		

Exhibit E

Joint Tenants with Right of Survivorship and Tenancy by the Entireties

Joint Interest	Treatment	Authority
Property Acquired by Gift or Inheritance	Equal ownership for each Co-owner; decedent's basis increased to FET value	Reg 20.2040-1(a)(1)
Non-spousal Joint Property	Contribution Rule; portion contributed by decedent increased to FET value	Reg 202040-1(a)(2)
Spousal Joint Property from Jan. 1, 1977, through Dec. 31, 2009	50% Rule; one-half property increased to FET value	IRC 2040(b)
Spousal Property pre-1977	Gallenstein Rule; portion contributed by decedent increased to FET value	*Gallenstein v. United States* 975 F2d 286. (6th Cir. 1992)
Spousal Joint Property Jan. 1, 2010, and following	Can step-up $3,000,000 to decedent's basis; all other assets get carry-over basis	IRC 1022(c)(2)
Non-spousal Joint Property Jan.1, 2010, and following	Can step-up $1,300,000 to decedent's basis; all other assets get carry-over basis	IRC 1022(b)

Exhibit F

Declaration of Ownership as Trustees

We, JOHN Q. DOE and MARY A. DOE, declare as follows:

1. JOHN Q. DOE is the Trustee of the John Q. Doe Trust dated December 11, 2003. MARY A. DOE is the Trustee of the Mary A. Doe Trust dated December 11, 2003.
2. Under Paragraph ___ of both trusts, the duty of the Trustee to identify trust property is modified through the power granted the Trustee to:

   hold any trust property (i) in the name of the Trustee or in the name of a nominee and (ii) with or without indicating that such property is held in trust; such power to include the power to title property in the name of the Trustee and one or more other individuals as joint tenants, without indicating that such property is held in trust, with the intent that the parties; respective shares be held as tenants-in-common.

3. We currently own certain property as (i) joint tenants, (ii) joint tenants with rights of survivorship or (iii) tenants by the entireties, collectively referred to herein as property owned by us "jointly."
4. We declare and agree that (i) all property currently owned or hereafter owned by us jointly **is** hereafter owned by us as Trustees of our respective trusts, and (ii) as Trustees, each of us hereafter owns an undivided **one-half (1/2)** interest in such property as tenants in common. This jointly owned property includes, but is not limited to:

   1. financial institution accounts (checking, savings, certificates of deposit, etc.);
   2. mutual funds (stock mutual funds, bond mutual funds, money market accounts, etc.);
   3. securities (stocks, bonds, treasury bills, notes receivable, etc.);
   4. real estate

5. This declaration is binding upon ourselves (both individually and as Trustees of our respective trusts) and our heirs, administrators, personal representatives and assigns.
6. The certificate of a Trustee of either of our respective trusts that the Trustee is acting in accordance with this declaration shall fully protect all persons dealing with the Trustee.
7. This declaration may be revoked only by a written instrument executed by one or more of the Trustees of either trust.
8. This declaration revokes all prior declarations of ownership, if any, with respect to all property governed by this declaration, whether executed by one of us or both of us.

We have signed this instrument on ______________________________.

WITNESSES:

_____________________________________ ____

JOHN Q. DOE

_____________________________________ ____

MARY A. DOE

State of Michigan)
County of) ss.
The foregoing instrument was acknowledged before me on _______________________ by JOHN Q. DOE and MARY A. DOE.

____
Notary Public
____________________County, Michigan My Commission Expires:
____

DRAFTED BY:

This form taken from "Douglas A. Mielock, "Funding Trusts", ICLE Planning for the Taxable-Estate,-December-2004-(used-by permission).