GASSMAN CROTTY & DENICOLO P.A.
ATTORNEYS AT LAW

THE THURSDAY REPORT

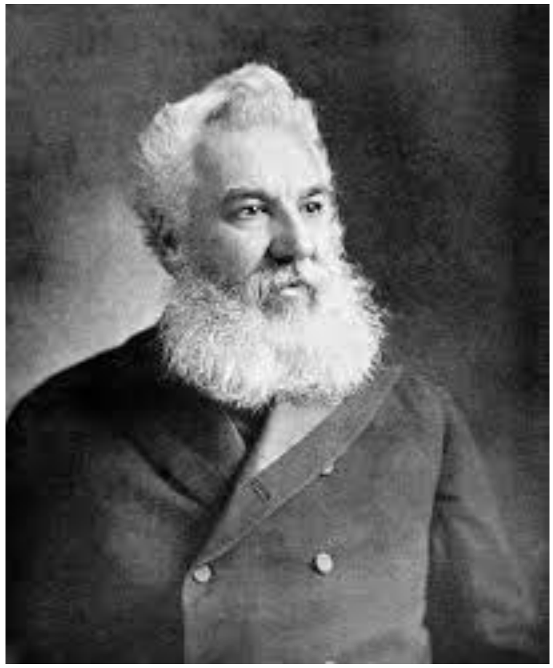
Issue # 262 Thursday, March 7, 2019

Re: The That's All That Happened on March 7th? Report

In This Issue:

We welcome contributions for future Thursday Report topics. If you are interested in making a contribution as a guest writer, please email Alan at agassman@gassmanpa.com

Quote of the Week



Mr. Watson — Come here — I want to see you. [First intelligible words spoken over the telephone]
-Alexander Graham Bell, March 10, 1876

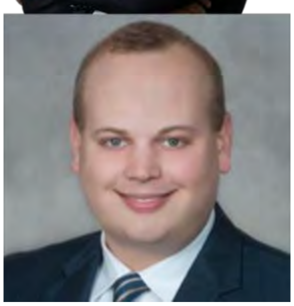
Alexander Graham Bell was a Scottish-born scientist, inventor, engineer, and innovator who is credited with inventing and patenting the first practical telephone. He also founded the American Telephone and Telegraph Company (AT&T) in 1885.

Bell's father, grandfather, and brother had all been associated with work on elocution and speech and both his mother and wife were deaf, profoundly influencing Bell's life's work. His research on hearing and speech further led him to experiment with hearing devices which eventually culminated in Bell being awarded the first U.S. patent for the telephone in 1876. Ironically, Bell considered his invention an intrusion on his real work as a scientist and refused to have a telephone in his study.

Don’t Come Around Here No More: Going Down the Rabbit Hole and Avoiding Issues With Internal Revenue Code Section 2036(a)(2) – Part 1 of 2

by Alan Gassman, Ken Crotty, Chris Denicolo and John Beck

The following is an article in process which will be submitted to Leimberg Information Services. We welcome all comments, questions and suggestions for this (not ready for prime time) article.



EXECUTIVE SUMMARY

In a series of chess-like moves, the IRS has advanced on the board to challenge family limited partnerships (and family limited liability companies)[1] where the taxpayer has failed to follow some obvious, and not-so-obvious, rules of the game. In response, the Tax Court has issued the *Powell* and *Cahill* decisions, which should be of concern to many taxpayers and practitioners.

The Tax Court has been using Section 2036(a)(2) of the Internal Revenue Code as a flamingo croquet mallet to hit the poor hedgehogs (in this case, the value of the assets of the partnership) through the arches of playing cards and into the hole (or back into the decedent’s estate as a retained life interest).

The decisions in *Cahill*[2] and *Powell*[3] may make the IRS more confident than ever that it can win the croquet match, holding the transferors responsible for estate taxes related to interests that they have already relinquished.[4]

The objective is to use statutes and case law to stand up to the authority figures of this new forum of “Wonderland,” so that taxpayers can wake up from this nightmare in time to safely avoid the clutches of the IRS’s Queen of Hearts, as she

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[1] While there might be distinctions between limited partnerships and limited liability companies at state law, the federal tax law in this area regarding the treatment of these types of entities is roughly similar to the point where there are typically no material differences between the use of a family limited partnership or a family limited liability company for federal tax purposes. Therefore, all references to family limited partnerships under this article also include references to family LLCs. Accordingly, general partner and limited partner interests under family limited partnerships refer to also voting and non-voting interests (respectively) in limited liability companies.

[2] *Estate of Cahill v. Commissioner*, T.C. Memo 2018-84 (2018)

[3] *Estate of Powell v. Commissioner*, 148 T.C. 18 (2017).

[4] The author would like to thank Todd Angkatavanich, Esquire and Eric Fisher, Esquire for their wonderful article entitled *Family Co-Investments in the Wake of Powell and Cahill: Time to Kick the Tires on Old Vehicles* and for the helpful footnotes they used of which the author of this article took full advantage.

The author would also like to thank John Porter for his enlightening presentation entitled “A View from the Trenches: What’s Happening with Transfer Tax Audit Controversies in the Era of Higher Exemptions?” that was presented on January 17, 2019 at the Heckerling Institutes on Estate Planning in Orlando, Florida. The author also took full advantage of the ideas and cases cited to during the seminar.

tries to persuade the courts to tax interests that the taxpayer has already given away while trumpeting, "[O]ff with their heads!"[5]

A creative and imaginative mind, such as Alice's, is often the key to winning the chess game and be crowned "Queen, or King, of Wonderland."

"Why it's simply impassible!"

"Why, don't you mean impossible?"

"No, I do mean impassible. (chuckles) Nothing's impossible!"[6]

Many practitioners believe that the *Powell* and *Cahill* cases are based on bad facts and will likely be overturned on appeal. The authors of this article agree that these decisions will likely be overturned, but this article is based on the assumption that these decisions will upheld.

FACTS

Under Internal Revenue Code Section 2036(a),[7] assets transferred to a limited liability company or a limited partnership may be considered as owned by the transferor, for estate tax purposes, even after the transferor no longer holds any interest in the entity.[8]

The following three criteria must be satisfied in order for this to occur:

1. The decedent made a transfer of property during his or her life;

2. The transfer was not a bona fide sale for adequate and full consideration (because if it was, section 2036 would not apply); and

3. The decedent kept the right, alone or "in conjunction with" others, to designate persons who would enjoy the property.[9]

The "in connection with" others language as mentioned in item 3. above is troubling, becuase simply retaining any right to vote on when a liquidation or distribution may occur will cause inclusion of the entity's assets in that individual's estate for federal estate tax purposes. This holds true even if the individual can easily be out-voted by other Members holding the right to vote on such matters.

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[5] Lewis Carroll, *Alice's Adventures in Wonderland*.

[6] *Id.*

[7] *See generally* 26 U.S.C. § 2036(a).

[8] *See generally Powell*, 148 T.C. 18. This marked the first time the Tax Court applied section 2036(a)(2) to a decedent who did not own any interest as a general partner of a family limited partnership and was merely a limited partner. Todd Angkatavanich, Esq. & Eric Fisher, Esq., *Family Co-Investments in the Wake of Powell and Cahill: Time to Kick the Tires on Old Vehicles*, 44 Tax Management: Estates, Gifts and Trusts Journal 4-12, 5 (Bloomberg Tax 2019).

[9] *See* 26 C.F.R. § 20.2036-1(a).

John Porter stated the following during his presentation at the 2019 Heckerling Institute in Orlando, Florida:

> Typically we [practitioners] thought that it [the rights] dealt with distribution powers as a general partner or as a managing member of the LLC, but with the *Powell* case, it also goes to the rights to vote on liquidation, which is a pretty depriving decision.[10]

In addition, the court in *Cahill* held that simply holding the right to vote on an amendment to an entity's operative documents would be considered to hold the right to vote on a liquidation and/or a distribution if the entity's operative documents could potentially provide that person with such right.[11]

It therefore appears that, upon formation of a family limited partnership, a taxpayer with estate tax concerns should not have the right to participate in any amendment to the entity agreements even if the voting right is only 1% and the other voter has 99%.

Once a taxpayer holds any of the rights described above in any entity, the taxpayer will be deemed to continue to hold such rights for three (3) years after such rights are relinquished, unless such rights were relinquished through a bonafide sale..[12] For example, if a person has the direct or indirect right to vote on a liquidation or distribution, and this right has been given away, the person still has to live three years before being considered to not hold the power or right upon death for federal estate tax purposes.[13]

This "three-year rule" under Internal Revenue Code Section 2035 does not apply in situations where there has been a bona fide sale for adequate and full consideration made by the taxpayer.[14] Therefore, if the taxpayer retains an interest in the entity, and sells the entity interest to a third party in a bona fide sale for adequate and full consideration, then any rights appurtenant to the interest sold will be outside of the scope of the three year rule under Internal Revenue Code Section 2035.

It is impossible to sell a retained interest for good and valuable consideration if the taxpayer no longer owns it, such as when a taxpayer forms a limited partnership and initially owns such right but, then gifts or "bargain sells" a 99% limited partnership interest. The sale of the remaining 1% interest for good and valuable consideration will not avoid the application of the three year rule, at least as to the 99% that was gifted or sold.

As per the above, the three year rule is only concerned with the rights that are retained by the taxpayer. Therefore, if a taxpayer funds an entity and retains the right to vote on liquidations and distributions, but gifts away all of the ownership interest in such entity, that taxpayer would be deemed to own 100% of the entity for estate tax purposes.

"But I don't want to go among mad people," Alice remarked.

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10 John Porter, "Porter Talk," Heckerling Conference (Orlando, FL Jan. 14-15, 2019).

11 *See* Angkatavanich, supra note 8, at 5.

12 *See* 26 U.S.C. § 2036(b)(2).

13 *See* 26 U.S.C. § 2035(a). *See also Estate of Bongard v. C.I.R.*, 124 T.C. 95 (2005). Here, the Tax Court held that the assets attributable to an interest in a family limited partnership the decedent transferred to his wife within three years of his death were included in his gross estate under section 2035(a). Angkatavanich, supra note 8, at 8.

14 *See* 26 U.S.C. § 2036(d).

"Oh, you can't help that," said the Cat: "we're all mad here. I'm mad. You're mad."

"How do you know I'm mad?" said Alice.

"You must be," said the Cat, "or you wouldn't have come here."[15]

Conclusion

Practitioners need to decide as quickly as possible on how to handle this issue for new and existing cases and reach out to their clients regarding the choices they have.

No one knows when they will die so clients and their advisers need to plan accordingly, especially in light of the possible three year recapture rule under Internal Revenue Code Section 2035(a). The last thing you want to tell your client as an adviser is "Oh my furry whiskers, I'm late, I'm late, I'm late."[16]

"How do you know I'm mad?" said Alice.

"You must be," said the Cat, "or you wouldn't have come here."[17]

Be sure to read part 2 in the next issue of the Thursday Report

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199A Final Corrected Regulations Impact On Planning with Trusts

with Alan Gassman and Martin Shenkman

Recently, Marty and Alan spoke on planning with trusts and the following may be of interest…

Impact on Trusts Generally

Martin Shenkman: The next topic that we are going to talk about is the new regulations under Code Sec. 643(f) that govern the use of multiple trusts.

Alan Gassman: The final Code Sec. 643(f) regulations were a surprise, at least to me, because the proposed regulations had been more generous and gave examples where you could be in the clear if you set up trusts that would, for example, benefit separate

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[15] Carroll, supra note 6.

[16] *Id.*

[17] Carroll, supra note 6.

children during the lifetime of each child and then meld back into benefitting all grandchildren.

Otherwise, these final regulations are not a big surprise and I think most of us were assuming that they were already in effect just from the statute.

Further Planning With Trusts

Martin Shenkman: Alan, do you have any planning suggestions with respect to the impact of trusts on the application of Code Sec. 199A?

Alan Gassman: I think it is important to point out that many individuals and families who have income from a Specified Service Trade or Business (SSTB) will be able to shift a good portion of that income to lower tax bracket trusts or family members in order to take advantage of both the Code Sec. 199A deduction and lower tax brackets to generate some material income and Medicare tax savings.

For example, a high earner married couple with $600,000 or $700,000 of taxable income will not be able to take the Code Sec. 199A deduction on income from a medical, legal, or accounting practice, but will be able to allow children, grandchildren, or trusts for children and grandchildren to receive income to qualify for the deduction and also be taxed at lower tax brackets.

Martin Shenkman: It is noteworthy for us to mention that in many states professional practices have to be owned only by professionals. In such a case, it may be possible to have arm's-length management, billing, marketing, or factoring companies established to be owned and possibly even operated by lower generation taxpayers, to provide arm's-length services to an SSTB and allow reasonable net profits to be taxed to lower bracket taxpayers. But, what about the situation where the highly compensated professionals may not actually want their children, grandchildren, or even parents to receive monies directly, which may not be properly spent?

Alan Gassman: This is where it can make sense to have irrevocable trusts that presently exist in a family situation to own interests in a management company, or an SSTB if this is permitted under state law. The trust or the SSTB can then either accumulate income to take advantage of the lower brackets that a trust is in on the first $12,750 of income for 2019, or to pay out income, as permitted under the trust agreement, to or for the benefit of lower bracket taxpayers, given that the final regulations permit a complex trust to accumulate up to $160,700 of income that can qualify for the 20% deduction, while distributing any excess income to or for the benefit of lower bracket beneficiaries.

Martin Shenkman: Is there a way to have the income taxed to a lower bracket taxpayer while holding it for his or her benefit and possibly even using it for other family members or charities? We have been talking about Code Sec. 678 and how this might work as an income, gift, and estate tax planning tool for affluent clients who have either SSTB income, or income from a trade or business that does not have sufficient wages or Qualified Property to qualify for the deduction if the income is received by the high bracket primary owners.

Alan Gassman: Yes, Code Sec. 678 provides that income paid to certain trusts will be taxable to a specific beneficiary of the trust who has had the right to withdraw all corpus or income from the trust at a particular time in the past, notwithstanding that the income paid to the trust may be retained by the trustee and sprinkled among a number of beneficiaries. If you have a child or grandchild that has no other income it would be possible to give them a withdrawal power over a contribution of an ownership interest in an entity that owns an SSTB, or an entity that manages, provides products to, or provides services for a SSTB or a trade or business that does not have sufficient wages or Qualified Property to allow the income payable to a high-bracket taxpayer to qualify for the deduction. Then the income payable to that trust will go on the tax return of the lower income beneficiary who has had the withdrawal power in the past, to qualify for the deduction, while being accumulated for a number of family members.

Martin Shenkman: How do you design such a trust, taking into consideration that if it is considered to be a grantor trust as to the grantor/contributor thereto, then the Code Sec. 678 rule will not apply and the high earner taxpayer who sets the trust up will have to pay tax on the income?

Alan Gassman: It is important that the trust be designed *not* to be a "grantor trust" as to the contributor. This is fairly easy to do by simply making sure that neither of the grantor/contributor or the spouse of the grantor/contributor has the right to replace trust assets with assets of equal value, the right to borrow money without providing adequate security, and also making sure that no individuals or other parties have the right to add beneficiaries to the trust, or to make distributions to the grantor's spouse without the consent of an "adverse party." An "adverse party" is a beneficiary who has the possibility of receiving a distribution from the entire trust. In addition, the grantor's spouse should not have the ability to direct how the trust assets pass before his or her death, except in the event of the death of a child of the grantor or such spouse.

If you set up a trust in this manner, it will be possible for a trustee other than the grantor or the grantor's spouse to make distributions for the health, education, maintenance, and support of the grantor's spouse and other family members besides the beneficiary who was given the one-time withdrawal power and is taxed on the trust income.

Martin Shenkman: What are the possible savings from this type of planning? Is it really worthwhile?

Alan Gassman: This will vary based upon each potential scenario, but even when you deal with a complex trust or the kiddie tax, the savings from the lower brackets and avoidance of the 3.8-percent Medicare tax on a $12,750 buffer before the highest bracket applies will be over $2,000 a year, and the 20% deduction will apply in addition thereto, saving a little bit over another $11,000 a year, assuming a $160,400 threshold can be used.

If you set up three or four of these for a family having three or four children or grandchildren in this situation, then you are saving $35,000 to $45,000 or more a year from a relatively simple arrangement, which has creditor protection and family planning benefits that can far outweigh the legal and tax preparation costs, to make this worthwhile even if the deduction will not be available after 2025 or thereafter.

Martin Shenkman: But will this work if the purpose of the arrangement is to avoid tax under Code Sec. 199A, given the avoidance provisions under the final regulations?

Alan Gassman: While the brackets of a complex trust that is established or funded with a primary purpose of avoiding tax under Code Sec. 199A will be aggregated as to the threshold with the grantor of the trust, this does not prevent use of the Code Sec. 678 trust, or using a complex trust that simply pays out the distributable net income to the lower bracket taxpayer or for the lower bracket taxpayer's direct benefit so that the aggregation of the threshold with the grantor is not a factor.

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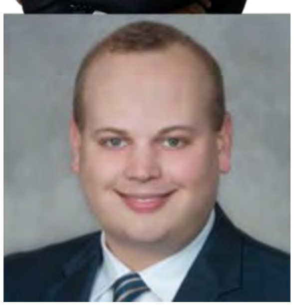
Update: Degrees of Protection Under Internal Revenue § 2036(a)(2)

by Alan Gassman, Ken Crotty, Chris Denicolo and John Beck



This is an update to our article from two weeks ago. We have updated the portion of this article regarding the use of swap powers under paragraph B. of the "House of Wood" discussion.

Basic Premise: A contributor to a family LLC or limited partnership may be subject to estate tax on the value of all of the assets that he or she contributed to the entity, without discounts, even if significant ownership interests in the entity were gifted or sold, if the contributor directly or indirectly retains one or more of (1) the right to control the entity, (2) the right to vote on if and when there will be a liquidation or distribution from the entity, or (3) the ability to amend the organizational documents of the entity.

Tax Court decisions have held that such retention by the contributor exists when the power is held by an individual who is also named in the contributor's durable power of attorney, as an agent.

IRC § 2035 provides that once this right has been retained, it will be considered retained until three years after it is transferred away or somehow released, unless the right is sold for adequate consideration.

Example: A mother places $994,700 of assets into a limited partnership and receives a 99% limited partner interest and a 47% interest in a company that controls the 1% general partner interest.

Her children contribute $5,300 to the limited partnership and receive a 53% interest in the company that controls the 1% general partner interest. This effectively gives the children control over the limited partnership.

Although her children could outvote her, she has the power to vote on if and when there would be a liquidation or distribution of the partnership, so 99.47% of the partnership assets may be subject to estate tax when she dies. This is the case even if she has given away some or all of the 99% LP interest.

Possible Solutions are discussed below, in simplified form. Taxpayers and advisors should not rely solely upon this write-up with respect to planning.

1. HOUSE OF BRICKS I - For new entities or for changing old entities more than three years before the death of the original contributor.

A. For a new partnership, the best practice would be for the contributor not to be a general partner, and to make sure that no individual "controlled by," or who acts as a fiduciary for the contributor, has a general partner interest or any right to vote on general partner decisions such as when liquidations or distributions should be made from the partnership.

B. Also, ensure that neither the contributor, nor any attorney-in-fact of the contributor, have any right to vote on or join in any amendment to the partnership agreement.

C. Alternatively, simply dissolve the entity with an existing issue, and use reasonable business purposes to reformulate strategies for the family without having the new entity be considered to be the "alter ego and in substance a continuation" of the original entity that is liquidated.

Keep in mind that powers given to individuals who act or are appointed to act as a fiduciary for the contributor may be considered as held by the contributor, such as when a parent gives the power to a child who is also authorized to act as agent under a power of attorney for the parent.

2. HOUSE OF WOOD (HOPEFULLY STRONGER THAN HOUSE OF STICKS)

A. Contributor retains the right to control the investment decisions for the entity, but not any right to cause a liquidation, a distribution, or to vote on any amendment to the partnership agreement.

The IRS could conceivably argue that the right to control the investment decisions allows the contributor to invest the partnership assets in illiquid investments, and possibly even investments that could not be distributed, which would effectively allow the contributor to control the potential distribution of the assets of the entity.

This risk can be ameliorated by providing for an investment policy, such as "the partnership will remain invested in a conventional and diversified portfolio of publicly-traded stocks and bonds, mutual funds and ETFs owning publicly-traded stocks and bonds, and other conventional investments, as recommended by ABC financial advisors on their fiduciary fee-for-service platform, or comparable investment advisors who must be reasonably approved by the partner or partners, who have the right to make liquidation and distribution decisions."

B. The most common way to achieve grantor trust status is to retain the power to swap assets of equal value with the trust. The power to swap assets allows the grantor to substitute trust assets without impacting the economic interests of the beneficiaries.

The Treasury Department has ruled that retaining the power to swap assets will not cause the trust assets to be included in the grantor's estate under IRC Secs. 2036, 2038 and 2042 "provided the trustee has a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value." The standard that should be used to determine whether a promissory note should be considered as equivalent value is whether a willing buyer and seller would enter into a similar transaction. Additionally, the rulings do not permit the grantor to use swap powers in a manner that would shift benefits among the beneficiaries of the trust.

Special care must be taken if the grantor is attempting to swap a promissory note for trust assets to ensure that the transaction in not simply a loan. In the Benson case, the court could not decide whether the promissory note was a loan or a substitution because other assets were transferred into the trust along with the promissory. Thus, it seems clear that contribution of a promissory note alone would most likely be considered a loan and not a swap.

Alternative strategies of achieving "defective grantor trusts" status can be considered, which could include giving the trustee or another fiduciary the ability to make distributions to the grantor's spouse without consent of an adverse party, to add one or more new beneficiaries to the trust, or to allow the grantor to borrow from the trust without adequate security.

3. HOUSE OF STICKS?

Can the contributor have the right to replace the partners who have the liquidation and distribution decision-making power?

The partnership agreement can provide that the power to make liquidations and distributions will be held by one or more individuals selected by the contributor, in their capacity as trustees of a trust for specific individuals, other than the contributor. In using this strategy, the liquidation and distribution powers must be exercised by the trustee in the capacity of a fiduciary for such beneficiaries.

It would seem that it would be safe to allow the contributor to replace the acting trustees of such trust with one or more individuals who are not related to or employed by (subordinate to) the contributor, within the meaning of Code Section 672(c). The IRS could potentially argue that by retaining the right to remove and replace the partners who have liquidation and distribution decision-making powers is essentially the same as the contributor retaining that power, causing the assets to be included in the contributor's estate.

For more detail on this please email any of the authors for a copy of our more extensive white paper on this subject.

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An Excerpt from Florida Law for Tax Business and Financial Planning Advisors: Unauthorized Practice of Law and Ethical Considerations

by Alan Gassman

The 2015 edition of this book is on Amazon, please email us if you would like to be a beta reader for the 2019 update which is currently being revised.

UNAUTHORIZED PRACTICE OF LAW AND ETHICAL CONSIDERATIONS

A. UNAUTHORIZED PRACTICE OF LAW – CAN YOU ADVISE FLORIDIANS IN THE FIRST PLACE?

Florida Legal Practice Rule 4-5.5 permits a lawyer who is licensed outside of Florida to perform services that either (a) "arise out of or are reasonably related to the lawyer's practice in the jurisdiction in which the lawyer is admitted to practice" or (b) "are performed for a client who resides in or has an office in the jurisdiction in which the lawyer is authorized to practice" as long as the non-Florida lawyer does not (1) establish an office or other regular presence in Florida for the practice of law, (2) hold out to the public or otherwise represent that the lawyer is admitted to practice in Florida, or (3) appear in court or before an administrative agency unless authorized to do so by the applicable tribunal. This exception will not apply for a lawyer who has been suspended from practicing in any jurisdiction, or has been disciplined or held in contempt in Florida for any legal misconduct. Separate rules apply for lawyers admitted to practice only in jurisdictions outside of the UnitedStates.

In addition, a lawyer admitted and authorized to practice law in another state may provide legal services on a temporary basis in Florida if undertaken in association with a Florida admitted lawyer who actively participates in the matter.

It is safest to have a Florida lawyer actively involved to review documents and strategies in order to ensure that the work is done properly. Malpractice liability insurance policies may also limit coverage for work done outside of the home state of a law firm having occasional Florida clients.

The Florida Supreme Court has shown that it will not be lenient on those who attempt to practice law in Florida without a license. For example, Jay Mitton, an attorney who was not licensed to practice in

Florida, and his company used to hold seminars on asset protection and estate planning in Florida. In 2000, the Florida Bar filed a complaint against Mitton, alleging that he was engaging in the unauthorized practice of law at these seminars. Mitton claimed that he never practiced law in Florida, but was caught up in Florida's justifiable concern about non-Florida attorneys practicing law in the state without a license. The Florida Supreme Court entered an order perpetually enjoining Mr. Mitton and his asset protection company from practicing law in Florida. The Court's decision in this matter can be found at its website, www.floridasupremecourt.org, case number SC00-2171. Mr. Mitton's rebuttal to commentaries on this decision can be found at his website: http://jaymitton.com/floridarebuttal.html.

Specific questions regarding the practice of law in Florida by an attorney licensed in another jurisdiction may be answered by the Florida Bar by calling (850) 561-5840.

There has been a significant increase in the phenomenon of accountants forming companies and other entities for clients, and this is a violation of the unauthorized practice of law rules. Certified public accountants risk licensing sanctions or even loss of licensing for engaging in the unauthorized practice of law. Further, the vast majority of these accountants simply form the entity on the Secretary of State's website and provide no documentation to confirm ownership, Operating Agreements or By-Laws, or issue stock or partnership interests. This is an extremely dangerous practice, but the Florida Bar is apparently unwilling to take steps to prevent this significant risk of harm that can befall individuals or families who believe that they are receiving appropriate protection and tax characteristics that will simply not be the case upon IRS or Florida Department of Revenue audit or creditor challenge.

The Florida Bar Ethics Hotline

Ethics Hotline for Lawyers
www.floridabar.org

The Florida Bar (800) 235-8619

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For non-attorneys General Information

One of the first of its kind established in the nation, and still one of only a handful in operation, the toll-free Ethics Hotline was established in 1984 to help guide lawyers through the minefields of conflict dilemmas, confidentiality questions, communication concerns, trust accounting problems, and other ethics difficulties unique to the profession.

Hotline attorneys are authorized to respond to inquiries from members in good standing of The Florida Bar who are asking about their own contemplated conduct. When there is no Florida authority upon which to base an answer to an inquiry, ethics counsel can decline to issue an opinion. Staff *must* decline to render an opinion when an inquirer asks a question of law, a question about past conduct, a question about another attorney's conduct, or a question about the subject of a pending grievance.

Advisory ethics opinions are appealable to the Professional Ethics Committee and, ultimately, to the Bar's Board of Governors according to The Florida Bar Procedures for Ruling on Questions of Ethics.

Oral Advisory Opinion:

Members of The Florida Bar in good standing who wish to receive an oral advisory opinion about their own contemplated conduct may call (800) 235-8619 to reach an ethics attorney.

To leave a message call (850) 561-5780. Written Ethics Opinion:

To receive a written ethics opinion, which takes 3-5 weeks, members of The Florida Bar in good standing may make written inquiry to The Ethics Department, The Florida Bar, 651 E. Jefferson Street, Tallahassee, FL 32399-2300.

B. ETHICAL CONSIDERATIONS

The following Bar ethical rule change must be considered by estate planning lawyers:

It is well known that lawyers must follow the Disciplinary Rules of the Florida Bar, and that Ethical Considerations exist as useful guidance and commentary on how to follow the Disciplinary Rules.

It is also known that lawyers are often criticized for being named in legal documents as personal representatives and trustees, and then charging a percentage of the assets and consequent amounts that may far exceed what would typically be paid for the time spent by a responsible individual needing commensurate services and responsibilities to be fulfilled.

In 2017, the Florida Bar proposed the following amendments to Rule 4-1.8(c):

> RULE 4-1.8 CONFLICT OF INTEREST; PROHIBITED AND OTHER TRANSACTIONS
>
> (c) A lawyer ~~shall not~~ is prohibited from soliciting any ~~substantial~~ gift from a client, including a testamentary gift, or ~~prepare~~ preparing on behalf of a client an instrument giving the lawyer or a person related to the lawyer any ~~substantial~~ gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this subdivision, related persons include a spouse, child, grandchild, parent, grandparent, or other relative with whom the lawyer or the client maintains a close, familial relationship.

The Supreme Court of Florida approved the above amendments and issued new language as part of the updated Ethical Considerations to Rule 4-1.8(c), which became effective February 1, 2018:

> **Gifts to lawyers**
>
> A lawyer may accept a gift from a client, if the transaction meets general standards of fairness and if the lawyer does not prepare the instrument bestowing the gift. For example, a simple gift such as a present given at a holiday or as a token of appreciation is permitted. If a client offers the lawyer a more substantial gift, subdivision (c) does not prohibit the lawyer from accepting it, although the gift may be voidable by the client under the doctrine of undue influence, which treats client gifts as presumptively fraudulent. In any event, due to concerns about overreaching and imposition on clients, a lawyer may not suggest that a gift be made to the lawyer or for the lawyer's benefit, except where the lawyer is related to the client as set forth in subdivision (c). If effectuation of a gift requires preparing a legal instrument such as a will or conveyance, however, the client should have the detached advice that another lawyer can provide and the lawyer should advise the client to seek advice of independent counsel. Subdivision (c) recognizes an exception where the client is related by blood or marriage to the donee.

The updated Ethical Considerations to Rule 4-1.8(c) also provide commentary with respect to lawyers who serve as the fiduciary of any estate planning documents that they draft, which is copied below:

> This rule does not prohibit a lawyer or a partner or associate of the lawyer from

serving as personal representative of the client's estate or in another potentially lucrative fiduciary position in connection with a client's estate planning. A lawyer may prepare a document that appoints the lawyer or a person related to the lawyer to a fiduciary office if the client is properly informed, the appointment does not violate rule 4-1.7 [Conflicts of Interest; Current Clients], the appointment is not the product of undue influence or improper solicitation by the lawyer, and the client gives informed consent, confirmed in writing. In obtaining the client's informed consent to the conflict, the lawyer should [1] advise the client in writing concerning who is eligible to serve as a fiduciary, [2] that a person who serves as a fiduciary is entitled to compensation, and [3] that the lawyer may be eligible to receive compensation for serving as a fiduciary in addition to any attorney's fees that the lawyer or the lawyer's firm may earn for serving as a lawyer for the fiduciary.

Lawyers and firms who have routinely named themselves as trustees or personal representatives will, therefore, be well advised to take care to follow these rules. There will doubtlessly be probate court challenges to compensation requested by lawyers named in documents signed after February 1, 2018, who are acting as fiduciaries when the above new Ethical Considerations are not followed.

Joseph Corsmeier, who is a Florida Bar lawyer specializing in the representation of lawyers having disciplinary issues, had the following to say about this:

> "Bottom line: This Bar Rule amendment clarifies the rule and a lawyer will now violate this rule if he or she solicits any gift from a client or prepares an instrument with a gift, regardless of the size of the gift.
>
> Be careful out there."

Additionally, advisors will have to be very careful to not violate ethical rules and practical mistakes with respect to conflicts of interest. It is important to educate clients so that they understand that information provided to a lawyer or other advisor under joint representation will be accessible to both clients, and that in the event of a conflict, the common lawyer would not be able to advise either client with respect to general subject matter without mutual consent.

Florida Bar's Professional Responsibility Rule 4-1.7 provides the following language for regulation of conflicts of interest and reads as follows:

RULE 4-1.7 CONFLICT OF INTEREST; CURRENT CLIENTS

(a) **Representing Adverse Interests.** Except as provided in subdivision (b), a lawyer must not represent a client if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a substantial risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) **Informed Consent.** Notwithstanding the existence of a conflict of interest under subdivision (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a position adverse to another client when the lawyer represents both clients in the same proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing or clearly stated on the record at a hearing.

(c) **Explanation to Clients**. When representation of multiple clients in a single matter is undertaken, the consultation must include explanation of the implications of the common representation and the advantages and risks involved.

(d) **Lawyers Related by Blood, Adoption, or Marriage.** A lawyer related by blood, adoption, or marriage to another lawyer as parent, child, sibling, or spouse must not represent a client in a representation directly adverse to a person who the lawyer knows is represented by the other lawyer except with the client's informed consent, confirmed in writing or clearly stated on the record at a hearing.

(e) **Representation of Insureds.** Upon undertaking the representation of an insured client at the expense of the insurer, a lawyer has a duty to ascertain whether the lawyer will be representing both the insurer and the insured as clients, or only the insured, and to inform both the insured and the insurer regarding the scope of the representation. All other Rules Regulating The Florida Bar related to conflicts of interest apply to the representation as they would in any other situation.

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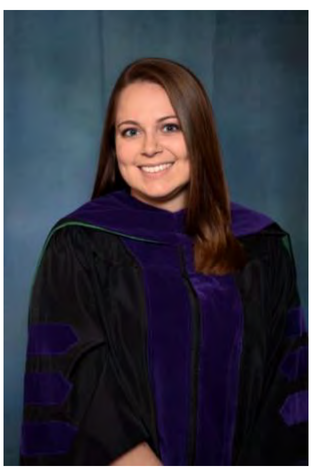

The Use of Swap Powers and Section 2036

By Kelsey Weiss

The most common way to achieve grantor trust status is for the grantor to retain the swap power. Swap power allows the grantor to substitute trust assets without impacting the economic interests of the beneficiaries.

The Treasury Department has ruled that retaining the power to swap assets will not cause the trust assets to be included in the grantor's estate under IRC Secs. 2036 and 2038 (Rev. Rul. 2008-22) or 2042 (Rev. Rul. 2011-28) "provided the trustee has a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of this power bysatisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value." Additionally, the rulings do not permit the grantor to use the swap power in a manner that would shift benefits among the beneficiaries of the trust, and the trustee must have a duty to ensure that this does not happen.[1]

By using the language "satisfying itself," the Treasury Department clarified that judicial approval is not required for the swap to occur.[2]

It is, however, required that the substituted property **must** be equivalent to the property that was 'swapped' out of the grantor trust. If the value is not equivalent, the IRS could argue that the swap power was used improperly and subsequently assert that the grantor retained control over the trust asserts. If this occurs, the assets could be brought back into the estate under IRC Section 2036.

Even with the importance placed on equivalence, the IRC does not define "equivalent value" thus spurring on several cases. Each of the below cases discuss whether a promissory note in particular can be substituted for hard assets and considered equivalent value.

In the case of *In re Conditotti*,[3] the grantor of a grantor trust attempted to substitute the full value of the trust's assets for a promissory note. The court held that the trustee had the power to decide whether the proposed transaction was a substitution or actually a request for a loan. The court determined that based on the language of the trust and the intent of the grantor, this transaction was clearly an attempt to exercise the loan power.[4] Along the same lines, the Second Circuit in *Rothstein v. U.S.* held that the exchange of an unsecured promissory note used by the grantor to purchase trust assets was a loan.[5]

Alternatively, in *Benson v. Rosenthal*, after weighing the many factors the District Court could not determine that the promissory note was a loan rather than a substitution.[6] First, the language of the trust simply stated that the substitution be for property of equivalent value with no provision stating that a promissory note, which the court stated "most certainly has value," would be prohibited for substitution.[7] Second, "the real estate and loan forgiveness that Plaintiff offered as part of the substitution are further proof that a loan was intended."[8]

Additionally, the court in *Benson* found that *Rothstein* and *Condiotti* were distinguishable because the promissory notes offered by the grantors in those cases were unsecured. In *Benson*, the Plaintiff tendered fully secured promissory notes based on qualified appraisals bearing adequate interest rates along with tangible assets and other property in order to form equivalent value for the substitution. Based on the court's reasoning in *Benson*, however, if a court determines that the transaction was simply a loan by itself (secured or not), the transaction will not be considered a swap.

Issues may also arise in cases where the value of the promissory note comes into question. In *Schinazi v. Eden*, the grantor of the trust also attempted to use a promissory note in a substitution.[9] However, in this case, the promissory note was for the value of a partnership interest. According to the court, some evidence suggested that the value of the partnership interest increased just days after the tender when another entity purchased the company owned by the partnership in question.[10] While the purchase was not finalized until after the promissory note was tendered, the purchase had been announced months earlier. Therefore, the court determined that material questions of fact remained regarding breach. The *Condiotti* court did, however, provide us with the proper standard to use when determining if a promissory note should be considered as a substitution: The willing buyer willing seller fair market value standard. By using this standard, the grantor is not permitted to use the swap power with assets from the grantor trust to enhance the personal net worth of the grantor. This was reiterated by the court in *In re Dino Rigoni International Grantor Trust for the Benefit of Christopher Rajzer* where the court quoted Revenue Ruling 2008-22 in stating that a grantor "cannot exercise the power to substitute assets in a manner that will reduce the value of the trust corpus" or increase the grantor's net worth.[11]

Lastly, the court in *Manatt v. Manatt* dealt solely with the timing of the trustee's "fiduciary duty to satisfy himself that the properties acquired and substituted are of equivalent value."[12] The Defendant, Erik Manatt, argued that the valuation of the substituted asset must occur before the substitution takes effect. However, the court, using the reasoning from *Benson* and *Rigoni*, determined that based on the plain language of the substitution provision, the grantor had the unilateral right of substituting assets. Therefore, Erik's fiduciary duty as the trustee to determine whether the substitution was of equivalent value "did not abridge, delay, or block" the grantor's right of substitution.[13] This case also highlights the importance of the requirement that the trustee also be impartial.

In summation, because the IRS has not defined "equivalent value" in the IRC, many have turned to the courts to determine whether a substitution such as a promissory note meets the equivalency test even though a court determination is not required. Based on the decisions so far, items such as promissory notes may be considered equivalent value, however there is a high likelihood that a court may determine that the "swap" was instead a loan. It seems clear that a promissory note could be used as part of an overall swap transaction as long as the note is transferred to the grantor trust along with other assets. The net value of all such assets transferred to the grantor trust must be equal to the assets received by the grantor trust. As evidenced by the cases brought forth so far, there are many murky areas and pitfalls to consider when making this substitution.

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[1] Rev. Rul. 2008-22, modified by Announcement 2008-46.

[2] While judicial approval is not required by the Treasury Department, many grantors will likely seek out approval from the courts particularly with regard to using the swap power with high net worth trusts or trusts where the grantor and trust beneficiaries are at odds. In these situations, attaining judicial approval can lessen the likelihood of lawsuits down the road.

[3] *In re matter of Condiotti*, No. 14CA0969 (Col. App. July 9, 2015 unpublished opinion).

[4] The same reasoning was followed by the court in Schinazi v. Eden: "In construing an express trust, we look first and foremost to the language therein and interpret that language to effectuate the intent of the settlors." In this case, the language of the trust agreement clearly gave the grantor the right to require the trust property by substituting property of equivalent value.

[5] *Rothstein v. United States*, 735 F. 2d 704, 707 (2nd Cir. 1984).

[6] *Benson v. Rosenthal*, No. 15-782, 2016 WL 2855456 (E.D. La. 2016).

[7] *Id.* at 3.

[8] *Id.* at 4.

[9] *Schinazi v. Eden*, 338 Ga. App. 793 S.E.2d 94 (Ga. App. 2016).

[10] *Id.* at 799.

[11] *In re Dino Rigoni International Grantor Trust for the Benefit of Christopher Rajzer*, 2015 WL 4255417 (Ct. App. Mi. July 14, 2015 unpublished opinion). The *Rigoni* court also determined that the trial court was proper in not applying any discounts to the membership interests held by the trusts in determining the "equivalent value" of the substitution.

[12] *Manatt v. Manatt*, 2018 WL 3154461 (S.D. Iowa May 2, 2018).

[13] *Id.* at 7.

Humor...or something similar...

Be sure to hear Alan as he discusses the new 199A ramifications with Bloomberg…

To listen, click HERE

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For the Tax Section of The Florida Bar:

Join Alan Gassman and Leslie Share for This Florida Bar Event At Stetson University:

Creditor Protection Nuts and Bolts

Thursday, April 18, 2019, 10:00 am - 2:00 PM

Stetson-Tampa Law Center

Please join Alan and Leslie Share to present four informative and unique programs for The Florida Bar in Tampa:

Primary Florida and Federal Creditor Protection Laws

(10:10 am - 11:00 am)

A Closer Look at Florida and Federal Creditor Exemption Laws and Planning

(11:00 am - 11:50 am)

Tax and Practical Aspects of Using Limited Liability Companies, Limited Partnerships, and Domestic and Offshore Trusts and Related Planning with Leslie Share

(12:00 PM - 1:10 PM)

Putting it All Together with Alan Gassman & Leslie Share

(1:10 PM - 2:00 PM)

These programs will be sure to fill in missing knowledge or answer questions you may have in regards to the unique situations presented in Florida as well as national creditor exemption tips, tricks, language and implications, Limited Liability Companies and much more.

For information on Registration, please contact Barbie Gonzalez at Bgonzalez@CFSarasota.org

Agassman@gassmanpa.com

las@pnrlaw.com

GASSMAN CROTTY & DENICOLO P.A.
ATTORNEYS AT LAW

PNR Packman Neuwahl Rosenberg

Calendar of Events

Newly announced events in RED

EVENT	DATE/TIME	LOCATION	DESC.	REGISTRATION
New Jersey Bar Association Presentation	March 11, 2019, 9:00am - 12:00PM New Jersey Law Center, New Brunswick, NJ	Strategies for Clients Who no Longer Have to Worry About Federal Estate Tax with Deirdre Wheatley		To Register click HERE
New Jersey Bar Association Presentation	March 11, 2019, 1:00 PM - 4:35 PM New Jersey Law Center, New Brunswick, NJ	*What New Jersey Lawyers Need to Know About Florida Law*		To Register click HERE
9th Annual Pinellas County Medical Association Continuing Medical Education Cruise	March 14-18, 2019 	Port of Tampa	Biggest Mistakes Physicians Make in Medical Practice	FOR INFORMATION AND RESERVATIONS CONTACT JEN BOLL 727-526-1571 / 1-800-422-0711
Presentation for the Tax Section of The **Florida Bar Association**	April 18, 2019, 10:00 am – 2:00 PM	Stetson Tampa Law Center *Primary Florida and Federal Creditor Protection Laws, A Closer Look at Florida and Federal Creditor Exemption Laws and Planning* And *Putting it All Together with Leslie Share*		Contact: Agassman@gassmanpa.com
University of North Carolina Tax Institute	April 25-26, 2019	Creative Planning with Section 199A After the New Regulations		Contact: Agassman@gassmanpa.com
FSU FICPA Accounting Conference	May 6 – 8, 2019, Tallahassee, FL	Alan will be speaking on the new 199A finalized regulations		Contact: Agassman@gassmanpa.com

FICPA Mega CPE Conference for the TCJA	June 10 – 13, 2019	Alan will be speaking on the new 199A finalized regulations		Contact: Agassman@gassmanpa.com
MER Conference Internal Medicine for Primary Care	June 13 – 16, 2019, Chicago, IL	1. Lawsuits 101 2. Ten Biggest Mistakes That Physicians Make in Their Investment and Business Planning 3. Essential Creditor Protection & Retirement Planning Considerations. 4. 50 Ways to Leave Your Overhead & Increase Personal Productivity.		Contact: Agassman@gassmanpa.com
Maui Mastermind Financial Pillar Super Course	June 22-23, 2019	Hilton-Atlanta Airport	Crucial Legal and Tax Principals for Accumulating Wealth	Please Click HERE
45th Annual Notre Dame Tax Institute	September 26-27, 2019	South Bend, Indiana	TBD	Contact: Agassman@gassmanpa.com
FICPA Accounting and Tax Conference	October 24, 2019	Estero, FL	TBD	Contact: Agassman@gassmanpa.com
Special Asset Protection Presentation	Friday, October 25, 2019	University of Miami Law School	Advanced Asset Protection Workshop with Les Share	Contact: Agassman@gassmanpa.com
Maui Mastermind Wealth Summit	November 3-8, 2019	Wailea Beach Resort, Maui	Essential Aspects and Decisions for Your Remarkable Financial Future	Please Click HERE
Certified Contractors Network Presentation	January 4, 2020 - Orlando	Orlando, FL	Creditor Protection for the Intelligent Construction Family – It Wasn't Raining When Noah Built the Ark	Contact: Agassman@gassmanpa.com
Venice Estate Planning Council Presentation Hosted by Community	Tuesday, January 21, 2020, Venice then Sarasota, FL	For the Venice Estate Planning Council and Sponsored by the Community Foundation of Sarasota County, Alan will be conducting a morning presentation, "Innovative		Contact: Barbie Gonzalez: BGonzalez@CFSarasota.org

Foundation of Sarasota County		Charitable Techniques, Asset Protection Strategies You Didn't Know and Creative Planning Under Section 199A" He will be answering questions (and telling many bad jokes) for VIPS at the hosted luncheon and will be the dinner speaker to finish the event off. Starting in Venice, these events will conclude in Sarasota.	