A Method to the Madness:
A Proposed Hermeneutic for
Designing the Appropriate Estate Planning Technique

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Judge a man by his questions rather than his answers.
Voltaire

The purpose of this monograph is to address a critically important issue that I feel strongly has been virtually ignored by the estate planning community: how to design an estate planning tool or technique. Knowledge of the "what" about an estate planning tool or technique is irrelevant in my opinion without an in-depth understanding of "how" to design an estate planning tool or technique in a particular situation.

In my opinion, Monte Carlo simulations can only take you so far in this effort. Indeed, a malpractice or negligence claim may be lurking in the future without a clear grasp of the "how" to design an estate planning tool or technique. I intend this monograph to provide some much-needed guidance in this regard and to sound a clarion call for more analysis and study of this subject.

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Chapter 1—Overview of Importance of Finding Proper Estate Planning Tools and Techniques

1.01 Purpose of this Part: Attempting to Find the Right "Fit"

[A] Introduction. This part offers a study of the process of evaluating and designing estate planning techniques. It also offers a tool of analysis to assist estate planners in the selection and design of the right estate planning technique in a given situation. Estate planners also can utilize this tool of analysis to avoid putting clients into the wrong technique or design parameter, which can be just as valuable to the estate planner as the client.

The proper evaluation and design of an estate planning technique involves a tripartite consideration:

> factors peculiar to the technique itself, i.e., the essence of the technique
>
> factors peculiar to assets that may be involved or affected by the technique

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factors relating to the "players", i.e., persons (including the client) who are involved in or potentially affected by the technique

The array of "players" in estate planning techniques varies greatly from technique to technique. Some techniques, e.g., a will, involve just the client. Other techniques involve a great many others, including spouses, descendants or other loved ones, business partners, lenders, suppliers, estate planning advisors and appraisers.

As the graphic below illustrates, it is paramount that the estate planner recommends a plan that achieves the proper "fit":

[B] Overview-Why Estate Plans Fail. Many incidents of failure or underperformance in estate planning can be directly attributed to incomplete or inaccurate evaluation or design of an estate planning technique. In other words, one or more of the legs of the estate planning "stool" were weak. The reasons for poor technique evaluation or design often involve a mismatch between the players,

the asset or the technique, e.g., a players-technique mismatch or a technique-assets mismatch.

[C] Hermeneutic. Even with the proliferation of Monte Carlo simulations and advanced projections, there is no Rosetta Stone, Oracle of Delphi or "Magic Eight Ball" for selecting or designing the "perfect" or "optimal" estate planning technique. Even after a flawless implementation, the client's circumstances may change dramatically. Despite the estate planner's best due diligence efforts, the client may have failed to supply complete or accurate information. There are many subtleties and counterintuitive factors involved in the process of selecting and designing techniques. The goal in technique selection and design is the best long-term "fit" between the asset and the players. A secondary goal is implementation of a technique that does not have a negative effect on the client or the players, a gesture toward Hippocrates' advice to physicians in *The Epidemics* to "do no harm."

The best we can hope for is some tool of analysis, or hermeneutic, for evaluating and designing estate planning techniques.

1.02 Why technique evaluation and design is important to the estate planner

[A] Requires More Than Competence. There is much more to estate planning than technical competence, i.e., knowing "how" to design and implement estate planning tools and techniques. The reasons "why" and "when" an estate planning technique should or should not be used is just as important. Aristotle's timeless wisdom, expressed in the *Nichomachean Ethics*, applies to estate planning:

> [I]t is always hard work to find the mean in anything, *i.e.*, it is not everybody, but only a man of science, who can find the mean or centre of a circle. So too anybody can get angry--that is an easy matter--and anybody can give or spend money, but to give it to the right persons, to give the right amount of it and to give it at the right time and for the right cause and in the right way, this is not what anybody can do, nor is it easy. That is the reason why it is rare and laudable to do well.

This is particularly true if the technique or design feature chosen turns out badly, and the client or someone else, including a subsequently engaged estate planner, suggests that the estate planner was the one responsible for the selection or design feature flaw.

[B] Hindsight. Estate planners should be aware that their advice is always subject to being second-guessed.[1] This risk to estate planners is separate and apart from the risk of malpractice in the implementation of an estate planning technique. Estate planners should have a baseline knowledge of the tax and non-tax potential "side effects" of any technique about which they counsel clients. Estate planners should possess even greater knowledge of the side effects of the estate planning techniques that the estate planner actually either recommends or those techniques with which the estate planner assists in implementation.[2]

Unfortunately, some estate planners only respond to adverse malpractice case law, so there is some of that. Chapter 2 discusses examples of poor or inappropriate use or design of an estate planning technique, which can, but does not necessarily, lead to malpractice exposure, especially where clients make the decision regarding estate planning technique or design after full explanation.

1.03 What Do Most Clients Want in Estate Planning?

In performing estate planning services, it is essential to know what clients want to accomplish. Many clients want what some estate planners have called the "pipe dream estate plan"[3]-total control/no tax/asset protection-and this usually does not exist. There has been a proliferation of "new" estate planning techniques and variations of old estate planning techniques, as both clients and estate planners continue in quest of the estate planning pipe dream. Many estate planners feel pressed to "keep up with the Joneses" (and ahead of the cocktail party discussion) with respect to the latest and greatest estate planning techniques and the design and

1 c.f., Ashton-Blair v. Merrill, 187 Ariz. 315, 928 P. 2d 1244 (App. Div. 1 1996).

2 See, e.g., ABA Model Rules of Professional Responsibility, Rule 1.1 (Competence).

3 Cite Dick Oshins articles.

implementation of those techniques. Some creative estate planners brag about innovative or creative techniques, sometimes to their detriment.[4]

Very little has been written on how to select or design estate planning techniques or on how to assess applicability of an estate planning technique to a client's situation or to design the technique in a particular client's situation. Likewise, there is a dearth of writing on why estate planners push or nudge a client toward a particular technique, or away from another technique.

Chapter 2—Analysis of Evaluation and Design of Estate Planning Tools and Techniques

2.01 Can Estate Planners Be Held Liable For Technique Evaluation or Design?

Poor or inappropriate estate planning technique or design can cause financial harm. Estate planners may be held liable for negligence in estate planning work. Could estate planners be held liable for damages incurred for advice leading to inappropriate selection or design of an estate planning technique?

The answer to the question is "yes." But what are the characteristics of estate planning techniques?

2.02 Possible Estate Planning Technique Characteristics.

[A] Introduction. Let's begin our quest by trying to set out and analyze the universe of possible estate planning technique characteristics. Every technique does not have every characteristic discussed in this section. This list probably is not exhaustive, despite its intent. To some extent, these characteristics may be viewed as goals of estate planning.

[B] Characteristics.

4 See, e.g., Notice 2002-59.

[1] Retention of Control. An integral part of the estate planning process involves client realization about how much continuing control the client wants or needs to retain. There often is an educational aspect to this process, particularly with respect to how much continuing control the clients needs to retain versus how much control the client wants to retain. Some clients may be willing to part with more control than that which the estate planner may believe that the client can safely part. Some clients desire to retain so much post-implementation control that the client cannot safely enter into the technique without taking on significant estate tax risk.

Most estate planning techniques, including the decision not to engage in significant lifetime or in tax-advantaged estate planning, can be designed with whatever continuing control the client wants or needs. Of course, there is estate tax tension in this regard. The retention of too much control can obliterate some or all of the benefits of certain lifetime techniques.[5]

[2] Asset Protection. Evaluation of client exposure to liability should be a part of every estate planning process. Some techniques can increase asset protection; some designs actually can decrease asset protection, e.g., guarantees or loans.

[3] Flexibility in Distribution of Income. It is important to some clients to retain flexibility with respect to income distribution. Sometimes, flexibility as to identity of the recipients of income is desired. Sometimes, flexibility as to the timing of income is more important. While this is a characteristic of some estate planning techniques, it also is a design feature that, if desired, must be built into a technique. Some techniques offer greater flexibility as to timing of distributions than as to identity of the recipients of distributions. A GRAT is an example of a technique that has limited flexibility in making distributions and the amount thereof, as is a private annuity. On the other hand, a wholly discretionary spray trust offers significant flexibility in this regard.

[4] Flexibility in Distribution of Principal. The same considerations discussed in [3] above relative to income also apply to principal. Some techniques permit greater flexibility relative to distribution of principal.

5 IRC Secs. 2036-2038.

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[5] Access to Capital. This is one of the most important characteristics hoped to be achieved in the successful implementation of an estate planning technique. It is axiomatic that estate planning begin with the client's lifetime needs. Unfortunately, some estate planners focus too much on the property transmission and tax minimization aspects of estate planning. This sometimes can cause an estate planner to miss the fact that a recommended technique will compromise the client's need for access to capital, leaving the client potentially exposed.

[6] Access to Income. Many of the same considerations attendant to the importance of access to capital in [5] above apply to the need for retained access to income.

[7] Transfer of Future Appreciation and/or Income. Many estate planning techniques permit the transfer of future appreciation or income, or both. Of course, it requires the cooperation of the property used in the technique. Some estate planning techniques, e.g., GRAT, only provide a net benefit if the property appreciates or produces income in excess of the IRC Sec. 7520 rate.

[8] Transfer of Opportunity. While opportunity may sometimes fall with the rubric of "appreciation" discussed above, transfer or diversion of unrealized opportunity outside of the transfer tax system often creates some of the best estate planning successes.

[9] Generation-Skipping. Many clients desire to achieve generation-skipping as one of their estate planning goals. Some techniques are particularly well-suited for transfers of wealth down more than one generation; some techniques, e.g., GRAT's and QPRT's, are not well suited for that.

[10] Income Tax Deferral. For many clients, the deferral of income tax is a desirable or even necessary goal. For other clients, income tax deferral is not as important as other goals. A few estate planning techniques permit deferral of income tax, e.g., charitable remainder trusts; while other techniques, intentionally defective grantor trust, create immediate income tax liability on the income from trust assets for the grantor.

[11] Estate or Gift Tax Deferral. Some estate planning techniques permit effective deferral of estate or gift tax. While transfer tax deferral historically (at least since 1976) has not been as lucrative as income tax deferral, it still is a necessary component in the estate plans of many clients.

[12] Qualification for Tax Benefits. The effect of some estate planning techniques is to purposefully qualify an estate for tax benefits, including qualification under IRC Secs. 303, 2032A and 6166. Some applications of estate planning techniques can cause loss of qualification for tax benefits.

[13] Use of Gift Tax Exemptions and Exclusions. The gift tax statutes still contain exemptions and exclusions that are not included in the estate tax provisions. Some techniques facilitate more efficient and less costly usage of these exemptions and exclusions than other techniques, e.g., some techniques, family entities and GRATs, permit greater potential for leveraging these exemptions or exclusions.

[14] Maximize Usage of Estate Tax Applicable Exclusion Amount and Deductions. Most clients desire to fully utilize the transfer tax benefits that are granted in the Internal Revenue Code. Some techniques assist with achieving this desire; some don't.

[15] Equalization. Some clients desire to equalize estates between spouses; others desire to achieve equalization between branches of their descendants. Equalization may make tax-sense, yet may be neither advisable nor risk-free, e.g., equalization between spouses via outright transfers may be tax-wise yet problematic if the couple divorces (where a lifetime QTIP transfer may be safer).

[16] Satisfaction Through Transfer. While the satisfaction of having made a significant gift or legacy is not susceptible of measurement in monetary means, it nevertheless is a characteristic of some successful implementations of estate planning techniques.

[17] Improving or Protecting Lifestyle. This might be viewed as the flipside of [16] above, but it may be construed as being from the viewpoint of the

recipient. Nevertheless, the client who enters into an estate planning technique that permits a child or spouse to not work, or to not be as financially strapped, often does so to allow that child to enjoy the fruits of the client's bounty. And there are plenty of examples where such planning has spoiled the recipient.

[18] Facilitating Charitable or Civic Desires. Some techniques facilitate a client's desire to assist the community or some charitable cause that is important to the client.

[19] Tax Finality or Predictability. Some techniques increase the possibility of achieving finality, or at least predictability/certainty, in tax result, certain lifetime gifts that are properly disclosed on the gift tax return.[6] This can be very important in some situations.

[20] Providing Tax-Deferred Diversification. Some estate planning techniques, e.g., the charitable remainder trust, permit diversification of assets without having to immediately reduce the principal by the tax on the gain produced by a sale.

[21] Providing Guidance and Management. Some estate planning techniques can be designed to assist in providing management and educational guidance or training to loved ones. This usually is a significant focus in the drafting of trusts and entity governance documents.

[22] Encouraging or Discouraging Behavior. Estate planning techniques can, within the confines of state law, be set up to reward behavior of loved ones deemed positive by the client and to punish behavior that falls outside of those boundaries.

[23] Level Playing Field and Provide Framework for Resolution of Disputes-Real and Perceived. While this usually is a function of design, estate planning techniques can provide a series of "checks and balances" and also provide a framework for dispute resolution.

6 IRC Sec. 2001(f).

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[24] Liquidity. Liquidity often is a necessary component of a good estate plan. Some techniques assist in liquidity directly, e.g., irrevocable life insurance trust; other techniques indirectly assist in liquidity by reducing the need for liquidity, e.g., the charitable lead trust.

2.03 Estate Planning Risks.

[A] Introduction. Unfortunately, the road to achievement of estate planning goals is fraught with potential risks. This section attempts to lay out an exhaustive list of risks of entering into, or even in refraining from, estate planning techniques. These risks also apply during the administration of the technique after implementation.

[B] Risks in Estate Planning.

[1] Risk of Loss of Access to Capital. The risk of a client's loss of access to capital is one of the most common in estate planning. Yet it is a risk to which too many estate planners expose their clients. Some estate planning techniques overly restrict a client's access to capital. The techniques through which excessive loss of access to capital can happen range from simple, e.g., outright gifts, to intermediately complex, e.g., charitable remainder trusts, to the very complex, e.g., installment sales to intentionally defective grantor trusts. It also bears mentioning that the federal gift tax has no corollary to IRC Sec. 6166.

[2] Valuation Risks. Valuation risks can occur in estate planning either because initial value is too high or too low, or if there is a significant change in value after implementation. The inherent subjectivity of valuation, to which even publicly traded assets are exposed, presents a significant risk.

[3] Risk of Family Disharmony. The mere mention of dispositive estate planning creates a risk of family disharmony. This is true even if no final decisions are being made or any property is transferred. Estate planning often necessitates or requires tough decisions. The prudent estate planner should expect that some of the players may not like the decisions made.

[4] Risk of Tax Recharacterization. Some techniques present a risk of tax recharacterization. The estate planner should ascertain the potential and magnitude

of the risk of recharacterization, as techniques vary greatly in the potential magnitude of the effects of tax recharacterization, e.g., a post-death redemption of stock in a family corporation.[7]

[5] Risk of Loss of Tax Qualification. This risk can occur relative to loss of the tax qualification of a particular technique, and it can occur where implementation of a technique can cost the client qualification for another tax benefit, such as IRC Secs. 303, 2032A or 6166.

[6] Risk of Loss of Flexibility. Techniques and designs vary significantly in the amount of flexibility lost after implementation. Virtually every technique entails the loss of some flexibility, whether it is loss of flexibility in access to capital or retention of income, or it is loss of flexibility as to recipients or the sharing between recipients. Every estate planner must ascertain the level of appropriate loss of flexibility for a client.

[7] Risk of Estate Tax Inclusion. Estate planning techniques vary significantly in the potential for estate tax inclusion. Nevertheless, even a perfectly designed and implemented estate planning technique can result in estate tax inclusion based on post-implementation actions.

[8] Risk of Law Change. The risk of a change in the law or in the interpretation of a law is one that can occur either prior to or after implementation.

[9] Risk of Doing Nothing. Estate planners often compare a proposed planning technique with doing nothing. Most estate planners do not accurately portray or estimate this risk by failing to consider realistically possible events, such as downturns in net worth, etc. Many estate planners illustrate the "cost of doing nothing" as merely the tax savings to be achieved if the technique is implemented. Nevertheless, there is a cost to inaction or to failure to timely act. It might be the loss of available gift tax exclusions. It might be the increase in a client's estate through failure to divest an asset that appreciates in value. It may be subsequent changes in the law. Unfortunately, some estate planners are the reason why the client does nothing, too often because the estate planner is unable to sufficiently explain the proposed technique and the risks to the client.

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7 IRC Sec. 302(b)(3).

[10] Risk of Technique That Has Effect Contrary to Client's Intentions. Some estate planning techniques or designs can produce effects that are contrary to a client's intentions. Sometimes, these potential adverse results are counterintuitive; others are reasonably foreseeable. It sometimes takes patience and deeper analysis to play a scenario out to ascertain the existence of possible unwanted effects so as to either redesign or plan accordingly.

[11] Risk of Changes in Circumstances. Significant changes in circumstances present significant difficulties because sometimes their effects are felt whether or not the technique is used. Nevertheless, the estate planner should endeavor to gauge the client's exposure to a change in circumstance such as loss in net worth or loss of income on the client's fit with a particular technique.

[12] Risk of Paying Too Much Tax. The risk of paying too much tax can occur either through improvident execution of a technique, such as a taxable gift of an asset that declines in value prior to the donor's death (when it could have been bequeathed to the recipient at the lower death value) or improvident inaction (through failure to utilize a technique that would have reduced tax). It can apply to both income and transfer tax.

[13] Risk of Uncertainty in Law Interpretation. Several estate planning tools and techniques have significant unknowns as to the ultimate tax effect, e.g., whether assets inside of an intentionally defective grantor trust obtain a new income tax basis at the grantor's death. The risk of employing an estate planning technique that has uncertainty in the interpretation of applicable law can be a very significant risk in estate planning, and estate planners must clearly articulate these risks in writing to the client.

2.04 Examples of Poor or Inappropriate Estate Planning Technique or Design.

[A] Introduction. The two examples of poor or unfortunate design that are included below are not intended to be singled out. Indeed, these applications certainly are not the worst estate plans that have ever been devised. Their inclusion in this monograph in no way signifies any opinion that either fact pattern involved negligence on the part of the estate planners. However, both fact patterns are

instructive and illustrative of the sorts of problems associated with inappropriate or unfortunate estate planning selection and design.

[B] Martin.

[1] The Situation. In *Martin v. The Ohio State University Foundation, et al.*,[8] former clients, sued their former professional advisors and a foundation that the Martins claimed to have improperly benefitted from an estate plan gone bad. When they entered into the plan, the Martins were in their 60's and had annual income of approximately $24,000. They owned a piece of essentially non-income producing property that was worth approximately $1,300,000 that was encumbered by a small loan. The Martins' expressed estate planning goals were to sell the real estate and buy retirement property in Florida. Mr. Martin was not in great health and was uninsurable by himself.

[2] The Proposed Plan. The advisors proposed a 8% (ultimately reduced to 7% at the foundation's request) net income with remainder charitable remainder unitrust ("NIMCRUT") as the estate planning technique that would solve the Martins" problems, combined with a $1,000,000 life insurance policy on Mrs. Martin's life that called for a premium of approximately $45,000 for several years. There was conflicting testimony as to whether the Martins were told that they would not receive any distributions from the NIMCRUT until the NIMCRUT sold the real estate, which did not happen for over two years following creation of the NIMCRUT. However, apparently unaware that they were not going to receive any money from the NIMCRUT until the real estate was sold, the Martins paid the first premium on the life insurance policy (which was due immediately) as well as a down payment on their Florida retirement property shortly after forming the NIMCRUT.

[3] The Plan Implodes. Unfortunately for the Martins, and ultimately, their former professional advisors, the insurance premiums were due immediately. The Martins ultimately could not afford to pay the premiums on the "wealth replacement" life insurance policy, despite reducing the initial policy death benefit

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[8] 139 Ohio App. 3d 89, 742 N.E. 2d 1198 (10th Div. 2000).

by 75%, and the policy lapsed before they received the first distribution from the NIMCRUT.

[4] Advance Clues as to Problems with the Plan. One did not have to evaluate the "he said she said" of the testimony and other evidence adduced at the hearing, which largely focused upon the Martins" allegations of fraud, negligent misrepresentation and breach of fiduciary duty against their former advisors. There were plenty of clues that the proposed estate plan was problematic from the outset, even setting aside the issue of whether the advisors' enthusiasm for the plan was in the $30,000 commission to be generated by the life insurance policy sale. For starters, there was a significant gap between the Martins' current income and the proposed expenditures for the Florida retirement property and the life insurance. The latter expense, by itself, was almost double the Martins' annual pre-tax income.

It seems clear from the opinion that the lynch-pin of the proposed estate plan was the liquidity to be created by the sale of the real estate that had been contributed to the NIMCRUT. There were clues that it might take some time to sell the property. When the NIMCRUT was formed, the real estate had already been for sale for five years. If the sales proceeds from the real estate were critical to funding the Martins' desires (and the NIMCRUT payments), there apparently were no contingency plans for an extended delay in the sale of the real estate. Therefore, the Martins first dropped part of the insurance policy, and then dropped the entire policy. In fact, the real estate in the NIMCRUT didn't sell for over two more years after having been placed therein.

[5] The Alleged Problems with the Advisors' Technique Work. The appellate court, in reversing the trial court's directed verdict against the Martins, found that the Martins' former advisors had committed the following offenses:

> They presented illustrations that were at odds with the potentially true situation. The illustrations showed the Martins were going to begin receiving distributions from the NIMCRUT immediately, even though those distributions could not commence until the real estate was sold.

The advisors omitted giving the Martins a memo comment from the foundation representative that the Martins would not receive any distributions until the NIMCRUT sold the real estate.

They only illustrated two possible plans (the NIMCRUT/Replacement Life Insurance Plan versus an installment sale of the real estate), and told the Martins that the latter plan was a "bad plan."

The estate planners arranged for a tax lawyer to draft the NIMCRUT, which the Martins did not even see until the day that the NIMCRUT was executed.

While Model Rules of Professional Conduct, Rule 1.2 permits lawyers to tailor the scope of representation, it is unclear as to whether, or to what scope, an estate planning attorney can exclude responsibility for estate planning evaluation or design, but query how much this exclusion can cover.

[C] Armstrong

[1] The Background. The situation involving the Armstrong family did not arise in the context of a lawsuit against professional advisors, but rather in tax cases. The father, then age 91, was the majority shareholder of a closely held company. The father had recently made donations of real estate to "two young women with whom [the father] had kept company."

His adult children, possibly already weary over having to wait so long to inherit, seemed to have become nervous over the prospects of losing the closely-held business. The father and his children apparently began to negotiate. Everyone had wants and needs.

[2] The Parties' Desires. The kids wanted immediate control of the family company and metaphysical certitude that they would not be displaced. The father was not opposed to his children's desires, but he wanted and needed the same amount of income that he was enjoying now. The father also did not want to pay any of the transaction expenses. Neither the father nor the children wanted to have to pay any current taxes.

During the estate planning process, both the father and his children expressly rejected both a "net gift" arrangement, which would have required the children to pay the taxes, as well as a traditional gift arrangement, which would have required the father to pay gift taxes. The wise estate planner confirmed these rejections in a letter.

[3] The Plan. The father and the children implemented the following plan in December 1991 and January 1992:

In the December 1991 leg, the father gifted some shares of common stock in the family company to the children. The family company redeemed all of the father's preferred stock in exchange for a private annuity. In the January 1992 leg, the father gifted some of his family company common shares to children and to trusts for the benefit of his grandchildren. The family company redeemed the balance of the father's common stock in exchange for a non-negotiable promissory note. The father then assigned that note to a grantor trust in which the father was the sole beneficiary. The trustee was obligated to pay the gift and income taxes generated by the transactions. The children agreed to be responsible for any additional gift tax incurred on subsequent IRS audit.

[4] The Plan Implodes. The stock in the family company was all valued at $100 per share for the transactions. The trust paid all but approximately $40,000 of the father's income and gift taxes. The IRS subsequently questioned the valuation of the donated stock and proposed a higher value ($109 per share). In the meantime, and within three years of the gifts, the father died.

The father’s executor did not include any of the gift tax paid within three years of the father's death, despite IRC Sec. 2035(b). The IRS audited the father's estate tax return and adjusted it upward to include the roughly $4.2 million in gift tax paid within three years of the father's death pursuant to IRC Sec. 2035(b). The added tax left the father's estate insolvent. IRS pursued the donees in separate actions.

The donees and the estate sought refund of all of the gift tax paid, and they made several arguments in favor of refund. First, the donees argued that the transfers were not really gifts at all, in part because the donees asserted (remarkably, per the opinion) that the father in effect retained the power to revoke the gift by "refusing to accept heroic measures and procedures for prolonging his life or by otherwise acting, or refusing to act, in a manner calculated to eliminate his chance of

surviving for three years [which would have eliminated the IRC Sec. 2035(b) inclusion element]." The donees argued that the benefit of the gift was eviscerated by the transferee liability for the estate tax generated by the IRC Sec. 2035(b) inclusion.

The donees also argued that the arrangement really was a "net gift," which should have reduced the size of the gift by the amount of gift taxes. The children pointed to their agreement to be responsible for the taxes. The court easily disposed of this argument. First, the court pointed to the letter from counsel that confirmed the parties' express rejection of the net gift arrangement. Moreover, the court felt that the children's argument that they were responsible for the gift tax was undercut by the existence of the grantor trust and the express requirement in the trust instrument that the trustee pay those taxes. The court further pointed out that the trust in fact paid the taxes in question. The court further highlighted that the agreement to pay gift tax was limited to additional gift tax on IRS audit, not the gift tax as per the gift tax returns. The court found the children's legal obligation to pay even additional gift tax to be illusory.

[5] Reasonably Foreseeable Problems With the Techniques Selected. From the standpoint of estate planning tools and techniques, given the father's age, one might be tempted to ask why the parties even risked IRC Sec. 2035(b) inclusion. The real question is why they used a gift at all. The father did not appear to possess significant lifetime donative intent, as he waited until he was 91 years old to part with control. Additionally, the father only agreed to engage in the plan if he continued to receive the same level of income that he had been receiving prior to the transactions. The father also did not want to pay any gift tax. Generally, people who decide to make large taxable gifts are resigned to pay the gift tax, even if they are only resigned to that fact, since IRC Sec. 2502(c) provides that donors are liable for gift tax. The father essentially was transferring much of his net worth–usually contrary to classic gifting advice. The risk of valuation uncertainties also do not seem to have been addressed in the plan. The family put together a transaction that seems to have belied the truth, and it has thus far resulted in seven reported decisions at the federal level.[9]

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[9] *Estate of Frank Armstrong, Jr., et al. v. Comr.*, 119 T.C. No. 13 (2002); *Estate of Frank Armstrong v. United States*, 277 F. 3d 490 (4th Cir. 2002); *United States v. Frank Armstrong, Jr. Trust*, 86 AFTR. 2d 2000-6674 (W.D. Va. 2000); *Estate of Frank Armstrong, Jr. v.*

2.05 Reasons for Poor Technique Selection.

Typically, the reasons why a client ends up with a less than optimal estate planning technique or design scheme include:

> *Lack of sufficient accurate information provided to the estate planner.* Some clients are better than others in providing complete and accurate information to estate planners. Estate planners should be aware that some clients, whether purposefully or unintentionally, do not provide either accurate or complete information. Inaccurate or incomplete information can ruin an estate planning technique or cause it to underperform.
>
> *Estate planner failure to ask for enough information or to fully analyze the information provided so as to find inconsistencies or contraindications ("side effects") that would indicate a possible need for a different technique or design.* Estate planning techniques differ significantly on the amount of due diligence required to prevent miscues or to minimize "side effects" in the implementation phase. However, the same is also true with respect to evaluating the "fit" between a client and a particular technique. Some techniques require information from more people than just the client, such as in a family limited partnership or any other split interest technique.
>
> *Changes in client situation following selection and implementation.* Dramatic changes in a client's situation, especially adverse changes, often are not the fault of the estate planner. To the extent that adverse changes can be mitigated or planned for in advance, the possibility for an adverse change should at least be contemplated. Quite often, the adverse change comes in the form of sudden loss of income or value, each of which usually indicates a lack of diversification of income and wealth, and each of which is to some

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United States, 85 AFTR. 2d 2000-1320 (W.D. Va. 2000); *Frank Armstrong, III, et al. v. United States*, 7 F. Supp. 2d 758, 82 AFTR 2d 98-5008, 98-2 USTC P 50,518 (W.D. Va. 1998); *Frank Armstrong, Jr. Trust v. United States*, 132 F. Supp. 2d 421, 87 AFTR 2d 2001-707 (W.D. Va. 2001); *Armstrong v. Comr.*, 114 T.C. 94 (2000).

extent preventable. Clients have sued advisers where subsequent events such as valuation declines impacted the viability of an estate planning technique.[10]

Estate planner over focus on certain facts in the evaluation and design phase to the exclusion of other significant facts. Estate planners can focus on the value of an asset or of an estate in determining the appropriate technique. In so doing, estate planners can overlook a key fact that might militate either toward doing nothing during lifetime or recommending a different technique, such as how much diversification of income that the client has or the relationships between the client and other players.

Estate planner failure to adequately consider alternative techniques or designs, or to simply refrain from recommending lifetime planning techniques. Over time, estate planners can build up prejudices in favor of and against certain estate planning techniques and design parameters. Some of these prejudices or biases are overt, while others are subtle or even subconscious. Sometimes it is a matter of an estate planner not wanting to leave his or her comfort zone or a failure on the estate planner's part to stay abreast of new estate planning techniques and new twists on old ones, or more importantly, insufficient information about the long-term effects of a particular technique.

Estate planner belief that taking some estate planning step always costs less than doing nothing. Stated differently, many estate planners labor under the assumption that because of the estate tax rates, any technique that projects estate tax savings in excess of the technique transaction cost is worth it to the client. This view overlooks other possible costs, including loss of access to capital or to income, as well as possible incurrence of tax liability before it might otherwise have been incurred.

Bad drafting. Obviously, the best designed estate planning technique will not perform optimally if the drafting of the documents used to implement the technique is flawed.

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10 *Goldberg v. Frye*, 217 Cal. App. 3d 1258, 266 Cal. Rptr. 483 (4th Dis. 1990).

Miscalculation or inaccurate valuation. The subjectivity of valuation must be taken as a given. Thus, this subjectivity must be factored into the design of the estate planning technique, whether through the use of formula or other methods.

Solution for one estate planning problem that causes another. Estate planning techniques have side effects. Just like prescribed medicines, an estate planning technique that solves one problem may well cause another.

Failure to consider an exit or contingency strategy for changed circumstances. Some estate planning techniques require cooperation of people for a long time. Some estate planning strategies can be affected by subsequent changes in the law. Prudent estate planners should consider exit strategies, or at least point out to clients that there may be no easy exit, before the technique is implemented. Consider the second of the late Dr. Stephen Covey's *Seven Habits of Highly Effective People*: Plan with the end in mind.

Failure to properly advise clients as to uncertainties in the law concerning a technique. The proliferation of estate planning techniques and a flurry of changes in the law have created significant uncertainties with respect to the viability of techniques. Some estate planners become numb to the new reality of uncertainty, and they fail to properly inform clients as to uncertainties in the law, to which clients are not numb.

Failure to properly administer or follow through on a technique. Some estate planning techniques require significant administration after implementation. Failure to properly administer the technique can ruin an otherwise flawless implementation. An example of this problem includes the charitable remainder trust that is improperly administered. In *Atkinson Est. v. Comr.*,[11] the Tax Court struck down an otherwise valid charitable remainder trust because it was not administered pursuant to the strict requirements for charitable remainder trusts. Courts have essentially

[11] 115 T.C. No. 3 (2000), aff'd, 309 F. 3d 1290 (11th Cir. 2002).

disregarded family limited partnerships where the families themselves failed to observe the formalities.[12]

Adverse developments in, or interpretations of, the law. Many estate planners fashion and implement techniques under the assumption that a law will be interpreted in a certain way. Some estate planners may actually structure techniques assuming that the law will be administered in a certain way. Estate planners should know that unless and until the IRS and the courts agree with the estate planner's interpretation, there is a risk that subsequent administration or interpretation, even subsequent legislation, could impact the viability of the technique. The pressure to be creative and to save taxes sometimes leads to a false sense of security, especially since there is a dangerous lag time between implementation of a "cutting edge" technique and ultimate determination of the tax consequences of the technique or design.

Other problems, including conveyances. This "catch-all" category covers all other errors that can happen in the evaluation, design and implementation of an estate planning technique.

2.06 Caution Advisable as to any Lifetime Transfers.

Often, estate planners break estate planning considerations down to whether the client can afford to do lifetime estate planning. Of course, estate planners to often attempt to make the determination whether the client can afford to do lifetime gifting, instead of the client's determination on that score. Sometimes, the estate planner's advice is couched in terms of what the client cannot afford **not** to do, particularly in the area of annual exclusion gifting. In retrospect, many clients who engaged in annual exclusion gifting ultimately cut back on those gifts because of fear of running out of money or because of actually running out or short of money.

[12] *Thompson Est. v. Comr.*, T.C. Memo. 2002-246; *Reichardt Est. v. Comr.*, 114 T.C. 144 (2000); *Harper Est. v. Comr.*, T.C. Memo. 2002-121; *Schauerhamer Est. v. Comr.*, T.C. Memo. 1997-242.

A common example of inappropriate annual exclusion gifting occurs when clients make systematic annual exclusion gifts of income producing property yet continue to receive income attributed to the gifted property that is not reduced or substantially affected by the gift, e.g., gifts of interests in closely-held entities when the senior generation continue to receive salary or rent or other forms of consideration. If a sales opportunity for the entity materializes, the senior generation may look adversely at the opportunity, even where the offered price is more than fair (or even generous), if the senior generation's share of the offer price would be insufficient (due to prior lifetime transfers) to generate the income that the senior generation presently enjoys. The junior generation may pass on the sales opportunity, despite the favorable offer, in order to maintain family peace in the valley.

Chapter 3: Factors that can Influence the Selection and Design of Estate Planning Techniques-Generally.

3.01 Introduction.

The estate planning techniques discussed in this monograph can be grouped into those techniques that are stand-alone and those techniques that are used in conjunction with other techniques.

In practice, some estate planners tend to evaluate or recommend techniques based in large part on what the estate planner believes a client will or will not do or understand or what IRS or the courts think (or may think) about the technique. Sometimes, technique design and selection are informed almost solely by the nature of a client's asset makeup or by the limitations of the client's wealth or life needs.

3.02 The Three Categories of Factors Influencing Technique Evaluation and Design.

The issues bearing upon selection and design of an estate planning technique appear to break down into three basic categories: (1) those related to the particular types of assets that will be transferred in, or impacted by, the technique; (2) those

peculiar to the estate planning technique itself; and (3) those relating to the "players." The term "players" includes not only the client, but also the client's family and any other person significantly impacted by a particular estate planning technique, including unrelated third parties such as lenders, partners, suppliers, etc. Some of the considerations discussed below in each of the three basic categories may seem repetitive, but caution is encouraged in this regard. While some of these considerations are related and interactive with one another, there are subtle differences between the consideration when viewed through the lens of each category, e.g., the assets, the technique and the players, that can make a significant difference, positive or negative, on an estate planning technique.

As discussed above, quite often the decision concerning technique selection is based solely upon one factor, e.g., a QPRT is implemented because the clients have a valuable home, without considering whether the clients can stand the loss of access to capital. In other words, the knee-jerk recognition of the fit between technique and asset may cause the estate planner to miss the obvious. However, the questions and commentary that follow in the next section attempt to explore in a more in-depth manner the "fit" of a technique to a client's situation. Some of the answers may provide conflicting indications of the appropriateness of a technique or design. The best fit between technique, asset and design will not guarantee a great result, but it gives the best chance of success.

Chapter 4: Asset-Related Technique Evaluation and Selection Issues.

4.01 Valuation.

[A] Generally. The nature of the federal transfer tax makes valuation one of the most important issues to evaluate in estate planning. The costs and risks of valuation simply cannot be ignored in evaluating and designing estate planning techniques.

[B] Valuation Factors.

Does the asset have a value that is readily ascertainable without having to resort to an appraisal? The subjectivity and impreciseness of valuation entails a risk that an estate planner must factor into the technique evaluation and design process, one that estate planners should discuss with clients. There are three principal risks associated with valuation: error in ascertaining value (either too high or too low), the cost of ascertaining value and the costs (financial and non-financial) of disputing and resolving value.

Where is the asset's current value in relation to its historical high and low values? The relative values of many assets ebb and flow over time, often in business cycles. It often is important to have a feel for where the current value of an asset is in relation to its historic high and low values. For example, if an asset is on the higher end of its historic value, it may not be appropriate to transfer that asset in a technique that requires the payment of consideration pegged at the high value as there is a risk of moving wealth upstream, especially if the asset's value recedes.

If the asset must be appraised, what is the range of possible values of the asset? While historic ranges of value present difficulty in technique evaluation and design, the current range of value of a particular asset is a separate risk to consider. Valuation may be expressed in the form of a single number or as a range. Depending upon assumptions made by an appraiser, each of the three valuation approaches, i.e., market, income and asset-based, generates separate indications of value. These indications of value could be construed as the range of value of that asset, which may or may not be the range. However, each valuation approach itself can generate a range of possible value indications. Sometimes, the range of values can be large. It can be important in the design and evaluation phase to know the size of the range of values of an asset, e.g., to evaluate the risk of tax recharacterization.

What is the volatility of the asset's value? What factors contribute to the value volatility and how might any of those factors affect use of the particular estate planning technique? The risk of volatility is related to, but separate from, the risk of range of value because volatility in value can risk the loss of tax benefits through post-implementation changes in value. Many assets are particularly subject to value volatility, and there are many possible reasons for this volatility, e.g., dependence upon a small number of customers or suppliers.

What is the asset's present value relative to its adjusted income tax basis? In the evaluation and design phase, the estate planner must consider the spread between an asset's current fair market value and the client's adjusted tax basis in that asset. An asset's fair market value and adjusted tax basis also must be considered against the backdrop of the current level of debt, if any, secured by or otherwise burdening the asset. Not only should the spread between current adjusted basis and fair market value be considered, but how that spread may be impacted or even eliminated, by subsequent events, e.g., a new basis at death under current IRC Sec. 1014.

As a percentage of the value of the client's estate, what is the asset's concentration? Concentration plays a critical role in investment advice due to the general advisability of diversification. The wisdom of diversification is timeless and goes back at least as far as the admonition in *Aesop's Fables* to not "put all of one's eggs in one basket." Estate planners also need to consider asset concentration in the selection and design of an estate planning technique. There may be little that a client can do immediately about a heavy concentration in a particular asset. However, the estate planner needs to carefully consider how that heavy asset concentration could impact the client's vulnerability with respect to a particular technique.

In *Goldberg v. Frye*,[13] the value of an asset used in a lifetime estate planning technique went down, putting the squeeze on other techniques and resulting in a lawsuit against the estate planner.

Is the technique impacted either by pre- or post- implementation by value volatility, and if so, how? Volatility in value of an asset can present some significant obstacles and matters to consider in the evaluation and design of a technique for that asset. All other things being equal, the more volatile the value of the asset, the more cautious that an estate planner should be in recommending a technique that pegs value in a use that triggers either gift or income tax or a payment obligation, such as a taxable gift or installment sale of a highly volatile asset.

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[13] 217 Cal. App. 3d 1258, 266 Cal. Rptr. 483 (4th Dis. 1990).

4.02 Use and Management.

[A] Generally. The present (and potential future) use of an asset can significantly impact the evaluation or design of an estate planning technique.

[B] Use and Management Factors.

Is an asset's value or present use tied or related in any way to any other asset or purpose, and, if so, to what asset or purpose, e.g., closely held business entity operating on real estate owned separately by the client or by other players? Quite often, estate planning technique decisions are hastily made on consideration of one issue, e.g., value or appreciation potential, to the exclusion of other factors that may be as important, if not more so. One of these other factors often is how the asset presently is being deployed. The present use of the other asset may well contraindicate the use of certain techniques.

Sometimes, the use of an asset in a technique will impact another asset, and estate planners should consider that effect. For example, a closely-held business may lease its operating property from the client or another related person. Estate planning with the business entity interest may necessitate consideration of the contractual arrangements and ownership of the leased property. In some situations, a buy-sell agreement involving the closely-held business interest may include the leased property as well.

What management skills or efforts does the asset require, and how might the estate planning technique or the players involved impact the management of the asset? Assets vary dramatically in the level of management skills and effort required. This can impact the technique evaluation and design. This consideration also can impact the identity of the recipient of the asset, who will manage the asset as well as whether the client should retain the asset.

A fairly routinely faced example of this is rental real estate being managed by a client who is getting up in years. The client is laboring under the assumption that her children will manage the real estate as she has. The problem is that the children have never shown any interest in being burdened by real estate management chores, or they have already demonstrated a considerable lack of talent in so doing.

Yet the client is insistent on utilizing a technique that will allow her heirs to preserve her real estate portfolio intact. In such a situation, the scheme should be designed to be able to facilitate and afford third party management. This could well eliminate an installment sale from consideration given that there will be principal and interest payments coming out from the real estate revenues, which could put a squeeze on the property's profitability and the management expenses.

What are the costs of maintenance and capital requirements of the asset to be used in the technique? Assets widely vary in the amount of maintenance and capital requirements. These costs must be factored into the technique evaluation and design process, particularly where the technique itself has costs of maintenance and payouts on top of the asset cost requirements.

What is the asset's remaining useful economic life? What factors might affect the asset's useful life, e.g., technological obsolescence, demographic shifts, real estate neighborhood trends, etc.? This factor goes to the heart of both value and the advisability of engaging in a technique with a particular asset. If the asset has risks of losing value or is expected to significantly decline in value, then this factor will impact whether certain techniques, such as outright donations, split-interest donations or installment sales, should be used, especially since the payment obligations or taxable gifts will be calculated at the higher values, but the payments will have to be amortized out of lower values. It also can impact whether the long-term worth of an asset is too speculative to utilize certain planning techniques. For example, if the likelihood that an asset will not hold value for the long-term, it may not be worth it to use gift tax exemptions to shelter the gift of such an asset, since the value may disappear.

Does the asset generate current net cash flow, and, if so, how much, and is the cash flow positive or negative? Assets vary significantly in the amount of net cash flow that the asset generates. Asset cash flow can impact technique selection and design because some techniques require cash flow.

Does the asset possess, by its nature, separate management authority or control from the right to economic benefits of the asset? LLC interests and assignee interests in partnerships and LLCs come to mind here, but non-voting stock can give the same effective result. However, the ability to separate management

control from economic enjoyment of an asset can be very important in the design of an estate planning technique.

What is the prospect for appreciation or depreciation of the asset? What is the expected level of appreciation or depreciation, and when might it be reasonably expected to occur? Some estate planning techniques, e.g., GRAT, only provide a net benefit if the asset appreciates in excess of the IRC Sec. 7520 rate.

4.03 Ease of Transfer/Division.

[A] Generally.

The ease by which an asset may be divided or transferred can have a significant impact on an estate plan, and in particular, on the selection or design of an estate planning technique.

[B] Ease of Transfer/Division Factors.

How susceptible to transfer is the asset? Is third party consent required? Estate planners routinely face third party involvement in the estate planning process, which can involve lenders, business partners or others. Before a technique is implemented, and possibly even before a technique is recommended to a particular client, the estate planner should know whether obstacles to transfer of an asset exist. This question is related to, yet is distinct from, the question of tax and non-tax costs of the transfer. The possible tax and non-tax costs of a technique are irrelevant if the asset cannot be transferred, or if the transfer is subject to negotiation or to some other transfer procedure. The estate planner must consider both the current and potential future impacts on transferability.

How marketable is the asset? What is a realistically probable time to sell the asset? Who are likely potential buyers? This is an important consideration in that it can point to possible contingency plans as well as the selection or design of the technique. Liquidity is necessary in many lifetime techniques, and it is critical in some techniques, e.g., charitable remainder trust or private annuity. If the technique will commence with an illiquid asset it is imperative to analyze possible sales and length of time to sell. The marketability of related assets also can play a

role in technique evaluation or design, especially if that property is heavily dependent on the other asset, such as property that may be constrained in alternative use, e.g., effectively single use property like an automobile dealership property.

What transfer costs would be incurred in transferring the asset in implementing the technique? Asset transfer costs can range from virtually nothing to considerable outlays. The estate planner must investigate the costs of transferring the asset prior to the implementation phase.

Is the client or any of the players emotionally attached to the asset to be used in the technique for the asset itself (instead of the economic value represented by the asset)? Clients do not always base estate planning decisions on a bottom line consideration of taxes. If the client or one of the players has an emotional attachment to the asset, whether it is the stock of a family company or the stock of a publicly traded company for which a parent or other family member worked or even a piece of real estate that has been in the family for a long time, any technique that involves transfer of that asset is likely not to be accepted by the client. This is not to say that the estate planner should not advise a client to transfer an "emotional" asset, especially where that asset occupies a significant portion of the client's portfolio, even if the advisor knows that the client is unlikely to heed that advice.

How susceptible to division is the asset? Some assets are readily divisible without significant expense or diminution in value. The ease by which an asset may be divided without significant expense or reduction in value impacts technique selection and design, particularly in designing for changes in circumstances. One example of this is whether a corporation has more than one line of active trade or business so that the corporation could be divided on a tax-free basis pursuant to IRC Sec. 355.[14] A corporation that operated passive assets would not be as easily divided due to the restrictions of IRC Sec. 355.

Has the client already promised the asset to anyone or otherwise intimated that the asset would go to someone, and, if so, to whom? This is not to say that clients

[14] See, e.g., PLR 200239002.

cannot change their minds about the recipient of a particular asset. However, the estate planner should inquire as to whether a client has promised or otherwise intimated to anyone that a certain person would either get the asset or get control over it. Fallen expectations, legitimate or otherwise, can impact the viability of an estate plan, and can give rise to lawsuits against estate planners. Sometimes, it is important to know whether the client is prone to such discussions.

Is the client, or any of the players, either currently, or in the future, economically dependent upon either the income or capital represented by the asset? Simply stated, economic dependence on a particular asset, particularly on the capital represented by the asset, necessitates caution in any lifetime technique. Indeed, such dependence may well justify not going through with a lifetime technique. At a minimum, the estate planner should identify the vulnerable parties and attempt to fashion a plan that minimizes this vulnerability consistent with the client's desires.

Are there any income tax consequences involved in implementing the technique with a particular asset, and, if so, what are those consequences? While a consideration of income tax consequences is paramount prior to the implementation of an estate planning tool or technique, income tax often gets overlooked due to a focus on transfer tax consequences. Income tax costs often impact the salability of property in the eyes of the client, and, as such, can impact transferability or, at least, the mode of transfer.

4.04 Asset as Collateral.

[A] Generally. The desirability or attractiveness of an asset as viable collateral plays a definite role in the evaluation and design of many estate planning techniques.

[B] Asset as Collateral Factors.

Is the asset to be employed in the technique encumbered by a security interest or lien? Liens or encumbrances definitely affect design or selection of an estate planning technique. Some techniques, e.g., a charitable remainder trust, cannot really be implemented with encumbered property without some preliminary planning. Other techniques permit encumbered property to be used, but this can

add considerable complexity or risk to the technique to be used. Estate planning techniques have particular characteristics, both positives and negatives.

How difficult is it to seize the economic benefits represented by the asset? Asset protection often plays a key role in estate planning, particularly asset protection for a recipient of property who is obligated to make payments. Some assets have less susceptibility to seizure than other assets, e.g., LLC membership interests and assets that are subject to a superior lien or encumbrance. Other assets, while seizable, may not be as appetizing to creditors, including non-voting stock, non-control interests, assignee interests, etc.

Would a third party consider the asset to be good collateral? Somewhat related to the preceding question, whether a third party would consider an asset to be good collateral may assist in the fashioning of a possible exit strategy.

Chapter 5: Technique-Related Issues.

5.01 Introduction.

There are considerations in the estate planning process that focus upon the characteristics of the potential technique. The essential characteristics of an estate planning technique, and the design features that are possible with each, are important to consider in the evaluation and design process.

5.02 Technique-Related Factors.

[A] Creation and Separate Existence.

Does the technique involve the creation of a separate entity? Some techniques involve creation of a separate entity, while other techniques do not. New entities bring with them additional costs of maintenance and record keeping, including new tax or information returns, which may not fit the clients well.

Are there any governing instrument language requirements for the technique? Techniques have certain requirements for validity and respect both for tax and non-

tax purposes. However, some techniques, e.g., charitable remainder trusts, QPRT's and GRAT's, have provisions that are required to be included in the document for tax purposes.[15]

Does the technique have to remain in existence for a period of time to become a net benefit? If so, is it a matter of the technique either providing less benefit or actually becoming a detriment (compared to doing nothing)? Some techniques, e.g., a GRAT, have to remain in existence for a specified period of time in order to generate a new transfer tax benefit.[16]

Can the technique remain in existence for too long period, i.e., provide no benefit if it is in existence for too long? Some techniques, e.g., a regular private annuity, won't generate a net transfer tax benefit if the annuitant outlives actuarial life expectancy, if the annuity obligation continues even past the point of having paid the annuitant back all of his principal. The same can be said for the death-terminating installment note, where the note payee lives past the age of projected mortality.

[B] Valuation.

Does use of the technique require a valuation, and, if so, how many and when? Most techniques require at least one valuation, unless the asset being used consists of cash or marketable securities. Some techniques, e.g., private unitrusts, charitable remainder unitrusts and charitable lead unitrusts, require annual valuations. Valuations can add significant cost and uncertainty to a technique. One risk is the possibility that appraisal costs will cause the client to fudge on the necessary valuations. The uncertainty and subjectivity of valuation may necessitate special attention in the design phase.

Does the valuation volatility of the asset used affect the technique, and, if so, how? May valuation volatility be minimized, and, if so, how? Valuation volatility is a risk on the asset side, but it also presents risk in the area of technique selection and design.

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15 See, e.g., Treas. Reg. Sec. 25.2702-5(c).
16 Add Badgley cite

Does the effectiveness of the technique depend upon the subsequent appreciation of the asset and, if so, how, and may the risk of depreciation be minimized? It is obvious that subsequent appreciation of an asset enhances any estate planning technique. However, some techniques will not achieve net wealth transfer success unless the property appreciates at a certain rate. For example, property in a GRAT must appreciate more than the IRC Sec. 7520 rate in order to confer a net estate planning benefit.

[C] Taxation.

Does the technique require a tax return, and, if so, how many? Some estate planning techniques require no additional tax returns; some require numerous additional tax returns. While tax return considerations would rarely, if ever, solely, inform the selection or design of a particular estate planning technique, the estate planner should discuss this issue with the client, if for no other reason, to coordinate delegation of the responsibility for preparation and filing of any new tax returns. Additionally, some clients have trouble tolerating the perceived additional cost and complexity associated with additional tax returns.

Is the technique a tax-reportable transaction, and, if so, what taxes are involved? Some techniques, e.g., a bargain sale, are reportable for both income and transfer tax purposes. Some techniques are only reportable for either income, e.g., installment sales, or transfer tax purposes, e.g., gifts. Applications of some techniques may be reportable for neither. There could be a question or issue as to whether the technique is a tax-reportable transaction. Whether or not the technique involves a tax-reportable transaction impacts the due diligence required in preparing to implement the technique.

Does the technique offer any transfer tax finality? The risk of change in the tax consequences of an estate planning technique or design is significant. Nevertheless, finality in transfer tax consequences is a desirable outcome, and many clients desire, and even require, this certainty. Unfortunately, estate planning techniques vary widely in this regard. The IRS has been hostile to many attempts to achieve transfer tax finality on the grounds that they violate public policy,[17]

[17] *Procter*, etc. However, taxpayers have had considerably more success in court with defined value clauses and transactions.

Some techniques, including the GRAT and split-interest charitable trusts, offer regulatory protection in the way of continuing tax qualification in the event of revaluation.[18] Other techniques, including private annuities and defined value gifts, through the use of formulas, should be able to achieve transfer tax finality, although the IRS may well disagree.

What is the level of tax law uncertainty of the technique? How vulnerable is the technique to law changes, either through legislation or jurisprudential/regulatory developments? Can these risks be minimized and, if so, how easily? How easy would it be to minimize these risks? Fast moving changes bring with them uncertainties. And so do fast moving innovations in estate planning. Clients should be told this, and often. Some estate planning techniques, or variations on techniques, e.g., limited partnerships, outright gifts and traditional trusts, have long standing existence in state law and offer relatively little risk of uncertainty in state law. Other techniques, e.g., LLC's and private unitrusts, are still of fairly recent vintage and have generated relatively little judicial interpretation or legislative amendment, but these techniques could be adversely affected by subsequent amendment and judicial interpretation. These techniques offer much more uncertainty and prospect for adverse judicial interpretation. One problem with "cutting edge" techniques or designs is that they are replete with uncertainty as to tax consequences. Estate planners simply must identify this risk to clients before implementation, or the estate planner risks lawsuit. In *Williams v. Ely*,[19] a malpractice action involving the tax consequences of a disclaimer, the court stated:[20]

> The problem is not that Gaston Snow gave reasonable advice that in good time proved to be wrong. The problem is that the apparent certainty of the opinion given, at a time when the issue was not conclusively resolved, denied the plaintiffs the opportunity to assess the risk and to elect to follow alternative estate planning options.

Are there risks of gift tax audit of the technique, and, if so, how severe are they and can they be minimized? With the enactment of IRC Sec. 6501(c)(9), the prudent

18 See, e.g., Treas. Reg. Sec. 1.664-2(a)(1)(iii).
19 423 Mass. 467, 668 N.E. 2d 799 (1996).
20 Id at 476.

estate planner takes the position that the gift tax statute of limitations may never go away. All techniques that have a gift (or any potential for a gift) have a risk of audit. Although some taxpayers who are audited may not agree while an audit is ongoing, the prospect of audit is important and serves as a governor on excessive and abusive transfers and encourages tax compliance.

Estate planning techniques vary widely in the risk of audit or subsequent adjustment. Often, the nature or value of the asset deployed in a technique significantly informs the risk of audit. Nevertheless, the technique or design also separately impacts the risk of audit. Some techniques, e.g., limited partnerships and LLCs, arguably increase the risk of audit even in the case of proper execution and administration.

Techniques vary widely in the possibility for minimizing the adverse impact of an audit.

What is the risk that the technique can be recharacterized, and what effects would likely flow from recharacterization? The risk of recharacterization and magnitude of that risk differs significantly from technique to technique. Some techniques could have recharacterization effects for both income and transfer tax purposes.

Is there a risk that the technique will implode if the client does not survive for a specific period of time, and, if so, what are those risks and how can those risks be minimized? The GRAT is virtually useless unless the client survives the entire GRAT terms, so careful thought must go into establishment of the GRAT term.

If the technique does not involve a gift tax reportable transfer, what is the ultimate transfer tax risk of the technique? Annual exclusion gifts come to mind here. The fact that no reporting is done for gift tax purposes leaves the transaction open forever for both gift and estate tax purposes.

[D] Financial and Management Issues.

Is the technique use impacted by the cash flow of the asset used, and, if so, how? Some techniques only operate optimally if an asset generates cash flow, whether by income or monetization.

If the technique requires payments back to the client, what form of payment does the technique permit? Some techniques that call for payments to a client are more flexible in the form of payment than other techniques. For example, the GRAT prohibits payment of the GRAT annuity via a note.[21] Some techniques permit effective deferral of payments for a period of time, such as charitable gift annuities and installment sales.

How is the technique affected by interest rate fluctuations or levels? Split-interest techniques such as the GRAT, charitable remainder trust and charitable lead trust are significantly affected by interest rate fluctuations. Installment notes that are tied to a federally mandated interest rate also are affected by interest rates.

Does the technique itself offer any appreciable level of asset protection? Some estate planning techniques offer asset protection. Sometimes the protection of a client's stream of payments through a technique depends upon the asset protection of the person obligated to make those payments.

Does the technique depend upon the credit-worthiness or cash flow of the client or of any of the other players? In many techniques, a client's stream of payments depends upon the financial ability of the person obligated to make those payments.

What is the cost of implementation of the technique? Techniques vary significantly in cost. In most cases, the cost of implementation is measured in terms of potential transfer tax savings. One of the biggest risks for an estate planner is to accurately estimate the costs of implementation. Implementation expenses can include legal and accounting fees, appraisal expenses and other costs.

What ongoing administration will the technique require and what will that administration cost? Estate planning techniques vary dramatically in both the amount of ongoing administration required post-termination and the impact of proper administration on the respect of the technique for tax purposes. The estate planner must consider both the cost of post-implementation administration and the risks of improper administration in the evaluation and design phase.

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[21]Treas. Reg. Sec. 25.2702-3(b)(1)(i).

For example, in *Atkinson Est. v. Comr.*, the Tax Court held that the failure to properly adhere to the post-implementation dictates of an otherwise perfectly formed charitable remainder trust resulted in invalidation of the trust for tax purposes, and the Eleventh Circuit upheld that result. The courts have similarly held in the arena of family entities.[22]

Does the technique require the use of assets that are liquid or that produce cash flow? One of the greatest possibilities of mismatch between an estate planning technique and an asset lies in the monetization of the asset, or the ability of the asset to generate cash flow. Some estate planning techniques offer virtually no flexibility with respect to the need for or design of cash flow, such as the private annuity, since the payout is computed principally based upon actuarial assumptions. Other techniques offer somewhat more flexibility, but still are subject to some limitations, such as the charitable remainder trust, which has a 5% minimum payout requirement yet also has effective ceilings on payout as well due to the 10% remainder requirement.[23]

Some estate planning techniques offer varying levels of flexibility in the design phase. Some techniques, such as the installment sale, offer virtually complete flexibility in the design phase. Some techniques offer flexibility that is not complete, but that must be balanced against other factors, such as the amount of taxable gift and the risk of estate tax inclusion.

Does the technique offer any asset diversification possibilities for the client? Very few estate planning techniques offer or enhance asset diversification possibilities without some loss of flexibility or access to capital. Nevertheless, a client's level of non-diversification in asset holdings can impact the selection or design of an estate planning technique. Generally, the more non-diversified a client's assets are, the more cautious an estate planner should be in designing and implementing an

22 See, e.g., *Thompson Est. v. Comr.*, T.C. Memo 2002-246; *Reichardt Est. v. Comr.*, 114 T.C. 144 (2000); *Harper Est. v. Comr.*, T.C. Memo 2002-121; and *Schauerhamer Est. v. Comr.*, T.C. Memo 1997-242.

[23]IRC Sec. 664(d)(1)(D) (annuity trusts) and 664(d)(2)(D) (unitrusts).

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estate planning technique. There is a point at which a client is so non-diversified as to render the client ineligible for most, if not all, lifetime planning techniques.

How does the technique impact the classification of property as separate or community? In states that have community property regimes, the estate planner is forced to factor property classification into the technique design phase, or risk exposing the client or the players to an undesired classification. For example, suppose that a parent desires to transfer property to a married child directly, and the parent requires that the property be the child's separate property. While a gift (outright or in trust) should be the child's separate property under the laws of most community property jurisdictions, a sale to that child will have to be carefully designed in order to achieve separate property status, as there is a presumption in many community property jurisdictions that property acquired by purchase during a marriage is community property.[24]

In sales of entity interests to a child, it might be so simple as converting the sale from being between parent and child to between parent and the entity, i.e., a redemption. However, there often are other hurdles in this regard, including the tax treatment of the redemption[25], the parent's desires concerning a continuing relationship with the entity, the existence of other owners and whether the child already has an interest in the entity that will increase by redemption. Property that a parent desires to sell that is not in an entity may have to be placed in one prior to the sale. Alternatively, the cooperation of the spouse may be required, which is probably advisable in any event.

If the technique requires payments back to the client, what timing of payments are permitted (immediate only, deferred, etc.)? Split-interest payment techniques vary significantly in this regard. Some techniques mandate virtually annual payments, such as the GRAT or CRAT, while others permit varying degrees of flexibility, like the private annuity, charitable gift annuity or the installment sale.

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[24]See, e.g., La. Civ. Code Art. 2340.

[25]Would need to comply with IRC Sec. 302(b)(3).

If the technique requires payments back to the client, what flexibility does the technique offer relative to the amount of payments back to the client? Techniques vary considerably in this regard. For example, GRAT's offer somewhat limited flexibility in setting the amount of payments, as the only amount variance permitted is an increase in any year that does not exceed 120% of the GRAT payment of the previous year.[26] Charitable remainder trusts usually offer little flexibility relative to the amount of the payments. On the other hand, the installment sale offers considerable flexibility relative to the amount of payments.

Does the technique permit the client to retain continuing control or security over the economic benefits represented by the asset used in the technique, and, if so, what and how much control? Estate planners wrestle with clients over the level of required continuing control on several different levels. The first level is trying to have the client contemplate and arrive at a conscious level the client's real need for continuing control. Clients vacillate significantly on this score. The second level is trying to square the client's control requirements with the selection of technique, especially since techniques vary widely in this regard. The third level is trying to square the client's control requirements with the design of the technique that is selected. The final level is squaring the inevitable tension between the client's control requirements with the risks of adverse tax consequences that are associated with too much retained control. Some client's control requirements, rational or irrational, contraindicate the use of some techniques and some designs.

Techniques vary widely in the possible control over the economic benefits of assets deployed in the technique.

[E] Clients and Players Issues.

Does the technique meet the client's goals and objectives? While it might seem axiomatic that an estate planning technique must be consistent with a client's goals and objectives, divergence between the ultimate effect of the technique and the client's goals and objectives can easily creep in. Many estate planners fail to properly ascertain a client's estate planning goals and objectives. When this happens, the likelihood increases that the estate planner will propose a plan or technique that may seem to fit the client's asset profile and might even make sense

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26 Treas. Reg. Sec. 25.2702-3©(1)(ii).

for estate tax planning, but that conflicts with the client's estate planning goals and objectives. Sometimes this divergence arises as a result of the client's failure to understand or even realize his or her estate planning goals and objectives, or to clearly communicate those goals and objectives to their estate planner. Whatever the reason for divergence between the effect of an estate planning technique and a client's estate planning goals and objectives, this divergence represents a risk to the estate planner of either client dissatisfaction or even malpractice. The prudent estate planner should expect to encounter some lack of clarity or even dissonance within clients (or set of clients) as to the goals and objectives.

Does the technique require disclosure of personal financial information of the client or any of the players to third parties, and, if so, to whom and how extensive must that disclosure be? Client feelings about disclosure of personal financial information can run the gamut from "life is an open monograph" to the client not wanting to disclose financial information to other advisors, a spouse or children. Some techniques either require some disclosure or facilitate disclosure of financial information. Clients who are averse to disclosure should be steered away from such techniques, or at least alerted to the risks of disclosure prior to implementation.

Is the technique impacted by the age or health of the client or that of any other player? Some techniques are dependent upon the availability of the actuarial valuation rules of IRC Sec. 7520. Where a client has less than a 50% chance of surviving for 18 months following the technique implementation, these particular techniques cannot be used. All other things being equal, the older or less healthy that a client is, the fewer the techniques that are available.

Other techniques, e.g., taxable gifts and family entity formation, have been discouraged either by IRC Sec. 2035(b) or by the courts.[27]

[27] *Reichardt Est. v. Comr.*, 114 T.C. 144 (2000); *Harper Est. v. Comr.*, T.C. Memo. 2002- 121; *Schauerhamer Est. v. Comr.*, T.C. Memo. 1997- 242.

How will the technique help or hinder players other than the client who might be affected after the client's death, and, if so, how? For this purpose, the term "affected" means more than the personal grief brought on by a loved one's death and principally focuses on financial effect. Estate planning techniques often bring with them shifts in the balance of power, and with such shifts comes the prospect of exposure of vulnerable parties. One example is the unrelated key employee, who may not be subject to the whim and caprice of a new boss, but who may really be invaluable to the business even though that new boss doesn't understand or appreciate that fact.

Are there any risks of mortality of persons other than the client who are involved in the technique and, if so, what are those risks and what can be done to minimize those risks? Any time that a technique puts rights or vests powers in another, there is a risk to the client if that person predeceases the client. A very good illustration of this is where a client gifts control to a child yet the parent continues to work in a business and draw livelihood from it, and the child dies before the parent. Does the estate plan contemplate the effect of the child's death on the parent's right to continued income? This also can be an issue in installment sales to children who are working in a business where the debtor-child dies first. Absent some alteration to the plan, the family of the deceased child will have debt to continue to pay but perhaps no income to service that debt.

[F] Flexibility.

Can the technique be undone if circumstances warrant and, if so, how easily can the technique be unwound and what will it cost? Will there be any tax consequences? Can an exit strategy be devised in advance? This is easier to do for some techniques than for others. The question that every estate planner must encounter is the fine line between need for an exit strategy and whether the client should enter into a particular technique in the first place. Some changes in circumstances are often encountered, e.g., divorce. Others are much more difficult to anticipate, and therefore, the estate planner must keep eyes peeled for these risks.

What retained flexibility does the technique offer relative to changing needs of the client and the other players? Everyone wants total flexibility, but this is not

possible with some estate planning techniques if they are to be respected for transfer tax purposes. Some people need flexibility. Estate planning techniques vary widely in the amount of flexibility that can be built into the design. There is a fuzzy line between the amount of flexibility that can be built in and whether the client's critical need for flexibility effectively rules the client out for a particular technique.

Flexibility pertains to a wide range of possible issues, including payout to the client, payment by the client or by someone else, the ability to change the ultimate recipients as well as how much each is to receive. Estate planning techniques differ significantly in the level of flexibility each offers in each category.

[G] Complexity and Sophistication.

How complex is the technique to design and implement? Some estate planners thrive on complexity, and they are drawn to the most complex and intricate of estate planning techniques and designs. However, complexity in a technique or design presents a possible separate risk to the success of the estate plan. Some techniques are complex in and of themselves. Sometimes, complexity creeps in through the layering of multiple techniques that alone are not complex in design or in implementation. Complexity in design or technique also increases the risk of error on the estate planner's part.

How complex is the technique to explain to clients and other players? Actual complexity is irrelevant. Perceived complexity, and fear of possible complexity are enough to steer some clients away from certain techniques. Complexity of a technique or design is a separate issue from how the client or the players perceive the technique to be. Techniques vary widely in the ease by which they may be explained. The ability of estate planners to explain techniques or designs to clients also varies significantly. The comfort level of understanding of a technique or design that clients or players must have prior to going forward with implementation ranges from blind faith in the estate planner to metaphysical certitude in comprehensive understanding of the technique or plan.

The same can be said for uncertainty in tax consequences. Some techniques have a much more solid backstop in statutory and regulatory or other published guidance.

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The IRS is able to select the techniques on which it offers guidance and when it offers that guidance. The IRS also is able to select which applications of techniques that it will challenge. Some techniques, such as the installment sale to a defective trust, have been the subject of virtually no IRS guidance or judicial interpretation, which the prudent estate planner must advise translates into additional risk to the client and players in the form of uncertainty.

Estate planners have been held liable for failure to apprize clients as to the state of the law of an estate planning technique.[28]

How important is it that the client obtain continuing professional advice with respect to the technique after implementation? As discussed earlier in the context of charitable remainder trusts and family entities, some techniques have complex rules that require careful attention after implementation. Clients who tend to view estate planning more as an event than a process, and who tend to avoid professional advice may not be well served by implementing a technique that requires careful professional attention.

Does the illustration capability for the technique accurately and completely depict the reasonable outcomes and, if not, how may the excluded factors be illustrated or factored into the mix? As far along as technique illustration has come in the past few years, there are still many parameters of estate planning techniques that remain insusceptible of complete illustration or analysis. In *Martin v. The Ohio State Foundation, Inc., et al.*, discussed in Chapter 1.08, supra, the planners illustrated a net income with makeup charitable remainder unitrust as making distributions from the first year without showing the possibility that the trust might not make any distributions unless the property contributed to the trust was sold. In fact, the illustration provided to the Martins showed distributions beginning in the first year, which ultimately proved not to be the case. Illustration materials should be viewed as potential exhibits to law suits against estate planners, before they are given to clients or others.

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[28] *Williams v. Ely*, 423 Mass. 467, 668 N.E. 2d 799 (Mass. 1996).

Is use of the technique effectively precluded for use with certain persons, e.g., non-citizens, "skip-persons" by the ETIP restrictions of the GST Tax and S corporation shareholder limitations? There are some techniques, e.g., GRAT and charitable lead annuity trust, that effectively cannot be used for "skip-persons". Limitations as to who can be an S corporation shareholder also are important. The law puts additional limitations on certain techniques or on design features for certain classes of people who are related to the client, e.g., "applicable family member" in Chapter 14, with the effective result that some techniques, split purchases and GRIT's, may not be used by related persons. Other tax laws, e.g., IRC Sec. 318, affect the design of some techniques such as redemptions.

Does the essence of the technique cause use of any particular asset to be either foreclosed or not attractive? The essence of some estate planning techniques clashes with certain types of assets. For example, a charitable lead trust funded solely with a parcel of non-income producing raw land probably will create problems when the trust payout to charity is due. This problem could require the charitable lead trust to sell property improvidently, or it could force the trust to borrow money to make the charitable trust payout.

Some techniques, e.g., QPRT, essentially cannot be used except with residential property.[29] The essence of other techniques make use of certain types of assets difficult, e.g., S corporation stock in some techniques, or suggest use of different techniques for these assets.

How easily undone or modified is the technique if relationships sour? Some estate planners would rather not focus on or get enmeshed in such a distasteful subject. Nevertheless, the prudent estate planner should factor this possibility into the evaluation or design, or at least consider the risks to the client or the players if it happened. There are ways to build in peaceable solutions in advance, such as division methods, buy-sell obligations, etc.

Does the technique require ongoing communication and cooperation after implementation between the players amongst themselves as well as with the client, and, if so, how important is it that the players and/or the client are able to

[29] Treas. Reg. Sec. 25.2702-5(c).

communicate and cooperate? Can the technique be designed to contemplate and/or accommodate a failure in communication and/or cooperation? Techniques vary considerably over the requirement of effective communication.

Estate planning advisors too often persuade a client to implement a recommended estate planning technique on the ground that the Acost of doing nothing@ is too high. However, the cost of doing nothing often is greater or even less than the cost of implementing the "wrong technique." Has the estate planner estimated the potential cost of the technique where its use is improvident or improper? Estate planners too often portray the "cost of doing nothing" as the potential transfer tax savings to be achieved by the implementation of a particular technique. However, in many situations, this estimate fails to consider many variables, including future value of the property. This estimate also neglects to consider a number of variables, including the risk of entering into the technique. For example, if money is committed to a life insurance trust and annual exclusions, applicable credit amount and even GST Tax exemption is allocated, if the policy lapses down the road, those exemptions and exclusions will have been wasted. The same can be said for a taxable gift of an asset that significantly declines in value. Estate planners should assess the effect of the technique under possible adverse post-implementation scenarios.

Chapter 6: The Players-Related Technique Evaluation and Design Issues.

6.01 Generally.

The human factors inherent within estate planning are very significant.

6.02 Players-Related Technique Evaluation and Design Issues

[A] Financial and control issues

What contractual obligations exist between the client and others that can impact the planning? Obviously, clients should not be permitted or encouraged to enter

any estate planning technique that will create an event of default under any other agreement. Some estate planning techniques require the consent of third parties. It is important to review governance documents, including powers of attorney. Contractual arrangements can include marital agreements, loan or security documents, entity governance documents, buy-sell agreements, etc.

Does the client want to risk loss of control of the economic benefits represented by the asset to be used in the technique, and, if so, what is the client's comfort level with respect to loss of control? Can the technique be designed to protect against damage occasioned by the client's loss of control? Some clients' penchant or even obsession with control can foreclose consideration of techniques that might solve the client's problem. However, other clients simply cannot afford to lose control over the economic benefits represented by the asset to be employed in a technique even if deployment of the technique might solve some problem of the client.

Can the client risk loss of access to capital caused by the technique? This really is a threshold consideration for every client who is considering a significant gift, even while retaining an interest or control. Failure to address shortcomings on access to capital on the part of estate planners is one of the most common errors made by estate planners. For example, a client who has a marginally taxable estate probably should not create a charitable remainder trust with any significant portion of his or her estate, even with a generous payout, because the client's access to capital will have been limited. This might hamper the client's financial security.

Can the client afford to pay the gift or income tax associated with implementation of the technique, including possible increases on audit, and, if so, does the client want to commit to doing so? It is one thing for an estate planner to impress upon a client that it is cheaper from a transfer tax standpoint to pay gift tax than estate tax[30]. It is quite another to evaluate whether the client can afford to pay the gift tax. In light of the current uncertainty in the estate tax law between now and 2026, most estate planners are not advising clients to pay gift tax, so this issue is not as big as it might have otherwise have been.

[30] Obviously, the income tax also has to be figured in.

Estate planning advisors also must consider the client's ability to pay increased gift tax (and penalties and interest) in the event of audit, as well as the possibility of inclusion of the gift tax paid within three years of death in the client's gross estate under IRC Sec. 2035(b).[31]

If the client has a family operating business, do all of the family players work in that business? Any situation in which less than all of a client's children are either going to ultimately receive a business, even by purchase, is a potentially volatile situation. The estate planner must deal with these sensitive issues, which are beyond the scope of this monograph.

How sensitive to cost of planning are the client or the other players? Some clients are very sensitive to the cost of planning and administration, even to the point of not implementing correctly a plan or technique that could yield significant benefits relative to the projected costs. The concept of benefit-cost should be considered by estate planners.

How many sources of income does the client have? The more diversified the client's sources of income, particularly passive income, as a general rule, the less risk that the client will have in engaging in a technique with an asset that produces income.

Is the client's economic livelihood/security and/or income dependent substantially on any particular asset? If the client is significantly dependent upon the income or capital of a particular asset, this can significantly impact the advisability of any technique that does not call for the sale of the asset outside of the client's family or other diversification method.

[B] Personal and Health Issues.

How is the status of the client's marriage and that of any players who could be affected by a marital dissolution? What are the plans of unmarried players? Marital status, and the status or stability of marriages, of the client and the players

[31] See, e.g., *Armstrong*, supra.

definitely impacts design of estate planning techniques, and can impact the selection of estate planning techniques.

Do any of the client's goals potentially or actually conflict? Sometimes, clients desire more than is possible. Moreover, some estate planning goals conflict with one another. For example, a client's desire to equalize gifts and legacies may have trouble leaving an asset of disparate size to one child.

What is the client's age, health and remaining expected life expectancy (considered not just from actuarial tables but also considering the particular client's health and family history)? The health and life expectancy of a client and players forecloses the use of some estate planning techniques, and it can have significant design implications. Too often, estate planners do not focus on health or life expectancy in evaluation or design once they have determined that the likelihood that the client will survive for the next twelve months is at least 50%, which is the test for using the IRC Sec. 7520 tables.[32] However, some clients have family mortality experience that are very relevant in designing techniques, such as the GRAT or QPRT, the success of which is dependent upon the client's survival for a period of time. Other techniques, such as family partnerships, also might be impacted.

How are the client's relationships with the players and the relationships of the players amongst themselves? The pre-technique relationships do not always inform how those relationships will be after implementation. Nevertheless, the current relationships are important in estate planning technique evaluation and design because some techniques put such a premium on good relationships.

How important is retaining future flexibility in estate planning for this client? Some clients value flexibility to such an extent that significant lifetime planning is not advisable, even if the client can afford to do it. Many clients require flexibility to such an extent that significant lifetime planning, including annual exclusion gifts, is inadvisable. For some clients, retention of flexibility will be the overarching important evaluation or design factor, outweighing all other factors.

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[32] Treas. Reg. Sec. 1.7520-3(b)(3).

What are the relationships between the players (other than the client) amongst themselves and how will the technique work if those relationships change? Can anything be built in to the technique to allow for solving these problems? Some estate planning techniques put a premium on ability to get along, e.g., family entities. Some techniques virtually require it. Sometimes, techniques can be designed either to separate beneficial interests or governance protections can be built in.

Could the client's death affect the technique after implementation, and, in particular, the post-death relations between the players, including the relative economic positions of the players? This question involves the relationship of the players. However, like the preceding question, this question takes on a different twist because it involves consideration of how the players' relationships, including economic relationships, might change when the client dies. Death can alter relationships, either positively or negatively. Death causes changes in control and the relative positions of vulnerability of the players. Some of this can be factored into design of an estate planning technique.

Does the client have any real current charitable or donative intent? Any technique that involves a donation by a client to child or charity requires donative intent on the client's part. Some clients do not really have donative intent. Therefore, they are unlikely to do any technique that involves a donation. Moreover, if a client and players enter into a transaction that belies the truth of the transaction, e.g., a gift that really is a sale, adverse consequences could ensue.[33]

How well do the client and players communicate, and how might poor communication impact the implementation or administration of the technique? The importance of communication varies from technique to technique. A technique that requires communication between the client and the players can cause damage if it is implemented in a situation where the client and the players do not communicate well. Unfortunately, it is outside the professional ambit of estate planners to be able to evaluate the communication skills of clients and players. However, the estate planner must make a rough assessment of communicability in an effort to

[33] See, e.g., *Armstrong*, supra.

avoid creating a disaster (or a malpractice case) by prescribing the wrong technique or design.

Is the client dependent upon any of the players, and, with respect to each player, are any of the players dependent upon or vulnerable to one another? The estate planner ignores the economic relationships of the client and the players in evaluation and design of estate planning techniques at his peril, particularly where economic dependence is concerned. Economic dependence, through employment, or even contractual or even fiduciary relationships, can signal vulnerability and susceptibility to influence. The susceptibility to influence can compromise or seriously weaken an estate planning technique.

What is the client's risk tolerance for tax uncertainty or controversy, e.g., IRS audit and/or recharacterization with respect to the technique? Saving taxes is one thing; making a life miserable through anxiety, or, worse yet, hastening its end via concern about uncertainty or litigation, is quite another. Some clients can handle a squabble with the government better than others. The lives and businesses of some clients or other players are clean, while others have problems that could rear their ugly heads in a nasty audit or litigation.

What kind of witnesses could the client, the players and other advisors make? While this consideration would not solely inform the selection of an estate planning technique, the prudent estate planner should not ignore this prior to implementation, especially since perception often is more important than reality.

Do the players appreciate, accept and respect the complexity of a proposed technique? This can be a tricky call for the estate planner to make, particularly if the estate planner's real access to the other players is limited by the client. While such a squelching of information retards a good recommendation, it is frequently encountered. Nevertheless, clients and players differ greatly over their respective facilities and comfort levels with complexity.

Conclusion

In conclusion, it's the underlying premise of this monograph that the "how" to design estate planning tools and techniques is at least as important as

knowledge of the “what” about a particular tool or technique. In this monograph, I introduced a tripartite hermeneutic to assist in the design of an estate planning tool or technique.

The hermeneutic focuses on three independent factors: those relating to the assets involved in the tool or technique; those relating to the tool or technique by virtue of being that technique, its unique characteristics and limitations; and those related to the “players,” i.e., the people or entities involved in or affected by the tool or technique.

This is a very serious issue that greatly affects the likelihoods not only of our clients but ourselves (and our malpractice insurance providers), yet it hasn’t been studied much if at all in a systematic fashion. It is my hope and dream that the monograph will spur on more serious inquiry and study into what makes some estate plans fail while another succeeds using the exact same technique before any more estate plans or the livelihoods and reputations of any more estate planners are rendered asunder by poor design.