

tBf The Boston Foundation
Philanthropic Advisor
 A GUIDE TO CHARITABLE GIVING FOR PROFESSIONAL ADVISORS

Sederbaum's Seven Signposts to Effective Family Limited Partnership Planning

BY ARTHUR D. SEDERBAUM, ESQ.
 PATTERSON, BELKNAP, WEBB & TYLER LLP

The family limited partnership is an estate planning technique intended to transfer assets (in this case limited partnership interests) to the intended beneficiaries at discounted values. However, the family limited partnership is not made for everyone; one size does not fit all. The seven signposts are criteria that all planners should take into account in arriving at the decision on whether the client should undertake a family limited partnership and, if so, the appropriate inputs necessary to structure the entity.

The signposts are intended to form the basis of discussion. They are by no means an exclusive checklist for FLP planning. They are the basic decision-making questions which the practitioner should consider.

1. Is the client a proper candidate for FLP planning? Is the FLP the proper entity for this client?

IRS tends to focus on FLPs formed by an old client, infirm or terminally ill client. See *Schauerhamer, Reichardt, Strangi I and II and Thompson*. The client must be willing to dot all i's, cross all t's and follow all rules. FLP and personal assets cannot be comingled; non-pro rata distributions cannot be made. The client must understand the complexity of the FLP and must be willing to seek follow-up advice when necessary.

Partnership must be administered as a business (*Stone*) not as an extension of the client (*Strangi II*). The client cannot have "first call" on partnership income and distribution. *Abraham; Hillgren*.

2. Are the proper assets being contributed to the FLP?

Although the cases hold to the contrary, an FLP consisting primarily (or even entirely) of marketable securities is scrutinized with far more intensity by IRS, and far less of a discount will be allowed without protracted negotiations. See especially *Senda*. One must always be concerned with IRC § 721, the invest-

ment company provisions. Also consider allocation of built-in gain of appreciated property IRC § 704(c). (See signpost 7). See primarily *Strangi II* where the Tax Court emphasized the proportion of the clients' property that had been placed in the FLP. *Accord: Harper Estate, Reichardt, Thompson*.

3. Have state laws on fiduciary responsibility been observed?

Fiduciary responsibility is key. *Strangi II*. The FLP cases repeatedly cite *Byrum*.

The client must be educated that once she contributes assets to the FLP, the use of those assets no longer are subject to her control. Partnership agreements which limit (or in *Thompson*, eliminate) fiduciary duty of the general partner to the partnership is a fatal mistake. It could provide IRS the key to unlock the entrance to IRC § 2036. See *Strangi II*.

4. Are the limited partners so limited that IRC § 2036 can be invoked and/or the gift tax annual exclusion can be threatened?

There should be no such thing as unlimited control by the general partner. If the client so insists, he fails the test of Signpost 1. See *Thompson* (majority); *contra: Kimbell* which look to taxpayer's actual control of the GP. The existence of powers of the limited partner, while theoretically decreasing discounts, will serve as the answer to IRC § 2036. Assignment of interest should be permitted, subject to rights of first refusal. Guidelines should be established in the agreement for distributions, at least to cover limited partner's income tax liabilities. These powers will probably be sufficient to avoid the denial of the annual exclusion that was sustained in *Hackl*.

5. Are the limited partners required voting percentages coordinated with the eventual ownership of the client's LP interest?

The lack of coordination was fatal in *Jones* where any discount for lack of marketability was denied because the gifted limited partnership interest was of such size to provide sufficient voting power to dissolve the partnership. Therefore, when the FLP is created, the gift giving plan should be fully discussed with the client and goals should be established.

Continued on page 2

Continued from page 1

6. Are the operational provisions sufficient to conduct the FLP in the same manner as an ALP (“Arms-length Limited Partnership”)?

Separate books and records, separate bank accounts; minutes. In *Stone* parents and each of the children had separate legal counsel. Non-pro rata distributions must be avoided at all costs. The FLP agreement should provide for imposition of interest at the IRC §7872 rate on any such pro rata distributions. Any guaranteed payment pursuant to IRC §707 could trigger IRC §2036 treatment, especially if the guaranteed payment bears any resemblance to the income of the partnership. See *Harper Estate*.

7. Prior to finalizing the partnership agreement, have you consulted your income tax partner and your client’s accountant about the following?

- a. Investment company rules.
- b. Allocation of income, deduction, gain and loss rules.
- c. Triggering of taxable events.
- d. Determination of sufficient assets to be retained by client to treat standard of living.

Since the valuation of limited partnership interests is subject to differing opinions, in order to prevent an increase in value resulting in a taxable gift, the *McCord* case considers the concept of a “defined value” gift. The concept behind defined value is that a transfer of limited partnership interests to the donor’s family makes will be equal to a fixed dollar amount, as finally determined for federal gift tax purposes. If there is any excess value, as finally determined, that value passes to a non-taxable entity such as a spouse or, in the *McCord* case, one or more charities. Therefore, whatever IRS determines the value of the transferred to be, there will be no additional transfer taxes due, since only a fixed dollar amount passed to the donor’s family. In *McCord*, the majority opinion does not decide the bona fides of the defined value clause preferring, instead, to focus on the actual amount which passed to the charities as per agreement six months after the actual gifts. The *McCord* case has been appealed to the 5th Circuit, and a decision is pending.

Citations:

- Hackl* 118 T.C. No 14 (2002)
Hillgren T.C. Memo 2004-46
Kimbell, 371 F3d 257 (5th Cir 2004)
McCord 120 T.C. No. 13 (2003)
Reichardt 114 T.C. 114 (2000)
Schauerhamer T.C. Memo 1997-272
Senda T.C. Memo 2004-160
Strangi “I” 115 T.C. 478 (2000)
Strangi “II” T.C. Memo 2003-145
Thompson T.C. Memo 2002-246 aff’d sub. nom *Turner*, 94 AFTR 2d 2004-5764 (3d Cir 2004)

ADVISOR TO ADVISOR

The Boston Foundation is pleased to present a new “Advisor to Advisor” feature of the Philanthropic Advisor newsletter. This column will be written by local practitioners to provide practical tips and guidelines in specific practice areas where charitable giving may be incorporated.

We are grateful to Marjorie Suisman, Esq., of Davis, Malm and D’Agostine, P.C., for contributing the first article.

Special Needs Trusts: Guidelines for Planning for Disabled Beneficiaries

BY MARJORIE SUISMAN, ESQ.
DAVIS, MALM & D’AGOSTINE, PC

Estate planning for a disabled client, or for a client with a disabled child or grandchild, is challenging and rewarding work for an advisor. It requires specialized knowledge of the availability of governmental assistance and also calls for attention to estate and tax planning issues and an awareness of opportunities for charitable giving.

Needs-based assistance

Although some clients have sufficient wealth to cover all their potential needs over their lifetimes, it is often the case that a disabled person can benefit from assistance from, for example, the MassHealth (Medicaid) program covering medical expenses or from Supplemental Security Income (SSI) providing cash assistance to those who are unable to work because of their disability. Each program has special rules which have the effect of permitting a recipient to remain qualified for assistance while also benefiting from a trust. The desired result is that the government program will provide for basic needs while the trust will cover “special needs” - the funds in the trust can be devoted to improving the quality of life of the beneficiary. These trusts are often referred to as Special Needs or Supplemental Needs Trusts.

Self-settled trusts

To be eligible for SSI and certain Medicaid programs, a disabled person cannot have more than \$2,000 in countable assets. A self-settled trust – one that the disabled person sets up with inherited assets or with the proceeds of a personal injury award – is a countable asset in determining eligibility for benefits in these most common programs. An exception is made for trusts which contain a state payback provision, providing that,

Continued on page 4

Professional Advisors Give Back to the Community

The Boston Foundation would like to recognize the following named attorneys, investment advisors, financial planners and accountants who have helped to facilitate at least one new fund or planned gift to the Boston Foundation during Fiscal Year 04.

Does Your Name Belong Here?

Please let us know if your name should be added to the list of Friends of the Boston Foundation in future issues of this publication. Simply let us know that your client is including the Boston Foundation with a current or future gift. Your client may remain anonymous if desired.

FRIENDS OF THE BOSTON FOUNDATION

| | | | |
|--------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|
| Robert M. Allen, Esq. Robert Cushman Barber, Esq. <i>Looney & Grossman LLP</i> | David Ferris <i>Merrill Lynch</i> | Colin S. Marshall, Esq. <i>Bingham McCutchen LLP</i> | Jennifer K. Rankin, Esq. <i>Margolis & Associates</i> |
| Cynthia A. Brown, Esq. <i>Nixon Peabody LLP</i> | Stephen K. Fischer, Esq. <i>Metaxas, Norman & Pidgeon, LLP</i> | Paul McCarthy <i>Merrill Lynch</i> | Regina Ransford <i>U.S. Trust</i> |
| Alexander A. Bove, Esq. <i>The Law Firm of Bove & Langa, P.C.</i> | Beth C. Gamel, CPA, PFS <i>Pillar Financial Advisors</i> | Jacqueline R. McCoy <i>Paul McCoy Family Office Services LLP</i> | Hanson S. Reynolds, Esq. <i>Rackemann, Sawyer & Brewster</i> |
| Lynn A. Buskey, Esq. <i>The Law Firm of Bove & Langa, P.C.</i> | Elizabeth Garabedian <i>Merrill Lynch</i> | Eric F. Menoyo, Esq. <i>Palmer & Dodge LLP</i> | Arthur K. Ross, Esq. <i>Ross & Ross</i> |
| Brian T. Calabro <i>Mellon Private Asset Management</i> | A. Silvana Giner, Esq. <i>Wilmer Cutler Pickering Hale and Dorr LLP</i> | Allison Montgomery <i>Merrill Lynch Private Client Group</i> | Edward Simmons <i>Merrill Lynch</i> |
| Cynthia M. Coddington <i>Coddington Financial Partners</i> | William C. Hays, Esq. <i>Hays & Skerry</i> | Evelyn V. Moreno, Esq. <i>Nixon Peabody LLP</i> | Zachary Slater <i>Merrill Lynch</i> |
| Sarah Demers <i>Merrill Lynch</i> | Gail E. Horowitz, Esq. <i>Wade & Horowitz LLC</i> | Alison H. Mosca <i>Audax Group</i> | Geoffrey Soper <i>Merrill Lynch</i> |
| Morgan Dewey <i>Merrill Lynch</i> | Terence Hunt <i>Merrill Lynch Private Client Group</i> | Mary B. Mullin, CFP <i>Merrill Lynch Private Client Group</i> | Marjorie Suisman <i>Davis, Malm & D'Agostine, P.C.</i> |
| John Doyle <i>Merrill Lynch</i> | Edward J. Joyce, Esq. <i>Ropes & Gray LLP</i> | Richard B. Osterberg, Esq. <i>Weston, Patrick, Willard & Redding, P.A.</i> | Chris Stafford <i>Merrill Lynch</i> |
| Sean Doyle <i>Merrill Lynch</i> | Jennifer L. Kulick <i>Mellon Private Asset Management</i> | Frederick S. Price <i>Merrill Lynch</i> | Brian Walsh <i>Highmount Capital, LLC</i> |
| Douglas R. Ederle <i>SCS Financial</i> | Melissa Langa, Esq. <i>The Law Firm of Bove & Langa, P.C.</i> | Toni-Lynne Rafanelli, Esq. <i>Harrington & Rafanelli, LLC</i> | Robert Woodburn, Jr., Esq. <i>Palmer and Dodge LLP</i> |

Since 1915, the Boston Foundation has supported the community by making grants to thousands of effective community-based organizations in the Greater Boston area and nationwide, helping hundreds of donors accomplish their charitable gift plans, and building an endowment to meet the future needs of the community. Together we are working to improve the quality of life for all residents in our community.

Continued from page 2

on the death of the disabled beneficiary, the state will be reimbursed for all Medicaid benefits paid out. Only after the state is repaid can the remaining trust property pass to the beneficiary's heirs, loved ones or charities. 42 USC 1396p (d)(4)(a) governs the so-called safe harbor trusts. An irrevocable trust meeting the requirements of that statute will not be counted for eligibility purposes in the Medicaid and SSI programs, and the transfer of assets to such a trust will not be treated as a disqualifying transfer.

This highlights the importance of carefully determining which benefits the client is receiving. For example, Social Security is not a needs-based program. Persons who have worked and paid into the social security system for the requisite time period receive Social Security Disability (SSD) payments rather than SSI payments, and there is no asset test associated with the SSD program. Self-settled trusts for individuals on SSD need not qualify for the safe harbor.

Similarly, under current law in Massachusetts, disabled persons who are under age 65 and living in the community are eligible for Medicaid without an asset test. Providing such an individual with a "(d)(4)(a) trust" might trigger a state payback when none was required. Given the volatility of the laws and regulations governing eligibility for needs-based programs, however, it is important to maintain flexibility in the trust by giving the trustee power to amend the instrument to conform to changes in the law or the beneficiary's circumstances.

Disabled persons in the community who are over 65 do not have the option of establishing a (d)(4)(a) trust but can benefit from another type of safe harbor trust – a so-called pooled trust where their assets are managed together with the assets of other disabled persons. These

trusts are administered under the direction of charitable organizations such as the Massachusetts Association of Retarded Citizens. On a participant's death, the charity keeps a portion of the assets before the state payback provision kicks in.

Third party trusts

A third party trust – one that, say, a parent establishes for a disabled child – has fewer restrictions than a self-settled trust.

A third party trust can be a stand-alone trust or can be under the umbrella of the donor's estate planning trust. It should be drafted as a fully discretionary trust with no ascertainable standard. There should be no language at all in the instrument indicating that the trust is to be used for the support of the beneficiary. Under current law, as long as the trust is not a support trust, its existence will not interfere with the beneficiary's eligibility for benefits. There is no requirement that anyone other than the natural objects of the donor's bounty benefit from the trust after the beneficiary's death.

Some practitioners add descriptive language to special needs trusts, directing the trustees to use the trust funds to "supplement and not supplant" government benefits, following this with a lengthy list of what expenses to cover and what not to cover. In the author's view, a better practice is to include this information in a side letter rather than in the trust instrument – this will avoid possible contradictions or inconsistencies and inadvertent inclusion of language that can be interpreted as support language.

Distributions from special needs trusts

In addition to drafting the trust to meet the requirements of the appropriate benefits programs, the advisor

Continued next page

The Boston Foundation Planned Giving Design Center

A free service for Charitable Gift Planning
www.tbf.org

The **Planned Giving Design Center** offers professional advisors an easy way to stay updated with the most current information on charitable gift and estate planning. By logging onto www.tbf.org and clicking on the Planned Giving Design Center, advisors gain access to a library on planned giving techniques and articles by top professionals, as well as email news alerts about IRS rulings, court decisions and legislative updates. All are designed to assist professional advisors in helping clients realize charitable objectives. The Boston Foundation website also provides access to PG Calc for calculating charitable gifts.

Continued from page 4

must also assist the trustee in understanding the rules regarding distributions from a special needs trust – especially if the beneficiary is receiving cash assistance. For example, cash distributions from a trust will reduce the beneficiary's cash assistance on a dollar for dollar basis. In-kind distributions of clothing will reduce the beneficiary's cash assistance by one-third. In-kind distributions of household goods will have no effect on the benefits, unless the item is a luxury item which might itself push the beneficiary over the asset limit.

Tax planning

While concentrating on the special drafting issues in a special needs trust, it is important to keep the tax rules in mind as well. For example, in drafting a self-settled trust, the advisor must decide whether or not to make the transfer to the trust a completed gift for transfer tax purposes, and should consider the tax implications of the gifts to the remaindermen. Care must also be taken to think through the income tax treatment of the trust. In most cases, grantor trust status will be desirable and will not be automatic. The advisor should work out which "defects" can be included to ensure grantor trust status and also to benefit the beneficiary. For example, in a self-settled trust, the power to borrow without adequate interest or security may be useful so that a grantor/beneficiary needing a cash distribution can instead borrow from the trust without triggering a dollar for dollar reduction in cash assistance.

Estate planning

In addition to being tax sensitive and sensitive to the availability of government benefits, the trust should cover all of the matters normally included in a well-drafted estate plan. The dispositive provisions must be considered carefully since in most cases the trust will be irrevocable and the advisor is often planning for a beneficiary whose full potential is unknown at the time.

In preparing a self-settled trust for a client under guardianship, the advisor must seek court approval of the plan. If the client is not a minor, an estate planning petition can be brought in probate court under M.G.L.c. 201, s. 38. For minor clients, an equity petition can be brought in the probate court. Alternatively, if the settlement of a personal injury suit is the source of the client's funds, the superior court can authorize a trust as part of the settlement approval process under M.G.L.c.231, s. 140C ¹/₂.

Charitable opportunities

Frequently a disabled person has benefited from the work of national or local charitable organizations and specialized health care providers as well as from governmental assistance. In those instances, the client may

wish to benefit those charities which have provided services or which advocate for the disabled in general. This can be accomplished by naming a charity as a remainder beneficiary in either a self-settled or third party trust, or through charitable planning by a parent or grandparent. For example, if a child is not receiving cash assistance, it may be appropriate for a parent to establish a charitable remainder trust, paying an annuity to the disabled child for life with the remainder to the organization which provided direct or indirect services to the child.

Advisors should not hesitate to explore charitable planning with a disabled client or his or her family. Parents of a disabled child are often very willing to discuss the child's history which frequently includes heroic work on the part of a medical team or an educational program which has helped the child reach maximum potential. In discussing the dispositive provisions of a special needs trust, it is fitting to ask whether the client or family members would like to benefit one or more of those heroes or programs.

Disclaimer: This article is intended as a general overview only and not as legal advice. Note that the laws applicable to the benefits programs are constantly changing and must be reviewed regularly. Even more so than with most clients, each planning opportunity for a disabled beneficiary demands its own unique solution.

About the Authors

Arthur D. Sederbaum, Esq. is a partner in the New York City law firm of Patterson, Belknap, Webb & Tyler LLP and outside counsel to New York Community Trust. His practice includes a broad range of matters in the personal planning area including estate and tax planning, administration of estates and trusts, contested Surrogate's Court and tax proceedings, administration of tax exempt organizations and intergenerational family business planning. Mr. Sederbaum received his undergraduate degree, cum laude, from Columbia University, his law degree from Columbia Law School and a master of laws in taxation from New York University Law School. He is a member of the Bar of both New York and Florida. Mr. Sederbaum was the featured speaker at a recent presentation on family limited partnerships sponsored by the Boston Foundation.

Marjorie Suisman, Esq. is a shareholder at Davis, Malm & D'Agostine, PC, practicing in the Trusts and Estates Group. She concentrates her practice in the areas of estate planning, estate and gift taxation, and trust and estate administration. Ms. Suisman is a frequent lecturer and writer on all aspects of estate planning and taxation. She has recently lectured and published articles on using trusts with personal injury awards, the establishment, administration and tax consequences of special needs trusts, and estate planning for non-traditional families. Ms. Suisman is a member of the Boston Foundation's Professional Advisors Committee.

Case/Legislative Updates

IRS Announces February CFMR – For purposes of determining the present value of an annuity, an interest for life or a term of years, or a remainder or a reversionary interest, Revenue Ruling 2005-08 indicates the charitable federal midterm rate under Section 7520 for February 2005 is 4.6%, unchanged from the January of 4.6% and up 0.4% from the December rate of 4.2%. In addition, the deemed rate under Section 642(c)(5) for transfers to new pooled income funds during 2005 is 4.0 percent.

Assignment of IRAs, Annuities to Charity Not Taxable – The Service has ruled that the assignment of IRAs and annuity contracts that named the decedent's estate as beneficiary to a 501(c)(3) charity will not cause the estate or any of its beneficiaries to have taxable income or cause the estate to include any amount in its distributable net income. PLR 200452004

White House Releases Executive Order Creating Tax Reform Panel – An executive order signed January 7, 2005 by President Bush announced the creation of a tax reform advisory panel comprising nine members appointed by him, with the purpose of submitting to the Secretary of the Treasury revenue-neutral tax reform proposals in a report to be delivered no later than July 31, 2005. The panel was asked to recognize "the importance of home ownership and charity in American society."

For more information log onto www.tbf.org and go to the Planned Giving Design Center, "News Stories."

Board of Directors

Carol F. Anderson, *Former Managing Director,
HarbourVest Partners, LLC*

Marianne B. Bowler, *Chief U.S. Magistrate Judge
United States District Court*

Richard M. Burnes, Jr., *General Partner, Charles River Ventures, Inc.*

Louis Casagrande, *President, Children's Museum*

Catherine D'Amato, *President and CEO,
Greater Boston Food Bank, Inc.*

Richard B. DeWolfe, *Managing Partner, DeWolfe & Company, LLC*

Atsuko Toko Fish, *Consultant,
U.S. – Japan Cross Cultural Communications*

Christopher Gabrieli, *Chairman, Massachusetts 2020*

Paul Guzzi, *President and CEO,
Greater Boston Chamber of Commerce*

Reverend Ray Hammond, *Chair, Pastor, Bethel AME Church*

Michael B. Keating, Esq., *Partner, Foley Hoag LLP*

Jack Meyer, *President and CEO, Harvard Management Company, Inc.*

Herbert E. Morse, *Former Managing Partner,
KPMG's New York Metro Practice*

Kevin C. Phelan, *Executive Vice President, Meredith & Grew, Inc.*

Hanson S. Reynolds, Esq., *Partner & Director,
Rackemann, Sawyer & Brewster*

Binkley C. Shorts, *Senior V.P., Partner and Equity Portfolio Manager,
Wellington Management Company*

Micho F. Spring, *Chairperson New England,
Weber Shandwick Worldwid*

Benaree P. Wiley, *President and CEO, The Partnership, Inc.*

Paul S. Grogan, *Boston Foundation, Inc., Ex Officio*

Philanthropic Advisor is provided for general informational purposes only.

Nothing contained herein is intended as legal advice or legal opinion.

For more information about the Boston Foundation, please contact the Development Office at 617- 338-1700.

♻️ printed on recycled paper

The Boston Foundation
works with individuals,
professional advisors,
and organizations
to facilitate
charitable giving.

75 Arlington Street
Boston, MA 02116
617-338-1700
www.tbf.org

INNOVATION. INFORMATION. IMPACT.
The Boston Foundation

NONPROFIT ORG
U.S. POSTAGE PAID
BOSTON MA
PERMIT NO. 56001