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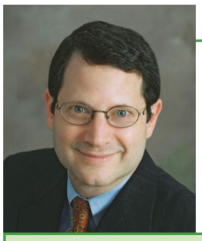

PRACTICAL PLANNER

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD

THE INTELLIGENT VALENTINE'S DAY KISS

Summary: KISS –Keep It Simple Stupid. If you don't have a $5 million+ estate do you want a short, simple and cheap will as your estate plan as the American Taxpayer Relief Act of 2012 (ATRA) made the $5 million inflation adjusted exemption and portability (you can benefit from the unused exemption of your deceased spouse) all permanent? Fear of the estate tax is gone for most wealthy people! Planning for those worth $5 (single) or $10 (couple) million+ remains complex—See Checklist. But the cavalier application of the KISS principal will likely undermine your goals. Yes, in many cases planning can be simpler and less costly for those under the $5/$10 million wealth range. A more intelligent application of the KISS principal to simplify planning when appropriate is the way. "For those under the new exemption amounts, planning remains hot," Christian Grey, Esq. suggests. "While the KISS principal can apply, there remain at least 20 shades of estate planning." This requires more than a form will. "Your estate planner needs new tools in his or her estate planning playroom to deal with the new planning environment," he adds.

Repurposed Bypass Trust: Your will could establish this trust and bequeath the federal exemption amount (or a lower state exemption). Your surviving spouse can benefit but the assets are all removed from his/her estate. That was standard planning for years. Now what? You might still benefit by removing assets from state estate tax. These trusts can still protect assets from a remarriage, lawsuits, etc. Consider a couple of tweaks in how you apply them post ATRA. Consider giving an independent trustee a right to distribute the assets outright to your spouse and terminate the trust. In that manner, if the trust isn't needed, or obtaining a basis step up on the surviving spouse's death is beneficial the assets can be paid out. Basis step up means that assets included in your estate get an increase (step up) in the amount on which gain is calculated on sale (tax basis). Some like disclaimer bypass trusts. You bequeath all the assets to your surviving spouse and then he/she can disclaim (renounce) some of the assets into a trust for his or her benefit. This is theoretically a better approach, but few surviving spouses actually complete the disclaimer. Also, as the exemption increased in past years many bypass trusts only benefited the surviving spouse, because the amounts were so large. But ATRA was a paradigm shift. For most taxpayers the income tax, not the federal estate tax, is the problem. If your spouse and all descendants are beneficiaries of the bypass trust, then the trustee can sprinkle income to beneficiaries in the lowest bracket to avoid the new 3.8% Medicare tax. You can repurpose a bypass trust to save income tax if you don't worry about federal estate tax. With portability, when your spouse dies, you succeed to his or her unused exemption. So you may never need a bypass trust to avoid federal estate tax. Assets in a bypass trust may trigger higher income tax during the surviving spouse's life, no federal estate tax savings, and no basis step up on the second spouse's death. Your old style bypass trust could cost you more in income tax while you're alive, cost your heirs more in income tax when they sell assets after you've both died, and at best give you a state estate tax savings less than these costs. Not necessarily a winner. The analysis can be affected by the nature of your assets, your tax basis, future appreciation, and other variables. Christian, help, I need a KISS! So repurpose

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CHECKLIST: WEALTHY '13 PLAN

Summary: If your net worth is over the $5/$10 million federal threshold, you should plan quickly and aggressively. Do I sound like the estate tax version of Chicken Little? Maybe, but President Obama has made his position clear that the wealthy should bear more tax. More fiscal cliffs are looming, and President Obama has repeatedly called for changes to key estate tax planning techniques that most in Washington would view as mere "loophole closing." These include: Eliminating grantor trust benefits by including them in your estate. Grantor trusts make the income of a trust taxable to you even though the economic benefits accrue inside the trust (outside your estate). For the really wealthy, a grantor trust permits you to sell interests in a highly appreciated business to a trust and not recognize gain. Valuation discounts are on the block. So is the ability to allocate GST exemption for more than 90-years.

√ **Get With the Program** – If you're in this wealth category and did not gift your exemption amount last year, get moving before the rules change for the worse. Most people that should have made gifts in 2012 but backed off

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your bypass trusts with the changes suggested above for flexibility. How you invest (asset location) and other variables can also squeeze more bennies out of your repurposed bypass trust. In some instances, such as when your estate is small enough that the alternatives below aren't worthwhile, a bypass trust might remain the hot choice, but for many bypass trusts might be used as a backstop to better planning. You need to update your will and plan even if you're under the exemption amount!

Repurposed Life Insurance – Folks under $5/$10 million used to buy survivorship life insurance to pay estate tax. While still useful for state estate tax, for those safely under the exemption amount survivorship insurance may be a hard limit. But don't discard insurance. Repurposed, it may still be a winner. Consider a permanent insurance policy on one life. Evaluate the projected return on a one-life rather than a survivorship policy. Consider the increased income tax benefits of a permanent insurance policy in light of the increased income tax rates and the 3.8% Medicare tax. Investments can grow inside a policy free of income tax. These dollars can be borrowed, often in a tax advantaged manner. Insurance can still be great, but for most folks, it will be applied in a different manner for different benefits.

Repurposed Irrevocable Life Insurance Trusts (ILITs) – The classic ILIT is a trust that held life insurance so claimants couldn't reach proceeds, beneficiaries couldn't squander it, and it wouldn't be included in your estate. If you're under the new exemption the third component may not matter, but the first two benefits remain important. Instead of a survivorship ILIT for those safely under the exemption, consider the repurposed ILIT: Have an ILIT for one spouse's life, not a 2nd to die policy. Own a permanent policy to take advantage of income tax growth inside the policy. Set it up so your spouse/partner is a beneficiary and funds can be borrowed on the policy and distributed. This is akin to the Spousal Lifetime Access Trusts (SLATs) many use. Consider incorporating a long term care feature on the policy. You need to update your ILITs and insurance plan even if you're under the exemption.

Multi-Purpose Irrevocable Life Insurance Trusts™ (MILITs) – Yeah, so I made up a new name! But this could be the Intelligent KISS for estate planning for folks with enough wealth to plan, but not enough wealth to put up with costly and complex planning. This is a repurposed ILIT and a few more steps. SLATs were the rave in 2012. It was a great way to remove assets from both spouses' estates but let one spouse have access, and even if done creatively and with a little risk (handcuffs not required), the spouse setting it up could benefit too! Well the MILIT can do everything both an ILIT and a SLAT can do. Why pay for two trusts if you can use one. Remember we want that KISS. But you can do better. Let's say you live in one of the 20 or so states that have decoupled from the federal estate tax and that your state has a $1 million estate tax exemption. Ignore Connecticut since it has a gift tax and that is a hard limit. Under traditional bypass trust planning you'd put $1 million in a bypass trust under your will on your death for your spouse. But if your combined estate is say $4 million (well below the federal exemption for a couple) you could still owe hundreds of thousands in state estate tax on the 2nd death. The solution may be a MILIT! You may have an ILIT anyway. You can do more than make annual gifts to an ILIT to pay insurance premiums. Put more in, just like you would with a SLAT. As you get on in years, you can gift more. You can put far more into your MILIT then a bypass trust could hold since after $1 million your estate would pay state estate tax on the first death. And that's a hard limit. But in any decoupled state (other than CT) you can gift up to $5 million+ to your MILIT before death and reduce your state estate tax by more then a bypass trust. MILIT benefits: All benefits of the repurposed ILIT. Avoid much more state estate tax. Use a single trust instead of an ILIT, SLAT and bypass trust. It's simpler, better income and estate

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Review: *Andrew Wolfe, CPA, Esq.*

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...CHECKLIST: WEALTHY 2013 PLAN

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did so because they did not appreciate the mechanisms that can be used effectively to assure them, their spouse/partner and family access to the funds transferred. Yes, you'll have to jettison the KISS principal, but at this wealth level if simplicity is your goal, and costs are your concern, you're not seeing the forest through the trees. You can set up non-reciprocal SLATs (each spouse or partner sets up a somewhat different trust for the other), self-settled trust (DAPT) or some hybrid variation of it, and more. If the "loopholes" above are closed these planning ideas won't have the bang they did in 2012.

√ Top off Your Irrevocable Gift Trusts – If you set up an irrevocable gift trust last year but used less then your entire exemption, and if the trust was set up appropriately for your circumstances (e.g., sufficient access to the trust assets if you need them), top off the gift and use up the remaining exemption. Also, since the $5 million exemption is inflation indexed it increased another $130,000 in 2013. Gift that amount too. If you wait and the loopholes are closed you might need to have your current trust split into separate subtrusts to hold gifts before the change and those after. If your trust wasn't drafted with enough flexibility, you might even need a new trust. Not a very practical prospect for $130,000. Perhaps gift cash for each year's inflation adjustment then swap in business interests later. Gift now!

√ Sell Assets to Your Trust – If your wealth is substantial enough that gifting $5,250,000 (the maximum 2013 exemption amount) or $10,500,00 if you're married, is only a down payment on your planning, you should evaluate selling assets (e.g., interests in a family investment LLC, real estate entities, etc.) to your grantor trusts (the trusts you set up in 2012 were likely grantor trusts, but be sure before you sign!). This is a great way to freeze the value in your estate and shift future appreciation to a trust outside of your estate. It can also lock in significant valuation discounts. If the loopholes above are closed this technique, which has been the keystone of many high net worth families' plans, may be impractical. That will be a huge tax benefit to lose out on.

√ Revisit GRATs – Some advisers were pushing these last year because of the proposals to require a minimum 10 year term for GRATs. That would take much of the zing out of the technique and make the mortality risk of GRATs impractical for older or ill taxpayers to bear. Using GRATs in 2012 if you hadn't used your exemption generally didn't make sense. But now, if you've used up most of your exemption on your 2012 gifts, using GRATs which can be structured to shift growth out of your estate without using any significant current exemption, could be a great technique, If you have closely held business interests this is a potentially valuable approach to consider. Again, you have to move before the GRAT "loophole" is closed.

√ Decant and Clean Up – If you have old trusts and planning, the time to clean them up is now. If the grantor trust and GST "loopholes" are closed you will have fewer options and more difficulty cleaning up past planning "stuff." Decanting is the process whereby you pour an old trust into a new and better crafted trust. While no one can be sure what if any "loophole" closing will occur, or its

RECENT DEVELOPMENTS

The American Taxpayer Relief Act (ATRA) permanently eliminated estate tax worries for most taxpayers. So now, what do you do with those family limited partnerships (FLPs) and limited liability companies (LLCs) that you set up for estate planning purposes? No one enjoys the formalities of maintaining FLPS/LLCs, the cost and hassle of the extra income tax returns, and more. So if they don't provide an estate tax benefit, deep six'em! Not. Repurpose them (just like lots of other planning can be modified for the New Normal of estate planning as illustrated throughout this newsletter). FLPs and LLCs continue to benefit you by: ? Providing control over assets (e.g. as a manager of a manager-managed LLC you can control within reason investment, distribution and other decisions). ? Protect assets from creditors. In many states charging order protection is available (the claimant can get your share of distributions but cannot take over as a member or partner). ? Limit irresponsible heirs by controlling how much say if any they have in FLP/LLC operations and what distributions they get. Even if the federal estate tax benefits were zapped, these entities should remain the cornerstone of many plans. But, just like those late night infomercials (don't ya love Sham Wow!) there's more! Given the restrictions on itemized deductions many high income taxpayers may find itemized deductions disappearing. Creative but careful use of FLPs/LLCs may secure certain deductions. Most important, FLPs/LLCs were historically used to shift income (subject to the family partnership rules of IRC Sec. (e)) to lower bracket family members. This can avoid the top 39.6% rate and perhaps the 3.8% Medicare tax on passive income. ? Bottom Line: Most taxpayers should retool FLPs and LLCs and morph them into asset protection, family control and income tax planning tools. . ? For really wealthy taxpayers, see the Checklist article. The ultra-wealthy should use discounted FLP and LLC interests to fund gifts or sales to grantor dynasty trusts now before the rules change. PP

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PLANNING POTPOURRI

You need to share more love with your 2012 planning to enhance the chance it will succeed. Ignoring what you did last year will almost assure failure. While there are lots of steps that will have to be taken, and they'll all depend on the details of your particular plan, a list of many of the common steps to take (or avoid) might help you understand some of what is involved: ? Typos and incomplete steps exist. No plan or document could have escaped oversights and loose ends with the mad rush to consummate gifts in 2012. Whatever you did, it all should be given a second look. ? Many transfers were completed with the minimal documentation needed to conclude the transfer. For example, if you made gifts of stock to a trust, a stock power and assignment may have been signed. Circle back and be sure to issue a stock certificate to the trust, execute an amended and restated shareholders' agreement, etc. ? Some transfers were made without securing required lender or other approvals. Contact any third parties and obtain the necessary approvals. ? Some trusts were funded with gifts of cash because appraisals could not be obtained in time. Consider swapping in the hard to value assets that you initially intended to be in the trust. ? Gift tax returns will be required for almost all 2012 transfers. Be sure which professional will have primary responsibility for the preparation and that they begin the process of obtaining the necessary information. ? Income tax returns should reflect the consequences of 2012 transfers. This may require allocation of entity income to the time period before and after the transfers, filing returns for new entities and trusts, etc. ? Review asset allocation and location decisions. ? Review insurance coverage to be sure all assets and risks remain covered and new ownership interests, entities, are properly reflected. ? Distributions must be consistent with the post-transfer ownership. If 35% of an FLP was gifted to a trust, distributions must be made 35% to the trust. ? Observe all post-transfer formalities. If new entities were formed to hold assets given, be sure the right people with the appropriate positions/titles sign appropriate documents and confirm appropriate actions. If an investment trustee is require to approve trust investment decisions be sure that individual executes investment documentation. The manager of a

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