

## PRACTICAL PLANNER NEWSLETTER

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### More Info:

• Seminars: RV4TheCause Rides Again! Our charity devoted to educating professional advisers on helping clients living with chronic illness will be presenting lectures on "Estate and Financial Planning for Chronic Illness" in ► Princeton NJ 3/24 ► Bethesda MD 3/25 ► Chapel Hill NC 3/28 ► Jacksonville FL 3/31 and 4/1 ► Tampa FL 4/5. ► Leimberg Information Services, Inc. (LISI) will host a webinar on 3/31, 1:30 EST see [www.leimbergservices.com](http://www.leimbergservices.com). ► 5 consumer webinars will be broadcast from different Good Sam RV parks. See [www.RV4TheCause.org](http://www.RV4TheCause.org) "Seminar/Meetings"

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## PLANNING POTPOURRI

"Live long and prosper" is said after a Vulcan salute, but all you Tax Trekkies knew that! But did Spock or Mrs. Spock actually stay it? Since women outlive men on average by six years who should be calling the final shots? Is the female living longer but not prospering because the shorter lived male pushes gift transfers? Perhaps dad is feeling more generous about gifts 'cause dad won't be around to need the money, but mom might be left trying to make ends meet. 6 years is a long time.

Is 4% the Magic Number: Some folks test your ability to retire by multiplying your investable assets by 3-5% and comparing the resulting amount to your budget. Not a bad rule of thumb for a preliminary chat till you crunch numbers with your financial planner. But is that budget number really right? Many financial gurus say you should

"need" 75% of your pre retirement income to support your post-retirement lifestyle. But according to a recent article quoting researcher Dan Ariely folks "want" a lifestyle that might require 130% of pre-retirement salary. So it's not only teenagers who confuse "need" and "want." But think about the implications to estate and retirement planning, especially gifts and other wealth transfers! What numbers must remain for the female of the couple (+ 6 years) to have the lifestyle she "wants" before gifts can be made?

Are estate planners pushing clients to make tax advantaged wealth transfers before stress testing realistic numbers with the client's wealth manager? Are clients assured they have economic security first? The answer in too many cases might be negative. The client who is reluctant to make large gifts may just be the prudent client.

**Trustees of Insurance Trusts:** Watch your fiduciary back! If an insurance policy will be replaced have an independent insurance consultant and the broker give a written analysis confirming the advisability of the change.

*Cochran v. Keybank, 901 NE2nd 1128 (Ind. App. 2009).*

**Low Interest Rates:** Great for GRATs, lousy for CRATs. Charitable Remainder Annuity Trusts don't work well when interest rates are low. A taxpayer's CRAT recently missed the mark and the IRS permitted the CRAT to be rescinded and the property returned to the taxpayer. PLR 201040021. Sometimes "backsies" is allowed! But to get this



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# PRACTICAL PLANNER

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

## ODE TO THE TRUST – 1ST SONATA

**Summary:** So here's a topic almost as exciting as watching paint dry -- how you should operate your trusts. You know so much about seed gifts, guarantees, and grantor trusts, that you've become the fav guest on the cocktail party circuit. The fun part is planning your trust, but then the mundane but essential part begins – running it. Pay attention to lots of mundane details! For your trust to have a shot at the respect that eluded Rodney Dangerfield, annual meetings of fiduciaries and advisers is a must. Tax uncertainty? Most of the tunes that follow are classics that you'll have to hum for many seasons regardless of the Congressional tax winds — oldies but goodies.

**Type of Trust:** Understanding the type of trust involved will help identify other important issues that will allow you to properly operate your trust, e.g. tax filing requirements (grantor trust, split-dollar loan statement, gift tax return, etc.). The tune of your trust can be classified in a myriad of ways: Revocable versus irrevocable (can't change); Grantor (person establishing the trust is taxed on the trust income) versus non-grantor (trust pays its own tax, subject to the complex "DNI" rules on when distributions carry income out to beneficiaries); Testamentary (formed at death) or inter-vivos (formed while you're alive); etc. The type of assets held by a trust can have a significant impact on the terms of the trust and required operational steps: life insurance, S corporation stock, etc. Each note has importance to operational steps:

**Life Insurance Trust:** In most instances, Irrevocable Life Insurance Trusts ("ILITs") are grantor trusts. This means that trust income (which is usually negligible) is taxed to the grantor/insured. It also can have benefits in avoiding potential adverse income tax consequences when transferring or selling policies. ILITs are typically set up to assure that the proceeds are excluded from the grantor/insured's estate and not reachable by creditors or ex-spouses. These latter benefits will remain vital whatever the tax finale Congress sings. There are many variations on this type of planning and the types of trusts that might own life insurance. Evaluate transferring existing policies to the ILIT in light of the new \$5M exemption, or unwinding split dollar loans.

**Dynasty/GST Trusts:** These perpetual trusts are typically (2010 remains an oddity) intended to continue for a loooong time, often in perpetuity, without triggering estate or GST tax at multiple generational levels. This may require an allo-

cation of GST exemption on a gift tax return unless it is confirmed that the GST automatic allocation rules apply. Plan now, the Obama budget has proposed limitations on these trusts. **Child's Trust:** Confirm whether Crummey powers are used. Was the trust structured as a grantor trust so that the parent/grantor's payment of income tax leverages greater growth in the trust?

### Payments to Be Made:

Many trusts require exacting payment schedules. Are they monthly, quarterly or annually? What date are they due?

The anniversary date of the funding of the trust or year end? Charitable Remainder Trusts ("CRTs"), Grantor Retained Annuity Trusts ("GRATs") require periodic payments be made to the grantor. If not made as required the trust will hit a flat note for tax purposes. Identify the amount and timing of the required payments and assure they're sung in tune. If there is a unitrust payment, or inflation adjustment, be certain the calculations follow the trust terms. If an appraisal

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## CHECKLIST: 2011-12 PLAN

**Summary:** Tax uncertainty lives! But there is one certainty, doing nothing won't help. "Wait and see," may well become "wait and pay." Most importantly, the \$5M gift exemption enacted at the end of 2010 presents the greatest tax, estate and asset protection planning opportunity in decades, and that opportunity may not be around for long.

✓ Late for Supper but not for GST:

So you made gifts in early 2010 to your children or

trusts, but now that you know 2010 has a zero percent GST tax rate, what can you do? It might be possible through disclaimers (renouncing an interest in a gift or bequest) for

grandchildren ("skip persons" in GST parlance) to become the donees or beneficiaries of certain 2010 transfers that would then be subject to a 0% GST tax rate (can't get lower than that!). The GST rules also permit you to make a late allocation of GST exemption in 2011 to 2010 gifts. That might be a good fix. You have to act after 4/15/11. IRC Sec. 2642(g); Treas. Reg. Sec. 26.2642-2(a)(2).

✓ Carryover Basis Allocation to LLCs: LLCs (and partnerships) have inside basis (LLCs' investment in its assets that determine gain/loss if the LLC sells the asset) and

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## ...ODE TO THE TRUST – 1ST SONATA

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is necessary to calculate a payment make sure the trustee can make a timely payment. Have your CPA set up a chart of payments and corroborate them so you're ready when Uncle Sam comes knockin'.

**Trust Permanent File:** Every fiduciary should have a file of critical trust documents. Once this file is set up in an organized fashion, tailored to the specific trust involved, operating your trust becomes as simple as playing Choptstix. Consider: **Trust agreement.** This is the key to all operational decisions from investments to distributions. Be certain you have the entire trust and all ancillary documents, including: schedules listing assets transferred, amendments (if not irrevocable), etc. **Fiduciary actions.** The fiduciaries (trustees, investment advisors, distribution committee, someone holding a power to designate a charitable beneficiary, etc.) of a trust may have

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**Review:** Andrew Wolfe, CPA, Esq.

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the authority to take certain actions that affect the trust. Maintain copies of all fiduciary actions. Corroborate whether anyone holding a power has exercised it (e.g., if someone has a power to substitute assets whether or not they have done so is essential to confirming the assets of the trust). Periodic confirmations of actions not taken can be as important as actions taken. **Beneficiaries.** Current data on trust beneficiaries should be maintained: addresses, Social Security numbers, residency, which may affect how the trust is taxed, etc. **Crummey Powers:** If the trust requires notices of annual demand powers be issued to qualify gifts for the annual exclusion, then records confirming them should be maintained. Consider whether a gift tax return can be filed reporting all gifts to toll the statute of limitations on an IRS audit. Too often, years after a trust has been established, notices are lost, or are handled contrary to the terms of the trust. Even if you are sure that estate taxes will never matter (the estate tax exemption will plummet to \$1M in 2013) failing to adhere to the terms of an irrevocable trust may demonstrate that you have ignored the formalities of the trust, and may jeopardize the trust's protection in the event of a future suit.

**Trust assets.** Are the assets properly insured with the trustee properly covered? Too many people have residential real estate that is owned by a trust but insured as if owned by them personally. Will that suffice to protect the asset and trustee in the event of a casualty or suit? The assets may determine which fiduciary (e.g., investment advisers) has responsibility. Assets can impact state tax filing requirements. Assets should be consistent with the trust Investment Policy Statement (IPS). Should trust assets be augmented by additional gifts to capitalize on the new \$5M gift exemption? The Obama budget proposal calls for a reduction to a \$1M gift exemption.

**Ancillary Transactions:** Ancillary transactions affect the necessary legal documentation, trust income tax return, etc. **Split-dollar insurance.** A split-dollar arrangement may have been used to pay for a portion of life insurance premiums. A statement may have to be filed with the trust's

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and premium payor's tax returns. If the trust involved is not an insurance trust, it might be the party advancing premiums for the policy owned by an insurance trust or family business. Split-dollar arrangements all need to be reassessed, and many unwound using the new \$5M gift exemption. **Guarantee.** If the family engaged in any intra-family sales (e.g. a note sale to a grantor trust) a trust other than the purchasing trust may have guaranteed a portion of the payments. Are guarantee fees advisable? Were they in fact paid and reported appropriately? The \$5M gift exemption gives leeway to make gifts to reduce or eliminate the need for guarantees.

**Loan Arrangements.** With historically low interest rates many family entities have engaged in intra-family loans. Proper documentation, payment and reporting of interest, etc. is essential. Post tax season be certain you have all relevant documents that the interest rate charged is adequate, and that other formalities are adhered to. **Personal use assets.** If a trust purchases a house for a beneficiary, be certain that property tax and mortgage interest deductions are being properly handled both for the trust and those using the property.

## ...CHECKLIST: 2010-11 TAX PLAN

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dent Obama's 2011 budget proposal already calls for a reduction in the gift exemption to \$1M. Why is this so vital? **State Tax:** For folks living in high tax states that don't follow the federal estate tax rules ("decoupled") giving it away before they check out could leave no assets in the state estate tax vice. Example: You have a \$5M estate and live in NY which has only a \$1M estate tax exemption. Give away \$4M today and there is no gift tax (unless Obama's change goes through in which case this planning opportunity evaporates). Beware of the NJ inheritance tax and its 3-year rule. On death if you're under \$1M there is no state estate tax either. If instead you do nothing, on death your \$5M estate will trigger more

than \$400,000 in NY tax. Ouch. **Non-Married Partners:** The gift tax has always been a tough impediment to non-married partners equalizing wealth. For most, the \$5M gift exemption obviates the issue. Gift now before Congress turns the tax spigot off. **Asset Protection:** Shifting assets into a protective structure had to plan around the \$1M gift exemption. With \$5M (\$10M married) there might no longer be any tax impediment to shifting assets. Go for it!

✓ **Change in Venue:** Income stocks are

only taxed at 15% rate. But Bush 15%

tax siesta for dividends may end in

2013 and dividends may be nailed at a

39.6% rate. So, just like hermit crabs

who need to find a larger shell to

grow, your dividend paying stocks

## RECENT DEVELOPMENTS

**S Corp 2<sup>nd</sup> Class of Stock:** Although LLCs are the entity of choice, 2 million+ S corporations still exist. One of the many requirement to qualify and maintain tax favored S corporation status is that the corporation can only have one class of stock. Economic turmoil has forced many S corporations to restructure debt. While that could run afoul of the single class of stock rule, there is some leeway. In a recent private letter ruling the IRS held that the restructure of debt in which the lender negotiated warrants to receive Class B non-voting common stock did not constitute a disqualifying second class of stock. Reg. 1.1361-1(l)(4)(iii)(b)(1). The IRS cited 3 factors influencing the favorable result: (1) The warrants were issued to induce the lender to restructure debt; (2) The lender is regularly engaged in the business of commercial lending; and (3) The warrants were issued in connection with a commercially reasonable loan. PLR 201043015.

**Split Dollar Loan Filings:** A loan can be made under the split-dollar life insurance loan regime but it must have interest paid or accrued at the applicable federal rate ("AFR"). Most of these loans are non-recourse to the borrower, and the lender can only look to the life insurance policy and proceeds for repayment of the loan. This makes the loan contingent with adverse tax consequences. However, this unfavorable characterization can be avoided if the borrower and lender each must file a written statement (representation) with their tax returns in which they state that a reasonable person would expect the loan to be repaid. In these rulings neither the employer or employees filed the required representations concerning the nonrecourse nature of the split-dollar loans with their tax returns. The IRS has recently afforded some leniency by providing an extension of time to meet these filing requirements. PLR 201041006 – 201041024. PP