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Planning Potpourri

■ IRA Protection: An inherited IRA (by other than a spouse) is generally not protected from claimants. Clark v. Rameker. However, state law might provide to the contrary. If so, then the IRA should not be reachable in bankruptcy. 11 U.S.C. §522(b)(3)(A). A recent state case held that an IRA inherited by a New Jersey debtor from his parent was excluded from his bankruptcy estate under Bankruptcy Code section 541. In re Andolino, Case No. 13-17238 (RG) (2/25/2015). A handful of other states (Ohio, Alaska, Texas, Florida, Arizona, North Carolina).

■ Politically Correct Planning Won't Work: While it's a sad statement about our country, the reality is that different assumptions about longevity have to be used for certain clients. "…we are headed toward a one percent phenomenon, with only the very wealthy able to afford the cutting edge healthcare that adds meaningfully to life… higher-income white-collar workers outlive blue-collar workers by 2.5 years, on average, from age 65…Other research points to a sizable longevity gap by educational attainment and race." Can you really plan for life insurance, long term GRATs, private annuities, and other transactions using general demographic data about life expectancy? See Miller, Mark "Why Cutting-Edge Healthcare Will Help The Rich Live Longer," Reuters, May 8, 2015.

■ Clean-up: Your estate planning transactions may evolve over time. A loan used by a trust to purchase assets might be repaid or modified. If the loan was supported by a guarantee or other security documents, were those ancillary documents modified or terminated to be consistent with the loan changes? Trusts might be decanted or trustees changed. If you sent a stock certificate to the institutional trustee for a dynastic trust that was given stock interests, did someone retrieve that certificate and forward it to the new trustee for safekeeping? If the trust protector of a trust died, was a document signed indicating that the new trust protector accepted the position? When beneficiary addresses change was the trustee notified so that the trustee can appropriately issue reports or other communications to the beneficiary? Housekeeping is vital to the success of your planning, but it requires regular and proactive attention. PP

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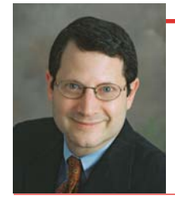
VOLUME 10, ISSUE 2
Apr-Jun 2015



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PRACTICAL PLANNER®

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

Campfire Estate Planning Chat

Summary: Summer at the beach, barbeques, flying kites and S'mores. What you need to keep the young ones smiling is some good estate planning chatter. Hopefully the following estate planning tidbits will make you the hit at the next campfire.

■ FLP discounts: – The IRS is continuing its onslaught against partnership valuation discounts. The latest salvo will be regulations negating discounts on FLPs/LLCs (perhaps only on those not operating an active business). What should you be doing? Well, it depends. If discounts are nixed and your estate is under the federal exemption amount, you might do a happy jig! Why? Because the IRS will have done most wealthy, but not ultra-wealthy, taxpayers a favor. You may have created an FLP or LLC to achieve valuation discounts. But now, most wealthy people's estates are below the $5,430,000 (2015) estate tax exemption amount. So you're not subject to federal estate tax. Absent the IRS regulatory change, the IRS could argue that the FLP/LLC interest must be discounted so that the assets in your estate will not receive the same quantum of basis step up on death. With a regulation prohibiting discounts your estate might get a bigger basis step up (less capital gains to heirs) at no estate tax cost. Thanks Uncle Sam!

■ Administration: It's best to meet regularly with all of your advisers after completing a complex/large transaction in order to properly administer that plan. Most folks seem to feel that once the documents are signed their good to go. But it just isn't so. Every plan must be administered. A few of the myriad of vital steps folks so often get wrong include: missing note payments, missing GRAT or CRT annuity payments, paying fees from the wrong entities/trusts, failing to monitor defined value mechanisms, not issuing Crummey notices, not monitoring trust termination dates, and more. If you meet your wealth manager semi-annually, at least one of those meetings should have your CPA and attorney in attendance. Few plans will have much chance of success without periodic professional involvement.

■ Basis: Estate planning has taken on a new focus on the search for basis, i.e., maximizing the assets included in your estate (or others you plan for) so that the tax basis (on which gain or loss is determined on sale) is increased on death to the fair value of those assets (i.e., capital gains are eliminated). While there is lots of talk about this how much cost and complexity are you willing to tolerate to accomplish this? What techniques do you have the comfort to agree to? Have you reviewed with your professional advisers the myriad of issues that might arise using these techniques? For example, one technique is to give someone a general power of appointment over a trust. That means they will be given the right ton death o designate who will receive the assets of the trust. Are you really comfortable doing so? While layers of limitations can be placed on such powers they do bring increased layers of complexity. Another common basis maximizing technique is to borrow money on appreciated assets and gift the borrowed funds away. This is particular useful to avoid tax in a decoupled state that has no gift tax (e.g., New Jersey). Example: You have a highly appreciated stock portfolio worth $6M. You might choose to retain those stocks in your estate so that on death the significant appreciation is eliminated by a basis step up. If you borrow $3 million using the highly appreciated stock as collateral, you can gift the $3M to a grantor trust. You will grow the value of those assets out-

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Checklist: Swap Powers

Summary: Swap powers have proliferated like Tribbles (you are a Trekkie aren't you?). Most irrevocable trusts that are created are structured to be grantor trusts so that the income is taxed to the settlor creating the trust. That continues to reduce your estate by the tax you pay on income inside the trust. Grantor trusts often include a swap or substitution power that permits you to swap cash into the trust for appreciated trust assets.

√ Basis: These are key to obtaining the new tax planning holy elixir of basis step up because the trust assets swapped back into your estate will, on your death, have their tax basis increased to the fair value of the assets. This will eliminate any capital gains. But alas, like so many planning techniques, once the magic lingo is included in the documents most folks don't give it the attention it deserves, or simply ignore it.

√ Example: You set up an irrevocable grantor trust in 2012 and made a gift of $5M of cash. If most of that cash was invested in equities (likely because the growth would be outside your estate), you're sitting on some mega appreciation. What have you done about swapping the most appreciated assets out?

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...Campfire Estate Planning Chat

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side your estate. While you'll pay the income tax on trust income that reduces your estate, and your estate will be reduced by interest charges. This might well help whittle your estate down over the years to below the inflation adjusted federal exemption. However, there are risks. What if interest rates on the loan increase? What if the securities the trust invests in, with the funds borrowed, plummet in value? Maximizing basis and minimizing estate tax can all be accomplished but you have to weigh the cost, complexity and economic risks of any technique you consider.

■ DAPTs: With the demise of the estate tax for most wealthy folk's asset protection planning has assumed a more important role in planning. Domestic asset protection trusts ("DAPTs") are trusts that you set up (you're the settlor) and you are a beneficiary of, called "self-settled" trusts. Although there have been a number of court cases suggesting that self-settled trusts might not work, the facts on all of those cases have been pretty ugly. This suggests that with proper planning DAPTs might work just fine. Also, the number of states that permit self-settled trusts has grown over the years and is now 15. Other states permit self-settled-like trusts (you can set up a marital trust for your spouse and on his or her demise the assets come flow into a credit shelter trust that you are a beneficiary of). All told there is a significant number of states that permit self-settled trusts. There are also a host of modifications or precautions you can consider: defer your right to receive any distributions for 10+ years (the bankruptcy laws permit a trustee in bankruptcy to set aside transfers to self-settled trusts with 10 years); instead of having yourself listed as a beneficiary let a trusted person acting in a non-fiduciary capacity (i.e., not a trustee or trust protector) have the power to appoint descendants of your grandparents. Thus, you are not a beneficiary when the trust is created, so arguably the trust is not a self-settled trust. Should years in the future you need access to trust funds that person might add you as a beneficiary.

■ Decanting: It is now permitted in 22 states. This creates interesting planning opportunities, but it might also create a new risk for trustees. If you're a trustee of an irrevocable trust, and the trust agreement is not optimal, in the past it might have been presumed that "it is what it is." But now, do you have an obligation to use decanting to improve the provisions of the trust? Might a disgruntled beneficiary argue that merely administering the trust "as is," without addressing the potential for modifying that trust, isn't sufficient? How will the cost and complexity of trust administration change a trustee cannot assume that the governing instrument can be relied upon as the governing instrument? If decanting makes sense, pay careful attention to the statutory requirements under which the decanting is achieved. One common restriction on decanting is not adding new beneficiaries. In re Johnson, 2015 NY Slip Op 30017 (N.Y. Surr. Ct., 2015).

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Aging: Alzheimer's affects 47 percent of those over 85. How can you not plan for the risks of aging? Addressing the issues of an aging are critical for many. Taxes, while unquestionably an exciting cocktail party topic, are just not as important for many folks as more complex fuzzy personal topics. Planning for the inevitability of aging is emotionally challenging. Practical steps such as consolidating assets, organizing and computerizing records, involving children or others who will serve in fiduciary capacities so that they are aware of their roles, and more, is essential. Yet many people are uncomfortable and unwilling to address these matters. While everyone complained that taxes were complex and costly to address (and they still are), they were emotionally neutral. Everyone wants to save taxes. What can be done to get you comfortable taking steps that are vital but which you and your loved ones find unpleasant to consider?

■ Powers of Attorney: Powers of attorney are ubiquitous in estate planning. Most individuals and even many professionals assume they are standard fare. That can prove to be a dangerous assumption. Who is monitoring the agent? PP

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Reviewer: *Andrew Wolfe, CPA, Esq.*

Publisher Information: Practical Planner (Reg. U.S. Pat. & Tm. Off) is published quarterly by Law Made Easy Press, LLC, P.O. Box 1130, Fort Lee, New Jersey 07024. For Information or subscriptions: email news letter@shenkmanlaw.com, or call 888-LAW-EASY.

...Checklist: Swap Powers

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√ Monitor: Are your swap powers and trust assets being properly monitored and administered? Too many wealth managers ignore these and not monitoring them which is a great concern.

√ Credit: Proactively create lines of credit or take other steps to facilitate the quick exercise of a swap power if necessary. Otherwise how will you find the cash, especially if the swap has to be done quickly?

√ Documents: Have your attorney prepare templates of documents to be used to effectuate a swap now. The most likely time to try to exercise a swap power is just prior to death. Illness and other challenges, or an unforeseeable accident, might all make it a time sensitive situation. If you have the requisite legal documents ready in the on-deck circle, you'll have a much better shot at completing the swap in time.

√ Reporting: Should you report the exercise of a swap power on a gift tax return? Arguably no, there is no gift, but if the value of what was swapped is not equivalent if it is not reported the statute of limitations won't run.

√ Appraisal: If you're swapping Apple stock in the trust for cash you can look up the stock value. There should be little risk of not assuring equivalent values. But if the trust holds 25% of the stock in your family Widget Corp. what is the real value? You should consider having an independent appraisal completed and using the value of that appraisal to corroborate that the cash you swap into the trust for the stock is really of equivalent value. Sometimes folks try to save a buck by using an old outdated appraisal, or tinkering with some numbers on their own. The consequences of a bad appraisal can be worse than just the difference from the real value to the value used. The "bad" swap might taint the entire transaction. If the cash you put into the trust for the trust asset you swap out is substantially less the IRS (and creditors) might argue that you really retained control over all of the trust assets and so all of those assets are taxable in your estate.

√ Defined Value Mechanism: If you're going to swap a hard to value assets such as real estate or a family business, consider including a defined value mechanism so that only the interests (e.g., LLC units) equivalent in value to the cash you swap in will be distributed to you. This might avoid violating the equivalency requirement.

√ Disability: Who can exercise your swap power if you cannot do so? On death the swap power and grantor trust status terminate. But what occurs if you are incapacitated? The stats are that about 50% of those 85 and older have some degree of cognitive impairment. Who will exercise the swap power? Don't jump to conclusions that the agent under your power of attorney can do it. Perhaps, but it is the terms of your trust that control. What does it say? If the trust says that the agent under a durable power of attorney can exercise the power if you cannot do so, see the next planning tip below. If the trust document designates a successor does that person know they are so designated? Will the effectiveness of the swap power be adversely impacted by a designated third party exercising it on your behalf? Does this third party know they are in line for this important power?

√ Power of Attorney: Should express powers be given to your agent to exercise swaps? PP

Recent Developments

■ Not So Crummey Planning: You can make a gift of up to $14,000 (2015) to any person (donee) and it should qualify for the annual gift exclusion. If you make the same gift to a trust it may not qualify unless express steps are taken to make that gift qualify as a gift of a "present interest." That means that the beneficiary can access the funds immediately. The means to accomplish this is to give beneficiaries a right to withdraw the money gifted to the trust for a period of time. That right is known as an annual Crummey power. A recent case approved a trust that had 60 Crummey power holders. The gifts qualified even though the property in the trust was not liquid. Some power holders were minors, others spouses of descendants. There was even a funky forfeiture clause. Yet the Court blessed the gifts as qualifying. Do the math: 60 x $14,000/year. That amount could be doubled if the spouse joined in the party (called "gift splitting"). Think of how much money could be transferred over several years. Mikel v. Comr, T.C. Memo 2015-64, Crummey v. Comr, 397 F.2d 82 (9th Cir. 1968). If your estate is taxable a similar trust with lots of Crummey power holders might solve your tax problem. Why bother with complex GRATs and other planning acronyms? But just like the Sham Wow late night cable infomercial, "There's More!" Let's say your estate is $5M, under the estate tax exemption, but you live in a high tax state like New Jersey that only has a $675,000 exemption. If you made gifts to such a trust you won't save federal estate tax, but you could drastically cut state estate taxes with this simple technique. But "There's More!" What if you don't even face an estate tax? Most folks don't now that the federal exemption for a married couple is $10,860,000 (2015). Why would you set up such a trust (assuming helping your lawyer's retirement fund wasn't a good enough answer)? You can give an elderly relative with a small estate a general power of appointment over the trust. All assets in the trust may get a step-up in basis on the death of that elderly poor relative, eliminating capital gains taxes on those assets. PP