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MARTIN M. SHENKMAN, PC
PO Box 1300, Tenafly, NJ 07670
Email: newsletter@shenkmanlaw.com

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PLANNING POTPOURRI

Islamic Estate Planning. It is obligatory on all Muslims to ensure that the distribution of their estate is done in accordance with Islamic laws of inheritance. The Qur'an, provides guidelines as to how assets should be distributed to eligible heirs. These rules are further clarified in Hadith. These requirements can be integrated into a modern estate plan, but caution is in order. Without careful planning, non-probate assets might inadvertently fall outside the ambit of a well planned estate. One approach is to establish a revocable living trust that would own, or be named beneficiary of, certain assets and provide for the proper disposition of those assets in accordance with Islamic law. Examples include: retirement accounts (401K, IRA), proceeds of life insurance, and annuities. Many people, after creating a Shari'ah compliant will, might assume that they've addressed all steps required. However, the disposition of significant assets might be governed by how they fill out bank and brokerage account forms, or how title to a checking account was created. Joint accounts, POD accounts, and similar titles could result in a dispositive scheme that unintentionally violates Islamic law. Title to every asset, and every beneficiary designation, not just the will, must be reviewed. Thank you Dr. Majid Khan.

Administering Complex Trust Plans: So you set up an insurance trust and avoided visiting your estate planner, CPA and insurance agent for 10 years. But you think the trust is fine and golly you saved all those professional fees for all those years. Well cowboy, you may be riding in the wild west of estate planning, but don't forget your Shakespeare, "All's Well That Ends Well." And bluntly, you won't be here when it ends to see if it ends well! Neglecting a "simple" insurance trust is bad enough (Crummey powers, hanging powers, insurance policy performance, GST allocations, etc.). But if you skip properly administering the more complex trusts that proliferated in 2011-12 you're playing with fire. These trusts were far more complex then the simple insurance trusts (which in reality were never simple). While the typical insurance trust has a trustee, the SLATs, DAPTs, etc., may have an institutional general trustee, an investment trustee, a loan director, a person empowered to substitute assets, someone authorized to add charitable beneficiaries, etc. Heed the warning from your favorite

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PRACTICAL PLANNER®

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

A LITTLE OF THIS, A LITTLE OF THAT

Revisit Your Prenuptial Agreement: 'Cause it was so much fun the first round! Portability, the right to use the estate tax exemption of your deceased spouse, was only made permanent in January 2013. So, most prenups don't address it. For some couples that could be a biggie. Consider amending your prenup to address portability. ► Should a portability election be made? The tax benefits may inure to your new spouse's kids, so your executor may not care. ►Who should bear the cost of electing portability which requires the filing a federal estate tax return that may otherwise not be required? Since the surviving spouse's heirs will benefit, perhaps the surviving spouse, not the estate, should bear the cost. But, much of the work of filing an estate tax return has to be completed to determine the income tax basis of assets you held at death, so how should overall costs be allocated? ► Should the decision as to whether to file a return be left solely to the surviving spouse? ►If so, how will the spouse have the authority to act? Should he or she be named as a "special executor" solely for this limited purpose ► You might obligate your executor to cooperate and make available copies of any gift tax returns you filed, and asset data. Similarly, the surviving spouse may be obligated to provide your executor with a copy of the return filed. ► You might be obligated to file a state estate tax return and the decisions the surviving spouse makes on the federal return may affect that state filing, the cost and taxes for which your heirs may be responsible. Should you require that the surviving spouse provide your executor with a draft return to review in advance? What if there is a conflict in positions?

Power up Your Power of Attorney: Powers of attorney may need to be revised to include the following: "I hereby authorize my Agent to exercise any power granted to me as Principal under any irrevocable trust to which I am the "grantor," as such term is defined for purposes of the federal income tax laws, to swap assets out of said trust for property of equivalent value, if permissible for the Agent to act under the terms of said irrevocable trust. ► Consider expressly authorizing your agent to borrow against your assets in order to raise cash to consummate the swap of assets with an irrevocable trust as provided for above. Better still, establish margin and other lines of credit now to facilitate an agent taking action.

Self Cancelling Installment Notes (SCIN) Riskier: ►The IRS is a bit thin scinned about this estate planning technique. You can sell an asset to an heir, trust or anyone for a note. If you do, the value of the note is included in your estate. Notes can come in a myriad of flavors, and one such flavor is a cancellation feature. The note could provide that if you die before the note is paid off, the note is cancelled. If it's cancelled then there is no value to tax in your estate. Conceptually, so long as a fair price is paid for this benefit (which could be either a higher interest rate or a larger principal amount) it should be a fair deal. That was the concept behind the SCIN planning technique. ►However, in a recent pronouncement, Chief Counsel Advice 201330033, communicated the IRS' tougher position on the SCIN technique. In the case, the taxpayer was in poor health when the sale occurred, and died six months later, before receiving any payments. The value of a note for gift tax purposes is the face value of the note plus accrued interest unless the

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CHECKLIST: BYPASS TRUSTS

Summary: One of the most common estate planning techniques is the bypass trust. If your spouse predeceased you, you likely have a bypass trust now. If you're both living you likely have bypass trusts in your wills (or in your revocable trusts). In a nutshell a bypass trust is intended to give the surviving spouse access to the assets it holds, yet keep those assets from being taxed in the survivor's estate. To assure maximum confusion, lawyers will call bypass trusts by many names: applicable exclusion trusts, credit shelter trusts, exemption trusts, family trusts, etc. Let's say you have a bypass trust now. What are some of the points to consider?

√ **Do you need the trust**:

Probably, but perhaps for different reasons then you think. Most discussions start and end with estate taxes. But estate taxes are only one part of the analysis. Assets in a bypass trust may escape creditors and claimants. We live in the most litigious society in history and that won't change so don't terminate the trust without careful consideration of the asset protection it provides for you, and possibly your heirs. Elder financial abuse is epidemic. If you have funds snug in an irrevocable

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...A Little of This, A Little of That

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taxpayer can prove a lower value. Reg. Sec. 25.2512-4. ►The IRS held that the notes should be valued using the standard gift and estate tax valuation rules ignoring the cancellation feature. Reg. Sec. 25.2512-8. That would include the decedent's life expectancy, considering the decedent's actual medical history on the date of the gift. ►The full value of the notes was included in the decedent's estate.

2012 Gift Hangover: ►Many gifts made in 2012 used what is referred to as a defined value clause. A mechanism to cap the maximum amount of gift to hopefully avoid a taxable gift if the IRS were to successfully challenge the value of the gifted assets as being worth more than your appraisal. ►Many 2012 gifts were made with appraisal guesstimates because of time pressure. When the final appraisals were received in mid-2013 the numbers sometimes difference considerably. You now have to pick through the exact language of the defined value clause, and the documents assigning the interests involved to see what has to be done. ► The results in some instances are surprising, and problematic. ►Example: At the end of 2012 you made a gift to irrevocable Trust-1 a sufficient amount of your membership interest in an LLC so that the fair value of the LLC interests, as finally determined for federal gift tax purposes, does not exceed $2.5 million. You also made a gift to another trust, Trust-2, of LLC interests worth $2.5 million. While you were certain your LLC interests were worth more than $5 million when the gifts were made, the actual appraisal valued all your interest at a mere $2 million. Did you make a gift of all of your interests to Trust-1? Did you gift ½ of your LLC interest to each of Trust-1 and Trust-2? ► What steps have to be taken to clarify or correct which trust owns what? Do you create a corrective assignment and state that ½ of your LLC interests are held by Trust-1, and ½ by Trust-2, since you intended to give an equal amount to each trust? Is the assignment valid since it might be interpreted as giving away more than you owned? It may all depend on the language used in the assignment or other transfer documents, and the defined value clause formula. ►If those documents are ambiguous then you may have to look to state law for guidance. That too may not be a simple decision since so many trusts were created in trust friendly jurisdictions like Delaware. Did the documents specify a governing law? Is it Delaware law or your home state law that applies? ►Might you have to transfer additional LLC interests you own to fulfill the mandate of the transfer documents? Reality is that many 2012 gift tax returns were completed in September and early October under time pressures not much less onerous than the time pressures under which the 2012 gifts were made. ►Go back and review the exact language contained in all relevant documents and determine what action should be taken to clarify any ambiguity. Be certain that the amended and restated LLC operating agreement, certificates (if your LLC issues them), and K-1s on the partnership income tax return, all reflect the same and defensible LLC interests. ►Some assignments were drafted so that up to the $2.5 million would be transferred. In those cases it might be that Trust-1 will own the entire interest transferred and Trust-2 nothing. If the language of the transfer documents supported that ½ of the transferred interests, each not to exceed $2.5 million was given to each of Trust-1 and Trust-2, then each trust may in fact own ½ of what was given, albeit worth less than anticipated. ► If the results from the assignment and formula clause are not what was intended, there may be some simple fixes. The moral of all this is that the governing documents on all sophisticated trust transactions need to be carefully thought through and a myriad of "what-ifs" considered. Those seeking to complete sophisticated planning on a shoe-string will often find themselves confronted with problems from cutting corners. Last year there was insufficient time to address all nuances. ► Consider options to correct these issues. Decant or merge the trusts into new trusts that accomplish the intended goals. Since the estate tax laws didn't sunset in 2013 if Trust-1 received the

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Review: Andrew Wolfe, CPA, Esq.

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...Checklist: Bypass Trusts

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trust, that alone may justify keeping the trust going.

√ Are you really saving estate taxes: Maybe. Most bypass trusts were created when it was assumed that a 50% federal estate tax could apply to all assets over $1M. Now, there is a permanent inflation adjusted $5M exemption and portability (your surviving spouse benefit from your unused exemption even without the use of a bypass trust). So very few folks will be subject to a federal estate tax. If you're married and have a net worth say over $8-10M, using a bypass trust may sound like a no-brainer, but there are better planning options. For everyone else, if there is no concern about federal estate tax, the only estate tax savings is if you live in one of the approximately 20 decoupled states (e.g., NY, NJ, MA, and CT) but the maximum rate is 16%. That is not insignificant and your heirs will likely appreciate the savings, but for most the savings are not what was anticipated.

√ Oh, but you lose the basis step up: Many estate planners are suggesting you won't benefit from a bypass trust because on the death of the second spouse the assets in the trust will retain the same tax basis for determining capital gains. In contrast, if the assets were held outright by the surviving spouse, the tax basis would increase to the fair value of those assets on death and the capital gains on pre-death appreciation will disappear. All true, but not the whole story. Many older people (and it's usually older folks that have funded testamentary bypass trusts) have a relatively conservative investment allocation. If you locate bond accounts in the bypass trust and equity accounts in your own name, you can retain your desired asset allocation, but minimize post-death appreciation in the bypass trust, rendering the basis argument moot. Proper investment management has always been a key to successful estate planning, now it's even more important.

√ Bypass holds appreciated assets: Your wealth manager may be able to harvest gains and losses and reduce those appreciated positions over time. If that won't suffice, read the language of the will that created the bypass trust, including the often ignored provisions near the end (too often dismissed as "boilerplate"). Your trustee may have sufficient flexibility to distribute appreciated assets to you. If so, those assets will be included in your estate and receive an increase in basis on death. If you live in a decoupled state you have to weigh the capital gains savings versus the increase in state estate tax the distribution might cause.

√ You really don't need or want the bypass trust: You weigh all the pros and cons and determine that in spite of my best efforts above to convince you otherwise, you really don't want the cost and hassle of the bypass trust. Again, carefully read the entire will that created the trust. Some bypass trusts permit a distribution of "any and even all principal." That might suffice for the trustee to simply distribute trust asset to you and terminate the trust. Many bypass trusts limit distributions to an "ascertainable standard" which means maintaining your standard of living. That language rarely would permit the termination of a trust. Many, perhaps most, trusts have "spendthrift" provisions. A court would be loath to easily terminate a trust with such a provision since it indicates that the testator establish-

Recent Developments

Charitable Gift Agreements: It's becoming more common for donors to work out arrangements with charities when large donations are made. These agreements should specify the use of funds, naming considerations (what any dedication plaque will say, where it will be displayed, etc.) and other considerations of concern to the donor. Also, the details should be flexible enough to give the charity reasonable latitude to address changing circumstances, but without thwarting donor intent. Likely that the use of this formality will grow. As a recent court decision makes clear, charities must take these commitments seriously. Charities can't solicit funds for a particular project and then put the funds to another use. In Adler v. SAVE, the New Jersey court required a Princeton, NJ animal shelter to return $50,000 donated by a couple who expected the donation to fund construction of a new facility that was never built.

Reasonable Compensation: Reasonable compensation can be a critical factor in planning for any closely held business. If you own an S corporation, you might be tempted to pay a modest salary and draw out profits as a distribution to avoid payroll taxes. The IRS could argue that the salary you've taken is unreasonably low. If you make a gift of business interests to a trust, you might take out an excessively large salary since you cannot receive all of the distributions if you no longer own all the stock. Taking an excessive salary might be argued by the IRS as proof that you never really gave away the stock. The compensation porridge cannot be too hot or too cold, or the IRS bear might snarl. Reasonable compensation, however, must be based on all the facts and circumstances. In a recent case the IRS expert evaluated only the gross revenues of a real estate business, but the court said all facts and circumstances had to be considered. Sean McAlary Ltd, Inc., TC Summary Opinion 2013-62. When tax issues become a facts and circumstances test careful homework along the way, corroborating the reasonableness of the positions taken, may go a long way towards supporting the desired result. PP