PRACTICAL PLANNER NEWSLETTER
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- Seminars: July 8, 2008 "How to be an Executor". Practical seminar for professionals and those serving or named as executors. Call 201-845-8400 for more information.

NEW FEATURE—AUDIO - Audio clips of each article, with more background and explanations, will be posted starting this issue on www.laweasy.com. The goal is to make the content more accessible to those with less technical backgrounds, or that have difficulty reading the newsletter.

Creative solutions that coordinate all your planning goals:
· Estate · Tax · Business · Personal
·Financial ·Asset Protection

PLANNING POTPOURRI

Protect Home Mortgage Interest Deduction: The mortgage market remains chaotic. Parents may have to help children out with a loan if no other source is available. But for the kids to deduct the interest paid to their parents, the parents must secure and perfect their loan under state law (recording a mortgage), or the interest paid won't qualify for the home mortgage interest deduction.

Custodial Account into FLP: A common scenario is a parent endeavoring to consolidate various family investment accounts into a single family investment entity, such as a family limited partnership (FLP). Custodial funds belong to the child and some brokerage firms won't transfer custodial funds into an FLP account that restricts the child's access to the funds more than does the custodial account. Possible solution: include in the partnership agreement a special withdrawal right that lets the child have a window, say 60-days, after attaining the age of majority to withdraw the economic value of his or her partnership interest without discount or reduction. This is analogous to the withdrawal right given under 2503(c) trusts when the child beneficiary reaches age 21. "Notwithstanding anything herein to the contrary, if any partner is a minor for whom custodial funds were transferred or invested in this Partnership ("Minor Partner"), then upon the minor attaining the age of majority (determined by the laws of the State) such Minor Partner may upon notice given at any time within Sixty (60) days of the date of attaining the age of majority that all of his or her partnership interests attributable to said custodial fund contribution and the growth thereon must be liquidated and the fair value thereof, unreduced by discounts, be distributed to said partner. If this right is not exercised within said period this right shall lapse."

Estate Tax Deferral: Executors can defer estate tax on interests in closely held businesses if a series of requirements are met. Deferral is not available to non-business assets. Is cash held in a business a business asset? Planning tip: If you are holding cash in a business for working capital, repair or other needs, corroborate that with periodic entity minutes confirming the business reasons for holding the cash. PP

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Practical legal stuff... in plain English

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PRACTICAL PLANNER

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GUMBY ESTATE PLANNING

Summary: Gumby, that loveable dark green humanoid, known for its being able to be bent into almost any direction or shape, has become the new mascot for estate planning. The tremendous uncertainty about the future of the estate tax, and the economy, requires similar flexibility to keep options open regardless of what happens next. Here's some ideas to Gumby-ize your planning.

Disclaimers.
You can structure a document with disclaimers into wills and trusts so that your heirs have the flexibility to shift assets when appropriate based on the law when you die. For example, you can leave assets outright to your spouse and give him or her the right to disclaim (file a legal document saying that he or she doesn't want those assets). The disclaimed assets will then pass to the next named heir (which can be a trust) under the will or other governing document. Similarly, you can name a spouse as beneficiary of an IRA and he or she can disclaim in favor of the next named beneficiary inherits (which could be a trust of which the spouse is a beneficiary or children). Disclaimers sound seductively simple, and they are quite flexible, but the reality is that too often a surviving spouse is reluctant to give up control, or some benefit has been accepted from the assets making it impossible to disclaim. To make a disclaimer more likely to work, involve the heirs who may make the disclaimer in the planning process so that they understand what is involved.

Grantor Trust Toggle.
The newest tax dance since the twist is called the "toggle". You can set up a trust for a child or other heir as a grantor trust. A grantor trust is taxed to the grantor for income tax purposes. Paying income tax on trust income will result in more value being transferred to the heir. However, if estate tax repeal happens, or the exclusion is raised substantially, turn off grantor trust status to eliminate this additional wealth transfer. This can be done, for example, by having a trust protector terminate the power provided in the trust that causes it to be characterized as a grantor trust. Dick Clark would love this!

Power of Attorney.
Establish a good comprehensive, personalized, durable power of attorney with a well crafted gift provision. This way you can avoid making large estate tax planning transfers today but retain the ability to move assets at a later stage outside your estate even if disabled. A gift power should address a number of key issues *Who can receive gifts? Children only? Grandchildren? Spouses? Partners of children? * Should gifts be equally by child family line? * Can gifts be made to 529 college savings plans? Can those gifts be front-loaded (the law lets you give 5 years worth at one time, but should your agent be permitted to do this?). * How much can be given? Should it be limited to the annual gift exclusion (currently $12,000/year/donee)? Consider including broad rights to change beneficiary designations of retirement plans and life insurance. These mechanisms may provide flexibility to adjust your plan if changes in the estate tax occur at a time that you don't have the competency to modify your plan yourself.

Make Trusts Flexible.
If you need to set up an irrevocable trust (cannot be changed) build in flexibility to deal with future uncertainty. Name a person (trust protector) that can change trustees,

(Continued on page 2)

CHECKLIST: BUSINESS PERM FILE

Summary: Your CPA should have a number of key documents regarding your closely held business in what CPAs call a "permanent file". The comments next to each item explain some of the ways your CPA might use these documents. Your accountant's focus on these documents is often very different from what your corporate attorney might focus on. If your accountant doesn't have these documents, important issues could be missed and you could be hurt on a tax audit. If your CPA is missing any of the items address it.

√**Certificate of Incorporation: More than 2 million closely held businesses are organized as S corporations which are only permitted one class of stock. A second class of stock can exist but only if it differs solely in voting rights, not economic rights. The Certificate can list key rights of shareholders and other items that might affect projections, distributions and other work your CPA does.**

√**Amendment to the Certificate. If there are any amendments to the Certificate your CPA should review what was changed as it might affect any financial reports issued. New classes of stock might be is-**

(Continued on page 3)

...Gumby Estate Planning

(Continued from page 1)
the location of the trust, and other factors to add more flexibility. Give trustees broad discretionary authority to make distributions since the future is unknown. Example: In a bypass trust under your will (the trust used to protect the estate tax exclusion amount, currently $2 million) consider naming your surviving spouse and all heirs and giving the trustee the right to "sprinkle" funds to whomever they determine.

Use a Marital Trust instead of an Outright Transfer.
Instead of bequeathing assets outright to your surviving spouse use a marital trust in order to provide more flexibility to determine what portion of assets should qualify for the marital deduction for estate tax purposes.

Buy Life Insurance.
You can purchase life insurance (or better yet have a trust do it so the insurance is protected and outside your estate) and then take a wait-and-see approach with the estate tax developments. Caution: If you do this, consider purchasing a permanent policy that is structured to minimize premiums in early years, or a term policy with conversion features. If you develop a health problem and the tax laws become more unfavorable, mere term insurance may not be renewable when you need it.

529 Plans.
Front load five years of annual exclusion gifts to a college savings plan and remain the account owner. This permits you to gift $60,000 now, but since you are the account owner you can take the money back (yes, with taxes and a penalty) in the future. Caution: If you die within five years part of the gift may be pulled back into your estate. Using 529 plans and annual gifts is a way to move assets out of your estate that you can reclaim if circumstances warrant.

GRATs.
A complex trust planning technique lets you shift excess growth in a portion of your stock portfolio, or other assets, out of your estate (i.e. growth in excess of a federally mandated rate of return, currently about 3.84%). This can move some growth out of your estate but keep your principal so you can evaluate re-using the technique each year as circumstances change. This is a great way to initiate a controllable amount of planning that can be monitored and tweaked as circumstances warrant. Caution: If Congress repeals the technique of using rolling GRATs, the GRATs in future years may not be possible.

Self Funded Trusts.
You can set up a domestic asset protection/dynasty trust in any one of more than a dozen states, the most popular being Delaware or Alaska, and gift substantial assets to the trust (or use more esoteric techniques to transfer even greater amounts of value). Since these states purport to let you remain a discretionary beneficiary of the trust you can still benefit from trust assets should you need them in the future. If successful, you can remove substantial assets from your estate yet still benefit from them if you need.

Terms in red defined in the glossary at www.laweasy.com. Audio-newsletter now at www.laweasy.com.

Revocable Living Trust. Set up a revocable trust and transfer substantial assets to the trust (a funded trust). You can be your own current trustee (or co-trustee) and designate trusted persons to succeed if you become disabled. Give the successor trustees broad power to change your estate plan in the event that circumstances change. This can provide flexibility to deal with the uncertainty even if you are disabled and cannot change your plan yourself.

It Ain't Just About Taxes.
Don't forget that estate planning is never just about taxes. Taxes should never be the only, or even the primary, focus of your planning. Tax savings should only be pursued if consistent with other important personal goals. Asset protection, business succession planning, disability concerns, income tax planning, protecting loved ones and a myriad of other issues are vital to address. Elvis says: "Don't let the tax tail wag your estate planning dog!" Repeal, no repeal, you need comprehensive planning.
PP

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...Checklist: Close Business' CPA Permanent File

(Continued from page 1)
sued, and the number of shares authorized might be changed.

√**Certificate of Authorization in Other States**. If the corporation is authorized to conduct business in other states your CPA may have tax filing issues in those states, and have to revisit the allocation of income among the various states where activities occur. The opposite might also be worth investigating. If your CPA is filing tax returns in states other than where your corporation was incorporated he or she should alert your attorney to address the requirement to have the corporation authorized to do business there.

√**Bylaws**: Bylaws provide a host of details as to the operation of your corporation that may be important for your CPA to know. The titles and responsibilities of the different categories of officers of the corporation are listed in the bylaws. This could affect an analysis your CPA performs to establish the reasonable compensation for various officers. If someone has a title and is being compensated that officer title and description of responsibilities should be consistent with the compensation.

√**Shareholder Agreement**: There is a raft of points your accountant should review and consider. If specific reporting requirements are mandated (e.g. the type of statements to be issued) these should be adhered to but your CPA cannot do that without reviewing the agreement. Testing of formulas (for buy out, compensation, etc.) to make sure they work and are funded is an important role for your CPA. Working capital, distribution and other provisions may require monitoring by your CPA.

√**Stock Certificates**: In too many cases the ownership percentages listed on the Form 1120-S K-1s (S corporation returns) differ from the actual shares issued by the corporation. This can occur if gifts are made but the documentation not completed, etc. It is important that the tax returns and corporate records agree. Failing to do so could undermine gift programs and trigger assignment of income issues.

√**Corporate Bank Account**. A bank statement will enable your accountant to confirm that the title and tax identification number on the account are correct. Frequently account information can be incorrect. When there are many different entities the risk of mixing up accounts and undermining the integrity of the entities involved can be significant.

√**Notes**: Loans are a hot issue for closely held businesses. Undocumented loans from the corporation could be recharacterized as dividends, salary, or other forms of distribution. Undocumented loans are a factor cited when seeking to pierce the corporate veil.

√**Consulting and Employment Agreements**: Proper classification as an employee or independent contractor is essential to comply with state and federal withholding tax requirements. Your CPA can review these agreements to assure tax compliance.

√**Annual Minutes**: Salaries, bonuses, working capital, loans, gifts, and other key decisions that involve your CPA are often noted in annual cor-

Recent Developments

Who is an Heir: A direct descendant to the JELL-O fortune, born out-of-wedlock and given away for adoption relinquishing her parental rights, is not entitled to be a beneficiary of a family trust for descendants and living children. Further, there was no evidence that the grantor knew of her birth or adoption. *In the Matter of the Accounting by Fleet Bank, as Trustee of the Trust f/b/o Barbara W. Piel*, 2008 WL 656471 (N.Y.), 2008 N.Y. Slip Op. 02082, March 13, 2008. The importance of the meaning ascribed to the term "descendants" will continue to grow as family structures continue to morph, and trusts continue for longer periods.

Qualified Joint Ventures: The Small Business Act of 2007 added IRC Sec. 761 (f) permitting spousal qualified joint ventures ("QJVs"). A QJV is not treated as a partnership for federal tax purposes. If a husband and wife own a rental property in an LLC 50/50 they can avoid filing a partnership tax return. Each is instead treated as owning a proprietorship and files tax returns accordingly. Making a QJV election won't cause self-employment (SE) tax on income from rental real estate that would otherwise not be subject to SE tax. The IRS reasoned that the purpose of a QJV was not to characterize income as subject to SE tax that would not otherwise have been. CCA 200816030. Consider whether avoiding filing a partnership return is really an advantage if there is a suit.

Alternate Valuation: The Tax Court, in *Kohler,* TC Memo 2006-152, permitted a reduction in the value of stock as a result of a post-death corporate restructuring when the estate elected to value assets at the date 6 months after death (called the alternate valuation date). The IRS has attempted to flush away that result by issuing proposed regulations that only allow post-death changes in market conditions could reduce value for estate tax purposes. Prop. Treas. Reg. Sec. 20.2032-1. PP