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PRACTICAL PLANNER

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PLANNING POTPOURRI

If you're disappointed with your accountant, the two winners below are probably looking for new clients.

Is this the guy you want advising you?

The CPA in this case reported \$21,553 profits from his accounting practice, and \$83,451 from his gambling endeavors. On his tax return, all of his gambling income was offset by gambling losses. The IRS objected to the use of the gambling losses. Instead of settling with the IRS he took the case to court (to maximize his public embarrassment?). He lost because he did not demonstrate that the "primary purpose" of his gambling activities was to earn a profit. This is a tax law requirement to deduct them. Ah shucks. He failed because he only spent 17 hours/week gambling. You can be considered in the trade or business of gambling if you gamble with "continuity and regularity" and your "primary purpose" is to

earn a profit. So if this guy won, his clients would have really been inspired. A sporadic hobby doesn't qualify. Since this CPA was only a sporadic gambler the Court held that his gambling wasn't a business. The result, his gambling losses were only deductible as an itemized deduction. *Mohammadpour, TC. Summary Opinion 2007-163* Need a new CPA?

Why waste the client's money?

For some transactions it's advisable to seek advance IRS approval (private letter ruling). In this case, it was just a tad embarrassing. *PLR 200729004*. The client subdivided a property into two parts, then transferred one to a qualified personal residence trust (QPRT). The client restricted the second part with a conservation easement. The tax adviser submitted three questions to the IRS: (1) was the first part a "personal residence", (2) did the trust qualify as a QPRT, and

(3) was the interest retained by the client a "qualified interest". The IRS issued the requested ruling, and took the client's payment for the request, but didn't answer the last two questions. Instead, the IRS referred the adviser to Rev. Proc. 2003-42, 2003-1 CB 993 which provides sample trust language for QPRTs. The IRS said that if the client follows the cookbook provided they "can be assured" that the IRS will recognize the trust as a QPRT, provided that the trust is operated in accordance with the terms of the trust, and is a valid trust under local law. In other words, tax adviser, read what we publish before asking the same question. **PP**



*Practical legal stuff...
in plain English*

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HAVE FAITH IN ESTATE PLANNING

Estate Planning should not be just about the transmission of wealth. Estate planning should be about the transmission of values. For many, this encompasses the transmission of religious beliefs. With a modicum of effort, every legal document and transaction can be reconciled with your religious views.

Religious Considerations Relevant to Many

According to many surveys, 95+ percent of Americans believe in G-d or some type of higher power. While some define religion as a belief in G-d, not all religions do. While Buddhism and Scientology are considered religions, Buddhism does not teach its adherents to believe in G-d; and Scientology does not necessarily require a belief in G-d. For some, spirituality may be a vital part of their lives, but not include a belief in G-d. Whatever your religious views or spiritual nature, your estate planning should be consistent with your beliefs and preferences, or even lack thereof. Unfortunately, few estate plans address religion, spirituality and values. If you endeavored to live your life in conformity with your religious beliefs, then your final medical decisions, funeral arrangements and distributions under your will, the overall "tone" of your documents, should be consistent with those beliefs.

Should You Address Religious Matters

Even if you're personally indifferent, ignoring religious issues can lead to painful family strife. Even if religious rituals are not important to you, make the effort to specify what you do and don't want. Say you've become more "modern" and less observant, out of respect for family at least consider addressing religious considerations. If you're debating whether to conform your estate plan to the doctrines of your faith, consider the solace that traditions can bring to those suffering tragedy.

No Religious Beliefs

If you're not religious don't assume that nothing needs to be addressed in your documents. This is a dangerously incorrect assumption. If you've determined you do not want the traditions of a particular faith, or any faith, adhered to, then it's incumbent upon you to make that point clear to avoid incorrect assumptions by family and others that religious restrictions or customs should be applied. The level of diversity of religious affiliation and observance among family members can be substantial. If

you don't want religious observances of other family members imposed you, then an express statement that certain rituals or practices should not be followed is vital.

Sampling of Topics to Address

Distributions – Agents and fiduciaries should be given guidance, and granted legal authority, to disburse funds for religious education (e.g. supplemental religious education or private school), religious travel (pilgrimages to holy sites), charitable giving (to inculcate a core religious value in heirs), and other purposes consistent

with your religious goals. Boilerplate distributions in many documents won't suffice.

Charitable Giving – Every religion advocates the virtues of charity, but charitable giving can be tailored to reflect the unique nuances of your faith. Charitable giving is essential to the Baha'i Faith as it demonstrates devotion. Baha'is are expected to give a certain percentage of their income and assets to Baha'i charitable organizations through a mandatory dona-

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CHECKLIST: VOLATILE TIMES

The stock market, interest rates, and other economic and political circumstances have experienced considerable volatility of late. How should your planning be modified to address volatility?

✓ **Core Planning:** It shouldn't change. Whatever the markets and environment, volatile or calm, you need to have the key legal documents and planning in place. More significantly, since estate planning is long term, your planning and documents will be impacted by volatility at many points in the future, even if you view the waters as calm at any particular time. Here's the "volatility

spin" on estate planning:
✓ **Rolling GRATs:** Not even a distant cousin to Dylan's rolling stone. Grantor Retained Annuity Trusts ("GRATs") are a technique that can shift value out of your estate for modest gift tax cost. Transfer assets to a GRAT which pays you a high annuity for a short period, say two years. To the extent that your investment returns exceed the current federal interest rate, that gain is outside your estate tax free. If you catch the upside volatility in your GRAT you have the tax equivalent of a grand slam. If you catch the wrong side of the market swings, the

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...HAVE FAITH IN ESTATE PLANNING

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tion to *Huququ'llah*. Other religions mandate tithing to charity.

Pregnancy and medical decisions -

Pregnant women should carefully address the issues of pregnancy in their living will and/or health proxy since medical decision making concerning a mother and her fetus vary greatly among different religions. Generally Catholicism proscribes taking direct action that would cause the death of the unborn child, or the mother. You cannot choose the life of the mother over the life of the unborn child, or vice versa, since all life is sacred and that decision lays in God's hands alone. Unless this matter is expressly addressed in your living will, no one may know the degree of your devotion. You cannot expect health care providers to have the knowledge necessary to carry out your wishes without clear guidance from you. In contrast, under

Jewish and Islamic law, saving the mother's life is generally given preference to that of the fetus.

Pain Relief - Many patients and health care providers view the alleviation of all pain to be an essential and ideal objective. There are exceptions. For an Orthodox Christian, the act of suffering can be an experience providing for purification, redemption, and salvation. While suffering is clearly not encouraged, pain relief to the point of making someone unconscious during their last days may prevent them from addressing profound and moving observances essential to their religious beliefs. The customs of the Christian Orthodox Church encourage you to be lucid during your last days so that you may be free to confess sins and receive Holy Communion. If the attending physicians are not aware of this, they cannot be assumed to respect and foster this type of care. Similarly, according to Buddhist tradition, your consciousness near death correlates to the level of rebirth.

Funeral and other post death arrangements -

Most religions provide for post death rituals and law. Under Jewish law autopsies and embalming are generally prohibited. In the Buddhist tradition, it is a common belief that incense should be burned near death to help provide symbolism of the path upward toward enlightenment and to guide your last thoughts upward. Many Buddhists believe that for a period following death often for a minimum of at least one week, the spirit may remain with the body and, therefore, the body should not be moved. These traditions may be impossible to carry out in any medical or health care facility so it could be quite important to make advance arrangements to spend one's last days in a hospice sensitive to these religious beliefs or at home. Some religions prohibit cremation, other religions or cultures favor it.

Transmitting religious values to heirs -

Your selection of trustees will have a profound impact on the transmission of values. Providing a detailed and personal letter of instruction about the upbringing of young children is essential to transmit values.

Terms in red defined in the glossary at www.laweasy.com. For e-newsletter sign up at www.laweasy.com.

Disposition of assets on death - A secular will may have to be modified to reflect the Baha'i, Jewish, Islamic, or other religious laws of inheritance. The Quraan and Old Testament include detailed provisions as to how inheritance must be handled. While there is similarity to both, they are typically addressed in quite different manners in will drafting. These provisions need to be coordinated with estate, financial, and ethical issues. For the Christian Orthodox, if you do not provide for your family and relatives, it is as if you have disowned the faith, and you are worse than a non-believer. For Catholics guidelines of charity and justice apply.

Charging of interest - Both Islamic and Jewish law include prohibitions on the charging of interest. These concepts can be incorporated into powers of attorney, wills and trusts.

Conclusion

Your personal religious considerations can, if you wish, permeate your estate plan. Planning should never be restricted to mere legalities and tax issues because fundamentally, estate planning is about the "people" not the "stuff". **PP**

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...CHECKLIST: PLANNING FOR VOLATILE TIMES

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GRAT busts, and you try again, with little down side. This repeated application of GRATs is referred to as rolling, or **cascading, GRATs**. These short term GRATs thrive on volatility.

✓ **Market Timing:** While investment theory advises against market timing, estate planners love their version of it. If interest rates are high QPRTs work better. If interest rates are low GRATs and IDITs work better, and so on. From this perspective, volatility can enhance planning.

✓ **529 Plans:** Not feeling financially secure? Instead of making annual gifts (you can gift \$12,000/year/donee gift tax free) to the grandkids or trusts for them, instead gift the cash to 529 college savings plans for which you're the account owner. If the volatility hits you the wrong way, and you're in need of milk money, as the account owner you can withdraw funds from the 529 plans (yes, subject to a penalty, but at least you can access the assets). If your worries prove unfounded, the money can remain in the 529 plan so Junior can go to college instead of flipping pizza for a living.

✓ **Self Funded Trust:** Set up a self funded (you put the money in) trust in which you remain a beneficiary. This type of trust is permitted in a number of states, including Delaware and Alaska. Arguably (but it's not guaranteed and proven) you can gift assets to the trust and they will be removed from the reach of your creditors, and from your taxable estate. You will still be able to receive distributions from the trustee if you need them. If volatile times make you feel too financially insecure to give up assets completely, but you want to continue asset protection and estate tax minimization planning, these trusts could be the ticket.

✓ **Bypass Trust:** These are the trusts used to safeguard the amount that can be passed estate tax free on the death of the first spouse. Many **bypass trusts** are drafted to permit distributions to the surviving spouse, children, and even others. If volatility has your stomach in knots, modify the trusts in your wills so that the bypass (**applicable exclusion** or credit shelter) trust names only your spouse as beneficiary. If times get tight, it may be better not having the kids' fingers in that pot. If you're really worried, bequeath everything outright to your surviving spouse (and vice versa) and give your spouse the right to disclaim into a bypass trust. This gives the survivor the right to total control over the funds if times are tight.

✓ **Buy Life Insurance:** Stop your gift program if you're worried you'll run out of money, and instead buy life insurance to pay estate tax or provide an inheritance for your heirs. Put a bumper sticker on your new Hummer "I spent my kid's inheritance on this car".

✓ **Plan and Draft Flexibly:** If volatility has you concerned make your planning and documents more flexible. For example, don't mandate distributions from trusts in case someone else needs them. Reduce specific bequests to friends, charities and other secondary beneficiaries in your will so that key heirs inherit more, or limit them by using percentages instead of fixed dollar bequests. **PP**

RECENT DEVELOPMENTS

1031 Exchange: Everyone loves a tax deferred, like kind, or **1031 exchange** because you can defer tax on swapping real estate instead of selling the property and paying capital gains tax. Well, the Treasury Inspector General for Tax Administration has noticed all that love and issued Audit Report 2007-30-172 "Like-Kind Exchanges Require Oversight to Ensure Taxpayer Compliance" Dated 09/17/2007. The report notes that there is a growing number of taxpayers using 1031 exchanges, but that many don't meet the requirements. No surprise there. When real estate lawyers can boast that they can structure a like kind exchange for \$500 at the closing using a service company that prepares the paperwork, you have to get a bit curious. 1031 is not exactly a cake walk of simplicity. These deals should really be done under the guidance of tax attorneys and tax accountants (thank you Uncle Sam!). When you use a 1031 exchange you must report it to the IRS on Form 8824. In 2004, 338,500 Form 8824s were filed deferring \$73.6 billion. The Report noted particularly that there are those promoting the inappropriate tax free exchange of vacation and second homes. It acknowledges the complexity and lack of clarity and guidance concerning the exchange of vacation homes. Other areas of concern include tracking the gain on subsequent transactions, related party exchanges, incorrect property basis data (which is essential to determine the taxable gain when you finally liquidate), partial, step and bartering 1031s. Bottom line expect more audits of 1031 transactions.

Payroll Tax: One member limited liability companies (LLCs) that are disregarded for tax purposes (you file a schedule C or E on your Form 1040), and qualified Subchapter S subsidiaries (Q-Subs) are all to be treated as separate entities for employment tax purposes. Previously for such an LLC (Notice 99-6, 1999-1) you may have filed payroll taxes under your name and Social Security number. T.D. 9356; Reg. § 1.134-1; Reg. § 1.1361-4; Reg. § 301.7701-2. **PP**