

PRACTICAL PLANNER NEWSLETTER

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PLANNING POTPOURRI

Checklist: Obama Tax Plan (continued from page 1)

✓ **New Age FLPs.** FLPs in an environment with reduced or eliminated discounts and higher marginal taxes, will take on non-tax planning objective of the days of yore – shifting income to lower bracket family members.

✓ **New Age GRATs.** The grantor retained annuity trust (GRAT) game had been to put volatile asset classes into high payout short term GRATs. A confluence of factors might now make a long term GRAT with a different investment strategy the better approach. **Consider:** interest rates are at historic lows, it might take years for assets to recover their prior values, the needs of the federal fisc might lead to the repeal of the GRAT technique, etc. Consider long term GRATs with single

asset classes. If the GRAT realizes a large gain, the old technique (called immunization) was to substitute T-bills for volatile GRAT assets to lock in gain. But with a long term GRAT with years remaining that won't work, so instead immunize with a conservative but diversified portfolio to minimize downside while providing some upside potential.

✓ **Tax Credits.** Credits have always been a favored technique to motivate specific types of investments. Obama tax proposals might include new and enhanced tax credits for job creation, investment in education, alternative and renewable energies, and other targeted objectives. These in turn will have to be factored into trust, FLP and other estate and family tax planning.

✓ **Conclusion.** Significant tax legislation

is likely, even though it might have to play backseat to more pressing economic, health care and other objectives. The landscape of the income and transfer tax systems could change rather significantly for wealthy taxpayers in particular. If done intelligently, there will be tax pain, but remember "No pain, no gain". If it helps right the economy and vital social objectives, we'll all be better off. **PP**

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

PRACTICAL PLANNER

YEAR END GIFT PLANNING

Summary: Year end gift planning is always a big thing. What tax advantaged goodies can you tuck under the tree this year? The economic meltdown, the varying impact of the economy on different heirs, and the specter of tough new tax legislation for the wealthy, all serve to change year end gift giving. (FYI next year the annual exclusion increases from \$12,000 to \$13,000).

Gift equalization is more of an issue. You daughter and her family are having a hard time financially and her husband recently lost his job. She needs more help than your son and his family. That's fine. Perhaps you ramp up annual gifts (e.g., include her husband which you hadn't done before). But what about your other child? Do you want equality of gifts? Or, do you feel that helping a child in greater need doesn't have to be equalized? It's a philosophical question worthy of thought. Whatever you feel, what will the reaction of the children be? You might unintentionally undermine their relationships with each other with substantially unequal gifts. If you decide to equalize how will you achieve this and with what tax results? You might opt to make an equalizing bequest under your will but how will the amount to be paid be determined? You could state in your will that a bequest should be made to equalize lifetime gifts by child family line. The problem is how do you prove what gifts were actually made? You could state that only gifts reported on a gift tax return will be considered in the calculation. But annual exclusion gifts, which can create tremendous inequality if child family lines differ significantly by size, wouldn't be included. You could use a formula that assumes you made the maximum annual gifts in each year from the date specified in your will, until the date of death. **Caution:** If you equalize lifetime gifts under your will, be sure to address the allocation of any state and federal tax costs. Your daughter will have received the lifetime gifts without any tax consequences, but depending on how your will is written, your other child's equalizing bequests could be reduced by estate taxes.

Loan or gift. Risk of divorce or financial problems of the donee/borrower might both be exacerbated by economic turmoil. A loan is likely to be better for these reasons. A loan has to be repaid. So, unlike a gift of cash which is like-

ly to be commingled with marital assets, it might be protected from a divorce. A loan can also solve the equalization issue. Unlike a gift, the funds have to be repaid. If you're concerned that the child serving as executor might demand repayment of the loan from the financially struggling child, an option is to incorporate a technique called a self cancelling installment note (SCIN). The note ends on your death so no balance is due. This benefit to your child/borrower is paid for by a higher interest rate, or an increase in the prin-

cipal to be repaid. Finally, if you charge interest, consider religious issues to charging interest.

Medical/Tuition. If family members are struggling with job loss and other financial problems, you can help out by covering any amount of tuition and medical costs, without any gift tax, so long as qualifying payments are made directly to qualifying education institutions or direct to medical providers. Evaluate whether these

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CHECKLIST: OBAMA TAXES

Summary: We're entering a new chapter in American history. The tax system will be changed but this will require a high wire balancing act: raise funds from those that can afford to pay to address the deficit and expanding government programs, while simultaneously not choking off economic incentives and exacerbating current economic problems. It's premature to call the changes, even though proposals have been made. Much detail, and the inevitable political horse-trading, remain. Here are some thoughts (wild guesses) on some possible tax changes.

✓ **General Thoughts on Obama Tax Legislation.** GW's tax bennies expire at the end of 2010 so President Obama will have to address tax legislation before then. Most administrations are reluctant to enact tax increases. Letting some of the bennies expire, or perhaps making them permanent in a less generous form, might be a politically palatable way to raise revenues. The alternative minimum tax (AMT) remains problematic and will have to be addressed. The need to periodically enact patches to prevent the AMT from applying to a broad

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...YEAR END GIFT PLANNING

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types of gifts should equalized and how.

UGMA/UTMA. Many benefactors make gifts to minor children, grandchildren, nieces, nephews or other donees by simply writing out a \$12,000 check to a custodial account. **Caution:** If you make a gift to a Uniform Gift to Minors' Act or Uniform Transfers to Minors' Act account for a child or grandchild, if you remain the custodian, the assets will all be taxed in your estate on death. Avoid this trap by naming another custodian.

529 Plans. Unlike UGMA/UTMA accounts, you can remain the "account owner" for a 529 plan to which you make gifts and the assets in the plan will not be included in your estate. As the account owner, you can pull the assets back should you need them. This ability will make 529 plans the optimal gift vehicle for many people. If you are

caught between the Scylla and Charibdis of not having enough assets because of the market meltdown and worrying how much more costly the estate tax might become in the next administration, hedge your bets with 529 plan gifts.

Step-Up What? A drawback of giving away assets is that your heirs won't benefit from the step up in tax basis at your death (if you paid \$10 for a stock and its worth \$280/share now, if you hold it until death the tax basis becomes \$280 and the \$270 capital gain disappears). Most folks have no shortage of assets that have little or no appreciation so that the step-up issue might only be wishful thinking. Gifting losers is not a winner either. So cherry pick the right assets for gifts.

Larger grandchildren gifts. If tough economic times makes you want to help grandchildren more than mere annual gifts and current tuition there are some clever techniques that can help you do just that. Make advance payments of non-refundable tuition for all your grandchildren and great grandchildren for all future years. If they're all in private schools, the amount you can transfer is substantial. There are a few requirements: 1) You must pay the tuition directly to the school; 2) The school must be a qualified educational institutions as defined in IRC 170(b)(1)(A)(ii); 3) You must have an agreement with the school that the tuition payments cannot be refunded. PLR 200602002. **Caution:** Remember private letter rulings such as this cannot be relied upon by other taxpayers, but might be viewed as an indication of what is acceptable to the IRS.

Make a Big Gift Now. Consider stuffing those holiday stockings with the maximum gifts you can make, including using up your \$1 million

lifetime exemption. If assets values are at a nadir now is the time to gift away family business and real estate interests, the family vacation home and more. Whether a simple direct gift (e.g., shares in the family widget company) or a more complex gift (GRATs, IDITs and other acronyms)

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now may just be the time to gift big and get future appreciation out of your estate. **Example:** The business had been worth \$6 million about two years ago. Declining sales and increased raw material costs have reduced the appraised value of the business. The family business was just appraised at \$4 million. The appraiser determined that this value should be discounted by 40% to reflect the lack of marketability and control a 10% or lesser shareholder would have. So the percentage of stock you can gift to every child, grandchild and spouse of a child or grandchild might be significant. \$12,000/[\$4 million x (1-40%) = \$2.4 million]. With four married children, each of whom has three children, you and your spouse can gift [\$12,000 x (4+4+(3x4)) = 20] = \$240,000, for a total for both of you of \$480,000, which equates to 20% of the business (\$480,000/\$2,400,000). If you make similar gifts in January '09 you'll have given away 40% of the business.

Watch Your Overall Gift Limits. Your variable insurance policy got nailed in the stock market meltdown so you will have to make larger gifts this year to your insurance trusts. All gifts count towards the \$12,000 an-

...CHECKLIST: POSSIBLE OBAMA TAX CHANGES

(Continued from page 1)

swath of taxpayers desperately needs to be addressed. The AMT could be modified so that it only serves the purposes it intended, or something more substantial might be undertaken (although with the tough agenda facing the Obama administration simpler fixes may be preferred).

✓ **Tax Rates.** Progressive is in! Expect higher personal income and capital gains taxes for higher earning tax rates. Before getting too bent out of shape, remember that progressive tax rates for wealthier/higher income taxpayers have been part of our tax system for lots of years. The new relationship between the highest marginal ordinary income tax rates and capital gains rates might also be a factor affecting future planning (e.g., the bigger the spread the more worthwhile the alchemistic techniques of transforming ordinary income into capital gains). Expect lots of small dollar tax benefits with low threshold phase-outs to help moderate and lower income taxpayers.

✓ **Obama Estate Tax.** The word is a \$3.5 million exclusion and 45% rate. However, taxing income above \$250,000 puts a much higher percentage of income earners in the maximum bracket than \$3.5 million does to the estate tax. If Obama tax legislation made the same percentage of taxpayers subject to the estate tax as would be subject to the income tax, the \$3.5 million exemption could be lowered. Portability might be in! If you die, your surviving spouse, if he/she doesn't remarry could take advantage of your unused exemption. That effectively would give married couples \$7 million of exemption before an estate tax kicked in. Portability makes ignoring planning seductive in that you can avoid tax on up to a \$7 million family net worth without the

need to re-title assets and include a bypass trust in your will, complications required under the current estate tax. **Caution:** Bypass trust planning to protect assets from new spouses, claimants, appreciation above the exclusion and more will remain important. Don't be lulled into inaction if portability is enacted. (Bypass trust and related planning will also remain important for your estate planner reaching his retirement goals, but we'll assume that doesn't motivate you to plan more).

✓ **Will you have to Kiss Favorite Estate Tax Acronyms Goodbye?** OK, so we all argue with the IRS that those 65% discounts on family limited partnerships (FLPs) with marketable securi-

ties are eminently reasonable (with a straight face no less). The reality is the income tax laws have included restrictions on related party transactions for a long time. Legislating away discounts on family transactions might eliminate one of the most significant estate tax reduction mechanisms the wealthy have used to minimize gift, estate and GST tax. While they're at it, the Obama tax writers might just deep-six grantor retained annuity trusts (GRATs) as another wealthy taxpayer technique that has some inherent unfairness to it (heads the taxpayer wins, tails the taxpayer doesn't lose). What about those annual demand powers in trusts that rich folk have used to shift large chunks of value? Some folks have just

RECENT DEVELOPMENTS

ADA: The House of Representatives approved the ADA Amendments Act on 9/25/08 expanding protections against workplace discrimination under the Americans with Disabilities Act. This measure will overturn Supreme Court decisions that narrowly construed the original ADA's definition of the term "disability". This will prohibit consideration of measures taken to overcome the effects of an employee's condition (e.g., medication, prosthetic device, etc.) in the analysis of whether such a person is "substantially limited in a major life activity." This will now include brain and neurological functions. As before, employers should endeavor to reasonably accommodate employee disabilities, document the attempts to do so, and document performance issues that are independent of the disabilities. If you're seeking to cut an employee because of the economic downturn, these changes are yet another minefield to navigate.

CRT Sale: While selling your income interest in a CRT to raise money and accelerate the charity's interest might be viable, taxpayers have abused this to the point that the IRS identified such sales, when the selling taxpayer recognizes little gain, as "transactions of interest." If you engage in such a sale, disclose it appropriately. Your tax advisers will have both disclosure and record (list) retention requirements. Notice 2008-99, 2008-47 IRB.

Title: Daughter had a joint bank account with a right of survivorship with her mother. The presumption that daughter as joint tenant did not trump because the account and signature cards did not contain survivorship language. The daughter had the burden of proving that the bank account was a joint tenancy or gift to her. Because the intent of the deceased mother, as expressed in her will, was to divide her estate equally among her four children, all of the account in issue should have been deemed assets of the estate and subject to distribution in

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