

## PRACTICAL PLANNER NEWSLETTER

MARTIN M. SHENKMAN, PC  
PO Box 1300, Tenafly, NJ 07670  
Phone: 201-845-8400  
Email: newsletter@shenkmanlaw.com  
RETURN SERVICE REQUESTED

First-Class Mail  
US Postage Paid  
Hackensack, NJ  
Permit No. 1121

### More Info:

- Publications: Sign up for an e-version of this newsletter at [www.laweasy.com](http://www.laweasy.com).
- Seminars: CPE Seminar: "Real estate appraisals; Depreciation Planning; Component Depreciation; Sec. 179; Special Rules". David Grant of J.H. Cohn & Co., LP, and Ron Gold, ASA. Monday 11/10/08 8:30-11:15 Marriott Glenpoint, Teaneck, NJ. Call 201-845-8400 for information.

For address corrections, or to be removed from this mailing list, email us at [newsletter@shenkmanlaw.com](mailto:newsletter@shenkmanlaw.com) or call 888-LAW-EASY.

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

## PLANNING POTPOURRI

### Readers' Comments:

**Qualified Joint Venture** – May 2008 Recent Developments discussed CCA 200816030. For a husband and wife to make the election under Code Section 761(f) to avoid filing a partnership tax return, they must be conducting a "trade or business". The IRS has indicated that the spouses must own the business as co-owners and not in the name of a state law entity. [Thanks to Todd Wieseneck, Esq.]

**Appraisals** – August 2008 Lead article "Appraisals: Key to Planning" mentioned that the factors noted in Revenue Rulings 59-60 and 68-609 should be considered. Of the two, 59-60 remains the primary source. According to one expert the capitalized excess earnings method of 68-609 is not commonly used. [Thanks to Kenneth Arlein].

[We welcome your comments!](#)

**Rental Real Estate Audits will Increase:** It appears that environmental issues are not the only clean up many property owners have to worry about. Many need to clean up their tax reporting! The government has estimated that 53% of individuals owning rental properties inappropriately report their tax results, to the tune of an aggregate \$12.4 billion understatement. That's not chickenfeed. Expect tougher tax audits of real estate rental activities. If you're being loose with your compliance clean up your act before Uncle Sam begins what will likely be a crack down. GAO-08-956. See the full report at <http://www.gao.gov/new.items/d08956.pdf>.

**Declining Insurance Rates:** Good News: Life insurance rates are declining, in part due to increased mortality. With the stock market meltdown, one source of savings might be to review your insurance coverage and see if

you can identify any opportunities for cost savings. Bad News: For those of you who got snookered (whether by a broker or your own greed) into buying an insurance policy with the intent to sell it in a couple of years, the deal just got worse (apart from other clamp-downs on such policies). Increased life expectancy means buyers will pay less for those policies! Evaluate your options with an independent insurance consultant. **PP**

**Contents:** ■ Economic Meltdown & Trust Planning p.1  
■ Business Contraction Checklist p.2  
■ Malpractice Risk p.3 ■ Employee Termination Taxation p. 3



Practical legal stuff...  
in plain English

[www.laweasy.com](http://www.laweasy.com)



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

# PRACTICAL PLANNER

VOLUME 3, ISSUE 9  
SEPTEMBER 2008

## ECONOMIC MELTDOWN & TRUST PLANNING

**Summary:** The markets are in turmoil. Daily Dow movements make Cedar Point roller coasters look tame. Move over Vin Diesel. The next "Fast and Furious" will star Henry M. Paulson, Jr. Lending sources have dried up for many. Tax, business, economic, investment matters are increasingly uncertain. How does this affect your planning? Reevaluate all aspects of your planning with consideration to the current environment, while at the same time continuing to maintain planning basics. This article will provide an overview of some of the points you might consider. Ugly news is coming at Warp Speed. Some of the comments below may not even be relevant once this newsletter hits your desk. Beam me up Scottie!

### Insurance and Insurance Trusts (ILIT)

Even in rosy financial environments it is advisable every couple of years to review the financial status of the insurance company, obtain an in-force illustration and so on. Whether you've done this recently or not, current turmoil demands you review now. Don't assume your insurance company is safe. Query how that changes the fiduciary responsibility of trustees? If the policy is a variable policy, how badly have the underlying mutual funds been hammered? How might this affect the performance and viability of the policy? If the variable policy is held inside a trust how might this impact future gifts? What if the grantor has made other plans for her annual gifts? Just because your brother in law asked you to be a trustee doesn't mean you can ignore your responsibilities as trustee! **Action Steps:** Review and document the current status of the insurance company. If new insurance is purchased, diversify – use a different carrier. Reevaluate whether the lower rate from a less secure insurer is a bargain or a problem waiting to happen. Obtain an **in-force illustration** and review steps you might take to shore up the policy. If you're a trustee, meet with counsel and review the benefits or obligations to communicate these matters with trust beneficiaries.

Insurance may need to be evaluated from another perspective. If your other income sources have been reduced, can you reduce or even delay insurance premiums for a couple of years until your financial situation turns around? Recent market shockwaves may have altered the funda-

mental reasons you purchased the insurance (to pay estate tax on your now defunct mortgage lending business?). **Action Steps:** Analyze what your insurance needs are now. You may want to freeze what had been an aggressive gift plan so that your insurance needs may increase. Perhaps you are now convinced that economic developments will force Congress to toughen the estate tax. So increasing insurance coverage in spite of economic conditions may be the right move for you.

### Securities GRATs

Grantor Retained Annuity Trusts come in many flavors. A common flavor has been a short term, typically two year, GRAT designed to capture upside (not downside!) market volatility. The annuity paid to the grantor would be set high enough so that the GRAT would have a nominal value for gift tax purposes (the so-called post-Walton zeroed out GRAT). The result of this approach is that a substantial

*(Continued on page 2)*

## CHECKLIST: BUSINESS SHRINK

**Summary:** Economic problems might force a business or professional practice contraction. **Caution** – go slow around those curves. There are a myriad of issues to consider. This checklist reviews only a few. (See Practical Planner April 2007 for an employee's termination checklist).

✓ **Can you Fire a Partner.** When business was humming, marginal partners may have been profitable. Now they may not be tolerable. Can you fire a partner? While severe, it may become necessary. There may be no right under state law to remove a partner. The provisions of the legal agreements

are essential to consider. Review all governing documents (employment agreement, shareholders' agreement, etc.). What do they provide for? Is there a mechanism to force a buyout or termination? Has the situation eroded to a point where application of a "for cause" provision can be justified? The remaining partners owe a fiduciary duty to the targeted partners. What are the demographics of the partners you're seeking to terminate? Evaluate the risk that a terminated partner may claim discrimination based on age, race, etc. Terminated partners might also sue on the basis that the re-

*(Continued on page 3)*

## ...ECONOMIC MELTDOWN & TRUST PLANNING

(Continued from page 1)

portion of the assets of the GRAT (your principal plus the 7520 mandated return) would be paid back to you as the grantor setting up the GRAT. Any market returns (do you remember what that means?) above the mandated federal interest rate, would inure to the benefit of your heirs (or a trust for them under the GRAT). You might wish to re-GRAT the large distribution you receive in each year from the original GRAT to a new GRAT. This is why the technique of using repetitive short term GRATs is referred to as “rolling” or “cascading” GRATs. Whoops, instead of earning more than the mandated interest rate, your GRAT is worth 30% less than what you initially transferred to it. Most likely your GRAT will bust. All the assets will be distributed back to you with nothing left for the heirs. What do you do? When life hands you a lemon, make lemonade! **Action Steps:** When the final

GRAT assets are repaid to you, the trustees should sign a short acknowledgement that the GRAT has been terminated with a final payment to you (so that there is a record in the files of what happened should a question arise in future years). Next, continue your plan. Set up a new GRAT and re-gift the assets to the new GRAT. This was your plan when you undertook the rolling GRAT plan; no need to change now. If in fact the markets have been sufficiently hammered, this may be the ideal time to contribute depressed assets to a new GRAT. Stick with the discipline. If the asset class contributed to the GRAT rises within two years, you'll have made GRAT lemonade.

### Real Estate and Business Note Sale Transactions

A common estate planning technique is to sell assets to a trust. This type of transaction can take many forms. The sale can be to an irrevocable grantor (taxed to you as grantor) trust (IDIT) for a note, for a **self-cancelling installment note (SCIN)**, for a private annuity, etc. Similarly, many clients gift fractional interests in assets to GRATs. A key to these transactions achieving their goals is that the assets will generate sufficient cash flow for the trust to pay the note, or the GRAT to make its periodic annuity payment. If economic developments have cast doubt on the trust being able to make payments out of cash flow, don't miss any payments as it may provide a basis for the IRS to challenge the validity of the entire transaction. Audits have focused more attention on compliance with the formalities of maintaining the transaction. Issuing a note back to you to meet a GRAT payment won't fly. While it might be feasible to secure third party lending by the trust, this is likely to be complex in normal times, and perhaps impossible under current market

conditions. The result will be that the trust may have to distribute back to you part of the equity in the underlying real estate, business interests, etc. This will require an appraisal. Watch out for discount whipsaw! If you claimed a 35% discount on the 45% LLC interest you sold to the

*Terms in red defined in the  
glossary at  
[www.laweasy.com](http://www.laweasy.com).  
For e-newsletter sign up at  
[www.laweasy.com](http://www.laweasy.com).*

IDIT, or gave to the GRAT, will a higher discount apply to the 2% LLC interest that is distributed back to you? Again, while it is a cost, it doesn't necessarily disrupt your plan. Most of these transactions contemplated re-distribution of equity interests anyhow. **Action Step:** Review cash flow and payment options now, not when they become due.

### Discounts and Valuations

Discounts are a cornerstone of many estate planning leveraging techniques. A discount is simply illustrated: 30% of a \$100 business is worth less than \$30 because the minority interest is hard to market and has no control. Has recent market turmoil legitimately increased the discounts on certain transactions? Credit risks may be far greater than they have been in years. Unique factors certainly exist in the current market. **Action Step:** Now may be an opportune time to structure gifts. Higher discounts might be justified. Asset values may be depressed. Interest rates remain low. Estate taxes are unlikely to be repealed. Stop hiding under the bed. Keep planning!

### Conclusion

Market developments are depress-

*Disclaimer to Readers:* Practical Planner provides reasonably accurate information, however, due to space limitations, and other factors, there is no assurance that every item can be relied upon. Facts and circumstances, including but not limited to differences in state law, may make the application of a general planning idea in Practical Planner, inappropriate in your circumstances. This newsletter does not provide estate planning, tax or other legal advice. If such services are required you should seek professional guidance. The Author and publisher do not have liability for any loss or damage resulting from information contained herein. This newsletter constitutes attorney advertising 22 NYCRR 1200.

*Review:* Andrew Wolfe, CPA, JH Cohn LLP, Roseland, NJ.

*IRS Circular 230 Legend:* No information contained herein was intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties. Practical Planner was not written to support the promotion, marketing, or recommendation of any tax planning strategy or action.

*Publisher Information:* Practical Planner is published monthly by Law Made Easy Press, LLC, P.O. Box 1300, Tenafly, New Jersey 07670. Information: newsletter@shenkmanlaw.com, or call 888-LAW-EASY.

*Copyright Statement:* © 2008 Law Made Easy Press, LLC. All rights reserved. No part of this publication may be reproduced, stored, or transmitted without prior written permission of Law Made Easy Press, LLC.

## ...CHECKLIST: BUSINESS CONTRACTION

(Continued from page 1)

maining partners violated their fiduciary or contractual obligations owed the terminated partners. **Pointers:** Incorporate the disruption to the practice, legal costs, and severance payments into your analysis. Perhaps creating a contract or non-equity partner status may be a preferable compromise and reduce the likelihood of suits and costs that offset the hoped-for savings.

### √ Defer Making a New Partner.

Your medical practice hired a new associate 2 years ago under an employment agreement that gave you an opportunity to “date” until both sides made a decision as to partnership. Your practice focuses on high end elective procedures so that the economic downturn is having an impact on your revenues, and you fear it will worsen. If the associate is a good fit, perhaps you can delay partnership another year to keep the practice profitable for existing senior partners. Before making this move carefully determine who told what to the new associate. If the managing partner of your practice promised the associate that she'd be a partner “for sure”, she might have a successful claim against you for the deferral. **Pointer:** This doesn't mean that deferral isn't a possible course of action. Just be mindful of the risks inherent in the process.

√ Non-Compete. Will the non-compete in the partnership/employment agreement protect your business? Non-compete laws are constantly evolving, and vary by state. Caution is always in order. In a recent California case, for example, *Edwards v. Arthur Andersen, LLP*, S147190 (Cal. Aug. 7 2008), the court upheld a California statute limiting non-compete agreements. In this case the employee signed a non-compete when he began employment as a tax accountant in which he agreed that for 18-months after ter-

mination he would not perform similar services for any clients of his employer, and or 12 months he would not solicit any of the employer's clients. The court found that the non-competition agreement was invalid because it restricted the employee's ability to practice his profession in violation of the statute. **Pointers:** Review restrictions before taking action. If a former employee/partner will be able to compete, especially at a lower cost in hard economic times, is termination best? Be certain all future agreements contain enforceable provisions, include severability clauses that endeavor to save the rest of the agreement (and other restrictions) in the event the non-compete (or any other clause) is deemed too broad to be valid.

√ Get a Release. If you're terminating an employee/partner, it's common to make a severance payment to obtain a release to hopefully avoid the issues outlined above. But releases aren't a guarantee against suit. **Pointers:** Give the employee reasonable time to review the release. The release should be understandable. If you can't read it without crib notes, it won't past muster! Use captions. Define technical terms. Some claims can only be waived if they are expressly noted in the release, such as the waiver of age based claims under the EEOC or the Older Workers Benefit Protection Act (OWBPA). Some claims cannot be waived in a termination agreement with an employee, such as claims under the Fair Labor Standards Act (FLSA), so

## RECENT DEVELOPMENTS

Malpractice Coverage. All professionals need it (except for those streakers who think going bare is smart). An attorney was recently sued for malpractice. Then the nightmare of all professionals took place. The insurer denied coverage. The insurer claimed that the attorney had an awareness of the claim in 2003, so that coverage under a 2004 policy was not required. The attorney should have notified the insurer in 2003 when he first became aware of the issue. *Ackerman v Westport Insurance Corp.*, Dist. Ct. (Linares, USDJ), 9/8/08. Deteriorating economic conditions, deals falling apart, and more, are all likely to trigger more claims. All professionals should be wary of the lessons of this case and report any possible issues at the first appearance of a potential claim.

Taxation of Payments Received by Former Employee. Apropos to the checklist article is a recent ruling on tax consequences of structuring a settlement with a terminated employee. A former employee entered into a settlement with her employer relating to mental anguish and emotional distress from a claimed hostile work environment. The IRS held that the economic benefit and constructive receipt doctrines would not apply to cause the employee to report income prior to her actual receipt of cash. PLR 200836019. The Settlement Agreement and Release which the employer and employee entered into required a payment of a lump sum initially, and periodic payments for other claims. The agreements preclude the employee from accelerating, deferring or otherwise changing the payment sequence. The employee cannot elect to receive the commuted value of the periodic payments. The employer could enter into a non-qualified assignment with a company that will make the payments. No assets were set aside to secure these payments. The employee is not deemed to have received any property when the employer pays the assignment company funds. Because of the restrictions on the employee, she cannot be deemed to