

PRACTICAL PLANNER NEWSLETTER

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PLANNING POTPOURRI

Continued from Page 3 Current Developments

S Corp: S Corporation built-in gains holding period reduced from 10 years to 5 years for sales occurring in 2011 if the 5th year in the recognition period precedes the taxable year beginning in 2011 (generally companies electing S status before 2006).

PDA: Deductions for cell phones, PDAs and the Blackberry surgically glued to my hip, all had required detailed logs proving business use. The Act eliminated these burdensome rules by no longer treating them as "listed property."

Small Business Incentives

Credits: Carryback period for general business credits extended to five years for eligible small businesses including non-publicly traded corporations, partnerships and sole proprietorships; average annual gross receipts for the prior three tax years cannot

exceed \$50 million (flow through owner must also meet gross receipts test). Effective for the first tax year beginning after 12/31/09. Eligible small business credits are allowed to offset Alternative Minimum Tax.

Capital Gains: 100% exclusion for capital gain from the sale of qualified small business stock acquired after September 27, 2010 and before January 1, 2011 if the stock is owned longer than five years. Additionally the Alternative Minimum Tax preference item attributable for that sale has been eliminated.

Start Up Costs: Prior law let you deduct up to \$5,000 of "start-up expenses" in the year your new business launched and amortize the balance over 180 months. The \$5,000 figure was reduced by the excess of total start-up costs over \$50,000. Deduction for start-up expenditures is increased to \$10,000 for 2010, and phase-out

threshold increased to \$60,000.

Health Insurance: Deduction for health insurance of business owners (sole proprietors, partners, members, and >2% S Corporation shareholders) is allowed in calculating self-employment tax for 2010 (first tax year beginning after December 31, 2009). Thanks to Julie A. Welch (Runtz) [Julie@meara.com].

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Probate: If you have few or no family or relatives consider executing an affidavit of kinship confirming this while you are alive to make the eventual probate process easier. Proactively call the probate (surrogate) court



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PRACTICAL PLANNER

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TRUST SITUS, STAR WARS, AND STATE TAXATION

Summary: All you Wookies hear about is estate tax repeal. Be on guard, a Jedi Light Tax Saber can nick your money when and where you least expect it. So you followed the advice of the legendary Jedi Tax Master Obi-Wan Kenobi: "Let go, Luke. Luke, trust me," and you set up a trust. Ahh, but it will take the likes of Jedi Master to sort out the state tax issues affecting your trusts.

Change Situs of Real Estate

State "B" may assess a state estate tax on real estate (and tangible personal property) located in its jurisdiction. If you live in (domiciled) State "A" your real estate in State "B" may thus be taxed. However, it may be possible to avoid State "B" estate tax on your real estate there by transferring title to the realty in State "B" into a trust. If you (grantor) and perhaps the trustee live in State "A" this might convert the asset in State "B" from realty into an intangible interest that State "A" won't tax for a non-domiciliary. This tax alchemy can save a lot of galactic credits. But Hans, if you thought Jabba the Hutt was a tough creditor – some states will disregard a living trust, or a single member LLC, as not sufficing to transform real estate into a non-taxable intangible interest.

An LLC May Change Situs of Trust Real Estate

State tax laws differ on these issues, but since NY tends to lead the way in state tax sophistication (and baseball teams), let's look at recent Empire State law. Decedent was not resident in NY. Decedent had interest in a revocable living trust which owned interests in limited liability companies (LLCs) owning NY real estate. NY held that he was is not subject to NY estate tax. The issue was whether the nonresident decedent's interest in a revocable trust should be characterized as intangible. The conclusion depends on the nature of the property in the revocable trust. Here the nonresident decedent's revocable trust owned interests in LLCs that own NY realty. The LLCs in question were multiple member LLCs treated as partnerships under the check-the-box regs. Is the implication that a single member LLC may not have the same positive NY tax result? Assuming that IRC § 2036 or economic substance doctrines do not apply, an LLC taxed as a partnership is considered to be separate from its owner. Therefore, the estate's interest in the revocable trust was an intangible asset and was not included in the estate's NY gross estate. NY Advisory Opinion TSB-A-10(1)M, 04/08/2010.

Investment Advisers and State Law

Under some state laws the trustee can transfer (direct) full responsibility and liability of trust investment decisions to an investment adviser. If the state law does not permit this, the trustee may merely retain (delegate) an investment adviser, but will be left with some liability. OK Chewbacca this gets a bit hairy. The laws in various states differ considerably as to the impact on a trustee for following the direction of a designated person. The distinctions could be critical if

a major goal of the grantor is to have a family business retained. In states with the most liberal directed trust statutes the trustee following direction will have no liability without willful misconduct. In other jurisdictions the protection afforded a trustee following investment direction is less secure. Some states follow the Uniform Trust Code (UTC) Article 808(b): "Powers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible

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CHECKLIST: RELIGIOUS EST PLN

Summary: Estate planning should be a holistic multi-disciplinary process that addresses all of your important goals. Here's a general list of concepts to begin the process:

✓ **Religion Counts:** according to many surveys, 95+ percent of Americans believe in God or some type of higher power. While some define religion as a belief in God, not all religions do. While Buddhism and Scientology are considered religions, Buddhism does not teach its adherents to believe in God; and Scientology does not necessarily require a belief in God. For some, spirituality may be a vital part of their lives, but not include a belief in

God. Whatever your religious views or spiritual nature, your estate planning should be consistent with your beliefs and preferences, or even lack thereof.

✓ **Think Broadly:** Religion can broadly be viewed to encompass your life philosophy, spirituality and values. This inadequacy has tremendous personal impact, because no area of the law is more fraught with religious issues than estate planning. If you endeavored to live your life in conformity with your religious beliefs or philosophy, then your final medical decisions, funeral arrangements and the distributions under

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...TRUST SITUS, STAR WARS, AND STATE TAXATION

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liability. On the other hand, the trustee does have overall responsibility for seeing that the terms of the trust are honored....A trustee must generally act in accordance with the direction. A trustee may refuse the direction only if the attempted exercise would be manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty..." While a trustee can find some comfort in following direction to retain an investment under a trust with a situs in a UTC jurisdiction, that comfort must be guarded. The trustee must still demonstrate that adhering to the direction would not be "manifestly contrary to the terms of the trust," or a "serious breach of the duty owed." While this is clearly less oversight than a trustee must exercise without a direction statute, it is not a guarantee escape from the Death Star. In a situ-

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ation where one beneficiary is active in the business the trust owns, and other beneficiaries are not, the risks associated with these standards could be significant. Some states, such as Delaware, have created far more secure standards.

Investment Adviser Can Be Tax'n
Caution should be exercised in retaining an investment adviser since the impact can extend beyond mere legal liability issues. For example, if a trust protector for a Delaware directed trust designates a NY person as investment adviser, NY may seek to tax the income of the trust even though, but for that investment adviser, the trust would not have any tax nexus to NY. TSB-A-04(7) I, 2004 N.Y. Tax Lexis 259 (Nov. 12, 2004). It's not clear how other states may view advisers as creating nexus.

NY View of Intangibles and Trustees
Consider intangible assets in NY. The situs of intangible assets is deemed the domicile of the trustee. TSB-A-94(7) I, 4/8/94. In this Advisory Opinion the assets involved were cash, money market accounts, marketable securities, etc. most held by a NY trust company. None were connected with or derived from a business carried on in NY. The situs of intangible assets of the trust was deemed to be trustee's domicile.

Trustee Domicile
And how can a CPA confirm where the Trustee hangs his/her hat? NY, like many states, is increasingly aggressive in arguing that NY'ers remain domiciled in NY even if they are absent. NYS Taxation of Nonresidents, Pub. 88, says: "In general, your domicile is the place you intend to have as your permanent home. Your domicile is, in effect, where your permanent home is located. It is the place you intend to return to after being away...You can have only one domicile. Your NY domicile does not change until you can demonstrate that you have abandoned your NY domicile and established a new domicile outside NY State...A

change of domicile must be clear and convincing. Easily controlled factors such as where you vote, where your driver's license and registration are issued, or where your will is located are not primary factors establishing domicile... A change of domicile is clear and convincing only when your

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primary ties are clearly greater in the new location." How will this new aggressiveness impact trust taxation? Is it ever safe to use an individual trustee with uncertainty of where they're domiciled? Why not always use an institutional trustee that's based in a tax favored state? Should lawyers draft so that if a trustee moves into a bad tax state they'll be removed automatically? If the assets are intangible and the trustee is domiciled outside NY, you're still not NY tax free yet. There's a 3rd test: "All income and gains of the trust are derived from or connected with sources outside of NY state..." Landmines exist. NY has held that managing bank accounts and trading securities for ones own account "does not constitute the carrying on of a business, trade, profession or occupation in NY State..." In this ruling the taxpayer lived in NYC and formed/ funded an LLC, then transferred 99% of the LLC to a trust, retaining 1%. The trustee of the trust owned 99% of the LLC but was not a NY resident. The taxpayer remained the managing member of the LLC, conducted all LLC business, and the LLC had a NY post office box as its address, etc. The LLC income was deemed not connected and NY tax

...CHECKLIST: RELIGION AND ESTATE PLANNING

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your will, the overall "tone" of your documents, should be consistent with those beliefs.

✓ **Not Interested?** Even if you're personally indifferent, ignoring religious issues can lead to painful family strife. Make the effort to specify what you do and don't want. Say you've become more "modern" and less observant in your faith, 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 religious traditions, and the guidance of a priest, rabbi, imam or other religious figure, can bring to a family suffering through tragedy.

✓ **No Religious Restrictions:** 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 diversity of religious affiliation and observance among family members can be substantial. If you don't want religious observances of other family members imposed on you, then a statement that certain rituals should not be followed is vital.

✓ **Tailored Wishes:** It seems that the most common approach is often a hybrid. Some people will have their documents adhere to all the strictures of their faith, but exclude restrictions on cessation of heroic medical measures for fear of being kept alive in a vegetative state. Others prefer no religious customs or restrictions in any of their planning, but wish only that a funeral and burial be in accordance with their religious traditions. The key is to tailor your documents and communications to accomplish your goals, but with

sensitivity and compassion to minimize the potential for negative impact on others.

✓ **Details:** 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 core religious values in heirs), and other purposes consistent with your religious goals. Boilerplate distribution provisions in many documents just won't suffice to accomplish these specialized goals. Simple tweaks will often do the job.

✓ **Will:** Your secular will may have to be modified to reflect the Baha'i, Jewish, Islamic, or other religious laws of inheritance. The Quran 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 tax, estate, financial and succession planning, 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, general guidelines of charity and justice are vital.

✓ **Fiduciaries:** Your selection of trustees will have a profound impact on the transmission of values. Providing a detailed and personal letter of instruction about the care and upbringing of young children is essen-

RECENT DEVELOPMENTS

The Small Business Jobs Act of 2010, P.L. 111-240, was signed September 27, 2010. The Act contains countless provisions intended to goose up the economy and cover some of the costs of doing so. The Act is so long and complex that the following is barely a tasting menu.

General Business Incentives

Expensing: If you buy equipment you have to depreciate it over a number of years, but Code Section 179 may permit you to write it off in the year of purchase. The maximum is increased retroactively to \$500,000 for 2010 and 2011 (\$25,000 after 2011). If you bought over \$800,000 this bennie was phased out. That threshold is increased to \$2M of annual purchases (\$200,000 after 2011). Previously only tangible personal property qualified (e.g., a machine). Now up to \$250,000 of certain real estate, qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property (as defined in Code Sec. 168(e)(6),(7) and (8)), may also be expensed.

Bonus Depreciation: If you buy "qualified property" 1/2 can be deducted ("bonus depreciation") in the year placed in service (your tax basis is reduced by this so you can't double dip with big depreciation deductions later). 50% bonus depreciation will be allowed retroactively for certain property purchased and placed in service during 2010 (2011 for certain property) including most types of new property and qualified leasehold improvements other than buildings. Contractors using percentage of completion method are allowed to treat qualified property as if bonus depreciation did not apply permitting them to benefit from bonus depreciation even if they do not complete their contracts within the same year. Effective for property placed in service in 2010. Bonus depreciation of up to \$8,000 allowed for luxury automobiles purchased and placed in service during calendar year 2010 (thus making the total first year depreciation for