

PRACTICAL PLANNER NEWSLETTER

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More Info:

- Webinars: A series of 8 webinars will be conducted the week of October 17, National Estate Planning Awareness Week. See insert.
- Freebies: Seminars conducted with the AICPA, COPD Foundation, National Multiple Sclerosis Society, Alzheimer's Association and the Michael J. Fox Foundation for Parkinson's Research will all be free and are all designed to help consumers with practical planning ideas in simple English.

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· Financial · Asset Protection

PLANNING POTPOURRI

Current Planning Ideas: CCH Financial and Estate Planning Advisory Board meeting occurred September 14, 2011. Here are a few tidbits from the call: **Life Insurance:** Put more into a trust now instead of just annual gifts. Take advantage of the \$5M exemption and avoid future Crummey notice complexity. **Qualified Personal Residence Trust ("QPRT"):** Consider an outright gift to a trust without the QPRT retained right, then lease-back at fair value. Note that there won't be a basis step up. **Spousal Right of Election:** This may not be satisfied by a typical bypass trust under some state laws (e.g. NY). Review the right of election and determine if a waiver should be signed to prevent the plan from being undermined. Which state law governs? **Caps:** Consider updating your will/revocable trust to set a maximum amount that can fund

a bypass, marital or GST trust. **4768 Extension:** To extend 2010 returns until March 2012 **Form 8939:** To elect into carryover basis. Was initially due with income tax return, then 90-days after a final form, then 11/15/11 now its due 1/17/12, Notice 2011-76. IRS estimates only 7,000 estates will opt for this. Are you one? **State Estate Tax:** 22 states have estate tax or inheritance tax and Maryland and NJ have both. Gift planning now, especially for elderly clients can solve the issue. If your estate is under \$5 million a simple gift may be all it takes to reduce the estate below the state estate tax threshold. Watch out, Connecticut (\$2 million) Tennessee and Puerto Rico have a gift tax that could snag that effort. **Tax Burn:** Grantor trust status remains a powerful technique to reduce an estate. **Low Interest Rates:** Note sales, GRATs, CLTs are great in this environment. Current proposals will virtually de-

stroy GRATs. Proposals to restrict discounts will take some of the benefit out of sales and gifts. **Portability:** If your spouse dies you can use what remains of his or her unused \$5M estate tax exemption. Too many taxpayers may be lulled into forgoing real planning by the perceived benefits of portability. It's almost a dangerous distraction given the many limitations and should not be relied upon by taxpayers, more traditional planning should almost always (if not always) be pursued. It doesn't apply for state estate tax, GST, affords no asset protection, etc. **Insurance Trusts:** Unwind split-dollar arrangements that don't work well any long-



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PRACTICAL PLANNER

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STAIRWAY TO (ESTATE PLANNING) HEAVEN

Summary: Led Zeppelin's classic hit has remained popular with boomers as a paradigm for their estate planning. Rung by rung you can improve your tax and asset protection benefits by climbing upward towards estate planning heaven. We'll start at the bottom and work upward.

Father Knows Best Trust. Coke classic might be great, but not Trust Classic. Antique trusts mandate that income be paid out annually, name the beneficiary as a trustee, give the beneficiary the right to distribute money to himself (often limited to an "ascertainable standard" – health, education, maintenance and support). These trusts pay out trust principal at specified ages, say as 1/2 at ages 25, and the balance at 30. Well, if you think wearing one of those Jim Anderson outfits is fresh, then this is just the type of trust you'd still want in your planning arsenal – Not! If your trust is a model T, don't give up, you might be able to have the trust invest assets in a well crafted limited liability company to create a layer of control and protection. Other corrective steps might be possible. But this is not the kinda trust you want.

Be a Paris Hilton Trust Fund Baby. Hey being a trust fund baby ain't a bad gig if you can get it. But too often trust fund wannabes lose out 'cause their benefactors want their plans to be "simple," or they "don't want to rule from the grave." But if you have affluent parents or other benefactors (even a spouse or partner), even if you'll only get average gifts or bequests, they should be received by you in appropriately-structured trusts. A long term or perpetual trust, from which you can benefit and exert reasonable controls, should remain out of reach of your creditors, ex-spouse's and the Tax Man. To be effective this has to be planned before the property reaches you. The folks can get a simple will from a legal-whiz.biz website. It will be simple, and your malpractice claimants will thank them. If the folks don't want to "rule from the grave," what they'll really accomplish is limiting your flexibility. Good planning enhances the value of your inheritance and can be done with your input. That's not "ruling," its being prudent. If the folks don't want to deal with all this you can set up the trust yourself and just have mom leave your inheritance to the trust instead of directly to you. Gee that's so simple even a Congressman could do it!

2011: A Trust Odyssey. We hired HAL, Esq. to design your trust so it has the best provisions. Here's what HAL, Esq. recommended: A fully discretionary trust with no

enforceable rights an ex-spouse, or malpractice claimant can attach. You're named management trustee so you can have reasonable input. An independent trustee in a jurisdiction with laws favorable to trusts (the Four Tops are: Alaska, Delaware, Nevada and South Dakota). An independent trustee makes all distributions. The trustee can hold assets for your use. That slick Airstream trailer can be owned by the trust, used by you, but out of reach of creditors. The trust lasts as long as state law permits providing

asset protections to your heirs. **A Little DAPT will Do Ya'.** Who could forget the famous Brylcreem advertisement for Domestic Asset Protection Trusts! In most states you can't transfer assets to a trust, benefit from the trust, but keep your creditors at bay. Like the Brylcreem ad: "The creditors will all pursue ya,--They'll love to put their fingers through your hair." But a self-settled trust, created prior to a claim, in a state with favorable trust laws, may enable you to transfer

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CHECKLIST: CROSS-PURCHASE

Summary: Buyout agreements are vital to closely held businesses. With economic turmoil and rapidly changing laws you need to ask the question of the Vikings: "What's in your wallet?" If you haven't reviewed your buy-sell in the past year. Jump to it. The following checklist will explore aspects of just one option, commonly called a trustee cross-purchase which in ways is akin to an escrow arrangement.

✓ **Redemption v. Cross-Purchase:** There are two categories of buyouts: (1) Redemption (entity buys equity); or (2) Cross-purchase (each equity owner, say shareholder) buys

the equity (say stock) of the other. Cross-purchase can provide several advantages, namely an increase in basis. If you buy a deceased shareholder's stock, your basis (investment) for determining capital gain if you ever sell the company is increased to reflect what you paid. Also, the shareholders, not the corporation, own the life insurance that might be used in the buyout so that the cash value isn't exposed to corporate claimants. ✓ **Structural Options:** Issues are legion, options are many: the shareholders can own the buyout insurance on each oth-

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...STAIRWAY TO (ESTATE PLANNING) HEAVEN

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assets that are protected from creditors after a statutory number of years. While there are no guarantees, and some risks exist (e.g., will other states respect the trust and transfers to it), many advisers are pretty confident that DAPTs will give your asset protection planning that Brylcreem bounce. DAPTs, without more, aren't a tax save. They'll be included in your gross estate and are grantor trusts so the income is taxed to you.

Completed Gift DAPT. The CGDAPT builds on the DAPT by your making the transfers to the trusts completed gifts. Giving up the control necessary to make the gift complete should remove the trust assets from your estate, saving estate taxes in the future. With the current \$5 million gift exemption you can transfer a substantial amount of wealth to the DAPT. This can be followed by a sale of significant assets to the trust. This tech-

nique, a note sale to a grantor trust, may be one of the most significant ways to shift assets into a protective structure. If the value of the interests sold to the trust are discounted, further leverage and benefit is added. Your paying the income tax on earnings that remain in the trust burns assets in your estate while enhancing assets in the trust. But this party might last for long. The Democrats' wish list of revenue proposals include rolling the estate tax back to 2009 levels in 2012. That might include a \$1 million gift exemption which will squeeze a lot of benefit out of complete gift transfers.

The "Have Your Cake and Eat it Too Trust." In the DAPT or completed gift DAPT, you're the settlor establishing the trust and making transfers to it. Some advisers believe having another person, say a parent, set up the trust for you, makes the trust a safer structure from both a tax and asset protection perspective. If this approach is used, the trust will still need to be characterized as a grantor trust as to you. This is essential so that you can sell appreciated assets to the trust without triggering tax. This is achieved by your having an annual demand power (Crummey power) to withdraw annual gifts the settlor (e.g., your parent) makes to the trust. That mechanism can provide the desired status. Thus, this trust is called a Beneficiary Defective Irrevocable Trust since it is a grantor trust (defective) as to you as beneficiary. When another person establishes the trust for you, you may have greater powers without jeopardizing the tax and asset protection benefits. Proponents maintain you can have the use and enjoyment of the assets purchased by the BDIT, the right to change the trust through a power of appointment, and not jeopardize creditor protection and estate tax savings. But as with many planning techniques, there are differing opinions on how far you can go.

Insuring the Success or Your Trust

Plan. When Robert Plant crooned: "Ooh, ooh, and she's buying the stairway to heaven," he was referring to her purchase of a permanent life insurance policy inside the completed gift DAPT/BDIT. If one of the assets inside these trusts is an insurance policy a number of other bene-

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fits might be achieved. Insurance can provide for a tax free build up of growth inside the tax protective envelope of the policy. With much talk about raising income taxes on the wealthy as part of the Budget Control Act's directive to reduce the deficit by \$1.5 trillion, the new Medicare tax on passive investment income that takes effect in 2013, etc., insurance may be enhanced as a tax favored asset class. For some, the conservative returns of a cash value insurance policy might provide some offset to the risk in other portions of their portfolio. If you die prematurely, before the tax burn which the grantor trust status has on your remaining estate can be felt, the insurance may cover the estate tax that would be due. If the trust owns life insurance, then the loan used in the sale of assets to the trust might be designed to fall within the ambit of the split-dollar life insurance loan regulations. If so, and the appropriate steps required under those regulations are adhered to, the characterization of the transaction as a loan for tax purposes might be assured. Insurance can enhance income/estate tax leverage and protection that the completed gift DAPT or BDIT might offer. *Thanks to Dick Oshins, Esq.*

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Review: Andrew Wolfe, CPA, Esq.

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...CHECKLIST: TRUSTEED CROSS-PURCHASE

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er, a partnership (LLC) could be used to own the insurance, a trustee arrangement could be used, and other options have been advocated. No option is perfect, none are without risks, but all are more involved than many business owners imagine. Embrace the complexity or the downside might be tax and legal bumps.

✓ **Life Insurance:** Will the cross-purchase be insurance funded? Partly? Entirely? Assuming all owners are reasonably insurable most opt for some life insurance to minimize the financial hardship on the business of a buyout. But the value of the business will hopefully grow over time. Unfortunately, time brings age and often health issues so that additional insurance to cover that increasing value might become costly or unobtainable. Consider structuring the policy as an increasing benefit policy that grows over time.

✓ **More than Death:** Life insurance won't solve the buyout issues of disability (disability buyout insurance might but it can be costly), termination, retirement, disagreement, etc. Too many shareholders focus on death to the exclusion of other issues. All need to be addressed.

✓ **Trusteed Arrangement:** If the shareholders own policies on each other's life, with 2 shareholders you need 2 policies. With 3 shareholders 6 policies. The formula is n times (n-1) with "n" the number of shareholders. Not only is this complex but ponder, what happens with 3 shareholders on the death of the first? The deceased shareholder's estate owns policies on the two surviving shareholders that the survivors need when the next shareholder dies. How do you get those policies to the surviving shareholders? What if a shareholder tries to borrow on or cash in a policy? All these issues can be addressed to some degree by having the policies held in an escrow-like "trusteed arrangement." What if a shareholder is

sued or divorced years after the plan is put in place and the cash value of the insurance has increased? It might provide some asset protection for the trustee arrangement, not the individual shareholder, to hold the policies.

✓ **Who Should be Trustee:** A bank or independent person should serve as trustee (escrow agent). It is preferable not to have the insureds serve. Independence can avoid problems if differences arise between the parties. It also lessens the risk of the IRS, ex-spouse or claimant, arguing that a shareholder has control over the policies. If the IRS could show that a shareholder/trustee could exercise control, it could pull the policy proceeds into the shareholder's taxable estate. Some draft around these is-

sues, avoiding streets with potholes is safer than steering around them.

✓ **Coordination:** Coordinate the trustee or escrow agreement and the provisions of the shareholders' (or other) governing instrument.

✓ **Hybrid Buyout:** The buyout might be a multi-tiered approach: corporation buys shares up to some amount, the trustee arrangement buys the next tier, and the surviving shareholders then buy directly the final tier of the excess.

✓ **Transfer for Value:** This sinister tax rule could taint insurance proceeds as being taxable. Consider a valid partnership of the shareholders to potentially mitigate these risks.

✓ **101(j):** These tax reporting provisions, if not complied with, can also

RECENT DEVELOPMENTS

Taxes are a Drag: If you run a business, losses may be deductible. But if the IRS views it as a mere hobby, they won't be. The Tax Court held drag racing activities were a hobby. IRC Sec. 183. The dragster and his two kids formed a drag racing team that raced a Chevy in local, divisional, and national racing events. Cool. But earning \$2,150 in prize money while spending \$117,660 didn't get the taxpayer to the finish line with the IRS. The court found that the taxpayer had an interest in racing, got a lot of pleasure from it, and didn't in good faith expect to profit. Reg. 1.183-2(b). Zenzen, TC Memo 2011-167.

Not an Easy Ride: Dennis Hopper, star of Easy Rider, filed for divorce from Victoria, wife No. 5. Victoria is only 6 years older than Dennis' daughter Marin. Dennis Hopper not only had a trust, he updated it after the relationship between he and Victoria soured (unless, of course, you believe Victoria who says the documents were only changed as an effort by Dennis' kids to cut her inheritance). The story goes on But the lesson is the same. Meet with your planning team yearly. Document actions, and update your planning and documents. It can save everyone tremendous grief.

2011 Decedents: Instructions for the federal estate tax return require executors to file to secure portability. The 2010 Tax Act that permits a surviving spouse to use the 1st to die spouse's unused exemption. Regardless of the size of your estate, if you don't secure this now, it will not be available in the future if your estate needs it. The IRS has made it clear, no backsies. Consider the application of this if your family last name is not Brady. You die. Your 3rd wife gets the house which was owned jointly and an insurance policy you bought for her. Your daughter from your 1st marriage is named executrix and gets your entire estate. You carefully planned this so that your daughter and much younger new wife would not have to interact concerning your estate. Ooops. Your new wife won't