NAEPC

Journal of Estate & Tax Planning

Click here to view the First Quarter 2014 Issue

PRACTICAL PLANNER® NEWSLETTER
MARTIN M. SHENKMAN, PC
PO Box 1300, Tenafly, NJ 07670
Email: newsletter@shenkmanlaw.com

RETURN SERVICE REQUESTED

More Info:

◦**Publications:** Sign up for an e-version of this newsletter at www.laweasy.com or email your address to newsletter@shenkmanlaw.com to be added to the bi-monthly hard copy mailing.

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

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

Heckerling Planning Potpourri

■ Delaware Incomplete Non-Grantor trusts ("DINGs") were approved in several rulings. The trusts were structured to avoid powers that could trigger grantor trust status. A distribution committee had to approve distributions which could be made only with the consent of an adverse party. Because the donor retained a testamentary power to appoint the remainder of the trust assets among descendants the transfer was not a completed gift. The donor's consent power over the trust income and principal rendered the gift incomplete. The use of DINGs had been chilled by the IRS reexamining its earlier conclusions. These rulings likely will encourage a resurgence of Delaware DINGs. Current Developments 2013.

■ How do you obtain a basis step up for assets held in a bypass trust? Some suggest granting a contingent general power of appointment to the surviving spouse to pull appreciated assets into the survivor's estate to obtain a basis step-up. Consider including in the bypass trust a general power of appointment over the portion of the bypass trust to cause inclusion in the estate of the surviving spouse for Federal estate tax purposes under Section 2041. See PLRs 200403094 and 200604028. Can the general power of appointment be granted only over appreciated assets? Perhaps appreciated assets can be defined as assets owned by the bypass trust upon my spouse's death the income tax basis of which may increase (and not decrease) under IRC Sec. 1014(a) if such assets passed from my spouse. Can you structure a tiered formula of sequential contingent general powers of appointment to secure a basis step up on assets exposed to the highest tax brackets first? In a decoupled state, the cost of a state death tax must be considered. Some suggest not having the spouse serve as the trustee if these powers are granted. "Clinical Trials With Portability" by Franklin and Law.

■ It is not uncommon that a surviving spouse fails to fund a bypass trust under his or her spouse's will. What can be done after the fact to correct the situation? Identify the assets to be used to fund the trust. Determine how income earned in the interim should be allocated among beneficiaries. Be alert for discounts or premiums if a fractional interest in an asset is used to fund the trust. A funding agreement, along with transfer documents, may confirm the decisions made. "Funding Unfunded Testamentary Trusts," by Davis. PP

LAW MADE EASY PRESS

Practical legal stuff...
in plain English

www.laweasy.com

VOLUME 8, ISSUE 1
JAN-FEB 2014

PRACTICAL PLANNER®

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

Heckerling Teaser Tips

Summary: The Heckerling Institute of Estate Planning is the pinnacle of estate planning conferences, with a week of seminars covering the gamut of estate planning. Hold on to your socks because there is sooooo many ideas as experts from around the country have digested the implications of the 2012 tax act and other recent tax law changes. Estate planning is being transformed by the new exemption, higher income tax rates, developments in technology, changing demographics, and so much more. Following is a teaser of a few of the myriad of topics that will be presented. This year's conference is January 13-17 at the Marriott World Center in Orlando. See http://www.law.miami.edu/heckerling/ for more information.

■ Stretchy IRA Distributions: The name of the game for IRAs has generally been to streeeeeeeetch out payments for as long as possible to defer income tax. A beneficiary may defer distributions over his or her remaining life expectancy, which often runs to about age 83+. That magic tax elixir may be zapped. Senator Baucus proposed requiring that most inherited IRAs and qualified retirement plan accounts be liquidated within 5 years of death. President Obama included this change in his 2013 budget proposal to Congress. A majority of the Senate approved the change in July 2013. This change would eliminate many of the planning hoops taxpayers have been jumping through for years, but it has really painful teeth for beneficiaries (an estimated bite of $4.7 billion). Exceptions to the 5 year rule may be provided for a surviving spouse (perhaps by permitting a rollover similar to current law), a beneficiary who is disabled or chronically ill, a minor child and others. "Planning for Estates Under $10 Million" Hoyt.

■ Cool IRA Beneficiary: There may be a more interesting beneficiary to name for your IRA than what most people do. This approach may be ideal for baby boomers in their second (third, fourth….) marriages, and who have some of their 1970s do-good idealism intact. Many taxpayers named a bypass trust (a/k/a credit shelter or unified credit trust) as beneficiary to use up their estate tax exemption, benefit their surviving spouse, and assure that the value would not be taxed in the survivor's estate. That was not a winner for a lot of reasons. But there may be a better way. Name a two-generation charitable remainder uni-trust (CRUT) as beneficiary. The surviving spouse would get an annuity for life, e.g., 5% of the value of the trust each year (kinda like the payment of income from a bypass trust). When the surviving spouse dies the annuity stream could be paid to the children (e.g., to children of a prior marriage – boomers have a higher divorce rate than all preceding generations) for their lives. There would be no income tax triggered by the transfer from the IRA to the CRUT 'cause CRTs are tax exempt. PLRs 199901023 and 9820021. On the death of the last child whatever assets remained in the CRUT would go to charity. That might be consistent with the way boomers begin to redefine retirement and estate planning as they did every other social institution over their lifetimes. Hoyt.

■ Under 10M Estates: For estates not subject to the federal estate tax some taxpayers might assume that there is little planning to do, but hey we're lawyers, there's always something we can find to complicate their lives. The reality is that eliminating the need to address a federal estate at most obviates only one of the myriad of issues that comprehensive planning can address. "Planning for Estates Under $10 Million" Akers. The simplicity many

(Continued on page 2)

Checklist: GRATs

Summary: Grantor Retained Annuity Trusts ("GRATs") have been a popular planning tool for many years. Maximizing the benefits of a GRAT will take more than just drafting a trust document that complies with tax law requirements. Thoughtful selection of assets to fund the GRAT, and careful administration of the plan, are crucial. The following checklist is drawn from "The Care and Feeding of GRATs" by Carlyn S. McCaffrey, Esq.

√ There are 8 tax requirements that must be reflected in the trust document for a GRAT to be respected for tax purposes. However, the IRS has argued on audit that merely reciting the requirements is insufficient and that the GRAT must be administered in accordance with those requirements as well. In Atkinson v. Commissioner, 309 F.3d 1290 (11th Cir. 2002), aff'g 115 T.C. 26 (2000) the court found that adherence to the charitable remainder trust rules, not merely listing the requirements in the trust, was required. This argument has been extended to GRATs which are patterned after similar rules.

√ A GRAT cannot issue a note to satisfy the annuity amount due the grantor. Treas. Reg.§ 25.2702§ -3(b)(1)(i). That restriction does not

(Continued on page 3)

...HECKERLING TEASER TIPS

(Continued from page 1)

expect is often not practical. Maximizing income tax basis increases available on death is a major goal that will change the face of estate planning.

■ Portability: On the death of the first spouse portability permits the surviving spouse to use the first spouse's estate tax exemption. In the past this benefit could not be captured without a bypass trust (you probably still want a bypass trust, but that may have some different provisions then in the past). So, on the first spouse's death an estate tax return should be filed so that this tax benefit can be protected. Filing the return is how the survivor makes the election. While some taxpayers might object that the process is too costly, that is not necessarily the case. The decedent's assets must be valued in all cases for basis purposes so the incremental cost of preparing a return may not be that much more. The portability regulations allow a relaxed reporting procedure to merely list assets qualifying for the marital deduction rather than listing values of each of the assets. Filling out the estate tax return for most estates will not be overly onerous.

■ Trusts: Many folks will be tempted not to use trusts and instead favor outright bequests if there is no perceived tax advantage. But liability and divorce risks make outright bequests a risky gambit. So trusts will continue to be the preferred dispositive scheme. However, trusts that provide for distributions to maintain the beneficiary's standard of living (health education maintenance and support, or "HEMs") may not provide the desired protection. Discretionary trusts, in which the trustee can determine if, when, and how much to distribute, should be favored. Another approach that will likely become more common is granting a beneficiary a general power of appointment over trust assets. That will cause estate inclusion and secure an increase (step-up) in basis. However, a general power may also expose the assets over which the power can be exercised to the reach of creditors as well. Akers.

■ Home Sweet Home: For folks under the federal estate tax exemption state estate tax is the tax to avoid, and that may depend on which state they have the closest tax connection. States generally tax those who are resident for income tax purposes, and estates of those who were domiciled in the state. With some state income taxes reaching 13%+ the determination as to which state you a resident in for income tax purposes can have significant economic implications. With about 20 states having a death tax, determining when they can assess that tax is critical. Generally, the taxpayer must be "domiciled" in a particular state for that state to subject him or her to a death tax. The Black Law Dictionary defines "domicile" as "The place at which a person has been physically present and that the person regards as home; a person's true, fixed, principal, and permanent home, to which that person intends to return and remain even though currently residing elsewhere." That simple definition can give rise to a myriad of issues, among them that more than one state may claim you as a domiciliary to tax your estate. Adding to the complexity are the varying definitions some states have. Domicile can also be a sticky concept. While many people feel that they have moved out of a particular state, their "moving" might not be sufficient to break the tie of domicile in that prior state. The determination may turn on a subjective intent of where you intend to return. Domicile and residency often go hand-in-hand, but not necessarily. You might make more than a transitory visit to a state thereby subjecting yourself to income tax in that state, but retain your domicile elsewhere. Delaware, for example, includes in the definition of a resident for income tax purposes anyone who is domiciled in the state. A California case provides an extensive listing of factors to consider in the residency analysis and may be a useful starting point. Appeals of Stephen D. Bragg, 2003-SBE-002 (May 28, 2003). The decisions are very fact specific which means reviewing any case law in the states in issue will be critical. It also means that those who plan carefully to have the facts support the position they intend will likely fare better. Nenno and others: "There's No Place Like Home, But Where's Home?" PP

For seminar announcements follow "martinshenkman on www.twitter.com and www.Linkedin.com/in/ martinshenkman

≈

For e-newsletter sign up at www.laweasy.com.

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, publisher and NAEPC 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, Esq.*

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 recommenda-tion of any tax planning strategy or action.

Publisher Information: Practical Planner (Reg. U.S. Pat. & Tm. Off) is published bi-monthly by Law Made Easy Press, LLC, P.O. Box 1300, Tenafly, New Jersey 07670. Information: news letter@shenkmanlaw.com, or call 888 -LAW-EASY.

...CHECKLIST: GRATS

(Continued from page 1)

prevent the use of notes issued by another person (e.g., the grantor's spouse), or another family trust, to make an annuity payment. For, example, if the GRAT is having cash flow shortfall the GRAT might sell GRAT assets to a family trust for a note, and then use that note to pay the annuity payment to the grantor.

√ GRATs are grantor trusts during the period the annuity payment is made to the grantor. This means all income of the GRAT assets is taxed on the grantor's income tax return. There are several important benefits to grantor trust status. No gain or loss is recognized if the trust sells appreciated assets to the grantor, or buys assets from the grantor. The GRAT can distribute appreciated assets to pay the annuity due without triggering gain. No gain occurs on sales between the GRAT and another grantor trust of the same grantor. The trust will be permitted to hold shares in an S Corporation. This is significant in spite of the popularity of LLCs in that there are over 2 million S corporations.

√ While some believe that a series of short term (e.g., 2 year) GRATs are always better than a longer term GRAT, especially if volatile assets (e.g., stocks) are given to the trust, this is not always the case, especially now. If interest rates rise or if tax laws change, it may prove preferable to have locked in the initial rates and rules.

√ While many transfers have relied on formula clauses to reduce the tax risk of the IRS challenging the valuation of a hard to value asset (e.g., an interest in a family business), GRATs remain the only assured approach to avoid the tax risk of a valuation challenge. This can be a safety net for anyone endeavoring to gift close to their remaining gift exemption amount ($5,250,000 in 2013).

√ GRAT annuity payments are permitted to increase 20% per year. Using an increasing payment GRAT can reduce cash flow requirements in early years, making the transfer of family business or certain other assets easier to structure. If the property will increase over time, an increasing annuity payment will result in the transfer of greater economic value to the remainder beneficiary.

√ Getting granular can enhance the results of a GRAT. If feasible establish several GRATs each holing a specific asset class (or get more granular with each holding a single asset). This can insulate outperforming GRATs from the laggards.

√ There may be benefits to the remainder beneficiaries transferring their remainder interests in the GRATs. This might be impeded if the GRATs include a spendthrift clause. If the transfer is a sale to a GST exemption trust it may permit a GRAT which is not efficient for GST tax planning, to effectively transfer the remainder interest to a GST exempt trust.

√ Make your GRAT a sure bet by funding it with carefully selected assets such as preferred family LLC interests, discounted interests, stock subject to a restriction on transfer (e.g., SEC or a lock up from a public offering) that will end prior to the GRAT term ending, and other specific types of assets.

√ Monitor GRAT performance. If the assets in the GRAT don't appreciate during the early years the GRAT will be unlikely to succeed. Consider buying the assets out of the GRAT and transferring them to a new GRAT. PP

RECENT DEVELOPMENTS

■ A detailed summary of current developments from the past year has long been a hallmark of the Heckerling Institute. The following won't even qualify as an appetizer for what is to come. "Recent Developments 2013" Belcher, Harrington and Pennell.

■ With portability permanent many estates will (should) file a federal estate tax return to secure the first spouse to die's exemption. Some experts have questioned whether a QTIP marital election is valid if the estate is under the federal exemption amount (and therefore did not need the marital deduction to avoid tax). This has profound implications in decoupled states that don't permit a separate state QTIP election. The Treasury-IRS Priority Guidance Plan has added this topic.

■ The Obama administration has again proposed that estate, gift, and GST rates and exemptions revert to 2009 tax rate of 45%, $3.5 million estate and GST tax exemptions, and $1 million gift tax exemption).

■ The Supreme Court held that DOMA unconstitutionally deprived persons of equal liberty in violation of the Fifth Amendment. Windsor v. United States, 570 U.S. ___, 133 S. Ct. 2675. The ripple effects continue. For example, in Obergefell v. Kasich, 2013 U.S. Dist. LEXIS 102077 (S.D. Ohio July 22, 2013), an Ohio federal district court ordered the Ohio registrar of death certificates not to accept a death certificate for a gay couple unless it recorded his status as married and his same-sex surviving spouse's status as his surviving spouse. This trend will likely continue.

■ Retaining the right to receive dividends on a life insurance policy to benefit his former spouse was not deemed an incident of ownership and the policy was not included in his estate. CCA 201328030.