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

ESTATE PLANNING NITS THAT MIGHT HELP YOUR

Folks like the big stuff. A fancy 70+ page trust, a big insurance policy, a complex note sale transaction, a combo of an insurance trust with a policy to replace wealth transferred to a charitable remainder trust (CRT). The big picture items are key to getting an estate plan right, but the little stuff, the nits that are often ignored, can really be critical to your plan succeeding. Below is a list of what might seem inconsequential, but may not be.

■ Signature Blocks: Any trust or entity document that is signed should be signed with the appropriate format. If, for example, a trust owns an interest in a family LLC, the signature lines should indicate the name of the LLC, being signed by the trust (using the formal name of the trust) as a member of that LLC, and the appropriate person should sign on behalf of the trust. The signature block should indicate the name and title of the person. This can be tricky because for some trusts it might simply be the trustee signing. For other trusts, the particular document might be under the purview of an investment director or adviser for the trust. If you want the IRS and creditors to respect the entities and trusts that comprise your plan, you should try to make sure that you follow all the appropriate formalities.

■ Loan Documentation and Payments: One of the most common weak links in many plans is improperly handled related party loans. If there are a number of trusts and entities in your plan, and a particular entity or trust requires additional cash, the tendency is to simply make a transfer from a trust or entity that has excess funds. After all, they're all family controlled. But you need to adhere to formalities. If one entity advances funds to another family entity or trust, or family member, sign a loan document, with arm's length terms. Be certain that the interest rate is sufficient to avoid the imputation of interest by the IRS. Interest should be paid on the note in accordance with the terms of the note. At the maturity of the note the principal should be paid or refinanced. Be certain that your CPAs are informed of the note so that they can reflect it on both the borrower's and lender's tax returns. If financial statements are prepared the loan should be properly reflected there as well. Loans are so often mishandled that it is a common matter for IRS auditors, or litigants pursuing a settlement, to look into.

■ Investment Policy Statements (IPS): Your investment adviser likely insists on having an IPS documenting how your assets are invested. Extend that concept a bit further. If you have a family limited partnership (FLP) that holds significant marketable securities, that FLP should have its own IPS. That could be important not only to identifying the right asset allocation for the FLP, but also for demonstrating the business purpose of the FLP if that is ever challenged by the IRS or a claimant. You might prepare a broader family IPS with the appropriate asset allocation for the family unit as a whole, and separate IPS's for each trust or entity that has significant securities. That can be used to fine-tune the asset location decisions—which asset classes in a non-grantor trust, grantor trust, etc.).

■ Transferring Assets to Trusts and Entities: This sounds so simple, but many people set up trusts and entities but never follow through on transferring assets to them. The best life insurance trust won't do much good if you own the policy personally. A revocable trust won't avoid probate on assets you haven't transferred into the trust. A LLC set up for asset protection won't afford much benefit if you haven't transferred assets to it. Also, be sure all formalities are adhered to. If you transfer a business entity to the trust be certain to comply with approval and other requirements in the governing document (operating agreement, etc.). If you transfer real estate to a trust be certain that transfer taxes, due on transfer clauses in a mortgage, and lease covenants are not violated, and so on. Details are really important.

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CHECKLIST:2020 ELECTION

Summary: No one can predict what the 2020 election might bring, but if it brings a sufficient shift in power to the Dems, that will likely be followed by a much more stringent estate tax system and perhaps even a wealth tax. While there is no assurance that any planning you complete today will survive such changes unscathed, isn't it smarter to complete planning in advance to have a chance of avoiding the harsh changes then to just take your chances? We might see a $1 million gift exemption, $3.5 million estate exemption, grantor trusts taxed in your estate, GST (dynastic) planning limited, GRAT torpedoed, and annual gifts capped at $20,000/donor (not per donee). Below are some thoughts about planning you might jump on now.

√ Grandfathering: If you get a plan in place before an adverse change in law, that plan might be respected and excluded from the new tax regime. That has traditionally been called "grandfathered." While there is no guarantee that if you set up a trust today it will be grandfathered from changes the Dems might enact, consider the flip-side. Is it worth missing out on what might prove to be the last great estate planning opportunity before massive changes? Its probably not. Since the Dems have spoken of clamp-

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…ESTATE PLANNING NITS THAT HELP YOUR PLAN

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■ <u>Correct Assets on Trust Statements</u>: A trust company that serves as trustee will usually list the trust assets on the trust statement. Be sure to check the description and details to confirm all is done correctly. Some folks transfer assets into a trust (e.g. signing as an investment trustee) but never tell the general trustee what they've done. Not a great idea. Also, many trust company statements are constrained by a limited number of characters in a data field. Sometimes the truncated descriptions are unclear and may not appropriately describe the trust asset. Review and fix these so that the descriptions are consistent with what the trust actually owns. If transfers were made subject to a price adjustment mechanism (e.g. a Wandry type clause transferring $1 million of stock not 100 shares of stock) be certain that the descriptive language in some way indicates that arrangement.

■ <u>Correct Crummey Powers</u>: These are the annual demand powers that support the use of gift tax annual exclusion to cover gifts to irrevocable trusts (or in some plans to create a beneficiary defective irrevocable trust or "BDIT" taxable to the beneficiary instead of the settlor). Make sure these are actually done, and done right. For many folks this formality is just off radar. It shouldn't be. For others they forget that if they make gifts to children, they may not have the full $15,000 (2019) annual exclusion for a gift to the trust for that beneficiary. Also, Senator Bernie has proposed capping annual gifts at $20,000/donor. That could eliminate traditional annual gift planning if the Dems sweep in 2020.

■ <u>Consistent Reporting on Tax Returns</u>: So you gave or sold 25% of a family business to a dynasty trust. Oops, you never told your CPA and the tax returns don't reflect the transfer. That's gonna be a rather negative fact if the IRS audits your gift tax return and finds it inconsistent with the income tax return for the entity. It also is not a winner if you get sued or divorced and want to argue that the gift to the trust was real and therefore protected. Why should your claimant have to respect a transfer you didn't?

■ <u>Carrying out Terms of a Note Sale</u>: A common wealth transfer technique (but not without risk and complications) is to sell business or real estate interests to a grantor trust. That should allow you to freeze the value of that business interest in your estate and shift post-sale appreciation outside your estate into the purchasing trust. But you must adhere to all the formalities of such a sale. Reflect the sale on tax returns, financial reports, trust company statements, etc. If the trust used a note to purchase some or all of the stock, be sure to pay interest on the note as due. Have the governing legal document (e.g. shareholders' agreement for a corporation) updated and executed to memorialize the transfer.

■ <u>Respecting Gifts You Made</u>: Yeah you gave your daughter 10% of the family business but you decide you want 100% of the distributions this year. You shouldn't contradict the estate planning transaction you consummated and expect the IRS or creditors to respect it. Distributions should be pro-rata to owners. Formalities should be followed. If there is any doubt or issue consult with your advisers before you pay a dividend or take other action. Yep its likely easier to address your concerns or goals and complete the distribution or transaction correctly, then to correct a mishandled transaction later. While fixing a botched transaction is preferable to ignoring it, having too many corrections can be bad.

■ <u>Updating Property, Casualty and Liability Insurance</u>: If you transfer an asset to an entity or trust be sure your property, casualty and liability policy reflects the new trust/entity owner. The correct owners must be insured, for the right amounts, etc. If you had an asset appraised, e.g. as a gift, before transferring it to a trust, compare that appraised value to your insurance coverage and make adjustments if appropriate.

■ <u>Reasonable Compensation</u>: If you work for a business, and that business is transferred to a trust, discuss with your CPA what level of compensation is appropriate for you. When you owned 100% of the business it may not have mattered, but if a trust owns a percentage it does matter. If your compensation is too high it might look like you have retained control over the business and the transfer to the trust might not be respected. If you take too little compensation, the IRS might argue that the underpayment to you was an indirect gift to the trust.

■ <u>Minutes, Consents, Records</u>: Discuss with your attorney having minutes or unanimous consents completed for business entities and perhaps occasional consents by trustees to document that trust formalities are being followed. PP

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...Checklist: Plan Before the 2020 Election

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ing down on GST/dynasty trusts, grantor trusts, adding a wealth tax, raising the tax rates, it might just be worth the effort to create a grantor dynasty trust and get assets into it today before changes are enacted.

√ **Spousal Gifts** (and the "step-transaction doctrine"): **If all the dough is in your name, you might need to gift some assets to your spouse so that he or she can engage in planning. The sooner you make that transfer, and the longer time that exists between your gift to your spouse, and his or her subsequent gift to say an irrevocable trust, the less risk of the IRS challenging it as if you made the gift to the trust instead of your spouse. That could have disastrous tax consequences. If you can gift to your spouse in 2019 and your spouse wait until 2020 to make transfers, that might be even better – inserting a tax year end between the two steps.**

√ **GRATs: A grantor retained annuity trust in simple terms works like this. You put assets into the GRAT and get paid an annuity based on current interest rates. If the assets grow faster then current interest rates the excess is removed from your estate with no gift tax cost. Some advisers push GRATs but if the gift tax exemption declines after the 2020 election (mandated 10 year term and 25% gift value for assets contributed, etc.) consider techniques that use and safeguard your exemption instead of GRATs that don't use exemption. If you've already used all of your exemption, GRATs might be a good technique to freeze asset values in your estate before the election. But given the proposals to clamp down on GRATs you might consider longer term GRATs. Under a traditional GRAT plan assets are put into a GRAT. When the annuity payment is received from the GRAT a year later, that payment can be put into a new GRAT, and so on. That's called rolling or cascading GRATs. But if you can't roll GRATs past the election, perhaps for example a 6- or 8-year GRAT might make more sense than the typical 2-year GRAT. If Dems to take over what about a last minute 99-year GRAT?**

√ **Insurance Trusts: There's talk of limiting tax free annual gifts to $20,000 per donor per year. Under current law every donor can gift $15,000 to any number of people. It might be advisable to transfer assets into insurance trusts today so that the income from those assets can pay insurance premiums in all future years.**

√ **Note Sales: A common planning technique is for you to sell interests in a closely held business to a grantor trust. The interests are say 50% or less of the equity so that the value is discounted. Discounts may be repealed in post-election tax legislation. Grantor trust assets may be included in your estate. Dynasty trust assets may be subject to tax every 50 years. Completing these types of transfers now, especially for equity in a family business, may prove incredibly advantageous if the transaction is grandfathered from those types of changes.**

√ **Non-Reciprocal SLATs: A common planning technique is for each spouse to set up a trust for the other spouse and descendants. That way each spouse is the beneficiary of the other spouse's trust and the couple as a whole may retain benefits from all of the assets given away. Those assets may be protected from creditors, estate taxes and other transfer taxes. But if the spousal trusts are too similar the IRS or a creditor can uncross them and the plan will collapse. One way to make these trusts different is to create and fund them at different times. If wife's trust is set up and funded in November 2019 and husband's trust for wife is created and funded in October 2020, that might help the success of the plan.**PP

Recent Developments

■ **A recent Bankruptcy case may have important implications to estate tax minimization and asset protection planning. The Court in the Rensin case found that an existing asset protection trust administered in Belize was subject to Florida law and not the laws of Belize. That conclusion could have undermined the entire trust and plan. In this case, because the trust assets were invested in annuities, they were ultimately protected from creditors under Florida law. However, the application of Florida law instead of Belize law (which some commentators believe is an error) has important planning implications to anyone who is the settlor and beneficiary relying on domestic or offshore asset protection trusts. You must consider this possibly increased risk that courts may apply the law of the state of your residence (e.g. New York) instead of the law of the state where the trust has situs and is administered (e.g. Alaska). Example: You set up a self-settled trust in Nevada and you are a beneficiary. Your goal is to make a completed gift of assets to that trust to use your current gift tax exemption – i.e. to get the assets outside your estate before the estate tax laws change. However, if a court applies the Rensin approach, New York law, not Nevada law, might apply to the trust. This could permit New York creditors to reach those assets. One of the tests for whether you have removed assets from your taxable estate is that your creditors cannot reach them. If Rensin could result in creditors reaching those assets, your estate tax plan could be undermined. From an asset protection perspective you might consider using a "belt and suspenders" approach. For example, have your trust own less than 100% interests in multiple member LLC's and limited partnerships that have charging order protection. If you are really worried, perhaps you should move to a DAPT friendly state. Some commentators might suggest that you move the trust offshore to avoid the application of the full faith and credit clause of the U.S. Constitution. But you must consider possible contempt of court and other risks. It is not clear whether what appears to be incorrect legal reasoning will apply in future cases, or that a bankruptcy court decision will affect non-bankruptcy decisions, but caution is in order. In re Rensin, 17-11834-EPK, 2019 WL 2004000 (Bankr. S.D. Fla. May 6, 2019).** PP

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■ Domicile: Domicile is the place you permanently live and intend to return to. Your domicile may be different then your residence. Domicile can be important to determine which state income tax (if any) you pay, whether you are subject to estate tax in a particular state, and which state law governs any legal matter you're involved in. Domicile considers a myriad of factors including: whether you have a home (permanent place of abode) in a particular state, where your near and dear items are located, where your family lives, your work connections and more. There are a lot of other factors like where your car is registered, which state drivers license you have, where you vote, etc. Those factors are easier to control and should be changed to the state in which you want to maintain domicile. You may also have to track days carefully in each state. If you are in a state more than 183 days and have a permanent place of abode in that state, that state might tax you regardless of any other factors. Technology has changed a lot of this analysis so don't use outdated checklists or planning articles without considering the impact. For example, where you had bank accounts was an important factor historically. But today many people do all their banking on line so which branch their accounts may be at might be irrelevant. Home phone records used to be important to show where you were, but many people no longer use home phones, so that factor might be irrelevant for many. Today the location of cell towers off which your cell phone calls were processed can be determined. Another critical change. Folks use to shop at places called malls. Now they may do most of their shopping on the internet. Years ago no one carried around a camera. Now, almost everyone has a smart phone glued to their hip. Use it wisely to shoot photos to corroborate your change in domicile. Remember the old adage "A picture is worth a thousand words." Consider an app for your phone that uses the location finder to track the states you are in to prove day counts. Bottom line, careful records and good facts are key, but consider technology to make the facts you document relevant. One of the most important points to demonstrate is that you changed the focal point of your life. Domicile is where your heart is. What factors can you use to corroborate where your social, spiritual and other aspects of your life have moved? Be mindful of changes in the law when you move. Your new state may have very different laws about post-nuptial agreements, spousal rights of election, creditor protection, self-settled trusts and more. Look before you leap and be sure to modernize records. PP

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