NAEPC
Journal of Estate & Tax Planning

Click here to view Issue 23

Wolters Kluwer

Estate Planning Review THE JOURNAL

OCTOBER 22, 2015
VOLUME 41, NO. 10

Contents

Highlights of the CCH Financial and Estate Planning Advisory Board Meeting

Estate Planning 184
Portability and Basis Planning Present New Challenges

State Law 198
Impact of State Law on Planning

Insurance 202
New Developments and Changes to the Life Insurance Industry

Retirement Planning 207
Retirement Planning Update

Planning for an Aging Population 211
Dealing with Aging Clients and Those with Chronic Illnesses

Investment Planning 226
An Advisor's View of "Tax Efficient Investing"

Wolters Kluwer®

Estate Planning Review *THE JOURNAL*

Consulting Editor
Sidney Kess, J.D., LL.M., C.P.A.

Portfolio Managing Editor
Karen A. Notaro, J.D., LL.M.

Editors
Bruno Graziano, J.D., M.S.A.
Laura A. Tierney, J.D.
Michael G. Sem, J.D.
Thomas K. Lauletta, J.D.
Alicia C. Ernst, J.D.

Graphic Design
Kathie Luzod

Layout Design
Craig Arritola

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

For article submission guidelines, contact Bruno Graziano, ESTATE PLANNING REVIEW—The Journal, 2700 Lake Cook Road, Riverwoods, IL 60015, or send e-mail to EPRJournal@wolterskluwer.com.

ESTATE PLANNING REVIEW—THE JOURNAL

(ISSN 0098-2873), published monthly by Wolters Kluwer, 4025 W. Peterson Ave., Chicago, Illinois 60646 **POSTMASTER:** SEND ADDRESS CHANGES TO ESTATE PLANNING REVIEW, 4025 W. PETERSON AVE., CHICAGO, IL 60646. Printed in U.S.A.

© 2015 CCH Incorporated and its affiliates. All rights reserved.

Advisory Board Members

Ben G. Baldwin, Jr.
Baldwin Financial Systems, LLC
Arlington Heights, Illinois

Svetlana V. Bekman
Northern Trust—Legal Dept.
Chicago, Illinois

Lyle K. Benson, Jr.
L. K. Benson & Company, PC
Baltimore, Maryland

Carol Cantrell
Cantrell & Cantrell, PLLC
Houston, Texas

Charles D. Fox IV
McGuireWoods LLP
Charlottesville, Virginia

Robert S. Keebler
Keebler and Associates, LLP
Green Bay, Wisconsin

Sidney Kess
Of Counsel to Kostelanetz and Fink
New York, New York

S. Timothy Kochis (Emeritus)
Kochis Global
San Francisco, California

Stephen J. Krass
Krass, Snow & Schmutter, PC
New York, New York

Richard A. Oshins
Oshins & Associates, LLC
Las Vegas, Nevada

Barbara Raasch
RCL Advisors
New York, New York

Sanford J. Schlesinger
Schlesinger Gannon & Lazetera LLP
New York, New York

Martin M. Shenkman
Martin M. Shenkman, PC
Fort Lee, New Jersey

Lee Slavutin
Stern Slavutin-2 Inc.
New York, New York

Wolters Kluwer®

CURRENT FINANCIAL AND ESTATE PLANNING TRENDS

Highlights of the Financial and Estate Planning Advisory Board Meeting

On August 19, 2015, the FINANCIAL AND ESTATE PLANNING Advisory Board met to discuss current planning issues and practice trends. This year, the Advisory Board, along with moderator **Sidney Kess**, Of Counsel to Kostelanetz and Fink, New York, New York, and members of the Wolters Kluwer editorial staff engaged in a series of round-table discussions centered on five broad topical areas—(1) estate planning and drafting, (2) the impact of state law on planning, (3) insurance, (4) retirement planning, (5) dealing with aging clients and those with chronic illnesses, and (6) investments.

Participants and contributors to this year's discussions included **Ben G. Baldwin, Jr.**, Baldwin Financial Systems, Inc., Arlington Heights, Illinois; **Lyle K. Benson, Jr.**, L.K. Benson & Company, PC, Baltimore, Maryland; **Carol Cantrell**, Cantrell & Cantrell, PLLC, Houston, Texas; **Charles D. "Skip" Fox IV**, McGuireWoods LLP, Charlottesville, Virginia; **Robert S. Keebler**, Keebler & Associates, LLP, Green Bay, Wisconsin; **Stephen J. Krass**, Krass, Snow & Schmutter, P.C., New York, New York; **Bernard A. Krooks**, Littman Krooks LLP, New York, New York; **Richard A. Oshins**, Oshins & Associates, Las Vegas, Nevada; **Barbara J. Raasch**, RCL Advisors, New York, New York; **Sanford J. Schlesinger**, Schlesinger Gannon & Lazetera LLP, New York, New York; **Martin M. Shenkman**, Martin M. Shenkman, PC, Fort Lee, New Jersey; and **Lee Slavutin**, Stern Slavutin-2 Inc., New York, New York.

Wolters Kluwer

ESTATE PLANNING

Portability and Basis Planning Present New Challenges

Sidney Kess, Sanford Schlesinger, Robert Keebler, Martin Shenkman, Richard Oshins, Bernard Krooks, Skip Fox, Carol Cantrell, Stephen Krass, along with Mark Luscombe of Wolters Kluwer, participate in a discussion of current estate planning issues including portability, basis planning, estate and gift tax audits, ethical considerations, and the possibility of upcoming regulations under Code Sec. 2704.

Sidney Kess: Recently regulations were finalized dealing with the subject of portability [T.D. 9725]. Sandy, could you please start us off with a discussion of the final regulations and what they mean for our subscribers and their clients?

Sanford Schlesinger: Of course. They are really not dramatic, frankly. Probably the most dramatic thing that has come about as a result of portability and the regulations is that the IRS is not automatically sending out closing letters for Form 706, as has been my experience during 48 years of practice. You now have to request a closing letter and you should not request it until at least four months after the return is filed.

I think this is a ridiculous administrative hardship on an estate, and my guess is that when you write after four months, you're going to be told, "Call back in another four months." That comes out of portability because many of the returns that are being filed are merely returns to elect portability, and the IRS allegedly anticipates a great increase in the number of returns. So, that is one major practical issue.

One of the key points on the portability final regulations is that the extension of time under Reg. §301.9100-3 to elect portability may only be granted to those estates that are under the threshold filing amount and not otherwise required to file a return.

An executor of an estate who files a timely, complete return doesn't need to file a protective election for portability. That could be a bit of a problem. How do you know if you have done it unless the IRS gets back to you? So, whether you have filed an appropriately complete return to effectively elect portability, the IRS is telling you that you should not and, I guess, that you cannot elect to file a protective refund claim.

There is also a provision for non-citizen spouses who become citizens. If the portability election was made, the amount of the deceased spousal unused exclusion (DSUE) amount will be adjusted and become available to the spouse on becoming a U.S. citizen.

What they didn't address, and very importantly so, was an unnecessary qualified terminable interest property (QTIP) election. Specifically, whether the IRS will respect a QTIP election that wasn't necessary to reduce the estate tax liability to zero. This is an outgrowth of Rev. Proc. 2001-38 [2001-1 CB 1335], and the IRS said it will issue guidance on this in a future Internal Revenue Bulletin.

Another important aspect of the portability final regulations is that they confirmed the prioritization of use of the DSUE amount. As we had expected, if you have a DSUE amount from spouse number one, and then spouse number one dies, you make gifts with that amount, and then you marry spouse number two, spouse number two dies, you can use the deceased spouse's DSUE amount in that order of priority.

I think those are the key elements of portability. One other comment, although I think I may have already editorialized a little bit too much. I don't like it. It makes my job much harder. I think planning is much harder. There is too much that I don't know. I don't know whether the client is going to remarry. I don't know whether the spouse is going to leave the client a DSUE amount. It is very hard to draft, especially in states that have a state estate tax, in order to take full advantage.

© 2015 CCH Incorporated and its affiliates. All rights reserved.

Sidney Kess: Bob, do you have any advice you have been giving your clients on portability?

Robert Keebler: Well, I would echo what Sandy said. The paradigms have shifted, and lawyers and CPAs need to change their focus to both the income tax and the estate tax and to understand basis amounts. Typically, we are preparing spreadsheets to analyze the choices.

Drafting will change because there will be an emphasis on trying to have your cake and eat it too. For example, trying to fund a bypass trust when the husband dies, but then giving the wife some type of power of appointment, or perhaps through a QTIP, or some other way whereby it is going to be included in her estate when she dies and receive a step up in basis.

I think we are going to go through a five or 10-year period of time before we come up with new rules of thumb. In the meantime, we are going to have to work closely together to build those new paradigms.

There is a question, and we are not going to attempt to answer it here, of exactly what is the standard of care in the CPA world when you are doing a tax return for someone and his or her spouse dies and there is a lawyer handling the administration of the estate. What do you do with regard to advice on filing a 706, even if you have not been asked to?

I was named as an expert in litigation where a lawsuit was brought against a CPA who was not engaged to do anything, but he was a 1040 preparer, and he failed to tell the estate that it should file a 706 to elect portability.

What I think we need to pay the most attention to is the absolute, unequivocal need to file a Form 706 if you want portability. That concept is still not fully grasped out there. In big CPA firms and big law firms, I think it's very possible that some partners do not understand that. That can be the case in smaller firms too, of course, but the scary part is that in a big firm, somebody might have a very large client, but he or she is not an estate planning person. The CPA or lawyer could easily miss this by thinking, "Well, you're only worth $5 million, which is below the threshold. So, there is no real need to file."

So, again, the key thing is the absolute need to file, even for those below the threshold, in order to obtain portability. And, from a drafting perspective, Sandy is exactly right. The lawyer's job is much harder now for the average couple worth between $5 and $10 or $12 million because it used to be very black and white— draft a bypass trust to shelter the exclusion amount. Now it is a case of, do we use portability or do we use a bypass, or do we set it up with flexibility so that we can pick?

Sanford Schlesinger: I wanted to comment, not just on the need to file a 706 to elect portability and the inadvertent non-filing of a return. Obviously, there is a possibility of relief under Reg. §301.9100-3 if that is the only reason you are filing a return. My understanding is that the IRS is being very generous on that relief.

Having said that, my problem is the resistance of clients to file the return. It's not just the professional accountants or attorneys. The resistance comes in the form of, "Why am I filing a return? There is no tax due. It's not necessary."

Now, here is one little piece of good news. In New York State, where we do have an estate tax, the best argument is that in order to file the New York estate tax return, you have to do a pro forma 706, believe it or not. So, since you have to do a pro forma 706 anyway, filing a 706 for portability is a good thing to advise the client.

But in other states, or states where there is no estate tax, we are getting a lot of pushback from clients, who will say, "Why do I have to spend money on doing a 706? Why do I have to pay for an appraisal?" I know there are certain areas where appraisals are not necessary, and I'm not going into that here. But, I am not risking not having an appraisal if the IRS valuation could be very different from what we are saying it is.

The bottom line is that a 706 can involve considerable expense to people, and we are getting a lot of pushback on doing it to make the election.

Sidney Kess: Do you know what states specifically recognize portability?

Sanford Schlesinger: As far as I know, Delaware and Hawaii recognize portability. But, I am not completely up to date on that.

Skip Fox: Here in Virginia, we do not have a state death tax and there is no specific recognition of portability.

© Wolters Kluwer

Sanford Schlesinger: Related to this issue, does anyone remember how many states have an estate tax now? I think it is 19, is that correct?

Skip Fox: Yes, there are 19 states and the District of Columbia.

Sanford Schlesinger: So, you have to realize, then, that 31 states do not have an estate tax, and it is not an issue. I have asked people why states are not enacting portability. In April 2014, New York revised its estate tax quite dramatically, and specifically did not adopt portability. There is separate legislation pending in New York to adopt portability, but it has not been passed.

I do not quite understand it. People have told me that it is a state revenue issue. But consider what can happen in a state like New York, where a husband dies and the wife moves to Florida. There is no New York estate tax if the wife moves out. There is a very big issue of whether New York would collect the secondary tax anyway.

The real argument is now becoming, "Why not just leave everything to my spouse outright and let the spouse take care of it." Now, possibly, that may be easy enough with first and only marriages where people are never going to remarry. Because people are involved in second marriages now, and many people have children from multiple marriages, it becomes an academic discussion bequeathing directly outright to a surviving spouse and with a disclaimer. And, even without a disclaimer, especially in states without an estate tax, portability becomes very appetizing to the client. There are publications in the popular press encouraging people to do exactly what I said, which may not be the best planning in the long run.

Income Tax Planning for High-Income Taxpayers

Sidney Kess: Thank you. Moving over now to the income tax side, the federal income tax structure following the American Taxpayer Relief Act of 2012 (P.L. 112-240) represents not only the potential for higher tax rates overall, but also the partial loss of certain itemized deductions. In addition, there are other kinds of taxes, such as the net investment income tax (NIIT) that we have to consider.

Bob, in terms of planning for high-income taxpayers, what are some of the strategies that you are using to mitigate the NIIT and the limitations on the phase out of itemized deductions and the personal exemptions?

Robert Keebler: Well, Sid, just a little background. The NIIT [Code Sec. 1411] is a 3.8-percent tax that is imposed when income exceeds a certain threshold. For a married couple, that threshold is $250,000, and for individuals, it is $200,000. Those thresholds are not inflation-adjusted. For estates and trusts, it is the amount at which you reach the 39.6-percent bracket, which is $12,300 in 2015.

So, when you get over those threshold amounts, you get hit with an extra 3.8-percent tax on your investments. One way to lessen the impact of the NIIT is by reducing the turnover on your portfolio so you have less capital gain, through index funds and things like that. The other way for many people would be through the use of annuities and life insurance.

If someone is selling property for a large capital gain, and they have charitable intentions, they would be very wise to consider a charitable remainder trust. I am a bit surprised as to how slowly the charitable remainder trust is coming back. Many of us thought that it would come back faster, like in the mid-1990s when it was so popular.

Another strategy is looking at installment sales. Say that I am going to sell a significant piece of what I own for $1 million, and it will be an $800,000 gain. Instead of taking all that gain in one year, I can take it over three, four, or five years, trying to stay below the NIIT threshold.

I think individuals are going to be using regular trusts and charitable trusts for their family to shift income to family members who are not subject to the tax. Usually this means shifting income from older to younger generations.

In addition to the NIIT is the scaling back of itemized deductions. When my income goes over what is called the Pease threshold, I start to lose my itemized deductions. Simply, for every dollar you are over the threshold, you lose three percent of your itemized deductions [Code Sec. 68].

That applies to individuals. It does not apply to trusts, which is good news. So, the basic strategy is managing your income to keep below the threshold, which is important. [For 2015, the threshold is

© 2015 CCH Incorporated and its affiliates. All rights reserved.

Wolters Kluwer

$309,900 in the case of a joint return or surviving spouse and $258,250 in the case of an unmarried individual who is not a surviving spouse.] You can lose up to 80 percent of your itemized deductions, which can be a very painful experience.

My partner, Peter Melcher and my son, Grant, wrote an article for Leimberg Information Services about how to use Nevada incomplete non-grantor trusts (NINGs). You could also use a Delaware, South Dakota, or Alaska-based trust. Generally, when people talk about NINGs, it is about saving state income taxes. But, somewhat surprisingly, you can also save federal income taxes by getting the income off of the individual return and onto a trust return, where there is no three-percent scale-back of itemized deductions.

So, if you had a $20 or $30 million gain and you did not want to lose the equivalent three percent of that in itemized deductions, you would drop the property into a NING if your AMT and regular tax were going to be exactly the same. You will end up saving not only state income taxes, but probably federal income taxes, as well, which is a fascinating result.

On the subject of trusts, a charitable lead trust will be very efficacious for some families because there is no three-percent scale back, nor is there a 50-percent limitation on your charitable deductions. In addition, interestingly enough, on Form 1040, the NIIT is computed before the Code Sec. 170 charitable deduction.

So, if I had interest and dividends of $500,000, that would be the measuring point. It would not matter that I gave $250,000 to charity. But if that was in a trust, say a NING or charitable lead trust, you would get around that because the Code Sec. 642(c) charitable deduction is below the line.

That is great for gifts of cash. The bad news is that it does not work so well with appreciated securities because the government position is that you do not get to deduct the fair market value of securities given away through a non-grantor charitable lead trust or a regular Code Sec. 642(c) trust.

Sidney Kess: Bob, could you describe what a charitable lead trust is?

Robert Keebler: A charitable lead trust is a trust in which the charity receives benefits upfront and the remainder then passes to the remainder beneficiaries, normally children. So, if the interest rate was zero, and I wanted to give $1 million to my favorite charity, I might place that into a 20-year lead trust. The trustee would give $50,000 a year to my favorite charity, and at the end of the 20 years, if there was any property left in that trust, then that would pass to my children.

Given today's low-interest rate environment, you would use an interest rate of around 2.4 percent to freeze that. That rate changes monthly, by the way. So, if you had investments growing at 5 percent and the trust froze everything at 2.4 percent, there would be an arbitrage of the difference between the growth of the assets and the freeze rate.

So, a charitable lead trust can have both positive income tax implications and positive estate and gift tax implications. The non-grantor lead trust can also bring you some extra income tax benefits in the right context when you want to reduce your NIIT.

Sidney Kess: I wanted to briefly mention the phase out of the personal exemptions ("PEP") [Code Sec. 151(d)(3)]. I know a prominent lawyer who has five children. He used to have seven exemptions, and assuming the exemption is $4,000, that is $28,000 in deductions that he loses out because of PEP. It is amazing how high-income people are hit in ways they never anticipated.

Planning for Basis

Sidney Kess: Let's move over to basis planning next. With the federal estate tax applicable exclusion at $5.43 million per person in 2015, federal estate taxes now hit a very small number of estates. However, under current law, property acquired from a decedent still receives a step up in basis. This can have a significant impact on planning strategies.

Marty, you recently gave a seminar on this topic. Why don't you begin our discussion by describing how planning for basis is changing the estate planning world.

Martin Shenkman: Most clients are under the federal exemption amount, so there is no federal estate tax. That being the case, the focus for many clients now is to maximize the amount of assets included in their estates so that they can get the

© Wolters Kluwer

step-up to fair market value at death or the alternate valuation date, if that applies.

In the past, the paradigm was that if you incurred a federal estate tax cost, the benefit was that you would get a step up in basis. For most clients—I believe it's only about 0.2% of taxpayers who are subject to an estate tax—there is no toll charge to get basis step-up.

This requires us to rethink all the planning that we have done in the past and revisit, and perhaps repurpose or restructure, prior planning. Bypass trusts that were commonly set up years ago may have served a valuable estate tax minimization objective when they were created, but at the present time they simply serve to keep assets from the surviving spouse's estate on his or her death and thereby miss out on the basis step-up.

So, we need to evaluate all those irrevocable trusts for clients that are safely out of harm's way from an estate tax and consider whether or not distributions could be made that could put assets back into the estate.

That is sort of the simple version of that concept. Then the more realistic version takes account of those states that have a state estate tax. Are we creating a state estate tax by doing that in order to get the basis step-up?

Are there liabilities that they may face in the surviving spouse's estate that could jeopardize them? In many cases, the maximum state estate tax—and a 16-percent rate is the highest, I believe—will still be well below the federal amount. But with multiple marriages, possible lawsuits and claims, the complexity of the state estate tax, and so on, the supposedly simple concept of moving assets back into an estate is anything but simple, and it is a very dangerous planning process. As Sandy mentioned earlier, just as portability has made our lives more risky and complicated as advisors, so too has the concept of basis planning.

Another idea that people have given a lot of attention to is including powers of appointment in various forms to cause assets to be included in an estate. In the simplest sense, you could give a poorer family member, which may be an elderly family member, a general power of appointment over a trust, and those trust assets will then be pulled back into that person's estate and gain a basis step-up.

So, on a basic level, if I set up a spousal lifetime access trust (SLAT) for my wife and descendants, I could give my mother-in-law, who lives in a state with no estate tax and has a very modest estate, a general power of appointment over that trust. It not only will give me a basis step-up, but if I have, for example, real estate assets, it may give me the ability to start depreciating those real estate assets yet again when my mother-in-law passes away.

But, this simple concept becomes much more complex and fraught with problems as we start to evaluate what to do with it. What about potential liability exposure? What if my mother-in-law decides to name somebody else? So, then you build in safeguards of requiring the consent of someone else to the exercise of the power. Perhaps it is a limited power and you give someone the right to convert it to a general power.

Gaining basis step-up in creative ways is a great planning opportunity, but just as with making distributions from irrevocable trusts, the concept of giving powers of appointment also comes with its own set of problems.

There are other ways to look at basis step-up. For example, if we have a client who lives in a community property state, you can get a basis step-up on the full community asset when either spouse dies. But if we have a client who does not live in a community property state, we may be able to pursue that kind of planning by setting up a trust in Tennessee or Alaska where we can take advantage of the community property laws that those states afford.

So, might that give a client who, say, lives in New York, which is not a community property state, the ability to step up basis on an asset in an Alaska community property trust? I don't believe there is any law upholding this Tennessee or Alaska approach, but it is yet another possibility. The list goes on. There is a myriad of different ways we can try to counsel and guide clients on how to gain a basis step-up on death, but it has transformed the planning process both pre- and post-mortem.

So what about swap powers [Code Sec. 675]? They are ubiquitous in trusts. Most of the irrevocable trusts many of us have set up for a number of years now have been intentionally structured to be grantor trusts, not only for the

Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

tax burden that results from the grantor paying the income tax, but, by virtue of including a swap power, we can also swap highly appreciated assets from that trust back into the grantor's estate and get a basis step-up.

It is another great planning opportunity, but just as with the others that I have briefly run through, when you get to the practicalities and the implementation, it's like the old saying, "The devil is in the details." Is anyone really monitoring the swap power? I have found that in a very significant number of cases, even major institutional trustees that are managing trusts holding marketable securities are not routinely monitoring the appreciation level and the ability to benefit from a swap.

If the client's assets in the trust are a closely held business, we may need an appraisal in order to do the swap. That is not only expensive, it is costly to monitor. If the clients are only going to do this in the event of a client's death, we have to monitor the appraised value year by year. When do we pull the trigger and make the swap?

So, to sum up, there is a myriad of ways that we can seek out, and should seek out, maximization of basis step-up at death. It is all part of what I describe as the income tax being the new estate tax for most clients. But it becomes very complicated, very difficult to implement, and I am concerned, just as Sandy expressed concern with portability. A lot of these things sound great on the surface and clients come in thinking things are pretty simple, when in reality they are far more complex.

Sanford Schlesinger: Marty, if I may add one more complexity to it. You do not know when that asset is going to be sold, or if it is going to be sold. It may even pass through another estate, like the spouse's estate or even a child's estate decades later. And, more importantly, you do not know whether the asset is going to increase or decrease in value.

Martin Shenkman: We have a crystal ball, Sandy. That's how we determine those factors.

Sanford Schlesinger: Then I'm going to call you every time I have the question because I expect a correct answer.

Martin Shenkman: To take Sandy's comment and show you what you really have to do with the planning, in my mind you have to visualize a decision tree with discounted present values thrown back. And, on that decision tree, take a simple, common, almost ubiquitous asset like a family vacation home. One decision tree branch will be the home being kept for generations, just like Mom and Dad expect. What probability do we assign to that? What tax rate do we determine would apply 50 years from now if it is sold?

Another branch in the decision tree may be that the house is converted to a rental property and they do a Code Sec. 1031 exchange. Another one may be that a child moves in and converts it to a principal residence and can use the home sale exclusion. Yet another one may be that the kids, in sharp contrast to what the parents think, sell the house as soon as the parents are gone because they always hated going to that place.

But to take Sandy's comment a step further, the decisions to really do a proper analysis are legion. Again, I think that as with portability, clients have been misled by these nice short, 500-word blog posts in the media to think that this stuff is simple, and it is far from that.

Sidney Kess: Thanks, Marty. Dick, please give us some of your thoughts on portability and basis planning.

Richard Oshins: I agree with the others about portability. I do not like it and have many reasons why.

Proponents of portability advance several reasons why they like it. The two primary reasons are (1) that it is simple and avoids the complexities of setting up and operating a credit shelter trust and (2) the spouses receive a second basis step-up at the survivor's death. It has been mentioned today and in previous meetings that portability in practice is not the simple panacea that we had anticipated when it was enacted. We have estate tax filings, appraisals, record-keeping, and many of the complexities that prior planning had.

More importantly, achieving the anticipated virtue of two basis step-ups is problematic. I do not understand why many advisors simply assume that their clients' assets will all go up in value during the surviving spouse's lifetime. Presumably, some assets will appreciate and/or

Wolters Kluwer

there will have been depreciation on assets and the basis will step up at the second death which is a good result. Alternatively, after the survivor's death, there will be assets that will have a basis at death that is higher than the estate tax value. For those assets, the basis will step down. The portability approach results in compromising the next inheritor's benefits for assets of which the basis steps down.

The inefficient planning can be avoided by transferring the inheritance in trust and using the general power of appointment (GPA) technique that Marty mentioned (or the "Delaware Tax Trap") to obtain a basis step-up at the survivor's death on low-basis assets. The GPA would not be given to assets that would step down so the higher carryover basis is preserved. In addition, the GPA can be given to assets that will most benefit from a step up, such as low or negative basis real estate rather than capital gain assets, if there is a need to avoid transfer tax on the survivor's death. Using a credit shelter trust obtains the step-up and avoids the step-down.

In addition to permitting selective basis planning with the surviving spouse, the bypass trust can be designed to give GPAs to others, such as a parent as Marty mentioned, an in-law, or another individual. That will enable the surviving spouse to obtain benefits during his or her lifetime from basis planning. Further, the basis planning can be expanded as a result of the increased number of powerholders. My 97-year-old mother with a modest estate provides me with a potential tax shelter—her unused estate tax exemption for my appreciated assets.

A client of ours has a parent and both in-laws in the mid-90s all living in Florida who he supports. They represent potentially over $16 million of unused GPAs that will be applied to low and negative basis real estate. That is a very valuable commodity. They say that "you can't take it with you." That is not true with respect to their unused exemption.

My second observation with respect to portability is, why do advisors generally recommend QTIP planning to prevent against the surviving spouse controlling the power of disposition while also being dismissive of the ability of the survivor redirecting wealth received outright through portability? There is a lack of consistency in the thought process. It makes no sense that the advice incorporates a 180-degree turn in theory as to whether or not to enable the surviving spouse to alter the disposition of the inheritance. I generally believe that advisors overuse QTIPs and many planners simply use a QTIP as the recipient of all marital deduction trust transfers. For the family who wishes to continue with the wealth-shifting process and is not concerned about the survivor's right of disposition, the income/GPA marital trust is superior to the QTIP because it permits lifetime transfers to others.

My third comment regarding why "in trust" planning should prevail over portability is that a discretionary trust with the descendants as permissible beneficiaries will enable the lower-generation beneficiaries to participate in the family wealth earlier when they really need it. If clients live to their normal life expectancies, it is reasonable to project that the children will become orphans in their 60s. I think that many clients would like their children and grandchildren to participate in the enjoyment of the wealth earlier in their lives when it is most helpful. I know I would.

The fourth virtue of using a trust is that assets received and kept in a proper trust will have creditor protection benefits that are not available to assets inherited outright. A properly designed and sitused trust set up and funded by someone else is the best creditor protection vehicle available to our clients. Why would clients compromise this shelter for their surviving spouses? I believe that the answer is either that the option was not explained to them or, if it was, it was either not adequately explained, or the explanation was colored by the general bias or complacency of the advisor.

Surviving spouses often remarry. I can provide my wife (or she can provide me) with better sheltering than she (or I) can obtain with a prenup. Actually, protection from possible creditors or divorcing spouses makes me conclude that an inheritance in a credit shelter trust is arguably less complex than portability. It is certainly much more complex for the surviving spouse to litigate a lawsuit, pay the claimant, or have to scramble to find funds to replace money lost in compromising or satisfying claims. I know Bernie Krooks will be discussing elder law planning [see page 211]. A bypass trust can be designed to accomplish what Bernie advises. Because the bypass trust is third-

© 2015 CCH Incorporated and its affiliates. All rights reserved.

party created, it maximizes the sheltering provided that it is properly structured.

There are many other virtues of alternative spousal planning, such as sprinkling, avoiding certain state income taxes, potential state and federal estate tax savings, GST planning, etc. However, I believe that the foregoing observations are the primary considerations and that for most clients "in trust" dispositions should prevail.

Basis Reporting

Sidney Kess: Mark [Luscombe], could you please highlight the recent changes regarding basis included in the highway bill [the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41)], which was recently passed and will impact planners. What do planners need to do?

Mark Luscombe: There were several things that were in the recent legislation, which are directed toward closing the tax gap and increasing third-party reporting of items to help the IRS track income. There is a new requirement for executors of large estates to report to the IRS and to beneficiaries the fair market value of property transferred to beneficiaries of the estate [Code Sec. 6035], and, then, for the beneficiaries to use that fair market value as the basis in the property [Code Sec. 1014(f)].

This is a revenue raiser in the highway trust fund projected to generate about $1.5 billion over 10 years. It applies only to estates that are required to file estate tax returns. So, you are probably missing a great deal of property being transferred since only 8,000 to 9,000 returns are being filed.

And, I think there is also just the practical issue of how the IRS will track this over time. In some cases, you are talking about property being held for generations. Will the IRS really be able to make some sense of a valuation when the property has been held for some period of time and, for example, changes have been made to the family home? How important will that information really be in the IRS's hands?

Martin Shenkman: Executors will be required to report to beneficiaries. But, what will they report? Executors will be required to report basis information to beneficiaries within 30 days after the due date of the estate tax return, or from the date the return is actually filed. Transmitting appropriate information to beneficiaries will be yet another issue executors will have to address. How can and should this new administrative burden be handled? It may be inadvisable to provide a beneficiary with a complete Form 706. [In Notice 2015-57, IRB 2015-36, 294 (released on August 21, 2015), the IRS delayed to February 29, 2016, the due date for the statements to be filed with the IRS and furnished to beneficiaries for an estate tax return filed after July 31, 2015].

Sidney Kess: Thanks. Before we leave basis planning, are there any other comments the board members would care to make?

Bernard Krooks: Yes, regarding Marty's very thoughtful comments about basis planning and granting to someone else a general power of appointment in order to accomplish the basis step-up, we were recently involved in a case where the person who was granted the general power of appointment ended up spending the last three or four years of her life in a nursing home, and the facility and the state Medicaid agency went after those assets. It caused an enormous set of complications for the family.

The case was ultimately settled, but the caveat here is you have to be careful that the person to whom you give the power of appointment does not end up in a nursing home.

Skip Fox: As to the recent highway bill, a real Pandora's Box is being opened up when you think about the need to give notice to all the beneficiaries who are going to receive any property as to what their basis will be.

One of the items that is not addressed in the legislation, but undoubtedly is something that the Treasury Department is going to have to look at in issuing its regulations, is what if a beneficiary decides to dispute the basis that he or she is given in property, for example, whether it is too high or too low? Say they prevail in some sort of judicial or administrative proceeding. What impact does that have on the estate tax return that has presumably been filed with a basis that has been challenged by a beneficiary?

Wolters Kluwer

I think this is an example of the Treasury Department perhaps getting hoisted on its own petard. It has been emphasizing and requesting this change for many years in the annual budget proposals, and now that it is law, it could create a real mess.

Sanford Schlesinger: I would like to add one other thing on the highway bill. This information is required, as I understand, to be furnished to the beneficiaries within 30 days after filing the estate tax return including extensions. Now, in most cases, you have not done an accounting in an estate within that period because you usually don't account until you finish the estate tax audit, or you get a closing letter, which I talked about earlier [page 184].

I would like to ask the panel if anyone has ever furnished 706s to the beneficiaries, which is probably the only thing you can do at that point.

Skip Fox: We have done it on a few occasions.

Sanford Schlesinger: But, it's not a normal practice.

Skip Fox: No, not a normal practice.

Sanford Schlesinger: The legislation directs you to give it to them within 30 days. That is well before there is going to be an audit, if there is going to be an audit, or before you have a closing letter.

Skip Fox: Absolutely. That is what I mean when I say this could really be a Pandora's Box.

Carol Cantrell: I seem to remember that the penalty for failure to prepare and furnish the basis statements—I will call them 1099s just for ease right now—is very small, something under $100. And, if the failure was intentional or willful, it would be 10 percent of the unreported amount. But, it does not seem like the penalties are any more onerous than they are for 1099s. I don't think you would have that many basis statements to issue in an estate anyway.

So, I wonder how much voluntary compliance there is going to be on this with small estates.

Sanford Schlesinger: Well, you do have a penalty on the beneficiary for an underpayment and that is 20 percent if he overstates the basis [Code Sec. 6662]. So, it is the beneficiary you are putting at risk more than the fiduciary.

Estate and Gift Tax Audits

Sidney Kess: Let's move over to estate and gift tax audits, which can present a lot of difficult issues for practitioners. Carol, could you please highlight some of the issues that the IRS is looking at? When should a practitioner agree to extend the statute of limitations or seek a closing letter? What tactical things should a CPA be doing in order to successful represent their clients and avoid litigation?

Carol Cantrell: Let me hit some of the highlights. The statistics are fairly interesting on the number of Forms 706 and 709 that are being filed. They are on the increase. There is no doubt about it. There were 34,000 706s filed in 2014, and every one of those is manually examined by people they call "classifiers" at the Cincinnati campus.

My first bit of advice is to assume that your 706 will be audited. So, clean and polish it up. Attach what you need to. Disclose what you need to. And be prepared to defend it.

If the 706 is just being filed for portability and there is no tax due, the statistics show that, in 2014, only two percent of 706s under $5 million were even examined. That is a really small percentage and kind of encouraging to people who are on the fence about whether they should file a 706 just for portability, along with all the other reasons that have been discussed.

But, there is about a 21- to 27-percent chance of the larger estates being selected for examination. When the classifiers go through the stack of 34,000 Forms 706, they are using paralegals to help them decide which ones have significant issues. And, those significant issues are generally defined as, is this going to produce a tax due if we audit it. That is the number one criteria that they look at.

They will also heavily scrutinize any elections, such as the Code Sec. 6166 installment election or the Code Sec. 2032A special use valuation. Those are pulled out and looked at to verify eligibility, perhaps to attach a lien, and whether the installments are calculated properly. My advice there would be that if you have a choice as to whether to make an election, don't

© Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

do it. There are other opportunities to extend payment of the estate tax.

One of my colleagues has a client who made a 6166 election and after they got the initial request for documentation on it, they did not hear from the examiner for over six months. Probably what is happening is that the examiner is ordering up the IRS's own appraisal, checking all of the eligibility requirements, and, in the meantime, the clock is ticking on the statute of limitations and the right to appeal an adverse determination. As you know, you cannot get an extension on the statute of limitations on a 706. When that three years is up, the IRS folds up its tents and it is over.

Worse, the new accelerated audit guidelines require the IRS to issue a 90-day letter if they are within 270 days of the statute running. So, that does not give you much time between when the 706 is filed and nine months before the three-year statute is up, to get to appeals. Therefore, you could lose your appeal rights if the auditor or the examiner has been dragging his feet.

My recommendation there, besides avoiding a 6166 election if you can, would be to call that examiner every 30 days and say, "What's going on? Let's move it along." Because if you get within 270 days, you will have one choice, and that is to pay the tax they determine, however fair or unfair it is, or file a Tax Court petition.

There are so many ways that you can access appeals before that happens through fast-track settlement and mediation. You have three bites at the appeals apple, and you will lose them if the examiner is dragging his feet in that audit.

Recently we have become aware that due to the volume of portability returns being filed, the IRS is not issuing estate tax closing letters anymore unless you request one more than four months after filing the Form 706. The closing letter, Letter 627, is issued straight from the Cincinnati campus. It is not the same as a letter you get at the end of an audit that is also an estate tax closing letter.

Frankly, in the IRS's defense, I can see why they don't issue those closing letters anymore. By the time four months is up, they will have pulled that return and manually looked at it, and I do think you will get a closing letter if you ask for it. But, it is an enormous burden on them. They are losing staff. People are retiring and they are not hiring. It takes quite a bit of human capital to issue those letters.

Sanford Schlesinger: We have had the most bizarre events on estate tax audits in the last year, including getting closing letters where there were significant tax issues, meaning there could be tax payable, and valuation issues.

On the other hand, we have an estate in Florida, so there is no state estate tax. More than three years has passed since we filed the 706, and we have never heard from the IRS and never received a closing letter.

Carol Cantrell: Well, what could have happened is that when they classified those returns, they may have pulled those returns for audit. However, they hold them in a batch at the Cincinnati campus, and the territory managers will order returns based on their local needs. They have an enormous amount of 706s that are flagged for audit, but never get sent to the field because there is not the demand based on the staffing available.

Eventually they will close those out, and the ones that you are talking about that could have had issues may escape simply because they did not have the capacity to audit them.

Sanford Schlesinger: That is as good an explanation as any. It's better than my explanation, which was they may have lost the file.

Carol Cantrell: Well, just so you know, they keep them for 75 years.

Stephen Krass: I guess 2012 would be the year in which the biggest gifts were made and many gift tax returns were filed. However, we have not been notified of a single gift tax return from 2012 being selected for audit, which we found very strange. We put them all on extension and filed them in October. I think there was a government shutdown around that time, so who knows what happened. Has anyone else had any experience with audits of 2012 gift tax returns?

Carol Cantrell: Yes, I have had them audited and in every case the returns were very close to the threshold. Those are the low-hanging fruit. All the IRS has to do is increase the valuation by a

© Wolters Kluwer

few dollars and they have some tax. And, then once they do that, if you have given an interest in the same entity for several years before or after, you can bet they are going to be auditing every one of those.

My advice would be to avoid filing gift tax returns that are just under the threshold because you will almost certainly be audited.

Stephen Krass: Well, it turned out that some of the 2012 returns involved clients who had made gifts and then asked us to prepare returns. A number of them were very close, and particularly with real estate LLCs. But again, at this date, not a single one has been selected for audit.

Ethics

Sidney Kess: Let's move over to our next area. Skip, you have spoken a great deal at the Heckerling Institute on ethical issues. Are there any ethical issues that estate and gift tax practitioners need to keep in mind when representing clients?

Skip Fox: When I talk about the ethical issues that estate planning practitioners need to keep their focus on, the most important one is the area of competence.

An attorney, the same as with an accountant or any other estate planning professional, really should not take on a matter unless he or she feels that they can provide competent representation to the client. I think all of us have a good idea of whether we may or may not be competent to represent a client in a particular matter.

But, as has been discussed so far, we are dealing these days with so many complicated issues and then those issues are further complicated by the rules changing, such as portability and whether you do portability or A/B planning, and decisions like that. It is highly complex, and if you are not competent to take on the representation of a client in a particular matter, you really should consider not taking it on.

Another area that I think estate planning professionals sometimes fail to pay sufficient attention to is whether or not, if you are based in one state, such as New York or Illinois or Virginia, you can represent clients who reside in another state.

There have been a lot of changes in the rules in this area over the years. The rules have loosened up over time. For many years, you really could not represent a client in another state. But, over the last 10-15 years, the ethical rules have evolved in most of the states so that you can represent clients in another state, provided that you submit yourself to the disciplinary authority of that state, and provided also that your representation of the client in a foreign state arises out of your representation of a client in your home state.

But, there again, state laws are different. Sandy was talking about New York law and planning for a married couple in New York and taking account of the New York estate tax. If you represent a client in another state and you don't know what you are doing, you're opening yourself up to a possible malpractice claim and ethical claim if you fail to provide competent representation.

There are a whole host of issues that come up, but I think the most important ones revolve around competency.

Another area that I think we all have to pay attention to is perhaps where we overreach or appear to overreach. This is the area of whether or not a lawyer or an accountant should also act as the fiduciary, whether it is as an executor or trustee. Certain states, such as New York have very specific laws as to what sort of disclosures have to be made to a client as to who can act as an executor and what are the advantages and disadvantages, say, of a lawyer, a layperson, or a corporate trustee acting as fiduciary.

Other states do not have those specific disclosure requirements, but one of the areas that courts seem to look at quite often is whether the lawyer or CPA overreached when they said they could act as executor/trustee, whether they made full disclosure of the advantages and disadvantages of them acting as a fiduciary compared to the advantages and disadvantages of others acting as a fiduciary (such as a family member, friend, other adviser or corporate fiduciary), and whether they were the best choice.

A third area that I think causes great angst to clients, especially given our desire to do as much work as possible and have as many clients as possible, is the issue of providing timely service to clients. The cases are full of situations in which a lawyer may have taken on the responsibility for preparing

© 2015 CCH Incorporated and its affiliates. All rights reserved.

a will or other estate planning documents for a client and failed to complete them for seven or eight months, for example, and then the client dies in the interim. And, the will or other documents that the lawyer was preparing would have changed the client's dispositive scheme greatly.

Does that lawyer owe a duty to the potential recipients under the will that was never executed because the attorney was dilatory? As many of us know, this relates to the doctrine of privity, under which doctrine a lawyer is only liable for mistakes to the client. But, the traditional concepts of privity, which determine whether a lawyer is going to be liable for malpractice for failures such as a drafting mistake, have changed greatly and continue to erode in many states.

The issue of timely completion of work, I think, is one that is going to continue to be very important. There was one case in which the state bar finally went after a lawyer who took, I believe, 15 years to administer an estate that had two assets, each worth $5,000. That is the type of situation that drives clients nuts, and it is the type of horror story that gives all estate planning professionals a bad name.

A fourth area where I think we will see increasing focus is the need to charge reasonable fees. I know that the fees charged vary between the size and type of firms, the locality in which one practices, and areas of practice. But, is what we charge for the work that we do reasonable? How exactly do we determine what is a reasonable fee to charge? I think we need to keep our eyes on that.

So, those are just a few of the areas that I think we need to pay attention to.

Sidney Kess: Skip, what about if the lawyer drafts a trust agreement or a will, and has himself appointed the trustee and then is handling all the investments, where he himself is collecting fees for his investment advice?

Skip Fox: That is a really tricky situation, and I think in some states that may not be allowed. In other states, there is usually an exception that says if you make full disclosure to the clients about the work that you are going to do, such as the investment work, and how you are going to charge for it, and they understand that and agree to it, then it is okay.

But, the issue there is exactly what constitutes full disclosure. Maybe I am too old fashioned when it comes to this. But, I think that if you are a lawyer, you should only charge for your work as an executor either based on some fixed fee agreement or based on an hourly rate. You should not charge for extra services, such as commissions on investments, because you are really only acting as a fiduciary, and I think you have an inherent conflict of interest if you charge for both the legal work and the investment work.

Others disagree on that and say that you can keep the legal and investment work separated. But, to me, that is probably crossing the line. Even if it's not a legally impermissible line, it's a line you should not cross because I think we all have an obligation to do what is absolutely best for our clients, and such a practice just does not seem to meet that obligation.

Code Sec. 2704 Regs Coming?

Sidney Kess: I want to move now to the possible Code Sec. 2704 regulations. There has been a lot of speculation recently about the possibility of the IRS trying to limit entity discounts by way of these regulations. Skip, do you want to comment on what Code Sec. 2704 is about and what the regulations might contain?

Skip Fox: Code Sec. 2704, as I think we all know, is one of those provisions that has been around as part of chapter 14 since 1990. It basically provides that certain restrictions, sometimes called applicable restrictions, can be disregarded for transfer tax purposes in valuing interests in corporations or partnerships transferred to family members.

Essentially, it is the restrictions in those corporations or partnerships or limited liability companies (LLCs) that underlie many of the discounts that are available in the planning that we recommend for clients and help them to implement. I think everybody participating today would probably agree that the IRS absolutely detests the discounts from the underlying value of the assets that are available for transfer tax purposes for limited partnerships and LLCs.

The focus of the IRS for the last several years has been on Code Sec. 2704(b)(4), which basically says that the Secretary of the Treasury can

Wolters Kluwer

provide by regulations that other restrictions, in addition to the ones that currently are ignored in determining discounts, can be disregarded in determining the value of a corporation or partnership when it is transferred to a member of the transferor's family.

This is an area that has been the subject of much discussion and litigation in the past. I think that, from about 2009 through 2012, the Treasury Department in the annual budget proposal of the administration (the "Greenbooks") requested that Congress basically eliminate valuation discounts for the transfer of limited partnership and limited liability company interests between family members. They eventually dropped the proposals when it became obvious that they were not going anywhere in Congress.

But since then, there has been this project in the Priority Guidance Plan to basically issue new regulations on Code Sec. 2704(b) that would list additional restrictions that could be ignored, thereby reducing or eliminating the availability of discounts.

It seems as if the IRS is getting ready to issue these regulations. Cathy Hughes of the Treasury Department mentioned at an American Bar Association meeting in the spring that she expected that the proposed regulations would come out sometime later this year. [As we went to press, the proposed regulations had not been issued.]

We don't really have any idea as to what these regulations will do. There has been some talk that these regulations have been sitting around in various forms at the Treasury Department and the IRS for many years now. They are ready but have been held back because the IRS really was not sure when would be a good time to issue them. They wanted to see whether there might ever be a legislative fix, which is obviously not going to happen right now.

So, what are they going to attempt to do? Well, if you look at the revenue proposals in the Greenbooks for those years from 2009 to 2012, they said that there would be a gain of $18 billion of additional revenue over a 10-year period if Code Sec. 2704 was amended. This works out to an average of $1.8 billion per year in added revenue.

A 40-percent estate and gift tax rate applied to $4.5 billion of value otherwise lost to discounts would raise about $1.8 billion in estate and gift tax. So, one possibility is that the IRS is going to try to eliminate through the regulations those discounts that they think would equal about $4.5 billion a year.

Another approach that Treasury may take is to consider the composition of the assets in the entity because it is pretty obvious that an entity holding cash or publicly-traded securities is the easiest target for which to eliminate the restrictions, as opposed to entities that hold operating companies or hard-to-value assets.

A third thing that Treasury could try to do in the new regulations is to eliminate the availability of the legitimate and nontax reason test for family entities that was first expressed, I think, in the *W. Bongard Est*. case [124 TC 95, CCH Dec. 55,955], which was a way that you could justify the existence of a partnership or limited liability company and get the discounts.

Treasury might leave operating businesses alone. It might look at who created the restriction. It might look to see whether it is family members who can remove the restriction, in which case the regulations might provide for ignoring the restriction. If non-family members were the only ones who could remove the restriction, Treasury might treat that restrictions differently and permit it to be taken into account in determining the discount.

Whatever they do, we will all be interested to see what happens when these regulations come out. I think it is almost a guarantee that they will be issued this year, but I have been wrong about the timing of these types of things before.

One other issue is the effective date. There will be two elements to the effective date. The first element is the effective date, and the second is defining what type of event will be subject to that effective date.

There are two possible dates as to when these regulations will become effective. We are expecting proposed regulations to be issued. Normally, regulations are not effective until they are finalized, which would be after a comment period. That comment period could last several months. However, it is possible for the regulations to be effective as of the date that they are proposed. The IRS has done that before.

The more important factor is what event is going to be measured against the effective date, and

© 2015 CCH Incorporated and its affiliates. All rights reserved.

there are two possibilities there. One is the creation of the restriction. So, if the restriction was created before the effective date, and that is the measuring event, then post-enactment transfers from an entity that is already created and funded are not going to be subject to these new rules.

On the other hand, if the event that you look at under the likely regulations is not the creation of the restriction, but the transfer of the restricted interest, then it is probably not enough to have the entity in place before the effective date. That is because the way regulations would likely apply the effective date is that any transfer of a restricted interest after the effective date would be subject to these new rules that would eliminate or reduce the availability of discounts.

If you have an effective date that is the date of the final regulations, rather than the date of the proposed regulations, it may mean that you will see an acceleration of taxable gifts prior to that effective date in order to take advantage of the availability of discounts before the final regulations come into force.

Now, I think that there is going to be, shall we say, a far-from-mild reaction to these regulations when they come out. I would think that at some point, the validity of any new regulations will be challenged, either as overreaching or on some other grounds. I do not know how effective such a challenge will be, as I think right now we are in the speculative phase.

Whatever happens, I am sure that many people will offer comments, some opposing the new regulations, others offering technical suggestions. My guess is that the IRS will perhaps accept some of the technical comments and ignore any comments that essentially say that the IRS is overreaching. Then, at some point, there will probably be litigation involving the application of the new regulations to a particular situation to see whether or not the regulations are upheld by the courts.

In any event, the regulations are coming, unless there is a dramatic change at the IRS or the Treasury. It seems highly unlikely that we will see some sort of legislation passed to stop the IRS from issuing these regulations. My guess is that the President would veto anything passed by Congress. But, you could have legislation to overturn the regulations passed once a new Administration takes office.

Martin Shenkman: For a certain segment of clients, these regulations may actually be positive. For clients who are below the federal estate tax exemption, the loss of discounts means that the FLPs or LLCs that have been set up in the past to reduce an estate tax will no longer apply to reduce the basis adjustment.

So, if a client has existing FLPs or LLCs, and even though they are below the estate tax threshold, they will get a full basis step-up based on the undiscounted value of the underlying assets, including the decedent's estate. So, in some cases, this could be positive.

I think from that perspective, for the vast majority of clients who are no longer subject to an estate tax, practitioners need to think about what we can do to minimize or eliminate the impact of discounts. While we continue to use the entities for other purposes, such as asset protection and management control, we should look at how we can minimize those discounts. Of course, we need to keep an eye on the wealthier clients consistent with the comments that Skip made.

One thought I had on this is, what if you gave the executor or personal representative, in the operating agreement, a sort of put right without discount, analogous to where we used to create these Code Sec. 2503(c) trusts for when the child turned age 21 and they could demand their money but may have chosen not to do it.

So, if an executor holds a right in an operating agreement for an LLC that, say, within 60 days of appointment or 120 days of death of the decedent to put the LLC membership interest back to the LLC for the full undiscounted value of underlying assets, I think that would eliminate the ability of the IRS to argue in favor of discounts, leaving aside the new regulations, and give us a full basis step-up.

I believe that approach may still leave intact the entity because we are not liquidating the entity, and it may even leave intact significant asset protection for members or owners of the entity that still want asset protection other than the decedent because it is only an executor being given that right.

That may be a creative way to eliminate discounts in case these regulations do not apply and we have a nontaxable estate.

© Wolters Kluwer

STATE LAW

Impact of State Law on Planning

Sanford Schlesinger, Stephen Krass, Skip Fox, Martin Shenkman, and Richard Oshins join Sidney Kess to consider recent state law developments that impact estate and asset protection planning.

Sidney Kess: I'd like to move over now to state law developments. Sandy, we have been speaking throughout the program about the federal estate tax hitting a small number of decedent's estates. State estate taxes remain a problem for many estates. In addition, there are various aspects of state law that have a very significant impact on planning for trusts.

Could you begin our discussion on state law developments and their impact on planners and their clients?

Sanford Schlesinger: As we said before, 19 states, plus the District of Columbia, still have a state estate tax. Only one state, Connecticut, has a gift tax, which parallels the Connecticut estate tax.

State estate taxes may be as high as 16 percent. Of course, you have a federal estate tax deduction for that state estate tax, which makes it somewhere around eight percent if you qualify—if the deduction is even applicable, because so few estates are subject to federal estate tax in the first place even without the deduction.

The planning obviously with state estate taxes is serious. I want to go through which states have an estate tax or some version because I think it's sort of interesting that there is really no pattern. It's not geographical or anything like that.

This is the list. Connecticut, as I said, has an estate and a gift tax. Delaware, contrary to most people's opinion, does have an estate tax on residents, as do the District of Columbia, Hawaii, and Illinois. Iowa only has a separate inheritance tax, which was formally repealed effective July 1, 2014, but was really repealed in 2004, when the federal credit was done away with because it was equal to the federal credit.

Kentucky has only a separate inheritance tax. Maine has an estate tax. In Maryland, legislation has been enacted to increase the estate tax exemption over five years to equal the federal estate tax exemption in 2019. Massachusetts, Minnesota, which, as an aside, enacted a gift tax in 2013 and repealed it almost immediately retroactively–have an estate tax. Nebraska has only what's called a county inheritance tax. I have been asking the entire world what that is and nobody has been able to answer that.

New Jersey, New York, and Oregon have an estate tax. Pennsylvania only has a separate inheritance tax. Rhode Island has an estate tax. Tennessee's inheritance tax is being phased out completely as of January 1, 2016. Vermont and Washington State have an estate tax. So, it becomes extremely problematic in doing estate planning as to what state your client is going to die in and, obviously, that may not be the state in which you drafted the documents or did the estate planning.

I'm a New York resident and most familiar with New York law. The New York State estate tax is an unqualified disaster. And, again without doing a two-hour seminar on it, effective April 1 of 2014, New York enacted tremendous revisions to its estate tax where it increased its exemption gradually over the next few years. By 2019, the New York estate tax exemption is supposed to equal the federal estate tax exemption.

As of April 1, 2015, the New York exemption is $3,125,000. That is the New York exemption that is slowly being phased in over time until January 1, 2019. And, that sounds great and that's very wonderful, but what most people don't know is if your estate is 105 percent of the exemption, your exemption becomes zero.

Look how complicated planning gets in New York. So, in New York, for this year, if your estate was $3,281,250, you would have an estate tax of $208,200 on the overage above $3,125,000.

© Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

So, people are even suggesting that you should give the amount that's above the exemption to charity, because it really costs more than 100 percent if you don't do so. So, I think that's one of the basic things.

Also, any gifts made within three years of death come back into the computation. Again, greatly complicating planning in New York State. It's almost impossible to plan, because, obviously, you don't know what the stock market is going to be on a given day. So, your planning has to now turn the other way around and basically what you have to do is carve out a New York State estate tax amount in a formulaic manner if you want to avoid exceeding the 105-percent amount. Of course, the better way to solve the problem is to move to Florida.

Stephen Krass: What do you do in situations where the clients made major gifts in 2012, which are not added back to the New York estate tax calculation, and now you have a remaining federal estate tax exemption amount that is significantly less than the New York State exemption amount?

© Wolters Kluwer

Sanford Schlesinger: Meaning you may incur no New York estate tax, but incur a federal estate tax?

Stephen Krass: Well no. I mean, if you did a credit shelter trust based on your remaining federal exemption, you're going to be losing a good part of your New York exemption and adding that probably into the spouse's estate, which then could drive the spouse over and above the 105-percent amount.

If you gear it to the New York estate tax exemption and you create a federal tax, you're looking at a 40-percent tax, so you're not going to want to do that. Marty, you practice in New Jersey also. Others, how are you dealing with that situation?

Martin Shenkman: New Jersey's exemption is only $675,000, which is the lowest exemption amount among the states. Since New Jersey has no gift tax, it can be advantageous to make gifts and reduce the New Jersey taxable estate. However, for clients under the federal exemption amount, the New Jersey estate tax savings can be less than the incremental capital gains tax cost to heirs from losing the basis step–up on assets gifted. Caution is in order.

Stephen Krass: But, if you made a $5 million gift, you've got $430,000 left. But I mean, just the concept.

Sanford Schlesinger: You're saying you have no federal exemption—let's take an extreme example. You have no federal exemption, but you still have a New York exemption.

Stephen Krass: Yes.

Sanford Schlesinger: That's what you're saying.

Stephen Krass: Well, effectively. So, what do you in the planning?

Sanford Schlesinger: I certainly don't want to incur a federal estate tax.

Stephen Krass: So, you have to give up your New York exemption.

Sanford Schlesinger: I'm either going to do a marital or charitable trust, if that can work. Or, guess what? I'm not being funny. I have advised clients to move out of New York. Based on this statute, I had a client who had no problem doing that. He was a resident of Arizona and New York. He's now an Arizonian.

Stephen Krass: I can understand that. It seems to be between a rock and a hard place when you get to that situation taking into account the major gifts that were made in 2012.

Sanford Schlesinger: I agree completely. You're going to have to make a decision, and my decision is not going to be to pay the federal estate tax.

Stephen Krass: I agree with that.

State Trust Decanting

Sidney Kess: Skip, do you have any observations on state local trust decanting transfer taxes? Asset protection?

Skip Fox: I'll try to be real brief. I think Sandy has done an excellent job of talking about the current status of state estate taxes. In many ways, this has been a quiet year without the changes that we saw in the past.

On trust decanting, I believe 23 states currently permit decanting. I think the interesting development is that a new uniform decanting act, the Uniform Trust Decanting Act, has been recently approved by the Uniform Law Commissioners. This Act basically tries to look at the current states that have decanting statutes and suggest the appropriate rules or provisions for decanting statutes both in the existing and for states that might consider enacting decanting.

Sidney Kess: Can you describe what you mean by decanting?

Skip Fox: Decanting is where the trustee has, depending upon the state, the ability to either, on an ascertainable or non-ascertainable basis, distribute income and principal to the beneficiaries, to appoint the property in an existing trust to a new trust, which, although you usually cannot eliminate beneficiaries of that trust, depending upon the state decanting law, you might be able to or change certain of the terms. It is a technique that many people have used successfully to take a current irrevocable trust that might have unfavorable terms and put the property into a new trust with more favorable terms.

New York, I believe, had the first decanting statute maybe 20 years ago.

Sanford Schlesinger: But, I think New York is kind of in reverse. You can't add a new beneficiary, but you can eliminate current beneficiaries.

Skip Fox: Maybe that's what you can do in New York. Different states permit different actions under their decanting statutes. But, I think it will be interesting to see what the responses of the states are to the new Uniform Act on decanting.

Richard Oshins: Because different states have different laws, advisors should give strong consideration as to the selection of which state's law should be used to decant the trust. Most modern trusts permit jurisdiction-skipping. An inferior trust forum can be switched and the trust than can be decanted under enabling, or better laws.

One of the primary reasons that many trusts are decanted in addition to correcting errors or to change beneficial enjoyment is that many are inefficiently designed or drafted. As long as you are fixing errors, strong consideration should be given to the selection of the best situs. I believe that many advisors don't give adequate consideration to the benefits of better state laws and the enormous potential loss of assets to unnecessary taxes and predators that can be avoided by "renting" a better forum. Because there are several trust companies that charge relatively modest fees, clients can access favorable laws cheaply. The reason that the cost can be compressed is that these trust companies are minimally involved, generally only to the extent that the client can use the better state laws. Thus, they do not impose more than negligible complexity or controls.

Skip Fox: I think one issue that's always been out there about decanting, and one on which the IRS really is not offering any guidance right now, is if you take an existing irrevocable trust that's exempt from generation-skipping tax (GST) and decant that to a new trust, have you preserved your GST exemption?

The IRS issued rulings on this for a few years, and then it said, "We aren't going to do it anymore." They had it on the priority guidance plan for a while, but it has been removed. The best guess is— and I think it's true—that as long as the whole trust was exempt from GST tax and the decanting does change the beneficiaries and their rights, the new trust will be exempt from GST tax as well.

Richard Oshins: We are doing a lot of decanting. Most of them have been done to eliminate staggered distribution (for example, force-outs at different ages, such as age 25, 30 and 35) into a trust that continues for multiple generations. This gives the beneficiaries creditor and divorce protection that many existing irrevocable trusts do not provide. It also allows us to do some future income shifting for both federal and state income tax purposes since the traditional staggered distribution trust forces the future income onto the tax return of the recipient of the distributions.

Along those lines, we have done many decantings primarily to save state income taxes by looking at the current trust income tax situs rules and then decanting the trust to move it to Nevada or to another state with no state fiduciary income

© 2015 CCH Incorporated and its affiliates. All rights reserved.

tax. We would remove any trustees that are causing a state income tax and any other provisions that are causing this tax so that future undistributed income is sheltered. We are seeing this especially with California, New York, and New Jersey trusts, although this impediment exists for many other states. For example, there are a substantial number of credit shelter trusts and ILITs (irrevocable life insurance trusts) where the insured has died that are accumulating income in the trust and needlessly pay state income taxes.

Starting on October 1, Nevada law permits us to remove mandatory income distributions. We have a lot of trusts in process where we moved them to Nevada and are going to decant them in October to remove those mandatory entitlements for state income tax savings purposes and to shelter them for creditor and divorce protection reasons.

Asset Protection

Skip Fox: It's been a very quiet year, I think, in asset protection. No new state, as far as I know, has enacted legislation permitting domestic asset protection trusts. I think we're at 15 states (Alaska, Delaware, Hawaii, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, and Wyoming) and we haven't seen the challenges from the bankruptcy courts that we saw a couple of years ago in cases like *Huber* (*In re: Huber*, 201 BR 685 (Bankr. W.D. Wash. 2013 [see e.g., "Domestic Asset Protection Trusts," ESTATE PLANNING REVIEW—THE JOURNAL, September 19, 2013, page 162, and "Due Diligence in Asset Protection Planning," ESTATE PLANNING REVIEW—THE JOURNAL, September 18, 2014, page 162, for a discussion of *Huber*]).

Digital Assets

Skip Fox: The last thing—and I think this is one of the most important issues—is the issue of digital assets and how executors and trustees and agents under a power of attorney can handle the digital assets of a decedent or a beneficiary who may be incompetent or of a principal under a power of attorney.

There was an attempt made to have a uniform law, the Uniform Fiduciary Access to Digital Assets Act, UFADAA, enacted in a large number of states earlier this year. The internet providers really didn't like UFADAA. They actually introduced their own legislation. An earlier version of UFADAA has been enacted in one state, Delaware. The internet providers' legislation, Privacy Expectation Afterlife and Choices Act (PEAC)], was enacted in Virginia this year, very surprisingly as it just sort of snuck up out of nowhere during the spring session of the Virginia General Assembly at a time when UFADAA had also been introduced and most trusts and estates professional thought that UFADAA would be enacted.

Twenty-seven states had UFADAA proposed and none of those other states enacted it. The good development is that a modified version of UFADAA was just put together in the last couple of months after a lot of discussion. Many of the internet and web-based people who had been opposed to UFADAA, now have agreed that the modified version is acceptable and that they can live with it [see "Digital Assets–An Update," ESTATE PLANNING REVIEW—THE JOURNAL, July 23, 2015, page 137, for a discussion of the current status].

I think you'll probably see some form of the new or modified UFADAA introduced in states in the legislative sessions next year. It will probably be enacted, which will make it a lot easier for fiduciaries to deal with digital assets.

And, as I think we all know, just getting access to information a person has on e-mail accounts or on various providers, Google, for example, can be very important, both in handling a person's affairs while alive and also after he or she passes away.

Sanford Schlesinger: I think it's very important to draft for digital assets, even without the legislation—as far as I know, only nine states have enacted legislation—not the Uniform Act, but their own acts, and they vary considerably from one state to the other, and they're usually very limited. But, I think it's very important. We now have almost a page-long clause in our wills about access to digital assets by the executor or personal representative or trustee, trying to give him some semblance of access.

© Wolters Kluwer

INSURANCE PLANNING

New Developments and Changes to the Life Insurance Industry

Ben Baldwin, Lee Slavutin, and Richard Oshins analyze recent events in the insurance industry.

Sidney Kess: Ben, in recent years, there always seems to be something significant going on in life insurance, and you recently offered a column in ESTATE PLANNING REVIEW—THE JOURNAL["The Changing Landscape of Life Insurance Company Risk," August 20, 2015, page 147], centering on some of the hot issues relating to insurance. Could you please comment on some of these items?

Ben Baldwin: Yes Sid, there is a great deal to talk about the changing landscape in life insurance company risk. We have two major trends causing life insurance companies to take actions that are changing their risk parameters relative to what they have taken in more normal times. Life insurance companies run on interest rate spreads as a result of their general account reserves consisting of about 80 to 90 percent bonds so the following to trends are dictating the actions of life companies:

1. Interest rates continue to surprise by being persistently low, and there really is no end in sight.
2. Regulations continue to require life insurance companies to hold higher reserves.

One action that some companies have been taking has been to sell themselves or certain parts of their business to private equity firms. Currently over 22 insurance companies are now owned by private equity firm. Specific examples are:

- Apollo Global Management, LLC supporting Athene Holding Limited, a Bermuda-based insurance holding company's acquisition of the Iowa domiciled annuity and life insurance company, Aviva, USA from Aviva PLC in October 2013;
- Guggenheim Capital's acquisition of Sun Life's variable annuity business and Security Benefit Life Insurance Company; and
- Harbinger Group's acquisition of Fidelity and Guarantee Life (F&G).

The question is, how will these private equity firms generate positive returns for their firms by investing in the life insurance industry during these troubled times of low interest rates, unprofitable legacy products, and increasing regulatory burdens? One reason is that insurance companies and books of unwanted legacy businesses are available at low cost, at book value, and below. This was demonstrated by Harbinger's purchase of F&G from Old Mutual at 35 percent of book value in 2011.["Private Equity Firms Find Bargains In Insurance Deals," *InsuranceNewsNetMagazine.com*, by Linda Koco, December 2012]

It gives the private equity firms, in the business of managing assets, the opportunity to manage general account assets more profitably, albeit with possible exposure to higher risk. It gives the private equity firms the right to service closed books of business, such as the Sun Life variable annuity business, for a fee and to manage the assets supporting the product. It also offers private equity firms (PE) the opportunity to increase business, as has happened in the indexed annuity space, increasing the private equity firms' market share from 5 to 15 percent in one year and tripling their market share in fixed annuities. Of the top five fixed annuity sellers in 2014, three were owned by private equity. ["Private Equity Firms Growing in

Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

Fixed Annuity Market," *Annuityfyi.com*, by Rachel Summit, December 2012]

So, the question from the advisor's standpoint is, first, who does own my life insurance company, and second, what is that private equity firm's plan for squeezing property or profit out of the acquisition?

Another action life insurance companies are taking is "jurisdiction shopping". That is, moving its domicile from a state with conservative accounting rules to a state with less conservative accounting rules. Life insurance expert and critic Professor Joseph Belth thinks that the Iowa rules relating to parent company guarantees to wholly owned subsidiaries allow Iowa-domiciled companies to engage in improper accounting practices that significantly distort the financial condition of the subsidiary and the parent.

…the bottom line is that the stress of low interest rates and increasing regulatory issues are causing life insurance companies to take actions to lower reserve requirements and increase returns that truly change the landscape of life insurance company risk that advisors need to be aware of.

An example of this: *Ross v. AXA Equitable Life Insurance Company*, in which policy owner Ross (probably with the assistance and advice of his full estate and financial planning team), made a decision to buy his required life insurance from AXA, based on all the available facts at the time of purchase. Later, he learned that AXA had issued $1.9 billion of parent company backed letters of credit to secure reinsurance obligations. AXA then moved the letters of credit into its Bermuda-based captive reinsurer. As a result of the movement of the $1.9 billion in letters of credit from the parent company, AXA received an $11 billion credit reserve, which reduced its aggregate reserve requirement and increased its total adjusted capital. These parental guarantees increased the company's risk-based capital ratio by 127 percent, which made the company appear more financially stable than it was.

The case was dismissed by the District Court of the Southern District of New York on July 21, 2015 [Case No. 14-CV-2904], because Mr. Ross hadn't been hurt. Nothing had failed in the way of the delivery promises of his contracts. He had brought the suit because he felt that he had been deceived. One would guess that Mr. Ross's advisors, including his AXA representative, were embarrassed by not being aware of AXA's actions in response to the two trends of long low interest rates and increasing reserve requirements that is, the use of captive reinsurance and shadow insurance. Recently AXA has taken the same steps other life companies have been taking of increasing existing and new life insurance expenses and mortality charges. Advisors need to get re-illustrations on all existing universal life insurance contracts, particularly indexed universal life. The NAIC, the National Association of Insurance Companies, is reigning in the pie-in-the-sky index universal life illustrations with new limitations as to assumptions of returns in illustrations. Even the new limitations are hardly restrictive enough to cause all illustrations to come close to long term economic reality.

So Sid, the bottom line is that the stress of low interest rates and increasing regulatory issues are causing life insurance companies to take actions to lower reserve requirements and increase returns that truly change the landscape of life insurance company risk that advisors need to be aware of.

Sidney Kess: Thank you so much, Ben. Lee Slavutin, do you have any observations on insurance?

Wolters Kluwer®

New Developments

Lee Slavutin*: Yes, thank you, Sid, there have been a number of developments. Earlier this year, there was another case involving trust-owned life insurance where a trustee was sued for breach of fiduciary responsibility. This was the case of *Rafert v. Meyer* [Neb. Sup. Ct., 290 Neb 219, 859 N.W. 2d 332 (2015)]. In this case, which was very instructive, the trust had a provision that supposedly excused the trustee from his responsibility to pay premiums and to monitor the payment of premiums. After the policies were purchased by the trust, the first premiums were paid, but then subsequent premium notices went to the wrong address. It appears that the trustee gave the insurance companies a false address. I don't know why. The premium notices were not received. The premiums were not paid and the policies lapsed. The beneficiary sued the trustee, and the Nebraska Supreme Court ruled that the trust provision did not relieve the trustee of his liability or his responsibility to properly manage the insurance policy.

This is the third trust-owned life insurance case where there has been an issue regarding fiduciary management of life insurance. The other two cases were *Cochran v. KeyBank* [711 N.E. 2d 1265 (Ind. 1999)] and *French v. Wachovia* [CA-7, 722 F.3d 1079 (2013)]. Those two cases were also instructive because, in both, an independent third party evaluated a life insurance replacement transaction, and the trustees were vindicated.

The second development this year in insurance is a very favorable *Crummey* power case, *I. Mikel* [109 TCM 1355, CCH Dec. 60,277(M), TC Memo. 2015-64], where there were 60 *Crummey* beneficiaries.

I think the important message for all of us with *Crummey* powers, besides the proper requirements for drafting in the trust, is—and this is the headache—to make sure that all the beneficiaries are getting their notices every year. Someone really has to be responsible to make sure that it happens.

The third development is *Our Country Home Enterprises* [145 TC—, No. 1, CCH Dec. 60,344], which deals with a welfare benefit plan, also known as a 419 plan. These plans are designed to obtain an income tax deduction for life insurance premium payments on permanent life insurance where a business enterprise sponsors a welfare benefit plan. The deductions were disallowed, and penalties were imposed.

There have been many cases like this. It's just a reminder that there are really only three ways in which you can safely obtain an income tax deduction for life insurance: the policy is part of a retirement plan or is part of a group-term insurance plan, or the premium is reported as compensation to the employee when it's paid by the employer.

When you start to deviate from those three standard practices, you usually get into trouble, and there have been many cases like *Our Country Home* to show this.

The fourth development involves private placement variable life insurance. This is the *J. Webber* case [144 TC —, No. 17, CCH Dec. 60,336] where a venture capital investor bought a number of offshore private placement life insurance policies. These policies are legitimate. There is nothing wrong with them. It's just that in this case it was abused.

Offshore private placement life policies are policies in which wealthy clients can invest substantial amounts of premium. Usually millions of dollars of premium are invested in these policies. Why? First, there are much lower commissions than with regular life insurance; second, there is no current income tax on the growth of the underlying investment as is true with any cash value life insurance policy; and third, the client can invest in hedge funds that you can't access in a typical life insurance policy.

But, here the client went too far. He indirectly controlled the choice of the investment through his accountant and lawyer. The IRS said, "No, you can't do that." There is a basic doctrine called "investor control," that prohibits the insured client from controlling the investments. The IRS imposed income tax, and also penalties in this particular case.

The fifth development relates to the combination of life insurance planning with other planning techniques, in particular grantor retained annuity trusts (GRATs) and sales to defective grantor trusts. The use of GRATs in life insurance planning is a very powerful tool, for example, when a client sets up a split-dollar life insurance arrangement. Even though the rules changed dramatically in 2003, we are still using split dollar very effectively in certain situations. But, you must have an exit

Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

strategy from a split-dollar arrangement. And, the most effective exit strategy that I have seen is when you combine split-dollar with a GRAT. You set up the GRAT independently of the split-dollar arrangement. The GRAT terminates in five to 10 years, and the remainder beneficiary of the GRAT is the insurance trust. The insurance trust is then funded with a large amount of money, assuming the GRAT works, and can repay the donor the split-dollar premiums.

Another technique that can be combined with life insurance is the sale to a defective grantor trust. The grantor trust usually has assets generating significant income. The income can be used to pay interest on the note (the grantor trust usually acquires the assets from the grantor with a note) and premiums on life insurance owned by the grantor trust.

For the younger client who needs insurance protection and who wants a conservative savings vehicle, there are several reasons why whole life today is such a valuable product.

Wolters Kluwer®

Sidney Kess: Lee, could you comment about protecting property from casualties, such as the recently devastating Super Storm Sandy?

Lee Slavutin: Yes. Although I'm not a property casualty insurance broker, I do have a few points I'd like to make about this because we certainly saw tremendous damage from Sandy, especially in New York.

First, a very clear lesson is you must make sure if you have a property near the ocean or bay that you have flood insurance, because the typical homeowner's policy will not cover you for flood damage. You can get flood insurance today. Obviously, it's more expensive, but you can get it.

The second point about property and causality insurance is that it does usually pay with property insurance coverage to have a high deductible. You'll save significant money in premiums. And the deductible, although it's much higher than the normal, is not going to be significant in relation to the value of the property.

The third point on property and casualty insurance is that I think it's very important to make sure our wealthy clients have adequate umbrella liability coverage. You can now easily obtain $10 million of umbrella liability coverage. The premium is very low. It may be less than $1,000 a year for $5 million to $10 million of umbrella liability, but it's well worth it. If the client is sued by a third party for a car accident or someone slips in his home, such a policy will usually cover the liability.

Finally, although you can obtain property and auto insurance directly from certain insurance companies, it is often worth having an independent agent or broker act as your advocate, especially when it comes time for a claim. It's well worth paying an extra 10 percent or 15 percent in premiums to have an agent or broker representing you.

Before we go on to another subject, I think Ben has raised a very important issue about captive reinsurance companies. I would recommend people take a look at *The New York Times* article that was published earlier this year ["Risky Moves in the Game of Life Insurance," *New York Times*, April 12, 2015, p. BU1]. This is a long, very disturbing article on this subject, concerning the risk that some insurance companies are taking. I think it's a very important subject.

And, in response to the increase in cost of some of the non-guaranteed universal life policies that have been sold over the years, I'd like to make a case for whole life insurance for the right client. For the younger client who needs insurance protection and who wants a conservative savings vehicle, there are several reasons why whole life today is such a valuable product.

One, it's sold by mutual life insurance companies (e.g., Guardian, Mass Mutual, New York Life and Northwestern Mutual) that are among the most highly rated, most conservatively managed companies in the country. Although they're not

all domiciled in New York, they are all licensed in New York, which is by far the toughest regulatory state in the country. The New York insurance department has spoken out vigorously against captive reinsurance.

Another reason that the whole life product today is so suitable for the younger client is that it provides guarantees—guarantees for the premium, guarantees for the death benefit, guarantees for the growth of cash value. And, over the long term, at least 15 to 20 years, it will provide, on a non-guaranteed basis, about a three to four-percent growth rate in the cash value based on the dividends paid by the company. Also, the death benefit will grow over time as dividends are used to buy additional insurance. This can offset the effects of inflation over the client's life.

Another reason that the whole life product today is so suitable for the younger client is that it provides guarantees—guarantees for the premium, guarantees for the death benefit, guarantees for the growth of cash value.

Richard Oshins: We do a lot of work with clients who buy the whole life product, often from the carriers that Lee mentioned. These policies have the two primary attributes he alluded to: (1) the death benefit and (2) the tax-free internal growth. A problem that estate planners have been facing for years is that generally the insured client must compromise one of the two benefits. If the client wants to avoid estate tax on the death benefit, then he or she cannot own it at death or have made a gratuitous transfer of the policy within three years of death. In addition, the client cannot retain any rights in the transferred policy or release the rights within three years of death. As a result, the client cannot enjoy the inside build-up without estate tax exposure.

The typical strategy we advise is that all trusts are dynastic and they plan for the acquisition of life insurance on the lives of beneficiaries or anyone else where there is a legitimate insurable interest. My trust is designed to buy life insurance on my children or grandchildren, etc. It, in effect, is a funded irrevocable life insurance trust (ILIT) that achieves both of the primary virtues of cash value life insurance: access to the cash build-up and the death benefit sheltered from the transfer tax system. That increases the benefits of having the policy because it enables an insured/beneficiary to enjoy both of the primary benefits of the policy without sacrificing either. In other words, the policy's value is enhanced. It also achieves another meaningful advantage. Because the trust will generally have cash to fund the policy, that planning will avoid the *Crummey* issues that Lee addressed, and will avoid other funding issues and limitations.

The rules are simple. The insured cannot have any controls or rights over the policy. Thus, someone other than an insured trustee must make all decisions on the policy and the insured as a beneficiary cannot have a power of appointment over the policy or its proceeds. That restriction is of limited constraint. For instance, my child can be the trustee and acquire life insurance on his spouse's life (but not survivorship life), or on the life of any other beneficiary or person for whom the trust has an insurable interest. And, for policies on his life, my child can have firing and replacement rights over the special insurance trustee.

---

*CAVEAT: The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any federal tax penalties. Lee Slavutin is not authorized to give legal or tax advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal tax or legal counsel.

© 2015 CCH Incorporated and its affiliates. All rights reserved.

RETIREMENT PLANNING

Retirement Planning Update

Sidney Kess, Lyle Benson, and Stephen Krass discuss current issues in retirement planning, including resources available for practitioners, the impact of Supreme Court decisions on retirement planning, and proposals by the Obama Administration that would affect individuals' retirement plans.

Sidney Kess: Retirement planning remains a critical part of the overall planning process. Recently, the AICPA had a thought leadership program on retirement planning. Lyle Benson, who is chair of the AICPA Personal Financial Planning Executive Committee, will share some of the ideas discussed by the panel. Could you tell us what we can learn from your experience on this panel?

Lyle Benson: Absolutely, Sid. As Sid mentioned, we gathered 15 leaders in the CPA financial planning profession together last January and talked about all of the issues that come into play in the retirement planning area. We chose that topic because we have seen among our members, and certainly among the clients in my practice, an increased interest and need for retirement planning.

The statistics show that 10,000 baby boomers retire each day. Obviously, many of our clients are facing retirement. As practitioners, we need to help our clients balance the issues that come together when a client is faced with the decisions that intersect with overall financial planning in the retirement area.

To start with, the panel brainstormed all of the different areas that need to be addressed as part of this topic. We started the discussion by noting that people have longer life expectancies and higher health care costs. The clients that most CPAs, financial planners, and advisors work with have higher income, tend to live longer, and tend to have more health care costs as a result of their longer life spans.

Managing cash flow becomes a critical piece of that and is such a critical element of retirement planning. Helping clients understand their cash flow needs and projecting those out into the future is really the foundation that retirement planning needs to be built upon.

Once that piece of the picture is in place, the advisor and client can have a discussion about the withdrawal strategy. At my firm, we spend considerable time on that discussion. In subsequent discussions, we talk about retirement withdrawal strategies and the latest research that challenges the four-percent rule. That is the rule that a client can withdraw four percent of the principal each year and not run out of capital.

That rule has seen increasing challenges in the written academic articles and by speakers that have talked about the rule. Many are saying that the four-percent rule might apply in certain economic scenarios, but not in others. And, here we are with a stock market that has been doing pretty well over the last five or six years and with interest rates on the bond side that are historically low. In many cases, when the advisor runs the numbers, it becomes clear that the four-percent withdrawal rate may not hold up. Having the dialogue with clients and talking through the issues related to retirement planning, cash flow, and withdrawals is absolutely critical.

Another area that we talked about was Social Security and the importance of really thinking through the Social Security strategy. In our practice, we still see too many clients that just automatically assume when they reach age 62, or get to full retirement age, they should start taking Social Security. In many cases, that's not the best strategy. The AICPA has published a guide on Social Security [*The CPA's Guide to Social Security Planning*, updated for 2015, by Theodore J. Sarenski] that has examples of the way to approach this to maximize Social Security benefits. The panel also views that as a critical planning issue.

Members of the AICPA PFP Section have participated in webcasts, videos, articles, media rela-

Wolters Kluwer

tions and more about elements of the retirement planning area and different nuances. One of the key pieces, *The CPA's Guide to Practical Retirement Planning*, is written by James Shambo, CPA/PFS, who has been a very active member of the CPA financial planning world for 30 or 40 years.

The area of divorce planning is also significant as part of the overall retirement planning scheme. For the over-65 population, the divorce rate is something like over two times higher than the rate in the broader population. That should be considered in retirement planning consultations.

The panel's goal was to drill down into each of these key areas that we think are important. Over the course of this year, we have created, and are still creating, resources, such as webinars, articles, and podcasts, that are relevant to our members and to the broader population. Keep in mind that non-CPAs can certainly join the AICPA's personal financial planning section. It's open to all professionals and membership includes a variety of resources that can assist practitioners in discussions about the retirement planning area with clients.

That's a brief overview of what the panel talked about.

Wolters Kluwer®

Sidney Kess: Thank you so much, Lyle. Steve, could you tell us about new developments affecting retirement planning? What should practitioners be telling clients who are preparing for retirement?

Stephen Krass: In 2013, we had the *Windsor* case [*E. Windsor*, SCt, 2013-2 USTC ¶60,667; 133 SCt 2675]. The IRS and the Department of Labor came out soon thereafter ruling that, for qualified retirement plan purposes and IRAs, members of a same-sex marriage were both deemed to be spouses for purposes of those laws [Rev. Rul. 2013-17, IRB 2013-38, 201, amplified by Notice 2014-19, IRB 2014-17, 979, amplified by Notice 2014-37, IRB 2014-23, 1100; Department of Labor's Employee Benefits Security Administration Technical Release 2013–04]. Basically, the IRS adopted a place of celebration approach to same-sex marriage. However, the Social Security Administration did not; it has used the domicile of the individual.

Now, with the *Obergefell* decision by the Supreme Court [*Obergefell v. Hodges*, SCt, 2015-1 USTC ¶50,357, 135 SCt 2868], more same-sex couples will be recognized as married for purposes of determining entitlement to Social Security benefits or eligibility for Supplemental Security Income. And, in fact, the Social Security Administration has now encouraged spouses, divorced spouses, and surviving spouses of a same-sex marriage to apply for benefits. That is something outside of the retirement planning realm, but something important to consider.

Going back a couple of years in our discussions, we had talked about inherited IRAs and bankruptcy. [see "Planning for Traditional IRAs," ESTATE PLANNING REVIEW—THE JOURNAL, November 19. 2010, page 108]. There had been a number of courts that had held that a debtor's inherited IRA was an exempt asset of the debtor's bankruptcy estate, and a smaller number of courts had ruled otherwise. In 2014, the U.S. Supreme Court resolved the split among these circuits by ruling that funds held in inherited IRAs were not retirement funds within the meaning of the Bankruptcy Code [*Clark v. Rameker*, SCt, 2014-1 USTC ¶50,317; 134 SCt 2242].

Last year, I mentioned that at least one state, Florida, had amended its IRA protection statute to exempt inherited IRAs from claims of creditors ["Impact of New Developments," ESTATE PLANNING REVIEW—THE JOURNAL, October 23, 2014, page 205]. Since then, other states, Alaska, Arizona, Missouri, North Carolina, South Carolina, Ohio and Texas, have adopted or amended their statutes. A recent state case held that an IRA inherited by a New Jersey debtor from his parent was excluded from his bankruptcy estate under Bankruptcy Code Section 541 [*In re Andolino*, Case No. 13-17238 (RG) (2/25/2015)].

Looking at the New York statute, it may be possible that, even without an amendment, bankruptcy protection for an inherited IRA falls within the language. That may apply to other states and there probably will be more states that may amend their statutes, if necessary, to exclude inherited IRAs.

The other thing that I'm looking at is the Obama Administration budget proposals, as contained in the General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals (the "2016 Greenbook"), that address retirement planning. Although none of the 2016 Greenbook proposals affecting retirement planning have been enacted into law, the most interesting part is pronounce-

© 2015 CCH Incorporated and its affiliates. All rights reserved.

ments by the IRS. The IRS and the government generally seem to be looking to protect the retirement assets of people from themselves.

I will go over some of the proposals and my thoughts on the likelihood of them becoming law. There are many plans, such as 401(k) plans and employee stock ownership plans (ESOPs), where the accounts of employees are invested in employer securities. There has always been a tax advantage to that, in that if a recipient receives a distribution of appreciated employer securities from a plan, the recipient only pays tax on the basis of the securities. Even if the securities are sold a day after receipt, the gain is treated as long-term capital gain, and the subsequent appreciation after receipt is capital gain based upon the holding period from the date of receipt.

This was an advantageous approach and I've included it in my seminar outlines for many years. This year, I decided to keep it in the outline, but not talk about it. And then lo and behold, the 2016 Greenbook includes a proposal that would repeal the exclusion of net unrealized appreciation in employer stock for those who have not yet attained age 50 as of December 31, 2015. Participants who have obtained age 50 by the end of this year would not be affected by the proposal. Basically, the reasoning of the government is to reduce, or eliminate, the concentration of an employee's retirement savings in the stock of the company for which the employee works. The Administration wants to avoid a repeat of what happened with Enron and WorldCom.

I can see how this might apply then to a 401(k) plan where an employee may have a number of different funds in which he can invest his account balance. But, when it comes to an ESOP, substantially all of the assets must be invested in employer securities. So, it doesn't seem to work in an ESOP.

Another change was directed at rollovers. If a participant in a plan receives a distribution, the participant has 60 days to roll it over into either another plan or an IRA. But, a non-spouse beneficiary cannot do a rollover. A non-spouse beneficiary can do what's known as a "direct rollover," to go directly from a plan to an inherited IRA for the benefit of the non-spouse beneficiary. One of the proposals allows the receipt of that distribution and a rollover within 60 days and eliminates the requirement of a direct rollover.

Another proposal, again in line with the government looking to protect retirement savings, is aimed at ensuring people have enough money as they get older. The proposal would exempt an individual from the required minimum distribution (RMD) requirements if the aggregate value of the individual's IRA and qualified retirement plan accumulations does not exceed $100,000, indexed for inflation after 2016. So, if those were the only funds, the beneficiary would not have to take RMDs; but, in that situation, the beneficiary probably needs the money. To that end, I'm not sure really what the efficacy of that proposal would be.

Another Administration proposal dealing with RMDs is that non-spouse beneficiaries would generally be required to take distributions over no more than five years. There would be exceptions. This proposal would prevent the stretching out of IRA distributions.

Under current law, the non-spouse beneficiary can take distributions from an inherited IRA, for example, over the beneficiary's life expectancy. The proposal would change the timing of distributions. Under the proposal, the non-spouse beneficiary would have to take the entire amount within five years after death; probably, the last day of the fifth year following the year of death of the IRA or plan participant.

The exceptions would be for a beneficiary who is disabled, a chronically ill individual, an individual who is not more than 10 years younger than the participant or IRA owner, or a child who has not reached majority. With regard to a child who has not reached majority, the account would have to be distributed within five years of the attainment of majority.

Another proposal to encourage people to put money away would require employers in business for at least two years and that have more than 10 employees to offer an automatic IRA option to employees under which regular contributions would be made to an IRA on a payroll deduction basis. However, if the employer sponsored a qualified plan, a simplified employee pension, or a SIMPLE plan, it would not be required to do that. But, again, this is another effort by the Administration to help protect people.

Roth IRAs have been important now for a number of years. There were "carrots" given back in 2010 where the government removed the dollar

Wolters Kluwer

limitation on when a participant could do a conversion from an IRA to a Roth IRA. The participant had the added "carrot" of being able to pick up 50 percent of his or her income in 2011 and the other 50 percent in 2012.

One main incentive was that a participant did not have to take RMDs during his or her lifetime. And, so the participant could let it continue to grow, even if the participant lived into his or her 90s. One of the proposals is that an individual would not be permitted to make additional contributions to Roth IRAs after attaining age 70½, and that would be effective for taxpayers attaining age 70½ after this year.

Another proposal deals with Roth IRAs. Roth IRAs are generally treated in the same manner as other tax-favored retirement accounts mandating RMDs to begin on the required beginning date. The main benefit of a Roth IRA is that the individual does not have to take the money out and can let it accumulate. This proposal would take that advantage away. To me, this proposal is perplexing because at what point would all distributions from Roth IRAs be taxable with regard to all of the earnings, as opposed to the tax-free nature now?

Right now, the post-death RMD rules do apply. So, if a Roth IRA owner dies and designates a child as the beneficiary, the child has to commence distributions. The child must either take it all out by the last day of the year containing the five-year anniversary of the owner's death or take it out over life expectancy. The five-year rule that I mentioned earlier for qualified retirement plan benefits would, under the proposal, also apply to Roth IRAs.

One of the ideas that we've talked about at seminars is ways of making contributions to Roth IRAs when it would appear that an individual is not eligible to do that. There are dollar limitations. If the individual's adjusted gross income (AGI) exceeds certain thresholds, the individual cannot make contributions to Roth IRAs.

Our firm has had situations where the individual may be ineligible to make a Roth IRA contribution, but the individual can make a deductible IRA contribution. If the individual cannot make a deductible IRA contribution, the individual can make a designated non-deductible IRA contribution and convert it into a Roth IRA the very next day. That is one way to get around the problems of the AGI limitations.

One of the proposals would limit this tactic. Under the proposal, the individual would be able to do the contribution and then roll over only to the extent that the distribution of those amounts would be includible in income if not rolled over.

The last proposal that I will mention is a proposal to limit the total accrual of tax-favored retirement benefits. This is where a taxpayer who has accumulated amounts in tax-favored retirement systems, such as IRAs, qualified retirement plans, tax-sheltered annuities and governmental 457(b) plans, could not accumulate money basically in excess of an amount to pay an annual pension on a joint-and-survivor basis of $210,000, which currently is the maximum benefit. Under the Administration's calculations, that would limit an individual's account balance to $3.4 million.

If the individual continued to make contributions, then the individual would pay a penalty tax. The contribution would have to be taken out and a tax paid on it. Some practitioners may recall that back in the 1990s, we had the excess distributions tax [Code Sec. 4980A, prior to repeal by P.L. 105-34]. If an individual had accumulated too much money in an IRA and then died, the estate was subject to a special tax that was added to the estate tax [Code Sec. 4980A(d), prior to repeal by P.L. 105-34].

There was a rumor that when a senator's mother-in-law died, he took a look at the estate tax return and met with the attorney and accountant to question the additional tax. The advisors explained that the additional tax was due to the decedent's rollover IRA given to her by her late husband. A few months later, the whole tax was repealed.

The Administration's budget proposals are unlikely to become law given the way Congress has been behaving over the last year or so. But again, these proposals illustrate what the Administration and the IRS are trying to do.

The IRS will be issuing guidance soon regarding defined benefit plan distributions. Participants in defined benefit plans were offered by the plan sponsors the opportunity to stop taking annuity payments and take a lump-sum distribution. In Notice 2015-49, IRB 2015-30, 79, the IRS announced that this would no longer be allowed and that regulations would be issued to eliminate the distribution option.

Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

PLANNING FOR AN AGING POPULATION

Dealing with Aging Clients and Those With Chronic Illnesses

Sidney Kess leads a discussion with Bernard Krooks, Martin Shenkman, Lee Slavutin, Lyle Benson, and Sanford Schlesinger, concerning the particular issues encountered when dealing with elderly clients and those with chronic illnesses, including special needs trusts and government assistance.

Sidney Kess: As many of us are personally aware, dealing with aging parents or family members with special needs can be a daunting task. It can be financially and emotionally draining for all parties concerned.

Because of the importance of this topic, we've asked Bernie Krooks to join us. Bernie is a founding partner of the law firm Littman Krooks, and is chair of their Elder Law and Special Needs Department. He is nationally recognized in all aspects of elder law and special needs planning, and has spoken at many of my conferences. Bernie, welcome to our meeting, and could you lead us off in our discussion with some basics on what practitioners—accountants, lawyers—should know about special needs planning for clients?

Bernard Krooks: Sidney, thank you for inviting me. You're so right—this topic affects everyone. I think it was Marty Shenkman who earlier stated that maybe 0.2 percent of estates are going to require a federal estate tax return (see page 188), putting aside, of course, the issue of portability. But, you would be hard-pressed to find somebody on this call or otherwise, or any of our clients, who didn't either have a personal experience or know someone who had a personal experience with an aging parent or relative who could no longer take care of themselves, who needed to be in a nursing home or assisted living, or who had a child who has some type of developmental disability.

I saw a recent statistic that 1 out of 67 children now are born with autism. There is a big debate, of course, as to whether we are simply better at diagnosing this or whether there is some type of environmental factor going on, but the fact is that more and more families are going to need these types of services.

One of the reasons they are so critically important is that if you have a chronic illness, many health insurance plans and policies are not going to take care of you. And, even the plans that would be available under a state healthcare exchange or a federal exchange, or Obamacare, as it's called, are not going to cover long-term chronic illnesses. The harsh reality is the reason they don't cover chronic long-term illnesses is because it's too expensive. They couldn't find a way to pay for it.

So, although you can get health insurance, it will not cover long-term therapy that you might need because you have multiple sclerosis or because you have cerebral palsy. It would cover short-term therapy because you fell down and broke your wrist and you might need to go to physical therapy for six or eight sessions, but nothing of the chronic nature.

Clients are forced to either pay out of pocket for this, because the costs can be staggering, especially when dealing with someone who has got a debilitating illness, but otherwise has a very normal or typical life expectancy. That is basically what's happening here. People are still living out their normal life expectancies, but the cost of caring for them has gone up geometrically.

So, although we may have greater quantity in years, I'm not so sure we are having a greater quality of years. If you pay out of pocket for these services, private care in a nursing home in many metropolitan areas can be $10,000, $15,000, $20,000-plus per month, so you could be looking

© Wolters Kluwer

at a $250,000 a year just to take care of somebody. And, many people are under the misconception that Medicare is going to cover that.

Unfortunately, that couldn't be further from the truth. Medicare only pays for some short-term rehab. It pays for doctors and hospital bills, but there is very limited coverage if you need to hire somebody to come into your house to help take care of you, if you need assisted living, or if you need to go into a nursing home.

People don't realize this, in many cases, until it's too late because this is not something that people like to think about. I think the CPA is really in a unique position to bring these issues to clients' attention, because as an attorney, I usually get contacted when somebody has a problem. I'll get a call from the wife at the nursing home. My husband had a stroke. What do we do?" Or, from the child, "Mom has Alzheimer's. Can you do anything to help?"

But, it's the CPA who is, at least, seeing the client once a year, if not more often. Depending upon the type of client, they may have occasion to talk to the client three, four, or five times a year. When the clients are coming in for one of these planning sessions or to review the documents for their annual tax return, it's a perfect opportunity to start asking questions about estate planning. Hopefully, that can generate some interest in this.

One topic that the CPA ought to talk about is—whether a client has you taken any steps to protect assets from the catastrophic costs of long-term care?

Years ago, the big challenge for clients was to accumulate an estate. Now, I think one of the challenges is how are we going to make the money last.

Long-Term Care Insurance

The biggest concern for people, in addition to their longevity, is not necessarily the tax man, but it's what is going to happen if long-term care is needed. During these meetings, I believe the CPA ought to start talking to clients about the various ways that clients can engage in certain types of planning maneuvers that will allow them to protect their assets. One of the primary ones, I think, clients ought to consider is whether it makes sense to purchase long-term care insurance.

This is an insurance that you would buy that would cover the situation where you could no longer get in and out of bed. Or, you can't go to the bathroom by yourself without assistance. You can't eat, and you need some type of assistance with your activities of daily living. Your regular health insurance is not going to cover that. Medicare is not going to cover it, so either clients are going to pay out of pocket or they're going to have long-term care insurance that's going to cover it.

The time to buy the insurance is before you're sick, because once you're sick, there is not going to be an insurance company that's going to want to insure you. It's sort of a catch-22 because when you talk to clients who are in their 40s and 50s, they have children who are approaching college age, and as you know, that's a whole other financial commitment. They're still interested in how they're going to max out on their 401(k) and profit sharing and other retirement contributions.

To talk to that client about planning for what's going to happen when he or she is age 90 or 95 and in a nursing home, and to spend money to ensure against that fact is a very difficult conversation.

For that reason, not many people have actually purchased this insurance, but I think CPAs and others in the estate planning field can offer a valuable service to clients by, at least, making them aware of it and introducing them to people who specialize in this type of insurance so that they can consider the possibilities

If a policy is purchased, the CPA can also play a valuable role in determining whether or not the premiums for this insurance will be deductible. There are still some very creative opportunities available to clients, especially those who have C corporations. It can be given as an employee benefit. It's not subject to the rules of ERISA [the Employee Retirement Income Security Act of 1974 (P.L. 93–406)], so you can discriminate in favor of certain key employees.

These are things that CPAs need to start talking to their clients about in light of the fact that many of them are not going to have estate tax concerns.

Sidney Kess: At this point, Lee could you comment on long-term care insurance?

Lee Slavutin*: First of all, Bernie is right. It's not always easy to sell long-term care insurance to younger clients.

We often deal with clients in their 50s and 60s who seem to be more amenable to buying long-

© 2015 CCH Incorporated and its affiliates. All rights reserved.

term care insurance. I would say the basic premise of long-term care insurance is a no brainer for the client who does not have a huge amount of liquid assets, where the risk of serious depletion from nursing home or home healthcare costs is a significant. I think all of us probably either have someone in our own family or someone we know who is in this situation.

My mother is in a nursing home right now, so I can speak with first-hand experience. It's a very expensive proposition in the United States (my mother lives in Australia where costs are more reasonable). It's $200, $300, or $400 a day in a private room in a nursing home depending on where you live. It can be hundreds of dollars a day for a home health aide to take care of a parent.

The odds are high that someone will need this care, so therefore the selling proposition of long-term care insurance makes enormous sense. It's not a cheap policy. It might cost $8,000, $10,000, $12,000 a year, but when you compare it to the hundreds of thousands of dollars of expense that someone may incur, it makes tremendous sense.

The market has changed dramatically. The number of companies offering long-term care insurance has shrunk. Now, there are only five or six really good companies selling long-term care insurance, and the period that you can get coverage for has been shortened. You used to be able to get a life-time benefit. You can't get that now. You may be able to get a six-, or eight-, or 10-year benefit period for long-term care insurance.

You can still get a cost-of-living increase, which is a very valuable feature. Unlike disability insurance, the cost-of-living increase on the long-term care benefit begins the day you buy the policy (in a disability policy the cost-of-living increase begins when you have a claim). My wife and I bought long-term care insurance years ago. Our benefits have probably doubled since we bought the policy, simply because we bought the cost-of-living increase rider.

Bernie [Krooks] also mentioned the role of the CPA—this is very important. For example, New York has a long-term care insurance premium credit that allows a 20-percent credit for eligible long-term care insurance premiums on the New York state income tax return. That's a very important point for residents of those states that have such a credit.

*CAVEAT: The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any federal tax penalties. Lee Slavutin is not authorized to give legal or tax advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal tax or legal counsel.

The Role of the CPA

Sidney Kess: Bernie, I have a question. If a CPA or an attorney is guiding his clients on elder care, how do they get paid for this service? As the average practitioner dealing with the older client knows, clients are often reluctant to pay. Where does the CPA fit into this?

Bernard Krooks: This is one of the most common misconceptions about the elder care field. And, I think maybe one of the reasons why more people don't go into it is that there is a perception that you are dealing with lower middle-class families that don't have the means to pay.

But, that's not necessarily true, because one of the factors that enters into the decision of whether or not a client feels like they're getting value for their professional services dollar, or any other dollar, is what's going to happen if I don't engage the services of a competent professional.

And, in this particular case, as Lee and I have pointed out, the stakes of not doing anything or of doing something improperly, are extremely high.

I was speaking with a client this morning who is paying $650 a day to be in a nursing home and who doesn't have a lot of money. So, when it's explained to the client—and I think this is where the role of the CPA is critical—although long-term care insurance can be viewed by many as expensive, when you compare it to what happens if you don't have it, and if you have the proper advice in guiding the client to purchase the right product, that can be an invaluable service. That is one area that CPAs can be involved.

Another area that CPAs can be involved concerns clients who have had to sell assets in order to pay for the cost of long-term care. CPAs can be invaluable in helping clients perform the capital gains tax analysis and determine which assets to sell and then balancing that against any potential medical expense deduction that might be avail-

© Wolters Kluwer

able. This can help ameliorate some of the horrific expense that clients can be forced to incur when they are in this type of situation. We have worked with a number of CPAs over the years to do this analysis and help us advise the clients on which assets they need to sell.

We also set up many different types of trusts for clients for a variety of reasons. In the elder care law or long-term care field, trusts are one way that you can protect a client's assets. Because, as Lee mentioned (see page 213), the number of companies that offer such policies has dwindled to only a handful.

The reason why the insurance companies have gotten out of the business is because they couldn't make any money doing it. They were selling policies and they totally underestimated how much the cost of care was going to increase. They underestimated how sick people were going to get and the fact that none of this was going to be covered by any type of other insurance. They did not predict accurately that the bond market was going to be where it has been for so many years with a 10-year Treasury rate that is now barely above two percent. Insurance companies invest your premiums that you pay in a diversified bond portfolio. And they used to be able to earn six, or eight, or 10 percent on this money and now they're getting two percent. Consequently, they just don't have the money to pay the claims, which is why we're down to a handful of companies, and not many of them are offering anything more than three, four, or five years of benefits. It might be possible in some cases to stretch out a few more years, but you're not going to be able to get life-time benefits.

Many clients, in conjunction with the insurance, are also setting up trusts. And, the CPA could be invaluable in advising the client on the different tax considerations incident to setting up those trusts, and then preparing the fiduciary income tax returns on an annual basis. Especially now with the net investment income tax (NIIT), there are significant issues where the CPA can give advice to the client and demonstrate value.

Again, I think there are a whole host of issues where the CPA can be a valuable player on the team of professionals who are advising clients. Many of our clients want to stay at home, and they'll hire informal caregivers or family members, and there are significant tax issues that arise with respect to whether or not the person hired is going to be an independent contractor or an employee.

The overwhelming majority of care given in the United States is given by an informal caregiver, which basically means a family member, not somebody who is licensed. And, if this person is taking off work to care for Mom or Dad, in many cases, it might make sense for the senior to actually pay this person, and that might make sense not only for a tax perspective, but also from a long-term care and Medicaid perspective.

The IRS is going to certainly have a view on whether the person who is providing the care is an employee, and in most cases, frankly, they will be right. But, that's another area where the CPA can provide an invaluable service.

Lyle Benson: I just want to add a couple of comments from the CPAs perspective in working with clients in this area. Bernie is absolutely right in terms of these technical aspects, but it's the blending together of the non-technical aspects and the people skills that really are needed in this area that I think are so critical to the work we do with clients.

We see a lot of clients who put off these decisions about health issues because they don't want to deal with them. They are in denial about it, or they don't address the issues as early as they can. A lot of times the CPA or the attorneys or insurance advisors are closer to the clients than many of the children are. The clients have grown children who are scattered across the country. We see a lot of situations where we are the first ones to notice dementia in that surviving spouse and the kids haven't really picked up on it yet.

Many times, we have the opportunity to step in and try to have those conversations and get the family talking about it. This includes making sure we get parents to sign off in terms of letting us talk to the kids, but also bringing together the necessary non-technical aspects and the people skills. The communication among family members is the best way to move through this, and also to bring together the best team of outsiders.

Over the last few years we have worked with a number of geriatric care managers who have helped us in trying to look at what options are available in terms of housing when clients can no

© 2015 CCH Incorporated and its affiliates. All rights reserved.

Wolters Kluwer

longer stay in their homes. Having those kinds of professionals that you can access that can be part of the advisory team can be an important part of the service we provide to clients.

It's really bringing that all together, I think, that is going to be so much more important in the coming decade because we're all seeing it. We're seeing it personally with family members. We're seeing it with our clients and I think that's only going to increase over time. Next year, the AICPA PFP Section is focusing its thought leadership efforts around this topic and will be releasing resources in later 2016 to help practitioners in dealing with many of the topics covered here and more.

Bernard Krooks: Let me just add to something Lyle said because he is exactly right. For many of our clients, they won't make a move without talking to their CPA. So, even if we are recommending a certain type of planning strategy, whether it's a trust or that they buy long-term care insurance, they're not going to pull the trigger unless they talk to their accountant. That's the person they trust, and that's the person who knows them the longest. And in many cases, that's the person who is the quarterback of the estate planning operation.

Consequently, we make a concerted effort for the client's sake and for our own to make sure that the accountant is involved. And, let me point out that demographically, this is not just an over-65 issue. I know many of us in this call would not think 65 is anything near to being a senior. But, two thirds of the people who come to us who need this planning are over age 65. But, that means that one third of them are under age 65, and that statistic holds true throughout the country. Approximately one third of the people who need some type of long-term care are under age 65.

Although we tend to think of this as something that happens as people get older, sometimes life gets in the way. We have had clients in their 20s who are in nursing homes with very sad stories. But, about two thirds of us are going to need some type of care at some point during our life. We just don't know where or when it's going to happen, but we do know it's going to be expensive, and if we do nothing about it, it could bankrupt even a family of significant means.

Financial Abuse of the Elderly

Sidney Kess: Bernie, how often have you seen clients who don't have family members available to help with their finances, such as writing the checks, paying the bills? If they don't have a child or they don't have a brother or sister, or have just outlived the rest of the family, who handles paying the checks?

Bernard Krooks: This happens more and more often. Sometimes parents outlive their kids. And , it leads to some very unpleasant situations sometimes because there is a relatively new crime in this country, and I say "relatively" because it has been around a while, called elder abuse. There are all kinds of scam artists out there who will make a phone call saying, "Your grandchild has been arrested. You need to wire money to this account," or "You're eligible for a tax refund, but first you've got to send money here."

People who are elderly and lonely are very vulnerable to this kind of approach. I think in these particular cases, the CPA and people who run family office-type operations can really provide a valuable service to clients by way of some type of check and balance over the person's finances. This could take the form of either getting a copy of the bank statement, or being a signatory on the account, so that it's not so easy to have somebody be taken advantage of, and it also makes it easier to pay the bills.

One of the issues that has come up in our practice, at least with respect to long-term care insurance, is we've had clients who paid the premiums all these years, then get sick, or get Alzheimer's, forget to pay a few bills and then they go into nursing homes. The kids submit the claim and the insurance company says, "Sorry, your policy has been cancelled for failure to pay the premium."

Now, there may be ways around that. In fact, Virginia tried to enact a law requiring third-party notification on long-term care insurance, so that the bill, a copy of the bill, would also go the CPA, to an adult child, a friend, or a family member, so that the policy would not be cancelled.

Basically, I think you have raised a very interesting point. The overall management of the person's money is a slippery slope, especially for those who

© Wolters Kluwer

don't have children. I think again, the CPA is a natural choice for this. However, you have to be cognizant of the ethical issues that Skip Fox talked about earlier (see page 194). Certainly, you need to do things at arm's length. You need to keep accurate records, and there can't be any self-dealing.

Sidney Kess: The other problem is sometimes the caretakers work in conjunction with attorneys and they have the wills changed. I heard of one instance in Florida where the individual who is a senior was taken to an attorney and he gave the condo to his caretaker, the nurse that was taking care of him, and the lawyer redrafted the will. The nurse ended up with the car, the house, and the remaining members of the family didn't have enough money to fight her.

I would like to point out what I think is a big part of the future for all of our practices, which is planning for not just chronic illness and aging, but the challenges that affect so many clients who have limitations and can use more professional assistance.

Bernard Krooks: Well, that's unconscionable. The lawyer should always meet with the senior, the client, alone. This gets dicey because if a person who takes the senior to the lawyer's office is also the one who gets the senior their medication, the one who takes the senior out for a walk every afternoon on the boardwalk, and is really their only friend in life, it can be tricky.

Sidney Kess: And, if he or she is also working with the attorney.

Bernard Krooks: Yes, that gets complicated. Personally, I always assume that everything we do behind closed doors is going to be on the front page of *The New York Times* one day. So, people have to act and assume that whatever they are doing, others are going to find out about, and they have to be guided by their own conscience and the ethical rules that apply to their profession.

Clients With Chronic Illnesses

Sidney Kess: Marty, you've done so much work planning for people with chronic ailments. What advice can you offer?

Martin Shenkman: A lot of the planning for protecting clients from chronic illness is similar to the planning for clients that are aging, and everything that Bernie says applies. For statistics on aging see: Department of Health and Human Services, Administration on Aging, *www.aoa.gov/aoaroot/aging_statistics/index.aspx*. I just want to reemphasize a point that Bernie made because it's so commonly misunderstood. This is not planning only for clients who are older. It is something we need to be sensitive to for much younger clients as well. To demonstrate how significant these issues can be to practitioners' younger clients, 60 percent of those living with chronic illness are between the ages of 18 and 64. This is not only about the aging population, it includes that, but it is much broader.

The numbers are astounding. There are 130 million Americans living with chronic disease. And, many of us fall into the misconception that if the client looks fine, they must be fine. But, that is a misconception and can result in overlooking important planning.

The international symbol of disability of which everybody is aware, is a stick figure—a white stick figure in a wheelchair on a blue background. It is a terribly biased misrepresentation of what disability is about.

Only seven percent of those who are disabled use any type of walking device, meaning a cane, a walker, or a wheelchair. So, that symbol has led

© 2015 CCH Incorporated and its affiliates. All rights reserved.

many of us down the path of believing if the client looks fine, they are fine. But, most of the common symptoms of chronic disease can include chronic fatigue, chronic pain basically, a range of symptoms that are simply not visible. [See *http://invisibledisabilities.org/*]

I would like to point out what I think is a big part of the future for all of our practices, which is planning for not just chronic illness and aging, but the challenges that affect so many clients who have limitations and can use more professional assistance. This should be a burgeoning practice area for aging clients as well.

The idea of using a CPA as a monitor to ward off elder financial abuse is just one small component of it. I think as a profession, and again, to emphasize a point Bernie made well, while there is no correlation between health and wealth, people with wealth are not immune to these challenges. But, people with wealth affected by health challenges can afford professional help to make their lives more secure and easier.

I very often see clients who have had extensive estate planning done at major firms, great legal planning, great tax planning, but the human element of the planning, the planning for the health challenges they face, is just not addressed. We need to refocus on that because for all of our clients—the wealthy and those not subject to the estate tax as well—this is a big part of the future planning help and services they will need.

The fastest-growing cohort of clients is going to be elderly single woman, e.g., widows over age 85, given the longevity of women as compared to males. The average widow will live 14 years alone. What can we do to protect them?

In many cases, a fully-funded, revocable trust with a corporate trustee can create an excellent safety net to make sure that, if the client cannot manage his or her finances, there is somebody involved. If the assets are consolidated, especially at the institution named, before an event occurs, there is no slip with the passing of the baton from the client to the corporate successor trustee. The revocable trust can incorporate a range of protective provisions to safeguard the aging, ill or vulnerable client.

With respect to the use of powers of attorney, all of us in all the different disciplines need to take a much broader approach to helping clients deal with powers of attorney. It's not sufficient just to plan, draft, and execute the power of attorney document. It's planning the implementation and use of the document that is critical to its success.

How many times have any of us met with the person the client named as an agent? How many times has an agent sought out any professional advice? Earlier, Bernie made the comment that he often doesn't see the client until there is a problem. I think that is the same issue with people acting as agent under powers of attorney. We don't hear from anyone until there is a problem.

But, what if we as a planning team all proactively pushed to get clients to bring in their fiduciaries, and their family members for a meeting, maybe not every year, maybe not even every other year, but periodically? So, having the person that is going to be named as an agent under a power of attorney in the attorney, CPA or wealth manager's office, having him or her talk to the client's accountant, to understand from the client's attorney that they need to keep formal records, to understand what it means to be a fiduciary, is something that will go a long way to prevent a lot of the problems our clients have with powers and agents. It will help agents minimize liability and friction when serving.

But, those functions aren't the exciting technical big-dollar tax savings techniques that we all thrived on dealing with for decades. They are not as intriguing, perhaps, as how to craft a gift provision under a durable power of attorney. But, educating the family and the agent, if the agent is not a family member, as to what their responsibilities are, is vital to protecting the client as he or she ages or copes with chronic illness.

Helping clients do something as basic as consolidating their assets with a single wealth manager or bank, or say two wealth managers or banks, so that an agent can actually have a fighting chance to deal with the client's finances may seem simple; but it's incredibly practical and helpful, when people have to act in those roles. We have to emphasize the practical aspects of planning because it's just not being done. These administrative matters tend to fall between the roles of what various advisers typically address, and are not the legal and tax issues planners have typically dealt with.

Wolters Kluwer

Sanford Schlesinger: I think that's all well and good, but I think you're being unrealistic, unfortunately. Under the New York power of attorney statute, the attorney-in-fact has to sign. I don't know how much trouble other people have had just even getting that signature, much less getting them in the office.

Martin Shenkman: Sandy and I had a discussion, which I'd like to relate. I asked Sandy because Sandy is such a dynamic personality. I assumed he had no problem getting clients back to his office for periodic review meetings. He laughed and said maybe five or 10 percent come back. Was that the number, Sandy?

Sanford Schlesinger: That's accurate. And, there are a lot of reasons. People are busy and don't want to do it. It's unpleasant. They don't want to broach the subject. And, most importantly, they don't want to pay for it.

Your analysis is correct of what should be done and what is happening, but, one of my major complaints is that the power of attorney has gotten so complex in New York that I have clients who are not signing them.

Martin Shenkman: In some instances we have found that clients who are not willing to have an annual review meeting are willing to have a web-meeting. It saves the travel time, and is less costly and more efficient. Other clients are willing to authorize a phone or web conference of their advisers to keep planning on track.

Sandy said at a seminar years ago that it's actually easier to craft and have a client sign a revocable trust than a power of attorney. But, the point is that, as a planning team, we need to try this. The accountant, when he or she meets with a client should say, "Listen, it's not enough for me to do your tax return. We've got to talk about longevity planning." And, when the wealth manager meets with a client to go over whatever forecasts or investment allocation decisions, he or she should say, "Listen, I can't administer these trusts properly or have these complex swap powers without talking to your attorney."

And, if the accountant says, "I'm uncomfortable continuing to do a Form 1041 without having the appropriate documents in a permanent file." If we all collectively send the same message to clients, I think we will collectively not only get more work for ourselves as professionals, but do a dramatically better job for our clients.

I think that—and I don't mean to be insulting to all of us collectively as professionals—but, I think we had an easy time of it for decades because the tax driver pushed clients into our office. That tax driver is disappearing. It hasn't completely disappeared yet because I think a lot of clients still misunderstand the impact of taxes, and obviously many of our clients are still affected by taxes. But, I think it's becoming less and less potent of a force. While there has been much discussion of basis planning and other income tax aspects of estate planning, I'm not convinced that this type of planning can ever become the driver that a 50-percent estate tax was. The planning is very complex, doesn't always apply, and the payoff is less than the estate tax savings use to be that clients anticipated.

If all the different disciplines collectively are sending the same planning messages, that clients must come back for a periodic review and have all of the advisors involved, it can be beneficial for the client. I'm finding that by using web conferences and simple tools like that, the costs are not that significant, and, at virtually every meeting where I have convinced a client to have all their advisors participate, the benefits to the client have been obvious and they have all been pleased. The results have been positive and, professionally, it feels great to know you're really doing the right thing. But, it's a different dynamic than what I think we've had in the past. We have clients authorize, at their initial meeting, to communicate with their other advisers. We have recently begun to request clients sign a letter to their other advisers authorizing them to communicate with us and other advisers.

Sidney Kess: Marty, do you have any recommendations for how practitioners can become more knowledgeable in this area?

Martin Shenkman: I think that when you have a client with a specific health challenge or the challenges of aging, one of the ways to get more information and help the client is to involve a discipline that's been noticeably absent at the estate

© Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

planning team meeting, and that's a care manager. A care manager can bridge the gap between all the medical information and information from social workers and physicians and neurologists and psychiatrists and all the various medical people that are helping a client.

Sidney Kess: By care manager, are you referring to a geriatric care case worker, something like that?

Martin Shenkman: It's not only geriatric, because many of these clients who have these challenges are much younger.

Sidney Kess: Social workers?

There are numerous issues that come up when you have a family member who has special needs, but, for many families, the primary concern is making sure that the person with special needs has the highest quality of life possible.

Wolters Kluwer®

Martin Shenkman: A care manager is often a social worker or nurse who has additional licensing and training to be a care manager. What they can do is help in a myriad of different ways. They can comprehensively evaluate an individual's physical health and wellness, memory and mental health status, functional abilities, informal and formal social support networks, financial resources and living environment. They then make recommendations for care based on the information gathered from the assessment, coupled with an understanding of the client's wishes. Care managers are knowledgeable about the resources available to the client and the economic impact of the care required over time. Care managers coordinate the experts in different specialties to establish a comprehensive plan of care for the client.

A care manager can help translate a lot of the medical information and help us better understand what it means. So, for an attorney who is trying to assess or demonstrate capacity for a client, a care manager can be a very valuable tool.

For a wealth manager or an accountant who is preparing a budget, instead of using average or historical data for that client, or industry data on what certain expenses are likely to be, the care manager can prepare a plan and "dollarize" some of the costs that may be incurred.

If a client has to retrofit a house to make it accessible, that cost can be in the hundreds of thousands of dollars, depending on the client. For many of our clients, such an expense is an important line item to factor into budgeting and planning. So, a care manager can really play an important role.

One of the services that I like to use a care manager for is to mandate in a revocable trust that the corporate trustee must have a care manager meet the client in his or her home and do an evaluation. An assessment that takes place once a year so that, separate and independent of whatever the corporate trustee does under the revocable trust, separate and independent of whatever the retained physicians and medical personnel are doing, you have an independent person who is doing a periodic review. That can be invaluable in making sure that issues such as, not just elder financial abuse, but elder physical abuse, or a whole range of things aren't befalling a client.

And again, the percentage of our clients who don't have close, trusted family members to provide that safety net is very significant. And, over time, it's going to continue to grow. As clients age, their spouses, friends and, in some cases, even their children will predecease them. We need new procedures, new steps, new publications from sources like Wolters Kluwer, and new tools to help us address this.

The aging of the Baby Boomers, their values, and their goals are very different. They are, as a group, far more active and looking to remain active than prior generations. Their views of work are very different, and we're going to need to address all of this.

Special Needs Trusts

Sidney Kess: Bernie, you've done a lot of speaking on special needs trusts. Do you care to comment on them?

Bernard Krooks: This is another one of those up-and-coming areas where it applies equally to the rich and the middle class. And, it's not one of those things you can control.

There are numerous issues that come up when you have a family member who has special needs, but, for many families, the primary concern is making sure that the person with special needs has the highest quality of life possible. In order to do that, it typically involves making sure that they remain eligible for whatever government programs are available. There are not many, but there are two in particular, Medicaid and SSI [Supplemental Security Income], that are enormously valuable for people with special needs.

The object is to have these people remain eligible for the available government programs, but also to have a trust fund that's available, not to replace what the government will pay for, but to supplement and improve the things that you can get from the government.

So, this is one of those situations where you can have your cake and eat it too if you do it right. The care that is available from the government programs is not going to be the Taj Mahal of healthcare. It's going to be bare bones, but, then it is supplemented by this private fund.

There are basically two different kinds of special needs trusts that practitioners need to be aware of, and they are commonly confused. In the first type, the money that's used to fund the trust originally belongs to the person with special needs. That could be money from a lawsuit against a doctor or medical provider. It could be money that was received through an inheritance because the estate planning wasn't done properly. It could be child support payments because the parents got divorced. Although the divorce rate in this country is generally about 50 percent, for married couples who have a child with special needs, it's closer to 80 percent. It puts enormous stress on the marriage, so child support is frequently an item that gets deposited into a special needs trust.

Those are situations where the money that goes into the trust belongs to the person who has special needs. That is a completely different trust than one that is funded by a third party—a parent, a grandparent, an uncle, an aunt, a friend, or other relative. These third parties have no obligation to leave money for the person with special needs. They are doing it out of the goodness of their hearts, or because they feel morally obligated to, or they just want to.

The latter kinds of trusts have a whole different set of drafting considerations. I would say that the most common mistake that I see people making in this area is they will take a shortcut and get a form from the internet or from a seminar they went to, and use a first-party special needs trust when they should be using a third-party special needs trust.

Not to get overly complicated here, but, basically, what that means is, you use the form that was designed for the situation where the person who funded the trust was the person with special needs, when you really should have used the form that was designed for the situation where a third party funds it.

And, the reason that is such a big difference is that, in the case of a first-party special needs trust, when the individual with special needs passes away or there is an otherwise earlier termination of this trust, you have to account to the Medicaid authorities and pay them back for any cost of care that they provided to the individual with special needs. On the other hand, with a third-party trust, this is not the case because the person was under no obligation to set up the trust in the first place.

That's a big trap for the unwary, and we try to catch those before it's too late. You don't want to have pay back provisions in a third-party trust. As accountants who are looking to get more involved in this, I think it's important for them to work with attorneys who specialize in this area, because although the attorneys will draft the document, there are many tax considerations. I mentioned one earlier, the NIIT, which, unfortunately, hits special needs trusts very, very hard. This is so because, with many other trusts there may be a distribution requirement, for example if it's a QTIP or a similar type of unitrust, or something where you're required to pay an annuity out, at least you're getting a chunk of the income out.

With a special needs trust, many of these accumulate assets over a period of years until there becomes

© Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

a need for the beneficiary to purchase something, or for the trustee to buy something for the beneficiary. So, these types of trusts are especially susceptible to the NIIT, which kicks in at $12,300 for 2015.

Accountants can really be helpful in advising clients on how to mitigate that and advising trustees on what to invest in that might generate earnings or income that's not subject to the NIIT. This is a whole different, but related area to elder care, because many of the programs that are available to help individuals with special needs also help out the elderly in accessing the type of care that they need.

So, I think that for accountants to become more active in this area, one of the first things they ought to do is develop relationships with trustees, insurance people, and lawyers who work in this field. And, I think that will be a good way to whet their appetite and get involved in the field.

Dealing With Multiple Marriages

Sidney Kess: Bernie, with your elderly clients, do you ever get involved with guiding them through a second, or even a third, marriage or when to get divorced as far as Social Security is concerned?

Bernard Krooks: I'm not sure what the norm is anymore, staying married or getting divorced. We have so many clients who are getting divorced one, two, and three times.

First of all, from the long-term care perspective, people really don't get this. When you marry somebody, you are legally responsible to pay their health care expenses. So, in many cases, we would represent the monied spouse who would come to us, fortunately, in advance and ask if there are any consequences to getting married with respect to the future spouse's long-term care situation. And, we, unfortunately, have to tell them, "Yes, if you get married, you're going to have to pay, regardless of whether or not you've always kept the money separate, regardless of whether or not it's a second marriage, and regardless of whether or not you have a prenuptial agreement."

The reason for that is because the government is not a party to the prenuptial agreement. You can't legislate something in a prenuptial agreement and state that I'm not going to be responsible for my future spouse's long-term care needs, when, in fact, the law says you are.

In many cases, it makes sense for the monied spouse to purchase long-term care insurance on behalf of the future spouse-to-be because the cost of the insurance could end up being a lot less than the exposure, especially if you're marrying somebody older than you. The likelihood is statistically—although certainly not a guarantee—that they would need a nursing home before you.

In many cases, we have solved that problem or attempted to solve it by purchasing long-term care insurance on behalf of the monied spouse for the benefit of the spouse who doesn't have as much money.

Martin Shenkman: Practitioners should also be cognizant of what has become known as Silver Divorce. Nine percent of people aged over 65 were divorced in 2011—double than in 2001. [*http://www.dailymail.co.uk/news/article-3116079/Divorce-rate-OAPs-doubles-just-decade-One-ten-couples-formal-split-concerns-grow-rise-silver-separation.html*]

Social Security

Bernard Krooks: With respect to Social Security, I would be hard-pressed to think of another topic that I get more questions about now than Social Security. It is unbelievable how you can't open the paper these days without seeing an article about it. And the $64,000 question is always, "When do I claim?" And, I don't know if there is one right answer for everybody.

A lot of people are cynical and say, "I better take it as early as I can because it's not going to be there." Especially after listening to the debate, I may now even be in that camp. I never thought they would do it, but who knows?

So, the accountant can perform a valuable function in doing the analysis. The government is basically giving participants eight percent on their money for each year that they delay taking benefits between normal retirement age and age 70. Accountants can be very useful to people in the financial services industry and to clients in helping them decide once they make certain assumptions. One of the biggest assumptions concerns how long a person is going to live. If you don't have a crystal ball, that's difficult to figure out.

But, there is one technique that I've seen a number of articles on that is—I would hate to say a

Wolters Kluwer®

no-brainer—but, it probably works in most cases, and that is the file-and-suspend strategy. Social Security was originally enacted when women didn't work, so they wanted to provide a benefit for the female spouse, and they allowed the husband to file for Social Security early. That would trigger the spouse's right, in that case the woman's right, to file for her spousal benefits.

Now, of course, it's a unisex issue. We're living in different times than we did 80 years ago. What happens is that one spouse turns normal retirement age. That person then elects Social Security. That allows the other spouse to claim a spousal benefit based on the working spouse's work record and then the money that he or she gets does not count, or does not eat into the overall pie of Social Security money that the other spouse would be entitled to get. So, it's basically a freebie.

What typically happens is, if it makes sense for the monied spouse to not get Social Security now, they would file right away, which would enable the other spouse to file for the spousal benefits. The monied spouse would then suspend benefits so that he or she can continue to earn the eight percent tax free on the money the government gives them.

Practice Management

Sidney Kess: Do you have any tips on managing your practice to deal with people who are seniors?

Bernard Krooks: That presents unique challenges, and as I get older, I start to understand it a little bit better. Age 50 looks a lot different when you're on the other side of the hill, and then age 60 and age 70. As they say, beauty is in the eyes of the beholder.

One of the things the professional cannot underestimate is that as people get older, they don't see as well. They don't hear as well, and you can't take for granted that they're going to be able to comprehend everything that you say. So, it is enormously helpful in our practice, if we have adult children be part of the process.

Of course, we always spend time alone with the senior, but it is helpful to have someone else involved in the meeting because, invariably, people have dozens of questions after they leave the office. It's just too much information to be processed at the initial meeting. If we can't get a relative or a child or someone else involved in the process, then it is really important to speak slowly and clearly and make sure you have given the person the opportunity to ask questions.

We will send something in writing explaining what we discussed so that they can ponder it on their own. It's really important to me that the clients we talk to understand what we have discussed and ask intelligent questions.

Our office is set up to be ADA-compliant so that people with wheelchairs can get in, and it's welcoming to people. It's well-lit. We went to a seminar a few years ago and the presenter handed out glasses, and made all the audience participants put on the glasses. You got to experience what it is like for someone who had cataracts—basically you can't see. We tend to take it for granted that people are seeing and comprehending what we are telling them. But, if someone has cataracts and a lawyer is putting up a flow chart in his conference room, that person may not be able to see it.

You really have to be sensitive to the needs of the clients and accept and understand whatever limitations there are and represent them to the best of your ability. If there comes a point in time where they do have diminished capacity and can no longer understand, then, the laws of each state will tell you what you ethically are able to do in terms of disclosing information and making sure that they continue to remain protected.

Caregivers

Sidney Kess: Another thing that many people don't recognize, and it's very important to bear in mind, is the treatment of caregivers. If you have someone in the family with dementia, you need someone to be with that person. Sometimes it's 24 hours a day. That can be $225 a day or more, but the question is how do you handle that individual?

Although you may find a terrific person off the books, there are all kinds of dangers. For one, it's illegal. They can always come back against you because there is no statute of limitations for failure to pay Social Security tax.

Now, in several states, including New York, Massachusetts, and California, there exists something called the Domestic Workers Bill of Rights. Under the Domestic Workers Bill of Rights, you have to pay caregivers overtime after 40 hours.

Wolters Kluwer®

© 2015 CCH Incorporated and its affiliates. All rights reserved.

They have vacation time that they're entitled to, sick days. Many people are not handling this properly and these domestic workers have a right to go against you. You have to be aware of that.

Have you encountered that problem, Bernie?

Bernard Krooks: Absolutely, Sidney. You're 100-percent correct, and this is actually having ramifications that were probably not thought of by the good-natured people who enacted this law.

It's getting harder and harder because people don't want to hire workers under this condition. So, more and more people—of course, none of my clients—are ending up paying cash because they don't want to be subject to all these rules and regulations.

Guardianships

Sidney Kess: Another question, how about guardianships? We haven't spoken about that.

Bernard Krooks: This is one of those things that in most cases can be avoided. If you can explain the power of attorney to the client and the client understands and they can sign it, or if they can do a revocable living trust and a healthcare proxy and living will, nine times out of ten, you won't need to have a guardianship.

A guardianship is the last resort where somebody needs to have a court involved to appoint somebody to make medical and financial decisions for somebody else. But, I have been involved in cases, Sid, even where people did all the right things and still ended up in guardianship court. They had a power of attorney and they had a healthcare proxy. We still had to go to guardianship because the agent under the power of attorney wasn't acting properly, or the healthcare agent didn't want to make decisions, or there was a dispute between the two agents under the power of attorney.

Although it's not a guarantee that you won't need a guardianship, taking the time to do the advance directives will go a long way towards avoiding a guardianship. Guardianships can be costly, very time-consuming, and not to mention, an invasion of privacy. They can run tens of thousands of dollars. They can be heart-wrenching because brother is disagreeing with sister and they are fighting it out in court.

It's the thing that you have to do as a last resort, but it's something that you certainly want to avoid.

Martin Shenkman: You might consider a fully funded revocable trust with an institutional or corporate trustee and a comprehensive power of attorney permitting an agent to pour remaining assets into the trust. If these are coupled with a comprehensive health proxy, or a POLST (Physician Order for Life Sustaining Treatment) the likelihood for guardianship might be reduced further.

Medicaid

Sidney Kess: With all of these expenses, when it comes to individuals, it is very possible to run out of money. Having a caregiver 24 hours a day can add up fast. It is certainly possible to go through a few hundred thousand dollars. After two or three years, you may not have the money for the caregiver anymore.

In New York State, you could try to get help under Medicaid for those individuals. There are different rules on Medicaid for household help than there are rules for Medicaid for other purposes. Could you go over that?

Bernard Krooks: We could easily spend three hours on this topic alone. But, yes, Medicaid is different than Medicare. Many people confuse them because they both begin with the same letter and they're both run by the same government agency, the Center for Medicare and Medicaid Services. But, they are completely different. Medicare is what you get when you turn age 65. It pays for the doctors and the hospitals. You can also get Medicare if you're receiving Social Security disability for two years. But, Medicaid, when it was enacted in 1965, was intended to be the health insurance system for the poor, the poverty stricken, and the destitute. The idea was that we were going to take care of people so that they don't have to go out on the street. Instead, it has turned out to be the safety net for the middle class because the rich people, even if the long-term care costs a quarter of a million dollars a year, many of them can self-finance it.

The poor people would go on Medicaid, but the person who has got a few bucks in the bank really is faced with a Hobson's choice of spending

© Wolters Kluwer

all that money, as you point out, and going broke and then going on Medicaid, or going to lawyers like me. And, for the 90 plus percent of the population who haven't purchased long-term care insurance, it ends up being too late to purchase once they are ill.

Going to lawyers like me and figuring out how to structure their assets and qualify for Medicaid is really not much different than setting up a note sale to a defective grantor trust and taking the position that any future appreciation escapes the tax man. it's a similar type of technique, but it is the last resort. You don't want to be involved in that situation because the rules are complex. As Sid pointed out, there are completely different rules if you need to go into a nursing home where there is a five-year lookback, as opposed to the rules for at-home care.

The state discrepancies are enormous, so one person might be eligible for Medicaid in New York, but not in New Jersey and not in Pennsylvania and not in California. So, it really behooves the practitioner to work with somebody who specializes in that area of the law, and in that particular state, in order to make sure that everything is done properly.

Sidney Kess: Bernie, can you make this a little clearer for us? Let's say you have an individual who has dementia and there is caregiver who is watching her, if funds are transferred out, even though it was done a few months before, there is no five-year look back. If they have less than a certain amount, they can get Medicaid and if they are incapacitated, they can even get household help.

On the other hand, if the person has to go to a nursing home, if the assets are transferred within five years, then there is a problem.

Bernard Krooks: You're exactly right, Sid. And, what you're pointing out is something that's very unique to New York, the fact that you can get home care, even though you have given away assets within five years. New York State happens to have the absolute best home care program in the country.

Although what you state is completely accurate for New York, it's not true in most of the other states. It's much more complicated and cumbersome to get somebody to come into your house and provide care. But yes, that is a big discrepancy between the situations presented when someone needs a nursing home vs. needing to get care at home.

One of the problems with the strategy you discussed is that, if you gave away the money now and then got someone to come into your house for six or eight months and then you fell down or you got sicker and then you needed to go to a nursing home, you already made that gift. How are you going to find the nursing home to pay for your care when there is a five-year look back period?

Many times people are advised to make these gifts because there is no penalty period for home care, and you know, unbeknownst to them, within five years something happens and they need to go into a nursing home. And, then they're stuck.

Client Record Keeping in the Digital Age

Sidney Kess: Another thing, and I don't know whether any of those who are represented here at this meeting are doing this, but one of the larger accounting firms has an approach where they have all their clients fill out a statement of records. They keep track electronically of where all the documents are, who the doctors are, what medications they are taking, passwords for their computer, etc. The firm then charges their clients to get a set of records so if anything happens to them, they become incapacitated, or they die, whoever is working on the estate has all this information available while they were able to give it to them, instead of having to recapitulate everything after they're dead.

Bernard Krooks: That's an excellent point because in the old days when you had an estate, you would go to the person's mailbox and you would wait for the bills to come in, and that's how you knew what accounts they had.

Now, many people get their statements and their invoices from the phone company and the bank, etc. via e-mail. So, if you don't have access to their computer, you don't have the password and username for all these other accounts, you can't even begin to work on the estate.

Then, you have the whole other issue that was raised earlier [see page 201]. Even if you have their password, Facebook, Yahoo, and other companies won't even give you access to the informa-

Wolters Kluwer®

© 2015 CCH Incorporated and its affiliates. All rights reserved.

tion because they don't want to be bothered with it. This is an issue that I think we are going to have to grapple with as the Baby Boomers continue to age, and even for people in earlier generations — we have many senior clients who are very computer literate. We have just hit the tip of the iceberg with this.

Sidney Kess: Is there anything else anyone would like to bring up at this time?

Martin Shenkman: This is part of the whole process of later-life planning, not only to deal with aging, but to deal with the large number of people with chronic disease and disabilities.

As part of the same team approach to planning, all of us as advisors should be encouraging our clients to have their accounting firms help put them on Quicken or some other comparable program to maintain their records. When we create trusts that provide for maintaining somebody's standard of living, what is that standard of living? If we have five years of Quicken records as to what the person has been spending, it's relatively easy to do because you've got records.

When we're trying to prevent elder financial abuse and you have several years of records on Quicken®, it's fairly simple for the accounting firm that's engaged to monitor this or to prepare this on, say, a quarterly basis, to compare expenses to see if something stands out as inappropriate.

For passwords, we routinely recommend clients use one of the apps like Keeper Security, and input all of their passwords into an encrypted app because we have found far too often that the information is just never available. [See *https://keepersecurity.com/*] Or, what some clients do is tell you that they write it down somewhere, but no one can find where they wrote it. But, if it's put on an app, it's dealt with.

We have also begun to routinely use a cloud-based portal system through Citrix-Share files and post all of the clients' documents in the cloud, so that if the accountant or wealth manager or anybody else wants a copy of any of the documents, the client doesn't have to call us and doesn't have to incur fees. They can simply give the password that they have selected to that advisor or that child or whoever they want to access the documents. [https://www.sharefile.com/]

The same mechanism can afford a smartphone app, so that if a client is rushed to a hospital, they can download their health proxy from their smartphone. So, the technology and expanding the scope of the services that we can offer, I think is going to be a growth opportunity for most practitioners. And, I think a great help to most of our clients as they age.

Later Life Planning in General

Sidney Kess: Any other comments or observations? Marty, do you have any suggestions as to how practitioners can improve their ability in this whole area of elder care?

Martin Shenkman: For one, I think we have to define it much more broadly. One of the situations I've seen come up a number of times involves very wealthy clients with special needs adult children and the precautions and steps that are taken not only to protect the child, but to help the aging parent provide care to that child.

I have seen a number of cases where special needs trusts have been provided and the wealth is so substantial and the particular needs and circumstances of the special needs child such that that limitation may not be appropriate.

I think we all need to think in broader terms how we approach planning. I think we need to consider all the different optional services that we can offer and so on.

There is a lot of opportunity. I think one of the things that firms need to reconsider is the mandatory retirement age. Are we relegating partners to have to leave a firm's practice just at the point in time when they have the most knowledge, expertise, and best skillset to help guide our aging clients?

I believe it's incredibly important to evaluate what policies firms should or shouldn't have in order to address serving as fiduciaries. When can partners or former partners serve? What policies do we have?

Who should make the fees from these things? Is there an ethical issue when a former or retired or current partner is serving and hiring the firm to provide services? So, I think there's just a tremendous area of new services and places to which we can expand.

Wolters Kluwer

INVESTMENT PLANNING

An Advisor's View of "Tax Efficient Investing"

Barbara Raasch, RCL Advisors, LLC New York, New York, provides insight into her firm's methodology for practicing "tax-efficient investing."

Intuitively, tax-efficient investing makes a lot of sense and many firms in the investment industry proclaim that they practice "tax-efficient investing." However, what is the definition of "tax-efficient investing" and what processes can firms employ to manage client portfolios in a tax-efficient manner? Today I would like to share some of the ways that we at RCL Advisors, LLC approach tax-efficient investing for our clients in an attempt to answer these questions.

Before I begin that discussion, I'd like to share a little background information which I hope you will find interesting and help you to focus on tax-efficient investing as part of your year-end planning. I believe this topic is particularly timely because many mutual funds have accumulated a lot of unrealized capital gains which may come home to roost unexpectedly before year-end unless properly managed in a tax-efficient manner.

Given that the Russell 3000's return averaged 16.03 percent per year over the past five years (through August 31, 2015), one could surmise that investors in U.S. equity mutual funds may incur large capital gains taxes this year.

The table below shows the average capital gains exposures and average annual turnover ratios based on Morningstar data as of September 25, 2015 [Editors' Note: This material was submitted after the Advisory Board meeting was held]:

Morningstar Category	Capital Gains Exposure %	Turnover Ratio %
US Large Cap Growth	19.78	70.32
US Large Cap Blend	14.99	58.57
US Large Cap Value	5.04	54.34
US Mid Cap Growth	17.17	69.13
US Mid Cap Blend	13.14	71.39
US Mid Cap Value	10.58	59.46
US Small Cap Growth	16.06	79.94
US Small Cap Blend	9.45	67.05
US Small Cap Value	6.95	67.92

It is important to note that the turnover ratios shown above may be larger this year due to the fact that fund flows have reversed their course in 2015. Year-to-date through August 31st, U.S. equity fund flows have been -$67.8 billion which contrasts starkly with the positive fund flows over the prior two years totaling $101 billion.

The U.S. equity fund outflows experienced so far in 2015 may have created a negative return impact as funds were forced to sell securities in order to meet redemption requests. However, this market impact may be exacerbated for investors continuing to hold the mutual funds or purchasing mutual funds prior to their capital gain distribution record dates this year. Since a mutual fund's asset base serves as the denominator in the calculation of potential capital gains exposure, an increase in assets dilutes the tax impact of previous shareholders while a decrease in assets causes a greater tax impact for remaining investors.

At our firm, we work hard to minimize these and other potential negative tax impacts throughout our clients' investing cycles. Below is a discussion of our approach to maximizing our clients' results during six points in their investment cycles.

Initial Implementation

Initial portfolio implementation is more challenging when positions have large embedded gains. In such a case, forcing sales across the board to implement our highest conviction client-tailored portfolio can be problematic due to the immediate tax cost created from selling the existing positions. In all cases of initial portfolio implementation it is important to be mindful of the acquisition of mutual funds that currently have large potential capital gains exposure, particularly near the end of the year.

Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.

For example, if a new client's existing portfolio has securities with an embedded gain of 25 percent, liquidating this portfolio could result in a tax cost of six to 10 percent. If you then invest the liquidation proceeds in mutual funds prior to the capital gain distribution record date, you could be looking at an additional tax cost of two to five percent. That's tantamount to a very expensive front-end load.

We also ask and answer the following questions before implementing our best investment solutions for new clients:

- What is the most advantageous timeframe for implementing our highest conviction investment solutions?
- What is the anticipated tracking error of the appreciated investments currently held to the relevant benchmarks?
- What is the anticipated performance of our highest conviction investment solution versus each existing investment?
- Should a passive solution, such as an index fund be used to avoid potential capital gain exposure?

Once these questions have been answered, we work with our clients and their accountants to design their tax-efficient initial implementation strategies and develop a plan to move toward the desired portfolio at the most appropriate time. This process includes defining the acceptable tax hit, continually monitoring for market pullbacks, and managing mutual fund capital gain distributions each year.

Portfolio Repositioning

Portfolio repositioning can be quite costly in the event that clients are moving even a small amount of their exposures out of an appreciated asset class. When redeploying a portion of an appreciated holding, it is critical to analyze the lots purchased to identify which to liquidate first.

If no opportunities exist to reduce the tax burden of portfolio repositioning to a minimal amount, we estimate the projected performance benefit of implementing the change to ensure the tax cost is likely to be neutralized before implementing.

It is important to note that we have been able to work with most of our clients' custodians to set up all their accounts for optimal tax lot management. This has been advantageous because we know that the highest cost long-term capital gain lots are liquidated first unless we select otherwise.

Year-End Mutual Fund Gain Distributions

Due to the high equity market returns over the past few years and the recent market pullback, investors that purchased mutual funds earlier this year may have an unrealized loss in a mutual fund but end up with a capital gain distribution. Depending on the magnitude of the distribution, these clients should consider selling the applicable mutual funds in advance of their capital gain distribution record dates.

Long-term investors may also be better off selling mutual fund before the capital gain distribution record date in 2015 since capital gains distributions may be large this year.

The process that we undertake for our clients each year in order to minimize the tax impact of capital gain distributions is as follows:

- Beginning each November, we review the websites of mutual funds held in our clients' taxable accounts to identify the amount and character of the capital gains they are expecting to distribute.
- Using our proprietary analytical tool, we identify the positions in each client's taxable portfolio expected to generate capital gain distributions in excess of $5,000.
- For each identified mutual fund, we determine whether there would be any short-term redemption fees, contingent redemption fees, or repurchase restrictions if the mutual fund is sold one day and repurchased shortly after.
- To the extent redemption fees, contingent redemption fees, or repurchase restrictions apply, we identify appropriate exchange traded funds to represent the asset class of the mutual fund to use as a placeholder during this restriction period.
- For each identified mutual fund, we determine clients who will owe greater than $1,000 more in income taxes based on our proprietary analytical tool and reach out to them to recommend that they sell the applicable lots of the mutual fund one day prior to the capital gain distribution record date and generally repurchase the mutual fund the day following the record date.

© Wolters Kluwer

Tax Loss Harvesting

Tax loss harvesting is often a once-per-year occurrence at many firms. However, if tax loss harvesting makes sense at the end of the year, we believe that it can make even more sense if implemented all year round. By continuously monitoring during market downturns, our clients are able to maximize the benefits of loss harvesting by taking advantage of opportunities that might have gone unrealized had we just waited until the end of the year.

No one likes to lose money, but our clients understand that down times will occur and appreciate the concept of creating a "tax asset" from any losses. They realize that this is advantageous as long as the process does not disrupt the portfolio structure or reduce returns.

To harvest losses without adversely impacting the portfolio's structure and return capacity, it is important to identify an investment alternative for each security you plan to sell so the alternative can be an effective placeholder for the wash-sale period. And, we work closely with applicable clients' separate account money managers to implement loss harvesting programs. For mutual funds, we identify another investment solution or appropriate exchange traded fund in an effort to achieve the overall portfolio's desired results.

Charitable Gifts

While we look for pullbacks to maximize loss harvesting opportunities, we seek upward spikes to maximize the tax benefits of charitable giving for our clients throughout the year. To do so, we:

1. Ask each of our clients to advise us of any charitable contributions they intend to make during the year in excess of $5,000 at the beginning of each year;
2. Sort each applicable clients' holdings in all their taxable accounts by unrealized gain to initially identify the securities to consider transferring to charities;
3. Monitor the performance of those securities throughout the year and recommend to clients to consider making the contribution earlier in the year when markets are up significantly if the security does not generate much dividend income;
4. In late October, provide our clients' tax accountants with year-to-date portfolio income information and charitable contribution information and work with them to determine whether it makes sense to create or contribute to a donor advised fund to accelerate contributions into the current year in the case of high income years;
5. By late October, determine whether additional gifts desired to be made in the current year would be better made from the client's donor advised fund in the case of low income years; and
6. By the end of November, implement the transfer of mutual fund units to charities to ensure they occur before the end of the year.

Investment Solution Terminations

Investment solutions may need to be replaced for a variety of reasons. When looking to implement the termination of an investment solution, we undertake a process similar to the process we utilize when implementing a new portfolio by asking and answering the following questions before proceeding:

- What is the most advantageous timeframe for implementing the replacement investment solution?
- What is the anticipated performance of the replacement highest conviction investment solution?

At RCL Advisors, we form guidelines for each client as to the amount of tax they are willing to pay to reposition and terminate investment solutions based on a number of factors, including manager dispersion in an asset class, anticipated payback period, anticipated holding period, etc. While adding these types of additional steps to the investment process creates a tremendous amount of work, we believe that our clients who are sensitive to taxes greatly appreciate this diligent approach.

Our adoption of "tax efficient" techniques such as those described above throughout the investment process now permeates our firm culture and is a source of great pride amongst our staff. We believe that the work we do in this area helps differentiate our firm from others in the private client space.

Wolters Kluwer

© 2015 CCH Incorporated and its affiliates. All rights reserved.