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PRACTICAL PLANNER

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PLANNING POTPOURRI

◦ **Tax deferred exchanges:** Like kind (1031) exchanges require that you swap property for replacement property. How long do you have to hold the replacement property? There is no safe harbor. The issue is intent. Cases have held that if you intended at the time of the exchange to sell the property acquired that the exchange won't succeed. If you 1031 exchange a property for a rental house that will qualify as like kind. Subsequent behavior is used to determine intent at the time of the exchange. If a short period of time after the exchange you convert the former rental into a personal residence you may taint the required intent at the time of the prior exchange. This is a fact sensitive issue. Did you have a contract signed before? How much time passed? Did you really rent the property after the exchange? Was it rented for an arm's length price to an unrelated person? Fact sensitive, no bright line rule. In *Click v. Comer*, 78 TC 225 (1982) as an example, the

court said that holding the property for 7 months and then making a gift of it demonstrated that the taxpayer did not intend to exchange it at the time of the 1031.

◦ **Property Insurance Review:** Mold coverage may be excluded or limited to a modest amount, when a higher limit might be advisable. Some homeowner policies limit contents coverage to a percentage of the structure's coverage. For many homeowners, these limits are inadequate. Scheduled property (art and jewelry) should be reviewed and appraised periodically. Does your policy provide identity theft coverage? Is your personal liability coverage adequate? Are vacation home, rental properties and other land holdings covered? Do they need to be listed separately? Have you coordinated business and personal coverage to avoid overlaps or gaps? If you are handling an estate or trust that

owns property does the policy properly list and cover the trustees and executors?

◦ **Divorce:** If you are in the process of divorcing, a final conclusion can be a years off. Update all of your estate planning documents to name persons other than your ex-spouse to be agent. Secure resignations of your ex-spouse's family as fiduciaries. Old powers of attorney and other documents need to be revoked. Weigh the cost of using a married filing separate tax status versus married filing joint. If the amounts are not significant, it is better to begin the separation of tax filings earlier (if an audit occurs in 3 years the entanglements are often not worth the



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SIMPLICITY: IS THAT REALLY YOUR GOAL?

Simplicity!

Simple is best! The KISS principle (Keep It Simple Stupid) is supposedly a goal of many. Is simplicity itself really an appropriate goal? A simple document or plan may sound admirable, but what you really want is simplicity in result. **Document:** A short will may be simple, but might create a myriad of problems if the unexpected occurs. On the other hand, a comprehensive will requires more time to prepare, discuss and understand. But if the unexpected occurs and the situation is dealt with adequately, simplicity in result occurs. **Plan:** One dimensional planning might be simple, but can often fail to achieve your goals.

Disability Planning More than Insurance:

Disability insurance can be a great planning technique, but never the entire answer. To address business issues created by disability, evaluate business disability buyout insurance, business interruption insurance and disability provisions in shareholders agreements. Personal disability insurance waiting periods can be coordinated with salary continuation provisions contained in an employment or shareholders' agreement. To address personal problems created by a prolonged illness, implement powers of attorney and health care proxy to address decision making if disabled. A revocable living trust is a tremendous technique for disability planning. Having a home equity line and margin account in place can facilitate meeting short term cash flow needs through an emergency. Simple?

Offbeat Ways to Finance a Retirement Home:

The simple way to finance a retirement home is to use savings to pay for it or take out a mortgage. In some instances, something more unusual may fit the bill.

◦ **Life Insurance:** Retirement is a time to re-evaluate all aspects of your planning, including life insurance. If you have life insurance you no longer need nor want, even in an irrevocable life insurance trust (ILIT), its value might be put to better use. Example: Husband has insurance on his life owned by an ILIT. Wife is a co-trustee and beneficiary of the ILIT. Husband recently sold his business and they are living

in retirement on the investment returns from the proceeds. The primary and secondary needs for life insurance (to replace his earnings if he died, and to deal with the illiquidity of the family business) no longer exist. The only possible benefit of the life insurance is to address the estate tax. But, with a \$5 million estate, a current federal estate tax exclusion of \$2 million each, and an expectation of spending assets down, you may opt to cash in (or sell) the insurance. The trustee can terminate or sell the policy and distribute the

cash proceeds to Wife who uses it to buy the retirement home. Before cancelling or selling a policy, however, review all options first: Keep the existing policy and trust; Keep the existing policy and trust but use various options to modify the coverage and or trust; 1035 exchange or buy a new policy to better meet your new needs; Cancel the policy and use the proceeds as above; Sell the policy.

o Rental: Evaluate converting the policy and distribute the

o Rental: Evaluate converting (Continued on page 2)

PROTECTING YOUR CHILD

Protecting your child is the primary goal of every parent. Our country took a collective pause with the recent sad passing of Dana Reeve, leaving Christopher and Dana Reeve's young son, Will, an orphan. Some solace can be obtained by trying to take a positive lesson from the tragedy — Plan now to protect your children. There are 5 key steps:

◦ **Complete An Emergency Child Medical Form:** Complete an emergency child medical card. Your living will won't address your child's care if you are gone. See www.laweasy.com for a sample form.

◦ **Appoint a Guardian:** Sign a will and name a guardian. You need to designate a guardian for your child. name someone who will show sensitivity and understanding to raising your child. Consider where the guardian resides. Will it be an advantage for your child to move to where the guardian lives? Would it be better to name someone who lives nearby so your child can maintain the same friends and school? Be careful to name several successors. Also, name one person at a time, not a couple. If you name a couple, what happens

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...SIMPLICITY

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your existing home into a rental property. Its not only a cash flow and income tax decision. There may be lots of estate tax bang to the plan too if you look at it as part of an overall estate plan. Convert your New York house to a rental and contribute it to a limited liability company (Realty LLC). Then purchase your Florida retirement home and use the rental income (LLC distributions) to pay for your expenses. Transfer Rental LLC to another limited liability company that can own marketable securities and other investments (Investment LLC). Thus, Investment LLC owns Realty LLC (like a subsidiary). Ownership of Investment LLC can be given to heirs and irrevocable trusts to reduce gift and estate taxes, and protect assets from malpractice and other claims. The inclusion of the rental property may support larger valuation discounts to leverage the gift and estate tax benefits. If the rental property is

worth \$1M and the securities \$1M, a 10% interest may be valued at \$150,000, not its pro-rata \$200,000 value. The rental property is a key to the entire plan because it is truly a non-liquid, non-marketable asset that creates real business purpose and discounts for the Investment LLC (it differentiates their facts from many of the recent tax court cases ruling against taxpayers on these techniques). Your extra mileage out of the plan: cash flow for your retirement home, avoiding ancillary probate because the New York property is held by an LLC (assuming you become a Florida domiciliary), gift/estate tax benefits, asset protection benefits, and a cool plan! You get everything but simplicity.

o QPRT: You may have given your primary residence into a qualified personal residence trust (QPRT) to transfer it to your heirs at a substantially reduced value for gift taxes. Your QPRT can sell your primary residence and purchase a new home in the area you want to move following retirement. Same plan, new house. Different, but simple. When the trust ends, your heirs own the retirement home and you can rent the retirement home from their kids. This is a great way to reduce estate taxes by transferring more money to your heirs as rent.

Selling A Closely Held Business:

Selling a closely held business can be viewed from a simple perspective: sell the stock and report a capital gain. Invest the proceeds. But there are many more planning techniques that might help you achieve an array of goals: income tax savings, gift/estate tax savings, charitable goals, and more. Usually some combination of techniques, while more complex than a single plan, can help you better tailor the results to meet your overall goals:

o Gift part of the business interests to a charitable remainder trust (CRT) before the sale. Use the charitable contribution deduction to offset some of the gain on sale. The CRT can provide cash flow for your life, and the life of your spouse. Most CRTs are structured as CRATs making a fixed annuity pay-

To achieve simplicity in results, may require a plan or document that is complex.

ment. If you'll rely on the cash flow for a long period use a CRUT -- the annual payment you receive, a unitrust payment, is a percentage of the trust value each year, so it can increase over time as your portfolio grows.

o An insurance trust (ILIT) might be used to replace the stock value given to the CRT. Some planners call this a "wealth replacement trust". Set up an ILIT. It buys insurance on your life. On death, your heirs receive the insurance in lieu of the value of the business given to charity using a CRT. A CRT may also be structured with a donor advised fund.

o Simple sale for part of the transaction. Often, it's advisable to leave a portion of the sale unencumbered by planning so that you have unfettered use of the money. While a CRT offers benefits, you cannot access more money in any year than the CRT formula provides for.

o Gift shares of stock to trusts for heirs well before the sale strategy is pursued. This can sometimes be done at a lower value, and further reduced by discounts. Use trusts for these gifts to

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...PROTECT YOUR CHILD

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if they divorce? Should you tell the guardian of the appointment? If you don't what if they don't wish to serve, have an impediment you weren't aware of? But if you discuss the appointment what happens if change your will? Consider whether the guardian should be a co-trustee to have input. However, you may not want to have the guardian as the sole trustee as there would be no checks and balances.

Set up a Trust: Set up a trust to protect your child's assets. This can be done in your will so that should you die the assets bequeathed to your child will be managed for the child's benefit, and protected. If you plan to make significant gifts to the child while you are alive, it's probably advisable to set up a trust while you are alive to protect those assets as well. If you own or are planning on purchasing life insurance (see below) the insurance should generally be owned by a trust. Why a trust? A trust can provide management of assets through co-trustees and other fiduciaries, protection from claimants and divorce; tax benefits; and more. The trust document can set standards for distributions to assure your goals are achieved. You can also include reasonable personal directions in the trust to provide guidance to the trustees as to your goals. For example, you might authorize the trustee to fund an addition on the guardian's home, foreign travel, religious school education, extra-curricular activities, etc. Be careful that personal provisions are flexible enough to avoid binding a trustee if the child develops differently or circumstances change. If you establish a trust just for only your child, the trend is to use long term, lifetime or even perpetual trusts, to provide protection for your child. Such a trust would likely provide that on your child's demise the assets would pass to

the child's descendants. If the trust is to benefit your child, then it should authorize the trustee to distribute money "without regard to remainder beneficiaries". That language is vital to the determination of investment and distribution decisions.

Buy Life Insurance: If your estate isn't large enough to be assured of having sufficient resources for your child, supplement with life insurance. Buying insurance to protect children is often simple and inexpensive. If your child is 6, a 20-year term policy should assure getting the child through college. A longer policy might be safer. Whether you opt for permanent coverage and other features is secondary to making sure that there are enough resources

for your family if you die prematurely. The insurance should generally be purchased by a trust to assure that it is not in your estate, and that the proceeds won't be squandered. If there are children from different marriages, or children with special needs, insurance can address these differences. A young child may require funding for school, that your older children received. Yet, if you divide assets unequally in your will, you worry of offending the older children. A separate life insurance policy can provide the extra funding for your youngest child without offending the other children.

Write a Letter of Instruction: There are a myriad of personal decisions to communicate that should not be in your

RECENT DEVELOPMENTS

o Foreign Asset Protection Trust (FAPT). A common planning goal is "old and cold". If something has been in place for years, it's more likely to "fly". Well, not always. In a recent case U.S. v. Grant, (U.S. Dist. Ct. So. Fla. 9/2/05) the court ordered the repatriation of assets that had been offshore for 20 years. What went wrong? The grantors who established the trusts retained the "unreviewable discretion" to change trustees to new trustees "anywhere in the world". The grantors had too much control over the assets given away. How much control is too much? There is no clear answer. The plethora of powers a grantor can retain control over, including naming persons to serve in various fiduciary and quasi-fiduciary functions (e.g. investment adviser, distribution committee), each increases the risk of a FAPT, or even a domestic asset protection trust which may be pierced for claimants. Bottom line: old and cold is good, but the less control the better.

o Investments: If you are a fiduciary investing trust, estate or a ward's assets, you must exercise caution to document the investment decision making especially when holding a concentrated stock position. In a recent case, Estate of Charles G. Dumont, 791N.Y.S.2d 868 should, although the charge against the corporate trustee was reversed, serve as another reminder to fiduciaries. The Prudent Investor Act governs how fiduciaries invest. You can be held liable if you don't handle investments properly. The standard is one of process not outcome. You don't have to realize a great investment performance result, you have to properly document why you made the investment decisions you did. For non-financial professionals serving as trustees, an annual meeting for the trust and a periodic review by an independent planner or manager issuing a written report, is clearly advisable. Don't ignore the documentation process simply because the trust is holding a fami-