PRACTICAL PLANNER NEWSLETTER
MARTIN M. SHENKMAN, PC
PO Box 1300, Tenafly, NJ 07670
Phone: 201 845-8400
Email: newsletter@shenkmanlaw.com
RETURN SERVICE REQUESTED

First-Class Mail
US Postage Paid
Hackensack, NJ
Permit No. 1121

More Info:

◦**Publications: Practical forms for CPAs (700 pages worth!) - for solos, office sharing, succession, disability planning, hiring staff, managing and growing your practice, merging and terminating an accounting firm. All with explanation and guidance. Shenkman, <u>Life Cycle Planning for the CPA Practice</u>, $98.75 from <u>www.cpa2biz.com</u> or 888-777-7077 (AICPA 2007). Product code 090496. .**

For address corrections, or to be removed from this mailing list, email us at newslet-

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

Planning Potpourri

<u>Sweat the Small Stuff, It Really Matters</u>

Yeah they sold a lot of books with this theory, but the small stuff is really important. You should sweat it. Here's commonly overlooked things you should worry about.

Keep copies of current signed beneficiary designation forms. With bank mergers they disappear into the merger abyss. If you want a pre-deceased child's issue (grandchild) to receive that child's share the document has to provide for this.

Be sure that you've changed beneficiary designations on insurance policies, retirement accounts, etc. post divorce. Don't forget policies provided by work, the safe deposit box, and other small items.

Are your estate planning documents up to date for new children or grandchildren? While most well written documents address these changes (e.g., my children shall include any children born after the date of this will") don't assume so. Dannielynn's mom, Anna Nicole Smith, didn't get it right in her will.

Update insurance policies for current values and assets. When is the last time you had your jewelry and art tallied and appraised? You could be dramatically under-insured and not have key items listed.

What's the maximum liability protection you have? If your estate has doubled in size, and your coverage hasn't been updated since your mother-in-law last visited, your entire estate could be jeopardized by a suit.

Clean up old trusts and UGMAs. Trusts often have ending dates. Children attain the age of majority. Leaving assets in trusts and custodial accounts past their ending date could be a problem. Terminate and wind up trusts, UGMAs and other accounts that have ended.

Update your will for charitable pledges you've signed.

If executors and other fiduciaries have died, or reached a stage where it is impractical for them to serve, update your documents removing them to avoid complications.

Sign an independent document authorizing access to private health information (HIPAA release) so that loved ones can monitor your care .

Have adult kids sign powers of attorney and living wills. PP

Practical legal stuff...
in plain English

VOLUME 3, ISSUE 1
JANUARY 2008

PRACTICAL PLANNER

Martin M. Shenkman, CPA, MBA, JD

Do FLPs (and LLCs) Right!

Summary: Family limited partnerships (FLPs) and limited liability companies (LLCs) are viewed by many as modern day reverse-alchemy able to turn valuable marketable securities into devalued interests for estate tax purposes. A recent case points out (yet again!) that this stuff is not child's play, and risks abound. And as with so many estate, financial planning, asset protection and other techniques, most folks remain their own worst enemy by not taking the time to meet regularly with their advisers, adhere to formalities, and follow up. Yes Virginia you have to come back regularly and meet with that crusty lawyer of yours. This is like making gumbo, all of the many ingredients collectively have to pass the smell and taste test when it's done.

The following discussion is merely a starting point for how to do an FLP/LLC right. In the recent case, *Estate of Concetta H. Rector, v. Comr*. T.C. No. 20860-05; T.C. Memo 2007-367 (12/13/07). Judge Laro again reminds taxpayers that FLPs and Professor McGonagall's Wand are not one and the same. Concetta and her revocable trust formed an FLP with assets consisting of cash and marketable securities, comprising most of her wealth. No significant change in the assets occurred following the formation of the FLP. Concetta made gifts of limited partnership ("LP") interests. When she died she owned a 2% general partnership interest and more than 70% of the LP interests. The Court found that the FLP was really just a mechanism to transfer her assets at death. It was primarily a "testamentary substitute." The Court found that there was an implied understanding that she would have access to FLP assets. The Court noted that no principal distributions were made from the by pass trust for her benefit set up under her husband's will. No surprise there. The kids were simply trying to keep assets out of her estate.

What lessons can be learned from this case and Carnac the Magnificent (he crossed the picket lines to help us):

● While some advisers are now advocating structuring arrangements as a co-tenancies (i.e., without the use of an entity) a co-tenancy may be treated as a partnership under state law. Such an effort may be a vain attempt to highlight lack-of-form over substance. Therefore, if such an alternative is used, still address every issue in this checklist (and applicable case law). Don't rely on using a non-entity approach as a panacea. It won't prove to be.

● There should be a significant non-tax business purpose for the FLP. What a novel idea, a business purposes for a business! Saving estate taxes (and making gifts) doesn't get you any Brownie points. The amazing thing about this requirement is that there are a host of non-tax benefits you can score with an FLP with proper planning. FLPs can be a tremendous tool to protect assets from lawsuits, keep ex-spouse's at bay, open up new investment opportunities, consolidate assets, maintain control, provide business succession planning, and more. Document it.

● The longer before death that the FLP is set up and funded the less it will look like a testamentary substitute (i.e. a mechanism to transfer wealth at death). Since the Grim Reaper doesn't usually send "reserve the date" notices, do it sooner, not later.

(Continued on page 2)

Checklist: Trust Distrib.

Summary: There are lots of ways you can have your trust distribute money to your beneficiaries. Here's a checklist of some of the considerations, jargon and approaches. Too often people view these critical and personal decisions as mere "boilerplate". Doing so may well jeopardize your intended goals for setting up a trust. You need to take the time, and think through the "what ifs" to make it work.

When preparing a trust agreement consider all aspects of distributions decisions. Who should make the decisions. Who are the trustees? Should you provide for a distribution committee to make these decisions? When they should be made. How they should be made. Start with personal details then conform them to meet tax laws. Here are some points to consider:

√ Should there be any limits on a trustee's power to make distributions?

√ Should different trustees have different standards by which they can make distributions? For example, an institutional co-trustee may be given a very broad standard

(Continued on page 3)

...DO FLPS (AND LLCS) RIGHT

(Continued from page 1)

● When the FLP is being set up, have separate lawyers represent different partners. Follow Dr. Phil's advice and make it a "real deal" (maybe everywhere but California). Real deals aren't typically done with one lawyer. Each partner gets her own lawyer (you need to maximize those legal fees). Have each partner's attorney provide written comments which can be saved to demonstrate this. Using Microsoft Word with track changes and comments is a great way to corroborate that the different attorneys and partners each had input. Real deals have negotiated changes, not the first draft simply being signed.

● Purchase and maintain a kit (analogous to a corporate kit). It's a good repository for all the original signed documents. Issue certificates (analogous to stock certificates).

Review: Andrew Wolfe, CPA, JH Cohn LLP, Roseland, NJ.

Publisher Information: Practical Planner is published monthly by Law Made Easy Press, LLC, P.O. Box 1300, Tenafly, New Jersey 07670. Information: newsletter@shenkmanlaw.com, or call 888-LAW-EASY.

● Let the assets you transfer to the FLP age a bit before you make gifts. While in real deals with unrelated parties transfers of equity interests are commonly made at the same table as asset transfers, the courts have stated that time should elapse. At a minimum, all transfer of assets, including proper documents evidencing contributions to the FLP, should be completed before gifts are made. This is why calling your attorney to form and make FLP gifts just prior to year end isn't advisable.

● Have periodic (at least annual) entity meetings. Having your advisers attend the annual meeting (by conference call if necessary to minimize costs). Minutes should be prepared and signed. Have entity operations reviewed by all advisers.

● Persons and entities other than the parents/donors should invest significant assets on the formation of the entity. Having mom put most of her assets into an FLP doesn't look great.

● Some modest distributions in proportion to equity interests should be made to corroborate that the ownership interests are being respected. Get the percentages right. The income tax return for each partner should reflect their actual ownership. This can be tricky during years when the ownership percentages change (e.g. a new partner was admitted, or an existing partner made an additional contribution so that her ownership interests increased). Have your CPA prepare a spreadsheet detailing the changes in ownership interests in such years.

● Don't make distributions to be used to pay ongoing expenses of the parents. Don't make distributions every time mom needs money. Having FLP distributions track Mom's personal expenditures is great proof for the IRS that mom had an implied agreement with the rest of the family/partners to retain the use of the underlying FLP assets for her use.

● Prepare a budget demonstrating that more than adequate resources have been left outside the entity to meet the needs of the parents. No magic numbers.

●

Terms in red defined in the glossary at www.laweasy.com. For e-newsletter sign up at www.laweasy.com.

Negotiations of the transaction is cited in many cases as important.

● Decedent's advanced age and poor health are cited in many cases as negative factors. The concept is that the entity is being used as a will substitute. Obtain a medical opinion of the parent's life expectancy.

● When feasible, contribute non-liquid assets, not just cash and marketable securities. Importantly, whatever assets are contributed initially, the more the nature of those assets change will demonstrate a real pooling of family resources to undertake new and hopefully more financially profitable investments. Personal assets don't belong in FLPs.

● Have a pre– and post-contribution investment analysis completed, and

...CHECKLIST: TRUST DISTRIBUTIONS

(Continued from page 1)

("comfort and welfare") while an individual trustee may be limited to maintaining a beneficiaries lifestyle ("ascertainable standard"). You may view the institution as a stronger decision maker that won't be pressured by a beneficiary in the same manner as a family member trustee.

√ It's common to limit distributions to the beneficiaries Health, Education, Maintenance and Support ("HEMS" – cause tax lawyers need more acronyms to keep clients confused), what the tax law calls an "ascertainable standard". This is loosely translated as maintaining the beneficiaries "standard of living". Lot's of people are comfortable with this standard for distribution, but what does it mean? What is a beneficiaries standard of living? When should it be determined? When you sign the trust (or will creating the trust)? After you die? After Junior starts spending that big insurance policy he collected after your death?

√ How should the trustee balance distributions to multiple current beneficiaries of one trust? It's common to name a surviving spouse and children all as beneficiaries of a by-pass trust (intended to safeguard the current $2 million federal exclusion, or often a lower state exclusion, from tax in the surviving spouse's estate). Who should be favored?

√ How should the trustee balance distributions when there is a beneficiary (e.g., your third spouse) and remainder beneficiaries (children of your first marriage) of one trust? Some guidance as to how the trustee should balance distribution decisions should be provided. Who should be favored if anyone? In some cases a unitrust approach is advisable (e.g., pay 4% of the value of the trust each year to the spouse, the remainder on her death to the children). It's reasonable and clear. But often it's too simplistic and rigid to accomplish your goals. If so, you need to provide parameters.

√ Who should be included in the definition of beneficiaries? If your children are named as beneficiaries of a trust, what about their children (although GST issues will have to be considered). How do you define grandchildren? Should adopted children be included? Others (child's spouse or partners)?

√ Should the other resources available to a beneficiary be considered? If grandma set up a trust to pay for you daughter's lifestyle should the trust you set up distribute what effectively will be a duplicative amount? Must a beneficiary's assets be invested?

What about a house? Should a beneficiary be required to take out a reverse mortgage (or otherwise tap home equity) before the trust can pay out? If you mandate that support be considered this could be a risk. If your spouse is a beneficiary of a by pass trust (not included in her estate) and the QTIP trust (marital trust taxed in her estate) mandates distributions consider all resources, increasing the distributions from the by pass trust will effectively increase the tax on her death. Is that the intent?

√ Must all beneficiaries of a trust be treated equally? Equal sounds simple and superficially "fair" but does nothing to account for changed circumstances, different needs, etc. If

RECENT DEVELOPMENTS

Summary: When costs are incurred to start or restructure a business, there are several ways these costs may be treated for tax purposes. Costs that benefit a future period generally cannot be deducted currently (they're capitalized). Exceptions exist. A recent private letter ruling clarified some issues.

● Sec 165: If a business fails than costs incurred may be deducted as a loss if the endeavor is abandoned. Rev. Rul. 73-580. ● Sec. 195: Start-up costs are incurred to investigate, acquire, or create an active business before the date on which business begins. Rev. Rul. 99-23. These are costs incurred after the investigatory process has determined that a particular business should be bought or set up, but before the business actually begins. Examples include advertising costs, fees paid to consultants, and professionals, etc. ● Sec. 248: Organizational costs are expenses incurred in forming a corporation (incident to its creation, chargeable to capital, and of a type that, if the corporation had a limited life they would be amortized over that life). Sec. 248(b). Examples include attorney fees, accounting fees, organization meeting, and fees paid to the state for incorporation. The corporation can elect to deduct up to $5,000 of these costs, and amortize (ratably deduct) the remainder over 15 years. ● Sec. 263(a): Costs of a restructuring generally must be capitalized. ● PLR: The IRS rejected taxpayer's argument that certain investigation costs were Sec. 195 start-up costs eligible for amortization under Rev. Rul. 99-23. The taxpayer evaluated divisive reorganizations but Rev. Rul. 99-23 is limited to acquisitions of a new business. Costs incurred to investigate and pursue non-mutually exclusive business restructurings (multiple separate transactions) that were not consummated are deductible under Sec. 165 as a loss when each potential option is abandoned. These could include a recapitalization, spin-off of a business division, or the divestiture of a division. Costs incurred to investigate and pursue mutually exclusive transactions must be capitalized as part of the costs of the completed