PRACTICAL PLANNER NEWSLETTER
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Planning Potpourri

GRATs and Grandkids: Grantor Retained Annuity Trusts are a great technique to leverage gifts to children without gift tax. They're not used for grandkids because you can't allocate GST exemption to avoid the Generation Skipping Transfer tax on gifts to grandkids until the GRAT ends, and by then the property has likely appreciated. If you've used up your $1 million lifetime gift exclusion, made no gifts to grandkids, and don't contemplate future large gifts to grandchildren, you might use a GRAT to leverage gifts to grandkids even if the allocation of GST exemption at the end of the GRAT term is inefficient. Caution: estimate the growth in GRAT assets to avoid exceeding the $2 million GST exclusion.

Avoid Estate Litigation: Maintain consistency in your planning and documents. If you make equal gifts to your heirs while alive, then equal bequests to them in your will when you die, there really isn't likely to be much issue if an agent under your power of attorney makes equal gifts to the same people if you're disabled. However, if into that equal mix you deed your home to your eldest daughter, the question is why? There may in fact be nothing untoward in that your daughter lived in the home with you and cared for you full time while your other children didn't. So you made one special provision for her. But how will other heirs know that was the case, rather than your daughter merely manipulating you during a weak moment. Address inconsistencies in gifts, bequests and planning documents in a manner that makes it clear that those differences are intentional. Sign a gift letter explaining the rationale for the gift. File a gift tax return. This will also reconfirm the gift many months later when the return is due. At yet another date sign a new will that expressly acknowledges the prior gift and that you intend that your remaining assets should be bequeathed equally. If you include a favorite nephew in those who can receive gifts under your power of attorney, but not in your will, expressly state in the power the maximum gifts that can be made to him. Address differences explicitly and with detail to avoid fights and challenges later.

Beneficiary Designations: Horror stories of lost forms abound. Make a copy for your files as well as send a copy to your CPA for his permanent file for you, and your estate planner. Better yet, have the professionals review the forms to be sure they accomplish your goals. PP

Practical legal stuff... in plain English

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PRACTICAL PLANNER

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Succession Planning for Solo Professionals

Succession Issues for Solos: Physicians, dentists, accountants, attorneys, etc. often practice alone - "solo". Special planning is required in the event of your disability or death. The half-life of your solo professional practice in your absence is short. Without advanced planning the economic value you might receive if disabled, or your heirs if you die, will evaporate. Your patients/clients may be irreparably harmed if you don't have a succession plan in place. If another professional cannot step in quickly, a critical tax, court, or other, deadline could be missed. If patients/clients aren't advised quickly to make alternate arrangements, or if records cannot be transferred quickly, problems can occur. There are significant differences in planning for each profession, so the general comments below will need to be tailored for you.

Transitions to Plan for: There are many events you have to plan for:

o Temporary Disability: If you are unable to practice for a few weeks or months as a result of illness, surgery or other matters, what happens to your patients/clients? What happens with your practice? You need to bridge your practice operations for this limited duration absence. Emergencies need to be tended to, but many matters may, with proper communication, be deferred until your return. Bills need to be paid, but major financial decisions can often wait. Failing to plan, however, can have catastrophic results. Patients/clients fearing the worst may simply leave. Reassurance from a covering professional may keep most or all of your practice intact.

o Permanent Disability: If you will not return for a long or indefinite duration, your practice probably should be sold (if feasible). This may best serve your patients/clients and preserve some economic benefit to you, or your heirs. Your planning needs to address the dividing line between temporary and permanent disability. The line may also differ depending on how "solo" you are. If you are truly solo, with no professional staff, the time period before sale of your practice is much shorter than if you are "solo" as the only equity professional, but have associates that can maintain the practice for a longer period.

o Death: This is the contingency most often planned for because its simpler to address -- no definition issues as with "disability"!, and if life insurance is affordable, the solution is easy. But you need more. Your patients/clients must be transitioned, charts/files returned, and if possible, your practice sold to provide your heirs some economic benefit from your years of work. This requires a succession plan, and generally an arrangement with another professional to assist through the transition.

o Retirement: An exit strategy needs to be developed years in advance of your proposed retirement. You could sell the practice to another practitioner, have an associate buy into the practice (often in some type of sweat-equity or salary reduction arrangement), sell the practice to a larger firm, or simply wind down the practice by transitioning patients/clients to other practitioners and limiting your work gradually to zero.

o Other Events: Suspension or revocation of your license will also destroy your practice. However, it may be feasible to transition to another licensed practitioner to liquidate, or if feasible, sell, it.

Special Issues Professionals Must Consider: Succession planning for licensed professionals differs from planning for other businesses. The expertise of another licensed professional (perhaps with the same specialty) may be required to transition your

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Checklist: Misconceptions

You can't plan properly if your basic assumptions about planning are wrong. You'll never *really* hear what your professionals are telling you if you're filtering their advice through faulty misconceptions. Following are some common misconceptions:

√"I want to avoid probate": Many become so focused (obsessed) about avoiding probate that real planning isn't done. Avoiding probate makes sense in some circumstances, but it's rarely your most important goal. Many assume their revocable living trust accomplishes all they need. It doesn't. Solution: Take a broad and holistic approach to planning that addresses all your goals. Be sure your plan addresses: sufficient funds for an emergency and retirement, asset protection, proper insurance coverage (not just life, but property and liability), management of your assets in the event of disability, and so on. If you have a rental property in another state, transferring it to a living trust may avoid probate, but not liability issues. Using an LLC to own the property may accomplish both.

√"I signed my documents": Signing documents does not complete your planning. Almost every planning docu-

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...Succession Planning for Solo Professionals

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practice. In many cases ethical restrictions of your profession will have to be addressed with great care during the transition. For example, your power of attorney may not suffice because your named agent may not be a licensed professional and can't address practice succession. The ethical rules of your profession may prohibit a non-licensed person from seeing practice records. While your agent can hire a licensed professional to transition your practice, addressing this issue directly is best. Patients/clients may own their charts/files and may have to be returned which is a costly responsibility (e.g. for lawyers see ABA Formal Opinion 92-369). Strict confidentiality rules may making succession planning more difficult. Malpractice coverage may be required for your practice following your disability or death, and the professional helping transition your practice. If you had claims made coverage a tail policy may have to be purchased once you are permanently disabled or die. If the professional helping transition your practice continues to see patients/clients for his practice, he'll need coverage for that. Will his policy also cover work he does for your practice? Will your policy provide protection for his efforts? Is another policy needed?

Arrangements For Transition: There are a myriad of ways to structure deals:

o Agreement with Colleague: A common approach for solos is to sign a simple arrangement with another independent practitioner. Often these are reciprocal – another solo needs a transition plan and agrees to cover you, if you cover her.

o Operating Agreement: If your practice is an LLC a modified operating agreement can provide the transition for your practice. You can be the sole member (owner) and manager of the LLC. The agreement can list the powers of each. Then, in the event of your incapacity or death a successor manager can be named and the agreement can provide for the transition to your named successor as manager. This approach has the advantage that banks and others understand operating agreements and the role of manager, so the authority given may be easier for the professional to implement.

o Agreement with an Associate: If you have an associate in your practice, his employment agreement, or a separate agreement, can be used to provide him the authority to manage your practice during a transition.

o Consulting Agreement: You might create a more formal arrangement with another professional, even listing them on your letterhead, in the capacity as a consultant ("of counsel" for attorneys), and address succession in that agreement. An advantage is that your patients/clients will have seen the successor's name well in advance of an issue arising. If this approach is used verify with your malpractice carrier if any additional steps are required.

o Patient/Client Agreement: Any agreement you provide patients/clients (e.g., retainer agreement or engagement letter) might indicate that you have a succession arrangement in place that conforms with the requirements of your profession, and that the patient/client is agreeable to it.

Personal Documents: Your power of attorney could expressly prohibit your general agent from addressing practice issues and instead name a licensed professional to handle practice matters. Alternatively, you could sign a durable power of attorney for personal matters, which precludes your agent from handling practice matters, and sign a separate durable power authorizing a named licensed professional to manage your practice during a transition. This could include express requirements of the professional agent to abide by all applicable ethics rules, etc. The powers given to the agent should address management during disability, and sale if your disability becomes permanent. Your will should designate a special fiduciary, not your general executor, to handle all practice matters, including managing the practice and negotiating the sale of the practice. Specific powers can be granted in your will (or revocable trust) to facilitate this (e.g., powers to operate a business), and the fiduciary should be obligated to adhere to all ethical, confidentiality and other rules of your profession. PP

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...Checklist: Planning Misconceptions

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ment will require regular follow through for it to be effective. Trusts need assets transferred to them (what good is an insurance trust if it doesn't own insurance?). Documents need to be kept current (property and other laws change frequently, not just tax laws). The ownership (title to assets) needs to be adjusted to conform with your plan. Corporations should have annual minutes. And so on. Solution: Make up a "To Do" list with your estate and financial planner and be sure you don't stop until each item is checked off. Then meet once a year and get a quick review and update to be sure all issues are addressed and new ones tended to. It's a lot cheaper heading problems off at the pass then leaving them to fester.

√"I have a will and life insurance": Planning is not only about dying. Estate planning should address retirement, disability, lawsuits and lots of other things that "go bump in the night". Failing to do so will give you a one dimensional plan, which is never enough. If you have the world's greatest will, but run out of money before you die because your investment planning is way off base, the will is useless. Solution: Involve all your advisers in your planning process. The best way is a big board meeting of key family and advisers. The cheap way, meet with your key planner and have him or her conference call the other advisers as needed. That will assure that your accountant, attorney, financial planner, insurance consultant all weigh in so that your plan addresses all aspects of your life, not just death.

√"My Uncle Joe will handle everything": Assuming friends and family are reliable and trustworthy can be true, but not every uncle is a Jim Anderson (Father Knows Best). Relationships change, the pressure people are under can change, so caution is important. Solution: Name co-trustees to have a check and balance. Consider naming an institution in appropriate situations. Provide detailed parameters as to what the various fiduciaries can do. Another example, make the guardian of your children a co-trustee so she can have input, but name another independent person as co-trustee with the guardian to have a check and balance. Instead of relying on a power of attorney, fund a living trust with successor co-trustees. For more sophisticated trust planning, name a Trust Protector, who can be authorized to replace trustees and take other actions to provide another safeguard.

√"We've planned for the estate tax": So your will has a by pass trust and you've bought some life insurance. That's great, but the estate tax is not the only tax you have to plan for. Income tax issues are a significant factor in estate planning. If you avoid the estate tax on mom's house through a gift plan, but you end up with a large capital gains tax when you eventually sell, you may be better off than had you done no planning, but you haven't really achieved the goal of reducing all taxes. State income, estate and inheritance tax can be significant too. Solution: Involve all your advisers, especially your accountant. Be sure your estate planner talks about income taxes, not just estate taxes. Remember assets given away during life will be subject to the same tax basis as the donor (carry over basis), whereas assets retained until death will avoid capital gains tax (stepped up basis). PP

Recent Developments

Home Sale Exclusion: You can exclude from gross income up to $250,000 ($500,000 joint) of gain from the sale of your principal residence. To qualify you have to have owned and used the home for 2 of the 5 years before sale. Also, the exclusion can only be claimed once every 2 years. An exception is provided if you do not meet the ownership and use tests, or the limit of one sale in two years, as a result of a change in place of employment, health, or unforeseen circumstances. IRC Sec. 121(c). Unforeseen circumstances include: involuntary conversion (e.g., fire), death, divorce, or other situations deemed appropriate. Reg. Sec. 1.121-3(e). The following factors will be considered in determining if another circumstance qualifies: The sale and the circumstances giving rise to it are close in time; the suitability of the house as your principal residence materially changes; your financial ability to maintain the property is materially impaired; the circumstances giving rise to the sale were not reasonably foreseeable when you began using the property as your principal residence; and the circumstances giving rise to the sale occur during the period you in fact own and use the property as your residence. Reg. 1.121-3(b). In a recent ruling the IRS held that the commission of a violent crime against a homeowner at his home justified a sale and waived the requirements. PLR 200630004. A reduced exclusion applies to gain from the sale of the home. The $250,000/$500,000 maximum exclusion is multiplied by the following fraction: The numerator is the shortest of the following three periods: the period you owned the property during the 5-year period ending on the date of sale; the period you used the property as your principal residence during the 5-year period ending on the date of sale; or the period between the date of the prior sale or exchange of property for which you excluded gain under Code Section 121 and the date of the current sale. This period is divided by 730 days. The result is the allocable portion of the exclusion you can claim. PP