PRACTICAL PLANNER NEWSLETTER
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· Estate · Tax · Business · Personal
·Financial ·Asset Protection

Planning Potpourri

Crummey is Bad with a Special Child: If you have a grandchild with special needs it's a common recommendation to set up a third party special needs trust (SNT) under your will to help care for the special grandchild. Instead set up the SNT now while you are alive (an inter-vivos trust) so it is something that is more tangible. That will help family understand better what was done. Also, an inter-vivos trust could serve as a receptacle for any family member that wants to help. Caution well meaning family members not to give funds outright to the special child. Don't casually include a Crummey power (right to withdraw so gifts qualify for the annual exclusion) in the trust since it could affect the special beneficiary's qualification for government benefits.

Crummey is Good with a Successful Child: If Junior is an entrepreneurial wizard recommend she not own her next start up entity. Why have it subject to estate tax if the business is a success? Some might transfer the newfound business to a trust for their children (your grandchildren). But they can do better. You as the parent can set up an irrevocable trust with $5,000 giving son a Crummey power (the right to withdraw to qualify for the annual exclusion and grantor trust status) and let son sell equity interests to this trust. This is a beneficiary defective irrevocable trust (BDIT) as to daughter, and she will be the owner (grantor) of the trust for income tax purposes. Keep assets in this trust for the duration of your daughter's life to avoid any marital issues.

The Crummey Kid: In Terrorem Clauses are common. If an estate is large enough provide some real dollars behind an in-terorrem clause. A $500,00 bequest to the bad child, subject to loss if the in-terorrem clause is violated, has some teeth. If your estate is worth $10 million, as a percentage of the estate it is modest. Do a new will every six months so you create a pattern of consistent bequests. Have a memorandum of why a child was treated differently, and explain to witnesses why you are treating one child differently.

Escape Hatch: Negotiate termination fees with an institutional trustee when you're setting up the trust. Be sure the exit isle is clear. Some institutions charge costly back end fees to terminate a trust (maybe you don't want a trustee that would present that as a starting point). Have the arrangements agreed to memorialized in a fee agreement. PP

Practical legal stuff... in plain English
www.laweasy.com

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PRACTICAL PLANNER

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

Nuggets from Heckerling

Summary: The Heckerling Institute on Estate Planning is the estate planning world's equivalent of the Oscars. Can you imagine anything more spellbinding then nearly 3,000 tax attorneys discussing estate tax planning for an entire week? Well, if you missed all the excitement, we've culled some hot tips from the week long extravaganza! We've kinda violated our Newsletter's usual format a bit. Please forgive us but there were so many pearls to share.

Funky Gifts: Interests or rights you may hold may cause estate tax inclusion at death. These rights might include: a retained life estate, the retained power to vote stock in a closely held company, the power to remove and replace a trustee, incidence of ownership in life insurance, etc. Now is an ideal time to review existing estate planning documents, especially those dusty old trusts that have not been given any love by your estate planner in years. Gift or terminate these rights now.

Family Harmony: Equalizing family lines. If clients have made annual exclusion gifts to children, spouses, and grandchildren, etc. over time the different family lines may have become quite unequal. Some clients would like to equalize. The $5 million exemption affords a great opportunity to do this.

Liquid Diet: Everyone loves to stretch an IRA and lots of planning is done to accomplish this tax wonder. But does it work? An AXA study concluded that 87% of children liquidate an inherited IRA within one year of death. All the great planning is really pretty much for naught! Glucosamine might help those joints stretch further.

Surviving Spouse and IRA: Surviving spouses can rollover an IRA (and rely on portability to preserve the estate tax exclusion of the deceased spouse). While rollovers are the cat's meow for most estates, there are times when it's not advisable. Say the surviving spouse is young, say 49, and she will need money from the IRA for living expenses. If she withdraws money from a rollover IRA she'll get nailed with a penalty. So, when a surviving spouse plans to roll over her deceased spouse's IRA and she's under 59 ½, it may be prudent to leave enough money in the deceased spouse's IRA account to cover the withdrawal's she'll need until she reaches age 59 ½ to avoid penalties. So a partial rollover may be the wiser move.

Appreciate Portability: If you die and didn't plan properly (title to assets, appropriate trust under your will) then your surviving spouse (wife) could lose out on your estate tax exclusion. But under the 2010 portability rules, your wife might be able to benefit anyway since your exclusion may be available to her through portability. Most tax attorneys pooh-pooh portability because appreciation in assets after your death are not removed from your wife's estate, whereas it would be if your assets instead are transferred to a bypass trust to benefit your wife. Assets in a bypass trust can appreciate yet remain outside of your wife's estate. But if a big chunk of your assets are in IRAs and those fund your bypass trust, the mandatory distributions your wife will have to take out if the trust is structured as a conduit bypass trust, significant dollars may flow out of the bypass to your surviving wife's estate even using a bypass trust. So portability ain't so bad. The moral of this tale is that generalizations on planning are dangerous. You need to consider the specific assets, the realistic likelihood of appreciation, spending patterns and more. If that kinda sounds like the wealth manag-

(Continued on page 2)

Checklist: More Nuggets

√ Your Tax Reimbursement Clauses Might be Dangerous: Some grantor trusts (income taxed to you) include a provision that permit the trustee of a trust you create to reimburse you for taxes you pay on trust income. If reimbursement is mandatory, Go To Tax Jail, Do Not Pass Go. It causes inclusion in your estate. So does that mean a discretionary reimbursement is guaranteed not to cause inclusion of trust assets in your estate? Not so fast Charlie. If your creditors cannot reach the trust assets under state law the trust assets should not be included in your estate. But (all tax rules have a "but") so long as there was no implied understanding between you and trustee. An actual pattern of distributions (e.g., taking all income, having all taxes reimbursed over a number of years) would probably sink your tax ship. But what if you and the trust sell stock in closely held business that you had used to fund the trust and you immediately get a tax reimbursement? Was there an understanding from the get go that you'd get the tax paid by the trust? Most folks probably don't want these clauses anyhow since the tax payments reduce your estate. There are other options. Don't let the trust reimburse you and thereby give the IRS the right

(Continued on page 3)

...NUGGETS FROM HECKERLING

(Continued from page 1)

er needs to be involved in tax decisions advance to Go and take $200.

Estate Planning for the Producers: Why limit the percentage interest you sell in a play to a mere 100%? Too often, even the smartest benefactor's estate plan seemingly tries to give Mel Brooks a run for the money. Estate contests often involve conflicting agreements. Contracts often trump trusts or wills. The most common is the title to assets. So your will created a great trust for Junior, but the specific assets you intended to bequeath to Junior's trust were owned jointly with your yoga instructor. She wins, Junior loses. But this can be even more fun. Perhaps your separation agreement with a former spouse obligated you to bequeath that particular asset to her or your children. What if there is a buy sell agreement that obligates your estate to sell the business interests involved to a partner for a set price. Could you have inadvertently contracted for 400% of the asset involved? Mel Brooks got laughs when he did it, but you probably won't. Ancillary documents shouldn't be treated like Rodney Dangerfield.

Transformer Trusts: Often you can transform a trust under the terms in the trust document. If you and your spouse each set up a trust for the other that are so similar, the IRS might argue they should be unraveled and you should be treated as having set up your trust and your wife as if she had set up hers. The theory the IRS would use to ruin your trust plan is the "reciprocal trust doctrine." If both you and your spouse were trustees of the other's trust, you can both resign and if both live three years that might solve part of the problem. Trustees might change trust asset, Some states, like New York permit the amendment of an irrevocable trust. If the grantor is alive, and all the parties to the trust contract agree, they can change the terms.

Settle Estate Fights with Uncle Sam's Help: Estate wars can be costly and bloody. But sometimes your Uncle can help. The income tax considerations can be significant and may help save the day. Property received by gift or bequest is not subject to income tax. But if the estate is in a high income tax bracket, and beneficiary is in a low bracket, playing the spreads can add dollars to the pot used to settle estate challenges. What if you can structure the settlement as damages or payment for services. The estate may obtain a deduction at a relatively high tax bracket, and the beneficiary may recieve the payment and report it as income at a much lower bracket.

DSUEA – Gesundheit! DSUEA is "Deceased Spouse Unused Exemption Amount." This is the amount you can get to use of your deceased spouse's exclusion. The portability rules include the concept of privity. If H-1 dies, W-1 can use his exclusion, but if W-1 remarries to H-2, H-2 can "inherit" W-1's exclusion but not the exclusion H-1 "gave" to W-1. Or can he? W-1 can use H-1s exclusion if she makes lifetime gifts. If W-1 remarries to H-2, can H-2 join W-1 in gift splitting? Gift splitting enables one spouse to make a large gift and have the other non-donor spouse treat the gift as if were ½ theirs. Can H-2 make a gift and split gifts wth W-1 thereby using some of H-1s exclusion to cover a gift by H-2?

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Big Brother is Watching: So you gave your vacation home to the kids. Shhhhh. Don't tell the IRS or your CPA. Surprise! IRS has recently looked at property transfer records in 15 states. More perhaps to come. The IRS has found 60-90% of gratuitous non-spousal real estate transfers were not reported on gift tax returns. If you made a gift transfer of real estate, say to your kids, and …. Oooops forgot to tell your CPA to file a gift tax return, fess up before big brother catches you! File the missing gift tax return. For most donors there is not likely to be a gift tax because of current $5 million exemption. And don't think that your bad deed ends with that one return. If you make future taxable gifts and have to file gift tax returns, those future returns have to disclose your prior gifts. This means all future gift tax returns would also be incorrect. If your executor becomes aware of an unreported gift and fails to report them on the estate tax return, that too would be incorrect. This is a snow ball running down hill. PP

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Review: Andrew Wolfe, CPA, Esq.

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...CHECKLIST: MORE HECKERLING NUGGETS

(Continued from page 1)

to raise the "implied understanding argument." Instead, the trustee can loan you money to pay the tax. See PLR 200944002; Rev. Rul. 2004-64.

√ Zapped by a Gift Tax: So here's the law. A donee is personally liable for the tax, even if it is not their gift subject to tax. Ouch! Example: You made a large gift to your new spouse which qualifies for marital deduction – no tax. You make a separate large taxable gift to another donee, your kid from a prior marriage. You're a bum and don't pay the gift tax. Your kid should be liable. But, even your new spouse is on the gift tax hook if tax on other gifts is not paid! This is so even though the gift to her did not trigger any gift tax. IRC Sec. 6324. Here's the reality TV version: Son is named agent under Dad's power of attorney. Dad used up his $5 million gift exemption, then fell ill. Any new gifts will be taxable. Son makes gifts to his siblings of $2 million and to Dad's New Wife of $1 million but doesn't pay the gift tax from Dad's funds as agent or from his funds. New Wife can be held liable for the gift tax of $700,000 on the $2 million gifts to Dad's kids from a prior marriage.

√ Sunrise Sunset: If Tevye was setting up a dynastic trust today he might want to consider one trust for $1,390,000, the $1M inflation adjusted GST amount, and a second trust for the excess of the current 2012 $5,120,000 GST exemption amount over the $1,390,000 in a second trust. If the GST rules sunset in 2013 this might provide greater certainty. Use separate trusts to address potential risk of GST rules sun-setting. Don't create trusts simultaneously in case there is an ordering rule. You could contribute the balance of your GST exemption to a direct skip trust (no non-skip beneficiaries like the kids are included), and do it in 2012 while the law is clear. What is affectionately called the "move down rule" should lock in your GST move. IRC Sec. 2653. Even if the GST rules sunset after 2012, the GST event that closed the year before. Importantly, if sunset happens, the grandchildren beneficiaries of that trust are not skip people for future years because of application of the move down rule.

√ No Backsies: Not All Roth's Are Created Equal: If you do an in-plan rollover of your 401(k) into a Roth account in that plan, it could be a tax homerun. But, just as with a conversion of your traditional IRA into a Roth, you have to pay income tax on the value of the plan in excess of your basis. But with an in-plan rollover, you can't change your mind like you can with a conversion of a regular IRA to a Roth. If plan assets decline in value you lose!

√ Just Say No Doesn't Always Work with the Tax Man: If a loved one is diagnosed with Alzheimer's disease plan and act quickly. Address elder care issues quickly while he still has testamentary capacity. If you have sufficient capacity (competence) sign a medical proxy, will, power, etc. Your spouse's will should set up a trust for your benefit in case he or she predeceases you. This trust should be a special needs trust. Don't rely on portability. Many people assume the spouse with Alzheimer's will die first and if he or she can disclaim assets bequeathed from the other. In New York a disclaimer is not treated as a fraudulent transfer by disclaiming beneficiary, except for Medicaid. This is the minority rule, so it might work elsewhere. PP

RECENT DEVELOPMENTS

The IRS has sought to prevent taxpayers from restructuring a business post-death and using a lower alternate valuation date value (valuing assets 6 months after death instead of at death), and to then game the estate tax system. The prior proposed regulations described events that would be ignored for estate valuation purposes. New regs identify events that will accelerate the asset valuation date prior to what would otherwise be the six month alternate valuation date. Exceptions for transactions that occur in the "ordinary course of business" that don't change the business ownership structure, are provided.

The power to acquire a life insurance policy in non-fiduciary capacity from a trust, so long as the trustee can require the determination of an appropriate value, will not cause estate inclusion under IRC Sec. 2042. 2011-28.

Mom set up a 3 year QPRT. At end of the QPRT term she should have moved out or paid rent. The children said mom intended to pay rent but just hadn't gotten around to getting a lease or actually paying. But mom died before year end. Mom had even paid house expenses post QPRT termination. Somehow the QPRT was upheld by the court. Estate of Riese. This result was pulling a rabbit out of the proverbial audit hat. Don't count on t.

Taxpayer made a transfer using a defined value clause that would cause any increase in value on a tax audit to be paid to a charity. The charity, a donor advised fund, had independent counsel and engaged an independent appraisal. Hendrix. Defined value clauses are not simple or assured.

The step transaction doctrine can be used by the IRS to torpedo all sorts of estate plans. If you discussed with your advisers setting up a trust and making gifts before the $5 million exemption changes. Then you formed an LLC and transferred assets to an LLC. After that you make a gift of LLC interests to the trust. If the IRS can demonstrate that this was all part of one integrated plan, and each