PRACTICAL PLANNER NEWSLETTER
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More Info:

- **Publications:** Sign up for an e-version of this newsletter at www.laweasy.com.
- **Seminars:** Bergen Community College – 4 upcoming sessions: **May 10** -- Post-Season Tax Update: Gift Tax Compliance; **June 14** -- FLP and LLC Tax Planning, IRS FLP Audits; Foreign Reporting with Lawrence Horn, Esq. and Richard Sapinski, Esq. both of Sills Cummis & Gross P.C.; **July 12** -- Tax and Estate Planning Tips and Techniques: Checklists; **August 16** -- Estate Planning and Matrimonial Issues. To register or for info call: 201-447-7488. 3 CPE and CFP credits awarded per session. Podcasts posted on www.laweasy.com.

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Planning Potpourri

Gift Tax Blues: So you filed a gift tax return to report the zillion dollar zeroed out GRAT (say the gift value was a buck so you could report it). Good move (even better move to make the annuity payments on a timely basis!). Your CPA attached so many documents to meet the adequate disclosure rules that a fork lift was used to file the return with the IRS. Good move. But as Charlie Tuna knows, not every Tuna gets to be Starkist and toll the statute of limitations (the time period when the IRS can assess gift tax). Did you report all your charitable gifts? According to some commentators the tax Regulations suggest that the gift tax return charitable deduction requires donations be reported. What if you don't? Code Section 6501(e) says that if you don't report more than 25% of your gifts the statute of limitations on the entire return is extended from 3 to 6 years. So the IRS might be given 6 years instead of 3 to bond with you over the gift tax return you filed reporting a zillion dollar GRAT. Avoid this risk by reporting contributions.

Care Bear: Everyone thinks of their attorney, insurance agent, and CPA when thinking of their estate planning team. But many folks need a bigger cast to make the playoffs. Effective planning may not be achieved, if you're on in years, have a significant health issue, or don't have close reliable family members. More is needed. In many instances adding a care manager (RN, social worker, geriatric consultant or similar professional) to your team can be the key to your security. Helping you better present and explain health issues to those you must interact with, even direct consultation with key family members, can be an important role for the care manager to fulfill. A care manager describing the physical and psychological implications of your health status to others on your estate planning team can be invaluable in assuring that documents and planning are tailored to best serve your evolving needs. The care manager can help develop a plan for your care for the future, and help your estate planners craft the mechanisms to assure that the plan will be implemented.

2010 Trusts: If you signed a trust in 2010 before the 2010 Tax Act was passed call your planner and confirm what must be done, if anything, to be sure your trust has the desired GST status. Planners tried to anticipate the unknown tax law in lots of creative

Practical legal stuff...
in plain English

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PRACTICAL PLANNER

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Ode to the Trust – 2nd Sonata

Summary: Here's Part 2 of the, can't catch your breath topic, how to operate your trusts. Folks think if they've signed a trust they're done, but as the Carpenter's sang: "We've only just begun." Follow through is essential to achieve any personal, tax, or legal objectives. This article highlights a few of the myriad of matters to address. If you don't heed the follow up warning when the IRS/claimant comes a knockin, your estate planner will be singing Buddy Holly words back at ya: "Don't come back knockin' at my office's closed door."

Income Tax Filings: **Form 56** notice of a fiduciary relationship should be filed with the IRS office where the income tax Form 1041 is filed. File Form 56 When: The first return for a trust is filed; When there is a change in trustees (as a new trustee you have personal liability for unpaid taxes and if the IRS has no notice of the trustee name and address tax notices could be missed); On termination of a trust (attach the document terminating the trust). Keep a copy of every Form 56 in the trust permanent file. **Estimated Tax** Non-grantor trusts may be required to make estimated tax payments. Determine whether the fiduciary should elect to have any of the estimated tax allocated to the beneficiary (e.g., if distributions result in the income being passed out to the beneficiary who as a result may have underpaid his/her estimated tax). File Form 1041-T by the 65th day after the trust's tax year. **Grantor Trust Reporting** - which method will be used to report income: 1) some accountants don't file – bad move; 2) some CPAs use a bare bones "skeleton" return - a Form 1041 with only a statement: "This trust is a grantor trust and all income and deductions are reported on the grantor's income tax return Form 1040, Social Security No. 111-22-0000); 3) Some CPAs attach a complete schedule of income, deductions, etc. with a statement – better still. For legal and tax purposes detailed disclosures demonstrate the independent operation of the trust, and confirm which assets the trust owns.

Grantor Trust Status: **Is it or Isn't It**: Determine whether the trust is properly characterized as a grantor trust for income tax purposes. **Tax Version of the Clapper**: "Clap on Clap off, the Clapper!" Who could forget that memorable moment of Americana. Some grantor trusts are inadvertent, others intentionally include provisions to turn grantor trust status on or off (toggle) and you must confirm which direction the switch is flipped to for the tax year involved. **Lay Down Sally**: Bet you never knew Eric Clapton was a CPA? SALY (same as last year) the favorite phrase young CPAs use in their work papers, is not a valid explanation, for why a trust is a grantor trust. Too often the prior year return may not have reached the appropriate conclusion. Confirm whether grantor trust status has changed from prior years. Obviously if the grantor has died grantor trust status will terminate, but there are less obvious ways the trust's status can change that require inquiry. If the trust relies on a particular mechanism to achieve grantor trust status, such as the right to substitute assets or add charitable beneficiaries, if those rights were waived, grantor trust status might have terminated. There should be a clear note in the trust records as to why the trust is classified as grantor or non-grantor trust. Ideally, obtain a confirmation for the trust records from the various fiduciaries as to which specific powers were waived, exer-

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Checklist: Physician Letter

Summary: Physician letters are commonly obtained for a myriad of estate and financial planning matters. Determining maximum sustainable spending rates should not ignore real life expectancy. If you're planning a sale of assets for a private annuity your current medical status is important. If the you have a shortened life expectancy the actuarial tables that are normally used to calculate the annuity amount may be inappropriate to use. Rev. Rul. 66-307, 1966-2 C.B. 429; Treas. Reg. Sec. 1.7520-3; 20.7520-3(b)(3). But too often medical letters are a generic non-committal paragraph that get stuck in a file but don't really corroborate what is required. What should these medical letters address? Consider the following checklist as a starting point to be tailored to the particular planning goals and your health.

√ **Medical History**. Provide a general medical history beginning at least several years prior to any contemplated transactions, not merely a current snapshot. Too often medical letters describe a patient's current status and nothing more. This can often be inadequate. The history will help establish a baseline of the status of your medical

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...ODE TO THE TRUST – 2ND SONATA

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cised or not exercised. This extends well beyond the determination of grantor trust status and can affect many significant aspects of the trust. For example, if a person is granted the authority to add a charitable or other beneficiary, did they? An affirmative executed statement confirming that they did not is probably necessary to determine with certainty who the beneficiaries were for the year. The ideal approach is to have an annual trust meeting and have every fiduciary execute a statement annually as to the status of their position and any actions during the prior period.

Passive Loss: If the trust owns interests in entities that generate losses a determination has to be made as to whether the trust is a material participant in those activities such that the losses will be deductible. In evaluating whether a particular taxpayer has materially participated the participation of that taxpayer's spouse is attributed to the taxpayer. Temp. Reg. Sec. 1.469-5T (f) (3). How this test should be addressed in the context of trusts is uncertain. The IRS in TAM 200733023 reached the opposite conclusion as to how this should be determined from the court in The Mattie K. Carter Trust v. US., 256 F. Supp. 2d 536 (Tex. 2003). Advise the trustee of uncertainty in the law and determine what types of disclosure should be made with the return. Time has not resolved this dichotomy. The IRS is sticking to its guns requiring trustees to materially participate. PLR 201029014.

Non-Resident Beneficiary: If there are non-resident alien beneficiaries the trust may be required to withhold income tax on certain distributions. The trustee should be certain to confirm the requirements and have the trust CPA file Forms 1042 and 1042-S if required. The trustee may also have an obligation to file Form 1040-NR for that foreign beneficiary unless the alien has handled the filing or has appointed an agent.

State Income Tax Status: Determine in which states the trust must report income or file returns. Don't assume that last year's determinations necessarily apply. If a trustee, or depending on the state another fiduciary like the investment adviser, moved to a different residence, the determination of which states can tax the trust income may have also changed. The general paradigm (subject to many exceptions and variations) is that a state will tax a resident trust on world-wide income, and a non-resident trust only on income within the state. A trust is characterized as a resident trust based on the residence of the grantor, beneficiaries and/or trustees, and/or on the basis of the situs of trust assets or the specifications in the trust agreement. Some states tax based on residency of the fiduciaries. So depending on the state, if a fiduciary moved, his or her home to a different state, the old state may no longer tax the trust, or tax it less, while the new state may for the first time exert tax authority. Trustees should document the residence of beneficiaries and other factors that may affect this before filing returns.

A change in fiduciaries (trustee, trust protector, investment adviser, etc.), or the location of trust real estate assets, or the operations of an active business in which the trust owns an interest, could all affect state tax nexus. If there's no requirement to file in a state - best not to do so. It's much more difficult to cease filing, then never to have filed if not necessary.

For upcoming seminar info call Bergen Community College at 201-447-7488

Investment and Other Deductions: Expenses of a non-grantor trust may be subject to the 2% of adjusted gross income floor. IRC Sec. 67(e)(1). The rules as to which expenses are subject to this have been subject to considerable controversy.

Gift Tax Filings: Form 709 Filing gift tax return should be considered more broadly then many CPAs have done in the past. It might have been common in the past for CPAs to encourage gifts under the annual gift exclusion (now $13,000) to avoid filing. But as Bob Dylan croons: "The Times They Are A-Changin'." Many practitioners would now recommend a more proactive approach to filing gift tax returns, attaching a complete trust, reporting annual gifts under Crummey powers, attach full appraisals of the assets given, affirmatively allocating generation skipping transfer ("GST") tax exemption (or

Review: Andrew Wolfe, CPA, Esq.

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...CHECKLIST: PHYSICIAN LETTER

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health. It also provides a context to the progression (or stability as the case may be) of your health status.

√ Acute Conditions. If you had or have any acute medical conditions, e.g. pneumonia, these should be indicated and their status explained. Explain the course, medical management and whether or not there are (or expected to be) any residual affects, or instead was there (or is there expected to be) complete resolution? A conclusion that the acute condition should not have a significant negative impact on life expectancy will help.

√ Chronic Conditions. If you have any chronic medical conditions these should be indicated and their status explained. Are they stable? How are they medically managed?

√ Stability. Describe whether from all indications you were in reasonably stable medical condition despite the chronic illnesses or other health issues you were living with and that are described in the letter.

√ Life Expectancy: Do any of your known health conditions independently, or will several in the aggregate, significantly shorten your life expectancy? Specifically, which if any of the conditions create life expectancy limitations?

√ Attention to Medical Care: Do you visit your physician on a regular basis for health care maintenance? How often? Do you see any specialists? Have you sought and received appropriate medical treatment for any health conditions.

√ Medical Regime: What is your medical regime? This should describe what medications you take, how often you take them, when you began taking them, whether you have a special diet (and what it is) or regular exercise program (and what it is)? Are you were compliant with your medical regime? Providing some level of detail, rather than just broad statements, is preferable.

√ Future Testing: Is there any planned medical testing or monitoring that has been scheduled or even recommended after the date of your last complete physical examination? What tests have been recommended, when and for what purpose? Example: If you had an abnormal EKG, is a stress test planned to rule out the presence of ischemic heart disease? What follow-up is recommended? Oftentimes when a patient enters the hospital for even routine surgery, studies are done to rule out pre-existing diseases. Be certain your physician summarizes the results of any such tests as part of the medical letter. This can be valuable if a later acute condition occurs by corroborating that there was no knowledge or even anticipation of that acute condition at the earlier test date.

√ Social Habits: Do you smoke or drink alcohol? Are you significantly overweight? How regularly do you tend to your medical needs? An affirmative statement that you do not smoke or drink in any excess, or use recreational drugs, can be important. If you had engaged in these, or other, activities in the past, the letter should provide a history and indication of when you stopped.

√ Conclusions: If feasible, an affirmative statement that you do not have "an incurable illness or other deteriorating physical condition such that there would be a meaningful impact on normal life expectancy might help. If the letter is to support a sale of your assets for a private annuity, if feasible a conclusion that there is not "a 50 percent or greater proba-

RECENT DEVELOPMENTS

The Cost of Love: Cora lived with Bernie for 22 years handling all household matters, including, cooking, cleaning, and so forth. Bernie must've been listening to Paul Simon's tune (50 ways to leave your lover…) and the couple broke up. Cora filed a palimony suit but Bernie died before the matter resolved. Bernie's estate claimed a deduction for the palimony claim. The IRS disagreed and the case ended up before the 9th Circuit which held that it was likely that Nevada would join other states (e.g., Arizona and California) in finding that homemaking services like those rendered by Cora can be adequate consideration for a property-sharing agreement between cohabitants, and hence a palimony claim. That claim had to be valued as of the date of Bernie's death. Estate of Bernard Shapiro v. U.S. , 107 AFTR 2d 2011-XXXX (9th Cir.).

Time in a Bottle: So you beef 'cause your lawyer keeps time records, but you had best do the same. Losses on passive activities, like owning a limited partnership interest in a real estate rental partnership, are limited as to how they can be deducted. One out is if you meet the requirements to be classified as a real estate professional. IRC Sec. 469(c)(7). This exception from the harsh passive loss rules requires that more than half of personal services performed during a tax year are real property businesses with "material participation", and that you provide more than 750 hours of service for those businesses during the year. The taxpayer kept detailed time records, but failed to meet the 750 hour test. Taxpayer spent 1,003 hours managing real estate, but 324 of the hours were spent on operating a short-term (less than 7 day rentals, like a hotel) rental property. Short term rentals aren't considered a rental activity under the IRS rules. Temp. Reg. 1.469-1T(e)(3)(ii) . 1,003 – 324 = only 679 < 750! Bailey , TC Summ. Op. 2011-22 (Tax Ct.) Remember Jim Croce's lyrics: "If I could save time in a bottle the first