PRACTICAL PLANNER NEWSLETTER
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◦**Publications:** Series of articles on estate and financial planning for those living with a neurologic condition will appear in **Neurology Now**, a publication of the American Academy of Neurology. Great magazine targeted to non-physician's wishing to learn about issues they or a loved one faces. Get a free subscription at www.neurologynow.com.

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Planning Potpourri

Standby-BDIT: With 2013 potentially bringing whopping estate tax increases, bolstered by President Obama's proposals to zap lots of fun estate planning toys (GRATs, discounts, grantor trusts, dynastic planning), what can rich folk do to protect their kiddies future estate plans? Set up a beneficiary defective irrevocable trust ("BDIT") today for each kid and gift $5,000 to it. Use the cheapest trustee you can find in Alaska, Delaware, Nevada or South Dakota. That will create for each kid a trust, the Standby-BDIT, that will hopefully grandfather grantor trust status, GST/dynastic tax benefits, and more. Wow! But just like with the Sham Wow infomercials…There's more! Read on…

The Gift that Keeps on Giving: While the average rich kid should get the folks to set up a BDIT described above, here's an idea that could be waaaay better than a Standby-BDIT (Sorry Dick!)? Richie Rich can't get his folks to make him a gift since they've likely used up their $5.12M exemptions on non-reciprocal dynasty trusts or DAPTs. So how can Richie Rich, the poor little rich boy, take advantage of his $5.12M exemption and grandfather all the great benefits of the Standby BDIT technique above? Try this one on for size. Richie Rich should get his dad Richard Rich Sr. to loan him say $6M so Richie could make a gift to a Richie DAPT. But that loan won't be respected 'cause Richie doesn't have enough assets in his own right to support the repayment of the loan. The IRS would challenge the purported loan as a taxable gift. Ouch, even Richard Rich Sr. wouldn't find that painful. Enter Super-InsuranceMan! Neato, Presto, Zap! Zowie. If Richie will buy a big permanent life insurance policy the loan can be structured as a split-dollar loan with the appropriate elections filed as required by the split-dollar Regs. Gee, now the IRS has to recognize the transfer as a loan 'cause its own Regs say it has to. Richie can gift the $5.12M to his very own DAPT. Years from now the DAPT, as a grantor trust, could buy the insurance from Richie, if advisable. Now Richie has a fully funded $5.12M grantor, dynastic trust that hopefully will be grandfathered if the laws are all changed. This will be the keystone for all of Richie's future planning. Oh, but what if Richie dies while the policy is held by his estate? Gee, everyone will still be way better off as a result of the large poli-

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PRACTICAL PLANNER

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Root Canal Estate Planning and More

Summary: Some simple analogies can be used to explain important and essential planning concepts.

Root Canal Estate Planning: - Most clients use the root canal method of estate planning. Wait 5, 10 perhaps 15+ years between appointments and you to will need an estate planning root canal. Do you complain about your estate planning being very complicated? Do you gripe about the costs? Is it a frustrating process? That may largely be due to your using the root canal method. Why don't you try skipping your semi-annual dental cleaning for years too! Just wait until a tooth hurts like the Dickens, call your dentist and wind up at the endodontist for a root canal. Ouch! If you went to your dentist and estate planner regularly, things could be different. You can't expect to avoid the dreaded root canal if you don't take care of your teeth. Ditto on your estate plan. Annual visits to all of your advisers is the way to root out problems before they become more complex and costly. Regular care makes your planning less painful. Estate planning is an ongoing process, not the mere signing of documents. You have an important responsibility in all of this.

Jigsaw puzzle: Starting with the big picture is usually the best way to tackle a complex situation. To really plan properly, you and your advisers need the mile high view to make sure the global decisions are logical and coordinated. Then you can drill down to get the details. A gardening website summarized it all: "Shrubs require consistent and routine trimming to maintain a healthy and well-manicured hedge. Occasionally a hedge is neglected and becomes overgrown. With the proper pruning technique, an overgrown hedge can be restored. Depending on how out of control your hedge is, it may take a few years of trimming to completely train it." If your estate plan looks like a jungle, you might have to opt for the Jigsaw approach. Focus on identifying the corner pieces. Perhaps the succession plan for your business or getting your life insurance into a trust. When you're able to solve a few pieces at a time (i.e., able to add a few corner pieces) the rest gets easier. Pick independent planning steps that can be handled relatively independently to chip away at the puzzle. These are the pieces of the puzzle that just looking at them you know where they fit. With the corner pieces and a few obvious puzzle pieces in place, often even the most complex or messy plans can take shape. This can be a lot more efficient and palatable than struggling to pull all the disparate parts together from the get go in one comprehensive plan.

Rocket Ship: If you shoot a rocket ship to the moon and are an inch off in your aim at launch, you could miss the moon by 100s of miles. So to with a budget and financial plan. If you're overspending today, 20 years from now you may be wiped out. Even for very wealthy people, spending at too high a rate, which may seem inconsequential today, could have a devastating impact over time. When Elton John sang his famous song about financial planning, he crooned "And I think it's gonna be a long long time." He was right on target. The compounding of excess spending over a long long time is ruinous. So focus on the details and even the small issues today. You can put it off, but one belt notch of tightening today may save 3 tomorrow.

Oxygen Mask: When you're on an airplane the flight attendant tells you that if the oxygen masks fall, put yours on first before helping anyone else. (Don't ask your anesthesiologist 'cause she might say put the mask on a

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Checklist: Trust Distrib.

Summary: Many folks are contemplating transferring flow through entity interests into dynasty and other sophisticated irrevocable trusts in 2012 to use their gift exemption. Should you be in the game? How do these transfers affect trust distributions and related decisions? Can you get money out of such a trust?

√ If you transfer entity interests in 2012 any entity distributions paid after the transfer should be paid to the then record owner, which will be the trust. Prior to transfer of a flow through entity to the trust all distributions should be paid to the then member of record, you, in your personal capacity. Some transfers may result in an interim closing of the entities books and a pro-ration between you and the trust.

√ Since most dynasty trusts, DAPTs and BDITs (Beneficiary Defective Irrevocable Trusts), are grantor trusts, all income will be reported on your personal income tax return. Your CPA should file a Form 1041 tax return for the trust, including a statement that income earned by the trust is reported on your personal return. President Obama has recommended legislation undermining grantor trust benefits.

√ Distributions to fund tax payments are common. Ex-

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...Root Canal Estate Planning and More

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child and certain other people first, and that would ruin our analogy). So too with planning. Too many folks are so preoccupied getting enough money and help to their kids that they forget about taking care of themselves first. It is a wonderful thing to be generous and helpful to your children or other heirs, but not to the point you have to ask them for money so you can step up your meal plan to something more enticing than a Happy Meal. Put the oxygen mask on your financial planning first. Sure, funding irrevocable trusts is a great way to save estate tax and keep your CPA filing tax returns. But if you're not a beneficiary of that trust, how can you get access to money if you need it? Read Murphy's law below.

Murphy's Law: What can go wrong will go wrong. The key questions in every plan is "what if." What if this, what if that….keep asking what if until its impractical. Asking what if questions and considering planning to address them is vital.

Sailboat: You cannot sail a boat straight into the wind. The sail will flutter and you won't get anywhere. You need to tack back and forth constantly readjusting to hit your target. Planning is like that too. There will be years you just have to overspend your budget (yes, even uber-wealthy folks need a budget). In some years you just cannot afford the time or emotional investment to undertake certain important planning tasks. No problem. Make up for it next year by tacking in the other direction. Being reasonable with yourself, and flexible but diligent in your planning, is the realistic way to stay on track.

Cream and Milk: - GRATs, grantor retained annuity trusts, are tough for some folks to understand. Perhaps thinking of the milk and cream from a freshly milked cow will help (you have milked a cow haven't you?). The cream rises to the top of the milk. In a GRAT you get the milk and the cream that rises to the top over the mandated 7520 federal interest rate is what get's skimmed off.

Waterbed: – Grantor trusts (you as the person setting up the trust pay the income tax) seems like an odd concept to many people. But grantor trusts are one of the hottest planning techniques for wealthy taxpayers (well today -- the Pres wants them out). Grantor trust status is the core of a DAPT (domestic asset protection trust) or Dynasty trusts. The waterbed analogy might help. If you push down on the foot of the bed, the top of the bed rises. The overall volume in the bed doesn't change. In a grantor trust you pay the income tax on income earned by the trust so the assets in the trust, like the top of the waterbed, rises. The assets in your name decline. But you haven't lost any wealth, just redistributed it.

Tylenol vs. Advil: Everyone has taken both Advil (a non-steroidal anti-inflammatory agent, NSAID) and Tylenol (Acetaminophen) for a headache (perhaps after reading each issue of this newsletter with the cramped type and odd attempts at humor). But do you have a clue how each drug helps that headache? Nope. But that doesn't mean they don't work. They do. And you (and everyone you know) takes them without having a clue why they stop that headache or pain. You should know dosages, possible side effects to be concerned about, drug interactions to avoid, etc. But do you really need to understand how it works? But then when it comes to a complex estate planning technique like a defined value clause, a Graegin loan, or a split-dollar loan, you feel you need to understand all? Certainly you should understand the big picture. What you are doing, what your options are and generally how they impact you. But bear in mind the Tylenol/Advil analogy. Don't let understanding a complex tax, estate or investment strategy or technique to the degree your adviser does, dissuade you from taking steps that are in fact appropriate for you.

Weakest Link: Everyone remembers the TV show, but the same paradigm applies to an estate planning team. Most folks are reticent about letting their advisers (CPA, business attorney, estate planning attorney, insurance consultant, wealth manager, etc.) really coordinate as they should. The best crafted plan can be undermined by any adviser not addressing his role properly. PP

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Review: Andrew Wolfe, CPA, Esq.

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...Checklist: Complex Trust Distributions

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ample: Family S corporation distributes 40% of income to shareholders as a distribution so each will have enough cash to pay income taxes. The estate plan of transferring interests to a trust, will complicate this mechanism. Once the flow through entity interests have been transferred to the trust all distributions must be made to the dynasty trust as the record owner (member, partner, S shareholder). That won't infuse funds into your bank account for you to pay your income tax on the earnings of the flow through entity. The income, however, will still pass to your personal return since the trust is likely a grantor trust.

√ The optimal means of handling this situation from a tax and asset protection perspective is to not make any distribution from the trust to fund your income taxes because the tax payments you make will reduce the size of your estate. This is one of the key leveraging benefits of these trusts being structured as a grantor trusts. The greater the unreimbursed tax burn, the lower your estate.

√ Some advisers include a provision in such trusts permitting the trustee to reimburse you for income taxes paid (this is OK under some state laws, like Delaware). Other advisers shun such provisions because of concerns the IRS will argue that there was an implied agreement to reimburse for taxes if the provision were activated. Like many complex tax issues – ask different advisers and you'll get different opinions.

√ So, like the old Wendy's commercial, "Where's the beef?" Well Clara, here it is, and they're Hot 'N Juicy:

► Salary and compensation may still be paid from the entities given or sold to the trust, when appropriate. But care should be taken to corroborate that these are reasonable arm's length payments made for services really rendered. Consider contracts supporting the payments and listing the services and a report from an independent CPA or appraiser indicating the reasonable range of fees.

► Distributions may be able to be made to your spouse from your trust. But be cautious about the risk of an implied understanding.

► Distributions may be able to be made from your spouse's trust to you and perhaps your spouse (if it's a DAPT – a Domestic Asset Protection Trust of which your spouse is a beneficiary and the grantor).

► The trust could make a loan for adequate interest to you, or perhaps your spouse. This is a great mechanism as it retains the values intact inside the protective envelope of the trust, and, if properly handled like a loan, it should not seem to raise the specter of the tools the IRS uses to pull these transfers back into your estate. Use proper documentation.

√ Caution, if any of the above possible distributions follow a pattern, or appear to correlate with your tax or other expenditures (e.g., a kids wedding), the IRS may argue that there was an implied understanding between the trustee and family on these distributions. This could result in the IRS disregarding the trust and pulling trust assets back into your estate.

√ The valuation of the interests to be transferred may have to consider forthcoming distributions, and if there is a pattern of making distributions so members can pay income tax on their pro-rata share of income, that pattern of payments may be viewed as reducing discounts and may undermine asset protection. PP

Recent Developments

Beneficiaries on the Hook: A recent case held that the beneficiaries of an estate who were serving as trustees were liable for unpaid estate taxes. Johnson, (DC Utah, May 30, 2012).

Trustee Not Liable on Change in Insurance Policies: Wachovia was the trustee on an insurance trust and structured a Code Sec. 1035 exchange through its insurance subsidiary. Trust beneficiaries challenged Wachovia for self dealing, the loss in cash value and more. The court found Wachovia had done its job right and held it had no liability. However, there are some important lessons in this case for anyone serving as trustee. The most obvious and most important lesson, which few individual trustees seem to get, is that being a trustee is serious stuff. Wachovia did the job right, but few individual trustees seem to. First, the trust agreement permitted self dealing. Few individual trustees really understand the trust documents and fewer still meet periodically with an estate attorney to review their responsibilities under the trust. French v. Wachovia Bank, N.A., 2011 U.S. Dist. LEXIS 72808 (E.D. Wisconsin 2011).

Employer Owned Life Insurance: EOLI has strict reporting requirements in order to avoid having insurance proceeds taxable. In a recent ruling, the IRS gave an employer some leeway in accepting the agreement between the employer and employees as meeting the notice requirements, although the employer failed to obtain from its employees the specific documentation required by the "notice and consent" requirements of Code Sec. 101(j)(4). PLR 201217017. While the ruling was quite favorable to the taxpayer it points out what could be an extraordinarily costly tax trap for many businesses who have been lax with the 101(j) requirements, or even ignored them. This should serve as a reminder call for any