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# NEWSLETTER SUMMER 2013

To Our Clients and Friends:

In this Newsletter, we will continue to update you by briefly covering topics that we've found to be of the most current interest to our clients.

1. Estate Tax Update ( Fall from Fiscal Cliff Avoided). New $5.25M Estate Tax Exemption.

On the last day of 2012, Congress enacted the American Taxpayer Relief Act of 2012. This Act finally addressed and quieted concerns that the Estate Tax Exemption might fall to as low as $1M or even $3.5M. In fact, there are those who believe that estate planners and their wealthy clients made out like bandits in the legislation, with a large and increasing exemption and with all of our planning techniques intact. As we proceed into 2013, the exemption is now $5.25M for each decedent (reduced by lifetime taxable gifts), with a 40% tax rate on assets above the exemption. This exemption amount is scheduled to rise with inflation in the future.

Previously, married couples have planned in their Living Trusts to fund an Exemption Trust upon the first death with the maximum exemption, so that double the exemption amount, e.g. $10.5M, could be inherited tax-free by their beneficiaries. Now, couples with collective net worth (including retirement plans and personally-owned life insurance) of less than $5.25M may not want or need to use an Exemption Trust on the first death, if they are perfectly happy with all of the estate going outright to the surviving spouse. In fact, even couples with net estates over $5.25M may still be able to take full advantage of leaving all of the estate outright to the surviving spouse, as the surviving spouse may, after weighing various post-mortem factors, elect "Portability", by filing an Estate Tax Return within nine months of the first death. With a timely Portability election, the unused estate tax exemption of the first to die can be transferred to the surviving spouse.

If a couple believes that their total estate might be worth more than $10.5M after both deaths, perhaps due to good investments, hard work or by receiving an inheritance from a relative, retaining an Exemption Trust as part of the Living Trust may still be prudent. Other reasons why a couple may want to use the Exemption Trust to protect the decedent's one-half of the assets include: (i) concerns that the surviving spouse may remarry a floozie or gigolo and give all of their money to them, rather than to the children of the first marriage; (ii) creditor protections that the Exemption Trust provides against the lawsuits, debts or other "predators" of the surviving spouse; and (iii) certainty that the decedent's one-half of the estate will end up with the children or other beneficiaries if the surviving spouse doesn't need those funds for support or health.

Some of our clients recently have been using a "hybrid" of the Exemption Trust planning, such that 100% passes to the surviving spouse's portion of the Trust, with the surviving spouse having the right to choose within nine months after the first death to disclaim (e.g. renounce) part or all of the assets of the decedent, in which case those assets would fund the Exemption Trust and retain the "predator" protections.

So, now more than ever, we continue to urge clients to meet with us every three to five years to review their estate plans, to see whether the changing probate and tax laws would mandate changes to their estate documents to be more or less complex. We find that preserving flexibility is essential to selecting among postmortem alternatives.

We cannot stress enough that with all of the planning that goes into your Living Trust, when there is a death or a Trustee change, the successor Trustee needs to contact the team of estate planning professionals, including the attorney, accountant and financial advisor within a few weeks, and prior to taking any action on behalf of the Trust. There are normally advantageous and time-sensitive post-mortem tax and perhaps Portability elections to make, along with Prop 13 property tax notifications, beneficiary notifications and IRS matters to consider. On top of all that, Trustees need to protect themselves from potential lawsuits by other beneficiaries by learning of their fiduciary duties. Recent cases have held a successor Trustee could be liable to the remainder beneficiaries (e.g. children) for the Trustee's breach of a fiduciary duty even while the parent is still living and the Trust is revocable (e.g., where the parent may be incompetent). Let the team of advisors "teach" the non-professional successor Trustee how to be a Trustee.

2. <u>Continuing Tax Planning Opportunities</u>:

(a) <u>Gift Tax Annual Exclusion</u>. The IRS gift tax exclusion amount has risen to an inflation-adjusted $14,000 for 2013. Thus, an individual can give this year up to $14,000 to each person desired, without needing to report the gift on a Gift Tax Return, and without needing to use any of their Estate Tax Exemption (currently $5,250,000). A gift tax return is due next April 15 for gifts in excess of $14,000 per person this year.

(b) <u>Sales to Grantor Trusts</u>. Many clients with larger estates have already taken advantage of this ability to sell S-Corporation stock or income producing real estate (directly or through an LLC, limited partnership or corporation) to a Grantor Trust for their children, without incurring any capital gains tax on the sale and only reporting a small portion (e.g. 10%) of the value of the real estate on the gift tax return. The children's Grantor Trusts normally pay to the parent 10% down and issue a promissory note for 90% of the purchase price, which is ultimately repaid by the property's rental income. The parent continues to pay income tax on the earnings of the property, so that the excess income and future appreciation can accrue in the Grantor Trust of the child. Congress continues to consider whether to end this planning opportunity.

3. <u>The Challenge: Selecting a Successor Trustee/Executor</u>

The question of who to designate as a successor Trustee is sometimes difficult to decide upon during initial estate planning meetings, and this is also the area that clients are most likely to update and revise every few years. The Trustee's most important jobs are to invest and manage the Trust assets, and to oversee and decide upon distributions to the beneficiaries.

Criteria for designating a successor Trustee include the following: 1) Someone who is honest and will not abscond with the estate; 2) Someone who has the common sense to hire good financial and legal advisors; 3) Someone who is fair-minded, and hopefully will have a reasonable rapport with the beneficiaries; and 4) Someone who has the time to gather the assets, work with the lawyer and accountant, pay final medical and other bills, sell the properties, etc. It is normally good, but not crucial, to select a Trustee who lives nearby.

We sometimes hear that a parent believes he/she "should" select the oldest child, even if the middle or younger one is much better qualified for the job. After many years of administering Trusts, it is our strong opinion that the parent “should” choose the most qualified individual, regardless of birth order, to reduce the likelihood of arguments and delays in the Trust settlement.

We also sometimes hear that a parent wants to choose all five of his/her children, "to be fair", and the parent "hopes" they’ll all get along, even though they have not all gotten along in the past. Don’t do this. Two or three, or even five individuals can legally be co-trustees, but if they don’t get along, all that will happen is that they will each hire their own trust attorney, incur lots of expenses and emotional drama, and be stuck in court litigation gridlock.

When there is no appropriate child, relative or close friend, some clients designate their attorney or accountant as successor Trustee, where there is a good relationship and the person is qualified. Another good alternative is to select a professional Bank/Trust Company as successor Trustee. Normally, an institutional Trustee will keep the assets safe and provide professional management, and still provide a rapport between the professional Trustee and the beneficiaries. There may be higher fees from a professional Trustee; however, keeping Trust assets safe and avoiding litigation are important factors to consider and are good offsets. Some bank trust departments are better than others, and you should get a good referral, and/or allow a trusted friend or family member the power to change from one bank trust department to another after you are deceased.

Sometimes clients let their children know in advance who they’ve selected to be the successor Trustee, so that if there are questions or opposition, the parent will handle it now, and avoid surprises later.

4. <u>Corporate and Entity Records and Bogus Solicitations</u>.

Every year, our office prepares and mails out annual corporate minutes for clients who are on our regular system. This keeps their Minute Books up to date, as mandated in the corporate Bylaws, and is an important factor in protecting the corporate records in the event of IRS audit, for corporate creditor protection, and in the event of a future sale of the business.

For our clients who have both a Living Trust and a corporation or other legal entity, the Stock Certificate, Minutes and other records of the entity should generally name the Living Trust as the owner. This will not only help to avoid court probate and conservatorship and but also facilitate someone acting on behalf of the entity in the event or an emergency or death. You should review your entity’s records to make sure the title is correct.

In recent years, many of our clients are receiving an official looking document (sometimes in a green envelope) asking for money to be sent to "Corporate Records Service" to prepare annual minutes. If these solicitations are scrutinized very carefully, you’ll see at the bottom a statement that it "... has not been approved or endorsed by any government agency...". So, be careful. On the other hand, when the Secretary of State sends you an official notice, they’ll want your payment made to Secretary of State. Let us know if you have questions, and ignore such fraudulent forms and correspondence.

5. <u>The Mix of Retirement Assets and Charitable Bequests –Avoiding Estate and Income Tax</u>.

For our clients who would like to make charitable bequests and who have investments in a tax-deferred retirement plan (such as an IRA, profit sharing plan, 401K, 403B or defined benefit plan), if a charity is designated as a beneficiary of the retirement plan, then not only will funds be received by the

charity beneficiary free of estate tax, but the deferred income tax on retirement accounts will also be avoided. Thus, depending upon each individual circumstance, it is often better to designate charities as beneficiaries of retirement funds and family members as beneficiaries of the Living Trust. Sometimes, so that a charity is certain to not be "forgotten", we include the charity bequest in the Living Trust document, but specify that if the charity has already received funds as a retirement beneficiary, the Living Trust bequest will be voided or reduced.

6. Planning for Children with Substance Abuse.

When parents are aware of substance abuse issues with their teenager or older child (or grandchild), it is important to protect those children from receiving an inheritance that will, at best, be wasted, and at worst, immediately be spent on life-threatening drugs. Many of those families have opted to use special distribution criteria in their Living Trusts so that a Trustee can demand a drug test and can have broad, unquestionable authority to withhold distributions until a later time when the child has proven to be continually "clean". Some families have simply mandated that a Trustee must continue to have control over when and how funds are distributed until a much later age, or even for the child's entire lifetime.

7. Avoid Probate - Probate Court Filing Fees Now Risen (To $435+), Delays Increase!

With finances tight for the courts, and probate courts throughout Los Angeles County closing and consolidating, there is even more reason to plan for avoiding the need for conservatorship in case of incompetence and for probate upon death. Be sure that you have a Living Trust, and that each asset title reflects the Trust's ownership. When our estate planning clients return for review visits every 3-5 years, this is one of the main problem areas to update and resolve. Especially prevalent is the client who removes a property from the Trust title temporarily for a refinance, but then forgets to have escrow or our office prepare a new deed to return the property to the Trust title.

Also, courts have recently held that title to assets cannot be held simply in the name of a Living Trust, and instead title must be held by the Trustee, as Trustee of the Living Trust (e.g. title should read "Bob Jones, as Trustee of the Jones Living Trust" rather than just "Jones Living Trust"). Our clients with older deeds prepared by other attorneys should review those deeds to ensure that title has been properly transferred. In some recent instances, after a death, title companies have refused to recognize the real estate transfer to the Trust, requiring the extra cost and delay of commencing a proceeding in probate court to legally transfer title.

8. Corporation, LLC, Entity Document Preparation Services.

We have had clients bring to us for our review organizational documents for their corporation or other entity prepared by a document preparation service, not an attorney. We have found that much of what was "prepared" are merely blank forms without any customization or planning as to the client's needs and business deal and simply leave to the client the task of finishing the job. In a number of situations, the forms were wrong or incomplete. Much more tax and business planning goes into forming an entity than just providing "canned" paperwork. Thought needs to be given to many factors including the client's business objectives, the type of business and its capitalization, the tax structure, creditor protection, management, and owners' exit strategies. If you have any such uncompleted "blank form" paperwork, you should direct your attention to them now.

Copies of this Newsletter and those of prior years can be found on our Firm's website, www.Magasinn.com

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