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SNIPPETS

AN ESTATE PLANNING AND FINANCIAL PLANNING NEWSLETTER
SUMMER 2013

Obama's 2014 Budget Proposal Makes the New "Permanent" Estate and Gift Tax Laws Not So Permanent

Do you think Congress finally provided us with some long awaited clarity on estate and gift tax laws when they fixed the so-called "fiscal cliff" back in January? Think again. The "fiscal cliff" budget deal, which President Obama signed into law via The American Taxpayer Relief Act (ATRA) of 2012 in early January, supposedly made the estate and gift tax laws "permanent." However, a mere four months later, the President's 2014 Budget Proposal now seeks to lower the estate and gift tax exemptions, increase estate and gift tax rates, and target a number of estate planning tools that may have you and us reevaluating your estate planning strategy *once again*. Let's take a look at what some of these proposed changes could mean for you:

Estate, Gift and GST Taxes

Current Law
The current estate, GST, and gift tax rate is 40 percent, and each individual has a lifetime exclusion for all three of the above type of taxes of $5.25 million (indexed for inflation).

Obama's Proposal
The President's Budget proposal, if adopted, would as of January 1, 2018 increase the federal estate tax rate from 40% to 45% and would lower the individual exclusion amount from the current $5.25 million to $3.5 million for estate and GST taxes, and $1 million for gift taxes. There would be no indexing for inflation. By limiting it to $1 million for gifts, your ability to utilize gifting techniques to remove assets from your estate will become more limited.

Grantor Retained Annuity Trusts

Current Law:

A "GRAT" (grantor retained annuity trust) is a tax-reducing trust popular for giving assets to family members while retaining an income benefit for some time period determined by the grantor (i.e. creator of the trust). Usually, the grantor (i.e. often times the parent) funds the trust with highly appreciating assets and gets back an annuity which pays a fixed amount each year to the grantor. Gift tax is paid when the GRAT is created and the tax is based upon the present value of the remainder of the trust. Any appreciation after the property is in the GRAT is non-taxable, provided that the grantor survives the term of the trust. If the grantor dies before the trust ends, the assets become part of the taxable estate and the beneficiary receives nothing. For that reason, a GRAT usually has a short term, such as two years, to make it more likely that the grantor survives beyond the term of the trust.

Obama's Proposal:

The proposed budget would require that all GRATs have a minimum term of 10 years and the initial value of the GRAT be greater than zero. This ensures that some tax will be paid upon creation of the GRAT and makes it much more likely that the grantor may die during the trust's existence. If this occurs, the trust is taxed as part of the grantor's estate, effectively sacrificing nearly half its value to taxes.

Intentionally Defective Grantor's Trust

Current Law

An "IDGT" (intentionally defective grantor trust) is a type of trust used to freeze the value of appreciating assets for tax purposes. This strategy allows the grantor to be the owner of the assets for income tax purposes but it removes the value of the assets from the grantor's taxable estate. As the value of the trust increases, the transferor receives the income earned by the assets (and pays tax on the income) but the assets grow outside of the transferor's estate.

Obama's Proposal

Under the proposed budget, an IDGT would be indistinguishable from a grantor trust in the tax code. Estate or gift tax would have to be paid on the trust at the time of the owner's death. This will make use of an IDGT obsolete.

Valuation Discounts

Current Law

Currently, intra-family transfers of interests in certain types of entities (limited partnerships, limited liability companies and corporations) are valued after applying discounts for lack of control and lack of marketability, which can be considerable. These discounts may significantly reduce the value of gifts made and/or assets included in the estate.

Obama's Proposal

The proposed budget seeks to toughen the rules for valuation discounts, by ignoring certain restrictions when valuing an interest in a family-controlled entity transferred to a member of the same family. The precise impact of these rules is unclear, but the obvious intent is to curtail discounting in intra-family gift and estate tax planning.

Limited Payout Options for Non-Spouse Beneficiaries of Retirement Accounts

Current Law

Under current law, non-Spouse beneficiaries of an inherited IRA must take distributions and pay taxes on them, though currently the payments can be stretched over a long period, thereby deferring the income tax impact over several years.

Obama's Proposal

The proposed budget would require distributions from an inherited IRA to a non-spouse beneficiary to be taken in no more than five years. This would eliminate the ability to "stretch-out" IRA distributions over the life expectancies of young beneficiaries, such as children or grandchildren.

Conclusion

Changes to federal estate taxes are just one of the complexities of the estate planning process. While these "proposals" are just "proposals", they clearly indicate that the $5 million exemption may not be as "permanent" as Congress so indicated last year and that some of the most effective estate planning tools are in danger of extinction. If your estate plan already includes, or you are considering utilizing, one or more of these techniques, then any change could have a significant impact on you, your loved ones, and your assets. We do not know effective dates, so it might be better to be pro-active with your planning.

Where is the United States Going on Long Term Care?

Each year the Genworth Insurance Company publishes a study regarding the cost of different types of long term care. It covers all 50 states. The study states:

- The median cost of a nursing home room went from $65,525 in 2008 to $83,950 in 2012. That is a five year 4.45% compound annual growth rate. This is a serious concern for an aging population. The Massachusetts median cost was $133,225. Florida was $91,250 and Rhode Island was $111,125.
- The cost of assisted living also increased to $3,450 per month or a five year 4.26% compound annual growth rate.
- The cost of adult day care and licensed home health aides was somewhat flat (less than 1.5% increase). Good news.
- 70% of people over 65 will need long term care services at some point in their lifetime. Long Term Care service consists of many choices today from homemaker, to adult care, aids, nursing home, etc.

Insurance companies' response this growing financial issue has been to increase their long term care premiums significantly or abandon the product. The result is a 38% decrease in long term care policies issued since 2004.

An alternative has come in the form of life insurance policies with long term care riders (called hybrid policies). By combining the two concepts you can lock in a payout to your family so if you do not ever use the policy, or use only use a portion of the long term care feature of the policy. Your family might get back some premium you paid over the years either on death or to use for your long term care. In just a straight long term care policy, you do not get any return of the premium even if you do not make any claim for the policy benefits.

Obviously, there are many variations of these hybrid type of policies and their coverage may not be as good as in a traditional long term care policy. They are usually limited to the death benefit so if you buy a $200,000 policy and the nursing home stay is for 3 years (average length of nursing home stay), you are liable for the difference. Also there is no inflation protection so if the costs continue to rise as the above indicates, you may not have sufficient funds in 10-15 years. Since you are getting something extra with these life insurance policies, they will normally cost more than a regular life insurance policy. However, you can guaranty the premium that you will pay which you cannot do with a traditional long term care product. Usually it is done with a universal life policy versus term, whose premiums can go up based upon age. The ownership of the policy can also be designed so that the policy could be owned by an irrevocable trust so as to keep it out of your estate. You could also add this long term care rider with an existing life insurance policy that has cash value through a tax free exchange.

This approach is not for everyone. Every client is different. For example if Alzheimer Disease or Multiple Sclerosis runs in the family, then your need for benefits may be greater than what is available in the rider. You might need more physician involvement to get the benefit or it might be more stringent to get other long term care benefits under the hybrid policy.

The above is intended to merely educate you about this new type of option. Each situation would require its own analysis.

Schlossberg, LLC Estate Planning Annual Maintenance Program

When it comes to estate planning, many clients who are in the process of implementing an estate plan for the first time express to us this sentiment: “I am glad we are getting this done now so that I don’t have to think about it any more.” This is a typical response among clients who draft an estate plan for the first time.

Putting a plan in place is certainly a significant accomplishment. Clients should feel good about being proactive with their planning. Implementing an estate plan is an unselfish act that underscores the fact that a person is taking responsibility for themselves and their families. It is the right thing to do.

But the sentiment is not really accurate. Estate planning is more than the lawyer drafting documents once and the client signing them. Effective estate planning requires that the client and lawyer work together on implementing the plan once it is signed (by retitling assets in a way that minimizes estate taxes and probate of the assets in the client’s estate) and reviewing that plan, and changes to the ownership of the client’s assets, from time to time thereafter. At Schlossberg, LLC, we work with our clients after signing their plan to make sure assets are titled correctly and their plan is funded properly. We remind our clients three years from the date they sign their documents that it is time to review their plan. We also inform our clients of general changes in the law and important developments by way of this ‘Snippets’ newsletter. In practice, however, this requires a certain level of proactivity from the client. They must then contact us in order to obtain a more specific review of their plan. Some clients tend to be more proactive than others. Other client tend to put this on the backburner and we do not hear again for many years even though their circumstances have significantly changed. In order to address this difficulty, Schlossberg, LLC has introduced our Annual Maintenance Program (hereafter “SAM Program”), and clients are taking advantage of the opportunity. Our SAM Program is an option available to those of our clients who might benefit from a more structured annual review process. To entice clients to do this review, we are offering it at $550 for married couples and $500 for individuals. As an added benefit we also include various discounts for services that otherwise would be billed hourly. This should result in significant savings to those clients that want their estate plan reviewed each year.

For those clients who choose to participate in the yearly program, the SAM Program includes a 40% discount on initial trust funding. Regardless of whether the client utilizes the SAM Program or not, the review and retitling of assets is a crucial part of the estate planning process. This part of the process may include transferring the ownership of real estate to your trust, brokerage accounts, or ownership of business interests, as well as changing beneficiary designations on life insurance policies and qualified retirement accounts. Clients in the SAM Program will receive 40% off of their legal fees on the initial funding of their plan as well no further legal fee on all future trust funding and retitling of assets.

Additionally, clients in the SAM Program can take advantage of a free yearly meeting with us to review their plan. Subsequent phone calls and emails will also be free of charge. Basic changes to the client’s documents will also be free of charge. And the client will receive a yearly summary of their estate planning documents as well as the funding of their estate plan.

Lastly, the client will have access to their own online personal estate planning data “vault” where the client can access all of their estate planning documents and provide internet access to other family members and advisors if they wish. This way all concerned parties can see the latest documents.

Ultimately the SAM Program will benefit those clients who need that little extra ‘push’ in order to keep their estate plan current, or any client who prefers a more structured program. For those who do not wish to participate in the SAM Program, nothing is changing regarding their level of service. Schlossberg, LLC is offering the SAM Program as an additional option in order to better serve the needs of all of our estate planning clients. The estate planning team at Schlossberg, LLC is available to discuss the SAM Program or any other aspect of your estate plan at your convenience.

COMING SOON IN THE NEXT SNIPPETS:

1. **Estate Planning for Married and Unmarried Same-Sex Couples After the Supreme Court's Landmark DOMA Decision?**

2. **How to Leave Assets to Adult Children: Providing Asset Protection and Promoting "Fiscal Responsibility"**

SCHLOSSBERG, LLC – ESTATE AND TRUST TEAM

For further information on any of these topics or to review your estate plan, please contact an Estate and Trust Team Member

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