Price & Farrington's Estate and Tax Planning *Fast*Faxts

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Estate, Tax, Business and Wealth Planning for Advisors and Clients

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Summertime Smorgasbord: *A Few Estate Planning Topics to Nibble On...*

☞ ***Estate Planning on the Back-burner.*** A national telephone survey sponsored by Lawyers.com was recently conducted to determine attitudes about estate planning. It found that death may be one of only two things certain in life, but less than half of adult Americans are preparing for it. Slightly less than 60% of respondents don't even have a basic will.

The Highlights: Lacking a basic will is just the beginning, according to the survey. Almost 70% of respondents have no living will or medical directive. Just 27% of respondents have powers of attorney for health care, and even fewer—26%—have financial powers of attorney. And only about one in five respondents said they had created a trust as part of an estate plan.

This isn't a good situation. Without crucial documents like powers of attorney and living wills in place, many Americans are leaving their loved ones vulnerable to the heartache and expense of having to make life or death (or financial) decisions that could easily have been addressed at a time when the emotional strain is not nearly so intense. Myths about estate planning abound (see our April, 2004 *Fast*Faxts: "Common Estate Planning Myths and Misconceptions: *A Vigorous Debunking*" in our *Fast*Faxts archives located at www.pricefarrington.com). According to the survey, more than 20% of respondents without an estate plan say their biggest reason is a lack of sufficient assets. (See above, Myths and Misconceptions #1). Fifteen percent say they aren't old enough to need a plan.

Many Americans report that they have suffered from the effects of poor planning. Nearly 18% of survey respondents say they personally experienced problems after the death or disability of a loved one because of no—or an improperly prepared—estate plan, including conflicts over asset distribution.

In addition, more minorities lack estate plans. For example, just 45% of African-Americans and Hispanics have estate planning documents in place, compared to 57% of whites. Only 28% of African Americans and 20% of Hispanics have wills, compared to 46% of whites.

Of the survey respondents who do have estate plans, 25% say their biggest motivation for creating one was the arrival of children. Only 7% were motivated by a significant long-term relationship, such as a marriage. And Americans who have estate plans claim to do a decent job of updating them. Almost 40% of respondents with plans say they review or anticipate reviewing their estate plan documents at least once a year, while 22% say once every two to three years. Whether these intentions represent wishful thinking more than reality is an open question. (See above, Myths and Misconceptions #18)

Watertight Wills

Some steps to consider if you plan to cut someone out of your will or divide assets unevenly:

☑**Videotape yourself** spelling out your wishes as proof you were lucid at the time of your decision

☑**Consider a "no contest" clause** rather than a disinheritance, reducing the incentive for a legal challenge

☑**Draft your will several times** (known as multiple execution), "layering" minor changes so that if the most recent will is successfully challenged, the courts will generally rely on the will preceding it, effectively discouraging a will challenge.

☑**Use a revocable living trust** to own some or all assets, thereby assuring those assets pass to beneficiaries privately, bypassing probate. Challenging an RLT is more difficult and costly for the disgruntled heir.

☑**Minimize a favored heirs' role** in the estate planning process to avoid claims of undue influence.

☑**Discuss your plans** with your heirs. A common thread in estate planning disputes is lack of communication. The feeling that something was concealed from them can drive some heirs crazy, causing major disputes. ■

"He was always a man of very few words."

☞ ***Estate Planning Update Alert!*** Comprehensive estate plans always include wills, trusts and disability planning documents. A *Durable Power of Attorney for Health Care Decisions* (Health Care Power of Attorney or HCPOA) names a trusted person to take over the direction of your health care if you become unable to do so. Problem: ***A HCPOA signed before 2004 could be rejected by your health care providers*** — physicians, dentists, pharmacists, HMOs — because the document lacks privacy waivers required by the federal Health Insurance Portability and Accountability Act (HIPAA). This important law protects the privacy of information you provide to those with whom you have entrusted your health care. Without the HIPAA language, your health care providers might not disclose medical information to your health care agent.

We strongly recommend that you execute an updated Health Care Power of Attorney with HIPAA waiver language to ensure that your designated health care agent can act on your behalf if and when it becomes necessary. Please don't hesitate to contact our office to follow through on this.

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☞ ***Protecting a Will From a Messy Probate.*** It is estimated that about one-fifth of all estates are divided unequally among heirs. While this can be a legitimate planning approach, it can lead to an ugly situation, the estate becoming tangled in a legal contest.

While in some cases the law may require money to be set aside for the care of a spouse or for minor children, there's usually nothing that says a penny has to be given to grown children, siblings, caretakers or even spouses who have signed a property agreement. Still, cutting people out or giving unequal distributions can be a dangerous game. Family members who feel cheated can try to grab a share by contesting the will in probate. The most common attacks come in two forms: claims that the deceased's thinking was too muddled to draft a legally binding will, and assertions that the deceased was unduly influenced, usually by the favored heir. A will contest can place an estate in limbo, with legal fees diverting money from the rightful beneficiaries. (See our February, 2004 *Fast*Faxts, "Planning to Use Your Willpower: *How to Avoid Will Contests*" at www.pricefarrington.com)

Roughly 20% of parents divide their estates unevenly, usually for benign reasons, to support a child who requires greater financial assistance or who has helped support them during a major illness — unaware that they're setting the stage for a skirmish. Some clients can't bring themselves to give money to a problem child or to someone who has done less for them over their lifetime. In those cases, planners turn to a handful of tactics intended to stifle disputes. For examples, *see* box on page one: *Watertight Wills*.

☞ *Estee Lauder's Estate*

A media report that recently deceased cosmetics mogul Estee Lauder's children were selling stock to raise $550 million for taxes, seems shocking. An estate tax bill of that size means that the estate was worth about $1 billion and raises the question why Lauder, who surely had access to the best legal advice, would die with so many taxable assets. Her death in April when she was in her late 90s couldn't have been totally unexpected by her advisors.

Of course, things are rarely what they seem. Often, tax concerns compete with other pressing needs. Arrangements to lower an estate tax bill might also diminish a person's power and net worth, which is frequently unacceptable to older clients, especially an aging matriarch. Even extremely wealthy clients have an emotional, irrational fear of becoming impoverished.

As for Lauder, if we crunch publicly available numbers we find that she probably did some very effective estate planning. The company she founded, Estee Lauder Inc., appears to be worth about $7.6 billion. Her family will continue to own almost half of that— around $3.5 billion– after a planned stock sale. That means the family might be paying estate taxes of about $550 million on a $4 billion company. That's pretty good planning.

☞ ***No Valuation Discounts for Retirement Accounts.*** Louis Smith died owning two employment-related retirement accounts consisting of marketable securities. His estate filed an estate tax return which listed the retirement accounts at their face value, and paid $140,358 in federal estate taxes. The estate later requested an estate tax refund of $78,731, stating that *the value of the retirement accounts should have been discounted 30% to reflect the income tax liabilities inherent in the accounts,* and that therefore they were overvalued on the estate tax return. Not surprisingly, the IRS denied the refund claim and the estate filed suit in U.S. District Court.

The only issue before the court was the correct valuation methodology for the retirement accounts. The IRS asserted that the estate wasn't entitled to a valuation discount and that the accounts should be valued based upon the underlying value of their assets, the marketable securities. The estate argued that the "willing buyer-willing seller" test applied — that a willing buyer would take into account the federal income tax liability attributable to the retirement accounts, citing a number of cases in which the value of closely-held business interest was discounted for built-in capital gains tax liabilities.

The Court wasn't persuaded by the cited cases and ruled that a willing buyer would not consider the retirement accounts' income tax liabilities but would look at the value of the accounts' underlying assets (marketable securities) in determining the fair market value of the retirement accounts. The court stated that a valuation discount would provide an unfair advantage to the beneficiaries of the accounts since *they are already entitled to an income tax deduction equal to the federal estate taxes attributable to the retirement accounts under Section 691(c) of the Internal Revenue Code.* (For a discussion of how 691(c)works, *see* our May, 2004 *Fast*Faxts, "The Overlooked Trillion Dollar Plus Income Tax Deduction" at www.pricefarrington.com.

☞ ***Control=Ownership=Taxes.*** The assets of a trust are included in the estate of a grantor (the trust creator) for estate tax purposes whenever the grantor controls trust distributions. In a recent case, the trustee of a trust was permitted to distribute property to beneficiaries only after receiving unanimous approval from an advisory committee, which consisted of the grantor, his spouse and a non-relative.

In a private letter ruling (PLR) the IRS concluded that because the trustee's distribution power was not limited by an ascertainable standard (e.g., "health, education, maintenance and support") the grantor's power to veto or consent to distributions caused the trust property to be includible in the grantor's estate at death under Internal Revenue Code Section 2038. That section includes any property transferred by a person in which the enjoyment of the property was, at the date of his death, subject to any change through the exercise of a power by the person (here, the grantor) acting alone or in conjunction with anyone else.

What's the moral of all of this? You can have your estate planning done properly or improperly, effectively or ineffectively. The outcome depends upon whether you care enough to do it right by seeking competent legal advice. The stakes are too high— for you, your family and your legacy—to do otherwise.

You can always feel free to contact our firm for proper estate planning advice. It's what we do. ■