THE LAW OFFICES
OF
Louis P. Lepore

1110 South Avenue • Staten Island, NY 10314
Tel: 347-273-1385 • Fax: 347-273-1484

40 Wall Street • New York, NY 10005
Tel: 212-400-7197 • Fax: 347-273-1484

331 Newman Springs Road
Building 1, 4th floor, Suite 143
Red Bank, NJ 07701
Tel: 732-784-2826 • Fax: 347-273-1484

THE PLANNER

THE JANUARY 2012 EDITION Volume 7, Issue 01

A monthly newsletter for Accounting, and Financial Professionals with a focusing on Estate Planning, Elder Law, and Special Needs Persons.

The Planner is a newsletter to inform and educate Accounting and Financial Professionals of the ever changing areas of estate taxes, and elder law to better service their clients.

From: Louis Lepore

Louis Lepore is an attorney admitted to practice law in the states of New York, New Jersey, and Florida. He has dedicated his practice of law to providing quality legal representation and personal attention to all of his clients on Estate Planning, Elder Law issues, Probate, Business Succession Planning, Asset Protection, Tax and Business Planning.

TABLE OF CONTENTS

Continuum of Care: Client Update Meetings/Financial Control System.

You want a satisfying, long-term relationship with clients, meaningful recurring revenue and referrals from existing clients. Your clients want a trusted advisor relationship with you and they want coordinated estate, financial and tax planning that protects them, their family, and their business interests.

A client update process or financial control system is an essential strategy that will assure these outcomes over time. It also creates the opportunity for recurring, positive contact between the various members of the client's estate, financial and tax planning team.

In this edition of The Planner, you will learn some strategies for how to implement and/or improve a client update process/financial control system in your practice. You will also learn how to manage it so that it will produce a winning situation for the client and the various members of the advisory team.

Coming Together as a Financial Lifeguard for the Client

The team approach brings together the attorney, investment advisor, CPA, and insurance professional, among others. Sometimes it is the attorney who holds the team together; other times it is the CPA or financial advisor. Whoever it is, the key thing to remember is that no one advisor is as smart as all of them are together. All are needed to meet the client's needs, and often the help of one or more team member is required to move the client forward in the planning process.

These three questions will guide the team through the process of arriving at a joint planning recommendation:

• For what purpose? This sets up the situation and the next steps.

• By what means? This creates a pattern of expectations. While there may be many options to explore, this helps to structure an agreement as to how the team members will be paid (full disclosure is required).

• What are the consequences? This helps to complete the action and may veer to an unexpected direction requiring innovation when an adverse consequence is identified. The team solves the problems and meets the client's needs.

The Registered Investment Advisor's Role Compliance

Because registered investment advisors may be audited at any time by the SEC or by the State, they must monitor their compliance with the applicable regulations. They must keep careful records, and information must be presented and recorded accurately. Disclosure brochures must also be used.

Planning Tip: Before the client meeting, the advisors can discuss whether sensitive information that might need to be protected by the attorney-client privilege is likely to come up and if team members will, therefore, need to exit the meeting while these private matters are discussed. Letters, memos and other documents passing between the attorney and the client also may need to be kept within the protected environment of the attorney-client privilege.

Investments

Investment advisors develop Investment Policy Statements; provide cash management and long-term investments; establish appropriate performance benchmarks; adapt to changing conditions and family objectives; and monitor and provide performance reporting.

Information Management

Investment advisors maintain account documents and records. An internet service may be used to provide easy, 24/7 accessible storage of these records and the investment advisor shares this information appropriately, as determined by the client.

Planning Tip: It is best to allow the client to determine which advisors and family members will have access to which information. Secure internet-based document vault services (e.g., The Advisors Forum's ClientDocx) can provide record storage with varying access authorizations depending upon the particular person's need to access specific information.

Education

Investment advisors keep up to date on investment strategies, tax codes, philanthropic concepts, etc., and can provide ways to teach younger generations about money and financial concepts.

Planning Tip: It can be a good idea to bring in the younger generation to review meetings in order to introduce them to the planning concepts and the team of advisors. With the client's consent, this can introduce them to the concept of wealth and wealth management over a period of some time, as opposed to their suddenly inheriting wealth with little or no preparation to manage it.

Client Update Meetings/Financial Control System

Using a financial control system for the client meetings lets the team identify tasks (pre-implementation, implementation and ongoing maintenance) and assign responsibilities.

Pre-Implementation Tasks (Planning or Discovery Phase)

Client meetings will likely occur in person or, in some cases, via teleconference (like "GoToMeeting"). Meetings should have a written agenda, an assigned record-keeper for minutes, information sharing ("DropBox" can be useful) and secured document storage. Keeping notes about follow-up actions to take shows the advisor is organized and provides protection in case of an audit.

Investment evaluation includes making financial projections, determining a risk profile, and developing an investment policy statement with asset allocation and sensitivity analysis.

Insurance evaluation includes determining a need, structuring ownership and beneficiaries, designing policy features, and establishing funding levels and sources. Existing policies can often be replaced with a better product at no extra cost to the client.

Implementation Tasks

Before implementing the plan, the team will need to review legal documents, verify ownership and titling, have signed advisory agreements, fully disclose any fee sharing and continue to update the client checklist.

Investment tasks in this phase include a recommended investment policy, the investment advisory agreement and a letter of intent for funding the investment accounts with different levels of risk. Accounts will then be established and funded.

Insurance tasks in this phase include the application and underwriting process for any new policies and a review of existing policies.

Planning Tip: The attorney and investment or insurance advisor will need to work together, especially if there are multiple beneficiaries in the plan.

Ongoing Tasks

Investment tasks include monitoring investment results, rebalancing investments and preparing reports, with copies typically going to the attorney and CPA.

Insurance tasks include obtaining in-force illustrations, analyzing results, determining funding levels and allocating cash or variable values.

Legal and Accounting tasks are mostly concerned with compliance and include tax and accounting, funding, payments to beneficiaries, sending Crummey notices, and creative task sharing.

Planning Tip: The attorney, investment advisor and CPA should discuss details in person or by telephone to make sure everything is implemented and reported correctly in order to avoid costly mistakes. For example, Crummey notices should be issued to make sure the annual gifts qualify for the gift tax annual exclusion; QTIP elections must be made (there is no forgiveness if the box is not checked); transfer of trust property after the grantor dies must be implemented properly, etc.

Administrative tasks are also ongoing. Documents and records must be maintained (on paper or electronically). Comprehensive financial information must be provided in custodial, performance and tax reports. Completed planning must be monitored and adapted to changes in the tax laws and regulations; family needs and goals (i.e., there is often concern over how to pay for long term care); financial and investment environment (i.e., there is more risk aversion today after the market meltdown in 2008); and philanthropic strategies (lifetime and/or after-death giving to church, charities).

Client Education: It's important to connect with clients on an ongoing basis to let them know about new investment and planning strategies through newsletters, bulletins, quarterly education programs and seminars. Annual meetings and family retreats also provide an opportunity and environment to teach younger generations about money.

Conclusion

Everyone benefits when advisors come together to work for a client. The client benefits from the comprehensive estate, tax and investment planning; the younger generation benefits from the protection of these assets; and the advisors benefit again when, after building relationships with the younger generation, assets are kept under management at the incapacity or death of the first-generation client.

Using a client update process or financial control system will provide the necessary framework for the advisory team to work from, so that everyone stays informed, on track and accountable to meeting the client's changing goals and objectives.

Top Income Tax Planning Ideas for 2011 and 2012

With the recent discussions about closing tax loopholes and increasing taxes for the "wealthy" incident to increasing the national debt limit, clients are beginning to fear that the taxes on their wealth will increase. Even without higher tax rates, wealthier Americans will pay more in taxes if allowable deductions (possibly charitable) and exemptions (probably estate tax) are lowered.

We need to be prepared to help our clients as they begin to draw down retirement savings and look for more tax-efficient investments for their stocks, bonds, real estate and savings.

In this issue of The Planner, we will examine some of the top income tax planning ideas to implement in 2011 and 2012.

Income Tax Overview

Anything can happen between now and January 1, 2013, but, based on current law, that will be the date the top income tax rate increases from 36% to 39.6%, qualified dividends become subject to ordinary income tax rates, the tax on long-term capital gains jumps from 15% to 20%, and the 3.8% Medicare surtax kicks in (unless the Florida Federal District Court decision striking down the health care reform act is upheld). Let's look more closely at how these taxes can impact your clients, and what you can do to help them.

Qualified Dividends

Under current law, in tax years beginning on or after January 1, 2013, qualified dividends will be subject to ordinary income tax rates. Therefore, C Corporations with accumulated earnings and profits and the cash to do so should consider making larger dividends in 2011 and 2012.

Example, Distribution of C Corp Dividends: Should the sole shareholder of a C Corp make a $1 million dividend to himself in one lump payment in 2012 or in $200,000 increments over five years (2012-2016)? Assuming he is in the highest marginal income tax bracket, 15% capital gains tax rate on dividends in 2012, and 39.6% + 3.8% = 43.4% ordinary income tax rate on dividends for 2013 and beyond, he would pay $150,000 in taxes on the lump sum distribution in 2012 and $377,200 on the incremental distributions paid over five years. He would save $ 227,200 by taking the lump sum in 2012.

Long-Term Capital Gains

Under current law, in tax years beginning on or after January 1, 2013, long-term capital gains will be taxed at a top rate of 20%. Taxpayers should consider selling (or otherwise disposing of) appreciated property and recognizing the taxable gain in 2011 and/or 2012. Taxpayers who have realized capital gains deferred on an installment note may want to consider accelerating the unrecognized gain in 2011 and/or 2012.

Example: Acceleration of Gains: In 2012, Judy sold her business for $1 million in exchange for a nine-year installment note. At the time of the sale, she realized a $900,000 gain. By electing out of the installment treatment, she would pay $135,000 in capital gains tax on the lump sum in 2012 vs. $175,500 on the installments in 2012-2021, and would save $40,500 in taxes (900,000 x .15 = 135,000 versus 900,000 x .1 x .15 = 13,500 plus 900,000 x .9 x .2 = 162,000).

Ordinary Income

Under current law, in tax years beginning on or after January 1, 2013, ordinary income tax rates will increase to their pre-2001 levels. Taxpayers should consider accelerating certain types of ordinary income (bond interest, annuity income, traditional IRA income, compensation income) into 2011 and 2012 if they expect to be in the same tax bracket or higher in future tax years. This is especially true for top bracket taxpayers who may pay the 3.8% Medicare surtax on their "net investment income."

Example: Accelerating Bond Interest: Mike has $100,000 of accrued bond interest that will be paid on January 3, 2013. Mike is in the 35% tax bracket for 2012 and 39.6% + 3.8% for 2013. If he sells his bonds (at par) before the end of 2012 and recognizes the accrued interest income, he will pay $35,000 in taxes vs. $43,400 if he waits and collects the interest in 2013, and will save $8,400 in taxes.

Example: Sale/Repurchase of Bond: James purchased $1 million of corporate bonds in 1993 at par value; they mature December 31, 2011. On December 31, 2012, he sold them for $1,050,000. On January 3, 2013, he repurchased the same bonds for $1,050,000. Under tax law, this $50,000 premium can be used to offset his interest income over the remaining life of the bond (one year). By selling the bonds in 2012 and repurchasing them in 2013, he realizes a net income tax savings of $14,200 ($21,700 in income tax savings on the bond premium, less $7,500 in capital gains tax on the sale of the bonds = $14,200).

Additional Income Tax Planning Ideas

Oil and Gas Investments

Intangible drilling costs (IDCs) provide a large immediate income tax deduction (up to 85% of the initial investment). Losses, if any, created as a result of IDCs will be ordinary and will lower the taxpayer's Adjusted Gross Income. Depletion and other depreciation provide for additional deductions during the term of the investment. Additional tax credits may be available for certain oil and gas ventures.

Planning Tip: Be careful with oil and gas investment where the client may be subject to the alternative minimum tax (AMT). The AMT may limit the amount of deductions allowed.

Gold Investments

Generally, gold held as coins or bullion is treated as "collectibles," for which the long-term capital gain rate is 28%. All short-term capital gains are treated as ordinary income. Therefore, a taxpayer in a lower tax bracket would be better off triggering short-term rather than long-term capital gain on gold coins or bullion. On the plus side, the "wash sale rule" (explained below) does not apply to "collectible" losses.

Planning Tip: The "collectibles" tax rate does not generally apply to gold held in mutual funds or to non-exchange-traded options on gold. Gold futures must be "marked to market" and the unrealized gain/loss must be recognized each tax year. Moreover, gold futures gains are subject to special tax treatment (60% long-term capital gain or 40% short-term capital gain).

Foreign Currency Transactions

Gains and losses in foreign exchange transactions are ordinary income/loss rather than capital gain/loss. Generally, taxpayers will want to recognize ordinary income in 2011 and 2012 and push ordinary losses to 2013 and later years.

Index Options

These have special gains treatment on certain broad-based listed options (60% long-term and 40% short-term). For taxpayers in the highest marginal income tax bracket in 2013, this would result in a blended capital gains tax rate of 29.36% ((.6 x .2) + (.4 x .434)).

Loss Harvesting

Loss harvesting can apply to individuals, trusts/estates, and charitable lead and remainder trusts. Considerations include:

Wash Sale Rule: Capital losses are denied to the extent that a taxpayer has acquired (or has entered into a contract or option to acquire) a "substantially identical" stock or security within a period beginning 30 days before the sale and ending 30 days after the sale of a stock that was sold at a loss ("loss stock"). The disallowed loss on the loss stock is added to the cost basis of the new stock, and the holding period of the loss stock is carried over to the new stock. This rule also applies to ETFs, index funds, IRAs and taxable investment accounts. It does not apply to "collectibles."

Diminishing Real Value of Capital Losses: Because of the cost of capital, the sooner a capital loss is used the better.

Efficiency of Capital Loss Offsetting: In general, capital losses are more tax effective if they can be used to offset income taxed at higher tax rates (short-term capital gains and ordinary income). Long-term losses used against short-term gains are tax-efficient. Short-term losses used against long-term capital gains are tax inefficient.

Income Shifting to Junior Generations

Income taxes can be saved by shifting income-producing assets from parents or grandparents who are in a high income tax bracket to their children and grandchildren who are in lower tax brackets. Planning considerations include asset protection (accomplished through the use of trusts) and the "kiddie tax" for beneficiaries under age 24.

What makes this most attractive in 2011 and 2012 is the $5 million per person gift tax exemption: a married couple can gift up to $10 million and no gift tax will be incurred on the gift. The gift can be made in trust and then used to invest and/or purchase life insurance on the donors.

Example: Husband and wife, who are taxed at the current top (35%) rate, own $16,000,000 in S Corporation stock. They gift $10 million of it to their four adult children (15 5/8% of the S Corporation stock to each child). The S Corporation income is $2 million per year. After the gift, 37.5% is attributed to the parents and taxed at their rate and 62.5% is attributed to the children and taxed at their lower rates (assume 25%). Annual income tax savings: $10,000,000 x 10% = $100,000.

Planning Tip: Income can also be shifted upwards. For example, a high-earning professional can make the gift to his/her elderly parents who are in a lower tax bracket. The additional income can be used to help pay for medical and/or assisted living expenses. After the parents die, the assets can go to the original donor's children (if the "kiddie tax" does not apply) for additional income shifting.

Roth IRA Conversions

Benefits of converting include a lowering overall of taxable income long-term; tax-free compounding; no required minimum distributions (RMDs) during the owner's life; tax-free withdrawals for beneficiaries; and more effective funding of the bypass trust. For most people, converting to a Roth IRA is highly beneficial over the long term.

Planning Tip: When exploring a Roth IRA conversion, consider the tax rate in the year of conversion vs. the tax rate in years of withdrawals; the owner's ability to use outside assets to pay the income tax on the conversion; and the need for the IRA to meet annual living expenses.

Net Unrealized Appreciation (NUA) Planning

If an employee has employer securities in his/her qualified retirement plan, he/she may be able to convert a portion of the total distribution from the plan from ordinary income into capital gain income. The distribution must be made as a lump-sum distribution due to the employee's death, attaining age 59 1/2, separation from service, or becoming disabled within the meaning of Code section 72(m)(7).

Taxation of Lump-Sum Distribution

Ordinary income is recognized on the cost basis of the employer securities distributed (a 10% early withdrawal penalty is due if the employee is under age 55 at the time of distribution). The difference between the fair market value at distribution and the cost basis is Net Unrealized Appreciation (NUA). NUA is not taxed at the time of distribution, but at a later time when the stock is sold, and is taxed then at long-term capital gain tax rates. (Ten-year averaging is available to those born before 1/2/1936; 20% capital gain applies to pre-1974 contributions only.)

Planning Tip: NUA does not receive a step-up in basis at death, although subsequent gain above the value at distribution should. Also, if an estate or trust contains NUA stock, a fractional funding clause must be used; otherwise, the NUA will be subject to immediate taxation.

Charitable Planning

If the capital gains tax rate increases to 20% and the 3.8% Medicare surtax applies, charitable remainder trusts (CRTs) could become very attractive again. That's because appreciated assets that are transferred to a CRT are not taxed, so the full value of these assets is available to provide income to the donor, generating much more income than if the donor had sold the asset, paid the capital gains tax, and re-invested the proceeds.

Planning Tip: With the current historically low 7520 rates, charitable lead trusts can be used now by charitably inclined clients to shift significant wealth while using only an insignificant amount of their estate/gift tax exemption.

Inherited IRAs

An IRA is treated as inherited if the individual for whose benefit the IRA is maintained acquired the IRA upon the death of the original owner. Under the tax law, the IRA assets can be distributed based upon the life expectancy of the beneficiary if the beneficiary is a living person or a trust that meets certain requirements, such as that it is irrevocable, all beneficiaries are natural persons, and the oldest possible beneficiary can be determined.

Spouse as Beneficiary

A surviving spouse named as beneficiary of the deceased spouse's IRA may roll it over into a new or existing IRA in the spouse's own name. The spouse is then treated as the owner and may delay taking required minimum distributions (RMDs) until he/she turns age 70 1/2 and then take distributions based on his/her life, often allowing for a greater stretch-out period.

Planning Tip: If the surviving spouse is under 59 1/2, rolling over can expose him/her to the early withdrawal penalty if the IRA funds are needed before the surviving spouse reaches 59 1/2. Safer strategy is to wait until then to roll over and use the inherited IRA withdrawal rules before then.

Non-Spouse as Beneficiary

Naming a non-spouse beneficiary avoids having the IRA assets being subject to estate tax in the surviving spouse's estate. Required minimum distributions (RMDs) occur over the life expectancy of the designated beneficiary.

Common Inherited IRA Mistakes to Avoid

For non-spouse beneficiaries, it is critical to keep the inherited IRA in the name of the deceased IRA owner. Correct wording for an individual: "John Smith, deceased, IRA for the benefit of James Smith." Correct wording for a trust: "John Smith, deceased, IRA for the benefit of James Smith as Trustee of the Smith Family Trust dated 1/1/2010."

Other mistakes include not taking required minimum distributions, not using disclaimers when appropriate, not analyzing contingent beneficiaries, and taking a lump-sum distribution at the death of the IRA owner.

Life Insurance Planning for Inherited IRA

If the IRA owner's taxable estate does not have sufficient other assets, it could be necessary to use a portion of the IRA to pay estate taxes. Because this use triggers additional income taxes, between 60-80% of the IRA could be lost to taxes.

A solution is to establish an Irrevocable Trust that holds a life insurance policy on the IRA owner's life. Upon his/her death, the death benefit proceeds can be used to provide liquidity to the IRA owner's estate and preserve the inherited IRA. To the extent that the grantor does not hold any "incidents of ownership," none of the trust assets will be included in his/her taxable estate. Another alternative is to annuitize the IRA and contribute the annuity payments to the Irrevocable Trust where they are used to pay premiums for life insurance on the IRA owner.

Conclusion

The current income tax laws and the tax increases that will happen in just 16 months (unless the Congress and President agree otherwise) provide some unique opportunities for estate planning professionals to work together as a team to help our mutual clients. Take advantage of this limited time to meet with your clients, ask the right questions, and make a positive difference for them and their families.

THE AUTHOR. To ensure compliance with requirements imposed by the IRS under Circular 230, we inform you that any U.S. federal tax advice contained in this communication (including any attachments), unless otherwise specifically stated, was not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another party any matters addressed herein.