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THE PLANNER

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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.

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Planning for Advanced Asset Protection

Asset protection is vitally important in our ever more litigious society, and more wealth planning teams are needed who understand the intricacies of this area and can collaboratively implement advanced strategies. Whether creating an entire plan for the client or creating additional asset protection measures added on to an existing plan, you want to know with a high degree of certainty that the plan will be effective if an attack ever comes.

Asset protection planning is designed to provide increasing levels of protection, starting with where the client is today and moving to where he or she would like to be. Planning appropriately includes making sure there is neither too little nor too much planning.

In this issue of Planner, we will review and build on a prior issue ("Asset Protection Planning — Teamwork Is Required for Success"). We will also include some specific advanced asset protection strategies that will strengthen the plans you and your colleagues create for your mutual clients.

The Advisor Team Approach: The Three-Meeting Strategy

Asset protection planning is advanced. It is anything but "one size fits all"! Therefore, it requires both an in-depth understanding of the client and a collaboration of all the professionals involved. Therefore, we highly recommend that an asset protection engagement proceed deliberately and with a structure agreed to in advance by the client and the team members. The recommended and proven structure is:

1) Initial Meeting with Advisors and Client: The purpose of this meeting is to gather financial and objective information and to build a relationship with the client. To preserve the attorney/client privilege, it may be necessary to excuse non-attorney advisors from part of the meeting so the client and attorney can talk freely. It is also important to set some reasonable expectations and explain what asset protection is, how the laws work, and what the client can expect.

2) Advisors' Meeting: After the initial meeting, the client's involved advisors (attorney, CPA, financial advisors, insurance advisors, etc.) meet without the client present to review the client's objectives, discuss various legal and financial solutions, and determine a consensus solution. During this meeting, it is important to lean on the expertise of specific advisors to determine a comprehensive solution. All potential ideas and concerns should be discussed and explored and differences of opinion ironed out here, not in front of the client.

3) Client Solution Meeting: Here the advisor team presents a unified solution plan, including all legal and financial components, to the client and gets the clients' approval to proceed with plan implementation.

Talking Points for the Initial Meeting

It is important to explain to clients that asset protection is not about hiding or concealing assets. Rather, it is using existing laws appropriately to obtain the best possible level of protection for their assets. The goal is to take advantage of planning opportunities in a way that they can be as defensible as possible if and when the time comes that they are needed.

Client objectives typically include:

• High degree of certainty of the outcome. While there may be circumstances that neither client nor advisors can control, the end result should be considerably better than if the client had done no planning at all.

• Maintain control of their assets and their destiny. This is typically especially important to professionals and entrepreneurs.

• Discourage lawsuits from the outset. Rearranging business affairs and asset ownership can make clients less likely to be personally liable. For example, rental properties that are owned individually or in a revocable living trust can be moved to an asset protected arrangement like a limited liability company (LLC).

• Avoid liability "traps" like partnerships and joint ownership. It's one thing to be responsible for your own actions, but quite another to have your assets vulnerable to the actions of another.

Types of risks faced by clients often include:

• Professional liability: As a general rule, you cannot limit your own professional liability. Also, most states do not permit nonprofessionals to own a portion of a professional practice. Professional liability protection therefore begins with adequate malpractice or errors and omissions insurance coverage.

• Professional liability of a partner or employee: In a partnership, each professional is exposed to liability for the malpractice of every other partner and employee. The practice can be legally structured in such a way that each professional is protected from personal liability for the errors of others.

• Non-practice personal liabilities: These could come from business deals that have gone bad or tort claims (auto accidents, etc.). Within the practice, there could be non-professional liabilities from employment practices, employment discrimination, premises liability, and sexual harassment claims. Again, structures can be set up that isolate clients and client assets from these risks.

• Estate planning risks: These can include unnecessary or excessive income and estate taxes; a partner's next spouse who might be a problem with ownership interests; children's spouses and their behavior which can lead to loss of family assets, etc. These can be dealt with in general estate planning.

The best and most effective time to plan is before a claim arises, when there are only unknown potential future creditors. But even with an existing claim, some options (such as making a contribution to an ERISA qualified plan or doing a Roth conversion) may still be available to shield assets.

Planning Tip: Be aware of potentially fraudulent transfers. Also, because clients often submit incomplete information, obtain a solvency certificate and seek permission to independently investigate their financial situation through online/court house records and other advisors.

Levels of Asset Protection

Level 1: Exemptions: Certain assets are automatically protected by state or federal exemptions. State exemptions include personal property, life insurance, annuities, IRAs, homestead, joint tenancy or tenancy by the entirety. Different states protect assets differently and amounts of the exemptions will vary greatly. Federal exemptions include ERISA which covers 401(k), pension and profit sharing plans. The Pension Protection Act protects up to $1 million in IRAs for bankruptcy purposes.

Planning Tip: Sometimes it is possible to convert non-exempt assets into exempt assets. For example, cash can be used to pay down a mortgage to increase home equity. An IRA that is not well protected under state law could be put into an ERISA qualified retirement plan that is absolutely protected from creditors. Outside cash can be used to pay taxes on a Roth conversion, thereby increasing the net protected asset pool.

Level 2: Transmutation agreements (in community property states): Separate property assets of the "safe spouse" generally are not reachable to pay certain creditors of the "at risk spouse." Community property assets can be converted to separate property for the spouse not at risk, but once transmuted, the property may not become community property again in some states.

Planning Tip: Commutation of community property to separate property will have consequences, including the loss of stepped-up basis on the death of the non-owner spouse. Also, in the event of a future divorce, these assets would already be owned by the "safe spouse." It is important to explain these implications and possible consequences to the clients in writing. Be sure to evaluate commutations from a fraudulent transfer perspective before the transfer.

Level 3: Professional entity formation (PA/PC/PLLC): State laws will vary, but if available, a PLLC is usually more desirable than other forms of entity because of the charging order limitations that prevent a creditor from seizing the creditor's ownership interest in a multi-member entity. Instead, the creditor is often limited to the distributions that would have been made to the affected member. Income tax consequences for the creditor and debtor must also be considered. Using a jurisdiction that makes the charging order the sole creditor remedy is highly desirable.

Planning Tip: Using separate entities or a PLLC can limit liability for a partner's malpractice claims.

Level 4: Equipment and Premises Leasing LLCs: LLCs can be created to own specialized or valuable equipment and/or real estate to remove these assets from the business or professional practice. Lease agreements can then be created between the professional practice and the asset holding LLCs. It is important to segregate real estate, equipment and securities accounts from malpractice exposure and it may be desirable to separate them from each other. The state in which the LLC is formed is very important, as a jurisdiction that allows the charging order as the sole remedy is highly desirable.

Planning Tip: Accounts receivable, which can be significant, can be protected by pledging them to a friendly creditor or factoring them. In the event an unfriendly judgment creditor appears in the future, the unfriendly creditor will not be able to attach to the receivables because they are already pledged or factored to another creditor.

Planning Tip: One structure to consider is creating an irrevocable life insurance trust (ILIT) and funding it with a life insurance policy that is designed to have significant cash build up over time. Using a conventional trust structure that works in every jurisdiction, the insured is not a beneficiary, but the spouse and descendants can be. (If the insured is to be a beneficiary, a self-settled asset protection trust would need to be used.) The ILIT trustee (an independent party) can use discretion and enter into a credit line arrangement with the insured (the business owner/professional). In exchange for granting the credit line access to the cash value of the insurance policy, the insured would need to pledge significant assets to secure the potential drawdown. These pledged assets can include accounts receivable. There are turnkey accounts receivable protection plans that include bundling (creation and funding of the ILIT with a particular insurance product, along with the proper documentation) or the advisor team can create one. Either way, be sure to document carefully.

Level 5: FLP/FLLC to own non-practice assets: Consider forming a family limited partnership (FLP) or family limited liability company (FLLC) to own non-practice assets. These can include personal use real estate, investment accounts, cash or bank accounts, investment real estate and highly valued collectibles (vehicles, artwork, etc.). These can be leased back to an individual for personal use. Again, a favorable jurisdiction that has the charging order as the sole remedy is preferred.

Planning Tip: Ownership interests can be gifted, often at discounted values, and the current $5.12 million gift tax exemption provides an exceptional opportunity to transfer assets this year. Should this exemption decrease to $1 million in 2013, as the law currently states, the ability to make lifetime gifts will be significantly affected.

Planning Tip: With a personal residence, one option would be to borrow the maximum on the mortgage (through a home equity line of credit) and transfer the loan proceeds to an asset protection trust (APT) which then becomes a member of the FLP/FLLC. (Establish the APT first for interim protection.) A second option would be to sell the residence to an intentionally defective grantor trust (IDGT) in exchange for a note that is structured in such a way that it would be unattractive to a creditor.

Planning Tip: A qualified personal residence trust (QPRT) can also be used. Under a QPRT, the grantor retains the right to live in the home for a pre-determined number of years. At the end of the term, the home is owned by the trust beneficiaries, which can include the descendants of the grantor. Because it is a self-settled irrevocable trust, some states have limitations that can reduce its effectiveness for asset protection during the primary term. Also, the funding of a QPRT when there is a known claim could be considered a fraudulent transfer. However, there may be other reasons to use a QPRT, including the ability to do significant gift planning and asset value freezing.

Level 6: Domestic asset protection trusts: Non-practice or leasing LLC assets transferred to a DAPT before any claim arises may provide additional charging order protection. The downsides include having to fund the trust in the jurisdiction that allows it (e.g., Nevada, Delaware, Wyoming, Alaska, etc.) and the need to have a resident trustee in that jurisdiction, which may be a significant ongoing cost. There is also the risk under the Bankruptcy Act of a 10-year clawback for transfers to a DAPT.

Planning Tip: The creator of a non-APT trust cannot be a beneficiary and still achieve asset protection. However, the spouse and children can be the beneficiaries. A flight provision can be included so the assets could go to another jurisdiction if the trust is attacked. A trust protector can oversee the trustee, change the trustee, direct the trustee to move the trust to another jurisdiction, and even be able to decant and move the assets to another trust for the benefit of the same beneficiaries. The alternative is to establish a DAPT in a jurisdiction that allows them, so that the grantor can be a discretionary beneficiary and still achieve asset protection. (Alaska, Delaware, Nevada and Wyoming are often the most popular.)

Level 7: Offshore asset protection trusts: These are established under the laws of a foreign jurisdiction. With an offshore trust, the assets are in the hands of a foreign trustee and are outside the reach of any U.S. court. However, there may be tax issues. Also, if the court orders the assets repatriated and they can't be, the client could be cited for civil contempt and even jailed. In addition, offshore trusts are expensive to establish and maintain.

The Risks of Doing Asset Protection

Proceed with caution when doing asset protection planning for your clients. Be aware of potentially fraudulent transfers, concerns of solvency, and that there may be creditors you don't find out about. It will be much better for you if the client will let you do some level of due diligence. Make sure your client understands the issues and has some reasonable expectations of what the asset protection planning may or may not accomplish. Sometimes the advisors will conclude that it may not be possible to do everything the client wants to do.

Conclusion

Asset protection planning is a challenging and rewarding area in which the advisor team has many opportunities to work together for the mutual benefit of their clients and themselves.

Maximizing Social Security Retirement Benefits for Married Baby Boomers

On the final day of the 2012 NAELA Annual Conference in Seattle in April, Attorney David A. Cechanowicz, JD, MSFS from Albuquerque, New Mexico, delivered an eye-opening presentation entitled "Maximizing Social Security Income for Dual Income Boomers." His message was so novel and surprising to many of the boomers and other members of the National Academy of Elder Law Attorneys in the audience that this issue of the Planner newsletter addresses the topic, with permission of Attorney Cechanowicz.

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As we all know and statistics confirm, the American population is aging, people in general are living longer than past generations did, and in many cases women outlive men. For these reasons, it is important for people in their sixties to make the best choices in how they elect to claim their Social Security retirement benefits. For some people – particularly for those with diseases that make a relatively early death likely – election to start receiving their Social Security retirement benefits as early as possible may be the best choice. However, for many, starting to receive their Social Security retirements later can result in a large increase in the total amount of benefits received over the rest of their lives. What most of us are unaware of is that married people have the option to receive Social Security benefits under their own work record, their spouse's work record, or in some circumstances, both their own and their spouse's work record. If the choices made are not optimal, the result can be less than maximum monthly benefits for two, three or even four decades – a very long time.

Planning Note: Married people have the option to receive Social Security benefits under their own work record, their spouse's work record, or both, in some circumstances.

The members of the baby boom population (defined as those born between 1946-1964) born in 1946 are now 65 years old or have recently turned 66 years old. For the next 17 years, an average of more than 10,000 boomers per month will turn 65. This huge population of people needs to make decisions about when to start receiving their Social Security retirement benefits. Some have already elected to start receiving benefits as early as age 62.

The annual statement entitled "Your Social Security Statement" was mailed to taxpayers automatically for the past several years. The Social Security Administration stopped sending this statement automatically in 2011 due to budget constraints, but announced in February 2012 that it would begin sending the statements again to workers age 60 or older who are not yet receiving benefits.

The 2011 annual statement listed data for the worker's benefits upon retirement or disability, and projected benefit data for the worker's survivors. The 2011 statement also contained the following one-line comment in a list of potential benefits: "*Family - If you get retirement or disability benefits, your spouse or children may also qualify for benefits." This line did not provide any data. The last page of the 2011 statement amplified this point as follows: "Family - If you're eligible for disability or retirement benefits, your current or divorced spouse, minor children or adult children disabled before age 22 also may receive benefits. Each may qualify for up to about 50 percent of your benefit amount." Despite this information, most people are completely unaware that this benefit exists, that they need to elect it in order to get it, and that it can make a huge difference in their benefits received over the rest of their lives.

Attorney Cechanowicz compares the choices people in their 60s face to a three-legged stool. The legs are mortality, election, and taxation, and ignoring any leg will make the stool fall over. Each "leg" is discussed below.

Mortality

As mentioned above, the population as a whole is aging and individuals are living longer than ever before. Many factors affect how long individuals will live, but key factors are lifestyle, including diet, exercise, stress, sleep, exposure to dangerous conditions at work and at home, exposure to environmental health risks and unpredictable risks such as a car accident caused by someone else, and genetics. Some people now facing decisions about Social Security are already in terminal conditions or have substantial likelihood of not living many years. For these people, getting benefits earlier may be a better decision than waiting to receive more benefits later. But individuals whose health is good and exposure to predictable risks is low, and whose parents and ancestors have tended to live long lives, may choose to plan on a long lifetime.

Despite the fact that people are living longer, according to the SSA's Annual Statistical Supplement for 2011, 74% of Social Security recipients have elected to start receiving benefits early. This can be a huge mistake for a very long time.

Planning Tip: Electing to receive benefits early can be a huge mistake.

Election

Social Security election is often viewed as having to make one of three choices: to take early at a decreased benefit rate, take at the "full retirement age," or take late at a larger benefit level - sort of each man or woman for himself or herself. Although that is true on one level, it ignores the fact that more often than not, women live longer than men, and with a married couple, the surviving spouse is most likely going to be the wife who may live for many years after the husband dies. Dual income and formerly dual income families have more election choices than each spouse for himself or herself.

There are a few defined terms with which the reader needs to be familiar. Primary Insurance Amount (PIA) is the benefit (before rounding down to the next lower whole dollar) a person would receive if electing to begin receiving retirement benefits at Full Retirement Age (FRA, defined below), as calculated when the worker reaches age 62. The benefit a worker would receive if electing to begin receiving benefits at FRA is the PIA plus any cost-of-living increases between age 62 and the FRA.

An individual worker's PIA is calculated from the average of the worker's 35 highest income years, with each past year adjusted for inflation. The PIA formula for 2012 is in three parts:

1) 90% of first $767 of average indexed monthly earnings, plus
2) 32% of average indexed monthly earnings over $767 and through $4,624, plus
3) 15% of average indexed monthly earnings over $4,624

In order to be eligible for Social Security benefits based on a worker's own earning record, the worker must have at least 40 credits, meaning 40 quarter years for which Social Security withholding was withheld.

Optimizing the Social Security retirement benefits that a dual-income family or former dual-income family (due to being divorced or widowed) can obtain depends on the:

1) Worker #1's work record;
2) Spouse of Worker #1's work record;
3) Worker #2's work record;
4) Spouse of Worker #2's work record;
5) Survivor's benefit may be based on the Worker #1's record, Worker #2's work record, or both.

Full Retirement Age (FRA) depends on when the worker was born.

- 1937 or earlier - Age 65
- 1938-1942 - Add 2 months per year to 65
- 1943-1954 - Age 66
- 1955-1959 - Add 2 months per year to 66
- 1960 or later - Age 67

Avram L. Sacks, Social Security Law Analyst with Wolters Kluwer Law & Business, commented about the determination of FRA as follows: "[A]n individual is deemed to have attained a given age on the day BEFORE the anniversary of one's date of birth. And, technically, the rule is based on when an individual attains age 62. Thus, for individuals born on January 1, the applicable rule used to determine FRA is the rule for the preceding December 31. Thus, for example, an individual born January 1, 1960, attains age 62 on December 31, 2021. Since age 62 was attained in 2021, that person has FRA at age 66 and 10 months."

A worker with FRA of 66 may elect to receive benefits based on their own work record as early as age 62. However, the benefit is reduced to 75% of their PIA if taken at age 62 (a 25% reduction), 80% if taken at age 63, 86.6% if taken at age 64, or 93.3% of PIA at age 65. (The percentages in these examples apply to individuals who elect to start receiving benefits exactly in the month that their age changes. The numbers actually change each month of worker age, not just each year.) Adding insult to injury, if the worker continues earning wages while receiving Social Security benefits based on their own work record, the Social Security benefits are decreased based on the ongoing earnings.

A worker's benefit based on their own work record can increase above their PIA if receipt of benefits is delayed to as late as age 70. They receive 108% of their PIA if they start receiving benefits at age 67, 116% of PIA if starting at age 68, 124% if starting at age 69, and 132% if starting at age 70. This is an 8% increase for each year the starting date is delayed, up to age 70. (Again, these percentages actually change monthly, although the examples are yearly.) For a worker who is likely to live a long time and has other assets and income to live on while waiting, delaying the start of receiving benefits may be very profitable. If the worker continues earning wages after their FRA, there is NO decrease in the benefit; the worker gets the full benefit.

Important Rules

1) Early receipt of Social Security benefit reduces the worker benefit AND the spousal benefit.

2) The spouse of worker benefit reaches its maximum at the worker's FRA. Delayed retirement credits do not increase the spousal benefit.

3) Early receipt of benefits based on the worker's own work record before their FRA causes "deeming". The worker is deemed to have made all allowable elections as of that date.

4) Deeming does not occur if the worker elects to receive benefits based on their own work record at or after their FRA.

5) Prior to FRA, the worker has an earnings test that may cause repayment of Social Security benefits.

6) The Senior Citizen's Right to Work Act of 2001 eliminates the earnings test at or after the FRA.

Planning Note: There are several ways to maximize benefits for a couple.

When a two-worker couple elects to start receiving Social Security benefits based on their own work records, optional monthly choices over nine years for each worker result in 11,664 possible age combinations. There are four more ways to maximize the benefits for a couple:

When a two-worker couple elects to start receiving Social Security benefits based on their own work records, optional monthly choices over nine years for each worker result in 11,664 possible age combinations. There are four more ways to maximize the benefits for a couple:

Claim and Suspend.

A worker who has attained FRA can claim benefit but then suspend the benefit and collect Delayed Retirement Credits (DRCs). This allows the worker's spouse to claim and receive the "spousal benefit," which is one-half of the worker's benefit, based on the suspended worker's record.

Claim Now, Claim More Later.

The spouse of a worker who claims, or claims and suspends as described in the preceding paragraph, claims the spousal benefit (one-half of the other worker spouse's benefit), then later claims higher personal benefit at their FRA or later increased by DRCs.

Do Over.

A claimant can change their claim election within 12 months after claiming, but claimant must repay the benefits received. Taxes paid may be reclaimed from the IRS and state.

Stop-N-Go.

An individual who has started receiving benefits can stop temporarily, and later resume receiving benefits enhanced by DRCs based on a smaller amount.

Articles from the Center for Retirement Research at Boston College go into great detail about this and suggest which scenarios will work best based on relative incomes of the spouses. Seehttp://crr.bc.edu/; and http://fsp.bc.edu/social-security-claiming-guide/.

Another tool for planning is available at https://www.socialsecuritytiming.com/.

As should be evident, the maximum family benefit is not an individual calculation, nor even two individual calculations. It is a lifetime choice, and electing early Social Security benefits based on your own work record is betting against you living a long life.

Taxation

The way Social Security recipients blend their Social Security benefits with other income can make as much difference in net benefit as the election choice because Social Security is a tax-preferred form of income. That said, for those recipients whose only source of retirement income will be Social Security, very likely all of their retirement income will be income-tax-free. On the other end of the income spectrum, people who make several hundred thousand dollars per year of earned or investment income tend to be less concerned about optimizing the tax treatment of their Social Security. It is the middle income category of seniors who can make the most significant improvement in how their Social Security benefits are taxed by how they make their elections.

Social Security benefits are tax-free below the lower numerical thresholds in the following table:

Taxpayer who is:	50% Taxable	85% Taxable
Single or Head of Household	Over $25,000	Over $34,000
Married Filing Jointly	Over $32,000	Over $44,000

To examine the income tax effect of delayed receipt, compare the following two scenarios.

In scenario #1, a couple receives a blend of 42% Social Security benefits and 58% income from other income including IRA and 401(k) income. Their total income of $72,000 is made up of $30,000 Social Security and $42,000 other income. Adjusted gross income from this scenario (the taxed portion of Social Security plus other income) comes out at $40,050.

In scenario #2, the couple increases to 72% Social Security benefits ($52,000), and decreases other income to 28% ($20,000). Adjusted gross income (the taxed portion of Social Security plus other income) in this scenario is $8,700 due to the greater share of Social Security benefits, which are only partially taxed.

To further illustrate this concept, consider the combined state plus federal income taxes in the following states

State	Scenario #1 ($42k other income/$30k SS)	Scenario #2 ($20k other income/$52k SS)
NM	$6,135	$690
AZ	$5,599	$864
WA	$4,718	$590
CA	$5,057	$590
NY	$5,897	$790
GA	$6,798	$1,350
TX	$4,718	$590

The average adjusted gross income for scenario #1 is $5,560. The average adjusted gross income for scenario #2 is $780. Thus, scenario #2 provides a tax savings of $4,780 per year. Over 20 years, such tax savings multiplies to $95,600.*

*Source of calculations for this discussion: David A. Cechanowicz, "Maximizing Social Security Income for Dual Income Boomers", presentation at NAELA Annual Conference, Seattle, Washington, April 28, 2012.

Conclusion

Baby boomers face important choices to make the best elections in their choice of Social Security retirement benefit start dates. Dual income couples have very substantial opportunities to increase their total benefits above the sum of what two single individuals can receive. Dual income couples can plan carefully for the most likely survivor, and take optimum advantage of the spousal benefit available from Social Security in addition to the benefit available to each individual based on their own work record. Former spouses and widows and widowers in their 60s may have similar opportunities to receive additional spousal benefits based on the work record of their former or deceased spouse in addition to the benefits they are entitled to, based on their own work records.

If you have any questions or would like to discuss any items contained in this newsletter, please feel free to call our office.

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