The Estate Planner

January/February *2013*

Tax deal reshapes estate planning landscape

Are your children prepared to handle your wealth?

Planning your digital legacy

Estate Planning Red Flag
You're married and relocating into or out of a community property state

Weston Hurd LLP
Attorneys at Law
Cleveland ▪ Columbus ▪ Beachwood

The Tower At Erieview
1301 East 9th Street, Suite 1900
Cleveland, Ohio 44114-1862
tel 216.241.6602 • fax 216.621.8369

10 West Broad Street, Suite 2400
Columbus, Ohio 43215-3469
tel 614.280.0200 • fax 614.280.0204

24100 Chagrin Boulevard, Suite 200
Beachwood, Ohio 44122-5535
tel 216.241.6602 • fax 216.621.8369

www.westonhurd.com

Tax deal reshapes estate planning landscape

The American Taxpayer Relief Act of 2012 (ATRA) that averted the United States' descent over the "fiscal cliff" includes some welcome relief from both the large estate tax increases that had been scheduled to go into effect in 2013 and the uncertainty that has plagued the federal estate tax regime in recent years. The act addresses gift, estate and generation-skipping transfer (GST) tax rates and exemptions, as well as various breaks that may affect your estate plan.

Estate, gift and GST taxes

Beginning in 2013, ATRA sets a maximum tax rate of 40% for estate, gift and GST taxes. It also retains a $5 million unified estate and gift tax exemption and a $5 million GST tax exemption. Both exemptions are adjusted annually for inflation, so the 2013 exemptions will be a little more than the 2012 exemptions of $5.12 million.

Estate taxes will increase over those of 2011 and 2012 (and, in some cases, 2010), when the maximum tax rate was 35%. If Congress hadn't passed ATRA, however, the increase would have been much larger: The maximum rate would have reverted to 55% in 2013 and the exemption amount would have dropped to $1 million (with no adjustment for inflation except for the GST tax).

ATRA also removes the veil of uncertainty surrounding federal gift, estate and GST taxes by making these changes permanent — or at least as permanent as any tax code provision can be. There's nothing to stop Congress from modifying these taxes in the future. But the absence of an expiration date allows people to develop estate planning strategies with greater confidence.

Portability

ATRA also makes "portability" of estate tax exemptions between spouses permanent. When one spouse dies, his or her estate can make a portability election, allowing the surviving spouse to use the deceased spouse's unused exemption amount.

Portability enables married couples to take advantage of their combined exemption amounts without sophisticated estate planning techniques, such as credit shelter trusts. A credit shelter trust makes the most of the deceased spouse's exemption and, by limiting the surviving spouse's control over the trust, keeps the assets out of the surviving spouse's taxable estate. Portability, on the other hand, preserves the deceased spouse's exemption even if the surviving spouse gains unrestricted access to the deceased spouse's wealth.

Before ATRA, the value of portability was hampered by its temporary nature: It was available only in 2011 and 2012, making it risky for couples to rely on it. Permanence now makes portability a viable alternative to more complicated estate planning techniques.

Keep in mind, however, that trusts continue to offer significant benefits, including:

- Professional asset management,
- Protection of assets against creditors' claims,
- Avoidance of transfer taxes on future appreciation,

- GST tax planning (portability doesn't apply to the GST tax), and
- Preservation of state exclusion amounts in states that don't recognize portability.

In addition, if a surviving spouse remarries, the benefits of portability with respect to the first spouse may be lost. (Portability is available only for the most recent spouse's exemption.)

Other provisions

ATRA permanently preserves several other provisions that affect estate planning, including:

- The federal estate tax deduction (rather than a credit) for state estate taxes,
- Deferral and installment payment of estate taxes attributable to qualified closely held business interests, and
- GST tax protections, including deemed and retroactive allocation of GST tax exclusions, relief for late allocations, and the ability to sever trusts for GST tax purposes.

The act also extends through 2013 the ability of individuals age 70½ and older to make tax-free IRA distributions to charity (up to $100,000 annually).

Review your plan

Now that ATRA has brought some stability to the federal transfer tax system, your estate planning advisor can help you determine whether you should adjust your strategies. It's also a good idea to monitor legislative activities in the coming months. Congress may make additional gift, estate and GST tax changes in connection with its deficit-reduction efforts. ✤

Is it time for a Roth conversion?

The recently enacted American Taxpayer Relief Act of 2012 (ATRA) makes it easier to convert an existing traditional 401(k), 403(b) or 457(b) account into a Roth account — a potentially attractive tool for providing for your children or other heirs.

Contributions to Roth accounts aren't pretax. However, qualified distributions — including earnings — are tax-free. Essentially, the choice between a Roth or a traditional account comes down to whether you want to pay the tax now or later. A Roth account may be more attractive if you wish to prepay the tax liability on an account you plan to leave to your heirs.

Under pre-ATRA law, participants in employer retirement plans were allowed to make "in-plan" Roth conversions only if they were entitled to take distributions eligible for a rollover. Generally, this prevented current employees from taking advantage of a Roth conversion. Now, if your employer's plan allows it, you can convert a traditional retirement account into a Roth account even if you're not eligible for a distribution.

Keep in mind that you'll need to pay any taxes due on your account balance in the year of conversion.

Are your children prepared to handle your wealth?

Stories of "trust fund babies" who've squandered the wealth their parents carefully set aside for them to ensure their financial well being are all too common. If you've built up a large estate and are eager to share your wealth with your children, you may be concerned about their ability to handle it. Fortunately, there are steps you can take to help ensure they won't blow through their inheritance at a young age.

Build incentives and flexibility into a trust

An incentive trust is a trust that rewards children for doing things that they might not otherwise do. Such a trust can be an effective estate planning tool, but there's a fine line between encouraging positive behavior and controlling your children's life choices. A trust that's too restrictive may incite rebellion or invite lawsuits.

Incentives can be valuable, however, if the trust is flexible enough to allow a child to chart his or her own course. A so-called "principle trust," for example, gives the trustee discretion to make distributions based on certain guiding principles or values without limiting beneficiaries to narrowly defined goals. But no matter how carefully designed, an incentive trust won't teach your children critical money skills.

Many parents take an all-or-nothing approach when it comes to the timing and amounts of distributions to their children, either transferring substantial amounts of wealth all at once or making gifts that are too small to provide meaningful lessons.

Put on your teacher's cap

There's no one right way to teach your children about money. The best way depends on your circumstances, their personalities and your comfort level.

If your kids are old enough, consider sending them to a money management class. For younger children, you might start by giving them an allowance in exchange for doing household chores. This helps teach them the value of work. And, after they spend the money all in one place a few times and don't have anything left for something they *really* want, it teaches them the value of saving. Opening a savings

account or a CD, or buying bonds, can help teach kids about investing and the power of compounding.

For families that are charitably inclined, a private foundation can be a great vehicle for teaching children about the joys of giving and the impact wealth can make beyond one's family. For this strategy to be effective, children should have some input into the foundation's activities. When the time comes, this can also be a great way to get your grandchildren involved at a very young age.

Consider distribution amounts and timing

Many parents take an all-or-nothing approach when it comes to the timing and amounts of distributions to their children, either transferring substantial amounts of wealth all at once or making gifts that are too small to provide meaningful lessons.

Consider making distributions large enough so that your kids have something significant to lose, but not so large that their entire inheritance is at risk. For example, if your child's trust is worth $2 million, consider having the trust distribute $200,000 when your son or daughter reaches age 21. This amount is large enough to provide a meaningful test run of your child's financial responsibility while safeguarding the bulk of the nest egg.

Or maybe you want to encourage financial success by making matching gifts equal to the amount of income your children earn each year. Be careful, though, not to accidentally dissuade your beneficiaries from pursuing other worthwhile though less financially rewarding endeavors.

Spell out your plans

Your estate plan can be a powerful teaching tool, but only if your children or other beneficiaries understand the lessons you're attempting to impart. To avoid hurt feelings — or even litigation — it's important to discuss your plans with your family. For example, if you set up an incentive trust for your children, communication is critical to ensure

they understand your motivations and the values you're trying to reinforce. Or if you're limiting your children's inheritance so they can make their own way, providing nothing more than a financial safety net so they won't end up on the street should they fail, explain to them your reasons.

Whatever approach you choose, ensure that everyone in the family is on the same page. There are many ways to achieve this, including informal discussions, family letters explaining your intentions, structured family meetings and family mission statements.

Make your legacy last

If you plan on leaving a sizable amount of your estate to your children, consider incentive trusts, educate your children on money management and be smart with your distributions to them. Perhaps most important, communicate with your children about the reasons behind your decisions. These steps will increase the chances there will be money left to pass on to your grandchildren. ✤

Planning your digital legacy

If you had a suitcase full of cash that you wanted to leave for your family, would you bury it in the backyard without telling anyone about it? Of course not. But you may be doing the equivalent if you manage assets online without leaving instructions on how to access them.

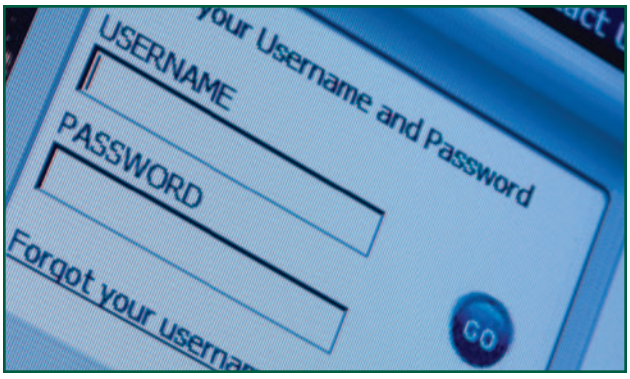
Unfortunately, in an increasingly digital world, people often overlook digital assets when developing an estate plan, and the consequences can be disastrous.

Living a virtual life

Meet Tim. He's a 45-year-old single father and, like many tech-savvy, environmentally conscious people, he does just about everything electronically. His paychecks are deposited directly into his checking account. He manages his bank and brokerage accounts online and receives the statements via e-mail. Most of his bills are delivered electronically and paid automatically from his checking account. He files his tax returns online and doesn't keep hard copies. He uses a Web-based storage service to back up important documents.

Several companies have established Web-based services that store user names, passwords and other digital assets and make them available to your loved ones according to your instructions.

Tragically, Tim dies unexpectedly. His executor searches his home but finds no paper records of Tim's assets and debts. He finds a laptop and a smartphone, but both are password-protected. No one in the family knows where Tim had accounts, and even if they did, a court order would likely be required to access them.



The executor has little choice but to hire an IT expert to hack into Tim's computer. But without user names and passwords, he still has to go to court to gain access to Tim's accounts.

Meanwhile, Tim's bills are still being processed automatically. But with no more paychecks being deposited, his checking account has insufficient funds to pay them.

Protecting digital assets

As people rely less and less on paper records, scenarios like Tim's will become increasingly common. And the impact goes well beyond personal finances.

A sole proprietor or small-business owner likely uses computers to maintain customer and product information, to track orders and to prepare bills and probably relies on e-mail for most correspondence. If the owner dies and his or her family lacks access to this information, the business may suffer.

In addition, many people have digital assets with great sentimental value, such as online photo and video galleries, social media pages and personal websites.

To avoid a situation similar to Tim's, you must include digital assets in your estate plan. Fortunately, it's not hard to do. It can be as simple as listing (on paper or on a flash drive or similar medium) the locations, user names and passwords for all digital assets and storing the list in a safe-deposit box or other secure place.

One problem with this approach is that the list is of little use if you change your passwords frequently. A better alternative may be to use password management software on your computer and other devices and to write down the master password and store it in a safe place together with the password for unlocking the computer itself.

In recent years, several companies have established Web-based services that store user names, passwords and other digital assets and make them available to your loved ones according to your instructions. For example, a service might release your information after two or more trusted "verifiers" confirm that you've died or become incapacitated.

Reducing stress on your family

If, like many people today, you have significant digital assets, talk to your estate planning advisor about strategies for ensuring that your family or personal representatives have access to them when the time comes. A little preparation now can make things much easier on your family during a stressful time. ✤

Estate Planning Red Flag

You're married and relocating into or out of a community property state

There are 10 community property states: Alaska (optional), Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. In these states money earned and property acquired by either spouse during marriage generally belongs to the "community" — meaning each spouse has an undivided one-half interest (regardless of how property is titled). When one spouse dies, his or her share of community property goes to the surviving spouse unless a will provides otherwise.

Typically, property retains its character as community or separate property when you move from one state to another unless you take an action — whether intentional or not — that causes the character to change. For example, a couple might use a marital property agreement to convert community property into separate property or to agree that income from separate property will also be separate property. Or a couple might unintentionally convert separate property into community property by commingling it with community property.

A common mistake made by couples relocating *from* community property states is to convert their community property into jointly held property. Community property offers a tax advantage: It generally is entitled to a fully stepped-up basis in the hands of a surviving spouse, so he or she can sell it without triggering capital gains tax. With jointly owned property, the surviving spouse receives a stepped-up basis on only *half* of the property's value.

For couples who relocate *to* community property states, a potential trap involves "quasi-community property" — property that would have been community property if the couple had lived in the new state all along. Some states treat such property as community property, which can lead to unpleasant surprises.

When relocating, it's critical to find out how a new state's laws will affect your property rights. If necessary, modify your will or use trusts or other tools to ensure that your estate plan continues to operate as desired — or to take advantage of new options that weren't available in your old state.

Weston Hurd LLP

Attorneys at Law

Angela G. Carlin is the Co-Chair of Weston Hurd's Estate, Trust and Probate Practice Group. She focuses her practice on estate, trust and probate administration and litigation, and tax matters. Angela is the author of the Merrick-Rippner Probate Law publication which is the recognized authority in Ohio on probate law. She received the Nettie Cronise Lutes Award from the Ohio State Bar Association in 1996 as the Outstanding Woman Lawyer and for many years, she has been named as an *Ohio Super Lawyer* by Law & Politics Media, Inc. and a *Leading Lawyer* by Inside Business Magazine.

Karen A. Davey focuses her practice on estates, trust and probate administration. She also handles litigation in probate related matters, such as will contests, trust contests, and power-of-attorney disputes.

Jerrold L. Goldstein focuses his practice on estate planning, probate and corporate law. Jerry is also Co-Chair of Weston Hurd's Estate, Trust and Probate Practice Group. He represents clients in a wide variety of matters involving probate administration, probate litigation, estate and income tax compliance, wills and trusts, business formation, contract negotiations, and commercial real estate.

Jeanne V. Gordon focuses her practice on all aspects of ERISA and employee benefits matters, specifically the design, development and implementation of various retirement and welfare benefit plans.

Eugene (Gene) A. Kratus advises individuals in the areas of tax, business and estate planning and counsels privately-owned businesses and their owners on corporate, tax, mergers, acquisitions and business succession issues. His estate planning practice includes implementing various estate planning techniques, ranging from modest By-Pass Trusts to the implementation of sophisticated planning with family limited partnerships, family limited liability companies, charitable trusts and private foundations.

Samuel J. Lauricia III focuses his practice on tax planning, at both the Federal and state level, involving corporate, partnership, individual and gift tax issues, succession planning and general corporate transactions, contracts, mergers and acquisitions. Sam has been recognized as an *Ohio Rising Star* in the area of Taxation by Law & Politics Media, Inc.

Shawn W. Maestle is the Chair of Weston Hurd's Appellate section and a member of the firm's Litigation section. He focuses his practice in the areas of appellate, estate planning and probate litigation.

Melanie R. Shaerban is an Associate with Weston Hurd LLP. She focuses her practice on commercial and business litigation, employment law, estate, trust and probate law, insurance defense and insurance coverage matters, as well as governmental liability.

Joseph B. Swartz focuses his practice on estate planning, estate administration, trust administration, labor, employment, and income tax for individuals, estates and trusts. Joe served as chair of the Ohio State Bar Association's Labor and Employment Law section for 2010-2012 and he has been recognized as an *Ohio Super Lawyer* for Labor and Employment by Law & Politics Media, Inc.

Medallion Signature Guarantee – An Inconvenience

By Jeanne V. Gordon

You have done all the planning necessary to make your passing and the distribution of your estate an easy transition for your family. You have identified your assets, transferred them to a trust and made the important parties aware of your wishes. As part of your estate, you have assets that include stocks, bonds or other types of securities in certificate form. It may be necessary for your estate to liquidate them or transfer them to your beneficiaries. In most instances, the transfer agent of these securities will require executed forms with a Medallion signature guarantee. And that, according to the Securities and Exchange Commission, can be an inconvenience.

A Medallion signature guarantee is often confused with a notarized signature. The Medallion stamp program was adopted to assure transfer agents, who increasingly have no employee agents who know the securities holder, that the transaction request is coming from a person who has the authority and capacity to make the request. When your trustee requests the transfer agent to liquidate your stocks to pay the expenses of your estate, the transfer agent can allow the liquidation without fear of liability for allowing an improper transfer. Why is that? Because the financial institution (usually a commercial bank, savings bank, credit union, or broker-dealer) which provided the Medallion signature guarantee is obligated to immediately make up any loss and pursue any ultimate remedy on its own if the transaction request is fraudulent. The Medallion guarantor is pledging that the signature is genuine (similar to the effect of a notarized signature) and that the signer has authority and capacity to issue the transfer instruction (unlike a notarized signature). This removes virtually all liability from the transfer agent for any unauthorized or improper transfer.

Unfortunately, financial institutions have decided that providing this service (a service for which they do not generate revenue) is no longer feasible, considering the risks and costs involved in guaranteeing the efficient and secure transfer of securities. As a result, finding an institution that will provide a Medallion signature guarantee can be difficult for your trustee, executor or beneficiaries and virtually impossible if they do not maintain a relationship with the institution that is requested to issue the Medallion guarantee. This can be especially frustrating if your trustee or beneficiaries are dealing with on-line brokers or mutual fund companies.

One way to alleviate this "inconvenience" is to have your securities held in the name of your brokerage firm or in the brokerage firm's "street" name. Securities held in "street" name are held in the name of the brokerage firm for the benefit of the investor in the securities. Securities in "street" name do not need signature guarantees in order to be transferred.