

# *The* ESTATE PLANNER

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**Life insurance**

**A POWERFUL ESTATE  
PLANNING TOOL FOR  
NONTAXABLE ESTATES**

**4 WAYS TO TRANSFER  
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**ESTATE PLANNING RED FLAG**

**You don't have a health  
care power of attorney**

**Weston Hurd** LLP  
Attorneys at Law

Cleveland ■ Columbus ■ Beachwood

The Tower At Erieview  
1301 East 9<sup>th</sup> 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](http://www.westonhurd.com)

## LIFE INSURANCE

# A POWERFUL ESTATE PLANNING TOOL FOR NONTAXABLE ESTATES

For years, life insurance has played a critical role in estate planning, providing a source of liquidity to pay estate taxes and other expenses. It's been particularly valuable for business owners, whose families might not have the liquid assets they need to pay estate taxes without selling the business.

Today, the estate tax exemption has climbed above \$5 million, so estate taxes are no longer a concern for the vast majority of families. But even for nontaxable estates, life insurance continues to offer significant estate planning benefits.

### REPLACING INCOME AND WEALTH

If you die unexpectedly, life insurance can protect your family by replacing your lost income. It can also be used to replace wealth in a variety of contexts. For example, suppose you own highly appreciated real



estate or other assets and wish to dispose of them without generating current capital gains tax liability. One option is to contribute the assets to a charitable remainder trust (CRT).

*If you're philanthropically inclined, life insurance can help you support your favorite charities in a cost-effective manner.*

As a tax-exempt entity, the CRT can sell the assets and reinvest the proceeds without triggering capital gains tax. In addition, you and your spouse will enjoy an income stream and charitable income tax deductions. Typically, distributions you receive from the CRT are treated as a combination of ordinary taxable income, capital gains, tax-exempt income and tax-free return of principal.

After you and your spouse die, the remaining trust assets pass to charity, reducing the amount of wealth available to your children or other heirs. But you can use life insurance (a cost-effective second-to-die policy, for example) to replace that lost wealth.

You can also use life insurance to replace wealth that's lost to long term care (LTC) expenses, such as nursing home costs, for you or your spouse. Although LTC insurance is available, it can be expensive, especially if you're already beyond retirement age. For many people, a better option is to use personal savings and investments to fund their LTC needs and to purchase life insurance to replace the money that's spent on such care. One

advantage of this approach is that, if neither you nor your spouse needs LTC, your heirs will enjoy a windfall.

## FUNDING CHARITABLE GIFTS

If you're philanthropically inclined, life insurance can help you support your favorite charities in a cost-effective manner. One strategy is to donate life insurance to charity. If you transfer a policy to a charitable organization, so that the organization becomes both owner and beneficiary, you'll enjoy a charitable income tax deduction (subject to certain limitations), plus additional deductions if you continue to pay the premiums. Or, you can simply name a charity as beneficiary. You won't be entitled to any charitable income tax deductions, but you'll retain control over the policy, including the right to tap its cash value or change beneficiaries. When you die, your estate will be entitled to an estate tax charitable deduction.

Another strategy is to use other assets to fund charitable gifts and purchase life insurance to replace the wealth donated to charity. This strategy is particularly valuable if you have a significant amount in traditional IRAs or retirement plans. If you leave these assets to your heirs, they'll be subject to income tax on any distributions they receive. But if you leave the assets to charity and purchase a life insurance policy for your heirs' benefit, both the charity and your heirs will receive the funds tax-free. You can even withdraw funds from an IRA or retirement plan and use the after-tax proceeds to pay the premiums.

## TREATING YOUR CHILDREN EQUALLY

If much of your wealth is tied up in a family business, treating your children fairly can be a challenge. It makes sense to leave the business to those children who work in it, but what if your remaining assets are insufficient to provide an equal inheritance to children who *don't* work in the business? For many

## Why ILITs are still relevant

Historically, the primary purpose of an irrevocable life insurance trust (ILIT) has been to remove an insurance policy — and its proceeds — from your taxable estate. But even in a nontaxable estate, an ILIT offers significant benefits. A properly drafted ILIT can protect the trust assets against creditors of the grantor as well as of the beneficiaries, particularly if it's established in a state with favorable asset protection laws.

In addition, an ILIT will shield your insurance proceeds against estate taxes in the event your estate becomes taxable in the future — either because your wealth grows unexpectedly or because Congress decides to reduce the estate tax exemption.



families, the answer is to purchase a life insurance policy to make up the difference.

## PROTECTING YOUR ASSETS

Depending on applicable state law, a life insurance policy's cash surrender value and death benefit may be shielded from creditors' claims. For additional protection, consider setting up an irrevocable life insurance trust (ILIT) to hold your policy. (See "Why ILITs are still relevant" above.)

## FINDING THE RIGHT POLICY

These are just a few examples of the many benefits provided by life insurance. Talk to your estate planning advisor to help determine which type of life insurance policy is right for your situation. ❖

# 4 WAYS TO TRANSFER A FAMILY BUSINESS

For many people, a family-owned business is their primary source of wealth, so it's critical to plan carefully for the transition of ownership from one generation to the next.

The best approach depends on your particular circumstances. If your net worth is well within the estate tax exemption, for example, you might focus on reducing income taxes. But if you expect your estate to be significantly larger than the exemption amount, estate tax reduction may be a bigger concern.

Here are four estate-tax-wise techniques to transfer a family business:

**1. IDGT.** An intentionally defective grantor trust (IDGT) is an *income* defective trust. As such, it can be a highly effective tool for transferring business interests to the younger generation at a minimal gift and estate tax cost.

*An estate defective trust is designed so that beneficiaries are the owners for income tax purposes, while the assets remain in the estate for estate tax purposes.*

An IDGT is designed so that contributions are completed gifts, removing the trust assets and all future appreciation in their value from your taxable estate. At the same time, it's "defective" for income tax purposes; that is, it's treated as a "grantor trust" whose income is taxable to you. This allows trust



assets to grow without being eroded by income taxes, thus leaving a greater amount of wealth for your children or other beneficiaries.

The downside of an IDGT is that, when your beneficiaries inherit the business, they'll also inherit *your* tax basis, which may trigger a substantial capital gains tax liability if they sell the business. This result may be acceptable if the estate tax savings outweigh the income tax cost. But what if the value of your business and other assets is less than the current estate tax exemption amount, so that estate taxes aren't an issue? In this case, you might consider an *estate* defective trust.

**2. Estate defective trust.** Essentially the opposite of an IDGT, an estate defective trust is designed so that beneficiaries are the owners for income tax purposes, while the assets remain in the estate for estate tax purposes. This technique provides two significant income tax benefits. First, assuming your beneficiaries are in a lower tax bracket, this strategy will result in lower "familywide" taxes. Second, because the trust assets remain in your estate, the beneficiaries' basis in the assets is "stepped up" to fair market value, reducing or eliminating their potential capital gains tax liability.



This strategy assumes you'll have little or no estate tax liability. If your estate increases unexpectedly or Congress decides to reduce the exemption, the benefits may be lost.

**3. Sale to an IDGT.** If you prefer to sell the business to your children, consider an installment sale to an IDGT (with the payments funded by the business's cash flow). Selling to a trust allows you to retain some control over the business while removing it from your taxable estate. And by structuring the transfer as a sale, you'll avoid gift taxes. Also, when you sell assets to a grantor trust you're essentially selling them to yourself, so there are no capital gains taxes on the transaction.

**4. BIDIT.** One drawback to selling to an IDGT is that, if you die before the sale is complete, the IDGT will be converted to a nongrantor trust and your estate will be hit with a capital gains tax liability (usually based on the present value of

all unpaid installments). To avoid this risk, some taxpayers have started using business intentionally defective irrevocable trusts (BIDITs). A BIDIT works like an IDGT, except it's established by the business itself rather than the owner. Because the grantor is an entity rather than a person, this technique eliminates the income tax risk associated with the grantor's death.

Be aware that the BIDIT is relatively new and untested, but its proponents believe that it can provide a variety of estate tax, income tax and asset protection advantages over an IDGT.

If you own a family business, be sure to review your ownership succession plan in light of recent tax developments. Determining the right strategy to implement when transferring ownership of the business to heirs depends on the value of your business and other assets and the relative impact of estate and income taxes. ❀

## CHANGING FAMILY MAKEUP REQUIRES ESTATE PLAN REVIEW

Today's American families have grown increasingly diverse. A typical nuclear family consisting of a breadwinning husband, homemaker wife and their children no longer represents the dominant configuration. Instead, the family may include unmarried parents of adopted children or married parents with unadopted stepchildren. If your family's demographics have recently changed, it's time to revisit your estate plan. Let's take a closer look at a few specific family makeups.

### FAMILY WITH RECENTLY ADOPTED CHILDREN

Adopted children are placed on an equal footing with biological children in most situations for estate

planning purposes. Thus, adopted and biological children are treated the same way under a state's intestate succession laws, which control who inherits property in the absence of a will.



In addition, adopted children generally are treated identically to biological children for purposes of wills or trusts that provide for gifts or distributions to a class of persons, such as “children,” “grandchildren” or “lineal descendants” — even if the child was adopted after the will or trust was executed.

## **BLENDED FAMILY WITH STEPCHILDREN**

Stepchildren generally don’t have any inheritance rights with respect to their parents’ new spouses unless the spouse legally adopts them. If you have stepchildren and want them to share in your estate, either adopt them or amend your estate plan to provide for them expressly.

Of course, estate planning isn’t the only reason to adopt stepchildren. Adoption also gives you all of the legal rights of a parent during your life.

Before you adopt stepchildren, however, you and your spouse should consider the potential effect on their ability to inherit from (or through) their other biological parent’s relatives. In most states, when a child is adopted by a stepparent, the adoption decree severs the parent-child relationship with the other biological parent and his or her family.

If you wish to *exclude* stepchildren from your estate, in most cases it’s sufficient to do nothing. But some

states permit stepchildren to inherit through intestate succession under certain circumstances, so be sure to check with your estate planning attorney regarding the laws in your state of residence.

*Adopted children are placed on an equal footing with biological children in most situations for estate planning purposes.*

## **FAMILY WITH SECOND-PARENT ADOPTIONS**

A growing minority of states now permit second-parent adoptions, in which an unmarried person adopts his or her partner’s biological or adopted children without terminating the partner’s parental rights.

For unmarried couples who can’t obtain a second-parent adoption, or choose not to, estate planning is especially critical — if they want the “nonparent” to have custody of the child should the “parent” die or become incapacitated and if the nonparent wants the child to inherit from him or her.



First, the parent should consider using a power of attorney for parental authority and appointing the nonparent as a guardian to ensure that he or she can act on the child’s behalf and has priority over the parent’s blood relatives in the event the parent dies or becomes incapacitated.

Second, both partners should amend their wills. The parent’s will should name his or her partner as the child’s guardian,

and the nonparent's will should spell out any property to be inherited by the child.

## A CHANGE IN YOUR FAMILY MAKEUP?

If you and your spouse recently have adopted a child or your new spouse has children from a previous

marriage whom you haven't legally adopted, it's important to revisit your estate plan — specifically your will or living trust — to ensure those children are treated according to your wishes. Relying solely on your state's intestate laws may result in unwanted circumstances. ❀

### ESTATE PLANNING RED FLAG

## You don't have a health care power of attorney

What happens if illness, injury or age-related dementia renders you unable to make decisions or communicate your wishes regarding your health care or financial affairs? Unless your estate plan addresses these situations, your family may be forced to seek a court-appointed guardian.

Health care arrangements are particularly important because your wishes won't necessarily coincide with someone else's judgment about what's "in your best interests." To help ensure that your wishes are carried out, create a health care power of attorney (HCPOA). Sometimes referred to as a "health care proxy" or "durable medical power of attorney," an HCPOA appoints a representative to make medical decisions on your behalf if you're unable to do so.

Who should be your representative? The natural inclination may be to name your spouse or a child, but they may not be the best choices. A close family member may find it difficult to act as a health care proxy, especially if it involves decisions about whether to continue or terminate life-sustaining measures. Designate someone you trust to make the tough decisions in order to carry out your wishes when the time comes.

Your HCPOA should provide guidance on how to make health care decisions. Although it's impossible to anticipate every potential scenario, the document can provide your representative with guiding principles. For example: What are your desired health outcomes? Is your top priority to extend your life? Is artificial nutrition or hydration an option? Under what circumstances should life-sustaining treatment be withheld or terminated?

Other documents to consider include a living will — which communicates your preferences regarding life-sustaining medical treatment in the event you are dying of a terminal condition or an end-stage condition. Also consider a revocable trust and durable power of attorney to provide for a trusted representative to manage your financial affairs in the event you're unable to do so.



## FUNDING THE COSTS OF DISABILITY THROUGH AN ABLE ACCOUNT

BY JERROLD L. GOLDSTEIN



**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.



**Gary W. Johnson** advises clients on matters involving commercial litigation, business entities creation and maintenance, land use, construction law, zoning, estate planning and probate. Gary has been recognized as an *Ohio Super Lawyer* in the area of Business Litigation by [Law & Politics Media, Inc.](#)



**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.



**Teresa G. Santin** is an Associate with Weston Hurd LLP. She focuses her practice on matters involving business, employment, estate planning, real estate, and white collar litigation.



**Joseph B. Swartz** focuses his practice on estate planning, estate administration, trust administration, 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.](#)

The "Achieving a Better Life Experience" or "ABLE" legislation, initially proposed in 2009, was finally enacted on December 19, 2014 as a part of the Tax Increase Prevention Act of 2014. The law, which generally extended the so-called tax-extenders through 2014, also included the substantive terms of the ABLE Act authorizing tax-favored savings accounts for individuals with disabilities.

Individuals with disabilities depend upon a wide variety of public benefits (SSI, Medicaid) which are means or resource tested limiting eligibility to individuals with less than \$2,000 in savings, retirement funds and other assets or earnings of more than \$680 per month. To remain eligible for these public benefits, an individual must remain poor.

The legislation eliminates bureaucratic obstacles to help people save their own money to help pay for the care of family members with disabilities. Eligible individuals and their families will be able to reserve funds in excess of program resource limits that will not affect their eligibility for public benefits and can secure funding for disability-related expenses on behalf of designated individuals with disabilities ("beneficiaries") that will supplement, but not supplant, benefits provided through private insurance, Medicaid, SSI, the beneficiary's employment and other sources. While the original scope of the proposal had to be cut back to reduce its initial \$20 billion price tag, the legislation still represents a significant policy change in recognizing the extra and significant costs of living with a disability.

The new law will allow eligible individuals with disabilities to open special accounts which can be used to save up to \$100,000 without risking eligibility for SSI or Medicaid coverage. An individual is "disabled" for purposes of the ABLE account (a) if that individual is receiving, deemed to be, or treated as receiving supplemental security income benefits or disability benefits under Title II of the Social Security Act or (b) that individual has a medically determined physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months or is blind, and provides a copy of their diagnosis signed by a physician.

The program is modeled after §529 college savings plans. Earnings on the accounts will be income tax free and the assets can be accumulated, invested, grown and distributed free from federal taxes and the funds in the accounts can be used to pay for education, health care, transportation, housing and other expenses. There are no federal tax benefits provided to contributors to ABLE accounts.

Accounts may be opened yet this year. However, while the Federal law has been modified to allow for creation of ABLE accounts, they cannot be opened until the states adopt conforming legislation to permit financial institutions to make the ABLE accounts available.

The following summarizes the highlights of the legislation.

1. Contributions to the accounts are not tax deductible.
2. The individual beneficiary must have become disabled before reaching age 26.
3. Only one ABLE account may be established with respect to each disabled individual.
4. The annual contributions to an ABLE account by all persons is limited to \$14,000.
5. Maximum contributions over time cannot exceed the residence state limit for education-related §529 plans. For Ohio residents the contribution limit is \$414,000.
6. Only \$100,000 of the ABLE account is excluded as an SSI resource. However, ABLE account proceeds used for a beneficiary's housing expenses will be taken into account when determining SSI benefits. As a result the one-third reduction rule will apply.
7. SSI benefits are suspended once the account value exceeds \$100,000.
8. Medicaid benefits are not affected by the size of the ABLE account or by distributions made from the account. States are, however, able to recover the medical costs paid for the beneficiary after the ABLE account was established from the balance remaining in the ABLE account at the beneficiary's death.
9. Expenses payable from an ABLE account ("qualified disability expenses") are any expenses related to the designated beneficiary as a result of living a life with disabilities. Expenses include education, housing, transportation, employment, training and support, assistive technology, personal support services, health care expenses and other services. Non-qualified disbursements will be subject to a 10% penalty on the earnings portion of the distribution and all earnings would be subject to regular income tax.
10. No account can be established until the Secretary of Treasury promulgates regulations and individual states adopt enabling legislation to establish and operate an ABLE program.
11. Accounts must be established in residence state.
12. The ABLE account cannot be used for the general support (food, clothing) of a disabled individual.

An ABLE account will provide more choices and control for the beneficiary and his or her family. The cost of establishing an ABLE account will be considerably less than either a Special Needs Trust or a Pooled Income Trust. Determining which option is the most appropriate will depend upon individual circumstances. For many families, the ABLE account will be a significant and viable option in addition to, rather than instead of, a trust program.