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# Financial Advisor Current Events Update
# April/May/June 2014

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## I. Reflection of the Month

"Humor is mankind's greatest blessing. Against the assault of laughter nothing can stand" - Mark Twain

Humor and laughter are amazing tools. They can turn any serious situation into something to laugh about. They can lighten the mood just about anywhere.

And a lighter mood is often better space to work in because now your body and mind isn't filled to the brim with negative emotions. When you are more light-hearted and relaxed then the solution is often easier to both come up with and implement.

## II. On the Lighter Side: Taxes

Taxes: Of life's two certainties, the only one for which you can get an automatic extension. ~Author Unknown

Death and taxes may be inevitable, but they shouldn't be related. ~J.C. Watts, Jr.

The wages of sin are death, but after they take the taxes out, it's more like a tired feeling, really. ~Paula Poundstone

## III. Obama's 2015 Budget and Estate Planning - Everything Old is New Again – by Julie Ann Garber

Even though the passage of the American Taxpayer Relief Act of 2012 ("ATRA") has been touted as providing certainty to federal estate tax and gift tax laws that has been absent for the past 13 years, we should not become complacent and lose sight of what is being proposed in Washington since, as the saying goes, "A law is only permanent until Congress decides to change it." And while under ATRA the 2014 estate tax exemption of $5.34 million will continue to be indexed annually for inflation and is expected to reach $9 million per decedent by 2034, the struggle in Washington to balance revenues with spending may very well lead Congress to close some of the "loopholes" that the ultra wealthy have benefited from in the past in order to decrease the values of their estates for estate tax purposes and allowed them to create "Dynasty Trusts" that will continue to grow estate tax free for many years into the future.

With all of that said, President Obama's 2015 budget, which was released last week, is yet another rehash of budgets from prior years, none of which had any chance of being enacted, nor does this one. Nonetheless, all of the budget proposals from past years which would curtail certain sophisticated estate planning techniques and close those "loopholes" remain in the 2015 budget, and one or more of these proposals could very well be tacked on to unrelated legislation in the next few years (as Forbes writer and attorney Deborah L. Jacobs points out, "*watch those transportation funding bills*"). So, without further ado, below is a summary of the provisions of President Obama's 2015 budget that could impact estate planning.

First up, the same old proposals:

1. Here we go again - as in Obama budgets past, the 2015 budget would **decrease the federal estate tax exemption to $3.5 million, decrease the lifetime gift tax exemption to $1 million, and increase the top estate and gift tax rates to 45%, but not until *2018*.** President Obama has supported these numbers since he first ran for president in 2008 and he even pushed for these numbers to be included in ATRA, to no avail. To me this proposal is like listening to a broken record or waking up on Groundhog's Day everyday like Bill Murray. Let it go, President Obama, let it go.
2. Eliminating the estate tax benefits of sales to intentionally defective grantor trusts.
3. Requiring all grantor retained annuity trusts ("GRATs" for short) to have a minimum term of 10 years, and eliminating zeroed-out GRATs.

4. Including assets held in grantor trusts in a decedent's estate and making distributions from grantor trusts during the grantor's lifetime subject to gift taxes.
5. Limiting the length of time that Dynasty Trusts can remain estate tax and generation-skipping transfer tax free to 90 years.
6. Making distributions from Health and Education Exclusion Trusts (HEETs for short) subject to generation-skipping transfer taxes.
7. Eliminating "stretch IRAs" by requiring IRAs inherited by non-spouse beneficiaries to be cashed out within 5 years of the deceased owner's date of death.

And here is one new thing to ponder - **saying goodbye to "Crummey" withdrawal rights**.

The 2015 budget proposes the elimination of the present interest requirement for gifts that qualify for the annual gift tax exclusion (currently $14,000 per donee). Instead, a new category of transfers (without regard to the existence of any "Crummey" withdrawal or put rights) would be created, and would impose an annual limit of $50,000 per donor on the donor's transfers of property within this new category that will qualify for the gift tax annual exclusion. This would result in a donor's transfers in the new category in any given year that exceed a total amount of $50,000 being treated as taxable gifts, even if the total gifts to each individual donee did not exceed $14,000. The new category would include transfers in trust, transfers of interests in pass-through entities, transfers of interests subject to a prohibition on sale, and other transfers of property that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee.

## IV. Using Trusts As Beneficiaries of IRAs by Bradley E.S. Fogel

The benefits of IRAs and qualified plans have reached almost mythical proportions. Deferring income tax liability until distribution of the assets provides the opportunity for tax-free growth of an IRA and, thus, enormous income tax savings.

Although not new, The Andersen Firm has been working with clients and Financial Advisors for over 8 years with The IRA Inheritance Trust. Here is how it works.

To maximize the tax savings, the employee generally defers distributions from the IRA as long as possible. After the employee’s death, the beneficiary of the IRA should similarly seek to defer payout of the IRA. Of course, the opportunity for deferral is limited by the Internal Revenue Code’s required minimum distribution (RMD) rules.

During the account owner’s (a/k/a the “employee’s”) lifetime, the RMD is calculated to pay out the IRA over the lifetime of the employee and a beneficiary. IRC § 401(a)(9)(A). After the employee’s death, the RMD is calculated to pay out the remaining balance of the IRA over the “designated beneficiary’s” lifetime. IRC § 401(a)(9)(B). Thus, it is advantageous to appoint the youngest possible beneficiary, to the extent consistent with the estate plan. Practical considerations, however, require additional safeguards when appointing a young individual as beneficiary of any substantial asset—including an IRA.

Suppose, for example, that the employee wishes to appoint her grandchild as the IRA beneficiary. Appointing such a young beneficiary may be wise in terms of taxation. But, if the beneficiary is a minor at the employee's death, the beneficiary's incapacity creates practical problems when the beneficiary becomes owner of the IRA. Moreover, if the beneficiary is a young (or immature or disabled) adult, the employee will be anxious to assure that the IRA is not squandered.

One solution to these problems is to leave the IRA to the beneficiary in trust. This creates two issues, however. First, consider the easy issue: how does one designate a trust as a beneficiary of an IRA without running afoul of the RMD rules? These rules require distribution of the IRA within five years of the employee's death if the IRA has a non-individual designated beneficiary. IRC § 401(a)(9)(B)(ii).

Second, consider the more subtle issue: In structuring the trust, how does the estate planner assure distribution over the lengthy life expectancy of the young intended beneficiary rather than the shorter life expectancy of some older contingent beneficiary?

### Administrative Issues

Only individuals may be designated beneficiaries of an IRA. Otherwise, the IRA must be paid out within five years of the employee's death. Treas. Reg. § 1.401(a)(9)-4, Q&A 3. It is important to meet four relatively simple requirements so that the individual beneficiary (or beneficiaries) of the trust are treated as the designated beneficiaries of the IRA. Treas. Reg. § 1.401(a)(9)-4, Q&A 4. First, the trust must be either valid under state law or valid if there were a corpus. Second, the trust either must be irrevocable or must become irrevocable at the death of the employee. These requirements allow the use of a revocable trust even if it is unfunded or nominally funded. Third, the individual beneficiaries who will be treated as the designated beneficiaries must be identifiable. Fourth and finally, certain documentation (generally a copy of the trust instrument or a list of the beneficiaries) must be provided to the plan administrator. Treas. Reg. § 1.401(a)(9)-4, Q&A 6(a).

It is important to note that these requirements must be met when identification of the beneficiaries is necessary for determination of the RMD. Treas. Reg. § 1.401(a)(9)-4, Q&A 5(b). Unless the individual designated beneficiary is a 10-year-younger spouse, this does not occur until the employee's death. Specifically, the IRA beneficiary will be the designated beneficiary if she was a beneficiary at the employee's death and remains a beneficiary as of September 30 of the calendar year following the calendar year of the employee's death. Treas. Reg. § 1.401(a)(9)-4, Q&A 4.

The delay between the employee's death and the date the designated beneficiary is determined allows for a variety of planning opportunities. One is the strategic use of disclaimers. An older beneficiary can disclaim his interest so the balance of the IRA can be paid out more slowly. Treas. Reg. § 1.401(a)(9)-4, Q&A 4. A second planning opportunity is to take advantage of the time between the employee's death and September 30 of the following calendar year, which can be used to divide the IRA into separate shares for each beneficiary to provide the slowest payout possible. Treas. Reg. § 1.401(a)(9)-4, Q&A 4(a). A third is to make use of the fact that the trust does not need to be irrevocable when it is named as a beneficiary, which means that the trust may be testamentary. See, e.g., Treas. Reg. § 1.401(a)(9)-5, Q&A 7(c), ex. 1.

If the beneficiary is the trustee of a trust, then the designated beneficiaries of the IRA will be the beneficiaries of the trust as of September 30 of the calendar year following the calendar year of the employee's death. Treas. Reg. § 1.401(a)(9)-4, Q&A 5. The greatest tax deferral results from the youngest possible designated beneficiary. The goal, therefore, is to structure the trust so that the youngest possible individual is treated as the designated beneficiary. Unfortunately, this is easier said than done.

### Designated Beneficiaries When a Trust Is the Beneficiary of an IRA

Only individuals may be designated beneficiaries. IRC § 401(a)(9)(E). When there is more than one designated beneficiary, the proceeds of the IRA are paid out over the oldest beneficiary's life. Treas. Reg. § 1.401(a)(9)-5, Q&A 7(a). In a trust, this means that the IRA proceeds must be paid out over the lifetime of the oldest beneficiary of the trust. Thus, the goal in structuring the trust is to assure that only the youngest possible individuals are treated as the beneficiaries of the trust.

For example, suppose that an employee wishes to designate a minor grandchild as the IRA beneficiary. The employee's child is 35 years old and her grandchild is five. Of course, designating the grandchild as the beneficiary of the IRA accomplishes the result of maximizing deferral because the balance will be paid out over the grandchild's lifetime. But the grandchild's minority, and concomitant legal incapacity, makes this simple designation unwise.

Similarly, for myriad reasons, it may be unwise to designate the grandchild as beneficiary even if she is an adult. For example, the grandchild may be immature, incapacitated, or a spendthrift. In any of these cases, leaving the IRA to the grandchild in trust, as opposed to outright, would better protect the grandchild and the assets. The trust must be carefully structured, however, so that the grandchild's life expectancy is used to calculate the required minimum distributions after the employee's death.

Suppose that a typical trust during minority is used. The assets are held in trust until the grandchild attains age 35 or the grandchild's earlier death. At that time, the grandchild receives all trust assets outright, if living, or, if not, the assets are paid to the employee's then living issue. The problem is that these very typical trust terms will cause the required minimum distributions to be calculated based on the 35-year-old child's life expectancy rather than the five-year-old grandchild's. Treas. Reg. § 1.401(a)(9)-5, Q&A 7.

This unfortunate result obtains because contingent beneficiaries of a trust are deemed designated beneficiaries of an IRA held by the trust. Treas. Reg. § 1.401(a)(9)-5, Q&A 7(b). Thus, the age of the oldest beneficiary, whether vested or contingent, determines the required minimum distributions. But contingent beneficiaries who are merely "successor beneficiaries" are not considered designated beneficiaries. Treas. Reg. § 1.401(a)(9)-5, Q&A 7(c). A contingent beneficiary is a disregarded successor beneficiary if her interest is solely that “the person could become the successor to the interest of one of the employee’s beneficiaries after that beneficiary’s death.” Id. Arguably, this language could be read to include the 35-year-old child in the above example as a “successor beneficiary.” The very next sentence makes clear, however, that such a contingent beneficiary is not disregarded as merely a successor beneficiary.

The import of the regulations can be demonstrated best by an example. In the hypothetical above, suppose that the contingent beneficiaries of the trust are the employee’s 35-year-old daughter, but, if she is not living, then the employee’s 70-year-old brother. Even though the five-year-old grandchild is the primary beneficiary, and, practically, distributions to the daughter or sibling are unlikely, both the grandchild and child will be considered designated beneficiaries. The sibling, however, is merely a successor beneficiary (successor in interest to the employee’s daughter) and, thus, is not considered a designated beneficiary.

Of course, the greatest tax deferral results if the grandchild (or the grandchild and additional younger beneficiaries) is the sole designated beneficiary. The problem is: how to structure the trust to accomplish this result in a way that is consistent with the employee’s goals. The trust will likely continue until the grandchild reaches a specified age, say age 30. At that age, trust assets (the IRA) will be paid outright to the grandchild. In reality, the grandchild likely will live until the specified age. Nonetheless, the identity of the contingent beneficiary is pivotal. IRC § 401(a)(9)(B)(ii).

Typically, the trust will specify a contingent beneficiary in case of the grandchild’s death before trust termination—for example, the grandchild’s then living issue, if any, or, if none, the employee’s then living issue. As discussed above, however, this common provision will, in the above example, make the employee’s child one of the designated beneficiaries of the trust. This is because the child is a contingent beneficiary, but not merely a successor beneficiary. Treas. Reg. § 1.401(a)(9)-5, Q&A 7.

It is tempting to try to avoid this result by excluding any beneficiary other than the grandchild. For example, the trust could require that trust assets be distributed to the grandchild’s estate in the event of her untimely death. Under state law, this would make the grandchild the sole beneficiary of the trust. Unif. Trust Code § 103(3), (8). But, because the IRA could be distributed to the grandchild’s estate, the IRS would likely view the grandchild’s estate as a contingent beneficiary of the trust and, thus, a designated beneficiary of the IRA. Because the estate is not an individual, if it is a designated beneficiary of the IRA, all IRA assets would need to be paid out within five years of the employee’s death. IRC § 401(a)(9)(B)(ii).

Similarly, suppose the trust document does not specify a beneficiary in the event of the grandchild’s death before trust termination. Under state law, the settlor (presumably the employee) would have a reversionary interest in the trust. Of course, after the employee’s death this means that the holder of the reversion—typically the employee’s estate—would hold the reversion. Thus, the employee’s estate would receive the IRA on the grandchild’s death. Once again, the IRS would likely argue that a non-individual is one of the designated beneficiaries and that IRA assets would need to be paid out over five years. IRC § 401(a)(9)(B)(ii).

In this situation, the taxpayer may try to argue that the regulations specifically state that the designated beneficiaries are the beneficiaries of the trust. Treas. Reg. 1.401(a)(9)-4, Q&A 5(a). Even though the employee/settlor retained a reversion under state law, that reversion does not make the employee, or his estate, a beneficiary of the trust. Unif. Trust Code § 103(3), (8). In many trusts the settlor retains some incidental, and often insignificant, reversionary interest. Nonetheless, the settlor is not treated as a beneficiary on account of this reversion. Thus, the IRS's supposed argument is inconsistent with state law regarding the identity of the trust beneficiaries.

That argument has merit and is supported by state law. The fact remains, however, that the IRA would pass to the holder of the reversion on the grandchild's death before trust termination. Thus, that entity is effectively the contingent beneficiary of the IRA, even if not a contingent beneficiary of the trust.

If the employee tries this technique, it may be wise to transfer the reversion to some younger individual, for example, the employee's child. In that case, if the IRS's above-described argument were to prevail, the child (age 35, in our hypothetical) and not the employee's estate would be the additional designated beneficiary. This would require payout of the IRA over the child's, rather than the grandchild's, life expectancy. But this would likely be a slower payout than the five-year payout required in case the estate is deemed a designated beneficiary. Thus, this may be an acceptable fallback position.

If the employee has several grandchildren, then the other grandchildren can be the contingent beneficiaries. That is, if the primary grandchild beneficiary dies before termination of the trust, the IRA would be distributed outright to the other grandchildren. In this case all of the grandchildren would be designated beneficiaries of the IRA. This would require payout of the IRA over the life expectancy of the oldest grandchild, which may be an acceptable result. On the downside, though, if the primary-beneficiary-grandchild dies before termination of the trust, the IRA would potentially be distributed to a cousin from a different branch of the family. This would skew the distribution of shares within the family. Further, the distribution to the contingent beneficiary grandchildren must be outright. Otherwise, the contingent beneficiaries of that continuing trust would also be designated beneficiaries. Of course, if the contingent beneficiaries are minors (or immature or incapacitated) at the time of the distribution, this outright distribution would be problematic.

Perhaps the simplest alternative is a so-called conduit trust. A conduit trust requires that any funds paid from the IRA to the trustee must be paid directly to the designated beneficiary. Treas. Reg. § 1.401(a)(9)-5 Q&A 7, ex. 2. In such a case, the regulations provide that only that beneficiary will be considered a designated beneficiary. Id. This, of course, accomplishes our goal. If the trust is structured so that it qualifies as a conduit to the grandchild, then only that grandchild will be a designated beneficiary of the IRA held by the trust. Thus, the longest possible income tax deferral is secured.

The planning drawback of a conduit trust is the requirement that the IRA distributions be "paid directly" to the beneficiary, even if that beneficiary is then a minor. Id. Once again, the minor's legal incapacity makes this payment to the beneficiary problematic.

Any estate planner familiar with Crummey or other withdrawal powers, would likely consider giving the grandchild-beneficiary a lapsing power to withdraw the funds, rather than requiring outright payment. Unfortunately, the regulations specifically state that a withdrawal power is insufficient. Treas. Reg. § 1.401(a)(9)-5 Q&A 7, ex. 1(ii). If the beneficiary merely has a withdrawal power, then IRA distributions may be accumulated for the contingent beneficiaries, and, thus, the contingent beneficiaries will also be designated beneficiaries. Id.

Although not addressed in the regulations, it seems that a requirement in the trust document that IRA distributions be paid to, or used for the benefit of, the beneficiary should be sufficient. From an income tax perspective, using the IRA funds for the benefit of the beneficiary is no different from paying them to the beneficiary. Further, to the extent the concern, as reflected in the regulations, is that IRA assets might be accumulated for the contingent beneficiaries, this is not possible if the IRA distributions are used for the benefit of the beneficiary.

Nonetheless, the disadvantages of a requirement that the IRA distributions be paid to, or used for the benefit of, the grandchild-beneficiary are significant. This requirement may make it more difficult to protect the distributions from the beneficiary's minority or folly. Moreover, if the beneficiary is incapacitated, this requirement may make the assets available for the purpose of the relevant government benefits.

**Conclusion**

As detailed above, there are, broadly speaking, two alternatives regarding how to structure a trust to protect an IRA while simultaneously assuring the longest possible income tax deferral. The first alternative is to simply accept that the contingent—but not the "successor"—beneficiaries will be designated beneficiaries of the IRA. This allows for the greatest flexibility in structuring the trust and, thus, the greatest possible protection of the assets. For example, the trust could be fully discretionary, thereby providing the maximum protection from creditors and Medicaid.

The extent to which this reduces the income tax deferral will depend on the difference in age between the primary and contingent beneficiaries. For example, if the employee's family situation requires that the contingent beneficiary be the primary beneficiary's parent, then the lost opportunity for income tax deferral may be significant because of the difference in life expectancy between the primary beneficiary and his parent. In contrast, if the contingent beneficiaries can be other individuals the same age as or younger than the primary beneficiary (such as siblings and cousins), then the deferral lost from using the life expectancy of the eldest designated beneficiary may be nominal.

In essence, this option allows for the most flexibility in creating the trust, but that flexibility comes with the likely necessity of sacrificing some income tax deferral. The amount of increased taxes will depend on the tax brackets, ages of primary and contingent beneficiaries, and so on.

A conduit trust assures that the life expectancy of the primary beneficiary will be used to determine the required minimum distributions. As long as the trust document requires that distributions from the IRA be “paid directly” to the primary beneficiary during her lifetime, the contingent beneficiaries will not be considered designated beneficiaries. Moreover, as discussed above, it should be possible to allow the trustee to use the IRA distribution for the beneficiary’s benefit, instead of mechanically delivering a check to her.

Further, because a separate conduit trust can be created for each beneficiary, each beneficiary’s share of the IRA will be paid out over his or her individual life expectancy. Thus, the greatest aggregate deferral is assured.

The greater deferral possible through use of a conduit trust comes at the cost of flexibility in the trust’s terms. It is not permissible for IRA distributions to be accumulated in the trust. This may compromise some of the asset protection benefits that are likely the reason for using a trust in the first place.

The answer “it depends” is never particularly satisfying. That is, however, the answer to the question of how to structure a trust that is intended to hold an IRA. The estate planner must weigh the value of additional tax deferral against the value of flexibility in the trust’s terms in light of the employee’s family situation, goals, other assets, and income. Only through careful balancing of these factors will the estate planner be able to recommend the best course of action for the client.

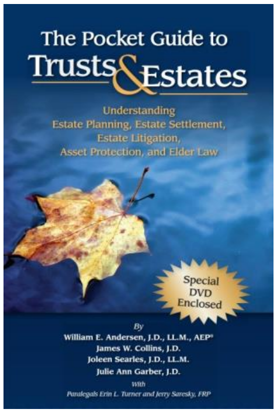
## V. Latest Federal Estate Tax Data

The IRS has released its statistics on federal estate tax returns (IRS Form 706) that were filed for deaths that occurred in 2012. In comparing the number of estate tax returns that were filed in 2003 (= 73,100) and in 2012 (= 9,400), it doesn't take a rocket scientist to understand why the IRS saw a whopping *87%* decline in the filing of such returns - this is primarily due to the significant increase of the federal estate tax exemption from *$1 million* per decedent in 2003 to *$5.12 million* per decedent in 2012. This $4.12 million increase in the exemption resulted in a decline in net estate tax revenues from about $21 billion in 2003 down to only $8.5 billion in 2012. And the decline in the number of returns to be filed and the revenue to be collected will only continue into the future since the exemption is now indexed for inflation (it sits at *$5.34 million* in 2014), and so with average inflation the exemption will be about *$9 million* per decedent by 2034.

Looking at estate tax returns filed by state of residency in 2012, California had the highest number, followed by Florida, New York, Texas, and Illinois. But when adjusted for the number of estate tax returns filed as a percentage of the adult population (ages 18 and over), the District of Columbia topped the list, followed by Connecticut, Florida, California, and New York. – (IRS)

## VI. The Pocket Guide to Trusts and Estates

Bill Andersen, Joleen Searles, Julie Ann Garber and Jim Collins with Erin Turner and Jerry Saresky have released their collaborative book ***The Pocket Guide to Trusts & Estates: Understanding Estate Planning, Estate Settlement, Estate Litigation, Asset Protection and Elder Law***. If you have not already received your complimentary copy, call Pat Bowman today at 866.230.2206 and she will send you your personal copy. Books can be purchased on Amazon.com as well.


The Pocket Guide to
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Estate Litigation,
Asset Protection, and Elder Law
Special DVD Enclosed
By
William E. Andersen, J.D., LL.M., AEP®
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Joleen Searles, J.D., LL.M.
Julie Ann Garber, J.D.
With
Paralegals Erin L. Turner and Jerry Saresky, FRP

## VII. Estate Planning With a Non-Citizen Spouse - By Bill Bischoff

These days, it is not uncommon for U.S. citizens who live in this country to be married to non-citizen spouses who also live here. Or two non-citizens may get married while living here. In tax lingo, non-citizens who are permanent U.S. residents are termed resident aliens. Unfortunately, standard estate tax planning advice that works for most married couples will not necessarily work when one or both spouses are resident aliens. Here's what you need to know if this is your situation.

**Federal estate tax basics:** In general, American citizens and resident aliens alike are covered by the same set of federal estate tax rules. If you die in 2014 with a taxable estate worth over $5.34 million, the IRS wants 40% of the excess.

Thankfully, the federal estate tax can often be minimized or avoided with advance planning. The most common drill is to bequeath (give away at death) some of your assets to your children and grandchildren (either directly or via trust arrangements) while bequeathing the remainder to your surviving spouse.

For example, say you are a married American citizen or a resident alien with an estate worth $7 million. You can completely avoid the federal estate tax by bequeathing $5.34 million to your children and bequeathing the remaining $1.66 million to your surviving spouse—as long as your spouse is a U.S. citizen. In fact, you can bequeath an unlimited amount to your spouse federal-estate-tax-free if he or she is a citizen.

Alternatively, you can gift away an unlimited amount to your spouse before you die—provided he or she is a U.S. citizen—without any federal gift tax bill.

This privilege of being able to make these unlimited tax-free wealth transfers to your spouse is called the unlimited marital deduction. Taking advantage of this privilege is the key element of most estate and gift tax planning strategies.

**The potential problem with a non-citizen spouse:** Unfortunately when your spouse is not a U.S. citizen, the unlimited marital deduction privilege is unavailable. That is true regardless of whether or not you yourself are an American citizen. Going back to the preceding example, let's say that you pass away this year and bequeath $5.34 million to your children and the remaining $1.66 million to your non-citizen spouse. The amount going to your kids is federal-estate-tax-free thanks to your $5.34 million federal estate tax exemption. But there's no shelter for the amount going to your non-citizen spouse. So the federal estate tax hit is $664,000 (40% x $1.66 million). Ouch! If you bequeath your entire $7 million estate to your non-citizen spouse, the federal estate tax bill is the same $664,000, because the first $5.34 million is sheltered by your federal estate tax exemption while the remaining $1.66 million is unsheltered and taxed at 40%. Ouch again! This is bad news if you've been (wrongly) assuming that you qualify for the unlimited marital deduction privilege.

**What to do:** There are several ways to get around the non-citizen spouse estate-tax dilemma. Here are some tax-saving moves to consider.

First, you can make sure you marry an American citizen. This is a potential solution if you are currently single, but obviously not very practical if you are already married to a non-citizen.

Second, your spouse can become a citizen. That can take place after you've died but by no later than the due date for filing the federal estate tax return for your estate (the deadline is generally nine months after your death). As long as your spouse attains citizen status before the deadline, the unlimited marital deduction deal is available, which means your spouse can be left an unlimited amount free of any federal estate tax hit. However, your spouse may not want to become a U.S. citizen for various reasons. For example becoming an American citizen might require renouncing one's home country citizenship, which could affect the right to own property in that country.

Another idea is to gradually reduce your taxable estate by making substantial gifts to your non-citizen spouse while you are still alive. Such gifts are eligible for a larger-than-normal annual exclusion. For example, the exclusion for 2014 is $145,000 (compared with the standard $14,000 exclusion for 2014 gifts to other folks). By taking advantage of the larger-than-normal annual exclusion, you can gradually transfer wealth to your non-citizen spouse without incurring any federal gift tax and at the same time whittle your taxable estate down to the point where it will be sheltered by your federal estate tax exclusion ($5.34 million for 2014).

A fourth potential solution involves setting up a qualified domestic trust (QDOT). The QDOT can be formed under the terms of your will, by the executor of your estate after you have passed on, or by your surviving spouse. Basically the assets inherited by your spouse go into the QDOT. Then the federal estate tax on the value of those assets is deferred until your spouse takes money out of the QDOT or dies. At that point, the QDOT assets are added back to your estate for tax purposes, and the deferred federal estate tax bill comes due. In other words, the QDOT arrangement only defers the federal estate tax hit. It doesn't reduce the amount that ultimately must be paid to the U.S. Treasury. However, if your surviving spouse becomes a citizen, he or she can then take all the assets in the QDOT, and the deferred tax bill will go up in smoke. In effect, your spouse is treated as if he or she had been a citizen all along.

**The bottom line:** The non-citizen spouse estate tax threat can potentially affect many well-off couples. Thankfully, the threat can often be mostly or completely disarmed with advance planning. You may need assistance from an experienced estate planning pro to get the job done right.

**COMMENTS:** The Andersen Firm is available to assist clients, Financial Advisors and other financial professionals in comprehensive estate planning. Call Angela Christian or Sherry McCall at 866.230.2206 to organize a time that works for your schedule.

## VIII. Flowcharts – Explaining Estate Planning to Your Clients

Many of our financial advisors have requested flowcharts to explain Estate Planning to their clients. They are available for you to download directly from our website at TheAndersenFirm.com. Call us if you have questions or need our assistance in working with you and your clients.

1. Foundational Planning: The Basics

2. IRA Inheritance Trust: Planning For Qualified Money

3. Qualified Personal Residence Trust: Getting The Value of Your Homes Out of Your Estate
4. Irrevocable Life Insurance Trust: How To Hold Insurance

5. Build Up Equity Retirement Trust: Spousal Gifting Trust

6. Legacy Trusts: Gifting To Children and Grandchildren and Others

7. Grantor Deemed Owner Trust: How To Hold Large Insurance Policies

8. Wyoming Close LLC: For Asset Protection and Gifting

9. Wyoming Domestic Asset Protection Trust: The Best Domestic Asset Protection Available

10. Florida Domicile Checklist

11. Multigenerational Planning

## IX. Historic Rulings for Same Sex Couples

**VIRGINIA:** U.S. District Judge Arenda Wright Allen ruled that Virginia’s ban on marriage for lesbian and gay couples is unconstitutional in the case *Bostic v. McDonnell* brought by the American Foundation for Equal Rights (AFER). Her ruling is stayed pending appeal, meaning marriages will not occur immediately in the commonwealth. HRC President and AFER co-founder and board member Chad Griffin issued the following statement:

“Yet another court has upheld the fundamental idea that gay and lesbian Americans are entitled to full equality under the law. Nearly fifty years ago, another Virginia case struck down bans on interracial marriage across the country, and now this commonwealth brings renewed hope for an end to irrational barriers to marriage for loving and committed couples across the country.

“Following recent decisions in Utah, Oklahoma, Ohio and Kentucky this Virginia ruling proves that marriage equality is once again on the fast track to the United States Supreme Court. From the South to the Midwest, this historic progress sends a message that no American should have to wait for equality, no matter where they live.

“Right now this nation is divided into two Americas—one where full legal equality is nearly a reality, and the other where even the most basic protections of the law are nonexistent for loving gay and lesbian couples. We cannot and will not tolerate that patchwork of discrimination, and we won’t stop fighting until fairness and dignity reaches each and every American in all 50 states.”

Tim Bostic and Tony London as well Carol Schall and Mary Townley are the two plaintiff couples challenging Virginia’s amendment. Tim and Tony have been together for nearly 25 years, and Carol and Mary, who are also raising a teenage daughter, have been together for 30. Carol and Mary are also long-time HRC members, and it was through HRC’s plaintiff recruitment efforts that the couple came to join this historic case.

The Virginia ruling comes on the heels of a year-long string of electoral, judicial and legislative victories for marriage equality. Recently the New Mexico Supreme Court and a federal district judges in Utah, Oklahoma, Ohio and Kentucky have ruled in favor of marriage for lesbian and gay couples.

**MICHIGAN:** In a historic ruling that provided a huge morale boost to the gay-rights movement, U.S. District Judge Bernard Friedman Friday struck down Michigan’s ban on same-sex marriage, making it the 18th state in the nation to allow gays and lesbians to join in matrimony, just like their heterosexual counterparts.  However, Michigan Attorney General Bill Schuette wasted no time filing an emergency motion requesting a stay of U.S. District Judge Bernard Friedman's ruling that Michigan's ban on same-sex marriage is unconstitutional

**WHAT’S AHEAD:** It's not clear what cases will ultimately go the U.S. Supreme Court though the Michigan case could be one of them, along with Virginia, Oklahoma and Utah.

## X. Pitfalls Seen in a Turn to Privately Run Long-Term Care

**By- Nina Bernstein**

Even as public attention is focused on the Affordable Care Act, another health care overhaul is underway in many states: an ambitious effort to restrain the ballooning Medicaid cost of long-term care as people live longer and survive more disabling conditions.

At least 26 states, including California, Florida, Illinois and New York, are rolling out mandatory programs that put billions of public dollars into privately managed long-term care plans, in hopes of keeping people in their homes longer, and expanding alternatives to nursing homes.

Subway advertisements and highway billboards feature smiling old people as plans jockey for shares of this vast new market. Companies promise profits for investors and taxpayer savings, too. And some states say the new system is already working.

But a closer look at Tennessee, widely cited as a model, reveals hidden pitfalls as the system of caring for the frail comes under the twin pressures of cost containment and profit motive. In many cases, care was denied after needs grew costlier — including care that people would have received under the old system.

“The notion of prevention saving money in the long run only works if you actually provide care in the long run,” said Gordon Bonnyman, former director of the Tennessee Justice Center, a patient advocacy group. “Tennessee is probably as good as it gets in terms of oversight and financial regulation, and thus I think it is a cautionary tale.”

Like many advocates, he originally supported managed long-term care, seeing it as a way to break the stranglehold of nursing home lobbies that opposed shifting more Medicaid money to home and community-based care. But now he says too high a price is being paid by very debilitated people denied care when they need it most — people like Billy Scarlett II, who was 33 in 2005 when he sustained severe brain injuries in an A.T.V. accident, and Glenn McClanahan, who is 79.

Mr. McClanahan’s case illustrates both the appeal and the perils of the new system. Once a high school quarterback, a successful car salesman and a ladies’ man, he was living alone on Social Security, already hobbled by arthritis and emphysema, when at 75 he abruptly lost nearly all of his sight. For years, Tennessee residents like him had to move to nursing homes, with Medicaid paying the bills from a mix of state and federal money.

But in 2010 the new program gave Mr. McClanahan another choice: Stay at home with daily help, and go to a nursing home later if he needed it. Medicaid paid a fixed monthly sum to an insurance company to cover and coordinate his future care. For about 30 months, Mr. McClanahan was happy to manage at home with four hours of help daily. The government and the insurance company benefited, too, because his care cost much less than the monthly Medicaid sum paid to the plan — $3,820, which was less than the $4,583 a nursing home would have cost.

But when he developed dementia and his health fell apart in the fall of 2012, the state and the insurer denied his application for nursing home placement and told him he would lose his home care, too. Under tighter rules adopted by the state to serve more people without spending more, Mr. McClanahan was one of thousands of applicants deemed not disabled enough for Medicaid to pay for any help.

The change was new scoring that sharply raised the disability threshold required to get into a nursing home, or to get equivalent care at home. Such thresholds vary from state to state. But in Tennessee, 41 percent of 34,000 applications for care were denied over the 13 months after the change, compared with under 10 percent previously.

In the real world of budget cuts, state officials say, this was the only way to double the proportion of Medicaid recipients served outside nursing homes, to 40 percent. “Yes,” Ms. Killingsworth said, “sometimes that means that not everybody is going to get everything that they think they need.”

In Mr. McClanahan’s case, the day after an official letter scored his need for care at zero, he fell from his short-stay convalescent bed, gashing his face and breaking his nose.

“It’s all about the money,” his son, David McClanahan, said. “I wouldn’t want anybody to have to go through what I went through with my dad.”

**Changes and Audits**

For years, efforts to curb fast-rising Medicaid costs centered on welfare mothers and children, even though Medicaid spends more than five times as much on an aged or severely disabled person in long-term care as it does on a poor child.

Long-term care cases traditionally were considered too vulnerable and politically sensitive to be assigned to a managed care company. But between recession-starved budgets and the looming costs of an aging population, many states have decided the old system is unsustainable. About 4.2 million people receive long-term services paid by Medicaid, representing only 6 percent of Medicaid beneficiaries, but about $136 billion, or one-third of all Medicaid spending. They include many formerly well-off people in nursing homes who have “spent down” their “countable” assets — the primary home is the major exclusion — to less than $2,000, the maximum for Medicaid eligibility in many states.

Under the old system, providers bill Medicaid directly, a model plagued by perverse incentives for expensive, unnecessary and even fraudulent care. Despite arguments that people should not have to enter high-priced institutions to get help with activities of daily life like bathing and eating, relatively little Medicaid money was available for cheaper alternatives. Nursing homes have often used political muscle to keep it that way.

Managed care promises more predictable, controlled spending. From a fixed sum per enrollee, plans pay networks of providers to deliver care, which could be as cheap as a recorded medication reminder, or as costly as a nursing home stay.

Like the rationale behind health maintenance organizations, the idea is that plans will benefit financially by keeping costs lower and people healthier, and that the expense of customers who need more care will be counterbalanced by those who need less.

But now, as the formula is applied to a more fragile population, some states have already run into problems that marred the early history of H.M.O.s.

In New York, enrollment in the largest plan, VNSNY-Choice, was suspended for several months last year over the cherry-picking of able-bodied seniors, lured into the system by new adult day care centers offering free takeout food, casino trips and games of table tennis. An audit, undertaken after an article in The New York Times documented the problem, found hundreds of enrollees who were not impaired enough to be eligible, but who cost Medicaid $3,800 a month each, or nearly $34 million in all. Meanwhile, advocates for the elderly and disabled complained, plans were shunning the most impaired, including bed-bound seniors with dementia.

In Wisconsin, which Gov. Andrew M. Cuomo of New York has called a model for his Medicaid reforms, the price of expanding managed long-term care rose by 43 percent in three years, as more people signed up than expected. Further expansion was suspended. The program, which relies on homegrown nonprofits, saw two of nine plans go broke; others cut caregivers' hours and pay, shifting burdens to relatives.

Still, Kitty Rhoades, Wisconsin's Medicaid chief, said, "We're closer to getting it right than most other states."

Even Minnesota, a pioneer of the system, came under congressional fire for shifting state costs to Medicaid, which is federally subsidized. And a 2011 audit found that it had overpaid at least $207 million since 2003 to insurers, including high executive salaries and expenses like a luxury box at a sports stadium.

**Helped at Home**

Northeast of Nashville, in the house on his father's farm where he grew up, Mr. Scarlett, who was severely injured in an A.T.V. accident nine years ago, is living proof that high-quality care at home can be better than care in a nursing home. But his family has had to struggle to keep it, under the financial pressures inherent in the shift to managed long-term care.

In 2005, Tennessee shrank Medicaid from one of the most expansive versions in the country to one of the most restrictive. That bitterly contested move, made amid spiraling costs in a state without an income tax, eliminated coverage for more than 170,000 people, many with severe chronic illnesses.

Though the state had experienced more than its share of managed care scandals in the 1990s, it embraced that approach for long-term care, under tight rules and a governor who had been a managed care executive. Officials say it helped keep increases in the state's Medicaid budget to half the national trend line.

Before his family signed him up for the new program, Mr. Scarlett spent a year in a nursing home, with relatives keeping vigil. Whenever a mucous plug threatened to choke him, his sister, Kimberly Maynard, recalls, she dashed to the nurse's station to beg for someone to suction the tracheostomy tubing. He was sent to the hospital six times with pneumonia and battled two antibiotic-resistant infections linked to institutional health care. At home, he has been tended 24 hours a day, mostly by licensed practical nurses, and had to go to the hospital only once.

One weekday last fall, propped in a recliner with tubes linking him to life, he struggled to raise a thumb so his father could kiss it, and moved one bare foot against a beach ball that his sister had gently aimed there. "Attaboy," said his father, Billy Scarlett, 75, who still hopes his son will emerge from what doctors call a persistent vegetative state. "Knock it over here to Daddy!"

But since 2010, when the state expanded the program, called TennCare Choices, and AmeriGroup, a major insurer, took over the case, the program has been trying to drop Mr. Scarlett. The form letters began with a mistaken claim that the family had asked to quit. A letter last fall ordered him “disenrolled” on Dec. 1 and added, “You can’t appeal again.”

The problem: His home care, while it served him best, cost $330,000 a year. If he were dropped from TennCare Choices, he would most likely end up in a nursing home, at an average annual tracheostomy rate of $144,000, potentially a big savings.

In a nursing home “he’d have been gone a long time ago,” Billy’s sister said.

A customer service representative, Barbara Murphy, center, and a coach, Theresa McMahon, right, at AmeriGroup, a major insurer in Tennessee's managed long-term-care program.Credit Luke Sharrett for The New York Times

“I just can’t do that,” she added, “because now if you were to do that, you’d actually be murdering him.”

The program offered an alternative: Instead of paying an agency $37 an hour for 24-hour care, AmeriGroup would pay the family about $15 an hour to hire caregivers earning less than agency employees, without benefits like health insurance.

The family withdrew its appeal after the state’s lawyer warned at a hearing, “By trying to get something better, they could get nothing.”

Still, AmeriGroup said late last year that the rules had changed again: A nursing home was now the only choice — an ultimatum withdrawn eight hours later, after The Times inquired about it.

WellPoint, which recently acquired AmeriGroup for $4.9 billion, referred questions to TennCare, where officials said privacy laws did not allow discussion of the case. But Kelly Gunderson, a TennCare spokeswoman, added that in any long-term care program, “difficult public policy decisions must be made, including whether to provide an unlimited array of benefits to a few, or a reasonable package of benefits sufficient to safely serve individuals in the community to many.”

Tennessee has chosen to be as cost-effective as possible, she said, and that has allowed the state to eliminate waiting lists for community-based services, which now serve nearly 13,000 people, up from 5,000, while keeping the number of nursing home residents flat at 19,200.

Beneficiaries include Sara West, 64, a former medical records worker who was in rehabilitation centers for months after infections from operations left her in a wheelchair. “I would be in a nursing home if it wasn’t for this program,” she said, calling it a godsend.

Through UnitedHealthcare, TennCare provided a roll-in-shower and pays for about five hours of daily help by aides Ms. West hires herself. Despite having recent amputations and needing nightly bedpan help, Ms. West, a diabetic, has stayed within a $55,000 annual cap for three years, she said, by relying first on her husband, a retiree with dementia, and now on cousins who take turns spending the night.

**Assisted Living**

Last spring, Mr. McClanahan, in his late 70s and nearly blind, had already cycled through hospitals, rehab centers and geriatric-psychiatric units when he became one of 5,283 people who were told that they did not qualify even for a new, temporary category of home services limited to $15,000 a year — one-third of the state's Medicaid rate for a nursing home.

Glenn McClanahan in April, in a photo taken by his son after Mr. McClanahan was injured in a fall from bed in a short-stay convalescent home. His need for care had just been scored at zero by Tennessee's managed long-term-care program, which denied him nursing home placement or coverage for help at home.

Officials acknowledge that among the 1,451 of those denials that were appealed, more than a third turned out to be based on inadequate information and were later reversed. Members have 30 days to appeal denials.

When David McClanahan threatened to publicize a gruesome photo of his father's face after his fall, UnitedHealthcare, the managed care company, offered placement in an assisted living center, costing a third of the nursing home rate. Such centers are not regulated or equipped for people with serious impairments.

The McClanahans were unaware that the center, Elmcroft of Twin Hills, had been under state investigation for resident deaths linked to neglect, and for complaints that it kept residents who needed more care than it could deliver.

Elmcroft, acquired by a 19-state chain in 2011, said it had fixed the problems by last spring, when it passed a state inspection. But relatives noticed unwashed sheets and pills scattered on Mr. McClanahan's floor, and said the center demanded $460 more a month from Mr. McClanahan because he needed more care than expected. It settled for his full Social Security income. "He remained a viable assisted living resident" under state rules, Bob Goyette, a spokesman for Elmcroft, said, "even though he required more care."

Mr. McClanahan soon ended up back in a hospital, and the whole process began again. Eventually, after his son threatened to sue the state, another denial was reversed and Mr. McClanahan secured a nursing home bed. "They're trying to see what they can get by with," his son said.

Alice Ferreira, a spokeswoman for the insurer, said, "UnitedHealthcare has worked very closely with the family and the TennCare to ensure the member has the appropriate care."

Ms. Gunderson, the state spokeswoman, said: "The due process procedures we have in place work effectively to ensure that members are able to receive the appropriate level of services in the appropriate setting."

For raising the level of impairment required to qualify for nursing home-level care, Ms. Killingsworth said, "I make no apology."

She called the previous threshold — a significant deficiency in one activity of daily life — one of the lowest in the country, while the new threshold is based on a weighted point system that typically requires serious deficiencies in three activities.

Nationwide, publicly traded companies like UnitedHealthcare are replacing nonprofits. There are trade-offs, said Michael J. McCue, a professor of health administration at Virginia Commonwealth University, whose comparative study found that publicly traded plans focusing primarily on Medicaid enrollees reported the highest percentage of administrative expenses, and received lower scores for quality of care.

“They have to make sure that they meet earnings expectations to help improve their stockholders’ wealth,” Professor McCue said. “They could argue that, hey, maybe we have a more effective way of managing the care or cost. And one can ask, hey, are they denying care?

“We’ll have to collect the data on that and see.”

**COMMENTS**: So we will watch the evolution of health care over the next years. For now, ensuring clients have a solid estate plan and financial plan in place while they are healthy will prove beneficial in the coming years. If you have questions, please feel free to call us.

## XI. Case Studies

*The following are case studies and do not reflect actual clients. The names and situations presented are fictional and for educational purposes only.*

***Case Study 1: Business Transfers***

Business owners face major challenges in transferring valuable businesses to the next generation, and they needed to avoid significant estate taxes and liquidity issues upon their deaths. Determine which (or all) of the following techniques could be used and define how they would be used without incurring any estate or gift taxes:

(1) converting the stock in the enterprises to voting and nonvoting stock;
(2) gifting a portion of the nonvoting stock to special trusts designed to reduce income taxes and provide protection for the benefit of the second generation;
(3) selling a portion of the nonvoting stock to a specially designed trust that resulted in no income taxes payable on the gain resulting from the sale; and
(4) using significant discounts for lack of control and lack of marketability.

**Case Study Two: Beneficiary Designations**

Archie and Edith have drafted wills stating their assets are to be divided equally among their 3 children, Mike, Gloria, and Joey after they have both passed away. They have named each other as primary beneficiary on both of their IRA’s totaling $300,000. However, Mike is the only contingent beneficiary listed. They expect him to divide the IRA’s equally between the 3 children as directed in the wills (Mike is the executor of their wills also).

***So what happens to the IRA’s if Archie and Edith pass away at the same time?***

Since both are deceased, the IRA’s will pass 100% to the contingent beneficiary, Mike. Gloria and Joey will have no rights to the IRA assets even though they are equal beneficiaries in the wills because the IRA’s are an asset with a beneficiary designation. Therefore, not subject to the will.

***What beneficiary benefit is lost for Gloria and Joey?***
Since Gloria and Joey were not listed as contingent beneficiaries on the IRA’s, they cannot roll the portion of the IRA’s their parents wanted to go to them into an inherited IRA. Legally 100% of the IRA’s are Mike’s and he is the only one who can roll them into an inherited IRA.

***What does Mike do now to honor the wishes of his parents?***
Being the executor of their wills, Archie and Edith thought Mike would easily be able to give Gloria and Joey their one-third portion of the $300,000 in the IRA’s. Unfortunately, there are two things to be aware of with that strategy:
1) Mike will have to pay taxes on the two-thirds distribution of $200,000. This large distribution will likely push him into a higher tax bracket. If we assume he would be in the 35% tax bracket, $70,000 ($200,000 x 35%) in taxes would be due leaving $65,000 ($130,000 ÷ 2) each for Gloria and Joey.
2) When he gives Gloria and Joey $65,000 each, he will have to file a gift tax return and will be responsible for any gift tax that may be due. The IRS allows a gift of $13,000 or $26,000 (if married) a year without having to file a gift tax return.
Mike will need to discuss with the attorney settling the estate what options are available to distribute Gloria’s and Joey’s portion of the IRA’s to them, and which is best for their situation.

## XII. The Andersen Firm Areas of Practice

**Estate Planning**
- At The Andersen Firm we have planned for a vast array of estates ranging in size from a few hundred thousand dollars to a hundred million dollars, all the while realizing each specific case is different and requires specialized attention.

**Estate Settlement**
- The process of settling an estate can be difficult and emotionally painful for the family and loved ones of the deceased. It is our goal at The Andersen Firm to ensure that the process be handled with compassion, expedience, professionalism and expertise, while protecting the rights of all parties involved. If the circumstances surrounding a client’s estate require probate, our attorneys offer extensive experience in handling the processes and legalities involved.

**Estate Litigation**
- Our lawyers are not only skilled at handling cases involving estate and trust disputes, they draw on a thorough knowledge base of the specific procedures surrounding these issues. The Andersen Firm can efficiently take each case through to completion realizing that full blown litigation often can be avoided if we work diligently to come to resolution.

**Asset Protection**
- For some, putting an Asset Protection Plan in place is advisable in order to attempt to

remove the economic incentive to be sued and also to try and increase the ability to force an early settlement in the event a suit is filed.

**Elder Law**

- The three major categories that make up elder law are (1) Estate planning and administration; (2) Medicaid, disability and other long-term care issues; and (3) Guardianship, conservatorship and commitment matters, including fiduciary administration.

## XIII. Estate Litigation

Estate attorneys at The Andersen Firm represent beneficiaries, trustees and personal representatives in various jurisdictions dealing with estate litigation and probate litigation matters. A will contest challenges the admission of a will to probate or seeks to revoke the probate of a will that is already pending before the probate court. A similar type of estate litigation can take place contesting the terms of a trust. The most common causes of action in both will contests and estate litigation can be found at www.TheAndersenFirm.com or call us at 866-230-2206.

## XIV. Mail Away Estate Plans

If a client is in another state, unable to travel, on vacation, a snowbird or another situation that would prevent them from meeting with an attorney in person, The Andersen Firm attorneys are able to design, draft and execute estate plans via telephone conference and mail away documents.