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News You Can Use

Trust and Estate Department

September 2011

Gifting and Portability: What You Need To Know

1. Gifting

Congress significantly increased your ability to make lifetime gifts in 2011 and 2012. Under the 2010 Tax Relief Act, each individual may gift up to $5MM (married couples may gift $10MM) without paying any out-of-pocket tax on the gifts. The increased ability to gift combined with depressed asset values provides even more bang for your gifting buck. For instance, a stock portfolio worth $1.5MM gifted in today's down market should see resurgence in value. In five years the same portfolio may be worth $2.5MM in the hands of your donee. Not only have you provided generously to your donee, but you have also removed the initial gift and $1MM in appreciate from your taxable estate. The increased gifting ability may not be available in 2013 when the 2010 Tax Relief Act is scheduled to sunset. Please contact us to discuss taking advantage of this limited gifting window.

2. Portability

The 2010 Tax Relief Act provides that a deceased spouse may share any unused estate and gift tax exclusion amount with a surviving spouse. The concept of sharing the unused estate and gift tax exemption amount is popularly referred to as "portability." Under the Act, a married individual who dies in 2011 or 2012 may exclude the first $5MM from estate tax. If a deceased spouse only used $3MM of estate tax exclusion amount, the executor of the deceased spouse can make a tax election to transfer the balance of the exclusion amount, $2MM, to the surviving spouse. The surviving spouse would then have a total of $7MM of estate and gift tax exclusion amount available to make lifetime gifts or shelter assets at death. The "portability" of the unused estate tax exemption amount may be unavailable in 2013 when the Act is scheduled to sunset. If your spouse passes away in 2011 or 2012 you must file an estate tax return to take advantage of this opportunity. Please contact us for more information.

Leave Your Dog A Bone

Today's society recognizes the important role that a pet holds in our day-to-day lives. From boutiques to bakeries and even employer-provided health insurance, we are catering to our pets in ways that were traditionally reserved for those walking upright on two legs. It should, therefore, come as no surprise that an individual can incorporate the future care of a pet into their estate plan.

Under New York law, an individual can set up a trust fund, during life or at death, for the benefit of their pet(s). For instance, if you were concerned for the care of your dog or cat after your death, you could provide in your Will that a trust be funded with a specific amount of money for that pet's continuing care. The trustee, who may or may not take possession of your pet, can expend funds for your pet's benefit for the rest of its life. Upon your pet's death, the remaining trust assets are distributed in accordance with your wishes expressed within the trust.

There are very few restrictions on trusts for pets. However, if you over-fund a pet trust a court may reduce the fund if it exceeds the amount required for the pet's care. An example of excessive funding was seen when Leona Helmsley, a billionaire real estate developer in New York City, left a $12 million fund for her pet Maltese. A court subsequently, and not surprisingly, reduced that amount.

Prior law provided that a pet trust could only last for 21 years at which point it was required to terminate. A recent amendment to the law provides that a pet trust now terminates at the death of the pet. Although a home dwelling pet does not typically live beyond 21 years, the new law benefits those animals such as horses, tortoises and other exotic pets whose life expectancies can easily exceed the prior limitation.

Contact your estate planning attorney to discuss how you can integrate your four-legged friend into your estate plan.

When Interest Rates Are Down, Charitable Lead Trusts Are Up

For individuals who want to integrate charitable giving into their overall estate plan, there are many vehicles available that can fulfill a donor's philanthropic goals and simultaneously achieve tax savings. One such vehicle for consideration is a Charitable Lead Trust ("CLT"). A CLT is particularly attractive in the current low-interest rate environment.

Generally, a CLT provides for a fixed payment over a term of years to a chosen charity. The yearly payment can be in the form of an annuity (a Charitable Lead Annuity Trust, or "CLAT") or a fixed percentage of the trust assets revalued annually (a Charitable Lead Unitrust, or "CLUT"). At the end of the trust's term, the balance of the trust assets are held in further trust for, or are distributed to, the donor's chosen remainder beneficiaries (typically members of the donor's family). When structured correctly, a CLT created during life can provide for both a gift tax deduction and income tax deduction. A CLT created at your death (usually in your Will) can provide for an estate tax charitable deduction.

Under Internal Revenue Service ("IRS") rules, a CLT is considered a split-interest trust, meaning that the trust benefits both a charitable interest and a non-charitable beneficiary upon termination. Therefore, the charitable and non-charitable interests must be separately valued for gift, estate and income tax purposes. Only the value of charitable lead interest will qualify for a tax deduction.

In order to value the separate interests, the IRS provides a table of interest rates (often referred to as the Section 7520 rates), which are published from month-to-month. When the interest rates are low, a CLT will produce a higher value for the charitable interest and a corresponding lower value for the taxable non-charitable remainder interest. The applicable 7520 rate for the month of September is 2%. For comparison, during this same time frame in 2000, the applicable rate was 7.6%. The effect of the interest rates can be seen in the following examples:

Example 1: Using a 2% rate to value the interests, a donor who funds a CLAT with $100,000 providing a 5% annuity to charity for 15 years will value the charitable interest at $64,247 (leaving a $35,754 taxable gift of the remainder). Using a 7.6% rate, the charitable interest is valued at $43,863. As shown, the value of the charitable (and deductible) interest increases as the interest rate decreases. In both examples, if the trust assets grew at 6% over 15 years, $75,000 would have been paid to the charity over the trust term leaving $123,276 for the remainder beneficiaries.

Example 2: Instead of a set term of years, a CLT can also be structured to run for the life of a donor or donors. Under the same facts of Example 1, a CLAT is created at a 2% rate that runs for the joint lives of husband and wife, ages 65 and 63, respectively. The value of the charitable lead interest is $86,486, reducing the taxable gift of the remainder. If this same CLT was created when the interest rate was 7.6%, the value of the charitable lead interest is significantly less, $52,321, in

turn decreasing the amount of the charitable deduction. Based on IRS life expectancy tables and a 6% growth rate, the charity would receive $115,000 over the term of the trust leaving $146,996 for the remainder beneficiaries.

The decision to provide the charity with an annuity, the CLAT, or an annual percentage of trust assets, the CLUT, will depend on several factors. For instance, a CLAT generally shifts all appreciation in the trust assets to the remainder beneficiaries. However, if the assets decrease in value or do not experience sufficient growth, there is an increased chance that the annuity payments will deplete the trust prior to termination. If that occurs, the remainder beneficiaries receive nothing. If the use of your lifetime gifting exclusion amount is a concern (currently $5MM/individual), it is also possible to structure a CLAT to eliminate any taxable gift to the remainder beneficiary. In general, a CLAT is recommended for assets that are expected to appreciate.

In contrast, a CLUT will share any increases or decreases in the value of trust assets proportionately between the charitable and remainder interests. However, a CLUT cannot generally be structured to eliminate a taxable gift and the assets of a CLUT will need to be revalued on a yearly basis, thus adding to the administrative costs. The CLUT is recommended where the donor wishes to hedge against the risk of falling asset values to preserve some remainder for the beneficiaries. This can be seen in the following example.

Example 3: If the donor in Example 1 created a CLUT at a 2% rate, giving the charity a 5% unitrust interest, the deductible charitable lead interest would be $53,485. Assuming the assets grew at 6%, at termination of the CLUT the charity would have received $79,209 leaving $112,277 for the remainder beneficiaries. The 6% growth was effectively split between the charity and the remainder beneficiaries, and the same result would occur if the assets values had dropped.

In addition to the payment method, there are various other considerations including whether to structure the CLT to obtain a current income tax deduction (for lifetime trusts) and issues involving what type of assets are best situated for use in a CLT.

You are encouraged to contact your estate planning attorney to discuss whether a CLT is an appropriate option to reach your philanthropic and tax planning goals.

Leaving Retirement Assets To Children

A retirement account is often an individual's largest asset. Married persons generally want to leave their retirement account benefits to their spouses with their children as contingent beneficiaries. If the children are mature adults, naming them directly as contingent beneficiaries is easy. However, if the children are young they may need the protection of a trust. What can be done to meet the needs of the children while still maximizing the amount of time over which the tax deferred income must be withdrawn?

Let's look at several situations. First, suppose Wife and Husband have been married for many years and there are no concerns leaving assets outright to the surviving spouse. If Wife names Husband as primary beneficiary at her death, the Husband can elect a "spousal" rollover of the account. This allows the Husband to take the assets into his own IRA. As such, Husband can defer taking benefits until age 70½. The rollover has the further advantage of allowing the Husband to name his own beneficiaries. The Husband's beneficiaries can spread the benefits following his death over their own life expectancies. As a result, the income tax deferral can be extended for many years.

Suppose further that there are young children. Leaving assets to them outright may not be prudent. With careful attention, the assets can be left in trust for the children without sacrificing maximum tax deferral. A spousal rollover allows the surviving spouse to roll the account into an IRA in the spouse's own name. The surviving spouse can then name individual trusts (probably

created under the spouse's Will) as beneficiaries to take on his or her death. As long as each trust has a single, identifiable, individual beneficiary, the retirement account benefits can be paid out over the trust beneficiary's life expectancy. This results in the same income tax deferral as if the account were left to the child outright while providing the protection of a trust.

In some young families, especially where there are fewer assets, it makes more sense to maintain a single trust that benefits all of the children as opposed to separate trusts for each child. This trust can be the beneficiary of the retirement account; however, doing so may not maximize the deferral opportunity for the trust beneficiaries. In this case, the retirement account benefits would have to be paid in accordance with the oldest trust beneficiary's life expectancy, reducing some ability to defer tax. The effect could be significant if there is a large age gap among children.

Finally, suppose Wife does not feel comfortable leaving retirement assets outright to Husband. For example, Husband could have been previously married with children from the first marriage. The Wife may want to protect the balance of the retirement account so it passes to Wife's children at Husband's death. Naming a trust for the benefit of the surviving spouse as beneficiary of the retirement account can be very effective. The spouse will receive the benefits during his life. At Husband's death, the remainder will pass to the Wife's children. However, the minimum required distributions will be calculated using Husband's life expectancy determined as of Wife's death, rather than the child's. Thus, the tax deferral is reduced substantially as contrasted to the spousal rollover situation discussed above. While one would prefer not to give up the extra deferral, circumstances often warrant doing so. Note also that if the retirement account is subject to ERISA, e.g., a 401(k) account, the spouse's prior permission to designate the trust will be required. The spouse's permission is not needed for an IRA.

Designing and implementing the right beneficiary designation of your retirement account is among the most important estate planning decisions you can make. Several principles need to be kept in mind.

1. Put the non tax needs of the beneficiary first. If a beneficiary needs financial oversight or asset protection, e.g. a young beneficiary, the benefits of leaving the retirement account assets to a trust almost always outweigh the loss of tax deferral.
2. Beneficiary designations must be submitted to and accepted by the plan administrator. Retirement accounts may have restrictions on what beneficiary designations are acceptable. Until a beneficiary designation is received and accepted by the administrator, it is ineffective. Designating the plan beneficiary in your Will does not work.
3. Never name "my Estate" as beneficiary. Doing so results in a loss of an estate tax deferral opportunity and exposes assets that are otherwise protected to claims for payment of your debts.

Employing Domestic Workers in The Household

New Employment Legislation Impacts Individuals

Individuals and families who employ domestic workers in their homes are now subject to a host of employment rules, which in the past expressly exempted these types of employment relationships. These rules are contained in The Domestic Workers' Bill of Rights and The Wage Theft Prevention Act.

The Domestic Workers' Bill of Rights

In late 2010, the New York State Domestic Workers' Bill of Rights took effect—the first law of its kind in the nation. Individuals who employ domestic workers, such as nannies, housekeepers or home health aides, are now considered "employers" and must abide by typical employment rules, like minimum wage and overtime. Significantly, these requirements apply even if you employ just one domestic worker.

Not every worker in a home qualifies as a domestic worker under the law. Excluded are those working on a "casual basis" (i.e. part-time baby sitters who work on an irregular basis), those related to their employer or the person for whom they care, and those providing "companionship services," as defined by the Fair Labor Standards Act (FLSA) who are employed by an entity other than the household or family (i.e. those working through an agency.) Despite these exclusions, coverage of this law is quite broad, and would cover workers engaged in childcare, housekeeping and companionship to the elderly (keeping in mind that the companionship exception applies *only* to those employed through a third party.)

The Domestic Workers' Bill of Rights also amends the New York State Human Rights Law to extend the prohibitions against workplace harassment to the household setting. In other words, domestic workers are now protected from sexual harassment, which is defined as "unwelcome sexual advances, requests for sexual favors, or other verbal or physical conduct of a sexual nature," as well as harassment based on gender, race, religion or national origin. This amendment to the Human Rights Law will undoubtedly create a host of questions about the proper application of this law.

The Wage Theft Prevention Act

The Domestic Workers' Bill of Rights is not the only new employment legislation that New York employers of domestic workers must contend with. In December 2010, Governor Paterson signed the Wage Theft Prevention Act. This Act, which took effect on April 12, 2011, imposes new notification and recordkeeping requirements on employers, significantly expands the Department of Labor's enforcement powers, and increases employer's potential liability for violations of the Labor Law. The law contains no exception for employers of domestic workers.

Under the Wage Theft Prevention Act, whenever a new employee is hired, employers must provide a list of relevant information to each new employee before the employee starts work. In addition, the statute requires employers to obtain an acknowledgement of receipt of the information. In addition, the statute also requires employers to provide the same notices to all workers on an annual basis.

The Act now mandates the inclusion of certain information in all employee wage statements, such as pay rates, overtime rates, allowances, deductions and net wages, among many other required disclosures.

When an employer fails to abide by these notification requirements, or fails to pay wages to the worker, the law also provides significant new remedies for workers.

Household employers using a payroll service should consult with the service to ensure they are in compliance with these requirements. Those handling payroll directly should also take steps to ensure compliance.

If you are currently employing, or plan to employ any domestic workers, you are encouraged to contact your attorney to review these new requirements to ensure that you are in compliance.

Florida Legislative Updates

New Florida Durable Power Of Attorney Law

In prior issues we provided information about noteworthy changes in New York's power of attorney law. Recently, Florida has also enacted substantial changes to its power of attorney law.

A durable power of attorney ("DPOA") typically grants broad authority to the agent to act on behalf of the principal. A DPOA normally survives the incapacity of the principal, providing an alternative to guardianship in the event a principal becomes unable to act for himself or herself.

The Florida legislature has revised the Florida power of attorney statute and the new law is effective for all power of attorney ("POA") documents executed on or after October 1, 2011. However, the new law applies to all POAs no matter when executed with respect to various fiduciary duties now imposed upon an agent.

The new law imposes certain mandatory fiduciary duties on agents that cannot be eliminated by contract as well as default duties that can be waived by written agreement.

If more than one agent is designated to act on behalf of the principal, unless the instrument provides otherwise, a co-agent may act independently of the other co-agent(s). However, if a co-agent has actual knowledge of a fiduciary breach by another co-agent or predecessor agent, the co-agent has an affirmative duty to take reasonably appropriate action to safeguard the principal's best interests. Failure to take such action renders the agent liable to the principal for the principal's reasonably foreseeable damages that could have been prevented had the agent taken action.

The new law also imposes new requirements when enumerating an agent's authority to act on behalf of the principal. Global provisions, such as those attempting to grant the agent authority to do all acts the principal can do, are now ineffective. The following powers must be specifically granted in the POA and the principal must sign or initial next to each specific grant of authority:

a. Create an inter vivos trust;
b. To amend, modify, revoke, or terminate the trust, but only if the trust instrument explicitly provides that the settlor's agent may do so;
c. Make a gift (as further discussed below);
d. Create or change rights of survivorship;
e. Create or change a beneficiary designation;
f. Waive the principal's right to be a beneficiary of a joint and survivor annuity, including a survivor benefit under a retirement plan; or
g. Disclaim property and powers of appointment.

An agent's authority to make gifts, described above, is limited in amount to the federal gift tax annual exclusion (currently $13,000), per donee, regardless of whether the annual exclusion applies, unless the POA provides otherwise.

If an agent is not an ancestor, spouse or descendant of the principal, the agent cannot exercise authority to grant an interest in the principal's property to the agent or to an individual to whom the agent owes a legal obligation of support, unless the POA states otherwise.

To revoke a POA, the principal must now do so by expressly stating the revocation in a subsequently executed POA or other writing signed by the principal; mere execution of a subsequent POA, without indicating revocation of prior instruments, is no longer sufficient to revoke prior executed POAs.

Due to the number of changes in this Florida law, we strongly recommend you review your existing POA(s) with your Florida licensed attorney.

Probate And Trust Changes In Florida

The Florida legislature recently enacted significant changes to its probate and trust code. Some of the key sections of the legislation became effective on July 1, 2011 and others became effective on October 1, 2011. The legislation creates or substantially modifies the following: I) Intestate succession; II) Reformation of a will; III) Challenges to revocation of a will and trust; and IV) Attorney-client privilege relating to fiduciaries.

I. Intestate Succession

When a decedent dies without a will, the assets are distributed according to the laws of intestacy. Current law provides that the intestate share of a surviving spouse is the first $60,000.00 and half of the remaining estate, where all children of the decedent are also the children of the surviving spouse. Effective October 1, 2011, the law changes and the intestate share of a surviving spouse of a decedent is the entire estate. The legislation does provide, however, that if the surviving spouse has children both unrelated and related to the decedent, the surviving spouse's intestate share is half of the estate.

II. Reformation of a Will

Florida law permits reformation of a trust instrument to correct a mistake. Prior to the new law, however, the reformation of an unambiguous will was not allowed. Effective July 1, 2011, Florida law now permits reformation of a will to correct a mistake or modify a will to achieve a testator's tax objectives.

The "mistake statute" allows an interested person to seek reformation of the terms of a will to conform to the testator's intent. In order to seek reformation, the interested person must prove by clear and convincing evidence the testator's intent. This law potentially allows for reformation of a will that may be completely inconsistent with the last will and testament executed by the testator.

The "tax modification statute" permits an interested person to seek reformation of the terms of a will to achieve a testator's tax objectives. Allowing modification of a will to achieve tax savings for the estate, and thus the beneficiaries, is consistent with the ideal of effectuating the testator's intent.

Although there is potential for abuse by persons who may bring these actions frivolously to promote their own interest, the new law does provide a strong disincentive – the court must award attorney's fees and costs to the prevailing party.

III. Challenges to Revocation of a Will and Trust

Florida law provides that a will or trust is void if procured by fraud, duress, mistake or undue influence. A testator or settlor may revoke a will or trust by writing or act. Under previous law, there was no mechanism to challenge a revocation of a will or trust by physical act based upon fraud, duress, mistake or undue influence. Florida law now provides that *revocation* of a will or trust is void if procured by undue influence, fraud, duress or mistake.

IV. Attorney-client Privilege relating to Fiduciaries

Florida law provides that communication between an attorney and the client is confidential if it is not intended to be disclosed to third parties. However, under Florida law, there was an exception for communication between an attorney representing a Personal Representative or Trustee if the

communication related to administrative matters. The legislation clarifies and expands existing law so that communication between a fiduciary client and the attorney is confidential and privileged and no longer subject to the above exception. Additionally, the personal representative or trustee must provide notice to the beneficiaries that an attorney-client privilege exists between the fiduciary and the attorney employed by the fiduciary.

If you have any questions regarding these recent changes in Florida law and how they may affect you, please contact us.

The foregoing is only intended to provide a general discussion and, therefore, should not be relied upon for your estate planning needs. However, if you have any questions about this memorandum, or its application to your specific situation, please contact any of the members of our Trust and Estate Department listed below.

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