

Stepping Stones

A Publication of the
Probate, Trust &
Personal Planning Group

Spring 2012

In this Issue:

- ~ Expiring Federal Transfer Tax Provisions Provide Opportunities: Why Give Them Up to Uncle Sam?
- ~ Powers of Attorney - Sign Early, Review Often
- ~ Trust Planning for the S Corporation Owner

Save the Date

Stepping Stones Conversations:

How to Talk to Your Children About Financial & Estate Planning

April 21, 2012

9:00 a.m. - 11:00 a.m.

Partridge Snow & Hahn LLP

180 South Main Street

Providence, Rhode Island 02903

PARTRIDGE SNOW & HAHN LLP
COUNSELORS AT LAW

Closer to the issues

Expiring Federal Transfer Tax Provisions Provide Opportunities: Why Give Them Up to Uncle Sam?

Marvin S. Silver



Since 2001, changes to the federal estate, gift and generation-skipping transfer tax ("transfer tax") laws have made planning more complex because of periodic adjustments to tax exemptions and rates that are subject to expiration dates, creating uncertainty for future planning. Transfer tax exemptions are the highest in the history of the transfer tax laws while the top tax bracket has been reduced from 55% to 35%. "Sunset provisions" cause the current favorable exemptions and tax rates to expire on December 31, 2012. While Congress may act to extend or further modify the current transfer tax laws, we urge clients to take advantage of the current exemptions and lower tax rates.

The transfer tax exemptions currently shelter from tax up to \$5,120,000 per person for transfers at death, so that couples can shelter \$10,240,000 from the transfer taxes. In addition, the estate tax rate has been reduced to 35%. An individual is allowed to gift the same amount during his or her lifetime and the estate tax exemption available for transfers at death would be applied to the lifetime gifts.

In 2013, the estate and gift exemption amount will revert to \$1,000,000 and the maximum tax rate will revert to 55% without action by Congress. (The gift tax annual exclusion of \$13,000 per recipient, which is subject to adjustments for inflation, is unchanged in 2012.)

Transfer tax law changes that took effect in 2010 also introduced a new concept to the federal estate tax law called "portability". Portability allows a surviving spouse to benefit from the unused exemption (if any) in his or her predeceased spouse's estate, avoiding the necessity of creating complex new trusts. Portability is currently effective only until the end of 2012 and, without Congressional action, would be applicable only to spouses who died before the end of this year.

In states that have separate state estate tax laws such as Massachusetts and Rhode Island, portability is not available for state estate tax purposes. In 2012, the Massachusetts estate tax exemption is \$1,000,000, and the Rhode Island exemption is \$892,865.

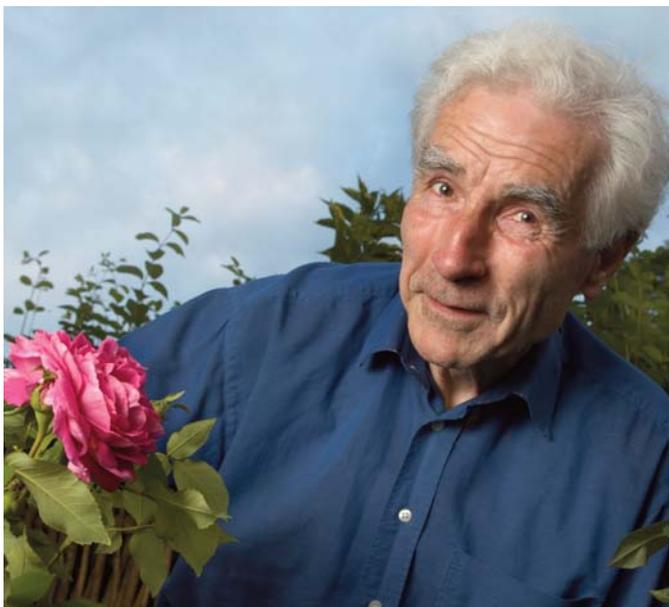
In the long history of the federal estate tax, the exemption amount has never been reduced. However, Congress has shown a propensity in recent years for unexpected legislation and short-term thinking. While we hope that Congress will act to extend the current federal estate and gift tax exemptions, the future of the federal transfer tax system remains uncertain.

Thus, for those clients with assets that exceed their present needs, the year 2012 may be a golden opportunity to reduce future transfer tax liability by making substantial gifts to children, grandchildren and other beneficiaries. This is a great time to review estate plans and consider strategies for preserving wealth.

Powers of Attorney - Sign Early, Review Often

Kristin N. Matsko

People are living longer as a result of advances in medical technology, as well as an increased emphasis on healthy lifestyle choices. Between 1980 and 2007, life expectancy



in the United States increased from 70 to 75 years for men, and from 77 to 80 years for women. Unfortunately, with increased life expectancy comes an increase in the prevalence of conditions affecting mental capacity, like Alzheimer's disease. Executing powers of attorney while you are healthy and competent is more important than ever.

Powers of attorney enable a person (the "principal") to appoint another (the "agent") to make decisions for financial matters and health care decisions. The agent effectively stands in the shoes of the principal and makes decisions in accordance with the principal's wishes, regardless of the agent's own thoughts and opinions.

Durable Financial Power of Attorney: A financial power of attorney is "durable" if it continues to be effective despite the principal's future incapacity. A durable financial power of attorney enables the designated agent to pay bills, sign checks, and conduct other routine financial transactions. Additionally, depending on the contents of the document, the principal may grant to the agent the ability to create and fund trusts, carry out strategic gift planning, and more. This authority can potentially result in significant tax-savings by reducing the principal's gross estate upon the principal's eventual death.

Power of Attorney for Health Care: A power of attorney for health care, sometimes called a proxy or surrogate, gives the designated agent the authority to make decisions relative to medical treatment, pain management, artificial hydration and nutrition, and similar issues regarding the principal's health care. The document may also address issues regarding life support, burial preferences and desires about organ donation.

Avoiding Guardianship Proceedings: One of the benefits of powers of attorney is that, in many circumstances, it may be possible to avoid guardianship proceedings in probate court wherein a judge appoints a guardian to act on behalf of an incapacitated person (the "ward"). Courts are often hesitant to restrict an individual's personal liberties to such an extent and are likely to do so only where there is no other less restrictive option available.

Guardianship is a course of last resort for other reasons. For instance, guardianship proceedings are conducted in open court and the documents and transcripts become a matter of public record. This can be embarrassing for individuals who value their privacy. Additionally, guardianship proceedings can take a significant amount of time. The proposed ward's physicians are required to verify that the health of the proposed ward justifies

imposition of the guardianship. The probate court will also appoint a guardian *ad litem* to interview the proposed ward and give an independent opinion that guardianship is appropriate. The overall cost of guardianship includes filing fees, guardian *ad litem* fees, and attorneys' fees, and may become more expensive in adversarial situations involving many family members.

Precautionary Measures: Unfortunately, even a power of attorney is not failsafe - financial or medical institutions sometimes refuse to honor them. This may happen if the institution has reason to believe that the power of attorney was signed under duress or if the documents are "stale" as determined by the institution's internal policies.

To improve the likelihood that your powers of attorney will be honored:

- ~ Review your whole estate plan often and update your plan upon any changes in your health or financial situation, particularly if there is a marriage, divorce, birth, inheritance, retirement or death of a spouse;
- ~ Execute new powers of attorney every 3-5 years, even if the information is the same. This will prevent the documents from becoming "stale";
- ~ Provide a copy of your power of attorney for health care to your primary care physician and nursing/assisted living facility before an illness or incapacity occurs; and
- ~ Provide a copy of your durable financial power of attorney to your bank and investment officer before an illness or incapacity occurs.

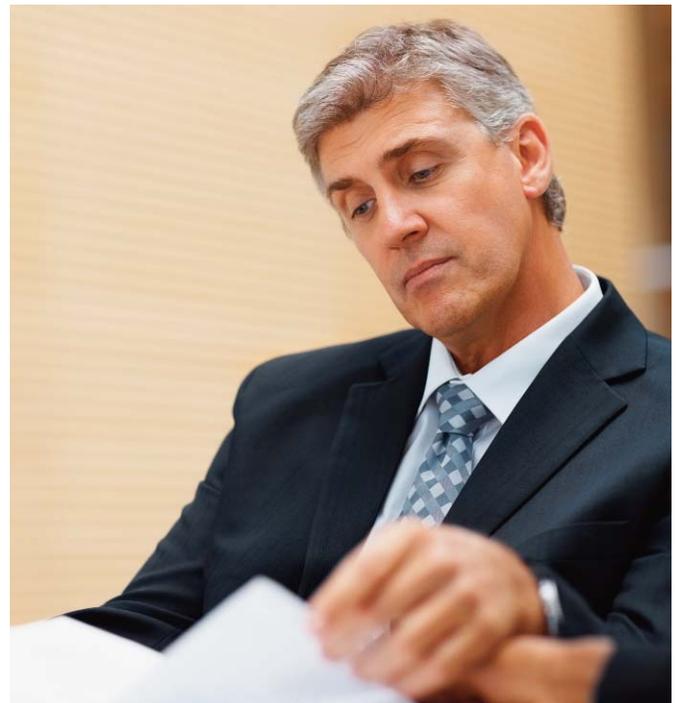
Trust Planning For the S Corporation Owner

Kathleen A. Ryan and David C. Morganelli

S Corporation owners enjoy tax benefits from the structure of their business. All income, losses and deductions pass through to S Corporation shareholders for federal and state tax purposes. This avoids the traditional double taxation on income at the corporate level and then again on dividend income distributed to the owners. Planning for the continued S Corporation qualification after a death or transfer of an interest in the business is important in order to maintain these tax benefits.

To qualify for S Corporation status, a company must comply with strict stock ownership qualifications. There may only be one type of stock issued by the company and no more than 100 shareholders. Corporations or partnerships are not eligible to be shareholders. However, individuals and estates, as well as certain trusts, may hold stock in an S Corporation so long as they meet specified qualifications approved by the IRS. Succession plans for S Corporation owners may include trusts that satisfy the S Corporation rules in order to avoid losing the tax benefits of S Corporation status.

There are three basic types of trusts that qualify as an S Corporation shareholder. The first is a trust treated for income tax purposes as if it is owned by an individual who retains certain powers over the trust. The second type is a trust that has only one income beneficiary for the beneficiary's lifetime and upon termination, the trust would be distributable to the same income beneficiary. The trustee must elect to be treated as a qualified trust S Corporation trust within two months of the transfer of the S Corporation stock to the trust. The third type of qualifying trust allows multiple beneficiaries and trust income to be distributed or sprinkled among the beneficiaries and is called an "Electing Small Business Trust". Electing Small Business Trust treatment requires an election by the trustee similar to the qualified trust S Corporation trust election.



Succession planning for any business owner tends to focus on finding the best ownership, control and management structure to facilitate the continuation of the business. For an S Corporation shareholder, a trust is useful in addressing concerns to protect the business where a future owner is under age, has a disability or lacks financial or business judgment to run the business. The S Corporation owner may transfer the shares of stock to a trust for the benefit of such future owners so long as the trust is qualified under IRS regulations to preserve S Corporation status.

Traditional trust planning for estate tax purposes also benefits the S Corporation owner. For a married person,

www.psh.com

Providence
180 South Main Street
Providence, RI 02903
Tel: 401-861-8200

Warwick
2364 Post Road, Suite 100
Warwick, RI 02886
Tel: 401-681-1900

SouthCoast
128 Union Street, Suite 500
New Bedford, MA 02740
Tel: 774-206-8200

MetroWest
1700 West Park Drive, Suite 200
Westborough, MA 01581
Tel: 508-599-3000

Disclosure Under IRS Circular 230: Any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any tax-related transaction or matter.

This publication is part of a continuing series aimed at informing our clients about current issues that may affect their wealth transfer planning. It is published by the Probate, Trust & Personal Planning Group at Partridge Snow & Hahn LLP, a business law firm with offices in Providence, Warwick, SouthCoast and MetroWest. The articles may be copied for educational purposes. We request that any such copies be attributed to the author and to Partridge Snow & Hahn LLP. This publication is not meant to provide legal advice, and readers should consult legal counsel prior to acting on any information contained within. The Rhode Island Supreme Court licenses all lawyers in the general practice of law. The court does not license or certify any lawyer as an expert or specialist in any field of practice.

Copyright © 2012
Partridge Snow & Hahn LLP

planning involves the use of trusts at death of a spouse to minimize estate taxes by creating a bypass trust for a surviving spouse and/or other beneficiaries to which estate tax exemptions are applied to reduce estate taxes. The remaining assets are then typically held solely for the benefit of the surviving spouse in a separate trust to which the unlimited marital deduction for estate tax purposes may be applied to further defer and minimize federal and/or state estate tax.

Using trusts in succession planning for S Corporation owners requires special attention to the strict limitations imposed under the Internal Revenue Code. Careful drafting is necessary to ensure that any trusts designated to receive S Corporation stock meet the owner's succession goals while preserving the S Corporation tax benefits.

Water Cooler Conversations

The Pawtucket Foundation names **John J. Partridge** as "Person of the Year".
Kathleen A. Ryan is now licensed to practice in the State of Florida.

Referrals Welcome

Our firm, like other professional service firms, relies on satisfied clients as an important source of new business. We welcome and value your referrals.

Thank you for your consideration.

Meet the authors:



Kristin N. Matsko **David C. Morganelli** **Kathleen A. Ryan** **Marvin S. Silver**

Kristin N. Matsko (knm@psh.com) concentrates her practice on estate planning, elder law and probate administration in Rhode Island and Massachusetts.

David C. Morganelli (dcm@psh.com) is chair of the Firm's Tax Practice Group and advises clients concerning federal and state estate and income tax issues, charitable giving options, business succession and the development of state and federal tax strategies.

Kathleen A. Ryan (kar@psh.com) applies her knowledge of probate, trust and tax laws to advise clients on wealth transfer planning, business succession, charitable giving, and estate and trust administration issues.

Marvin S. Silver (mss@psh.com) provides counsel to clients in connection with estate planning, business planning and the administration of trusts and estates. He advises clients on the creation of business entities and succession planning.

Contact your attorney in the Probate, Trust & Personal Planning Group for a consultation on how these issues may impact your situation. Our attorneys are admitted to practice in Rhode Island, Massachusetts and Florida. Through our association with Meritas, an organization of worldwide independent law firms with broad-based practices, Partridge Snow & Hahn LLP offers its clients access to quality legal services on a national and international basis.

For general comments or questions regarding this publication, you may contact Kathleen A. Ryan, kar@psh.com | 401-861-8200.