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- Charitable Gift Planning
- Design and Administration of private foundations and other types of charitable organizations

Notes from the Editor



As of this writing, we are still without Congressional guidance as to the future of estate, gift and generation skipping transfer taxes. Out of adversity sometimes comes opportunity and sometimes not. As to adversity, this issue explores the 2010 nightmare of carryover basis created by the Congressional failure noted above. By way of opportunity, we discuss how trusts might be good Roth IRA beneficiaries after conversion and why some creditors need not always be paid from a decedent's assets. Also by way of opportunity, consider the following.

For those whose estates are so large as to almost certainly incur future estate or gift tax liabilities regardless of whether the federal exemptions are set at 1 million, 3 million or 5 million, consider taking advantage of the 2010 gift tax rate of 35%. Typically this tax weighs in at around 45%. Since gift taxes actually paid are excludible from a decedent's tax base for calculating the estate tax so long as three years elapse between the payment of the tax and death, the effective rate drops to the 25% range. Granted, no one likes paying tax before its time, but in the right circumstance, this closing window of opportunity may pay real dividends especially if the value of the gift is depressed due to current economic conditions. As of this writing Grantor Retained Annuity Trusts also remain a valuable tool which may soon be swept away by Federal Legislation. The time to act may be now.

Please give us a call to discuss any of the issues presented in these articles. We are here to help.

Ronald F. Wayne
Editor of the Trusts & Estates Bulletin

FEATURE ARTICLES

Catch 1022: The Dilemma of the Carryover Basis

By: George F. Frank



Few attorneys, lawmakers, or pundits thought 2010 would actually arrive with the elimination of the federal estate tax. The Economic Growth Tax Relief Reconciliation Act (EGTRRA) of 2001 was a ten-year plan that gradually stepped up the minimum estate value upon which estate taxes would be levied. That value peaked at \$3.5 million in 2009, and the tax rate was 45%. The law provided that in 2010 there would be no federal estate tax, but the tax would be reinstated in 2011 at a 55% rate. It remains to be seen whether Congress will take action to increase the applicable exclusion amount, decrease the rate, or implement a combination of the two for 2011.

Almost overlooked in the debate over what to do about the estate tax is the change in the treatment of the taxable basis of a decedent's assets for 2010. Under the prior law, Internal Revenue Code Section 1014, assets owned by a decedent received a "step-

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up” in basis to their date of death value. For example, if the decedent purchased his home in 1980 for \$50,000.00, and it was worth \$200,000.00 at the time of his death, his beneficiaries could sell the property for \$225,000.00 and pay capital gains tax on just \$25,000—the difference between the sale price and the stepped-up basis of \$200,000.00, not on the full \$175,000.00 increase in value since the original purchase. This treatment not only eased beneficiaries’ gains tax burden, but it also simplified recordkeeping. It is relatively easy to value almost any asset as of a recent date; it is far more difficult to track down individual purchase prices for 1,000 stock certificates a decedent may have purchased in the 1940’s.

Beneficiaries of decedents dying after December 31, 2009, face just such a nightmare. As part of the sunset provisions of the EGTRRA, Internal Revenue Code Section 1022 replaces Section 1014. Instead of being stepped-up, the original basis of a decedent’s assets is “carried over.” Thus the same beneficiaries in the example above would pay capital gains tax on the full increase in value of \$175,000.00 since the original purchase of the home.

Section 1022 eases the tax bite somewhat by granting the decedent’s personal representative the authority (and the fiduciary responsibility) to allocate up to \$1.3 million (\$60,000.00 in the case of a non-citizen decedent) of allocable basis increase among the decedent’s assets. For example, if the decedent owned stock with a basis of \$100,000 that is now worth \$1 million, the personal representative may allocate \$900,000.00 of the allocable basis increase to that stock to bring it up to its fair market value at the decedent’s date of death, leaving \$400,000.00 to be allocated among the decedent’s other assets and to one-half the value of assets the decedent owned jointly with another at the time of his or her death. Estates with surviving spouses receive an additional \$3 million allocable increase, which may be allocated to outright spousal gifts and Qualified Terminal Interest (QTIP) Property. Thus, only beneficiaries of estates of single decedents valued at over \$1.3 million and, with careful planning, those of married decedents valued at over \$4.3 million, will face larger capital gains tax bills than they would have under the prior law. The Internal Revenue Service was apparently as surprised as everyone that this law took effect because, as of this writing, no form to allocate basis has yet been published.

One unusual aspect of the new law is that it grants personal representatives, who normally have dominion only over a decedent’s probate assets, the authority to allocate the basis increase to non-probate assets such as joint accounts with rights of survivorship, payable-on-death accounts, and retirement accounts that pass by beneficiary designation. The personal representative may allocate the increase among all of the decedent’s assets as he or she sees fit. It is easy to imagine a beneficiary facing an enormous capital gains tax bill suing the personal representative who allocated the increase to his own assets instead of the beneficiary’s, alleging a breach of fiduciary duty and self-dealing. For this reason, estate planners should now include a clause in wills granting the personal representative absolute discretion to allocate the increase as the representative sees fit—including assets passing to him- or herself as beneficiary—and specifically authorizing the representative to allocate the increase to assets outside of the testator’s probate estate. Alternatively, a testator may specify those assets to which any allocable increase should be applied.

It remains to be seen what the ultimate estate tax solution for 2010 will be. A popular theory is that estates will be given the option to elect to pay no estate tax, with an accompanying carryover basis, or to pay tax on estates with a value over a yet-to-be-determined exclusion amount but receive the step-up in basis as in the past. Given that Congress has had nearly ten years to implement a solution but has not done so, no one should assume that the law will change before the end of this year. Estate planning attorneys and testators should acknowledge the impact of Section 1022 in their documents, personal representatives should prepare to hunt for purchase records from years ago, and beneficiaries should steel themselves for a sizeable capital gains tax bite.

“...estate planners should now include a clause in wills granting the personal representative absolute discretion to allocate the increase as the representative sees fit...”

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Trusts May Be Good Beneficiaries for IRA's after Roth Conversion, But Watch Out for How the Trust Is Structured

By: Patrick J. Weschler



In 2010, IRA account holders have the opportunity to convert their plans into Roth IRA's, regardless of their taxable income. Prior to 2010, this opportunity was available only to individuals with modified adjusted gross incomes ("MAGI") or \$100,000 or less.

Many folks are finding conversion an attractive proposition, even though it will require payment of income taxes on the entire account balance converted into a Roth IRA. Once the conversion has occurred, all future growth in the plan balance will be tax-free. No taxes will be due in connection with withdrawals. In addition, taxpayers who do Roth conversions this year will have the option of reporting the income on their 2010 return, or deferring it to be reported on their 2011 and 2012 returns.

If you are considering such a conversion, you will want to look at how your IRA beneficiary designation presently reads. A common arrangement is for the beneficiary designation to provide for the participant's spouse to be the primary beneficiary, and for the participant's children to be secondary beneficiaries.

For a regular IRA, this can be an excellent arrangement. When the IRA is divided for the participant's children at the second death, each child has the option of drawing the IRA over his or her life expectancy. In the case of a child in his or her 40's who takes only the required minimum distributions ("RMD's"), this gives the option of drawing the IRA for 40 or more years, with RMD's of 2.5% or less in the early years.

Note that these are minimum distributions. If the child wishes to withdraw more from his or her share of the IRA, the child is permitted to do so.

As the child makes the withdrawals, he or she will have to pay income tax on the amounts that are withdrawn. This income tax result will serve as a brake on most children against withdrawing the IRA assets too quickly.

In the case of a Roth IRA, however, there is no tax on the withdrawals a child makes from his or her share of a parent's plan. The RMD rules still apply, however, so the child will need to withdraw the IRA proceeds over his or her life expectancy. But – and this is important -- the lack of tax on the withdrawals removes the incentive that the child had to refrain from taking too much out of the plan.

The biggest benefit of a Roth IRA is its ability to grow, tax-free. This benefit is premised on the assumption that the child will leave his or her share in the plan to grow as much as possible on a tax-free basis. But without the disincentive of having the withdrawals subject to income tax, there is the concern that children receiving shares of Roth IRA's will completely withdraw their shares and forfeit the benefit of tax-deferred growth.

One way to avoid this result is to leave a child's share of a Roth IRA in trust, with standards to be applied in connection with the making of trust distributions. In this way, the child will not control how much to take out of the IRA.

If you elect to take this approach, you will want to make sure that the trust is structured so that all of the trust beneficiaries will be "qualified beneficiaries" for purposes of calculating the RMD's for the IRA. If all of the trust beneficiaries are qualified beneficiaries, then the RMD will be based on the life expectancy of the oldest beneficiary of that trust.

Note that the rules in this regard do not apply just to the current trust beneficiary, but also to any beneficiaries

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who will receive the trust assets if the current beneficiary dies before the trust assets are fully distributed.

For example, Mr. Jones sets aside assets in trust for his son John, who is 35 when the last of Mr. and Mrs. Jones dies. Let's say the trust provides for John's share to remain in trust until he is 45, but that the assets will pass to John's children if he dies prior to age 45. The trust also goes on to say that the assets will go to John's siblings, if he dies without children, and that they will go to the siblings of Mr. and Mrs. Jones in the unlikely event that none of John's siblings is alive. Assume that the oldest of Mr. Jones' siblings is 82 years old.

In the example above, the oldest beneficiary is Mr. Jones' 82-year-old sibling. To avoid this result, care will need to be taken that the trust beneficiaries do not include individuals who are significantly older than the primary beneficiary for whom the trust share is set aside.

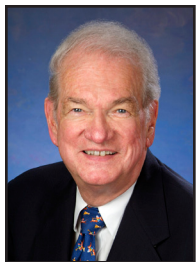
Moreover, if one of the beneficiaries is not a "qualified beneficiary," then the trust must withdraw the entire plan assets in a five-year period. For example, if the trust says that the assets will go to the Akron Community Foundation if the child dies and has no surviving children, the five-year rule will apply. Because a charity does not have a life expectancy, it is not a qualified beneficiary. The foregoing example is not intended to discourage individuals from using trust dispositions for their newly converted Roth IRA's. Buckingham's estate planners are well versed in structuring trust instruments to receive both Roth and non-Roth IRA assets in a manner designed to permit the distribution of the IRA over the lifetime of the primary beneficiary. If you decide that a trust-based IRA beneficiary designation is desirable, the key thing to bear in mind is that the designation must be structured carefully and correctly. Let us help!

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When Someone Dies, Do Creditors Always Get Paid?

By: Thomas E. Sliney



When a person dies there are essentially three activities in the administration of an estate that are the responsibility of the personal representative. The first is marshalling and determining assets; the second is payment of debts, taxes, and expenses of administration; and the third is distribution of the estate proceeds to the beneficiaries.

A question that comes up infrequently, but one that is of significance, is whether the creditors of an estate always get paid, and what constitutes a creditor in the context of this question. In essence, when an estate is opened the personal representative of the estate steps into the shoes of the person who has died. The representative has to carry out the decedent's incomplete business transactions, including paying the creditors. One of the most frequent creditors is the holder of a mortgage. A mortgage constitutes a prior lien on a person's real property, whether it is homestead property or not. If the mortgage is not paid, the mortgage can be foreclosed by the lienholder.

In today's society there can be a variety of creditors waiting for payment when an estate is opened. Some of the most frequent creditors are credit card companies. People naturally think that they will be able to pay off their

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credit cards balances, but often when a person gets sick or is unexpectedly terminated from a job, that person's only recourse for a short period of time may be the use of credit cards to pay ongoing expenses.

Other types of debt can be unsecured loans (either from institutions or from individuals), and medical expenses, particularly in the case of a death preceded by a lengthy illness. In order to create a valid claim for payment of unsecured debts that were outstanding as of the date of death, a claim must be filed in the decedent's estate for any debt for which there is no prior lien. Even where there is a prior lien, a claim may be filed to cover any difference between the debt and the value of the collateral. The claim rules in the State of Florida provide for a Notice to creditors to be published, following which the claimant is able to file a claim within the 90-day creditor period set forth in the statute. There also is an obligation under Florida law to notify all reasonably ascertainable creditors. If a creditor is notified and does not timely file a claim, then that creditor is barred; however, if a reasonably ascertainable creditor is not notified, that creditor's claim is not barred. Ohio law provides only a 6 month window during which creditors may file claims.

Suppose that a creditor files a timely claim – does that ensure that the creditor will be paid? In most instances, the answer is “yes” – but in a number of cases that I have come across in recent years, the answer is “maybe.” The reason why a creditor may be eligible for payment but may not be assured of payment concerns the nature of the estate assets, which can ultimately be subject to little or no administration. For example, a person may have a number of assets, but those assets may be made payable to certain beneficiaries. If an asset was not owned in the decedent's name at the time of his or her death, or if an asset is payable to a named beneficiary or is, perhaps, jointly owned, then that asset is not subject to administration. It is therefore possible to have a situation in which, technically, there is a large gross estate for tax and other purposes, but few or no assets requiring probate so that a formal estate is not opened. A creditor that has timely filed a valid claim, in an estate with assets that are insufficient or not subject to probate, may not get paid (at least in the estate proceeding).

Another instance in which a creditor may not be paid is when assets that are subject to administration consist solely or mainly of homestead property (or other exempt property, such as life insurance and annuities). If, upon the filing of a Petition of Determination of Homestead, the court determines that the real property in an estate is a homestead, then the homestead property will be exempt from the claims of creditors. Even if there are no other assets in the estate that can be used for payments to creditors, the homestead will be exempt.

Thus, even though a decedent leaves assets, these assets may not have to be utilized for the payment of creditors. Increasingly, individual debt amounts are rising, and people have structured the ownership of their assets to prevent them from being payable to their estates.

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UPCOMING EVENTS

David Drechsler (Cleveland), **Ron Wayne** (Cleveland) and **David Woodburn** (Akron) will speak at the Ohio Accountancy Show on October 27 and 28th at the International Exhibition Center (I-X Center), Cleveland, Ohio. Their topic: “*Inheritance Controversies: Did Grandfather Really Intend to Will All of His Assets to the Cocktail Waitress Or Is Something Fishy Going On?*”

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RECENT NEWS

Michael D. Mopsick (Boca Raton) was recently certified by the *Florida Supreme Court* as a Circuit Civil Mediator.

David Woodburn (Akron) was quoted in four separate articles featured in the *Akron Beacon Journal*.

“Everyone needs these documents,” Lin-Fisher, July 25, 2010

“Leave road map for paying bills,” Lin-Fisher, July 25, 2010

“You may not need living trust,” Lin-Fisher, July 18, 2010

“Where there’s a will...,” Lin-Fisher, July 18, 2010

The following **members of Trusts & Estates practice group** were recently selected by their peers for inclusion in *The Best Lawyers in America® 2011**:

- *Robert W. Briggs*
- *Patricia A. Pacenta*
- *Jeffrey A. Halm*
- *Ronald F. Wayne*
- *David J. Lewis*
- *Patrick J. Weschler*
- *David Kern*
- *David W. Woodburn*
- *Robert W. Malone*

Allan Sweet (Cleveland) presented to the Akron Tax Club on July 28, 2010. His topic was “*Estate Planning Opportunities in 2010.*”

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