*FALL 2013 ISSUE*

# CLIENT UPDATE & WEALTH ADVISOR

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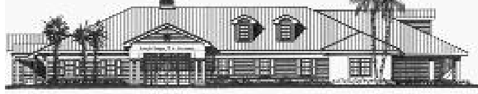

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*The hiring of a lawyer is an important decision that should not be based solely upon advertisements. Before you select an attorney, ask them to send you free written information about their qualifications and experience.*

## *PREPARING FOR FISCAL CLIFF #2*

***-PRESIDENT OBAMA ADMINISTRATION'S 2014 ESTATE TAX PROPOSALS-***

As budget talks continue, Senate Majority Leader Sen. Harry Reid (D-Nev) has said any tax reform must raise significant revenue, a position that congressional Republicans firmly oppose as a tax increase which they have pledged they won't permit. Each side has been arguing their position and the Obama Administration has set forth its wish list for proposals to increase

*See FISCAL CLIFF #2 on page 12*

## *SNOWBIRDS: NORTHERN STATE DEATH TAXES ARE GETTING HARDER TO SHAKE*

***- A SHIFT OF FOCUS IN BASE LEVEL PLANNING -***

Many residents of Florida are seasonal, having abandoned their lifelong northern domicile in favor of Florida, but maintaining the northern home as a summer residence. Often their change of residence (domicile) to Florida was not so much driven by lifestyle, as it was tax savings. Leaving a northern home behind and not divorcing oneself of ownership may result in lingering death tax exposure, even though the federal estate tax exemption increased to $5.25 million (indexed). This is because many

*See NORTHERN STATE DEATH TAX on page 4*

## *WHAT TO THINK ABOUT NOW - "JOINT TRUSTS"*

***- TO SPLIT OR NOT TO SPLIT -***

Traditional estate planning dictates that spouses split a sufficient amount of the ownership of their property to use their respective estate tax exemptions, and then place what has been split into their respective revocable living trusts. Doing so is commonly recommended to accomplish two primary objectives: (1) full

*See TO SPLIT OR NOT TO SPLIT on page 7*

## *FIRM WINS HOMESTEAD CASE*

***- CASE OF FIRST IMPRESSION BENEFITS QPRT USERS -***

In a case of first impression, the Martin County circuit court and Judge Mirman ruled in favor of the Firm's client on summary judgment, finding that homestead qualification remains uninterrupted when children follow a proper strategy of granting their parents the right to live in a home conveyed to a qualified personal resident trust ("QPRT"), even after the retained term expires. Mr. Kempe explained to local media the importance of

*See FIRM WINS HOMESTEAD CASE page 15*

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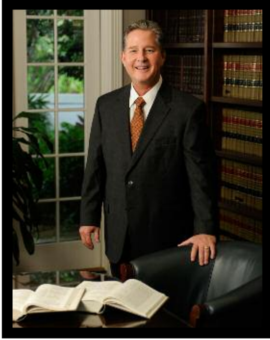

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## *WHAT'S NEW: NOT A LOT, SAME OLD THING*
### *- TAX REFORM, POLITICS, AND THE ECONOMY -*

Year-end 2013 is unlikely to be a repeat of 2012, at least we hope! But, what really has happened? Our budget problem hasn't been fixed, the Democrats want to raise taxes, the Republicans want to cut spending, and our economy remains vulnerable. Sequestration remains a cliff on the horizon, with some pleading to increase spending. Both political parties are seeking major tax reform, but none seems as if it will be effective earlier than January 1, 2014. Thus, those that may desire to take advantage of present laws and interest rates are encouraged to consider planning before year-end. If you desire to learn more about why, see our Tax Reform White Paper on the homepage of our website beginning on page 8 at www.jckempe.com.

Several developments have caused a new focus in estate planning. Historically, estate tax planning greatly overshadowed income tax planning because the estate tax was so high and income taxes were relatively low. With the substantial increase of the federal estate tax exemption ($5.25 million) and increase in income taxes, planning has now often been turned on its head. The focus now is often on achieving income tax savings, where the methods don't have a considerable impact on estate tax. Furthermore, state death taxes have increased as the federal estate tax has fallen. When compared to federal estate tax exposures, many states impose significantly higher death taxes (e.g., CT, Ill, MA, MD, NJ, NY, RI, VT and others). As a result, many more seasonal residents of Florida are being impacted by state death taxes. This can occur in one of two ways: (1) where a Florida tax resident owns real property (homes, land, or investment properties) in those northern states, or (2) where children live in those states and inherit wealth that is not otherwise sheltered by the generation skipping tax exemption. This Client Update focuses on these situations.

As I am writing this Client Update, the 10 year treasury yield has spiked to almost 3% and the US equity markets are moving sideways with a sense that a correction is overdue. Unemployment figures have only slightly improved, depending on how you look at them. GDP is stagnant. Returns generated by market momentum and a potential herd mentality may become more difficult, and investors seeking alpha are now learning to use various financial metrics (some new and some old) to judge their investment policies, performance, and the cost they are paying for that performance.

Where is the next bubble, when is the next tax reform, and what is certain? I know the answer to only one of these three questions and it is: death and taxes!

*FISCAL CLIFF REDUX ?*

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# When Incurring Generation Skipping Tax Makes Sense

## - Senior Family Member Planning for Children Living in Northern States -

Often estate plans are designed to pass wealth on to the next generation in a protected mode, while providing children with control over their inheritance. Most senior family members we counsel choose to use their generation skipping tax exemptions in order to better protect wealth passing to their children. Doing so protects inheritances and family wealth from divorce and third party liability risks, while also exempting much of what passes from again being taxed in the childrens' estates. If, for example, a surviving widow has three children and a $15.25 million estate, her estate tax would be $4 million ($15.25 less $5.25 x 40%) and the residual $11.25 million estate would be divided into three shares: $3.75 million for each child. Recognizing that these amounts will be included in her childrens' taxable estates, she chooses to use her generation skipping tax ("GST") exemption, which is equivalent in amount to her $5.25 million estate tax exemption but not one and the same. As such, her estate plan divides her $5.25 million GST exemption into three shares, $1,750,000 for each child. Thus, each child inherits a $2 million non-GST exempt share and a $1.75 million GST exempt share. Typically, the children would be educated to first invade the non-GST share for their needs, preserving and allowing the GST exempt share to grow. This is because the GST exempt amount will not be added to and taxed in each child's estate.

Most estate plans are designed to force

See GST-Children in Northern States page 12

# Strategic Planning Aimed at Locking-In Current Low Rates and Current Laws

## - Learning About the Power of Substitution Inherent in Grantor Trusts -

Grantor trusts were the most commonly used estate planning tool employed by estate attorneys to confront Fiscal Cliff #1. They will also likely be the most commonly used to confront Fiscal Cliff #2 . There are a variety of grantor trusts that are used, and two of the most common types are known as "GRATs" (grantor retained annuity trusts) and grantor defective trusts. Grantor trusts are taxable to the grantor (person who established the trust) for income tax purposes under Subchapter J, subpart E of the Internal Revenue Code. They are often referred to as defective because they are a nullity for income tax purposes- meaning income from assets transferred to the trust remains taxable to the original grantor of property to the trust, as if the trust did not exist.
Nevertheless, if a transfer is made, it is commonly designed to be effective for estate and gift tax purposes. For example, if a gift is made to a grantor trust it may be subject to gift tax, even though it is defective and a nullity for income tax purposes. This has been the IRS agreed interpretation of relevant law for many years. See Rev. Rul. 85-13. As a result, it has become a highly regarded and effective tool for advanced estate planning.

Grantor trusts are commonly used in what we call Phase 3 estate planning. Typically, Phase 3 planning involves sales type transactions, where senior family members transfer assets to a family trust and retain a specified cash flow stream. In a low interest rate environment, as we have had, the value of the cash flow stream retained by the senior family member is worth more than in a high interest rate environment. Since the value of the cash flow stream retained is essentially subtracted from the total value of what has been transferred by the senior family member in order to determine whether a gift has been made, low rates and high present values are preferred. When the value of what is transferred is equal to the value of what is retained, no gift has been made. As we leave a period where interest rates have appeared to trough and

See Strategic Planning page 13

***Plan of Care***

*A Plan of Care is a holistic appraisal of a person's particular situation taking into account current health, physical environment, particular needs, working diagnosis (if any), and anticipated future. It can and often does involve both legal and medical issues. It should ask three questions: where are you now, where are you going, and how this should be accomplished. Obviously, as the goals of care change, the method of approach also changes. The most important feature in a Plan of Care is maximizing and maintaining a person's quality of life for as long as possible. When that goal is no longer viable, the goal changes to helping the person and their family through the dying process in such a way that the person's dignity and pain are adequately addressed and the family unit is supported.*

MARNIE RITCHIE PONCY, ESQ.
REGISTERED NURSE

HEALTH CARE ADVOCACY
BIOETHICS LAW
DEATH WITH DIGNITY

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## *NORTHERN STATE DEATH TAXES*

*(continued from cover)*

states have a state death tax exemption that falls below the federal exemption, which is known as being "decoupled" because historically state death tax exemptions were coupled with (equal to) the federal exemption. As federal exemptions have risen, states have sought to protect their tax revenues by decoupling their tax system from the federal system and higher exemption. For example, the New York exemption is presently $1 million; Connecticut's is $2 million; New Jersey's is $675,000; Massachusetts' is $1 million; Illinois' is $4 million; Maryland's is $1 million; and Rhode Island's is $910,725. How have these states made it harder to shake their death taxes? Let's see!

Many northern states may impose a death tax on Florida residents who own real property (a home or otherwise) in their jurisdiction. For example, if a married Florida couple have a combined wealth of $10 million with ownership of those assets evenly divided and Dad dies owning a $2 million home in New York , the corresponding NY death tax exposure in 2013 would be $156,640. For a married couple, in order to avoid a state level tax on the first spouse's death, the amount in excess of the "state" exemption ($4 million in our example) must qualify for the marital deduction. What this means is that the amount in excess of the exemption amount ($4 million) must pass to the surviving spouse or in another qualifying way, (often through use of a qualified terminable property trust ("QTIP")), in order to obtain a marital deduction for the excess and avoid the state level tax. However, doing so for purposes of any of the above mentioned states would mean that the marital deduction is greater than would be required for federal purposes, since the federal exemption is $5.25 million (indexed) and only amounts in excess of this amount need to qualify for the marital deduction to avoid federal tax. Thus, with a $5.25 million estate, the marital deduction would be overfunded for federal purposes by as much as $4.25 million in New York. This is called "overfunding the marital deduction" because it potentially results in a larger amount of property value being included in the estate of the surviving spouse. What qualifies for the marital deduction is potentially taxable in the estate of the surviving spouse (the tax on assets qualifying for the marital deduction may just be deferred), unless absorbed by the surviving spouse's federal estate tax exemption or consumed over his or her lifetime. **What is important to understand throughout this article is that couples can eliminate both state and federal death taxes on the death of a spouse, if the amount in excess of the relevant exemptions qualifies for the marital deduction.** However, since the state and federal exemptions are now different because many states have decoupled and some states don't allow you to take a different marital deduction for state and federal purposes, dealing with competing tax exposures has complicated planning and estate administrations.

The problem that must be recognized is that sometimes there is a trade-off in using the marital deduction for state death tax purposes, **unless a separate and independent decision may be made for federal purposes that is not binding for state purposes.** This is because to avoid state death tax, all of the states mentioned above would require a marital deduction that is larger than that required for federal purposes, thus not fully utilizing the federal exemption and potentially causing greater federal death taxes on the surviving spouse's estate. If a state forces a spouse's estate to forego full use of the federal estate tax exemption to avoid state tax, because the federal exemption is higher, it will necessarily require a larger federal marital deduction and potentially increase the surviving spouse's federal taxable estate. Conversely, in order to use the full federal estate tax exemption and reduce what is potentially taxable in the surviving spouse's estate for federal purposes, some states will impose a tax ($156,640 in our example) as a result of the smaller marital deduction because the federal decision is binding for state purposes

*See NORTHERN STATE DEATH TAXES on page 14*

## A New Focus on Tax Basis and Joint Trusts

### - Obtaining Basis Step-Up Within Estate Plans -

As a result of the increase of the estate tax exemption to $5.25 million (indexed), tax planners are now more focused on income taxes since they have increased while estate taxes have decreased. Securing increases in tax basis on which capital gains taxes are computed has become an increasingly important part of estate planning, and so has how property is owned and titled. This article discusses both, after first providing some background.

Property passing from a decedent receives a tax basis step-up (or step down) for future capital gains (or loss) purposes in the hands of the heir receiving it, generally based upon the fair market value of that property at time of death. The ownership interest in joint property included within a taxable estate where survivorship rights exist ("JTWRS Property") is a little more difficult to determine, and depends on whether (1) the joint property is owned by spouses, (2) the property was acquired by them before 1977, (3) who contributed the consideration for the property's purchase; and (4) the type of property involved. (If there are no survivorship rights in jointly owned property, the general rule of the first sentence of this paragraph applies.) The general rule for JTWRS Property is that a deceased joint owner includes within their estate the proportion of its date of death value equal to the percentage of consideration they paid for the property's purchase. Thus, if a deceased father contributed 100% of a $100,000

See Tax Basis: Capital Gain Avoidance page 6

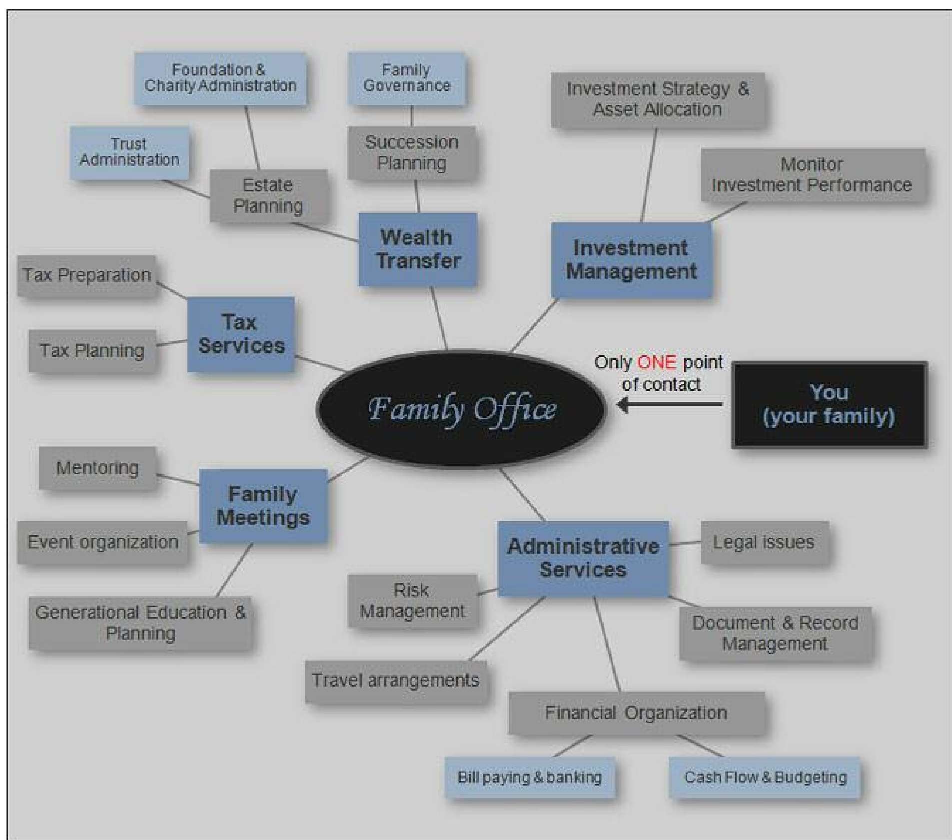
## Banks: Many Improving and the List Shortened

| Bank | Rating |
|---|---|
| Bank of America | C+ |
| Bank United | A- |
| BB&T | C+ |
| Deutsche Bank and Trust | A- |
| Enterprise National Bank | C+ |
| First Citizens Bank & Trust | B |
| Grand Bank and Trust | E+ |
| Gulfstream Business Bank | B |
| JP Morgan TC NA | C- |
| Northern Trust NA | B- |
| Sabadell United Bank | B- |
| Seacoast NB | C- |
| Stonegate Bank | B+ |
| TD Bank NA | C |
| Wells Fargo Bank NA | C+ |
| Wilmington Trust Co. | B |

Source: Weiss Ratings/The Street.com as of June, 2013. Please note that other rating organizations may have higher or lower ratings for these institutions and that these ratings may have changed.

## Family Office Services

### -Demand Increasing for our Family Office Services –



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## *Tax Basis: Capital Gain Avoidance*

(continued from page 5)

purchase of JTWRS Property owned with a child and dies when the property is worth $500,000, the entire $500,000 value is included within the father's taxable estate and the child receives it with a new cost basis of $500,000. If in this example the child contributed $50,000 of the original purchase, the amount included in the father's taxable estate is $250,000 and the basis of property in the hands of the child would be $300,000- original $50,000 contribution plus $250,000 step-up for the father's interest passing as JTWRS Property.

What if in the above example the JTWRS Property were owned by spouses? The rules change! JTWRS Property owned by spouses is considered "Qualified Joint Property," and this type of property comes under an important exception to normal rules that became effective in 1977. If Qualified Joint Property, who contributed to the original purchase is irrelevant. The deceased spouse includes 50% of the date of death value of that property in their taxable estates, and the surviving spouse receives a basis step-up (or step down) in that portion. In the above example, if the child were the spouse, in both instances of the example the results would be the same as where the child contributed 50%. Whether or not the surviving spouse contributed anything, the first spouse to die includes 50% of the date of death value in their taxable estate and the survivor receives a 50% basis step-up. But what if the JTWRS Property was acquired prior to 1977? An exception to the exception applies (the "Gallenstein Rule"), and the general rule regarding the relative consideration paid in the original purchase applies and the results would be the same as in the examples above concerning the child. Thus, if Dad died owning pre-1977 property which he purchased with his funds, it may be advantageous for Mom to recognize a full basis step-up using the Gallenstein Rule.

One of the focuses of current estate planning is obtaining a 100% step-up in basis on the death of the first spouse, with no estate tax. This is generally relevant where clients use joint trusts or hold a substantial portion of their property as JTWRS Property and the Gallenstein Rule doesn't otherwise apply. With proper planning, the results of the Gallenstein Rule (a basis step-up of more than 50%) can be obtained if the Qualified Joint Property consists of bank, brokerage, or other investment accounts ("Qualified Property"), that is not otherwise tenancy by the entireties property). Under another exception to the Qualified Joint Property rule, the surviving spouse may "disclaim" that portion of the JTWRS Property that is attributable to the decedent's contribution to the original purchase of Qualified Property. Thus, if Dad acquired Qualified Property with his own funds after 1976, and at death that property is owned as JTWRS Property, Mom can disclaim the full value of the property and that property will receive a full basis adjustment equal to its value at time of death. If the estate plan is properly designed, disclaimed property will pass to Mom in any event or in certain protective trusts for her benefit.

Another focus of current estate planning is use of joint trusts. Most recently, those unlikely to have taxable estates as a result of the increase in the estate tax exemption are now using joint trusts in order to simplify their affairs, while securing probate avoidance. Another motivation may be to gain the asset protection benefits of tenancy by the entireties ownership, if the trust is drafted to achieve these objective. See Page 1, What to Think About Now. Properly drafted, all of these benefits may be achieved using a joint trust in some instances, even for larger estates. In some instances, a full basis step-up for all property held by a joint trust on the death of the first spouse may be achieved, notwithstanding who originally contributed toward the trust property's purchase.

### *7520 Rate History*

| | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|
| Jan | 1.0 | 1.4 | 2.4 | 3.0 |
| Feb | 1.2 | 1.4 | 2.8 | 3.4 |
| Mar | 1.4 | 1.4 | 3.0 | 3.2 |
| Apr | 1.4 | 1.4 | 3.0 | 3.2 |
| May | 1.2 | 1.6 | 3.0 | 3.4 |
| June | 1.2 | 1.2 | 2.8 | 3.2 |
| July | 1.4 | 1.2 | 2.4 | 2.8 |
| Aug | 2.0 | 1.0 | 2.2 | 2.6 |
| Sept | 2.0 | 1.0 | 2.0 | 2.4 |
| Oct | 2.4 | 1.2 | 1.4 | 2.0 |
| Nov | | 1.0 | 1.4 | 2.0 |
| Dec | | 1.2 | 1.6 | 1.8 |

Use of the 7520 rate is required in many estate tax strategies. Generally, the lower the rate the better. Those that acted in the second half of 2012 benefited.

**Romita Asrani, CPA**
Tax Accountant
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### Top 1% Gain -US Income Inequality Reported by Berkeley –

Economists at the University of California at Berkeley reported that the incomes of the top 1% in 2012 rose nearly 20% compared to 1% for the remaining 99%. This is the biggest share of household incomes since the Roaring '20s. Three main reasons were cited: (1) US workers are now competing with China and other low-wage labor markets; (2) technology is increasingly replacing workers performing routine tasks; and (3) union power has subsided, with workers represented by unions falling from 23.3% in 1983 to 12.5%.

But, the wealthier they are, the harder they fall. The richest Americans were hit hard by the financial crisis, with their incomes falling 36% during 2007-2009 (the "Great Recession"). Incomes for the bottom 99% only fell 11.6%.

### *We are Pleased to Announce that Benjamin M. Devlen, CPA, Has joined the Firm*

*Mr. Devlen joins us from WTAS, LLC (formerly Arthur Andersen) in West Palm Beach, where he gained substantial experience in federal and state tax compliance and investment consulting and reporting. He was also a mentor at WTAS, where he trained and developed staff and interns. Prior to joining WTAS, Mr. Devlen interned with the Multistate Tax Commission in Washington, D.C.*

*A magna cum laude graduate of the University of Notre Dame's Master's of Science in Accountancy, Mr. Devlen obtained his BS degree in accountancy at Florida State University. He joins our Tax Compliance and Wealth Management Departments.*

**Ashley M. Sundar, Esq.**
Probate Litigation
Estate Administration

## *To Split or Not To Split - Joint Trusts*

*(continued from front cover)*

use of both sets of estate and generation-skipping tax ("GST") exemptions and (2) probate and guardianship avoidance. With the increase of the estate and GST tax exemptions to $5.25 million (indexed), the vast majority of married couples in the US no longer have an incentive to split assets for estate tax purposes. There nevertheless remains an incentive to use revocable living trusts. Use of revocable living trusts in traditional planning, however, came with a loss of the asset protection afforded married couples under Florida law when property is owned jointly, as tenants by the entireties.

With the increase of the estate tax exemption, more focus is being placed on the use of joint trusts; particularly, those drafted to gain the benefits of tenancy by the entireties status. A review of Florida law provides ample authority for creation of such trusts. The rationale is that beneficiaries of a trust hold equitable title to the trust property, and furthermore that a husband and wife can hold such property in tenancy by the entireties. See Passalino v. Protective Group Securities, Inc., 886 So.2d 295 (Fla. 4th DCA 2004).

We have been recommending that married clients, who are unlikely to have taxable estates, consider joint trusts drafted to qualify the beneficial interests as tenancy by the entireties. In some cases, joint trusts are also recommended for those with taxable estates. Factors that are considered are (1) the size of the estate; (2) the extent of capital gain inherent in assets comprising the estate; (3) the benefit perceived in securing tenancy by the entireties protection from claims (lawsuits) of third parties; and (4) whether there exist children of prior marriages. For further information on whether a joint tenancy by the entireties trust is recommended in your circumstances, please feel free to call.

Joseph C. Kempe
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## PASSIVE INVESTING OR "ACTIVE SHARE"

### - WHAT ARE YOU PAYING FOR: IS YOUR MANAGER ACTUALLY A CLOSET INDEXER (INSIDE ZEBRA)? -

How Do You Know?
Princeton Professor
Burton Malkiel:

"Many may incorrectly judge the quality of investment advice by the price charged. Individual and institutional investors may suffer from overconfidence and truly believe that they can select the best manager and earn excess returns [Alpha], despite historical evidence to the contrary."

WSJ, Op-Ed, May 28, 2013

This article is about how you can tell what you are paying for when choosing investment advisors and money managers. It is about a financial metric called "Active Share." In several prior Client Updates we have written about studies suggesting that passive investment styles are the most cost effective approaches to equity investment over long periods. Some of these articles quoted Princeton Professor Burton Malkiel who, in May of this year, wrote a Wall Street Journal editorial entitled "You're Paying Too Much for Investment Help." But how do you know? Furthermore, and notwithstanding what Malkiel claims, in sideways and volatile market environments, where market performance isn't expected to be that great, some investors may seek active managers and are willing to pay higher fees for that management. Active managers are expected to have a Beta of other than 1, in order to pursue Alpha (performance in excess of benchmark indexes). "Active Share" is a relatively new metric that may be employed to understand whether you are truly paying for active management (a manager who is seeking Alpha) or whether you are paying too much for a manager who is knowingly or unknowing only seeking pure market performance (a portfolio with a Beta of 1 with benchmark weightings and risk), because no disparity in risk-higher or lower- from that of the benchmark is incurred. However, if you are truly seeking to outperform the benchmarks (seeking Alpha), and willing to pay for that, a manager should take active steps to beat the benchmark, and not simply be a "closet indexer."

Malkiel points out that as money under management has risen from $26 billion in 1980 to $3.5 trillion in 2010, the cost savings inherent in these economies of scale were not passed on to investors. Average expense ratios of mutual funds have actually increased during this time period from .66% to .91%. He posits why investors continue to pay higher fees for less than market performance and concludes: "Many may incorrectly judge the quality of investment advice by the price charged. Individual and institutional investors may suffer from overconfidence and truly believe that

*See* PASSIVE INVESTING OR "ACTIVE SHARE" page 10

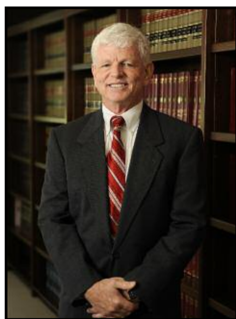
## TRACKING ERROR OF INVESTMENT ADVISORS AND MONEY MANAGERS

### - AN HISTORIC MEASURE OF PERFORMANCE, AND HOW TO USE IT -

Active Share (discussed above) is not necessarily a historic measure and is not a measure of performance. It is more of a snapshot of a portfolio relative to its benchmark at a given point in time, in order to assess expectation. It can be used in conjunction with other tools to assess investment advisors and money managers. Tracking Error, on the other hand, is commonly defined as the standard deviation of a fund or portfolio's past returns relative to that of its benchmark. Traditionally, it too has been used to measure a portfolio's degree of active management. However, tracking error has certain limitations for this purpose, but used in conjunction with Active Share, adds interesting statistics that can be used in assessing investment advisors and money managers.

Tracking Error is believed by some to represent a better indicator of "factor bets," than Active Share. (Factor bets, as opposed to pure stock selection, often involves over or under weighting of entire sectors, industries, or regions.) Due to its nature of computation, a low Tracking Error is not necessarily an indication of a passive management style. Tracking error, for example, could be low just because stocks within a portfolio, but not a benchmark, were within similar industries and in similar proportions as the

*See* TRACKING ERROR page 10



JOHN L. AVERY JR., ESQUIRE

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APPELLATE LAW

Joseph C. Kempe
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ATTORNEYS AND COUNSELORS AT LAW

## A View of the Markets -Fundamentals versus Technicals – Quoting Pimco's Mohamed A. El-Erian's view of the recent spike in interest rates:

In all likelihood, the Fed will taper for a mix of reasons. Specifically, it will likely be comforted by the notion that the American economy continues to heal, but also frustrated by the gradualism of the recovery and the threat of collateral damage. Meanwhile, look for the Fed to try to compensate the potential contractionary impact of tapering by evolving its forward guidance policy.

The most difficult call relates to technicals. Given their behavioral finance dimension, they have a bad (though understandable) habit of surprising even the most experienced and astute investors. And as much as they may be discounted by some long-term investors, bad technicals can contaminate fundamentals…

… fixed income investors should respect the technicals for now…. They should look to exploit large technical dislocations … given that the bad technicals will run their course eventually, they should prepare to take advantage of broader overshoots that provide both attractive valuations and solid carry.

… investors should guard in particular against the potentially disruptive element of fixed income technical overshoots – meaning interest rate spikes that cannot be validated by an economic recovery, policy rate increases, or sustainable asset shifts.

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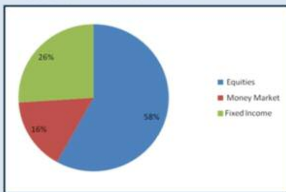
There is an old saying, "when interest rates turn, they turn," but not in a straight line! JCK

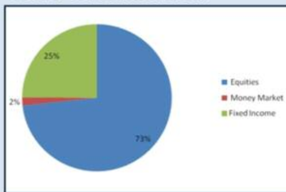
**Patrick E. Mangan, CPA**
Tax Accountant
Business Accounting
Wealth Management

# Wealth Monitoring Services

### Asset Allocation




### Yield Distribution




### Significant Transactions

Joseph C. Kempe
Professional Association
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Client Name: Jane Doe

Client #: 999.281

Date: 08/31/2013

## Client Snapshot

**CURRENT**

| | |
|---|---|
| Total Family Wealth: | 12,500,000 |
| Tax Exempt Trusts & Entities | 5,000,000 |
| Husband Estate Size: | Deceased |
| Wife Estate Size: | 7,500,000 |
| Joint Estate Size: | 0 |
| Current Estate Tax: | 900,000 |
| Percent of Current Estate: | 7% |
| *Projected Gross Estate: | 16,500,000 |
| *Projected Estate Tax: | 1,336,000 |
| Percent of Projected Estate: | 8% |
| Marginal Tax Bracket: | 40% |
| IRA Portfolio: | 1,000,000 |

* Based upon a 3% return, net of expenses over life expectancy.

**Total Estate Value:**

**$12,500,000**

**Performance Since 2011*:**

| | |
|---|---|
| **Portfolio:** | **17.96** |
| S&P 500: | 38.76 |
| Barclays Agg: | 1.81 |

*Performance through July 2013 on monitored investment accounts

**FOR PERIOD ENDING 2012**

| | |
|---|---|
| Total Income: | $300,000 |
| Adjusted Gross Income: | 250,000 |
| Taxable Income: | 180,600 |
| Tax Free Income: | 50,000 |
| Marginal Tax Bracket: | 33% |

The current Estate Tax estimate assumes new law implementing a $5,250,000 exemption and 40% tax through 2013 and indexed for inflation in later years. We are assuming an inflation rate of 2.5%.

## Estate Planning Developments

| Reviewed & Current | YES | NO |
|---|---|---|
| **Will:** | X | |
| **Trust:** | X | |
| **DPOA:** | X | |
| **HCP:** | X | |
| **Living Will:** | X | |
| **IRA Integration:** | X | |
| **Recommendations:** | Estate Freeze | |
| **Document Code:** | Single 80-20 | |

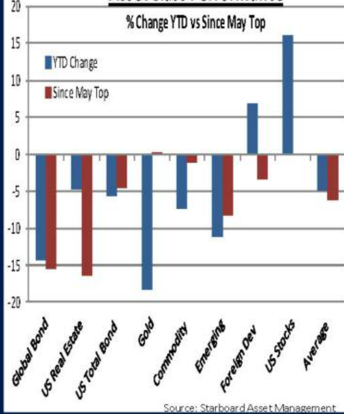
**Miscellaneous**

| | |
|---|---|
| **QPRT Termination Dates:** | 5-10-14 |
| **Crummey notices verified:** | Yes |
| **Family Partnership Records Current?** | Yes |
| **RBD Date: H/W** | 4/2006 |
| **RBD Compliance:** | Yes |
| **IP = RBD In Progress** | |

### Legal Developments

As a result of tax reform, we are commencing a study of the state law tax system where your children live to determine if modifications should be made to your wills and trusts. This study involves the interplay between how your generation skipping tax exemption is used in your estate plan and the level of state death tax exemption available in the state in which they reside. For example, the combined federal and state tax may be as high as 49.6% in some instances, and incurring a 40% generation skipping tax to save 49.6% may be warranted.

## Economic Developments




### Observations

Debate over how the Fed is curtailing stimulus is causing nervous markets, with the 10 year treasury spike nearing 3%. That is considerable.

Some professionals are raising cash in anticipation of a market correction, while others that aren't anticipating more than a 10% correction are holding their positions. A significant correction has already occurred in the emerging markets, which may further erode if the US market falls.

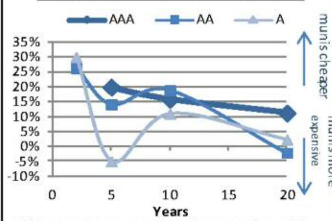
The US equity markets appear to be trading sideways with Active Share management (stock selection) overshadowing market momentum. Emerging markets could be a leading economic indicator, as the world economy has been correlated in recent years with some having become decoupled perhaps for only a short period.

### Economic Statistics

| | Reported | SGS |
|---|---|---|
| Consumer inflation | 2.0% | 9.6% |
| Unemployment | 7.3% | 23.3% |
| GDP | 1.6% | -1.8% |

*Source: BLS, ShadowGovernmentStatistics*

### Muni-implied Tax Rate*




* We equate municipal and corporate yields

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## *Passive Investing or "Active Share"*

*(continued from page 8)*

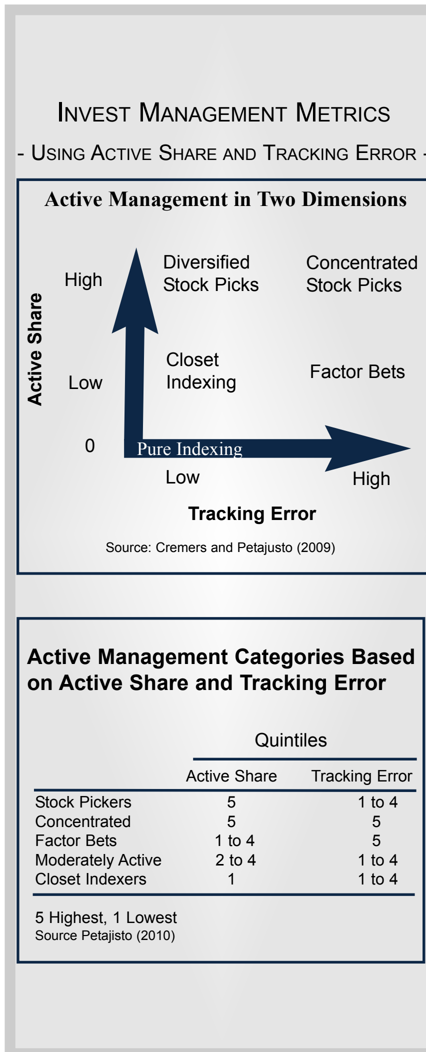
they can select the best manager and earn excess returns (Alpha), despite historical evidence to the contrary."

As Malkiel (and others in academia) point out: "Outperforming the consensus of hundreds of thousands of professionals at the world's major financial institutions is next to impossible. Over long periods, about two-thirds of active managers are outperformed by the benchmark indexes. The one-third that may outperform the passive index in one period are generally not the same as in the next period."

You might ask why this is so often the case and why it is difficult to find managers who can outperform their benchmark index, after fees. Are managers truly trying to be competitive and beat the index (seek Alpha)? Perhaps complacency with index performance is intended, as a kind of "herd mentality." If a manager strays too far from the herd, perhaps a hungry lion lurks there. As one manager (Ralph Wanger) aptly describes this: "A portfolio manager for an institution, such as a bank trust department, cannot afford to be an Outside Zebra. For him the optimal strategy is simple: stay in the center of the herd at all times… where he cannot be faulted [or eaten by the lion]." Based upon our experience and the 100's of reports we review, after fees are removed, performance tends to be just under the benchmark index.

How can you tell if you are paying too much for a manager that is following a herd mentality and is actually an Inside Zebra- also known as a "closet indexer"? In 2006, two Yale professors (Cremers and Petajisto) developed a metric known as "Active Share." Active Share is, generally speaking, the percentage of securities in a portfolio that differs from those in a corresponding benchmark index. It is a measure of holdings and weightings, and can range from an Active Share of zero (exactly equal to the corresponding benchmark) to 100 (a portfolio that deviates completely from its benchmark), assuming no short positions or leverage. As a holdings based metric, it differs from performance based metrics, such as "Tracking Error" (discussed on the bottom of page 8). Cremers and Petajisto point out that Active Share has two basic sources: security selection and factor timing or sector rotation. Coupled with Tracking Error, Cremers and Petajisto summarize four investment styles money managers employ (described in the left margin). They concluded that Active Share is a useful indicator of a portfolio's chances of outperforming a benchmark, albeit with more risk of not beating it too. In the context of this article, if a low Active Share exists (According to Cremers and Petajisto an Active Share of 60 or lower), the manager is considered a closet indexer and the investor should not be paying active management level fees.

Active Share is a tool that we suggest that our clients use when assessing investment managers. It is used as an indicator of an advisor's or manager's propensity to outperform (or underperform) its benchmark, and can be used to assess fees. It is not commonly available. Often we use Active Share as a discussion point in negotiating money management and investment advisory fees for our clients, as their attorney.




**Active Management Categories Based on Active Share and Tracking Error**

| | Quintiles | |
|---|---|---|
| | Active Share | Tracking Error |
| Stock Pickers | 5 | 1 to 4 |
| Concentrated | 5 | 5 |
| Factor Bets | 1 to 4 | 5 |
| Moderately Active | 2 to 4 | 1 to 4 |
| Closet Indexers | 1 | 1 to 4 |

5 Highest, 1 Lowest
Source Petajisto (2010)

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## *Tracking Error*

*(continued from page 8)*

benchmark industry weightings. Active Share, on the other hand, is said to have a better ability to capture a manager's stock picking actions. Together the two are modeled by Cremers and Petajisto (discussed in above article) to break managers and advisors into 5 categories. See charts in left margin.

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**What's a Few Million, When the IRS Wants a Couple Billion -Estates of King of Pop and Basketball Mogul in Tax Court-**

**Estate of Bill Davidson**- the IRS alleges in Tax Court that the accountants of the former Detroit Pistons owner grossly undervalued the stock in his company and misused life expectancy tables, while seeking $2 billion in additional taxes, and seeks $10 million from his widow as a result of poor cash management, because the "household account" was used for construction costs for her daughter. Moral: do good estate planning, use professional appraisers, and make sure cash management and accounting are in sync with proper legal structure and documentation.

**Estate of Michael Jackson**-the estate filed petitions in Tax Court challenging estate tax deficiencies and penalties assessed by the IRS. The petition, which had all monetary figures redacted, indicates the estate and IRS have differing valuations for numerous real and intangible properties that belonged to the King of Pop. The estate claims that the valuations submitted were accurate and were based upon qualified appraisals by qualified appraisers who had extensive experience in valuing entertainment industry assets. For the first time, the IRS is attempting to tax the value of a person's image. Moral: using well documented appraisals and negotiating with the IRS prior to allowing matters to get to Tax Court is the best strategy. Reason often prevails, even with the IRS.

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GENERAL PRACTICE

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## *MANAGING TRUSTS: HOW MUCH CAN BE TAKEN WHILE THE TRUST IS PRESERVED*

### *- UNDERSTANDING THE IMPACT OF DISTRIBUTIONS ON TRUSTS AND RESOLVING INCOME AND REMAINDER BENEFICIARY CONFLICT -*

A traditional rule of thumb we follow in guiding our clients is that a 5% distribution will cause a trust's principal to spiral down, potentially through to exhaustion over time. This becomes important in a variety of contexts: designing estate plans for surviving spouses, children, or grandchildren; settling disputes between income and remainder beneficiaries; assisting with retirement or financial planning; and constructing unitrust conversions in favor of income beneficiaries. For example, as a result of our low interest rate environment, many states have modified their laws to provide mechanisms for converting the interests of "income" beneficiaries of a trust to a unitrust, which allows a unit amount (a percentage of principal, such as 4% as of January 1 of each year) to be substituted for the income interest. Often this is intended to put income beneficiaries and remainder beneficiaries on the same side of the issue, both benefiting from portfolio growth rather than having the remainder beneficiaries pressing for a portfolio skewed toward growth and an income beneficiary preferring fixed income investments (those that generate dividends, interest, rents, or other sources of ordinary income).

There are many factors to consider in analyzing a particular case and its probability of success: time horizon, investment policy, rate of inflation, total return assumptions, and management expenses are the primary inputs or factors that go into the analysis. A recent study by Credit Suisse used these factors and concluded that assuming a medium risk investment policy (2% cash, 44% equities, 29% fixed income, and 25% alternatives) a 4.5% withdrawal rate could be withstood with a 90% probability of success over 20 years, which assumed a 1% inherent annual expense to the trust and an increase of the 4.5% withdrawal rate annually by a 2.4% rate to account for inflation. A conclusion of the study was less than remarkable, but one that is meaningful when broken into its components: the higher the probability of success and time horizon desired, the "smaller the withdrawals the portfolio can withstand. " By breaking the analysis into components, various factors can be tweaked as part of the planning, settlement, or unitrust conversion. For example, the unitrust can be adjusted depending on annual returns realized, fees can be negotiated, and investment policies can be adjusted. Furthermore, some "alternative investments" (a significant 25% percent position in the Credit Suisse analysis) have their own expenses and time horizon considerations.

Note: The Credit Suisse analysis focused on whether the principal balance would exhaust rather than whether it would be preserved for remainder beneficiaries. Thus, the more the factors are tweaked in favor of remainder beneficiaries while securing the desired cash flow stream for the income beneficiary, the higher the probability that the principal of the trust can be preserved and grown. In our present environment, some trustees are comfortable with a 3.5% distribution and allowing the unit amount to be applied toward the fluctuating principal amount on an annual basis, whereas the Credit Suisse analysis was based upon an initial unit amount of 4.5% on the initial trust principal, and that amount is increased by 2.4% annually, notwithstanding investment performance. A typical unitrust formula will apply the percentage against the annual fund balance on January 1 of each year, whether that balance increases or decreases. Unlike in the Credit Suisse model, therefore, a typical unitrust will theoretically never exhaust the principal because applying a fraction (%) to a balance will always leave a balance, though at some point it may be infinitesimal.

## *FISCAL CLIFF #2*

*(continued from page cover)*

taxes, including proposals to increase the estate tax and to eliminate certain estate tax reduction tools. In general, the same recommendations that applied in confronting Fiscal Cliff #1 last year, are recommended for 2013 year-end planning. The largest movement of family wealth in U.S. history occurred in the last quarter of 2012, and the last quarter of 2013 will likely be a fraction of what occurred in 2012 but will nevertheless produce significant movement as a result of proposals that are aimed at constraining the use of traditional planning techniques. Both the Republicans and Democrats are urging major tax reform for 2014, but in different ways.

President Obama is seeking $1 trillion in new taxes. As part of his administration's budget and agenda, estate taxes would be raised in 2018 by increasing the estate tax through a reduction of the exemption from $5.25 million to $3.5 million and increasing the estate tax rate from 40% to 45%. Additionally, as of the effective date of reform (which could be as early as January 1, 2014), the following changes are proposed to existing tax law:

1. Grantor retained annuity trust (GRAT) terms would require a minimum duration of 10 years;
2. The use of estate valuation discounting strategies would be restricted;
3. The duration in which wealth can be sheltered from estate taxes over multiple generations becomes limited by federal as opposed to state law; and
4. The ability of heirs to take a position that their basis in inherited assets is different than reported by the decedent's estate would be eliminated.

Most of the provisions related to proposed tax reform are meant to be effective for dates and transactions occurring after the effective date, which would likely be January 1, 2014 at its earliest. As such, those contemplating planning would want to secure the benefits of current law before then. The likelihood of reform as early as January 1, however, is far from clear. Nevertheless, it is being pushed by both isles of Congress, albeit from different poles. For more on planning to confront Tax Reform, see Tax Reform White Paper at www.jckempe.com beginning on page 8.

Senator Tax Reform Proposals Held Secret for Decades - Reluctance to Submit Proposals Met with a Reminder -

As part of what is called a "blank slate" approach to revamp the entire tax system and pursue comprehensive tax reform, the Senate Finance Committee requested proposals from all senators- but they weren't forthcoming, apparently as a result of concern with political repercussions. As a result, the senators were reminded of what has been called by a Committee spokesman as "standard operating procedure:" submissions will be held confidential in a locked vault until December 31, 2064 (in excess of 50 years).

## *GST-CHILDREN IN NORTHERN STATES*

*(continued from page 3)*

inclusion of the non-GST share (the $2 million share) into the childrens' taxable estates to avoid the generation skipping tax. This is because the GST share ($1.75 million in this example) is all the Internal Revenue Code allows to pass on the death of the children to grandchildren without incurring a generation skipping tax and without being taxed in the childrens' estates. The GST is a flat 40%, which historically has been pegged to the highest estate tax bracket. This is based upon the rationale of the US wealth transfer tax system: that wealth should be taxed in each generation. The rationale is further that if someone is choosing to avoid a generation of tax, they must be in the highest estate tax bracket so that bracket (40%) should apply. As such, in our example, the $2 million share would be added into the estates of the children and taxed as part of the children's estates, but the GST exempt amount of $1.75 million would not. A tax savings of $700,000 per child results, plus 40% of any growth of the $1.75 million GST exempt trust over the life of each child. Furthermore, this GST exempt wealth may be perpetuated over multiple generations for so long as state law allows (known as the "Rule Against Perpetuities").

*See GST-CHILDREN IN NORTHERN STATES on page 13*

**JANICE B. RICHARDSON, ESQ.**
ESTATES AND TRUSTS
ESTATE ADMINISTRATION

## GST-Children in Northern Staes

(continued from page 12)

If both Mom and Dad had accomplished this planning, the figures would be doubled. Any wealth exempted under the umbrella of the GST exemption on the death of one spouse can grow exempt over the life of the surviving spouse, the children, and so on for as long as heirs wish, subject to the Rule Against Perpetuities.

Notwithstanding the benefits of the GST exemption, planning focused on optimizing the results in the children's generation might suggest that automatically forcing the non-GST share ($2 million each in our example) into their taxable estates might not prove optimum in all cases. For example, the effective estate tax rate (federal and state) for residents of New York is 49.6% and of Connecticut is 47.2%. Thus, forcing estate inclusion of the non-GST share ($2 million) into the estate of each child to avoid a 40% flat federal generation skipping tax might increase overall death taxes on the childrens' estates by 9.6% or 7.2%, respectively. What if you don't know whether this will benefit the children and grandchildren, but it may? IRS regulations provide a useful strategy, which allows a mechanism that is contingent and dependant on each child's circumstances. An estate planning mechanism can be built into senior family member wills and trusts that allows each child to either trigger GST taxation or allow the wealth to be taxed in their estates. Under this strategy, each child would be able to trigger generation skipping tax at 40% in order to avoid, for example, the potential for a 49.6% combined tax if they lived in New York. In these circumstances, as the title to this article suggests, incurring generation skipping tax may make sense.

## Strategic Planning

(continued from page 3)

est rates have appeared to trough and are now rising, it is an opportune time to lock-in low rates.

Several techniques are designed to remove from a taxable estate the excess growth of, or return on, an asset above a threshold rate. For example, if a senior family member sells a $10 million asset to a grantor trust in exchange for an interest only promissory note bearing 2.5% interest, and that asset appreciates at 8%, $550,000 ($800,000 less $250,000) of estate and gift tax free wealth <u>annually</u> can be shifted out of the grantor's taxable estate. Similar results can occur with GRATs, but generally sales to defective trusts are preferred. What happens if the asset's 8% performance weakens during the payment period, and the grantor has another asset that is generating a total return (growth and yield) of 10% that he or she wishes were in the trust? If the trust has been written to contain a "power of substitution," the grantor can exchange properties based upon relative values without being treated as selling them for income tax purposes. The power of substitution is a key provision within grantor trusts, as it is likely the most common provision attorneys use in drafting trusts to have them qualify as grantor trusts in the first place. This power can also be used to cure GRATs that are not performing well, by substituting higher performing assets.

Some advisors are presently advocating "shelf GRATs" in order to confront a 10 year minimum GRAT term proposed by President Obama and to lock-in rates. They would use the power of subsitution at an appropriate time to fund the trust with high appreciating assets. We do not recommend this technique for a variety of reasons.

Article Highlights Benefits of Low Interest Rates
In Estate Planning and Reasons Promoted by Administration For Tax Reform
-Jackie O and the Walton Family Planning Highlighted -

A recent Bloomberg article highlighted some of the arguments presented by the Administration to further reform estate tax rules aimed at eliminating the benefits of family partnerships and tools that lower estate taxes in low interest rate environments (GRATs and sales to defective trusts). Both the techniques used in the Walton and Jackie Onasis estate planning are highlighted as examples used by many estate tax planners. "The whole tax structure since I came to Congress actually has gotten more and more unfair," said James McDermott, a Washington Democrat who's been in the House since 1989 and has sponsored unsuccessful bills to close estate-tax loopholes. "We shouldn't have a situation where gimmicks allow rich people to avoid estate taxation," quoting William Gates Sr. **<u>See</u>** Mider, How Wal-Mart's Waltons Maintain Their Billionaire Fortune: Taxes, Bloomberg 9/12/2013.

<u>See</u> 7520 rate history on page 6.

**Daniel Alvarado, CPA**
Tax Accounting
Business Accounting
Wealth Management

Decoupled States With Death Taxes:
Below is a List of Some States
(and Exemptions)

Connecticut ($ 2 million)

Delaware ($5.25 million)

DC ($1 million)

Hawaii ($5.25 million)

Illinois ($4 million)

Maine ($2 million)

Maryland ($1 million)

Minnesota ($1 million)

New Jersey ($675,000)

New York ($1 million)

North Carolina ($5.25 million)

Oregon ($1 million)

Rhode Island ($910,725)

Vermont ($2.75 million)

Washington ($2 million)

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## *Northern State Death Taxes*

*(continued from page 4)*

and the increased marital deduction reduces the state amount exempted (technically reducing the amount absorbed by the state death tax credit). These general rules have become more complicated when a nonresident owning property is involved and as a result of the new federal portability rules.

Using our example above involving a Florida resident (domiciliary) dying in 2013 with a $5 million estate and $2 million home in New York, in order to avoid paying the $156,640 of death taxes to NY the amount in excess of the $1 million exemption ($4 million) would need to qualify for the NY marital deduction. The problem is that NY and some other states don't allow you to take a separate state level marital deduction that is different from the one elected for federal purposes. Thus, if for federal purposes the full $5 million of Dad's estate were sheltered using the federal $5.25 million exemption, the NY liability would remain $156,640. The only way Dad's estate can avoid the $156,640 tax is to limit the use of the $5.25 million federal exemption to $1 million, so that for NY purposes the marital deduction is $4 million, which would eliminate any NY death taxes on Dad's estate. However, by doing so, Mom's "federal" taxable estate has now become $9 million ($4 million marital deduction plus her $5 million of assets) rather than $5 million, and exceeds the federal exemption ostensibly (and momentarily ignoring portability) exposing her estate to a $1.5 million tax ($9 million, less $5.25 million exemption, times 40%). So, in this example, to currently save $156,640 of NY tax on Dad's estate, the potential estate tax on Mom's estate has risen from zero to $1.5 million.

There are essentially three ways to avoid these competing adverse tax problems, but each is dependent on the evolution of particular state death tax laws and the IRS's view of certain federal laws: (1) by using QTIP trusts, with different marital deductions for state and federal purposes (here optimally, $4 million for NY purposes and zero for federal purposes); (2) using the new federal portability rules, by electing to transfer Dad's unused federal exemption of $4 million to Mom; or (3) using strategies to eliminate Dad's ownership of NY sited property prior to death. Some states permit QTIP elections to utilize the marital deduction that are different from that elected for federal purposes. If in this example no federal QTIP election were made to qualify any of Dad's estate for the marital deduction, no tax occurs because Dad's $5 million estate is absorbed by his federal $5.25 million exemption. However, that exceeds the NY exemption by $4 million and thus produces a NY tax because the property in NY worth $2 million exceeds the NY $1 million exemption. What would be optimum is for two shares to be created as follows: a $1 million share using both the NY and federal exemption, with the residual $4 million elected to qualify for the NY marital deduction, but not for federal purposes (this can be done in some states that permit a state level QTIP election that is independent of a federal election). (If Dad's estate were $8 million, there would be three shares: (1) an exempt trust equal to the New York exemption; (2) a state QTIP trust for the difference between the state exemption of $1 million and the federal exemption of $5.25 ($4.25 million); and a federal QTIP trust for the balance ($3.75 million)). The problem is that NY does not permit inconsistent use of the marital deduction and a state QTIP election that results in different shares for state and federal purposes, except in a situation where no federal estate tax return is filed. In Dad's case, that could be a solution because filing a return is not mandatory (his estate is not $5.25 million, which would necessitate filing). However, in order to reduce Mom's estate tax exposure, filing a federal return would be advisable in order to elect portability (discussed below). But, as long as Mom's estate weren't expected to exceed $5.25 million for federal purposes (a gamble), use of portability would not be necessary. Note: New Jersey and Connecticut have rules similar to New York's. The following states permit a state level QTIP election

*See Northern State Death Taxes on page 15*

Some States Also Impose an Inheritance Tax on the Recipient

Indiana
Iowa
Kentucky
Maryland
Nebraska
New Jersey
Pennsylvania
Tennessee

The Following States Permit a QTIP Election that Differs from a Federal Election

Illinois
Kentucky
Maine
Maryland
Massachusetts
Ohio
Oregon
Pennsylvania
Rhode Island
Tennessee
Washington

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## *Northern State Death Taxes*

*(continued from page 14)*

that differs from the position taken on a federal return: Indiana, Illinois, Kentucky, Maine, Maryland, Massachusetts, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, and Washington. **As such, planning is simplified in these states, but it is important that estate planning documents are drafted to permit both a state and federal QTIP election.**

As alluded to, "portability" is a potential solution (portability is a new federal law that permits transfer of the first spouse's unused exemption to the surviving spouse). In our base example, in some states the solution may be to forego the full use of Dad's federal $5.25 million exemption by qualifying $4 million of his estate for both the NY and federal marital deductions, and absorbing the remaining $1 million of his $5 million estate under the NY and federal tax exemptions. This ostensibly means that Dad has wasted $4 million of his federal $5.25 million exemption, thus exposing Mom's estate to a larger federal estate tax as above explained. Under the portability rules, any unused federal estate tax exemption may be transferred to a surviving spouse, if certain conditions are met. However, in order to use these rules, a federal estate tax return must be filed, and as above explained in Dad's situation, the federal filing binds Dad's estate for New York purposes. The same result would occur in New Jersey and Connecticut, but not in the other states cited above where independent QTIP elections can be made . (Note: No states presently offer portability of their exemptions.)

What if in Dad's case a federal return is filed to elect portability and a $4 million QTIP (marital deduction) election is made, foregoing $4 million of federal exemption in Dad's estate but having it transfer under the portability rules to Mom. Doing so ostensibly provides a method of electing portability while having consistency in use of state and federal marital deductions and exemptions. The IRS has ruled that the overuse of the marital deduction by QTIP election will be ignored for federal purpose. See Rev. Proc. 2001-38. Commentators differ on whether taxpayers can affirmatively use this strategy, since 2001-38 was a relief ruling, rectifying a mistaken overuse of the marital deduction and waste of the federal exemption, which isn't the case with Dad - it is intended! Furthermore, it is unclear whether states would follow the same rationale. This issue is presently a priority under IRS study. See Treasury Announcement, 2013-2014 Prority Guidance, 8/9/2013.

In closing, planning for Florida residents with homes and property in different jurisdictions has gotten more difficult as states look for ways to raise revenues. The best way of dealing with northern properties is to divorce yourself of title using proven strategies. Use of intrafamily gifting, sales, and other strategies are made simpler at the state level, because only two states (Connecticut and Minnesota) have gift taxes. Furthermore, qualified personal residence trusts ("QPRTs") remain the vehicle of choice for most clients seeking to avoid federal and state death taxes on homes.

## *Firm Wins Homestead Case*

*(continued from front cover)*

the case, as many Florida residents use QPRTs in their estate planning: "The case is important because homestead status offers important economic and personal protections. Senior family members are often happy to utilize the tax laws to benefit their children, as long as it doesn't cost too much or significantly affect their personal lives and financial securities. We were happy when we obtained IRS approval of this technique several years ago, in what have come to be known as the "reverse QPRT" rulings, and are even happier now that our view of the Florida homestead law has been upheld by local courts."

Although Martin County has expressed an interest in appealing the case, both Mr. Kempe and attorney Ashley Sundar, who argued the case, are confident that the weight of Florida law favors Judge Mirman's decision.

Note: Martin County elected not to appeal.

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**Summary of Recent Florida Cases**

Florida appellate courts establish law when they decide cases and in the last year there have been many cases decided in the real estate area that our readers may find interesting.

**Did you know that:**

1. A purchaser of a condominium from an association that took the title back through foreclosure is liable for assessments owed by the association and not by the previous unit owner against whom the association foreclosed. CAUTION: If you buy a condominium unit from the association, make sure all the assessments accruing while the association owned the unit have been paid.

2. If a construction lien is transferred to a surety bond during the pendency of the foreclosure of the lien, the lien claimant has one year to state a claim on the bond. CAUTION: Just because your lien foreclosure is pending, you could lose out unless you also state a timely claim on the bond.

3. A lease that requires a landlord's consent before the tenant can sublease, that does not contain specific standards for approving the sublease, subjects the landlord to a duty of good faith such that approval of the sublease may not be arbitrarily withheld. CAUTION: In your leases, don't allow subleasing but if you do, include standards that the subtenant must satisfy, such as credit approval, income verification, and the absence of a criminal record.

4. Your HOA may not impose a fee on an owner's right to lease to third parties if the declaration of restrictive covenants permits only "reasonable requlations" on leasing. CAUTION: As a board of director, don't get "greedy" and try to collect fees that you may not be allowed to collect under your HOA documents.

5. The duty to disclose material defects regarding the property imposed on the seller of "residential" property does not apply to commercial sellers -Florida remains a "buyer beware" state. CAUTION: If you are purchasing commercial property, you need to do a thorough due diligence as the seller need not make disclosures, but you can include representations and warranties in the contract for protection.

6. A verbal extension of a due diligence period in a contract for the sale of real property is not enforceable and promissory estoppel is not an exception to the Statute of Frauds that requires contracts for the sale of real property to be in writing. CAUTION: When dealing with real property contracts, get it in writing!

7. Where a property owner conveys his homestead to a revocable trust, upon his death the property passes to his wife for life with the remainder to his surviving minor children and is not subject to disposition through the trust. CAUTION: Make sure you contact Joe to properly plan your estate.

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