WINTER 2015 ISSUE

CLIENT UPDATE & WEALTH ADVISOR

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IN THIS ISSUE

LEAVING YOUR SPOUSE (OR NOT) A DSUE OR OTHER FORMS OF AUGMENTATION

- THE EVILS PORTABILITY HAS BROUGHT -

I was first exposed to gifts of augmentation while at Nixon, Hargrave, et al, as a young attorney in (Burt) Reynolds' Plaza in the late '80s. Joined by two other 30-year-old young turk lawyers, we would stop downstairs at the Backstage periodically for a cocktail before going home to our wonderful families. A 40-year

See LEAVING YOUR SPOUSE A DSUE on page 10

TRUSTS CAN SAVE INCOME TAXES FOR YOU AND YOUR CHILDREN TOO

- NEW USES EVOLVE WITH THE RENEWED FOCUS ON INCOME TAX PLANNING -

Our last several Client Updates discussed how the increase in the federal estate tax exemption ($5.43 million in 2015), and increase in federal and state income taxes, have created renewed focus on strategies to reduce state and federal income taxes. Two strategies work particularly well, with one aimed at benefiting children living in Northern states, while the other involves reducing the phase-out of itemized deductions under the so called "Pease limitation."

See TRUSTS CAN SAVE INCOME TAXES TOO on page 12

THE GOAL OF AVOIDING PROBATE LEADS TO MANY MISTAKES

- THOUGH A WORTHY GOAL, THERE ARE MANY MISUNDERSTANDINGS -

Estate planning generally encompasses three objectives: (1) avoidance of probate, (2) elimination of taxes, and (3) the maintenance of control (including protections against threats). Avoidance of probate is a misunderstood area, as simply naming an intended heir as a beneficiary of an account or holding an asset jointly with survivorship rights can avoid probate, but it is seldom the best way and may cause more harm than good. Titling assets improperly to accomplish probate avoidance can result in adverse estate and gift taxes, adverse income tax results, and a removal of the affected assets

See AVOIDING PROBATE LEADS TO MISTAKES on page 10

WHY WE OFFER COMPLIMENTARY REVIEWS OF ESTATE PLANS

- POINTING OUT MISTAKES OR OMISSIONS ALLOWS US TO EDUCATE -

We spend a lot of time reviewing the existing estate plans of prospective clients, and we do so without cost. It has proven to be a beneficial policy, as it produces benefits to individuals and their families while establishing long term relationships with new clients. There are several common errors or omissions that we find, and this article will attempt to communicate why these errors and omissions are so common. Whether these exist, we sometimes find overreaching, where inappropriate involvement of

See WHY WE OFFER COMPLIMENTARY REVIEWS ON page 6

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PROFESSIONAL ASSOCIATION
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LENSES WITH WHICH TO SEE
- VOLATILITY IN MARKETS, ECONOMIES, AND LAW -
- 2015 STARTS-OUT WITH GREATER PROSPECTS FOR CHANGE -

Many often don't like change, but as President Kennedy is quoted "… those who look only to the past or present are certain to miss the future." But, we don't have a crystal ball and only have the past and present to rely on and the present moves with surprising speed. We need tools to see!

This Client Update focuses on some changes in perspective and what tools are available to help us along the way. Things are changing, and some see it while others feel it. Often to see change you must view things through different lenses, like John Lennon viewing the world through rose colored glasses. As we explain in this issue, an income versus estate tax perspective (lens) has uncovered new methods of using trusts to save income taxes, where Florida resident parents can now use their Florida residency to save northern state income taxes for their northern state resident children and also save federal income taxes for themselves. Similarly, through the lens of a QTIP trust, commonly used to avoid estate taxes on the death of the first spouse, a new method of saving income taxes using the new portability law has emerged.

From a wealth management perspective, investment portfolios and positions can be analyzed using lenses that view portfolio construction and positions from a market perspective or a fundamental perspective. A fundamental lens might suggest that, notwithstanding what the market says, the fundamentals of portfolio constituents provide convictions to confront volatility and stave off change.

2015 started with greater market volatility, world turmoil, and greater prospect for tax law change, given an invigorated Republican controlled Congress and White House proposals. Major tax reform is desired, though the prospects are doubtful given fundamental differences in policy approach. Nevertheless, forecasting and monitoring domestic and international economics and politics can also be viewed through different lenses when managing wealth, and those lenses can abruptly change color. Take the Swiss National Bank's abrupt decision on January 15 to abandon the franc's cap against the euro, as a precautionary measure against the European Central Bank's decision to promote quantitative easing to confront deflationary ("dis-inflationary" is a more politically desirable term these days) pressures. A currency lens can help one see how fiscal and monetary incentives to stimulate an economy may be counter balanced by market forces. Or, take President Obama's January 17th proposal to impose a capital gains tax in addition to an estate tax at death. Though unlikely to become law through the lens of a Republican controlled Congress, it nevertheless interjects a degree of uncertainty when planning.

Our Firm has invested in a number of lenses to assist our clients in the management of their wealth. These systems permit us to track laws, economics, and geopolitics on a more comprehensive basis. Whether simply preparing wills and trusts for clients using the latest legal strategies, performing tax compliance through use of our staff of CPAs, administering estates and trusts, litigating client conflicts, or forming or reorganizing businesses, our aim is to represent our clients to the best of our abilities using the latest technologies. We have thus expanded those abilities and capabilities by investing in systems and technology. We have spent several years expanding and integrating our Wealth Management Department and our ability to assist our clients in the monitoring of their money managers and investment advisors. Whether it is our proprietary systems developed through integration of legal and accounting processes, how we use Lexis®, Advent®, or a Bloomberg® machine, or how we view client portfolios using HOLT® and Morningstar® lenses, our goal is to fulfill the needs of our clients as their attorney, in an ever faster, more complicated, and less rosy world.

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WHY UNWIND EXISTING ESTATE PLANS?

- TERMINATING STRUCTURES CAN PRODUCE SUBSTANTIAL BENEFITS -

In 1990, Congress enacted Chapter 14, a set of four Internal Revenue Code sections that establish and regulate many of the advanced estate tax reduction tools that are available to reduce the federal estate and gift tax. It is as a result of Chapter 14, that QPRTs, GRATs, family partnerships, and other techniques proliferated to reduce estate tax exposures. A lot has changed since 1990, with the number of estates required to file and pay estate tax reduced approximately tenfold. However, many estate planning strategies founded on these rules remain in place, and many should be used while others should be terminated. Termination is often beneficial because these strategies no longer produce a benefit and likely cause harm. For example, if someone created a qualified personal residence trust ("QPRT") to save estate taxes on their home and no longer has a taxable estate, the original cost basis is typically transferred to children and the difference between that cost and the sale price when sold will produce capital gains tax that is avoided if the QPRT is terminated and the property is owned by the senior family member at death.

The estate tax exemption was $600,000 in 1990 and the highest marginal estate tax rate was 55%, plus a 5% surtax on amounts over $10 million. The number of Federal estate tax returns filed for U.S. decedents with gross estates at or above the $600,000 filing requirement was 50,367. The total size of estates filing returns was $87 billion. The number of estate tax returns declined 87 percent from about 73,100 in 2003 to about 9,400 in 2012, primarily due to the gradual increase in the filing threshold. The gross estate filing threshold was $5.12 million in 2012, the last year for which data is available, up from $1.0 million in 2003. In 2012, the total net estate tax

See WHY UNWIND EXISTING ESTATE PLANS *on page 13*

HAVING YOUR CAKE AND EATING IT TOO

- IRS SOLIDIFIES THE SINGLE QTIP AS THE TRUST OF CHOICE -

Some background is needed to understand the renewed importance of the QTIP trust and this is a long but important article. A typical estate plan for a married couple will utilize formulas within a will or, preferably, revocable living trust to prevent any tax on the first spouse's death. There are various funding formulas that are designed to capture the decedent's unused estate and gift tax exemption (in 2015, $5.43 million), with the balance qualifying for the marital deduction so that no death tax will be incurred on the first spouse's death. For example, if a husband dies with a $10 million estate, a typical funding formula will cause an estate in 2015 to be divided into a $5.43 million exempt share and a $4.57 million nonexempt share, less costs of administration. If more passed to the wife without fully utilizing the husband's $5.43 million exemption, it is called "overfunding the marital deduction." A "single QTIP trust" allows the executor by election to fund the exempt share, overfund the marital deduction, or use any combination of the two. It is also important to note that under current law all assets comprising the deceased husband's $10 million estate will acquire a cost basis equal to their date of death value. This is commonly referred to as a "step-up" (or "step-down") in basis. Historically, assets captured using the husband's $5.43 million exemption amount would receive a step-up in basis, but not again on the surviving spouse's subsequent death, whereas those qualifying for the marital deduction would receive two basis step-ups because those assets are also included in the surviving spouse's estate.

As has been mentioned in recent Client Updates, there are many disadvantages to reliance on what is known as "portability." In our example, if the deceased husband simply passed all of his assets to his wife and overfunded the marital deduction without using a trust, those assets will be taxed in her estate. Nevertheless, the husband's unused $5.43 million estate and gift tax exemption (the "DSUE," explained in the first article of this Client Update on page 1) is ported to the surviving wife, leaving her with an estate and gift tax exemption of $10.86 million, that can be used to shelter her now larger estate from estate and gift taxes on her death. However,

See HAVING YOUR CAKE AND EATING IT TOO *on page 14*

Physicians Orders on Life Sustaining Treatment

- Pilot Program Attempts to Provide More Certainty -

A "Physician Orders on Life Sustaining Treatment" Form (POLST) is in a final pilot project for the State of Florida. The POLST project is the result of a recent grassroots effort by the medical community to address patient desires at the end of life. POLST has garnered approval from an increasing number of state legislatures and is expected to receive similar endorsement from the Florida legislature following the current trial. POLST is a specifically written set of medical orders designed to honor the goals of care of persons with advanced illness or frailty.

The primary catalyst for the POLST effort was, and is, the legal requirement for hospital staff to follow a medical order. When no specific medical orders exist or conflicting medical orders are written, there can be confusion and delay in implementing a patient's Advance Directive or Living Will. Historically, the treating physician was often the last person to learn of a patient's desires regarding end of life care because the patient's wishes, formatted in a lawyer's office, were not communicated by the patient to the doctor. So, it has not been unusual for standard medical orders to conflict to varying degrees with patient wishes.

In Florida, POLST requires both physician and patient/surrogate signatures, thus mandating a conversation or at least agreement on goals of care during the medical decline of the patient - in other words, POLST implements a patient's Advance Directive.

As was discussed in a prior Client Update, the necessity for an Out of Hospital Do Not Resuscitate Order ("DNR"), in addition to (or because of) a client's Advance Directive, is a primary example of the need to translate a patient's desires into appropriate medical orders.

The recognized need for portability of such physician orders at the end of life was another impetus for establishment of POLST. When even a DNR order did not necessarily follow the patient beyond the hospital emergency room or to another facility, patients and their loved ones suffered both emotional and sometimes even physical adverse consequences. By both law and medical consent POLST orders will follow the patient. They cannot be delegated to "emergency room authority only" by hospital risk management, nor can they be ignored by a discharge plan.

POLST addresses a myriad of medical procedures and issues in addition to a DNR. The goal of this doctor-driven movement is to partner with a patient at the end of life in the provision of consistent appropriate care regardless of change of facility or geographic location. While not yet recognized in all fifty states through legislative action, POLST appears to have reached a tipping point. There is presently no reported "failure to honor" case.

Both patient autonomy in the decision-making effort and the continuing medical appropriateness of POLST orders are provided through triggers for medical review and a stated ability at any time to revoke by either a patient with capacity or his/her surrogate. Thus, Advance Directives and surrogate documents should address POLST.

POLST is a specific kind of advance directive. While clearly not applicable when healthy, we believe the time to learn about it is when one is able to appreciate its significance. Although it is not for everyone, it does provide another arrow in the quiver for patient driven management of illness at end of life. Our office is prepared to discuss POLST as part of our preparation of your healthcare documents because, whether or not it becomes law in this state, it is a very useful planning tool for the educated individual.

POLST Trial Will Try Physician Schedules and May Lead to Outsourcing

The consequences of POLST decisions will take time to appreciate, and the already stressed work schedule of doctors may be tested and may lead to outsourcing. We are already experiencing questions by clients concerning the consequences of POLST decisions or the absence of them.

POLST Order

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Banks:
4 Upgraded
10 Downgraded

Bank	Rating	
Bank of America	C	↑
Bank of NY Mellon	C+	↑
Bank United	A-	—
BB&T	B-	↑
Bessemer Trust	B+	—
CenterState Bank of Fl	C+	—
Citibank NA	B-	↑
Deutsche Bank and Trust	B+	—
First Citizens Bank & Trust	B-	↓
Goldman Sachs Bank USA	A	↑
Grand Bank and Trust	C-	—
Haverford Trust	A	—
JP Morgan Chase NA	C-	↑
Morgan Stanley Bank NA	B+	↑
Northern Trust NA	B-	↑
Sabadell United Bank	B	—
Scottrade Bank	B-	—
Seacoast NB	C	—
Stonegate Bank	B-	—
TD Bank NA	C	—
TIAA-CREF Trust Co	C-	—
UBS Bank USA	B+	—
Wells Fargo Bank NA	C-	—
Wilmington Trust Co.	C+	—

Source: Weiss Ratings as of September 30, 2014. Please note that other rating organizations may have higher or lower ratings for these institutions and that these ratings may have changed.

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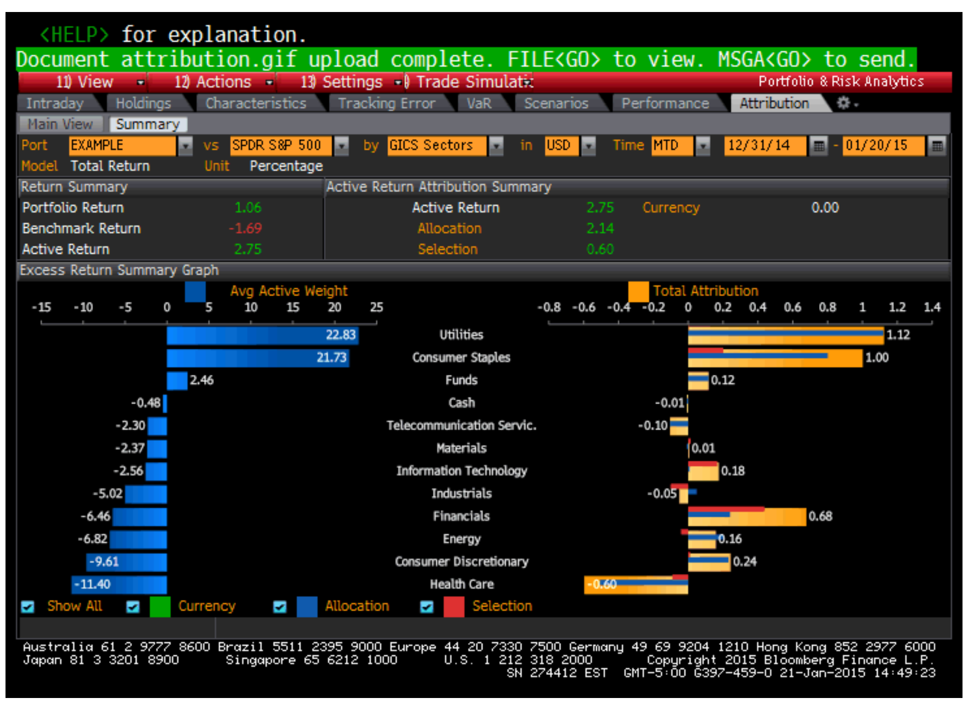
What Are You Paying For?
- Portfolio Attribution and Active Share -

We have written about "Active Share" (whether a manager's portfolio decisions are sufficiently separated from a benchmark and purposefully seeking alpha) in prior Client Updates. There is a tendency for money managers to hug the indexes so they don't find themselves "outside zebras" - a money manager who strays too far from the heard may be eaten by the lion (risk taking can cause loss of clients)! This tendency is one of the reasons index funds have flourished, because generating excess return ("alpha") over a benchmark (like the S&P 500) through active management has been found by many to be a highly improbable. So, the theory goes, save money and simply passively own the index and don't hire active managers. This is particularly true with investment in active and efficient markets, where most individuals invest.

How do you know whether your money manager is seeking alpha? Do you want him or her to? Active Share is one metric, but several services (e.q., Bloomberg and Factset) provide "attribution" metrics. A portfolio's performance may be affected by sector weightings, stock selection, or market momentum. Execution cost and currency can also affect performance. Attribution analysis consists of comparing the effect of each of these performance factors with a benchmark. If positive performance is attributed to momentum, the manager may have added nothing for which he or she should be compensated if that attribution is market index driven. However, if positive performance produced alpha, that will likely be attributed to sector weightings, stock selection, or both for which the manager should be rewarded. Attribution analysis is a process that is useful in assessing the cost benefit of an active manager. We are happy to assist our clients with this analysis for discussion with their money manager.

Bloomberg's Version of Attribution
- Yellow to the Right is Best -

The below is one of Bloomberg's attribution reports as it relates to a portfolio we monitor. In the Total Attribution column to the right, yellow to the left is negative portfolio performance measured from the S&P index, and yellow to the right is positive performance. Blue within the yellow is sector allocation and red is the stock selection within the sector. (You can be in the right sector but pick the wrong stocks or vice-a-versa.) The blue and red lines within the yellow explain the effect of sector weightings and stock selection within positive or negative performance attribution.



7520 Rate History

	2015	2014	2013	2012	2011
Jan	2.2	2.2	1.0	1.4	2.4
Feb	2.0	2.4	1.2	1.4	2.8
Mar		2.2	1.4	1.4	3.0
Apr		2.2	1.4	1.4	3.0
May		2.4	1.2	1.6	3.0
June		2.2	1.2	1.2	2.8
July		2.2	1.4	1.2	2.4
Aug		2.2	2.0	1.0	2.2
Sept		2.2	2.0	1.0	2.0
Oct		2.2	2.4	1.2	1.4
Nov		2.2	2.0	1.0	1.4
Dec		2.0	2.0	1.2	1.6

Use of the 7520 rate is required in many estate tax planning strategies. Generally, the lower the rate the better. Those that acted in the second half of 2012, early 2013, and the end of 2014 benefited. Rates are ebbing down in early 2015.

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WHY WE OFFER COMPLIMENTARY REVIEWS

(continued from cover)

third parties is unnecessarily (and unknowingly) interjected.

In general, most individuals want to control their wealth and to pass it on to family members, in such a manner that those family members succeed to that control and various protections. What most individuals (and some advisors) don't understand is that wealth can pass controlled, but also protected and tax exempt. Once understood, most individuals desire to achieve these benefits for their heirs. Why don't they? Most clients just don't realize they have this ability. For example, most individuals don't realize they have two sets of tax exemptions, one that avoids estate and gift tax on their estates and another that can be passed on to and perpetuated by their heirs. In other words, we all have an exemption ($5.43 million in 2015) from tax on our estates. However, we also have another exemption (also $5.43 million) that can be passed to our heirs and perpetuated so that this amount of wealth and appreciation on it is not subjected to estate tax ever again. These exemptions are doubled when married. A simple example illustrates:

Dad has a $5.43 million estate and so does his son, Paul. If Dad dies in 2015, and assuming he made no taxable gifts during life, there would be no estate tax on Dad's death. However, if Paul died later in the year, his estate would be subject to a tax of $2.172 million ($10.86 less Paul's $5.43 million exemption, times tax of 40%). Like most individuals, Dad wasted his second exemption, which could have been extended to Paul and the $2.127 million tax could have been avoided. Doing so involves effective use of Dad's generation skipping tax ("GST") exemption. If married, Dad and Mom both have this second GST exemption and most people unknowingly waste it.

In the above example, Dad likely would have sought to avoid the tax exposure in the estate of his son, had he known he had such an exemption. Most individuals are not educated to the use of this exemption, but would use it if they understood. Related to use of the GST exemption is protection of what passes to heirs from divorce risk, in-law rights, and third party liability risk. Few clients want what passes to heirs exposed to third party liability risks and in-law rights, such as exist in a divorce. Most desire to protect wealth. What many advisors don't fully understand is that there is a relationship between the GST exemption and protection of wealth as it passes to heirs.

Once these exemptions become appreciated, there becomes a desire to preserve them. However, their waste is quite common, particularly where existing estate plans involve irrevocable trusts (insurance trusts, qualified personal

See *WHY WE OFFER COMPLIMENTARY REVIEWS* on page 8

THE IMPORTANCE OF VALUE, MANIPULATING IT, AND KEEPING TRACK OF IT IN ESTATE AND TAX PLANNING

- FAIR MARKET VALUE, GST, AND OTHER CONSIDERATIONS -

Estate and gift taxes are excise taxes on the transfer of property. The tax is measured by a rate that is applied to the value of the property transferred. The value is generally the "fair market value" of the property on the date of transfer, which is generally the date of gift or death of a decedent. During life, gifts are valued and a gift tax is imposed unless an exclusion or exemption applies. There are exemptions for direct gifts to charity, for education, medical needs, or for certain gifts under the annual exclusion amount, which in 2015 is $14,000 per donee. Taxable gifts are accumulated from year to year and, until the total exceeds the "applicable exclusion amount," which is $5.43 million in 2015, no tax is payable. The applicable exclusion amount can be more if a " DSUE" exists from a deceased spouse. See *Leaving Your Spouse (or Not) a DSUE* on the cover. Nevertheless, to the extent the applicable exclusion amount is exceeded by lifetime gifts or by the value of property passing at death, a 40% excise tax is imposed on the excess. For example, if you made total taxable gifts of $3 million during life and then died, and your estate passes $5 million to your heirs, your tax would be $1,028,000 ($8 million minus $5.43 million, multiplied by 40%). Value absorbs exemptions, so let's reduce it!

See *IMPORTANCE OF VALUE IN ESTATE PLANNING* on page 8

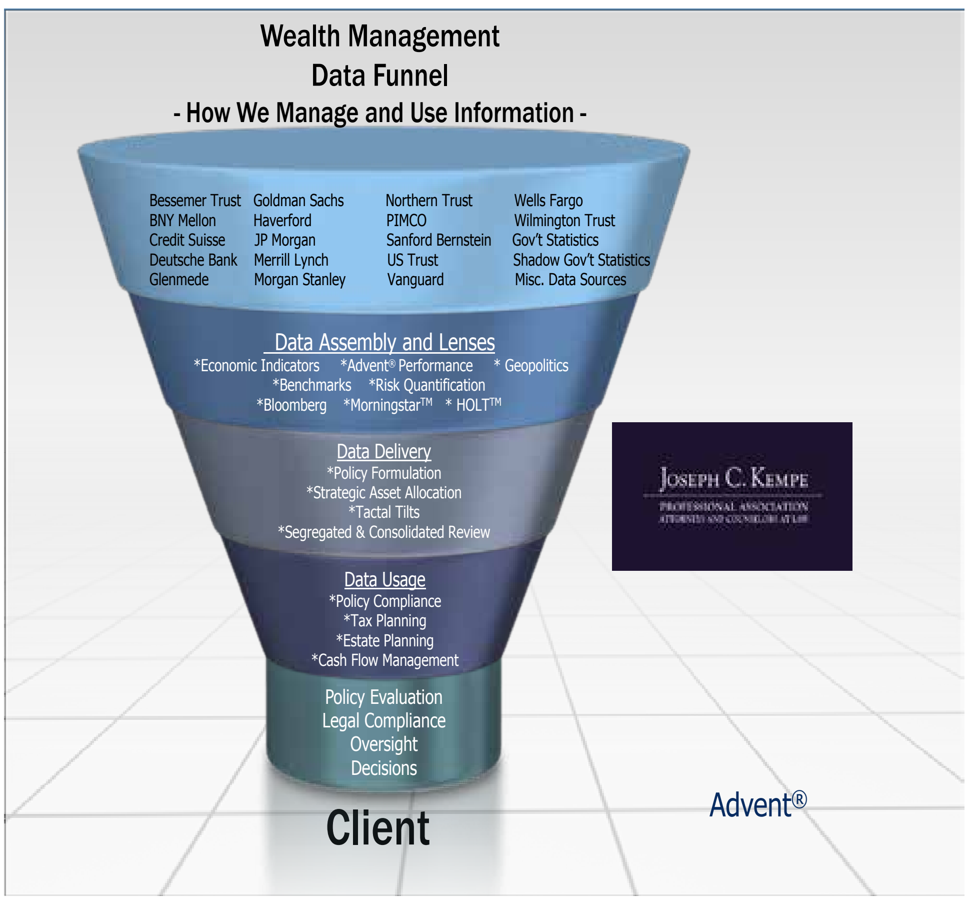
Economics and Geopolitics at the Start of 2015

- Where are We Headed and How are We Going to Get There -

At the start of 2014, most prognosticators expected a rise in interest rates through the year when the 10 year Treasury bond was at 3%. The rate actually fell approximately 33% by year end. On January 5th, 2015, Bloomberg reported that a consensus of analysts expect the rate to be 3.06% by the end of 2015, only returning to where it was two years earlier. What happened, and where are we? On January 15 (10 days later), the 10 year fell to 1.77% as a result of disinflationary pressures (global deflation). The U.S. is growing at an anemic rate, but growing despite global deflationary pressures from Europe, China, and other countries. There is a fear that the U.S. will import this deflation, which is compounded by a high dollar. The Fed desires to inflate our economy and increase interest rates, but there are many headwinds fighting against this action- global deflation, a strong dollar, employment underutilization, low wages, and a plunge in oil and other commodities- all providing low inflation that discourages a Fed move to raise rates. Action on January 22 by the European Central Bank to undertake QE (as difficult as it may be) is hoped to inflate Europe and cut off the importation of deflationary pressures. The US equities market applauded. But then there is Greece!

All eyes are now on earnings. Already high valuation multiples (accepted given low interest rates) can no longer inflate elevated market valuations. If global deflation is imported into the US the fear is that lower earnings will cause equity markets and valuations to contract. There is some belief that the Fed will nevertheless raise the Fed Funds rate, but anemically. This will likely continue to hold down and flatten the long bond. Globally, nominal rates (those unadjusted for inflation) have begun to turn negative- if one doesn't invest, you have to pay banks to hold deposits. Both Switzerland and Denmark have gone negative on deposits. In the US, deposits aren't nominally negative, but deposits through the 10 year bond are either negative or zero on a real (adjusted for inflation) basis- Bill Gross's new neutral! Core inflation (excluding food and energy) was 1.6% for 2014, below the Fed's 2.0% target, and recent estimates are we are negative (deflatinary) if food and oil were included. Both Gross and Gundlach and BCA Research think we are at or approaching the end of a "debt supercycle," where ever increasing debt has come to an end and can only be maintained with low interest rates. See left margin.

There is room for optimissim with the Conference Board reporting January 23, 2015 that eight of their 10 leading indicators were positive in December, furthering four months of expansion. A strong domestic market supported by consumer spending (attributed to lower oil prices) as the key contributor. (Consumer spending is reported to account for 70% of the economy.) As we have been saying, companies will have to earn out of this situation to support their values. Everyone is watching and it is hoped that the worst in overseas markets is behind us, given government monetary stimulus. But, hold on!



Since He Called 2014, What is He Saying Now - Gundlach Thinks the Fed Will Do it Anyway -

The stars aren't aligned to raise interest rates, but Gundlach thinks they may do it anyway. His 2013 views of 2014 were spot on, so let's look at what he is saying about 2015:

- The 10 year Treasury bond could get to 1%, particularly if oil goes to $40. If oil goes to $40, something is very wrong in the world.
- Oil has a big impact on CPI. 35% of capital spending from the S&P 500 is from the energy sector.
- Inflation will be 2%, and akin to the 30 years after 1913 when the Fed was established.
- The long bond (30 year) will be drug down to 2%.
- Margin debt has peaked.
- The employment situation looks like it might be time to raise rates, but the inflation data is saying the opposite.
- All of the job growth from the recession until today can be attributed to the shale oil boom.
- Since the financial crisis, every interest rate hike has been met with a reversal and this is what I think is going to happen.
- I think the Fed will raise rates just to do it.
- The bond market says that inflation will be negative for two years.
- Oil tends to lead CPI.
- The dollar looks to be headed higher.
- Its almost unthinkable that I would want German bonds instead of U.S. As long as the yield is below 1%, I can't see how US 10-year yields are going to go up.

Many of these sentiments are echoed by Bill Gross. Lacy Hunt, a 72 year-old chief economist at Hoisington Investment Management, thinks lackluster demand and low inflation will keep yields low for years to come.

Sources: Business Insider, January 13, 2015 and December 9, 2014. Bloomberg, Bill Gross Says the Good Times are Over, January 6, 2015. Bloomberg, One Hundred Years of Bond History Means Bears Fated to Lose, (Dec. 8, 2014).

Why We Offer Complimentary Reviews

(continued from page 6)

residence trusts ("QPRTs"), grantor retained annuity trusts ("GRATs"), or others. This is because if gift tax returns are not properly filed (even when taxable gifts have not been made), exemptions can be inadvertently wasted. The filing of a gift tax returns is often required to opt-out of automatic allocations and use of exemptions, when use is not required and wasteful. The opposite is also sometimes true, where a gift tax return should be filed to affirmatively allocate and use exemptions. Filing gift tax returns is often a maintenance matter.

As a result, our review of estate plans is often not just of legal documents, but of related tax return filings and compliance.

It is quite common for our review to lead to new engagements. After our review, should there be a need to update documents or to file tax returns, we provide a written fee quote for our services. Our goal is to educate and to optimize our clients' affairs on a competitive fixed fee basis and this is why we offer complimentary reviews of the affairs of prospective clients.

Importance of Value in Estate Planning

(continued from page 6)

In addition to the estate and gift tax, a tax is imposed on taxable skips to heirs more than one generation younger than the donor- for example, grandchildren. This tax is called the generation skipping tax ("GST"), which is a tax that many individuals fail to recognize. Most also fail to utilize their GST exemption. The importance of the GST can be understood with a simple example. If a grandparent wants to transfer $1 million to a grandchild, and the grandparent has previously exhausted or wasted their applicable exclusion amount and GST exemption, it will cost the grandparent $1.96 million to do so. This is because there would be a $400,000 gift tax on the transfer, a $400,000 GST, and further a gift tax on the GST in the amount of $160,000. This same pyramiding of tax can occur through estate plans that fail to properly utilize their GST exemption when wealth passes to children, unsheltered from the estate and gift tax system. What's more, individuals that have created irrevocable trusts during life will often have their GST exemption automatically taken and wasted, unless they file a gift tax return to opt-out of what is called "automatic allocation." Note: *A thorough discussion of the automatic allocation rule is beyond the scope of this article, but we have written about it in prior Client Updates. Please let us know if you need further information.*

The importance of recognizing the extent of gifts and use of exemptions cannot be overstated. If a gift tax return is not filed and a taxable gift is made, the statute of limitations remains open and the value can be adjusted by the IRS, even after death many years later. Furthermore, without tracking the total value of gifts made, and the amount of GST and estate and gift tax exemption used (or inadvertently wasted), neither you nor your heirs may appreciate the gift, estate, or GST exposures that are being created or opportunities for tax savings that are being wasted. Again, value absorbs exemptions!

In all of this "value" is important and the sooner that value can become fixed and sheltered in an exempt form the better. Value can oftentimes be manipulated in such a way that less exemption is used so that more exemption remains available for later use. For example, a traditional valuation manipulation (reduction) tool is a family partnership. Effectively used, the fair market value of shares of a family partnership are significantly less than the underlying assets it owns. As such, many families consolidate assets in them for management, asset protection, and other reasons and gain the tax benefit of reducing the value of their assets for tax purposes. In our experience, appraisers value the shares of the partnership from 32% to 40% less than the value of the underlying assets. There are other methods of artificially reducing the value of assets, thus preserving more estate and GST exemption. Estate plans are often fashioned to incorporate fractional ownership of assets, replacement of assets with intra-family promissory notes, use of GRATs, QPRTs, and other tools.

See IMPORTANCE OF VALUE IN ESTATE PLANNING *on page 12*

President Obama Proposal for a Simpler, Fairer Tax Code That Responsibly Invests in Middle Class Families

On January 17, 2015, the White House made the following proposals, among others:

Qualified Dividends and Long-Term Capital Gains

- The capital gains rate would increase to 28% for couples with income over approximately $500,000.

Treating Bequests and Gifts as Realization Events

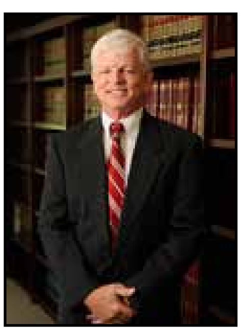
- Capital gains would be realized on gifts and bequests of property. There would be no tax between spouses. Various exemptions would apply for homes, tangible personal property, and family farms and businesses.

- Capital gains at death of up to $100,000 per individual ($200,000 per couple) would be exempt.

Retirement Plans

Employer's having more than 10 employees would be required to automatically enroll its workers in an IRA (an "auto-IRA"). A tax credit of up to $3,000 would be provided to any employer with 100 or fewer employees that offers an auto-IRA. The President also proposes to increase the start-up credit for small employers who newly offer a retirement plan from $1,500 to $4,500. Small employers that already offer a plan but add auto-enrollment would receive an additional $1,500 credit.

Attempting to predict tax legislation is difficult. Given a Republican controlled Congress, the belief is that business tax reform will take precedence, with estate and individual reform to pay for newly proposed education and social programs unlikely.

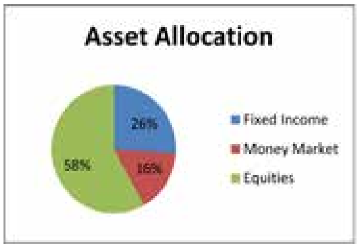


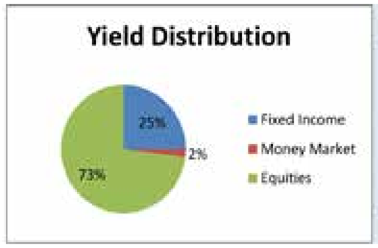
John L. Avery Jr., Esquire

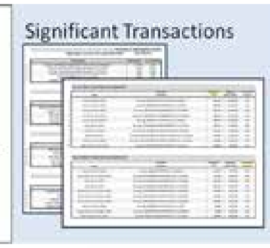
Trial and Litigation Attorney
Appellate Law
Real Estate and Business Litigation

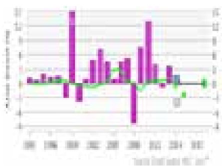
Joseph C. Kempe
Professional Association
Attorneys and Counselors at Law

Wealth Monitoring Services

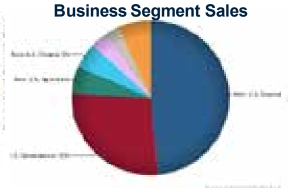




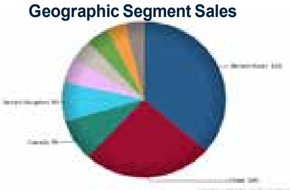




Business Segment Sales



Geographic Segment Sales



Tax Tail of the Investment Dog - Recognize Your Investment Biases -

No one wants to pay taxes, and often that behavioral bias will cause inappropriate investment decisions. For example, momentum is a recognized market phenomenon where market values may be pushed higher or lower because of herding mentalities- on the upside, sometimes causing bubbles. Prior to the burst, some might want to sell but dislike the capital gains tax they will pay, which may freeze them from taking action. In reality, selling high and buying low is often what we want to do irrespective of tax. For example, selling a $1 million investment with a cost basis of $500,000 will produce a capital gains tax. Assuming a 20% tax, there is a $100,000 tax to pay, or 10% of the investment, leaving $900,000 of cash. Compare that to selling after a correction (defined as a 10% or greater downturn). If the same investment were sold at $900,000, the tax would be $80,000 ($900,000 -$500,000 x 20%), leaving $820,000. Which is better, particularly if you were to invest the $900,000 in quality positions that have themselves corrected, where you have obtained a new $900,000 cost basis? The answer is clear! Avoiding the bias against recognizing capital gains is sometimes the best choice, but never allow the tax tail to wag (outweigh) good investment decisions.

Benjamin Devlen, CPA
Tax Accounting
Business Accounting
Wealth Management
Advent® Analyst

JOSEPH C. KEMPE
PROFESSIONAL ASSOCIATION
ATTORNEYS AND COUNSELORS AT LAW

Client Snapshot

Client Name:	Jane Sample
Client #:	9999.281
Date:	January 20, 2015
Reporting Period:	December 2014
Legal Assistant:	Louise Fisher
CPA:	Patrick Mangan
Advent Analyst:	Aaron Flood
Lawyer:	JCK

CURRENT	
Total Family Wealth:	$11,887,000
Tax Exempt Trusts & Entities	$5,674,000
Husband Estate Size:	0
Wife Estate Size:	$6,213,000
Joint Estate Size:	0
Current Estate Tax:	$349,000
Percent of Current Estate:	3%
*Projected Gross Estate:	$15,928,000
*Projected Estate Tax:	$529,000
Percent of Projected Estate:	3%
Marginal Tax Bracket:	40%
IRA Portfolio:	$63,000
*Total Family Partnership	$6,257,000

•Based upon a 3% return, net of expenses over life expectancy and no valuation discounts.

YTD Investment Performance	
Portfolio:	**18.29%**
S&P 500:	13.98%
Barclays Agg:	5.86%
Performance Since 2012	
Portfolio:	**46.38%**
S&P 500:	75.04%
Barclays Agg:	8.08%

(Performance through November 2014 on monitored investment accounts.)

Income for the Period Ending 2013	
Total Income:	$273,955
Tax Free Income:	0
Adjusted Gross Income:	$271,554
Taxable Income:	$198,712
Marginal Tax Bracket:	33%
Gift & GST Exemption Used	
Husband Gift:	n/a
Wife Gift:	$88,160
Husband GST:	n/a
Wife GST:	0

The current Estate Tax estimate assumes new law implementing a $5,340,000 exemption and 40% tax through 2014 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:	Update LP Min	
Document Code:	Single 80/20	

Miscellaneous		
QPRT Termination Dates:	12/2024	
Crummey notices verified:	n/a	
Family Partnership Records Current?	n/a	No, 2012
RBD Date: H/W	n/a	4/2009
RBD Compliance:	n/a	Yes
IP = RMD In Progress	Complete	

Legal Developments

Tax overhaul is likely to face a tough road in Congress in the coming year despite strong support from the business community. Many lawmakers are pressing for comprehensive tax reform, while the White House is only supporting a corporate overhaul, an official from the National Foreign Trade Council said Jan 9. At the same time, President Obama, on January 15, is requesting a 7% budget increase, which will likely be met with opposition by Congress but will provide some insight to how reform may become shaped. On the 17th he also introduced estate tax reform denying cost basis step ups.

Economic Developments

Volatility Index

Observations

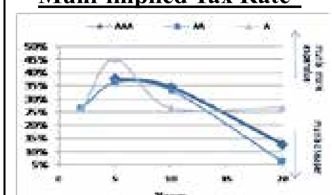
Since few portfolios had significant losses as a result of market gains in 2013 and 2014, only nominal volatility was spurred at the end of 2014 as a result of tax loss selling. It appears that managers delayed raising cash to adjust portfolios until 2015, thus deferring the recognition of gains until a new tax year (2015). As a result, 2015 has started out with greater volatility which many think will continue given the consternation over interest rate rises, oil prices, and global disinflationary pressures. All eyes are currently on Europe, given a surprise move by Switzerland to drop its currency cap on the Franc in order to confront an expected ECB QE program, like but materially different from the one the U.S. had implemented. An ECB QE program should lighten Europe's deflationary headwind on the U.S markets.

Economic Statistics

	Reported	SGS
Consumer inflation	1.3%	9.0%
Unemployment	5.6%	23.0%
GDP	2.7%	-1.7%

Source: BLS, ShadowGovernmentStatistics

Muni-implied Tax Rate†



† We equate municipal and corporate yields

Joseph C. Kempe
PROFESSIONAL ASSOCIATION
ATTORNEYS AND COUNSELORS AT LAW

Leaving Your Spouse a DSUE

(continued from cover)

old bartender had been on sabbatical, but on her return she had a new glow and looked different - at least between her head and waist - apparently her father had died and left them to her.

It's funny how tax law can bring back these memories and estate planning options. Thus, the "DSUE" or Deceased Spouse's Unused Exemption gains relevance. You see, the DSUE is a form of augmentation you can leave to your spouse, if you wish. If not, the augmentation can be prevented. (We don't advocate such sinister planning, but our job is to educate our clients to their choices, not condemn or insert our biases.)

The DSUE is a new term that has been recently created as a result of the evils portability has brought. See *left margin for important reasons why experienced estate planners steer their clients away from use of the DSUE and portability without use of a trust*. Portability, you see, allows a surviving spouse to receive the unused estate tax exemption that historically would be wasted if the first deceased spouse's estate lacked proper planning. For example, historically, if a husband had a $5 million estate and left it all to his wife, the family would have lost his estate tax exemption, because he overfunded the marital deduction by leaving his entire estate to his wife rather than having created an exempt trust using his exemption for her benefit. Historically, his unused exemption would lapse and not pass to the surviving spouse. On the facts of this example, the new "portability" law allows the husband's unused exemption (the "DSUE") ($5.43 million in 2015, and increasing thereafter) to pass to the surviving spouse, but only if an election is made on a timely filed estate tax return, Form 706, and his will does not direct his executor not to make the election. If the election is made, the surviving spouse's exemption is augmented to $10.86 million by adding her deceased husband's exemption to hers. What's more, if she remarries and survives her second husband, her exemption could increase to as much as $16.29 million in 2015 and, as a result of indexed increases, more each year thereafter. (She can use the last deceased husband's DSUE for gifts and, if she remarries again and he leaves his estate to her, she may receive another DSUE from the second husband, according to Temp. Reg. 20.2010T-3(b).)

Now for more sinister motive through augmentation: What if she can't use the DSUE because her estate isn't large enough, does augmentation make her more marketable in the realm of love? Maybe, and here's how. The DSUE of the first spouse is worth $2.172 million dollars in real dollars (40% tax on $5.43 million). Should she remarry a gentleman with a sizeable estate, he can use her DSUE and her applicable exclusion amount (another $5.43 million or $2.172 million in real dollars - $10.86 and $4.344 million, respectively in total) to benefit his family. Shouldn't she be compensated or does she just come to the marriage with a different glow- at least until the lawyers begin to negotiate the value of augmentation?

Avoiding Probate Leads To Mistakes

(continued from cover)

from the estate plan, that was designed to provide heirs with various tax benefits and protections against threats that now become lost.

Our last several Client Updates have addressed this subject but we continue to find individuals confused over this topic. Much of this confusion is driven by advisors who are trying to be helpful, but who aren't qualified to understand and explain that probate is a misunderstood term. Probate is a process of proving a will and clearing title to assets through a court monitored process. It has nothing to do with taxes. Most of our clients have estate plans that are designed to avoid probate. However, more importantly, their estate plans are designed to confer substantial benefits (tax and asset protection) on their heirs, that those heirs can't obtain themselves. The heart of most estate plans is the revocable living trust, which serves the purpose of a will without having to be probated. The cost of creating a living trust should be no more than the cost of creating a will centric estate plan.

See *Avoiding Probate Leads to Mistakes* *on page 11*

Why the Informed Design Estate Plans that Don't Rely on Portability Without Trusts -The DSUE is for the Less Informed or those using the Single QTIP -

Portability was enacted to allow a couple to be viewed as one taxpayer under the estate and gift tax system, so that the estate and gift tax exemption of the first deceased spouse doesn't go wasted as a result of poor planning. It was also thought to provide taxpayers with greater simplicity. However, the law did not go far enough and once understood the shortcomings become clear. Failure to capture the estate tax exclusion of the first deceased spouse through use of an exempt family or spousal trust results in the following detriments:

- Failure to protect the surviving spouse against the risks of creditors or remarriage and divorce.

- Failure to shelter the growth of assets of the first deceased spouse from being exposed to taxation in the surviving spouse's estate. Portability does not shelter growth, while traditional bypass or exempt trust planning does.

- Failure to capture the deceased spouse's GST exemption, which most people want to use once it is understood. The generation skipping tax exemption is not portable and its use keeps your assets from being taxed in the estates of your children, grandchildren, etc.

- Related to capturing the first deceased spouse's GST exemption is protecting what passes to children and grandchildren from in-law rights in divorce or at death and third party liability claims. In other words, proper exempt trust planning gives family members control, but often more importantly protection against the threats of unfriendly hands in everyday life.

The above failures are often caused by advisors who don't understand that these protections are lost when pay or transfer on death designations are used with the objective of avoiding probate. A basic estate plan is designed to avoid probate, but more importantly to overcome the failures above described. Furthermore, much of more recent planning is focused on not only overcoming the above failures, but also securing a step-up in basis of assets on the death of both spouses. A new way of doing so has evolved - See Having Your Cake and Eating it Too on page 3.

Sector Performances as of January 23, 2015

Sector	YTD	1Yr	3Yr	5Yr
Basic Materials	-0.10	-5.1	4.13	2.70
Communication Services	-0.27	5.08	15.67	11.84
Consumer Cyclical	-0.29	2.24	23.02	18.05
Consumer Defensive	-0.61	7.01	14.83	13.11
Energy	0.24	-6.41	3.37	5.59
Financial Services	0.01	10.27	18.68	8.65
Healthcare	-0.05	20.74	26.63	18.30
Industrials	-0.04	7.42	18.04	14.26
Real Estate	1.0	18.56	15.78	12.72
Technology	0.06	17.71	22.11	14.87
Utilities	0.02	17.61	10.86	6.68

Source: Morningstar

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General Practice

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Attorneys and Counselors at Law

Where Was Joan Rivers Domiciled?

- A Glimpse at Some Distinctions Through Her Estate that May Apply to You -

We have previously written on the distinctions between "residence" and "domicile," and their income and estate tax ramifications. Residence is more of an everyday life concept, where one spends most of their time, but it can be different from where the heart calls home. Domicile is more this latter concept, and is often the more important of two or more states where one spends time and lives. In Joan Rivers' circumstances, the dispositive provisions of her estate plan were controlled by a revocable living trust that remains largely unknown (a significant benefit of trusts), but her will which was recorded in New York offers a glimpse at some of the planning that is the focus of this Client Update- income versus estate tax planning.

Joan's will clearly indicates that she was a resident of New York, but it also clearly provides that she was domiciled in California, where she was laid to rest. How this ostensible ambiguity can be reconciled might be as simple as understanding the differences in the tax regimes of California and New York. From an income tax standpoint, she likely wanted to be taxed on her non-California sourced income as a resident under New York law. California will tax California source income of non-residents, but not non-California (New York) source income of nonresidents of California. Even though New York is known as the state with the highest tax burden, Joan may have actually paid less income taxes to New York as a top earner (8.82 percent New York State tax plus 3.876 percent New York City tax), as compared to a slightly higher California income tax. More importantly, however, is the difference in estate tax. She would have very much favored avoidance of New York's burdensome estate tax and to benefit from the laws of California, which hasn't had a state death tax for those domiciled there since Jan. 1, 2005. Should New York contest her domicile, however, the estate tax stakes could be in the tens of millions. The estimated value of Joan's estate by some vastly exceeds New York's current estate exemption amount ($2,165,625) by more than 5 percent, and thus under New York's new convoluted death tax system, the exemption is forfeited. Therefore, there would be taxes due on the full value of her estate, at a top rate of 16 percent when the estate exceeds $10 million.

There is some speculation over why Joan's will was recorded in New York, when it explicitly states she was domiciled in California. This invites New York to claim she was domiciled there. There is no Constitutional prohibition from being exposed to two or more state death tax regimes, though here California does not have one. Some think it may be posturing in anticipation of a wrongful death action in New York, where she died undergoing medical procedures. Alternatively, it would not surprise us if Joan's estate wasn't as large as thought and that the death tax exposure in New York isn't that great. The estates of actors, athletes, and entertainers are often much smaller than many would think, given poor management and accelerated lifestyles. If her estate wasn't that large, and the exposure to New York death tax not that significant, there would be no incentive to argue that California was her domicile. Perhaps less dramatic, it may just be that the facts were clear that her residence and domicile were both in New York, and that there was no reason to invite a controversy with New York and incur the costs associated with a hopeless battle. Perhaps her will was simply outdated!

Avoiding Probate Leads To Mistakes

(continued from page 10)

But, more important than probate avoidance, the trust permits benefits to be conferred on heirs through an estate plan. The three objectives are thus accomplished: probate is avoided, tax and other benefits are bestowed on heirs, and control is maintained and conferred on heirs after incapacity or death.

State Income Tax Planning Moves to the Forefront - Like Foreign Planning in the Old Days -

State income tax planning parallels that of foreign structures historically used by families, investors, and businesses. The federal government reacted with laws to curtail much of this planning, but states don't have the same leverage as the US government. For example, federal law causes penalty taxes on foreign trusts that benefit US tax residents So, if income is deferred offshore but ultimately paid to a US taxpayer (as a result of residence or citizenship), penalty taxes may apply. (They are intended to discourage offshore deferral and encourage current payment.)

States don't have the same leverage because you can fairly easily move from a taxing state to a non-taxing state. For example, if income is deferred in a trust administered in Florida or Delaware for the benefit of one or more beneficiaries living in a state that imposes income tax, income tax is only paid when received by a tax resident. California and recently New York enacted laws similar to our federal law to discourage deferral by imposing a penalty tax once received by the tax resident beneficiary. However, if the beneficiary moves out of the taxing state prior to receipt, the tax is avoided. US citizens and resident taxpayers don't have this same ease of migration to a foreign country without severe exit taxes associated with expatriation. There is no expatriation tax when a person changes a state of residence from a taxing state to one, like Florida, that does not impose income taxes on individuals. Any attempt by a state to impose an exit tax would likely violate the Constitution.

Andrea L. Blair, MBA, CP, FCP
Estate Administration
Fiduciary Services
Wealth Management

Joseph C. Kempe
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Attorneys and Counselors at Law

Trusts Can Save Income Taxes Too

(continued from cover)

Most individuals desire to leave their families inheritances in trust, in order to protect that inheritance from reach by unfriendly hands, including in-law rights, third party liability rights, and state and federal wealth transfer taxes. Most individuals also desire that those who inherit control that wealth. The children of many Florida residents live in northern states that impose income taxes. As a result, the income that is distributed from, or accumulated within, a trust that migrates to an income tax imposing northern state will be subject to income tax in that state. However, if that income were not currently needed, a properly structured trust, inherited by heirs in northern states or administered by parents in Florida, can defer the taxation on that income until it is distributed to them from the trust. Should that heir at a future date change residence to a state, such as Florida, that does not impose a state income tax, the state level tax on that accumulated income may not only be deferred but completely avoided.

The so called "Pease limitation" is named after Congressman Donald Pease (D-Ohio) and is designed to phase-out itemized deductions (state and local taxes, mortgage interest, charitable contributions, and others) when an individual's adjusted gross income ("AGI") exceeds a prescribed threshold. That threshold in 2015 is $258,250 for single persons and $309,900 for married couples filing jointly. The higher the AGI, the larger the extent to which itemized deductions are phased-out, up to an 80% phase-out. A trust design is available to allow income to be accumulated in such a way that it does not increase your AGI, even though the income is available. This type of trust has come to be known as an ING or DING Trust, though I tend to call it an Anti-Pease Trust. An Anti-Pease Trust can also be used to avoid state level income taxes, as discussed in the previous paragraph. For example, a Florida resident parent can assist children in northern states not only avoid the Pease limitation, but defer, if not totally avoid, state level income tax on income from investments that are not currently needed.

This note focuses on the use of certain trust structures from the viewpoint of a Florida resident parent, and how these structures can benefit children living in northern states that impose income tax. These same structures can also be used to reduce federal income tax for the parent and children. What is beyond the scope of this note, is that variations of these trusts can also be used by anyone (including parents) living in northern states. For example, historically before the sale of an asset that has substantially appreciated, some would move out of a taxing state. Now trusts can be used to avoid the need for a change of residence.

Importance of Value in Estate Planning

(continued from bottom of page 6)

Value is thought to be a point, but it is often a range. As attorney we generally engage the appraiser in order to preserve attorney client privilege so that we can debate various valuation principles with the appraiser and accomplish what is best for our client within the range of values. *(Mr. Kempe's B.S. degree was in real estate appraisal and finance and while in law school he worked with General Henry Graham, recognized as one of the leading appraisers in Alabama- also the General who walked Governor Wallace off of the steps of the University of Alabama.)* Some assets, like marketable securities, are not subject to a range and their value is a point, which is why many families create family partnerships, whose shares aren't susceptible to a point in value in a given market where they are traded. They are valued by extrapolating data from other markets, whereas marketable securities are a point fixed by objective market data on the date of gift or death.

In summary, value is important and clients have the opportunity to use IRS rules to manipulate value in their favor. Value should be tracked, so that tax liabilities aren't inadvertently incurred or exemptions inadvertently wasted. Capturing value in an exempt form, that allows wealth to be used but passed on through generations without estate, gift, or generation skipping tax, is what more advanced estate planning involves and why a comprehensive review of both an individual's legal documents and tax returns is so important.

FINRA To Put Client Best Interest First
- Suggests Seniors are Vulnerable to
Biased Investment Advice -

On January 6, 2015, FINRA (the regulator of investment advisors and brokers) issued its regulatory and examination priorities for 2015 with a goal of placing customer interests first — particularly when the advice concerns vulnerable investors, such as seniors or wealth events such as inheritance or individual retirement account rollovers. In its letter to member firms, it provided:

"A central failing FINRA has observed is firms not putting customers' interests first." The letter states, "Irrespective of whether a firm must meet a suitability or fiduciary standard, FINRA believes that firms best serve their customers — and reduce regulatory risk — by putting customers' interests first. This requires the firm to align its interests with those of the customer."

Data revealed that customer's concerned with market volatility and low interest rates had been sold a variety of alternative products that are marketed typically as arbitrage or hedge-fund styled investments. Many of these products attempt to capture yield and limit risk through complex structures. However, when these products produce losses, FINRA members are sued and judged by those who find suitability difficult to understand. Second, as the baby boomers retire with their self-funded retirement assets, many will be interested in obtaining returns beyond that offered by relatively safe interest-bearing investments. When losses occur, retirees often look to litigation as a means of restoring their assets and have the advantage of perception before arbitrators or juries, who in hindsight question the wisdom of broker-dealer or investment advisor recommendations that lead to the retirees' woes. Accordingly, FINRA is advising member firms to take steps to have procedures in place for these situations, which provide for supervisory review and careful documentation.

It is important to note that Florida has severe penalties against investment advisors or others that take advantage of the elderly.

Donna Baummier, LA
Estate Administration
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Wealth Management

Why Unwind Existing Estate Plans

(continued from page 3)

reported on all estate tax returns filed for the year was $8.5 billion. California had the highest number of estate tax returns filed in 2012, followed by Florida, New York, Texas, and Illinois. Furthermore, the estate tax rate has been reduced to 40%, still higher (almost double) than the capital gains tax rate, and the exemption has increased to $5.43 million in 2015.

Given the decrease in individuals confronted with federal estate tax exposure, advanced estate tax reduction tools are used by fewer individuals because they are no longer confronted with an estate tax. For those that have such strategies in place, they should consider terminating them. Doing so may result in junior family members (typically children) being considered to make a gift back to their parents, but often these children do not have taxable estates of their own and the gift back is absorbed by their own exemption (for 2015, $5.43 million or $10.86 million if married). Furthermore, if the senior family member's estate plan is properly designed, when their estates (including the assets of the terminated strategy - QPRT, GRAT, family partnership, etc) will pass in a manner where it is not exposed to estate tax in the estates of the junior family members. As a result, even if the junior family members were considered to have made a gift to their parents, and used their exemption, the use of that exemption will permit the assets of the terminating structure to grow exempt from estate tax exposure in the estates of the junior family members over their remaining lifetimes.

What follows is a typical example:

In 1995, Mom transferred her $750,000 home to a 25 year QPRT. The home originally cost $500,000 and is currently worth $1.5 million. A $16,000 gift was made in 1995 when the QPRT was created. Mom's estate is presently worth $3 million excluding the home, but $4.5 million if the QPRT is terminated and the home is included in her estate. Daughter has her own estate, which is presently worth $4,500,000.

If the QPRT is not terminated, Daughter will inherit the home and the balance of Mom's estate, causing daughter to have a taxable estate equal to either $6 million or $9 million, depending on whether Mom effectively uses her generation skipping tax exemption ("GST" exemption). We will assume that Mom has competent counsel and is using her GST, but for technical reasons seldom is a QPRT drafted to be GST exempt. As such, if the QPRT is not terminated, Daughter's estate would be $6 million and taxable, but the remainder of Mom's estate would pass to Daughter exempt from estate taxation because the balance has been made GST exempt. However, daughter would inherit the home with an inherent $1 million of capital gain, resulting in a capital gain tax of $200,000 upon sale. Two detriments occur to daughter in this example if the QPRT is not terminated: (1) $200,000 of capital gain tax exposure exists (20% rate on gain), and (2) Mom's failure to fully utilize her GST causes the home to be taxed in daughter's estate- a tax of $228,000 ($6 million, less $5.43 million exemption, times estate tax of 40%). This assumes that daughter does not treat the termination of the QPRT as a gift by her to Mom. If she did, she would use a portion of her $5.43 million exemption. In either case, the results favor termination.

Terminating QPRTs, GRATs, and family partnerships should seriously be considered where a senior family member no longer has an estate tax exposure. There can be a number of reasons to do so. We are happy to offer our analysis of your facts and circumstances to assess the feasibility of doing so.

__Note__: As of this writing, President Obama is proposing the imposition of capital gains tax on property owned at death and elimination of the step-up in basis. Variations of this proposal have existed several times in our tax history, but have been repealed each time. Nevertheless, it imposes a level of uncertainty in planning to unwind existing strategies that needs to be monitored.

SEC Reacts to Criticism on Regulation of Dark Pools, While More Firms Create Them - High Frequency Trading is a Target of Both Sides -

While SEC Chair Mary Jo White says that the growth of "dark trading" is harmful to markets and pledges tougher regulation, Fidelity, Blackrock, BNY Mellon, J.P. Morgan and others are joining together to create a private dark pool to facilitate their trading that is known as Luminex Trading & Analytics. The SEC has fined several dark pools for unfair dealing in disclosure and access. In the largest, UBS was fined $14.14 million for a series of violations related to high speed trading using its dark pool, including permitting only certain participants to trade in sub-penny increments that provide an unfair advantage which violates SEC rule. Both allowing only some to exercise this advantage and permitting sub-penny increments are both violations of SEC rule. UBS's dark pool is the second largest in the U.S. UBS did not admit or deny the allegations, but paid the fine.

Luminex Trading was created with the intent of having predominantly fund companies share a trading platform that is not susceptible to high-frequency traders who may take advantage of the systems. Firms that wish to join Luminex will be required to undergo rigorous due diligence. About 14.4% of all stock trading took place in dark pools in the first quarter of 2014, according to research consultant, Tabb Group.

Source: Wall Street Journal, Money Managers Plan Private Dark Pool (January 20, 2015); Bloomberg, SEC Pokes Hole In Argument It's Too Slow to Get a Grip on Markets (January 16, 2015).

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Having Your Cake and Eating it Too

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as we have warned, relying on portability and the DSUE alone without use of a trust is not wise, because doing so forfeits many other benefits that most people want to secure for their families that can only be achieved using trusts. Most important, a decedent's generation skipping tax ("GST") exemption is not portable and would be forfeited if not captured in a trust for the surviving spouse. Furthermore, all assets passing to the surviving spouse and descendants become exposed to remarriage and liability risks, if not passed in trust. Once this is understood, very few if any clients decide to rely on portability alone and not use trusts. As a result of a recent IRS announcement, the motivation to use trusts for the surviving spouse has increased further. A surviving spouse can now inherit a trust that qualifies for the marital deduction while receiving the deceased spouse's DSUE. Doing so provides all of the protections offered by a trust, spousal control, use of the decedent's GST exemption, and now a double step-up in the basis of assets - in our example, the $10 million in assets would receive a date of death value on husband's death and those assets will again receive a step-up in basis for all post death appreciation on the death of the surviving spouse. A significant benefit!

For many years we have advocated use of the "single QTIP" testamentary funding formula on the death of the first spouse, instead of what are known as pecuniary funding formulas. As mentioned, funding formulas are designed to capture the first deceased spouse's estate tax exemption ($5.43 million in 2015), while avoiding any tax on any excess by having it qualify for the marital deduction. The vast majority of documents we draft for married couples rely on single QTIP trust funding for the surviving spouse. Single QTIPs provide funding flexibility (the ability to overfund the marital deduction or not and to make separate elections for state exemptions), the ability to integrate retirement plans without adverse income tax results, the use of the decedent's GST exemption, and protection of what passes to the surviving spouse from remarriage and third party liability risk. (These are many of the same reasons behind our warnings about relying on portability in securing probate avoidance.) A double cost basis step-up is a new reason for using a single QTIP funding formula, which has emerged as a result of clarification of an IRS position, which is explained below. This further entrenches the single QTIP as the funding vehicle of choice for a surviving spouse.

Under the Treasury Department's 2015 Guidance Plan, the IRS is in the process of clarifying its position in Rev. Proc. 2001-38 that will allow the use of a single QTIP trust to overfund the marital deduction while also allowing the DSUE to pass to the surviving spouse. In doing so, it allows portability to be relied on, thus securing a second basis set-up, without giving-up all of the advantages of a trust. Under Rev. Proc. 2001-38, the IRS in 2001 announced its position that it would disregard a QTIP election that was "mistakenly" made, thus overfunding a marital deduction without creating a share using the decedent's estate tax exemption. In other words, by mistakenly making a full (100%) QTIP election and overfunding the marital deduction, the taxpayer in this case failed to carve out a separate trust using the decedent's estate tax exemption, and the IRS ruled the amount qualifying for the marital deduction would be reduced by the exemption amount, thus restoring the decedent's otherwise wasted tax exemption. Property that is qualified by election to use the marital deduction will be taxed in the surviving spouse's estate, thus ostensibly wasting the first spouse's estate tax exemption, which would otherwise shelter that property from being taxed in the surviving spouse's estate. But what if it wasn't mistaken? Many had worried that you couldn't purposefully overfund the marital deduction and rely on portability using a QTIP trust, without the IRS disqualifying the part that would be absorbed by the decedent's estate tax exemption. So, why might we want to overfund the marital deduction? To get that double tax basis step-up!

Relying on a single QTIP funding formula and portability provides all the protective benefits available through trusts, as well as full use of the decedent's GST tax exemption (which isn't portable), and

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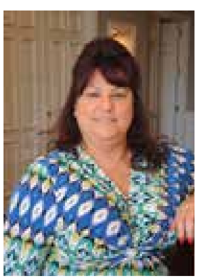
now also a significant additional income tax advantage. As mentioned, when a person dies, their assets receive a cost basis step-up, so that all capital gains through date of death are eliminated. Generally, when a trust is established using the decedent's estate tax exemption, those assets receive a cost basis step-up at the time but not again on the surviving spouse's death. Utilizing a single QTIP trust and portability, however, forgoes the current use of the first decedent's estate tax exemption by overfunding the marital deduction and relies on portability so that the exemption is not wasted (the decedent's exemption is passed to the surviving spouse for use on their death). Pursuant to Code Section 2044, the assets in the QTIP trust will be included in the estate of the surviving spouse, the DSUE along with the survivor's exemption will be applied so that both spouses' exemptions will be used, and those assets will receive a second cost basis step-up. As a result, utilizing an estate plan that relies on a single QTIP testamentary trust funding formula offers its traditional advantages, but now also the ability to secure a second basis step-up on the death of the surviving spouse. This planning also proves to satisfy all planning objectives because the executors of the first deceased spouse can make an election called a "reverse QTIP election" under Code Section 2652(a)(1), which preserves the first decedent's GST exemption, whereas without this special rule the GST exemption would be lost.

In summary, this planning protects the wealth passing to a surviving spouse from unfriendly hands, preserves both spouses' GST exemptions, and secures a double basis step-up on assets included in the estate of the first deceased spouse's estate. The key, however, is how the base estate plan is drafted, because relying on portability won't always be best. For estates likely subject to estate tax on the survivor's death, and where the surviving spouse is likely to live an extended period after the first death, it may not be advisable to rely on portability by overfunding the marital deduction using a single QTIP trust. Capturing the estate tax exemption on the first spouse's death and sheltering future growth on that amount from taxation in the survivors estate, will often outweigh the benefits of a second cost basis step-up on the second death. What is important here to recognize, however, is that the single QTIP funding approach will provide flexibility and the opportunity for the executor of the estate to choose the best approach given the facts existing on the death of the first spouse. Other commonly used formulas do not provide this advantage. Having proper base estate planning documents, and qualified counsel during the estate administration process, come together in what we call Phase 4 planning (post death). Optimum results however, can only be secured if the base Phase 1 documents are written to secure those benefits.

SEC Slaps Standard & Poors - S&P Fails to Recognize its Prior Failures -

On January 21, 2015 the SEC announced a $77 million settlement with Standard & Poors in reaction to a "false and misleading" report it issued on mortgages in 2012. The SEC found that the data relied on by S&P was "flawed and inappropriate." Standard & Poors had ignored the concerns of one of its report authors, that the report amounted to "a sales pitch" for customers of S&P. The biggest concern of the SEC was that S&P did this after their failures leading to the Great Recession and their role in the subprime mortgage crisis.



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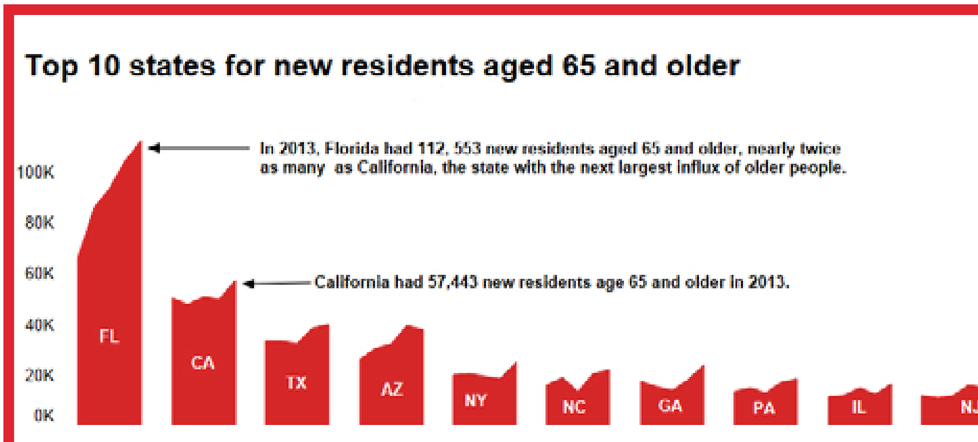

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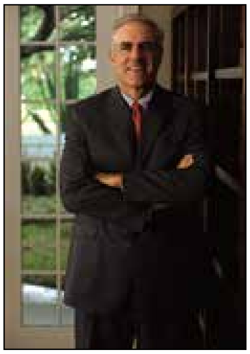

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Low Yields Drive Consideration of New Asset Classes
- Direct Ownership of Real Estate for Cash Flow Increases -

Many clients are searching for sources of yield, to increase their cash flow given the current state of the fixed income markets. One source we are commonly requested to investigate is managed rental real estate. Advantages of rental real property include higher yields and the ability to shelter some of that income through depreciation, amortization, and other deductions. If you are interested in exploring access to the investment real estate market, please contact us.

Loans to Family Members and Others ...... Be Careful

- Lending to Family Members has Gotten More Complicated -

In another of the many examples of legislation that goes too far, The Dodd-Frank Wall Street Reform and Consumer Protection Act became law in July 2010. The law was passed following the housing crisis in 2006 that led to record numbers of loan defaults and bank failures that created the Great Recession. Dodd Frank created a massive Federal agency named the Consumer Financial Protection Bureau ("CFPB"), purportedly designed to educate consumers, enforce federal consumer laws, and study consumers, financial services, and markets.

Dodd Frank has had a major impact on a number of our clients who engage in private lending. With limited exceptions, unless a private lender complies with Dodd Frank (Regulation Z and the Loan Originator Rules), a private lender can no longer make a consumer loan secured by a dwelling or real property that includes a dwelling. So, for example, if your daughter (and her husband) are buying a home and you want to finance the purchase and take back a mortgage to secure the loan (this provides some divorce protection), you are required to comply with Dodd Frank. The penalties for violating Dodd Frank are $5,000/day per violation, $25,000 per day for reckless violation, and $1 million per day for knowing violation. Courts may also grant rescission of the loan contract, refund of monies (interest), and payment of damages - possibly even to a son or daughter-in-law.

Does this mean you should not loan your child and his/her spouse money to buy a home? Not if you think your child (or his/her spouse) will default and invoke a Dodd Frank defense or report you to the CFPB. However, it does mean that if you engage in private lending to a consumer for a residential property, e.g., their residence, you should reconsider doing so if you cannot comply with Dodd Frank.

What if you want to sell a property and hold a mortgage from the buyer? If you are a natural person, estate, or trust and you provide seller financing for one property in any twelve month period you are exempt from the Loan Originator Rule and Reg Z. However, you must have owned the property securing the financing, not have constructed the property in your ordinary course of business, the financing cannot adjust for at least five years, and it must not have negative amortization.

If you are an LLC (limited liability) financing entity and the LLC finances the sales of three or fewer properties in any twelve month period, you are exempt if the LLC owned the property being financed, the LLC did not construct the property in its ordinary course of business, and the financing cannot adjust for at least five years and must be fully amortizing. In our experience, this will discourage most loans as LLC sellers do not want to hold 15 or 30 year notes.

If you still want to do private money lending, all is not lost. If the loan is for business, commercial, or agricultural purposes, the aforementioned rules do not apply. (These rules are aimed at residential (home) mortgages.) The borrower should be an entity such as a limited liability company, the property should not be for the borrower's personal residence (even the residence of the owner of the LLC), and you should document that the loan is for business purposes.

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