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Client Newsletter
By
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**Married Couples with Pre-2002 Plans
Need to Have Their Plans Reviewed
Immediately in Light of Estate Tax Laws
Which Became Effective January 1, 2010**

In our last newsletter (January 2010), we pointed out that those of our clients who had not had their trust agreements drafted or redrafted on or after January 1, 2002, need to have their estate plan and estate planning documents reviewed and likely updated, based upon the state of the current laws on estate and gift taxes, and the uncertainty that currently exists. If you have any questions, please review our last newsletter.

If you do not have a copy of the newsletter, one can be obtained by going to our website which is <http://www.HiltonHeadEstatePlanning.com> and looking under our "Client Newsletters" section. If you do not have access to the Internet, and can not find your copy of the newsletter, please give us a call and we will mail a copy to you.

Similar considerations apply to married couples and single individuals with Generation Skipping Transfer Trusts, even if executed on or after January 1, 2002. After we sent out the newsletter, we realized that there is still another somewhat smaller category of clients whose documents may be affected, even though they were updated on or after January 1, 2002. These are the documents with generation skipping transfer trusts. They may need review and updating because they too may have a formula allocation, based upon estate and

This newsletter is intended for the exclusive use of our clients who live in South Carolina. You have received this newsletter because, according to our file, we did estate planning work for you in the past and your primary residence is in South Carolina. If this is not correct, or we have mailed this newsletter to the wrong person, or if you have hired another attorney to take care of your estate planning work, or if you have moved out of state, or if you would otherwise like to be removed from our client mailing list, please let us know so that we can take you off of our client mailing list and/or move you to the proper list.

generation skipping tax law. Some will not, because during the planning we suggested what to do in the event that there was no generation skipping transfer tax; however, for good reasons, clients often choose not to take our suggestions.

Generation skipping transfer trusts are designed to continue for the lifetime of your children and then be distributed to your grandchildren, or possibly more remote descendants. Again, some, but not all, of these may also have formula provisions that may cause uncertainty. If you have any doubts, you should have it reviewed to be sure.

Please Visit Our Website. It is Up and Running and Fully Operational

After nearly six (6) months of working on our website, it is fully up and running and operational. It is what is referred to as a “content rich” website, which means that it would be hard to go in and review everything because it has many hundreds of pages of text and information. Some of the information is quite serious, and some is humorous (i.e., *Alice and the Mad Hatter* when they discuss probate).

The website is designed both for the general public, prospective clients and those of you for whom we have done legal work in the past, which we call returning clients on the website. There are numerous articles and information on estate planning, probate, elder law issues, estate and gift tax issues, and asset protection planning.

The website is also set up so that you can either perform a Google search for information, or a Pico search to find the information that you are looking for.

Also included on the website are special offers and discounts designed to encourage people to use the website. This includes not only prospective clients, but returning clients as well.

We also have “The Howell Blog” where we post new articles and information on estate planning, probate, and related matters. *What follows in this newsletter is the content of articles and information from our website.* Once this newsletter is published, it will also go onto our website and the Blog information will ultimately be removed and replaced with additional content.

As we have stated many times in the past, the cost of these newsletters has become more and more expensive. We believe that the day will come when we will only use the website to provide new information to our clients due to its cost effectiveness.

However, due to the uncertainty created by Congress, the state of the current economy, and to encourage the use of our website, we will likely send more updates and newsletters this year, than we have in the past.

Special April Newsletter Rate

As we often do with our newsletters in order to gauge whether or not they are being read and to encourage our clients to read them, for returning clients, we are offering a 15% discount for any estate planning work that we start during the month of April and finish prior to the end of May, with a minimum discount of \$250. However, no other discounts apply.

This basically means that in order to qualify, the first meeting has to take place in April and the signing must occur on or before May 31, 2010, which is in conformity with our usual time schedule for estate planning work.

Asset Protection Planning for Your Children and Their Families with a Spendthrift Trust

In today’s economy, more and more clients have adult children who need creditor protection. If

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you have children or other beneficiaries who are having problems with possible bankruptcy, judgment creditors, or other creditors, you should consider protecting them with a spendthrift trust.

A spendthrift trust can be set up to take care of your children and their families, yet have the assets protected from their creditors. These are assets that you would otherwise give to your children, outright, during your lifetime, or leave to them after your death.

These trusts often need to be tailor-made to the specific situation of the beneficiary. Much depends upon how serious the creditor problem is, the amount of the assets that will go into the trust, the type of assets, the number of children and grandchildren, the marital status of your children, their level of sophistication, and if there are any disabilities, including the inability to handle significant sums of money.

It should be kept in mind that a qualified trustee is needed. Often, unless the trust assets are significant, it is difficult to find a corporate fiduciary to take on the trust. Even if you can use one of the larger bank trust departments, some are charging minimum fees in the \$10,000-\$14,000 range, so it is expensive to have a bank or brokerage firm be the trustee.

If you use an individual trustee, it is often difficult to find a friend or relative willing to take on what may be a lifetime task with significant duties and also potential financial liability, if they do not properly manage the assets. You then have to consider who will be the trustee, if the trustee that you named can no longer serve.

Once these hurdles are taken care of, a spendthrift trust can give you the piece of mind of knowing that your children and their families are protected.

The Basics of Asset Protection Planning (For Yourself)

Asset protection planning is the process of arranging one's financial affairs both to preserve and protect assets in the event that creditor problems are incurred due to lawsuits, divorces, and high risk activities. Asset protection planning also involves preserving assets by avoiding or reducing income, estate, gift, and generation skipping transfer taxes.

Sometimes the creditor is someone who obtains a judgment, maybe because of a lawsuit or a foreclosure with a deficiency judgment, and sometimes it is just the Internal Revenue Service looking for tax dollars. At other times, it may be a spouse in a divorce proceeding.

Asset protection planning is not new and there is nothing unusual or dishonest about it. It is part of good financial and estate planning for protecting you and your family.

For years, estate planning attorneys have incorporated asset protection planning into their estate planning. Sometimes asset protection planning is simply structuring matters so as to reduce taxes. Often, estate planning attorneys protect their clients' assets for family members by setting up trusts and/or entities, such as limited liability companies and limited partnerships.

These trusts and entities often protect the assets from income, estate, gift, and generation skipping transfer taxes. They also often protect the assets from the beneficiary of the trust making unwise decisions and wasting assets needed for their support.

Trusts for family members are often designed to mitigate the possibility that the assets can be reached by a creditor of the beneficiary or the spouse of the beneficiary, in the event of a

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divorce. These types of trusts are often called "Spendthrift Trusts."

It was made clear by our new trust code that these are allowable in South Carolina. They are effective tools to protect assets; although, there are some limitations. They are also easier to establish under our new trust code than they were in the past.

However, they can not be used for self-settled spendthrift trusts. This basically means that you can not set up such a trust for yourself in South Carolina. Although you can not set them up for yourself, you can set them up for your beneficiaries, but there are some limitations. These limitations relate mostly to the beneficiary's obligation to support his or her own family.

Attorneys also often set up corporations designed to make sure that the creditors of a business can not reach beyond the business assets. Similar considerations apply to Limited Liability Companies, also called LLCs, which are often set up for similar reasons. Most businesses engage in this type of asset protection planning. This type of planning is also often incorporated into estate planning.

In states like Florida, North Carolina, and New Jersey (but not in South Carolina), assets are often held in both spouses' names as tenants by the entirety. With a tenancy by the entirety, creditors of one of the spouses can not take the property even by a judicial proceeding, unless the other spouse dies first or also has creditor problems.

Often, individuals engage in what is referred to as "Poor Man's Asset Protection Planning," which is simply transferring assets to their spouse's name. Obviously, this entails a different type of risk considering that the divorce rate is now in excess of 50%.

It also assumes that the spouse receiving the assets does not have any creditor claims or similar problems. The spouse with the assets should not be a co-signer or a guarantor on any loans; otherwise, they could find themselves with creditor problems at a later date. When using a spouse for asset protection planning, the idea is to try to make sure that the spouse with the assets is free of actual or potential creditor claims or problems. With the divorce rate being what it is, this type of planning should not be engaged in unless the marriage is very stable.

With respect to the divorce rate, another common form of asset protection planning when contemplating marriage is a Prenuptial Agreement. These are agreements that can protect assets from a marriage in the event of death, divorce, or other circumstances. Although these are helpful in a first marriage, they are almost a necessity in second marriages, especially if there are children from a previous marriage or relationship, who need to be protected.

Going back 20 or 30 years or so, individuals in high risk occupations began to set up offshore trusts to protect their assets from lawsuits and creditor claims. Such individuals usually transferred a substantial portion of their assets, but reserved certain benefits, and the assets were thought to be beyond the reach of their creditors. Often the laws of these countries do not honor or have limited recognition of judgments issued by United States Courts.

Even with these so-called self-settled spendthrift asset protection trusts, the countries where they are set up will not recognize them if there are creditors who are being defrauded, hindered, or delayed in the collection of their debts. However, often the burden of proof required by creditors as to whether they are being defrauded, hindered, or delayed, is much higher and much harder to prove than in the United States. In

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addition, the time limit for challenging the trust on these grounds is much shorter than in most United States jurisdictions.

One problem with offshore trusts is that many people are afraid to set up trusts and transfer significant assets into them, if they are in other countries. This is especially so since most offshore asset protection trusts are set up in small island republics that simply changed their debtor-creditor laws to attract trust business. However, they do not necessarily have armies, navies, and other infrastructure needed to protect themselves or the assets, or so it is perceived by many investors.

Some states such as Alaska, Delaware, Nevada, Missouri, Oklahoma, Rhode Island, Utah, South Dakota, Tennessee, and Wyoming, allow self-settled Spendthrift Trusts, which can compete with these offshore trusts. Such trusts are somewhat similar to the offshore trusts and are designed to own assets of high risk, high net worth individuals. Depending upon which state the trust is set up in, the persons setting up the trust can retain certain lifetime benefits and yet protect their assets from their creditors for themselves and for their families or other beneficiaries.

Also, many states protect retirement plans, annuities, and insurance policies from creditors without the use of these types of trusts, but there are differences. For instance, South Carolina offers more limited protection than a state like Florida. However, South Carolina protects wages from garnishment much more than Florida does, which has somewhat limited protection.

However, Florida has a more or less unlimited homestead exemption built into its constitution, which prevents creditors from taking the family homestead so long as it is not on more than ½ of an acre in a municipality or not more than 160

acres outside a municipality, no matter what its value. South Carolina offers a much more limited protection.

Whereas in the past, the most likely candidates for serious asset protection planning were high risk individuals such as certain types of physicians and those engaging in other high risk activities, now due to the current economic conditions, asset protection has come to those who were not considered to be a high risk. We received more inquiries in January of 2010, than we received in the previous 2 to 3 years combined, concerning asset protection planning.

The problem with most "asset-protection" planning is that you may not be able to successfully transfer assets to protect them if the purpose is to hinder, delay, or defraud a creditor from collecting their debt. This is because of what is referred to as the Statute of Elizabeth in South Carolina and what in others states is called the Uniform Fraudulent Transfer Act. If the statute is violated, then a creditor can undo the transaction and recover the transferred assets to apply against their debt; although, the process of doing so can be quite expensive.

These laws are somewhat different from state to state. Although there is some disagreement among practitioners, South Carolina's version may be one of the more strict versions of all of the states due to its very broad wording. It is considered pro-creditor by many practitioners. States such as Florida are somewhat more favorable to the debtor, as are a number of other states.

Many people wait until it is too late to engage in asset protection planning and there is not as much that can be done. The planning needs to be engaged in when there are no current or contemplated creditor problems.

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Notwithstanding the limitations, there are planning techniques that may be legitimately implemented in, which may protect assets in the event of serious creditor problems. However, the planning needs to take place before the problems become too serious. Otherwise, you have to employ damage control measures that entail much more risk, effort, and cost, and are much less certain.

Some of the planning works completely, while other types of planning serves more to give the debtor more room to negotiate with the creditor. This is due in large part to the fact that the creditor may have to engage in expensive legal processes to get at the assets that have been transferred to asset protection trusts, other persons, other entities, or that have been converted from non-exempt property to exempt property.

There can also be a fine line between legitimate asset protection planning as part of your estate planning and engaging in fraudulent transfers under the Statute of Elizabeth or otherwise unlawfully delaying or hindering a creditor. Again, this is a good reason to engage in the planning before matters have already become serious and the creditors are more or less known.

Sometimes people engage in their own asset protection planning or do so with minimal input and advice from a qualified attorney. Asset protection planning is not something that people should try on their own. It can be quite risky and a "trap for the unwary."

There are also many misconceptions and, quite frankly, a lot of bad advice on how to achieve asset protection planning. Even the best of plans designed by a qualified attorney can fail, much less one with little or no input from a qualified attorney.

Also, creditors' attorneys seeking to upset asset protection planning on behalf of their clients are getting better and better at their jobs. More and more employ the assistance of attorneys who have created and set up these asset protection plans and know where the weaknesses are and how to exploit them.

If you think that you may need to incorporate asset protection planning into your estate planning, then you should not wait until it is too late or, at least, very difficult to implement. Procrastination may also lead to having to declare bankruptcy.

With respect to bankruptcy, often people do not realize that there is a difference in terms of property that is exempt in a bankruptcy proceeding and assets that are exempt from judgment creditors, if there is no bankruptcy. Sometimes bankruptcy becomes the only viable option. In other cases, it is best not to declare bankruptcy because you may lose, or have severely limited certain protections that are granted under state law.

These are complex matters that require careful planning and not an impulsive act. Asset protection planning is a serious legal matter and should not be engaged in or considered without the advice and input of a qualified attorney who can fully assess the planning options and then help implement the plan.

For those of our returning clients who are seriously interested in estate planning that incorporates asset protection planning into it, we have educational CDs that you can borrow, listen to and return. If you have a serious interest in asset protection planning and want to borrow the CDs to learn more, please give us a call and we will arrange for you to pick up the CDs.

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As far as the cost of serious or significant asset protection planning, it is much more expensive than normal or standard estate planning. We provide estimates for normal or standard estate planning services in our fee schedules, but it is difficult to do so when a major focus is asset protection planning.

For this reason, we can only provide estimates on a case by case basis. However, just to arrive at an estimate normally takes several hours of meetings and information review.

We charge hourly for all time that we spend on a case, subject to a credit for up to one hour of attorney time against any charges for the initial consultation. For new clients, please review the Free Consultation section of our website for more detail. In addition, you need to listen to the CDs prior to coming in to obtain the credit. Note that for asset protection planning, the credit is also for returning clients, and not just for prospective clients.

Don't Forget to File Gift Tax Returns

During this income tax season, please make sure that your income tax return preparer knows if you have made any gifts during the year. In certain cases gift tax returns are required to be filed even if there is no tax due. In other cases, it can be advisable to report all gifts whether or not they require the filing of a gift tax return.

Some years back Congress changed the laws with respect to the finality of gift tax returns to help with the preparation of estate tax returns but in the process, made things somewhat more complex. Basically, if you report a gift and provide all the details on a gift tax return, the statute of limitations will run on the gift usually in three (3) years similar to the manner that the statute runs with respect to income tax returns.

However, even if you file a gift tax return but do not report one or more gifts or do not report them completely, there is now no statute of limitations. The opposite is true of an income tax return. If income tax returns are filed and items are inadvertently left off, the statute of limitations will run on the income normally in about three years in most cases.

In some instances, where there are substantial unreported amounts, time limits can be longer. Again, the same is not true with the gift tax return. There may be no statute of limitations.

For all the above reasons, please make sure that if you made any gifts, you report them to your income tax return preparer so that he or she can consider filing a gift tax return. My suggestion is that if there is any doubt, the doubt should be resolved in favor of filing a gift tax return and reporting all gifts.

If you have engaged in any estate planning that involves the transfer of assets to a third party, make sure your income tax preparer knows about these. This also applies if you set up Charitable Remainder Trusts or Irrevocable Life Insurance Trusts.

Also, if you are ever late in filing gift tax returns, it is often better to be late than not file at all.

Carryover Basis on Inherited Assets or Stepped-Up Basis? Only Congress Can Tell

One consequence of Congressional inaction, in addition to there being no estate tax as of January 1, 2010, has to do with the tax basis of inherited assets (other than IRAs, annuities, pension type benefits and other "income in respect of decedent" assets).

In the past, when someone died and you inherited their assets, such as stocks or real

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estate, you took as your tax cost basis, for taxable gains purposes, the fair market value of the assets as of the date of death of the decedent.

This means that when you sold the asset, you basically subtracted the basis from the sales price to arrive at your taxable gain on the sale. Usually, with “ever increasing values”, the date of death value was significantly higher than the decedent’s cost basis, if the decedent owned the asset for a long period of time. This meant that by inheriting the asset and getting a “stepped-up” basis, your taxable gain on the subsequent sale was often less than if it had been sold by the decedent.

As of January 1, 2010, generally, you take the same basis as the decedent had, which is called the carryover basis. In theory, if a decedent held an asset for a long period of time, his or her basis would normally be less than the date of death fair market value, which meant that the taxable gain on the subsequent sale and resulting income tax would usually be higher with a carryover basis. However, with the stock market and real estate market over the last 10 years or so, this may not be the case.

Additionally, there are special rules as of January 1, 2010 providing for a step-up in basis of \$1,300,000 in assets and an additional \$3,000,000 for marital deduction assets. What this means is that for most decedents, the new rule may not have a significant impact over the old rules, but it can and will require additional analysis.

So far, almost all tax practitioners have ignored the problem on the theory that it would never actually come into being, but it is here. However, although it is currently the law, most practitioners and commentators believe that Congress will retroactively reinstate the law as it was in 2009, or something similar, and go back to stepped-up basis.

What Congress will actually do, is anybody’s guess these days. However, we do want you to be aware of the potential issues and possible need to thoroughly evaluate the sale of significant inherited assets prior to sale. Keep in mind that similar considerations apply to selling assets while you are alive that might otherwise be inherited by family members upon your death. Lastly, please keep in mind that there may be other adjustments that may need to be made that are not discussed here. This is not an exhaustive analysis and you should consult with your CPA, if you have any questions.

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