Insight on estate planning

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Plus!

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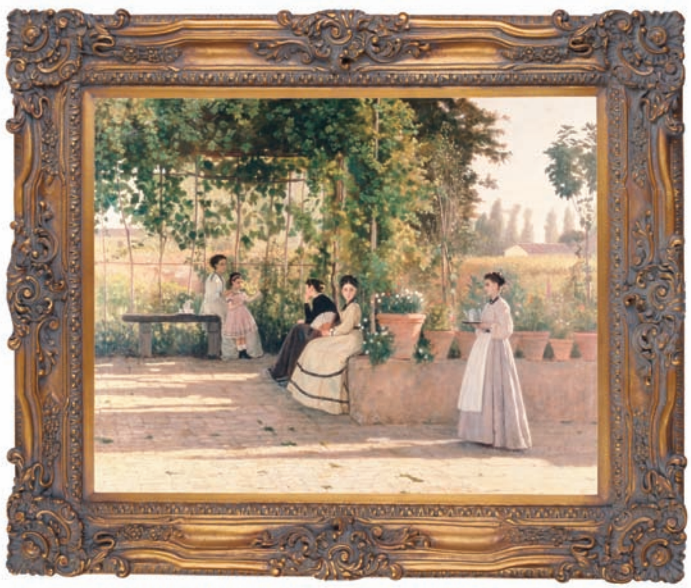
What to do with the collectibles?

Incorporate them into your estate plan

Collectibles such as art, antiques, jewelry, stamps, coins and automobiles may make up a significant portion of your estate. To avoid unnecessary estate taxes, administrative and legal fees, and other costs involved in settling your estate, it's smart to incorporate these assets into your charitable giving and estate plans.



Valuing the assets

When planning for the disposition of your collectibles, have a credible appraiser value them. Why? Because an incorrect valuation could subject you to additional taxes, penalties and interest. The value of property for federal gift, estate and income tax purposes generally is its fair market value (FMV), which is why establishing this value is essential.

In instances where gifts or bequests of art are valued at $20,000 or more, IRS auditors may refer the appraisal of the gifts to an Art Advisory Panel of the IRS. The panel's findings are adopted as the IRS's official position on the art's value.

Donating to charity

Gifting art and other collectibles to charity can provide you with significant tax savings. For example, you avoid capital gains taxes. This can be particularly advantageous for collectibles, which are taxed at a 28% long-term gains rate, rather than at the 15% rate that applies to most capital assets.

If the charity's use of the donated property is related to its tax-exempt purpose, you're also entitled to a charitable income tax deduction equal to the property's FMV — up to 30% of your adjusted gross income (AGI). Otherwise, your deduction may be limited to your cost basis (up to 50% of AGI).

If you donate a painting to a museum for display or to an art school for use in one of its classes, for example, the use is related to the charity's exempt purpose. If the charity sells the painting, however, it's not used for a related purpose, and your deduction may be limited to your basis.

If you give away your collection gradually and it continues to appreciate, your deductions will grow with each donation. Giving collectibles away gradually also can help you avoid losing deductions that exceed the 30%-of-AGI limit. Although excess deductions can be carried forward for up to five years, you may lose the deductions permanently if a work or collection is extremely valuable.

If you'd like to keep your collection together but aren't ready to completely give it up, you can give a fractional gift by donating an undivided percentage interest in your collection. For example, if you donate a 50% interest in your art collection to an art museum, the museum can display the art for six months each year, and you can deduct 50% of the collection's fair market value and also enjoy the art for the remaining six months of the year.

A bargain sale is another option to consider if you wish to give your collectibles to charity. If you sell appreciated property to a charity at a price lower than its FMV, you're allowed a charitable deduction for the difference between the sale price and the FMV.

You must allocate the property's cost basis between the gift element and the sale element, based on the FMV of each part. You'll recognize a taxable gain on the difference between the sale price and the cost basis allocated to the sale element, but you won't be taxed on the gain allocated to the gift element.

Gifting to heirs

If you wish to leave collectibles to your heirs, make specific bequests in your will or living trust. If you transfer collectibles through residual gifts — as part of the property that's left after other beneficiaries receive their bequests — the recipient may be faced with tax liabilities. For example, he or she could become accountable to the estate for taxes related to the piece.

You also can transfer collectibles to your loved ones during your life. Tax-advantaged ways include:

Annual exclusion gifts. Gifts of collectibles can qualify for the $12,000 per beneficiary annual gift tax exclusion ($24,000 per year for married couples). Collectibles you gift in this manner are entirely removed from your estate.

Lifetime gift tax exemption. If you've already used your annual exclusion for a particular beneficiary or want to make gifts in excess of the exclusion, you can use your $1 million lifetime gift tax exemption ($2 million for married couples) to make gifts of collectibles without incurring federal gift tax.

Art LLC or art partnership. You can place your art or other collectibles in a family limited liability company (an Art LLC). Even though it can be fairly complex, an Art LLC can be a convenient vehicle through which to manage and control a collection,

What are my collectibles worth?

Follow these guidelines when having your collectibles appraised:

1. Assemble background information on each piece of property, including the sales receipt, details of how you acquired the piece, and the history of the piece.
2. Schedule an appraisal consultation with an accredited appraiser. Choose an appraiser who charges an hourly rate or flat fee. Reputable appraisers won't offer to sell your items for you or base fees on a percentage of an item's worth.
3. Request a report from your appraiser that gives a fair market value of your collection that complies with the latest IRS requirements. The appraisals should be performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP).
4. Keep your appraisal report with your other estate planning documents. Appraisal reports are recognized by courts as reliable testimony to the worth of your possessions.
5. Have your appraisal updated approximately every five years. Market conditions can change, potentially affecting the value of an item. A regularly updated appraisal can help an appraiser better determine what your possessions might be worth in the future or at the time of your death.

regardless of who the owners of interests in the LLC might be.

And if you gift interests in the Art LLC to family members or trusts, an appraiser likely can apply discounts to reflect that the gifted LLC interest isn't readily marketable and doesn't permit the recipient to control the entity's affairs. Such discounts can reduce the gift tax cost on the transfer of the interest.

Devising your best plan

You have many options to consider when gifting your art or other collectibles to charities or loved ones, while enjoying significant tax savings for your estate. Be sure to explore these and other methods for transferring your valuable assets to determine the best technique for you. ▮

Trusting your heirs

The ins and outs of an inheritor's trust

Multigenerational trusts have existed for many years, but an inheritor's trust puts a different spin on the age-old strategy: It allows heirs to take control of their future inheritance.

An inheritor's trust lets you transfer wealth to future generations. It's similar to a dynasty trust, except your heir creates the inheritor's trust — with your permission — to receive his or her inheritance in trust rather than outright.

Assessing the benefits

Having assets pass directly to a trust not only protects them from being taxed on future transfers, but also shields them from other creditor claims, such as divorce. For example, if your son is having marital problems and is concerned that his inheritance could one day become community property, establishing an inheritor's trust can provide asset protection. Why? Because everything you gift or bequeath to the trust (including growth and income from the trust) is owned by the trust, and therefore can't be treated as community property. An inheritor's trust can't replace a prenuptial or postnuptial agreement, but it can provide a significant level of asset protection in a marriage.

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An inheritor's trust provides other benefits as well, such as:

Wealth building opportunities. If you fund an heir's trust before you die, your loved one can use a portion of the money to, for example, start a new business. In addition to starting a business, a prefunded inheritor's trust can own the general partnership interest in a limited partnership or the voting interest in an LLC or corporation. If you decide to fund the trust now, your initial gift to the trust can be as little or as much as you like.

Protection from creditors and lawsuits. Because the trust, rather than the heir, legally owns the inheritance, and because the trust isn't funded by the heir, the inheritance is protected from the heir's creditors and claimants in lawsuits.

Avoiding the awkward

You can't discuss estate planning without talking about death and money, two sensitive and often uncomfortable topics for discussion even among close family members. But families who wait too long to have estate planning discussions may miss the opportunity because of a sudden incapacitating illness or death.

Make the best of a potentially awkward conversation by focusing on positives, such as the financial security that planning now will provide for your family. Open communication and organized planning can help ensure that your money and property are distributed according to your wishes — and without being whittled away by unnecessary estate taxes — for generations to come.

Additionally, other than modifying your will or living trust to indicate that your heir's inheritance will be directed to the trust already created on his or her behalf, your estate plan will not be affected.

Creating the trust

To ensure full asset protection, your heir must create an inheritor's trust before he or she receives the inheritance. The trust is drafted so that your heir is the investment trustee, giving him or her power over the trust's investments. Your heir then selects an unrelated person — someone whom he or she knows well and trusts — as the distribution trustee. The distribution trustee will have complete discretion over the distribution of principal and income, which ensures that the trust provides creditor protection.

Your heir should design the trust with the flexibility to remove and change the distribution trustee at any time and make other modifications when necessary, such as when tax laws change.

Your heir sets up the trust and will incur the bulk of the fees, which will vary depending on the trust. In addition, he or she may have to pay annual trustee fees. Your cost, however, should be minimal — only the legal fees to amend your will or living trust to redirect your bequest to the inheritor's trust.

Gifting control

Think an inheritor's trust is right for your family? Before you give your consent, your heirs should consult with an estate planning professional to ensure the trust is established in accordance with tax codes and laws to avoid potential IRS audits and court challenges, and to maximize protection of their inheritance.

All in the family

A GRAT can help transfer ownership in your business to your heirs

You've spent most of your life building a profitable company. And now that you're approaching retirement, you want to establish a tax efficient way to transfer ownership in your business to your children while maintaining a significant income stream for yourself. A grantor retained annuity trust (GRAT) could be the answer.

How GRATs work

A GRAT can transfer all or part of the value of your business to your heirs — and typically without the burden of estate taxes. As grantor, you transfer stock or other assets to this irrevocable trust.

In return for your contribution, the trust pays you annual payments for a specified term, allowing you to enjoy a cash stream while giving up control of the trust assets. At the end of the trust term, the assets' value and all future appreciation are no longer in your taxable estate. With a GRAT, the annuity payments are a fixed percentage of your initial contribution's value. (Note that, with a grantor retained unitrust (GRUT), the annuity payment is a fixed percentage of the trust's assets recalculated on a periodic basis.)

The payment amounts, the term of the trust and an IRS-determined interest rate determine how much of a taxable gift has been made. You can cancel out any gift by setting up the trust so that the value of the annual annuity payments is equal to the value of the shares contributed to the GRAT, often referred to as a "zeroed-out" GRAT.

At the GRAT term's end, the remaining assets are transferred free of gift or estate taxes to your heirs, the trust's beneficiaries. How can there be assets remaining if the value of the annuity is equal to the value of the contributed shares? Because the value of your business can grow at a higher rate than the IRS-determined rate.

Keep in mind that, because a GRAT is a "grantor trust," you pay any income taxes on the trust's earnings. But you should look at this as an additional tax-free gift to your heirs.

GRAT in action

An important caveat, however, is that you must survive the trust's term. If you don't, the GRAT assets will be included in your taxable estate. Let's say your closely held business is valued at $5 million. Your company is on track to double its revenues and profits within five years, which will cause its value to appreciate significantly.

Because you're approaching retirement, you want to gift your company stock to your son, Jack, who's the vice president. If you make direct transfers during the next five years, your tax-free gifts will be limited to the annual exclusion amount of $12,000 ($24,000 if married and consent to a joint gift) and the $1 million gift tax exemption ($2 million if married and consent to a joint gift).

If you create a GRAT instead, you can direct the future appreciation in your stock to your son with little or no gift tax. You can contribute your stock to a five-year GRAT and receive the annuity payments during the next five years.

If the stock in the GRAT doesn't garner adequate income to fund the annuity payments, the principal of the trust will be distributed back to you to satisfy the payments. Exercise caution if you gift non-income-producing assets without a readily ascertainable market value to a GRAT.

At the end of the five-year period, Jack will receive the remainder of the trust — the stock. In addition, the GRAT can help transfer your stock's appreciation in value during the term of your annuity — passing gift-tax free.

Is a GRAT great for you?

With research and planning, a GRAT can help reduce the size of your taxable estate, maintain a cash flow for your retirement and transfer interests in your business to your heirs in a tax efficient manner. And because a creditor typically can make a claim only against a grantor's retained income interest and not the trust's assets, a GRAT can stave off creditors.

An estate planning professional can help you determine if a GRAT is the right option for your estate plan. ∎

Estate Planning Pitfall

Someone may challenge your durable power of attorney

You're getting ready to sign a durable power of attorney for property to appoint someone you trust to handle a broad range of financial transactions, from paying bills to managing your portfolio to selling your real estate, should you become incapacitated. But you're afraid a family member may disagree with the person you're designating as your agent and will question your competency.

A relative could, in fact, take action to challenge your durable power of attorney in court. So before you're dragged into a legal battle, use these strategies to protect your agent choice:

Consult an estate planning lawyer. Doing so gives you peace of mind that you have the proper documents in place.

Get a note from your doctor. Your doctor can attest to your mental competency in writing. Be sure that he or she signs and dates the statement and ask your attorney to attach it to your durable power of attorney document as proof that you were mentally competent at the time of the signing. If necessary, your attorney also can testify that you were of sound mind.

Round up witnesses. Sign critical documents in the presence of witnesses. Then ask each witness to sign a statement declaring that you signed the documents voluntarily and with a sound mind. Statements from your witnesses can serve as further proof of your competency should challenges to your durable power of attorney for property arise.

Show and tell. Adding a second layer of protection with a videotaped statement of your intent to make and sign the durable power of attorney can be a good idea.

About Us

Tarlow, Breed, Hart & Rodgers, P.C. is committed to providing high quality, comprehensive legal services to its clients. Formed in 1991, we have focused our practice on offering sophisticated legal counsel to entrepreneurs, businesses, individuals, families and institutions. We offer expertise in corporate law, employment matters, mergers and acquisitions, litigation and dispute resolution, estate planning, taxation, real estate, bankruptcy and municipal law. Our objective is to help clients make informed decisions and achieve their goals. By carefully listening and utilizing our expertise and firm resources, we find creative solutions for our clients. This approach has resulted in lasting relationships of trust and confidence with our clients.

Our seven core practice areas cover a range of issues that face our clients.

Corporate Law and Business Transactions

Our Corporate Law and Business Transactions Group represents entrepreneurs and businesses in all aspects of business law including choice of entity, contract negotiations, mergers and acquisitions, employment matters and financing transactions.

Litigation and Dispute Resolution

Our Litigation and Dispute Resolution Group has extensive experience in complex commercial litigation in all state and federal courts, involving contract disputes, shareholder rights, environmental litigation, employment law, probate litigation and many other areas.

Estate Planning and Administration

Our Estate Planning and Administration Group provides sophisticated wealth transfer and estate planning strategies to individuals and families, with special emphasis on developing business succession solutions to family—owned businesses. We represent clients in all aspects of the administration of decedents' estates and family trusts.

Real Estate

Our Real Estate Group provides effective and efficient legal counsel to developers, investors and banks in all aspects of commercial and residential real estate transactions and financing.

Taxation

Our Taxation Group has extensive experience in planning and structuring business and financial transactions in order that the lowest legal amount of federal and state taxes are imposed on our business and individual clients.

Municipal Law

Our Municipal Law Group acts as special counsel to municipalities in various environmental, tax title and bankruptcy matters.

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Our Hospitality Group has extensive experience in every phase of restaurant and lodging operations and development.