

Cohen and Burnett, PC Legacy Analytics, LLC

Autumn 2005

Estate and Financial Planning Update



Founding Partner



I. Mark Cohen
JD, LLM & CFP™

It's October. It is my favorite month to be in Virginia. The kids are in the thick of school again. Michael is a junior at Thomas Jefferson High School, and he is taking a very ambitious schedule, and doing very well. In addition to the classes, he is a theater critic and associate editor of the school newspaper and literary magazine. A nice benefit of this job is that he and I get to see every new play that opens at the Arena Stage in DC. Last night we saw "Born Yesterday." If you want to see his reviews send me an email and I will attach it in the reply. Rachel continues to be an outstanding sophomore at Marshall in the Latin IB program. In addition to being a top student, she plays clarinet in the band, works part-time scooping ice cream at Baskin and Robbins, works out with me most mornings, and is learning to drive. Kathy and I are pleased to see that her job has given her a healthy appreciation for employment, customer service, and the value of a dollar.

Kathy continues to teach part-time and run the household. She is also very happy with her new car now that we set aside her old car for the kids to use.

I continue to work on my Uniform Trust Code book most of the time when I am not in the office. I am still on track to have it completed by the end of the year.

Beneficiary of a "Stretch" IRA

New PLR Clarifies Trust as Beneficiary of a "Stretch" IRA

We get this question all the time: "If I name my trust as the beneficiary of the IRA will it qualify for the "stretch IRA" and if so, whose life expectancy will be used?" The answer to the first question is "yes," and we have written on that in earlier editions of this newsletter. See our website if you can't find your earlier issues.

The second answer continues to be that the life expectancy of the oldest in the group of beneficiaries is to be used. In the typical case where it is your children, the difference in life expectancies between the youngest and oldest is not material. However, what if say grandchildren are included or the age difference is otherwise large? We often provide for continuing trusts for grandchildren ending at age 35 where their parent is not living (or disclaims the inheritance).

A new Private Letter Ruling (PLR 200537044) clarifies that if the separate shares for the grandchildren or other trust beneficiaries *are designated in the IRA beneficiary form* then they will be treated as separate beneficiaries for purposes of the life expectancy calculation. This can get complicated because the amounts or percentages going to each beneficiary's separate share must also be designated in the IRA beneficiary form, but at least we have some guidance now on how to do this.

I am sure that many of you are wondering, "*What is the bottom line to me?*" If you have big differences in the ages of the trust beneficiaries and a large IRA where the stretch feature is important, there is a way to make it work, but we should review the trust and IRA beneficiary designation form to make sure it happens correctly.

Cohen & Burnett, PC and Legacy Analytics, LLC
7601 Lewinsville Road, Suite 460, McLean, VA 22102
Cohen & Burnett (703) 847-8900 Legacy Analytics (703) 847-0965
Fax (703) 847-8902
www.cohenandburnett.com www.legacyanalytics.com

Managing Partner



Weston D. Burnett
JD, LLM & CFP™

Through several clients I have been exposed in the past months to what events are like in New Orleans and in Iraq; very sobering in both cases.

For my mother's 81st birthday party we brought her over from Annapolis. Our son Edward was home from his deployment to the Mediterranean on orders to attend a Navy school for three weeks. There was way too much laughing and everyone was talking at the same time.

During law school I had one interview with a Navy recruiter and signed on for what turned out to be 27 years. My son, David, at UVA in his second year, expects 50 interviews in one month. He'll sort out which law firm he will work for next summer and probably stay with after he graduates and starts practicing law. A cast on his right arm, earned in a bicycle accident, has made wearing a suit jacket and tying his tie and shoe laces decidedly tougher.

David and daughter Jennifer are both teaching as part of their graduate studies. My wife, Barb, found it especially amusing to see both of them grading nights and weekends, when they were home for Edward's visit, as they had seen Barb do for decades as a math teacher.

For me, life and work is great. I love helping you. Our firm went to a Washington Nationals baseball game and some of our clients joined us. Some also joined us at the President's Cup, where we saw the top American and international golfers go head to head. Recently, I got to live out a fantasy by being allowed to drive cars very fast on a closed circuit course with just cones to guide me. The cones were still standing.

Buyers Beware of IRS Estate Tax Liens

Always buy title insurance when buying a house from an estate (or anyone else).

Imagine purchasing a house from someone and later getting a nasty letter from the IRS stating that the seller owed estate taxes and the IRS is going to seize your house and sell it to cover the taxes, unless you pay up. (Gulp!) That is exactly what happened to three home buyers in *First American Title Insurance Co. et al. v. United States*, a recent US District Court case. Fortunately, the buyers sent the nasty letters to their title insurance company who paid the bill – over \$200,000.

Unfortunately, the title companies were stuck with the bill. Here is what happened. Mother, Roberta, died owning three houses and some closely held stock (read – hard to value stock). Daughter, Penny, was the executrix and heir. She titled the houses to herself and then sold them personally. The IRS audited the estate and increased the value of the closely held stock. Penny refused to pay and the IRS went after the houses. The title company sued IRS claiming that the tax liens should be divested when the proceeds were used to pay the expenses of administration, but they lost.

How did this happen?

Welcome to the special estate tax lien. Code Section 6324(a)(1) creates a special estate tax lien that attaches to the gross estate of a decedent for ten years from the date of death. The tax lien can be divested earlier if it is proven that the sales proceeds were used to pay estate expenses *with the specific approval of the court*. In this case, the probate court gave Penny permission to dispose of the property but it never specifically approved of the sales to the buyers.

What is the moral of this sad story? Always buy title insurance. You can never be certain that what you are purchasing will not be subject to a tax lien.

Great Court Room Moments

In a courtroom, a purse snatcher is on trial and the victim is stating what happened. Her testimony, ***"Yes that is him. I saw him clear as day. I'd remember his face anywhere."*** At which point, the defendant jumps from his seat, points his finger at her and shouts, ***"You are lying! You couldn't see my face! I was wearing a mask!"***

Laughing so hard it hurts.

There once was a young fellow who fell prey to a speed trap in a small southern town. The cop wrote him a ticket and then hauled him before the local Justice of the Peace. The Justice fined the young man \$200 and collected the money on the spot. The young fellow turned to go but was called back by the Justice and handed the old ticket. The speedster said, "Just what am I supposed to do with this? I paid my fine!" Whereupon the old J. P. replied, "Keep it, when you get three, you get a bicycle!"

A dog ran into a butcher shop and grabbed a roast off the counter. Fortunately, the butcher recognized the dog as belonging to a neighbor of his. The neighbor happened to be a lawyer.

Incensed at the theft, the butcher called up his neighbor and said, "Hey, if your dog stole a roast from my butcher shop, would you be liable for the cost of the meat?" The lawyer replied, "Of course, how much was the roast?" "\$27.98."

A few days later the butcher received a check in the mail for \$27.98. Attached to it was an invoice that read: Legal Consultation Service: \$250.

An 800 Lbs. Production



ROLLOVER DISTINGUISHED FROM TRUSTEE-TO-TRUSTEE TRANSFER

In a recent Private Letter Ruling (PLR) **200513032** a person died leaving his trust as the beneficiary of his IRA. The Trustee then requested, completed and submitted forms to complete the rollover of the IRA from the investment company to another investment company. The funds were moved to the new investment company and the next year, the Trustee received a 1099R for the entire amount of the IRA, requiring that the entire proceeds be included in income and losing the very valuable prospect of a stretch IRA. The Trustee then tried to reverse the earlier transaction but the investment company refused stating that the 60 days for a rollover had passed.

The Trustee then submitted a request to the IRS to waive the 60-day rollover requirement on the IRA distribution, claiming that failure to waive such requirement would be against equity or good conscience under the provisions of Code Section 408(d)(3)(I) and Revenue Procedure 2003-16.

The IRS denied the request on the grounds that since a rollover is not permitted for an inherited IRA, the 60 day rule does not apply so it cannot be waived.

There is a difference between a rollover and a trustee-to-trustee transfer. In a rollover, an IRA owner or spouse/beneficiary receives a distribution, and then rolls some or all of the distribution over into an IRA (or in some cases a qualified plan) within 60 days of the distribution. In a trustee-to-trustee transfer, an IRA owner or beneficiary transfers IRA benefits from one trustee or custodian to another. Note the distinction. An IRA or a spouse/beneficiary can do either a rollover or a trustee-to-trustee transfer. However, a beneficiary OTHER than a spouse is limited to a trustee-to-trustee transfer, and cannot do a rollover.

It's critical to understand that inherited IRAs cannot complete rollovers, and that any account transfers must be completed by trustee-to-trustee transfer. Attempting to complete a transfer by distribution and rollover will cause immediate, full taxation of the account proceeds – which may prevent decades of tax deferral for an existing designated beneficiary!

It is also important to note that, unlike other situations where "IRA rollover mistakes may happen," erroneous distributions from inherited IRAs cannot be remedied by trying to simply "put the funds back in the account," nor can the IRS grant rollover relief to fix the problem. With inherited IRAs, it's absolutely critical to "look before you leap", and fully understand the rules before making any distribution or transfer transactions.

Great Quotes: Nothing is more destructive of respect for the government and the law of the land than passing laws which cannot be enforced.

Albert Einstein

Laughing so hard it hurts.

The devil visited a lawyer's office and made him an offer. "I can arrange some things for you," the devil said. "I'll increase your income five-fold. Your partners will love you; your clients will respect you; you'll have four months of vacation each year and live to be a hundred. All I require in return is that your wife's soul, your children's souls, and their children's souls rot in hell for eternity."

The lawyer thought for a moment. "What's the catch?" he asked.

What's the difference between a good lawyer and a great lawyer?

A good lawyer knows the law. A great lawyer knows the judge.

What do you call a man with an IQ of 50? A lawyer.

What do you call a lawyer with an IQ of 75? Your honor.

What do you call a lawyer gone bad? Your honor.

What do you call a judge gone bad? Senator.

A judge, bored and frustrated by a lawyer's tedious arguments, had made numerous rulings to speed the trial along. The attorney had bristled at the judge's orders, and their tempers grew hot. Finally, frustrated with another repetition of arguments he had heard many times before, the judge pointed to his ear and said, "Counselor, you should be aware that at this point, what you are saying is just going in one ear and out the other."

"Your honor," replied the lawyer, "That goes without saying. What is there to prevent it?"

Money... it comes and goes.

Where Does the Federal \$ Come From and Where Does it Go?

If someone asked you where the federal government gets its money, you would probably say, "taxes," and you'd be right. The real question is, "What kind of taxes; and, how much each one does contribute to the total?"

Here's a quick summary:

- Individual income taxes – 43%
- Corp. Income taxes – 10%
- Social insurance & retirement receipts – 39%
- Excise taxes – 4%
- Estate & gift – 1%
- Customs duties – 1%
- Miscellaneous – 1%

What caught us a bit by surprise here were two items. The first was the relatively low percentage of government receipts derived from corporate income taxes, only 10%. Individual taxes – income taxes, social insurance, and retirement receipts – accounted for 82% of the government's income.

The second item was the figure for estate and gift taxes, slightly more than 1%. With all of the discussion and at times heated debate about so-called "death taxes," you might have guessed it to be higher. By comparison, excise taxes, those little nuisances that are added to things like your telephone bill, amount to almost four times the revenue collected by the estate tax. Hardly seems worth all the controversy.

On the spending side, most of the outlays fall into four key areas. These are:

- Health & human services (includes Medicare) – 23.7%
- Social security – 23.1%
- Defense – 19.1%
- Treasury – 16.3%

Those four items add up to more than 82% of what the government spends, and they're all pretty much "untouchable" as far as the political process is concerned. Incidentally, about 90% of the figure for "Treasury" is interest on the public debt – almost \$322 billion in interest payments for the past fiscal year.