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Estate Planning, Probate, Elder Law, Tax, Real  
Estate, and Business and Corporate Law

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## What's New in Estate Tax Reform

As we reported in our last newsletter, debate continues to rage in Congress over the status of the estate tax. Although the current law provides for a one-year repeal in 2010, a number of Republicans are pushing to make the repeal permanent. Unfortunately, the economic climate is taking a lot of the wind out of the sails of the proponents of a permanent repeal. We had indicated a year ago that most experts expected a compromise and that the amount of the applicable exclusion amount (credit shelter amount) would be set at a figure somewhere between \$3,000,000 to \$7,000,000 for each individual. With the deficits growing at an alarming rate, the news has changed.

Since 2001 when Congress passed the current tax bill, budget surpluses have turned to budget deficits, we had the September 11 attacks and entered war on two fronts, and Congress approved the Medicare prescription drug benefit. Some Senators who have previously supported full estate tax repeal are increasingly concerned with the budgetary implications of such policy.

The Congressional Budget Office (CBO) estimates a five-year budget deficit of \$1.18 trillion, and a ten year deficit of \$980 billion. These budget are projected based on current law, which means that their projections assume the resumption of pre-2001 tax levels in 2011. Couple this with the concerns over the transition costs of Social Security reform, Medicare drug benefits costs, and the continued cost of the war in Iraq and Afghanistan.

All this means that repeal seems extremely unlikely and the amount of the reform will not meet our earlier forecasts. It has been suggested (See AALU Bulletin No: 05-38 March 31, 2005)

that if any estate tax related legislation is considered this year, it will be estate tax reform and not repeal.

Estate tax reform proponents have considered a level of reform that should be sustainable on a permanent basis—a unified credit of \$2 million or \$2.5 million (\$4 or \$5 million per couple), a 45% tax rate, an increased unified credit for qualified family farms and businesses, and an increased annual exclusion from gift tax liability. This is supported by the fact that a credit of \$2.5 million would protect more than 99.5% of the American public from estate tax liability. It is our opinion that with the increasingly deteriorating budget outlook, reform is the most likely scenario and that repeal is not an option. At the very least such a bill would provide some certainty for estate planning purposes while providing relief for many families and businesses potentially subject to the estate tax.

All of this means that you will need to continue to review your current plan in light of the current and future changes in the tax laws and the changes that occur in the size of your estate. Our office will be happy to answer your questions and to suggest changes if necessary. It is YOUR plan; don't let it become outdated!

## Revocable Trusts—Do I really need one?

Living Revocable Trusts continue to be a hot topic. A lot of people push such trusts as a panacea for all of your estate planning problems. The truth is that living trusts are NOT the cure for all estate planning problems. It IS a cure for some problems in specific situations. Let's explore when a revocable living trust is appropriate.

First of all, a revocable living trust is a probate avoidance tool. This is its primary feature. It takes the place of your will as your primary estate planning document. The assets disposed of by the trust are not subject to the probate process and, therefore, are not subject to the delay and expense of the process. In addition the trust takes care of the same aspects as the will, i.e. tax planning, setting up trusts for minors, appointing personal representatives, handling contingent dispositions, etc. The process is private (handled by the family) as opposed to public (handled by the courts).

With all of the advantages, it sounds as though the living revocable trust is a slam dunk. It isn't that easy—there are other ways of avoiding probate that are less expensive and require less work. It really boils down to a cost/benefit analysis. With the average cost of a trust plan running twice as much as a plan with wills, which is truly the best and the most economical? Take for example a couple with a \$2.0 million estate made up of a home worth \$300 thousand and the balance in marketable securities, both of which are held jointly. There is no probate at the death of the first spouse because of the rights of survivorship. Since North Carolina does not allow beneficiary designations on brokerage accounts, at the death of the second spouse the probate charge alone on the securities is \$3,000.00. Add in attorney fees and the costs are prohibitive. This makes the cost of a revocable living trust at \$1,500.00 look very reasonable. What about the person who has property in several states? Some type of probate proceeding will be conducted in each state if a will is used. With a trust, no probate proceeding is needed in the various states.

The answer to the initial question is that there is no standard answer. Here is our rule of thumb: If we are dealing with (a) securities accounts or stocks which are not in retirement plans or annuities and which are valued at more than \$300,000 and/or (b) dealing with out of state real estate, then we typically recommend the use of a revocable living trust. There are other special situations where the living trust presents

significant advantages over a plan centered around wills: second marriage situations or situations where we want a step-up in basis on all of the assets at the first to die. We must decide on a case by case basis as to the appropriate method. Our goal is to educate our clients and allow them to make an informed decision. Call or email our office if you have questions.

## Medicaid Update

We receive at least 5 calls a week wanting to know how to shelter assets from nursing homes. The state and federal governments are facing increasing deficits and are scrambling to find ways to pay less on “welfare” programs such as Medicaid. It is becoming more and more difficult to preserve assets for the family and still qualify for Medicaid.

In general, in order to qualify for Medicaid, the institutionalized individual and his spouse must have **nonexempt** assets of not more than \$2,000.00. The key phrase is nonexempt. The noninstitutionalized spouse may have a community resource allowance allocated of \$19,020 (minimum) to \$95,200 (maximum) as exempt assets. The home is generally an exempt asset. Household furnishings, personal effects and an automobile are exempt assets.

If you attempt to transfer assets, you may be disqualified from receiving Medicaid for a period of time. If you have transferred assets within 36 months (the look back period) from the date that you apply for Medicaid, the disqualification is calculated by dividing the value of the transfer by \$4,200 and the result is the number of months of disqualification. For transfers from a trust created by you, the look back period is increased to 60 months. For example, if you gave a piece of real estate to your children that was worth \$100,000, then the disqualification period is 25 months.

In spite of the rules and regulations, there are a number of ways to preserve all or a part of

your assets in the event of institutionalization of you or your spouse. Some examples are:

1. Make the transfers and then wait 36 months or more before applying for Medicaid.
2. Purchase exempt assets with your liquid assets.
3. Pay outstanding debts on exempt assets.

These are just a few of the options available in planning for institutionalization. You must be very careful to consider the income, estate and gift tax consequences before you attempt to transfer any assets. Our office can assist you in putting together a plan that makes sense for you and your family.

### **Paying Your Tax Debt**

We hope you have filed your tax returns by April 15, or obtained an extension to file which will expire on August 15 of this year. If you weren't able to pay your taxes in full on April 15, there is hope. While failing to pay your taxes in full by April 15 does subject you to a penalty, there are alternatives available to lessen the burden of paying in full.

Before reviewing your payment options, we want to remind you that you should always timely file your return even if you can't pay the bill in full. Failure to file is a criminal offense and also generates an additional penalty of up to 25% of your tax owed. This penalty will be added to the failure to pay penalty and can result in a debt which is more penalty and interest than tax.

One key thing to remember is that IRS wants to be paid and will work with taxpayers to ensure that a full opportunity to pay is afforded to all. The first option to explore when the tax bill is due is your available credit – home equity lines, credit cards or family loans are all potential sources of cash to pay the tax bill. If your credit is exhausted, you can request an installment agreement from IRS. Such an agreement will allow you to pay your taxes without the worry over

garnishment, seizure of property or, in some cases, tax liens. If your liability is under \$25,000 and you can pay it off in one year or less, you can be assured of an installment agreement. There is a simple IRS form to complete to request such an agreement. We can provide you with information on this form or assist you in completing and filing it if you should so desire.

If your liability is over \$25,000 or if you will need more than one year to pay off the debt, you can still apply for an installment agreement. In this instance you will need to complete a financial statement for the IRS along with the application form for the agreement. Again, we can assist you with this process, if needed. In most cases the IRS will accept your application if the payments will result in the liability being paid off in five years or less.

In applying for an installment agreement, never propose a payment amount more than you can pay. You should also be aware that you must make all future tax payments in full and in a timely fashion to keep the agreement in place. Of course, timely filing of your future returns is also a requirement. The IRS's first goal is to get you back on track with timely filings and payments on future payments. Collection of old liabilities is important, but is a secondary goal.

If an installment agreement is not feasible or if you have a source of funds that the IRS cannot reach by its collection activities (e.g., a family member or friend willing to loan you the money), you can try an Offer in Compromise. Many TV lawyers advertise that they have settled IRS obligations for pennies on the dollar. While it is true that the IRS has a compromise settlement program, it is not as easy to qualify for as the installment plan. Approximately, 20 to 25% of offers submitted are accepted. The IRS process for review of offers in compromise is based on one criteria – will the IRS receive more from the offer in compromise than from an installment agreement or collection activities? If you have the ability to borrow funds or to make payments from your income, your offer may be rejected. However, if you have a source of funds that the IRS cannot

reach, you may be able to submit an offer to pay less than the full amount owed and have it accepted.

The IRS wants to make a deal. The agency is hampered by Congressional cutbacks in funding which has left many offices undermanned. If you communicate with the collection officers, you can almost always work out a feasible plan to catch up your old liabilities. We have had great success in assisting taxpayers in reaching workable agreements with the IRS. Hopefully, you will not need these services, but should the occasion arise please call upon us.

## Real Property Corner

A large portion of our practice concerns real property matters. Whether your need is for a residential purchase, residential refinance, commercial transaction, a 1031 tax-free exchange, or estate planning related to real property, we have the personnel and expertise to handle the legal requirements. Our close relationship with various lenders, builders, real estate agents and other parties involved insure that our office is equipped to smoothly guide you through the process. Our attorneys and staff have the training and flexibility to deal with all parties involved to make your real estate closing a pleasant and memorable day. Please think of us in regard to your real estate matters.

## Frequently Asked Questions About 1031 Exchanges

Everyone knows the basics of a 1031 tax-free exchange. Any real property held for productive use in a trade or business or for investment purposes can be exchanged for any other "like-kind property" in a tax-free exchange. However, as with many things in life, the devil is in the details. Every situation comes with

numerous questions and the proper answer is the difference between a successful tax-free exchange and an unsuccessful one.

One interesting and frequently asked question is whether or not you may exchange a vacation home as part of a 1031 exchange. The answer to this question depends on whether the party can fully substantiate that the home had been made available for rent for at least fifty out of fifty-two weeks in the year. If the owners have reserved no more than two weeks for personal use then in fact the vacation home can qualify. It is also important to note that the home did not need to be rented fifty weeks of the year, just that it was available for rent. If these circumstances cannot be met, then a vacation home would not qualify.

There are myriad other questions in this area. Some other questions involve whether or not vacant land is required to be bought if vacant land it being sold, whether rental property could be bought until retirement age and then moved into as a home, and how and when a reverse exchange is appropriate. Please call our office if you have any questions in this area and we will be more than happy to assist you.

## Advance Directives

The Schiavo matter has made everyone aware of the need to express your wishes as to your health care in the event of incapacity. EVERYONE needs to make a living will and a power of attorney for health care.

In North Carolina both the living will and health care power of attorney are authorized by statute. A living will states in advance a person's desire to receive, or to withhold, life-support procedures. The durable power of attorney for health care is a document that allows patients to specify in advance who should make health care decisions for them should they become unable to make their own health care decisions. We can draft these for you with only a phone call. The cost of the health care power is \$35.00 and a living will \$15.00. (No charge if we draft other documents). Call if you have additional questions.

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