the Estate PLANNER

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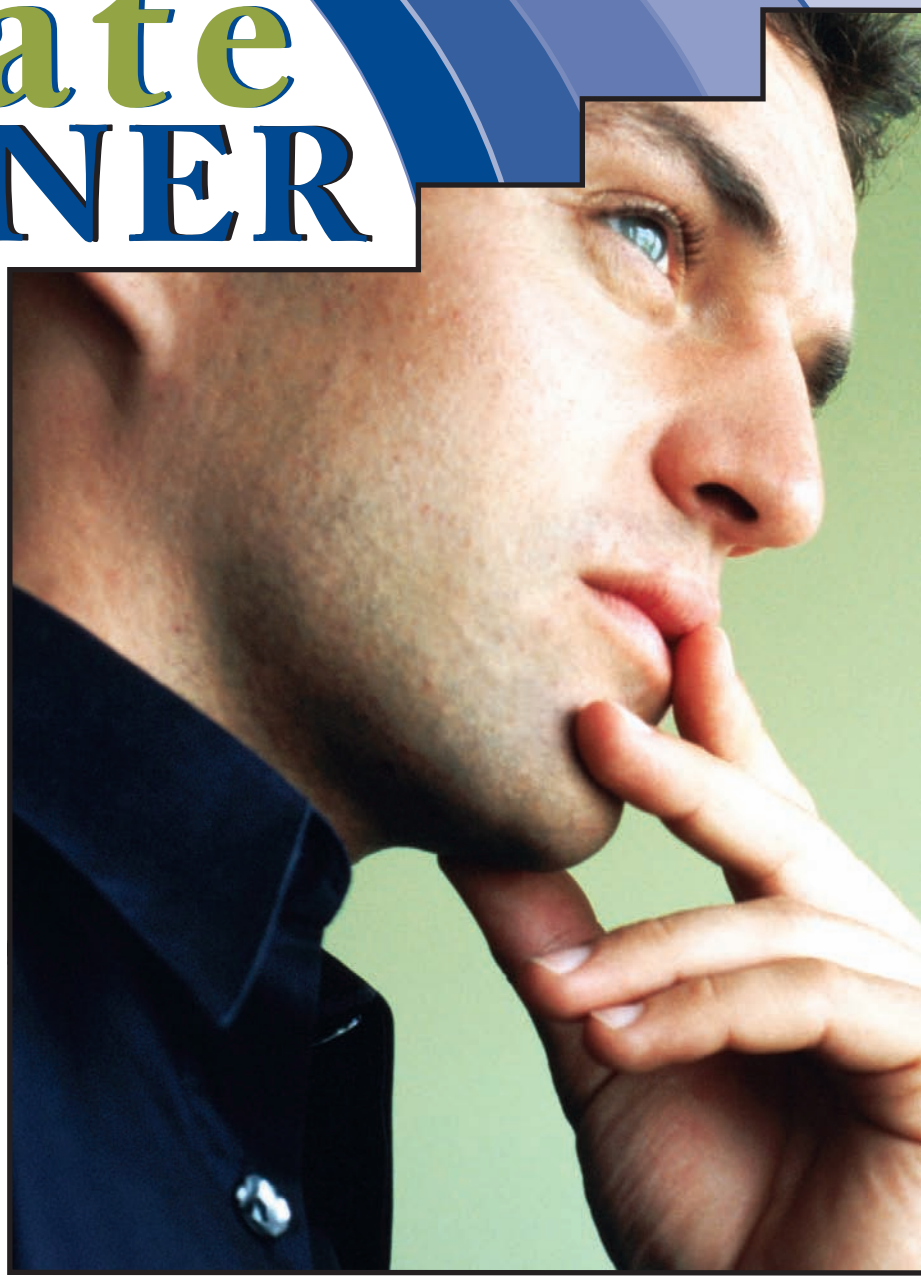

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Executor decisions

7 FAQs about being a personal representative

If a loved one asks you to be the executor or personal representative of his or her estate, it's important to understand what you're getting into before you say "yes." Here are the answers to seven common questions on the subject.

1. Are "executors," "personal representatives" and "administrators" the same thing?

Not quite. *Executor* (sometimes called *executrix* for a female executor) is the traditional term for a person named in a will to administer an estate. *Personal representative* is the modern term for executor, and is used in many states. (In this article, the term "executor" refers to both executors and personal representatives.) An *administrator* is someone appointed by a probate court to administer the estate of a person (decedent) who dies without a will.

2. What's the difference between an executor and a trustee?

If an estate goes through probate, the executor will have significant responsibilities. He or she must obtain the probate court's approval to administer the estate and fulfill a variety of duties. (See Question 3.)

Many people use revocable living trusts to avoid probate. As long as the decedent transfers title of all his or her property to a living trust, the estate can avoid probate, and a trustee — the person appointed to manage the trust — can fulfill many of the executor's duties. Often, the executor and trustee are the same person.

It's difficult to avoid probate entirely. Most people own at least some assets in their name when they die. Typically, a "pour-over" will is used to funnel these assets into the living trust. Probate is still required, but the executor's primary responsibility is to ensure that the assets are properly transferred to the trust.

3. What are an executor's duties?

An executor's specific duties vary depending on state law and the terms of the will. Typically, an executor is the person ultimately responsible for the disposition of the assets of the deceased. Thus, an executor:

- Consults, as necessary, with an attorney, CPA, and other advisors who will assist with whatever needs to be done,
- Arranges for probate of the will and obtains the probate court's approval to act on the estate's behalf,
- Takes custody of the decedent's assets, submits an inventory to the probate court, and obtains appraisals of real estate or other assets whose values aren't readily ascertainable,
- Notifies creditors of their rights and handles their claims,
- Pays the estate's debts and expenses,
- Manages assets — such as bank and brokerage accounts or real estate — and makes investment decisions,
- Files federal and state tax returns on the estate's behalf,

Choosing an executor

When planning your estate, you must choose an executor. Here are a few tips on choosing the right person:

- Choose a person with the financial experience and skills to handle the job. Even though executors can engage professional advisors, they'll need a certain level of competence in financial matters to make informed decisions.
- Many people are more comfortable naming a family member as executor. If you feel that the job would be too much of a hardship, or that your family lacks the requisite financial skills, consider naming a trusted advisor, such as your lawyer, accountant or investment advisor, to fill the executor's shoes. Or, you could name a family member and an independent professional as co-executors.
- Be sure to name at least one alternate executor in the event your first choice declines to serve, resigns, becomes incapacitated or dies before your estate is settled.
- If you have reason to believe that a beneficiary may challenge your will or that there may be conflicts among beneficiaries, try to choose an executor who's familiar with the family situation.

- Distributes the decedent's assets according to the terms of the will, and
- Makes a final accounting to the beneficiaries and the court.

If the decedent was well organized and prepared a schedule of assets, identifying and collecting property can be relatively simple. Often, however, it's the executor who must uncover hard-to-find assets.

4. Do executors get paid?

Yes. An executor's fee may be set by the will or otherwise provided under state law. Some states provide a fixed payment schedule. Others simply allow "reasonable compensation," which typically depends on the size and complexity of the estate and the time the executor devotes.

5. Can executors be held personally liable?

An executor may be personally liable to an estate's beneficiaries or creditors for certain errors and omissions or for mismanagement of assets. Examples include failing to file tax returns or pay taxes, making inappropriate investment choices, allowing insurance policies to lapse, and self-dealing (such as buying assets from the estate at below-market prices).

6. Can I get help?

Of course. Unless you're a professional executor, no one expects you to have the expertise to personally handle all of the work. You may hire CPAs, attorneys, investment advisors or other professionals — at the estate's expense — as reasonably needed to carry out your duties.

7. Do I have to take the job?

Many people are honored to be chosen by a loved one to serve as executor. But it can be a big job and you may not feel up to the task, especially during a difficult time. (See "Choosing an executor" above.) Even if you tell the decedent that you will be his or her executor, you're not legally required to do so.

If you accept the job and begin to fulfill your duties, however, you can't just walk away. You'll need to notify the probate court of your intention to resign and may need to submit an accounting to the court or meet certain other requirements.

Carry out your loved one's wishes

If a family member or close friend names you as the executor in his or her will, you may feel honored and overwhelmed at the same time. Because acting as an executor can be complicated, seek professional advice. ▮

Giving away your business without giving away the store

If you own a family business, a smart succession plan is essential. If you're like most business owners, a significant portion of your wealth is tied up in the business, so you'll be relying on it to generate income for your retirement and to provide for your family. Unfortunately, only one-third of family businesses survive the transition to the next generation.

Succession planning involves a variety of complex issues, such as identifying and grooming a successor, determining how to treat family members who aren't involved in the business, and ensuring sufficient liquidity to pay taxes and other expenses. It's also important that your succession plan include strategies to minimize the impact of gift and estate taxes.

Start early

The earlier you begin transferring ownership of the business to your children or other family members, the easier it is to reduce the tax bite. Currently, the annual gift tax exclusion allows you to make tax-free gifts up to $12,000 per recipient per year ($24,000 for gifts you "split" with your spouse).

Transferring the business gradually over time also allows you to take advantage of minority interest valuation discounts, which means you can transfer more of the business at a lower tax cost. Once you transfer a business interest, any future appreciation in value bypasses your estate, so there's a big tax advantage to starting early.

Stay in control

Many business owners are reluctant to relinquish ownership because they fear losing control of the business. But there are a variety of techniques you can use that allow you to start sharing the wealth without giving up control. Examples include:

Nonvoting stock. Giving away stock without voting rights is a simple way to transfer business interests to your family while retaining complete control over the company. Plus, nonvoting stock generally is less valuable than voting stock, so you can discount the transfer for gift-tax purposes.

Family limited partnerships (FLPs). With an FLP, you form a limited partnership to own the business (or your interest in the business) and then transfer limited partnership interests to your children or other family members. By maintaining a small ownership interest and acting as general partner, you retain the right to manage the business indefinitely. And because limited partners have less control over partnership affairs, the values of their interests are deeply discounted for gift-tax purposes. Keep in mind that the IRS tends to scrutinize FLPs, so it's critical to structure and operate them carefully to preserve the tax benefits.

Grantor-retained annuity trusts (GRATs)/grantor-retained unitrusts (GRUTs). Under the right circumstances, a GRAT or GRUT can be one of the most powerful tools available for transferring a business to family members at a low tax cost or even tax free, while you continue to control the business during the trust term. A GRAT pays you an annuity — based on the trust's initial value — for a specified number of years. The payments from a GRUT, however, are determined based on the annual value of the trust.

At the end of the term, the business assets are transferred according to the trust's terms. The assets may be distributed directly to your heirs, or the assets can be retained in the trust and held for the trust's beneficiaries.

The gift tax value is equal to the present value of your beneficiaries' remainder interest, calculated using a relatively conservative assumed rate of return published by the IRS (the Section 7520 rate). If you set the annuity payments high enough and the term long enough, you may be able to reduce the gift tax value to zero.

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GRATs and GRUTs aren't right for everyone. For the trust to be effective, several things must happen. First, you'll have to outlive the trust term; otherwise, the tax benefits will be erased. Second, the business must generate sufficient cash flow to fund the annuity payments. And finally, for a GRAT or GRUT to successfully reduce transfer taxes, the business's value must grow faster than the Sec. 7520 rate. Otherwise, the tax savings may be offset by the wealth returned to your estate in the form of annuity payments.

Employee stock ownership plans (ESOPs). An ESOP is a qualified retirement plan that invests in the company's stock. By selling your stock to an ESOP, you can create liquidity and diversify your

portfolio. And if the ESOP ends up with at least 30% of the company's stock and you reinvest the proceeds in qualified U.S. stocks and bonds, you can defer your capital gains. Even if the ESOP acquires a majority ownership interest, participants have limited power over the company's day-to-day operations, so you stay in control.

In addition to providing ownership benefits to family members and other employees, an ESOP generates a variety of tax benefits for the company, including tax deductions for ESOP contributions. If the ESOP is leveraged — that is, if it borrows money to buy company stock — the company can fully deduct contributions used to pay both interest *and* principal on the loan.

Looking ahead

If your business is young and your retirement is decades away, you may feel that you have plenty of time before you have to start worrying about succession planning. But the earlier you start to plan, the greater your ability to both groom an appropriate successor and minimize future gift and estate taxes. ▮

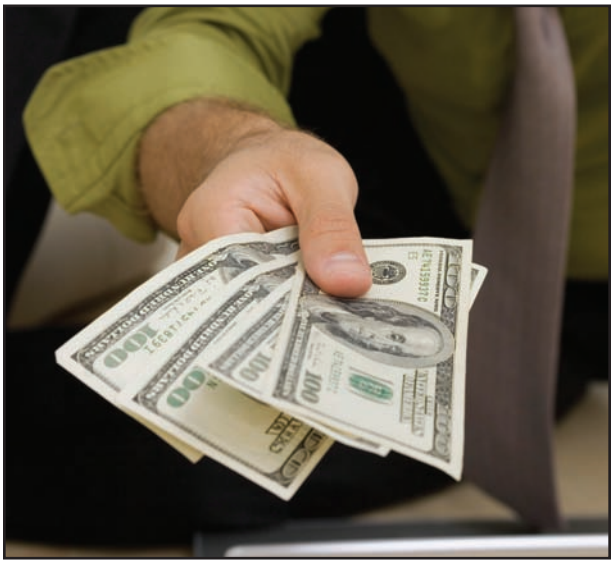
Intrafamily loans

It's personal *and* it's business

You may lend money to family members for very personal reasons, but if you don't treat the transaction in a businesslike manner, you can trigger unintended gift and income tax consequences.

Getting protection

When lending money to family members, the first question to ask is: "Is this transaction a loan?" If the IRS concludes that the transaction isn't a bona fide loan, it will recharacterize it as a taxable gift. By formalizing the transaction and treating it as a loan, you can avoid negative tax consequences and have the necessary documentation to support a bad-debt deduction in the event the borrower defaults.



The IRS and courts look at several factors in determining whether a transaction is a loan or a gift. Although no one factor is controlling, an intrafamily loan is more likely to be viewed as bona fide if:

- There's a written agreement,
- The borrower executes a promissory note,
- Interest is charged,
- There's a fixed repayment schedule, and
- The borrower actually makes the payments.

Not all of these factors must be present, but, the more that are there, the better your chances of the loan withstanding IRS scrutiny. And regardless of how much you plan, no strategy is bulletproof. The IRS still can recharacterize a loan as a gift if it determines that the loan's purpose was to avoid taxes.

Making the charges stick

If an intrafamily transfer is a loan, the next question to consider is: "Are you charging adequate interest?" A loan is considered below market if you charge less than a minimum interest rate, which is determined by the applicable federal rate (AFR).

The federal government periodically sets the AFR, and the rate varies depending on the type and term of the loan. For example, the minimum rate for a demand loan (one that's payable on demand or has an indefinite maturity) is the short-term AFR, compounded semiannually.

With a demand loan, the minimum rate varies during the life of the loan. So the easiest way to ensure that you charge enough interest is to use a variable rate that's tied to the AFR. With a term loan, use the AFR that's in effect on the loan date.

Giving the IRS a piece of the action

Below-market loans to family members have both income and gift tax consequences, and they differ depending on the loan type. For a demand loan, imputed interest is the difference between the AFR and the amount of interest you actually collect, recalculated annually.

Each tax year, you're treated as if you've made a taxable gift equal to the amount of imputed interest and the borrower transferred the money back to you as an interest payment. Depending on the loan's purpose, the borrower may be able to deduct this interest.

If interest is imputed to you, you'll owe income taxes on the fictitious payments. In addition, you may have to use up some of your $1 million

lifetime gift tax exemption or even pay gift taxes if the imputed interest exceeds your annual gift tax exclusion ($12,000 per recipient or $24,000 for gifts by a married couple).

Term loans are treated essentially the same way as demand loans for income tax purposes. But the gift-tax consequences are quite different. If you make a below-market term loan to a family member, your gift is equal to the excess of the loan amount over the present value of all future loan payments (using the AFR as the discount rate). In other words, you're treated as if you had made an up-front gift sufficient to cover all of the imputed interest payments during the life of the loan.

If you choose to make a low-interest or no-interest loan to a family member, try to avoid a term loan so you don't make a substantial upfront gift. A demand loan is the most effective way to preserve your unused lifetime exemption and make the most of your annual exclusions. An alternative approach is to charge a market rate of interest and then decide on a year-by-year basis whether to forgive some or all of the interest.

Having a plan

The decision to lend money to a family member is a personal one, and the terms of the loan shouldn't be driven solely by tax considerations. But it pays to evaluate the tax implications so you can plan a transaction that maximizes the benefits for you and your loved ones. ▮

Estate planning red flag

You haven't left final instructions for your family

When you die or if you become incapacitated, will your family know where to look for your will and other estate planning documents? In today's digital age of paperless transactions and electronic records, your family may not even know about certain assets unless you inform them. And even if they do know, without your username and password, it may take weeks or months before they can gain access to the accounts.

The last thing you want to do is make an already trying time more difficult for your loved ones. To smooth the process, keep a list of your important contacts, documents, assets and liabilities. Be sure to include:

- Contact information for your accountant, attorney and investment advisors,
- The location of your will, living trust, tax returns, powers of attorney, insurance policies and other important documents,
- A list of all stocks, bonds, real estate and other investments,
- Information about bank accounts, credit cards and mortgages,
- Information about your pension or other employer-provided retirement plans,
- The location of safety deposit boxes and keys,
- Safe combinations, and
- The location of family heirlooms and other valuable personal property.

In addition, consider writing a letter explaining your wishes in a way that's less formal than your will or living trust. Even though the letter isn't legally binding, it may provide needed guidance to your children or other heirs.