

THE BERNSTEIN REPORT

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Dear Reader,

There has been some progress on important tax legislation, but there is a long way to go to resolve all of the issues facing Congress. The most concrete bill language is the American Jobs and Closing Tax Loopholes Act of 2010 (H.R. 4213) approved by the House. The Senate may act quickly on this bill because it includes several popular extender provisions that expired at the end of 2009. The bill includes the following key provisions:

- A one-year extension to allow a non-itemizer to increase the standard deduction up to \$1,000 (joint filer) for state and local property taxes.
- A one-year extension to allow taxpayers to deduct state and local sales taxes in lieu of property taxes.
- The extension of the emergency unemployment compensation benefits through November.
- The extension of the premium assistance for COBRA for individuals terminated before December 2010.
- The extension of the tax-free qualified charitable IRA rollover of up to \$100,000 for eligible taxpayers through the end of the year.
- A new revenue raiser to prevent small professional practices from avoiding employment taxes by operating as an S corporation, partnership or LLC.
- A new revenue raiser to change the tax treatment of "carried interest" provided to investment managers from capital gains taxable at 15 percent to ordinary income.

Of course, there are a number of issues yet to be resolved besides the tax extenders and the required revenue offsets. The sunset provisions contained in the Bush Administration's tax cuts will begin to take effect beginning in January 2011. For example, absent any new developments, the federal estate and generation-skipping (GST) taxes will return to the 2001 levels starting next January. This means that the exemption amounts for the estate and GST taxes will revert to \$1 million and again be identical to the gift tax exemption. In addition, the maximum wealth transfer-tax rate will become 55 percent (60 percent in a complex surcharge for affected estates). Included in this discussion is the treatment of transfers for gifts or from estates for decedents dying in 2010. Conventional wisdom seemed to indicate a resolution of these issues by the end of last year. The only prediction that we'll make here is that a complete planning summary will be provided for you as soon as estate tax reform legislation is enacted.

Cordially,

Richard S. Bernstein

**A Second Opinion Costs You NOTHING,
But Could Save You MILLIONS!**

**WHEN IT COMES TO YOUR HEALTH, YOU GET A SECOND OPINION,
SHOULD YOUR FINANCIAL WEALTH BE ANY DIFFERENT?**

THE DURABLE POWER OF ATTORNEY: AN ESSENTIAL FINANCIAL AND ESTATE PLANNING TOOL

Estate planners warn their clients about the risks of dying without a will. Failing to plan for future incapacity could also result in irreparable harm to an individual and his or her family. Furthermore, the likelihood of a long-term disability is much greater than that of death during much of a person's lifetime. The risk of serious incapacity increases with age, and the demographic trends indicate that the segment of the population over age 65 is growing much faster than the rest of the population. This problem and the uncertainty about the future of the federal estate tax, state estate or inheritance taxes and other estate-settlement costs indicate that estate and financial plans should be flexible for changing needs. The durable power of attorney is an inexpensive device that permits a person to designate a family member or professional adviser to make critical financial and personal decisions and take action to preserve the estate when incapacity occurs.

WHAT IS A POWER OF ATTORNEY?

A power of attorney is a document in which the client (the principal) authorizes an agent (otherwise known as an attorney-in-fact) to act in his or her behalf. The power may be quite limited: for example, permitting the agent only to make deposits to the principal's bank account. Or the power can be broad, authorizing the agent to engage in nearly any transaction that the principal could.

A power of attorney is also limited in its duration. It can be expressly limited in time. For example, the agent may be given a power of attorney that terminates when a specific act is completed. Even if no duration is specified, a conventional or common-law power of attorney becomes inoperative upon the incapacity of the principal. To extend the power beyond the incapacity of the principal, the power must be made expressly durable.

A durable power of attorney takes effect immediately when the document is executed even though it may not be needed until much later, if ever. Some individuals, however, are reluctant to grant an agent broad powers to act at a time when the principal is capable of acting. These people would prefer to use a "springing" durable power of attorney. Recognized in many states, a springing power lies dormant and ineffective until a designated time, such as the principal's incapacity.

WHEN SHOULD A DURABLE POWER BE USED?

A durable power of attorney should be used whenever an individual feels he or she will need someone to make important financial and/or personal decisions after the individual loses capacity. Most individuals will have assets or personal affairs that must be managed should they lose capacity. If the individual has a complex estate plan, the durable power is essential. A wealthy individual who has begun his or her estate plan by making lifetime gifts or charitable donations will need someone to have the power to continue making such gifts or donations after the donor loses capacity. It would often be devastating to the individual's estate plan if the gifts could no longer be made. The uncertainty over the future composition of the federal estate tax indicates an increased need for flexibility to alter the plan. The durable power of attorney provides a mechanism for making the necessary changes to an estate plan without court approval for a legally disabled principal.

One example of the need to act for a disabled principal is the irrevocable life insurance trust (ILIT). Suppose the individual makes regular contributions to an irrevocable life insurance trust. A durable power must be in effect for the premiums to be paid from the principal's funds after the principal loses capacity. Otherwise, the principal's family might have to pay the premiums from their own funds for the rest of the principal's life. This, of course, would be counterproductive to the principal's estate plan. Or, suppose the principal has a living trust with terms that have become inappropriate due to the current status of the federal estate tax law. The attorney-in-fact can be empowered to revoke or amend the trust as necessary.

All states authorize the health care power of attorney. This durable power permits the agent to make health care decisions for the principal if the principal loses capacity. Many individuals prefer the health care power of attorney to a living will; some use the health care power in conjunction with a living will.

WHAT CAN A DURABLE POWER ACCOMPLISH?

One of the primary uses of a durable power is the delegation to an agent of the management and control of the principal's financial affairs during his or her incapacity. The following is a sample of the types of property management powers that might be considered for a power of attorney:

- to make deposits and withdrawals from bank accounts
- to sign tax returns and appoint an agent to represent the principal with the IRS
- to make investment decisions
- to deal with retirement plans, including IRAs
- to have access to the principal's safe-deposit box
- to create a living trust or fund a previously created living trust
- to revoke or amend a living trust or to direct the trustee to make distributions
- to revoke or change beneficiary designations
- to forgive or collect the principal's debts
- to enter into contracts on behalf of the principal
- to make gifts on behalf of the principal
- to disclaim gifts or bequests made to the principal
- to deal with life insurance on the life of the principal

WHY MUST THE DURABLE POWER BE DRAFTED CAREFULLY?

An individual might be tempted to avoid attorney's fees by purchasing a durable power document form from a business supply store or using consumer-oriented computer software to draft the power. However, a power of attorney is useful only if it works as intended. The likelihood of success is far greater if the appropriate professional advice is sought.

Because the possibility of abuse exists when the agent is managing the principal's financial assets, financial intermediaries such as banks, stock brokers, and insurers are often hesitant about complying with broad powers granted to an agent. State law often construes the power very narrowly to prevent the abuse of the power. If court intervention is required, it will be costly and will perhaps further limit the flexibility of the agent to use the durable power since the courts are likely to construe the power narrowly. Drafting the document so that the powers granted the agent are very specific is helpful in persuading third parties to enter into transactions with the agent. The more specific the language, the more likely it is that third parties will honor

the power because the intent of the principal is expressly stated in the document.

Another important point is the effectiveness of the exercise of a power of attorney for tax purposes. The IRS has successfully challenged and denied the annual gift tax exclusion for gifts made under broad-form powers of attorney in which the agent was not expressly empowered to make the gifts. A similar result should occur if the agent attempts to disclaim property inherited by the principal. The IRS may treat the disclaimer as invalid for tax purposes. A power of attorney granted without these express powers would render these estate planning techniques ineffective and increase the amount of estate taxes the principal's family will have to pay.

Recent Cases and Ruling

Case Demonstrates the Necessity to Consider Tax Apportionment Clauses

A recent state court decision (*Estate of Sheppard v. Schleis*, 2009AP1021 (May 4, 2010)) demonstrates the danger of the failure to draft a Will and consider the tax impact of items paid by beneficiary designation. The decedent died with approximately \$12 million, but had no Will. The majority of his property passed intestate to his heirs at law under Wisconsin law. Two large accounts (totaling \$3.8 million) passed to a minor beneficiary under the payable on death provisions of the accounts. The funds in the accounts were withdrawn by the beneficiary's parents at the advice of a guardian ad litem soon after the decedent's death.

The estate had significant estate taxes and state law indicates that "the burden of the federal and state estate taxes attributable to probate and nonprobate assets falls on the residue of the estate" absent a special statute or clear written instructions by the decedent. (Note: the apportionment statutes differ from state-to-state.) Hence, in this instance, the tax on all estate assets was payable from the probate share of the estate passing to the heirs at law. The court rejected the argument that a payable on death (P.O.D., also called transfer on death accounts in some states) account is a lifetime transfer with a retained life estate under IRC 2036(a). This prevented the estate from using a federal apportionment statute to collect the tax from the P.O.D account. There are a couple of important lessons here. First, it is important to have a Will and to clearly express the manner in which the estate's expenses will be paid. Second, it is critical to coordinate any P.O.D. registered accounts and other types of beneficiary designations consistent with the other goals of an estate plan.

This Tax Letter is intended to assist you to conserve your estate and to protect the interests of your family and business associates. Estate planning involves the joint services of a competent Trust Officer, Attorney, Accountant, and Life Underwriter. The experience and advice of each is generally essential.

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