THE ESTATE PLANNER

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Estate planning in a socially distanced environment

As we continue to recover from the COVID-19 pandemic and much of the economy reopens, the "new normal" demands continued social distancing in many areas of life. What does this mean for estate planning? Clearly, estate planning is as important today — or arguably more important — than ever. But how do you plan your estate and execute critical documents if you're uncomfortable with face-to-face meetings or are required to self-quarantine?

Fortunately, many estate planning activities can be done from the safety of your own home. Following are some options to consider, but keep in mind that requirements vary significantly from state to state, so it's important to discuss your plans with your estate planning advisor.

Most planning can be done remotely

There are definite advantages to meeting with your advisor in person to talk about creating or updating your estate plan. But these discussions can be conducted in video conferences or phone calls, and document drafts can be transmitted and reviewed via email, secure online portals or even traditional "snail mail."

Several options for signing documents

Traditionally, estate planning documents are executed in an attorney's office in the presence of witnesses and a notary public. In-office document signings may still be possible with appropriate precautions, such as wearing masks and gloves and practicing social distancing. But there are other options that allow you to avoid traveling to an attorney's office and that minimize the number of people involved. The options available depend in part on the type of document being signed:

Wills. In most states, a typewritten will (as well as a modification or codicil to an existing will) must be signed in the physical presence of at least two witnesses. Typically, those witnesses must be disinterested — that is, they don't stand to inherit or otherwise benefit under the will. But some states permit family members or other interested parties to serve as witnesses. In those states, it may be possible to conduct a will signing at home (with instructions from your attorney) and have members of your household witness it. If disinterested witnesses are required, you might have friends or neighbors observe the signing from a safe distance (in your backyard, for example). In some states a will can be valid without witnesses, if "clear and convincing" evidence is provided in court, after the will-maker's death, to prove its validity.

What about notarization? Wills are usually notarized as a best practice, but in most states it's not required. However, wills are often accompanied by a self-proving affidavit, which must be notarized. A self-proving affidavit is a sworn statement, signed by the will-maker and witnesses, that affirms the will's validity. It's not required, but it can streamline the probate process. One strategy for avoiding the presence of a notary (assuming online notarization isn't an option in your state) is to sign the will

Beware of do-it-yourself estate plans

In a time of social distancing, it may be tempting to explore one of the many do-it-yourself (DIY) tools for creating an estate plan. Software or online tools that automate the creation of wills, trusts and other documents have a certain appeal, but they also present some significant risks.

The requirements for executing estate planning documents are complex, vary dramatically from state to state and are subject to change. Many DIY solutions fail to meet these requirements or to keep up with changing laws, which may jeopardize the validity of your plan.

The best DIY tools may comply with applicable laws and be kept up to date. But while they can help you create individual documents, they can't help you see the big picture. Creating an estate plan means determining your objectives, making critical decisions and coordinating an array of carefully drafted documents designed to achieve those objectives. And doing so effectively requires professional guidance.

without a notary and then arrange for the parties to sign a self-proving affidavit in front of a notary when it's safer to do so.

Another option in some states is a "holographic," or handwritten, will, which generally doesn't require witnesses or notarization.

Trusts. In many states, you can sign a trust document without witnesses or notarization, and it may even be possible to sign it electronically. One potential strategy for avoiding traditional will-signing requirements is to sign a holographic "pour over" will that transfers all assets to a revocable trust, which can accomplish many of the same objectives as a traditional will.

Powers of attorney and health care directives. Depending on your state, it may be possible to sign a valid durable power of attorney (for financial or legal matters) without witnesses or notarization. This isn't advisable, however, since notarization usually confers presumptive validity, making it more likely that the document will be accepted by financial institutions or other third parties.

Health care powers of attorney or advance directives generally must be signed in front of witnesses, although typically they're not required to be notarized.

Monitor legal developments

Requirements for signing estate planning documents have been evolving in recent years, and the COVID-19 pandemic may accelerate the process. A few states permit electronic wills (e-wills) and online notarization, which makes it possible to execute these documents without the need for physical interaction with anyone. These technologies are still in their infancy, but they're being considered by lawmakers in many states.

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Even if your state doesn't allow e-wills or online notarization, be sure to monitor recent legal developments. A number of states have considered temporarily permitting online notarization or electronic signatures during the public health emergency. ▪

Valuation of pass-through entities

Why tax-affecting matters

If you own a closely held business, it likely represents a significant portion of your wealth; wealth that your loved ones will rely on as a source of income after your death. So, the valuation of the business for gift and estate tax purposes is critical to determining how much of your estate goes to your family and how much goes to the government.

If the business is structured as a pass-through entity — such as an S corporation, partnership or limited liability company (LLC) — the use of tax-affecting can substantially reduce its value, allowing your estate to slash its tax bill.

Tax-affecting defined

Tax-affecting — which involves discounting a pass-through entity's projected earnings by an assumed corporate income tax rate — is widely accepted in the valuation community, but the IRS routinely challenges the practice. Historically, the U.S. Tax Court has sided with the IRS. In a recent estate tax case, however, the Tax Court accepted the use of tax-affecting by a valuation expert. Although the practice remains controversial — at least from the IRS's perspective — the court's decision may signal a greater willingness to accept it in future cases.

Why tax-affect?

When valuing businesses or business interests, valuation professionals often rely on income-based methods — which project the business's future earnings or cash flow and discount them to present value — or on market-based methods — which apply earnings multiples derived from public or private company market data. In either case, the subject company's earnings are critical.

Pass-through businesses pay no entity-level taxes. Rather, as the name suggests, their profits and losses are passed through to the owners, who report their shares on their personal income tax returns. Nevertheless, valuation professionals often discount a pass-through entity's earnings to reflect an assumed corporate income tax rate. Why? Because, despite the lack of entity-level taxes, owners still pay taxes on their shares of the entity's profits at their individual rates, and pass-through entities commonly distribute sufficient earnings to cover those taxes.

Another rationale for tax-affecting is that it accounts for the risk that a pass-through entity will convert to a C corporation in the future (because, for example, it loses its S corporation status or merges into a C corporation).

Although it's important to recognize the real impact of taxes on a pass-through entity, applying an assumed corporate rate, without more,

may undervalue the entity because it ignores the tax advantage such a structure provides. Because there's no entity-level tax, pass-through entities avoid the double taxation experienced by traditional "C" corporations.

A C corporation's earnings are taxed twice, once at the corporate level and again when they're distributed to shareholders in the form of dividends. Thus, valuators often add a premium when valuing pass-through entities to reflect this tax advantage. But note that, since the Tax Cuts and Jobs Act cut corporate income tax rates, this advantage isn't as significant as it once was.

Tax Court's position

Starting with its 1999 ruling in *Gross v. Commissioner*, the Tax Court has consistently rejected tax-affecting in cases involving the valuation of pass-through businesses. This has been based on the reasoning that these businesses paid no entity-level taxes and were unlikely to convert to a C corporation in the near future. However, in a more recent case — *Estate of Jones* — the court approved tax-affecting in the valuation of two family-owned timber businesses, one structured as an S corporation and the other as an LLC, for gift and estate tax purposes.

The court found that the estate expert's approach best accounted for the tax impact of pass-through status. He tax-affected the entities' earnings, using a 38% rate for combined federal and state taxes, to arrive at an initial value, and then added back a premium to reflect the benefit of avoiding a tax on dividends. Tax-affecting was only one of several issues, but because the estate expert's position prevailed, the family saved tens of millions of dollars in gift taxes.

The future of tax-affecting

Although the Tax Court distinguished its previous rulings on tax-affecting based on the facts of those particular cases, its decision in *Estate of Jones* seems to signal that it's more receptive to the practice today. One thing is certain: To ensure that a valuation that incorporates tax-affecting holds up in court, it's critical to engage a qualified valuation professional who can explain and support your position. ▮

What are your options to pay for long-term care?

The Centers for Medicare and Medicaid Services has reported that nearly 70% of people over age 65 will need long-term care (LTC) services and support at some point in their lives. Needless to say, the cost of long-term home health care or an extended stay at a nursing home or assisted living facility can quickly erase your nest egg and derail your estate plan. Let's look at three options available to help cover the costs of long-term care.

1. LTC insurance

An LTC insurance policy supplements your traditional health insurance by covering services that assist you or a loved one with one or more activities of daily living (ADLs). Generally, ADLs include eating, bathing, dressing and transferring (in and out of bed, for example).

LTC coverage is relatively expensive, but it may be possible to reduce the cost by purchasing a

tax-qualified policy. Generally, benefits paid in accordance with an LTC policy are tax-free. In addition, if a policy is tax-qualified, your premiums are deductible (as medical expenses) up to a specified limit.

To qualify, a policy must:

- Be guaranteed renewable and noncancelable regardless of health,
- Not delay coverage of pre-existing conditions more than six months,
- Not condition eligibility on prior hospitalization,
- Not exclude coverage based on a diagnosis of Alzheimer's disease, dementia, or similar conditions or illnesses, and
- Require a physician's certification that you're either unable to perform at least two of six ADLs or you have a severe cognitive impairment and that this condition has lasted or is expected to last at least 90 days.

It's important to weigh the pros and cons of tax-qualified policies. The primary advantage is the premium deduction. But keep in mind that medical expenses are deductible only if you itemize and only to the extent they exceed 7.5% of your adjusted gross income (AGI), so some people may not have enough medical expenses to benefit from this advantage. It's also important to weigh any potential tax benefits against the advantages of nonqualified policies, which may have less stringent eligibility requirements.

2. Hybrid insurance

Also known as "asset-based" policies, hybrid policies combine LTC benefits with whole life insurance or annuity benefits. These policies have several advantages over standalone LTC policies. For example, their health-based underwriting requirements typically are less stringent, and their premiums are usually guaranteed — that is, they won't increase over time. Most important, LTC benefits, which are tax-free, are funded from the death benefit or annuity value. So, if you never need to use the LTC benefits, those amounts are preserved for your beneficiaries.

Bear in mind that the features, terms and conditions of these policies can vary dramatically, so it's important to shop around.

3. Employer-provided plans

Employer-provided group LTC insurance plans offer significant advantages over individual policies, including discounted premiums and "guaranteed issue" coverage, which covers eligible employees (and, in some cases, their spouse and dependents) regardless of their health status. Group plans aren't subject to nondiscrimination rules, so a business can offer employer-paid coverage to a select group of employees.

> *An LTC insurance policy supplements your traditional health insurance by covering services that assist you or a loved one with one or more activities of daily living.*

Employer plans also offer tax advantages. Generally, C corporations that pay LTC premiums for employees can deduct the entire amount as a business expense,

even if it exceeds the deduction limit for individuals. And premium payments are excluded from employees' wages for income and payroll tax purposes.

Ease the financial burden of LTC

Too often, people planning their estates focus on tax and asset-protection issues and overlook long-term health care needs. But the high cost of LTC can quickly devour resources you need to maintain your lifestyle during retirement and provide for your children or other heirs. LTC insurance may be the answer. Contact your estate planning advisor to learn more about the various LTC insurance options. ▮

ESTATE PLANNING RED FLAG

Your revocable trust isn't fully funded

If your estate plan makes use of a revocable trust — sometimes known as a "living trust" — it's critical to ensure that the trust is fully "funded." Revocable trusts provide significant benefits, including the ability to avoid probate of the assets they hold and facilitating management of your assets in the event you become incapacitated. To obtain these benefits, however, you must fund the trust — that is, transfer title of assets to the trust or designate the trust as the beneficiary of retirement accounts or insurance policies.

To the extent that a revocable trust isn't funded — for example, if you acquire new assets but fail to transfer title to the trust or name it as beneficiary — those assets may be subject to probate and will be beyond the trust's control in the event you become incapacitated. To avoid this result, it's a good idea to take inventory of your assets periodically and ensure that your trust is fully funded.

Another important reason to fund your trust is the ability to maximize FDIC insurance coverage. Generally, individuals enjoy FDIC insurance protection on bank deposits up to $250,000. But with a properly structured revocable trust account, it's possible to increase that protection to as much as $250,000 *per beneficiary*. So, for example, if your revocable trust names five beneficiaries, a bank account in the trust's name is eligible for FDIC insurance coverage up to $250,000 per beneficiary, or $1.25 million ($2.5 million for jointly owned accounts). Note that FDIC insurance is provided on a per-institution basis, so coverage can be multiplied by opening similarly structured accounts at several different banks.

FDIC rules regarding revocable trust accounts are complex, especially when a trust has more than five beneficiaries, so be sure to consult your advisor to maximize insurance coverage of your bank deposits.

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- A creative and imaginative approach that focuses on finding solutions, not problems.
- Accessible attorneys who give clients priority treatment and extraordinary service.
- Effectiveness at a fair price.

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Estate planning is a complex task that often involves related areas of law, as well as various types of financial services. Our clients frequently face complicated real estate, tax, corporate and pension planning issues that significantly impact their estate plans. So our attorneys work with accountants, financial planners and other advisors to develop and implement strategies that help achieve our clients' diverse goals.

Shumaker has extensive experience in estate planning and related areas, such as business succession, insurance, asset protection and charitable giving planning. The skills of our estate planners and their ability to draw upon the expertise of specialists in other departments — as well as other professionals — ensure that each of our clients has a comprehensive, effective estate plan tailored to his or her particular needs and wishes.

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