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Estate Planning

Planning for Non-Married & Non-Traditional Families

All individuals need at least basic life and estate planning; however for single persons and persons in non-traditional relationships, the planning is even more critical. Single individuals obviously cannot take advantage of the unlimited marital gift and estate tax deduction. Also, same-sex couples are unable to use the marital deduction because federal law does not recognize same-sex marriage, regardless of state law. At the minimum, all individuals should have the following basic planning documents in place:

Basic Documents

- Will or Revocable Trust
- Power of Attorney
- Health Care Power of Attorney
- Living Will / Advance Directive / Medical Directive
- HIPAA Authorization
- Funeral, Burial and Remains Planning
- Proper Beneficiary Designations
- Planning for Minors (where applicable)

Will or Revocable Trust (RLT) states a person's wishes upon his or her death. If a person does not have a Will or RLT, then state law determines who receives the assets. Each of the states has different intestacy laws, but generally the assets pass to the nearest blood relatives. Children would receive assets at the age of majority in the particular state, generally 18 or 21. An RLT allows assets to pass outside probate, which provides privacy, and can reduce or eliminate probate fees.

Power of Attorney allows an individual (principal) to designate another individual (agent) to handle the principal's affairs in the event of absence or inability to act. The power of attorney can be written to be immediately effective or to "spring" into effect upon a person's disability.

Health Care Power of Attorney allows a principal to appoint an agent to make medical decisions if the principal cannot make such decisions.

Living Will/Advance Directive/Medical Directive enables a person to provide instructions relating to his or her wishes regarding prolonged life support in the event of an incurable illness.

HIPAA Authorization – Recent laws have provided people with a higher right to privacy regarding their health information. Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), specific authorization is now required for medical

personnel to release "protected health care information." Without a HIPAA authorization, a doctor or nurse may be prevented from discussing a patient's medical condition with a loved one.

Funeral, Burial and Remains Planning is particularly difficult for surviving family and friends. Proper planning allows a person to state his or her wishes and eliminates any potential disagreement among those persons who must make the final plans.

Proper Beneficiary Designations are vital. Often times, people fail to change the named beneficiaries when life changing events occur. For example, if a life insurance designated beneficiary is no longer living, typically the proceeds are paid to the estate; and in most states asset protection of the proceeds is lost. Also people may not realize that careful selection of an IRA beneficiary can allow for a "stretch IRA" such that taxable distributions are spread out over a long period of time, saving income taxes for the beneficiary.

Planning for Minors – If a person has not appointed custodians, state law will determine how custodianship is established.

Gift Tax Exclusions

In addition to proper documents, all individuals need to be aware of and utilize the available gift tax exclusions.

• Annual gift tax exclusion

Each person can gift \$13,000 annually to another person. Gifts can be contributed to an irrevocable trust to provide asset protection for beneficiaries.

• Lifetime Gift exclusion

Currently, the unified gift and estate tax exemption amount is \$5,000,000 per person. However, the exemption is scheduled to return to \$1,000,000 after 2012.

• Tuition paid directly to certain education institutions is a tax-free gift.

• Medical expenses paid directly to a health care institution are also tax-free gifts.

In Summary. All people need to have basic life and estate planning in place; however, the planning is particularly important for single persons and persons in non-traditional relationships. State law seldom passes property and establishes custodianship as an individual would desire. Additionally, the 2010 Tax Act provides a short-term, but substantially expanded, gifting window of opportunity for all taxpayers.



Taxation – Estate & Gift

Portability: Is Planning Still Necessary?

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Act) created the Deceased Spousal Unused Exemption Amount (DSUEA). This new concept, also referred to as Portability, allows the estate of a surviving spouse to utilize the estate tax exemption of a predeceased spouse without the use of a Credit Shelter Trust. As with much of the 2010 Tax Act, the law authorizing Portability expires December 31, 2012.

- **Exemption Amount:** When an individual dies, estate taxes are due on the value of his or her assets. Each individual has an exemption amount which allows him or her to transfer a certain amount of assets free of estate tax. The 2010 Tax Act provides for an increased exemption amount for two years. During 2011 and 2012, each individual may transfer a total of \$5,000,000 either during life or at death, plus any DSUEA of the individual's last deceased spouse. However, beginning in 2013, the exemption amount is scheduled to return to \$1,000,000; the DSUEA is also scheduled to disappear.
- **Marital Deduction:** Married individuals can transfer an unlimited amount of assets to one another without paying gift or estate tax

under the unlimited marital deduction. However, in many instances with the marital deduction, estate taxes are merely deferred until the death of the surviving spouse.

- **Credit Shelter Trusts:** Historically, one common planning solution between spouses for the reduction of estate taxes has been the use of a Credit Shelter Trust. Upon the death of the first spouse, an amount of the deceased spouse's assets equal to the exemption amount is transferred to a Credit Shelter Trust. The surviving spouse typically has access to trust principal and income for his or her health, education, support, and maintenance; any unused assets are transferred to the succeeding generation estate-tax free upon the death of the surviving spouse.

The DSUEA is a legislative attempt to: (1) ease the operational burdens and costs associated with forming and maintaining Credit Shelter Trusts, and (2) provide a parachute for those persons who failed to do the requisite planning to reduce estate taxes.

Review the following chart for more information about the comparison of the DSUEA and the Credit Shelter Trust.

Features of DSUEA	Features of Credit Shelter Trust
<ul style="list-style-type: none"> ▪ At the first spouse's death, an estate tax return must be filed and the DSUEA must be elected. 	<ul style="list-style-type: none"> ▪ The first deceased spouse's Will (or Revocable Trust) must have language that sets up a trust; the trust may be funded during life or at the first death.
<ul style="list-style-type: none"> ▪ A surviving spouse can only use the DSUEA of his or her last deceased spouse. 	<ul style="list-style-type: none"> ▪ If the surviving spouse remarries, the trust assets can remain segregated and protected.
<ul style="list-style-type: none"> ▪ The DSUEA is not indexed for inflation. 	<ul style="list-style-type: none"> ▪ The exempted assets and the future growth of those assets avoid future transfer taxation.
<ul style="list-style-type: none"> ▪ Surviving spouse takes assets subject to creditors. 	<ul style="list-style-type: none"> ▪ Assets are owned in trust and can be protected from creditors.
<ul style="list-style-type: none"> ▪ Assets are not sheltered from Generation Skipping Transfer taxes. 	<ul style="list-style-type: none"> ▪ Generation Skipping Transfer tax exemption may be utilized allowing tax free gifts to grandchildren and great-grandchildren.
<ul style="list-style-type: none"> ▪ Assets receive a step up (or step down) in basis to the value at the death of the surviving spouse. 	<ul style="list-style-type: none"> ▪ Assets in trust receive a step up (or step down) in basis at the death of the first spouse.

In Summary. The increased exemption and the new concept of Portability are great additions to the tax code. However, the risk is that many individuals will be lulled into failing to take action and review their estate plans. The issue is not whether Portability or traditional Credit Shelter Trust planning is better, but rather, whether you have reviewed your individual situation with a trusted adviser to determine the appropriate planning.

¹26 U.S.C. § 2056(a).



Asset Protection

Asset Protection Planning: Don't Wait

Historically many individuals did not consider planning for creditor protection because they never anticipated needing to avail themselves of laws or strategies to protect assets. However, several factors have converged during the past few decades which should put the issue of asset protection in the forefront of any individual's planning – particularly people who own homes, cars, and even limited other assets. With the increase in divorces, downturn of the economy, and current litigious environment, more people than ever are being affected by creditors' claims.

Following is an overview of current available statutory protection and a brief review of some commonly used strategies.

How Times Have Changed. According to the Americans for Divorce Reform, approximately 40% to 50% of marriages end in divorce—41% of first marriages, 60% of second marriages, and 73% of third marriages. The American Bankruptcy Institute reports that filings have risen every month during the five previous years – see table.

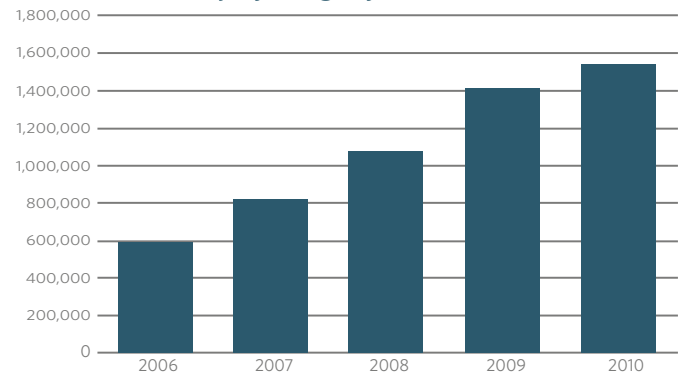
And because lawsuits seem to be everywhere, malpractice insurance and personal liability “umbrella” policies are now the norm.

Creditor Protection “Givens.” All states and the District of Columbia have laws that protect certain assets. However each state's law is different and the protections are typically sufficient only to continue a lean existence. Even the statutory exemptions may not be protected from certain claims such as alimony, child support, and federal tax liens. Following are the generally available exemptions:

- **Homestead exemption.** Some states have unlimited; others limit the exemption by dollar amount and/or acreage.
- **Qualified retirement plans and IRAs.** Generally retirement accounts of participants are exempt from the claims of creditors in bankruptcy proceedings, subject to certain limitations, i.e., traditional and Roth IRAs are subject to \$1,000,000 aggregate limit per debtor.
- **Life insurance and annuity contracts.** States vary as to death benefit and cash value protected; some states determine protection based on the relationship between the beneficiary and the insured.
- **Minimal amount of personal property and liquid assets.**

Some Asset Protection Strategies. Several strategies can be considered to protect assets while still allowing the owner or the owner's children to have access to the property. However it is important to understand the fraudulent conveyance issue. If a person makes a transfer out of his or her name after a creditor's claim exists – the transfer can be set aside as a fraudulent conveyance.

Bankruptcy Filings by Year 2006-2010



Source: American Bankruptcy Institute

Following are several of the more commonly used asset protection strategies.

- Corporations
- Irrevocable trust created for a third party / Dynasty trust
- Limited partnerships and limited liability companies (LLCs)
- Series LLCs - a relatively new entity structure available in only nine jurisdictions currently
- Domestic Asset Protection Trusts – also available in only limited jurisdictions
- Foreign Asset Protection Trusts / Offshore Trusts

Protection of Inherited IRAs – Recent Developments

The tide may be slowly turning regarding inherited IRAs. Several recent cases have held that an inherited IRA is exempt in federal bankruptcy proceedings: *In re Mathusa*, 2011 Bankr.Lexis965 (Bankr.M.D.Fla. March 28, 2011); *In re Chilton*, 426 B.R. 612 (Bankr ED Tex Mar 5, 2010) rev'd by 107 A.F.T.R.2d 1391 (ED Tex Mar 16, 2011); *In re Thiem*, No. 4:10-bk-19279-JMM. (Bankr. AZ Jan 19, 2011); *In re Nessa*, 426 B.R. 312 (8th Cir BAP 2010). Plus, on April 29, 2011, Florida passed a law that expressly exempts inherited IRAs in bankruptcy.

The issue of exemption appears to be dependent in large part on whether the exemption is sought under federal or state law. Historically, most bankruptcy proceedings using states' statutes have not allowed inherited IRAs to be exempt.

In summary. Now is the time to review your assets, determine the amount of protection needed to protect yourself and your heirs, and determine any action that needs to be taken. Don't wait until your assets are at risk. All asset protection planning should be entered into only after a thorough review of your assets and objectives, and with the assistance of a trusted adviser and a highly skilled attorney. Many shams exist with unreasonable promises that could result in unnecessary expense and exposure.



Business Planning

Series LLCs: Proposed Regulations Provide Guidance

In recent years, several states have enacted series limited liability company (LLC) statutes. As with most new state law creations, issues and questions abound. The IRS recently issued proposed regulations¹ which are being reviewed and commented upon by the legal community. Planners and business owners should be aware of the opportunities associated with the new series LLCs, but also they need to be aware of the issues involved as the law develops.

Series LLC - New Choice of Entity. Delaware enacted the first Series LLC statute in 1996, and since that time Illinois, Iowa, Nevada, Oklahoma, Tennessee, Texas, and Utah have enacted similar, but not identical, statutes. Each statute allows an LLC to create separate "series" or "cells" within the LLC. The individual series are not separate legal entities, but each series is permitted to have: separate members or participants with respect to that series; separate rights, powers, or duties with respect to specified property within a series; and the debts and liabilities of the series enforced only against the assets of the particular series. Any series may have a separate business purpose or investment objective.

Example: Mrs. Client regularly establishes hotels. A series LLC makes it easier for her to have a separate "cell LLC" for each of her new hotels without creating an entirely new LLC for each.

Requirements for Separate Treatment. The statutes also set out the requirements to receive separate series treatment. Each state's statute differs, but typically the statutes require:

- The LLC agreement must establish or provide for the establishment of a series;
- The assets of each series must be separately recorded and maintained;
- The LLC agreement must contain language that contemplates the series and establishes the segregation and distinctness of managers, members, assets, liabilities, and obligations of each series; and
- The LLC's certificate of formation must contain notice of the liability limitations.

Pros / Cons. The advantages and opportunities are clear: business owners are able to segregate assets and receive heightened asset protection, while being able to reduce the cost of creating and maintaining separate legal entities. The issues and problems may be less obvious. How will separate series be treated for employment tax and employment benefits purposes? Will courts in

non-series states uphold the separate liability among the series? How will series states handle filing fees? How will non-series states handle such filing fees?²

The Proposed Regulations provide for the following:

- Each series of a domestic series LLC is treated as a separate entity formed under local law, regardless of whether local law considers the separate series as a separate entity. (Certain foreign series conducting an insurance business are also included.)
- The treatment of the individual series is then determined under the "check-the-box" rules. Is the entity a separate entity as opposed to a disregarded entity? If so, what is the entity's classification?
- For federal income tax purposes, the ownership of interests in the series, and the ownership of the assets associated with a series is determined under general tax principals. For example, the series LLC will not be treated as the owner of assets merely because it holds the legal title to such assets. Rather, the ownership depends on who has the economic benefits and bears the burdens of the assets.
- The IRS will establish forms and require filing for series LLCs.
- The regulations are expected to be effective when finalized.

Business owners need to be aware of the opportunities the new series LLCs provide as well as the issues involved.

In Summary. The fact that the IRS has provided guidance for the treatment of Series LLCs indeed is opening the door to new opportunities for businesses. Series LLCs could work particularly well with real estate holdings and private equity funds. The proposed regulations are beginning to weave through the issues and help establish what will likely be a more widespread entity of choice in the future.

¹Reg-119921-09, September 14, 2010

²California has determined that each series in a series LLC is a separate LLC, and must pay its own registration fee to do business in California. California 2006 Limited Liability Company Tax Booklet, p. 4, Section F.

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