ISSUE 85
June 1, 2011

Elder Client PLANNER

Spidell Publishing Inc.®

TAX, LEGAL & FINANCIAL SOLUTIONS FOR YOUR RETIRED CLIENTS

New IRS gift tax compliance initiative

ESTATE/TRUST: The IRS is paying closer attention to gift tax compliance on in-family real estate transfers.

By Debra S. Petersen, J.D., LL.M., CPA
Sacramento Contributor

The IRS is now checking for gift tax compliance where taxpayers have transferred property to their family members between 2005 and 2010 for little or no consideration. This applies to all transfers to family members where there has been little or no consideration paid for the property, including adding family members as joint tenants on real property.

On December 27, 2010, the IRS filed an *ex parte* petition[1] requesting to serve a "John Doe" summons on the California Board of Equalization (BOE) requiring the BOE to produce property transfer records that show transfers between family members.

Josephine M. Bonaffini, the Federal/State Coordinator of the IRS Estate and Gift Tax Program, stated in a declaration filed with the court that, "Based on information received from examinations across the country and information voluntarily disclosed by other states, the IRS has determined that taxpayers who transfer real property to a related party for little or no consideration frequently fail to file Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, and report this transfer, despite the fact that they are required to do so by the internal revenue laws. Thus, the

See **Gift tax**, *page 2*

"I did the Roth conversion because I can."

TAX: With all the hype surrounding Roth conversions in 2010, many clients did conversions when they should not have.

By Tim Hilger, CPA
Editor

There are many variations of the old joke that lead to the punch line: "Because I can." There were far too many times this tax season where the set-up to that punch line was: "Why did you do a Roth conversion?"

With all the publicity surrounding the elimination of income limits on Roth conversions, many clients headed straight to their brokers, giddy at the prospect of doing something that seemed hip and sophisticated and giddier still knowing that they wouldn't have to face any consequences until a couple of years later given that the income from 2010 conversions can be deferred and split until 2011 and 2012.[1]

In many cases, those clients should not have done a conversion for any number of reasons. Thankfully, the damage can be undone and we have time. Upon learning of their actions, I immediately scheduled June appointments with some of those clients.

The mulligan

In golf parlance, a mulligan is a do-over: You just hit a horrific shot, so you take your mulligan. You get to pretend that the horrific shot never happened and you get to take another shot in its place.

In the world of Roth conversions, the mulligan is the "recharacterization." You made a conversion that you regret, so you recharacterize the conversion. Now you get to pretend that the conversion never happened.

What makes the IRA mulligan so inviting is that the deadline for taking it isn't until the extended due date of the return for the year of the conversion, and the extended deadline applies whether or

See **Roth**, *page 3*

In this Issue

Budget drama puts Medicare and its future center stage
Two very different proposals address the future of Medicare.
Article on page 4

Passive loss carryovers: Modified carryover basis or estate tax?
The passive loss carryovers of a decedent may be used or may be lost, depending on planning considerations.
Article on page 5

New instructions for calculating gift tax on the 709
The new instructions for Form 709 lower the tax rate on gifts made in prior years, resulting in less tax on current gifts.
Article on page 6

SURFing USA: Closing an estate updated
Article on page 7

Reverse mortgage should have both spouses on the loan
Article on page 9

Social Security benefits for spouses from other countries
Article on page 10

How old is your client's will (and trust)?
Article on page 11

News Briefs
Article on page 12

E-mail us:
ecplanner@spidell.com

SURFing USA: Closing an estate, updated

ESTATE: With the changes in estate tax laws, wrapping up an estate may be more confusing than ever — but it doesn't have to be.

By Richard Malamud, CPA, J.D., LL.M
Guest Contributor

Editor's note: This is an update of one of our most popular and useful articles, "Teach your clients how to SURF" from the August 2006 issue of Elder Client Planner™. The article is updated to account for new estate tax laws post-2009.

When someone dies, the trustee or executor (the "fiduciary") usually is undertaking that job for the first, and often the only, time. The process can be confusing even for a professional, and with the new realities under the 2010 Tax Relief Act, it can be more confusing than ever.

The process varies by state and depends on the trust, will, or how title to the property is held. Some estates will have to go through probate while others won't because title is in joint tenancy.

There is an easy place to start. Explain to your clients that they will need to:
Select experts
Understand the process
Retrieve information and documentation
Finalize the estate

Select experts

Which experts will be required depends of the knowledge and experience of the fiduciary and the complexity (and size) of the estate. Probate usually requires the advice of an attorney, while some fiduciaries can understand the terms of the trust or will (or the CPA or EA may be able to explain the terms to the trustee or executor). Real estate may require an appraiser, and there are often issues requiring consultation with advisors and insurance agents. Tax returns, especially complex trust returns, will require a tax preparer, and an estate or inheritance tax return can be prepared by either a CPA or an attorney. Lots of different experts may have to be consulted.

Understand the process

The next step is to help explain the process. Initially, this may simply be explaining what needs to be done and referring matters to the appropriate representative for advice. This may entail explaining that they need to go into "hunter-gatherer" mode, collecting the will, trust, and a general list of assets and liabilities. Once the will and trust have been reviewed and a basic understanding of the types and values of assets in the estate has been established, it should be clear what needs to be done and which professional should be in charge.

The most common question is whether there will be an estate or inheritance tax. For those dying in 2011 or 2012, the

Checklist of topics to discuss with clients		
Item	**Yes**	**No**
Final tax return (Form 1040)		
Estate tax return (Form 706)		
Inheritance tax return (state)		
Life insurance		
Joint tenancy property/community property		
Living trust (*inter vivos*)		
Funding of trust(s)		
Title to real estate/partnerships/autos		
Fund future trusts		
Pay debts		
Make distributions to beneficiaries		
Fiduciary income tax return (Form 1041)		
Notifying Social Security, pension payors, insurers, landlords, etc. of the death		
Important financial contacts		
Professional	**Name**	**Phone number**
Tax professional		
Attorney		
Insurance – life/home/car		
Stock broker		
Financial planner		
Banker		
Pension plan administrator		

See **SURF**, *page 8*

SURF, *continued from page 7*

answer is there is no federal estate tax as long as the net value of the estate (plus all prior taxable gifts) is less than $5,000,000. Larger estates will be free from estate tax only if the excess goes to a surviving spouse (directly or in trust) or to charity. The federal tax is 35% on the net value of the taxable estates over $5,000,000, plus there may be a state inheritance tax. Some states impose an inheritance tax even if there is no federal estate tax. In addition, for estates of less than $5,000,000 the survivor may be able to elect to supplement their $5,000,000 estate tax exemption to the extent the first-to-die's estate was worth less than $5,000,000.

Retrieve information and documentation

Financial Information: Now it's time to play detective. Often, even the surviving spouse is unaware of the decedent's bank accounts, life insurance, financial transactions, and debts. Other fiduciaries will know even less. Gathering all of the assets and liabilities will be necessary, even if the estate is small. It is more complicated if it is a large estate or if there are multiple heirs, because it may then require an accounting, tax returns, and so on.

An additional issue is now prevalent because so many people have gone paperless, and the fiduciary may not know the password for the email, bank account, or even the Quicken password. It's not as if they can get the bill in next month's mail! Those who know they will be fiduciaries should be told of this problem so they can deal with it prior to the death of the only person who has the list of passwords.

Legal Information: There is no way around it. Someone has to find the will, partnership agreements, and other documents. Most are very long, but the important parts are usually fairly short. Then they have to be read to find out what needs to be done, what the assets and liabilities are and who the beneficiaries are. Unfortunately, most documents use legalese, like QTIP, QSST, and Exemption Equivalent, so that the tax professional will be asked to explain the overall process to the client. This is usually best done in a face-to-face meeting. The initial meeting provides the fiduciary with a "Reader's Digest" version of what needs to be done, who needs to be consulted, and who has to do what. This is not the time to resolve all or even most of the fiduciary's questions. There will be plenty of time for that later.

Finalize the estate

Now it's time to gather the assets, pay the bills, and file the various tax returns. Then it will be time to make the distributions to the beneficiaries. Professionals will often be required to prepare income, estate, and/or inheritance tax returns, or advise the representative about estate and income tax elections. In many cases that will entail the allocation of the property into several trusts (exemption, marital, minor, charitable remainder, etc.). The possibilities are endless.

For deaths in 2011 and 2012 new law allows the executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse without creating a trust. This "portability" provision applies only with respect to the last deceased spouse of the surviving spouse, and it requires that an estate tax return be timely filed for the estate of the first deceased spouse, even though one would ordinarily not be required due to the deceased spouse having a taxable estate less than the estate tax exemption. As such, even for estates under the $5,000,000 exemption amount, an estate tax return will be required if an election is made to pass the unused exemption to the surviving spouse (rules forthcoming from the IRS).

Checklist of things to do

<u>Things to be done ASAP</u>

Deal with all funeral issues

<u>Things to do quickly</u>

Get 5–10 copies of the death certificate.

Locate and review copies of:

- Will
- Trust
- Birth certificate
- Social Security card
- Notify the Social Security Administration

If living alone:

- Take care of any pets
- Notify U.S. Postal Service to forward mail
- Talk to the landlord
- Where appropriate, cancel cell phones, newspapers, cable TV, magazines, extra telephone lines, etc.
- If the decedent has e-mail, you may want to keep it for a few months. Many financial transactions may be sent to the decedent by e-mail rather than by regular mail

<u>Things that can wait a short while</u>

Call all advisors with relevant information to share:

- CPA/EA
- Attorney
- Insurance agents
- Stock broker/investment advisor

Check with the employer/union/military about:

- Final paycheck
- Final benefits
- Pensions
- Other items, such as personal property at the office
- Union benefits
- Veterans' benefits (burial and insurance)

Locate all assets and liabilities that are easy to find (often they will appear as monthly statements in the mail, but increasingly this information will be sent by e-mail):

- Bank accounts
- Brokerage accounts
- Life-insurance policies (don't forget to notify the company)
- Pink slips for cars
- List of all real property
- List of any securities or partnership interests not held at a brokerage account
- Safe-deposit boxes and keys
- All credit card and other liabilities

<u>Things to do later</u>

Locate financial documents for use by whoever is preparing a Form 706 (assuming it is a taxable estate). In addition, the preparer will often ask for:

- Copies of prior gift tax returns
- Bank statement for the month prior to death and the next few months
- Brokerage account statements
- Last two years' tax returns
- Pensions – IRA, SEP, Keogh, Roth, 401(k), 403(b), 457, etc.
- Deeds for real estate
- Leases – for a car, mobile home, etc.
- Marriage certificate
- Death certificate

See **SURF**, *page 9*

SURF, *continued from page 8*

- Credit card statements
- Mortgage statement(s)
- Unpaid bills

File claims:

- Any reimbursement for health-related final illness that can be repaid by health insurance
- Life insurance
- Any reimbursement for IRC §125 flexible-spending arrangements

For attorney or accountant or both:

- If there is a trust, determine who is the new trustee and what has to be done
- If there is a will, determine if probate is required

Things to do later still

- Pay debts that are due and payable. You may want to check with the attorney if the estate will be subject to probate or if it appears that there are insufficient funds to pay all creditors
- Determine if any bank CDs should be closed, as most will not have a penalty for early withdrawal
- Talk to your advisors before making any distributions to heirs
- Determine whether you are required to notify current and contingent beneficiaries of their potential inheritance
- Gather all information for the final and fiduciary income tax returns
- Gather all information for the estate and/or inheritance tax returns
- Ask professionals what is missing from this list §

About the author

Richard Malamud is a professor in the Department of Accounting and Finance at California State University Dominguez Hills, where he teaches federal income tax law. You may reach him at: (310) 243-2239 or rmalamud@csudh.edu.

Reverse mortgage should have both spouses on the loan

ASSET PROTECTION: If only one spouse is on the loan documents, it may create serious problems for the surviving spouse.

By Kathryn Zdan, EA
ECP Staff

After a lawsuit was filed against the Department of Housing and Urban Development (HUD), the agency retracted a policy that led to the eviction of surviving spouses who were not named on the reverse mortgage loan documents.[1] This case illustrates the importance of both spouses being named on the loan to avoid future problems.

The policy, which HUD released in 2008 without notifying mortgagees, was such that if the individual named on the reverse mortgage died, the surviving spouse not named on the policy was required to immediately pay the loan in full in order to retain the property.[2] The original HUD policy set forth in 1994 was that the surviving spouse or heirs would never be responsible for paying more than the loan balance or the value of the property – whichever was less.

However, after the housing market crash, many homeowners with reverse mortgages were upside down on their property. In the case of a reverse mortgage, a surviving spouse who is responsible for the balance of the loan may well be paying more than the value of the property. The catch here is that if an unrelated party bought the home, they would pay less than the surviving spouse would have to pay to keep the home.

"If the individual named on the reverse mortgage died, the surviving spouse not named on the policy was required to immediately pay the loan."

This is what happened to the three individuals listed in the suit against HUD. All three were not listed on the loan documents, and under the HUD rules, do not qualify as "homeowners." Unable to obtain financing to pay off the loan balances, all three are facing foreclosure and eviction:[3]

- Mrs. D. Moore, age 79, married her husband late in life and was never added to the deed to the home or the Home Equity Conversion Mortgage.
- Mrs. L. Joseph, age 77, was removed from the deed to the property when her husband, suffering from dementia at the time, entered into the reverse mortgage.
- Mr. R. Bennett, age 69, had jointly owned the home with his wife since 1981. Without his knowledge, he was removed from the deed when the reverse mortgage was executed. His wife, who was ill at the time of the reverse mortgage transaction, died the following month.

HUD agreed to put a hold on the eviction and foreclosure of those named in the suit until final resolution of the case. §

Learn more about reverse mortgages

Go to www.elderclientplanner.com and sign in to find more information on reverse mortgages in past articles of the *Elder Client Planner*™:

- When must a reverse mortgage be paid? (April 2011)
- Is interest paid on a reverse mortgage deductible? (April 2009)
- Reverse mortgages: Lifetime annuity, lump sum, or both? (August 2008)
- More options available for clients considering a reverse mortgage (April 2007)

1 Fleck, Carol (April 8, 2011) "Reverse Mortgage Borrowers Win Reprieve" *AARP* Available at: www.aarp.org/money/credit-loans-debt/info-04-2011/reverse-mortgage-borrowers-win-reprieve.html

2 In a reverse mortgage, the balance becomes due when the homeowner dies, moves, or sells the house

3 AARP Press Release (March 8, 2011) "HUD Targeted in Suit for Illegal Reverse Mortgage Foreclosure Actions"