Estate Planning Traps and Mistakes for Real Estate Investors

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What We Will Be Discussing:

- Comparing **Estate Tax and Income Tax Rates**
- What's so unique about real estate investors-from an estate planning prospective?
- The estate planning **Traps** many real estate investors fall into;
- The estate planning **Mistakes** many real estate investors make;
- The relationship between **Estate Tax and Income Tax Planning**;
- The importance of the **Formula** in your plan and why your plan may need to be updated;
- **Portability** of the exemption between spouses; and
- The planning **Strategies** you need to consider.

The Relationship between Estate Tax and Income Tax Planning-It isn't just about Estate Tax!

- Estate Tax Exemption for 2016:
  - Federal $5,450,000
  - State $1,600,000
- Top Estate tax rates:
  - Federal 40%
  - State 16%
- Top Income tax rates
  - Federal 39.6%+3.9%
  - State 9.5%
- Basis:
  - On Lifetime Gifts-The Donee (recipient) takes the Donor's basis
  - On Gifts from a decedent's estate-A "Step-up" in basis at the decedent's date of death

What's so unique about Real Estate Investors-from an estate planning prospective?

- You prefer/believe in real estate for investment over other investment vehicles;
- You believe in leverage;
- You don't see the need to maintain significant (50% or more) liquidity (cash and marketable securities);
- You chase real estate tax benefits;
- Your favorite numbers are "1031" and "1014";
- You don't believe in life insurance-it's a bad bet; as well as
- Some other beliefs.

So what's the problem?

You Believe:	And the Problem is:
You believe in real estate for investment over other investment vehicles	YOU FORGO DIVERSIFICATION USING OTHER ASSET INVESTMENTS
You believe in leverage	GUARANTEES THAT HAVE TO BE DEALT WITH DURING YOUR LIFE AND BY YOUR FAMILY AFTER YOUR DEATH

So what's the problem?

You Believe:	And the Problem is:
▪ You don't see the need to maintain significant (50% or more) liquidity ▪ You chase real estate tax benefits	▪ LACK OF FUNDS TO HANDLE TAX AND DEBT ISSUES AT DEATH ▪ MANY OF WHICH COME BACK AT YOU LATER AT THE TIME OF SALE-Eg. DEPRECIATION RECAPTURE

So what's the problem?

You Believe:	And the Problem is:
Your favorite numbers are "1031" and "1014";	THEY BEAT "7 AND 11" BUT EXCHANGES OVER A PERIOD OF TIME BUILD UP SERIOUS TAX OBLIGATIONS; AND WAITING FOR THE "ALL MIGHTY-SOLVE ALL TAX PROBLEMS" "STEP UP IN BASIS" OFTEN CAUSE INVESTMENT DECISIONS RESULTING IN THE "TAX TAIL WAGGING THE DOG".

So what's the problem?

You Believe:	And the Problem is:
▪ Life insurance is a bad bet;	▪ LEAVING YOUR FAMILY AND ESTATE SCRAMBLING FOR CASH AT DEATH

Common Estate Planning Traps for Real Estate and Business Owners

AND, YOU MAY BELIEVE:	WHEN IN FACT:
That estate planning is an event not a process;	Estate Planning is a process conducted over time;
All you need is a simple Will;	A simple Will may guarantee that you pay more tax and costs for administration of your estate;

Common Estate Planning Traps for Real Estate and Business Owners

AND, YOU MAY BELIEVE:	WHEN IN FACT:
Everything you've heard about what's taxable;	Everything you own, wherever it's located including life insurance and your retirement plan;
That it's your opinion that counts regarding the value of the assets in your estate;	It's the Fair Market Value of your assets as defined by the IRS;

Common Estate Planning Traps for Real Estate and Business Owners

AND, YOU MAY BELIEVE:	WHEN IN FACT:
That if you change residency moving out of MN, that your real property held in an LLC, or other pass through entity is not taxed for estate tax purposes in MN.	If you change residence and still own your real property in your own name or a pass through entity, it will be taxed in MN for estate tax purposes.

Common Estate Planning Mistakes Made by Real Estate and Business Owners

- Failing to recognize and plan for the ***basic estate planning goals***:
  - Minimizing tax between both spouses' deaths;
  - Minimizing administration of your estate while you're alive and after death;
  - Taking advantage of straight forward asset protection for yourself, your spouse and your children; and
  - Making certain that your plan gets your assets to your intended beneficiaries.
- Dropping your life insurance because you've heard that your family will not owe any tax on your estate; however,
  - The growth of many real estate portfolios outpace the growth of the federal and state exemptions
  - Your plan doesn't take full advantage of the available exemptions

Common Estate Planning Mistakes Made by Real Estate and Business Owners

- Believing that you don't need a Will or Trust and that you can rely on ***Joint Tenancy, TOD and POD*** registration for all your planning;
  - These forms of registration only avoid probate and do not provide any "tax-wise" planning
  - If all of the assets pass to spouse by registration, there can be no use of the state exemption at the first death-there's no portability of the state exemption! Yes, you can use a disclaimer, but…!
  - If your assets are passing to a non spouse beneficiary, who will be responsible for taxes and expenses of administration of your affairs? Will one of your children have to collect checks from their siblings or other beneficiaries to pay the bills?

Common Estate Planning Mistakes Made by Real Estate and Business Owners

- Relying on the new Federal Exemption and Portability between spouses to deal with all of your estate tax planning;
  - Relying on the portability of the federal exemption does not address the state exemption!
  - Relying on the portability of the federal exemption allows for audit of the estate of the first spouse to die ON THE DEATH OF THE SURVIVING SPOUSE!

Common Estate Planning Mistakes Made by Real Estate and Business Owners

- Leaving your entire estate to your surviving spouse outright;
  - The important tax issues: *Example*
    - $7.5 million combined estates: H-$3.5 W-$4
    - H dies first and leaves entire estate to W
    - On W's death WITH AN ESTATE OF $7.5 MILLION:
      - No federal estate tax-USING THE FEDERAL EXEMPTION
      - State tax: $880,000 ($320,000 EXTRA TAX THAN IF PROPERLY PLANNED)*
  - The important non tax issues:
    - Forgoing important asset protection for surviving spouse;
    - And…W has the opportunity to name her own beneficiaries.

* THIS ASSUMES THE ADDITIONAL $2,000,000 OF TAXABLE ESTATE RESULTING FROM NO USE OF THE STATE EXEMPTION ON THE FIRST DEATH AND A TAX RATE OF 16%

Common Estate Planning Mistakes Made by Real Estate and Business Owners

- Leaving your entire estate to your children outright after your spouse's death;
  - You forgo important asset protection for your children and grandchildren exposing your assets, INCLUDING YOUR RETIREMENT ACCOUNTS:
    - TO DIVORCE
    - TO OTHER CREDITORS
    - TO YOUR CHILD'S BANKRUPTCY CREDITORS
    - TO YOUR CHILD'S MEDICAL ISSUES
    - TO THE STATE IF YOUR CHILD IS IN NEED OF GOVERNMENTAL NEED BASED BENEFITS:
      - MEDICAID
      - SSDI

Common Estate Planning Mistakes Made by Real Estate and Business Owners

- Failing to balance estate and income tax consideration;

  REMEMBER THESE RATES

- Estate Tax Exemption for 2016:
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  - State 16%
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General Problems when planning

- Relying on Portability of the Federal Exemption-doesn’t solve for the state estate tax!
- Forgoing a flexible plan that doesn’t respond to family issues and new law.
- Failure to rely on old formulas in your plan that respond to pre 2009 law and no planning for our state estate tax.
- Failure to rely on trusts as core of the plan and just using a will.

General Problems when planning-Strategies you need to consider

- Failure to review available tax reductions strategies and their application to your plan. The strategies include:
  - LLCs and LLPs-but administering them correctly;
  - Use of QPRTs;
  - ILITs allowing life insurance to pass without estate tax;
  - GRATS;
  - Installment sales to defective Grantor Trusts;
  - Disclaimers; and
  - Considering change of residence and careful planning for the ownership of real estate in MN.

Questions?

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