The Estate Planner

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Protecting your assets against fraud and ID theft

A fundamental estate planning objective is to provide financial security for your loved ones. To achieve that objective, your estate plan must include strategies for creating wealth (financial planning), preserving wealth (asset protection) and distributing wealth cost effectively (tax planning).

Wealth preservation typically focuses on protecting assets against creditors' claims and lawsuits, but it's also important to protect your wealth from erosion by fraud and identity theft.

Fraud can happen to anyone

When it comes to fraud, the most dangerous attitude to have is: "It can't happen to me." There's a common misconception that fraud victims usually are unsophisticated. True, fraudsters often target neophytes with get-rich-quick schemes, but there's no shortage of sophisticated investors who've been seduced by the promise of generous returns.

Just consider the Bernard Madoff debacle. Madoff's $50 billion Ponzi scheme snared corporate CEOs, wealthy celebrities, prominent investment funds, universities, not-for-profit organizations and other experienced investors. Many of these investors lost millions of dollars. Some lost billions.

Although there are no guarantees in the investment world, the best way to protect yourself against fraud is to do your homework and seek professional advice. Even in the Madoff scheme, there were warning signs that might have tipped off cautious investors, including:

- Returns that were unusually high and consistent given the volatility of the markets,
- Investment strategy explanations that likely wouldn't have held up to closer scrutiny,
- Use of the same investment strategy for every investor, regardless of his or her circumstances, and
- Lack of involvement of a third-party brokerage firm.

It appears that many investors had an emotional response to the prospect of enormous monetary gains and skimped on their due diligence on the basis of Madoff's reputation as a highly successful and well-respected investment advisor. A qualified, independent investment advisor can help you take emotion out of the equation and evaluate your investment options objectively and thoroughly.

Keeping your identity safe

Identity theft is a growing problem in the United States, claiming around 10 million victims every year, according to the Federal Trade Commission (FTC). Thieves who steal your identity may use your personal information to run up charges on your credit cards, drain your bank accounts, and take any number of other actions to make off with your wealth or destroy your credit rating.

To protect your identity, it's important to understand the many methods thieves use to obtain your Social Security number, bank and credit card account numbers, and other sensitive personal information. They include "dumpster diving" — that is, sifting

through your trash for bills, receipts, bank statements, credit card offers or other documents; "phishing," which involves sending phony e-mail messages from financial institutions or other companies asking you to reveal personal information; and old-fashioned stealing (your wallet or purse, for example).

If you become the victim of identity theft, there are steps you can take to restore your credit rating and recover stolen assets, but it can be a time-consuming, costly process. So at minimum take the following basic steps to protect your identity:

- ✦ Shred all paperwork that includes sensitive personal information.
- ✦ Don't give out personal information unless you're initiating the contact.
- ✦ Immediately report stolen credit cards, and check your credit report at least once a year.

When it comes to fraud, the most dangerous attitude to have is: "It can't happen to me."

When you share personal financial information with trusted third parties, don't hesitate to ask them about their privacy policies and security measures. And don't provide more information than necessary.

For example, even though employers, banks and businesses running a credit check need your Social Security number, most other businesses don't. If someone asks for your Social Security number, don't be afraid to ask why they need it, how it will be used, how they will protect it from theft and what will happen if you refuse to provide it.

Putting your trust in a trust

You can also use estate planning tools to help prevent fraud and identity theft. For example, many people use revocable living trusts to achieve a variety of estate planning objectives, including avoiding probate and managing assets in the event they become incapacitated. But trusts can also be an effective tool for preventing fraud, or at least catching it before too much damage is done. How? The trustee has direct responsibility for managing and protecting the trust assets, in essence adding an extra layer of protection between you and potential fraudsters or identity thieves.

By appointing an experienced professional trustee, you ensure that an extra set of eyes evaluates any contemplated investments or distributions of the trust's assets. In addition, a professional trustee will be in a position to monitor the assets closely and respond quickly to any suspicious activity.

Before you establish a living trust, be sure to consult your estate planning advisor to determine whether it's appropriate for you and to help you tailor the trust to meet your specific needs.

Safeguarding yourself

You likely invest much time and money into developing strategies to provide for your family and achieve your other estate planning objectives while minimizing gift and estate taxes. To be successful, you also must safeguard your wealth against fraud and identity theft. ✤

10 TIPS FOR CHOOSING A GUARDIAN

If you have minor children, choosing a guardian to care for them should you and your spouse die unexpectedly is one of the most important estate planning decisions you must make. It's also one of the most difficult. So difficult, in fact, that avoiding it is one of the most common reasons people put off estate planning.

If you're hesitant to name a guardian for your children, consider the alternative: A court will name one, without any input from you. So it's important to choose a guardian now, while you still have a say in the matter. Here are 10 tips to guide you in making your selection:

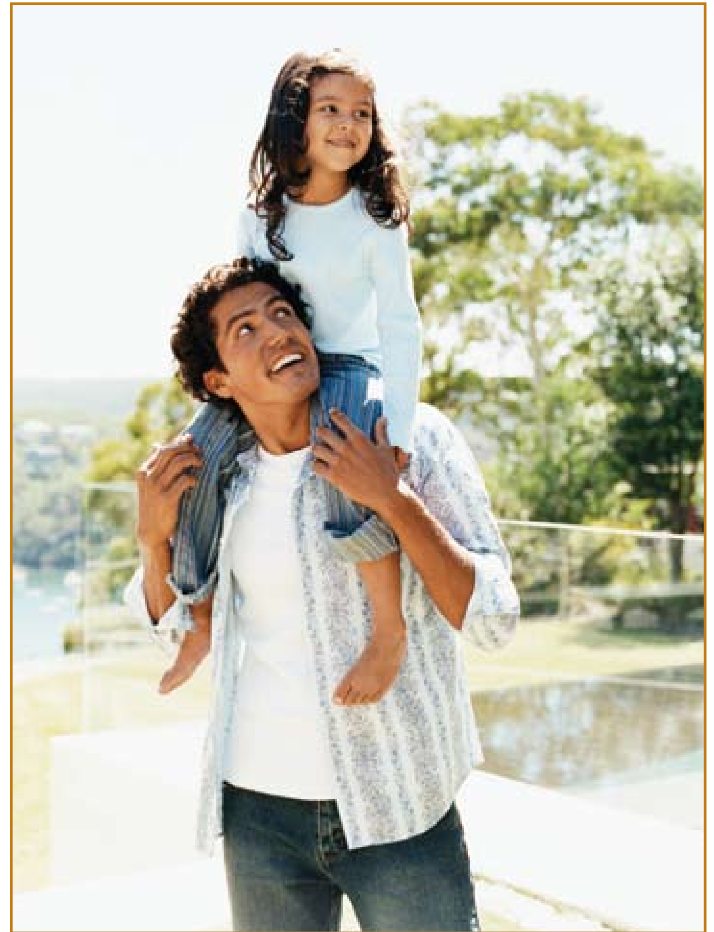
1. Take inventory. Make a list of potential guardians — people you trust to love and care for your children. Don't limit yourself to immediate family members. Extended family members, friends, teachers and child care providers may also be good choices if they have a close relationship with your children and share your values.

2. Make value judgments. Consider the values that are important to you, such as religious and moral beliefs, parenting philosophy, educational values, and social values. Determine which people on your list share these values most closely.

Narrow your list of potential guardians to a primary choice and one or two alternates, and discuss your plans with them.

You're not likely to find a perfect match, so you'll need to prioritize your values. For example, is it more important to you that your guardian share your religious beliefs or that he or she share your parenting philosophy? Can educational values take a back seat to social values?

3. Consider the intangibles. It's also important to consider potential guardians' intangible qualities such as their personalities and whether they'd be a good "fit" for your children. Are they affectionate? Do they have a good sense of humor? Do they have the maturity and patience necessary for parenting?



4. Consider age. The age of the guardian as well as the ages of your children are factors to consider. If your children are very young, a grandparent or other older person may not have the energy to keep up with them. And remember, if a guardian becomes necessary it means that something has happened to you. Choosing a younger guardian reduces the risk that your kids will go through the trauma of losing another loved one.

5. Be practical. Consider factors such as where potential guardians live, whether they have other children and whether their homes are large enough to accommodate your kids. Will your children have to change schools? Will they get along with the guardian's kids?

Ideally, your estate will include sufficient assets to provide your children with everything they need. But if it doesn't, will the guardian have the resources to support them properly?

6. Don't dismiss the possibility of separate guardians. If you have more than one child, it's generally best for all concerned to keep them together. But sometimes it's

preferable to split them up. This may be the case if you have children from different marriages, if your children are far apart in age or if they have special needs that are better served by separate guardians.

7. Talk it over. Narrow your list of potential guardians to a primary choice and one or two alternates, and discuss your plans with them. You can't force someone to act as your children's guardian, so it's critical to talk with all candidates to make sure they understand what's expected of them and are willing to take on the responsibility. If your children are mature enough, get their input as well.

8. Put it in writing. Nominate a guardian in your will and include at least one alternate in the event your primary choice is unavailable or changes his or her mind. To avoid uncertainty and disputes, be sure that you and your spouse nominate the same guardians. Also, if a married couple will care for your children, consider naming them as co-guardians so they each have the authority to act on your children's behalf. Note that naming co-guardians can cause complications if the couple later divorces, so you might want to specify what happens in that case.

Keep in mind that your choice of guardian isn't binding. In appointing a guardian, a court's sole concern is the child's best interest. But it will defer to your wishes unless it deems the person you choose to be unfit. To help ensure that your nominee is accepted, write a letter explaining the reasons for your choice. And if there is anyone you wish to *exclude* as a potential guardian, spell that out in your letter as well.

9. Choose a temporary guardian. In addition to nominating a permanent guardian, it's a good idea to name a temporary guardian to care for your children in the event you're unable to do so (for health reasons, for example).

Although your temporary and permanent guardians can be the same person, practical considerations may be more relevant when choosing a temporary guardian. The ideal permanent guardian may live across the country, for example, but it's best to choose a temporary guardian who lives nearby to avoid disrupting your children's lives more than necessary.

10. Be flexible. As your children grow older, their personalities, interests and needs change. The best guardian today may not be a good fit 10 years from now, so it's important to review your guardian designation periodically.

Another option is to appoint a "guardianship panel" of trusted relatives, friends and advisors who are empowered to select an appropriate guardian based on the circumstances at the time the need arises.

Review your plan

Your selection of a guardian can have a profound impact on your children, so it's important to choose carefully. Whether you name a guardian now or appoint a guardianship panel to decide later, review your estate plan frequently to ensure that it continues to accomplish your objectives and serve your children's best interests. ✤

A guardian may *not* make the ideal trustee

The person best suited to raise your children isn't necessarily qualified to manage their assets, so consider appointing someone else as a trustee. Not only will this help ensure that your children receive competent financial advice, but it also can avoid real or perceived conflicts of interest between your children and their guardian.

It's not unusual for trust distributions to benefit the guardian as well as the child. Suppose, for example, that a guardian uses trust funds to help pay for family vacations or to build an addition to his or her house to better accommodate your children. Appointing a separate trustee gives some assurance to other family members that trust assets are being used in your children's best interests.

Family split-dollar arrangement can ease gift taxes

One of the most effective techniques for avoiding estate taxes on life insurance proceeds is to set up an irrevocable life insurance trust (ILIT). If you pay the premiums on the policy, however, there may be gift tax consequences. A properly structured split-dollar arrangement may solve this problem.

ILIT basics

If you own an insurance policy on your life, the death benefit will be included in your estate and potentially be subject to estate taxes when you die. By having an ILIT purchase and own a policy on your life and naming the ILIT as beneficiary, however, you can ensure that your family receives the death benefit tax free. For an ILIT to work, you must not hold any "incidents of ownership" in the policy — such as the right to change beneficiaries or borrow against the policy's cash value.

To fund the policy premiums, the insured parent typically makes periodic contributions to the ILIT; these constitute taxable gifts to the ILIT beneficiaries.

You may be able to avoid gift taxes by using your annual gift tax exclusion (currently $13,000 per recipient, $26,000 for married couples) or your $1 million lifetime gift tax exemption. But if your available annual exclusions and exemption are insufficient to shelter your ILIT contributions from gift taxes, a family split-dollar arrangement may provide a solution.

Split-dollar strategy

A split-dollar insurance arrangement is an agreement between two parties to share the costs and benefits of a permanent life insurance policy, such as a whole life, variable life or universal life policy.

Split-dollar arrangements are commonly used by employers to provide employees with life insurance benefits at a low tax cost. Outside an employment setting, these arrangements generally are referred to as "private split-dollar" or, if the agreement is between family members, "family split-dollar" arrangements.

In a typical family split-dollar arrangement, parents contribute 100% of the premium payments to an ILIT that owns a second-to-die policy on their lives. When the second parent dies, his or her estate receives the policy's cash surrender value (or, if greater, an amount equal to the premiums paid), and the remaining policy proceeds are retained by the ILIT for the benefit of the children.

When structured properly, the value of the parents' contributions for gift tax purposes will be equal to the economic benefit received by the ILIT. Generally, the economic benefit is the current cost of life insurance protection (calculated using IRS tables), which is only a fraction of the total premium.

Split-dollar complications

The tax regulations governing split-dollar arrangements are complicated, and a discussion of them is beyond the scope of this article. But one of the challenges involved in designing a

split-dollar arrangement is that, for gift tax to be based on the economic benefit rules, the parents must be deemed the owners of the policy for purposes of the split-dollar regulations. If that's the case, however, there's a risk that the parents will also be deemed to possess incidents of ownership in the policy, exposing the entire proceeds to estate taxes.

In a private letter ruling issued last year, PLR 200825011, the IRS ruled that the parents were the owners of the policy for split-dollar purposes because, "under the terms of the agreement, the only economic benefit that will be provided under the split-dollar arrangement is current life insurance protection." Thus, the parents' gift was limited to the cost of that protection.

The IRS also ruled that the insurance proceeds weren't includible in the estate of the second parent to die.

Although the parents' interest in the policy was secured by a collateral assignment, their rights under the assignment were limited to repayment of premiums on termination of the agreement, and the trustee specifically retained all rights of ownership in the policy.

Handle with care

A family split-dollar arrangement can be an effective tool for reducing gift taxes on ILIT contributions, and PLR 200825011 provides valuable guidance on how to structure an arrangement that achieves this objective. But private letter rulings have no precedential value, so some uncertainty remains about the strategy's tax implications.

If you think a split-dollar arrangement would be right for you, discuss the pros and cons with your estate planning advisor. ✤

Estate Planning Red Flag

You make (or receive) "deathbed" gifts

Making annual exclusion gifts is an effective way to reduce your taxable estate. But if such gifts aren't "completed" before your death, they could be subject to estate taxes.

Currently, the annual gift tax exclusion allows you to transfer up to $13,000 a year tax free to an unlimited number of recipients. Annual exclusion gifts also are exempt from the "three-year rule," which provides that certain transfers within three years before your death are brought back into your taxable estate.

So making annual exclusion gifts is a popular "deathbed" planning technique for people who are terminally ill. Suppose, for example, that you give $13,000 each to 10 recipients and the federal estate tax rate when you die is 45%. Removing $130,000 from your estate could save your family $58,500 in federal estate taxes and possibly more if your estate is also subject to state death tax.

But, for a gift to qualify for the annual exclusion it must be a *completed* gift. Generally, a gift isn't complete until the donor has relinquished all control over the property. In particular, gifts made by check aren't considered complete until the check clears, because until that happens the donor retains the power to stop payment. If the donor dies before the check clears, the annual exclusion is lost and the funds are included in the decedent's estate.

To avoid this result, consider making deathbed gifts using certified checks or wire transfers, or even cash. And if you receive such a gift in the form of an ordinary check, be sure to cash it as soon as possible.

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