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Executive Compensation ■ Succession ■ Wealth Transfer Planning

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The Importance of Domicile for Your Estate Plan

Increased mobility in today's society has changed the way we live, work, and play. Compared to previous generations, it is now quite common for work and recreational activities to cross state lines, resulting in ownership of property and formal relationships in more than one state.

When you consider the terms **domicile, statutory residence**, and **residence,** they may seem similar at first, but it is important to understand how they are different. Your ***domicile*** is the state where you maintain your permanent residence and intend to return to for prolonged periods. An individual can have only one legal domicile at a time. A ***statutory residence*** is the place where you live and work; you are subject to the income tax for that state. If you are a statutory resident of one state, while claiming a domicile in another, your domicile state may also require you to file a tax return. Your ***residence*** is any place (or places) where you live; the term "residence" bears little or no legal significance.

Estate Planning

Where your will is **probated** is determined by your domicile. If your domicile is unclear at your death, several states may be able to claim you as a domiciliary and tax your estate accordingly. Keep in mind that estate tax laws vary by state, and state laws may differ from Federal laws. In some states, your spouse may be taxed on a portion of his or her inheritance that, in another state, would pass to him or her free of state estate tax. Some states exempt smaller estates and certain property from the probate process. Other considerations may also apply.

In addition, your choice of domicile can affect your overall financial plan, especially regarding property ownership. Not all states define property ownership in the same way. Some allow married couples to own property and income separately. In other states, known as community property states, married couples share ownership of all assets acquired *during* the marriage, but each spouse may own previously acquired property separately.

Further, your choice of domicile can affect your state income tax. Your income may be taxed in your state of domicile, the state where you earn income, or both. If you change your domicile during the tax year and both

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your present and former domiciles tax income, you may have to file partial-year tax returns in both states. The Tax Cuts and Jobs Act of 2017 limits the deduction for state and local income taxes to $10,000 annually for state and local property taxes or state and local income taxes or sales taxes.

Establishing or Changing Domicile

You can take certain steps to establish your state of domicile. In general, your domicile is not determined by the length of time you spend in a state. You may establish a domicile when you first occupy a property, or you may spend decades in a place and never call it your domicile. If you marry a person domiciled in another state, you may be able to claim your spouse's domicile as your own, even if you never visited that state.

If you have moved, your "true" domicile may hinge on the *number* and *significance* of the contacts you have in your former and present state. Here are other significant factors for you to consider:

Retention of "historical" home. If you have moved, have you sold your long-time residence in a former state?

Business relationships. In which state are your significant business contacts located?

Location of property. Where is most of your significant real and tangible personal property located?

Social connections. Where do you maintain civic, religious, or family connections?

Time spent. Where do you spend the majority of your time?

While you may feel your *intent* is clear, it is most likely that your *actions* will determine the evidence of your intentions. Consequently, simple acts such as registering to vote in a new locale, changing your automobile registrations and driver's license, resigning from organizations in your former state, and joining organizations in a new state may also be viewed as evidence of intent to change your domicile.

Because your choice of domicile can affect your overall estate planning, be sure to consult your professional legal and tax advisors for specific guidance on your unique circumstances. ■

Whole Life Insurance: What You Should Know

When faced with the wide range of life insurance coverage available, you may wonder what type really fits your needs *now* and what coverage you should have in place for the *future*. A good first step is to understand basic **whole life insurance** coverage.

Whole life insurance provides a benefit in the event of death, and it also has the potential for ***tax-deferred* cash value** accumulation. Premium payments first pay the cost of pure insurance coverage, including the expenses and mortality factors of the insurance company. The company then invests the remaining premium dollars to build the cash value of the policy.

A second feature of whole life insurance is the predictability of expense. As long as the insured continues to pay premiums according to the contract, premium amounts will not change and will continue until the policy matures, which is when the cash value of the policy equals the **face amount** of the policy. The point at which premium payments cease is clearly stated in the policy (typically age 65, 75, 85, or 95). The length of the payment period will, of course, affect the dollar amount of the premium payments.

The **guarantee** of insurability is a third feature of whole life insurance policies. Once the policy is issued and as long as premium payment responsibilities are met, the insured is guaranteed coverage for life in accordance with the terms of the policy. Evidence of insurability is not required after the policy is issued, as long as the original policy remains in force.

The final feature to consider is the ability to borrow against the cash value of a whole life insurance policy. Funds may be borrowed against the cash value of the policy at any time, depending on the policy. It is important to note that access to cash values through borrowing or partial surrenders can reduce the policy's cash value and death benefit, can increase the chance that the policy will lapse, and may result in a tax liability

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Living Together: Are There Strings Attached?

Unlike marriage, which involves numerous legal obligations and rights, a couple living together outside of marriage may be unaware of concerns unique to their domestic partnership, and could possibly face the following challenges over the course of their relationship: What happens when property is purchased together, or when one partner financially supports the other and then both individuals go their separate ways? What about assets accumulated while the couple lives together? Does a former partner have a right to such property? Suddenly, cohabitation could become more than a mere living arrangement and turn into an issue of asset protection or lifestyle preservation.

Untying the Knots of Obligation

Perhaps the most significant problem facing unmarried domestic partners is a potential claim to property, if and when the relationship ends. The issue of property rights can sometimes create major disagreements that, in some states, have resulted in **palimony** lawsuits.

"Palimony," which means the division of property and/or support payments as a result of the break-up of two unmarried individuals, does not have its origins in the law. The media coined the term in the 1970s amid several high-profile celebrity lawsuits. Although palimony suits generally occur in a limited number of states, unmarried couples could learn valuable lessons from such cases when planning a life together. In states where palimony suits are prevalent, **cohabitation agreements** are an increasingly popular method for unmarried couples to clarify their expectations and obligations. The parties can determine how comprehensive the contracts need to be, taking into consideration their combined assets. When properly drafted, these agreements may be enforceable in a number of states.

A carefully written agreement can outline everything from how jointly owned property will be distributed to what support will be provided by one partner to the other, in the event the relationship terminates. Like any contract, a written cohabitation agreement should be prepared with the assistance of legal counsel to ensure that both parties' wishes are equally and fairly represented.

For whatever reasons, one or even both partners may not wish to enter into a formal agreement. If one party is of substantial means, a personal asset protection plan may be an option for that individual to explore in further detail. However, there are other ways to help avoid potential problems. For example, it may be unwise to purchase significant assets together, title assets in joint names, regularly give money to a partner (unless it is made as a "gift" using the annual gift tax exclusion), place money into a joint account, or use a partner's last name.

In today's tax environment, estate planning for unmarried partners is complex. Although such planning can be challenging, it may be less difficult if both individuals have a realistic understanding of their rights regarding asset protection and lifestyle preservation. ■

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if the policy is terminated before the death of the insured. Loan approval must come from the insurer, but it is fairly routine. No repayment schedule is set beyond the regular payment of interest on the loan, with outstanding loan balances deducted from the death benefit in the event of the insured's death.

Your Personal Life Insurance Needs

Once you have considered the life insurance options available, be sure to evaluate them in relation to your personal needs. If you seek an instant "estate" to provide for loved ones, or wish to cover certain financial obligations in the event of your death, then a whole life policy may be a viable option for you. *Note:* Whole life insurance policies are subject to fees and charges. Guarantees are based on the claims paying ability of the issuer. ■

Wealth-Transfer Taxes Can Take a Toll on Small Businesses

Most business owners become wealthy the "old-fashioned" way—they work hard. But, suppose a business owner and his or her spouse were to die unexpectedly. Undoubtedly, they would hope their children or other family members involved in the business would reap the benefits of all their hard work.

Unfortunately for surviving family members who depend on the business for their livelihoods, their troubles may have just begun. Although estate planning concerns may arise for business owners from time to time, they are often relegated to the "back burner" due to the more pressing day-to-day demands of the business.

However, without prior planning, there may be no provisions in place to help pay estate taxes, which can be significant. The Tax Cuts and Jobs Act of 2017 retains the estate tax at 40%, but doubles the estate, gift tax and generation-skipping transfer tax (GST) exemption amounts, indexed for inflation, starting in 2018. This reduces the number of people paying the estate tax. Without any plans in place, selling or liquidating the business may be required to raise the cash to help pay estate taxes.

Potential Safeguards

Under the current estate tax laws, there are several steps a business owner can take to help prevent his or her business from being liquidated to raise cash to help pay estate taxes.

One option is to *transfer* business ownership to family members using certain gifting or sales techniques. Your tax professional can provide guidance regarding your gift tax liabilities. Although relinquishing some control and becoming a minor stockholder is not easy, it can help reduce a business owner's assets and thus, possibly, minimize the tax bite. In addition, a business owner could establish a **trust** to help ensure the estate is passed on to his or her heirs, avoiding probate.

Another option is to *defer* estate taxes. Estate taxes are due within nine months. However, the Internal Revenue Service (IRS) allows qualifying closely held businesses to defer taxes and then pay in installments (with interest) over a period as long as 10 years. In this case, the estate must remain open until all estate taxes have been paid. Therefore, according to IRS records, very few businesses choose this option. Still, family-held businesses may wish to consider taking this step as a way to help avoid a likely drain on valuable assets and the possibility of a closely held ownership coming to a abrupt end.

Benefits of Planning

One effective tool that estate planners often use to help fund estate taxes is life insurance. The business owner can establish an **irrevocable life insurance trust (ILIT)**, which purchases a life insurance policy on his or her life. The policy premiums can be funded by annual gifts made to the ILIT by the business owner, who can use his or her annual gift tax exclusion ($15,000 to each recipient for 2018) in accordance with rules pertaining to Crummey withdrawal powers (Crummey v. Comm, 397 F.2d 82 (9th Cir. 1968)).

Most business owners work long and hard to build their business and want to do all they can to help protect their heirs from a heavy estate tax burden, particularly if the company's continued operations may be in jeopardy. Therefore, it is important to develop a plan *before* the need arises.

Keep informed about any further changes in estate tax laws and maintain a strategy that works for your business and your family. Be sure to consult with a team of qualified estate professionals, including your legal, tax, and financial professionals. While there are obvious up-front costs involved in establishing an estate plan, in the long run, business owners generally find that it is money well spent. ■

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