

FEBRUARY 2013 NEWSLETTER

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HOW TO USE A TRUST TO PROTECT YOUR CHILDREN'S INHERITANCE FROM DIVORCE

1. NEWS ALERT:

A. IRS reaffirms its commitment to expand the audits of high net worth individuals.

At a recent tax conference, it was reported that the IRS has reaffirmed its commitment to expand in the coming years its efforts to audit high net worth individuals.

In late 2009, the IRS created the IRS Global High Wealth Industry Group (GHW) to target “global high wealth” individuals for audit and to ensure tax compliance among the group. GHW conducts what are called “enterprise examinations” when auditing a high net worth individual. An enterprise examination may cover more than just an individual’s personal income. It may also look into his partnerships, offshore trusts and various complex financial transactions to determine the individual’s tax compliance. As part of its comprehensive examination, the GHW will look at various tax returns, including income, partnership and gift tax returns.

GHW’s initial focus was on individuals with tens of millions of dollars in assets or income. However, in light of the recent criticism, GHW intends to target individuals at a lower asset and income threshold, such as \$1 million.

It may be wise to at least prepare yourself for an audit if you have assets and/or income in the millions. The first thing to realize with GHW audits is that they are not your traditional audit. GHW is part of the IRS Large Business and International Division (LBI), which handles audits of large public companies. Thus, GHW audits are conducted like other LBI audits as opposed to small business/self-employed division audits- the division which normally handles audits of individuals. This means that the IRS may conduct a field audit, as opposed to correspondence audit, and come to the individual’s place of business. Furthermore, the audit’s information document request is likely to be extensive and may cover information relating to more than a dozen different tax returns.

At the very least, one could conduct an internal review of his returns. You may want to consider conducting your own “pre-audit” of your tax returns, or begin gathering relevant business and investment information and possibly create electronic summaries and/or formal records to substantiate the proper operation of various entities. Review your recordkeeping protocols, keep summaries of your records and document your financial transactions.

B. Bill seeks to end the Pennsylvania Inheritance Tax on Family Businesses.

In January 2013, the Pennsylvania House Finance Committee approved the legislation from State Representative Steve Bloom, R-Cumberland, which seeks to end the inheritance tax on family businesses. If the bill is passed, it will end the assessment of the inheritance tax on all assets of a family business which are transferred at death.

Unfortunately, due to the current inheritance tax, some family businesses are forced to liquidate in order to pay the tax liability. Believing that Pennsylvania would be better off if these family owned businesses are permitted to survive and thrive, Rep. Bloom seeks to end the tax in the same way that a 2012 bill ended the tax for family farms.

Certain limitations would apply in order to benefit from the preferential tax treatment. For example, the family business would have to be operated for at least five years following the death. Furthermore, the “business” would have to qualify under certain common law definitions in order to be considering a qualifying family business. Potentially, if your business qualified, you could transfer all the assets of the business at your death without your estate having to pay taxes on the transfer of the assets. You would not need to risk shuttering you business just to pay

taxes if this were the case.

We strongly recommend that you contact your local representative to give your support for HB 48.

State Rep. John Taylor: 215-425-0901

State Rep. Mary Jo Daley: repmarijodaley@pahouse.net

State Rep. Rosita Youngblood: ryoungblood@pahouse.net

State Rep. Dwight Evans: devans@pahouse.net or akendra@pahouse.net

State Rep. Tim Briggs: tbriggs@pahouse.net

State Rep. Stephen Bloom R-Cumberland: sbloom@pahousegop.com

State Rep. Joseph T. Hackett: jhackett@pahousegop.com

State Rep. Kate Harper: kharper@pahousegop.com

State Rep. Margo Davidson: margo@votemargo.com

State Rep. Tom Killion: tkillion@pahousegop.com

2. ANNOUNCEMENTS:

A. Pozzuolo Rodden is pleased to announce that four of its attorneys have been named Region's Awesome Attorneys by Suburban Life Magazine in its December 2012 edition. Joseph R. Pozzuolo was selected in two categories: Business Planning and Estate Planning; Judith P. Rodden was selected in two categories: Commercial Litigation and Employment Law; Lesley M. Ibanez was selected in two categories: Commercial Litigation and Family Law; and Jeffrey S. Pozzuolo was selected in one category: Tax Law.

B. Pozzuolo Rodden is pleased to announce that Joseph R. Pozzuolo, Jeffrey S. Pozzuolo and Stephen P. Taylor have written an article titled "Using Trusts to Maximize Family Protection and Minimize Estate Taxes" which was published in the January, 2013 Practical Tax Strategies Publication of Thomson Reuters. A copy of the article is available by clicking here: <http://pozzuolo.com/PubsArticles.shtml>

HOW TO USE A TRUST TO PROTECT YOUR CHILDREN'S INHERITANCE FROM DIVORCE

Parents never want to envision their children going through a divorce, yet divorce is a common statistic and every parent should be aware of how to protect their children's inheritance in the event of divorce. Placing your child's inheritance in a trust is an important estate planning tool that every parent should consider.

In Pennsylvania, property acquired during a parties' marriage is considered to be "marital property" and subject to equitable distribution. While property acquired as a gift, bequest, devise or decent is excluded from the definition of "marital property" that exclusion only applies if that property is not co-mingled with "marital property." Therefore, if your child's gift, bequest or devise is placed into a joint account or used and enjoyed by both your child and his/her spouse then it may be subject to equitable distribution and your child would not receive the full inheritance you intended to give them.

A trust operates differently from a will or gift to your children, because the trust itself owns the assets you would have given to your children and your children are the beneficiaries of the trust, allowing them to receive distributions of the trust assets pursuant to the terms of the trust. A trust may be either revocable and/or subject to change or irrevocable with terms that cannot be changed. During your lifetime you can make the trust a revocable trust with yourself named a trustee, allowing you to control your assets and modify or amend the trust agreement as you see fit. However, upon your death the trust can become irrevocable, cementing the terms of the trust agreement and protecting your assets from children's creditors, such as an estranged spouse in divorce litigation, while you children remain beneficiaries of the Trust.

As beneficiaries, your children receive distributions from the Trust pursuant to the terms of the trust agreement. The terms of the trust can be drafted to allow your child's inheritance to be distributed over time according to the terms and conditions you set. This allows for greater creative flexibility in how your assets are disbursed to your children and offers far greater protection for your children's inheritance in the event of his/her divorce.

Furthermore, it is important to contact an attorney when drafting a trust. A poorly drafted trust agreement could easily do more harm than good in protecting your children's inheritance. However, a properly executed trust agreement can adequately protect your children's inheritance in the event of divorce and from other possible creditors. If you wish to further discuss using a trust as an estate planning tool please contact Pozzuolo Rodden, P.C. to schedule an appointment.

Please visit our web site: www.pozzuolo.com

Publications

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: [http://pozzuolo.com/Pubs Articles.shtml](http://pozzuolo.com/Pubs%20Articles.shtml)

Corporate/Tax Articles

Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business

Deferred Compensation Rewards And Retains Key Employees

Design Buy-Sell Agreements For Maximum Utility

How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend

How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations

How To Look, Act And Sound Like A Professional Corporation

How to Structure a Suitable Buy-Sell Agreement

How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool

Money Purchase Pension Plan Falls Out Of Favor

Protecting A Client's Business From Unfair Competition Using Restrictive Covenants

Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules

What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs

Why An Employment Contract Is Mandatory

Estate Planning Articles

Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples

College Funding Tool Offers Estate Planning Advantage

Diversify Strategies For An Effective Estate Plan

Divorce and Estate Planning

Divorce Raises The Need For Performing An Estate Planning Review

Drafting The Durable Power Of Attorney For Wealth Protection Purposes

Estate Planning For Pet Owners

Remarriage Situations Can Raise Special Estate Planning Considerations

Six Proven Estate Planning Techniques

Special Needs Trust - An Estate Planning Tool For The Disabled

The Limited Liability Company -A Sophisticated Tool For Estate Planning

Using Trusts To Maximize Family Protection And Minimize Estate Tax

Why Living Wills- Advance Directives Are An Essential Part Of Estate Planning

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.

This newsletter is courtesy of Pozzuolo Rodden, P.C.

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