FEBRUARY 2014 NEWSLETTER

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The Fundamentals of the Federal Gift and Estate Tax Exclusion Portability Between Spouses

NEWS ALERT:

UPCOMING SEMINARS:

Joseph R. Pozzuolo, Esquire and Jeffrey S. Pozzuolo, Esquire will be presenting a CPE/CLE at *Penn State Abington Campus* on **Thursday May 22, 2014** from **12:30pm-4:30pm**.

The Topic will be *"Retirement Planning for Middle Income Families"*.

Please contact Theresa M. Bloom, Education Program Manager to sign up.

Call 215-881-7402 or email: tmb17@psu.edu

QUESTION OF THE MONTH:

Revenge Porn- Do I Have Any Recourse?

Answer-See Page 4 of this Newsletter

The Fundamentals of the Federal Gift and Estate Tax Exclusion Portability Between Spouses

"Portability" is a concept under the transfer tax laws of the Internal Revenue Code. Specifically, portability allows a surviving spouse to use a deceased spouse's unused federal gift and estate tax exclusion (up to $5.34 million in 2014). Under the American Tax Relief Act of 2012 (ATRA), portability has become permanent.

1. Federal Gift and Estate Tax Exclusion

A person, John, could make a gift to his beneficiaries, whether during his lifetime or at his death, of up to $5.34 million without incurring federal gift or estate taxes on the transfer. The "first $5.34 million tax free" represents the gift and estate tax exclusion. The exclusion is "unified" which means that whatever portion of the unified exclusion John uses during his lifetime will no longer be available for use at his death. For example:

> John makes a lifetime taxable gift of $2 million in 2013. John dies in 2014. John will have $3.34 million of the estate exclusion amount remaining at his death, such that the first $3.34 million of his estate may pass free of federal estate taxes.

Every person is entitled to use the unified exclusion. In the past, when portability did not exist, married couples had strived to take full advantage of both of their estate tax exclusions through estate planning techniques. A common technique was to draft wills whereby the first-to-die spouse's estate would fund a trust, usually called a family or unified credit trust, using the full amount of the exclusion. The balance of the first-to-die spouse's estate would then pass either outright or through a trust to the spouse, taking advantage of the unlimited marital deduction. The result would be that the first-to-die spouse's estate would incur no federal estate taxes.

The lack of portability, however, meant that eventually, depending on the size of the spouses' estates, some portion of the first-to-die spouse's exclusion could go forever unused or some portion of the second-to-die spouse's estate could be subject to the 40% federal estate tax rates. For example:

> John dies leaving a $3 million estate, which passes through to a family trust, incurring no federal estate taxes. Without portability, John's remaining exclusion amount of $2.34 million would go unused. Furthermore, if John's wife had a substantial estate in her own right, such that her estate was greater than $5.34 million, her estate would incur estate taxes on the excess amount at a marginal rate of 40%.

2. <u>Portability</u>

If a first-to-die spouse dies in 2014 having not fully used the federal estate tax exclusion, the unused portion can be transferred to the surviving spouse. The surviving spouse's exclusion, for both gift and estate tax purposes, is the sum of his/her own exclusion plus the first-to-die's unused amount.

Thus, in the above example, when John dies leaving a $3 million estate to the family trust and an unused $2.34 million exclusion, John's wife would have a cumulative $7.68 million exclusion to use in the future for lifetime gifts or at her death. On the other hand, if John were to give his $3 million estate outright to his wife at his death, taking advantage of the unlimited marital deduction, then his entire $5.34 million exclusion would be available for his wife to use. She would have a total of $10.68 million in exclusion amount.

There are certain procedural issues to consider when taking advantage of portability, such as the fact that an election must be made by the estate of the first-to-die spouse. Making the election requires the filing of a federal estate tax return even if otherwise unnecessary. Furthermore, there are special rules governing portability where a surviving spouse remarries and has had multiple spouses predecease him or her. These rules must be examined closely when determining which unused exclusion may be used and in future gift and estate tax planning.

3. <u>Planning with Portability</u>

The fact that portability has become permanent certainly creates options in estate planning. While portability should not be the only estate planning tool relied on, it can be integrated with other estate planning techniques.

Before portability, the estate planning techniques described above, such as family trusts, were the common techniques. However, those techniques generally required that spouses evenly split and possibly, re-title their assets. Portability allows for flexibility and the avoidance of splitting of assets some of which may be impractical to split. In fact, with portability, there may be instances where spouses, even with substantial estates, make simple straightforward wills whereby they leave their entire estate to each other outright. Then, the second-to-die spouse could simply re-write his or her will at a later time.

It is still safe to assume though that the use of the traditional trusts is best because portability only enhances their benefits in estate planning and it is this firm's opinion that the tax exclusion portability should primarily be used to cover up for drafting or planning mistakes. For example:

> The unused exclusion amount does not appreciate over time. That is, while the exclusion itself will adjust year-to-year for inflation, the unused exclusion amount from a first-to-die spouse's remains stagnant. By funding a family trust at the first-to-die spouse's death, all subsequent appreciation of the family trust fund is also shielded from federal estate taxes at the second-to-die spouse's death. If the couple were rely only on portability and there is any time gap between the death of the first spouse and the time the surviving spouse subsequently uses the first-to-die spouse's unused exclusion amount, any appreciation occurring in the time gap that is not covered by the first-to-die spouse's unused exclusion may be subject to estate taxes.

Furthermore, by placing assets in a family trust, the couple will obtain the benefits of asset protection and asset management. In fact, a trust will easily create a legal barrier between the property held in trust and the spouse, his/her creditors, a divorcing spouse, undue influence, fraud, coercion and misrepresentation. In fact, financial exploitation is a fast-growing form of abuse of the elderly and it normally involves a trusted person in the life of the vulnerable adult. Moreover, only one in nine seniors report the above abuse with 1 in 20 older adults indicating some form of financial mistreatment. See January 6, 2014 blog on www.pozzuolo.com. For example, the surviving spouse may be an income beneficiary and/or discretionary principal beneficiary, yet the assets of the trust are protected from his or her creditors, a second spouse and undue influence/fraud. This is especially true when the surviving spouse is not good with managing his/her own money. That would not be the case if those assets were to pass to the surviving spouse outright.

Ultimately, portability may be beneficial for some families, and not for others. There are many considerations that will go into how and why a couple would use portability, and from there flows many different estate planning options and even lifetime gifting options. Each person's estate planning is unique and it is best to contact your estate planning attorney or professional to determine what techniques are best for you.

QUESTION OF THE MONTH:

Revenge Porn- Do I Have Any Recourse?

During the past few years this office has been contacted on more than a few occasions by parents of college and post college age daughter whose nude or semi-nude photographs have been posted on line by a former boyfriend. The parents were incensed and want to pursue any and all criminal and civil remedies against the former boyfriend.

In today's society where social media blurs the lines of personal privacy, more and more people are becoming the unwitting victims of revenge porn. Revenge porn is the term for the publishing of nude or semi-nude videos and/or photographs without the subject's permission. The typical scenario, which gave revenge porn its name, arose when a person in a relationship would share nude photographs of himself or herself with his or her partner, and that partner would post the pictures online after the relationship ended as a form of revenge. However, there are other types of non-consensual pornography, including victims whose emails and computers were hacked with private images stolen or even individuals who have had photographs of victims altered to appear nude, that can fall under the umbrella term revenge porn.

Currently, no federal criminal law exist to specifically provide protection to victims of revenge porn and California and New Jersey are the only two states with existing criminal statutes directly addressing revenge porn. In Pennsylvania, Senate Bill 1167 has been proposed to criminalize revenge porn. Accordingly, in most states, victims are forced to attempt to find redress under existing civil or criminal laws that were not specifically tailored to address revenge porn scenarios.

Victims of revenge porn have attempted to bring civil tort claims for intentional infliction of emotional distress and other torts, but often times this can be a challenging and costly option. One of the problems is that many internet sites that allow posting of revenge porn photographs and videos protect their members' identities so a victim may not even know who to name defendant in such claims. Furthermore, one of the main problems with a civil tort remedy is that it does not often apply to successor internet entities that actually republish the offending photographs, so often times even after the matter is concluded the offending photographs will have already been reposted on two or three other sites.

Pursuant to the federal law, under the Communications Decency Act ("CDA") internet publishers are often shielded from liability from content submitted by third-party users. This protects internet publishers from being liable for content posted in their user comments sections, and due to the broad protection offered by the CDA, internet sites publishing revenge porn photographs submitted by third parties are also shielded from liability.

Victims of revenge porn may also attempt to bring claims pursuant to copyright law. This is useful because internet publishers can be subject to liability for violations of copyright law and this could lead to the removal of the offending photograph from the internet. Copyright law allows a victim to send the internet publishers takedown notices or be at risk for copyright infringement. The largest limitation to copyright law is if the victim does not hold the copyright to the image at issue. Typically the photographer is found to be the owner of the copyright, but victims of revenge porn who were not the photographer can attempt to establish joint ownership of the copyright. However, it is unknown to what extent, if any, that courts will recognize such joint ownership.

In conclusion, if you have been the victim of revenge porn or are concerned about the effects of revenge porn in our society we strongly suggest you contact your federal and state representatives and request that they support laws criminalizing the posting of revenge porn. Please contact this office if you wish to further discuss these issues.

- If there are any legal questions you would like this office to answer in the future, please email the question to us at info@pozzuolo.com. Each month, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, corporate law, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning, estate administration, tax and pension law, family law litigation.

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

- **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