Insight on Estate Planning

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Digital assets

Does your estate plan account for today's technology?

If you're like many people today, you conduct a good part of your business and personal lives electronically. These activities generate valuable "digital assets" — which may be stored online or on a variety of computers and handheld devices.

Without addressing these assets in your estate plan, your family or other representatives may not be able to access them without going to court and, in some cases, may not even know that they exist.

What are digital assets?

Digital assets include e-mail accounts, online bank and brokerage accounts, online photo galleries, digital music and book collections, and accounts with social networks like Facebook, LinkedIn and Twitter.

For a business, digital assets might include websites, domain names, client and other databases, electronic invoices, e-mail correspondence, and a variety of important records and documents that are stored electronically on the company's servers or on a Web-based storage site.

Why is planning so important?

Traditionally, when a loved one dies, family members go through his or her home to look for personal and business documents, including tax returns, bank and brokerage account statements, stock certificates, contracts, insurance policies, loan agreements, and so on. They may also collect photo albums, safe deposit box keys, correspondence and other valuable items.

Today, however, many of these items may not exist in "hard copy" form. Unless your estate plan addresses these digital assets, how will your family know where to find them or how to gain access?

Suppose, for example, that you opened a brokerage account online and elected to receive all of your statements electronically. Typically, the institution sends you an e-mail — which you may or may not save — alerting you that the current statement is available. You log on to the institution's website and view your statement, which you may or may not download to your computer.

A digital solution for digital assets

It should come as no surprise that several companies now offer online services for passing on digital assets to your loved ones. Popular services include:

- Legacy Locker,
- Entrustet,
- AssetLock,
- VitalLock,
- DataInherit, and
- Deathswitch.

Each service establishes procedures for releasing passwords and other information about digital assets to a designated beneficiary in the event you die or become incapacitated. Some require a death certificate or other confirmation, while others send you periodic e-mails and release information to your designated representative in the event you fail to respond.

If something were to happen to you, would your family or executor know that this account exists? Perhaps you save all of your statements and correspondence related to the account on your computer. But would your representatives know where to look? And if your computer is password protected, how would they get in?

Even if your family knows about a digital asset, they'll also need to know the username and password to access it. If they don't have that information, they'll have to get a court order to access the asset, which can be a time-consuming process — and delays can cause irreparable damage, particularly when a business is involved. If your representatives lack access to your business e-mail account, for example, important requests from customers might be ignored, resulting in lost business.

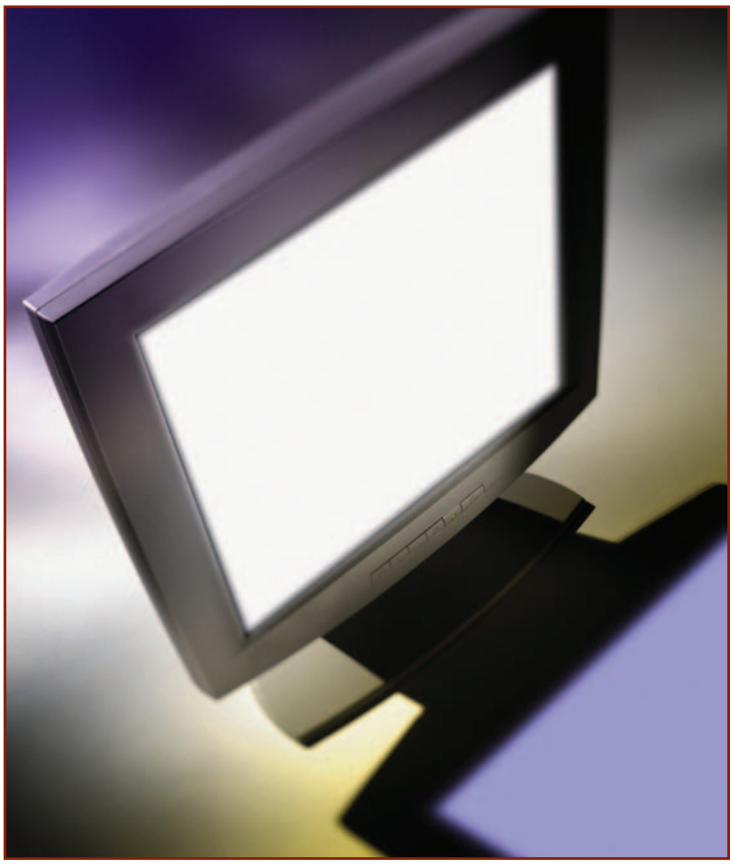
What should you do?

The first step is to conduct an inventory of all your digital assets, including any computers, servers, handheld devices, websites or other places where these assets are stored. Next, talk with your estate planning advisor about strategies for ensuring that your representatives have immediate access to these assets in the event something happens to you.

Although you might want to provide in your will for the disposition of certain digital assets, a will isn't the place to list passwords or other confidential information. For one thing, a will is a public document. For another, amending your will each time you change a password would be expensive and time consuming.

One solution is writing an informal letter to your executor or personal representative that lists important accounts, website addresses, usernames and passwords. The letter can be stored in a safe deposit box, with a trusted advisor or in some other secure place. However, the problem with this approach is that you'll need to update the list each time you open or close an account or change your password, a process that's cumbersome and easily neglected.

A better solution is to establish a master password that gives your representative access to a list of passwords for all your important accounts, either on your computer or through a Web-based "password vault." Another option is to use one of several online services designed for digital asset estate planning. (See "A digital solution for digital assets" on page 2.)



Next steps

The strategies outlined here help your representatives identify and gain access to digital assets after you're gone. But it's also important for your estate plan to deal with ownership issues involving digital assets. This can be done in your will or by using a trust that provides the trustee with the authority to manage digital assets and transfer them to your beneficiaries according to your wishes. ▮

TICs offer simple alternative to FLP, FLLC

For affluent families, family limited partnerships (FLPs) and family limited liability companies (FLLCs) can be effective vehicles for reducing gift and estate taxes and protecting assets from creditors. But they also have some downsides. For certain tangible assets — particularly real estate — transferring tenancy in common (TIC) interests can be an attractive alternative.

FLP/FLLC vs. TIC

FLPs and FLLCs can be beneficial in part because of the valuation discounts they can provide. They're particularly useful for transferring interests in a family business, but they may also be appropriate for other types of assets, including real estate and marketable securities.

However, FLPs and FLLCs can be costly to establish and administer. There's also some risk involved: The IRS has been known to challenge FLPs and FLLCs as tax avoidance devices, and some lawmakers would like to see their benefits curtailed.

TIC interests generally produce lower valuation discounts than FLPs and FLLCs, but they're simple to create and are less susceptible to an IRS challenge.

TIC interest in action

A TIC interest is an undivided fractional interest in property. So, for example, if you transfer equal TIC interests in real estate to your three children, then each child owns an undivided one-third interest in the property. "Undivided" means that each child has the right to use the entire property (as opposed to dividing the property into separate tracts).

A TIC interest holder may not take any action with respect to the entire property — such as selling or leasing it — without the consent of his or her co-owners. But each co-owner is free to sell, mortgage or otherwise dispose of his or her TIC interest without the consent of the other owners. A buyer would receive an undivided

fractional interest in the property and would share ownership with the remaining tenants.

When a co-owner dies, the TIC interest is transferred to his or her heirs or beneficiaries according to the terms of his or her will or trust. In contrast, an interest in property held as joint tenants with rights of survivorship would pass to the surviving co-owners.

Each co-owner retains a right of partition — that is, the right to petition a court to split the property into separate parcels or, if that's impractical, to force a sale of the property and divide the proceeds among the co-owners.

Valuation discounts

Because a buyer must share the property with other co-owners, TIC interests are generally more difficult to sell than 100% ownership interests. In addition, a TIC interest holder has less control over management of the property than a 100% owner.

To reflect this lack of marketability and control, valuation discounts are appropriate for gift and estate tax purposes. The size of the discount varies depending on the nature of the property and other factors, but discounts typically range from 15% to 50% or more. The result: substantially reduced values for gift and estate tax purposes.

Beware of the risks

The IRS and the courts generally recognize that TIC interests are entitled to valuation discounts. But there's a risk that the IRS will seek a lower discount than what is claimed on the relevant gift or estate tax return. Previously, the IRS took the position that the discount should be equal to the estimated cost of partition, the theory being that partition rights provided an exit strategy that eliminates concerns over lack of marketability or control.

The IRS and the courts generally recognize that TIC interests are entitled to valuation discounts.

The U.S. Tax Court has rejected this approach, however, finding that the cost of partition is merely one of many factors that affect the size of valuation discounts. Other relevant factors include the nature, location, size and topography of the property; the relative size of the interest being valued; the co-owners' ability and desire to hold on to their interests; and the cost and time involved in selling the whole property.

These factors can greatly affect the size of valuation discounts. For example, a property that can be sold quickly without resistance from the other owners would be substantially more marketable (and, therefore, discounted less) than one for which a sale would likely trigger a bitter, lengthy partition proceeding.

Get an appraisal

To avoid unpleasant tax surprises, it's a good idea to have TIC interests appraised by an independent, qualified appraiser. A professional appraisal will help you support and document any valuation discounts claimed on gift or estate tax returns so you can maximize the benefit from this estate planning tool. ▮

Before walking down the aisle …

… Consider the benefits of a prenup

Prenuptial agreements are commonly associated with divorce. And while the agreement provides couples control over assets in the event of a split, it can also preserve your estate by protecting assets from creditors and help ensure your estate is distributed as you wish.

Prenup and communication

A common misconception associated with a prenup is that the very existence of one means the marriage is bound to end in divorce. In fact, a Harvard Law School study concluded that a solid prenuptial agreement actually *improves* the chances of a successful marriage by getting couples to talk about what kind of marriage they want and what the legal consequences should be if one spouse veers off course.

Preparing a prenup encourages an open discussion of financial matters and requires each person to fully disclose all of his or her assets, liabilities and income sources. If a prenup doesn't include a complete financial inventory, there's a risk that it later will be challenged on the grounds that one spouse didn't fully understand what he or she was agreeing to.

Prenup and your estate plan

From an estate planning perspective, prenups are particularly useful if you have children from a previous marriage or you own a business you wish to leave to family members who work in the business. Most states give the surviving spouse rights to a substantial portion of the deceased spouse's estate, regardless of the terms of the will.

In community property states, for example, the surviving spouse has a 50% interest in all community property, which includes most property acquired during the marriage (other than by gift or inheritance). Most other states give the surviving spouse the right to an elective share of the deceased spouse's estate (one-third, for instance) that supersedes the will.

These rights can easily derail your plans, but a carefully drafted prenuptial agreement can override them and ensure your wishes are carried out. Even if you feel confident that your future spouse would never exercise the right to "take against the will," what if he or she becomes incapacitated and has left the decision to a guardian or other designee? A prenup can ensure that both spouses' wishes are clearly communicated to all concerned.

Postnup option

It's not unusual for couples to forgo drafting a prenup before the wedding. If after the fact you wish you could take advantage of a prenup's asset protections, you may have the option of creating a postnuptial agreement. Many states permit postnuptial agreements, but they require special care. Why? Because courts are particularly watchful for any signs of fraud or undue influence.

Also, keep in mind that, for a contract to be legally binding, each party must provide

"consideration." In other words, each party must exchange something of value, such as money, property, services or a promise.

With a prenuptial agreement, the marriage itself serves as consideration. But a postnuptial agreement requires additional consideration, such as a mutual release of marital property rights or a transfer of certain property from one spouse to the other.

Before you tie the knot

If you're soon to be married, consider adding one more thing to your wedding planning list: drafting a prenup. In addition to giving you certainty as to the distribution of assets in the event your marriage dissolves, it also can help you achieve estate planning goals. Consult with an experienced estate planning attorney to draft your prenup because it must comply with applicable state law. ▮

Estate Planning Pitfall

You haven't properly funded your living trust

For many people, avoiding probate is an important estate planning objective. Probate can be costly and time consuming, and its public nature raises privacy concerns. An effective tool for avoiding probate is a revocable, or "living," trust. It can also be used to manage your assets if you become incapacitated.

For a living trust to work, you must transfer assets to it that would otherwise go through probate — a process known as "funding" the trust. Most people fund their trusts around the time they sign the trust documents.

Once your estate plan is complete, however, it's easy to overlook the need to transfer later-acquired assets to your trust. If you don't transfer them, those assets may be subject to probate and will be outside the trust's control if you become incapacitated.

To avoid these problems, consult your estate planning advisor periodically — and any time you acquire a major asset — to be sure your trust is properly funded.

Procedures for transferring assets to a trust vary depending on the asset type. To transfer real estate, for example, you must execute and record a deed conveying title to the trust. Transferring bank and brokerage accounts typically involves providing forms or letters of instruction to the institution holding the accounts. Interests in closely held businesses usually require a simple assignment. Tangible personal property may require an assignment or bill of sale.

Certain assets *shouldn't* be transferred to a living trust, such as IRAs and qualified retirement plan accounts. These are "nonprobate" assets, so avoiding probate isn't an issue, and transferring them to a trust is considered a taxable withdrawal. Instead, you can simply name an individual as beneficiary. Or, if you don't want an individual to have complete control over the account, you can name your trust as beneficiary. But you'll need to take care to structure everything properly. Otherwise, the entire account balance may have to be withdrawn sooner than your heirs would prefer, potentially causing undesirable tax consequences.