FALL 2007

BRACEWELL & GIULIANI

# YOUR TRUSTED ADVISOR

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Bracewell & Giuliani LLP is a prominent international law firm. With more than 400 lawyers in Texas, New York, Washington, DC, Connecticut, Dubai, Kazakhstan and London, we serve clients concentrated in the energy and financial services sectors worldwide. In 2005, former New York City Mayor Rudolph W. Giuliani joined the firm as a senior partner. His reputation for leadership and problem solving is a unique asset for our clients, which include Fortune 500 companies, major financial institutions, leading private investment funds, governmental entities and individuals.


## PRIVATE FOUNDATIONS CAN HELP ACHIEVE CHARITABLE GOALS

Establishing a private foundation is an excellent way to create a legacy for carrying out charitable objectives. In addition, a private foundation can offer an opportunity to teach younger family members about the importance of philanthropy, and about management and investment techniques.


"A major advantage of a private foundation is that the donor can continue to control the contributed assets."


Private foundations are charitable entities created to hold assets for charitable purposes. Most private foundations undertake charitable activities indirectly. That is, they use their resources to make distributions to other charities. Contributions to a private foundation generally qualify for federal income, estate, and gift tax deductions (subject to technical limitation on deductibility for income tax purposes). A major advantage of a private foundation is that the donor can continue to control the contributed assets. This control applies both to (i) how the contributed property is managed and invested; and (ii) how funds are distributed to charities in the future. Many donors involve their family members as a way to educate family members about investing, as well as to encourage philanthropy in younger generations.

Congress perceives that some people may attempt to use private foundations inappropriately. As a result, private foundations are subject to certain requirements to ensure they are operated for purely charitable purposes. For example, donors and their family members are precluded from "self-dealing" with their private foundations. They cannot sell assets to, or buy assets from, the foundation, regardless of whether the transaction is "fair." While these rules are somewhat complex, most clients who operate private foundations have little difficulty abiding by them.

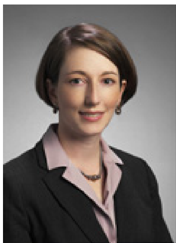
Giving to a private foundation involves some tradeoffs. While you and your family can retain control of the entity, the income tax benefits available for contributions are less generous than those available for contributions to public charities. Cash contributions are generally deductible up to 30 percent of the donor's adjusted gross income (AGI), while contributions of appreciated property are generally deductible up to only 20 percent of the donor's AGI. If the 20 or 30 percent limitation is exceeded, the excess deduction may be carried forward for five years. In contrast, a cash contribution to a public charity is deductible up to 50 percent of a donor's AGI, and a donor may deduct contributions of appreciated property to a public charity of up to 30 percent of his AGI.

In addition to the AGI ceiling placed on deductions, deductions for contributions of appreciated property to most private foundations are limited. In particular, if a donor contributes property other than money or publicly-traded securities, the donor is limited to deducting the cost basis of long-term appreciated property. As a result, most donors limit their

private foundation contributions to cash and marketable securities.

An individual may choose to create a private foundation under his or her will. In that case, the individual's estate is entitled to an estate tax charitable deduction for the amount passing to the foundation, but no income tax deduction is available.

Instead of setting up a private foundation, some donors choose to contribute to a donor-advised fund. A donor-advised fund is a charitable fund connected to a public charity that allows a donor to advise the fund on which charities should benefit from the contributions. (The donor's advice, while generally heeded, is not binding on the fund.) Contributions to a donor-advised fund are deductible to the same extent as contributions directly to public charities. Contributing to a donor-advised fund may be a good alternative to establishing a private foundation for clients who wish to avoid the added compliance work necessary to maintain a private foundation, and who don't mind losing control over the investment of contributed assets.



## Congratulations to Christine Borrett

On becoming Board Certified in Estate Planning and Probate law by the Texas Board of Legal Specialization.

## You Have Been Appointed Independent Executor. Now What?

Most of our clients choose to name an individual, usually a spouse or close family member, to serve as the independent executor of their estates. Serving as an independent executor is a great responsibility and one that should be taken seriously. The following advice is meant to serve as a reminder of some of the fundamental duties and responsibilities that an executor must follow once appointed by the court.

1. Read the will, discuss its provisions with your attorney and make sure that you understand your responsibilities. The will is the road map for the estate administration process.

2. Communicate with the estate beneficiaries promptly, frequently and properly. Frequent communication avoids many of the problems that might otherwise arise during the estate administration process. New legislation, effective for the estates of decedents dying on or after Sept. 1, 2007, *requires* that within 60 days of a will being admitted to probate, an executor give written notice to all beneficiaries. The notice must inform the beneficiaries that a will has been admitted and advise them that they are beneficiaries. The new law also requires the executor to give all beneficiaries a copy of the will. A beneficiary may waive the right to receive this notice. While it has always been prudent to provide the beneficiaries with a copy of the will, the Texas Probate Code now requires it.

3. Provide the beneficiaries with an overview of the assets that make up the estate. Consider sending them a copy of the estate's inventory once it is filed. Likewise, let the beneficiaries know about any debts, including taxes, owed by the estate. Providing this information will help manage expectations about the beneficiary's ultimate inheritance.

> "Communicate with estate beneficiaries promptly, frequently and properly."

4. Give the beneficiaries a timetable for the estate administration process. While simple estates can often be settled in as little as three months, other factors, including the size of the estate, the assets involved, whether an estate tax return will be required and whether an audit is likely, may cause the period of administration to be longer. Administration of a complex estate that owes federal estate tax can often take a year or more to complete. Most beneficiaries have no idea about the amount of time that may be required to administer the estate.

5. Secure the decedent's personal residence and any other real estate. Make sure that estate assets, including vehicles and boats, are properly insured. Inventory any items of personal property that could be subject to theft; consider making a video recording of the personal effects. While it is the executor's duty to safeguard the estate's property, these responsibilities should be exercised with sensitivity to the beneficiaries so that they do not feel unnecessarily shut out of the estate administration process. Again, communication is the key.

6. Notify financial institutions that issued credit cards or bank debit cards of the decedent's death and destroy the cards. The surviving spouse of the decedent should consider establishing credit under his or her own name before closing the decedent's accounts.

7. Consider obtaining written consents from the beneficiaries prior to undertaking any major transaction on behalf of the estate. While an independent executor is not required to get the approval of the beneficiaries for his or her actions, beneficiaries should be provided full disclosure. Prompt and full disclosure of transactions involving major assets of the estate may prevent beneficiaries from later second-guessing the executor's actions.

8. Keep complete records of your activities as executor. In most estate administrations, family members work together to help streamline the process. However, in some situations, questions or problems do arise. A thorough paper trail documenting the actions taken by the independent executor may help beneficiaries better understand the actions taken.

Many of our clients have read recent stories in the local press about problems with the probate process and our judicial system. The press reports may have been exaggerated, and these situations are by far the exception to the rule. We do advise our clients, however, to take their role as executor seriously. Be sure to consult with your advisors, including the estate's probate lawyers and accountants, in the estate administration process in order to minimize the issues and problems that can arise following the death of a loved one.

## IRAs Inherited From Non-Spouses Are Not Protected from Creditors

A recent case decided by the Bankruptcy Court for the Southern District of Texas reminds us why creating testamentary trusts for children can be an important part of any estate plan. While funds held in a retirement plan or Individual Retirement Account (IRA) are generally exempt from creditors' claims, the Bankruptcy Court recently held that an IRA inherited by someone other than a spouse is not protected from the beneficiary's creditors in bankruptcy proceedings.

The case involved a debtor who filed for bankruptcy, but claimed that the IRA he inherited from his mother was exempt from his creditors under Texas law. While Texas law seems to treat all IRAs the same, it incorporates federal income tax statutes that treat a person's own IRA (or an IRA inherited from a spouse) differently from one inherited from a non-spouse. The differences cited by the court include the fact that the beneficiary of an inherited IRA: (1) cannot roll the IRA over into another account; (2) cannot make contributions to the IRA; (3) can remove funds at any time, without incurring a 10 percent penalty for early withdrawal; and (4) must either start taking lifespan-measured withdrawals in the year following the account owner's death, or withdraw the entire amount within five years. In reviewing Texas law, the Bankruptcy Court reasoned that these differences in tax treatment warranted a different treatment in the bankruptcy context as well.

While clients hope their children will never have to file for bankruptcy, the Bankruptcy Court's ruling illustrates why clients often consider using lifetime trusts for the benefit of their children and other loved ones. Here, if the IRA had passed to a trust for the child that contained appropriate "spendthrift" language, it would have been shielded from his creditors. This case also illustrates the importance of coordinating beneficiary designations of non-probate assets with estate plans. In order to provide creditor protection, the beneficiary of the IRA must be styled as "the Trustee named in the Will of" the IRA owner, and not to the child individually.

## Estate Planning for Young Adults

When we discuss estate planning with clients, we recommend implementing documents that provide for their incapacity. These documents typically include financial powers of attorney, medical powers of attorney, living wills and authorizations for disclosure of medical information. Recent events remind us that these same documents may be important forms to put in place for college students and family members in their 20s and 30s. We recommend clients consider discussing these documents with adult children over 18 years of age.

The importance of having these documents in place is heightened by the patient privacy laws imposed upon hospitals and physicians under the federal Health Insurance Portability and Accountability Act (HIPAA). This statute generally prohibits health care providers from disclosing medical information to anyone without patient authorization. The law provides that a person who knowingly makes an unauthorized disclosure of health information may be fined up to $50,000, imprisoned up to

one year or both. Because of these harsh penalties, health care providers are understandably reluctant to disclose patient information to anyone else, even to the parents of the patient.

Once a child turns 18, parents no longer have authority over their child's financial or medical decisions. In fact, when distressed parents and family members of some students affected by the recent Virginia Tech tragedy tried to discover information about their children, medical providers were unable to release information without proper legal release forms. Thus, we recommend that clients with a college-age child discuss preferences and designate parents or others as attorneys-in-fact to make financial decisions and heath care decisions should the child become unable to do so. In addition, we recommend that children consider signing Authorizations for Disclosure of Protected Health Information and Directives to Physicians, also known as living wills.

When adult children prepare more detailed estate plans, they will decide whether to designate spouses, friends or family members as decision makers. Generally, however, a number of years go by between the time a person attains age 18 and the time he or she considers these estate planning issues.

We are frequently asked by clients to assist their children or parents with simple estate planning matters, often at the client's expense. Before undertaking the representation of more than one generation of family members, we typically seek the express permission of all parties, enabling us to undertake the representation while maintaining each client's confidences.

## Welcome Taylor Hill

Bracewell's wealth management group welcomes Taylor Hill to the team. Ms. Hill earned her law degree with honors in 2005 from The University of Texas School of Law and her undergraduate degree with high honors in 2002 from The University of Texas.

## Will the New Margin Tax Apply to Your Limited Partnership or Trust?

In a recent issue of *Your Trusted Advisor*, we noted that the Texas legislature had repealed its franchise tax, and had adopted in its place a new broad-based "margin tax." In cleaning up the margin tax rules this spring, the Texas legislature removed an exemption aimed at family limited partnerships, applying instead an exemption for all "passive entities."

Under the revised law, only partnerships and non-business trusts can qualify as passive entities. Corporations and limited liability companies cannot use this exemption, and as a result, will always be subject to the margin tax if their revenues exceed $300,000 per year. Surprisingly, under the new law, even a trust may be subject to the margin tax if it does not satisfy the passive income test.

A qualifying entity is a "passive entity" only if the entity does not receive more than 10 percent of its federal gross income from conducting an active trade or business, and the entity's federal gross income for the year consists of at least 90 percent of the following:

1. Dividends, interest, foreign currency exchange gain, periodic and non-periodic payments with respect to notional principal contracts, option premiums, cash settlement or termination payments with respect to a financial instrument and income from a limited liability company;

2. Distributive shares of partnership income to the extent that those distributive shares of income are greater than zero;

3. Gains from the sale of real property, commodities traded on a commodities exchange and securities; and

4. Royalties, bonuses, or delay rental income from mineral properties and income from other non-operating mineral interests.

Note that passive income does *not* include: (a) rent; or (b) income received by a non-operator from mineral properties if the operator is an affiliated company acting under a joint operating agreement.

If you hold an interest in a partnership or are serving as the trustee of a trust that derives more than ten percent of its gross income from rents mineral properties, or an active trade or business, please contact our wealth management group so we can discuss how to best address the possible application of the new margin tax.

**If you wish to receive future issues of *Your Trusted Advisor* electronically, please let us know by e-mailing toni.brown@bgllp.com.**

**Contact the Wealth Management Group at: 713.223.2300**

Mickey R. Davis mickey.davis@bgllp.com
Bridget O. Purdie bridget.purdie@bgllp.com
Matthew J. White matthew.white@bgllp.com
C. Christine Borrett christine.borrett@bgllp.com
A. Taylor Hill taylor.hill@bgllp.com