

# THE REPORT



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## NEW ESTATE AND GIFT TAX LAWS

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "Act") significantly changes the federal estate and gift tax laws. This article summarizes the Act's key changes and provides our observations about the Act's impact from an estate planning perspective.

### ESTATE TAXES

Before the Act, the federal estate tax was gradually reduced over several years and then eliminated for decedents dying in 2010. Prior law provided that the estate tax, with a maximum tax rate of 55% and a \$1 million estate tax exclusion amount, would be reinstated after 2010.

The Act reinstates the estate tax for decedents dying during 2010, but at a significantly higher estate tax exclusion amount of \$5 million, and a lower maximum tax rate of 35%, than under prior law. These estate tax laws continue for decedents dying in 2011 and 2012. Unfortunately, the new laws are temporary and will expire on December 31, 2012 and the prior estate tax laws, with a 55% maximum estate tax rate and a \$1 million estate tax exclusion amount, are reinstated at that time.

The Act also provides for "portability" between spouses of the estate tax exclusion amount for estates of decedents dying in 2011 and 2012 if both spouses die before 2013. Generally, portability allows surviving spouses to take advantage of the unused portion of the estate tax exclusion amount of their predeceased spouses, thereby providing surviving spouses with a larger exclusion amount. Special limits apply to decedents with multiple predeceased spouses.

### GIFT TAXES

For gifts made in 2011 and 2012, the Act limits the maximum gift tax rate to 35% and increases the gift tax exclusion amount to \$5 million. As discussed below, this change provides an opportunity to move significant amounts of wealth free of estate and gift taxes. Donors continue to be able to use the annual gift tax exclusion before having to use any part of their lifetime gift tax exclusion amount. The annual exclusion amount is \$13,000 per donee (married couples may continue to "split" their gift and may make combined gifts of \$26,000 to each donee).

### OBSERVATIONS REGARDING THE ACT

The estate and gift tax provisions of the Act are very favorable because of the substantial increase in the estate tax exclusion amount (\$5 million) and the lower estate and gift tax rate (35%).

The Act is a temporary fix, which expires on December 31, 2012, immediately after the next election cycle. It is impossible to predict whether it will be extended in either its current or some modified form, especially given the fact that taxes are a hot-button issue with both major political parties. If Congress fails to act, the Act will lapse and

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## CAPTIVE INSURANCE COMPANIES FOR PRIVATE COMPANIES? YES!

Most owners of privately held companies have either never heard of a captive insurance company (CIC), or thought it only applied to public companies, or see it as a risky offshore tax “scheme” to be avoided. Let’s separate fact from fiction.

A CIC is a corporation that provides insurance to an insured business entity. The CIC issues insurance policies are tailored to address the risks that the business entity wants to insure. If the CIC is set up as a “small” insurance company, the premiums paid to it are tax deductible by the insured business and are received tax-free by the CIC.

The CIC can be owned by one or more owners of the insured business entity, even if such owner(s) own the insured business. Thus, funds of the insured business entity can be moved out of one company on a tax-deductible basis and placed in the CIC, without the CIC paying tax on such funds. In time, the CIC can grow to be significant in terms of its holdings and value. In the simplest plan for using a CIC, dividends can be paid by the CIC to its owner(s), currently taxed at 15% under the Internal Revenue Code, or the owner(s) can liquidate and dissolve the CIC, taking the funds out of the CIC at a capital gains tax rate (also currently 15% under the Code).

A CIC can be owned, in whole or in part, by family members of the owners of the insured business, or by a trust for such family members. For family wealth planning purposes and with proper structuring, funds moved out of the insured company to the CIC create value of the CIC and its ownership can be passed to children and grandchildren of the business owners free of gift, estate and generation skipping taxes. Thus, a CIC can be valuable for retirement planning, for buying out business owners on death or retirement, and it can invest in ventures that the owners of the insured business have an interest in. There are other interesting uses of the CIC as well (e.g., use in structure to buy life insurance with tax deductible dollars of the insured business).

A “small” CIC is one to which no more than \$1.2 million of premiums are paid per year. Section 831(b) of the Internal Revenue Code expressly provides that insurance companies with such a premium limit can qualify for the exclusion of such premiums as income for income tax purposes, and §162 of the Code provides for the tax deduction as an ordinary or necessary business expense.

As an insurance company, the CIC becomes licensed in

jurisdictions that have appropriate laws. The jurisdictions for establishing a CIC are foreign (offshore) or domestic (i.e., Kentucky, South Carolina, Utah, Vermont, and others). Owners may have varying reasons for preferring one over the other, but must follow Internal Revenue Code requirements governing jurisdiction.

A newly established CIC is typically not used to replace existing commercial insurance, because it has insufficient capital and reserves to cover big risks/losses. But there

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are many kinds of insurance policies that can be written by the CIC, including gap insurance, insurance to cover deductibles, cyber insurance, employee theft insurance, D&O insurance, loss of key customer insurance, insurance to cover commercial policy exclusions, and many more. With a CIC, an owner can build asset values inside the CIC and with management of the claims that may arise for which there is CIC insurance, the CIC can grow to have considerable value.

A couple rules of thumb: (i) as a practical matter because of costs to set up a CIC, the business entity

should fund (pay premiums) of at least \$300K per year; and, (ii) annual premiums should not exceed 20% of insured’s gross revenue, according to the IRS.

Setup costs range from \$60,000-\$80,000. This includes analysis, actuary fees for setting the policy premiums, preparation of the insurance policies, formation of the CIC, formation of related entities (e.g., limited liability company for acquiring life insurance or for other purpose), formation of one or more trusts for family wealth planning (e.g., dynasty trust), application documents, filing fees paid to regulatory agency, and related planning on beneficial uses of the CIC by its owner(s). After the CIC is established and in operation, ongoing management will be needed to address and process claims, report semi-annually to the relevant insurance departments, conduct annual audits, oversee investment of the CIC’s funds to comply with regulatory liquidity requirements, respond to owners’ inquiries, and address general issues that may arise from time to time. Management is often provided via a management agreement with a firm that will handle all of the management for an annual fixed fee of \$36,000 - \$50,000 per year. These fees are business expenses and are tax deductible.

For more information about the uses and benefits of a CIC, please contact Jack Butler or your CPM attorney.

**NEW ESTATE AND GIFT TAX LAWS**

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the estate tax will revert to what it would have been under prior law (i.e., \$1 million estate tax exclusion amount and 55% maximum estate and gift tax rate).

From 2001-2010, the exclusion amount for gift tax purposes has been \$1 million. The Act increases this to \$5 million, or \$10 million per married couple. This change provides an unprecedented opportunity to move substantial amounts of wealth out of individuals' estates. Given the fact that the Act will expire without further Congressional action in 2012, we are advising clients that it would be prudent to implement estate planning techniques utilizing lifetime gifts before the December 31, 2012 expiration date.

One of the more notable provisions contained within the Act is the "portability" provision, which provides that if one spouse does not fully utilize his/her entire \$5 million estate tax exclusion amount, the unused portion can be used by the surviving spouse's estate. The initial reaction is that portability avoids the need for trusts (so called Marital/Family or A/B trusts) that are designed to take full advantage of the estate tax exclusion amount in both spouses' estates. However, both spouses must die before 2013 in order to benefit from the portability provision. Further, these trusts continue to provide the following significant additional benefits beyond just the use of each spouse's estate tax exclusion amounts:

- Ensuring that assets contained in the trusts pass to children of the couple and not to any new spouse of the surviving spouse or others.
- Ensuring that appreciation on the assets in the trust, which may exceed the estate tax exclusion amount at the surviving spouse's death, is not subject to estate tax at that time.
- Protection of assets in the trust from creditors of the surviving spouse, including any marital claims of future spouses.

Given the fact that the portability provision is scheduled to expire in 2012, as well as for the reasons stated above, for now we are advising clients to continue to use these trusts.

**SUMMARY**

To summarize, the key changes discussed above include the following:

- The estate tax exclusion amount increases to \$5 million per person for 2010 through 2012.
- The maximum estate and gift tax rate is reduced from 55% to 35% for 2011 and 2012.
- A "portability" provision is included, which allows surviving spouses to use any estate tax exclusion amount that is not used by the first spouse to pass away.
- The generation skipping tax ("GST") exemption amount is increased to \$5 million for 2010 through 2012.

- The Act expires at the end of 2012, thus making the foregoing changes temporary in nature.

We recommend that clients review their estate plans periodically and/or whenever a significant event occurs (e.g., change in laws, birth of a child, death of a spouse, significant change in net worth, etc.).

For clients with substantial amounts of wealth and with closely held businesses, we highly recommend that such clients consider using lifetime gifts to take advantage of the current \$5 million lifetime gift tax exclusion amount, which will expire absent further Congressional action at the end of 2012.

Please do not hesitate to contact us with any questions that you might have or if you would like to discuss your estate plan in light of the Act.

**DOL May be Looking for You!**

Think your record-keeping practices are up to snuff? Think again. If you currently keep records to comply with the Fair Labor Standards Act (FLSA), your obligations may soon change. The Wage and Hour Division of the Department of Labor (DOL) plans to introduce rules requiring employers to provide workers with basic information about their employment, including the way in which pay is calculated. The proposed rule would also require employers to conduct a classification analysis on all employees, provide a copy of the analysis to the employees, and retain a copy in the event a DOL investigator requests it. The proposed rule will also address failure to comply with these requirements.

Now would be a good time to review your record-keeping policies. If audited, you may be asked to demonstrate that you have:

- Time sheets for all employees going back three years, and corresponding pay records
- Pay-related policies, including safe harbors, that may be contained in your handbook
- Job descriptions and organizational charts to support overtime exemptions.

For more information about pay policies, job descriptions, or record-keeping requirements, please contact Megan Boiarsky, Brigid Heid, Joëlle Khouzam, or your CPM attorney.

## IN THE NEWS

**Brent Rosenthal** has been appointed as District Governor for Rotary District 6690 beginning July 1. District 6690 encompasses 59 Rotary Clubs and 3800 Rotarians in central and southeast Ohio.

**Scott Mergenthaler** recently worked with a firm client whose workers compensation premium statement showed a 463% increase, from \$28,000 a half-year to over \$190,000 a half-year, as a result of the Bureau's change in the manual classification of the company's employees. Reversing this misclassification saved the company over \$325,000 in premiums a year that was otherwise being assessed. If you have reason to believe that your manual classifications do not accurately reflect the job duties of your employees, please contact your CPM attorney well in advance of the next BWC billing cycle.

In a case of first impression decided by the Ohio Supreme Court, **Leon Friedberg** successfully overturned determinations by the State Tax Commissioner and the Board of Tax Appeals that would have assessed nearly \$700,000 plus interest and penalties against a corporate officer deemed a "responsible party" for the payment of the company's unpaid motor fuel taxes. The Tax Commissioner argued there was no deadline to making such an assessment; Leon successfully argued that such an assessment could only be made within four years of the company's tax return filing date. Congratulations, Leon, on handling this complex and unusual appeal!

**John Wilkerson** has been appointed as chair of the Board of Trustees of the Discovery District Special Improvement District. This district is home to the Firm, the Columbus Museum of Arts, the historic Seneca Hotel (which now houses apartments), Capital Law School, Columbus College of Art & Design, Columbus State Community College, and numerous other notable central Ohio businesses, and will also be the home of the 2011 Columbus Arts Festival in June.

Congratulations to **Jane Higgins Marx** and her husband Jeff, who welcomed Nathan Jeffrey on January 2, 2011. Nathan weighed in at 7 lbs. 13 oz. and was 20 inches long. Jane and Nathan are doing great!

Congratulations and best wishes to our friend and colleague **Dennis Stapleton**, of CPM Government Relations LLC, for his recent election as a Delaware County Commissioner!

**Mike Smith** and **Dan Barham** were panel presenters at the recent President's Forum, hosted by the Entrepreneurship Institute.

**Carl Aveni** recently competed on the game show Jeopardy, with airing scheduled to be in late May or early June. Follow the Firm on Facebook for more details.

## CPM Goes GREEN!!

Carlile Patchen & Murphy is concerned about its impact on the environment and has made it a priority to reduce its carbon footprint, and has worked diligently to implement numerous changes that we can all benefit from. Our efforts paid off - in December 2010, the Firm was certified by the City of Columbus as a "GreenSpot"! We will continue to look for ways to improve, and encourage you to contact our Green Team for ideas that you can implement at your workplace.

In the spirit of being Green, if you would prefer to receive your newsletter electronically, please send us a note at [newsletter@cpmlaw.com](mailto:newsletter@cpmlaw.com) and we will make sure your preference is noted.



### Banking & Finance

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- Creditor Right & Bankruptcy
- Loan Documentation/Structuring
- Loan Workouts/Restructuring

### Business

- Business Structures, Financing
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- Warehouse & Transportation

### Family Law

### Family Wealth and

### Estate Planning

- Will & Trusts
- Probate and Trust Administration
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### Labor & Employment

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### Litigation

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### Real Estate

- Acquisitions, Finance & Development
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- Title Agency

### Securities

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- Arbitration/Litigation
- Bond Counsel Underwriter
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- Registered Investment Advisory
- Formation & Representation

### Taxation

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- Exempt Entity Representation
- Like-Kind Exchanges
- Affordable Housing Tax Credits
- New Markets Tax Credits
- Personal Tax
- Qualified and Non-Qualified Deferred Compensation Plans/ESOPs
- Syndications/Tax Opinions