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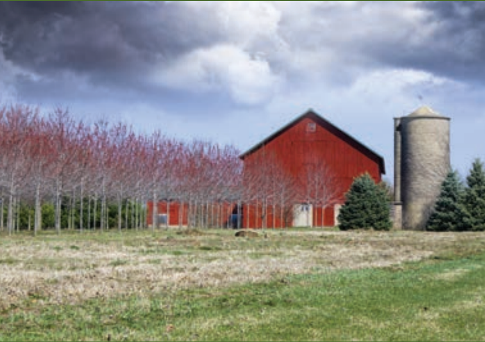
Client Advisory NEWSLETTER

SPRING 2013 • VOLUME NO. 23



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Wright Law Happenings

Laws continue to change, and we do our best to keep up with the changes. Congress averted the fiscal cliff with new tax legislation. From an estate tax perspective, the previous laws were essentially made permanent (see Jim Leonard's article for details). Income tax rates and capital gains rates were increased for high income individuals, as well as increases in employee withholdings and social security tax.

The Farm Bill was extended through September 30th, which may save payments and programs for this year. The next Farm Bill is still uncertain, but many programs are certain to be eliminated. We are monitoring the Farm Bill developments closely and will provide an analysis when Congress finally enacts it.

Last year the Ohio Legislature passed laws that provided greater creditor protection for LLC's. We have incorporated the new law into our LLC documents to take full advantage of these protective provisions.

In addition to keeping up with changes in the law, we also try to maintain the best technology and legal software that we can. We feel this allows us to work efficiently and produce well-drafted documents. We are part of a nationwide estate planning network that provides us with the latest updates and strategies to include in our estate planning work.

Robert & Kelly Moore

Our goal is to be aware of the most recent legal developments and have resources available that allow us to provide you the best legal services possible. It is our pleasure to work with you, and we appreciate your trust in us. We always welcome comments and suggestions as to how we can improve our services.

Would you like to request a presentation to your group from a Wright Law professional? Email your request to madams@wright-law.net or post your event information to our facebook page: www.facebook.com/Wright.Law.Net

Federal Estate Tax Exclusion Is $5 Million – but Good Estate Planning Is Still Needed

by James K. Leonard, *Attorney, OSBA Board Certified Specialist in Estate Planning, Trust & Probate Law*

With the American Taxpayer Relief Act of 2012, the uncertainty is over, at last. The federal estate tax exclusion is $5,000,000. It is indexed for inflation – for 2013, the exclusion is $5,250,000. For an estate greater than the exclusion, the excess will be taxed at 40%.

Jim Leonard, Attorney

For the first time in over 10 years, the federal exclusion is not scheduled to change. The $5,000,000 exclusion is "permanent"; it would take an action of Congress – not simply its inaction – for the exclusion to change.

The federal gift tax exclusion – also $5,000,000 – works in tandem with the estate tax exclusion; it is a combined $5,000,000 exclusion. You can use your exclusion during lifetime and/or at death, up to a total of $5,000,000, before the 40% tax kicks in.

A farm owner receives an additional $1,070,000 exclusion if certain requirements are met, including the farm land being at least 25% of the estate, all farm assets (land, machinery, crops, etc.) being at least 50% of the estate, and the family continuing the farming operation. Qualifying for this exclusion requires careful planning.

Each person has their own exclusion amount to use. With "portability," a surviving spouse can normally also use any unused exclusion of their deceased spouse. For example, if Bill dies and leaves his $4,000,000 estate to his wife Mary, he has not used any of his exclusion amount, because transfers to a spouse qualify for an unlimited marital deduction. This means that Mary will have a $10,000,000 exclusion – her own $5,000,000 plus Bill's – to use for her children's inheritances. (Special portability rules would apply if Mary re-marries and her new husband dies before her.)

The $5,000,000 amount also applies to estate plans with "generation-skipping." Let's say that Susan, a widow, has one child, Tom, who has children. Susan can create a trust for Tom that gives him some rights (income, for example) without allowing him to make unlimited withdrawals during his lifetime. At his death, the trust goes to his children. If the value of this trust is greater than $5,000,000, there will be an extra 40% tax on the excess.

Not changed by the new law are two transfers that do not use any of the $5,000,000 lifetime gifting exclusion. First, there are annual-exclusion gifts – gifts up to $14,000 per year (the 2013 amount) to as many family members or other persons as you choose. Second, there is the payment of a person's tuition or medical expenses. These can be made without limit, so long as the payment is directly to the school or medical provider.

Good estate planning does much more than eliminate estate taxes.

With the Ohio estate tax now abolished and the $5,000,000 federal exclusion with portability, for most people estate-tax minimization is not a pressing aspect of estate planning. However, for a single person with an estate approaching $5,000,000 or more, or a couple approaching $10,000,000 or more, estate-tax planning is still vital. It is also somewhat urgent, because the Obama administration has proposed legislation that will eliminate some of the tax-saving strategies (for instance, asset discounting through the use of a family LLC) that have been successfully used against the IRS.

Besides taxes, there are many other reasons to keep an estate plan up to date. Changes in our lives can give rise to changes in our estate plans. Here are some reasons why you may want to update your estate plan:

1. Will you pass a farm or other business on to just one (or two) of your children? If so, special planning is needed so that the distribution of your estate meets your goals.
2. Do you own farmland that you would like to protect forever from commercial development? If so, you can achieve this goal, plus enjoy significant federal income tax savings, through the use of an agricultural easement.
3. To avoid the probate process at your death, are there assets that need to be re-titled?
4. Are your beneficiary designations for IRAs, other retirement accounts, and life insurance up to date?
5. Do you have the right agents and successors named for your financial General Power of Attorney and your Health Care Power of Attorney? What about the Executor of your Will, and the Trustee of your Living Trust?
6. Are you interested in protecting your assets from lawsuits and divorce? After your death, your estate plan can protect your assets from the creditors of your spouse and children. In fact, under a new Ohio law, effective 3/27/2013, you can protect your own assets from future creditors during your lifetime.
7. Do you need "Medicaid planning" to address the risk of nursing home costs?
8. Would you like to make a gift to your church or other charity at your death? If so, the most tax-wise way to do this is to use part of an IRA or other tax-deferred account.

If any topic in this article is of interest to you, or if you have questions about your estate plan, be sure to give us a call.

Annuity Basics

By Marie Adams, *Attorney*

Marie Adams, Attorney

In the last newsletter I discussed the basic concepts surrounding life insurance. In this article I will attempt to explain annuities. Like life insurance, annuities are often used in retirement planning.

An annuity, in its most basic form, is an insurance contract that enables an individual to purchase a group of stocks or mutual funds, and the investment grows tax-deferred, similar to a defined contribution plan such as a 401(k) or 403(b) plan. The investment is tax-deferred since the earnings are not taxed until they are withdrawn; they are then taxed at the ordinary income tax rate. At retirement age, an annuity provides a steady stream of payments or a lump sum, whichever the annuitant chooses. Withdrawals cannot be made from annuities until the annuitant is age 59½. Withdrawals before age 59½ incur a ten percent early withdrawal penalty from the IRS. Think of annuities as purchasing mutual funds, with a blanket around them, protecting the earnings from taxes. Similar to other investments, annuities come in various sizes and shapes.

The two main types of annuities are deferred and immediate. A traditional deferred annuity grows for a period of time, generally until retirement, and then either pays out a lump sum or a series of payments. An immediate annuity begins paying out shortly after the investment is made. A series of payments from an annuity can be annual, quarterly, monthly. They can also be for the annuitant's life or for a fixed period of time.

Within those two types, there are fixed and variable annuities. Fixed annuities are annuities in which one does not choose any mutual funds, and the insurance company guarantees a fixed payment. Variable annuities are those which the payments may flex based on the underlying investment, the mutual funds chosen by the purchaser. Along with these basic annuities structures, each insurance company builds its product a little differently, with various features and riders available.

Annuities are not right for everybody. There are many advantages and disadvantages to consider. One of the main advantages of annuities is that they allow individuals who have contributed the maximum amount to their IRA, 401(k), 403(b), or 457(b) plan in a given year to contribute additional money to retirement, tax-deferred. Unlike other tax-deferred retirement plans, there is no annual contribution limit for annuities. Then, at retirement, many individuals choose to set up a steady stream of payments for a period of time or for the rest of their life, supplementing their income from their defined benefit or defined contribution plans.

The main disadvantage of annuities is the fees. Annuities almost always have a surrender charge for the first seven years of the investment. It is usually around seven percent and reduces by one percent each year. In addition, annuities charge annual insurance charges and management fees, along with any fees associated with riders chosen by the purchaser. These can all add up to three percent or more, not including the extra options. Also, most annuities are sold by agents or brokers that earn a commission on the sale. Some commissions can be upwards of ten percent. The fees of particular annuities should be weighed carefully against the tax benefits of contributions and other custom product benefits.

One common investment strategy known as a 1035 exchange is when a person who already owns an annuity trades it in for a new annuity and does not incur any tax obligations. This might be attractive to someone who has recently acquired the current annuity and has several more years to invest their money. This individual has time to wait for the surrender charge period to expire and for their investment to grow to take advantage of the new product features. However, the benefits of the new annuity should be considered carefully for someone who is already outside of the surrender charge period and may be getting close to retirement. Although there is no tax penalty for trading the old annuity for the new one, the surrender charge period will likely start over for the new annuity, and the broker will earn another commission on the new annuity.

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Good Estate Administration is Still Critical: A Non-Taxable Estate May Need to File a Federal Estate Tax Return

By Kelly Brakefield Moore, *Attorney*

On January 2, 2013, the President signed the American Taxpayer Relief Act of 2012. Many people were relieved to learn that the federal estate tax exclusion remained at $5,000,000 ($5,250,000 in 2013, indexed for inflation). Additionally, the exclusion is portable between spouses, so a married couple has $10,000,000 of exclusion between them, regardless of which spouse actually owns the assets. For the vast majority of people, the $5,000,000 exclusion is higher than their net worth, so estate taxes are not a concern. However, don't let the high exclusions fool you. Proper estate administration is critical if you are going to take advantage of what the law now has to offer.

Kelly Moore, Attorney

Should Married Couples File a Federal Estate Tax Return at the First Death?

For a married couple, the portability aspect of the federal exclusion has actually increased the need to administer an estate. Portability is not automatic. You must file a federal tax return at the first death in order to elect portability. For example, you and your spouse have $6,000,000 in assets which are titled joint with rights of survivorship. At your death the assets transfer to your spouse. Your estate does not file a federal estate tax return. When your spouse dies she has $7,000,000 in her estate ($6,000,000 plus $1,000,000 in appreciation). She only has her $5,000,000 exclusion. Therefore, she will pay 40% estate tax on the $2,000,000 ($7,000,000 - $5,000,000). Because your estate did not file a federal estate tax return electing portability, your family has incurred $800,000 in taxes.

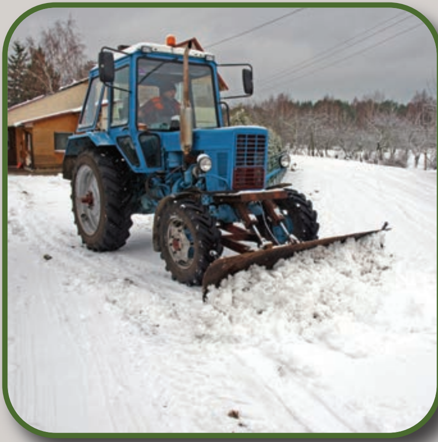
However, if at your death, portability is elected by filing a federal estate tax return, your estate has affirmatively "ported" your $5,000,000 to your spouse. Your spouse now has a $10,000,000 federal estate exclusion to use at her death. The $800,000 in federal estate tax is avoided.

Let's run through another example to show how trusts and portability work together. This time you and your spouse have $6,000,000 in assets which is titled ½ to each of your trusts. You pass away first with $3,000,000 of assets in your trust. The assets remain in your trust, and your spouse has the benefit of the trust for her lifetime. At your spouse's death, $3,500,000 ($3,000,000 plus $500,000 in appreciation) passes to her trust. No federal estate tax is owed. If a federal estate tax return is filed at the first death, the spouse will have an additional $2,000,000 exclusion ported to her. Trusts provide a good backup plan to portability in the event that the surviving spouse's assets increase dramatically, portability is overlooked at the 1st death, or the permanent law turns out to be not so permanent.

In General, When Should a Nontaxable Estate File a Federal Estate Tax Return?

Filing a federal estate tax return will also ensure that the assets of the deceased person receive a step up in tax basis. Estate tax returns must be accompanied by a certified appraisal; without an appraisal the step-up in basis may go unrecognized. For example, you and your spouse own a vacation home jointly. You bought it 20 years ago for $200,000. When the first spouse passes away, the home isn't appraised, and/or a federal tax return isn't filed. Three years later you sell the home for $500,000. You have realized a gain of $300,000 ($500,000 sell price- $200,000 basis). Let's say an estate tax return with an appraisal had been filed with the first death. Your spouse's interest would have received a step-up in basis to $200,000, the FMV at the time of death. Your basis would continue to be $100,000. Therefore the new stepped up basis in the asset would be a total of $300,000. You would now realize a gain of $200,000, likely saving capital gains tax of $15,000 - $20,000.

The new tax law and higher estate tax exclusion did not eliminate the need for estate administration in some cases; it is still highly necessary. In fact, the new estate and income tax laws have developed a need for a more comprehensive approach, both at the estate planning and the estate administration level.



Winter Weather Laws

By Adrienne Fisher, *Attorney*

Love it or hate it, winter weather in Ohio brings ice and snow. Below you will find some information that we hope will help make dealing with the snow and ice a little easier.

Adrienne Fisher, Attorney

Removing Snow and Ice From Your Property

Generally, you do not have a duty to remove naturally occurring snow or ice from your driveways or sidewalks. Because snow and ice are an expected occurrence during Ohio winters, they are treated as open and obvious dangers, and property owners are not expected to take extra measures to protect people from them. However, there may be local ordinances within your village, town, or city that require snow removal.

If you decide to remove naturally occurring snow and ice, you need to use common sense and avoid creating an additional unreasonable hazard. You do not want to do something that will make the situation more dangerous. For example, if you shovel or plow your driveway, you should not plow the snow into the roadway, as this could create an additional hazard for motorists. It is important to note that Courts have not held property owners liable for ice that results from shoveled snow piles that melt and refreeze.

If you choose not to remove the snow and ice, you still need to be aware of any neglected areas that could increase the danger to the public. This most often occurs with poorly placed downspouts or leaky gutters that empty into the sidewalk causing ice to buildup. In that situation, the water and ice is not naturally occurring, it is due to neglected repairs or poor planning, which could result in liability for the property owner if someone is injured as a result of the unnatural ice.

Landlords are not required to remove snow or ice unless it is part of the lease agreement. We recommend that all written leases address the issue of snow removal and whether or not it will be the tenant's or the landlord's responsibility.

Roadway Snow Removal

While the plows are always a welcome sight, there are times when you may experience property damage as a result of your street being plowed. Many local governments have policies regarding mailbox damages caused by snow plows. Some locations will replace the destroyed mailbox while others are more restrictive. Some areas will only replace a mailbox if you can show that it was damaged directly by the plow blade rather than those damaged by the force of snow.

Snow and Ice Removal From Your Vehicle

Ohio does not have a specific law addressing the removal of snow and ice from your vehicle prior to entering a public roadway, but drivers should always do so. This will reduce the risk of a piece of snow or ice falling from the vehicle and causing a hazard or leading to an accident. It will also help prevent accidents caused by diminished visibility.

Snow removal laws vary by state with some requiring the removal of snow and ice prior to entering a public roadway. Also, those traveling on various turnpikes may be refused access until the driver has satisfactorily removed snow and ice from the vehicle.

Studded Tires and Snow Chains

Ohio permits the use of both studded tires and tire chains. Studded tires can be used between November 1st and April 15th of each year. Tire chains can be used as needed when there is snow or ice on the streets or in the immediate vicinity.

These laws will also vary by state so travelers should take care to discover the laws of the states in which they will be traveling.

Headlights and Wiper Blades

Ohio has a relatively new law that requires the use of headlights whenever your wiper blades are in use. Failure to follow this new law is not a primary offense. This means that you cannot be pulled over solely for this offense, but if you are pulled over for another traffic violation, this violation can be added to your ticket.

Snow Emergency

Most of us are familiar with the snow emergency system in Ohio. A level 1 snow emergency means that the roads are hazardous and drivers should use caution. A level 2 snow emergency means that the public should not drive unless necessary, and they should use extreme caution. A level 3 snow emergency means that the roadways are closed to the public and should only be used by emergency personnel. A person who is traveling on a roadway during a level 3 snow emergency could be faced with a traffic ticket and/or criminal charges. More information is available on the Ohio Committee for Severe Weather Awareness' website at *http://www.weathersafety.ohio.gov/snowemergencyclassifications.aspx.*

Income Taxes on Oil & Gas Income – 2013

By David Miller, *Enrolled Agent*

The oil and gas boom in eastern Ohio is still going strong. Reports of lease payments of $5,000 or more per acre are not uncommon for those landowners that are now signing leases. Drilling of wells and the laying of pipelines are underway, and landowners will soon be receiving royalty payments and payments for pipeline rights-of-way or are already receiving these payments. Again, all of this economic activity begs the question, "How much of these payments will go to pay state and federal income taxes?" The federal income tax rates for 2011 and 2012 topped out at 35%. The highest Ohio income tax rate for those years was 5.925%; the tax rate on capital gains maxed at 15%. It was estimated that as much as 41% of the lease and/or royalty payments would go to pay Ohio and federal income tax in 2011 and 2012. However, for 2013 the tax rates are going up, and the amount left after paying taxes will decrease.

The first of the increases is contained in the Affordable Care Act signed into law in 2010. This increase, the 3.8% Medicare tax, applies to net investment income, which includes lease income, royalty payments, pipeline easements and payments for certain damages. This 3.8% tax does not apply to all taxpayers, only those with an adjusted gross income (AGI) that exceeds $200,000 (single), $250,000 (married filing jointly) and $125,000 (married filing separately). For example, if a married couple files married filing joint (MFJ) and has taxable income of $350,000 that includes a substantial lease payment or royalties, their marginal tax bracket is 33%, but since their AGI exceeds the threshold, the 3.8% Medicare tax is applied to the $100,000 in excess of the $250,000 threshold, increasing their marginal tax bracket from 33% to 36.8%. For a single taxpayer with the same income and AGI, the marginal tax rate would be the same at 36.8% (33% + 3.8%).

Additional tax increases starting in 2013 come as a result of the American Taxpayer Relief Act of 2012 (ATRA) signed into law on January 2, 2013. This bill left the existing tax rates in place, but added an additional bracket of 39.6% for taxable incomes exceeding $400,000 (single filers) and $450,000 (married filing jointly). The bill also increased the rates on capital gains to 20% for taxable incomes exceeding $400,000 (single filers) and $450,000 (MFJ). For taxable incomes less than $400,000 and $450,000, the capital gains rates are still 0% and 15%. If a married couple has taxable income of $500,000 for 2013 of which $50,000 is for a pipeline easement and $400,000 is for royalties or lease payments, their tax bracket will be 39.6% since their income exceeds the $450,000 threshold for the uppermost tax bracket. However, the 3.8% Medicare tax kicks in for the excess over $250,000, so their marginal tax bracket will be 43.4%. The payment for the pipeline easement is subject to capital gains rates, but again since the taxable income exceeds $450,000, the capital gains rate is 20% plus the 3.8% Medicare tax for a marginal rate of 23.8%. The marginal tax rates would be the same (43.4% and 23.8%) for the single filer. The Ohio income tax rates are unchanged for 2013 with the highest rate being 5.925%.

So what are the options for deductions in 2013 to reduce taxable income? On this issue there is good news and news that is not so good. The good news is that for the taxpayer who files a Schedule F (farm return) or Schedule C (non-farm business return), the ATRA increased the section 179 expensing option to $500,000 for 2012 and 2013. However, the amount of Section 179 that can be claimed is limited by the amount of business income. Lease payments, royalties and payments for pipeline easements are not business income and will not affect the amount of the section 179 expense claimed. But for the purposes of section 179, damages can be either business or non-business income. Damages paid for the installation of pipelines are business income to the extent the payment is for crop damage and is reported on Schedule F. Other damage payments, usually for land and timber damages, are not business income, are reportable on Schedule D and are taxable to the extent that those damage payments exceed the cost basis in the affected property. In most cases, the section 179 deduction will be limited to the taxpayer's business income.

More good news for taxpayers with business returns is that the 50% special deprecation allowance (SDA) has been extended for 2012 and 2013. This provision allows 50% of the cost of qualifying property to be written off in the year the property is placed in service, and, unlike section 179 expensing, there is no income limit for the SDA. Of course, any legal expenses that are incurred as part of any negotiations are also deductible.

The not so good news is that the ATRA re-introduced the phase-out of itemized deductions and personal exemptions for incomes over $300,000 (MFJ) and $250,000 (single filers). The meaning of this provision is that for every dollar of income over the limit, the taxpayer's total itemized deductions such as charitable contributions, state and local income taxes and real estate taxes, mortgage interest on a principal residence and other deductions will be reduced by the same amount. If the taxpayer's income exceeds the threshold and enough deductible expenses were paid to be able to itemize on Schedule A to reduce their taxable income, those deductions could be reduced to a point where the standard deduction for 2013 ($12,200 for couples and $6,100 for singles) is greater and the itemized deductions are of no value for tax savings. The personal exemption for 2013 is set at $3,900, but completely phases out at an AGI of $422,500 (MFJ) and $372,500 (single). Some tax experts estimate these phase-outs could increase a taxpayer's marginal tax rate 4% to 6% depending on the circumstances.

As a result of the Affordable Care Act and the American Taxpayer Relief Act, taxpayers receiving oil and gas proceeds in 2013 will be paying higher taxes on that income due to rates as high as 55% for state and federal taxes and fewer options to reduce their taxable income. As always, it is recommended that taxpayers consult with their tax advisor to determine their potential tax liability.

New Federal Tax Law Affects Farmers

By Robert E. Moore, *Attorney*

The new federal tax legislation introduced to avert the fiscal cliff will have significant impacts on farmers – some good, some bad. The following is a brief summary of a few of the changes; be sure to consult with your tax advisor to discuss how these changes might affect you:

- A 39.6% income tax bracket was added for persons making over $450,000 (joint filers) or $400,000 (single filers)
- Capital gains tax was increased to 20% for persons making over $450,000 (joint filers) or $400,000 (single filers)
- The 6.2% employee social security withholding was increased from 4.2%
- Estate tax rate was increased to 40%, and the exemption was set at $5,000,000 (indexed) (see Jim Leonard's article for more details)
- Section 179 depreciation was set at $500,000 for both 2012 and 2013
- 50% bonus depreciation was extended for 2013
- An additional 0.9% payroll/self-employment tax was added for persons with incomes over $200,000 (single filer) and $250,000 (joint filers)
- An investment income tax of 3.8% was added to persons making over $450,000 (joint filers) or $400,000 (single filers)
- The Farm Bill was extended through September 30, 2013, but it is unclear as to whether or what payments will be made later this year

The tax law changes will make it even more important for farmers and other business owners to manage their taxable income. The higher capital gains tax rates may result in even less farmland being sold. It is important that farmers and business owners have good, up-to-date business plans and estate plans to ensure that tax liability is being minimized.

Consider Updating LLC Agreements

By Robert E. Moore, *Attorney*

In 2012, the Ohio Legislature updated the Ohio LLC statutes to allow for more creditor protection. Generally, the updated law prohibits the creditors of an LLC member to cause the assets of the LLC to be liquidated. In most situations, the most to which a creditor is entitled is the member's share of any profit distributions.

At Wright Law, we have begun to include "poison pill" provisions in our LLC operating agreements that work in conjunction with the new LLC laws. The poison pill provisions make any creditor who attempts to assert any rights beyond what the law allows, pay for all damages and legal fees incurred by the LLC. We feel that the poison pill provision adds another layer of protection for the assets held in an LLC.

Please contact us if you would like to update your LLC operating agreement to include these new provisions or if you would like to discuss setting up an LLC for your farm or business.

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