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CHARITABLE REMAINDER TRUSTS

As the name implies, a charitable remainder trust involves the transfer of assets to a trust with the income going to an individual or individuals (which can include the owner of the assets) and with a charity receiving the assets at the expiration of the trust period. Such a trust device benefits the individuals who are the objects of the property owner's generosity, transfers assets to the property owner's preferred charities and yields tax savings for the property owner.

If the trust is created during the property owner's life, there is a charitable tax deduction equal to the present value of the charity's remainder interest, and the transferred property will escape federal estate tax. If the trust is established under a will, the charitable tax deduction will remove the property from the taxable estate.

There can be other, not so obvious, benefits. Where appreciated assets are transferred, especially where the assets have a low cost basis and there is a likelihood that the property owner would have sold the assets at some point had he not transferred them to the trust, the property owner avoids a capital gains tax that would be imposed upon an outright sale. If the

trust sells the assets, it will have no capital gains tax liability because the trust is a tax-exempt entity.

If the property owner has established the trust in his lifetime, the fact that the trust can sell the property tax-free maximizes the income base for the income beneficiary, which can be the property owner himself. Moreover, if the trust is a charitable remainder unitrust (CRUT), under which the income is measured as a percentage (no less than 5% of the value of the trust property in a given year), the trust serves as a hedge against inflation for the income beneficiary because as the trust property appreciates in value the income paid out increases. This is not true under the other type of charitable remainder trust, the charitable remainder annuity trust (CRAT), under which a fixed amount of income is paid out each year.

A CRUT can be used as a retirement plan. Although a CRUT usually pays a percentage of the trust's annual value, it can provide that income distributions may not exceed the amount of income actually earned by the CRUT in a given year. Any shortfall in income can then be made up when there is sufficient income. During the property owner's

preretirement years, the CRUT can be invested in growth stocks, thus producing little or no income. Upon retirement, those assets can be sold, with the proceeds invested in income-producing assets that will yield the agreed-upon income percentage, plus a "make-up" portion to compensate for the earlier shortfalls. Thus, income distributions from a CRUT can be minimized during the preretirement years and then maximized for the retirement years.

It is important to remember that a charitable remainder trust must meet a series of technical requirements and, therefore, should be drafted only by an experienced professional.

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NEW IDENTITY THEFT RULES AFFECT BUSINESSES

Faced with the reality that identity theft continues to cause billions of dollars in losses for individuals and businesses each year, the Federal Trade Commission (FTC) has issued “Red Flag Rules” that are intended to fight the problem by requiring businesses to implement procedures designed to detect and respond to identity theft.



Covered Accounts

The rules apply to financial institutions and creditors with “covered accounts.” The category of financial institutions includes entities such as banks, savings and loans, and credit unions holding “transactional accounts,” meaning a deposit or other account from which the owner makes payments or transfers.

The creditor category has raised some eyebrows because it embraces some businesses that in everyday parlance may not have been considered to be creditors. Basically, a “creditor” is

broadly defined as any entity that regularly extends, renews or continues credit. For example, this means not only finance companies, automobile dealers, mortgage brokers and utilities, but also nonprofits and governmental entities that defer payment for goods or services.

An account is a “covered account” for purposes of coverage of the new rules if it is used mostly for personal, family or household purposes, or if it is an account for which there is a foreseeable risk of identity theft, such as small business and sole proprietorship accounts.

Entities subject to the rules must develop a written policy to identify and detect the warning signs—the “red flags” of identity theft. Detection should involve the regular review of accounts, at a minimum. The plan must describe appropriate responses to prevent or mitigate the effects of the crime. There also must be training for staff members, oversight for any service providers, and overarching management of the plan by the board of directors or senior employees of the financial institution or creditor. How extensive a plan must be will vary depending on the size of the entity and the kind of credit accounts it maintains. The new rules also mandate an annual update of the plan.

Red Flags

So just what are the red flags for possible identity theft? An exhaustive list may not be possible,

but a supplement to the Red Flag Rules identifies and describes 26 separate red flags. They fall into five broader categories: (1) alerts, notifications, or warnings from a consumer reporting agency; (2) suspicious documents, including any that have signs of having been altered or forged; (3) suspicious personal identifying information, such as personal information that does not match information from external sources; (4) unusual use of, or suspicious activity relating to, a covered account, such as the use of an account that has been inactive for a long time or, more generally, any sudden and unexplained change in the patterns of activity for an account; and (5) notices from customers, victims of identity theft, law enforcement authorities, or other businesses about possible identity theft in connection with covered accounts.

The consequences for not complying with the Red Flag Rules are significant. The FTC itself has provided for the potential imposition of monetary sanctions and an FTC enforcement proceeding. An even more far-reaching incentive for compliance is not to be found in the fine print of the rules but is no less real: The Red Flag Rules are likely to become the prevailing standard of care for what preventive measures companies are expected to take if they hope to be able to defend themselves successfully in civil lawsuits arising out of identity theft.

FDIC INSURANCE UPDATE

In October 2008, Congress increased the basic limit on federal deposit insurance coverage from \$100,000 to \$250,000. The limit is scheduled to return to \$100,000 on January 1, 2014.

The temporary limit now in effect has not changed the fact that a customer has various means by which to effectively raise the applicable limit for the customer's collection of deposits at any one institution. The basic limit applies separately to different ownership categories. A single account in one name is insured up to \$250,000; a joint account for two or more people is insured up to the same limit, per owner; certain retirement accounts, such as IRAs, are covered up to the limit; and deposits meant to pass on to named beneficiaries on the death of the owner can be protected up to \$250,000 for each named beneficiary. This last category of deposits is a revocable trust account.

There also are other recent changes that favor depositors in insured institutions. For example, it used to be that the only beneficiaries under a revocable trust account who qualified for additional deposit insurance coverage were the account owner's spouse, child, grandchild, parent or sibling. Now an account owner can name almost any beneficiary, such as a more distant relative, a friend or a charitable organization, and each beneficiary will still benefit from the additional coverage.

ROTH 401(K)S

It has become more common for employers to offer not only conventional 401(k) retirement plans, but, since they became available in 2006, also Roth 401(k) plans.

For 2009, an employee can put away a total of up to \$16,500 in a 401(k) plan. If the employee is at least 50 years old or will be before the end of the year, the maximum contribution rises to \$22,000 because of a "catch-up" contribution of up to \$5,500. The total contribution may be allocated between 401(k) and Roth 401(k) accounts. In fact, the prevailing view is that it is a good idea to have some money in both types of plans because doing so will yield benefits from a diversified exposure to taxes.

From an income tax standpoint, a 401(k) and a Roth 401(k) are mirror images. Contributions to a traditional 401(k) come from pretax earnings, and tax is deferred on that money and the income earned by the account until money is withdrawn. By contrast, a Roth 401(k) is funded up front with taxable earnings, but then all withdrawals are tax-free after the account exists for five years and the account holder reaches the age of 59-1/2.

If the tax bracket were to stay constant throughout a taxpayer's working life and into retirement, there would be little or no financial advantage of one plan over the other. In most cases though, either through changes in the Tax Code

or due to changing income levels, or both, over the years a taxpayer moves among the various tax brackets. The direction in which the taxpayer is headed on this scale largely determines whether a conventional 401(k) or a Roth 401(k) makes more sense.

If you anticipate that your tax rate is now higher than it will be in the future, a traditional 401(k) is probably the right choice. A typical example involves the person nearing retirement who is currently in the last few peak earning years, but who soon expects to have lower income during retirement. On the other hand, a young adult worker just getting started may well be in higher tax brackets in later years, making the Roth 401(k) more attractive. For that individual, the future tax-free withdrawals from the Roth 401(k) will bring greater benefits.



**LIFE INSURANCE POLICY
RESCINDED**

A business executive was answering questions for an application for a \$3 million life insurance policy that named as the beneficiary a company he had started with others. He answered in the negative when asked the common question as to whether he “[e]ngaged in auto, motorcycle or boat racing, parachuting, skin or scuba diving, skydiving or hang gliding or other hazardous avocation or hobby.” In fact, on about 20 occasions, the executive had gone heli-skiing, which involves skiing down remote mountain trails after being dropped off by a helicopter.

Only three months after the policy was issued, the executive was killed in an avalanche while heli-skiing. The tragedy for his survivors and former business partners was compounded in the courtroom when a federal appeals court upheld the life insurer’s rescission of the life insurance policy on the ground of a misrepresentation on the application.

A reasonable person in the position of the life insurance policy applicant would have known that his heli-skiing avocation constituted a hazardous activity, as that term was used in the application. The applicant clearly was aware of the heightened avalanche risks associated with heli-skiing, as compared to resort skiing. He had routinely signed waivers to that effect

whenever he engaged a company that made arrangements for such excursions. It was hardly necessary for the insurer to point out, in making this argument, that heli-skiing commonly involves rescue and survival training and the use of specialized lights and breathing devices meant to increase one’s chances of surviving an avalanche.

About three weeks after the executive had completed the insurance application by telephone, an underwriter making calls for the insurer called him with some follow-up questions, including the same inquiry about “any hazardous activities.” This time, the executive mentioned in the conversation that he enjoyed skiing and golf, among other things, but still there was no mention of heli-skiing. Nor did the executive show any concerns or confusion over what the term “hazardous activities” meant. The beneficiary under the rescinded policy unsuccessfully sought to use this exchange to argue that the life insurer was chargeable with knowledge of the insured’s concealment of his heli-skiing avocation, and thus was precluded from seeking rescission.

The court ruled that the insured’s “skiing” statement, when combined with the negative responses to the general question of whether he engaged in hazardous activities, would not have put a prudent

underwriter on notice of the need to investigate further. Otherwise, any report by an applicant of a generally low-hazard recreational activity, such as wrestling, juggling or fishing, would unreasonably require the insurer to investigate the myriad possible “extreme” variants of such activities.

Instead, to make an insurer legally chargeable with knowledge of an undisclosed fact, generally it must be shown that it had knowledge of evidence indicating that the applicant was not truthful in answering a particular application question. In this case, there was no such “red flag” that might have allowed the policy beneficiary to avoid the consequences of the executive’s untruthfulness.

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