The Estate Planner

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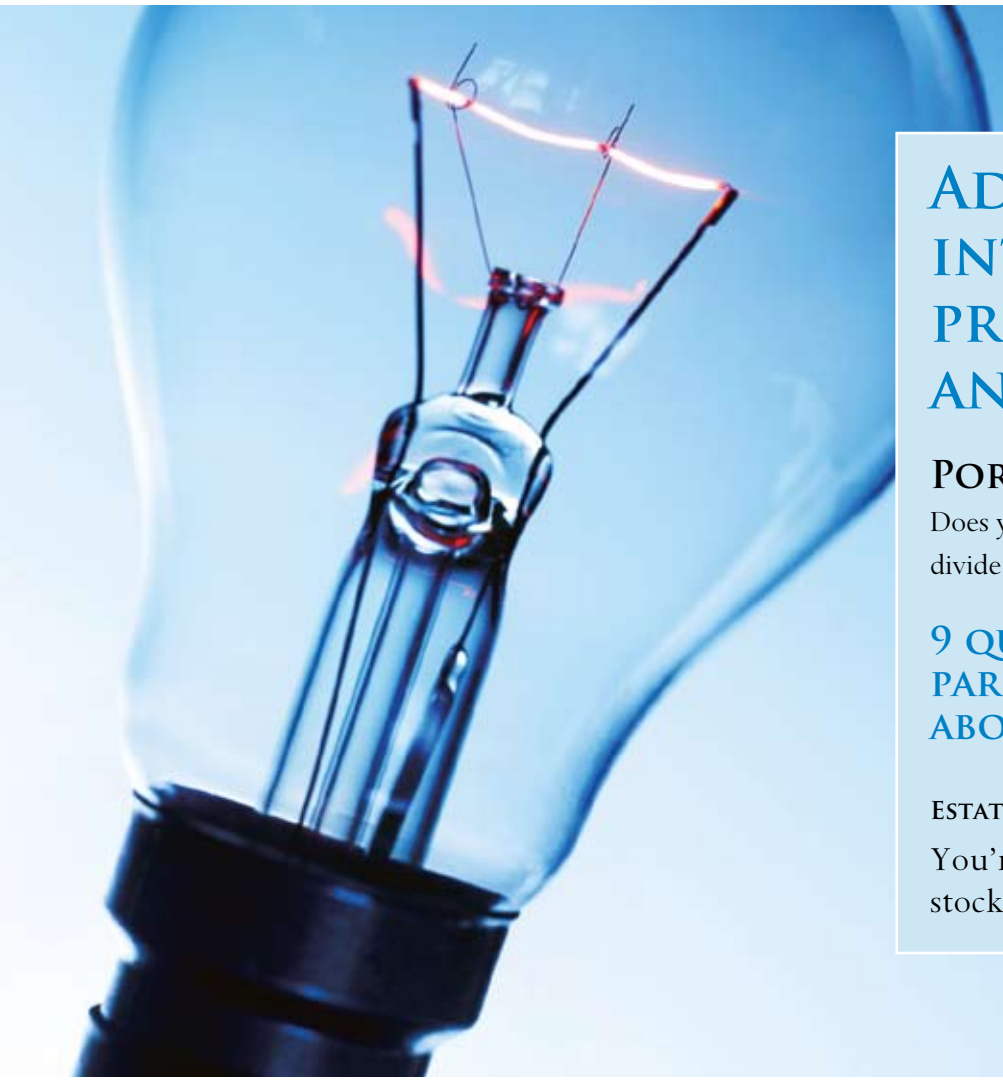

Addressing intellectual property in an estate plan

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Addressing intellectual property in an estate plan

Copyrights, patents and other forms of intellectual property (IP) can have enormous value. But whether IP rights are a significant source of wealth or only a small fraction of your estate, it's critical to address them in your estate plan. These intangible assets behave differently than other types of property, so careful planning is required to be sure their value is preserved for your family.

What is IP?

IP generally falls into one of four categories: 1) copyrights, 2) patents, 3) trademarks and 4) trade secrets. This article focuses on copyrights and patents, but if you or your business owns any type of intellectual property, it's important to discuss its treatment with your estate planning advisors.

Patents and copyrights are creatures of federal law. They're intended to promote scientific and creative endeavors by providing inventors and artists with exclusive rights to exploit the economic benefits of their work for a predetermined time period.

If you or your business owns any type of intellectual property, it's important to discuss its treatment with your estate planning advisors.

Patents protect inventions. A utility patent may be granted to someone who "invents or discovers any new and useful process, machine, article of manufacture, or compositions of matters, or any new useful improvement thereof." A design patent is available for a "new, original and ornamental design for an article of manufacture." To obtain patent protection, inventions must be "nonobvious."

Under current law, utility patents protect an invention for 20 years from the patent application filing date. Design patents last 14 years from the patent issue date. There is

a difference between the filing date and issue date. For utility patents, it takes at least a year and a half from date of filing to date of issue, and for business patents, it takes at least three years before an examiner even looks at the application.

Copyrights protect the *original* expression of ideas in the form of written works, music, paintings, sculptures, photographs, sound recordings, films, computer software, architectural works and other creations. Unlike patents, which must be approved by the U.S. Patent and Trademark Office (USPTO), copyright protection kicks in as soon as a work is fixed in a tangible medium.

For works created in 1978 and later, an author-owned copyright lasts for the author's lifetime plus 70 years. A "work-for-hire" copyright expires 95 years after the first

publication date or 120 years after the date the work is created, whichever is earlier. More complex rules apply to works created before 1978.

What are the estate planning considerations?

For estate planning purposes, IP raises two important questions: 1) What's it worth? and 2) How should it be transferred?

Valuing IP is a complex process. (See "Intangible value" below.) To make informed decisions about its disposition, you need to determine the value of IP and understand the gift and estate tax consequences of a transfer.

Intangible value

To plan for the disposition of intellectual property (IP) in your estate plan and understand the gift and estate tax implications, you need to know what it's worth. The value of patents, copyrights and other IP lies in the owner's ability to commercialize IP rights by creating products or granting licenses to others.

So the valuator needs to understand the extent to which the IP in question is protected by applicable law. The appraiser should also consider the ability of competitors to achieve similar results or develop similar products without infringing, which can impair or even destroy the IP's value.

It's also important for the valuator to understand the relevant market. The value of IP is typically based on the risk-adjusted present value of the future economic benefits the property is expected to generate. To calculate those benefits, the valuator must consider the market for products or licenses based on the IP, as well as potential economic, technological, competitive and regulatory factors that may affect the market or shorten the IP's productive life.

The value of IP is based on a unique combination of legal rights, the perceived economic benefits available to a business owner or potential buyer, and practical business considerations. To ensure an accurate result, be sure to engage a valuation expert with experience valuing the specific type of IP involved.

After you know the value of the IP, it's time to decide whether to transfer the property to family members, colleagues, charities or others through lifetime gifts or through bequests after your death. The gift and estate tax consequences will have an effect on your decision, but you should also consider your income needs as well as who is in the best position to monitor your IP rights and take advantage of their benefits.

If you will continue to depend on the property for your livelihood, for example, hold on to the property at least until you're ready to retire or you no longer need the income. If you feel that your children or other transferees lack the desire or wherewithal to exploit the IP's economic potential, and to monitor and protect the IP against infringers, you might want to retain ownership of the property.

Another option is to appoint a scientific or artistic executor or trustee with the appropriate skills and experience to manage the property and maximize its value. An important benefit of this approach is that it helps avoid disputes among your heirs about how to exploit IP, which can impair the property's value.

Whichever strategy you choose, it's important to plan the transaction carefully to ensure that your objectives are achieved. There's a common misconception that, when you transfer ownership of the tangible medium on which IP is recorded, you also transfer the IP rights. But IP rights are separate from the work itself and are retained by the creator — even if the work is sold or given away.

Suppose, for example, that you leave a painting, a written manuscript or a film to your child. Unless your estate plan specifically transfers the copyright to your child as well, the copyright may pass as part of your residuary estate and end up in the hands of someone else.

Have a plan

Whether artistic or scientific endeavors are the source of your wealth or simply meaningful diversions, it's likely that you care deeply about who ultimately possesses your works and enjoys their benefits. To ensure that your wishes are carried out, discuss IP with your advisors and be sure that it's addressed appropriately in your estate plan. ✤

Portion control

Does your tax apportionment clause divide the estate tax pie for best results?

The tax apportionment clause in your will or living trust specifies how the estate tax burden will be allocated among your beneficiaries. Many people view the apportionment clause as little more than boilerplate. But if your estate is large enough to generate a significant estate tax liability, the clause can have a big impact on your plan.

Failure to draft the apportionment clause carefully can result in a variety of unintended consequences, including the collection of estate taxes from unintended beneficiaries; ambiguity over the payment of taxes, resulting in disputes or litigation; and, in some cases, increased estate taxes.

Default plan

If you don't plan for estate tax apportionment, the government has a plan for you. Apportionment is generally governed by state law, though the federal tax code covers certain situations.

If, for example, life insurance proceeds or other assets transferred outside of your will are included in your estate for federal tax purposes, your executor can collect the estate taxes attributable to those assets from the recipient. This can happen if you transfer a life insurance policy to an irrevocable life insurance trust or to a beneficiary within three years before your death or if you retain certain "incidents of ownership" in the policy.

Another example is property transferred to a qualified terminable interest property (QTIP) trust. This trust allows a married couple to take advantage of the marital deduction for interspousal transfers while still preserving the trust principal for their children. To qualify, the surviving spouse must receive all of the trust income for life and the assets must be included in his or her estate for federal estate tax purposes.

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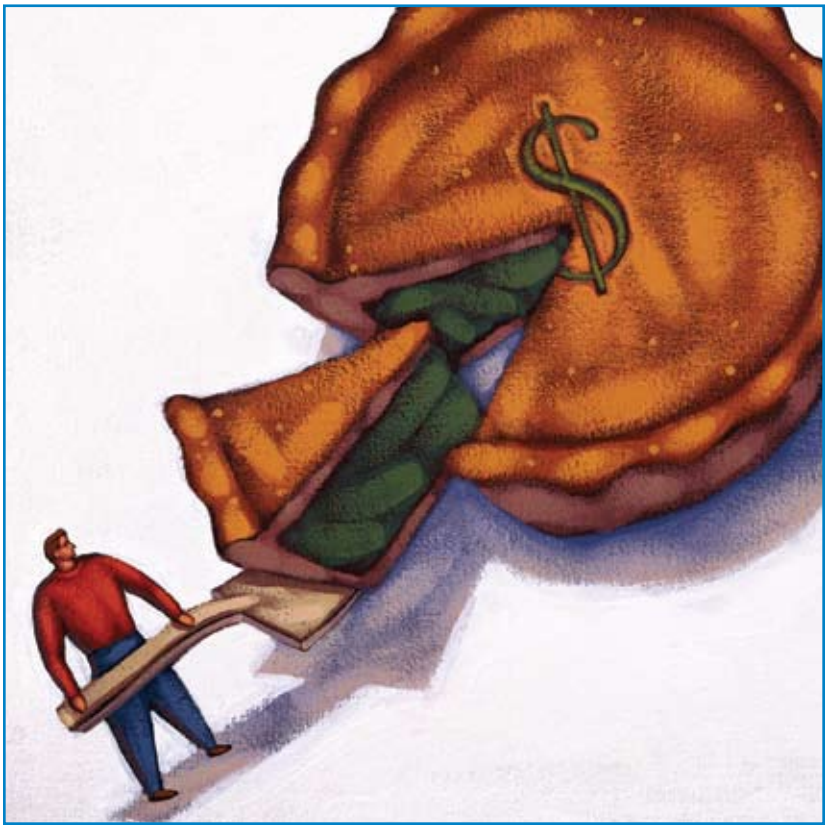


Suppose your estate includes assets in a QTIP trust established under your spouse's will. Unless your estate planning documents specify otherwise, your children may be responsible for paying the estate taxes attributable to the trust assets.

Federal law also covers assets included in your estate because you held a general power of appointment over the assets under the terms of your spouse's or someone else's estate plan, or you previously transferred the assets to your children or other beneficiaries but retained a lifetime interest in them. In either case, your executor can seek reimbursement of estate taxes from the recipients of this property unless you waive that right in your estate plan.

For assets other than the ones described above, apportionment of both federal and state estate taxes is governed by state law unless your plan provides otherwise. Apportionment rules can vary significantly from state to state. Historically, most states provided for estate taxes to be paid

from the residual estate — that is, from the assets that remain after all specific bequests have been made and all debts and other expenses have been paid.

Some states continue to take this approach, but most now require "equitable apportionment." In other words, estate taxes are distributed among beneficiaries according to the amount of tax generated by the assets they receive.

Tax traps

If you fail to address apportionment in your estate planning documents — or if you fail to carefully consider the implications of your apportionment clause — you can fall into some dangerous tax traps.

Suppose, for example, that Joe owns a family business. He has two daughters, Mary and Rachel, and he wants to divide his estate equally between them. Mary works in the business, but Rachel does not, so Joe leaves all of his stock in the business to Mary and leaves his residuary estate, which is equal in value to the stock, to Rachel. Unfortunately, the law in Joe's state provides for estate taxes to be paid from the residue, which means that Rachel's half of the estate will bear the entire tax burden.

Joe could have avoided this result by including a carefully drafted apportionment clause in his will that allocated half of the estate tax liability to Mary. To avoid requiring Mary and Rachel to sell any of the assets they inherit, Joe could also use life insurance to provide them with the liquidity they need to pay the estate tax.

In some cases, inattention to apportionment can actually *increase* your estate's overall tax liability. Suppose you leave half of your residuary estate to your spouse. If your estate plan specifies that your spouse's share doesn't bear any of the tax burden, the marital deduction shields the entire amount from estate taxes. But if taxes are allocated to your spouse's interest, the marital deduction is reduced, which, in turn, increases estate taxes.

Stay in control

Failure to direct how estate taxes should be paid can dramatically alter the way your wealth is distributed among your beneficiaries. A well-thought-out apportionment clause that clearly specifies which beneficiaries bear the estate tax burden can help ensure that you achieve your estate planning objectives. ✤

9 questions single parents should ask about their estate plans

In many respects, estate planning for single parents is similar to estate planning for families with two parents. Single parents want to provide for their children's care and financial needs after they're gone. But when only one parent is involved, certain aspects of an estate plan demand special attention. If you're a single parent, here are nine questions you should ask:

1. Are my will and other estate planning documents up-to-date? If you haven't reviewed your estate plan recently, talk to your advisors to be sure it reflects your current circumstances. The last thing you want is for a probate court to decide your children's future.

2. Have I selected an appropriate guardian? If the other parent is unavailable to take custody of your children should you become incapacitated or die

suddenly, does your estate plan designate a suitable, willing guardian to care for them? Will the guardian need financial assistance to raise your kids and provide for their education? If not, you might want to preserve your wealth in a trust until your children are grown.

3. Am I adequately insured? With only one income to depend on, plan carefully to ensure that you can provide for your retirement as well as your children's financial security. Life insurance can be an effective way to augment your estate. You should also consider disability insurance. Unlike many married couples, single parents don't have a "backup" income in the event they can no longer work.

With only one income to depend on, plan carefully to ensure that you can provide for your retirement as well as your children's financial security.

4. What happens if I remarry? Will you need to provide for your new spouse as well as your children? Where will you get the resources to provide for your new spouse? What if you placed your life insurance policy in an irrevocable trust for your kids to avoid estate taxes on the proceeds? Further complications can arise if you and your new spouse have children together or if your spouse has children from a previous marriage.

5. What if I become incapacitated? As a single parent, it's particularly important for your estate plan to include a living will, advance directive or health care power of attorney to specify your health care preferences in the event you become incapacitated and to designate someone to make medical decisions on your behalf. You should also have a revocable living trust or durable power of attorney that provides for the management of your finances in the event you're unable to do so.

6. Have I established a trust for my children? Trust planning is one of the most effective ways to provide for your children. Trust assets are managed by one or more qualified, trusted individual or corporate trustees, and you specify when and under what circumstances funds should be distributed to your kids. A trust is particularly important if you have minor children. Without one, your assets may come under the control of your former spouse or a court-appointed administrator.

7. Do I have an estate tax reduction strategy? If your estate is large enough that gift and estate taxes are an issue, it's important to begin tax planning as early as possible. As a single parent, you won't enjoy the benefit

of the unlimited marital estate tax deduction, so you'll need to rely more heavily on other tax-reduction strategies. For example, you might take advantage of the $1 million lifetime gift tax exemption or the $13,000 annual gift tax exclusion to make regular tax-free gifts to your children or to a trust for their benefit.

8. Have I left written instructions? Don't force your children's guardian or your other representatives to guess what you "would have wanted." Include instructions in your will on anything from religious and educational preferences to moral or social values.

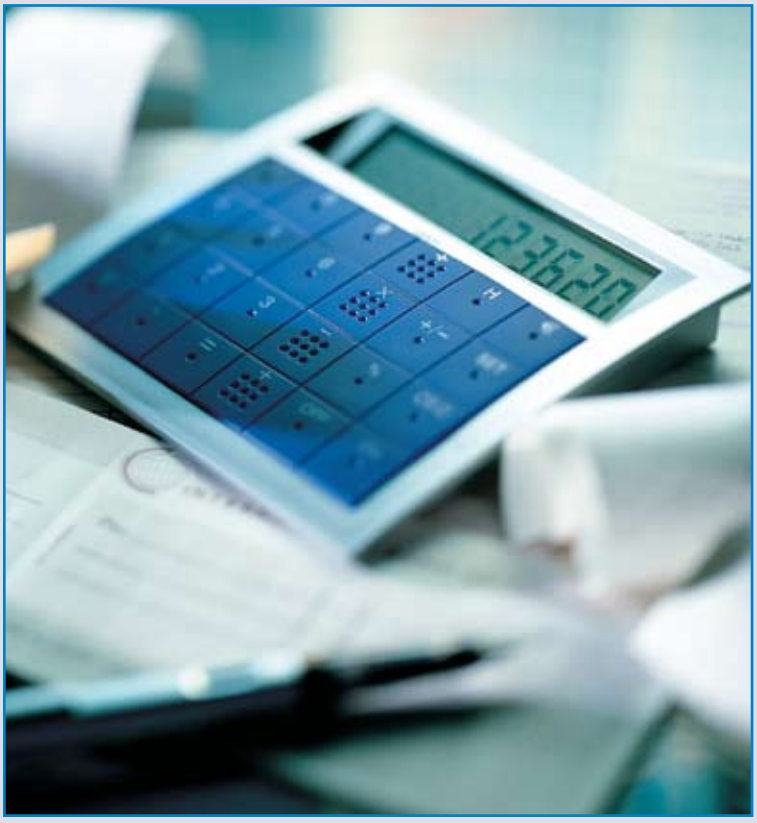
9. Can the other parent help? If your spouse (or ex-spouse) is alive, is he or she willing to help care for your children or provide financial resources? If your spouse (or ex-spouse) is deceased, does his or her estate plan provide any financial assistance for your children? ✤

ESTATE PLANNING RED FLAG

You're transferring S corporation stock to an ineligible trust

S corporations are subject to a number of strict requirements. They can't have more than 100 shareholders or more than one class of stock. In addition, eligible shareholders are limited to individuals who are U.S citizens or residents, estates, certain tax-exempt organizations and certain domestic trusts. If you transfer S corporation stock to an ineligible trust, you risk losing the corporation's tax-advantaged status.

Generally, for estate planning purposes, three trust types can hold S corporation stock: 1) grantor trusts — where the grantor is the owner for income tax purposes, 2) qualified Subchapter S trusts (QSSTs) and 3) electing small business trusts (ESBTs). A testamentary trust — that is, one established by your will — can hold S corporation stock for up to two years, but after that it must qualify as a QSST or ESBT to retain its eligibility. Foreign trusts are ineligible.



A full discussion of these trusts is beyond the scope of this short article but, from an income tax perspective, grantor trusts and QSSTs are often preferable because ESBTs are taxed at the highest marginal rate. From an estate planning perspective, however, grantor trusts and QSSTs have less flexibility. A grantor trust, for example, must be owned completely by only one person. And a QSST must distribute all of its income to a single beneficiary.

To qualify as an ESBT, a trust must file a timely election with the IRS and none of its beneficiaries may acquire their interests by purchase. In addition, the trust cannot have any "potential current beneficiaries" (PCBs) who would disqualify the S corporation if they held its stock directly. So, for example, if a trust's PCBs cause the number of shareholders to exceed 100, or if they include ineligible shareholders (such as nonresident aliens or charitable remainder trusts), it's not an ESBT.