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Inside This Issue

Intra-Family Loans - Can It Get Any Better Than This?

By Jonathan C. Kinney, Esquire

The Internal Revenue Service (IRS) allows related parties to borrow and loan money at very low interest rates. The applicable federal rate, published monthly by the IRS, generally corresponds to the yields of treasury bonds with corresponding maturities. The Applicable Federal Rate (AFR) sets the minimum interest rate that can be charged on intra-family loans.

The IRS divides loans into three categories: short-term (less than three years), mid-term (three to nine years) and long-term (over ten years). When this article was written on December 31, 2011, the rates were as follows:

- Short-term: .20 percent
- Mid-term: 1.27 percent
- Long-term: 2.8 percent

January 2012 rates are predicted to be even lower at:

- Short-term: .19 percent
- Mid-term: 1.19 percent
- Long-term: 2.66 percent

With rates this low, an intra-family loan is an attractive alternative to bank financing.

Here's the problem. The IRS will normally assume that intra-family loans are actually disguised gifts. As is often the case among family members, there is the temptation to avoid the formalities of loan transaction – his handshake is good for me – and while it may be good enough for you, but it's not good enough for the IRS. Intra-family loans need to be treated as bona fide business transactions with real expectations of repayment and the intention to enforce the debt.

What are the essential requirements necessary to meet the minimum safe harbor requirements? They include:

1. Charge at least the minimum safe harbor requirement, depending on the length of the loan. With rates as low as they are now, fix the rate for the term of the loan.

2. Establish a fixed repayment schedule

3. Sign a Promissory Note. The Note should, at a minimum, set out the interest rate, payment schedule and due date.

4. Be serious about requiring payments when they are due. If you're not

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requiring payments to be made when due, then the IRS may begin to look at the loan as a disguised gift.

5. Require collateral. No financial institution would make a loan without collateral unless it was to an extremely strong borrower with a history of repayment and high liquid assets. In many intra-family loan situations, the older generation is often selling an asset to the younger generation and taking back a Note. In that situation, wouldn't a normal seller want security on the loan? If the asset is real estate, a mortgage security or a limited liability company or partnership interest is a security interest with a UCC filing statement.

With rates where they are now, there's an excellent chance that children or grandchildren should be able to make a return on assets that exceed the interest they are paying to the older family member/lender. However, if they can't make more than a 1.9 percent return on a nine-year loan, do you really want to be making the loan?

There are a few other concerns. It's not uncommon for family members to make a loan and then forgive the payments as they become due, particularly if the loan payments are below the annual gift exclusion amount between family members (which is currently $13,000 per person per year). Just because it's a widespread practice doesn't mean it can't be challenged by the IRS. Under no circumstances should parties agree to a plan in writing to forgive payments as they become due, as that is an automatic red flag for the IRS. The entire loan could be recharacterized as a gift if there is a prearranged plan to forgive the loan – including loan payments – to avoid the gift tax. Case law seems to follow a case-by-case analysis. However, in those situations where Note payments are forgiven on a regular basis, particularly when there's a written plan or agreement to forgive loan payments as they become due and are contested by the IRS, as a general rule, the IRS wins. The taxpayer normally wins when there is no pre-plan to forgive the loan and where loan forgiveness was not an annual or regular event.

The best advice is to always follow the five rules set out above and to act as a financial institution would with a borrower. The borrower is already getting very attractive rates that are below what would be available from a commercial lender. Do they really need extra incentives which might only jeopardize the characterization of the loan?

With the applicable federal rate so low, it's a great time to use intra-family loans as an estate planning tool. Just remember, it's a loan, not a gift and treat the loan requirements in a commercially reasonable manner.

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Safeguarding Frozen Embryos Through Estate Planning

By Lori K. Murphy, Esquire and
Lauren K. Keenan, Esquire

It is often the case that our clients teach us more about the law than we learned in law school. This is the case for the issue of frozen embryos. When meeting with a client about her estate plan, the client volunteered that she had frozen embryos in storage. This provided an opportunity to delve into a newly emerging field.

For many with dreams of starting a family, the dream is not easily realized. Today, infertility affects a much larger demographic than ever before. Single women, same-sex couples, unmarried couples and married individuals alike face challenges when trying to start a family. According to the American Pregnancy Association, 6.1 million individuals throughout the United States face infertility. Most know that working with a doctor who is a fertility expert can increase their chances of conceiving, but few realize the legal issues that can result from undergoing such treatments. This article focuses largely on estate planning issues related to Artificial Reproductive Technologies ("ART") and highlights some of the key legal issues that should be considered by anyone seeking fertility treatments or anyone with frozen embryos in storage now.

To overcome fertility challenges, an increasing number of individuals are turning to in vitro fertilization, or IVF as it is commonly referred. IVF is the process of fertilization by manually combining an egg and sperm in a laboratory dish to create an embryo, which is later transferred into a uterus. When successful, IVF can help infertile individuals conceive.

Often, the result of IVF treatments is the creation of multiple embryos that are stored (frozen) for future use. Individuals undergoing IVF treatments should consider at the beginning of the process how they want to handle the embryos remaining after implantation. Answering this question has raised many more legal and ethical questions, especially if the person does not desire

additional children. There are a variety of preferences: some desire their embryos to remain frozen indefinitely; some would love the opportunity to donate their embryos to another infertile couple; some will allow the embryo to be "adopted;" while some may opt for the destruction of embryos that are not going to be implanted. These considerations, and particularly the final option mentioned, raise both legal and moral issues that have implications that differ depending on the applicable laws of the state in which a person resides and the state in which the embryos are stored.

Few clients, or their attorneys for that matter, will consider the issue of frozen embryos when thinking about estate planning. Few attorneys counsel clients about this issue, particularly because it is such a newly emerging field and many states are still divided or undecided as to how to treat embryos. The bottom line is that if you have frozen embryos or plan to undergo IVF treatments in the future, it is crucial to learn the laws in your state and to plan your estate accordingly.

Currently, there are three schools of thought on the legal classification of embryos: 1) an embryo is human life, 2) an embryo is pure personal property, no different than a pet or other household item, or 3) an embryo is property deserving of special respect. Existing statutes and case law in Virginia suggest that the Commonwealth follows the second approach: that embryos are treated as personal property. For an estate plan, this is good news in that an individual can provide for the disposition of their embryos in their estate plan rather easily and couples can enter into legally binding contracts to direct the future treatment of their embryos. Regardless of Virginia's stance on this issue, some clients will wish to treat the embryos as property deserving of special respect and that can be thoughtfully addressed in an estate plan as well.

In other states, especially where embryos are treated as human life, an individual must be exceedingly careful as to how and where the frozen embryos are stored. The potential destruction of the frozen embryos in these jurisdictions opens the door to serious legal issues that are often cloaked in moral issues. Couples undergoing IVF should review the frozen embryo storage contract carefully. Some contracts provide for the destruction of the embryo if the storage fee is not paid. Some contracts specifically address which party owns the frozen embryos (the donor, the husband or the wife). Some contracts specifically address who gets to decide what happens to the frozen embryos in case of legal separation or divorce. For example, one spouse may want to use the embryos created during the marriage after a divorce, while the other may be adamantly opposed to such an act. It is best to discuss these matters early in the IVF process, and a post-nuptial or pre-nuptial agreement may be the best way to memorialize both parties' wishes.

In addition to the contractual issues, estate planning issues require attention. It is important that your estate plan reflects your desired wishes for how you want your frozen embryos handled upon your death or incapacity. This means your wishes need to be memorialized in a Durable Power of Attorney (especially if you live in a state that follows either of the latter two approaches discussed above). Such a document should be clear as to whether you want the annual storage fee to continue to be paid on your behalf if you are ill or incapacitated and whether you want to allow for potential donation of your embryos, etc. Lastly, your wishes as to how you want your frozen embryos handled upon your death needs to be addressed in your Last Will and Testament or your Revocable Trust.

The decisions facing individuals with frozen embryos are extremely personal, and people's beliefs vary greatly on this subject. A licensed attorney can assist you with learning your applicable state laws and ensure your estate plan conforms to your beliefs and is a reflection of your wishes.

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Virginia Offers Advance Health Care Directive Registry

By Chester Hatstat, Paralegal

The Commonwealth of Virginia is offering a statewide Advance Health Care Directive Registry. This secure registry allows legal Virginia residents to store their Advanced Health Care Directive, Health Care Power of Attorney, Declaration of Anatomical Gift and other documents so medical providers, emergency responders, family members and anyone else they grant access will know and honor their wishes.

"This public-private partnership between the Virginia

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Department of Health, UNIVAL Inc., and Microsoft Corporation provides an important service to all Virginians," said William Hazel Jr., Virginia Secretary of Health and Human Resources. The registry is free for users.

An Advance Directive or Durable Health Care Power of Attorney assigns and authorizes the named agents to make health care decisions for you in the event you become incapacitated and are unable to speak for yourself. Your health care wishes for end-of-life or terminal illness situations are made known and relieve your family from having to make these difficult decisions without your guidance. The registry also allows the user to make known their wishes regarding organ donation.

Users of the registry enter basic information, create an account, select a personal identification number (PIN) and password and upload documents into the registry. The registry then issues an identification card containing the user's personal registry information so health care providers can access their information if necessary. PIN and password can be shared with friends, family and health care providers, thereby allowing them access to your health care information.

The registry will be interoperable with the statewide Health Information Exchange. The exchange is a secure, confidential, electronic system where a patient's records will be accessible to other health care providers throughout the nation if a patient chooses to participate. You may register https://www.Virginiaregistry.org . People without access to a computer can call 800-224-0791 to participate in the registry.

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