LAW and BUSINESS

FRASER TREBILCOCK DAVIS & DUNLAP, P.C.

MAY 2007

Coping With Federal Estate Tax Uncertainty

By Ryan M. Wilson

When the Economic Growth and Tax Relief Act of 2001 (EGTRRA) was enacted, most estate planning attorneys expected that Congress would enact some form of permanent tax legislation before 2011 to replace the provisions of EGTTRA which expire on January 1, 2011. It now appears increasingly likely that Congress and President Bush may be unable to come to agreement on permanent provisions.

EGTTRA gradually increases the amount that you can shelter from federal estate tax and reduces the maximum estate tax rate. For 2007 and 2008, the federal estate tax exemption amount is $2,000,000 and the highest federal estate tax rate is 45%. For 2009, the federal estate tax exemption amount is $3,500,000 and the highest federal estate tax rate is 45%. For 2010, the federal estate tax is repealed and there is no limit on the amount of assets that can pass federal estate tax free. However, if permanent legislation is not enacted before January 1, 2011, we return to the pre-EGTRRA rules, i.e., a federal estate tax exemption amount of $1,000,000 and the highest federal estate tax rate of 55%.

"If permanent legislation is not enacted before January 1, 2011, we return to the pre-EGTRRA rules, i.e., a federal estate tax exemption amount of $1,000,000 and the highest federal estate tax rate of 55%."

Republicans have had numerous opportunities to enact some permanent legislation, but have insisted on the elimination of the estate tax. Democrats have generally opposed the repeal of the estate tax, but have considered adopting higher federal estate tax exemptions and lower estate tax rates.

If President Bush and the Republicans give up on the idea of permanent repeal of federal estate tax and instead focus on compromise legislation that permanently adopts higher federal estate tax exemptions and lower estate tax rates, there is a slim possibility that some permanent legislation can be adopted in late 2007 or 2008. Unfortunately, 2008 is an election year and compromise legislation tends not to happen during a Presidential election year. The unfortunate reality of these uncertain times is that you need to start planning now for the possibility of a return to 2001 in 2011.

Estate planning during the next four years will be complicated so it is important to have your plan reviewed periodically. A return to the pre-EGTTRA rules creates a number of planning issues. So, how should you proceed? Here are some issues to consider.

Updating estate plan documents. Some provisions of your estate plan may no longer be necessary. Make sure you are not leaving as much to your children (in order to use the increased exemption) that you do not leave enough to your surviving spouse. Formula clauses in living trusts that relate to the various levels of the estate tax exemption are particularly vulnerable.

Reviewing life insurance coverage. The pre-EGTTRA rules will expose more people to federal estate taxes and will create significant liquidity problems for many. If you want to insure to cover the potential increased taxes, you need to plan now in case you become uninsurable before 2011. If you have insurance coverage in place, you need to think twice before canceling it. You might need it later.

continued page 2...

Coping With Federal Estate Tax Uncertainty *continued...*

Using irrevocable life insurance trusts. If you are thinking about buying additional life insurance, you should consider placing the insurance in an irrevocable life insurance trust ("ILIT") to keep the death benefit outside of your taxable estate. If you want to move an existing life insurance policy out of your taxable estate by 2011, the three-year look-back provisions of Internal Revenue Code Section 2035(a) means that the transfer should occur at least three years before January 1, 2011. Thus, individuals who do not currently have a taxable estate (but who may have a taxable estate in 2011) should consider the use of life insurance trusts or the transfer of existing insurance policies directly to heirs before the end of 2007.

> *"The return of the state death tax credit in 2011 may cause some confusion...you will not see any actual tax increase because of the revived Michigan Estate Tax; however, Michigan will see a return of previously lost revenue."*

Preserving retirement assets. With the higher exemptions and new rules permitting beneficiaries to make withdrawals from inherited IRAs over their lifetime, many individuals have planned to pass retirement plans to younger family members (to take advantage of the longer life expectancy) while passing other assets to the surviving spouse. These plans could create a number of problems if we return to pre-EGTTRA. For example, assume an individual had a $1,800,000 IRA and $2,200,000 in other assets. Under the individual's current plan, the IRA passes to the children from a prior marriage and the $2,200,000 is held in a martial-deduction trust, commonly referred to as a "QTIP" trust. At the present time, no federal estate taxes would be due at the individual's death. If the individual dies after 2010, there could be a federal estate tax of approximately $345,000 on the transfer of the IRA to the children. If the children take money out of the IRA to pay the taxes, they will create taxable income. If the children reach back into the IRA to pay the income taxes, they incur additional taxes. Some of the options to consider include: reducing the IRA bequest to the available exemption; pass other assets to the children to pay the estate tax liability; or pass non-IRA assets to the children, while passing the IRA to the surviving spouse.

Returning to the Michigan Estate Tax. In 2005, the state death tax credit was phased out and replaced with a deduction. Michigan used the amount of the state death tax credit as its state estate tax. As a result, there has not been a Michigan Estate Tax for decedents dying after December 31, 2004. The return of the state death tax credit in 2011 may cause some confusion. Fortunately, the Michigan Estate Tax would be a direct deduction from the amount of the federal estate tax. So, you will not see any actual tax increase because of the revived Michigan Estate Tax; however, Michigan will see a return of the previously lost revenue.

Planning for the family business deduction. Perhaps one of the most complicated pieces of federal estate tax legislation enacted, the deduction for qualified family-owned business interests could be restored in 2011, although at a total deduction of about $300,000 per decedent. Therefore, individuals with closely-held businesses passing to family member should make sure that their estate plans contemplate the potential restoration of the qualified family-owned business interests deduction.

Planning for the loss of basis step-up. Currently, when an individual dies, the beneficiaries receive most assets with a "stepped up" basis for capital gains tax purposes equal to the value of the assets on the date of death. In 2010, the basis step up will generally be limited to $4,300,000 for assets passing to your spouse and $1,300,000 for assets passing to a non-spouse. Now is a good time to put together a personal financial statement that lists your assets, their value and your original cost.

Anticipating incapacity. It is critical that you have durable power of attorney for financial matters in place to protect you if you become incapacitated. However, your agent cannot execute your last will and testament and estate planning documents. In some situations, there are clear indications that an individual's mental faculties are gradually failing. Such an individual may become incapacitated by 2011 and may be unable

to revise his or her estate plan. Thus, planning ahead for the return of pre-EGTTRA should be considered.

Eliminating the generation–skipping transfer tax. In 2010, the generation-skipping tax is eliminated. For an individual who dies in 2010, it would be possible to create a dynasty trust without regard to the limited generation-skipping tax exemptions. An unlimited generation-skipping transfer to a flexible dynasty trust could be the ultimate planning tool; however, you have to die in 2010. Given the elimination of the estate and generation-skipping tax in 2010, placing assets in the name of a chronically ill family member who may die in 2010 presents some unique planning opportunities.

Maximizing flexibility. Flexibility is the key to planning in this uncertain environment. The approaches that need to be considered include: use of limited power of appointment; use of disclaimers; and use of the full estate tax exemption of the first spouse to die.

In conclusion, no one really knows what Congress is going to do with the estate tax in the next four years. Planning in this time of uncertainty is going to require great flexibility, constant review, and updating. Virtually every estate plan will have to be re-examined in the next four years, either to account for Congress's failure to enact permanent estate tax legislation or to deal with the terms of any permanent legislation that is passed.

Mr. Wilson is Chair of the Estate Planning Department at Fraser Trebilcock Davis & Dunlap, P.C. in the Lansing office. He may be contacted at 517-377-0897 or at rwilson@fraserlawfirm.com.

Attorney Activities of Note

- The April 24, 2007 Grand River Connection event sponsored by the associates of Fraser Trebilcock Davis & Dunlap, P.C. broke organization records. An estimated 126 people attended *Moving Lansing Forward* an event that brought together Lansing's young professionals and the area's business leaders for an evening of networking.

Associate Katie Weed speaks with Julie Karkosak, Vice-President and General Counsel of the MEDC at the Moving Lansing Forward event.

- Jonathan E. Raven assisted Arialink Broadband in a $6 million financing with the Michigan Broadband Development Authority loan. This is the second financing Mr. Raven has handled for Arialink. Arialink is expanding broadband services to under served rural areas in Michigan.

Mr. Raven also assisted KTM Industries, a company that develops, manufactures and markets new technologies and applications that incorporate proprietary, non-toxic, environmentally safe bioplastics for a diverse range of consumer and industrial based markets, in obtaining and closing a successful loan from the 21st Century Jobs Fund.

Golden Nugget

Myth: Putting property in a *revocable* Living Trust prevents creditors from accessing those funds or assets.

Fact: Not true. A revocable Living Trust does not provide any general creditor protection. Since a grantor of a revocable Living Trust has complete and full access to the funds or assets of a revocable Living Trust, a creditor can normally reach the property in such a trust. There are some *irrevocable* Living Trusts that provide some creditor protection.

Interested in more information about Estate Planning and Probate issues? Sign up for Ryan Wilson's free monthly *Golden Bullets*. It is available in print and email format. For a subscription call Mr. Wilson at 517/377-0897 or email him at rwilson@fraserlawfirm.com.

Visit our newly redesigned web site,
www.fraserlawfirm.com.

PETER L. DUNLAP+
DOUGLAS J. AUSTIN
MICHAEL E. CAVANAUGH
JOHN J. LOOSE
DAVID E.S. MARVIN°
STEPHEN L. BURLINGAME
DARRELL A. LINDMAN
IRIS K. LINDER
GARY C. ROGERS
MARK A. BUSH
MICHAEL H. PERRY
BRANDON W. ZUK
MICHAEL C. LEVINE
THOMAS J. WATERS
MARK R. FOX*°
MICHAEL S. ASHTON
H. KIRBY ALBRIGHT
GRAHAM K. CRABTREE
MICHAEL P. DONNELLY
EDWARD J. CASTELLANI*
NAN ELIZABETH CASEY

PETER D. HOUK˜
JONATHAN E. RAVEN
THADDEUS E. MORGAN
ANNE BAGNO WIDLAK
ANITA G. FOX°
ELIZABETH H. LATCHANA
TODD D. CHAMBERLAIN
RYAN M. WILSON
KENNETH S. WILSON*
ROBERT B. NELSON
BRIAN P. MORLEY➢
MARY M. MOYNE‡
JOHN D. MILLER✺
TONI L. HARRIS‡
RYAN K. KAUFFMAN
KATHERINE A. WEED
JENNIFER UTTER HESTON
NICOLE L. PROULX
VINCENT M. PECORA
G. ALAN WALLACE
AZIZA N. YULDASHEVA

ARCHIE C. FRASER
(1902-1998)
EVERETT R. TREBILCOCK
(1918-2002)
JAMES R. DAVIS
(1918 - 2005)

OF COUNSEL
DONALD A. HINES
RONALD R. PENTECOST

˜RETIRED CIRCUIT JUDGE
*ALSO LICENSED IN FLORIDA
+ALSO LICENSED IN COLORADO
°ALSO LICENSED IN DISTRICT OF COLUMBIA
*ALSO CERTIFIED PUBLIC ACCOUNTANT
➢ALSO LICENSED IN NORTH CAROLINA
✺ALSO LICENSED IN GEORGIA
‡ALSO LICENSED BY U.S. PATENT & TRADEMARK OFFICE

Lansing Office:
124 West Allegan St., Ste 1000
Lansing, Michigan 48933
Telephone: (517) 482-5800

Detroit Office:
One Woodward Ave., Ste 1550
Detroit, Michigan 48226
Telephone: (313) 237-7300

FRASER TREBILCOCK DAVIS & DUNLAP, P.C.

The Law & Business is published as a source of general information about current developments in the practice of business law. If you have questions regarding any of the articles included in this issue or business law in general, please contact our lawyers prior to taking action. *The material in this newsletter may be reproduced only with the acknowledgment of its source and copyright.*

©2007 Fraser Trebilcock Davis & Dunlap, P.C.

FRASER TREBILCOCK DAVIS & DUNLAP, P.C.

FRASER TREBILCOCK DAVIS & DUNLAP, P.C.
124 W. ALLEGAN, SUITE 1000
LANSING, MI 48933

VISIT OUR NEWLY REDESIGNED WEB SITE AT
WWW.FRASERLAWFIRM.COM

PRST STD
U.S. Postage
PAID
Lansing, MI
Permit #565