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Estate Planning Insights

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THE 2012 FEDERAL ESTATE AND GIFT TAX: PROBLEM AND OPPORTUNITY

- Lynwood P. VandenBosch and Anna K. Gibson

When a person dies, his or her assets are subject to the *federal estate tax*. This tax is imposed on virtually all assets in which a decedent has any interest, including life insurance proceeds, after the assets exceed an exemption amount. For decedents dying in 2012, the exclusion amount is $5.12 million. This means that the first $5.12 million of a person's assets are free from federal estate tax. Assets over and above this amount are taxed at the rate of 35% (in 2012).

Because gifts reduce a person's assets that are taxable for estate tax purposes, the government subjects gifts to the *federal gift tax*, which can be summarized as follows:

a. Annual exclusion amounts. Gifts from any person to any other person of less than a certain amount each year (currently this amount is $13,000) are not counted for gift tax purposes. A husband and wife can effectively double up on these gifts to make a $26,000 gift to each child each year.
b. Exclusion amount. Gifts in excess of the annual exclusion amount are allocated against the estate tax exclusion amount (currently $5.12 million). Gifts applied against this exclusion amount reduce the available exclusion amount for federal estate tax purposes.
c. Tax rate. Gifts that exceed the annual exclusion amount and the estate tax exclusion amount are subject to gift tax at the rate of 35%.

THE CURRENT PROBLEM

Currently, the amount excluded from federal estate tax, and federal gift tax is $5.12 million and the excess is taxed at a rate of 35%. This will probably continue through December 31, 2012. However, if Congress does not act prior to December 31, 2012, the exclusion amount will be reduced to approximately $1 million effective January 1, 2013 and the gift and estate rates will increase to as high as 55%. Many commentators believe that Congress may act to change the exemption amount and tax rates before 2013, but we don't know what these numbers will be.

This uncertainty especially affects estates of more than $2 million. In a $5 million estate, for example, the estate tax consequences of resetting the exemption amount to $1 million could be more than $1,250,000, and for a $10 million estate, the estate tax consequences of such a resetting could be more than $3,500,000.

THE CURRENT OPPORTUNITY

The good news is that, currently, and probably at least through December 31, 2012, several favorable conditions exist to reduce a person's exposure to the federal estate tax. These include:

a. The $5.12 million exclusion for gift taxes and generation skipping transfer taxes;
b. Asset values are relatively low;
c. Interest rates are historically low;
d. Discounting (e.g., a minority interest in a family company) is currently permitted, and can be used to keep values down. As a general rule, discounts should only be taken where they can be supported by a qualified appraisal.

There are many options to take advantage of the current favorable environment. The following lists, very generally, a few of those options:

1. Consider using the annual exclusion amount for gifts ($13,000 per spouse, per beneficiary) before the end of 2012.
2. Consider making gifts that use up much, most, or all of your current $5.12 million exclusion amount, since in the next few months, we don't know what the exclusion amount will be next year or in future years. Examples of such gifts include:

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a. You can make the gift in trust for your spouse, with your spouse as the trustee and the beneficiary with the right to receive all income, to receive principal to the extent required for his or her health, support or maintenance, and to withdraw from principal an additional amount (not to exceed 5% each year).

b. Alternatively, the exclusion can be used to make gifts to or in trust for children.

The best candidates for gifts include assets that can be discounted and/or those with high potential for future appreciation.

For example, if you currently have a $6 million estate, you could set aside $5 million in an irrevocable trust right now. No gift tax would be due because you would utilize your full exclusion amount. You could draw income/principal from the trust as needed, but the $5 million would be out of your estate at death, and only the remaining $1 million in your estate would be subject to estate tax. If the exclusion amount is only $1 million at your death and the estate tax rate is 55% (the law in 2013 and beyond unless Congress acts to change it), this approach would save you approximately $2.7 million in federal estate tax.

1. Consider advanced estate planning techniques (e.g., irrevocable life insurance trust, sale to intentionally defective grantor trust, grantor retained annuity trust, generation-skipping transfer tax trusts, dynasty trusts, etc.).

There are many things to consider when reviewing your possible exposure to the federal estate tax and ways to minimize the tax. Like many other things in life, there are always trade-offs of pros and cons which must be balanced, and not all of the options listed above may be appropriate for your circumstances.

This article was only intended to provide a big picture view of the current federal estate and gift tax problem and opportunity. Please talk with your estate planning attorney to determine what the most appropriate plan is for you.

Lynwood P. VandenBosch
Attorney
P: 616.726.2201
E: lvandenbosch@fosterswift.com

Anna K. Gibson
Associate
P: 571.371.8280
E: agibson@fosterswift.com

LEGAL UPDATE : PUBLIC ACT 141 of 2012

On May 22, 2012, Governor Snyder signed into law an act setting the requirements for executing a valid durable power of attorney (for finances). The new law requires either: (a) the signature of two witnesses, neither of which can be the agent, or (b) the durable power of attorney to be notarized. The new law also calls for the agent to sign an acceptance acknowledging his or her responsibilities prior to acting as an agent. This new law will not affect any existing durable powers of attorney because it only applies to a durable power of attorney executed on or after October 1, 2012, and does not apply to durable powers of attorney as part of a corporate, mortgage, or other commercial transaction. If you have any questions on how this new law might affect you, please contact us.

ESTATE PLANNING FOR THE SENIOR ADULT

- Norman E. Richards

May was designated National Elder Law Month by the National Academy of Elder Law Attorneys (NAELA). "Elder Law" attorneys use a variety of legal tools and strategies to address the special concerns of "senior adults". These concerns often include estate planning, dealing with incapacity, finding quality long term care (whether in assisted living or a nursing home), and qualifying for government benefits to pay for long term care (such as Medicaid and VA benefits).

As many as one out of eight people over the age of 65 and one out of two over the age of 85 will be at risk for dementia-related incapacities. According to a recent USA Today article, as many as 5 million people in the U.S. today have a form of Alzheimer's, and that number is expected to triple by 2050.

Senior adults facing an incapacity need specialized estate planning. Estate planning often focuses on avoiding probate, protecting assets from creditors, reducing taxes, and distributing inheritances. In addition to these concerns, many senior adults also have concerns about financial security, preserving their independence and dignity, having enough money to pay for good quality care, and taking care of loved ones. Foster Swift attorneys can help balance all these concerns with comprehensive, holistic planning and precisely tailored estate plan documents.

As people age, their estate plan and legal documents may not be aging with them. Young and middle-aged clients typically engage in planning before there is any hint of a chronic illness or threat to mobility or capacity. Many make the mistake of thinking that a legal document will suffice for every situation. The reality is that legal and estate plan documents need to be tailored to the specific needs a client faces in their present season of life. A seventy-five year old client with grown children may be less concerned about their children's inheritance than they are about the implications of a diagnosis of Parkinson's or dementia. As people transition through the different seasons and circumstances of life they should make sure that their plans are transitioning with them.

How can senior adults make sure they have the right plan and estate documents in place?

- **Plan as early as possible.** Too often, senior adults wait until a crisis hits before asking an attorney for help. Usually the crisis triggers when a loved one is diagnosed with dementia, has a chronic illness, or is admitted to a nursing home for rehab. At that point some planning opportunities may not be available. Thorough pre-planning can preserve options and reduce complications when a crisis hits a family. The attorney should be contacted as soon as there is a hint of a health problem with long-term implications.

- **Update existing estate plan documents.** As a rule of thumb, we recommend that an estate plan should be reviewed at least every five years to account for changes in life, asset values, and law. In addition, older documents may not include important powers needed by senior adults for creative problem solving such as allowing transfers of assets between spouses, authority over retirement plans, and the ability to take steps to qualify for Medicaid, VA and other government benefits. If important powers are missing, responsible family members may not be able to carry out the intended plan or take advantage of legal strategies that could save assets.

- **Carefully select caregivers and money managers.** A plan is only as good as the persons authorized to execute it. Senior adults must carefully select the persons who will act on their behalf, especially when facing the increased likelihood of an incapacity. The best choice is not always a spouse or the oldest child. Distinctions need to be made between those qualified to make health care decisions and those who will make sound financial decisions. If necessary, two or more persons can serve at the same time. Accountability can be built into documents to reduce the risk of inappropriate decisions and attempt to prevent family squabbles.

- **Position for government benefits, if available.** Long term care is extremely expensive, with nursing homes costing $70,000 to $90,000 per year. Long term care costs may not be covered by Medicare or private health insurance. And many senior adults do not have the personal resources to pay for the care they will need. Public assistance may be available through Medicaid and the VA to help pay for care, but these programs have strict financial and complex legal requirements. Foster Swift elder law attorneys can guide clients through the confusing legal maze and help them steer clear

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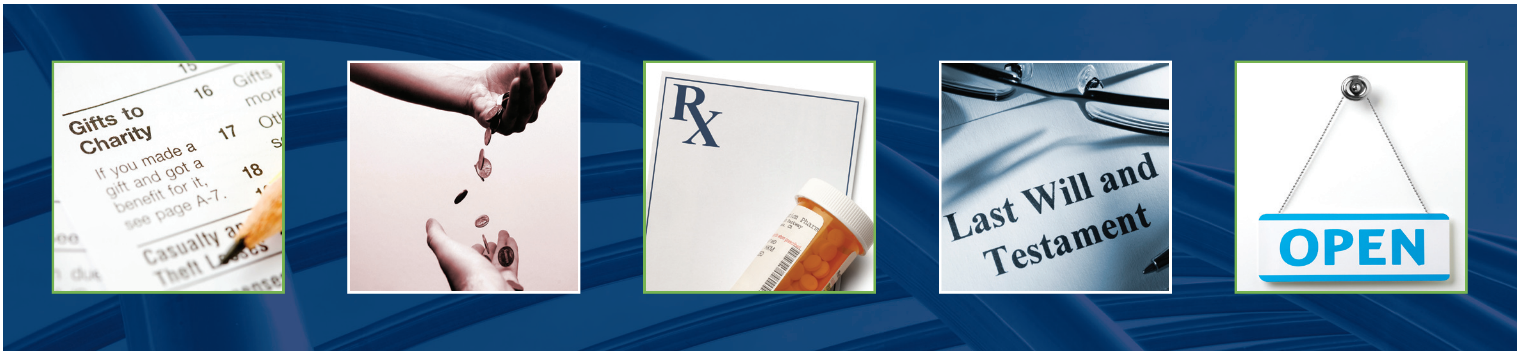

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- of mistakes that can jeopardize eligibility for benefits. With advance planning and the help of knowledgeable attorneys, many senior adults can position themselves to qualify for the maximum government benefits available to supplement their own personal funds, and protect spouses or disabled children from asset depletion.

- **Avoid costly mistakes.** When faced with a health crisis and the threat of costly care, senior adults and their families often make decisions that hurt them financially. Examples of potentially costly mistakes include: giving money/property away; signing deeds; adding children's names to accounts or real estate; selling assets; buying inappropriate financial products; and acting without legal advice. These and other mistakes can result in unnecessary loss of assets and ineligibility for Medicaid and VA benefits.

- **Recognize special planning situations.** There are some situations where an attorney can be especially helpful. These include:

    1. Married couples where only one spouse needs skilled or nursing home care.
    2. Senior adults with fading mental capacity.
    3. Senior adults without surviving or dependable family members to oversee their care or manage their assets.
    4. Owning real estate or a business interest with little available cash to pay for assisted living or nursing home care.

- **Build a team of professionals.** The best plans are built on the combined knowledge and experience of a team. The team may include select family members, an attorney, physicians, care coordinators, and financial advisors. When surrounded by a team, a senior adult can face the future with assurance that their needs will be met and decisions will be made in their best interest.

Senior adults face many challenges to their health and financial security. In order to overcome these challenges it is essential to have an estate plan that is current and tailored to their specific needs. The estate planning and elder law attorneys at Foster Swift skillfully and compassionately assist senior adults and their families through a comprehensive planning to develop the right plan for the right time.

Norman E. Richards
Attorney
P: 248.785.4724
E: nrichards@fosterswift.com

TRUSTS & ESTATES ATTORNEYS:

PRACTICE GROUP LEADER

Douglas A. Mielock
517.371.8203
dmielock@fosterswift.com

Allan J. Claypool | 517.371.8264
Jonathan J. David | 616.726.2243
Anna K. Gibson | 517.371.8280
Todd W. Hoppe | 517.371.8289
Erica E.L. Huddas | 517.371.8138
Charles A. Janssen| 517.371.8262
Mindi M. Johnson | 616.729.2252
Ryan E. Lamb | 616.796.2503
Steve L. Owen | 517.371.8282
Norman E. Richards | 248.785.4724
Dave R. Russell | 517.371.8150
Lynwood P. VandenBosch | 616.726.2201
Jennifer B. Van Regenmorter | 616.796.2502

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