

Estate Tax Planning: A Primer on Trusts, by N. Park

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Recent Governor Proposal:

A proposal to begin charging a tax on physicians' gross receipts is said to raise tax revenue, bring in more federal funds to Michigan and raise doctor's reimbursement rates for treating Medicaid patients. This proposal is met with opposition from the Michigan State Medical Society and its 14,000 physicians who state this will force physicians to pick up even more of the cost of health care for the uninsured. Stay tuned.

In addition to a will, many people today create a trust to transfer their property to beneficiaries of their choice, free of probate and potentially tax-saving.

It is both legal and safe to avoid probate. Why would you want to avoid probate as much as possible? Two principal reasons: time and money. First, the probate process may take six months to a year, and even longer. Second, probate fees are generally based on the size of the probate estate, and that could take a large bite out of what your beneficiaries may receive. However, you can reduce the fees by reducing the probate estate's worth. One approach to reduce probate fees is to transfer big items, such as your house and stock portfolio, outside of probate, and transfer only the less valuable items by your will.

But before delving further onto the value of trusts, a quick word on the necessity of a will. There are several good reasons to have one, even if you don't have much property, including:

A will is an easy and quick estate plan that can be refined later on as you get older and (presumably) acquire more property. Many younger people rely on a will to dispose of their property should they die unexpectedly, and make a probate avoiding estate plan when they grow older - generally in their 50s or 60s.

Wills are an effective and practical device to transfer some types of property, such as personal checking accounts and vehicles.

A will enables you to appoint a personal guardian for your minor children, and a property guardian for any property your children acquire.

A will is a necessary back-up for other estate planning devices. To transfer newly acquired property by devices other than a will, you generally must take specific action. However, deaths can be unexpected, and if you acquire valuable property shortly before death (for example, sudden inheritance or lottery winning), the newly acquired property will go to your residuary beneficiary without any further action on your part.

Here's a brief overview of trusts:

Two principal benefits of trusts are (1) probate avoidance and (2) for some, estate tax savings. The many types of trusts can be broken down to two main categories: revocable and irrevocable trusts. The primary difference between revocable and irrevocable is the ability to annul revocable trusts as long as you are alive. In contrast, irrevocable trusts cannot be revoked or altered once it is established.

Revocable Trusts

The most common type of trust and one of the most popular probate avoidance device is a revocable living trust. Under a living trust, title to property is transferred by its living owner (a "grantor") to a trust created by a document, called a "trust instrument." A "trustee," generally the same person who created the trust, manages the trust property. A "successor trustee" is also named to take over the management of the trust when the grantor/trustee dies. The trust "beneficiaries" are named by the grantor. When the grantor/trustee dies, the successor trustee transfers trust property to these beneficiaries, free of probate.

A revocable living trust allows you, as the grantor, to retain control over your property before you die. The only real drawback is that certain formalities are required.

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Cost Segregation



by C. Revilla

Are you thinking of constructing or purchasing, or have you purchased real estate? If so, you should also be thinking about applying cost segregation. Cost segregation is an asset depreciation technique that can provide remarkable tax benefits by allowing you to assign a shorter recovery period to assets, thus writing them off over much shorter periods of time. The

following is an explanation of how you can utilize this technique.

An engineering report should be obtained and used to divide real estate into four categories:

- Personal property
- Buildings
- Land improvements
- Land

The first category, personal property, includes things such as floor coverings, furniture, and appliances. These items can generally be depreciated over five or seven years, thus providing for a huge acceleration of tax savings and a corresponding increase in cash flow.

Buildings should be further broken down into components. If one of the components of the building has to be discarded, the taxpayer can write this component off with less difficulty. An example would be to value the roof of a building separately. Therefore, it could be written off much easier if it were destroyed and had to be replaced. As much value as possible should be placed on the building because any value that is remaining will be allocated to land, which is not a depreciable asset. Residential buildings will be depreciated over 27.5 years while nonresidential buildings must be depreciated over 39 years.

Land improvements have a 15 year recovery period and include such items as fences, docks, sidewalks, and parking lots. As much value as permissible should be assigned to this category, rather than including it in non-depreciable land.

Land will be the residual value that is left after assigning values to the above three categories. A taxpayer should have all the proper documentation to substantiate this residual value placed on the land. This could shield the taxpayer in an IRS examination.


As one can imagine, the most difficult challenge may be to differentiate between the above components. One example would be a built-in display cabinet that is permanently attached to the

floor versus a prefabricated display cabinet that can be disassembled and moved to another location in the room. The built-in cabinet may be considered a structural component of the building whereas the prefabricated display cabinet would most likely be considered tangible personal property. Your CPA may use the findings of the Tax Courts to be a great source of guidance to assist you with this task. The Tax Courts have set forth questions that may be asked to determine what is and what is not a structural component of the building. These questions include those such as can or has the property been moved and how difficult and time-consuming is the removal, and is it intended that the property will remain permanently affixed to the structure.

You may be asking, "What exactly does this mean for me in dollars?" The Journal of Accountancy, in the August, 2004 issue, page 31, provided the following example:

A taxpayer purchases a nonresidential building for \$12,135,000 (assume the land is owned by an independent third party). Without cost segregation, the taxpayer must use straight-line depreciation over 39 years to write off the cost of the building.

To the contrary, the taxpayer has a cost segregation study performed and the engineer's report shows that of the total purchase price, \$11,285,000 should be allocated to the building, \$50,000 to 15-year property and \$800,000 to 5-year property. As a result of a 5% discount rate and assuming a 35% tax rate, the study would provide \$133,563 of tax savings. The increased depreciation in the first and second year alone would be \$151,603 and \$238,956, respectively.


"Nonresidential buildings must be depreciated over 39 years."

As you can see, it is the time value of money that makes the faster depreciation deductions beneficial. However, even though the advantages of cost segregation can far outweigh the disadvantages, it should be noted that there are possible disadvantages. A cost segregation study can be expensive although the fees may vary widely. It may actually take four to six weeks to complete. Another disadvantage is that if the property is subsequently disposed of, the recapture provisions of the tax code may apply and will have to be considered. Also, a taxpayer that uses cost segregation too vigorously could be subject to potential tax penalties.

In conclusion, a well-documented cost segregation study, despite some drawbacks, can result in dramatic tax savings and should be considered when dealing with real estate.

Please feel free to contact us with any questions you may have.

Proposed SBT Legislation

Governor Granholm recently proposed the Michigan Jobs & Investment Act to change the single business tax (SBT) structure. The main objective for the Act is to create incentives for economic growth in Michigan. Whether the Act will actually spur such growth and business opportunities is being debated.



by N. Park

Fundamentally, the plan will:

- Cut the standard SBT rate from 1.9% to 1.2% - a 37% percent rate cut.
- Cut the alternative tax rate for small business from 2.0% to 1.2% - a 40% rate cut.
- Create a 35% personal property tax credit for manufacturing and R&D property.
- Provide a 1.2% credit for R&D labor expenses.
- Increase the profit component of the tax base for corporations by changing the tax formula to put more emphasis on profit and less on equipment, salaries and health care, with the expectation of reduced taxes when profits are down.

The plan would also:

- End preferential treatment for insurance companies by increasing from 1.07% to 2% premiums tax, bringing it more in line with the national average. (But this tax does not apply to Blue Cross/Blue Shield, HMOs or self-insurance plans.)
- Eliminate the Special Property Tax Treatment for Commercial Rental Property.
- Eliminate the special credit for unincorporated businesses.
- Eliminate the special credit for telephone property taxes paid.
- Eliminate Excess Compensation Reduction.
- Eliminate the Gross Receipts Reduction.
- Treat compensation of employees leased from a professional employer organization as compensation of the client business.
- Make small business credit eligibility independent of business organization or out-of-state affiliation.

If approved by the Legislature, this plan will be effective for the tax year starting on or after January 1, 2006.

Special Interest Section

H&S is growing! In addition to our new office in Grand Rapids and the hiring of NaLee Park (no doubt you read about our new office and NaLee in the newspaper), did you know H&S has hired two new team members in our Fremont office? .

Kathy Tanis came aboard in November of 2004. Kathy is a part of the audit team, as well as doing accounting, payrolls, and helps in our first impressions area. Her favorite pass time is to design her "dream house" - one that is realistic, affordable and easy to clean!!

Julie Reams joined us in January of this year. Julie is also part of the audit team as well as preparing tax returns and monthly accounting for our clients. Julie loves to mushroom hunt, but will not share her favorite hunting spots with Jodi (who, by the way, won't share hers with Julie either)!

Estate Tax...

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You must have a formal trust document prepared. If a property has a document of legal title, such as a house deed, it must be transferred to your living trust. For example, if you put your house in a living trust, you must properly execute and record a deed transferring ownership, naming the living trust. And as long as you remain the trustee, no trust income tax returns are required, and separate trust documents do not have to be kept. You simply report your income as primary beneficiary of a revocable trust on your standard federal 1040 tax return as if no trust existed.

Irrevocable Trusts

There are a number of irrevocable trusts that can be used to save on estate taxes, including the AB Trust to lower a married couple's overall estate taxes, Generation Skipping Trust for the benefit of grandchildren, and Charitable Remainder Trust to donate generously to a charity while giving you and your heirs a big tax break. First, two general rules to know before being concerned about reducing estate taxes, or also called "death taxes":

All property you leave to your (U.S. citizen) spouse is subject to the marital deduction, meaning exempt from federal estate tax; and,

Any property you leave to just about anyone else is subject to the personal estate tax exemption, and unless the value of your estate at death exceeds the exemption amount for that year (in 2005, it will be same as in 2004 - \$1.5 million), your estate will likely not owe any federal estate taxes.

Overall, irrevocable estate tax-saving trusts are more complex to create because they must comply with complicated IRS regulations in order to be effective, and a mistake can be costly. Also, irrevocable trusts are designed to be just that - irrevocable - so take a thorough consideration of all possible events over time.

For more details on these sophisticated tax planning trusts, consult with a tax advisor and attorney.

Computer Backup Strategies, by A. Bradshaw



People who use computers know they will inevitably crash. They can crash for a variety of reasons. There could be hardware failures such as a bad hard drive or a power surge, or there may be software problems, such as a virus. One way to protect yourself against these problems is to perform regular backups.



There are a variety of ways to backup a computer. For a personal computer the best options are USB thumb drives, CD's, and external hard drives. USB thumb drives are small devices, approximately the size of a thumb, that plug into a USB port on your computer. They don't require any external power and are easy to use. An external hard drive is a device that connects through a USB port on your PC and needs to have as much storage space as your C: drive. Some advantages and disadvantages of each method are:

	USB Thumb Drive	CD	External Hard Drive
Advantages	Inexpensive Easy to use	Inexpensive Included with most new computers	Completely automated Backs up entire system (programs and data)
Disadvantages	Not automated Usually only enough room for data (not programs)	Most time consuming method Usually only enough room for data (not programs)	Initial setup can be complex Most expensive method

For businesses that use servers, tape drives are usually used for backups. Tape drives have the largest capacity of any backup method, they are usually the fastest backup method, and they are able to backup the complex software on a server.

No matter which backup method is used, periodic test restores should be done. This will ensure that you are backing up all of your data and the backup method is working properly. When performing a periodic test restore; you should restore your data to a different folder on your computer or to a different computer altogether. Then, open some of the files you restored to make sure everything works properly.

As computers continue to be used more and more in business, computer downtime can cripple a business. By following these backup strategies, you can minimize your downtime and data loss in the event of a computer crash.



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