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MEMORANDUM

FROM: PASSARO & KAHNE LAW OFFICE, P.L.L.C.
DATE: JANUARY 8, 2009
SUBJECT: SPECIAL PLANNING ALERT

As we embark on 2009, in light of the current economic situation, we at Passaro & Kahne Law Office, P.L.L.C. thought it would be helpful for our clients and friends to be aware of and consider some of the items set forth below.

SOME CHANGES IN THE TAX LAWS FOR 2009

- **Suspension of Required Minimum Distributions.** For 2009 (only) the Required Minimum Distribution (RMD) for individuals over age 70-1/2 and for inherited IRAs has been suspended. For planning purposes you should consider not receiving your RMD for 2009. Some considerations in making your decision include:
 - Your need for the funds.
 - Your desire to allow the IRA to grow for 2009 without distribution.
 - Your income tax impact from any distribution, including the impact upon taxing social security benefits.
- **Federal Estate Tax Exemption Increases to \$3,500,000.** The federal estate tax exemption for 2009 has increased to \$3,500,000. The \$1,000,000 gifting cap remains unchanged. For married couples with estates over \$3,500,000, care must be taken:
 - to assure assets are titled to avoid probate, and
 - to split assets so that the exemption can be utilized no matter which spouse predeceases.

We anticipate federal legislation during 2009 to set the limit for future years.

- **Like Kind Exchanges and Vacation Homes.** Section 1031, Like Kind Exchanges, represents a viable planning tool for tax deferral for “trade or business” or “investment” property. In the past, personal use property such as vacation homes did not qualify for Like Kind Exchange tax deferral because of the “personal use” prohibition. However, the IRS has recently issued a ruling which would allow taxpayers to take advantage of the tax deferral provisions of Section 1031 with respect to vacation homes. ***If you are considering sale of an existing vacation home and reinvestment in another vacation home or other “trade or business” or “investment” property, you may qualify for the advantageous tax treatment under Section 1031.***
- **Sale of Principal Residence.** A change in the law, affecting sales of Principal Residences after December 31, 2008, may require the taxpayer to allocate the gain on the sale if the Principal Residence was ever used by the taxpayer for a nonqualified use such as a rental during the period the taxpayer owned the property (the change applies to periods of nonqualified use after December 31, 2008). ***If you are considering selling your principal residence and have used the property for other than a principal residence (after December 31, 2008) during your period of ownership, you should consult with your tax advisor as to the impact of this provision and any planning opportunities which may be available.***

TAX PLANNING OPPORTUNITIES

Some tax planning opportunities exist during these extremely challenging economic times. Considerations include:

- **Planning With Depressed Asset Values.** The extreme depression in the value of many publicly traded stock (50% or more in many cases) has also depressed the valuation of many privately held companies and much real estate. Consider gifting, selling or otherwise transferring publicly traded stocks, cash, or closely held business interests to younger generations (in trust or otherwise). Cash gifts could be utilized to invest at the current market.
- **Planning in the Current Low Interest Rate Environment.** The IRS publishes monthly minimum interest rates, Applicable Federal Rates (AFR), to be used in related party transactions between family members and between family businesses. For **January 2009** (only) the AFR are the lowest ever.
 - Loans 1-3 years (Short-Term AFR) - **.81%**
 - Loans 3-9 years (Mid-Term AFR) - **2.06%**
 - Loans over 9 years (Long-Term AFR) - **3.57%**
 - Special rate for certain planning transactions - **2.4%**

January 2009 is an ideal month to take advantage of the lower rates. Planning strategies in this low value, low interest rate environment include:

- **Simple Interfamily Loan Gift.** With low interest rates parents loan money to lower generations (or trusts) allowing the borrower to invest the funds in anticipation of returns at a higher rate. For example, parent loans child \$100,000 at .81% interest for 2 years and 11 months. Child invests the loan at a higher rate.
- **Gifting.** Now might be the opportune time to utilize the \$13,000 per year annual exclusion gifting rule plus utilizing some or the entire \$1,000,000 lifetime rule by gifting stock (units), real estate or cash. The concept is to shift post gift appreciation away from estate taxes.
- **Roth IRA.** For those who are eligible, fund Roth IRAs. This is especially true for younger children with earned income.
- **529 Plans.** Fund 529 Education plans for children and grandchildren.

BUSINESS PLANNING OPPORTUNITIES

Some planning strategies for family businesses include:

- **Restructure Related Party Loans.** Revamp loans during January between companies and family owners at lower rates.
- **Transfer Value in the Family Business.** Transfer ownership of closely held businesses (often non-voting stock or LLC units) to younger generations or trusts for their benefit. Reduced value coupled with low interest rates provide some great planning opportunities including:
 - **Gifting Stock.** Consider utilizing the \$13,000 per year gifting rule plus the \$1,000,000 lifetime gifting rule by gifting stock (units) in the family business.
 - **Installment Sale.** An installment sale to family members lock in the value of stock (units) sold. Lower interest rates mean lower payments are required by the buyer.
 - **Transfer to a Grantor Retained Annuity Trust (GRAT).** With a GRAT, a grantor transfers property to a trust in exchange for a fixed annuity for a defined term. At the end the remainder goes to a family member or a trust for their benefit. GRATs are very attractive when interests are low.
 - **Installment Sale to an Intentionally Defective Grantor Trust (IDGT).** IDGTs are trusts designed to purchase closely held business stock or LLC units. The IDGT is often designed to avoid income taxes upon the sale and to tax the business income (often S Corporation income) to the grantor instead of the beneficiaries. The result is that the beneficiaries receive tax free income. The IDGT is most advantageous in a low-rate environment.

- **Convert C Corporation to an S Corporation.** With the built in gain tax potential upon conversion from a C Corporation to an S Corporation, the best time to convert is when valuations are low. The lower the value is, the lower the built in gain potential if assets owned at conversion are sold within 10 years.
- **Increased IRS Audits.** With the increase in the number of IRS audits businesses must be diligent in updating minutes, related party loans and related party leases.

REAL ESTATE CONSIDERATIONS

- **Property Taxes - Notice of Assessment.** We have received several inquiries asking how the changes in property values over the last year may impact real estate taxes in 2009. In late February 2009, you will receive a Notice of Assessment from your local assessor, which will show the 2008 and 2009 proposed Assessed Value (AV), State Equalized Value (SEV) and Taxable Value (TV).
The 2009 Taxable Value is the value that will be used in calculating your 2009 real estate taxes. If you acquired the property in 2008, the 2009 Taxable Value should be less than or equal to one-half of the purchase price you paid for the property. If you owned the property prior to 2008, the 2009 Taxable Value should be less than or equal to one-half of the fair market value of the property as of December 31, 2008.
If this is not the case, you will need to bring this discrepancy to the local unit's March Board of Review by the dates indicated on the Notice of Assessment. To support a challenge, you will need supporting materials showing the value of the property prior to or as of December 31, 2008, such as an appraisal or a realtor market analysis/assessment certified to you. If you fail to challenge the valuation at the March Board of Review, you will waive your right to have the 2009 Taxable Value reviewed for 2009.
- **Principal Residence Exemption (PRE).** There is a substantial property tax advantage/savings in having your Michigan home classified as your "principal residence". In this regard here are a couple of items to keep in mind:
 - **Claiming the PRE.** If you have moved into a new residence which qualifies for the PRE, and have not yet claimed the PRE for 2009, ***you must file Michigan Department of Treasury Form 2368, Homeowner's Principal Residence Exemption Affidavit on or before April 30, 2009 in order to obtain the PRE for calendar year 2009.***
 - **Change of Residence to Michigan.** If you are considering changing your principal residence from another state to Michigan, in addition to filing Form 2368 on or before April 30, 2009, you must change the "indicators" of your residency such as voter registration, drivers license, vehicle registration, etc. to Michigan prior to April 30, 2009 (for a complete list please contact Passaro & Kahne Law Office for a "Michigan Domicile Checklist"). ***If the state of your current residency has a "homestead***

or homeowners” property tax exemption you must take affirmative action to revoke this exemption. If you do not, you risk the revocation of your Michigan PRE.

- **Maintaining the PRE on your Prior Residence.** If you purchased a new principal residence for which you intend to claim the PRE for 2009, but have as yet to sell your prior principal residence, ***you can retain the PRE for your prior principal residence for a period up to three (3) years*** by filing Form 4640, Conditional Rescission of Principal Residence Exemption, on or before April 30, 2009. ***To qualify, your prior principal residence must meet the following: (i) not be occupied, (ii) be for sale, (iii) not be leased, and (iv) not be used for a business or commercial purpose.***
- **Delinquent Condominium Dues.** We have been receiving numerous inquiries regarding the impact of foreclosure on delinquent condominium dues and fees. Mortgage foreclosures can have a significant potential financial impact on the Association, the level of assessment for the other co-owners within the project, and potential purchasers of units within the project. ***Association boards should develop “action plans” to attempt to minimize the impact of this situation. Action plans should potentially include the addition of a budget item for “Reserve for Delinquent Assessments”.***

In summary, some planning opportunities exist in the current environment, but timing is essential and in many cases January 2009 is the month. If you want to follow-up, please call us at (269) 983-0325.

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CIRCULAR 230 NOTICE

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