

**DUPAGE COUNTY ESTATE PLANNING COUNCIL
GIFT & ESTATE TAX UPDATE**

October 2, 2008

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Presidential Election and Taxes

The ongoing campaigning, debates and upcoming presidential election raise the question as to the positions the candidates have taken with various tax proposals. The candidates have proposed tax plans that would drastically increase the national debt over the next ten years. Some estimates show the Obama plan would reduce \$2.9 trillion in taxes for 2009-2018, while the McCain plan would reduce taxes by \$4.2 trillion over the same period. The big difference is how those reductions are spread amongst the taxpaying public. The Obama plan would give larger tax cuts to low and moderate income households, while raising taxes on high-income taxpayers in order to counter-balance some of the increases. The McCain plan generally cuts taxes across all income levels, but provides for the biggest cuts in the highest-income households.

Without taking a position, the following is an attempt to review and highlight the candidates' positions:

Tax Type	McCain Plan	Obama Plan
Income	<p>Extend the 2001 and 2003 tax relief. This includes the higher child tax credit, marriage penalty relief, new 10% tax rate, lower tax rates on dividends and capital gains, lower tax rates generally.</p> <p>Increase the dependent exemption (the 2013 level would be twice the level in 2009).</p> <p>Extend and index 2007 AMT patch</p> <p>New refundable health care tax credit (\$5,000 for family coverage, \$2,500 for individual coverage). Replaces the current exclusion for employer-based health insurance premiums.</p>	<p>Raise taxes for incomes over \$250,000, otherwise, extend the 2001 and 2003 tax relief. Tax relief includes the higher child tax credit and marriage penalty relief.</p> <p>Refundable "Making Work Pay Credit" of 6.2 percent of earnings, up to a maximum of \$8,100.</p> <p>Permanently index 2007 AMT exemption; increase exemption by additional 5 percent per year after 2013 (temporarily)</p> <p>Refundable "Universal Mortgage Credit" of 10 percent of mortgage interest for non-itemizers.</p> <p>Eliminate income tax for seniors making less than \$50,000 per year. Increase EITC phase-in rate to 45 percent for families with three or</p>

		<p>more children.</p> <p>Make the child and dependent care tax credit refundable and increase the maximum credit rate to 50 percent.</p> <p>Make the saver's credit refundable and allow 50 percent match up to \$1,000 of contributions.</p> <p>Increase the Hope education credit (100% match rate on up to \$4,000).</p>
Capital Gains	Retain the 15% rate set in 2003	Raise taxes on capital gains to 20–25%
Estate	Keep \$3.5 million exemption level (2009 level). Estate tax at 45%	Make permanent estate tax with \$5 million exemption level. Decrease the estate tax to 15%.
Corporate	Reduce the maximum rate from 35% to 25%	No changes

There are many resources to review and research on these proposals. The Tax Policy Center of the Urban Institute and the Brookings Institution, two nonpartisan research organizations, have published a study that has, perhaps, provided one of the better reviews of the candidates' respective positions. See, http://www.taxpolicycenter.org/taxtopics/presidential_candidates.cfm.

IRS Issues First Ruling on Taxation of Series Limited Liability Company

In Letter Ruling 200803004 the IRS has apparently rendered its first ruling on the taxation of a series limited liability company (SLLC). A series limited liability company is an entity that allows for the creation of separate ventures as part of one LLC. SLLC are allowed by only a few states, Illinois among them. The use of SLLC allows the segregation of assets and liabilities of separate businesses and properties. In a nutshell, when the property and obligations of each separate series are accounted for separately, then the property of one series may not be reachable by the creditors of another series.

The Letter Ruling holds that each series of an SLLC is a separate entity for federal tax purposes. Under the ruling, the IRS has indicated that each entity in the SLLC will be treated as a separate entity for tax purposes. While the IRS did not come out and specifically say that the entities within each SLLC are to be treated as separate entities, it implied this when they said that each can make its own entity characterization selection under the check the box rules and entity characterization rules.

Although this provides an insight into the direction of the IRS on this subject, it is, of course, not binding on anyone except the recipient of this private ruling. The ABA Section on Taxation requested that the IRS make the tax classification of series LLC's part of their annual business

plan and provide binding guidance on this issue. The IRS has included this topic in its 2008-2009 Priority Guidance Plan.

Estate, Gift, and Trust Issues in IRS 2008-2009 Priority Guidance Plan

The IRS has issued its “2008-2009 Priority Guidance Plan.” Out of an exhaustive list of over 300 regulatory projects that may result in a guidance issued through June 2009, there are 15 that relate to gifts, estates, and trusts:

1. Regulations under Sec. 67 regarding miscellaneous itemized deductions of a trust or estate. Proposed regulations were published on July 27, 2007.
2. Guidance under Sec. 529 regarding qualified tuition programs. An advance Notice of Proposed Rulemaking was published on January 18, 2008.
3. Final regulations under Sec. 642(c) concerning the ordering rules for charitable payments made by a charitable lead trust. Proposed regulations were published on June 18, 2008.
4. Guidance under Sec. 643 regarding uniform basis rules for trusts.
5. Adjustments to sample charitable trust forms under Sec. 664.
6. Revenue ruling regarding the consequences under various income, estate, gift, and generation-skipping transfer tax provisions of using a family owned company as a trustee of a trust. A proposed Rev. Rul. was published on August 4, 2008.
7. Final regulations under Sec. 2032(a) regarding imposition of restrictions on estate assets during the six month alternate valuation period. Proposed regulations were published on April 25, 2008.
8. Guidance under Sec. 2036 regarding graduated grantor retained annuity trusts (GRATs).
9. Guidance providing procedures for filing and perfecting protective claims for refunds for amounts deductible under Sec. 2053.
10. Guidance under Sec. 2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of administration expenses and claims against the estate.
11. Final regulations under Sec. 2053 regarding the extent to which post-death events may be considered in determining the deductible amount of a claim against the estate. Proposed regulations were published on April 23, 2007.
12. Final regulations under Sec. 2642(g) regarding extensions of time to make allocations of the generation-skipping transfer tax exemption. Proposed regulations were published on April 17, 2008.
13. Guidance under Sec. 2704 regarding restrictions on the liquidation of an interest in a corporation or partnership.

14. Final regulations under Sec. 7477 regarding declaratory judgment procedures relating to gift tax valuation issues. Proposed regulations were published on June 9, 2008.

15. Guidance under Sec. 7520 updating the mortality based actuarial tables to reflect data compiled from the 2000 census.

Emergency Economic Stabilization Act of 2008

On October 3, 2008, President Bush signed the Emergency Economic Stabilization Act of 2008 (referred to as the "Act"). The Act started out as a three page proposal with 12 sections when it was submitted by the US Treasury Department. It was over 100 pages and 45 sections when it was revised by Congress.

With passage the Treasury Department has \$250 million to deal with for stabilization efforts to purchase "troubled assets." The president is allowed to certify another \$100 million for this process. Congressional approval is necessary for the disbursement of the second \$350 million. The Treasury Department had requested that the entire \$700 billion be immediately authorized for use in handling the credit and liquidity crisis.

The Act also includes a number of tax changes affecting individuals, corporations, and businesses.

Tax Changes in the Economic Stabilization Act

Community Banks Receive Tax Relief for Losses on Fannie Mae and Freddie Mac Preferred Stock

Fannie Mae and Freddie Mac issued preferred stock became worthless with the federal government bail out of these two entities. While this created obvious major financial difficulties for all owners of the preferred stock issued by these entities, it also created tax problems for community banks that owned the preferred stock. Under pre-Act law, a financial institution that holds Fannie Mae or Freddie Mac preferred stock as a capital asset would recognize capital gain or loss upon the sale or taxable exchange of that stock. Loss on the disposition of preferred stock would be a capital loss and could be used to offset capital gains. Due to regulatory rules, however, community banks do not generate capital gains. The new Act provides that after Dec. 31, 2007, the applicable financial institutions may treat their losses on Fannie Mae and Freddie Mac preferred stock as ordinary losses and therefore they will be able to use those losses to offset their ordinary income. The IRS now has authority to issue rules necessary to carry out the purposes of this new ordinary loss provision.

Deductions for Executive Compensation Limited for Employers Participating in the Bailout

Before the Act, an employer had the ability to deduct reasonable compensation for personal services as an ordinary and necessary business expense. A publicly held corporation was limited to \$1 million per year paid or accrued to a covered employee. A covered employee is any employee who is (1) the principal executive officer (or an individual acting in such capacity), or (2) among the three most highly compensated officers for the tax year (other than the principal executive officer). Thus, only four employees are covered. The new law makes the limit \$500,000 for otherwise deductible compensation of a covered executive for any applicable

tax year for an applicable employer. An applicable employer is an employer that has sold over \$300 million in troubled assets pursuant to the Act.

Severance Pay for Top Financial Executives Subject to Golden Parachute Rules

Under the golden parachute rules of IRC Section 280G a corporation isn't allowed a deduction for excess parachute payments paid to a disqualified individual. There is also a 20% excise tax on excess parachute payments to the person who receives such payments. The Act specifically extends these rules to executives of employers who are involved in the asset sale program established by the Bailout.

Home Mortgage Debt Forgiveness Relief Extended for Three Years

Taxpayers generally may exclude up to \$2 million of mortgage debt forgiveness on their principal residence. That is, gross income doesn't include any discharge of qualified principal residence indebtedness. Under the prior law these mortgage relief provisions are effective for indebtedness discharged on or after Jan. 1, 2007 and before Jan. 1, 2010. The Act now extends the mortgage debt relief for three additional years through 2013.

Tax Extenders and Alternative Minimum Tax Relief Act of 2008

The "Tax Extenders and Alternative Minimum Tax Relief Act of 2008" (the 2008 Extenders Act), which was enacted as part of the Economic Stabilization Act provides extensions for several popular tax breaks and the addition of several new relief provisions, including disaster area tax relief. Here's an overview of the key provisions in the new legislation:

Deduction of state and local general sales taxes. The option to deduct state and local general sales taxes is extended through 2009.

Qualified tuition deduction. The above-the-line tax deduction for qualified higher education expenses is extended through 2009.

Teacher expense deduction. The provision allowing teachers an above-the-line deduction for up to \$250 for educational expenses is extended through 2009.

IRA rollover provision. The provision allowing qualified taxpayers to make tax-free contributions from their IRA plans to qualified charitable organizations is extended for tax years 2008 and 2009. This is the \$100,000 that can be paid directly out of an IRA plan to a qualified charitable organizations by a taxpayer who has reached age 70 1/2.

Additional standard deduction for real property taxes. The standard deduction for real property taxes for non-itemizers is extended through 2009.

Research and development credit. The research tax credit is extended through 2009. In addition, the alternative simplified credit is increased from 12% to 14% for the 2009 tax year, and the alternative incremental research is repealed for the 2009 tax year.

15-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements. The 15-year write-off for qualified leasehold, restaurant and retail improvements is extended through 2008.

Basis adjustment to stock of an S corporation making charitable contributions of property. Favorable Subchapter S basis rules for gifts of appreciated property are extended through 2009.

Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico. The provision allowing a Section 199 domestic production activities deduction for activities in Puerto Rico is extended through 2009.

Other extended provisions. Other provisions extended through 2009 include:

- Qualified zone academy bonds.
- Indian employment credit.
- Accelerated depreciation for business property on Indian reservation.
- Tax credit for certain expenditures for maintaining railroad tracks.
- 7-year recovery period for certain motorsports racetrack property.
- Work opportunity tax credit for Hurricane Katrina employees.
- New markets tax credit.
- Increased rehabilitation credit for structures in the Gulf Opportunity Zone.
- Enhanced charitable deduction for qualified computer contributions.
- Tax incentives for investments in the District of Columbia.
- Enhanced charitable deduction for food inventory.
- Enhanced charitable deduction for contributions of book inventory to schools.
- Special expensing rules for certain film and television productions.
- Exception under Subpart F for active financing income.

Increased AMT Exemption Amounts For 2008

For tax years beginning in 2008, the 2008 Extenders Act offers a one-year patch affecting the estimated 26 million taxpayers who could be subject to the AMT¹ for 2007. The 2008 Extenders Act increases the AMT exemption amounts (which were originally scheduled to decrease for 2007):

Married couples filing a joint return and surviving spouses, exemption amount is \$69,950 (from 2007 level of \$66,250);

Individual who isn't married or a surviving spouse, exemption amount is \$46,200 (from 2007 level of \$44,350);

Married individuals filing separate returns, exemption amount is \$34,975 (from 2007 level of \$33,125).

Despite the increases, the 2008 Extenders Act basically delays the reductions originally scheduled to take place without addressing the issue of how the AMT is applied. Therefore, the

¹ The Alternative Minimum Tax (AMT) is the excess, if any, of the tentative minimum tax for the year over the regular tax for the year. In arriving at the tentative minimum tax, an individual begins with taxable income, modifies it with various adjustments and preferences, and then subtracts an exemption amount (which phases out at higher income levels). The result is alternative minimum taxable income (AMTI), which is subject to an AMT tax rate of 26% or 28%. Under pre-Act law, an individual's AMT exemption amounts for 2008 (before the phase-out) were as follows: \$45,000 for married individuals filing jointly and surviving spouses; \$33,750 for unmarried individuals; and \$22,500 for married individuals filing separately.

reductions that were supposed to be in effect for 2007 will now go into effect for tax years beginning after 2008, i.e., for 2009 and later years. When first implemented in 1970 the AMT applied to 20,000 taxpayers. In 2007 it was estimated to be 4 million taxpayers. Without changes the estimate was 26 million taxpayers in 2008 would be subject to the AMT.

New Tax Relief Measures

The following changes were enacted on October 3, 2008, as part of the bailout tax relief. However, it should be noted that many of these items were being addressed by various committees and members of Congress before the bailout proposal was made.

Refundable Child Credit Eased

The child tax credit has allowed a taxpayer to receive a \$1,000 tax credit for each qualifying child who is under the age of 17. To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15% of earned income in excess of a threshold dollar amount (which is indexed for inflation and is \$12,050 in 2008). Families with three or more children are allowed to use an alternative formula (the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit) to determine if they can qualify for a larger credit than the determination made with the earned income formula. For 2008, the Act modifies the earned income formula for the determination of the refundable child credit to apply to 15% of earned income in excess of \$8,500.

Farming Business Machinery and Equipment Treated as 5-year Property

For property placed in service after 2008 and before 2010, the Act provides a five year recovery period for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which is used in a farming business and the original use of which commences with the taxpayer.

Preparer Penalty Eased

Legislation enacted in 2007 (part of the Small Business and Work Opportunity Tax Act) broadened the scope of the preparer penalty by applying it to all tax return preparers and altered the standards of conduct a tax return preparer must meet in order to avoid penalties for the preparation of a return when there is an understatement of tax. For reportable transactions the preparer must have a reasonable belief that the position would more likely than not be sustained on its merits. The provision is effective for returns prepared for tax years beginning after the enactment date.

Mental Health Insurance Parity

Private insurance plans covering 51 or more employees offering mental health benefits as part of the coverage will be required to offer such benefits on a par with the medical surgical benefits. This requirement will take effect for plan years starting after the one year anniversary date of the enactment date. Any cost-sharing or benefit limits imposed on mental health services must not be any more restrictive than those imposed on med-surgical services.

Nonqualified Deferred Compensation from Certain Tax Indifferent parties

Pre-Act law has allowed executives and other employees to defer paying tax on compensation until the compensation is paid. This essentially allowed the corporation paying the deferred compensation to defer the deduction related to the compensation until the compensation is actually paid. When an individual is paid deferred compensation by a tax indifferent party (such as an offshore corporation in a low or no-tax jurisdiction), there is no offsetting deduction that can be deferred. Therefore, individuals receiving deferred compensation from a tax indifferent party are able to achieve the tax benefits of deferred compensation at the expense of the US Treasury.

Under the Act, compensation of a service provider after 2008 that is deferred under a nonqualified deferred compensation plan of a nonqualified entity is includible in gross income by the service provider when there is no substantial risk of forfeiture of the service provider's rights to the compensation.

The rule is intended to apply to compensation that is contingent on the sale of a single asset held as a long-term investment, provided that the service provider does not actively manage the asset. In addition, the rule is intended to apply solely to compensation arrangements relating to passive investments by an investment fund in a single asset. The IRS is supposed to issue guidance within 120 days.

Tax Breaks for Film and Television Productions

With regard to qualifying film and television production taxpayers can elect to deduct the cost of the qualifying film and television production, starting before January 1, 2009, in the year the expenditure is incurred rather than capitalizing the cost and recovering it through depreciation allowances. A qualified film or television production is one in which the aggregate cost is \$15 million (\$20 million for productions in low income communities or distressed area or isolated area of distress) or less.

The expensing option for qualified film and television productions starting after 2007 has been extended for one year so that it applies for qualifying film and television productions commencing before Jan. 1, 2010. Further, the Act modifies the dollar limitation so that the first \$15 million (\$20 million for productions in low income communities or distressed area or isolated area of distress) of an otherwise qualified film or television production may be treated as an expense in cases where the aggregate cost of the production exceeds the dollar limitation.

Income Averaging for Exxon Valdez Litigation Amounts

Commercial fishermen and other individuals whose livelihoods were negatively affected by the '89 Exxon Valdez oil spill are now allowed to average any settlement or judgment-related income that they receive in connection with pending litigation in the federal courts over three years for federal tax purposes. The funds can also be used to make contributions to retirement accounts.

Excise Tax Exemption for Wooden Practice Arrows Used by Children

Pre-Act law imposed an excise tax of 39¢, adjusted for inflation, on the first sale by the manufacturer, producer, or importer of any shaft of a type used to produce certain types of

arrows. After the enactment date, the Act exempts such sales from the excise tax any shaft consisting of all natural wood with no laminations or artificial means to enhance the spine of the shaft used in the manufacture of an arrow that measures 5/16 of an inch or less and is unsuited for use with a bow with a peak draw weight of 30 pounds or more. On Senator Chuck Grassley's website it is stated that the estimated cost of the proposal is \$2 million over ten years.

Disaster relief

Included in the new legislation is Midwestern disaster area tax relief for victims of the disaster in Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska and Wisconsin, and a new tax relief package for victims of all Federally-declared disasters occurring after Dec. 31, 2007 and before Jan. 1, 2010 (e.g., eased loss deduction rules, a new business write-off for demolition, cleanup and repair, a 5-year carry-back for casualty losses or qualified disaster expenses, bonus 50% first year depreciation for property placed in service through Dec. 31, 2011 (Dec. 31, 2012 for real property), and increased expensing dollar limits).