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ESTATE PLANNING UPDATE

By Mark S. Samila

Status of Estate Tax Repeal

As this newsletter went to press, the House and Senate passed a ten year \$1.35 trillion tax relief package. The bill provides for repeal of the estate tax in 2010. In the interim, the "unified credit", or the amount that individuals can shield from the estate tax, increases from \$675,000 in 2001 to \$1 million in 2002. Thereafter, it increases to \$1.5 million in 2004, \$2 million in 2006 and \$3.5 million in 2009. The annual gift tax exclusion remains at \$10,000.

The question becomes, is estate planning still needed? Our view is yes. Between now and 2010, the legislation will have to survive five congresses and as many as three presidents. Soon to be Senate majority leader Tom Daschle has already been quoted as saying that the bill is good short-term politics, but disastrous long-term policy. Daschle predicts that Congress will ultimately have to come back and "make corrections" in tax policy. All of the above indicates that the ultimate repeal of the estate tax in 2010 is far from a sure thing. In the meantime, even with the increased exemption amounts, many people still need estate planning.

In addition, don't focus too heavily on the tax savings. Estate planning has been and remains more than just about saving taxes. It provides a vehicle for planning for the care of your family and is a mechanism for the orderly transfer and management of assets for the benefit of spouses, children and grandchildren. The prudent course of action is to focus on the near term relief without planning on total repeal.

Sham Family Trusts Under Attack

We have all seen advertisements in newspapers and on television touting trusts that avoid or reduce income tax. The 7th Circuit Court of Appeals recently issued a decision which should make you wary of these claims and underscores the need for competent legal counsel in drafting your estate planning documents.

In the case of *Muhich v. Commissioner*, the taxpayers paid \$12,000 to a promoter to establish a package of five trusts. The taxpayers assigned all of their property to a trust, including the husband's salary from a closely held business and all of the property owned by the taxpayers.

In all five trusts, the taxpayers were the sole trustees and sole beneficiaries. The trusts paid all of the personal expenses of the individuals, including housing, healthcare and children's college expenses. In addition, one of the trusts paid management fees to the taxpayers. After expenses, the trusts reported no taxable income and the taxpayers reported no income on their individual tax return.

The 7th Circuit Court of Appeals determined that the trusts and the transactions constituted a "sham transaction," having no economic effect other than to generate income tax losses, and, therefore, the IRS could refuse to recognize the trusts for tax purposes. The court disregarded the trusts, attributed income to the individual family members, denied deductions for trust administration expenses and also imposed penalties.

The Muhich case reaffirms the old adage of "if it sounds too good to be true, it probably is." In a related note, the IRS has announced that it will be conducting heavy audits of underreporting, non-filing and abusive trusts.

If you are interested in discussing your estate planning needs, please call one of the attorneys in the estate planning group: Alan Shovers, John Hegeman, Mark Samila, Allison Comstock or Amy Steinhart.