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# ESTATE PLANNING CONCEPTS WINTER 2009

## Choosing a Trustee

I have personally seen clients go through the whole process of establishing a trust, naming a trustee, funding a trust, and eventually settling and distributing the trust assets. While I can't point out all of the potential hazards in such a short article, I thought you may appreciate the following sugges-

tions if you are considering choosing, changing, or adding a successor trustee for your trust.

○ **Decide whether you should choose a family member, friend, or professional.** It may make sense to name two trustees, perhaps a family member and a professional. The professional could

handle investment decisions, while the family member could oversee those decisions and make distribution decisions.

○ **Don't rule out a professional due to fees.** While many friends and family members may act as trustee without compensation, they may not handle investment decisions as well as a professional.

○ **Set up performance guidelines in your trust account.** If the trustee fails to meet the guidelines, your beneficiaries will have grounds to change trustees.

I hope you find these suggestions helpful. Please call if you would like help choosing a trustee.

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## Attention Annuity Owners

If you own a tax-deferred annuity, this is an ideal time for us to review it for you. Some annuities have features that increase the value when interest rates are low. This feature is called a Market Value Adjustment (MVA). With interest rates at all-time lows, many annuities have a surrender value that is higher than the actual current value. You may want to take advantage of this now while interest rates are still low. Also, many of the new annuities include income benefits that guarantee that you will not outlive your money. These features did not even exist just a few years ago and can be a very attractive addition to your retirement plan.

Please call our office and make an appointment with Dean for a free annuity review.



# The Tax Consequences of Debt Forgiveness

**W**hen the value of a home is less than the outstanding debt, the homeowner's options are dismal. Foreclosure, deeds in lieu of foreclosure, and short sales all result in the loss of the home with serious credit consequences for the homeowner. In addition, if the lender forgives part of the loan, the homeowner walks away with nothing, and there may still be tax consequences:

- The foreclosure is considered a disposition of the home for tax purposes, which results in capital gain or loss. If the homeowner lived in the home for at least two of the five years preceding the foreclosure, up to \$500,000 of gain for married taxpayers filing jointly or up to \$250,000 of gain for single taxpayers can be excluded from income. Losses

cannot be deducted on the taxpayer's tax return.

- If there is a cancellation of debt (COD) by the lender, the amount of the COD is taxable as ordinary income.

There are a couple of situations where the taxpayer does not have to include COD in ordinary income:

- **The taxpayer is insolvent or in bankruptcy.** Insolvent means that the taxpayer's debts exceed the fair market value of his/her assets, both before and after the debt is forgiven.
- **The debt is nonrecourse debt.** This means that the homeowner is not personally responsible for the debt. The only recourse to the lender is to sell the home.

In December 2007, the Mortgage Forgiveness Debt Relief Act of 2007 was enacted, which



provides temporary relief for many taxpayers. This law excludes up to \$2 million of COD income resulting from debt cancellation of qualified principal residence indebtedness for foreclosures between January 1, 2007 and December 31, 2012. Some of the major provisions include:

- Qualified principal residence indebtedness is debt incurred to acquire, construct, or improve a taxpayer's principal residence, if the debt is secured by the residence.
- The amount of COD excluded from income reduces the taxpayer's basis in the home. Thus, it will increase the capital gain or loss from the disposition. However, since those limits are so large, most taxpayers will probably not have a taxable capital gain.
- COD income from home-equity loan debt used for purposes other than to improve the principal residence is not excluded from income.
- Vacation homes and other real estate investments do not qualify for the COD income exclusion.

Please call if you'd like to discuss this topic in more detail.  
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## Staying Calm During the Storm

**I**t is not easy to stay calm during the storm of market volatility. However, it is helpful to learn how to do so. Here are two ideas to help you remain focused during the current market volatility:

1. **Review your investment portfolio.** Remember that when we set up your portfolio, we took the time to discuss your needs, goals, and risk tolerance to develop a portfolio that would help you pursue your objectives. Therefore, unless your goals change, your portfolio probably still represents the way we want your money invested.

2. **Pay less attention to headlines.** Dramatic stories predicting doom and gloom may make you want to sell everything. Remember that emotions should not guide your investment decisions. We have set up a properly diversified portfolio for you so that you can be comfortable with it for the long term. If you are no longer comfortable with the risk level in your portfolio or if you have life changes, please call so we can discuss it in detail.  
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## The Case for GRATs

The federal lifetime gift tax exclusion was raised to \$1,000,000 in 2002, but is not scheduled to increase in the future. If you'd like to pass on more than \$1,000,000 to your heirs before your death, but don't want to pay federal gift taxes, a grantor retained annuity trust (GRAT) might be in order.

With a GRAT, you transfer an asset to the trust, retaining an annuity interest for a specified term. During that period, the trust pays you a specified amount every year. When the trust terminates, the property goes to the named beneficiary. The gift is valued based on the present value of the remainder interest, which is the property's value less the retained annuity interest's value. Any appreciation in the asset after transfer to the trust escapes gift and estate taxes. However, if you die before the trust ends, the trust property will be included in your taxable estate.



Recent declines in interest rates have made GRATs a more valuable estate planning strategy for a couple of reasons. When you initially place the asset in the trust, the lower interest rates will result in a lower value for your retained interest, thus reducing the gift's value. When your annuity payments are calculated, lower interest rates will result in a lower required annuity, leaving more assets in the trust for your beneficiaries. The interest rate that must be used for these calculations is 120% of the mid-term applicable federal rate. As of July 2002, that rate was 5.53% (Source: Federal Taxes Weekly Alert, June 27, 2002).

Assets that are typically good candidates for a GRAT are those whose value is expected to increase significantly during the trust's term. GRATs are sophisticated estate planning tools that may only be appropriate in certain situations. Please call if you'd like to discuss GRATs in more detail.

The Economic Growth and Tax Relief Reconciliation Act of 2001 contains sunset language stating that its provisions will not apply after December 31, 2010. Without further Congressional action, the 2001 tax will be reinstated beginning 2011. ○○○

### The Red Flags of Estate Planning

Estate planning — the process of preserving your assets and transferring them to your family, friends, or charities — is a critical area of financial planning. If any of the following applies to you, a thorough review of your estate plan may be needed.

- All or almost all of your assets are held jointly.
- You own property in multiple states.
- You have substantial qualified retirement plan and IRA assets.
- You own life insurance outside of an irrevocable trust.
- You have highly appreciated financial assets with low cost bases.
- You have a closely held business.
- You have significant assets vulnerable to creditors' claims.

With so much at stake, we should immediately discuss your estate planning objectives and develop a plan for effectively transferring your assets to your heirs. ○○○



## The Changing Dynamics of Home-Equity Loans

When home prices were increasing, home-equity loans were a convenient way to finance numerous types of expenditures. While the loan is secured by the home's equity, the proceeds can be used for anything, including expenditures that have nothing to do with the home. In addition, home-equity loans have a significant advantage over other forms of consumer credit — interest paid on up to \$100,000 of home-equity loan proceeds can be deducted on your tax return if you itemize deductions. Home-equity loans typically offer competitive interest rates, usually no more than the prime rate or 1% or 2% over prime. Competitive interest rates combined with tax deductibility can add up to very attractive after-tax rates.

With all those advantages, it's no wonder home-equity debt has



become popular with homeowners. Until recently, lenders were often willing to offer home-equity loans on up to 100% of your home's value, with a simple application process and a quick check of home prices in your area.

But with declining home values and increasing numbers of foreclosures, lenders are not as anxious to approve home-equity loans. While the loan is secured by the home, it is a second lien that is subordinate to the mortgage. Thus, following a sale, the home-equity loan won't be paid until the mortgage is paid in full.

Many homeowners are being notified by lenders that their home-equity line of credit is reduced or frozen. Most contracts contain a provision allowing the lender to reduce or suspend the line if home values fall significantly or the homeowner's ability to repay the loan decreases. Signs to the lender of a decreased ability to repay include a poor credit rating, a small down payment with no private mortgage insurance, or late payments noted on your credit report. If you receive such a notice but still need the line, call and discuss the situation with your lender.

If you are trying to obtain a

home-equity loan, be aware of possible changes:

- **The loan-to-value ratio will probably be lower.** In the past, it was not uncommon for a mortgage and home-equity loan to total 100% or more of the home's market value. Nowadays, anything over 90% is rare, and that percentage may be much lower in markets with declining home values. Some areas have limits as low as 65% of the home's value.
- **Your credit score is more important.** In the past, it was fairly easy to obtain a home-equity loan. Now, lenders are more concerned about your credit rating. If your credit score is less than 680, it will be difficult to find a lender willing to approve the loan. The higher your score, the more options available.
- **You'll need a full appraisal of your home.** In the past, a simple review of home values in your area was often enough for a home-equity loan. Now, you'll probably need a full appraisal, including a walk through of your home.

Please call if you'd like to discuss home-equity loans in more detail. ○○○

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