

A Closer Look at

THE LAW



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CONTENTS

**A Tax Deferral
Opportunity You Won't
Want to Miss** 2

**Michigan Repeals the
Rule Against
Perpetuities** 3

Cunningham Dalman, PC
321 Settlers Road
P.O. Box 1767
Holland, MI 49422
Phone: (616) 392-1821
www.holland-law.com
Fax: (616) 392-4769
www.holland-law.com

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Cunningham Dalman, P.C. is a full service law firm located in Holland, as well as in Douglas, Michigan. Our attorneys possess skill and experience in a broad spectrum of areas of practice, and have proudly served the lakeshore community for over 100 years.

A Tax Deferral Opportunity You Won't Want to Miss

By: [P. Haans Mulder](#)
Attorney at Law

Are you one of the many people who have purchased a second home either as a vacation property or primarily for investment? That trend has only accelerated in recent years. In 2005 alone, four out of every ten homes purchased were second homes. If you are, and if in particular you bought property a number of years ago, the value of the home has increased substantially. This means that you will be paying the tax man a significant amount of capital gain taxes when you sell the property. Not surprisingly then, you are probably looking to either minimize or defer these taxes.

One way that has been done is through a "1031 exchange." It can be very complicated, but at its simplest level, you sell your real estate and then use the proceeds to buy other real estate. If a number of requirements are met, the Internal Revenue Code allows you to defer the income tax you would have had to pay when the real estate was sold.

Until March of 2008, it was uncertain whether the sale of a second home would qualify for a 1031 exchange if there had been any personal use of the home in the year or two leading up to the sale. However, the IRS has now "blessed" a 1031 exchange for second homes as long as certain

requirements are followed. In general, this means that for two years prior to the sale, the personal use of the home cannot exceed the greater of fourteen days or 10% of the days the property has been rented. This obviously means that if you have used the property for a significant amount of personal purposes that you will need to scale this back and plan properly for qualifying for this tax deferral. There are other issues to keep in mind. For example, you should claim the mortgage interest that you have paid as an investment interest deduction (as opposed to home mortgage interest deduction) on your tax return in the year or two prior to the sale. Also, you will want to deduct maintenance expenses and depreciation. All of these things are necessary because you need to show the IRS in advance that you are actually treating this property as an investment (as opposed to merely your home). There are additional requirements for the use of the proceeds from the sale and how those are invested.

It is rare the IRS gives tax payers an opportunity to save or defer taxes. This is one of them. That being said, it is important to know the rules and to comply with them so that you can take full advantage of this tax deferral opportunity.

Michigan Repeals the Rule Against Perpetuities

By: [Jeffrey K. Helder](#)
And Michael T. Hoeker

Prior to this year, a trust established under Michigan law had to terminate within ninety years of its creation. However, under recently enacted legislation, Michigan residents with estates of all sizes can set up trusts to last for as long as they wish, even into perpetuity. The new Michigan law essentially makes the perpetuities rules inapplicable to interests in personal property (but not real estate) that is held in trust. Personal property includes all property that is not real property. So in other words, all investments in securities, cash and interests in partnerships would be considered personal property, and could be put into trust forever. A trust that lasts for many generations is typically referred to as a Dynasty trust.

Traditionally, Dynasty trusts were used by wealthy families to provide support through multiple generations while keeping the assets out of several intervening generations' taxable estates. Dynasty trusts are 1) estate tax protected, 2) creditor protected, 3) divorce protected, and 4) allow the grantor, the one who forms a trust, to control who ultimately inherits the assets upon a child's death, even though the grantor's descendants can enjoy considerable benefits and

control over the assets. More recently, because of the prevalence of divorce and litigation in our society, even those with more modest means have taken advantage of the considerable benefits of a Dynasty trust.

Essentially, a Dynasty trust is set up so that each of the grantor's children receives their inheritance in trust upon the grantor's death, as opposed to through a direct transfer. Although not required, the child often becomes the sole trustee, with the ability to add, remove, and replace a co-trustee at any time. The trust may provide for the beneficiary children to receive fixed disbursements, or may give the trustees wide discretion in making disbursements from trust funds.

Upon a child's death, the trust principal is divided into equal shares, one for each child of that beneficiary then living, and one for any deceased child, who then has living children. Each person for whom a share is created is called a primary beneficiary of the trust. Each share continues in trust as before, to benefit the primary beneficiary and his or her descendants. Until now, Michigan law imposed an ultimate limit on this process of 90 years from the date of the grantor's death.

The table below demonstrates the dramatic effect on the net worth of your family a dynasty trust (that

avoids estate tax and generation skipping tax at each generation) could have:

Years:	1	5	25	100	200
Value:	\$2,060,000	\$2,318,548	\$4,187,556	\$38,437,264	\$738,711,630

Long-term investments can have a huge impact—here is what results from a sample \$2M trust, with the funds invested at a 3% rate of return, compounded annually, over various lengths of time.

While this law clears a new path for providing for the long-term care of your descendants through the use of Dynasty trusts, its scope and complexity extends well beyond what

is addressed here. We'd be happy to discuss with you just what this new development in the law means for your family.