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ELDER LAW & ESTATE PLANNING

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REAL ESTATE IN AN IRA? NOT SO FAST.

BY GEORGE F. BEARUP, ATTORNEY

These days a real estate investment trust (REIT) is a "hot" investment to hold in a retirement account. But before you jump to the conclusion that any real estate is an acceptable investment to hold in your IRA, think twice. Investors often purchase real estate using their IRA funds at the suggestion of developers, as a "can't beat" investment. Using an IRA to invest in real estate is not for the faint of heart, though. Some traps to be aware of before you take the real estate investment plunge include:

1. Not all IRA custodians allow real estate as an IRA-acceptable investment. The custodian decides which investment options it will permit to be held in the IRAs it sponsors.

2. The purchase of real estate by an IRA can result in a prohibited transaction. If a loan is taken to purchase the real estate, using in part the IRA funds, with the IRA owner's guaranty of the repayment of the loan, the guaranty results in a prohibited transaction. Any loan to acquire the real estate must be non recourse to the IRA owner.

3. If the IRA's real estate is debt-financed, the income generated by the IRA that is attributable to the debt-financed portion of the investment is subject to unrelated debt-financed income; in other words, the IRA actually pays income taxes on its earnings.

4. Real estate requires additional cash to pay for property taxes, improvements, repairs, etc. The IRA owner cannot add money to the IRA to pay these related expenses; the money used to pay the expenses must come from other assets held in the IRA.

5. Real estate is illiquid. Beginning at age 70 ½, the IRA owner must begin to take required minimum distributions which are based upon the fair market value of all of the IRA's assets, which is reported each year to the IRS on Form 5498. In order to determine the IRA's fair market value, an appraisal must be obtained each year and must be paid for from the IRA and not by the IRA owner.

The IRA must use its own assets to purchase the real estate. Simply titling "real estate" in the name of an IRA does not mean that the real estate is actually owned by the IRA.

What is so bad about a prohibited transaction? If the IRA owner engages in a prohibited transaction, the entire IRA is disqualified and deemed distributed to the owner as of January 1 of the year in which the prohibited transaction occurred. The entire IRA is thus included in the owner's taxable income for that calendar year. Moreover, if the owner is under the age of 59 ½ when the prohibited transaction occurs, he or she is also subject to the 10% early distribution penalty.

While the Tax Code contemplates the purchase of real estate by an IRA

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'Tis the Season: Gift Makers Beware

BY NICHOLAS A. REISTER, ATTORNEY

As the holiday season approaches, business owners often make gifts to their employees and business associates. However, before making gifts, it would be wise to put some thought into the gifts and the nature of your relationship with the recipient if you want to prevent the IRS from playing the role of the Grinch.

In *Commissioner v Duberstein*, the U.S. Supreme Court addressed the issue of whether a gift is taxable for Federal Income Tax purposes. Mr. Duberstein received a Cadillac automobile from a business associate with whom Mr. Duberstein frequently exchanged names of potential customers. In the case, both the gift giver and the gift recipient considered the Cadillac a non-taxable gift. However, the IRS took issue with the transaction and asserted that the transaction was taxable.

The Court held that non-taxable gifts result from "detached and disinterested generosity" and which are often given out of 'affection, respect, admiration, charity or like impulses.' It held that the Cadillac was given out of a desire to encourage future beneficial business relationships between the parties. The holding in the case and subsequent tax court cases means that when making gifts, you need to be mindful of the size and nature of the gift as well as the relationship between you and the gift recipient. This becomes particularly tricky in circumstances when family-owned or closely-held businesses are involved because the lines between owners, employees, friends, family and business associates tend to naturally blur. Perhaps, unsurprisingly, the IRS has made gift giving complicated and highly-dependent on the facts and circumstances. A gift need not be extravagant like a Cadillac to run afoul of the IRS. Even a gift card with nominal face value carries with it tax implications, restrictions and reporting requirements.

If you have questions about personal or business-related gifts, please contact the Estate Planning and Business attorneys at Smith Haughey Rice & Roegge.

Contact Nick Reister at nreister@shrr.com or 616-458-8286.

Do-It-Yourself Estate Planning can be "Penny Wise and Pound Foolish"

BY KEVIN M. HUSS, ATTORNEY

A recent opinion from the Supreme Court of Florida (*Aldrich v. Basile*) highlights some of the potential pitfalls associated with **"do-it-yourself" estate planning**. In *Aldrich*, the Florida Supreme Court expressly recognized that, although the result of the case was the correct result under Florida law, the result was contrary to the decedent's true intent. In addition, the decedent's heirs spent thousands, if not hundreds of thousands, of dollars litigating the dispute through the Florida court system, only to lose. The issues

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Meet Melissa Baumgartner

Please join us in giving a warm welcome to one of our newest attorneys, Melissa L. Baumgartner.

Returning to her hometown of Traverse City, Michigan, Melissa joins us as an associate practicing in family law and estate planning.

In more ways than one, Melissa brings a unique perspective and experience to Smith Haughey. While working for the Legal Aid Society's Juvenile Rights Practice in New York, Melissa completed extensive sensitivity training, which helped her better assist children who have experienced emotional or physical trauma. Melissa's training and experience makes her mindful of the emotional impact that family law proceedings can have on children and adults alike, which in turn assists her clients in making the best decisions possible to support themselves and their families.

Melissa is excited to return to Traverse City where she can enjoy the comforts of home, as well as swimming, boating, golfing and exploring all that northern Michigan has to offer.

Melissa can be reached at mbaumgartner@shrr.com or 231-486-4505.

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raised in *Aldrich*, and the litigation leading up to that decision, would have likely been avoided had Mrs. Aldrich hired an experienced estate planning attorney at the start of her planning.

So, what went wrong? The following timeline lays out the pertinent facts.

In April of 2004, Ann created a Will using a pre-printed, "do-it-yourself" form. In the "Bequests" section of the Will, Ann wrote by hand instructions that all of the "possessions listed" be distributed to her sister, Mary Jane. The assets Ann listed were her:

1. House and all of its contents (specifically identified by the address of the real property)
2. Fidelity Rollover IRA (specifically identified by the account number)
3. United Defense Life Insurance Policy (specifically identified by policy number)
4. Vehicle (specifically identified by make, model and VIN)
5. Bank accounts at M & S Bank (each specifically identified by account number)

The pre-printed form that Ann used did not contain a provision to dispose of any other property Ann owned at her death, nor for property that Ann acquired after she signed her Will. However, Ann did identify in this form Will that if Mary Jane died before Ann, Ann wanted to leave the listed property to her brother, James. Ann's 2004 Will was properly signed and witnessed.

Mary Jane died in 2007. Ann inherited cash, personal property and real property from Mary Jane's estate. Ann deposited the cash from Mary Jane's estate into a new investment account and she held the real property that she inherited from her deceased sister.

In 2008, Ann attempted to update her Will. Ann attached a page to her original Will with her own handwriting and signature entitled "Just a Note." The handwritten note acknowledged that, because Mary Jane died, Ann wanted to "reiterate that all [her] worldly possessions pass to" James. The handwritten note also attempted to name Ann's niece, Sheila, as the personal representative of Ann's probate estate. The handwritten note was signed by both Sheila and Ann, but it was not properly signed in accordance with Florida law that governs the execution of wills. As a result, Ann's 2008 page was not enforceable under Florida law.

Ann died in October of 2009 without executing another Will. James petitioned the probate court in an attempt to have all of Ann's assets assigned to him, based on the terms of the 2004 Will and Ann's 2008 Note. Two of Ann's nieces from a deceased brother asserted an interest in Ann's probate estate. They argued that the 2004 Will did not properly dispose of the property that Ann inherited from Mary Jane.

James prevailed at the trial court level, but Ann's nieces appealed. On appeal, the trial court's decision was reversed. The appellate court determined that because Ann devised property in the 2004 Will with "painstaking specificity" and she did not identify her intentions with respect to any other property, the 2004 Will could only be relied on to distribute the five items identified in that document. As a result, Ann's nieces effectively received an interest in the property that Ann acquired from Mary Jane, as Ann's intestate heirs, clearly not the result that Ann wanted to achieve.

The case eventually made its way to the Supreme Court of Florida, which agreed with the appellate court. The Supreme Court found that it was clear from the language of Ann's 2004 form Will that she intended to leave all of the property listed in that Will to James in the event Mary Jane died before Ann. The 2004 Will was clear; it did not contain any ambiguity. However, the Supreme Court reiterated that the 2004 Will, as written, did identify Ann's intent to distribute all of her identified assets "without adding words to the document."

The *Aldrich* case is a tragic example that stresses the importance of complying with applicable law when preparing and signing estate planning documents. Simply put, estate planning documents that are incomplete, or improperly signed, risk being unenforceable. Unenforceable documents can lead to lengthy and expensive court battles like *Aldrich*, and can result in assets not being distributed the way the decedent intended them to be distributed. An estate plan is far too important to leave to chance. Don't be "penny wise and pound foolish" with your estate planning. The estate planning attorneys at Smith Haughey Rice & Roegge can help you to create an estate plan that clearly identifies your wishes and complies with Michigan law.

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(impermissible investments include life insurance and collectibles), just because the Code permits real estate as an investment does not necessarily mean that you will be able to. First, an IRA custodian may not permit an investment in real property. Secondly, depending on the circumstances, such an investment can run afoul of self-dealing prohibited transaction rules.

In sum, extreme caution needs to be exercised if an IRA owner uses the IRA to invest in real estate. It is probably better to stick with REITs if you want to expose your IRA to real estate as an investment class.

Contact George Bearup at gbearup@shrr.com or 231-486-4510.

Nick Reister Listed as a 2014 *Up & Coming Lawyer*

We are proud to announce that attorney Nicholas A. Reister has been named a 2014 *Up & Coming Lawyer* by *Michigan Lawyers Weekly*.

From nominations received state-wide, the *Michigan Lawyers Weekly* panel selects only 30 lawyers to hold this title annually. According to *Michigan Lawyers Weekly*, "Chosen from more than 70 nominations, these honorees have spent less than a decade in practice, and display the ambition, drive, determination and accomplishments to set them apart among their peers."

Nick demonstrates all of the above. He works tirelessly for his clients that range from individuals to families and start-ups to large family-run businesses. Nick is also very involved in his community, where he dedicates his time at the Outdoor Discovery Center, Haven Reformed Church, Porter Hills Foundation and Grand Rapids Community Foundation.