Insight on estate planning

Year End 2003

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PLUS!

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Handling intellectual property rights in an estate plan

There are several ways to acquire intellectual property (IP) rights. If you're a self-employed author or inventor, then IP may represent a major portion of your estate. But most people who own IP — such as patents, trademarks and copyrights — own it only incidentally, as a small portion of the assets they use to generate income.

But whether IP is your professional lifeblood or just a sideline, these rights may continue to be valuable long after your death. And because the law treats IP rights as intangible personal property, you should learn how they may affect your estate plan.

Determining IP worth

First, determine what your IP rights are worth. Only then can you calculate the gift and estate tax consequences of transferring IP rights to your heirs.

So have an independent valuation expert value those rights — as well as the underlying (tangible) works, if any. The expert must have experience valuating patents, trademarks or copyright, whichever applies in your situation.

Deciding how to transfer IP rights

Next, decide whether you'd like to transfer IP rights to your children, colleagues or others as gifts while you're still alive, or bequeath the rights as part of your estate by will or living trust after your death. To help make that decision, consider these questions:

Will you continue to use your IP rights commercially during your lifetime? If you depend on your patent, trademark or copyright for your livelihood, of course hang on to it at least until you retire or no longer need the income. Meanwhile, even if you expect to depend on the IP rights for many years, include them in your will or living trust so they will be distributed as you wish if you die unexpectedly.

Are you willing and able to monitor IP infringement and prosecute infringers? IP isn't worth much if you — or the person to whom you bequeath the rights — aren't in a position to defend your rights under the law. If you're not willing and able to defend them, now may be the time to transfer the rights to someone who can.

What are the gift and estate tax ramifications if you give away the rights? If your IP right's value exceeds $11,000 — the annual gift tax exclusion — you'll incur gift tax if you give those rights as a gift. If your estate's value, including IP, is $1 million or more — the estate tax exemption in 2003 ($1.5 million in 2004) — then you may need professional advice on how to minimize your estate tax, whether or not you intend to bequeath IP rights in your will or living trust.

If you depend on your patent, trademark or copyright for your livelihood, of course hang on to it at least until you retire or no longer need the income.

Will your children, colleagues or other heirs be willing and able to use your IP rights if they receive them as gifts or as an inheritance? The answer depends partly on how long the rights last. (See "Understanding intellectual property duration" at right.) Of course, you want to give or bequeath the rights to someone who can use them or at least sell them.

Additional considerations

If you die without a will, the probate court will decide how to distribute your assets — typically among your surviving spouse and children. Making a will lets you transfer nontrust assets to those whom you feel deserve them and can make the best use of them. In the case of IP, this consideration is key because not everyone can manage and benefit from IP rights.

It's important to distinguish in your will between tangible personal property and IP, and specifically designate to whom you wish to leave the latter. If you lump all your property together, the court may allow the transfer of all tangible property according to your wishes, but classify IP as "residuary property" to be distributed among your heirs differently.

Understanding intellectual property duration

Before you decide how to treat intellectual property in your estate plan, you need to know when rights expire. Here's a summary of how long patents, trademarks and copyrights last:

Patents. A utility patent — one that protects an invention that performs a useful function — applied for beginning on June 8, 1995, has a term of 20 years from the *filing* date. A patent issued before that date (or a patent issued after that date but applied for before it) has a term of either 17 years from the *issue* date or 20 years from the *filing* date, whichever is longer.

A design patent — one that protects the ornamental (nonfunctional) design of a product — lasts 14 years from the issue date.

Patents are not renewable. But applicants may extend a patent's duration in some situations because of regulatory or bureaucratic delays.

Trademarks. Trademark registrations remain in effect for 10 years and can be renewed indefinitely for additional 10-year terms if the mark is still in commercial use.

Copyrights. The rules for copyright depend on when the work was created, and whether an individual author or his or her employer in a "work for hire" arrangement owns the rights.

For work created in or after 1978, if the individual author owns the rights, the copyright lasts for the author's lifetime plus 70 years. If it was "work for hire," the copyright lasts 95 years from the first publication date or 120 years from the work's creation, whichever is sooner. For work created before 1978, the rules are much more complex.

Review your plan today

IP could be an important asset in your estate, with unique issues. If you haven't specifically addressed the disposition of IP in your will or living trust, do so as soon as possible. We would be glad to review your will or living trust and other estate planning documents to ensure that they treat IP properly and discuss your options when transferring IP rights. ▮

Ease the pain of estate tax by giving 'til it hurts

Transferring wealth to your children or other loved ones, while minimizing gift and estate tax, should be a primary goal when developing your estate plan. Much of your plan will likely center on what will happen to your estate after your death, but don't forget about the benefits of giving during your lifetime. These strategies not only reduce your taxable estate, but also may help family members pay for college, make a down payment on a house or realize other dreams.

Two gift types

Tax-free gifts fall into two categories: lifetime exemption and annual exclusion gifts. Each type has its own limits on how much you can give without paying gift tax. Here's a summary of these limits:

Lifetime exemption. This allows you to make tax-free gifts of up to $1 million during your lifetime. If you're married, the exemption doubles to $2 million. The lifetime exemption will remain the same (unless Congress changes the law), while the estate tax exemption increases to $1.5 million in 2004 and to $2 million in 2006. Giving a lifetime exemption gift requires that you file a gift-tax return for that year, even if you don't owe gift tax.

Annual exclusion. This allows you to make tax-free gifts of up to $11,000 per year, per person, to an unlimited number of people without using any of your lifetime exemption. This amount increases to $22,000 if you're married and elect to split the gift with your spouse. The exclusion amount is indexed for inflation, but because it increases only by $1,000 increments, the amount doesn't necessarily change each year. Remember that you must make annual exclusion gifts by Dec. 31 of any given year. If you miss the deadline, you'll lose your opportunity to use the annual exclusion for that year. Making annual exclusion gifts generally doesn't require you to file a gift tax return, unless you and your spouse elect to split your gifts.

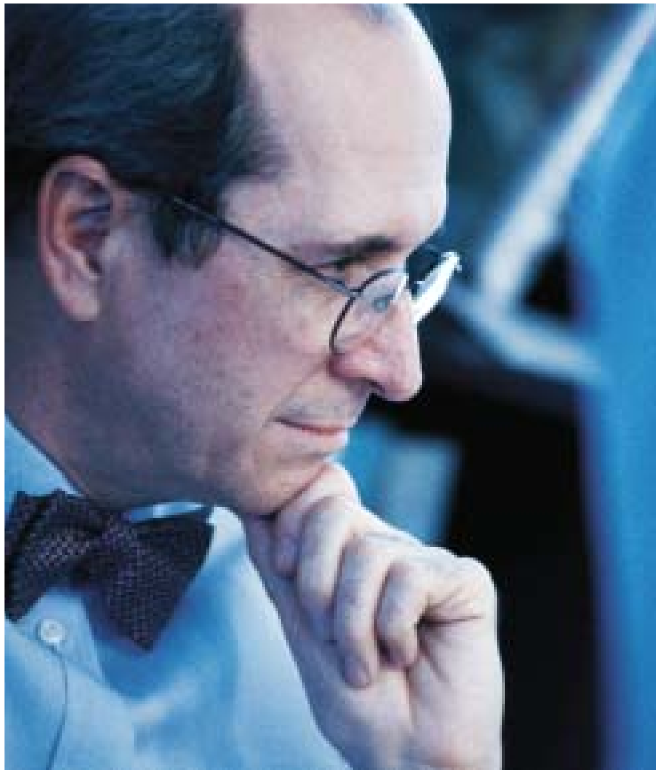
Gifts that don't qualify for the annual exclusion and exceed the lifetime exemption limit are subject to gift tax on the nonexcluded amount at a top marginal rate of 49% in 2003. According to the 2001 tax act, the gift-tax rate will fall one percentage point per year through 2007 and drop to 35% in 2010. But the rate will jump back to 55% in 2011.

Maximizing your giving power

With proper planning, you can make the most of your gift tax exemption and exclusions and transfer a substantial amount of assets to your children or grandchildren without incurring gift taxes. Here are a few examples:

Pay tuition or medical expenses. When you pay for your child's or grandchild's

college tuition or medical expenses, the gift is exempt from gift tax without using any of your lifetime exemption or annual exclusion. The key is to make payments directly to the school or health care provider — not to your child or grandchild.



Leverage your gifts. One way is to give assets that are likely to appreciate significantly in value. You remove not only the asset's current value from your estate, but also all future appreciation (up to the time of your death). And you can leverage gifts of highly appreciated assets by making them to your children or grandchildren whose tax bracket is lower than yours. If they sell the asset, they may pay a capital gains tax rate as low as 5%.

Give a life insurance policy. When you give someone your life insurance policy, its value for gift-tax purposes is its interpolated terminal reserve value. As long as this value doesn't exceed $11,000, it won't be subject to gift tax. But when you die, the policy's death benefit, which is probably many times the cash surrender value, also is excluded from your estate.

Use an FLP. Gifts of limited partnership units in a family limited partnership (FLP) in which you are the general partner also qualify for the annual exclusion if valued at $11,000 or less. The FLP's gift tax saving power results from valuation discounts based, for example, on lack of marketability. A limited partnership interest may be discounted by 30% or more for gift-tax purposes. Don't forget that as general partner, you may retain a measure of control over the partnership's underlying assets.

For example, say you want to give each of your children limited partnership units valued (for gift-tax purposes) at $11,000. Using a 30% discount rate, you may actually give FLP units worth $15,714 to each child without incurring gift tax.

Act before the end of the year

If you fail to take advantage of the annual gift-tax exclusion before the end of the year, you lose that opportunity forever. So assuming you can afford to make gifts without compromising your standard of living, do so each year. If you have questions about which assets to give away, we can answer them for you.

Don't trust your gift recipient? Give to a trust instead

Many people who can afford to take advantage of gifting strategies are reluctant to do so because they fear their children (or other recipients) won't responsibly manage the gift. In such cases, instead of giving money outright to your heirs, transfer it to a trust that you set up for their benefit. Trust beneficiaries don't receive trust funds until after your death or until they reach a specified age.

A gift to a trust qualifies for the annual gift-tax exclusion only if the trust is either:

- A trust for a minor beneficiary, provided the trust assets pass to the beneficiary when he or she reaches age 21, or
- A trust containing a Crummey provision, which requires the trustee to send "Crummey notices" to the beneficiaries each year, advising them of their present withdrawal interest in the gift.

A letter of final instruction can ensure last wishes are followed

Contemplating death can make some people uneasy. They'd rather have their next of kin handle their burial arrangements. On the other hand, others have definite thoughts on their final resting places. For example, they may have general burial or cremation plans, even specifying the clothes they want to be buried in or where to scatter their ashes.

If you feel strongly, put your wishes in writing — not in your will or living trust but rather in a letter of final instruction. A will or living trust is typically opened after the funeral, when it's too late to comply with your wishes.

What should the letter say?

When composing your letter of final instruction, express your wishes in clear, detailed language. You may want to include your thoughts on:

- Whether you want your organs donated,
- Whether you choose to be buried, cremated or have your body donated to medical science,
- Funeral arrangements, ceremonial rites, casket or urn type, flowers, and death notices,
- How your remains should be buried, stored or scattered, and
- Your preference in gravesite markers and adornments.

After completing your letter of final instruction, give copies of the letter, along with receipts for prepaid funeral expenses, cemetery plots and related records, to your spouse or son or daughter, and to your lawyer.

How will state jurisdiction affect your wishes?

In most states, a letter of final instruction by itself won't guarantee that your wishes will be honored. In fact, in some jurisdictions, the law gives the surviving spouse the final word, while others require the deceased's written requests be followed as closely as possible. Most jurisdictions fall somewhere in between.

You can increase your chances that your letter of final instruction will be honored by taking these steps:

- Prepay at least a portion of your burial or cremation costs. Doing so creates a binding contract with the funeral home of your choice, as well as a financial incentive for your family to abide by your wishes.
- Make arrangements with a local hospital or medical school as soon as possible if you'd like to donate your body to science. Again, doing so creates an obligation your loved ones may have to keep.
- Discuss your decisions with your family to resolve any differences before it's too late. Their concerns may influence you to change or modify your wishes and vice-versa. In case of an unresolved conflict, consider seeking mediation or counseling.

Finally, if family differences regarding your burial requests can't be resolved, you may add a "no contest" clause in your will or living trust, which disinherits anyone who contests your letter of final instruction. That in itself can motivate family members to honor your final decisions.

We're here to answer your questions

Knowledge of your state's law is important, as is sensitivity to your family's emotional needs and beliefs, in ensuring your final wishes are followed. We understand both aspects of this task and are here to help you navigate through this process.

Why name a trust as your retirement plan's beneficiary?

In 2001, when the IRS overhauled its rules for taking minimum required distributions from qualified retirement plans (including traditional and Roth IRAs), it also revised the rules for naming beneficiaries. Before 1997 you could designate a trust as a beneficiary only if it was irrevocable. Now you can name a revocable trust as well. When you designate a trust as your retirement plan's beneficiary, the trust's beneficiary will then receive the plan's distributions.

If you want your funds to pass to a minor or to a disabled adult, a trust will ensure that the assets are professionally managed according to your wishes. A trust also offers some protection from ex-spouses (for example, if the trust beneficiary is a child from a previous marriage) and creditors. Keep in mind that naming a trust as beneficiary includes professional asset management expenses and restricts your ultimate beneficiary from using the assets as he or she wishes.

If you'd like to name your spouse as your retirement plan beneficiary, consider designating him or her as an individual instead of using a marital trust. Why? Because some distribution options available to spouses as individuals aren't available for spousal trusts.

For a trust to qualify as the beneficiary of a retirement plan — whether it's revocable or irrevocable — it must be carefully drafted for that purpose. For example, the trust's primary beneficiary must be a clearly identified person, not a charity. For this reason, keep your trust updated and name a new beneficiary if the original one predeceases you. Because the qualification rules are complex, consult your estate planning professional to ensure your trust will qualify as a retirement plan beneficiary.

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Personal Legal Services Group

Joseph A. Bonventre has substantial experience advising individuals on estate planning, charitable planning, business planning, retirement planning, probate, post-mortem trust administration and related tax matters. Mr. Bonventre is a Fellow of the American College of Trust and Estate Counsel and a Fellow of the American College of Tax Counsel. There are only a handful of attorneys throughout the United States who are Fellows of both organizations. Fellows are selected on the basis of professional reputation and ability in the fields of trusts and estates and taxation and on the basis of having made substantial contributions to these fields through lecturing, writing, teaching and bar association activities. Mr. Bonventre is actively involved in charitable activities in the community.

Tel: (313) 965-8293 • **Fax:** (313) 965-8252
E-mail: jbonventre@clarkhill.com

Frederick H. Hoops, III counsels clients in all aspects of estate planning, tax minimization, asset protection, family partnerships, limited liability companies and the probate and non-probate administration of trusts, decedents' estates, guardianships and conservatorships. His experience also includes the preparation of estate and fiduciary tax returns for trusts and estates, and organizing and answering questions concerning charitable and other tax-exempt organizations. A frequent speaker and prolific author, he has co-authored *Family Estate Planning Guide* and *Planning for Estates and Administration in Michigan* (West Publishing), and is an adjunct professor in the tax program at Walsh College.

Tel: (313) 965-8323 • **Fax:** (313) 965-8252
E-mail: fhoops@clarkhill.com

Andrea M. Kanski's estate planning background includes analysis and development of overall tax and estate planning strategies consistent with the objectives of the individual and his/her family. She has extensive trust administration experience and probate experience with both supervised and informal proceedings involving deceased estates, guardianships and conservatorships. Ms. Kanski's practice also involves counseling owners of closely held, family-owned businesses concerning corporate, tax and estate planning issues.

Tel: (313) 965-8589 • **Fax:** (313) 965-8252
E-mail: akanski@clarkhill.com

J. Thomas MacFarlane works extensively with individuals on estate, tax planning and probate matters, and with businesses on succession planning and corporate restructuring. Mr. MacFarlane counsels clients on the various wealth preservation strategies which are available to high net worth individuals. He also serves as the leader of Clark Hill's Personal Legal Services Group. Mr. MacFarlane has published articles in *Estate Planning*, *Michigan Tax Lawyer* and *Laches*, and authored the estate planning chapter of the *Michigan Lawyer's Manual*.

Tel: (248) 988-5846 • **Fax:** (248) 642-2174
E-mail: tmacfarlane@clarkhill.com

Thomas S. Nowinski is a tax specialist with a broad background in counseling businesses and individuals in tax and financial matters. His taxation practice includes federal and state income taxes, the federal estate and gift tax, and the Michigan Single Business Tax. Mr. Nowinski specializes in state and local taxation, with particular emphasis on property tax issues of all kinds.

Tel: (313) 965-8244 • **Fax:** (313) 965-8252
E-mail: tnowinski@clarkhill.com

Douglas J. Rasmussen is experienced in all aspects of estate planning, including analyzing financial and distribution strategies, structuring plans considering the tax ramifications and the client's overall family objectives, and all appropriate estate planning documents. Mr. Rasmussen has served as Chairman of the Probate and Estate Planning Section of the State Bar of Michigan, and as Chairman of the American Bar Association Committee on Estate Planning and Drafting. Elected as a Fellow of the American College of Trust and Estate Counsel, he has served on its Board of Regents and as its Michigan State Chairman.

Tel: (313) 965-8234 • **Fax:** (313) 965-8252
E-mail: drasmussen@clarkhill.com

Thomas F. Sweeney has extensive experience with federal and state taxation with particular focus on estate and gift taxation, fiduciary and individual income taxation and telecommunication entity taxation, including planning, return preparation, negotiation with tax authorities and tax litigation, as necessary. He is also actively involved in the planning and administration of trusts and estates, including designing and implementing estate plans, including tax, probate avoidance and investment strategy planning, probate and non-probate administration of estates, trusts, conservatorships and guardianships, and other trust and estate fiduciary services.

Tel: (248) 988-5867 • **Fax:** (248) 642-2174
E-mail: tsweeney@clarkhill.com

**Additional (adjunct) members of Clark Hill's Personal Legal Services Group include:
Charles M. Bayer, Laura S. Del Pup, Thomas M. Dixon,
David E. Nims, Alan D. Szuma and Duane L. Tarnacki.**

CLARK HILL
PLC
ATTORNEYS AT LAW

Detroit: 500 Woodward Avenue • Suite 3500 • Detroit, MI 48226
Birmingham: 255 S. Old Woodward Avenue • Third Floor • Birmingham, MI 48009
Lansing: 2455 Woodlake Circle • Okemos, MI 48864