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Use of Disclaimer Wills Provides Estate Planning Flexibility

In 2001 the Federal Estate Tax Law was amended to increase the exclusion to $1 million per taxpayer and in 2006, the exclusion was increased to $2 million per taxpayer. Under the current law, a husband and wife would each enjoy a $2 million exemption and their combined estates should enjoy relief from federal estate taxation for up to $4 million.

The Estate Tax exclusion is scheduled to increase to $3.5 million per taxpayer in 2009 and the current law provides that the Federal Estate Tax will be repealed in the year 2010, but only for one year. Starting in 2011, unless Congress votes to make the repeal permanent, estates will once again be subject to the Estate Tax as it existed in 2001, with only a $1 million exclusion available. Only time will tell whether the repeal will be made permanent or whether other significant changes will be made as a result of the upcoming 2008 congressional and presidential elections.

Wills must be properly drafted in order to preserve the use of the exclusions in each spouse's estate. A simple will, by which one spouse leaves all of his or her assets to the other spouse, may have the effect of wasting one of the spouse's exclusion amounts. One way to safeguard the use of the exclusion in each spouse's estate is the mandatory creation of a trust in the will of the first spouse's estate, requiring that the amount of the exclusion is to be held in a trust for the benefit of a surviving spouse. While the provisions of such a trust can be generous, they will deny the surviving spouse free and unfettered use of the total assets of the estate. As the exemption grows to $3.5 million or if the Estate Tax Law is repealed, it may not be necessary to limit the surviving spouse's access to the estate, in order to save estate taxes.

Under New Jersey law, enacted in 2001, there is a New Jersey Estate Tax imposed on assets in excess of $675,000, passing to a beneficiary other than a spouse. This tax can be deferred to the extent assets are not required to be placed in such a mandatory trust.

In those estates between $2 million and $5 million, so-called medium size estates, the final shape of the estate plan is difficult to plan due to these changing Estate Tax rules. If we knew the final form of the Estate Tax Law and the size of the clients' estate at the time of the first spouse's death, we could plan the use of the exclusion trust with certainty. So why not wait and see? We can help many clients defer the decision by using a disclaimer will.

The disclaimer wll combines the features of a simple will and a more complicated exemption trust will, but the disclaimer will allows the surviving spouse to make the choice after the death of the first spouse. The decision to create the trust can be postponed until nine months after the date of the first spouse's death. After the first spouse's death, the surviving spouse, with the help and advice of counsel, can determine how much, if any, of the first spouse's estate needs to be disclaimed into the trust created for the surviving spouse's benefit, based upon the law in effect at that time. The assets disclaimed to the trust will be held for the spouse's lifetime benefit and will escape taxation in the first spouse's estate and the surviving spouse's estate. This flexibility or post-mortem estate planning is very beneficial in those estates which may not need to take full advantage of the maximum applicable exclusion amounts or where deferral of the New Jersey Estate Tax may be warranted.

The disclaimer technique provides estates with the greatest amount of flexibility to navigate the evolving and changing Estate Tax Laws.

Should you have any questions, contact Henry Matri at (201) 525-6235, or hmatri@coleschotz.com.

Year-End Tax Planning

As the end of the year rapidly approaches, it is important that you make sure that you have taken advantage of some year-end tax planning ideas to reduce potential estate and income taxes, such as:

- Annual exclusion gifting. In 2007, you can give up to $12,000 to as many people as you would like. With a spouse's consent, you can give up to $24,000 to each person (note that "gift splitting" requires the filing of a gift tax return). Annual exclusion gifting is a great way to gift to your family and other relatives to benefit them and to reduce the value of your estate for estate tax purposes without utilizing part of your $1 million lifetime gift tax exemption. If you do not want to gift this amount outright to a beneficiary because the beneficiary is a minor, you could create a trust to benefit the minor and then gift the $12,000 each year to the trust. These types of trusts require careful drafting to make sure that gifts to these trusts qualify for the annual exclusion.

- Charitable gifting. Subject to certain income limitations, gifts to qualified charities are deductible against your income.

- Charitable gifts from IRAs. In addition, 2007 is the last year that a person over the age of 70½ can donate IRA money directly from his or her IRA to charity. A person who is at least 70½ can donate up to $100,000 to a public charity in 2007 from his or her IRA. This donation must be paid directly from the IRA to the charity and not to the IRA owner. If the owner has not already taken his or her minimum distribution, the amount passing to charity is treated as a distribution for minimum distribution purposes. This planning idea is great for people who are planning on donating to charity and who may have more money in their IRA than they need for retirement.

- AMT planning. If you are likely to be subject to the Alternative Minimum Tax ("AMT") in 2007 but not in 2008, consider deferring non-AMT deductible expenses (like state and local taxes) to next year. You might not be subject to the AMT in 2008 if (1) Congress enacts an AMT "patch," (2) you are moving from a high tax area (like New York or New Jersey) to a low tax area (like Florida), or (3) you expect your income to change significantly next year due to retirement, job change, divorce, etc. If so, paying fourth quarter state and local taxes in January (not in December) can preserve this deduction that would otherwise be lost under the AMT.

- Declines in the real estate market make QPRIT valuations more attractive, especially for vacation homes expected to be kept in the family for many years.

- Relatively low AFRs for November and December make GRAT valuations attractive as well.

Don't let the year pass without considering these important tax planning techniques.

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Internal Revenue Code Section 409A Affects Employment Contracts and Deferred Compensation Arrangements

On October 22, 2004, President Bush signed into law the American Jobs Creation Act that created Section 409A of the Internal Revenue Code. Section 409A brought about sweeping changes to the tax treatment of deferred compensation, an arrangement which provides for a portion of an employee's income to be paid out at a date after that income is actually earned. Examples of deferred compensation plans include bonus arrangements, severance payments and stock options.

The enactment of Section 409A was a visceral reaction by Congress to the actions of corporate executives at Enron who accelerated their own deferred compensation benefits while leaving a majority of its employees with worthless securities in their 401k plans. While well intentioned, Section 409A and the complexity of the 397 page regulations have left many companies struggling to understand and apply these new rules.

Section 409A generally prohibits deferred compensation plans from accelerating distributions and restricts distributions to be no earlier than certain trigger events. If the requirements are not satisfied, the employee is subject to immediate income inclusion of the deferred compensation amount, interest charges, and an additional 20% penalty. These trigger events include: separation from service, death, disability, a specified time, change in control or an unforeseeable emergency. Section 409A also provides for strict timing requirements for initial and subsequent deferral elections. All deferred compensation plan documents must be brought into compliance by December 31, 2008.

Section 409A specifically exempts certain "qualified" deferred compensation. If an equity plan, severance pay plan or employment benefit arrangement does not meet the requirements of any exemption, it does not mean that the plan "fails" Section 409A and that the recipient is automatically taxed and penalized. However, it is important for employers to act now to identify those plans that are not compliant and to redesign them in accordance with Section 409A to avoid such a penalty. This identification and redesigning process may be easy or difficult, depending on the type of plan or employment contract involved and will likely require employers to consult with legal and tax counsel.

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Powers of Attorney and Health Care Directives for College Students

The tragic shootings at Virginia Tech University in April, 2007 brought to light one difficult and potentially terrifying problem – the inability of parents to get information about their college student's health and well-being. When distressed parents and family members of some of the students at Virginia Tech tried to get information about their children, they found that health care providers would not release any information without the proper release form. Parents no longer have legal authority over their child's financial or medical decisions once a child turns 18, even though high-school and college-age children usually are still dependent on their parents.

The Health Insurance Portability and Accountability Act ("HIPAA") imposes high standards of patient privacy on hospitals, physicians and other health care providers. Because of this, many medical providers will not provide any medical information to anyone without the authority of the patient.

One solution is for parents to ask their college-age children to sign a power of attorney and health care directive. These routinely prepared estate planning documents authorize the parents to obtain medical information and make medical and financial decisions for a child if the child is unable to make such decisions for himself or herself. By keeping copies (or, better yet, electronic copies) of these documents readily available, parents will be better prepared to respond in case of an emergency.

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