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LEGAL NOTES

INFORMATION FOR OUR BUSINESS AND CORPORATE CLIENTS

IN THIS ISSUE

A TIME TO RETHINK OLD ESTATE PLANNING STRATEGIES

On June 7, 2001, President Bush signed a new law entitled "The Economic Growth and Tax Relief Reconciliation Act," legislation that makes sweeping changes to the laws governing federal estate and gift taxation. This new legislation places into motion complex phased-in measures and transition rules that are to take effect over a number of years. The good news is that the estate tax is repealed for anyone who dies after December 31, 2009. The bad news is that the estate tax rises again and applies to anyone who dies after December 31, 2010. For those who die during the calendar year 2010, no tax will be imposed on the transfer of property from you to whomever you chose. For those who die during any other calendar year, this Act may require new approaches to savings, investing and the passing of property to family members.

During the intervening eight year period there are a number of other changes that do help. First the maximum tax rate for both estate, gift and generation skipping transfer taxes are all reduced gradually from a high of 55% to 45%, and the top gift tax rate is also reduced to 35%.

In addition to lowering the tax rates, the amount of wealth that can be transferred without incurring an estate tax also increases. Today that amount is reflected in a credit equivalent of $675,000, which means that if you die with an estate less than $675,000 you are relieved of the burden of filing a Federal Estate Tax Return and of paying any Federal Estate Tax. This threshold number increases over the next several years as follows:

Calendar Year	*Estate Tax Credit*
2002, 2003	$1,000,000
2004, 2005	$1,500,000
2006, 2007, 2008	$2,000,000
2009	$3,500,000

The credit for the tax imposed on gifts made during your lifetime remains at $1,000,000 through the calendar year 2010 and thereafter.

As you can imagine, the phase-in of exemptions and reduction of rates, the ultimate one-year repeal of the federal estate tax and generation skipping tax, the introduction of a new set of rules for a carryover basis for inherited property and the automatic reinstatement of the current tax law in the year 2011, will generate much confusion and uncertainty. Moreover, it will require a re-orientation and re-thinking of all existing estate plans. In particular, some strategies that were previously accepted and sound should now be reviewed, such as :

- ***Gift Planning*** – Should current gift-giving programs be continued?
- ***Family Limited Partnerships*** – Is there still value in this approach to pass assets onto family members?
- ***By-Pass or Credit Shelter Trust*** – Does my current Will and asset structure provide for my spouse and children as I would want in this changing tax environment?
- ***Life Insurance Trusts*** – Should I still maintain or create such a trust?
- ***Charitable Bequests*** – Is the use a charitable remainder trust or charitable lead trust still viable?

Because of all the uncertainty as to what the future will bring, there is a premium on planning over the next several years and making effective use of the temporary benefits which the Act provides to us, as transitory as they may be. Proper planning now is more important than ever.

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INCORPORATING RETIREMENT BENEFITS INTO AN ESTATE PLAN

For many individuals, amounts held in their Retirement Accounts ("IRAs" and accounts arising from employer-sponsored deferred compensation plans) constitute the bulk or at least a significant portion of their estates. The bad news is that changes in the tax laws over the past 20 years have created a complicated maze which has greatly diminished the value of such Retirement Accounts. At death, such Retirement Accounts are subject to federal estate tax and to death taxes in many states. In addition, the benefits paid from Retirement Accounts also are subject to income tax as they are withdrawn, even after death. The good news is that recent changes in the tax laws have liberalized the period over which funds can be withdrawn from an IRA. The timing of distributions and available elections, however, can have a significant impact on the value of your Retirement Account to you and your heirs.

Elections During Your Lifetime

The type of election you will make regarding the payout of your Retirement Account during your life has been simplified.

As a general rule an IRA owner must begin to receive distributions from an IRA (other than a Roth IRA) by April 1st of the year that follows the year in which he or she attains age 70 1/2 .

New proposed regulations issued at the beginning of this year simplify these distribution rules. Now, an IRA owner may determine the minimum amount he must withdraw annually by looking at a table and finding the number next to his closest age, and then taking that number and dividing it by the account balance in his IRA. The table is based on the joint life expectancy of the IRA owner and someone 10 years younger than he is. The table is used even if the beneficiary is less than 10 years younger than the IRA owner. The table is a uniform table and takes the guess work out of making an election when you reach 70 1/2.

The benefit of this new approach is that it lowers the required distribution for most IRA owners who are survived by their spouses, because most spouses are closer in age than 10 years. For example, if we had a couple where one spouse was 70 1/2 and the other was 68 and the older spouse had an IRA with an account balance of $900,000, under the old rules the required distribution would be $41,861. Under the new rules, the required distribution is reduced to $34,352. In our example if our couple needs more money, the IRA owner can always take the funds out more quickly. By keeping the funds in the IRA, our couple has less taxable social security, less adjusted gross income, less itemized deduction limitations and less personal exemption reduction on their annual Federal income tax return.

In addition, the required distribution will be even lower if your spouse is actually 10 years younger than you are. In such a case the table is not used and the actual joint and survivor expectancy number is.

Asset for Your Heirs

In the past, keeping funds in your IRA account was a great idea for retirement, but little was left after taxes for heirs other than a spouse. Since the benefits from your Retirement Account were subject to both income and estate tax, the value of the Retirement Account to your heirs (other than your spouse) could be reduced to only 27% of the original dollars in your Retirement Account if you were in the top (55%) estate tax bracket and your heirs were in the top (39.6%) income tax bracket. Each of those rates have begun to come down slightly. The top estate tax bracket will eventually decrease to 45%. The top income tax bracket will eventually be reduced to 35%. On the other hand, you cannot make a gift or transfer your Retirement Account during your life (except in connection with a marital settlement), and cannot avoid the estate tax if the potential beneficiary is someone other than a qualified charity. The value of your Retirement Account can be enhanced, however, if the benefits can be directed to low income tax bracket beneficiaries and/or if the income tax consequences can be deferred over the longest possible period.

Estate Planning Considerations

- **Spousal Rollover**

If you have a spouse, the simplest method of income tax deferral is to give the benefits to your spouse upon your death in a form which will allow your spouse to transfer the benefits to a Spousal Rollover IRA. If, at the time of your death, your spouse has not attained age 70 1/2 , distributions from such an IRA can be deferred by your spouse until he or she reaches that age. Your spouse then may make his or her individual election concerning the payout of such an IRA. If, however, your spouse has not reached age 59 1/2 at the time of your death, distributions cannot ordinarily be made to him or her without an early distribution penalty. Accordingly, the choice of a Spousal Rollover IRA may not be appropriate for a spouse under 59 1/2 if the surviving spouse needs a stream of income.

- **Designating a Trust as Beneficiary**

Naming your spouse as beneficiary of your Retirement Account will enable him or her to elect a Spousal Rollover IRA. However, the surviving spouse then ultimately decides which children or beneficiaries will receive the remaining benefits at his or her death. You may wish to provide generously for your spouse, but may want to control who gets the remaining benefits at his or her death. Naming a trust as the beneficiary of the Retirement Account can achieve such a goal.

If a trust is chosen as the beneficiary of the Retirement Account, the trust must meet certain requirements before the trust is entitled to certain income tax elections. First, the trust must be valid under state law. Second, the trust must be irrevocable. Third, the beneficiaries of the trust must be identifiable from the trust instrument. Fourth, a copy of the trust instrument must be provided to the plan. If these four requirements are met, a trust may be a beneficiary of a Retirement Account and the individual beneficiary with the shortest life expectancy (the eldest trust beneficiary) will be considered to be the beneficiary of the Retirement Account for income tax purposes.

- **Elections Available to a Trust**

If you have not started to take distributions prior to your death, generally all benefits from the Retirement Account are paid in one of three methods. First, the benefits are completely paid to the beneficiary you name by December 31st

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INCORPORATING RETIREMENT BENEFITS INTO AN ESTATE PLAN

of the fifth year from the date of your death. Second, the beneficiary may elect to receive equal periodic payments over his or her life expectancy, provided such payments begin within one year from your date of death. Third, in situations where the surviving spouse is considered to be the beneficiary for income tax purposes, the beginning date for payment from the Retirement Account may be deferred until the date you would have reached age 70 1/2 had you survived. Under this last alternative, at your spouse's death, the beneficiaries of such death benefits at that point may elect to receive the remaining benefits from the Retirement Account under the either of the first two options.

With regard to a trust designed for the benefit of your surviving spouse during her life, and your children at your spouse's death, your spouse would be considered to be the beneficiary for income tax purposes. Such a trust could receive the death benefits by December 31st of the fifth year from your date of death, or could elect either of the other two options stated above. The trust could either receive periodic payments over the life expectancy of your spouse (provided the first payment was received within one year from your date of death), or could elect to defer the first payment from the Retirement Account until the date you would have reached age 70 1/2 .

Such elections provide your surviving spouse and the trustees with a great deal of flexibility to determine when payments should be received from the Retirement Account and the ability to defer the income tax on such payments.

- **Careful Planning Will Pay Off - Now and Later**

Retirement Accounts are increasingly a significant portion of an individual's wealth. Careful consideration should be given first to how the benefits from such an Account are to be paid during your lifetime and, second, how any remaining benefits are to be distributed to your spouse and children, or other beneficiaries after your death. Not only will such planning achieve your objectives, but it also may prevent your beneficiaries from paying taxes that could otherwise be deferred or possibly avoided.

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SAVING FOR COLLEGE - REVISITED

College Savings Plans (commonly referred to as Section 529 Plans after the Internal Revenue Code section that allows them), are an excellent method for saving for college. A description of the types of plans available, and the benefits of such plans, appeared in an earlier article in the Fineman & Bach, P.C. newsletter (Volume 7 – Spring 2001). On June 7, 2001, President Bush signed a new law entitled "The Economic Growth and Tax Relief Reconciliation Act of 2001" which among other things, significantly broadens the appeal of financing a child's college education through 529 Plans.

529 Plans were already growing in popularity before the new tax law changes. About 40 states have created, or are in the process of creating, 529 Plans. The vast majority allow non-residents to participate, which means one can chose virtually any state's plan, regardless of where you live or what college your child is likely to attend.

529 Plans have no income limits so anyone can participate. Some plans allow large investments, even over $200,000 per beneficiary and, if your child does not end up using the money, most plans are very flexible allowing the transfer of the benefits of a plan to a sibling or cousin.

Under the previous rules, the build-up or increase in the 529 Plan account was tax free. However, the withdrawal of funds for educational purposes was taxed at the child's tax rate. The Act makes both the buildup and the withdrawal of the funds tax free if used for college expenses such as tuition or room and board.

Although the Act improves 529 Plans, there is concern about the "sunset" of the Act on January 1, 2011. In that year, all provisions of the Act are discontinued and the tax laws in place for year 2001 are reinstated. This means that withdrawals from these accounts will go back to being taxed unless Congress extends this break. Many experts believe Washington will not let the tax break expire; however, nothing is certain.

In addition to allowing the tax free buildup and withdrawal from the 529 Plans, the new Act also has turned a once useless savings account, the Educational IRA, now known as a "Coverdell Education Savings Account" into a real option for saving for college. The Act raised the annual Coverdell Account contribution limits from $500 per beneficiary to $2,000, and also allows more people to be eligible to contribute. Before the Act, married couples earning $160,000 or more were not allowed to contribute to a Coverdell Account. Starting next year, the income threshold rises to $220,000.

For many, $2,000 a year will still not be enough to pay for four full years of college. However, it may be available to pay supplemental expenses like commuting, laptop computers, tutoring and other incidental expenses that may not be considered "room and board". A Coverdell Account can also be used for "qualified elementary and secondary school expenses" at a public, private or religious school.

In addition, the restriction preventing contributions to a 529 Plan and a Coverdell Account in the same year is lifted. One can make contributions to both plans without penalty. Moreover, a Coverdell Account allows parents greater flexibility in the investment that they chose. A Section 529 Plan is typically invested in the investment vehicles offered by the sponsoring state.

The new Act creates many planning opportunities for you and may reduce the benefits of other techniques. Old planning strategies for financing a child's education may not make sense.

For more information, please call Scott H. Mustin (215) 893-8741

AN OUNCE OF PREVENTION NEEDED TO PROTECT YOU AS EMPLOYER

Charges of discrimination, sexual harassment or a hostile work environment continue to proliferate. Fifteen years ago, the Supreme Court suggested a way in which employers might avoid liability — but many have ignored that advice.

"Sexual harassment" has been defined as "unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature" which implicitly or explicitly are made a condition of employment or the basis for an employment decision. A "hostile work environment" is one in which there is discriminatory intimidation, ridicule and insult.

Employers all too frequently find themselves confronted by charges of discrimination, "sexual harassment" or of maintaining a "hostile work environment."

When a charge is filed, it almost invariably will occur after the employment relationship is terminated, whether by the employee or the employer, and occurs when the employee perceives that he or she has been treated unfairly in one way or another.

The first questions that an employer generally asks are along the lines of: What really happened? Has some form of discrimination occurred? Has one employee sexually harassed another? Has the atmosphere of the workplace become "objectively hostile or abusive," a somewhat nebulous definition which falls somewhere between conduct which would lead to a nervous breakdown and that which is merely offensive.

Whether due to tougher laws or a changing social environment, overt discrimination and sexual harassment generally are not accepted in today's society. Therefore, it is less frequent that they take place in front of an audience. Also, a charge may be based on events alleged to have happened months earlier without a contemporaneous record of any complaints that the charging party may have made at the time. Memories fade; perceptions differ; and witnesses are no longer available. All too often, it will simply be a case of the charging party's word against the supervisor or co-worker with little meaningful information from others. In short, it may be difficult for an employer to know exactly what did — or did not — happen.

A comprehensive anti-discrimination program has a variety of benefits. The existence of a mechanism for employees to air their perceived problems can enhance the working environment. Its mere existence is likely to reduce the likelihood of unfounded or exaggerated charges of discrimination, sexual harassment or a hostile work environment. A procedure which encourages the reporting of complaints and prompt investigation provides the employer with a record of what occurred; the absence of a complaint is not as easily explained by a charging party when a legitimate procedure exists.

An effective program can be developed which is not unduly expensive to create or burdensome to implement. Compared to the expense of defending a charge filed with the EEOC or an action instituted in federal court, it is an excellent value.

Elements of a successful program include:

- Adopt a clear and concise policy of non-discrimination which explicitly refers to sexual harassment and a hostile work environment.
- Distribute the company's policy to all employees, post copies in appropriate locations and make certain that employees are well-aware of the company's position.
- Create a procedure which encourages the reporting of discrimination and sexual harassment without fear of reprisal or bias.
- Objectively investigate complaints of discrimination as soon as possible and memorialize the results of the investigation.
- Develop appropriate sanctions for violations and take remedial action when warranted.

For further information, contact Steven R. Waxman (215) 893-8714

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The Alliance provides its members world-wide referrals through a web of law firms linked together by trust and a high level of individual expertise and competence. It adds value for member firms through the sharing of resources and knowledge as well as through operational efficiencies.

The bottom line is that membership in Legal Netlink Alliance further assures our clients the highest level of quality legal services.

For additional information, contact Mitchell L. Bach (215) 893-8708

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