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CLIENT MEMORANDUM
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As 2006 comes to an end, following are various estate and tax planning topics for you to consider.

♦ **Federal Estate Tax "Exemption"**. The following table illustrates what is the Federal Estate Tax exemption under current law:

Year	Exemption	Tax Rate
2006	$2,000,000	46%
2007	$2,000,000	45%
2008	$2,000,000	45%
2009	$3,500,000	45%
2010	no estate tax in this year	
2011 and after	$1,000,000	55% (max.)

Yes,...you read it right! The Estate Tax law is in a state of chaos. No one knows how, when or if this law will be "fixed". It depends on who gets elected and other politics.

♦ **New Jersey Estate Tax**. The N.J. Estate tax exemption is $675,000. On assets in excess of $675,000 up to $1M, the effective tax rate is about 10%. On assets in excess of $1M, the tax is about 6% and gradually increases to 16%. For example, on an estate of $2M, the N.J. Estate Tax is $99,600.

Thus, if your estate is more than $675,000, estate tax planning is still needed.

♦ **Periodic Review**. It is advisable to review your Will at least every three years, due to the constant changes in the tax laws. Also, it is beneficial to review your estate plan more often if there have been changes in your family situation (such as marriage, divorce, aging, births, death, or changes in your or a family member's health) or changes in your or a family member's financial circumstances. Beneficiary designations on IRAs and life insurance acquired after your Will was prepared should also be reviewed.

♦ **Year-end Gifting**. It may be advisable to make year-end gifts. The Federal annual gift tax exclusion is currently $12,000 per donee. There may also be additional benefits of making larger gifts.

♦ **Gifts for Tuition and Medical Expenses**. In addition to the $12,000 annual exclusion, you may make tax-free gifts by paying tuition and medical expenses for your family members. Payments must be made directly to the school or the health care provider.

♦ **College Savings Programs**. These are also known as ***Section 529 Plans***. You can establish a tax-advantaged account to save for your children's or grandchildren's college expenses. The monies can be used for tuition, housing, and books. You can change the beneficiary at any time. All interest, dividends and capital gains are totally income tax-free if used for educational purposes. This "tax-free" income is "as good as it gets" regarding saving for college!

- **Gifts and Valuation Discounts**. It is still very much advisable to reduce your taxable estate by making gifts. *The element of valuation is the most significant issue in determining the taxation on a gift or on an estate.* Generally, if assets are kept and taxed as part of your estate at death, valuation discounts are not applicable. If gifts are made (or assets are sold) to family members during your lifetime, under certain circumstances very substantial discounts can be applied, to significantly reduce the ultimate estate tax. This can be done by gifting a "minority interest" or a "non-voting interest" in a partnership or in real estate.

- **Unified Gift and Estate Tax System**. Essentially all assets are included as part of the "gross estate", including real estate, stocks and bonds, pensions, life insurance, and most other assets. It is not possible to eliminate estate taxes simply by gifting away your assets, because the Gift Tax rates are essentially the same as the Estate Tax rates. However, there are numerous estate planning techniques which can be used to reduce Estate Taxes.

- **Planning for Your Inheritance - Reduce Estate Taxes and Protect these Assets from Claims of Creditors**. Any bequests which you might receive from your parents will ultimately be includable in your taxable estate; this would exacerbate your estate tax problem. A better choice would be to have the bequest pass to a *trust for* you (rather than to you outright) which would eventually pass estate-tax-free to your descendants. These trusts can be very flexible. The assets held in trust would be available for your benefit during your lifetime. Also, you could be the Trustee of the trust, control the investments of the trust, have the power to make distributions from the trust to other individuals or entities, and have the power to determine how those assets would be distributed upon your death. Another potential advantage of such a trust is that it provides "asset protection"; that is, these assets are generally protected from any potential creditor which you might have. It is not possible for you to fund such a trust for yourself after receiving an outright bequest. Rather, this type of trust must be a part of your parents' estate planning. Or, you could create a separate trust and ask your parents to make a bequest of assets to that trust, rather than to you outright.

- **Generation-Skipping Transfer (GST) Trust for your Children**. Any assets which pass to your children outright would ultimately be includible in *their* respective subsequent taxable estates. Instead, a portion of your assets could be placed in GST *trusts for* your children which would be available for their benefit during their lifetimes and then pass estate-tax-free to their descendants. Your child could be the Trustee of such trust, have the power to distribute the assets of the trust to other individuals or entities during his or her lifetime, and could also have the power to determine how those assets would be distributed upon his or her death.

- **Utilizing Both Spouses' Exemptions**. If you are married, and if under your Will you simply leave all of your assets to your spouse, the net effect is that your $2M exemption will have been wasted. Instead, you can bequeath part of your assets to a *Trust for* your surviving spouse. Your surviving spouse would have the use and benefit of the Trust assets. This Trust is also known as a Credit Shelter Trust, and is also sometimes called a By-pass Trust. For example, if your total estate is $4M and you leave the entire amount to your surviving spouse, the tax at the time of the second death would be approximately $1M (that is, approximately a 50% effective tax rate on the excess over the $2M exemption amount). However, if you leave $2M to a By-pass Trust (and $2M outright to your spouse), then your exemption would apply against the Trust; and when your spouse passes away subsequently, the second exemption of $2M would be available to offset the tax on the spouse's estate. With this planning, your children would get the benefit of *both* spouses' $2M exemptions, and thus save approximately $1M in Federal Estate Taxes.

The New Jersey exemption is only $675,000; thus, use of a By-pass Trust should be considered for any estate over $675,000.

This may be effected at the spouse's option, using a "disclaimer trust", but only if the predeceasing spouse has a provision in his/her Will to allow this.

- **Titling of Assets**. Joint ownership with right of survivorship (JTWROS) is frequently *not* the best type of ownership for estate tax purposes. If you have too many assets in JTWROS, then this could result in unnecessarily higher estate taxes on the "second estate". It is better to have at least some of your assets separately titled, that is, some assets in the husband's name and some assets in the wife's name.

- **Qualified Personal Residence Trust (QPRT)**. This is also a very favorable technique, which allows you to give away your house at a discounted value. You retain the right to the full use and benefit of the house for a certain number of years; and your children receive the house when that term of years has expired. The potentially high estate tax on your house can be very significantly reduced.

- **Irrevocable Life Insurance Trust (ILIT)**. As a general rule, the face amount of life insurance is taxed as part of your estate. For example, without proper planning, the estate tax on a $1,000,000 life insurance policy would be about $500,000. It is generally advisable to use an ILIT, in order to remove the insurance from being taxed as part of your estate.

- **Self-canceling Installment Note (SCIN)**. Another estate planning technique is to sell assets to your family members in exchange for a promissory note which provides monthly payments to you. This would provide cash flow, which could more than replace the income which you would no longer receive from the assets which you had sold. It is possible to structure the transaction in a way that the note receivable expires (that is, it "self-cancels") at the time of your death, with the result that the note receivable would not be taxed as part of your estate. The Estate Tax savings could be huge. There are similar techniques, called a **Grantor Retained Annuity Trust (GRAT)** and an **Intentionally Defective Grantor Trust (IDGT)**.

- **Reverse Mortgage**. Another method of providing cash flow to elderly parents might be for the children to make monthly payments to the parents in the form of a "reverse mortgage loan". The child's loan is secured by a mortgage on the home. A reverse mortgage arrangement would provide cash flow to the parent to meet his/her daily needs, and reduce the net equity owned by the parent, thereby reducing estate taxes.

- **Roth IRA**. This is a type of IRA which compounds on a totally tax-free (not merely tax-deferred) basis. It is possible to convert your traditional IRA into a Roth IRA; and this can result in very significant long-term benefits to your family members. You can convert your existing IRA into a Roth IRA, but only in a year when your annual income is less than $100,000; however, effective in the year 2010, this $100,000 limitation will not apply. Conversion to a Roth IRA is a particularly advantageous technique for the very elderly, for the long term benefit of your children. Also, making a gift to your child, by funding his/her Roth IRA, can be very beneficial; the child must have some earnings.

- **Capital Gains Exclusion on Sale of Home**. If you sell your home and you are married, there is a $500,000 exclusion on capital gains from the sale. You must both own the home and use it as your principal residence for at least two of the prior five years. If you are single, that exclusion is $250,000.

- **Deficit Reduction Act**. This law took effect on February 8, 2006. Medicaid will pay your nursing home costs, only if your assets have total value of $2,000 or less. The new law severely limits the ability to qualify for Medicaid coverage of nursing home care. Now, all gifts are subject to a "5-year lookback" period. (Under prior law, there was a 3-year lookback.)

- **Recent Changes in the Tax Laws**.

  (1) Under prior law, if you wanted to make a gift to a charity from your IRA, you were required to first withdraw funds from the IRA, and pay income tax thereon. If you then gifted that amount to charity, you would most likely not receive the benefit of a full charitable deduction for such gift, because of the phase-out of itemized deductions, loss of exemptions, and other limitations on deductions. In 2006 and 2007 you may take an income tax-free withdrawal from your IRA if the proceeds are contributed directly to a charity. You must be at least age $70^{1}/_{2}$; the maximum amount is $100,000; and this will count toward your annual Required Minimum Distribution.

  (2) Higher contributions are now allowed for IRAs.

  (3) Many retirement plans, such as a 401(k) plan, require that, in the event of your death, the plan benefit be paid in a lump sum to your beneficiaries. If your beneficiary is your spouse, the spouse could make a rollover into an IRA, and thereby defer the income tax. However, if the beneficiary was anyone other than a spouse, a rollover was not possible, and if a lump sum was required under the plan then the entire benefit would be subjected to an immediate income tax. Beginning in 2007, a beneficiary other than a spouse may rollover a lump sum payment from a 401(k) or other such plan into an "inherited IRA". Then, that beneficiary could extend the withdrawal of the IRA over his or her lifetime, and thereby obtain very significant tax deferral.

  (4) The tax-advantageous treatment of Section 529 plans has been made permanent by the new law.

  (5) Under prior law, if a child was under age 14, his/her income was taxed at his/her parents' higher income tax rate. This is called the "Kiddie Tax". Under the new law, this affects all children up to age 18.

  (6) The new law has extended the maximum 15% tax rate on capital gains and qualified dividends through 2010.

- **Power of Attorney**. Everyone should have in place a Power of Attorney by which you grant to your spouse or to some other trusted person the power to handle your affairs in the event you were to become incapacitated. Without a Power of Attorney, your family might need to apply for a guardianship, which would be very expensive and time-consuming and unpleasant. The Power of Attorney should be updated periodically.

- **Living Will**. It is important that you have a Living Will which states your intentions regarding the maintenance or non-maintenance of artificial life support. You should designate a Health Care Representative in the Living Will; if you do not do so, then your family would need to go through a Court proceeding in order to have a Guardian appointed.