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ESTATE PLANNING CLIENT MEMORANDUM

Best Wishes to you and your family for 2007!

Dear Client:

The following are various estate and tax planning topics for you to consider:

- **Recent Changes in the Federal Income Tax Law Regarding IRAs and Qualified Plans Payable to Trusts.** The federal income taxation of IRAs and qualified retirement plans payable to a trust at death recently changed requiring the trust to have certain wording regarding the minimum required distribution in order to have the federal income taxation of the account spread out over the life of the beneficiary instead of having it taxed all at once at the owner's death.
- **Important Client Alert.** All clients who have IRAs and qualified retirement plans payable to a trust at death should have their documents promptly amended to include this special wording regarding the minimum required distribution to avoid unnecessary taxation. It is important to call our office to set up a review appointment as soon as possible to modify your documents.
- **Special Needs Trusts.** The law regarding trusts established for disabled persons with special needs has changed in recent years.
- **Important Client Alert.** All Wills and Revocable Deeds of Trust with provisions

providing for the possibility of trust income and/or trust principal to be distributed to or on behalf of a disabled person or a person with special needs should be reviewed, and possibly amended, to prevent the requirement of spending down the entire trust fund before being able to take advantage of state and federal government programs.

The New Pennsylvania Uniform Trust Act.

Michael J. Saile, Esq. is part of a select group of attorneys and judges appointed by the Pennsylvania Legislature known as the "Advisory Committee to the Joint State Government Commission on Decedents' Estates Laws" who volunteer their time to meet in Harrisburg several times a year to review, improve and draft new estate and trust law for the Pennsylvania legislature. This group drafted the Pennsylvania Uniform Trust Act (the "PUT"), which became effective on November 4, 2006.

The PUT became the first comprehensive uniform body of trust law in Pennsylvania. The PUT improved on several areas of law that were unclear and inconsistent throughout the Commonwealth. The major improvements

deal with: (i) the formalities of revocable or “living” trusts, (ii) jurisdiction issues with trusts, (iii) virtual representation, and (iv) the trustees’ duties and powers.

These issues are especially relevant to our clients at Saile & Saile LLP because many of our clients’ estate plans involve trusts. Also, the newly adopted doctrine of virtual representation allows for certain individuals, usually parents and adult children, to represent the best interests of incompetent, unborn or minor descendants without court approval. Virtual representatives in Pennsylvania can now be used to “close” an estate or trust without incurring thousands of dollars of additional costs and fees associated with having a guardian appointed by the court.

- **Important Client Alert.** All trustees of a Pennsylvania irrevocable trust (or a revocable trust which has become irrevocable due to the death of the owner that created the trust) must send a special notice in writing to the current beneficiaries and certain family members about the existence of the trust and how to contact the trustee. The trustee must also inform these individuals of other required information. This applies to trusts established under a Will of a decedent domiciled in Pennsylvania or a trust with a situs clause stating that the trust is governed by Pennsylvania law. This new law also requires the trustees of “older trusts” to send out the statutory required special notice.

These notice requirements affect the beneficiary’s ability to sue the trustee for mishandling the trust. It is extremely important for our clients who have an irrevocable trust (or a revocable trust which has become irrevocable) to contact our office as soon as possible so that we can draft proper notices to the beneficiaries.

- **Federal Estate Tax “Exemption”.** The following table illustrates what is the Federal Estate Tax exemption under current law:

Year	Exemption	Tax Rate
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 \$1 million, the effective tax rate is about 10%. On assets in excess of \$1 million, the tax is about 6% and gradually increases to 16%. For example, on an estate of \$2 million, 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 and Trust 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 Retirement Plans, IRAs and life insurance should also be reviewed.
- **Gifting.** It may be advisable to make gifts. The Federal annual gift tax exclusion is currently \$12,000 per donor to a 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. Payment must be made directly to the school or healthcare provider (not to any individual for reimbursement).
- **College Saving 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 (but no more than once every 12 months) 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!
- **Gift 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" 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 may 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, if the trust is drafted properly, these assets are protected from any potential creditor claims 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.
- **Generation-Skipping Transfer (GST) Trust for your Children.** Any assets which pass to your children outright would ultimately be includable 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 \$2 million 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 or a Disclaimer Trust. For example, if your total estate is \$4 million and you leave the entire amount to your surviving spouse, the tax at the time of the second death would be approximately \$900,000 (that is, approximately a 45% effective tax rate on the excess over the \$2 million exemption amount). However, if you leave \$2 million to a By-pass Trust (and \$2 million outright to your spouse), then your exemption would apply against the Trust; and when your spouse passes away subsequently, the second exemption of \$2 million would be available to offset the tax on the spouse's estate. With this planning, your children would get the benefit of both spouses' \$2 million exemptions, and thus save approximately \$900,000 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.
- **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 \$450,000. It is generally advisable to use an ILIT, in order to remove the insurance from being taxed as part of your estate.
- **Important Client Alert.** If you have changed your address, phone number, or any other contact information, please contact our office as soon as possible so we may update our file.

The information included in this newsletter is not intended as a substitute for consultation with an attorney. Specific conditions always require consultation with appropriate legal professionals. New IRS rules restrict written federal tax advice from lawyers and accountants. We include this statement because even inadvertent violations may be penalized. Nothing in this message is intended to be used, or may be used, to avoid any penalty under federal tax laws. This message was not written to support the promotion or marketing of any transaction. Contact the sender if you wish to engage us to provide formal written advice as to tax issues.

