

DANZIGER & MARKHOFF LLP

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2006 Estate and Gift Tax Update

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In this issue:

| | |
|---|---|
| 2006 Estate and Gift Tax Update | 1 |
| ESOPS and Effective Estate Planning | 1 |
| Protecting Retirement Assets from Creditors: IRAs vs. Qualified plans | 3 |
| Health Care — Fraud and Abuse Enforcement Activities in 2006 | 4 |
| In Our Firm | 4 |

The new year has ushered in some adjustments to the estate and gift tax laws. The following is a summary of some of the salient provisions of the estate and gift tax laws as they now exist.

Regarding federal taxes, the *estate tax exemption* is **\$2,000,000** (up from \$1,500,000 in 2005) and the *annual gift tax exclusion* increases to \$12,000 per donee (up from \$11,000 in 2005). The *lifetime gift tax exemption* remains at **\$1,000,000**.

Two points to make with regards to this change in the law. First, if Danziger & Markhoff prepared your Will, there is no need to revise your Will due to the increase in the estate tax exemption. The amount allocable to the credit shelter trust will *automatically self-adjust* for the increase from \$1,500,000 to \$2,000,000. Second, please take the opportunity to make sure that each spouse now has at least \$2,000,000 of assets in his or her own name (not joint ownership).

Regarding state estate taxes, New York's exemption remains at \$1,000,000 and New Jersey's remains at \$675,000. This means that if you are married and your Will is designed to shelter the first \$2,000,000 of assets from estate tax, this will trigger a New York or New Jersey estate tax of \$99,600 upon the death of the first spouse. Depending on your situation, it may be advantageous to pay this tax in order to save approximately \$500,000 of estate tax when the surviving spouse dies.

Connecticut changed its law in 2005 to establish a \$2,000,000 exemption. This jibes with the federal exemption and does not cause the headaches that New York and New Jersey residents suffer. However, the catch is that when the surviving spouse dies, to the extent that the survivor's estate exceeds \$2,000,000 (even by \$1), the entire \$2,000,001 is fully taxed without any exemption, incurring a \$101,700 estate tax.

(Continued on page 2)

ESOPS and Effective Estate Planning

A business owner interested in succession planning for his closely owned business should consider adopting an Employee Stock Ownership Plan ("ESOP"). An ESOP permits an owner to extract cash from his business without paying capital gains tax, all while retaining full control of his business. ESOPs can also be powerful estate planning tools as discussed below.

In order for an owner's sale of his stock to an ESOP to be tax-deferred, the ESOP must acquire at least 30% of the company stock. In many, if not most cases, the owner initially sells 30% to 50% of the company stock to the ESOP, stays involved with his business and retains the balance of the ownership interest.

(Continued on page 2)

ESOPS and Effective Estate Planning

(Continued from page 1)

The owner has several options for his retained ownership interest in the business:

First, if there are no family members in the business, the owner can remain in the business and, over a period of years, groom a management team to eventually take over, with a view towards a possible subsequent second sale of stock to the ESOP or to the management group. The owner thereby retains control over the transition of his business, gains liquidity, and avoids selling his business to unfriendly outsiders.

Second, if there are children involved in the business, the business

owner may consider gifting some or all of his company stock to one or more of his children immediately following the ESOP transaction. Since in the typical leveraged ESOP transaction the company borrows money which is used by the ESOP to purchase the stock from the selling shareholder, the value of the company and its stock, which is now burdened by the additional debt, is automatically depressed for a short period following the transaction. In addition, the value of the company stock will be further reduced after taking into account minority and lack of marketability discounts. As a result, more stock can be transferred by the owner to his children

without the payment of gift tax than would be the case had there not been an ESOP transaction.

Our office has had a great deal of experience representing clients in ESOP transactions. If you are interested in succession planning for your business, an ESOP should be considered. ■

Please contact Stanley E. Bulua, Esq., or Jay Fenster, Esq., for additional information.

Estate and Gift Tax Update

(Continued from page 1)

Custodian Account Update

We have advised many of our clients to arrange for the transfer of custodian accounts to an irrevocable trust once a child attains age 21. This helps protect the funds in case the child's marriage ends in divorce and from the child spending the money frivolously. In order to implement the trust, the adult child would transfer the assets of the custodian account (which technically rest in the name of the child at age twenty-one) to an irrevocable trust created by the child, with the parents as trustees. The trust's income and principal will only be paid to the child in the discretion of the parents. Upon the child's death, the assets are distributed to the child's children (i.e. your grandchildren). The trust's income will be taxed to the child. The trust does not have

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to file separate income tax returns and does not have to apply for a taxpayer identification number. The important point is that the account cannot be distributed to the child's spouse.

If the parents decide at some point that the trust is no longer necessary, they can, in their role as trustees, consent to collapse the trust and distribute the assets to the child.

The virtue of such a trust is that the child has given up control of the assets to his or her parents. In exchange, the trust helps earmark the assets as "separate property" for equitable distribution purposes and insulates the assets from a divorce proceeding. Since it is frequently awkward for parents to recommend a prenuptial agreement, this type of trust may be a more palatable alternative.

Gift Tax Exemption for Tuition and Medical Payments

Each individual can make gifts of \$12,000 of assets (\$24,000 if you are married) each year without any gift tax. There is an additional gift tax exemption that should also be considered. All payments of tuition or medical bills by a donor can be made over and above the \$12,000 (and \$24,000) exemption as long as the payments are made directly to the institution. In other words, an individual can write a check for \$12,000 (or \$24,000) to a grandchild and, in addition, pay a \$30,000 tuition bill as long as the check is written to the college and not to the grandchild. That individual can also pay a \$5,000 medical bill for a grandchild provided that the check is issued directly to the physician or hospital. ■

Please contact Michael Markhoff, Esq., to discuss these issues in greater detail.

Protecting Retirement Assets from Creditors: IRAs vs. Qualified Plans

Many of our clients have been asking: “I want to protect my retirement assets from creditors. Am I better off having the assets in a qualified plan such as a pension or profit sharing plan, or in an IRA, or does it not make any difference at all?”

Our answers are summarized in the following table. The balance of the article explains the impact of those answers.

| Available Creditor Protection | | | |
|-------------------------------|-----------------------|-----------------|--------------|
| | Traditional IRA | Qualified Plan | Rollover IRA |
| Federal ERISA Statute | No | Yes | No |
| Federal Tax CODE | No | Yes | No |
| Federal BANKRUPTCY ACT | Yes up to \$1 Million | Yes No Limit | Yes |
| State “Shield” Laws | Yes: NY | Yes: NY | Yes: NY |

The preceding table begins with ERISA (the basic federal statute governing employee’s rights to benefits under pension plans) which provides that qualified retirement plans are protected against claims by creditors. To qualify as an “ERISA” Plan, there must be at least one non-owner participating in the plan. The creditor protection in ERISA actually mirrors a similar provision in the Internal Revenue Code, so that plan participants and their beneficiaries have a double protection right out of the box.

The third line in our table above reflects recent revisions to the federal Bankruptcy Act which place all tax-qualified retirement plans, rollover IRAs, 403(b)s and 457 funds beyond the reach of creditors in bankruptcy. Non-rollover IRAs as well as Roth IRAs are also protected in bankruptcy, but only up to \$1,000,000.

Finally, in situations where the federal rules may not apply, IRAs and non-ERISA plans can be pro-

tected under state “shield” laws. For example, in a bankruptcy, a state law can provide protection to non-rollover IRA assets that are in excess of \$1,000,000. In addition, state laws can provide protection outside of the bankruptcy setting, such as protection against judgments awarded in non-bankruptcy cases.

Fortunately for most of our clients, New York has a very strong “shield” law. Under the New York statute all tax-qualified plans, whether or not subject to ERISA, and all IRAs and Roth IRAs, including non-rollover accounts, are protected, without any dollar limit and (in the case of benefits paid out of the plan) without any requirement that the amount be needed for the account holder’s support. Significantly, Connecticut, New Jersey, Pennsylvania and Florida all have state statutes that similarly protect IRAs and Roth IRAs.

Between ERISA, the Code, the federal bankruptcy statute, and state shield laws such as New York’s, retirement accounts including regular and roll-

over IRAs are now fully protected from creditors in most situations. Nonetheless, if the stakes are high or if you are nervous about a court’s interpretation of New York’s shield law, you probably should opt to keep your retirement funds in the time-tested ERISA Qualified Plan account, which is covered by the bankruptcy statute, by ERISA, the Code and by the New York shield statute.

Thus, a N.Y. resident whose IRA or Plan assets are located in N.Y. can rest assured that those retirement assets are unconditionally exempt from claims of creditors (except for certain limited areas such as spousal claims or government tax liens). ■

Please contact Ira Langer, Esq., Andrew E. Roth, Esq., or Jay Fenster, Esq., to discuss any of the points raised in this article.

Health Care — Fraud and Abuse Enforcement Activities in 2006

The beginning of each new year brings a rash of predictions about the areas in which government fraud and abuse enforcement activities will be concentrated. Based on statements by numerous government officials and private practitioners, the following list sets forth likely targets for such enforcement activities:

Proliferation of state whistleblower laws

The federal government has proven very successful under the False Claims Act in encouraging whistleblowers to report allegations of improper activity by health care providers which defrauds federal reimbursement programs. Recognizing such success, an increasing number of states have passed their own whistleblower statutes in order to increase such recoveries which will inevitably lead to more claims and more lawsuits.

Increased scrutiny of relationships between physicians and medical device manufacturers

Investigations have been initiated by the United States Attorney's offices in Newark and Boston into the relationship between physicians and medical device manufacturers

(specifically of orthopedic and cardiac devices). Notwithstanding federal and state regulation in this area, as well as the adoption of voluntary codes of conduct by device trade associations, there are many consulting and other arrangements to which physicians are parties which will continue to undergo careful governmental review.

OIG will increase its use of the Civil Money Penalty Law to address violations of the Anti-Kickback Statute and the Stark Law

In cases where the federal Office of Inspector General has found violations of the Anti-Kickback Statute or the Stark Law, it has used the evidence of such violations as a basis for imposing civil monetary penalties on the offending providers. This type of enforcement action is likely to increase, both against individuals or entities who accept as well as pay kickbacks.

Medicare provider enrollment will become increasingly burdensome

As if this process was not difficult already, the Centers for Medicare and Medicaid Services has announced it will increase its focus on

Medicare provider enrollment in an attempt to weed out sham operations and providers engaged in fraudulent activities.

CMS will devote significant resources to preventing fraud and abuse in the new Medicare Part D drug benefit program

Because of the groundbreaking nature of the new Medicare Part D drug benefit program, opportunities will be rife for unscrupulous providers to engage in fraud in many different ways. CMS will be on the alert for any such activities, although due to the newness of the program it is unlikely that many enforcement actions will be brought in 2006. ■

Fraud and abuse issues may appear in almost any agreement between a provider and another entity where the referral of patients or goods and services is made between the parties. Please call Joshua S. Levine, Esq., if we can assist you with the review of any such agreements.

In Our Firm

We are proud to announce that Andrew E. Roth, previously counsel with Danziger & Markhoff LLP, has become a partner at our firm. Andy is a member of our employee benefits department.

We are also pleased to announce that David P. Gesser has joined our corporate department. David has been representing closely owned businesses, including professional corporations, for the past twenty years and we are happy to have him join Danziger & Markhoff LLP.

Let us know if you would like to receive future issues of our newsletters by e-mail. All we need is your e-mail address. Please either fax your request to our office, attention: Paula Peck at (914) 948-1706 or e-mail Ms. Peck at Ppeck@dmlawyers.com.

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