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CLIENT MEMORANDUM

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In nearing the end of 2005, the following are various estate and tax planning topics for you to consider:

- **Federal Estate Tax.** What is the future of the Federal Estate Tax Law?

  The following is what the current law provides. The Federal Estate Tax exemption is now $1,500,000, and the maximum rate is 47%. The exemption will increase to $2,000,000 in 2006, and to $3,500,000 in 2009. In the year 2010, there will be no Estate Tax. And, in the year 2011, the so-called "new law" will expire, and there will be reversion to the "old law"; the Estate Tax exemption will then revert to $1,000,000 and the maximum rate will revert to 55%.

  Over the last several years there have been attempts by the President and by certain members of Congress to either repeal the Federal Estate Tax, or to at least increase the exemption to be in the range of $3,000,000 - $5,000,000.

  Now, "all bets are off" as to whether there will be any change in the Federal Estate Tax laws.

  The momentum has stopped for significant change in the Estate Tax laws. The government is now facing hundreds of billions of dollars in clean-up costs for hurricanes in various states, continuing the Iraq War, and addressing other costly issues such as Social Security and Medicaid. As the national deficit grows, it appears less likely that there will be a repeal of the Federal Estate Tax.

- **New Jersey Estate Tax.** The New Jersey Estate Tax has now also become a significant factor. Traditionally proper estate planning dictated that the first spouse to die would fully "utilize" his or her Federal Estate Tax exemption by bequeathing the exemption amount of assets into a "By-pass Trust" for his or her surviving spouse. The objective was to avoid wasting the exemption of the predeceased spouse. Thus, the family would obtain full advantage of *both* exemptions available to two spouses.

  However, utilizing that type of planning may now result in a New Jersey Estate Tax being unnecessarily payable at the time of the first death. For example, for an estate of

$2,000,000, the New Jersey Estate Tax which would be due on the death of the first spouse in 2006, by using this type of plan, is $99,600. For many estates, this tax would be unnecessarily incurred.

Most Wills which were drafted before 2002 incorporate this traditional type of planning, and thus need to be reviewed. Your Wills should be reviewed with this issue in mind.

- **Need to Review.** In summary, in all likelihood the Federal and New Jersey Estate Taxes will remain in their current form for the foreseeable future, and we are strongly recommending that clients review their estate planning. This is especially applicable if your Wills were drafted before 2002. Married couples should have an appropriate "By-pass Trust" in your Will in order for your children to obtain optimum benefit from both parents' exemptions, but now it is necessary to consider both the Federal and New Jersey Estate taxes when determining the appropriate amount to bequeath to the By-Pass Trust.

- **Disclaimer Planning.** Wills can be drafted to utilize "disclaimer" planning, which provides the surviving spouse with great flexibility. Although not necessarily the best approach in every situation, this plan does allow the surviving spouse to decide at the appropriate time, that is, at the time of the death of the first spouse, whether or not a By-pass Trust should in fact be created in order to best reduce estate taxes for your children.

- **Other Planning Techniques.** The following planning techniques are still very viable options which can provide significant tax savings:

(a) Gifts. The annual gift tax exclusion increases in 2006 to $12,000 per year per donee. This means, for example, that if you are married and have two children, and one grandchild, you could give $72,000 per year. If you go over the gift exclusion, this will use up part of your Estate Tax Exemption that is otherwise available at death; but it is usually better to use the Exemption sooner rather than later. Also, if you pay tuition and/or medical expenses of a grandchild, those are completely free of gift taxes.

(b) Family Limited Liability Company (similar to a Family Limited Partnership). You could create a Limited Liability Company (LLC) to which you transfer a portion of your assets and then make tax favorable gifts of Membership Interests to your family members, the objective being to ultimately reduce the value of your estate for estate tax purposes. Some recent Court cases say that a "business purpose" is needed.

(c) Qualified Personal Residence Trust (QPRT). A QPRT is a trust to which you transfer your principal or secondary residence for a specified term of years, during which time you use and live in the residence no differently than you do currently. At the end of the Trust term, the residence would pass to the trust beneficiaries or into Trusts for them. The interest passing to the beneficiaries is a future interest, the "present value" of which is less (often substantially so) than the current value of the property, and this present value will be included in your estate rather than having the

future appreciated value be included in your estate.

(d) Grantor Retained Annuity Trust (GRAT). A GRAT is an irrevocable trust to which you transfer assets and receive an annual annuity for the term of the Trust. The Trust can be structured so that you "receive back" all of the assets in the Trust in the form of annual payments, which are determined based on interest rates provided by the IRS. All income and appreciation in excess of the allowable interest rate passes to the beneficiaries of the Trust gift and estate tax-free.

(e) Sales of assets to next generation. This can be done through either a regular installment sale, or through a Self-canceling Installment Note (SCIN). If you sell an asset to your children and take back a regular Note Receivable, the remaining balance of the Note will be includable in your estate. If the Note is a SCIN, any balance remaining at your death would be cancelled and there would be no inclusion in your estate. Both types provide large estate tax benefits, and maintain cash flow for you as the seller.

(f) Irrevocable Life Insurance Trust (ILIT). The proceeds of any life insurance policy on your life which you own are includable in your estate for estate tax purposes. An ILIT is an Irrevocable Trust to which you transfer the life insurance, and once three years have lapsed the insurance will no longer be includible in your estate. Any new policy purchased by the ILIT will immediately be excluded from your estate.

(g) Charitable Remainder Trust (CRT). A CRT is an Irrevocable Trust to which you transfer property and retain, for yourself (or other non-charitable beneficiary) an annual annuity. At the end of the Trust term, the assets remaining are distributed to one or more charitable organizations which you have specified. You will receive an immediate income tax deduction for the value of the interest ultimately passing to the charitable organizations, and the income and gains of the CRAT are only taxed when they are received as part of the annual annuity to you (or other non-charitable beneficiaries)

(h) Charitable Lead Trust (CLT). By creating a CLT in your Will, your estate would receive a charitable deduction reducing the size of your estate for estate tax purposes. During the term of the Trust, charitable organizations would receive distributions, and at the end of the term your descendants would receive the remaining balance. Essentially, you would be deferring a portion of the amount that your children would receive from your estate, and shifting the amount that would otherwise be paid in estate tax to charitable organizations.

(i) Generation-Skipping Transfer (GST) Trust. A GST trust is created by you for the benefit of your descendants. Assets held in trust would be available for your children's benefit but would pass estate-tax-free to their descendants. Each child could be the Trustee of his or her own trust, could designate the

successor Trustees, could distribute trust assets to other individuals or entities (with some exceptions) during his or her lifetime, and could determine how those assets would be distributed upon his or her death. The objective is to protect assets from any future creditors, and to reduce Estate Taxes otherwise payable by the grandchildren.

- **Elder Law and Medicaid Planning**. There have been numerous changes during the last year or so regarding available planning to preserve assets for a family when entry into a nursing home becomes likely. There have been recent Court decisions regarding the use of commercial annuities and the use of gifting under a Power of Attorney, which generally makes this planning easier. However, there are some proposed changes in the Federal Medicaid laws which if passed will severely restrict making gifts for this purpose.

- **Power of Attorney**. A Power of Attorney is a critical document. Every individual with any assets should have a Power of Attorney in place. If you were to become incapacitated without having a Power of Attorney, only a Court-appointed Guardian would have the authority to make decisions and otherwise handle your financial affairs on your behalf. A recent change in New Jersey law provides that a "General Power of Attorney" is not as "general" as it used to be. Previously, if one granted a "General Power of Attorney", then it allowed the Agent to take virtually every planning step that you could have done on your own. Now, if you wish your Agent to be able to make gifts, which is a critically important facet of estate tax planning, then your Power of Attorney must specifically contain such gift-giving authority.

- **Living Will**. A Living Will is also a critical document. It is advisable that you state your intentions regarding the maintenance or non-maintenance of artificial life support in a situation with a terminal illness and no hope of recovery. Also, it is very important that you designate a Health Care Representative in writing. If you have not done so, then, generally only a Court-appointed Guardian would have the authority to make medical decisions on your behalf.

- **Titling of Assets**. It is important that your assets be properly titled. Sometimes, having assets in joint ownership is best - but not always. Depending on the size of a married couple's estate, it may be best to have some assets separately titled in the husband's name and some assets separately titled in the wife's name.

- **Designation of Beneficiary**. It is very important that a proper beneficiary designation be implemented for your IRA or other retirement plans. The income tax and the estate tax combined could consume over 70% of your IRA.