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CLIENT MEMORANDUM

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This is a year-end review of some pertinent estate planning matters.

1. Federal Estate Tax

Year	Exemption	Tax Rate
2009	$3,500,000	45%
2010	no estate tax this year	
2011 & after	$1,000,000	55% (max.)

2. New Jersey Estate Tax

Amounts	Effective Tax Rate
$0-$675,000	0%
$675,000-$727,175	37.0% *
$727,175-$900,000	4.8%
$900,000-$1,100,000	5.6%
$1,100,000-$1,600,000	6.4%
$1,600,000-$2,100,000	7.2%
$2,100,000-$2,600,000	8.0%
$2,600,000-$3,100,000	8.8%
$3,100,000-$3,600,000	9.6%
$3,600,000-$4,100,000	10.4%
$4,100,000-$5,100,000	11.2%
$5,100,000-$6,100,000	12.0%
$6,100,000-$7,100,000	12.8%
$7,100,000-$8,100,000	13.6%
$8,100,000-$9,100,000	14.4%
$9,100,000-$10,100,000	15.2%
$10,100,000-And above	16.0%

* Note: the benefit of the exemption is lost if the estate exceeds $675,000

3. What Will happen to the Federal Estate Tax Law? The current Federal Estate Tax law is as stated above. In the absence of any new legislation, in 2011 the Federal Estate Tax Exemption will be $1,000,000. It is widely anticipated that there will be some new legislation which will take effect on January 1, 2011; but it is still an unknown as to exactly what any such new legislation will provide. This creates much uncertainty in planning, but unfortunately that is the current status. There is still the Marital Deduction, which generally means that an estate will pay no estate taxes if most of the assets are payable to or for a spouse, in which case the obligation to pay estate taxes is deferred until the "second death".

4. Three Tax Issues which are likely to be addressed with New Legislation. Some legislators wish to extend the "Bush Tax Cuts" which will otherwise expire on December 31, 2010.

a. **Estate Tax**. The current law provides that the exemption will become $1,000,000 in 2011. Many lawmakers in the Senate want to keep the exemption generally at a level of about $3,500,000. However, the great polarity in Congress means that what will happen is still quite unpredictable.

b. **Income Tax**. Currently, the top income tax rate is 35% for married couples earning more than about $375,000. If the "Bush Tax Cuts" do in fact expire on December 31, then in 2011 the highest marginal tax rate for those couples would rise to about 39.6%. For married couples earning about $100,000, if the tax cut expires then the rate would rise from about 25% to about 28%.

c. **Capital Gains and Dividends**. Under the "Bush Tax Cuts", the top rate on long-term capital gains is 15%, and the top rate on dividends is 15%. If these cuts expire on December 31, then the tax rate on long-term capital gains will rise to 20% and dividends will again be taxed as ordinary income.

5. Non-Tax Estate Planning. This is also extremely significant. It is important that your Will and estate plan be implemented so that your assets will pass to your intended beneficiaries in the amounts and

percentages, and under the appropriate terms, as intended. It is important that you provide protection for your children by using Trusts as may be appropriate; and it is important that you name the Executor and Trustee and Guardian of your choice.

6. QTIP Trust. Especially in the case of a second marriage, you may wish to provide that your spouse have the use and benefit of assets for lifetime, but further provide that any remaining assets at the time of the death of your surviving spouse should pass to your children from your first marriage. A Marital QTIP Trust is frequently utilized for this purpose. It can be very broad or very restrictive, depending on your wishes.

7. Annual Exclusion. You may make gifts of $13,000 per donee per calendar year without paying any gift taxes and without using any part of your lifetime estate tax exemption. If you are married, the $13,000 exemption is effectively doubled to $26,000. If you make a gift by check, it is important that the check clear your account by December 31st. Certain gifts to Trusts will not qualify for the annual exclusion.

8. Gifts for Tuition and Medical Expenses. In addition to the $13,000 Annual Exclusion, you may also make tax-free gifts by way of paying tuition and medical expenses for your family members. For example, if you were to pay a $25,000 tuition payment for your grandchild, that would be gift tax free, and would not use up any part of your annual $13,000 exclusion. It is important to note that any such tuition and medical payments must be made directly to the provider.

9. Section 529 College Savings Plans. You can make a contribution to a Section 529 Plan, allow the investment to grow, and all future withdrawals would be exempt from income tax so long as the distributions are used for "qualified higher education expenses". You can use five years' worth of annual gift tax exclusion when gifts are made to a Section 529 Plan in a single year. The Section 529 account is flexible in that you can change the beneficiary in the future.

10. Unified Gift and Estate Tax System. 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. Utilization of “valuation-discounting” is currently a very significant factor to be used in estate tax planning.

11. Utilizing Both Spouses’ Exemptions. If you are married, and if you were to leave all of your assets to your spouse, the net effect is that your $675,000 New Jersey Estate Tax Exemption would be wasted. Rather than leaving all of the assets to your surviving spouse, 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. The net effect is that your heirs would receive the amount of $1,350,000 on a tax-free basis, rather than receiving only $675,000 on a tax-free basis. This would result in an estate tax reduction of between $50,000 and $350,000, depending on your circumstances. This technique is *highly advisable* for any couple with assets over $675,000.

12. Titling of Assets. It is extremely important that your assets be titled in a manner which is coordinated with your overall estate plan. It is common to hold assets in joint names, but holding too many assets in joint ownership could have the effect of defeating the intended estate plan and causing unnecessarily high estate taxes for your heirs. It is important to review this matter of titling, periodically, as your estate grows.

13. Beneficiary Designations on Life Insurance and Retirement Plans must be coordinated with the overall plan involving a By-Pass Trust. For example, even if a By-Pass Trust is established by your Will, if the surviving spouse is the beneficiary of the life insurance and retirement plans then the Trust would not be utilized. The result could be unnecessarily high estate taxes being paid by the children.

14. Guardianships and Trusts for Your Children. It is very important that under your Will you appoint a guardian for your children who are under age 18. Also, it is not advisable to make any bequests outright to any child under age 18, because without other provision the monies would be held by the Office of Surrogate until the child reaches age 18. If you create a trust under your Will, then you can name a Trustee who will then manage and use the Trust for your children, which provides much greater flexibility. Also, it is frequently advisable to provide that the trust would last until your child is age 25 or 30. The following are some reasons for creating Trusts for your children:

a. Protect against your child's creditors.

b. Protect against claims of your child's spouse.

c. Provide for distribution at a more mature age.

d. Allow your child to first obtain his/her own independence.

e. Prevent the assets from being taxed as part of your child's estate.

f. Protect assets for a disabled child.

15. Generation-Skipping Transfer (GST) Tax. If you leave assets to your children, it is likely that your grandchildren will ultimately pay estate taxes on your children's estates. You can leave assets to trusts for your children and grandchildren, and thereby by-pass the estate tax at the generational level of your children, but this constitutes a GST which is potentially subject to a GST Tax of 55% (in addition to the normal estate tax of 55%). However, every individual has a GST exemption. It is important to properly utilize this GST exemption by having the appropriate provisions in your Will.

16. 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 could be $550,000. It is generally advisable to use an ILIT in order to remove the insurance from being taxed as part of your estate.

17. 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 can retain the right to the full use and benefit of the house for a certain number of years, and provide that your children would receive the house when that term of years has expired. The potentially high estate tax on your house can be very significantly reduced. Low real estate values make this technique relatively more attractive.

18. Family Limited Partnership (FLP). This remains to be a very viable technique to consolidate assets, and also to serve as a means of making gifts to your family members in a leveraged manner. Generally, leverage is obtained, because by gifting a non-voting interest the value can be discounted for gift tax purposes. For example, for a partnership which has $1,000,000 in total value, a 20% interest might be deemed to have a value of only $120,000 for gift tax purposes, by virtue of allowable discounts in valuation. Sometimes a Limited Liability Company (LLC) is used in place of a FLP.

19. Grantor Retained Annuity Trust (GRAT) and Intentionally Defective Grantor Trust (IDGT). These are techniques by which you can retain for yourself the current value of certain assets which you currently own, and transfer to your family only the future appreciation with respect to those assets. For example, you could transfer $500,000 into a GRAT or an IDGT, and provide that you would receive back the $500,000 plus a yield of 1.8% over a period of, say, 5 years. If the property were to grow at a rate higher than the 1.8%, the excess will accumulate in the Trust, and will in effect be transferred free of any gift taxes to your children.

20. Self-canceling Installment Note (SCIN). Another estate planning technique is for you to sell assets to your family members. This would provide cash flow, which could more than replace the income which you would no longer receive from those assets. 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.

21. Paying your Children as Employees is a way to shift assets to them. Generally, if the compensation is "excessive", then gift tax consequences could result. However, there are planning opportunities in this area.

22. Intra-Family Loans. In today's low interest rate environment, you may be earning only 1% or less on your investments. At the same time, your children may be paying 5% or more in interest on their mortgage loans. It would be possible for you to lend money to your children at a rate of, say, 2.5%. Then, you would be earning 2.5% on your investment rather than only 1%; and your children would be paying only 2.5% in interest costs rather than 5%. The rate could be more or less depending on the term of the loan. Proper documentation is needed for your children to be able to claim the interest deduction on their tax return.

23. Transfer of "investment opportunity". Although this is somewhat of a grey area, it is possible to transfer an investment opportunity to your children. This would involve, for example, allowing them to create and own, *ab initio*, a separate division of your business, and this business would then grow and the future value would all accrue to them directly (rather than accruing the value in your name and then attempting to gift it). If the transfer is made when the opportunity has little or no value, then essentially the

entire business opportunity and its growth will accrue in the name of your children without any gift tax consequences.

24. Power of Attorney. It is advisable that you sign a Power of Attorney granting to your spouse, or some other trusted person, the power to handle your affairs in the event that you were to become incapacitated. If needed, this would prevent an otherwise expensive and time-consuming guardianship. The Power of Attorney can be worded to take effect either (i) immediately or (ii) only in the event that you were to become incapacitated.

25. Required Minimum Distributions (RMD) from Your IRA. The amount of the RMD (in most cases) is computed by dividing the “distribution period” into the value of your account on December 31 of the prior year.

UNIFORM DISTRIBUTION PERIOD TABLE*	
Participant's Age	Distribution Period
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8
76	20.9
77	20.1
78	19.2
79	18.4
80	17.6
81	16.8
82	16.0
83	15.3
84	14.5
85	13.8
86	13.1
87	12.4
88	11.8
89	11.1
90	10.5
91	9.9
92	9.4
93	8.8
94	8.3
95	7.8
96	7.3
97	6.9
98	6.5
99	6.1

For example, if the IRA is $500,000, then the RMD for the year at age 75 is $22,936 (that is, $500,000 ÷ 21.8).

These rules dictate only the required "minimum" distribution. A participant is always free to withdraw more than the RMD.

26. IRA and Pension Planning. It is important to note that retirement plan assets are subject to *both* estate tax and income tax. For example, the estate tax might be 50%, and the remaining amount would then be taxed as ordinary income (at, say, a 33% rate) to the beneficiary. It is very important that detailed attention be given to both the estate tax planning and income tax planning for your retirement accounts.

27. 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. If you convert before December 31, 2010, you can make a one-time election to pay half of the tax with your 2011 tax return and the other half with your 2012 tax return.

In summary, if you have a significant amount in your IRA, and especially if your estate will be subject to Federal Estate Taxes, our recommendation is that an analysis be made of the potential advantages of your converting all or any portion of your current IRA into a Roth IRA. The potential benefits to your family are quite dramatic. We can prepare projections using various assumptions, which will illustrate the consequences over a period of years of (i) retaining your traditional IRA, versus (ii) converting all or any part of your IRA to a Roth IRA. If you would like to make such an analysis, please give us a call.

28. IRA for Your Child. One advantageous method of making gifts to your child would be to fund an IRA for your child (either a traditional or Roth IRA).