

New Favorable Tax Treatment for Pension Plan Beneficiaries

If you participate in a pension plan—such as a 401(k) or profit-sharing plan—and die before you withdraw all of the plan’s assets, the remaining assets will pass to a beneficiary you designate. The beneficiary pays income taxes on the plan’s assets as he or she receives them. For this reason, it’s advantageous to defer the distribution of the plan’s assets to the beneficiary for as long as possible.

The tax laws have long allowed spouses to roll over pension plan assets into an IRA and withdraw the assets over the spouse’s life expectancy. However, employers often require non-spouse beneficiaries (including trusts) to withdraw all of a plan’s assets in a lump sum after the employee’s death and pay income taxes on the entire plan balance in one year.

Now, non-spouse beneficiaries may be able to take advantage of the favorable tax treatment afforded to spouses. Beginning on January 1, 2007, any beneficiary of a pension plan may make a tax-free rollover of the plan’s assets to an IRA, and stretch out distributions from the IRA over the beneficiary’s life expectancy. This enables non-spouse beneficiaries to defer the income taxes on the inherited retirement assets until the beneficiaries actually receive them. Pension plans are not required to adopt the new rollover provisions, so you should check with your employer if you have named someone other than your spouse as the beneficiary of your retirement assets, to see if this option will be available to your beneficiary. ❖

New \$25 Surcharge for Recording Deeds

On July 1, 2008, New Hampshire will begin imposing a surcharge of \$25 on each document recorded at the registry of deeds. The maximum surcharge per transaction is \$100. Money collected from the surcharge will fund the Land & Community Heritage Investment Program (LCHIP), an independent state agency that makes grants to conserve and preserve the state’s natural, cultural and historic resources. The New Hampshire real estate transfer tax remains unchanged at \$7.50 per \$1,000 of consideration (purchase price), assessed to both the seller and buyer (\$15.00 per thousand total; or 1.5% of the purchase price). ❖

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McDonald & Kanyuk, PLLC

ESTATE PLANNING AND
WEALTH MANAGEMENT
WITH A PERSONAL TOUCH

Congress Tightens Kiddie Tax Loophole (Again!)

Over 20 years ago, Congress enacted the “kiddie tax” to close a loophole that allowed parents to shift income producing assets to their children to allow the income to be taxed in the children’s lower tax bracket. Under the kiddie tax, the child’s unearned income over a minimum amount (currently \$1,700) is taxed at the parent’s highest marginal rate. A child’s unearned income includes interest, dividends, Social Security and pension benefits. The kiddie tax also applies to the income from property in a custodial account (such as a Uniform Transfers to Minors Act (UTMA) account) established for a child.

The kiddie tax initially applied only to children who were under the age of 14. In 2006, Congress increased the age limit to 18, and beginning January 1, 2008, the kiddie tax will apply to children who are (1) 18 years old, or (2) full-time students

Federal Estate Tax Reform Update

In the summer of 2001, Congress made radical changes to the estate tax rate and exemption amount. These changes were set to last until 2010. In 2001, nine years seemed like more than enough time to gather enough support to permanently repeal the tax. But September 11th, Hurricane Katrina, the Iraq war, mounting deficits and the shift of power to the Democrats in Congress have changed the political and economic landscapes in ways that no one could have predicted just six years ago.

Now, chances of total repeal of the estate tax appear very remote. The estate tax exemption amount is now \$2 million per person, and the top tax rate is 45%. The exemption amount is scheduled to increase to \$3.5 million in 2009. In 2010, the estate tax is scheduled to disappear—only to return in 2011 with an exemption amount of \$1 million per person and a top rate of 55%. Congress must do something in the next two years to avoid the bizarre “sunset” and reappearance of the tax. The Senate appears to be pushing for “fiscal responsibility”—tax relief paid for through increases of other taxes or projected budget surpluses, not by increases in the deficit or decreases in the surplus. This will be difficult to accomplish, given the current deficit and the priority Congress has given to fixing the alternative minimum tax (AMT) and other initiatives. As seasoned observers of the Beltway, we do not expect any serious movement on wealth transfer reform until perhaps mid-2009, as our elected representatives’ feet move closer to the fire.

We will keep you posted as events unfold in Washington. In the interim, the uncertainty regarding the future of the estate tax makes keeping your estate plan up to date doubly important to ensure that changes in the law don’t create unnecessary taxes upon your death, and that your assets are distributed in accordance with your wishes. ❖

over 18 but under 24. The tax applies regardless of whether either or both parents may claim the child as a dependent.

Changes to the kiddie tax do not affect the amount that you may gift to a child without tax consequences. In 2007, you can give away as much as \$12,000 to anyone without paying a tax or filing a return to report the gift. ❖

Civil Unions in New Hampshire

Beginning on January 1, 2008, same-gender couples in New Hampshire will be able to enter into civil unions, and have the same rights, responsibilities, and obligations as married couples in the state. New Hampshire also will recognize same-gender civil unions, domestic partnerships, marriages or other formal relationships legally contracted outside of the state.

The law has broad implications for estate planning for New Hampshire same-gender couples whose unions are legally recognized in New Hampshire or another state because they will be afforded all of the rights given under our laws to married couples. For example, in the area of probate law, a survivor to a civil union has protection against disinheritance by “electing against” a deceased partner’s will, and also will receive a share of the decedent partner’s estate if there is no will. They will be given priority over other family members relating to a disabled partner’s care and property management, and the disposition of a deceased partner’s remains. Nonetheless, same-gender couples (like mixed-gender couples) should execute estate planning documents to ensure that their specific wishes are carried out upon death, rather than relying on the much more general protections afforded by the state statutes.

It is important to note, however, that the Federal “Defense of Marriage Act” prevents the extension to same-sex couples of those federal tax and social security survivors’ benefits available to married mixed-gender couples. This means, for example, that civil union partners cannot file joint federal income tax returns or take advantage of the marital deduction that allows one spouse to transfer an unlimited amount of assets to another spouse without estate or gift tax consequences. ❖

New Certainty for Special Needs Trusts

Parents and grandparents often establish and fund trusts—called “special needs trusts”—to provide for a disabled child. Special needs trusts also can be established with a disabled person’s own assets, such as the cash received as the result of an insurance settlement or inheritance. These trusts are intended to be used for the disabled beneficiary’s expenses that are not covered by government aid.

A disabled person’s eligibility for public assistance is based on financial need, and disabled individuals who are not “categorically” needy must spend down most of their assets, and their income, before they can qualify for government aid. The assets and income of a special needs trust are not intended to be counted as a resource or income of the disabled beneficiary. However, the New

Hampshire Department of Health and Human Services (HHS) recently interpreted the financial eligibility rules as requiring distributions from a special needs trust to be counted as a disabled beneficiary’s “income.” Before the Supreme Court ruled against HHS’s position earlier this year, many special needs trust beneficiaries were threatened with disqualification from receiving public assistance.

The legislature has now definitively come to the rescue. Effective November 1, 2007, distributions from a special needs trust will not count as the beneficiary’s income, and beneficiaries will no longer need to worry that the trusts will make them ineligible for public assistance. ❖

Update for Florida Snow Birds

There’s a 44 degree difference between the February average daily temperature in Naples, Florida and Concord, New Hampshire. Is it any wonder that many Granite Staters migrate each fall to the Sunshine State? You might even decide to officially change your domicile to Florida, but must be very careful to take all of the steps necessary to do so. Otherwise, you run the risk that both New Hampshire and Florida will conclude that you’re domiciled in their state. This could be very expensive (especially after your death), since it could result in claims for multiple state taxes, as well as cost extra attorneys’ and fiduciaries’ fees.

Like New Hampshire, Florida has no income tax, capital gains tax or estate tax. Unlike New Hampshire, however, Florida does not tax unearned income like interest and dividends, and Florida repealed its “intangibles tax” effective January 1, 2007. Florida also provides more generous “homestead” laws that provide both creditor protection and property tax relief for Florida residents.

Florida homestead property (up to 160 contiguous acres) is exempt from creditors’ claims, if the property is owned by a Florida resident and used as a primary residence. (In New Hampshire, \$100,000 of the equity in your home (\$200,000 if you’re married) is protected from creditors’ claims.) A second home or investment property cannot be a Florida homestead.

Florida also has a \$25,000 homestead property tax exemption. In January 2008, Florida residents will vote on a proposal to increase the tax exemption. Under the proposal, 75% of the first \$200,000 of value of a homestead, and 15% of the next \$300,000 in value, would be exempt from property taxation. If you’re a Florida resident and your primary residence is worth \$500,000, nearly \$200,000

of that value will be exempt from property tax if this “super-homestead” exemption passes. This could save \$2,000 to \$3,000 per year in property taxes.

Even if you’re not domiciled in Florida, you can take advantage of a recently-enacted property tax roll-back. Florida cities and counties are rolling back their tax rates to the levels they were at in 2002. The total tax savings will depend on where the property is located, but some cities could see as much as a 9% decrease in their tax rates. ❖

New Law Allows Continuation of Insurance Coverage After Divorce

Effective January 1, 2008, insurance companies must allow divorced or legally separated spouses to remain on the ex-spouse’s group accident and health insurance policies for up to three years or until either spouse remarries. The former spouse will be eligible for benefits under the policy without paying premiums or obtaining a medical exam. Existing state and federal laws permit an ex-spouse to extend coverage under those policies for three years after divorce, but the cost to the ex-spouse is often prohibitive. ❖

Act Now to Secure the Benefits of Expiring Tax Incentives

Tax incentives for land conservation will expire at the end of 2007. Taxpayers who donate real property interests to charitable organizations for conservation purposes can realize very significant income tax savings. In particular, taxpayers who donate land for conservation can take a federal income tax deduction of up to 50% of adjusted gross income, with a 15-year carry-forward of any unused deduction.

As we mentioned in our last newsletter, a taxpayer who is 70½ or older can contribute up to \$100,000 to a charity directly from an IRA in 2007, without first including the distribution in gross income. Under prior law, the income tax charitable deduction available for donations of IRA distributions did not completely offset the federal income tax paid on the distributed funds. A distribution from the IRA can be made to any type of charity, other than a donor-advised fund, a supporting organization, certain private foundations and “split interest” entities (for example, charitable remainder trusts, pooled income funds and gift annuities). ❖

FOR MORE INFORMATION ON ANY OF THESE TOPICS, PLEASE CONTACT JOE McDONALD, AMY KANYUK OR WARREN LAKE AT (603) 228-9900, OR VISIT OUR WEBSITE AT WWW.MCKAN.COM.

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McDonald & Kanyuk, PLLC ■ Fall 2007



McDonald & Kanyuk, PLLC
ATTORNEYS AT LAW

7 Hills Avenue
Concord, New Hampshire 03301
603.228.9900
Fax 603.228.2802
www.mckan.com

