

## Private Client Services Update

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In this issue of our Private Clients Services Update, we will discuss developments in the estate and gift tax area; a provision in the recently enacted Katrina legislation which permits unlimited charitable contribution deductions, if made, under certain circumstances by year-end; and a recent New Jersey Court decision relating to the recognition of a properly executed “Living Will”.

### **Increasing Federal Unified Credit & Annual Gift Tax Exclusion**

As you know, 2001 legislation made major changes in the federal estate tax law, including increasing the amount exempted from federal estate tax (technically known as the “applicable exclusion amount”). For decedents dying in 2005 this amount is \$1,500,000. For decedents dying on or after January 1, 2006 and before January 1, 2009, this amount will increase to \$2,000,000. In 2009 the exemption is scheduled to increase to \$3,500,000. Thereafter, as you probably know, under the “sunset” provisions of the law, the estate tax is scheduled to be repealed and then reinstated in 2011 with the exclusion amount then reverting to \$1,000,000. At this point we would not hazard a guess as to what changes might be made to the estate tax during the coming years before the scheduled reinstatement in 2011. Nevertheless, the increasing exemption should, of course, be taken into account in considering your estate plan.

In any event, although the federal estate tax exclusion will be increasing as indicated, it should be kept in mind that the lifetime gift tax exclusion remains at \$1,000,000. However, under the gift tax law, gifts made to individuals during a calendar year not in excess of the so called annual exclusion are not subject to the gift tax and do not reduce the lifetime \$1,000,000 gift tax exemption. The annual exclusion is \$11,000 per recipient for gifts made in 2005 and

will increase to \$12,000 for gifts made in 2006. There is no limit on the number of individuals to whom annual exclusion gifts may be made. For example, in 2006 a husband and wife with 3 children can each make a gift of \$12,000 to each child (a total of \$72,000) without any of the gifts being subject to the gift tax, and without affecting each of the parents' \$1,000,000 lifetime gift tax exemption.

In order to qualify for the annual exclusion, generally the gifts must be made directly. Under some circumstances gifts may be made in trust and, where minors are involved, under a custodianship arrangement. Annual exclusion gifts provide current financial assistance to the recipient free of gift tax consequences and also have the added benefit of disposing of assets which might otherwise later be subject to estate tax. Gifts for payment of certain educational or medical expenses can be made without any limitations. Gifts to "Section 529" education plans also have potential additional gift and estate tax advantages.

### **Katrina Legislation**

In response to hurricane Katrina, Congress enacted tax legislation principally designed to provide victims of the hurricane with temporary income tax relief. Included in the legislation, however, is a temporary loosening of the restrictions on charitable contribution deductions for individuals, whether or not the individual was affected by hurricane Katrina and whether or not the contribution is for hurricane relief.

In general, contributions to public charitable organizations can be deducted in a given year only to the extent they do not exceed 50% of a taxpayer's adjusted gross income for that year. Any excess over that amount is carried forward for five years. Under the Katrina legislation, the 50% limitation is removed in the case of cash donations made directly to public charitable organizations. However, the removal of the 50% limitation only applies for contributions made during the period beginning on August 28, 2005 and ending December 31, 2005. The amount deductible under this provision is reduced by any other charitable contributions the taxpayer has made that year. Generally, contributions to private family foundations do not qualify for this increased deduction, except in limited situations.

Anyone wishing to make a large charitable contribution may take advantage of the more generous income tax deductions made available by the Katrina legislation. For example, a person receiving an unusual amount of ordinary income in 2005 might use the increased charitable deduction to help offset the “tax bite” while at the same time furthering the desired charitable objective.

**New Jersey Chancery Court Decision Provides Dramatic Example of Usefulness of Living Wills – The Importance of Advance Planning**

In the Matter of A.A., An Alleged Incapacitated Person, a recent decision of the Superior Court, Chancery Division, Somerset County, New Jersey, involved an application to the Court by a clinic seeking to administer electro-convulsive therapy to a patient. The clinic obtained the consent of the patient’s daughter, who had been named as decision maker under the patient’s Living Will. Normally, electro-convulsive therapy without a patient’s specific consent requires a formal incompetency hearing and other specific procedures. Nonetheless, the Court held that the Living Will named the daughter as the decision maker for medical matters, and was executed prior to the patient’s deterioration, making the more time-consuming and cumbersome procedures unnecessary. The properly executed Living Will, together with the opinion of the patient’s attending physicians that the patient lacked decision making capacity, was sufficient to allow the daughter to authorize electro-convulsive therapy. This is a dramatic example of the importance of executing a Living Will to deal with situations where medical decisions and actions must occur promptly and with a minimum of bureaucratic red tape.

The broader lesson to be learned from the AA case is the importance of clearly spelling out your intentions with respect to property and other matters at a time when you are competent to do so. Disputes among family members and others, frequently leading to litigation, have become all too common. A properly drawn Will is, of course, of prime importance – not only for tax planning – but also to provide clear instructions as to the disposition of property following death. Similarly, in addition to a properly executed “Living Will” dealing with medical matters such as was the subject of the AA case, consideration

should be given to the grant of a durable power of attorney giving a trusted person the authority to handle your affairs in general in case you become unable to do so. These are, of course, only a few of the myriad matters that you should consider and deal with, sooner rather than later.

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