



MASTERING THE LAW



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Pension Protection Act of 2006

In August the President signed the most sweeping pension and related tax reform law in thirty years. This 900 page law covers much more than pensions. IRAs and 401(k) plans play a critical role in modern estate planning. Here are some highlights:

Taxpayer-Friendly Retirement Rules Now Permanent

2001's Economic Growth and Tax Relief Reconciliation Act ("EGTRRA") enacted many beneficial rules for retirement plans and accounts, effective only through 2010. For 2011 and beyond, the less-favorable rules would resume. The Pension Protection Act made many EGTRRA tax breaks permanent. This allows more planning certainty for retirement savers and employers. The most important EGTRRA provisions which now are permanent tax code fixtures are:

Higher maximum amounts for defined contribution retirement arrangements including simplified employee pensions and additional elective deferral contributions for participants age 50 or older.

Higher maximum amounts for SIMPLE plans and additional elective deferral contributions for participants age 50 or older.

Larger maximum annual benefits allowed under defined benefit pension plans.

Bigger maximum amounts for traditional and Roth IRAs; additional catch-up contributions allowed for account owners age 50 or older.

Roth 401(k) and Roth 403(b) arrangements, which combine some characteristics of Roth IRAs and employer-sponsored 401(k) or 403(b) plans.

The "saver's tax credit" up to \$1,000 for those with modest incomes who contribute to 401(k) plans and IRAs (subject to income-based phase-out ranges that depend on filing status). Before the Act, this credit was scheduled to expire after 2006. For 2007 and beyond, the Act mandates inflation adjustments to the income-based phase-out ranges. Thus, more individuals will be able to claim the saver's credit in future years.

More flexibility to arrange tax-free rollovers of funds between various types of retirement accounts and plans and faster vesting for employer matches of employee contributions to retirement plans.

The revised top-heavy nondiscrimination and coverage rules and revised rules for employee stock ownership plans.

The small employer tax credit for starting up new retirement plans, which is worth up to \$500 a year for three years.

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Taxpayer-Friendly College Savings Plan Rules Now Permanent

Current beneficial tax rules for Section 529 college savings plans, such as the federal-income-tax-free treatment of qualified withdrawals from such plans, also were scheduled to expire after 2010. The Act makes current rules permanent, but authorizes the IRS to issue "anti-abuse" rules to prevent use of Section 529 plans in certain tax-saving strategies such as estate tax avoidance vehicles that let grantors retain control over how funds are used.

More Beneficiaries Able to Roll Over Money from Deceased Individual's Retirement Plan

Starting in 2007, the Act lets a non-spousal beneficiary's IRA receive a tax-free rollover of a qualified distribution from a decedent's retirement plan if accomplished with a direct (trustee-to-trustee) transfer. Rollovers will also be allowed for amounts paid to a non-spousal beneficiary of a decedent's Section 403(a) annuity, Section 403(b) annuity, or governmental Section 457 plan. Once in the IRA, the rolled-over amount will fall under the required minimum distribution (RMD) rules that apply to inherited IRAs. This new provision the valuable tax-free rollover privilege to beneficiaries who are not spouses. Only direct rollovers will qualify. Because required minimum distributions must be taken as to rolled-over amounts (calculated under the rules for inherited accounts), a new IRA should be established to receive the rollovers. The timing and amount of the required withdrawals from that IRA will depend on: the age of the decedent at the time death and calculations based on the age of the beneficiary using IRS-approved life expectancy tables.

Inflation Adjustments to Phase-Out Ranges for Deductible Traditional IRA and Roth IRA Contributions.

Because of income based phase-out rules, some individuals face restrictions on IRA contributions. Beginning in 2007, the Act requires inflation adjustments to the phase-out ranges for deductible contributions to traditional IRAs (the phase-out rules only apply for years during which the taxpayer or spouse participates in an employer-sponsored or self-employed retirement arrangement) and Roth IRAs. Inflation adjustments will allow more individuals to make deductible contributions to traditional IRAs and contributions to tax-free Roth IRAs.

In 2008: Direct Rollovers from Retirement Plans into Roth IRAs Will Be Allowed

Starting in 2008, eligible individuals may make direct (trustee-to-trustee) rollovers of distributions from retirement plans into Roth IRAs. This new Roth conversion privilege applies to rollovers from qualified retirement plans, Section 403(b) tax-sheltered annuity arrangements, and governmental Section 457 plans. For 2008 and 2009, only individuals with modified adjusted gross incomes of \$100,000 or less will be eligible for Roth conversions. For 2010 and later years, the \$100,000 rule is eliminated. More individuals eventually can take advantage of the Roth conversion strategy. *(Cont'd other side)*

Direct Deposits of Tax Refunds into IRAs Allowed

Beginning in 2007, an individual may arrange for a direct deposit of all or part of a federal income tax refund into an IRA (or into a spouse's IRA if the individual files jointly). This lets more people save for retirement with less effort.)

Charitable Contributions Directly From IRA Allowed

The Act lets individuals over 70 1/2 years old contribute up to \$100,000 per year from a qualified retirement plan to public charities through December 31, 2007. Gifting in this manner is a significant opportunity to reduce the value of a taxable estate by a charitable contribution not previously permitted, but note that there is no corresponding tax deduction for making the gift.

Life Insurance and Income Tax

If life insurance provided through your job is corporate owned life insurance (COLI) and issued after August 2006, businesses generally must include death benefit proceeds (in excess of premiums paid) in taxable income (previously, such insurance income was tax free). Exceptions: if the insured was employed less than 12 months before date of death; if the death benefit proceeds are paid to buy back certain equity ownership interests; or the insured was a "highly compensated employee" (a more-than-5 percent owner, a director, or any employee ranked in the top 35 percent by pay) when the COLI contract was issued.

This brief summary can only touch on a few of the provisions of the Act that will profoundly impact those engaged in retirement and estate planning, which increasingly are inseparable endeavors. All participants in 401(k)s and other plans, or who have IRAs, should check whom they have designated as beneficiaries and determine whether, in light of the Act, new beneficiary designations are advisable. Those with taxable estates who wish to reduce the value of their estates without being taxed on IRA withdrawals, should consider making charitable contributions directly from an IRA to the charity.

Animal Enterprise Terrorism Act Passes, Goes to President

In late November the House passed by voice vote the "Animal Enterprise Terrorism Act" (S. 3880), which amends the Animal Enterprise Act of 1992. The Senate passed this bill by unanimous consent in September. The bill will now be sent to the President. The Animal Enterprise Terrorism Act clarifies that it is a crime to damage or interfere with a legitimate, legal animal enterprise. As defined by the bill, "animal enterprise" includes commercial and academic enterprises that use or sell animals or animal products for profit, food, agriculture, education, research and testing. This definition also includes equine activities such as rodeo, horse shows and similar lawful equine events. The bill expands the monetary and criminal penalties for these crimes and requires restitution for certain economic losses. The bill contains a provision noting that this bill does not prohibit expressive conduct (including picketing or other peaceful demonstration), which is protected by the First Amendment to the Constitution. To read the full text of the bill, visit <http://thomas.loc.gov> and enter the bill number, S. 3880.

*Wishing everyone a wonderful holiday season,
and health and happiness in the New Year.*

Conservation Easement Boon

The Act creates great opportunities for landowners to conserve property and realize significant federal income and estate tax savings. **The new law only applies to permanent conservation easements donated in 2006 and 2007.** A conservation easement lets landowners to donate some of their land development rights to a conservation charity such as a land trust in so as to permanently protect important natural resources on the property. A conservation easement lets the landowner continue to own, use and live on the property; sell, gift or otherwise transfer the property subject to the easement's terms; makes it easier for rural families to leave land to their children by reducing or eliminating the burden of the federal estate tax; and protect the natural areas, open space, water and rural character of the land. The new law:

- Raises the deduction a landowner can take for donating a conservation easement from 30% of adjusted gross income (AGI) in any year to 50% AGI;
- Allows qualifying farmers and ranchers with more than 50% of their gross income from agricultural activities to deduct up to 100% of their AGI; and
- Increases the number of years over which a donor can take those deductions from 6 years to 16 years.

Landowners should begin immediately to explore the application of the new law to their specific tax and land ownership situations. An attorney experienced with conservation easements can analyze the specific opportunity to use this new law for the client's advantage and represent the client in all phases of this complex transaction.

TITLING-A CRITICAL ASPECT OF ESTATE PLANNING

With careful planning, many assets can pass outside of the probate process. This usually involves proper titling or the naming of beneficiaries. "Joint tenants with right of survivorship" gives all owners a present right to the asset, and the survivors take what's left. A "payable on death to" designation on a financial asset gives the payee no present rights, but the asset passes to the payee automatically upon the owner's death. Always name contingent beneficiaries to avoid having the asset default into the probate estate, which—especially for retirement savings can have dire tax consequences.

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