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## **ROTH CONVERSIONS: A UNIQUE OPPORTUNITY IN 2010**

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) permits all taxpayers, regardless of income, to convert a traditional IRA into a Roth IRA beginning in calendar year 2010. Whether this strategy is appropriate for your situation depends on many factors including what assets are held in your IRA, whether income and estate tax rates will increase in the future, the structure of your estate plan, the amount of retirement assets you have accumulated, etc.

A Roth IRA is different from a traditional IRA in that contributions to a Roth IRA are non-deductible for income tax purposes, but withdrawals are generally income tax-free. In addition, there are no mandatory

distributions for the owner of a Roth IRA commencing at age 70½. When a traditional IRA is converted to a Roth IRA, ordinary income is recognized to the extent of the value of the assets held by the traditional IRA. If the conversion occurs in 2010, one-half of the conversion income will be automatically recognized in each of 2011 and 2012. Despite the two-year phase in, you may also recognize the entire conversion in 2010.

The advantages of converting to a Roth IRA include:

- The assets contained in the Roth IRA and any growth will be distributed tax free so long as distri-

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## **NEW MANAGED CARE REFORM LAW IN NEW YORK BENEFITS PROVIDERS**

A new act signed into law in New York in July 2009 provides new protections for physicians with respect to their relationship with managed care entities. In most cases, the provisions of the new law become effective January 1, 2010.

Some highlights of the new law include the following:

- Insurers and HMOs must now pay "clean" electronic claims

within 30 days of submission - down from 45 days under current law.

- Effective for dates of service after April 1, 2010, the period of time within which physicians may submit claims has been increased from 90 days to 120 days. Any claim submitted after the 120-day period, up to one year from the date of service, must also be paid

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## ESTATE PLANNING UPDATES

### *Estate Planning in Today's Economy*

Ironically, with real estate and securities portfolios selling at depressed values, now is the time to consider gifting assets to children and grandchildren in order to minimize estate taxes. The reason is that as the market rebounds, all of the future appreciation will be excluded from your estate, permitting you to transfer more wealth estate tax free. For example, if you bought \$10,000 of stock in ABC Corp. in 2001 that is trading at \$7,500 in 2009 and you gift it to your child this year, in five years when it is trading at \$15,000, you have effectively removed \$7,500 of assets from your estate. The same holds true for a house that has lost value but is expected to recover over time.

Instead, however, of making outright gifts, there are vehicles such as Grantor Retained Annuity Trusts (GRATs), Limited Liability Companies (LLCs) and Qualified Personal Residence Trusts (QPRTs) which permit you not only to gift assets to lower generations, but also to take discounts to reduce the amount of the gift. For example, when using a GRAT, you would transfer marketable securities to a trust which would pay you an annuity for a short period of time, usually no longer than two years. When you establish the trust, the IRS assumes you will earn a certain interest rate, which now is approximately 3%. If you earn more than 3%, at the

end of the two years, after the annuity payments have ended, the assets remaining in the trust would be distributed to your children free of gift tax.

In an LLC arrangement, you transfer real estate and/or marketable securities to the LLC and make gifts of the membership interests to children and grandchildren. It is an attractive technique because the IRS has permitted such gifts to be discounted due to the fact that membership interests are entitled to a minority interest and lack of marketability discount since they have no voting rights and they are unable to be sold to third parties.

A QPRT is a trust which owns a primary residence (or vacation house) for a period of years after

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## NEW MANAGED CARE REFORM LAW

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subject to a maximum discount of 25%.

- Insurers and HMOs may not now implement an adverse reimbursement change to a provider contract on less than 90 days' notice. If the physician objects to the proposed change within 30 days of the receipt of notice, he may terminate the contract upon the effective date of the proposed reimbursement change.

- Health plans have been restricted with respect to certain network payment practices which they previously utilized. An insurer or HMO can no longer reimburse participating hospitals in which the admitting physician is non-participating on a non-participating basis, nor can it reimburse a participating physician who sees patients at a non-participating hospital on a non-participating basis.
- The credentialing process with respect to newly admitted physi-

cians to a group has been improved. Effective for credentialing applications submitted for such physicians after October 1, 2009, the application will be presumptively deemed approved if a health plan has not acted on such application within 90 days of submission. ■

*For more information with respect to the new managed care reform law in New York, please contact Joshua S. Levine, Esq.*

## ROTH CONVERSIONS

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butions are not taken within five years of the conversion and are not taken before you attain age 59½.

- Since Roth IRAs have no Minimum Required Distributions (MRD), the assets in your Roth IRA can continue to grow tax free during your and your spouse's lifetimes. Your children will be required to take tax-free distributions over their life expectancies.
- Taxes paid on the conversion would reduce your estate for estate tax purposes.
- A trust for your spouse or children which is named the beneficiary of a Roth IRA will receive the monies from the Roth IRA tax free. If a trust were named the beneficiary of a traditional IRA, the trust would pay tax at ordinary income tax rates on the monies received from the traditional IRA.

The disadvantages of converting to a Roth IRA include:

- Accelerating the payment of tax.
- The risk that future changes in the law could negate the benefit of the conversion.
- The tax rates in effect in 2011 or 2012 will determine the amount of tax on the conversion (and those rates may be higher than current rates), unless you elect to pay the tax in 2010.
- Your state may not yet provide the same creditor protection to

Roth IRAs as it does to traditional IRAs. Please note that New York State provides the same creditor protection to both Roth and traditional IRAs.

If you do not currently maintain a traditional IRA but would like to take advantage of this unique opportunity, you may roll over all or any part of your profit-sharing plan accumulation into a traditional IRA, and then convert that IRA to a Roth IRA. This option is only available if your profit-sharing plan permits in-service distributions. Note that this option is not available for your 401(k) plan accumulations or for your accrued benefit under a Defined Benefit Plan.

The law also permits you to reverse the conversion for any reason prior to the due date for filing your tax return, including extensions. Reversing the conversion may be advisable if, for example, the assets in your Roth IRA decrease in value after the conversion. For example, if in January 2010 you convert your traditional IRA to a Roth IRA when the assets were worth \$1,000,000 (creating a tax liability of approximately \$350,000) and in April 2011 the assets in the Roth IRA drop to \$500,000, you may wish to undo the conversion since you will pay tax of

\$350,000 on assets now worth only \$500,000. To undo a conversion, you must timely notify the trustee of the Roth IRA of your intent to re-characterize the Roth IRA back to a traditional IRA and have the trustee transfer the contribution to a traditional IRA.

Also, consideration should be given to converting your traditional IRA into separate Roth IRAs to provide greater flexibility to reverse the conversion. For example, if the value of the assets in your traditional IRA is \$1,000,000, consisting of risky

investments of \$500,000 and conservative investments of \$500,000, then converting the traditional IRA into two separate Roth IRAs, one with the risky assets and the other with the conservative assets, allows you to undo the conversion of only the riskier Roth IRA if those assets decline in value, while leaving the other Roth IRA in place.

The decision to convert your traditional IRA into a Roth IRA should be made only after consultation with your tax advisors. ■

*Please contact Robert B. Danziger, Esq. or William Miller, M.S.P.A., M.A.A.A., COPA if we can provide assistance.*

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## ESTATE PLANNING UPDATES

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which the house is distributed to the children. Again, the IRS uses certain actuarial tables to permit a discount of the gift of the house to the QPRT because the children will not receive the property for a number of years. For example, if a 60 year old transferred a \$1,000,000 house to a QPRT which permitted her to live in the house for ten years, the amount of the gift would be \$600,000 (which is equal to the present value of \$1,000,000 ten years from now). The benefit of the QPRT is that the amount passing to the children will be the full \$1,000,000 (or more since it will hopefully appreciate) even though the amount of the gift reportable to the IRS is \$600,000 which results in removing \$400,000 (or more) from the estate.

Stock in a closely-held business can receive the same discount treatment if it is an S Corporation. The only caveat with an S Corporation is that the stock must be recapitalized into voting and non-voting stock first. Then, the owner can gift the non-voting stock and discount the value of the gift of non-voting stock for the same minority interest and lack of marketability reasons as previously described.

A significant factor to consider when gifting is that the recipient

is receiving the donor's cost basis for capital gains purposes. In other words, if you bought a house for \$250,000 and you transfer it to a ten-year QPRT, if the children decide to sell the house at the end of the ten years for \$1,500,000, they will pay capital gains tax on the difference between \$1,500,000 and \$250,000.

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Instead, if you held the house until death, the cost basis that your heirs will use is stepped-up to the date of death

value of the house. So, even though you bought the house for \$250,000, if you do not use a QPRT and own the house until death and your heirs decide to sell it for \$1,500,000, they will pay zero capital gains.

This is important to consider because as the estate tax exemption has increased to \$3,500,000 in 2009 and asset values have fallen significantly, the techniques discussed above may not be necessary (and may even be disadvantageous) since, by using properly drafted Wills and trusts that take advantage of the \$3,500,000 estate tax exemption by creating "credit-shelter trusts", you can shelter up to \$7,000,000 of assets from estate tax without using these advanced options. Also, Congress is considering eliminating or reducing the effectiveness of the

GRATs and LLCs, so any interest in these techniques should be acted upon immediately.

### ***Powers of Attorney, Health Care Proxies and Living Wills***

In the past year, a number of clients have had experiences in which they were grateful they executed powers of attorney, health care proxies and living wills. As you might recall, a power of attorney permits you to name someone to make financial decisions for you while a health care proxy permits you to name someone to make health care decisions for you. The living will is a statement by you that you do not wish to have life prolonged if you are terminally ill. Please make sure you have them available so that your spouse and/or family can find them if needed.

Regarding powers of attorney, you might have read that effective September 1, 2009, New York has revised its form. Please note that all powers of attorney executed before September 1, 2009 are grandfathered and do not need to be updated. ■

*Please call Michael Markhoff, Esq. to discuss any of these estate planning issues.*

This publication is intended for general information purposes only. It is not intended to constitute individual legal advice to any specific client.

## CASH BALANCE PLANS: HOW TO INCREASE YOUR TAX-DEDUCTIBLE PLAN CONTRIBUTIONS

A “Cash Balance Plan” is the integral component of an innovative retirement plan design which allows you to make substantially larger tax-deductible contributions than those permitted under profit-sharing and similar defined contribution plans (DC Plans). Cash Balance Plans provide for easily understandable individual account balances. Each plan participant has his own account balance that is credited annually with a contribution and a specified rate of return.

Ideal candidates for Cash Balance Plans are businesses with several owners of different ages. In a Cash Balance Plan, similar or varying contributions can be made on behalf of each owner independent of their ages, so that each owner will know the exact amount of the contribution attributable to him.

When a Cash Balance Plan is combined with a DC Plan, the combination of the two plans gives the business owner both an increased tax deduction and a substantial amount of flexibility as to each year’s contributions.

The Table below illustrates how you can make an increased tax-deductible plan contribution to a Cash Balance Plan (see row D) even after contributing the maximum \$49,000 to a DC Plan. (Row A plus Row B equals the maximum \$49,000).

The Table shows one example of an allocation maximized for the owner; the assumption is that the staff contribution will be as low as IRS rules permit.

Type of Plan or Plan Feature		Contribution Amount
A.	Profit-Sharing Plan – Employer Discretionary Contribution	\$32,500
B.	401 (k) Salary Reduction Plan - Employee Discretionary Contribution	\$16,500
C.	Additional “Catch-Up” - [Participant over Age 50]	\$ 5,500
D.	Cash Balance “Add-on” Plan - [On top of Employer’s DC Plan]	\$43,450
E.	Total Contribution: Participant under Age 50 [A+B+D]	\$92,450
F.	<b>Total Contribution:</b> Participant over Age 50 [A+B+C+D]	<b>\$97,950</b>

When a business owner needs a substantially larger tax deduction, a stand-alone Cash Balance Plan is the answer. Depending on the business owner's age, contributions can range from \$75,000 to \$200,000 (or more) each year. Such plans require very careful analysis and preparatory actuarial studies. The most important factor is to ensure that the cost for covering the staff does not outweigh the benefit of the plan to the business owner. A thorough analysis of the employee data combined with creative planning concepts often result in a successful outcome for the business owner. Obviously, it would be foolhardy for a business owner to think of proceeding without the benefit of such an in-depth analysis.

Proper design, implementation and administration of Cash Balance Plans can dramatically increase contributions on behalf of business owners. The increases range up to an additional \$40,000 (or more in many cases), even when they are already fully funding contributions under their existing DC Plans. The increases can even be up to \$200,000 (or more) when a stand-alone plan is used. If you want to make a plan contribution for yourself in excess of \$49,000, a Cash Balance Plan is the answer. ■

*If you have any questions regarding Cash Balance Plans, please contact Ira Langer, Esq. or Andrew E. Roth, Esq.*