

DANZIGER & MARKHOFF LLP

Fall 2006

Danziger & Markhoff LLP
123 Main Street
White Plains, NY 10601

Telephone 914.948.1556
Fax 914.948.1706
www.dmlawyers.com

In this issue:

New Pension Protection Act Makes Far-Reaching Changes	1
Estate Planning: New Laws and The Need to Review Old Wills	1
Building Skills in New York State – New Workforce Training Grants	2
Sales of Stock to ESOPs Provide Significant Tax Benefits	3
New Pension Accounting Standard Issued	3
Roth 401(k)s are Here to Stay!	4
In Our Firm	4

New Pension Protection Act Makes Far-Reaching Changes

President Bush recently signed into law the Pension Protection Act of 2006 (the “Act”). While the Act was initially publicized as merely strengthening funding requirements to protect pension benefits, in reality it is far reaching and significantly alters the retirement plan landscape. The Act amends a multitude of provisions in the Internal Revenue Code and ERISA, thereby changing fundamental rules governing pensions, 401 (k)s and other types of retirement plans.

With this newsletter we begin a series of communications to our clients and friends that will highlight important changes that could impact you. Many provisions of the Act have deferred effective dates, which will give us the opportunity to discuss various changes in later communications. In this issue, we discuss two important new plan benefit distribution rules.

Rollovers by Non-Spouse Beneficiaries

Under prior law, if a plan participant died before receiving his full plan benefit and had designated his spouse as the plan beneficiary, the spouse could roll over the participant’s benefit into the spouse’s IRA, thereby deferring tax. However, if a child, a trust or some other person was the designated beneficiary, that non-spouse beneficiary could not roll over the plan benefit.

This rule created problems in at least two different situations. First, if the business that maintained the plan was discontinued after the death of the business owner, the business’s qualified plan would ordinarily be terminated and benefits fully distributed to the beneficiary. If the beneficiary was not the spouse, the beneficiary was hit with

(Continued on page 2)

Estate Planning: New Laws and The Need to Review Old Wills

We recommend that your Wills be reviewed at least every 5 years because economic and /or family situations have probably changed in that time period. The following are some reasons to review your estate plan with us.

1. Are the executors under your Wills, trustees of your trusts and guardians of your children still able and willing to serve? The individuals whom you initially named may not be appropriate

due to advanced age or lack of a continuing relationship with you and your family. Perhaps your children are now mature enough to handle this responsibility, or if there is acrimony among the family members, a bank or trust company may be a better choice.

2. The single most important concern for many of our clients who have married children is that their assets not

(Continued on page 4)

Building Skills in New York State – New Workforce Training Grants

Building Skills in New York State (“BUSINYS”) is a new workforce training grants program administered by the New York State Department of Labor.

BUSINYS grants of up to \$50,000 per year are available to businesses located in New York State with at least four employees. The grants are available for training existing employees in the following areas: Information technology, healthcare,

management/leadership, process improvement and customer service. For example, a physician could apply for a grant to pay for the cost of hiring a consultant to teach his employees billing and coding skills. Training must be done on company time.

In order to be eligible, businesses must complete and submit an online application and should expect to receive a response in no later than

four to six weeks. If approved, contract payments will be made on a reimbursable basis.

Additional information, including the online application itself and the answers to frequently asked questions, is available at the program’s website, www.workforcenewyork.org. ■

Please do not hesitate to call Joshua S. Levine, Esq. with any questions about these new grants.

New Pension Protection Act

(Continued from page 1)

a substantial income tax and lost the opportunity for further tax deferral. Second, even if both the business and the plan continued after the death of the participant, if the plan did not provide for installment payments and only allowed lump sum distributions, a non-spouse beneficiary had to pay taxes on the full benefit soon after the participant’s death.

The Act changes this rule, effective as of January 1, 2007, to allow non-spousal beneficiaries to directly transfer plan benefits to a separate IRA established for this purpose. As a result, participants can now continue to accumulate their benefits in a pension or profit sharing plan and have full confidence that upon their death, their beneficiaries (whether spouses or not) will have an opportunity to defer taxes by use of the “direct transfer to IRA” provision, even if a lump sum plan distribution must be made from the original plan.

IRA Distributions to Charity

Another distribution rule change applies to IRAs (but not pensions and other qualified plans). Under the Act, someone who has an IRA may now direct that distributions be made directly from the IRA to a charity on a tax-free basis. This rule – which applies only to distributions made in 2006 and 2007 - is subject to certain limitations. First, there is a \$100,000 cap per taxpayer, per taxable year. Second, the distribution must be to a tax-exempt charitable organization that is not a private foundation or a donor-advised fund. Third, the distribution must be made after the IRA owner has reached age 70½.

Distributions that satisfy the above requirements are excludable from the IRA owner’s gross income and count towards satisfying the IRA owner’s required minimum distribution requirements that apply after you reach age 70½. Thus, a charitably inclined IRA owner may make an IRA qualified charitable distribution in an amount equal to his Minimum Required Distribution for that year and will be considered to have satisfied his mini-

mum distribution requirement without having to increase his adjusted gross income for the year and without having to pay any taxes on the distribution. Of course, since the IRA charitable distribution is not included in the IRA owner’s income, it does not also create a tax deduction.

The benefit of this new provision is that a regular charitable contribution, using the taxpayer’s personal funds, is subject to various deduction limitations that typically hit wealthy individuals who are in a high tax bracket. Utilizing the IRA charitable distribution technique discussed above avoids all of these limitations.

Individuals who wish to take advantage of these new rules must exercise care to avoid possible pitfalls. ■

We encourage you to contact Ira Langer, Esq., Andrew E. Roth, Esq. or Jay Fenster, Esq. if you have any questions concerning these topics or other issues relating to the Act.

Sales Of Stock To ESOPs Provide Significant Tax Benefits

Employee Stock Ownership Plan ("ESOP") transactions provide significant tax benefits for the owners of closely-held businesses. One of the principal tax benefits of an employee stock ownership plan ("ESOP") transaction is that it permits the seller of stock in a privately held C corporation to defer recognizing gain that would otherwise be recognized as long-term capital gain from the sale of his stock. Under current tax rates, that translates into combined federal and New York tax savings of approximately 20%. Although capital gains rates are at historically low levels, a twenty percent tax bite on, say, a gain of \$5 million would still produce a tax of \$1 million which is a significant amount in absolute terms.

In order for the sale to qualify for this special tax treatment, the selling shareholder must have held his company stock for a minimum of three years prior to the sale. In addition, after the transaction the ESOP must hold at least 30% of the company's stock. Thus, for example, on an initial ESOP transaction the seller must divest himself of at least 30% of the company stock but on a subsequent sale to the ESOP, there is no minimum amount that must be sold since the ESOP already has a 30% stock holding.

One of the most important requirements to qualify for tax deferral is

that generally within one year of the sale transaction, the seller must re-invest the sales proceeds of the ESOP sale in qualified replacement property ("QRP"), defined as stocks and bonds of U.S. operating corporations; it does not include U.S. Treasury bills and notes, savings bonds, state and municipal bonds, other governmental obligations, certificates of deposit, or mutual funds. Most U.S. company equities and fixed income instruments will qualify as QRP.

Assuming that the seller has made a valid election and has otherwise complied with all applicable requirements, the seller will defer the tax on the sale of his company stock to the ESOP until such time as he sells or otherwise disposes of the QRP. However, a transfer of the QRP by gift or by reason of death will not accelerate the deferred gain.

It should be noted that a seller of stock who takes advantage of the tax-deferral benefit of selling to an ESOP cannot participate in the ESOP. There are attribution rules which also prohibit family members of the seller from so participating. Usually the tax benefit of deferring capital gains from a sale to an ESOP substantially outweighs the lost opportunity of not participating in an ESOP, particularly in a company with a large employee base where the amount contributed to an

owner's account would be limited to his percentage of total employee pay and with the contribution on his behalf capped at IRS limits (currently \$44,000).

As mentioned above, the tax deferral benefit is limited to the sale of stock in a C corporation. Nonetheless, it is possible for an S corporation to convert to C status prior to the sale in order for the owner to take advantage of the tax-deferral. Although the corporation would then have to continue as a C corporation for at least five years before reverting back to S status, during that C corporation period the substantial tax deductions provided by the Company's contributions to the ESOP will substantially reduce the Company's taxable income thereby reducing the disadvantage of losing S status (of course there may be other tax considerations which must be examined before converting between "S" and "C" status).

Danziger & Markhoff LLP is actively involved in structuring and negotiating ESOP transactions for the benefit of owners of closely held businesses. We have found that in many cases the tax-deferral advantages summarized above are a major motivating factor for our clients to engage in ESOP transactions. ■

Please contact Stanley E. Bulua, Esq. or Jay Fenster, Esq. for additional information.

New Pension Accounting Standard Issued

At the end of September, the Financial Accounting Standards Board (FASB), which sets rules governing financial statements, issued FASB Statement Number 158. This Statement amends various prior FASB statements relating to accounting for pension plans and post-retirement benefit plans. FASB 158 will require employers maintain-

ing such pension and benefit plans to immediately recognize various gains and losses of the plans, and to recognize market value of the plan assets on their balance sheets. While publicly traded companies must comply for fiscal years ending after December 15, 2006, non-publicly traded companies are not required to comply until fiscal years ending after

June 15, 2007 (therefore, for calendar year employers, the year ending December 31, 2007), a welcome extension. Danziger & Markhoff LLP can assist plan sponsors in understanding how the FASB Statement impacts their financial situation. ■

Please contact Ira Langer, Esq. for further information.

Estate Planning: New Laws and The Need to Review Old Wills

(Continued from page 1)

pass to their son-in-law and/or daughter-in-law if the children die or are divorced. Instead of leaving your estates outright to your children, you should consider leaving your assets in trust for the lifetime of your children (also known as generation-skipping trusts). The children can live off of the income and principal for their lifetimes and, when they die, the remaining principal can pass to their children (your grandchildren). In essence, this permits you to “dictate from the grave” where your assets will go.

3. Divorce requires a review in order to coordinate changes in your Will as

well as your retirement plan and life insurance beneficiary designations. If you have remarried, you should consider leaving your inheritance in trust for your spouse. The virtue of a trust is that your spouse can live off of the income, but upon your spouse’s death, the remainder principal of the trust will be distributed to your children or any other beneficiary you choose.

4. Presently the federal estate tax exemption is \$2,000,000. If your assets exceed this amount, you should consider revising your Will to create a “credit shelter trust” for your spouse. Also, if you have purchased a life insurance policy since we last met, we should discuss transferring

the policy to an irrevocable trust in order to remove the policy proceeds from estate tax.

5. If you have acquired real estate outside of the state where you reside, it may be appropriate to transfer the property to a limited liability company (“LLC”). The virtue of the LLC is that it serves to protect the real estate from creditors and, as a side benefit, it will pass to your beneficiaries without the added expense of a second probate. ■

If you have any questions about your estate plan, please call Michael Markhoff, Esq. or Stanley Bulua, Esq.

Roth 401(k)s Are Here To Stay!

While some companies and other businesses have been somewhat slow to consider amending their 401(k) plans to add Roth 401(k) contribution provisions, those that have are finding the new provisions very popular. According to a recent survey, nearly a quarter of employees who were newly enrolling in a 401(k) plan chose the Roth version when available. Roth 401(k) contributions are made with after-tax dollars, but funds – including all investment in-

come – are completely tax free when withdrawn, provided the account has been held for at least five years and the investor is at least age 59½. Roths can also be structured so that no minimum annual distributions need to begin at age 70½. Consequently, a Roth’s tax free buildup can continue for a substantially longer period of time than with a traditional 401(k).

Roth 401(k)s were originally sched-

uled to expire at the end of 2010. However, the recently passed Pension Protection Act of 2006 eliminates the 2010 sunset provision. As a result, Roth 401(k)s are now an attractive long-term tax savings program that you should consider. ■

Feel free to call Ira Langer, Esq., Jay Fenster, Esq., or Andrew E. Roth, Esq. to discuss implementing the Roth 401(k) provisions for your business enterprise.

In Our Firm

Expanding Our Offices

Our pension department has been expanding the services it provides to our clients, including representing clients in ESOP transactions, advising clients on Non-Qualified Deferred Compensation arrangements and providing a broader spectrum of actuarial services. To accommodate our additional staffing needs, we have taken additional space at our current location. We are excited about the new space, which we expect to be ready by the end of the year. When you next visit our office, please allow us to give you a tour.

Let us know if you would like to receive future issues of our newsletters by e-mail. All we need is your e-mail address. Please either fax your request to our office, attention: Paula Peck at (914) 948-1706 or e-mail Ms. Peck at Ppeck@dmlawyers.com.

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