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Whither the Estate Tax?



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The shift in Congressional power resulting from the 2006 elections has ushered in another round of prognostication concerning the future and scope of the estate tax.

Current Law. Under current law, the estate tax applicable exclusion amount is set to remain at \$2 million through 2008, and then increase to \$3.5 million in 2009. The estate tax is then set to be repealed in 2010 (for one year only). In 2011, the estate tax is to be reinstated with an exclusion amount of only \$1 million. The top estate tax rate is 46% for persons dying 2006, and then 45% for decedents dying in 2007 through 2009. In 2011, when the estate tax is reinstated following the one-year repeal, the top rate is set to be increased to 55%.

Potential Changes. The results of the 2006 elections make it more likely that the estate tax will not be repealed in 2010. Many believe that the current estate tax laws will remain intact through 2009, and that any reforms will take effect beginning in 2010. The extent of these potential reforms is not yet clear, however.

The estate tax features of the so-called “Trifecta” bill, which was narrowly defeated last summer, may hold clues as to the future of the estate tax. Under that bill, the estate tax exclusion amount would have increased from \$3.5 million to \$5 million from 2009 through 2015. That proposal also called for dramatic reductions in the top estate tax rates.

Although it did not receive the 60 votes in the Senate necessary to avoid filibuster, many Democrats voted for the Trifecta bill, and its parameters may be the beginning point for future proposals.

Planning Implications. Married couples may be particularly affected by future changes in the estate tax laws.

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The Pension Protection Act Of 2006 – More Than Just Pensions



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On August 17, 2006, President Bush signed into law the

Pension Protection Act of 2006 (the “PPA”). While adding many new provisions relating to pension plans, the PPA also affects the income tax charitable contribution deduction. The most notable provisions of the PPA that relate to the income tax charitable contribution deduction are as follows:

(1) Charitable Contributions from an IRA by Taxpayers Aged 70-1/2 and older. Under the PPA, taxpayer’s who are 70-1/2 or older may make charitable contributions to certain charities of up to \$100,000 a year directly from their traditional or Roth IRAs. Although these taxpayers may not take a deduction for the contribution, the taxpayer may exclude the IRA distribution from his or her taxable income, thus creating a “wash” for the taxpayer. A tax wash is more

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Married clients often include provisions in their documents that divide the first spouse's assets into a "credit shelter" trust and a "marital trust," the former being funded with assets equal to the then-current exclusion amount. The credit shelter trust is protected from estate tax, and often benefits the surviving spouse and the couple's children while the surviving spouse is living. The marital trust is held exclusively for the surviving spouse in order to qualify for the estate tax marital deduction. Dividing assets in this fashion makes it possible to avoid all estate taxes at the first death, and protects both spouses' exclusion amounts from tax.

If the exclusion amount is increased, more assets will flow to the credit shelter trust, and less to the marital trust. If the surviving spouse and the couple's children all are to share in the benefits of the credit shelter trust, to reduce disagreements it will be important to set forth clearly the extent of each beneficiary's interest in that trust during the surviving spouse's lifetime.

A particularly compelling feature of the "Trifecta" bill was a provision permitting a surviving spouse to take advantage of a deceased spouse's unused exclusion amount. If this proposal is enacted, or if the exclusion amount is increased significantly, it may no longer be necessary to divide the first spouse's assets into trusts for tax purposes. Thus, many married couples may choose to simplify their documents.

Conclusion. In the face of these proposed changes, regular reviews of estate plans will be required. ■

beneficial to a taxpayer because the tax benefit of the charitable contribution is not subject to the normal limitations relating to the taxpayer's adjusted gross income. This new tax benefit will only be available for tax years 2006 and 2007.

(2) New Penalties for Misstatements of Value. Taxpayers are subject to penalty taxes if they underpay their income taxes as a result of an overvaluation of property. The amount of the penalty depends on whether the overvaluation is a "substantial valuation misstatement" or a "gross valuation misstatement"; the penalty being greater if there is a gross valuation misstatement.

The PPA lowers the threshold for determining whether there is a "substantial valuation misstatement" or a "gross valuation misstatement." (The PPA also lowers the threshold for imposing penalties on misstatements of value for estate and gift tax purposes.)

Furthermore, the PPA provides that a taxpayer can no longer rely on a qualified appraisal performed by a qualified appraiser to avoid the penalty for a gross valuation misstatement. However, a qualified appraisal performed by a qualified appraiser may still be relied on to avoid a penalty for a substantial valuation misstatement, but the PPA adds more stringent requirements for qualifying as a qualified appraiser. The PPA also adds a provision that imposes a penalty on certain appraisers whose appraisals lead to substantial or gross valuation misstatements.

The new rules are effective for returns filed after August 17, 2006. (For individuals who file calendar year returns, the new rules are effective beginning January 1, 2007.)

(3) New Record Keeping Requirements for Contributions of Money, Clothing, and Household Items. The PPA requires that a taxpayer maintain a bank record or a written communication from the charity showing the name of the charity and the date and amount of the contribution in order to deduct a charitable contribution of money. (Under prior law, only contributions in excess of \$250 required substantiation.) Furthermore, the PPA requires clothing and household items be in at least "good used condition" to deduct a charitable contribution of such items. However, the deduction may be denied if the items have minimal monetary value. For individuals who file calendar year returns, the new rules are effective beginning January 1, 2007.

(4) Charitable Contributions of Fractional Interests in Tangible Personal Property. In order to deduct a charitable contribution of a fractional interest in tangible personal property, the PPA requires that a taxpayer own all interests in the property before the contribution is made. However, the PPA provides that the amount deducted will be recaptured (i.e., included in the taxpayer's income, thus causing the taxpayer to lose the benefit of the previous deduction) if, during the 10 year period following the

contribution (or at the taxpayer's death, if earlier) either (1) the taxpayer fails to contribute the remaining fractional interests in the property, (2) the charity at any time does not have substantial physical possession of the property, or (3) the charity at any time fails to use the property for a purposes related to its exempt purpose. If the taxpayer's deduction is recaptured, the amount included in income will also be subject to a 10% penalty tax.

If the taxpayer's deduction is not recaptured, the PPA provides that the when the taxpayer later contributes the remaining fractional interests in the property, the taxpayer's deduction is limited to the lesser of the fair market value of the remaining fractional interests at the date of the later contribution or the fair market value of the remaining fractional interests at the date of the initial contribution.

For individuals who file calendar year returns, the new rules are effective beginning January 1, 2007. Furthermore, these new restrictions also apply to the charitable contribution deduction for gift and estate tax purposes.

(5) New Consequence if Tangible Personal Property is Not Used for Charity's Exempt Purpose. Generally, if a taxpayer makes a charitable contribution of tangible personal property and the property is related to the charity's exempt purpose, the taxpayer may deduct the fair market value of the property (subject to the normal limitations relating to the taxpayer's adjusted gross income). However, the PPA provides that if the charity disposes of the property in the year that the taxpayer contributes the property, the taxpayer may only deduct his or her basis in the property. Furthermore, the PPA provides that if the charity disposes of the property within three years of the contribution, then in the year of the disposition, the taxpayer must include in income the excess of the amount of the deduction previously taken over the taxpayer's basis in the property.

However, the PPA allows a taxpayer to avoid these harsh results if an officer of the charity certifies in writing and under penalties of perjury that the property is related to the charity's exempt purpose and either such disposition is in accordance with such use or such use has become impossible or infeasible.

These new rules are effective for charitable contributions made after September 1, 2006.

(6) New Restrictions on Charitable Contributions to a Donor-Advised Fund. The PPA provides that a taxpayer may not take a charitable contribution deduction for contributions to a donor-advised fund unless the fund's sponsoring organization is a charity and the sponsoring organization provides the taxpayer with a contemporaneous written acknowledgement that the organization has exclusive legal control over the assets contributed.

These new rules are effective for contributions made after 180 days following August 17, 2006. These new restrictions also apply to the charitable contribution deduction for gift and estate tax purposes. ■

Estate Taxes on a Payment Plan: Qualification of Real Estate Investments



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Selling the
family business

usually is the solution of last resort when a family is faced with insufficient liquidity and the requirement of paying estate taxes nine months following the death of a family member. Fortunately, in a rare instance of altruism, the IRS has recognized and addressed this hardship by amending Section 6166 of the Internal Revenue Code with respect to real estate holdings.

Section 6166 of the Code provides that the executor of an estate may elect to pay estate taxes attributable to the value of a closely held business in up to ten equal installments (at an interest rate as low as 2%) if the value of the business interest exceeds 35% of the decedent's gross estate after deductions. In addition, the first tax payment (but not the interest) is deferred for five years.

An "interest in a closely held business" includes (i) an interest as a proprietor in a sole proprietorship, (ii) at least a 20% interest as a partner of a partnership or any partnership with 45 or fewer partners; and (iii) at least a 20% voting interest as

a shareholder of a corporation or any shareholder interest in a corporation with 45 or fewer shareholders. If the decedent owned interests in multiple closely held businesses, and if each of them qualified as an "interest in a closely held business" under the foregoing rules, then those interests are aggregated for purposes of the 35% requirement. However, under §6166, passive assets are not considered "interests in a closely held business."

For years, it has been unclear whether real estate holdings are eligible for §6166 treatment or instead are disqualified as mere passive investments. In a recently issued ruling (Rev. Rul. 2006-34), the IRS concluded that when evaluating a real estate business to see if §6166 treatment is available, in addition to considering all the facts and circumstances (e.g., the activities of agents and employees, management companies, and the decedent's ownership interest in any management company), the following nonexclusive list of factors also will be considered: (i) the amount of time the decedent (or employees of the decedent or entity) devoted to the business; (ii) whether an office was regularly maintained from which the activities of the decedent or entity (or employees of either) were conducted or coordinated; (iii) the extent to which the decedent (or employees of the decedent or entity) was actively involved in leasing activities; (iv) the extent to which the decedent (or employees of the decedent or entity) provided services other

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Twenty-One Trenam Kemker Lawyers Named to Best Lawyers in America 2007

Trenam Kemker is pleased to announce that twenty-one of our lawyers have been named by their peers to the 2007 edition of The Best Lawyers in America. Two Trenam Kemker lawyers are included for the first time, joining several Best Lawyers veterans as leading attorneys in the nation.

The following lawyers were recognized in their respective practice areas:

1. **Thomas D. Aitken** - Trusts and Estates
2. **J. Alan Asendorf** - Real Estate Law
3. **Marvin E. Barkin** (20) - Bet-the-Company Litigation; Commercial Litigation
4. **David R. Brittain** - Real Estate Law
5. **Robert H. Buesing** - Commercial Litigation
6. **Nelson T. Castellano** (*) - Securities Law
7. **Roberta A. Colton** (10) - Bankruptcy and Creditor-Debtor Rights Law
8. **Stanley H. Eleff** - Construction Law
9. **William C. Frye** (10) - Bet-the-Company Litigation; Commercial Litigation
10. **Michael P. Horan** - Bankruptcy and Creditor-Debtor Rights Law
11. **Richard O. Jacobs** - Health Care Law
12. **Richard M. Leisner** (20) - Corporate Governance and Compliance Law; Corporate Law; Securities Law
13. **Harold W. Mullis, Jr.** (10) - Corporate Law; Tax Law
14. **Albert C. O'Neill, Jr.** (20) - Tax Law
15. **Mary H. Quinlan** (*) - Real Estate Law
16. **Richard H. Sollner** - Real Estate Law
17. **Gary I. Teblum** (10) - Corporate Governance and Compliance Law; Corporate Law; Leveraged Buyouts and Private Equity Law; Securities Law
18. **John S. Vento** - Construction Law
19. **Roberta Casper Watson** (10) - Employee Benefits Law
20. **Don B. Weinbren** - Health Care Law
21. **William Knight Zewadski** (20) - Bankruptcy and Creditor- Debtor Rights Law

(*) Denotes First Year Listed

(10) Denotes Listed for at least 10 Years

(20) Denotes Listed for at least 20 Years

Employer-Owned Life Insurance – A New Tax Trap For The Unwary



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Neatly tucked away among the provisions

of the Pension Protection Act of 2006 lies new Internal Revenue Code Section 101(j), which applies to Employer-Owned Life Insurance (“EOLI”) policies issued after August 17, 2006. This draconian statute provides that, as a general rule, when an employer* receives death proceeds (directly or indirectly) from an EOLI policy insuring the life of any employee, the policy proceeds will be treated as **ordinary income to the employer**, except to the extent of premiums and other amounts paid by the employer for the policy.

Therefore, unless one of the exceptions to the general rule (discussed below) applies, **and** unless proper **notice and consent** are given **prior to the issuance** of the policy, the proceeds of, e.g., “key man” policies and policies used to fund a stock redemption that are received by the employer, less the policy premiums, will be taxed as ordinary income to the employer.

Notice and Consent Requirements

Under the notice and consent requirements, **before** an EOLI policy is issued, the following conditions must be met:

(1) the “employee” (defined to include an officer, director or highly compensated employee) must be notified in writing that the employer intends to insure the employee’s life, and the notice must state the maximum face amount for which the employee could be insured at the time the contract is issued;

(2) the employee must provide the employer with written consent to being insured under the contract, and that the employer may continue the coverage after the employee terminates employment; and

(3) the employee must be informed in writing that the employer will be a beneficiary of any death benefits.

Exceptions for EOLI with Respect to Certain Insureds or Beneficiaries

If all of the notice and consent requirements are met, and if one or more of the following exceptions apply, the death proceeds received by the employer from an EOLI policy will be income tax-free.

First exception: the insured was an “employee” (as defined above) of the employer at **any time during the 12-month period before his or her death**.

Second exception: the insured was, **at the time the policy is issued**, with respect to the employer, either:

- (1) a director,
- (2) a 5% owner at any time during the preceding year,
- (3) an individual who received

compensation in excess of \$95,000 (adjusted in the future for inflation) in the preceding year,

(4) one of the 5 highest-paid officers, or

(5) among the highest-paid 35% of all employees.

Third exception: the **policy proceeds** are income tax-free to the extent that they are paid to:

(1) a member of the insured’s family (within the meaning of Code Section 267(c)(4));

(2) any individual who is the designated beneficiary of the insured under the policy (other than the employer);

(3) a trust established for any such family member or designated beneficiary; or

(4) the estate of the insured; or

(5) the proceeds are used to purchase an interest in the employer from any of the persons or entities described in (1) through (4).

Reporting Requirements

Employers who own any EOLI policies issued after August 17, 2006 are required to file an annual report with the IRS for each year the policies are owned. (Code Section 6039I).

*Although the statute uses the term “applicable policyholder,” for convenience, the term “employer” is used for the purposes of this article. The term “applicable policyholder” includes the insured employee’s employer and certain persons or entities related to the employer. ■

than leasing services; (v) the extent to which the decedent (or employees of the decedent or entity) personally made, arranged for, or supervised maintenance and repairs; and (vi) the extent to which the decedent (or employees of the decedent or entity) fielded tenant requests or complaints.

As seen from this list, the more the owner personally participates in the day-to-day operations and management of a real estate investment business, the more likely that business will be treated as an "interest in a closely held business" for purposes qualifying for the IRS' estate tax "payment plan." ■

Annual Intangible Personal Property Tax Repealed



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The Florida annual intangible tax has been repealed, effective January 1, 2007.

Accordingly, Florida residents will no longer be required to file intangible tax returns that would have been due after 2006.

Many individuals had previously established special short-term irrevocable trusts at the end of each year to prevent the imposition of the annual intangible tax. These trusts will no longer be necessary.

The repeal completes a phase out of the annual intangible tax that had taken place over the last several years. Prior to the repeal, the rate of the tax had been reduced from 2 mills (\$2.00 tax per \$1,000 of value) down to one-half mill (\$.50 tax per \$1,000 of value). The exemption available on the annual intangible tax had also been recently increased to \$250,000 for natural persons, \$500,000 for married couples filing jointly and \$250,000 for taxpayers who are not natural persons.

Through proper planning many individuals had not

been subject to the annual intangible tax for years. Essentially the annual intangible tax had become a "voluntary tax." Now the burden of the annual intangible tax has been lifted for everyone. ■

Bernie Silver Elected Circuit Court Judge

The attorney's of Trenam Kemker would like to extend their congratulations to Bernie Silver who was elected to serve as a Hillsborough County Circuit Court Judge in the November 6 election. His service on the Court begins in January 2007.

Bernie joined Trenam Kemker in 2000, focusing his practice in the areas of eminent domain and condemnation, as well as personal injury matters. His ascension to the bench marks another extraordinary accomplishment in his career.

We are proud to have had Bernie as part of our team. He provided superior counsel and service to our clients and our Firm and we will miss him. ■

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