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FALL/WINTER 2015

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In this issue:

PROTECTING YOUR ASSETS FROM YOUR CHILDREN'S CREDITORS AFTER YOU DIE

This is a topic we have discussed far more frequently with you in the past 10 years, but it has been many years since we have written about it in this newsletter, and it deserves to be revived. While discussing the minimization of federal and state estate taxes is still a significant part of our meetings since there have been a number of changes recently, the bulk of the discussion now tends to revolve around how the children will inherit from you. There are generally three options. First, leave everything outright to the children, which rarely occurs if the assets are substantial. Second, if you have minor children, we typically recommend creating trusts for the children which terminate at ages such as 30 and 35, when they are older, more mature and can handle the inheritance. The third option has become most commonly (and almost universally) used by our clients with adult children and grandchildren, which is to hold the inheritance in a lifetime trust for the children, also known as a "generation-skipping trust". The primary reason is for creditor protection for the children. Creditors can arise as the result of an act of a failing business with a bank as a creditor, malpractice, if your child is a professional, or the divorce of your child.

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Connecticut Raises Probate Fees

Every state has a way of assessing fees and taxes to balance its budget, but Connecticut has taken this to a new level. Governor Dannel Malloy decided that there would be no funding for the Probate Courts for the next two years, so in order to make up the deficit, the General Assembly imposed a new 0.5% fee on estates exceeding $2,000,000 effective for deaths after January 1, 2015 and lifted a cap on the fee, which was $12,500. What makes this fee so onerous is that the decedent's estate must pay this fee whether or not it uses the court system as part of administering the estate. In other words, if all of the decedent's assets were held in a Revocable Trust which avoids probate, or if all of the decedent's assets were owned jointly with a child, the Probate Court will still assess a fee. Even real estate located outside Connecticut is part of the pot for purposes of this calculation. For example, a $5,000,000 estate will have a total fee of <u>$20,616</u> and a $10,000,000 estate will be assessed a fee of <u>$45,615</u>. The only solace is that any assets passing to a surviving spouse will be reduced by 50% for purposes of calculating this fee.

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CASH BALANCE PLANS: THE SMART WAY TO INCREASE YOUR TAX-DEDUCTIBLE PLAN CONTRIBUTIONS

A "Cash Balance Plan" is an integral component of 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 use easily understandable individual account balances not available under a traditional defined benefit pension plan. Each plan participant has his or her own account balance that is credited annually with a contribution and a specified rate of return.

Ideal candidates for Cash Balance Plans are successful businesses with two or more owners. In a Cash Balance Plan, similar or varying contributions can be made on behalf of each owner, and each owner will know the exact amount of the contribution attributable to him. Naturally, Cash Balance Plans can be successfully implemented for a sole proprietorship that produces substantial profits.

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

The Table below illustrates how you can make an additional tax-deductible plan contribution to a Cash Balance Plan (see Row D) even after contributing the maximum $53,000 to a DC Plan (Row A plus Row B equals the maximum $53,000).

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, and the owner's compensation is at least $265,000.

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 owners. A thorough analysis of employee data, combined with creative planning concepts, often result in a successful outcome for the business owners. Obviously, it would be imprudent for a business owner to think of proceeding without the benefit of such an in-depth analysis.

If you want to make a plan contribution for yourself in excess of $53,000, a Cash Balance Plan is the answer.

To learn more about Cash Balance Plans, please contact Andrew E. Roth, Esq. at 914-948-1556 ext. 8033 or by email at aroth@dmlawyers.com

	Type of Plan or Plan Feature	**Contribution Amount for Owner**
A.	Profit-Sharing Plan – Employer Discretionary Contribution	$ 35,000.
B.	401 (k) Salary Reduction Plan - Employee Discretionary Contribution	$ 18,000.
C.	Additional "Catch-Up": Owner Age 50 or older	$ 6,000.
D.	Cash Balance "Add-on" Plan [On top of Employer's DC Plan]	$ 47,150.*
E.	Total Contribution: Owner under Age 50 [A+B+D]	$ 100,150.
F.	Total Contribution: Owner Age 50 or older [A+B+C+D]	**$** 106,150.

*Note also that depending upon the level of staff compensation, and the age of the owner, the amount that can be contributed for the owner may be substantially larger.

Prompt Action May Prevent Section 409A Violations in Employment Agreements

Section 409A of the Internal Revenue Code imposes significant tax penalties on employees who participate in nonqualified deferred compensation plans that fail to meet certain requirements, either because the plan does not have the required provisions or because the plan is not operated according to the applicable rules. Section 409A generally requires, among other things, that payment dates for deferred compensation are fixed in advance, and payments are not subject to discretionary acceleration. When a plan violates Section 409A, employees who participate in the plan are hit with accelerated income tax liabilities and a 20% additional income tax on top of their usual income tax liability, plus, in some cases, an additional interest-like tax. Section 409A reaches not only traditional nonqualified plans, such as supplemental executive retirement plans (SERPs) and excess benefit plans, but can also extend to employment agreements (including severance and release provisions), bonus arrangements and stock-based compensation plans.

The long arm of Section 409A is illustrated by a recently-released Internal Revenue Service internal memorandum (Chief Counsel Advice 201518013 (April 14, 2015)). The memorandum concerns a fairly garden-variety retention bonus agreement between an executive and his employer which is subject to the requirements of Section 409A. After the agreement is entered into, but before the executive's right to the bonus vests, the employer realizes that the agreement contains provisions that violate Section 409A in that the employer is given discretion to accelerate payment dates. During the calendar year of vesting, but before the actual vesting date, the employer amends the agreement to delete the defective provisions. The executive thereafter vests, and the bonus is paid out in an otherwise Section 409A-compliant manner.

The IRS concludes in the memorandum that the employer's attempt to correct the Section 409A violation in the retention bonus agreement by amending the agreement during the calendar year of the vesting date does not prevent a Section 409A violation. However, the IRS memorandum acknowledges that a Section 409A violation can potentially be corrected if corrective action is taken *prior to* the calendar year in which the deferred compensation vests. Had the employer acted sooner and amended the agreement to delete the "wrong" language before the year of vesting, Section 409A penalties could have been avoided. For example, defective severance provisions (e.g., an employment agreement that allows the employee to choose between receiving severance in a lump-sum or in installments) should be correctible if amended before the calendar year in which the employee's employment is terminated.

The IRS memorandum shows that nonqualified deferred compensation plans must comply with Section 409A both in form (i.e., the plan must not have the "wrong" language) *and* in operation. Accordingly:

- employers should analyze each of their compensation and benefit plans and agreements (other than tax-qualified plans, such as 401(k) plans) to see if they are potentially subject to Section 409A;
- those that are potentially subject to Section 409A should be examined to determine whether the language of the relevant document complies with or is exempt from Section 409A;
- if a document has the "wrong" language, it should be amended, if possible, to correct the language before the calendar year in which the right to compensation vests; and
- nonqualified deferred compensation plans with the "right" language must be operated in compliance with their terms.

Our lawyers have broad and deep expertise and experience with all aspects of executive compensation, including Section 409A, and would be pleased to help you ensure that your executive compensation arrangements comply with the increasingly complex tax and other legal requirements governing this arena.

Please contact Mark Hamilton, Esq. for further information

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The "generation-skipping trust" provides income to the children and distribution of principal with the consent of the trustee. When the child dies, the trust will be distributed to the grandchildren. The advantage of the trust is that since the child does not have control of the assets (the trustee has the control), creditors cannot attach the trust principal. As a side benefit, this technique enables you to "dictate from the grave" that your estate will eventually pass to your grandchildren when your child dies and will not pass to your son-in-law or daughter-in-law upon your child's death.

For more information on this topic, please contact Michael Markhoff, Esq. or Harris Markhoff, Esq.

In Our Firm

We want to share with you that our firm has recently received the following honors. We thank our clients and colleagues for their continued loyalty and for helping us achieve these honors.

Best Law Firm:

Danziger & Markhoff LLP has been included in the 2016 U.S. News-Best Lawyers list of Best Law Firms in the United States.

The Best Lawyers in America:

Michael Markhoff has been selected by *Best Lawyers* as the *2016 Trusts & Estates Lawyer of the Year* for White Plains, New York. Only one lawyer in each practice area in each community receives this honored designation.

Harris Markhoff and Joshua S. Levine have been selected for inclusion in *The Best Lawyers in America 2016*. Harris was selected in the areas of Corporate Law and Trusts & Estates and Josh was selected in the area of Health Care.

New York Super Lawyers:

Michael Markhoff and Jay Fenster have been selected for inclusion in 2015 New York Metro *Super Lawyers*. Michael was selected in the area of Estate Planning and Probate and Jay was selected in the area of Employee Benefits/ERISA. Only 5% of the attorneys practicing in New York received this honor.

In other news

Harris Markhoff together with his wife, Cookie, were honored by the Holocaust & Human Rights Education Center at their annual benefit dinner held in October.

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Just to be clear, this fee is separate and apart from the Connecticut estate tax, which is assessed on estates exceeding $2,000,000. However, even if the taxable estate is under $2,000,000, an estate tax return must be filed with the Probate Court, and they will base their fee on the assets listed on the estate tax return and send the executor a bill.

We have had a number of estates this year assessed this new fee (both over and under $2,000,000) and, as demonstrated earlier, it can be quite substantial. What is there to do about it? Unfortunately for Connecticut, this fee, on top of increases in income, sales and luxury taxes, is going to cause more residents to vote with their feet and move.

For more information , please contact Michael Markhoff, Esq. or Harris Markhoff, Esq.