

Advisory

TRUSTS AND ESTATES DEPARTMENT | NOVEMBER 2006

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Counsellors at Law

Update on Recent Developments

In August, the Pension Protection Act of 2006 was signed into law. Despite its title, a substantial portion of the Act was not about pension reform, but about charitable giving matters and the regulation of non-profits. Other miscellaneous tax law changes were also enacted. Outlined below are highlights from the Act that may affect individuals' estate and income tax planning.

As of October 1, 2006, Connecticut has new law concerning the designation of someone to make health care decisions on your behalf. Information about the new law, and general information about the principles involved in delegating authority to make health care decisions, is found starting on page 3 of this Advisory.

Pension Protection Act of 2006

Section 529 Qualified Tuition Programs Made Permanent

In 2001, Congress authorized the creation of tax-advantaged college savings accounts known as Section 529 Plans. Although Section 529 Plans have become increasingly popular, and can be an excellent way of saving for college expenses on a tax-free basis (if the funds are ultimately used for qualified educational expenses), some people hesitated to transfer assets to such accounts because the legislation authorizing the accounts was set to expire after 2010 and it was not clear that the accounts would retain their tax-advantaged status thereafter. Under the Pension Protection Act of 2006, Section 529 has now been made permanent, removing that concern. *For more information about Section 529 Plans, please see our Spring 2006 Client Advisory on paying for education expenses.*

Increase in Contribution Percentage for Qualified Conservation Contributions in 2006 and 2007

Generally, charitable deductions relating to "qualified conservation contributions" are subject to the same percentage-of-income limitation as other charitable contributions. As a result, the deductibility of most such donations is limited to 30% of the donor's adjusted gross income. For 2006 and 2007, "qualified conservation contributions" will be subject to a separate percentage limitation, which will have the effect for most donors of raising the limit on the deduction to 50% of the donor's adjusted gross income. For "qualified farmers and ranchers" the limit is increased to 100% of the donor's adjusted gross income.

The most common type of "qualified conservation contribution" is a perpetual conservation restriction that is established through an easement or restrictive covenant on the land that provides for the preservation of open space (including farmland and forest land), the protection of natural habitat or the preservation of an historically important land area or certified historic structure. The power to enforce the conservation restriction must be given to a qualified organization, such as a governmental unit or a charity that is dedicated to conservation matters.

Charitable Contributions Permitted from IRAs in 2006 and 2007

One of the more popular provisions that was included in the Pension Protection Act of 2006 is a temporary provision which allows IRA owners who are at least age 70-1/2 to distribute up to \$100,000 per year from a traditional or Roth IRA directly to a charitable *continued next page*

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organization without having to count the distribution in the IRA owner's taxable income. Such a distribution is tax-free if the funds are given directly to a qualified charity.

Notably, a donor who makes a direct gift through an IRA does not also get an income tax charitable deduction for the gift, but the distribution counts toward the donor's annual required minimum distribution. Thus, for most donors, the tax benefits of making a direct contribution from an IRA exceed the benefits the donor would otherwise get by making a charitable contribution from another account. Making a charitable gift through an IRA account may also be especially advantageous for a donor who has already exceeded the 50% of adjusted gross income (AGI) limit for regular deductible charitable gifts for the year or for a donor who might typically take the standard deduction for income tax purposes (as opposed to itemizing deductions). Eligible donors should also consider making charitable gifts directly from an IRA so as to preserve non-IRA assets for heirs. Upon death, the value of an IRA may end up being depleted by estate and income taxes having a combined rate of up to 70% or more.

The new rules concerning charitable donations from IRAs only apply to gifts made in 2006 and 2007. Distributions from §401(k) plans, §403(b) annuity arrangements and other non-IRA retirement accounts do not qualify for the new rules. In order to claim the benefit of the new rules, the distribution must be made directly to the qualified charity; if the account owner withdraws the funds and then transfers the funds to the charity, the account owner will have to include the amount of the IRA distribution in his or her taxable income (though, in that case, the donor may be able to claim a charitable deduction for the gift).

Qualified charities that are eligible to receive IRA donations generally include all organizations commonly referred to as "public charities," such as churches and tax-exempt hospitals, schools and museums. Specifically excluded as eligible recipients are donor-advised funds operated by public charities and "supporting organizations." Also excluded as eligible recipients are charitable remainder trusts, charitable lead trusts and private non-operating foundations.

In order to take advantage of the new rules, you must have attained at least age 70-1/2 at the time the gift distribution is made. This is different from the required minimum distribution rules, which apply as of the taxable year in which the account owner attains age 70-1/2.

If you are considering making a direct charitable gift from an IRA, be sure to first contact the recipient charity to ensure that it is a qualified charity and to get payment instructions.

Rollovers to Non-Spouse Beneficiaries

Continuing a trend in recent years toward more flexibility in income and estate planning options that are available with respect to tax-advantaged retirement accounts, the Pension Protection Act added a new Code section which, beginning in 2007, permits non-spouse beneficiaries to rollover lump sum distributions from a qualified plan, §403(b) annuity account or governmental §457(b) plan to an IRA after the death of the plan participant.

As with traditional rollovers that can be made by plan participants or their surviving spouses, the new non-spousal rollovers are only available if the retirement plan otherwise permits lump sum distributions. The new non-spousal rollovers are also different from traditional rollovers in that the rollover IRA must be treated as an "inherited IRA" for minimum distribution

purposes. But being able to transfer the lump sum distribution to an IRA means that the beneficiary has more control over the investment of the account and the timing of distributions from the account. The beneficiary can also name his or her own beneficiaries for any amounts remaining after his or her death.

This new provision allows domestic partners and other unmarried couples the opportunity to better plan for a survivor's welfare. The new provision also enhances the likelihood that children of a plan participant will not end up with an accelerated income tax bill because the parent's retirement plan provides for a lump sum distribution upon the death of the parent. In some cases, further sophisticated income and estate planning with respect to retirement accounts can be accomplished through the use of a trust as the beneficiary.

Advance Directives

Advance Directives Generally

One of the most wrenching situations a family may face is having to take care of a loved one who is incapacitated. In the absence of advance planning by the incapacitated person, it is likely that a Probate Court will have to appoint a conservator of the person and of his or her estate. A conservatorship provides a mechanism for making crucial decisions about the incapacitated person's care and finances, but it can be costly, and periodic accountings to the Probate Court are required. In addition, the conservator may be unaware of what the incapacitated person's wishes would have been with regard to health care and end of life decisions.

The need for a conservator may be avoided if you execute an *advance directive* and a *durable power of attorney*. Typically, an *advance directive* includes a so-called "living

will," where you express your wishes with regard to end of life decisions, and a section where you appoint a health care representative to make health care decisions on your behalf. Generally, an advance directive is effective only upon your incapacity. A *durable power of attorney* is a document whereby you may appoint someone (*i.e.*, your "attorney-in-fact") to handle financial, business and other non-health care matters. A durable power of attorney may be drafted to be effective immediately (non-springing) or it may be effective only in the event of your incapacity (springing).

Recent Changes to Connecticut Law Concerning Advance Directives

This year, the Connecticut legislature enacted a comprehensive reform bill that takes important steps towards modernizing Connecticut's advance directives laws and streamlining a patchwork of confusing and unnecessarily duplicative provisions. The changes were effective October 1, 2006. The following is a summary of the changes that affect individuals who are residents of Connecticut:

1. Health Care Representative. The new law effectively combines the authority of a "health care agent" and an "attorney-in-fact for health care." Under prior law, a health care agent's authority was limited to conveying the patient's wishes about the withholding or withdrawal of life support, and an attorney-in-fact for health care was authorized to make all health care decisions other than those concerning the withholding or withdrawal of life support. Now the roles of the health care agent and the attorney-in-fact for health care have been combined into a single, unified role, called a "health care representative." A health care representative can make any and all health care decisions for you if you become incapacitated. The appointment of a health care represen-

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tative can only be revoked in a writing that is signed by two witnesses. The Probate Court has jurisdiction to review the actions or determine the capacity of a health care representative.

2. Living Will. The new law expands what may be addressed in a living will. Prior law provided that a living will could address only the withholding or withdrawal of various forms of life support. The new law provides that a living will can permit directives about any aspect of health care, including, but not limited to, the withholding or withdrawal of life support. A living will can be revoked at any time and in any manner, including orally.

3. Conservators. If a conservator of the person is appointed by a Probate Court, the conservator must comply with a previously executed advance directive, and cannot revoke the incapacitated person's advance directive without the permission of the Probate Court. The new law also provides that, in most situations, the decision of a health care representative regarding treatment decisions will take precedence over the decision of a conservator.

4. Durable Power of Attorney for Health Care Decisions. Under prior law, a durable power of attorney could include health care provisions. This caused confusion because the health care provisions could be utilized only if a person who granted the power of attorney (also known as the "principal") was incapacitated, while the financial provisions of a non-springing durable power of attorney could be exercised at any time, whether or not the principal was incapacitated. Since the health care representative can now exercise the authority to make health care decisions, the new law eliminates health care authority from the standard durable power of attorney form. A durable power of attorney will continue to be utilized by an attorney-in-fact to

handle other matters, such as financial decisions.

5. Validity of Advance Directives Executed Under Prior Law. All previously executed advance directives, such as a living will or the appointment of a health care agent or attorney-in-fact for health care, will remain valid after October 1, 2006. Although the new law does not explicitly state that a previously executed durable power of attorney that includes authority to make health care decisions will remain valid, most commentators agree that the legislature intended that all types of advance directives would remain valid.

Validity of Advance Directives in Other States

Generally, you should sign an advance directive in a form that is valid in the state in which you are a resident. An advance directive that is valid at the time it is signed is usually honored in other states, although, if need arises while you are out of state, there may be some delay because your health care provider may be unfamiliar with the form of an advance directive from another state. Connecticut's new legislation states that health care providers who are concerned about the validity of an advance directive (whether in the Connecticut format or from out of state) may rely on a court order or decision, a notarized statement from the patient or the person purporting to act pursuant to the advance directive, or the health care provider's own good faith analysis that an advance directive is in effect.

No matter what state you live in, you should plan for the possibility that you might become incapacitated at some point during your life, either temporarily or permanently. By planning ahead, you may reduce the potential for disagreement among your loved ones regarding these matters and will provide a way for your wishes to be honored at a time when you can no longer direct your own care.