

# WARD & MURPHY

ATTORNEYS AND COUNSELORS-AT-LAW

JANUARY 2003

## New Tax Laws Encourage Estate Planning

Changes in federal law that went into effect this year will reduce or even eliminate death taxes for many Americans. Now federal estate taxes do not apply unless your estate totals at least \$1 million, and the tax rates charged to estates have gone down dramatically. The new law sets rates and exemptions that are even more favorable in future years.

These changes are reason enough to consult your lawyer about possible revisions in your estate plan, but many other changes open up opportunities both to reduce taxes and save money for your own retirement and the education of your children or grandchildren.

Here's a brief run-down on the most significant of the changes. Your lawyer can help you craft a long-range plan that fits the needs of your family.

### Giving for Education

Federal tax law permits you to pay a student's tuition directly to the institution and not have the payment be charged as a gift tax. New features in federal law give you a number of other attractive alternatives to reduce your tax liability while advancing someone's education.

For a number of years now, states have offered **prepaid tuition plans** and **college savings plans**. The first of these permits you to make payments now toward the tuition of someone not yet enrolled in college. By paying for these **tuition credits** or **certificates** at today's tuition rate, you protect yourself against tuition increases in the future. (Tuition has been increasing far more than the inflation rate for many years.)

The second kind of state plan, the college savings plan, enables you to save for tuition and other expenses and use them at a wide range of colleges, in-state or out-of-state. Almost every state offers these plans now.

You can't get a federal income tax deduction for your contributions to either of these plans (though you may get a state deduction), but Section 529 of the Federal Tax Code now gives you a lot of attractive, tax-saving options. Earnings on your *contributions* accumulate tax-free until they are withdrawn, a significant benefit, especially for high-income taxpayers. Earnings *withdrawn* to pay tuition and other expenses are now free from federal tax for state-sponsored programs. (In the past, these withdrawals were taxable to the beneficiaries, and even if they paid at the

15% rate the taxes generated could be considerable.)

In another attractive change, tax benefits are now extended to contributions you make to a qualified plan established by an education institution, along the same lines that they are available to state plans, except that earning withdrawals will not be tax-free until January 1, 2004.

Another great feature of the Section 529 plans is that you maintain control over the accounts you set up. If you set up an account under the Uniform Gifts to Minors Act, for example, the account is owned by the recipient, who can use the funds for any purpose once he or she comes of age. In a Section 529 plan, you can change beneficiaries or even have the plan balance refunded to you.

### Savings on Estate and Gift Taxes

Even better, you can save on taxes through these plans. You can contribute up to \$11,000 annually to each plan you set up and pay no taxes on the gift. Or you can make gifts of up to \$55,000 to each plan in one year, excludable from taxation, as long as you make no other gifts to the plans for the next five years. This enables you to shelter more growth from taxation.

### Other Attractive Possibilities

Changes to federal law also give you a number of other tax-friendly options. Now you can give as much as (Continued on other side ...)

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\$2,000 to a **Coverdell Education Savings Account** in a single year for each beneficiary, up from just \$500 a year. These accounts, which used to be known as Education IRAs, can now be used to cover expenses in elementary and secondary school, not just higher education. Money withdrawn for qualified expenses is exempt from federal taxes.

You can make contributions to a Section 529 plan and a Coverdell account in the same year for the same beneficiary. (Previously, you could only make contributions to one plan or the other.) However, you could have gift tax consequences if you contribute a total of more than \$11,000 to a 529 plan and a Coverdell account in the same year.

**Hope tax credits and Lifelong Learning credits** are other tax benefits, though there are income limits to qualify. They enable you to claim credits of \$1,500 a year in the first two years of your dependent's college years, and up to \$1,000 in subsequent years.

You can claim one of these credits in the same year that you take a tax-free distribution from a Coverdell account, as long as you meet certain conditions.

### **Better Retirement Options**

Most lawyers recommend that you try to coordinate retirement planning, planning for educational expenses, and estate planning. The changes to the federal tax laws make this a good time to look into the attractive possibilities for financing your own retirement.

The annual limits for contributions to both traditional and Roth IRAs have gone from \$2,000 to \$3,000 (\$3,500 if you're over 50) Moreover, there is now greater portability to move your retirement money between a variety of plans. This is a boon to employees who have worked for a variety of employers and have different kinds of plans. Now they can roll them over more easily to one employer's plan or an IRA.

For self-employed workers and others using such retirement vehicles as SEP-IRAs and SIMPLE IRAs, restrictions have been lessened and the plans generally

permit you to save more and have greater flexibility to roll the accounts over.

### **Conclusion**

As usual with taxes, there may be requirements and exceptions that you and your lawyer ought to examine, but the bottom line is that there has never been a better time for planning. Whether you're looking to save on estate taxes, help someone's education, or plan for your own retirement, there are more possibilities'and more attractive possibilities than ever before.

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### **Who has my file from Ward or Webster's office?**

As we explained in previous issues, Ward & Murphy is the successor to both the law offices of Evan Webster in Groton and Jack Ward in Ithaca. We have files going back at least seven years from both offices. We are now sending this newsletter to keep all our clients up-to-date -- all our clients should be on these computer lists by December 2003.

You, of course, retain the choice of lawyer. Unless you tell us otherwise, Ward & Murphy will presume you wish us to continue our relationship and look forward to continuing that relationship with you -- and of course you can start or end matters at any other time as well.

### **Nice Blue Office ???**

So how did our Groton office get quite so blue? Liam Murphy had carefully selected a color in the same range as the old light blue -- just two shades darker. The intent was to get a darker slate grey-blue, but the result was little bluer than we expected. Fortunately, it has made giving directions to the office much easier! Come see for yourself ...

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