PROSKAUER ROSE LLP®

Personal Planning Strategies

A report
for clients
and friends
of the firm

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In this issue:

Changes In The Law May Affect Your Health Care Proxy

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") and its privacy rule changed the way health plans and health care providers can use and disclose an individual's medical information. We now have case law to the effect that your health care proxy should be sufficient under HIPAA to allow your health care agent to have access to your medical information in the event that you are incapacitated. However, we recommend that you add language specifically referring to HIPAA to reduce the chance that your health care agent will be refused access to your medical information should he or she be required to act on your behalf.

What is HIPAA?

Congress enacted HIPAA in 1996, addressing a broad range of health care issues, including provisions that allowed workers to retain health insurance coverage when they changed jobs, and encouraged the simplification and efficiency of the nation's health care system through the development of uniform standards and requirements for the

electronic transmission of certain health information. As part of the so-called administrative simplification of the health care system, Congress authorized the Department of Health and Human Services ("HHS") to issue rules governing the privacy and security of medical information.

The privacy rule that HHS issued limits how health care providers may use and disclose medical information. There are severe penalties for health care providers who violate the statute: up to $100 fine for each violation; $50,000 fine and one year in prison for a knowing violation; $100,000 fine and five years in prison for providing or obtaining medical information under false pretenses; and $250,000 fine and ten years in prison if the wrongful use of medical information was for commercial advantage, personal gain or malicious harm.

How does HIPAA affect your Health Care Proxy?

Your existing health care proxy is sufficient to give your agent the authority to obtain your medical information. HIPAA specifically provides that a personal representative – one who is authorized under applicable state law to act on behalf of the patient in making health care-related decisions, such as the agent you appointed under your health care proxy – has the same access to your medical information as you would have had to your own medical information.

However, because of the penalties under HIPAA, health care providers may be more cautious about releasing your medical information, even to an agent designated in a health care proxy.

A recent New York case, *Matter of Mougiannis v. North Shore-Long Island Jewish Health System* (May 19, 2004), highlights the effect of HIPAA on access to medical information. The patient had executed a health care proxy appointing her daughter to make medical decisions for her if she was unable to do so. After the patient became incapacitated, her daughter, as the health care agent, requested to see the medical records related to her mother's care. The hospital denied her requests, finding that her daughter's status as a health care agent did not entitle her to access her mother's medical records. The court held that, under HIPAA and New York law, a properly executed proxy qualified the daughter, as the health care agent, to seek access to her mother's medical records.

We recommend that you add the language below to your health care proxy, which should make it clear that your agent has the right to access your medical information. Please date, sign and print your name on the attachment below in the presence of two witnesses. The two witnesses (neither of whom should be your health care agent, spouse or blood relative) should then sign and print their names and addresses where indicated. Return the completed form to your Proskauer attorney who will attach it to your health care proxy.

I understand that my physicians, my other health care providers and others who may be authorized to collect and share my medical information may be restricted by provisions of the Health Insurance Portability and Accountability Act of 1996 (HIPAA) from disclosing so-called "individually identifiable health information" about me or from making my medical records available to others. By this proxy, I direct them to consider my health care agent as my personal representative under HIPAA and to treat requests made and instructions given by my health care agent as though they were made or given by me (insofar as the disclosure of such information or release of my medical records are concerned).

Dated: , 2004

(signature)_____
Print Name:

The above declarant is personally known to us and has signed the foregoing document (or has directed another to do so for him/her) in our presence. We affirm that he/she has done so of his/her own free will, without compulsion or duress, and that we believe him/her to be of sound mind, memory and understanding. We affirm further that we are not the persons appointed as health care agent hereunder.

Witnesses:

(signature)_____ residing at _____
Print Name:

_____

(signature)_____ residing at _____
Print Name:

_____

WITS: A New and Better Way We Maintain and Safeguard Your Estate Planning Documents

As a courtesy to our clients, we have always offered a way to help safeguard important documents, such as original Wills and trusts, by holding them in a fireproof vault. However, given the real risk of terrorist attack and other potential dangers, we have considered whether there is a better way to maintain these original documents while still ensuring their protection.

Our efforts on this front have led us to create WITS (short for "Wills Information Tracking System"). WITS is a customized document management system specifically designed for Proskauer's Personal Planning Department, which allows us to scan an original document, thereby creating and saving an electronic copy of that document, into a computer database. (Although this database is located in our office, it is regularly "backed up" or copied into a separate database located at an off-site location.) To date, we have used WITS to scan all existing documents already kept in our vault, and, going forward, we will use WITS to scan all new documents before they are placed in our vault.

WITS offers our clients several advantages. First, if a catastrophic event should occur that destroys your original Will and its file copy, the electronic copy of the Will would be available for a probate proceeding. Most jurisdictions will admit a copy of a Will to probate, provided certain requirements are met. One such requirement is that all of the Will's provisions are "clearly and distinctly" proved by a true and complete copy of the Will. A readily available electronic copy of the Will would help satisfy this requirement. Some jurisdictions have a requirement that the decedent's attorney maintained custody of the Will. WITS also would help satisfy this requirement, since the database contains only those documents over which we have physical custody.

Second, since an electronic copy of your document exists on our computer database, in the event of an emergency, we would be able to e-mail a signed copy of your document anywhere in the world. For example, if you urgently needed a copy of your health care proxy or durable power of attorney, we could instantly send those documents to the e-mail address you provide, which could be that of a hospital, bank, brokerage firm, etc.

Third, WITS allows us to search and retrieve documents meeting specific criteria. Since 1983, after every document that we prepare is executed, it is reviewed one more time and coded based on its particular provisions. As a result, if a new law is enacted or an existing law is changed, we can quickly find those documents affected by that new or revised law. We have retained this important feature in WITS, and we would then contact you to discuss any changes you might want to make to your documents.

Finally, in the future, you will be able to access WITS via the Internet to review and print your own documents. Of course, access will be restricted to those having a password and appropriate steps will be taken to ensure that your documents are kept confidential. To maintain confidentiality under the current WITS system, access to WITS is limited to Proskauer attorneys in our Personal Planning Department only.

Although WITS by name refers only to Wills, we have and will continue to use it for all original documents placed in our vault (for example, trusts, powers of attorney, health care proxies, etc.). We will continue to keep you updated as WITS helps us provide you with a new and better way to maintain and safeguard your documents.

Creating A "GRAT": Heads You Win, Tails You Break Even

Thanks to Wal-Mart, GRATs are better than ever!

Creating a grantor retained annuity trust (commonly referred to as a "GRAT") is a relatively simple way of transferring property to your children at virtually no gift tax cost.

When properly structured, a GRAT can pass to your children all of the future appreciation of the transferred property and reduce the value of the gift to virtually zero.

Trust Pays an Annuity to You

In a typical GRAT, you contribute assets to a trust which provides that you are to receive an annuity annually for a fixed number of years. The annuity amount is typically a stated percentage of the initial fair market value of the trust. It can be stated as a fixed percentage or as a percentage that can increase as much as 20% a year over the trust's term.

At all times during the term of the trust, you will receive the predetermined annuity amount, regardless of how much income the trust actually generates or whether its value rises or falls. To the extent that the income is insufficient to cover the annuity payments, trust principal will be paid to you to make up any shortfall.

At the end of the period, the property remaining in the trust passes to the ultimate beneficiaries of the trust, typically your children or other family members, in further trust or outright, depending upon your preference. Alternatively, you can delay the transfer of assets to your children by naming a trust for your spouse as the beneficiary until his or her death, at which time your children (or other family members) become the beneficiaries.

Gift Tax Is Minimized

The creation of a GRAT constitutes a gift to the ultimate beneficiaries for gift tax purposes, but the value of that gift is only the initial value of the trust assets *reduced by* the present value of the annuity you have retained. The calculation of the present value of your retained annuity is based, in part, upon the current interest rates promulgated by the IRS, commonly referred to as the "hurdle" rate. In order for a GRAT to be successful, the assets used to fund the GRAT must appreciate faster than the IRS hurdle rate. At the current hurdle rate for June, 4.6%, it is easier to have a successful GRAT. Since interest rates are near historic lows, the potential tax savings are maximized.

The most popular use of this device in sophisticated estate plans has been the short-term, "zeroed-out" GRAT, in which the term is limited to two or three years and the annuity amount is maximized in order to produce as small a taxable gift as possible. In this way, anticipated short-term growth in the trust assets can be availed of without risking longer-term uncertainty, and the risk of depreciation is neutralized by virtually eliminating the gift tax cost. With this short-term GRAT, the gift to your children can be nearly "zeroed-out," thanks to a recent case involving a GRAT that was created by the family that founded Wal-Mart. In that case, the IRS challenged the ability to create a GRAT without incurring a substantial gift tax. The government lost the case and in 2003 acquiesced to the court decision.

Suppose you create a GRAT with $5,000,000 to pay yourself an annuity of $2,673,795 per year for two years. Applying June's IRS factors, the value of your retained interest is approximately $4,999,997 and the taxable gift is only $3. If the principal of the trust appreciates over the two-year period, so that, after receiving your annuity payments, there are assets remaining in the GRAT – whether one dollar or millions of dollars – your children will receive that amount at virtually no gift tax cost. If the value of the trust goes down, you will simply get back everything you put in, and you will have lost nothing. Distributions may be made in-kind so there is no need to sell any property in order to receive your annuity payments.

In a two-year zeroed-out GRAT, your children or other named beneficiaries will receive the remaining principal in the trust at the end of two years at no gift tax cost to you or them. Set forth below is a chart showing the advantages of creating a $5,000,000 two-year GRAT if different rates of return are achieved over the two-year period. The chart shows that the annuity payments remain constant over the two-year term of the GRAT. The greater the growth rate, the greater the amount that is left to pass to your children free of gift tax at the end of two years.

Year	Beginning Principal	10.00% Growth	Annual Payment	Remainder
1	$5,000,000.00	$500,000.00	$2,673,795.00	$2,826,205.00
2	$2,826,205.00	$282,620.50	$2,673,795.00	$435,030.50
Summary	**$5,000,000.00**	**$785,620.50**	**$5,347,590.00**	**$435,030.50 to pass free of gift tax**

Year	Beginning Principal	20.00% Growth	Annual Payment	Remainder
1	$5,000,000.00	$1,000,000.00	$2,673,795.00	$3,326,205.00
2	$3,326,205.00	$665,241.00	$2,673,795.00	$1,317,651.00
Summary	**$5,000,000.00**	**$1,665,241.00**	**$5,347,590.00**	**$1,317,651.00 to pass free of gift tax**

Year	Beginning Principal	30.00% Growth	Annual Payment	Remainder
1	$5,000,000.00	$1,500,000.00	$2,673,795.00	$3,826,205.00
2	$3,826,205.00	$1,147,861.50	$2,673,795.00	$2,300,271.50
Summary	**$5,000,000.00**	**$2,647,861.50**	**$5,347,590.00**	**$2,300,271.50 to pass free of gift tax**

No Extra Cost If You Die Prematurely

If you die prior to the end of the annuity period, the annuity will continue to be paid to your estate and the value of the assets in the GRAT at your death will be included in your gross estate for estate tax purposes. Your estate will receive credit for any gift tax already paid, however. Thus, although you will have lost the tax advantage the GRAT was designed to achieve, your estate will be in no worse a position than had you not created it.

Gift of Stock in a Closely-Held Business

You may be able to achieve substantial benefits by transferring a closely-held business interest, which you anticipate will increase in value, to your GRAT. In fact, this may be the ideal estate planning device for such a transfer to your children, because you may be in a much better position to predict the future growth of your own business than that of other property.

Of particular appeal is the fact that the GRAT also removes the risk of undervaluing a closely-held business interest for gift tax purposes. With an outright gift, there is no way to guard against a substantial gift tax deficiency if the value of the property is increased by the Internal Revenue Service. But if instead the gift is the remainder interest in a "zeroed-out" GRAT, and if the annuity amount is expressed as a percentage of the initial value of the trust principal (rather than a dollar figure), any increase in the value of the business determined on an audit of the gift tax return would result almost entirely in an increase in the value of the retained interest and, in turn, in only a nominal gift tax increase.

In the previous example, if the IRS successfully asserts that the value of your company's stock transferred to the trust is $6,000,000 instead of $5,000,000, because your annuity is defined as a percentage of the value of the stock, your annuity is now worth $4,999,996 and the value of the resulting gift to your children, is $4 instead of $3.

Income Tax Considerations

Since the GRAT is a "grantor trust" for income tax purposes, all of its income and deductions are included on your personal return, as if there had been no transfer at all, until the property passes to the ultimate beneficiaries of the GRAT. Therefore, the GRAT is generally income tax-neutral, meaning that your income taxes should be the same whether or not you create the GRAT. If you choose to keep the property in trust for your children (or your spouse and children) after the two-year GRAT period, the continuing trust or trusts also can be structured as grantor trusts so that you can continue to pay the income tax attributable to the trusts' income each year until you choose otherwise. Your payment of the trust's income tax essentially is an additional tax-free gift to your children.

Summary

When properly structured, a GRAT can truly have a "heads you win, tails you break even" result. By adjusting the terms of your trust, you can nearly eliminate the gift tax associated with the transfer of property to your children.

All the appreciation in excess of the hurdle rate on the assets in the trust when it terminates will pass to your children free of gift tax. But if the appreciation is not as expected, or if you do not survive the term of the trust, there are no material adverse tax consequences.

Finally, in designing the manner in which the ultimate beneficiaries of the GRAT are to receive the trust assets at the end of the GRAT period, you may choose among many options available to achieve the result most consistent with your family and financial objectives.

You May Inadvertently Be Wasting Your Generation-Skipping Transfer Tax Exemption

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA," discussed in more detail in our June 2001 Client Alert) brought significant change to our estate and gift tax system. The general media has devoted its coverage to the increase in the estate tax exemption and 2010 repeal of the estate tax altogether, at least until the EGTRRA provisions sunset after 2010. Far less attention has been paid to the modification of the generation-skipping transfer tax ("GST") regime, especially to an obscure change that may affect anyone whose current estate plan includes any life insurance trusts, grantor retained annuity trusts ("GRAT") or qualified personal residents trusts ("QPRT").

Subject to a $1,500,000 GST exemption, the GST tax is imposed on all transfers to grandchildren and other so-called "skip" persons (which is defined as a person two or more generations below the generation of the transferor) and is in addition to estate and gift taxes. The government's logic for the GST tax can be explained as follows. If you have a taxable estate and give or bequeath assets to your children, a gift or estate tax will be imposed on that transfer. Another gift or estate tax would be

imposed when your children pass their assets (including what you gave them) to your grandchildren. So, if you skip your children and give property to your grandchildren, the government does not get its second estate or gift tax bite. The GST tax, which is imposed on lifetime or testamentary transfers, whether they be outright or to or from a trust, is a second layer of tax that fills in that gap.

The GST tax, like the estate and gift taxes, will be imposed only after you have allocated your entire lifetime exemption amount to previous transfers. In some cases, the allocation is automatic; in others, you must affirmatively elect in (or out) of its application to a transfer.

EGTRRA created a new level of automatic GST exemption allocation for transfers in which you may not want to allocate GST exemption. You may not wish to allocate GST exemption to various transfers to trusts including GRATs, insurance trusts and QPRTs, since those trusts may not have been designed to pass any assets to grandchildren or other skip persons. In order to opt out from the automatic allocation of GST exemption you must make an election on a gift tax return. In the absence of the election, all or a portion of your generation-skipping transfer tax exemption may be wasted.

If you or your accountant have any questions about whether the new automatic GST exemption allocation rules apply to your trust or how (or whether) to elect out of automatic allocation, please call us.

Has Your Address Changed?

Please let us know if your mailing address needs to be updated. Contact Deborah Chernoff with the correct information, either via e-mail: dchernoff@proskauer.com, or fax: 212.969.2900. Thank you.

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Personal Planning Newsletter

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