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CHICAGO'S CATHOLIC CHARITIES CONTINUES KATRINA HELP

In the aftermath of Hurricane Katrina, thousands were in need of shelter. While most found assistance in surrounding areas, a significant number found their way to Chicago. Catholic Charities has served nearly 500 people locally in the wake of the hurricane. Its eight emergency assistance centers in and around Chicago were put to immediate use.

The destruction caused by Katrina is massive, and rebuilding efforts will take years. Storm damage prompted Congress to take the unusual step of making adjustments to the IRS tax code in an effort to increase charitable giving. Please see *Katrina Emergency Tax Relief Act of 2005* pull out on page 2.

Catholic Charities' Katrina efforts have switched to a long-term recovery phase, which, through its national network, Catholic Charities USA, recently made a $25 million grant to Catholic Charities of New Orleans. "Catholic Charities helps people through direct access to on-the-

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Walter Ousley, Chief Operating Officer, and Rev. Michael M. Boland, Administrator, President and CEO, of Catholic Charities of the Archdiocese of Chicago.

TAX AND ESTATE PLANNING

TAX AND ESTATE PLANNING FOR YEAR-END AND LOOKING AHEAD TO 2006

Following several years of substantial tax legislation, 2005 produced relatively few changes to the tax law. While there was initial momentum to overhaul the Alternative Minimum Tax and reconcile outstanding questions as to the future of the federal estate and gift tax, Hurricane Katrina and its aftermath shifted the country's focus away from tax reform. Proponents of change, however, promise to renew their efforts in 2006. In addition, on November 1, the President's Advisory Panel on Federal Tax Reform released its recommendations for overhauling the tax code, which are now under review.

Although 2005 saw few changes to the tax law, taxpayers can still benefit from year-end planning opportunities. What follows is a summary of some of those opportunities. Please contact your BWM&S attorney with any follow-up questions or for additional information.

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Income Tax Considerations

Assess Your Tax Situation First

Proper planning requires that you first assess your current tax situation. Individuals and businesses should take the following steps:

- Estimate income, deductions, credits and exemptions for the year;
- Determine when any carryover items from prior taxable years (e.g., net operating losses, deduction for excess charitable contributions) will expire;
- Identify taxable items for which you can control the timing;
- Determine the amount of tax you must pay in withholdings or estimated taxes to avoid underpayment penalties; and
- Consult your tax advisor to take the actions necessary to make the best of your situation.

Accelerate Deductions and Defer Taxable Income

By deferring taxable income into a future year or accelerating deductions, you can reduce your current tax liability. Taxes can be paid in a later year allowing you to invest the savings in the interim. One common method for accelerating deductions is for taxpayers to make estimated tax payments for their 4th quarter state tax liability prior to year-end (ahead of the January 15 due date). You can claim a deduction for state taxes paid on your 2005 federal return.

Make 2006 Deferral Elections for Non-Qualified Deferred Compensation Plans

Many employers allow their executives to defer a portion of their compensation each year through non-qualified deferred compensation plans. If you are eligible to participate in a non-qualified deferred compensation plan, you are generally required to file your 2006 deferral election on or before December 31, 2005.

While it is generally preferable to minimize current year taxable income, remember to keep track of any carryover items generated in prior years. Some items terminate after a specified period of time. An individual or business would not be well advised to defer income to a later year or accelerate deductions into the current year only to see a loss carryover expire.

Gifts to Charity

A charitable contribution made before year-end can be claimed as a deduction on your 2005 income tax return. Also, by contributing publicly traded stock to a charity, you will avoid tax on the stock's appreciation and be able to deduct the full value of the stock. Regardless of the type of contribution, you must maintain a proper record of your gifts. For cash donations over $250, obtain a written receipt from the charity. If you give a non-cash gift, ask for a letter estimating the value of the gift. Gifts over $5,000 that are not cash or publicly traded stock require an appraisal.

Katrina Emergency Tax Relief Act of 2005

On September 23, 2005, President Bush signed into law the Katrina Emergency Tax Relief Act of 2005. In addition to providing assistance to the victims of Hurricane Katrina, the Act includes general tax incentives for charitable giving.

Prior to the enactment of the new law, an individual donor could deduct cash contributions to public charitable organizations up to 50 percent of his or her adjusted gross income. Contributions of long-term capital gain property (e.g., stocks and real estate held for more than one year) are deductible up to 30 percent of adjusted gross income. Under the new law, Congress has suspended the 50 percent cap on the deductibility of certain "qualified" charitable contributions. For the remainder of 2005, a donor may contribute and deduct certain cash gifts up to 100 percent of his or her adjusted gross income. A charitable contribution is deemed a "qualified" contribution if the gift is made in cash, between August 28, 2005 and December 31, 2005, and to a public charitable organization (whether or not the charitable organization is engaged in Katrina relief efforts). Gifts to a private foundation will not qualify. Likewise, non-cash gifts such as stock and real estate do not qualify under this new legislation.

The new legislation also temporarily suspends the phase-out of the charitable deduction for "qualified" contributions made by taxpayers whose income exceeds specified thresholds. In 2005, taxpayers with income in excess of $145,950 are generally subject to a partial phase out of their itemized deductions. Under the new legislation, individual taxpayers receive a dollar-for-dollar deduction for all "qualified" contributions. All other itemized deductions remain subject to the normal phase out rules.

Review Capital Gains and Losses

Review your portfolio for gains and losses you have recognized as a result of sales during 2005. To the extent you are in a net gain position, consider selling securities that have generated losses. Conversely, if you are in a net loss position or if you have capital losses that were suspended from prior years, consider locking-in some gains realized in 2005 by selling appreciated stock. You can utilize previously suspended capital losses to offset these gains. Corporations with suspended capital losses should always consider strategies to generate capital gains since corporations are only allowed to carry forward capital losses for 5 years. There is no time restriction on an individual's ability to carry forward a capital loss.

Max Out your 401(k)

Consider contributing the maximum amount to your 401(k) plan. The contribution limit was increased to $14,000 in 2005. In addition, individuals who will be at least 50 years of age by the end of 2005 may make an additional "catch-up" contribution of $4,000 in 2005. In 2006, the contribution limit increases to $15,000 and the catch-up contribution increases to $5,000.

Avoid Underpayment Penalties

Make sure that you have paid enough in federal and state withholding taxes to avoid penalties. For 2005, you will avoid a penalty for the underpayment of estimated tax if your tax payments (including withholdings) have been timely made and are at least equal to 100 percent of the tax shown on your 2004 federal income tax return (110 percent, if your adjusted gross income for 2004 exceeded $75,000 if you were married, but filed separately, or $150,000 for other taxpayers) or 90 percent of the tax shown on your 2005 federal income tax return, whichever is less.

Estate & Gift Tax Considerations

Annual Exclusion Gifts

In 2005, you may make a gift of $11,000 to any individual and certain trusts without any gift tax consequences. Married individuals may make gifts of up to $22,000. Gifts may be made outright or in trust and may be in the form of cash, securities, real estate, artwork, jewelry or other property. Giving property that you expect to appreciate in the future is an excellent way of utilizing your annual exclusion gifts because any post-gift appreciation is no longer subject to gift or estate tax. To take advantage of your annual exclusions for 2005, gifts must be made by December 31. Gifts over $11,000 or gifts that will be "split" between spouses must be reported on a gift tax return, which must be filed in April 2006.

For 2006, the annual exclusion amount increases to $12,000, and married individuals will be able make annual exclusion gifts up to $24,000 to any individual and to certain trusts.

Payment of Tuition and Medical Expenses

In addition to annual exclusion gifts, you may pay tuition and medical expenses for the benefit of another person without incurring any gift or generation-skipping transfer ("GST") tax or using any of your estate or GST tax exemption. These payments must be made directly to the educational institution or medical facility. There is no dollar limit for these types of payments and you are not required to file a gift tax return to report the payments.

Contribute to 529 Education Savings Plan

In planning for the future college costs of a child or grandchild, consider contributing to a 529 Education Savings Plan. So long as assets are used for qualified educational expenses, assets in a 529 Education Savings Plan grow tax-free (not just tax-deferred). Qualified educational expenses include tuition, fees, and books for a post-secondary education. Contributions are considered completed gifts and excluded from your taxable estate. You can contribute up to $55,000 ($110,000 for married couples) per beneficiary in a single year without incurring federal gift tax provided no further gifts are made to the same beneficiary over the next five year period. In addition, Illinois residents contributing to the Illinois 529 Plan (the "Illinois Bright Start College Savings Program") are allowed a deduction for state income tax purposes of up to $10,000 ($20,000 if married filing a joint tax return).

Lifetime Gifts Using Gift Tax Exemption

In addition to annual exclusion gifts and the payment of tuition and medical expenses, you may currently make gifts of $1 million during your lifetime without incurring a gift tax liability. Married taxpayers may make gifts of $2 million over their lifetimes without incurring gift tax. Although the amount you may exempt from estate tax upon your death will be reduced by the amount of such lifetime gifts, any future appreciation on the gifted property will be removed from your taxable estate.

Take Advantage of Today's Low Interest Rates

While interest rates have been trending up, they remain at historically low levels. Low interest rates enhance the benefits of several gift and estate planning strategies. One such strategy is the "grantor retained annuity trust" or GRAT. A GRAT is an irrevocable trust to which a donor transfers property and retains the right to receive a fixed annuity for a specified term. At the expiration of the term, the property usually passes outright or in trust for the benefit of descendants or other named beneficiaries. The amount of the gift resulting from the transfer of the property to the GRAT is the present value of the remainder interest that passes to the beneficiaries at the end of the term. Under the valuation methods adopted by the IRS, the lower the interest rate at the time of the gift, the lower the present value of the remainder interest and the smaller the amount of the gift that must be reported to the IRS. Interests in closely held family businesses are often ideal properties to transfer to a GRAT.

Another strategy is a private annuity. In a typical private annuity, a parent transfers property to a child in return for the child's promise to pay the parent a fixed periodic amount for life. If the fair market value of the property equals the actuarial value of the annuity, there is no gift tax due. Lower interests rates reduce the amount that the child must pay to the parent to prevent a gift from occurring on the transfer.

Finally, low interest rates also make sales to defective grantor trusts more attractive. Under this strategy, a taxpayer creates a trust, typically for his or her spouse and descendants. The taxpayer then sells assets to the trust taking back a note requiring the trust to repay the taxpayer in installments. The trust is structured so that it is ignored for income tax purposes, resulting in no income tax consequences upon the sale. The interest paid on the note is typically at the applicable federal rate, which changes month to month based on current market rates. The lower the interest rate on the note, the greater the amount of assets that will accumulate in the trust free of estate, gift and GST taxes.

This article was prepared by members of the BWM&S estate planning and taxation practices. Members include Karen MacKay, Stephanie Denby, Jonathan Michael, Martin Ryan, Melanie Witt, Terrence Stein and Greg Winters. You may contact your attorney or any of the attorneys listed above at **312/840-7000**. Additional contact information is available from the firm's website, www.burkelaw.com. B

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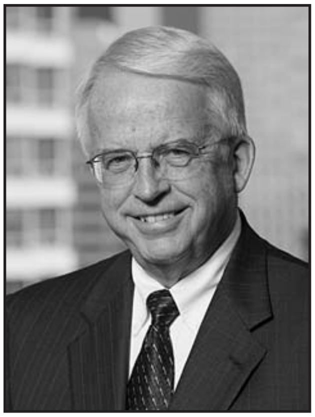
THE TIMING OF COMPANY 401(K) DEPOSITS

U.S. Department of Labor Regulation Sections 2510.3-102(a) and (b)(1) require the deposit of participant 401(k) contributions to be made as of the earliest date on which the contributions can be reasonably segregated from the employer's general assets but in no event later than the 15th business day of the month following the month in which the amounts would have been payable to the participant in cash. Some have interpreted this to mean participant contributions, even though withheld on a weekly basis, can be accumulated on a monthly basis and then deposited by the 15th business day of the following month. That is not what the regulation states.



Mike Virgil

The regulation requires contributions be deposited on the **earliest date on which they can reasonably be segregated** from the employer's general assets. The deposit of withheld federal income taxes generally has to be made within one week after the payday. If payroll taxes can be segregated and deposited on a weekly basis, it seems reasonable that participant 401(k) contributions can be segregated and deposited on a similar basis. The Department of Labor will quite likely take this position in the event of an audit of a 401(k) plan and a participant will clearly take this position if his employer is accumulating his contributions on a monthly basis and the stock market goes up 10% during the period when the contributions are being held un-invested. In addition, if a retirement plan is required to have an audit by a certified public accountant, the plan may receive a qualified opinion from its auditor if deposits are not timely made.

The best practice, and our strong recommendation, is for an employer to make deposits of 401(k) participant contributions on the same time frame as deposits of withheld federal income taxes are made. The same logic applies to participant contributions in Section 457 and 403(b) plans.

For more information, please contact Mike Virgil at 312/840-7015 or mvirgil@burkelaw.com. B

CATHOLIC CHARITIES

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ground efforts in the New Orleans area, in addition to housing people in Chicago and at many locations throughout the country," says Walter Ousley, Catholic Charities Chief Operating Officer. "People interested in offering assistance to Katrina victims should consider Catholic Charities."

The Catholic Charities' Disaster Relief Donation Hotline can be reached at 312/655-7174. Additional information on Catholic Charities' efforts is available at www.catholiccharities.net or at www.catholiccharitiesusa.org.

BWM&S together with its attorneys and staff donated more than $20,000 to Catholic Charities in support of its Katrina efforts. B