

SNSFE QUARTERLY REVIEW

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A newsletter for our clients and friends



From the President

As I closed my last note *From the President*, I promised a discussion of a change in focus at U.S. Immigration and Customs Enforcement (ICE). The focus is now upon you. On July 31, 2006 the New York Times (nytimes.com) headline announced: *U.S. Puts Onus on Employers of Immigrants*. The news was a 40 count federal indictment of an employer who allegedly violated our nation's immigration laws as to unauthorized employment. In April of this year, ICE arrested more employers and employees than they had in the whole of 2005.

The ICE enforcement effort has been spread across the spectrum of employers, large to small. An employer can not assume that it will be overlooked because it has only a few employees. Employers must comply with employment eligibility verification procedures. Those who fail to do so risk imposition of stiff civil and criminal penalties.

The compliance landscape is made more complicated by ICE's proposed regulations concerning "no-match" letters and defining "constructive knowledge" that an employee is an unauthorized worker; and, "safe harbor" provisions to be followed by employers who receive a no-match letter and who may then not be charged with having such constructive knowledge.

In brief, no-match letters are routinely sent by the Social Security Administration to employers, listing the names and Social Security Numbers (SSNs) of employees whose names do not match the SSNs provided to the employer. No-match letters may be sent to employers after inspections of employers' form I-9s. If you receive a no-match letter, under the proposed regulation, you may be deemed to have had constructive knowledge of the related unauthorized employment. If I-9 forms have not been properly completed, you may be charged with constructive knowledge of an unauthorized employment.

It is imperative that you know how to respond to no-match letters and how to cure errors or omissions in your I-9 compliance. Fixing errors in the wrong way might also subject you to penalties.

The space we have here is not sufficient to deal in necessary detail with each of these topics. If you would like to receive further information, please contact me.

On December 19th I will be reprising my webinar on managing risks in employment terminations. I will discuss employment topics critical to protecting your business, including managing the termination process and preparing for termination claims. You can register for this complimentary event from our website or call us at 312.621.4400.

Our next issue of the Quarterly Review will include articles on succession planning for business owners, the Illinois Home Repair and Remodeling Act, and a checklist for detecting stockbroker/financial advisor abuse.

Steven C. Filipowski

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What's All The Fuss About Variable And Equity Indexed Annuities?



April J. Lindauer

Variable and equity indexed annuities have gained significant popularity in the past five years as an alternative to traditional equity and fixed income investments, reaching \$217 billion in sales in 2005. Investors often do not understand their annuity investments and regulators are beginning to take notice. Moreover, annuity investors are turning to litigation and arbitration of disputes seeking redress for the unsuitable or misleading purchase or exchange of these products.

Regulators are closely scrutinizing sales of both variable and equity indexed annuities to the elderly.

As a result of investor complaints, high pressure sales tactics targeting seniors, and egregious suitability violations, the states are stepping up enforcement and enacting legislation to protect seniors. Recent enforcement actions by NASD and state securities divisions have targeted individuals and firms selling these products to seniors without proper suitability considerations.

Equity indexed annuities have also come under scrutiny recently due to the number of individuals marketing these complex products to seniors under the guise of a "senior specialist." These "specialists" offer free meals to seniors for an investment seminar which really turns out to be an aggressive sales pitch for equity indexed annuities. The reality is that some of these specialists have had little to no training. Seniors victimized by these sales tactics realize too late that their liquid net worth may be tied up for another 15 to 20 years. Older investors in need of income then are forced to incur high surrender charges for unexpected expenses, such as medical care.

Many annuities are marketed to customers as being tax deferral vehicles. For investors with a long time horizon, this may be true. However, investors needing their funds within a shorter time period may feel the tax sting, because the conversion of capital gains into ordinary income will end up costing the investor more money in the long run. Accordingly, investors looking for a place to put the proceeds from their 401(k) or IRA accounts should be wary of annuities. That is because IRA and 401(k) accounts already are tax deferred vehicles, such that rolling over the proceeds to an annuity may not provide the investor with any additional tax deferral.

Exchanges of variable and equity indexed annuities also have come under regulator scrutiny. Firms and individuals are being hit with large fines and sanctions for what regulators accurately describe as an egregious sales practice. In fact, the lack of a reasonable basis for an exchange is a serious abuse that is frequently the focus of litigation and arbitration.

Many investors do not understand how the value of their annuity is tied to their annuity sub-account investments. With equity indexed annuities, many investors have a difficult time figuring out just how performance is measured. As with any investment that carries any sort of risk, investment recommendations in the sub-accounts of these products must be suitable for the investor.

Investors have realized that the commissions and fees associated with these products can be onerously high (depending on the features of the annuity being sold), eating into any investment gains and costing much more than traditional equity and fixed income investments. Investors also have been wrongly convinced to pay a premium for specific annuity features, such as an increased death benefit or long-term care insurance, which they do not need.

At SNSFE, we assist both investors and financial advisors relating to the sale or exchange of variable and/or equity indexed annuities. ■

For more information, contact April at 312.621.4400 or ALindauer@SNSFE-law.com.

In the last six years, the NASD has filed 286 enforcement actions relating to annuity sales.

Investors must be made fully aware of the costs, risks and downsides to annuity investments.

Status of Estate Tax Reform



Sigmund J. Chavis

In our last issue, we reported that although there had been talk of revision of the federal estate tax law, on June 6, 2006, the U.S. Senate denied even floor consideration of a bill designed to do that.

Subsequently, proponents of a modification to the estate tax law sought to combine that modification with a package of popular tax policy extensions and a minimum wage hike. That too was unsuccessful in an early August vote. As of this writing, proponents of a modification are still considering linking it to other "sweeteners" in order to gain approval. However, opponents have told reporters that they cannot see any scenario under which senators would change their vote on the estate tax issue.

We will continue to monitor the situation.

Does Your Family Limited Partnership Pass Tax Court Scrutiny?



Every family limited partnership should be reviewed. Family limited partnerships have played an important role for many families in consolidating management of family investments, training younger family members in the family's investment philosophy, facilitating business succession planning, and providing creditor protection - especially to those practicing in liability vulnerable professions.

An important estate planning tool. If the partnership is structured properly, the partners, especially the older generation partners, are able to obtain substantial discounts in the value of their partnership interests for estate and gift tax purposes when compared to the value of the underlying assets held in the partnership.

The IRS's attacks. The Internal Revenue Service had been hostile to family limited partnerships so used, but it had been generally unsuccessful in its challenges. However, during 2005 the Internal Revenue Service scored some successes in a fifth circuit federal appellate court case and four tax court cases. *Strangi v. Commissioner*, No. 03-60992, July 15, 2005 (5th Cir. 2005); *Estate of Bongard v. Commissioner*, 125 T.C. No. 8 (March 15, 2005); *Estate of Bigelow v. Commissioner*, T.C. Memo 2005-65 (March 30, 2005); *Estate of Schutt v. Commissioner*, T.C. Memo 2005-126 (May 26, 2005); and *Estate of Korby v. Commissioner*, T.C. Memo 2005-102 (May 10, 2005).

Nevertheless, a careful reading of these cases fortifies the use of a family limited partnership in appropriate circumstances, especially where: (1) the contributing partner is willing to relinquish control, or (2) the partnership is engaged in an active trade or business. ■

For more information, contact Sig at 312.621.4400 or SChavis@SNSFE-law.com.

Whether you are a principal evaluating a potential investment, or a professional advisor retained to analyze a client's transaction, thoroughly investigating the investment is critical.

Ten Steps Of Due Diligence For Real Estate Investments



Two pre-conditions are necessary to proceed to the process:

- Do the investment materials disclose all material facts?
- Is the information provided in a manner that makes it possible to evaluate the merits?



Michael D. Weis

TEN DUE DILIGENCE ESSENTIALS: (source: Stuart A. Ober, AIFA, CFE)

1. **Investigate the business experience, integrity and track record of the principals.** An investment is only as good as the people who are in charge of it. You may wish to talk to the attorneys, accountants, bankers, and past investors of the principals.
2. **Carefully review the economic merits.** Does the project make economic sense?
3. **Examine the physical property.** Not only should you "kick the tires," you should also talk to the local bankers, realtors, and residents about the general conditions of this type of real estate in this area.
4. **Look at the organizational expenses, management fees, and commissions.** Are the fees payable to the sponsors fair? Compare to similar types of investments.
5. **Examine the arrangement between the general partner/manager and the limited partners/investors.** When does the investor's money get repaid?
6. **Tax issues.** If possible, examine the opinions of the lawyers or accountants.
7. **Financial viability of the sponsor.** Does the sponsor have deep pockets? Sponsors with limited financial resources and limited credit are always a risk.
8. **Examine conflicts of interest.** Look for family or close personal relationships. Does the sponsor have an alternative or hidden purpose for the investment? If there is a conflict, is it mitigated? Try to understand the sponsor's intentions and overall financial interests.
9. **Review all pertinent reports.** Review engineering, environmental, appraisal, financial, and market reports.
10. **Call in the pros.** You cannot do it all yourself. Utilize accounting, legal, appraisal, real estate and other experts as needed.

It may take time, effort and expense to complete the checklist, but in the long-term, you will protect you and your client's best interests. ■

For more information, contact Michael at 312.621.4400 or MWeis@SNSFE-law.com.

Every family that has a family limited partnership in place should have their partnership reviewed and modified if necessary.

The exercise will help determine whether the investment is favorable based on an organized, methodical examination.

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Shaheen, Novoselsky, Staat,
Filipowski & Eccleston, P.C.
20 N. Wacker Drive, Suite 2900
Chicago, IL 60606-9719

312.621.4400
312.621.0268 (fax)

www.SNSFE-law.com
www.FinancialCounsel.com

For more information, call or write:
Steven C. Filipowski, President

NOTICE: Important Changes In Pension Laws!

On August 17, 2006, President Bush signed the Pension Protection Act of 2006. This 900 page legislation contains the biggest changes to the pension laws since ERISA in 1974. For a copy of Scott Galbreath's summary of the Act, "The Top Ten Things You Need to Know About Pension Reform," please email us at CGrimes@SNSFE-law.com or telephone 312.621.4400.

upcoming events

Call 312.621.4400 for more information or to register.

See a full listing of upcoming events on our website at www.snsfe-law.com.

We're pleased to offer Illinois registered public accountants continuing education credit for attending select online seminars. Qualified attendees can receive 1 CPE.

Webinar: October 26

Succession Planning For Business Owners

Lawrence G. Staat. 11:00 AM - 11:50 AM. Complimentary. 1 CPE credit.

Webinar: November 28

Protecting Yourself In Bull And Bear Markets: What Investors, Their Accountants and Advisors Should Know About Investment Product Suitability and Investment Abuse

Ronald M. Amato. 11:30 AM - 12:00 PM. Complimentary.

Webinar: December 19

Managing Risks In Employment Terminations - The Issue of Pretext in Employment Litigation

Steven C. Filipowski. 11:30 AM - 12:00 PM. Complimentary.

SNSFE welcomes Stewart W. Byers as Of Counsel to the firm in its transactional areas. Stewart practices law in federal and state income tax, estate tax, real estate and probate.