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Estate Tax Exclusion Poses Opportunities and Challenges

The new federal tax law ushered in the highest estate- and lifetime gift-tax exemptions in U.S. tax law history: $5 million for individuals and $10 million for married couples. While this may appear to have taken off the pressure for careful estate planning — only 1% of U.S. estates are estimated to be larger than $5 million — the higher limits pose both opportunities and challenges for high-net-worth families.

Given the new law, here are some estate planning considerations married couples should address:

Change charitable donations? — The single most obvious benefit of the higher estate tax exemption is that if planned properly, a couple can now leave substantially more — $10 million instead of $2 million — to heirs and relatives. This is most significant to those whose primary reason for charitable giving is to reduce taxes. Given the new law, reviewing your purposes and strategy should be your first priority.

Accelerate and increase gifting? — For couples who have exhausted the previous unified gift-tax exemption of $2 million, the $10 million limit represents an unprecedented opportunity to move assets out of their estates without taxation. Keep in mind, however, that the annual limit on tax-free gifts is only $13,000 in 2011, $26,000 if a couple splits their gift.

Since the new tax law expires in 2013 and it's uncertain what future exemption limits will be, it may be a good idea to take full advantage of the higher limits over the next two years. Targeting appreciating assets — like stocks and real estate — should be the first priority. Even if Congress reduces the exemptions after 2012, once those assets are out of your estate, any appreciation on

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Inheriting Stocks

Typically, individuals who inherited stocks have received stocks that have increased in value over time. But what do you do if you inherit a stock that has decreased in value?

Inherited assets receive a step-up in basis to market value at the date of the original owner's death. Any gains from the sale of inherited stocks are subject to the long-term capital gains tax rate no matter how long you personally owned the stock.

However, when there is a loss, your basis in the stock still remains at its market value on the date of the original owner's death, so you get no tax benefit from the loss in value. Your choices are to sell the stock at its current price with no tax deduction for the loss or wait until the stock rebounds, paying capital gains taxes on the difference between your basis and your sales price.

To determine whether you should hold or sell an inherited stock, determine whether is it an appropriate investment for your financial goals. Don't hold inherited stocks for sentimental reasons. ❍❍❍

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Estate Tax Exclusion

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those assets is also out of your estate.

Trust or will? — The higher limit means you can avoid establishing trusts to remove greater funds from your estate. One disadvantage of testamentary transfers to beneficiaries is you lose control over how and when the funds are distributed. Wills must still pass through probate, which means there is the potential for considerable delay before your heirs gain access to the assets they may need to pay taxes or other bills. Wills also distribute assets without limitations as to the purposes they can be used for or when, such as reaching the age of majority or annual distribution amounts. Only trusts can establish these directions.

Understanding the new portability provision — One new feature of the tax law concerns "portability" of the estate tax exemption between spouses. Under this provision, any credit that has been unused by a deceased spouse can be transferred to the estate of the surviving spouse.

For example, if a spouse's estate has used only $2 million of the $5 million exemption, the remaining $3 million can be applied to the surviving spouse's estate, raising its exemption to $8 million. But there are two important caveats: 1) It's not automatic. Even if an estate won't owe a penny in federal estate taxes, it must file a tax return to establish the transferred credit. 2) Portability does not apply to generation-skipping trusts whose beneficiaries are grandchildren and great-grandchildren.

If the surviving spouse is predeceased by more than one spouse, the additional exclusion amount carried over to the surviving spouse is limited to the lesser of $5 million or the unused exclusion of the last deceased spouse.

Avoiding unintended disinheritance — Because estate laws are constantly changing, when it comes to dividing assets among different heirs, many wills and trusts rely on a "formula clause" that doesn't specify dollar amounts or percentages. For example, a document may simply say that children of the deceased are to receive the maximum amount allowed to pass to them free of federal taxes with the remainder going to the surviving spouse. For an estate that is $5 million or less, this means the spouse is effectively disinherited. Adding further clarification in such cases is vital to ensuring that an intended beneficiary isn't left penniless.

Lower state thresholds — Be aware that more than a dozen states also levy inheritance taxes, and the threshold of taxability may be considerably lower than the federal level.

Estate planning is an important part of your overall financial plan, no matter how large your net worth. To review your current estate plan in light of the new tax laws, please call. ❍❍❍

Roth IRAs: Are They for You?

Unlike a traditional individual retirement account (IRA), contributions to a Roth IRA are taxed while the earnings accumulate tax free. What's more, a Roth IRA can be funded with new money or converted from a traditional IRA. But is it for you?

Are you worried about an increase in tax rates? By investing in a Roth IRA before any potential tax increases, you can take advantage of current tax rates. This beats the traditional IRA where you would be paying taxes at a higher rate when you make a withdrawal in the future, except that most people fall into a lower tax bracket when they retire. Also consider this: if you convert your assets into a Roth IRA, it could take 15 to 20 years for the tax-free growth of a Roth IRA to make up for the taxes paid at the time of conversion.

How do the new rules affect you? One of the reasons Roth IRAs have become more attractive recently is because of their new income restrictions — or lack thereof. In the past, anyone making more than $100,000 a year couldn't convert their traditional IRA into a Roth. Starting in 2010, they can. The law hasn't, however, impacted annual contribution limits. The maximum annual contribution allowed for a Roth IRA remains $5,000 for anyone under 50 years old and $6,000 for investors 50 or older.

Does passing on wealth matter to you? A benefit of Roth IRAs is that you can pass the balance on to your beneficiaries tax free. Additionally, there are no minimum withdrawals required for a Roth IRA — you can take advantage of tax-free growth for as long as you like.

But Is It for You?

Roth IRAs clearly offer a number of attractive benefits when compared to traditional IRAs. But those benefits have a tradeoff: pay taxes now or pay them when you're retired. Consider whether the benefits of a Roth IRA — including the comfort of paying taxes today at a known rate — really matter to you.

Roth IRAs are just another option when investing for retirement. Because everyone's financial picture is different, you should take the time to carefully review your situation and to determine if a Roth IRA is for you. Please call if you need help. ❍❍❍

Life Insurance: A Key Component in Estate Plans

Because of its flexibility, tax advantages, and potential to leverage your assets, life insurance can be an important estate planning tool. The usefulness of life insurance in almost any estate plan of any magnitude makes it one of the most universally applied tools. There are three major reasons:

1. Creating an immediate estate.

For the price of a premium, even someone with no savings — like a newlywed or young parent — can quickly create a sizable estate with the potential to provide for the needs of dependent survivors. Of course, premiums vary according to type of policy and the amount of coverage purchased, so needs and affordability are issues every applicant for life insurance must contend with. But one of the great advantages of a life insurance policy is that most of the benefits paid out by the policy can be received tax free.

2. Providing liquid proceeds for final expenses.

Unlike wills, cash distributions from life insurance policies normally aren't required to pass through probate. As a result, beneficiaries can have more timely access to pay for such final expenses as unpaid bills, funeral expenses, and taxes.

3. Keeping post-tax asset values intact.

Even with the recent increase in the U.S. estate and gift-tax exemption to $5 million for individuals and $10 million for married couples, some estates will still be large enough to be subject to taxes. In a properly structured estate, the tax-free death benefit of a life insurance policy can be used to offset the taxes beneficiaries must pay, essentially allowing them to receive the benefit of the full value of your assets.

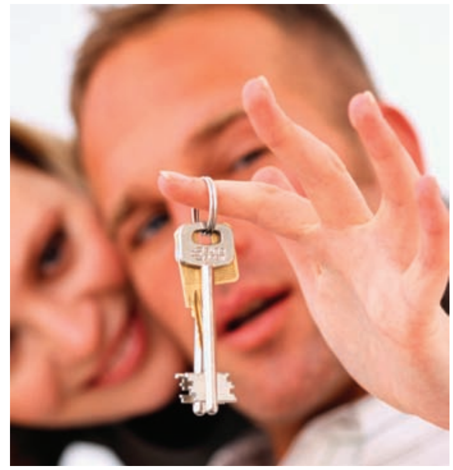
Planning Considerations

There are a host of issues to decide upon when considering the role that life insurance can play in your estate plan. First among them is determining the coverage amount and type of policy, which — even for a young family or one with fairly simple estate planning issues — can be quite complicated. But there are many other decisions to make, including:

✔ **Who owns the policy?** The policy's owner does not have to be the person who pays the premium. Who it is, however, can have important ramifications for the tax treatment of death benefits. For example, the death benefits from a policy owned by a business controlled by the person insured may be subject to estate taxes. On the other hand, ownership by the surviving spouse can merely delay estate taxes until the death benefits pass to the couple's children.

✔ **Who are the beneficiaries?** Is it the surviving spouse, the children, other relatives, a business or business partners, or a legal entity, like a trust? Again, the wrong choices can confound the purposes for which you buy the policy in the first place.

✔ **Should a trust be involved?** To avoid the pitfalls of ownership by the wrong person or entity, you can create an Irrevocable Life Insurance Trust (ILIT) as both the owner and the beneficiary. In this case, death benefits are generally distributed tax free. To ensure that is the outcome, the trust must be properly structured — a trustee, a settlor, and beneficiaries must all be properly named, and their roles regarding payment of estate taxes must be carefully defined.



✔ **How should your policy be coordinated with other trusts?** If your estate issues are more complicated than average, you may find your plan involves other trusts, like a qualified personal residence trust (QPRT), which involves the ownership of your dwelling by your beneficiaries, or a Qualified Terminal Interest Property Trust (QTIP), which is typically used when one spouse wants to ensure the distribution of assets after the remaining spouse's death. Each of these trusts can benefit from the way you structure the life insurance component of your plan, so coordination with your policies can be advantageous.

What role should life insurance play in your estate plan? Only a thorough analysis can provide the answer that's right for you. Please call if you'd like to discuss this in more detail. ❍❍❍

Reducing the Cost of College

While the cost of a college degree can certainly seem overwhelming, it is especially so during tough economic times. Consider these strategies to reduce the cost:

Look for scholarships not based on need. Generous merit scholarships are often available to students with outstanding high school grades and above-average entrance exam scores. Scholarships may also be available for athletes and for those with strong music backgrounds.

Apply to several different colleges. Don't make the mistake of thinking that aid packages will be the same at all universities. You may be surprised at how wide the differences can be. Even if your child is set on one school, it is generally wise to apply to several different colleges.

Talk to the university. If the financial aid package is not sufficient, talk to the financial aid officers at the university. By explaining extenuating circumstances or showing the college offers from other universities, you may be able to increase aid.

Don't overlook state public universities. Costs of public universities, especially in your state, are typically much more affordable than private universities.

Decide whether it makes sense to go to an expensive private college. First, you need to evaluate how much financial aid your student would be entitled to. If you are still left funding much of the cost yourself, consider whether your child's intended career makes it a good investment.

Consider starting at a two-year college. Two-year colleges are often much cheaper than four-year colleges, especially when you consider that most students live at home while attending. Before starting, however, your child should determine which four-year college he/she will transfer to and make sure all of the credits will transfer to the four-year college.

Send more than one child to the same university. Many universities offer discounts on tuition if more than one child attends at the same time.

Accelerate your child's studies. You can save a significant amount of money if your child can complete a four-year degree in three years. Another alternative is to have your child take summer courses at a local community college. ❍❍❍

Discussing Estate Plans

If you don't discuss your estate plan with heirs, disagreements and conflicts could erupt once the details of inheritances are revealed. At that time, you won't be able to explain your thoughts and wishes regarding your estate's distribution.

Discussing your estate plans will give you an opportunity to inform your heirs about your estate's distribution and why you decided to do it in that manner. You can go into specific detail, informing heirs how each asset will be distributed, or you can give a general overview of your estate plan. If you have selected one heir as executor or trustee, explain why you chose that individual.

Even if you reveal your plans to heirs, you may also want to include a personal letter. In that letter, include information about death and other benefits, special wishes, who should receive personal effects, your cemetery and funeral preferences, and the location of your safe deposit box and important documents. This letter will help your heirs identify all assets and benefits and avoid speculation about your wishes. Since the information is likely to change, review the letter at least annually. ❍❍❍

Financial Thoughts

Due to lower earnings and more time out of the workforce, the average employed woman has a balance in her defined-contribution plan that is only 60% of the average employed man's balance. Among workers 50 and older, women had saved $63,000 less than men (Source: LIMRA, 2011).

Almost 34% of Americans indicated that they have no retirement savings, up from 30% just 18 months ago (Source: Harris Interactive, 2011).

Approximately 58% of investors with a retirement account or other financial investment reported making at least one change toward being more financially conservative. The top three changes reported by investors were increasing savings, shifting away from stocks, and increasing their anticipated retirement age (Source: Investment Company Institute, 2011).

According to a recent survey, 84% of affluent baby boomers expect their retirement to be different from their parents, with most saying they will maintain a more active lifestyle (86%) and enjoy a higher standard of living (72%). Approximately 70% plan to continue working after reaching retirement age (Source: Bank of America, 2011). ❍❍❍

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