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New Rules for Estate and Tax Planning

Fourth Edition

Stewart H. Welch, III, AEP, CFP, Harold Apolinsky, Esq., EPLS, and Craig Stephens, Esq., LLM

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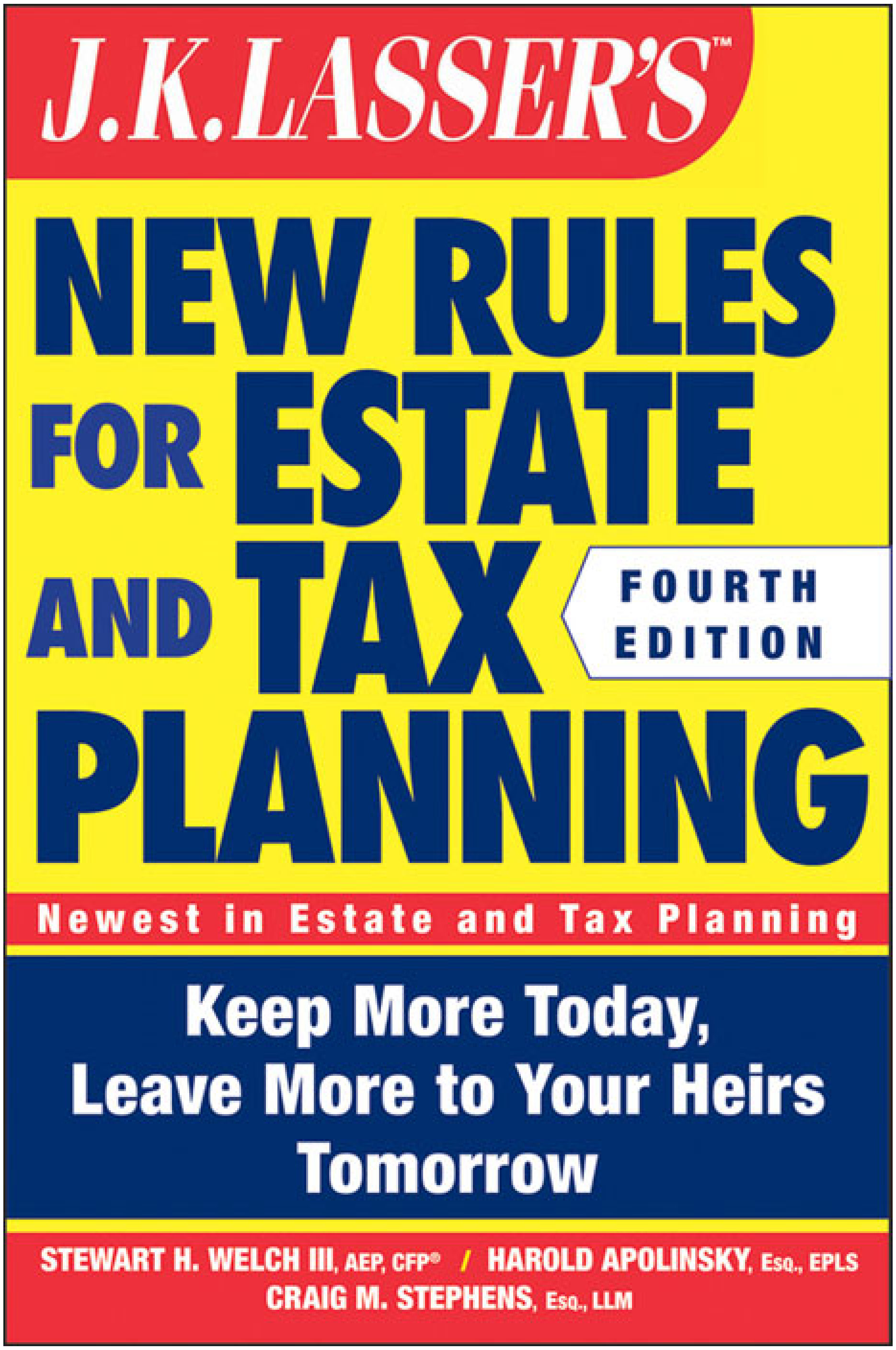
J.K. LASSER'S™
NEW RULES FOR ESTATE AND TAX PLANNING
FOURTH EDITION
Newest in Estate and Tax Planning
Keep More Today, Leave More to Your Heirs Tomorrow
STEWART H. WELCH III, AEP, CFP® / HAROLD APOLINSKY, Esq., EPLS
CRAIG M. STEPHENS, Esq., LLM

MAKING YOUR MONEY WORK FOR YOU

Maybe you're thinking it's time to review your investment strategy and make the most of the money you have today. Maybe you've already built a financially successful retirement egg and want to protect what you've built. Or maybe you need to bulk up your earnings to ensure your family's future.

Welcome to money for grown-ups. Where do you turn for credible information?

Dedicated to helping you protect your assets, stretch your dollars, and bolster your longterm security, AARP can offer you powerful solutions. Whatever your strategy for managing money, we've got suggestions that will help – from saving money on that next big purchase to planning your charitable giving. If you're taking your job to the next level or building up a second career, we've got strategies that will help you make your mark.

You may think your money — or your financial advisor — should be working harder for you. You may be watching market trends and seeing new opportunities. And, of course, you want to protect yourself and your loved ones from scams and data breaches. We can give you the support you need.

And turn to us for fun, too. (Is it time for that car, that trip, that weekend home you've always wanted?) Because that, too, is what this time of your life is about.

AARP is a nonprofit, nonpartisan membership organization that helps people 50 and older improve their lives. For more than 50 years, AARP has been serving our members and society by creating positive social change. AARP's mission is to enhance the quality of life for all as we age; lead positive social change; and deliver value to members through information, service and advocacy. This information in this book is for educational purposes and does not constitute financial advice.

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We are all constantly seeking and studying new estate planning ideas to help clients not only accumulate wealth, but keep wealth within their families. I want to acknowledge the encouragement of my wife, Marissa Levine Apolinsky, who exhibited unlimited patience as I spent time writing. Also, the years of encouragement from my children, Steve Apolinsky, Felice Apolinsky, and Craig Apolinsky, who convinced me that with hard work and determination nothing was impossible to achieve. Finally, without the help of our loyal assistants, Marsha Self and Beverly Stradford, and our top estate planning associates Tanya Shunnara, Esq., and Melissa May, Esq., the demanding publishing deadlines could never have been met. The most fun for me has been to work with Stewart Welch, a most gifted individual and innovative financial advisor.

Craig Stephens, Esq.

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I would also like to thank Harold Apolinsky and Stewart Welch III for providing me with the opportunity to be a part of the fourth edition of this book and a coauthor of the fourth edition. I am fortunate to have worked with Harold and Stewart on many projects, and our collaborative efforts will hopefully lead many families to produce a lasting legacy for decades to come.

Stewart Welch III, Accredited Estate Planner, Certified Financial Planner™

This book would have never happened without help and moral support from many people. First and foremost, I want to thank my coauthors, Harold Apolinsky and Craig Stephens. Harold is not only a true scholar but a true gentleman as well. He has been generous with both his time and his talents. Thanks, Harold. I also want to thank Craig Stephens for his insightful contributions to this revision. Craig is a rising star in the legal profession.

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As most of you are aware, insurance can be a very confusing product to understand. I am fortunate to have had the assistance of two of the country's top insurance specialists. I would like to thank my father, Stewart H. Welch Jr., CLU, who has been a top professional in the business for more than 50 years. He never ceases to amaze me with his energy and creative ideas. I have truly been blessed to have had his guidance throughout my life. Babs Hart specializes in long-term care insurance, and her input regarding that section of the text was invaluable.

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I feel very fortunate to have the opportunity to work with the prestigious publishing house of John Wiley & Sons, Inc., a traditional “blue blood” firm whose roots can be traced back to 1807. I could not mention John Wiley & Sons, Inc., without thanking Editorial Director Debra Englander, a longtime friend of mine who has become as much my sister as a trusted colleague.

Writing a book of this type is a full-time job in and of itself. Because running my company is also a full-time job, my family ends up paying a large price for my commitments. The biggest price by far was paid by my wife, Kathie. She endured many weeknights and most weekends alone while I spent much of my nonwork time writing. Throughout the entire time she remained very supportive, and I love her even more for it. I especially want to thank my mother, Sally Welch, for her constant prayers and support. She is a fine person who has been a guiding light all of my life. I also have two wonderful sisters, Jean Watson and Babs Hart, who have always been cheerleaders for all my endeavors.

There is no way to express how grateful I am for the wonderful clients I have the pleasure of serving. Each, in their own way, has contributed to my own learning and therefore to this book.

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In addition Professor Jeffrey A. Cooper is a professor of law at Quinnipiac University School of Law in Hamden, Connecticut. While using our book as a resource for his classes, Professor Cooper offered invaluable suggestions for improving the content for this revision.

Introduction

Writing a book of this magnitude requires a tremendous amount of time and emotional energy. I agreed to take on this project only under the condition that I could convince one of the country's best legal minds to join me as a coauthor. To my great delight, Harold Apolinsky agreed to my proposal. Harold is one of the country's most respected estate tax lawyers. He testified before Congress and spent innumerable hours in Washington lobbying influential senators and representatives. He served as general counsel for the American Family Business Institute. The American Family Business Institute is the premiere trade association educating members of Congress on the need for major reform of the estate tax. Dick Patten serves as the president and CEO of the American Family Business Institute in Washington, D.C. For more information, please visit www.nodeathtax.org. I am also delighted that Harold convinced his protégé, Craig Stephens to also coauthor this book. Craig is both highly intelligent and resourceful and has been a pleasure to work with on this project.

I own a fee-only wealth management firm serving a nationwide clientele, Harold is the senior tax and estate planning member of Sirote Permutt, one of Alabama's largest law firms along with Craig Stephens, who is a partner in the same law firm. Together, we have had the opportunity to work with many affluent individuals throughout the United States. The common characteristic that we find among them is that they take pride in both their financial success and in their ability to handle their finances. But this book was not written just for the affluent but for the many people who want to *become* affluent.

What does it take? Although you may already have accumulated a sizable estate and feel comfortable handling your investments, chances are you haven't paid sufficient attention to estate *planning*. This is the reason we wanted to write this book. The purpose of *J.K. Lasser's New Rules for Estate and Tax Planning, Fourth Edition* is to make certain that you have taken steps to make sure your estate is in order and that you have a specific strategy in place. Whether you are just getting your financial feet on the ground or you are a millionaire many times over, this book offers valuable strategies you can use today and in the future.

As you read this book, we encourage you to keep your parents' situation in mind because some of the more advanced strategies may be more appropriate for them than for yourself. You may want to discuss these issues with them or lend this book to them. After all, you should all share the goal of maximizing the amount of money that you can transfer to your heirs and charitable organizations.

The book begins with an overview of the most important aspects of the 2010 Tax Relief Act. You will be able to use this chapter as a reference tool for reviewing significant estate and income tax laws affecting you.

Next, you will need to assess the adequacy of your current estate plan. What is the value of your total estate? You will learn how to determine your *estate* net worth. This is vital because knowing its value will let you define the resources available to your family to provide for their income needs should you die prematurely. You will also be able to determine approximately how much in estate taxes your heirs might owe.

It is also important to assess whether you are on track toward retirement---are you accumulating enough investment assets to provide you with a worry-free retirement? Studies indicate that the average working American is saving less than one-third of what he or she needs to have enough assets to maintain the same lifestyle during retirement. In many cases, this shortfall will be made up from inheritances. If you find out that you're lagging behind, this book will help you figure out how much you need to be investing to get on track, and you'll learn how to devise an appropriate investment plan.

Another key aspect of estate planning is, of course, having a will. Research indicates that as many as 80 percent of adult Americans either don't have a will or their will is out-of-date. If you fall into this group, you should stop procrastinating. It really does matter if you die without a will! We'll outline the perils of dying without one. The resulting chaos will surprise you. You'll learn how to prepare yourself so that you can minimize the time and expense of working with an attorney.

The use of trusts is a vital part of most estate plans. You can use them to protect your children from themselves, to protect you from possible future creditors, or to save on income and estate taxes. These are powerful weapons in the war to protect your assets for yourself as well as future heirs. It is our experience that many people carry large amounts of life insurance, including their employer's group life. Utilizing some type of trust is often an invaluable estate planning tool. You'll learn about the irrevocable life insurance trust, living trust, and other types of trusts.

Many of you face the difficult task of funding your children's education. You'll learn how to effectively use qualified tuition plans and education individual retirement accounts as well as custodial accounts and minors' trusts. You'll also learn about how grandparents can be willing partners in assisting with your children's educational expenses.

If you are interested in providing financial support to a religious organization, an educational institution, or a favorite charity, you'll gain insights on the best ways to maximize the effectiveness of your donations. Often, gifts to tax-exempt organizations can solve a financial dilemma such as how to convert low-basis non-income-producing property into income-producing property while avoiding a large tax bill.

Once you have accumulated enough assets for your retirement years, you may want to shift your focus to transfer strategies for your children and other heirs. We'll outline strategies that will allow you to transfer to heirs significant wealth at a fraction of its market value while maintaining control of your property.

People who own a family business or farm often face a perilous future; this is especially worrisome because many of these individuals desperately want to ensure that the business or farm remains in the family so that it can be continued by future generations of family members. Obstacles to this goal include estate taxes and lack of liquidity. The solution is a well-developed transition plan, which is also fully explained in this book.

In today's litigious society, many people fear the threat of a lawsuit that results in financial ruin. Feeling helpless, we may cross our fingers and hope it does not happen to us. A preferable approach is to be proactive. If you consider yourself a likely target, you can do many things to protect your assets. Some solutions are as simple as transferring assets to a spouse who is less at risk. Other solutions include the use of trusts, family limited partnerships, and even more exotic options such as domestic or foreign asset protection trusts. For entrepreneurs, we extensively review the pros and cons of the various entity choices you have for operating your business.

As you develop and implement your estate plan, you'll almost certainly need the assistance of a qualified professional. Finding the right person, someone who is truly qualified, can be a daunting task. It is one of the reasons many people fail to establish their estate plan. To help support you with this process your coauthors will gladly help you find an advisor to assist you with your needs. In Appendix A are tips on how to get the most out of your advisors while minimizing their fees.

As Americans, our limitations are constrained only by our own imagination, our willingness to take time to develop an appropriate strategy, and the self-discipline to execute our game plan. Picking up this book is an essential first step. Carefully reading it and implementing the strategies most appropriate to your situation will enable you to take a giant leap toward taking charge of your financial destiny. May God smile on your journey.

Stewart H. Welch III, CFP®, AEP

Chapter 1

Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Relief Act) on December 17, 2010. With many tax provisions originally enacted under The Economic Growth and Tax Relief Reconciliation Act of 2001 set to expire or already expired, the 2010 Tax Relief Act was a necessity. Taxpayers needed stability, and Congress reached a compromise tax legislation bill with the 2010 Tax Relief Act.

Like previous tax acts, unfortunately, the stability will be short lived. Most of the provisions in the 2010 Tax Relief Act will, once again, expire after December 31, 2012. Therefore, we can expect a new tax act to be discussed, negotiated, and enacted sometime in late 2012. In the meantime, taxpayers should become familiar with an overview of the 2010 Tax Relief Act and its effect on income tax provisions, business tax provisions, education incentives, and transfer tax provisions.

Without a new tax act in 2012, income tax rates will rise, estate tax rates will rise, gift tax rates will rise, and generation-skipping tax rates will rise. Undoubtedly, these potential tax increases will become the subject of the 2012 election season. In 2012, there will be a presidential election and many seats in Congress will be up for re-election. Therefore, we can expect great debate on the future of our tax system as we approach the end of 2012. This debate will lead to *some* type of tax act that will likely be effective on January 1, 2013. Therefore, it will be important to remain in contact with your tax advisors to fully understand how the inevitable 2013 tax act will affect you. In the meantime, a short window exists for planning opportunities that will be discussed throughout this book.

Marginal Ordinary Income Tax Rates

Without the provisions of the 2010 Tax Relief Act, the marginal income tax rates were set to increase on January 1, 2011. The increase would have applied to both ordinary income tax rates and capital gains tax rates. Therefore, at the end of 2010, many taxpayers were contemplating transactions which would accelerate income tax recognition into 2010 since tax rates were set to increase on January 1, 2011. However, the 2010 Tax Relief Act extended the 2010 ordinary income tax rates and capital gains tax rates into 2011 and 2012.

Prior to enactment of the 2010 Tax Relief Act, the Obama Administration had pledged no new taxes on middle-class Americans. A similar pledge was not made for wealthy Americans. As a result of negotiations and compromise, the 2010 income tax rates were extended for all taxpayers, not just middle-class Americans and individuals making less than middle-class Americans. See Table 1.1 for a complete review of the schedule for joint and single tax filers.

Table 1.1 Schedule of Reduction of Individual Income Tax Rates

Year	$0–$17,000	$17,001–$69,000	$69,001–$139,350	$139,351–$212,300	$212,301–$379,150	$379,151+
Joint Filers						
2011–2012	10%	15%	25%	28%	33%	35%

Year	$0–$8,500	$8,501–$34,500	$34,501–$83,600	$83,601–$174,400	$174,401–$379,150	$379,151+
Single Filers						
2011–2012	10%	15%	25%	28%	33%	35%

Although the 2010 Tax Relief Act extended the income tax marginal rates, the predictability of income tax rates is somewhat short-lived. If Congress takes no action before January 1, 2013, the income tax rates will return to 15%, 28%, 31%, 36%, and 39.6%. Therefore, it is expected that many taxpayers will, again, consider acceleration of income tax recognition events into late 2012 unless Congress takes action before then that will address income tax rates starting on January 1, 2013.

Capital Gains Tax Rates

The Jobs and Growth Act–2003 provided significant capital gains tax relief. The law immediately dropped the maximum net capital gains rate by 5 percentage points from 20 percent to 15 percent. The 10 percent capital gains rate for lower-income taxpayers fell to 5 percent. The lower rates are expected to continue through December 31, 2012.

Tip

Review all assets where you have a long-term capital gain to determine if it is advisable to sell before the current capital gains tax (15% federal) reverts back to the old capital gains tax rate of 20% (January 1, 2013).

The 2010 Tax Relief Act also reduced the employee portion of social security taxes from 6.2% to 4.2%. This change is only in effect for 2011. The 2010 Tax Relief Act did not change the employer portion of the social security tax.

For self employed individuals, the 2010 Tax Relief Act reduced the self employment taxes from 12.4% to 10.4% for earned income in 2011 (no changes were made for post-2011 years).

Educational Provisions

The Tax Relief Act that was enacted in 2001 introduced many tax benefits for implementing an educational savings plan. With respect to the 2010 Tax Relief Act, additional benefits were enacted by extending the American Opportunity Tax Credit for Higher Education Expenses through 2012. This tax credit applies to all four years of an undergraduate college education. The amount of the tax credit is generally 100% of the first $2,000 in qualifying educational expenses. An additional 25% of the next $2,000 in qualifying educational expenses is allowed. The maximum credit is $2,500 (which assumes $4,000 in qualifying educational expenses). Qualifying educational expenses include tuition and related course materials, such as books, software, and lab supplies.

Education IRA

Under prior law, you could make a nondeductible contribution of up to $500 per year to an Education IRA, more commonly known as Coverdell Education Savings Accounts. Your earnings grew tax-free and the distributions, when used for qualified educational expenses, were taxed at the student beneficiary's tax bracket. While this Education IRA was beneficial, it was only a partial solution to the problem of funding today's education costs.

The Tax Relief Act of 2010 extended the benefits of the Coverdell Education Savings Accounts that were enacted by the Tax Relief Act of 2001. The most significant provisions of the benefits that were extended include the following:

- Increased the contribution limits from $500 per year to $2,000 per year.
- Provided that distributions, when used to pay for qualified education expenses, would be tax-free.
- Allowed tax-free withdrawals for elementary (including kindergarten) and secondary public, private, and religious school tuition and expenses.
- Included tuition, room and board, tutoring, uniforms, extended day program costs, computer technology hardware and software, Internet access, and special needs services for special needs beneficiary as qualifying expenses.
- Allowed HOPE Scholarship Credit and Lifetime Learning Credit for other expenses.
- Extended the time in which the contribution can be made to April 15 of the following tax year.
- Phased out your ability to contribute to an Education IRA above certain income levels. The 2010 Tax Relief Act extended the phase-out range for joint filers with adjusted gross income (AGI) of $190,000–$220,000. Also extended was the phase-out range for single tax filers with AGI of $95,000–$110,000.

The Coverdell Education IRA still provides a significant incentive to prefund education expenses. However, the $2,000 contribution amount is scheduled to drop to $500 after 2012. Unless the law is changed before that time, it is expected that Education IRAs will be a less attractive way to save for college expenses.

Tip

If you would like to make a contribution to an Education IRA for your child but you do not qualify because your AGI is too high, consider having your child contribute to his or her own account. Unlike other IRAs, a person does not have to have earned income to contribute to an Education IRA nor is there a minimum age requirement.

Section 529 Plans

While the 2010 Tax Relief Act did not modify the existing rules for Section 529 plans, because Section 529 plans have become a very flexible and taxpayer friendly way to save for education, we would like to retain the discussion of Section 529 plans in this new edition of the book.

WHAT IS A SECTION 529 PLAN?

A Section 529 plan is a program that allows individuals to (1) purchase tuition credits or certificates on behalf of a designated beneficiary, entitling the beneficiary to a waiver or payment of the beneficiary's higher education expenses; or (2) make contributions to an account that is established for the sole purpose of meeting qualified higher education expenses of the designated beneficiary of the account.

PLAN CONTRIBUTIONS

A Section 529 plan may only accept contributions in the form of cash and not in property. However, a Section 529 plan may accept payment by check, money order, credit card, or other similar methods.

There are no limits as to the amount of money that can be contributed to a Section 529 plan (unless limited by the plan sponsor); however, there are penalties for distributions not used for qualified education expenses. Most important, unlike the Education IRA, there are no income phase-out rules that prevent high-income taxpayers from contributing to a Section 529 plan.