Finance

AARP

J.K. LASSER™

New Rules for Estate and Tax Planning

Fourth Edition

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

Digital Edition

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.

J.K. LASSER'S™

NEW RULES FOR ESTATE AND TAX PLANNING

Fourth Edition

Look for these and other titles from J.K. Lasser™—Practical Guides for All Your Financial Needs

J.K. Lasser's Small Business Taxes by Barbara Weltman
J.K. Lasser's 1001 Deductions and Tax Breaks by Barbara Weltman
J.K. Lasser's Real Estate Tax Edge by Scott Estill and Stephanie Long
J.K. Lasser's The New Bankruptcy Law and You by Nathalie Martin and Stewart Paley

J.K. LASSER'S™

NEW RULES FOR ESTATE AND TAX PLANNING

Fourth Edition

Stewart Welch III
Harold Apolinsky
Craig M. Stephens

WILEY
John Wiley & Sons, Inc.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

Library of Congress Cataloging-in-Publication Data

Welch, Stewart H.
J.K. Lasser's new rules for estate and tax planning : keep more today, leave more to your heirs tomorrow / Stewart H. Welch, III, Harold I. Apolinsky, Craig Stephens. – 4th ed.
p. cm. – (J.K. Lasser–practical guides for all your financial needs)
Includes index.
ISBN 978-1-118-11355-4 (pbk.); ISBN 978-1-118-16644-4 (ebk);
ISBN 978-1-118-16645-1 (ebk); ISBN 978-1-118-16646-8 (ebk)
1. Inheritance and transfer tax–Law and legislation–United States. 2. Estate planning–United States. I. Apolinsky, Harold I. II. Stephens, Craig M. III. Title.
IV. Title: New rules for estate and tax planning revised.
KF6585.A66 2012
343.7305′3–dc23

2011029302

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

Contents

Acknowledgments

Harold Apolinsky, Esq., Estate Tax Law Specialist

It would not have been possible to write a book of this magnitude without the support, assistance, and encouragement of our law firm, Sirote & Permutt. We owe a special thank you to the 13 other members of our Estate and Probate Department: Katherine N. Barr, Elizabeth Hutchins, Shirley Justice, Leigh Kaylor, Melinda Mathews, Joel Mendler, Sandy Mullins, Tanya Shunnara, Melissa May, Peter Wright, Mike Thomas, John Baggette, and George Gaston—bright and gifted lawyers who believe in top-quality legal care, outstanding service to clients, and innovation.

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.

I would like to thank my wife, Jenna S. Stephens, who provided me with uninterrupted time working on this book. Juggling this book revision, a blessed practice, teaching Estate Planning at Cumberland School of Law, and parenting two-year-old twins required significant support from my loving wife, and I thank her for it.

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.

Bob Holman, CPA, is a senior partner with the accounting firm of Sellers, Richardson, Holman & West, LLP., in Birmingham, Alabama. I have had the distinct pleasure of working with Bob for more than two decades. He is unquestionably one of the brightest people I have ever met.

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.

I could not have considered attempting this project without the assistance and moral support of my associates. Greg Weyandt, CPA, is a member and the Chief Operating Officer and Chief Compliance Officer of both of my financial advisory companies and runs the day-to-day operations with near flawlessness which allowed me to concentrate on this project. Michael Wagner, CPA, CFP® and Kimberly Reynolds, MS, CFP® are Senior Advisors at The Welch Group. Their expertise and diligence in preparing for our client meetings has made my life much easier and enjoyable. Their efforts are ably supported by Associate Advisor, Foster Hyde. Jeff Davenport, Wendy Weber, and Ramona Boehm can always be counted on to make certain our administration operations run smoothly. Roxie Jones is our receptionist and always makes everyone feel well taken care of. Woodard Peay, CFP®, MBA, is a member in Fee-Only Planning Professionals, LLC, a financial advisory firm in which I am the principal owner. Woodard is extraordinarily bright and a seasoned professional. I am grateful to Woodard and his key associates; Beth Moody, MS; and Melissa Erikson for running their company so well. I owe a special thanks to Hugh Smith, CPA, CFP®, CFA, for his expert support of this project. Hugh is a member at The Welch Group and the Chief Investment Officer for both companies.

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.

Finally, Harold, Craig, and I would like to thank two people for their special assistance with this book project. Kimberly Bernard is Development Editor at John Wiley & Sons, Inc. Kim helped keep this project on schedule and provided valuable assistance to the editing process.

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.

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.

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%

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.

TAX-FREE GROWTH

Earnings in a Section 529 plan grow tax deferred until distributions are made, at which time the distributions are tax free if used to pay qualified education expenses. For example, suppose you and your spouse contributed $100,000 to a Section 529 plan on behalf of a one-year-old grandchild. This $100,000 would grow tax-free until such time as it is distributed for higher education expenses, presumably beginning at the child's age 18. If your plan sponsor averaged a 9 percent return, the account value would exceed $400,000 by the time you are ready to begin drawing funds for your grandchild's college. When the funds are then used to pay for qualified education expenses, there will be no income taxes due on those distributions. Qualified higher education expenses include tuition, books, supplies, equipment, fees, expenses for special needs services, and room and board (within certain limits). The amount of qualified higher education expenses is reduced by scholarships and amounts paid by the beneficiary or others that qualify for the HOPE Scholarship or Lifetime Learning Credits.

Tip

If you are currently using a Uniform Gift to Minors Account (UGMA) or a Uniform Transfer to Minors Account (UTMA) as a funding vehicle for your child's education, consider the Section 529 plan or an Education IRA instead. By doing so, you'll not only avoid current taxation on earnings (remember the so-called kiddie tax?), but distributions used for education expenses will be tax-free.

PENALTIES ON NONQUALIFIED DISTRIBUTIONS

If distributions from a Section 529 plan are not used for qualified education expenses, a 10 percent penalty is imposed on the recipient of the funds. In addition, the *earnings portion* of the distribution is subject to ordinary income taxes. Usually, the tax will be triggered when distributions exceed the educational expenses of the designated beneficiary. According to some states' plans, any funds not distributed prior to the beneficiary attaining the age of 30 will be deemed a nonqualifying distribution (some exceptions apply for a special needs beneficiary). Exceptions to this penalty apply for payments made due to the beneficiary's death, disability, or receipt of a scholarship.

INVESTMENT OPTIONS

One potential downside of Section 529 plans is that you are unable to direct the investments of the plan. The investment accounts are operated as blind pools where you have no input over specific investment decisions. Most plan sponsors do, however, indicate the general investment approach they use. Often, contributors have the ability to select from a variety of investment strategies, with some Section 529 plans offering as many as 10 options. An important feature added under the old Tax Relief Act–2001 is the ability to switch from one state-sponsored program to another every 12 months. This significantly increases your ability to change your broad investment strategy to meet your particular needs.

GIFT TAX CONSEQUENCES

A contribution to a Section 529 plan is considered a completed gift from the account owner to the designated beneficiary at the time of the contribution and is thus eligible for the annual gift tax exclusion (currently \$13,000 or \$26,000 in the case of a joint gift by spouses). If the contribution exceeds the annual gift tax exclusion, the amount not exceeding five times the current annual exclusion may be applied pro rata to annual exclusions over five years.

For example, you could make an initial contribution of \$65,000 for each designated beneficiary without incurring gift tax liability for the contribution. The \$65,000 contribution would be treated as if you made a \$13,000 contribution in each of the next five years. Note that this presumes that no other gifts are made to the beneficiary during this five-year period. Any additional gifts would be subject to gift taxes. However, because the annual exclusion amount is indexed for inflation, this amount could increase in future years. Married couples can join together in making gifts, thus increasing the potential contribution to \$130,000 without incurring gift taxes.

ESTATE TAX CONSEQUENCES

Even though the donor retains the right to change the designated beneficiary (to another member of the donor's family) and to receive distributions from the account if no other person is designated, funds invested in the Section 529 plan are not included in the donor's gross estate unless the funds are in fact returned to the donor. Thus, once you contribute an amount to a Section 529 plan, that amount is out of your estate(s), as is the future appreciation on that amount. However, if a contribution exceeding the annual exclusion is applied pro rata to the annual exclusion over five years but the donor dies before the fifth year, that portion of the contribution that has not yet been applied to the annual exclusion for the years following the donor's death will be included in the donor's estate.

For example, suppose Mr. Leonard contributes $65,000 to a Section 529 plan and elects to have this applied pro rata over the next five years to the annual exclusion. Furthermore, assume Mr. Leonard passes away in the fourth year following the contribution. The amount of the annual exclusion to be applied in the fifth year ($13,000) would be brought back into Mr. Leonard's estate.

Tip

Creditor Protection for Section 529 Plans?

Funds held in a Section 529 plan may be subject to the claims of creditors and divorce proceedings. Typically, state law will prevail. If you are concerned about creditor protection, consider using a Section 529 plan sponsored by a state that has strong creditor protection laws.

For more information on Section 529 plans go to the Resource Center at www.welchgroup.com; then click on "Links".

SOME FINAL THOUGHTS ON SECTION 529 PLANS

Note that under the Section 529 plan, you are able to change your beneficiary. This is important because one child may choose not to attend college or may attend a relatively inexpensive college while another child may attend a very expensive college. A Section 529 plan allows you to move your funds around as needed. The former Tax Relief Act–2001 included "cousins" in the definition of family member. However, be sure to check the applicable plan's rules and restrictions for changing beneficiaries.

2010 Tax Relief Act—Miscellaneous Provisions Relating to Education

Several other provisions of the 2010 Tax Relief Act are worth noting:

- Employers can still offer education assistance programs providing up to $5,250 per year for an employee. The payment is deductible by the employer and not includable in the income of the employee. Undergraduate and graduate courses qualify, and the courses do not have to be related to the employee's job-related field. This benefit is extended through 2012.

- The 2010 Tax Relief Act continues to allow for deductibility of student loan interest of up to $2,500 (with phase-out limitation) through 2012.

Business and Corporate Tax Relief

The 2010 Tax Relief Act extended certain business and corporate tax relief provisions that were previously enacted by the 2001 Tax Act and the Jobs and Growth Act of 2003. For business property placed in service in 2011, the business taxpayer can immediately deduct (rather than depreciate) up to $500,000 under Section 179 of the Internal Revenue Code.

For certain new property (instead of used property that may be new to the business), there may be an available 100% bonus depreciation depending on the type of property involved. This deduction is scheduled to end after 2012.

Estate, Gift, and Generation-Skipping Transfers

The 2010 Tax Relief Act provided sweeping changes to the estate, gift, and generation-skipping tax system. (See Table 1.2) The former 2001 Tax Relief Act repealed the estate and generation-skipping taxes for 2010. Prior to 2010, it was unclear whether the one-year repeal would take place, and if it took place, whether it would be extended for additional years. The 2010 Tax Relief Act confirmed that the estate and generation-skipping taxes were, in fact, repealed for 365 days during 2010. However, the estate and generation skipping taxes were reenacted on January 1, 2011, and, along with the gift tax, they became unified with a uniform $5 million exemption and a maximum tax rate of 35%. Uncertainty remains a planning hurdle in the transfer tax arena because the provisions of the 2010 Tax Relief Act are only in place until December 31, 2012. At that time, if Congress does nothing, the transfer tax laws will revert to pre-2001 provisions.

While the 2010 Tax Relief Act did provide *some* certainty with respect to a potential estate tax liability, uncertainty still exists for deaths occurring after December 31, 2012. The uncertainty is highlighted by the question in the following box.

Under the 2010 Tax Relief Act, what amount of federal estate tax will be owed on an estate of $5,000,000?

a. $675,000

b. $0

c. $2,045,000

TABLE 1.2 Potential Estate (Death) Tax Savings under Tax Relief Act–2001 as Compared to Death in 2011 and 2012

	$5 Million Estate	$10 Million Estate	$20 Million Estate	$50 Million Estate	$100 Million Estate
2011–2012	$0	$1,750,000	$7,000,000	$15,710,000	$33,250,000
2013 tax	$2,045,000	$4,795,000	$10,654,200	$27,154,200	$54,654,200
Savings	$2,045,000	$3,045,000	$3,654,200	$11,444,200	$21,404,200

The 2013 data assumes Congress allows the 2010 Tax Relief Act to 'sunset' and revert back to prior tax law.

Give up? The answer is that both (b) and (c) are correct! The answer b, is correct if you die in 2011–2012. The answer c is correct if you die in 2013 and the exemption reverts to $1.0 million. We hope you are beginning to see the importance of carefully developing your estate plan.

Please don't misunderstand, the 2010 Tax Relief Act does provide potentially significant tax relief, assuming that death occurs prior to January 1, 2013. Table 1.2 illustrates the estate tax savings under current law versus what taxes will be if the current law reverts to prior law on January 1, 2013 under the sunset provision.

Following is a list of select provisions that could affect your estate planning:

- The 2010 Tax Relief Act lowered the maximum estate, gift, and generation-skipping rates, and it raised the amount of assets that are not subject to estate, gift, and generation-skipping taxes. Table 1.3 outlines the new rates and applicable exclusion amounts.
- The new law enacted portability provisions. A decedent's applicable exclusion amount is now the basic exclusion amount of $5 million plus, in the case of a surviving spouse, the deceased spouse's *unused* applicable exclusion amount.
- For decedents who died in 2010, their estate was allowed to elect to have no estate tax apply for 2010, along with a carry-over basis system. Or, the estate could elect for an estate tax to apply in 2011 (with a $5 million exemption amount) and receive a step-up in basis.
- For 2011, the maximum generation-skipping tax rate became 35%.

TABLE 1.3 2010 Tax Relief Act Applicable Exclusion Amount

Year	Applicable Exclusion Amount	Maximum Estate Tax Rate (%)
2011–2012	$5,000,000	35
2013	$1,000,000[1]	55

[1] 2010 Tax Relief Act is automatically repealed unless Congress extends the law.

Estate Planning Issues under the 2010 Tax Relief Act

Because of the uncertainty surrounding the current status of the estate tax laws, everyone with a net worth of more than $1,000,000 (the exclusion amount in 2013 if Congress does nothing) should review their estate plan. An approach we favor is for the client to contact one of their professional advisors on the estate planning team, whether the estate planning lawyer, financial planner, life insurance agent, accountant, or trust officer. Authorize that team member to assemble the team in a preliminary meeting to review the listing of the assets and liabilities (financial x-ray), review the current documents, and then meet with the client and the client's spouse to make team recommendations. This approach maximizes the creative input and communication and often aids in identifying important new alternatives to consider. The financial x-ray would show what assets are titled in the name of each spouse; what, if any, assets are titled in joint names; and, ideally, what assets are in the children's names.

As has been said previously, what will be the estate or death tax is really elective. By making annual gifts during your lifetime, then transferring the maximum tax-free amount (applicable exclusion amount) to your children and grandchildren at death, and finally bequesting your remaining estate to a family charitable foundation, your estate tax would be zero.

Here are two areas to focus your attention:

1. Despite so-called portability provisions of 2011 and 2012, does each spouse have the new tax-free amount in his or her separate name? The first and simplest step of estate planning is to obtain two tax-free amounts for the family instead of one. This requires, however, not only the proper words in the documents, but that the first spouse to die have titled in his or her name (not jointly) assets with a fair market value (other than qualified retirement plans or IRAs) equal to the tax-free amount ($5,000,000 in 2011 and 2012). This step can basically save the family up to $3,461,600 in taxes.
2. The client should also focus on what is currently to be done with the tax-free amount at the client's death. Will it simply go in trust for the surviving spouse? Will it go in trust for the benefit of the surviving spouse, children, and grandchildren? Will it go outright to children and grandchildren?

In summary, you should take the following three steps as you undertake your estate planning review based on 2011 and 2012 estate tax laws and the possible changes in 2013 when the current law expires:

1. Contact your advisor(s) and request a review of your current estate plan in view of the range of changes most likely. Your plan will need to be flexible enough to deal with a variety of possible outcomes.
2. The most prudent assumption for you to make, considering the changes scheduled for 2013, is that the amount of assets that you will be able to