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NEW RULES FOR ESTATE AND TAX PLANNING

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STEWART H. WELCH III, AEP, CFP® / HAROLD APOLINSKY, Esq., EPLS
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Revised and Updated

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Stewart Welch III

Harold Apolinsky

Craig M. Stephens

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Craig M. Stephens, Esq.

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My Family

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Stewart Welch III

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. Carrie Simms serves as executive director (and is available to answer any questions). 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 in 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* 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 several 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. 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 don't have either 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. To heirs we'll outline strategies that will allow you to transfer 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 resolutions include the use of trusts, family limited partnerships, and even more exotic options such as domestic or foreign asset protection trusts.

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 this process your coauthors will gladly help you find an advisor to assist you with your needs. In this appendix 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

J.K. LASSER'S™

NEW RULES FOR ESTATE AND TAX PLANNING

Revised and Updated

Congress Plays 'The Guessing Game' with the Estate Tax Laws

The law signed on June 7, 2001, by President George W. Bush—the Economic Growth and Tax Relief Reconciliation Act of 2001 (Tax Relief Act–2001)—remains the largest tax cut in over 20 years and significantly reduced or eliminated death taxes for millions of American's while substantially increasing the allowed contributions to various retirement plans.

Unfortunately, the Tax Relief Act–2001 has a sunset provision, which means that unless Congress extends this tax law, or makes it permanent, it will revert back to the old law on January 1, 2011. In fact, the Tax Relief Act–2001 provided for the elimination of estate taxes altogether beginning January 1, 2010. Obviously, Congress has no intention of allowing this to happen but their preoccupation with passing healthcare reform distracted them from focusing on estate tax law changes.

Cautionary Note

Prior to the 2009 trillion dollar-plus deficit, both Democrats and Republicans had arrived at a consensus opinion that the estate tax exemption (the size estate you can own before you are subject to death taxes) should be set at $3.5 million dollars and then indexed for inflation. The combination of focusing on passing healthcare reform and the almost incomprehensible rising national debt has now left the final decisions regarding new estate tax rules up in the air. In preparing this updated book revision, the author's chose optimism and we have therefore assumed that Congress will settle on a $3.5 million exemption. So, as you review our examples throughout this book, note that we are using $3.5 million as the size estate you can own before your estate is subject to death taxes.

As of the date of this book revision (October 2009), we expect Congress to react within a range of possibilities:

- Before the end of 2009, Congress will likely extend the current estate tax exemption for one year. Meaning that for 2010, the estate tax exemption will remain $3.5 million. We believe there is no chance they will do nothing and allow estate taxes to be zero (as scheduled under the current law). What if Donald and Melania Trump died? Instead of receiving billions in death taxes, the federal government would receive nothing! And think of all the wealthy people who are in hospitals on life support. Avoiding millions in estate taxes would give a whole new meaning to 'Pull the Plug'!
- Extending the 2009 estate tax limits will buy Congress time to focus on this issue, which will likely be one of the top campaign issues of the 2010 mid-term elections. Politicians running for re-election are likely to feel the pressure of cross-currents of voting in favor of a law that helps the rich avoid taxes (i.e. keeping the estate tax exemption at $3.5 million) versus doing nothing and allowing the current law to 'sunset' on December 31, 2010, which will cause millions of middle-class Americans to be subject to death taxes. The result would be that anyone dying with an estate exceeding $1 million, could be subject to death taxes as high as 55% on the excess. Many middle-class families who own a home and have adequate life insurance will quickly become subject to death taxes.

Whatever Congress finally decides, we'll keep you well informed. For the most up-to-date details on estate tax law changes, go to www.jklasser.com.

Retirement Savings and Pension Reform

Tax Relief Act–2001 provided for significant increases in contribution limits to various types of retirement plans. Below are current provisions and contribution limits for some of the more common retirement plans.

Traditional Individual Retirement Accounts and Roth Individual Retirement Accounts

Qualifying taxpayers can deduct $5,000 annually for Traditional IRAs. If you are age 50 or older, the law provides for a catch-up provision, allowing additional contributions of up to $1,000 per year. The purpose of the catch-up provision is to allow individuals to make up for missed retirement savings opportunities earlier in life. Table 1.1 illustrates the contribution limits for 2010.

TABLE 1.1 Traditional IRA and Roth IRA Contribution Limits

Year	Maximum Contribution under Age 50	Additional Contribution under Catch-up Provision[1]
2010	$5,000	$1,000 (catch-up)

[1] For eligible individuals age 50 and older.

Unfortunately, income-based eligibility apply to both the Traditional IRA and the Roth IRA. For a refresher on these rules, review Table 1.2. Also, don't forget that alimony is considered earned income for the purpose of eligibility for contributions to both the Traditional IRA and the Roth IRA.

Employer-Provided Retirement Plans

The Tax Relief Act–2001 provided significant expansion of allowable contributions and rules to employer provided retirement plans. The types of plans covered include: 401(k), 403(b), SIMPLE (Savings Incentive Match Plan for Employees), and 457 plans. Table 1.3 provides a summary of the contribution limitations for these type of plans.

If you are age 50 or older you have an opportunity to contribute even more to these plans based on catch-up provisions. Table 1.4 illustrates your maximum contribution limits.

Eligible retirement plans offer employees the ability to make voluntary contributions into a separate account for their Traditional IRA and Roth IRA. We expect this to remain a popular feature, but a word of caution is in order. The primary advantage of this feature is that your contributions are made through payroll deduction. The disadvantage is that you will likely be limited to the investment choices currently available through your plan. Contrast this with your ability to open your IRA, for example, through a discount broker such as Charles Schwab and Company, where you would have access to over 5,000 mutual funds as well as individual stocks, bonds, and so forth. Generally, the

TABLE 1.2 Expected Adjusted Gross Income (AGI) Limitations for Deductible Contributions for 2010

	Traditional IRA	Roth IRA
Single	$55,000–$65,000	$105,000–$120,000
Head of Household	$55,000–$65,000	$105,000–$120,000
Married-Filing Separately	$0–$10,000	$0–$10,000
Married-Filing Jointly	$89,000–$109,000	$166,000–$176,000
Non-working Spouse[1]	$156,000–$176,000	$166,000–$176,000

[1] This AGI phase-out of deductibility limitations apply to nonworking spouses whose working spouse is an active participant in an employer-sponsored retirement plan.

TABLE 1.3 Expected Contribution Limitations for Certain Contributory Retirement Plans for 2010

Year	401(k); 403(b) Plans	SIMPLE Plans	457 Plans
2010	$16,500	$15,000	$16,500

better choice will be to maintain control of your IRA outside of your company's retirement plan.

The Tax Relief Act–2001 provided additional incentives for low-income taxpayers to contribute to their retirement plan [401(k), 403(b), 457(b), Traditional IRA, or Roth IRA] by providing tax credits for contributions, but the Pension Protection Act of 2006 made it permanent. For those who are eligible, this is an excellent opportunity to get Uncle Sam to pay a portion of your retirement plan contribution. This credit would be claimed on the individual's tax return. Table 1.5 outlines how the tax credit works.

An interesting option provided under the Tax Relief Act–2001 permits employers to add a feature that allows employees to elect Roth status for all or part of their contributions to their employer's 401(k) or 403(b) plan. This means that your contribution would be includable as income, but future distributions would be tax-free.

The Tax Relief Act–2001 raised the ceiling on the total dollar contributions for profit-sharing plans, money purchase pension plans, and contributory plans such as the 401(k). For 2009 and 2010, the limit is $49,000. Future years contribution limits are indexed for inflation.

Marginal Tax Rates

The Tax Relief Act–2001 increased the number of tax brackets from five to six by introducing a 10 percent tax bracket to replace a portion of the current 15 percent bracket. The law then reduced the 28, 31, 36, and 39.6 percent brackets over six years to 25, 28, 33, and 35 percent, respectively. The Obama

TABLE 1.4 The "Catch-up" Provisions: Retirement Plan Contribution Limits for Plan Participants Age 50 and Older (amounts described include base contribution, plus "catch up" contribution)

Year	401(k); 403(b); 457(b) Plans	SIMPLE Plans
2009	$22,000	$14,000
2010	Indexed[1]	Indexed[1]

[1] Indexing is based on allowable contributions excluding any catch-up contributions. See Table 1.3.

TABLE 1.5 Tax Credit for Low-Income Taxpayers Contributing to a 401(k), 403(b), 457(b), Traditional IRA, or Roth IRA

	Adjusted Gross Income (AGI)		
Credit %[1]	Single and Married–Filing Separate	Head of Household	Joint
50	up to $15,500	up to $23,250	up to $31,000
20	$15,501–$17,000	$23,251–$25,500	$31,001–$34,000
10	$17,001–$26,000	$25,501–$39,000	$34,001–$52,000

Example: Jim's employment income is $25,000 per year and his wife, Janice, is a stay-at-home mom. They decide to contribute $2,000 to an IRA. Because their adjusted gross income is less than $31,000, they will receive a $1,000 tax credit. This tax credit will offset dollar-for-dollar $1,000 of earned income.

[1] Credit applies to the first $2,000 of contribution.

Administration has pledged no new taxes on middle-class Americans while promising greater tax relief for poor Americans. Clearly, the government will need additional tax dollars to tackle an $11 trillion national debt that continues to rise at an alarming rate. If, as the Obama Administration promises, that tax burden will be born only by families with incomes exceeding $250,000 it's hard to imagine how this small group of taxpayers can pay enough taxes to adequately address the problem. Our best guess is higher tax rates on a broader base of taxpayers. See Table 1.6 for a complete review of the schedule for joint and single tax filers.

Although the Jobs and Growth Act–2003 accelerated the income tax marginal rate reductions, all of the rate reductions are subject to the Tax Relief Act–2001 sunset provision, which would return the rates to 15, 28, 31, 36, and 39.6 percent after 2010 unless Congress takes some affirmative action.

TABLE 1.6 Schedule of Reduction of Individual Income Tax Rates (bracket cut-off amounts could slightly change in 2010)

Year	$0–$16,700	$16,701–$67,900	$67,901–$137,050	$137,051–$208,850	$208,851–$372,950	$372,951+
Joint Filers						
2009–2010	10%	15%	25%	28%	33%	35%
Year	**$0–$8,350**	**$8,351–$33,950**	**$33,951–$82,250**	**$82,251–$171,550**	**$171,551–$372,950**	**$372,951+**
Single Filers						
2009–2010	10%	15%	25%	28%	33%	35%

Tip

Use these lower rates as an opportunity to increase your contributions to your company's retirement plan. When it's time to retire, you'll be glad to have the additional money in your account.

Education Funding Incentives

Saving and paying for educational costs became a lot easier under the Tax Relief Act–2001. The act made significant modifications to both Education IRAs and Section 529 plans. What follows is an overview of both plans.

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.

With the passage of the Tax Relief Act–2001, Congress took a giant step toward providing real assistance in reducing the costs of education. The most significant provisions included 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.
- Your ability to contribute to an Education IRA is phased out above certain income levels. The Tax Relief Act–2001 increased the phase-out range for joint filers with adjusted gross income (AGI) of $190,000–$220,000. The phase-out range for single tax filers is AGI of $95,000–$110,000, the same as the prior law.

- Repealed the excise tax when a contribution to an Education IRA is made in the same year as a contribution to a qualified tuition plan for the same beneficiary.

This enhanced Education IRA provided—and still provides—significant incentives to prefund education expenses. However, the $2,000 contribution amount is scheduled to drop to $500 after 2010. 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 does 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

Section 529 plans (also referred to as qualified tuition plans) received a dramatic boost under the Tax Relief Act–2001. Because of the importance of these programs in both funding the costs of higher education and estate planning, they will be covered in detail in this section.

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.