Advanced Strategies

WEALTH AND BUSINESS PLANNING 1st Quarter 2010

Author: Joseph Stenken, J.D., CLU, ChFC, Advanced Sales Marketing Counsel, Advanced Sales - UNIFI Companies

CHANGES IN 2010 MAY AFFECT YOU, YOUR ESTATE OR YOUR BUSINESS

Since 2009 has ended and Congress has not acted, there is no federal estate tax–for now at least. This development leads to a number of questions. Will Congress reenact the estate tax in 2010? If so, will it be reenacted retroactively to the beginning of 2010, or will it have prospective application? Or will Congress do nothing and allow the estate tax to return in 2011 with a vengeance at a $1 million exemption and a top rate of 55%.

There are a number of ways that Congress might address the estate tax this year.

First, Congress may reinstate the estate tax retroactively to the beginning of 2010 at levels at or near 2009 levels, with a $3.5 million exemption and a top rate of 45%.

Another option would be to enact the estate tax sometime during the year with a prospective effective date, so that there would be no estate tax for a period of time during 2010, but with an estate tax reinstated at some time during the year. A variation on this might be that Congress would reinstate the estate tax in 2011 at 2009 levels.

Or Congress might do nothing and let the estate tax return in 2011 with a $1 million exemption and a 55% top rate.

The bigger question though is: What can you do while we are in this period of uncertainty?

To quickly review what the rules are for 2010:

- The estate tax and generation skipping transfer tax are repealed for 2010.
- The gift tax exemption is $1 million.
- The highest marginal gift tax rate is equal to 35%. It is possible that if Congress reinstates the estate and generation skipping transfer tax retroactively to the beginning of 2010, the highest gift tax rate will rise as well.
- The step-up in basis rules are replaced by modified carry-over basis rules.

For 2011, the following rules are scheduled to come into effect if Congress does not act:

- The estate tax and gift tax exemption amounts will be $1 million.
- The generation skipping transfer tax exemption will be somewhat more than $1 million, based on inflation since 2003.
- The highest marginal estate and gift tax rate will be 55%, plus a 5% surcharge to phase out the benefit of the unified credit on estates with a value in excess of $10 million.

THE MORE THINGS CHANGE…

One thing to keep in mind is that some things do not change, even in the face of continual changes in the tax laws. One thing that will not change is that people will still die, and they will die unexpectedly. Young couples will want to protect their families in the case of an unexpected loss. Businesses will still need to make plans to deal with the death, disability, or retirement of an owner or key employee. And families will still be interested in providing for children with special needs.

Even though the estate tax may be repealed for one year, that does not mean that making plans in the case of an untimely death should not be done. The loss of someone's income could devastate a family. And the loss of an important employee could devastate a business, especially if the business has any kind of business debt.

PROTECTING A BUSINESS

In addition to the impact that a death might have on a family, a death of a key employee can affect a business and the families that rely on that business for support. While it may be obvious that a business should insure its building, machinery, and other equipment, it may be even more important to insure its most important assets—its managerial skill and experience. Andrew Carnegie was once quoted as saying that you could take away his factories, plants, railroads, ships, and money, but if you left him with his managers, he would be able to have back those tangible assets in two or three years. And the odds of a person dying before 65 are not remote. In a business with two male owners who are both age 45, there is nearly a 25% chance of one of the owners dying before they reach age 65.* If there are three male owners, each aged 45, there is over a 33% chance that one of the owners will die before age 65.* If the business will be continued after the death of a key employee, life insurance proceeds can be used to obtain a replacement key employee, replace lost profits, provide a financial cushion, or make survivor income payments. If the business will be sold, then there will be cash to fund a stock redemption sale. If the company will be liquidated, the cash can be used for the surviving family to offset the lost business value.

* Source: Don Cady, Field Guide to Estate, Employee, & Business Planning, 2010 ed., The National Underwriter Co., p. 195.

PROTECTING A DISABLED FAMILY MEMBER

Another area where life insurance can help in planning regardless of whether there is an estate tax is planning for a member of the family who is physically or mentally disabled. Most often the disabled family member is a minor or adult child, but special needs planning could also involve a dependent parent or another relative. If a disabled person is relying on you for care or support, life insurance is an ideal vehicle to ensure that that care and support will continue after an untimely death. The proceeds from a life insurance policy could be used to finance a "special needs trust" for the disabled individual. A special needs trust can be used to take care of property that can be used to benefit the disabled individual while at the same time ensuring that the disabled individual will not lose government benefits and services. The objective should be to have the life insurance proceeds supplement, not replace, government programs such as Supplemental Security Income (SSI) and Medicaid.

PLANNING IN A REPEAL ENVIRONMENT

With the carryover basis rules that are in effect for 2010 (so far), life insurance and life insurance trusts will continue to have a place while the estate tax is repealed. Life insurance can grow on a tax-free basis and will not be subject to income tax after the person whose life was covered dies. Also, using life insurance trusts in conjunction with the annual gift tax exclusion ($13,000 per person in 2010) can allow leveraging of the exclusion to even greater benefit. You may also want to take out a short-term life policy to provide funds to pay income taxes on property that will be subject to a carry-over basis, or to equalize distributions among beneficiaries who received assets with a built-in gain and others who received property where the basis step-up was allocated.

It is important that you try to keep records that indicate what was paid for particular assets. Also, provisions should be added to current estate planning documents that give your executor the power to allocate the allowable basis increase to your assets that could be included in your estate, regardless of whether those assets pass under your will (probate assets) or outside of your will (non-probate assets). Executors can be indemnified and held harmless for making this allocation (recipients of low basis property may complain about the allocations). Or specific direction could be given to the executor to allocate the basis step-up among particular assets.

If you would die in 2010, until the resolution of repeal and retroactive reinstatement of the estate tax, your executor may want to delay distribution of assets to your beneficiaries and forgo sales of assets during 2010.

Something else to consider is to make taxable gifts in 2010. The gift tax during 2010 is 35%, while the highest rate in 2009 was 45% and the highest rate is scheduled to rise to 55% in 2011. Note that it is possible that Congress may restore the 45% rate retroactively to the beginning of 2010, but that gift tax returns for gifts made in 2010 are not due until April 2011, or with extensions, October 2011.

Note that a formula provision in a will could lead to the disinheritance of a spouse. If the estate plan has the maximum amount going to the non-spouse beneficiaries that results in no federal estate tax, then nothing might remain to go to the spouse. This could cause a problem within the family. In many states a disinherited spouse is allowed to claim a portion of the estate of the deceased spouse. This portion can vary from 30% to 50% of the estate.

To avoid this problem, a simple amendment to a will or trust could be made that says something to the effect “I intend that the dispositive provisions of my will [or trust] be interpreted as though the provisions of the Internal Revenue Code of 1986 that were in effect on December 31, 2009, were in effect on the date of my death.” In fact some states have amended their laws to allow wills to be interpreted according to what the federal estate tax was in 2009.

UNIFI® Companies

Ameritas Life, Acacia Life, Union Central Life and affiliated companies

UNIFI Companies, or UNIFI, is a marketing name for the subsidiaries of UNIFI Mutual Holding Company, including Ameritas Life Insurance Corp., Acacia Life Insurance Company, The Union Central Life Insurance Company, First Ameritas Life Insurance Corp. of New York and Ameritas Investment Corp., member FINRA/SIPC. Ameritas Life Insurance Corp. and Acacia Life Insurance Company are not licensed in New York. Each UNIFI company is solely responsible for its own financial condition and contractual obligations. For more information, visit the UNIFI Companies web site at www.UNIFIcompanies.com.

UNIFI Companies is not authorized to give tax or other legal advice. For application of this information to your specific situation, consult an attorney. Your UNIFI representative can provide more information and assistance in obtaining life insurance, annuities and other products to help meet your financial planning needs.

First Quarter 2010 • Advanced Strategies is published quarterly.

Securities and advisory services offered through affiliate Ameritas Investment Corp., Member FINRA/SIPC.