Wealth Transfer Newsletter

CURRENT DEVELOPMENTS, HIGHLIGHTS & CHANGES
Wealth Transfer Practice Group
08.2009

Life Insurance Current Updates Individual Retirement Account Planning

Summertime often involves vacations, spending time at the coast (taking in the beautiful North Carolina beaches) or in the mountains (enjoying the cool breezes and spectacular views of the Blue Ridge) with family and friends, and taking time to relax and re-charge our personal batteries. Being able to take the time to regenerate is important for many reasons. First, it allows us to decompress from the stress that comes from our daily lives. Next, we are able to re-connect with friends, and often family, realizing the importance and value they have in our lives. And, last – but not least – it gives us the opportunity to evaluate, re-prioritize and clear our thoughts, resulting in fresh minds!

After enjoying personal vacations and time for reflection, the members of our Team have re-evaluated some of the topics and issues we have addressed in prior issues of our Newsletter and think it is an appropriate time to provide you with some updates. Thus, in this edition of our Newsletter, we reflect on various matters on which we previously commented, including: pending legislation impacting estate and gift taxes, important income tax considerations, and the continued viability of grantor retained annuity trusts (GRATs) in estate and gift tax planning. In addition, we address the importance of evaluating a commonly overlooked asset – your personal life insurance policy. Lastly, we highlight some valuable opportunities for your retirement plans.

The members of our Team hope you are enjoying your summer - whether you are spending it traveling or staying close to home - and find the information contained in this Newsletter helpful and informative. If you have any questions regarding your personal legal matters or issues addressed in this Newsletter we encourage you to contact any of us and we look forward to hearing from you.

Neill G. McBryde

Life Insurance: Are You Sure Your Policy is Serving Its Purpose?

Life Insurance – it is a term that elicits many different reactions, most of which are not pleasant . . . . Thus, it is often an asset that is commonly overlooked by those with even significant policies. Yes, your life insurance policy is an asset, whether term, variable, whole life or universal. The value of a life insurance policy can be viewed from various perspectives: the death benefit, the current cash value, and even the price a third party may pay to purchase the policy (through a life-settlement). Further, individuals acquire life insurance policies for various reasons; for example, to provide liquidity for estate taxes, as a tax-deferred investment vehicle, for retirement planning, or for business purposes. However, the reason a policy initially was purchased may change, as circumstances do, so that the policy may no longer serve the initial purpose for which it was

acquired or may no longer be necessary. Thus, we recommend to our clients that they engage in an annual policy review – either formally with an insurance agent and other advisors, or informally by obtaining two current in force policy illustration and evaluating the policy performance cost.

Insurance Needs

While a life insurance policy is an asset, it comes with a cost – in the form of premiums. Therefore, evaluating whether the benefit an insurance policy provides is justified by the cost should be the first step in any policy review. For individuals who acquire insurance policies to provide liquidity to pay estate taxes, they should consider the impact (1) the increase in the estate tax exemption amount (currently $3.5 million per taxpayer), (2) any gifting undertaken or wealth transfer planning instituted, and/or (3) the consumption of their assets (or decline in asset values) has had on their estate's need for the death benefit the policy provides. Often, clients find that through the implementation of effective estate planning techniques that estate taxes are significantly reduced, if not eliminated (particularly in conjunction with the increased estate tax exemption). To the extent that premiums are currently being paid on a policy, it may not be effective to continue to maintain the policy at its current level. Thus, the policy owner may be able to restructure the policy to provide for a lesser death benefit from the accumulated value in the policy and avoid future premium payments. Alternatively, if the policy is wholly unnecessary, the owner may consider surrendering the policy for the accumulated cash value or investigating the potential of selling the policy through a life settlement broker.

In other situations, clients may realize that they are significantly under-insured. Policies acquired at young ages and before the accumulation of significant wealth may not provide the necessary death benefits for current projected estate tax costs. Additionally, policies purchased to fund buy-sell agreements in closely held business arrangements may not provide sufficient liquidity to fund the purchase obligation as the value of the business has increased. In these situations, understanding what options and alternatives are available to acquire additional insurance through the exercise of options with regard to the existing policy, the acquisition of new policies or self-insuring will be important.

Policy Performance

Regardless of why a policy was acquired, its value is only as good as the insurance company issuing the policy and the performance of the policy itself for purpose of ensuring that the intended death benefit will be paid upon maturity of the policy. While most have never considered the viability of the insurance issuer, recent financial events have caused legitimate concerns in this regard and many have re-evaluated their policies. Additionally, with regard to universal, variable and whole-life policies, the performance of many of these policies has declined significantly. Many policies are structured such that they become "self-paying" based on the level of premiums paid in the initial years in conjunction with the projected performance of the policy. However, with the decline in interest rates, policies often are not meeting the projected returns and owners are required either to make premium payments for a longer period of time, or premiums are renewed in order to avoid a lapse in the policy (so don't throw out those notices from the insurance carrier!).

Yes, life insurance is complex, confusing and over-whelming, but ignoring the condition of your life insurance policies can be economically devastating. Thus, performing an annual review of your policies and life insurance needs, while mentally trying, can be fiscally beneficial.

Current Updates – Striving to Keep You Up to Date

Grantor Retained Annuity Trusts

(Originally highlighted in Newsletter of November, 2008)

As highlighted in our November 2008 newsletter, use of a Grantor Retained Annuity Trust ("GRAT") is an efficient strategy that facilitates the transfer of wealth to the next generation. Specifically, under the terms of a GRAT, the grantor retains the right to receive an annuity for a fixed term of years, following which the remainder will pass to specified successor beneficiaries. The current economic climate has created unique opportunities for the use of GRATs as interest rates are low and asset values are depressed. Thus, currently there is a greater likelihood of success for GRATs as the rate of return on the GRAT's assets need only beat the interest rate required by the IRS to be used in the applicable calculations i.e., the Section 7520 Rate, which for the months of August and September 2009 is 3.4%.

As discussed in greater detail in our November 2008 Newsletter, use of a short-term GRAT (i.e., 2 - 4 years) provides the greatest flexibility, benefits and likelihood that the GRAT strategy will be successful. Thus, in addition to current market conditions and interest rate environment making the GRAT a particularly attractive planning technique, time may be of the essence to put in place a short-term GRAT as there has been considerable speculation that applicable law may require GRATs to have a minimum annuity term. Specifically, the "Green Book" published by the Department of the Treasury in May, 2009, which contains the general explanation of the administration's fiscal 2010 revenue proposals, proposed, among other things, a minimum ten year term for GRATs, which could affect the flexible use of this technique.

Therefore, not only is the current economic climate conducive to the implementation of a GRAT, but also the fiscal policies of the current administration should be kept in mind when reviewing the implementation of this planning option.

Estate Tax Reform

(Originally presented in Newsletter of April, 2009)

There has been much discussion, and anticipation, regarding Estate Tax Reform that is highly likely to take place prior to the end of the year. We previously brought your attention to this issue in our April 2009 edition of the Newsletter, given the expiration of the current estate tax provisions under the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act") which expiration is referred to as the "Sunset" and is set for January 1, 2010, and summarized the key provisions of a few Bills for Estate Tax Reform which had then been introduced. Specifically, Senate Bill 722, which proposed to freeze the current 2009 estate tax exemption level at $3.5 million per taxpayer and lock the maximum estate tax rate at 45%, subject to adjustment for inflation. Additionally, this Bill would allow the surviving spouse to use the unused estate tax exemption belonging to the first spouse to die, a notion referred to as "portability." Another similar Bill was introduced in the House of Representatives, HR 436, which would also freeze the estate tax exemption amount at $3,500,000 and the estate tax rate at 45%, but would also limit valuation discounts applicable to ownership interests in such assets as a limited partnership or a limited liability company.

Since April, there have not been any significant developments or advancements with respect to those Bills and several other Bills have been introduced, none gaining any momentum. For example, HR 2023 would cap the estate tax exemption amount at $2,000,000, impose a tax at the rate of 45% on estate's in excess of this amount with an additional excise tax for taxable estates in excess of $5,000,000. In addition, HR 498 proposes to gradually increase the estate tax exemption amount by $250,000 beginning in 2010 and culminating in 2015 with an exemption amount of $5,000,000. Both HR 2023 and HR 498 contains provisions allowing for spousal portability of unused exemption amounts. Finally, three separate Bills have been introduced that would repeal the estate tax in its entirety. Commentators do not anticipate that these later bills have the political backing to gain traction in Congress at this time.

Given the lack of progress with regard to the various proposed Bills, likely as a result of Congressional attention to other matters, particularly health care reform, some commentators now believe that Congress may simply "patch" the Sunset, by extending the current exemption amount and estate tax rates and take up permanent reform next year. Whatever the case, we will continue to monitor these Bills and periodically update you of any significant legislative developments.

Income Tax Considerations and the American Recovery and Reinvestment Act of 2009

(Originally outlined in Newsletter of April, 2009)

In our April newsletter, we highlighted many of the key provisions in the "American Recovery and Reinvestment Act of 2009," and while Congress has not passed any further tax legislations in May the Obama Administration has announced its revenue proposals in the "Green Book." Of particular note, the Green Book sets forth the following proposals of the current administration:

- **Tax Rates**. To extend the 10, 15, 25, and 28 percent rates for another 10 years, but reinstate the pre-EGTRRA (2001 Tax Act) top rates of 36 and 39.6 percent for individuals with incomes over $200,000 and married couples filing jointly with incomes over $250,000.
- **Capital Gains**. To impose a 20 percent rate on capital gains and qualified dividends for individuals who then fall within the new 36 or 39.6 percent brackets. The zero and 15 percent rates would be made permanent for the lower brackets.
- **Itemized Deductions**. To reinstate the limitation on itemized deductions for individuals who then fall within the new 36 or 39.6 percent brackets, reducing itemized deductions by 3 percent of the amount of adjusted gross income that exceeds a statutory floor, but not by more than 80 percent of the otherwise allowable deductions. Additionally, the administration proposes to limit the value of all itemized deductions by limiting the tax value of those deductions to 28 percent whenever they would otherwise reduce taxable income in the new 36 or 39.6 percent brackets.
- **Personal Exemption Phase-Out**. To reinstate the personal exemption phase-out for individuals who then fall within the new 36 or 39.6 percent brackets.

Additionally, the Green Book announces the Administration's proposal to make the expanded American Opportunity Tax Credit a permanent replacement for the Hope Scholarship Credit. Also of note, several proposals have been introduced in Congress to further extend the availability of the first-time homebuyer tax credit, which is set to expire this fall, including a proposal to raise the credit to $15,000 for all homebuyers regardless of income.

Individual Retirement Account Planning Opportunities

Also highlighted in our April 2009 newsletter, required minimum distributions (RMDs) from IRAs have been suspended for the 2009 tax year. While the suspension of RMDs indirectly facilitates conversions of existing traditional IRAs to Roth IRAs in 2009, we would like to reiterate the planning opportunities of making a Roth IRA conversion in 2010. Previously, Roth IRA conversions were limited to taxpayers with an adjusted gross income under $100,000 (excluding any distributions from an IRA). However, in 2010, all taxpayers are permitted to make Roth IRA conversions, regardless of their adjusted gross income and may also elect to pay the resulting income taxes over two years. On balance, however, this may push some high income individuals into the Administration's proposed 36 or 39.6 percent tax brackets. Taxpayers should therefore, weigh the immediate tax cost against the potential future tax savings before making an election to convert their IRA. Additionally, it should be noted that an inherited IRA is not eligible for this conversion.