



Advanced Planning Strategies

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Dear Reader,

The tax policy portion of the presidential campaign has become clearer since our last letter. President Bush's plan has been implemented, in part, by the tax law changes in 2001 and 2003. His primary concerns continue to be on the expiration of the tax relief provisions in the two major tax overhauls enacted during his presidency. Much of the tax relief provided by these legislative changes will expire on or before 2011, and his goal is to make the tax reductions permanent. President Bush has proposed some fundamental changes to retirement savings and has backed the creation of other types of tax-advantaged savings accounts, but these were not included in final legislation. These proposals, along with some privatization of the retirement component of Social Security, will probably be considered if he is elected to a second term.

John Kerry's economic plan also favors the extension of some of the middle-class tax relief provisions enacted during the current presidency. Kerry, however, would reverse the tax bracket reductions for the upper brackets, returning the 33 and 35 percent brackets to their former levels of 36 and 39.6 percent. In addition, the 15 percent bracket for long-term capital gains and dividends would be eliminated for taxpayers with income over \$200,000. In lieu of the current plan to phase out the federal estate tax, Kerry proposes increasing the estate tax exemption to \$2 million per individual and creating an additional \$3 million exemption for family businesses or farms. Finally, Kerry has proposed tax credits to help with tuition costs and assist the uninsured to purchase health insurance.

With the discussion of tax policy and increasing or decreasing the burden of the wealthiest taxpayers, here's a statistic that you might find interesting. The number of millionaires worldwide has reached 7.7 million according to recent survey reports. (This statistic does not include the value of the personal residence in net worth.) The assets held by these individuals total \$28.8 trillion. Over 2.2 million of these individuals reside in the United States. We'll try to keep you informed of tax policy as the election grows near.

Knowledge is not power. Only knowledge in use is power.

ORGANIZATION OF DOCUMENTS AND RECORDS

A CRITICAL COMPONENT OF ESTATE PLANNING

The development and implementation of a comprehensive and cohesive estate plan are essential to achieve the most efficient use of an individual's wealth, both for the estate owner and his or her heirs. However, substantial costs and delays will be suffered if family members and caregivers are unable to locate information and documents at critical times. This information will have to be retrieved quickly if an individual loses capacity, must be placed in a hospital or care facility, or passes away. We urge everyone to take the appropriate steps to organize the information and communicate with the people who will be most likely to handle the care, housing, and estate settlement decisions. Although the types of records and documents will differ somewhat from individual to individual, the discussion below might provide useful guidance.

PERSONAL INFORMATION AND RECORDS

Personal identification documents are often necessary to get things done. These documents have been made even more essential by new homeland security rules that will require appropriate identification to accomplish many everyday tasks. It would be helpful to have quick access to birth certificates, Social Security cards, passports, and any other identification papers. Family records, such as marriage certificates, divorce agreements, and adoption information, should be available. For individuals not born citizens of the U.S., citizenship or residency documents might be extremely important, particularly for applications to receive government benefits or to file accurate income or estate tax forms. Finally, medical information, such as the names and numbers of physicians, hospitals, pharmacies, Medicare or Medicaid information, and any other relevant health care information, should be consolidated where it can be quickly retrieved.

ESTATE PLANNING DOCUMENTS

Will. Of course, every individual with the capacity to execute a will should have completed this task. Surveys have indicated, however, that more than 70 percent of Americans have not done so. After completing a will, it is important to inform the chosen personal representative of his or her role in settling the estate and to let the appropriate individual(s) know where to find the will. Sometimes the will is stored with the attorney who prepared the document, but often it is kept in a safe, accessible place in the home. Certainly, pertinent information such as the name and phone number of the attorney who prepared the will could be useful to the executor, because legal assistance is generally recommended to help the executor settle the estate.

Trusts. Trusts are often prepared as part of the estate plan. The grantor, trustee, and beneficiaries should generally have the original (or copies of) the trust documents. Again, the documents should be accessible, and the phone numbers of the appropriate individuals, such as legal counsel, trustees, and tax preparers, should be readily available to the people who will have to perform any transaction with the trust.

Living Will. A living will (advance medical directive) is a document for declarants to state their intentions with respect to health care if they are not capable of stating the intention at the time they receive the health care. This document should be available to family members who will have to arrange health care and should be provided to the declarant's physicians and health care facilities where the care is provided.

Power of Attorney. A power of attorney gives the agent (or attorney-in-fact) the ability to act in behalf of the principal. The power can be limited to perform one specific act (e.g., to sign an agreement of sale for the

principal) or can be broad enough to handle all financial matters. Generally, a broad (or general) power of attorney is made durable so that the attorney-in-fact can continue to act for the principal after the principal loses capacity. Another form of power of attorney is limited to making health care decisions for the principal. Of course, the attorney-in-fact should be given one or more original documents, and access to the document should be given to any successor attorneys-in-fact. It may also be a good idea to make any financial institution where the principal does business aware of the power of attorney to ensure that the institution will be willing to comply.

FINANCIAL RECORDS AND INFORMATION

Although the financial information that should be consolidated and found easily by family members is potentially voluminous, it should be stored in a safe, organized fashion. All financial accounts, records of pension plans or IRAs, individual securities, mortgage or loan information, keys to safe deposit boxes, titles to automobiles, annuities, and life insurance policies should be organized and the location communicated to the appropriate individuals. Tax returns and records will generally be necessary to prepare future returns or settle an estate. Deeds, leases, or other contracts related to real estate should be safeguarded and available to family members. Jewelry, furs, or collectibles may be hidden or placed in safe storage, and records of such property (and appraisals) will have to be available to appropriate family members. Of course, family members should have access to the names and numbers of any financial, tax, and legal advisers who assisted in creating the estate. These individuals are often invaluable in facilitating the organization of the information.

RECORDS AND INFORMATION INVENTORY

One good method to summarize and complete the task of organizing documents and records is to prepare a checklist of the types of items discussed above. The inventory should indicate the existence and location of the items relevant to the individual. Phone numbers and addresses of advisers and important contacts should be included. This inventory should be provided to the individuals who will potentially handle the estate of an individual who loses capacity or passes away. It can be prepared informally or according to inventory checklists available in business or legal book stores.

RECENT CASES AND RULINGS

LIFE INSURANCE CONTRIBUTED TO LLC INCLUDED IN INSURED'S GROSS ESTATE

Decedent (D) owned a life insurance policy on his life and contributed the life insurance to a limited liability company (LLC) formed to (1) maintain control of family assets, (2) consolidate fractional interests in family assets, (3) increase family wealth, (4) facilitate annual gifts to family members without fractionalizing assets, (5) restrict ownership of family assets to family members, (6) provide asset protection from creditors of family members, (7) prevent the transfer of LLC interests as a result of a family member's divorce, (8) provide business planning flexibility not available in other entity formats, (9) reduce administrative costs of disability or probate estates of a family member, and (10) enhance the knowledge and communication of the family about family assets. D and D's spouse (S) contributed other assets to the LLC in the formation process. S was named as the initial manager of LLC. The life insurance policy was assigned to the LLC, and the LLC was the designated beneficiary. One-half of the cash surrender value of the policy was credited to S's capital account. D transferred all of his interest in the LLC to his three children. D died about 16 months after forming the LLC.

In a technical advice memorandum (Ltr. 200432015) the IRS reached two conclusions adverse to D's estate. First, the IRS ruled that the life insurance policy was transferred by D for less than full consideration and is included in D's gross estate under Sec. 2035(a). Second, the IRS ruled that the proceeds payable to the LLC are not eligible for the estate tax marital deduction. The IRS determined that transferring the policy and crediting S's capital account for the cash surrender value represented an indirect gift of one-half of the policy from D to S. Sec. 2035(a) causes the inclusion of a policy in the insured's gross estate if the insured transfers incidents of ownership in it for less than full and adequate consideration within 3 years of the insured's death. The IRS reasoned that the insured's receipt of the LLC interests in exchange for the contribution of the policy and other assets did not represent full and adequate consideration because the transaction did not appear to be motivated primarily by legitimate business concerns, and the policy's transfer to the LLC was a substitute for a testamentary transfer rather than a bona fide sale. Since the policy was payable to the LLC directly and not to S, no federal estate tax marital deduction is allowable to D's estate for the death benefit.

Although this ruling appears to be extremely adverse to the creation of a family LLC or limited partnership, it represents the IRS's opinion about an estate plan that has not yet been litigated. It is quite possible that proper design, structure, and implementation of a family LLC or limited partnership incorporating life insurance would achieve a more favorable result.

This letter prepared, with the help of a nationally recognized tax authority, intends to promote interest in more comprehensive tax and estate planning. References are intentionally brief. If a topic interests you, you should investigate it more thoroughly with your qualified tax advisor. Effective tax and estate planning should involve competent advisors in relevant law, accounting, trusts, life insurance and investments. The knowledge and experience of each in their specialties can make the difference between a wealth transfer that works as intended and one that does not. Please seek competent counsel to determine and satisfy your individual needs.

*Positioning our clients
for the future*



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