



Advanced Planning Strategies

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Dear Reader,

The so-called extenders tax legislation was passed by the House and Senate last month as expected, but the Bill contained some surprises. The Tax Relief and Health Care Act of 2006 includes new provisions related to energy and Health Savings Accounts (HSAs). First, let's address the provisions that extend expiring tax relief items. Among the extenders are the

- allowance of a deduction of state and local sales taxes in lieu of deducting state and local income taxes for 2006 and 2007
- deduction for some taxpayers of up to \$4,000 of tuition expenses instead of claiming Hope or Lifetime Learning tax credits for 2006 and 2007
- extension of the Research and Development tax credit through 2007
- extension of the Work Opportunity and Welfare to Work Tax credits for employers through 2007. The credits will be combined and modifications will occur in 2007
- extension of the credit for renewable electricity production through 2008
- extension of the 30 percent tax credit for the purchase of qualified residential solar heating and electric equipment and fuel cell power plants through 2008

The bill also contains provisions to enhance (and encourage the use of) HSAs. This summary will be brief and will be discussed further in a later newsletter with respect to the limitations and other compliance details. The provision permits rollovers from health contributions in Flexible Spending Accounts (FSAs) and health reimbursement arrangements into the taxpayer's HSA. In addition, it allows a one-time rollover from an IRA to an HSA. Finally, the annual contribution limit to the HSA is repealed.

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

WHEN TO UPDATE AN ESTATE PLAN

An estate plan that is never updated works about as well as a car that is never serviced. They're both in great condition when they're new, but the wear and tear of the intervening years can take an enormous toll. Because even the most well-conceived plan cannot predict every contingency, a careful review of an existing estate plan is critical to making sure that it will continue to meet evolving needs.

The best time to review? Many people find it convenient to conduct an annual estate plan review after they file their income tax return. That way the review becomes a yearly exercise while financial information is easy to access. Other people prefer to use an important date (their birthday, for instance) to trigger an estate plan review. It doesn't matter which method is selected, as long as the plan is reviewed periodically.

KNOWING WHAT QUESTIONS TO ASK

As a starting point for reviewing an estate, determine if any of the following changes have occurred since the estate plan was created:

- Has there been a change in marital status? marriage, divorce, separation, remarriage?
- Are there more children in the family? More grandchildren? Has the number of dependents increased or decreased? Have any children moved out of (or back into) the home?
- Have any relatives or beneficiaries died?
- What about the relationship among family members and beneficiaries? Has it changed significantly between any of them?
- Have there been any changes in anyone's health? both physical and mental? that would materially affect the estate plan?
- Has there been a change in occupation?
- Has there been an address change, particularly a change to another state?

Now determine if there have been any of these other personal or professional changes:

- Have there been any changes in property ownership? Has any property been purchased either jointly or separately? Has any property been transferred to joint ownership? To a dependent? To a trustee? Has a residence in a different state been purchased?
- Has there been any other substantial change in family assets or liabilities? For example, have major assets been acquired, any gifts or inheritances been received, a significant sum of money been borrowed or loaned, or a tax-deferred annuity opened? Have investments been augmented?
- Was a business purchased? Has a business been mortgaged, sold, or liquidated? Has there been any other material change in business circumstances?
- Have there been any changes in the amounts or sources of retirement benefits (pensions, IRAs, profit-sharing plans, and so forth)?

Finally, ask these questions regarding the overall financial plan:

- Have any changes been made to a will, trust agreement, buy-sell agreement, or any other document that will have an impact on the estate plan?
- Has the person named as executor of the estate died? Has any trustee died? Or has the health of these individuals changed?

- Has any insurance changed? Besides life insurance, this includes health insurance, group insurance, any other employer plan, property insurance, and casualty insurance. Have insurers changed? Have any policies been surrendered? Have any policies lapsed?
- Have charitable intentions developed (or altered)?

Changes in any of the above areas might indicate that an estate plan has become outdated.

KEEPING UP WITH CHANGES IN THE LAW

Federal or state legislation might also have a significant influence on an existing plan. For example, increases in the applicable credit amount (sometimes called the unified credit) mean larger estate tax breaks. Although the gift tax exclusion amount is fixed at \$1 million, in 2007 the amount excluded from payment of estate taxes will be \$2 million. In addition, the generation-skipping transfer tax exemption is \$2 million. These exemptions could reduce the federal estate or generation-skipping transfer tax liability, but the estate owner's will or living trusts might have been drafted when lower exemptions were in effect. Or, perhaps the net worth of the estate has increased or decreased since the documents were executed. In either event, the amount left under the marital deduction and applicable exclusion (unified credit) shares of the estate will be significantly altered. It is important for anyone with a will or living trust containing a tax formula clause to fund these shares with his or her estate to have the documents reviewed to determine the impact of the exemption limits and the total value of the estate on the needs and expectations of the heirs.

With respect to nontax issues, many state probate laws, as well as laws affecting trusts, living wills, and powers of attorney, have undergone substantial changes in the past few years. For example, most states have adopted new flexible definitions of income and principal of a trust that could affect the distributions to various trust beneficiaries. In addition, states are adopting versions of the Uniform Trust Act that will affect actions of trustees and interpretation of document language. Depending on the goals of the estate plan, such changes at the state level could point to an estate plan overhaul.

MAINTAINING ACCURATE PERSONAL DATA

In addition to updating the estate plan itself, care must be taken to ensure that the addresses and phone numbers of all the individuals named in the plan (beneficiaries, executors, trustees) are current. It is a good idea to take an inventory of all estate planning documents? do family members know exactly where to find all these documents? There should be a written list of the location of all important financial information, along with a list of the financial advisors to contact in the event of death. Having this information readily at hand will make settling the estate that much easier.

Conducting regular estate plan reviews can pinpoint personal, professional, and legislative changes that will have an impact on the estate plan. Annual reviews will ensure that loved ones will be taken care of and property distributed according to an estate owner's wishes? in spite of unforeseen circumstances (good or bad) that have occurred since the plan was first drafted. Procrastinating can be a costly mistake.

RECENT CASES AND RULINGS

PERSONAL RESIDENCE INCLUDED IN GROSS ESTATE DESPITE COMPLETED GIFT OF PARTIAL INTEREST PRIOR TO DECEDENT'S DEATH

Decedent owned real estate that was used by her son as his residence. Decedent leased the remaining floors of the property to an unrelated tenant. Several months prior to her death, Decedent executed a deed giving her son a 49 percent interest in the property. The deed was given to the title company but was misplaced and not recorded until after her death. Decedent's executor filed a gift tax return reflecting the transfer of the partial interest to Decedent's son. Under the state's law, the court determined that the gift was completed despite the failure to record the deed because there had been intent by the donor to relinquish dominion and control.

However, the court determined that Decedent retained a life estate in the property, and 100 percent of the property is includible in her gross estate under Sec. 2036(a)(1). The facts of the case illustrated the retained interest of Decedent. Despite the gift of the 49 percent interest to her son, Decedent continued to receive all of the rent from the property from the unrelated tenant, and she paid most of the property's expenses until her death. In addition, the court disallowed an estate tax deduction for property taxes paid by her executor related to her share of the property because the property taxes were not an outstanding obligation at the time of her death. This case indicates that a good estate plan can be undone by the failure of the parties to follow normal arm's-length commercial standards in dividing a property interest between family members. (*Stewart v. Commissioner*, TC Memo 2006-225)

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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