ESTATE PLANNING

Ideas to Help You Plan for Your Future

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Will They or Won't They????

(OR MORE IMPORTANTLY
DO YOU NEED THE ANSWER TO THAT QUESTION????)

More thoughts about the repeal of the estate tax:

The Republican controlled Congress recently passed a tax law which purported to repeal the estate tax over 10 years. Actually, the bill gradually reduced the estate tax over 10 years, but then the repeal was repealed at the end of 10 years – the reason is Congress could not figure out how to reach statutory budget targets and still reduce taxes. At any rate, the law was dead on arrival at the White House, as the President vetoed it. It appears that estate tax change is dead until 2001.

If the estate tax is repealed you might have paid gift tax for no reason.

If a Republican gets elected President and if the Republicans control the Congress we might see another attempt to phase out the estate tax over 10 years. What will happen when the country tires of the Republicans and re-elects the Democrats? Remember what happened to the 28% top income tax bracket of the 1980's?

Some clients say they do not want to do estate planning because the estate tax might be repealed. I believe that is a bit short sighted. There is no guarantee that the tax will be repealed. Unfortunately, there is a guarantee that we all will pass to our reward.

The possibility of estate tax repeal may bring a slight change in strategy. For instance, making taxable gifts and paying gift tax actually results in an estate tax savings. This is because gift tax is not part of the estate so there is no estate tax calculated on it; further, the gift tax is itself a credit against the estate tax. That combination results in a tax saving of about 35% over waiting until death to make transfers and paying the estate tax.

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Will They or Won't They Cont'd….

On the other hand, if the estate tax is repealed you might have paid gift tax for no reason. My suggestion is not paying gift tax except in the case of elderly people with large estates, who might die during the next 11 years, and whose estates will be subject to tax even toward the end of the 11 years.

Similarly, if you would not be inclined to make charitable gifts but for the estate tax savings perhaps you should not consider creating an irrevocable charitable trust now if there is a possibility of estate tax repeal. Put it in your Will so that it will be effective if there is an estate tax when you die. For most of the estate planning devices we use the possible repeal of the estate tax is not really that important. Generally, the people to whom you make gifts, so your estate taxes are lower, are the same people who will be your beneficiaries at your death.

The talk of estate tax repeal is not a reason not to come to grips with your estate planning, but the possibility of repeal should be considered during the estate planning process.

PAY ATTENTION TO YOUR IRA!

IF YOU DON'T NO ONE ELSE WILL

Most of us pay considerable attention to our IRA investments. Yet some of us overlook two very important decisions about our IRAs; designation of a beneficiary, and the election of how the distributions will be calculated. I will discuss beneficiary designation in this issue of the newsletter, and calculation of required distributions from IRAs in the next issue.

Failure to designate a beneficiary of your IRA can have significant income tax impact. I am talking here about regular IRAs -- not Roth IRAs. Distributions from regular IRAs are subject to income tax, distributions from Roth IRAs are not. You must start making withdrawals from your IRA at age 70-1/2. April 1st of the year following the calendar year in which you reach age 70-1/2 is called your Required Beginning Date.

Failure to designate a beneficiary of your IRA can have a significant income tax impact.

The Required Beginning Date is the very last day upon which the first withdrawal from your IRA <u>must</u> be made.

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Pay Attention to ……….Cont'd

If you die before you reach your Required Beginning Date and have not designated a beneficiary, the IRA generally must be distributed by the end of the fifth year following your death, and it is often distributed to your estate.

If you designate a beneficiary of your IRA and you die before your Required Beginning Date, your beneficiary will be able to withdraw the IRA over the beneficiary's life expectancy. The following example demonstrates the impact of the failure to designate a beneficiary:

- ***Two brothers, Art and Bob, each had $500,000 IRAs, and each died prior to his Required Beginning Date. Art had named his 38-year old daughter, Ada, as beneficiary of his IRA. Bob failed to name a beneficiary, so his IRA passed under his Will to his 38-year old daughter, Bonnie.***

- ***Bonnie had to withdraw the IRA within five years of Bob's death, and paid income tax on the distributions. She invested the after-tax proceeds in 8% taxable bonds, with all earnings re-invested at 8%.***

- ***As a designated beneficiary, Ada left the funds in Art's IRA and made annual withdrawals based upon her life expectancy of 44.4 years. She paid tax on the withdrawals, and invested that money and the funds in the IRA in 8% bonds, reinvesting all earnings at 8%.***

- ***At the end of 30 years Bonnie had $1.5 million in assets, and no IRA.***

- ***However, Ada after 30 years had $1.5 million outside the IRA, and $1.4 million remaining in Art's IRA, and she still had a remaining life expectancy of 14.4 years over which to withdraw the funds in the IRA!***

Naming a beneficiary of your IRA before age 70-1/2 is extremely important.

Up to age 70-1/2 you can change the beneficiary designation without any planning impact other than who gets the money when you die. When you reach age 70-1/2 the beneficiary you designate will affect how much you must withdraw each year from your IRA. After age 70-1/2 you can change the beneficiary, but that may require you to take greater distributions from your IRA. The next issue of the newsletter will address more about IRAs.

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SAVINGS BONDS AS GIFTS

I continually learn from my clients and enjoy it!

I have a client who has substantial wealth. I have discussed with her the enormous amount which will go to the government in estate taxes when she passes away, and I suggested that she consider making $10,000 per year gifts to her children in order to reduce the size of her estate. I pointed out that for every $10,000 she gives away, she will be saving her family $5,500 in estate taxes.

She liked the idea of reducing the estate tax, but she was concerned the gifts might "spoil" her children and reduce their incentive to work hard. Further, she is concerned that some of the children might fritter the money away.

Some months later we again discussed her estate plan, and she told me she had devised a way to accomplish the gifting without the negative consequences which had concerned her. She has bought each child U.S. Savings Bonds, but has not given the bonds to the children. Every January she goes down to the bank and purchases a $10,000 Savings Bond in the name of each child, and she puts the bond in her safe. The bond is in the name of the child and bears the child's Social Security number, the gift is complete. When she dies, she has no right to the bonds, they will not be in her estate for tax purposes. The bonds accumulate interest and nobody must report the interest for tax purposes until the bonds are cashed. When the client dies the children will receive the bonds and the estate taxes will be saved.

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A pretty nifty solution to her estate tax problem.