

For Immediate Release
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How to Prepare Clients for the Coming Estate Tax Changes

by

There seems little doubt that the federal estate tax rules will fade away into the sunset at the end the decade. Through 2009, the current law allows for a \$3.5 million personal exemption or \$7 million in combined exemptions for both spouses, if they have taken the necessary steps to capture both exemptions.

The federal estate tax disappears totally for estates having to file for deaths in 2010, making it a unique occasion in the history of federal “death tax” avoidance.

To clarify what is expected to occur, a client with a \$3.5 million estate is an example. If the federal estate tax falls back to its 2001 level when there was a \$1 million personal exemption and a marginal 55% tax rate and dies in 2011, the estate taxes would be \$1.375 million.

Based on that illustration, what planning will be appropriate as far as new estate tax rules going forward from 2011?

First, there is indication that the 2010 death tax “holiday” may never occur. The Administration and Congress will find a way to agree that it would be too costly to give up 2010 for collecting the federal taxes for deaths that occur that year given the incredible deficits that we are facing and the political climate that we have. In light of the unprecedented federal budget deficits and their impact on taxpayers, it should be quite easy to retain the existing estate tax provisions in 2010.

Let’s assume federal estate taxes will *not* disappear, since it is neither politically nor fiscally realistic.

That said, we can expect personal federal estate tax exemptions to drop from the current \$3.5 million per person level. Although this may take place in 2011, it may be legislated at \$3.5 million for 2010 *only* and it is also possible that future estate tax exemptions will be indexed for inflation beyond 2010.

We can look for the marginal federal estate tax rates to run from 45% to 55%. It is quite likely that rates will be maintained at the 45% marginal rate, while possibly setting an additional 55% marginal rate for very large estates.

Even though much of the focus at this point is on the federal estate tax, it is equally important to be aware of the estate tax provisions of your state and their impact, if applicable, on the clients' needs. They often have different exemptions and provisions, although some states do not have estate tax laws, at least currently.

Second, advisors need to be proactive with clients starting immediately. If this sounds as if there is a sense of urgency, there is. Since this issue is being widely discussed in the press, clients are aware that changes are pending and wonder what the impact might be if they should die in the next couple of years. By having conversations with clients now, they know you are working on this issue. This will also mitigate the impact of someone else asking to meet with them about estate tax changes.

The initial conversation with a client should include two issues: 1) anticipate a need to review and redraft the client's will and trusts, if any, in conjunction with the client's attorney. Since a person's circumstances can change so rapidly today, redrafting a will to reflect the current situation is a necessity.

Then, 2) take advantage of the marital deduction and unified gift and estate tax credits. In a difficult and undulating economic environment, there are more unique estate planning opportunities than ever, particularly for high net worth clients. Outright gifts of stock or other property can transfer future growth in the property to heirs and remove the property from the estate.

Third, producers should sit with all their clients, prospects and centers of influence to review their life insurance plans. Quite candidly, periodic reviews are obligatory today for serving clients properly. This is what it takes to make certain the plan is current, especially when there is a confluence of changes involving

economic, political and tax issues, as well as family needs and dynamics. All these must be taken into account, along with marital status, residence situation, and other types of assets.

Fourth, have a contingency plan for clients. The recent Wall Street meltdown is a lesson no advisor dare forget: clients were not prepared. Clients deserve to know that regardless of what happens, that you, as their advisor, will assist them in protecting their family. *This is what will set you apart from others more than anything else.* When things change, they can count on you to be there.

To meet the challenges, personal uses of life insurance will be critical. Specifically, the needs include supplying family members with an income source after the death of the income earner, provide cash to pay estate taxes, mortgages and other debts, assure the intended amount for the beneficiaries, equalize inheritance and leverage the annual gift tax exclusions.

Fifth, clients should solve liquidity needs. These include paying administrative costs and anticipated tax liabilities, as well as any indebtedness and funding for business needs such as deferred compensation arrangements, death benefits for a key person/employees' families, financing of the replacement of a key employee, replacement of lost revenues due to loss of a key employee and provisions financing the purchase of the business.

Clients are finding they need to review the issue concerning the surviving family's lifestyle, since the financial impact of the recession has changed the plans for their future financial security. This requires re-evaluating the budgetary and cash flow planning for family members. Such a review must take the likely income and estate tax changes into consideration.

Plans can be devised to distribute the client's estate upon death to family members in an orderly method anticipating the increased estate tax liability.

Sixth, clients should take steps to reduce or even eliminate estate taxes. Depending on the particular situation, there are numerous planning techniques that can help reach this objective: gifts, Qualified Personal Residence Trusts, Grantor Retained Annuity Trusts, a Family Limited Partnership, selling depreciated assets and gifting net proceeds, making installment sales to an intentionally defective

Grantor Trusts, private financing and intra-family market loans (often coupled with the purchase of life insurance), private annuities and annuity maximization as well as other strategies.

Leverage using these strategies with a life insurance product can make a large impact for estate beneficiaries. For example, a client can use the Applicable Federal Rates (AFR) to lock in low imputed federal interest rates for intermediate and long-term private premium financing, which makes easy, low cost funding possible for a large life insurance policy that can be excluded from an estate.

This technique allows the family to minimize or eliminate current gift tax liabilities when transferring large amounts of money as premiums for Trust-owned life insurance.

The timing for planning involving gifts may currently offer especially low valuations, allowing for greater wealth transfer from the client's estate to the desired beneficiaries. Using such planning techniques as this will help shift future appreciation to coming generations and can be accomplished with only a minimized gift tax cost.

While no one knows what course the federal estate taxes law will take in 2010 and beyond, it is very important to engage clients in a review of all of the underlining issues so that they are prepared to protect both their family and their estates, now and into the future.

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