

Wealth Transfer Strategies For Troubled Times

If you happen to die in 2010, your estate planning problems are over—at least they might be. For a year, at most, the federal estate tax is gone. But the tax is scheduled to return in 2011 in a much more punishing form than it took in 2009, and that prospect could motivate a congressional compromise, with new rules that may be applied retroactively to wealth transfers during 2010. That means there's really no holiday for wealthy families looking for tax-efficient ways to move assets to the next generation. And though there is no federal estate tax in 2010, there is a limited step-up in basis which could trigger capital gains for beneficiaries of large estates assuming they sell the assets immediately. Still, with stocks, real estate, and almost every other kind of asset worth less now than before the recession, you may be able to transfer more to your heirs at lower cost, and today's rock-bottom interest rates could also help. Consider these five strategies that attempt to take advantage of the current economic environment.

1. Get the most from the annual gift tax exclusion. This tried-and-true vehicle may be worth more now than ever before. In 2010, you can give up to \$13,000 of assets to as many recipients as you choose—or a maximum of \$26,000 for each gift if your spouse joins in—without gift-tax liability. But keep in mind you'll have to file a gift tax return for joint gifts, even if the total gifts are \$26,000 or less. The trick here is to give away something whose

value has dropped but is likely to recover.

2. Take advantage of low interest rates to make a loan or asset sale to family members. Here, too, current economic circumstances can maximize

the value of funds you transfer to the next generation. You could lend money to buy a home or start a business, charging interest based on today's low applicable federal rate (AFR)—in June 2010 just 4.30% on

loans with a term longer than nine years. Or you might sell assets—whose value may be at a low point—to family members directly, or to an irrevocable trust set up for their benefit, with installment payments also based on the AFR rate.

3. Create a grantor trust with undervalued assets. This can be yet another way to capitalize on the temporarily depressed value of many assets. You can use your annual gift tax exemption—perhaps supplemented by some or all of the \$1 million lifetime exclusion that individuals may employ to shield gifts from taxes—to transfer assets into the trust. Then, you'll be responsible for income and capital gains taxes on trust assets. Though those payments further reduce your taxable estate, they aren't considered gifts to the trust's beneficiaries, and they enable trust assets to continue to grow unencumbered by taxes, adding to the potential recovery of beaten-down assets.

4. Boost the benefits of a grantor
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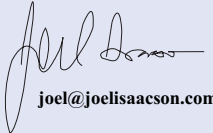
Is Volatility Testing Your Risk Tolerance?

Stocks turned sharply lower in the second quarter, erasing all of the first quarter's gains and leaving the S&P 500 down almost 7% through June 30. Bonds, which offer some protection in market downturns, did much better, returning between 2.5% and 7% depending on the particular instrument. But in July, we saw the S&P 500 surge 7% to bring domestic equity markets back to where they were when the year began.

Our overall outlook is characterized by concern over the challenges the global economy faces. The sharp swings in stock prices this year reflect a sort of tug of war between improving fundamentals on one side and serious concerns about debt-related stresses and their potential to derail the fragile recovery on the other.

The developed world must walk a tightrope as it deals with the pressing need to slow—and ultimately reverse—debt growth without also seriously harming economic growth. During these volatile economic times, it is imperative that you examine your true level of risk tolerance as you review your current financial plan and make any adjustments necessary to achieve your long-term goals. As always, we are available to address any questions or concerns you may have.

On an internal note, we have redesigned our company website (joelisaacson.com). Please take a moment to visit and share your comments!


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Beware Of Homeowner's Insurance Gaps

Disaster may strike your home when you least expect it. There could be damage from flooding, an earthquake, termites, or even mold—just to name a few possibilities. And though you probably assume repairs will be covered by your homeowner's insurance policy, they may not be. Your policy may exclude more events than you realize. Even when you are covered—for, say, flood damage—there may be “gaps” in your coverage that limit the amount you can recover.

The good news is that a typical homeowner's policy covers losses resulting from fires, tornadoes, and severe storms. But the list of what it normally doesn't cover may surprise you. For instance, coverage may not extend to floods and earthquakes, although you can usually add a policy rider for such events. The rider's cost will vary based on whether you reside in a high-risk area.

Similarly, if you have to clean up a mess created by a water or sewage backup, the expense won't be covered by standard homeowner's insurance. But here, too, you can purchase a special rider to avoid this headache, often for less than \$100 a year.

The list of other types of damage that usually aren't covered range from mold to insect and termite infestations to acts of terrorism, war, and nuclear attack. Dig your policy out of your files and take a few minutes to assess your risk exposure for these events.

Even if you're covered for damage—through standard insurance or a rider—payments from the insurance company are based on the property's replacement cost, not its fair market value. Also, if your home is destroyed and it's insured for

less than the replacement value, you'll have to pay some of the rebuilding cost. In addition, deductibles and maximum dollar caps may affect reimbursements for possessions that are destroyed or stolen.

In terms of liability exposure, one way to avoid dire consequences is to supplement your current coverage with an umbrella liability policy. As the name implies, the

umbrella policy sits on top of your homeowner's and auto insurance policies to provide additional protection. For instance, if a neighbor slips and is injured on your icy sidewalk or a tree topples onto a car parked in front of your home, an umbrella policy may pick up the slack.

Just like other forms of insurance, you'll need to shop around for the best umbrella policy. And keep in mind that umbrella coverage kicks in only after other insurance is exhausted, and umbrella



policies usually carry deductibles equal to the required underlying limits for the auto and homeowners policies. Still, the cost of umbrella coverage usually isn't prohibitively expensive. You may be able to obtain \$5 million in liability coverage for \$600 to \$1,000 a year. And you may get a discount for using the same carrier. That could prove a small price to pay for plugging the gaps in policies. ●

Your 401(k) Choices After A Layoff

If you're one of the millions of people who have received pink slips from their employers during these troubled economic times, things may look bleak. But there's something you can take with you from your old job—your 401(k) account—that could hold the key to better times ahead. Though there's no penalty for leaving your retirement funds where they are, you may be understandably reluctant to entrust the money to your ex-company, continue to pay what may be unreasonably high administrative fees, retain limited investment choices, and risk having uncertain access to your account if you decide to make changes

in your investment choices.

So what are the alternatives? Participants in 401(k)s and other employer-sponsored retirement plans can normally choose from among three main options: taking a lump-sum distribution, opting for annuity-type payments, or rolling the funds into an IRA or a 401(k) at your new job. There are pros and cons for each possibility.

1. Lump-sum distribution. If you're in desperate need of cash, this may be what you have to do. But it has several drawbacks. If you request a lump sum from your company, it's required to withhold 20% for federal taxes (and sometimes additional state

withholding), and you could owe more than that if you don't deposit the money in an IRA or another 401(k) within 60 days. You'll owe income tax on the amount of the distribution (which might push you into a higher tax bracket), plus you'll likely have to pay a 10% penalty if you haven't reached age 59½, bringing the total tax you pay on the amount received to almost 50%. Finally, of course, you'll be depleting your retirement savings well ahead of schedule.

2. Annuity-type payments. With this option, you're still on the hook for tax payments and a possible early withdrawal penalty, but at least the tax

New DB(k) Plans Could Be Tempting

As the owner of a small business, you can choose from a range of retirement plans. Yet while there are important variations among the many possibilities—401(k)s, simplified employee pensions (SEPs), defined-benefit pension plans, and others—they basically fall into one of two categories depending on who is responsible for funding and using the plan. With old-style pensions, your business promises employees a specific retirement benefit, generally a function of salary and years of service (as a lump sum or a lifetime annuity). In contrast, 401(k)s and other defined-contribution plans put the burden on employees to save and invest a retirement account and then decide how and when to tap it.

Beginning in 2010, a new hybrid—the defined-benefit 401(k) plan, dubbed the DB(k)—combines features of both types. A DB(k), authorized by the Pension Protection Act of 2006 and available to companies with two to 500 employees, provides a small but guaranteed company-paid lifetime monthly retirement benefit while letting workers also fund a 401(k). One major attraction is that DB(k)s are exempt from the strict nondiscrimination rules that normally apply to 401(k)s and other tax-advantaged retirement plans. But the fact that the DB(k) supplements employees' savings with guaranteed cash also has its

appeal at a time when the bear market has cut deeply into 401(k) account values.

The 401(k) part of the DB(k) is subject to the same rules as normal 401(k)s. Employees can direct as much as \$16,500 of pre-tax salary into the plan in 2010, and those age 50 and older may put away a maximum of \$22,000. Participating workers can bolster these dollars with optional employers' matching contributions, with total yearly savings capped at \$49,000 and \$54,500, respectively, for those under and over the age 50 dividing line. Workers (and business owners) who achieve those maximums should, over a working lifetime, amass a reasonable nest egg. But how much participants save, and how they invest the savings, is left up to them, and there's no guarantee they'll have enough to fund a long, comfortable retirement.

Nondiscrimination rules can be another stumbling block for business owners and other high-income workers enrolled in traditional 401(k)s. Such plans must meet strict requirements to ensure that highly compensated employees (HCEs) don't receive a disproportionate share of retirement plan benefits. If lower-paid employees choose not to participate, those at the top of the compensation ladder may find their own contributions restricted.

The defined-benefit 401(k) uses a

waiver of those rules to encourage business owners to adopt this new-style retirement plan, which supplements savings with a defined retirement benefit that's normally based on "final average pay." The plan must provide a benefit equal to 1% of an employee's final average salary multiplied by years of service, with a maximum annual pension equal to 20% of final pay. Meanwhile, the 401(k) part of the plan requires automatic enrollment of employees (who must opt out if they don't want to participate) and an employer's contribution equal to 4% of compensation. Your business's matching contribution rate for HCEs can't exceed the matching rate for non-HCEs, and you must immediately vest employees in their 401(k) accounts.

A second option for determining benefits is a cash balance approach that specifies annual minimum company commitments based on employees' ages. In this case, your business must set aside at least:

- 2% of compensation for participants age 30 and under
- 4% of compensation for participants between age 30 and 40
- 6% of compensation for participants between age 40 and 50
- 8% of compensation for participants age 50 or over

Plans that meet all of the requirements of a DB(k) need file only one document for the plan and one annual IRS Form 5500—even though this hybrid really consists of two separate plans. And no other testing is required.

Some experts expect the DB(k) to be particularly attractive to small professional groups—physicians, attorneys, accountants, architects. It can build up substantial retirement savings in a short time, and though it mandates a significant employer contribution, that could be an advantage for owners looking to fund their own retirements. Moreover, as the economy rebounds and businesses again compete for the best workers, offering a DB(k) could make your company stand out. The IRS is expected to announce more details about this new plan soon. ●

liability will be spread out over the years you receive payments. Typically, the amount you get is calculated according to your life expectancy or the joint life expectancies of you and your spouse. If you choose, payments may continue until the death of the second spouse.

3. Rollover. This has obvious advantages. Not only will you have more investment

choices, but the transfer—to a traditional IRA or to another employer plan at your new job—isn't taxed, and your money can continue to compound on a tax-deferred basis until you make

withdrawals during retirement. Just be sure to complete the rollover within 60 days of taking the money from your old 401(k), and keep in mind that your former employer will still automatically withhold 20% of your balance. To avoid that levy, which you can't recoup until you file your tax

return, arrange for a trustee-to-trustee transfer directly from your old account to the new one. Best of all, this option helps your money keep to its appointed task—saving for a secure retirement. ●



Marriage Doesn't Mean Owning All Your Assets Jointly

Marriage is all about togetherness. Yet when it comes to owning assets, too much togetherness may not be financially healthy.

Owning assets jointly is more convenient than individual ownership, and it's the simplest way to avoid probate after a spouse's death. But couples often should consider separating their assets. Here's why:

Estate tax implications. Estate rules let spouses leave unlimited property to each other tax free. That's okay when the first spouse to die leaves everything to the second, but the second death could result in a whopping tax bill. Couples likely to have estate tax issues could acquire property individually to help maximize the value of each other's estate tax exclusion. While owning a house jointly is important for giving both spouses equal claim if they divorce, other assets can and should be held separately in roughly equal shares.

Dividing jointly owned property. How you take title also affects who can inherit your property. If you own

it individually or jointly as "tenants in common," each of you may specify in your will that you want a particular asset or share of an asset to go to a designated heir. However, if you take title as "joint tenants" (with rights of survivorship) or "tenants by the entirety"—the most common form of ownership for married couples—you won't be able to say how assets are split. That may work if you and your spouse share the same beneficiaries. But it could be a problem if, for example, you're in a second marriage and want to divide assets among children from different marriages.

Consider John and Mary. Because they own their property as tenants in common, each holds 50%, and John can bequeath his share to children from a prior marriage. Mary won't automatically inherit John's interest.

But if they hold their assets as joint tenants or tenants by the entirety, the surviving spouse becomes the sole

owner of everything the couple owned together. It won't matter that John's will names his children as beneficiaries; if he dies first, the title documents will govern, and Mary will decide how assets are divided when she dies.

Other considerations. Owning assets separately is especially important if your combined net worth is at or above the IRS estate tax exemption. The exemption was \$3.5 million in 2009 but is set to drop to \$1 million in 2011 if Congress doesn't change the law. Once you approach those levels, it pays to consider ways to separate assets. Also, since joint-tenancy assets can be taken by creditors or lost in lawsuits once an individual's assets are exhausted, doctors or others who can be sued easily will want at least half of their assets in their spouse's name.

Deciding how to hold title to your assets is not a simple decision, as state laws differ and each situation is unique. We can work with your attorney to help decide what's best for you and your spouse. ●



Wealth Transfer Strategies

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retained annuity trust. A GRAT can preserve assets from the sale of a business interest or other holdings. Essentially, you transfer assets to an irrevocable trust, but retain the right to receive distributions over the trust term. The annuity is based on the amount transferred and the prevailing interest rate set by the government under Section 7520 of the tax code. (The 7520 rate as of June 2010 is 3.2%.) The lower the rate, the lower the payout, resulting in more asset preservation for your heirs—particularly if the assets rebound in value. It's also possible to "zero out" a GRAT, effectively eliminating any gift tax on the transfer to the GRAT. (Keep

in mind that Congress may modify the rules affecting these techniques.)

5. Use a charitable lead trust (CLT) to help charities and your heirs. With a CLT, income on trust assets during the term of the trust goes first to the designated charity and then to your heirs, who also ultimately inherit trust assets. Most nonprofits have suffered during the recession, and they'll welcome this annual infusion of cash. And if the CLT earns more than the specified yearly payment—based on a fixed amount or percentage of assets—the excess is added to principal. If an economic recovery increases the

value of trust assets, your beneficiaries could benefit.

One or more of these strategies could help you and your heirs benefit from an otherwise dismal economic environment. Yet uncertainty abounds. No one knows what will happen to the estate tax or to tax rates on gifts and income, and there's no guarantee that the economy will improve, or that stock prices or real estate values will soon recover what they lost during the long downturn. We can work with you and your attorney to consider your wealth-transfer goals and to create a plan that makes sense for you in these troubled times. ●

