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Financial Planning Strategies

A Financial Planning Update

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New Tax Act Extends Savings

A $70 billion tax cut package, the Tax Increase Prevention and Reconciliation Act (TIPRA), became law on May 17, 2006. At the center of this legislation is the extension of lower long-term capital gains and dividend rates through 2010. In addition, this measure provides AMT relief and extends the more generous Section 179 expensing limits for business owners. To balance these tax breaks with revenue-raising provisions, this bill applies the "kiddie tax" to children under age 18 instead of age 14, effective immediately, and permits higher-income taxpayers to convert traditional IRAs to Roth IRAs, beginning in 2010.

Good News for Investors

TIPRA extends the 15% tax rates on long-term capital gains and qualified dividends through 2010. Put in place by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), these reduced rates had been due to expire at the end of 2008. Taxpayers in the 10% and 15% income tax brackets pay 5% through 2007, and then zero tax on

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The Give and Take of Charitable Giving

Did you know that you can make a gift of a new or existing life insurance policy to your favorite charity? When properly designed, a **charitable life insurance** program can provide a powerful boost to your overall financial picture and offer substantial tax benefits, as well as play an important role in supporting a charitable interest.

There are generally three methods used to gift a life insurance policy to a qualifying charity: a **charitable bequest plan**, a **charitable gift plan**, and a **charity ownership plan**. Regardless of the method, policy ownership and **beneficiary** arrangements play an important role in the planning process. A consultation with a qualified legal professional can help solidify your goals and expectations, provide information on the limitations on charitable deductions, and help achieve the desired results while avoiding any unnecessary problems.

A Comparison of Gifting Strategies

A ***charitable bequest plan*** is ideal if you would like a charity to benefit from the proceeds of an existing life insurance policy but feel uncomfortable about

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New Tax Act Extends Savings

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long-term gains from 2008 through 2010. Prior to the enactment of JGTRRA, the top rate for long-term capital gains was 20%, while dividends were taxed as ordinary income at a maximum rate of 35%.

AMT Relief

This legislation also raises the 2006 AMT exemption amounts to $62,550 for married couples filing jointly and $42,500 for single filers. If no congressional action had been taken, the exemptions for the 2006 tax year would have fallen to $45,000 for joint filers and

$33,750 for individuals. Under the new law, taxpayers may use all nonrefundable personal credits to offset AMT liability.

A parallel tax system, the AMT typically applies to families taking large numbers of deductions. According to the Urban-Brookings Tax Policy Center, 3.6 million filers paid the AMT in 2005, but 18.9 million taxpayers would have been hit with the AMT in 2006 without additional relief.

Extended Section 179 Expensing

TIPRA extends through 2009 the favorable Section 179 expensing limits established by the Jobs and Growth Tax Relief Reconciliation Act of 2003. Section 179 expensing allows business owners to take an upfront deduction on qualified equipment purchases, including off-the-shelf computer software. Under JGTRRA, the expense limits quadrupled from $25,000 to $100,000, and this higher amount is indexed for inflation each year. In 2006, business owners can write off up to $108,000 of qualifying purchases. The deduction is reduced dollar for dollar if you buy more than $430,000, and if your purchases exceed $538,000, the remainder must be depreciated. Without TIPRA reform, the expensing limit would have dropped back to $25,000 in 2008, with a phaseout threshold of $200,000.

Expanding the Kiddie Tax

The law also raises the age limit for the "kiddie tax" from 14 to 18 years of age. These new rules take effect in 2006. Unearned income, such as dividends and interest, exceeding $1,700 for children under age 18 will now be taxed at the parents' top rates, unless the child is married and files a joint return. Prior law applied the kiddie tax to children under age 14. This allowed children 14 and older to pay taxes on their investment income at rates most likely lower than their parents' top rates. An exception applies to distributions from qualified special needs trusts.

Roth IRA Conversions

TIPRA also eliminates, starting in 2010, the current $100,000 adjusted gross income (AGI) ceiling on converting traditional IRAs to Roth IRAs. Funded with after-tax dollars, Roth IRAs offer tax-free earnings and tax-free distributions, provided you have reached age 59½ and have owned the account for five years when you make withdrawals. Unlike traditional IRAs, Roth IRAs have no minimum distribution requirements at age 70½.

Conversions are treated as distributions; therefore, they will be subject to income tax, but you will not be penalized for the early withdrawal. Critics of the tax package point out that the estimated $6.4 billion in tax revenues resulting from conversions of traditional IRAs to Roth IRAs will be cancelled out as withdrawals from Roth IRAs escape taxation over the coming decades.

Given the temporary nature of this latest reform and the possibility of further changes on the horizon, it is important to regularly review your tax and financial strategies. For more information and specific guidance, consult your tax professional. $

Taxes and Your Retirement Destination

What will you look for as you approach your "golden" years? As you decide where your retirement haven will be, in addition to considering lifestyle questions, you should research the effects of state tax structures on your projected retirement income. Here is a look at the following key tax areas:

Earned and unearned income taxes. If you plan on continuing to work, some states treat seniors like everyone else on their income tax rolls, some specifically give seniors tax breaks on earned income, and others do not tax earned income for any of their residents. Tax rates on unearned income may also vary from state to state. Be aware that several states tax former residents on **Individual Retirement Account (IRA)** distributions. Thus, if you move, you may have to file income tax returns in *two* states—and watch out for unexpected local income taxes.

Pension income taxes. In many cases, one key to financial survival for seniors is income from military, government, and private pension plans. Some states exempt all pension income from taxation, while others exempt certain types and/or amounts of pension income.

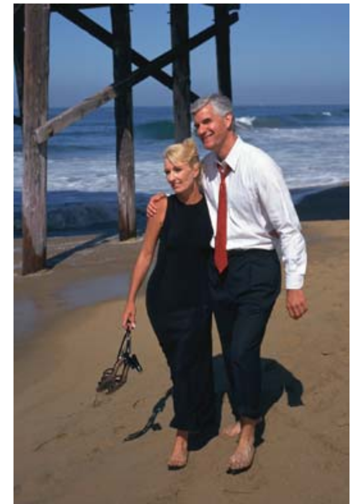
Social Security benefit taxes. Some states do not tax Social Security benefits at all, while others follow federal tax formulas for determining their tax on such benefits. Still others have developed their own formulas to determine the income tax on Social Security benefits.

Property taxes. This is another area where some states offer advantages to seniors. Familiarize yourself with the relevant personal property tax laws, especially on cars and boats.

Sales taxes. Many states—and sometimes localities within each state—tax clothing, gas, household goods, and sometimes even food and prescription drugs. When you look at what you have budgeted out of your fixed income for these items, remember to add sales taxes if they will apply when you move to your retirement haven.

Estate taxes. While they do not *directly* affect your cost of living as a senior, do not overlook estate taxes when determining the feasibility of settling in one state over another. In some states, your spouse may be taxed on a portion of his or her inheritance that, in another state, would pass to him or her free of state estate tax. Changes in state estate tax codes should be watched carefully as states study ways to make their financial environments "friendlier" to seniors.

No *single* tax consideration should be used to determine the most favorable tax environment for your retirement years. You need to analyze your *overall* financial situation and then look at all of your retirement options. Your main goal should be to spend your senior years where you will be relatively free from financial stress—to live the happy, healthy life you have earned. $



Second-to-Die Life: Expanding Your Insurance Horizons

The concept of **second-to-die life insurance** (also known as **survivorship life**) provides a different type of coverage that allows *two* people to be insured under *one* insurance policy.

One appealing aspect of second-to-die life insurance may be that it pays a death benefit at the death of the *second* insured. Therefore, these types of policies are generally less expensive than two individual policies and can be used to accomplish certain estate planning goals. However, it is important to recognize that survivorship life insurance may not be for everyone.

The uses of survivorship life may be different than traditional "single life" policies, since these policies pay a death benefit at the death of the second insured. Their cost-effectiveness generally makes them an ideal tool for helping to fund future estate tax liabilities, establish gifts to future generations or a favorite charity, or keep a business within the family. $

The Give and Take of Charitable Giving

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surrendering control during your lifetime. By merely changing the beneficiary arrangement to a desired charity, you retain the ability to enjoy the usual benefits of owning a policy. There is no immediate income tax benefit for this type of charitable gift because you still have **incidents of ownership** in the policy. However, upon your death, even though the death proceeds will be included in your gross estate, a charitable deduction for the full value of the policy proceeds is allowed.

If you wish to receive an *immediate* income tax deduction for a gift of an existing policy, you may wish to consider a ***charitable gift plan***. By simply changing the beneficiary *and* ownership designations on an existing policy to a favorite charity, you can enjoy an immediate gift tax charitable deduction for the policy. This deduction is based on the lesser of your (the policyowner's) cost basis or the value of the policy. You may also qualify for an income tax deduction.

If you make regular cash contributions to a charity, an opportunity to leverage smaller gifts into a larger endowment may exist. Under a ***charity ownership plan***, a life insurance policy—where permitted by state law (see below)—is purchased by, and made payable to, a charity of your choice. Policy premiums are technically paid by the charity. To offset this cost, you can make annual cash gifts to the charity, and as a result, you may be eligible to deduct a portion of your charitable donations

from your income taxes. A gift tax charitable deduction for the full value of the annual cash gift is allowed. As such, this method is truly a "win-win" situation for you and the recipient charity.

Watch Out for Insurable Interest Laws

Regardless of your gifting strategy, an important planning consideration will be the insurable interest laws in the state where the policy was originally purchased. Although the donor makes contributions to the charity in cash and the cash is then used by the charity to pay premiums on the life insurance policy, the life insurance policy insures the donor's life. Because insurable interest is typically considered to be an interest based on family, marriage, or financial obligation, the charity's insurable interest in the policy may be called into question, thereby jeopardizing the tax benefit and placing the policy proceeds as part of the donor's estate. A case for insurable interest can be anticipated and incorporated into the trust documents.

The Best of Both Worlds

If you are charitably inclined and are seeking tax advantages, the gifting of life insurance can offer unique planning opportunities. The potential for charitable income tax deductions or a considerable estate tax reduction, coupled with satisfying your charitable inclination, may make this type of gift particularly attractive. Such charitable life insurance gifts can typically be achieved with minimal amounts of legal challenges and publicity. However, careful planning under the guidance of a qualified legal professional is necessary to help ensure your charitable intentions are properly executed. $

Current tax law is subject to interpretation and legislative change. Tax results and the appropriateness of any product for any specific taxpayer may vary depending on the particular set of facts and circumstances. You should consult with and rely on your own independent legal and tax advisors.

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