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CLIENT MEMORANDUM
November, 1996
Estate and Tax Planning

In the closing months of 1996, please consider these estate and tax planning topics:

1. **Make Gifts before December 31.** You can make tax-free gifts of \$10,000 per donee per year. The number of donees is unlimited; and, if you are married, the exclusion is doubled to \$20,000 per donee. Each such annual exclusion gift results in a reduction in the size of your taxable estate. If your potential estate tax rate is, say, 45%, the estate tax savings is \$4,500 for each \$10,000 gift. *It is important that the gifts be completed by December 31.* Gifts of securities, or of partial interests in real estate, can also be made; and discounting may be available to "leverage" the gift.
 - b. Starting in 1997, full \$2,000 IRA contributions will be *permitted for non-working spouses* (but with high income limitations, as before).
 - c. Effective generally on July 1, 1997, *group health insurance plans* are subject to new requirements, which provide "*portability*" by placing limitations on exclusions for pre-existing conditions, and prohibiting discrimination based on health status.
 - d. Certain IRA distributions for purposes of medical expenses and medical insurance will be allowed *without the 10% premature distribution penalty.*
 - e. *Self-employed persons will get larger health insurance deductions:* 40% of their costs will be deductible in 1997, with increases up to 80% deductibility over 9 years.
2. **New Laws.** Recent legislation, commonly known as the Small Business Health Insurance and Welfare Reform Acts of 1996, included a few significant changes in the tax laws:
 - a. There is currently in effect a 15% excise tax on "excess distributions" from retirement plans and IRAs. Any distributions over \$155,000 per year are considered to be "excess" and subject to this 15% excise tax. *The new law provides that this excise tax will not apply during the years 1997 through 1999.* This interim waiver does not apply to the similar tax on an "excess accumulations" at death.

- f. *Rules for S corporations have been liberalized.* In the future, the number of allowable shareholders is increased from 35 to 75; more types of trusts may hold S corporation stock, making for easier financial and estate planning; S corporations will be permitted to have subsidiaries.
- g. *Five-year averaging* for lump sum retirement plan distributions will not be allowed after 1999.
- h. Regarding *Medicaid planning*, one of the new laws states that, effective 1-1-97, it will be a federal *felony* to dispose of assets, including by a transfer in trust, "in order for an individual to become eligible for medical assistance (under a state Medicaid plan) if disposing of such assets results in a period of ineligibility for such assistance . . .". Generally speaking, a gift will almost always result in a period of ineligibility, especially if application for Medicaid is made shortly after the gift. The potential reach of this statute is very broad! The law does not require that the transferor actually receive any Medicaid assistance. Thus, extreme caution must be exercised in making any gifts if there is a possibility that the transferor may later apply for Medicaid. This provision has caused much concern, and there are now efforts underway to repeal this provision, but, again, this creates great concern in Medicaid planning matters. However, there are available certain planning techniques which can still result in a net benefit, when planning for Medicaid coverage.
- 3. 1997 Income Tax Rates.** For married couples filing jointly, the 28% tax bracket will begin at \$41,200, the 31% bracket at \$99,600, the 36% bracket at \$151,750, and the 39.6% bracket at \$271,050. For single filers, the 28% bracket will begin at \$24,650, the 31% bracket at 59,750, the 36% bracket at \$124,650, and the 39.6% bracket at \$271,050.
- 4. Sale of Your Home.** The politicians have been making "promises" about reducing or eliminating the tax on capital gains upon the sale of a personal residence. *No such changes were included in the recently-passed law.* It seems very premature to rely on any such provision's becoming law. Who knows how any such law would affect future sale pricing!
- 5. Family Partnerships.** Family Partnerships remain to be an attractive estate planning technique. The gifting of Limited Partnership interests, usually allows for a discounting of intra-family gifts. This is a *leveraged method of transferring your estate* to your family members, with a minimum of gift and estate taxes. The potential estate tax savings is very significant.
- 6. Limited Liability Company.** The limited liability company is a "hybrid" entity, which provides "limited liability" (which previously was available only for corporations) and it allows "pass-through taxation" (which previously was available only to partnerships). Thus, the LLC combines the better attributes of both corporations and partnerships. This type of planning *should be considered for ownership of any rental real estate which you might own, for purposes of obtaining limited liability.*
- 7. Life Insurance Trust.** Generally, the face amount of a life insurance policy is taxable as part of your estate. The estate tax on life insurance can, in many cases, be rather easily eliminated by transferring life insurance policies into an Irrevocable Life Insurance Trust. If you own policies on your own life, please *consider transferring these policies into an Irrevocable Life Insurance Trust.* (Having your spouse as the owner does not solve the problem.) The potential savings, to your heirs, is about 50% of the face amount of the policy.
- 8. Powers of Attorney.** If you were to become incapacitated due to accident or illness, then generally *no one* is authorized to sign legal documents on your behalf. *A Power of*

Attorney is a precautionary document under which you could name your spouse or child or some other trusted relative or friend to be your "Attorney-in-Fact" to handle your financial affairs if you were to become unable to do so. Without such a Power, your family might be required to go to Court to have a formal guardian appointed, which is a very inflexible and expensive alternative. The Power of Attorney could be worded to take effect only if you were to become incapacitated, or it could be worded to take effect immediately. The Power of Attorney can be revoked by you at any time.

- 9. Estate Tax Rates Have Not Been Changed.** Please keep in mind that the *marginal estate tax rate* on an estate of \$750,000 is 39%, and the marginal rate at \$2,000,000 is 49%. If your estate is more than \$600,000 (including all real estate, securities, bank accounts, retirement plans, life insurance, etc.), then you should take planning steps, to create a "by-pass trust" under your Will, in order to minimize (or possibly eliminate)

the estate taxes. By devoting a few hours of attention to this important matter, you can provide very needed protection and very significant tax savings to your family.

- 10. Changes in Family Circumstances.** As a reminder, if there have been any significant *changes in your family situation, or in the nature or value of your estate*, it may be time for you to review and update your estate plan to reflect your current wishes.
- 11. Estate Planning for Retirement Plans.** Special attention should be given to your IRA or other retirement plan benefits, which are *subject to both income and estate taxes* at combined rates potentially as high as 73%. Also failure to comply with the minimum distribution rules can result in a 50% penalty. At age 702, you must elect a form of payment, which might include payment over your and your spouse's life expectancy; whether you choose the "recalculation" method or the "non-recalculation" method, carries significant consequences. *Please be sure that any such election is fully-coordinated with your overall estate plan.*