



Estate Planning for Unmarried Couples

There have been some distinct changes in the American cultural and sociological landscape in recent years. Among them is the increasing number of unmarried couples living together. This trend has created some complex estate planning challenges for the individuals involved. Let's take a look at some of the more common estate planning issues affecting these individuals.

A Family Affair?

The rules governing the ultimate disposition of assets are generally unfavorable for individuals who are not legally married or biologically related. If an individual dies without a **will (intestate)**, state intestacy law will determine the disposition of the decedent's assets. Although these rules vary from state to state, assets are generally disposed of through bloodlines. Thus, in the case of unmarried lifetime partners, assets may not be distributed according to the decedent's wishes.

A last will and testament generally protects against intestacy and allows an individual to specify who will receive assets upon death. However, a will alone may not be immune to challenges made by the decedent's family members who may have benefited from intestacy law if a will was not accepted by the local **probate** court. Therefore, it is essential that a will be drafted and executed when an individual is fully competent; it may also be important that the individual's partner does not serve as a witness to the execution of the will. If certain family members or relatives are to be disinherited, the will should include a list and an explanation of why such decisions were made.

Although a will can express a lifetime partner's wishes for the disposition of assets upon death, it does not provide any contingency arrangement for the management of assets or medical decisions if the individual is *incapacitated*. However, a **durable power of attorney** and a **health care proxy** enable an individual to *predetermine* who will make such decisions. Due to varying state laws, it may be necessary to specify powers in detail. Even then, some third parties may not accept a durable power of attorney and may require the use of their own forms. In the case of a health care proxy, a physician may be hesitant to follow the decisions of an agent who is not legally related,

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Patrick J. McNamara, MSFS

E-mail: pmcnamara@finconcepts.com

Financial Concepts, Inc.

A Member Firm of M FINANCIAL GROUP

617 Detroit Street, Suite 120

Ann Arbor, MI 48104-1112

Tel: (734) 214-9770 • Fax: (734) 214-9771

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Estimating College Costs

For most people, a child's college education is the second most expensive purchase (after a home) they will make during their lifetime. For parents and grandparents who wish to estimate the cost of a college education, the following table can facilitate an educated guess.

According to The College Board's *Trends in College Pricing 2008*, the average annual cost of in-state tuition, fees, room, and board at a four-year public institution is \$14,333 for the academic year 2008–2009. For a private institution, the cost of tuition, fees, room, and board is \$34,132. Both public and private colleges and universities

experienced an increase of over 5.5% from the prior year, 2007–2008.

If the cost of a college education continues to increase by 6% annually, and your child enters a private college in the 2020–2021 academic year, the estimated tuition will be \$69,996. Based on the projections below, a four-year education would cost approximately \$280,000. For young families, skyrocketing cost projections can lead to sticker shock, but there are strategies that can help you keep pace with tuition hikes. The College Board reports that almost 75% of undergraduate students receive some type of financial aid. In addition, the Fed-

eral government offers tax breaks for education savings, as well as other credits and deductions for taxpayers currently facing college costs.

Use the table below to estimate the approximate annual cost of tuition, as well as room and board, for a four-year undergraduate education based on the year a child will enter college, the inflation forecast, and the choice of a public or private institution.

How Much Do You Need to Save?

By starting a disciplined savings plan *now*, you may be better positioned to meet your child's future

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Projected Higher Education Costs						
School Year	Public Colleges & Universities			Private Colleges & Universities		
	3% Inflation	6% Inflation	10% Inflation	3% Inflation	6% Inflation	10% Inflation
09–10	\$14,769	\$15,217	\$15,834	\$35,170	\$36,237	\$37,706
10–11	15,218	16,156	17,492	36,240	38,472	41,654
11–12	15,681	17,152	19,323	37,342	40,845	46,016
12–13	16,158	18,210	21,347	38,478	43,364	50,835
13–14	16,649	19,333	23,582	39,648	46,039	56,158
14–15	17,156	20,525	26,052	40,854	48,879	62,038
15–16	17,678	21,791	28,780	42,097	51,893	68,534
16–17	18,215	23,136	31,793	43,377	55,094	75,711
17–18	18,769	24,562	35,122	44,697	58,492	83,639
18–19	19,340	26,077	38,800	46,056	62,100	92,397
19–20	19,929	27,686	42,863	47,457	65,930	102,072
20–21	20,535	29,393	47,351	48,900	69,996	112,760
21–22	21,159	31,206	52,309	50,388	74,313	124,568
22–23	21,803	33,131	57,787	51,920	78,897	137,611
23–24	22,466	35,175	63,838	53,500	83,763	152,021
24–25	23,149	37,344	70,523	55,127	88,929	167,940
25–26	23,853	39,647	77,907	56,804	94,414	185,525
26–27	24,579	42,093	86,065	58,531	100,238	204,952

Figures are estimated projections based on the average cost of tuition at public and private universities for the 2008–2009 academic year.

Coping with the Kiddie Tax Expansion

Lawmakers originally imposed the “kiddie tax” to make it harder for high-income households to evade taxes. In recent years, Congress has expanded the so-called kiddie tax to make it more challenging for parents to transfer investment income to a child to take advantage of the child’s lower tax rate. New strategies must be sought by parents whose primary goal is to save for their child’s education.

The limit on the kiddie tax increases to \$950 in 2009, up from \$800 in 2008. The first \$950 of unearned income in the child’s name is tax free, while the next \$950 of unearned income is taxed at the child’s tax rate. Any amounts above \$1,900 are then taxed at the parents’ marginal rate.

While the kiddie tax originally applied to children up to age 14, the cutoff limit rose to age 18 in 2006 and age 19 in 2008. In addition, starting in 2008, full-time college students under the age of 24 are also taxed at their parents’ rate on unearned income in excess of the exclusion amount, unless the student’s earned income is greater than one-half of his or her support.

The kiddie tax applies to non-wage, or unearned income, but not to income earned by the child through a part-time or full-time job. Unearned income is generally investment and capital gains income that includes interest, dividends, rents, profits on property sales, and certain types of royalties. Congress tightened the rules on giving appreciated stocks and mutual funds to children after it became apparent that families could exploit the 0% tax rate on capital gains taxes in effect through 2010 for investors in the bottom two income-tax brackets by shifting a portion of their investments to their children, who would then be able to sell these assets tax free.

The revised kiddie tax will have the biggest impact on families who saved for their child’s college education by putting money into custodial accounts, bonds, or other savings vehicles, at a time when tax-free education savings accounts were not yet widely available.

Parents can avoid being hit by the kiddie tax in the future by saving for

their children’s education using a tax-advantaged savings account. While contributions to Coverdell Education Savings Accounts (ESAs) are made with after-tax dollars, earnings grow tax deferred, and withdrawals are tax free when used for qualified education expenses.

In some cases, parents may also wish to encourage their older children to seek paid employment, which generates earned income that will be taxed at lower rates. College students, in particular, may be able to avoid the kiddie tax altogether by earning more than 50% of the amount needed to support themselves.

Parents who are business owners could also consider hiring their children to work as their employees, provided they compensate their children at no more than the market rate for the tasks they perform. This strategy provides the child with earned income, which is taxed at the child’s lower income tax rate.

For more information on how the kiddie tax may affect your tax situation, consult your tax professional. ■

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education funding needs. The table at right shows the return of monthly savings contributions, earning 6% interest, for intervals of 5, 10, and 18 years—the average college age. This hypothetical example assumes a 25% Federal tax rate and 3% inflation.

Many parents postpone planning education funding because the task seems overwhelming, or they think saving the required amount of money will force them to compromise their current lifestyle. While these are

legitimate concerns, they need not stop you from establishing and maintaining an effective college funding plan. Whether considering a public or private college for your child, the key to effective planning is to begin saving as early, and as much, as possible. ■

Savings Growth at 6%			
Save per Month	5 Years	10 Years	18 Years
\$50	\$3,109	\$6,454	\$12,339
\$100	\$6,219	\$12,909	\$24,678
\$250	\$15,549	\$32,273	\$61,696
\$500	\$31,099	\$64,546	\$123,392
\$1,000	\$62,199	\$129,093	\$246,785
<i>For illustrative purposes only. Not indicative of any particular savings vehicle or insurance product.</i>			

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especially if family members object. Therefore, it may be prudent for an individual to provide additional proof of his or her intentions (i.e., in the form of a written letter accompanying the health care proxy).

The addition of a **revocable trust** can further solidify an estate plan and help protect individuals from some of the planning problems related to wills and powers of attorney. The privacy associated with revocable trusts creates immediate appeal for lifetime partners, as does the ability to transfer assets. Such an instrument allows the **grantor** to make him or herself the **trustee** and elect his or her partner as the **successor trustee**. In the event of death, the successor trustee gains full control over assets held in trust. However, even with a revocable trust, it is prudent to provide a written confirmation of the grantor's wishes to be made part of the trust document, so any potential family challenges may be avoided.

Transfer and Estate Taxes

Another challenge facing lifetime partners is the issue of **transfer taxes**. Lifetime partners do not qualify for the **unlimited marital deduction** between spouses. Thus, the value of the transferred assets that exceeds the **annual gift tax exclusion** will

be subject to gift taxes. In this respect, the retitling of assets in **joint tenancy** with rights of **survivorship** may also create tax concerns.



For some individuals, total assets may be substantial. Thus, estate taxation may be a concern. Generally, if one partner has much larger assets than the other, or is much older than his or her partner, the use of the annual gift tax exclusion (\$13,000 for single filers in 2009) may assist in the gradual transfer of assets to a lifetime partner. However, the annual gift tax exclusion may not be a sufficient mechanism for the timely transfer of large assets. In this respect, planning for the use of the **applicable exclusion amount** may provide an opportunity to gift substantial assets (e.g., real estate or investments) to a lifetime partner. The applicable exclusion amount of \$3.5 million in 2009 will be repealed for one year only in 2010.* The increase should provide additional flexibility to lifetime partners in the years ahead.

For planning purposes, the use of **life insurance** may serve as one of the more valuable tools for ensuring the financial future of a surviving lifetime partner beneficiary. A life insurance policy can help the insured partner avoid potential family contestation by providing the surviving partner with a **death benefit** commensurate with the size of the insured's estate. Life insurance can also play an instrumental role in the funding of future estate tax liability. Generally, the life insurance policy is purchased either by a lifetime partner or an **irrevocable life insurance trust (ILIT)** that is written for the benefit of a lifetime partner.

Final Thoughts

While estate planning for lifetime partners can be complex and challenging, the individuals involved need to be aware of potential familial and tax issues. As with all estate planning matters, it is important to consult with qualified tax, legal, and financial professionals to help ensure that planning is in accord with a couple's objectives. ■

**Under Federal law, the Federal estate tax will be repealed in 2010 for one year and then will be reinstated in 2011 at levels in effect prior to the Economic Growth and Tax Relief Reconciliation Act of 2001, unless Congress takes further legislative action.*

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