

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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in this issue:

Is Estate Planning
Still Necessary?

Tax Benefits of
Donating Used
Vehicles to Charity

Disability Income Insurance: Protecting Your Most Valuable Asset

Have you ever wondered how you would manage if you were to experience a severe accident or illness that left you unable to work? How long could you maintain your quality of life, pay your bills, and cover your daily expenses? The likelihood of such an event may be greater than you think. According to the Insurance Information Institute (III, 2007), 43% of individuals between the ages of 40 and 65 will experience a long-term disability.

To be prepared for such a situation, it is important to *plan ahead*. A proactive approach to help protect yourself is to purchase an **individual disability income insurance** policy. However, there are a few considerations to be aware of when choosing this coverage:

- **Definition of Disability.** Carefully review your policy's definition of disability. Some policies may provide coverage if you are unable to work in the occupation in which you were employed or for which you were trained, or if your income is reduced because you cannot fulfill all the responsibilities of your job. In contrast, other policies may offer coverage only if you are unable to work in *any* occupation. Should you become disabled, this distinction can make a world of difference.
- **Residual Benefits or Partial Disability Coverage.** Under certain specified circumstances, if you become disabled and are only able to earn a *portion* of your previous income, residual benefits or partial disability coverage pays a percentage of your benefits. This may be a standard feature with some policies; however, with others, it may be a rider for an additional cost.
- **Guaranteed Renewable.** With this feature, the insurer cannot refuse to renew your policy or change any terms, except for premium cost, as long as you continue to pay your premiums on time.
- **Guaranteed Insurability.** This provision allows you to increase your monthly benefit, even if you experience health changes that would otherwise prevent you from obtaining additional disability coverage.
- **Cost-of-Living Adjustment (COLA).** This feature helps protect your benefits against the effects of inflation during a long-term disability.

continued on page three

Is Estate Planning Still Necessary?

Congress continues to debate the future of the estate tax. Over the past several years, both the House and the Senate have proposed scenarios in which the estate tax is reduced or repealed; however, Washington lawmakers are unable to come to an agreement on the issue. In spite of this uncertainty, it is important for individuals to understand how the potential changes may affect their estate planning, so that they are ready to respond should Congress pass new legislation.

The estate tax is generally paid by the wealthiest Americans. The tax can, however, also hit families with smaller assets, especially if they fail to plan for a possible estate tax liability. If the combined value of all of your property—including real estate, investments, insurance policies, savings, pensions, and even personal belongings—exceeds the estate tax exemption amount, your family members may have to pay both federal and state taxes on the inheritance.

Under current law, the estate tax exemption becomes progressively generous in the run-up to 2010, when it phases out completely for a single year. For tax year 2008, the federal estate tax exemption for an individual is set at \$2 million. It is scheduled to rise to \$3.5 million in 2009, before disappearing completely the following year. Similarly, the estate tax rate of 45% in 2008 will remain at that amount through 2009. If no new law is enacted, the estate tax will be repealed for one year only in 2010, and in 2011, it will automatically revert to pre-2002 levels: The estate tax exemption will fall to \$1 million, and the estate tax rate will rise to 55%.

With the fate of the estate tax in limbo, how should you plan? While

it may be impossible to predict whether, or to what extent, your estate will be subject to taxation at your death, creating and maintaining an estate plan provides essential legal and financial protection for your heirs. If you fail to leave behind a well-structured plan for the distribution of your assets, disagreements between family members may arise, and your estate could end up in probate court.

You can reduce the size of your estate by giving away some of your assets to family members during your lifetime. Gifting is especially beneficial from a tax perspective when income is shifted to a recipient in a lower tax bracket. The annual gift tax exclusion allows a donor to give away up to \$12,000 (subject to inflation indexing) per calendar year, per recipient, without incurring a gift tax liability. If you are married and your spouse consents to “splitting” the gift, the annual gift tax exclusion increases to \$24,000, even if only one spouse actually makes the entire gift. No gift tax is paid out of pocket until taxable gifts exceed the lifetime gift exemption, currently set at \$1 million.

Trusts are also valuable tools for minimizing taxes and protecting your assets from the potentially expensive probate process. A bypass trust is particularly useful for married couples, who can choose to make children or grandchildren, rather than each other, the beneficiaries of the estate.

In what is commonly referred to as an A/B arrangement, the bypass trust is combined with a marital trust. Used together, these trusts can help minimize estate taxes on transfers to the next generation, while still allowing the surviving spouse to withdraw funds from the trust for reasonable living expenses. To preserve family harmony and avoid future conflicts over inheritances, you may choose to supplement A/B trusts with a qualified terminable interest property (QTIP) trust, which gives you greater control over the distribution of your assets after your death.

The irrevocable life insurance trust (ILIT) is also frequently recom-



mended as a means of shielding a life insurance policy from federal taxes. When properly implemented, the proceeds of an ILIT will not be included in your estate and will, therefore, be paid out to the trust's beneficiaries without incurring any estate tax consequences. The trust may be used to finance your children's education or to provide a staggered income for your heirs.

Clearly, these trusts do more than simply protect your family's assets from taxation. By planning your

continued on page four

Tax Benefits of Donating Used Vehicles to Charity

Donating a used car or other vehicle to charity is a great way to support the nonprofit of your choice, while also allowing you to claim a deduction on your federal income tax return. But because the rules governing vehicle donations have tightened in recent years, it is important to be aware of the process involved in donating a car and the procedures that must be followed when claiming the deduction.

Many charities, both large and small, now accept vehicle donations. The types of vehicles that qualify for the tax deduction include all privately owned automobiles manufactured primarily for use on public roads, as well as boats and airplanes. In order to claim a deduction, however, the charity that receives the gift must be recognized by the Internal Revenue Service (IRS) as a 501(c)(3) organization. IRS Publication 78, available online and at most public libraries, includes an annually updated list of qualified charities.

Prior to a change in rules in 2005, taxpayers were permitted to write off the fair market value of the donated vehicle. But under current law, you are only allowed to deduct automatically the good faith fair market value of the car if the estimated amount does not exceed \$500.

The IRS defines fair market value as the price a willing buyer would pay and a willing seller would accept for the vehicle when neither party is compelled to buy or sell and both parties have reasonable knowledge of the relevant facts. When assessing the value of the vehicle, use a pricing guide that takes into account make, model, year, options, and accessories, as well as the condition of the car.

If the vehicle is assessed at a value between \$500 and \$5,000, the size of the deduction depends upon what happens to the vehicle after the charity has received it. If the organization sells the car, your deduction is limited to the exact amount of the sale price. Different rules apply, however,

if the charity makes what the IRS calls “significant intervening use” of the vehicle prior to sale or disposal. If, for example, a donated car with a fair market value of \$1,500 is used by the charity for several months for pickups and deliveries before it is sold at auction for \$1,200, the donor would still be permitted to claim a deduction of \$1,500.

The donor may also claim the fair market value, rather than the sale price, if the charity sold the car to a “needy individual” at a much lower price than the actual value or if the nonprofit makes a “material improvement”—generally, reconditioning work that is more than routine or cosmetic—before selling the vehicle. If, however, the vehicle is ultimately sold for less than \$500, the taxpayer may claim a deduction for the lesser of the vehicle’s fair market value on the date of the contribution or \$500.

Keep in mind that writing off your car donation is only possible if you itemize your deductions. To claim a

continued on page four

disability income insurance: protecting your most valuable asset

continued from page one

The Outlook without Protection

If you don’t have a disability income insurance policy, there are alternatives, although they all have shortcomings. For instance, you could self-insure. But, even if you save 10% of your salary each year, one year of disability could easily wipe out many years of savings. Or, perhaps your employer provides disability income insurance. Unfortunately, **employer-sponsored plans** are often limited in

scope and duration, and coverage is not portable upon termination of employment (except in certain executive disability policies). **Workers compensation** may be an option in some cases; however, it only covers injuries suffered on the job. Eligibility and benefits vary by state.

To qualify for **Social Security** disability benefits, specific criteria must be met, and even then, you may have to wait six months or longer for payments to begin. Social Security

disability was not intended to be an individual’s sole source of disability income. Thus, benefits are often less than what is needed to cover living expenses.

A debilitating illness or injury that reduces or eliminates your primary source of income can be a financially devastating experience—one from which it can be difficult to recover. Disability income insurance can play an important role in your overall financial program. ■

tax benefits of donating used vehicles to charity

continued from page three

vehicle deduction above \$500, the receiving charity must provide you with a written acknowledgement of receipt that includes detailed information about the intended use and sale of the vehicle. The charity is also required to provide you with substantiation of the donation within 30 days of the date when you signed over the automobile or, if the car is sold, within 30 days of the sale. A copy of the receipt must be filed with the tax return, along with IRS Form 8283, "Noncash Charitable Contributions." If the vehicle is worth more than \$5,000, you must also attach documentation from a qualified appraiser. If the donated car is worth between \$250 and \$500, obtain a

written acknowledgement of the contribution from the charity for



your records. You are not required to attach the acknowledgement to your tax return.

When donating a vehicle, steer clear of for-profit intermediaries that advertise offers to help you manage your charitable donation, as these middlemen often keep the bulk of the proceeds from the sales of donated cars. If possible, give the vehicle to a charity with a car donation program that enables them to accept the vehicle directly. You should also consider avoiding charities that do not allow you to re-title the car when turning it over to them, as this opens you up to liability.

If you're considering the donation of a used vehicle to charity, you may qualify for a federal income tax deduction. For more information, consult your tax professional. ■

is estate planning still necessary?

continued from page two

estate, you can resolve potential inheritance disputes prior to your death. If the estate tax is permanently eliminated in the future, new estate planning strategies will be necessary. Your heirs may become liable to pay capital gains taxes under new "carryover basis" rules, which are due to go into effect in 2010 and will likely remain in force if the estate tax is repealed. Under carryover rules, inherited property receives a basis equal to the amount the deceased originally paid for the item. Depending on how much the property rose in value between the

time of purchase by the deceased and the time of sale by the heir, the recipient of the property could owe much more in capital gains taxes under the carryover basis provision than under step-up basis rules.

In 2010, carryover basis applies to assets above \$3 million inherited by the spouse of the deceased, and assets of more than \$1.3 million inherited by anyone other than the spouse. Inheritances below these limits are subject to the step-up basis rules. Following the expiration of EGTRRA provisions on December

31, 2010, the step-up basis is scheduled to go back into effect.

Unresolved questions about the future of estate tax rates, exemptions, and the tax basis of assets make estate planning very challenging. Because it is impossible to predict what laws will be in force at the time of death, it is important to prepare for a number of different scenarios. Regular consultations with your tax and legal professionals can help ensure your estate planning decisions remain consistent with your financial and personal objectives, even as tax laws change. ■

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