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Life Insurance: Policy Ownership Considerations

While it is common to think of **life insurance** planning in terms of *type* and *amount* of coverage, a more complete analysis also includes **policy ownership**. In many cases, the proceeds of a life insurance policy may be unnecessarily included in your estate—unless you plan ahead.

Taking Estate Taxes into Account

Without insurance, many estates fall below the level at which they will be subject to Federal estate taxes. Under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Relief Act), the Federal estate tax is reinstated in 2011, with an applicable exclusion amount of \$5 million. Estates that exceed this amount are subject to Federal estate taxes at a maximum tax rate of 35%. The proceeds of life insurance can increase the value of your estate to a level where it will become subject to Federal estate tax.

Fortunately, you can prepare for the possibility of Federal estate taxes. There are two ways to keep insurance proceeds out of your estate:

1. Transfer ownership of your insurance policies to someone else, generally your **beneficiary(ies)**.
2. Transfer the policies to a **trust**.

Either option, if done properly and in a timely manner, can decrease your Federal estate tax. You may not need to worry about changing ownership of a policy that names your spouse as the **sole beneficiary**. The **unlimited marital deduction** allows your spouse to inherit the policy proceeds without estate taxation. However, you may benefit from transferring your policy out of your estate if the purpose of the insurance is to help pay estate taxes or provide for heirs other than your spouse.

The paperwork involved in changing insurance policy ownership is relatively simple. However, you do have to sign away all rights to your policies, which means the gift must be *absolute* and *irrevocable*. You cannot change your beneficiaries, and in the case of policies with **cash value**, you no longer have the right to borrow against them or surrender them for their worth in cash.

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How Charitable Giving Can Really Pay Off

Amy and Dennis regularly set aside a small portion of their budget for charitable donations. In addition to feeling good about supporting a number of worthy causes, they've been able to deduct the value of their charitable gifts from their Federal income tax return. Now, the couple thinks it is time to make a larger charitable contribution. Their intent is to donate some stock they purchased years ago for \$1,000 that has since increased in value to \$50,000.

Before Amy and Dennis move ahead, they realize that there are a couple of issues that need to be resolved. For instance, Dennis is reluctant to make the donation because, by doing so, he realizes their children will not reap the benefits of the stock. On the other hand, Amy wants to make sure the donation is advantageous to both them *and* the charity. Upon careful review, the couple has come up with a plan that helps alleviate their concerns. Here's a closer look.

The first step for the couple is to address Dennis' concerns. They can do this by purchasing a **life insurance policy** in an amount that is equal to the value of the stock—that is, \$50,000. Through the life insurance, they can help ensure that their children ultimately receive a benefit that is generally commensurate with the value of the donated stock. They will increase their expenses because of the policy's premiums, but, as you'll soon see, donating the stock may actually help pay for the policy.

Next, the couple can address Amy's concern by donating the *actual stock* to the charity, rather than selling the stock and then donating the proceeds. There are two reasons for this decision.

First, if they sold the stock, they'd realize a gain of \$49,000 (\$50,000 - \$1,000), that would, in turn, result in capital gains tax of \$7,350 (\$49,000 x 15%). Therefore, the couple's donation would be reduced from \$50,000 to \$42,650, if they choose to pay the tax from the proceeds. Or, they would need to cover the tax with other funds. By donating the stock directly to the



charity, any appreciation in the stock's value is not taxed (either to the couple or to the charity).

Second, the income tax benefit generated by a deduction for a charitable gift is based on the **fair market value (FMV)** of the gift and the couple's Federal income tax bracket. Thus, assuming the couple is in the 28% Federal income tax bracket, a gift of \$50,000 would result in a decrease in their income taxes of \$14,000 (\$50,000 x 28%). On the other hand, a gift of \$42,650 would only result in an \$11,942 decrease in their taxes (\$42,650 x 28%). In effect, donating the appreciated stock outright produces a greater current year tax deduction and results in a greater tax savings than selling the stock and donating the proceeds after taxes.

Ultimately, the money saved from the tax deduction can be used to help offset the costs associated with the life insurance policy. The end result truly is a “win-win-win” situation. The charity wins because it receives the full value of the stock, Dennis and Amy win because they get a maximized charitable income tax deduction, and their children win because

they eventually receive a life insurance death benefit that replaces some, or all, of the value of the stock.

Making the Most of It

If you would like to maximize the tax benefits of charitable giving, be sure to consult a qualified tax professional. There are some limitations on charitable giving based on the type of gift, the type of organization receiving the gift, and your **adjusted gross income (AGI)** for Federal income tax purposes. Nevertheless, the ability to receive an income tax deduction and possibly replace some of the donated wealth with life insurance makes charitable giving pay off for you *and* for the organizations you wish to support. ■

The Power of Networking

The term “networking” often conjures up visions of high-society hobnobbing at cocktail parties. But, networking is not just for those with an abundance of leisure time; it is for any professional who would benefit from building relationships with clients and other professionals.

As a business owner, building a thriving company necessitates getting the word out about the quality and range of products and services your business has to offer. Regardless of your industry, you likely rely on other professionals and members of the community for referrals, and for support and advice in resolving common issues and concerns.

Keeping in contact with other professionals can bring many benefits, such as getting and receiving referrals for new clients. When you know a professional and his or her business specialty well, you can be more confident of the quality of products and

services your clients are likely to receive, positioning yourself as a source of trusted knowledge and advice. It is also important for your professional development to keep in touch with peers in your industry, who can be a sounding board in good and bad times.

Professional and industry associations, both local and national, are often useful starting points for networking. These groups typically organize conferences and other events where colleagues meet and exchange experiences. You may also want to make use of your alumni network to maintain contact with your peers. To meet a wider range of area professionals, get involved with local chambers of commerce and business clubs.

Instead of relying solely upon existing networks to make professional contacts, reach out to other professionals in your local area by hosting receptions and open houses, or

educational sessions on industry topics. Consider organizing meetings with other business owners in related industries to share expertise on your individual areas of specialty. In some cases, it may even be possible to forge alliances with other businesses to order supplies in bulk or partner in charitable activities. If your business is large enough, you may want to hire a marketing professional who can serve as a liaison to the wider business community.

Whatever strategy you choose, keep in mind that to build and maintain a successful business, you need to reach out to others. Regardless of talent, no one could run a company without the help and support of friends, family, other professionals, and the community. As John Donne famously reminded us long before the term “networking” had been coined, “no man is an island.” ■

life insurance: policy ownership considerations

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Keep in mind that if the transfer is done within three years of your death, the policy proceeds are generally still considered part of your estate, regardless of ownership. Thus, proper planning is necessary to help ensure that you achieve your desired results.

Ownership of individual and, in most cases, group insurance can generally be transferred to anyone who is old enough to handle money. Depending on your particular circumstances, it may be advisable to transfer a policy directly to a beneficiary or, in the case of a minor, to a trust that is designed for the benefit of a child.

Before signing away insurance, it is important to carefully review the consequences. Gifting insurance may have gift tax consequences if the transfer is to anyone other than your spouse. In 2011, the annual gift tax exclusion is \$13,000 per gift to any single donee and \$26,000 for gifts made jointly by husband and wife. For specific guidance, consult your qualified tax and legal professionals.

For those in higher tax brackets, one useful technique to shelter large policies from estate taxes—and to protect the interests of minor beneficiaries—may be to transfer ownership

to an irrevocable life insurance trust (ILIT). When you die, the trustee named by you can distribute income to your beneficiaries or, if necessary, use the proceeds to pay estate taxes. Again, be sure to consult with your tax and legal professionals for specific guidance.

The decisions you make regarding policy ownership are no less important than the decisions you make regarding what type of policy and how much insurance you need to fulfill your objectives. When planning your insurance program, take care to cover all the bases. ■

Estate Tax Update: Changes from the 2010 Tax Relief Act

Among the provisions for individuals and businesses, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Relief Act) provides temporary changes to estate and wealth transfer taxes.

Estate Tax Changes

Under tax reform enacted in 2001, the Federal estate tax was gradually reduced and disappeared altogether in 2010, but it was scheduled to be reinstated in 2011 at pre-2002 levels. Under the 2010 Tax Relief Act, the estate tax returns with a maximum tax of 35% and an exclusion amount of \$5 million for 2011 and 2012 only.

The new law also eliminates the modified carryover basis rules that were in effect in 2010 and replaces them with stepped-up basis rules. Under stepped-up basis rules, the value of an inherited asset is “stepped up” from the original purchase price to the potentially higher market value of the asset at the time of inheritance, and heirs do not have to pay capital gains taxes on any increase in the asset’s value over the decedent’s lifetime.

New Portability Provision

The 2010 Tax Relief Act also includes a provision that allows the estate tax exemption to be transferred between spouses in 2011 or 2012,

so that if one spouse dies and does not use the full exemption amount, the remainder can be used by the surviving husband or wife, if he or she also dies in 2011 or 2012.

To make use of this so-called “portability” option, the executor of the first spouse must actively elect it on the estate tax return, even if no liability is owed. Then, when the remaining spouse dies, the heirs will owe estate tax only on any amount above the combined exemption. For estate planning purposes, this means that husbands and wives do not have to split assets between them, or be concerned about who holds the title on various assets.

Gift Tax Changes

Starting in 2011, the gift tax is reunified with the estate tax, with a top tax rate of 35% and an exemption of \$5 million. While the annual gift tax exclusion remains at \$13,000, this change in the lifetime exclusion amount greatly expands the potential for making tax-free gifts to family members. However, keep in mind that gifts made in excess

of the annual exclusion reduce the estate tax exemption.

GST Tax Change

Also starting in 2011, the generation-skipping transfer (GST) tax is equal to the highest estate and gift tax rate in effect for the year. Thus, for transfers to grandchildren made in 2011 and 2012, the exemption amount is \$5 million with a GST tax rate of 35%. While this tax is not portable between spouses, couples can combine their exemptions to give away a total of \$10 million without incurring GST tax.

For more information about changes in the estate tax and how they may affect your estate plan, contact your professional advisors, including a qualified tax professional. ■



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