Solutions
FOR THE TAX ADVISOR
2nd Quarter 2009

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2009 ESTATE AND GIFT TAX CHANGES AND THE IMPACT ON EXISTING PLANS

Increased Federal Exclusionary Amount

Virtually every existing estate and gifting plan needs to be reviewed in light of the changes in both the estate and the gift tax laws that became effective on January 1, 2009. Review of existing plans is especially important because these recent legislative changes are taking place in a recessionary economy and low interest rates are currently available.

One of the most notable changes in 2009 was the substantial increase in the federal estate tax exclusionary amount from $2 million to $3.5 million per U.S. citizen or resident. The top estate tax marginal rate remained the same at 45%. Though under the present estate tax law the estate tax is set to disappear in 2010 and then return in 2011 under the sunset provisions of the original 2001 tax legislation, most commentators and tax authorities anticipate that Congress will not allow that to happen and that something like the present 2009 rates will remain for the future. The new exclusionary amount does provide many planning opportunities but also can create a number of "tax traps" for those who do not adequately review their existing plans. In addition, many states have decoupled their inheritance and/or estate tax and the federal changes will not necessarily result in any state tax savings.

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For couples who have existing wills or trusts that contain formula bypass language, this language should automatically take into account the increase in the exclusion amount. If the estate is large enough, that may well solve the needed major adjustment. A problem could exist if due to the recessionary economy an estate has shrunk to the point that it is equal to the exclusionary amount. In such a situation, the surviving spouse may not receive any assets outright and that may defeat some of the intended planning goals and could place all assets in the bypass trust. In some cases, assets in the bypass trust pass directly to children rather than to the spouse for income and in that case, the spouse could be left with no assets. Consideration may be needed to removing the formula bypass for estates that have been reduced in value.

Great care is needed in looking at how assets are currently titled. For example, if each individual holds only $2 million in their own names, there would not be sufficient assets to use the new exclusionary amount. Individual ownership of assets may need to be increased to provide for complete implementation of the full bypass amount.

Existing estate and gifting plans should be reviewed in light of the changes in both the estate and the gift tax laws that became effective on January 1, 2009.

Planning For Gift Tax Changes

The lifetime gift tax exclusion amount remains at $1 million, which makes leveraged gifting programs more important than ever. The present interest annual gift tax exclusion increased in 2009 from $12,000 to $13,000 per year per individual. Married couples filing a joint gift tax return can now give up to $26,000 per year. Though the increase in the gift tax annual exclusion is small compared to the federal estate tax exclusion amount, the amount of assets that can be removed from an estate over an extended period can be substantial because of this increase.

Existing Life Insurance

If a family had purchased life insurance to provide for potential future estate tax liability, they may want to review their insurance program in light of the new estate exclusionary amount. In doing their review, the family needs to keep in mind that the economy will probably improve once again and with a reasonable increase in asset value over the next 10 to 15 years, they may need all of their existing insurance. In fact, they may need to consider additional coverage. The premium cost would be lower at their present ages than it would be in 10 years and they are locking in current insurability.

QUALIFIED PERSONAL RESIDENCE TRUST MAY BE AN EXCELLENT PLANNING TECHNIQUE FOR NOW

Normally, a Qualified Personal Residence Trust (QPRT) is not considered an effective planning tool in a low interest rate environment such as we are currently experiencing. Because of the substantial decline in the value of real estate over the past 18 to 24 months, a QPRT may present a very valuable estate-planning opportunity that more than makes up for the low interest rates.

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When interest rates are low, the value of the retained interest is lower, which increases the value of the gift to the remainder beneficiaries. When the Section 7520 interest rate is high, the value of the grantor's retained interest is higher, thereby reducing the value of the gift to the remainder beneficiaries. If the grantor dies before the end of the term, the fair market value (FMV) of the residence is included in his estate for estate tax purposes.

If the present market value has dropped by at least 20%, and even though the present Section 7520 interest rates are low, the numbers generally work out that it is financially better to establish a QPRT now rather than wait for a higher Section 7520 interest rate. Naturally, only by working the actual numbers for a client can an advisor be sure which is the best approach for a client.

IRS ISSUES GUIDANCE FOR EMPLOYER-OWNED LIFE INSURANCE REPORTING

The IRS issued Notice 2009-48 on Friday, May 22, 2009 which provides guidance in a question and answer format relating to the requirements that were enacted in 2006 under Internal Revenue Code section 101(j) for employer-owned life insurance contracts. Every employer must get a signed notice and consent from the insured employee prior to the issuance of the life insurance policy. The employer must file a Form 8925 each year in such manner as the Secretary prescribes setting forth certain information regarding the employer-owned life insurance.

The Notice 2009-48 did respond favorably to requests for clarification that had been sought in a number of areas, including:

- The employee consent to be insured generally will remain valid for up to one year after it was signed.
- The life insurance can be in more than one policy of life insurance.
- The guidance provides some limited ability to correct inadvertent employer failures to comply with the 101(j) requirements.
- The guidance clarified certain changes to the policy that will not be considered to be a "material change" for notice requirements.

This Notice will provide great assistance to employers and to tax advisors assisting employers in being able to comply with the requirements of 101(j) and with Section 6039I.

THE IRS CONTINUES TO CHALLENGE FAMILY LIMITED PARTNERSHIPS

The IRS has pursued a variety of arguments over the past decade to attack family limited partnerships (FLPs). The Service has attempted to use Sections 2036, 2701, 2702 and 2704 plus indirect gift arguments, business purpose, and economic substance doctrines in the assault on FLPs. The Service has experienced mixed results with these arguments and the taxpayer has prevailed in a number of the challenges. However, the Service continues to challenge the concept of the FLP and even when the taxpayer prevails, they have often done so at substantial cost before the Tax Court. The Service has had their greatest success against FLP discounts with Section 2036(a). The Service continues to challenge, arguing that certain FLPs must be disregarded for valuation purposes when they lack sufficient business purpose and economic substance, and that some should be disregarded because of the indirect gift argument.

Both clients and their tax advisors need to keep in mind that the Service is continuing the attack as they continue to pursue increased tax revenue. Clients need to carefully evaluate the benefits of FLPs versus the possible cost of defending them before the Tax Court.

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Second Quarter 2009 • Solutions is published quarterly.

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