



QUARTERNOTES

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The 2010 estate planning conundrum

Dan Duncan may have picked a very good year to die. Duncan's fortune was estimated at \$9 billion by *Forbes* magazine. He died, at age 77, in March of this year.

As matters stand today, there will be no federal estate tax imposed upon the Duncan estate. Not because he was a philanthropist, not thanks to the unlimited marital deduction, but because the federal estate tax has been suspended for this year. Had Duncan died last year, or next year, the estate tax bill could have been in the billions.

This one-year hiatus for the federal estate tax has been on the books since 2001, but most estate planners expected Congress to head it off with permanent estate tax reform. That didn't happen.

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Planning your estate

With this issue of *QuarterNotes*, we address some of the ways in which your savings may be deployed for family financial protection. We begin with a discussion of the strange circumstances for estate planning in 2010, when there is no federal estate tax. If the estate tax roars back next year, trusts will play an important part in limiting exposure to it.

On page three you'll find a review of your tax-preferred choices for funding a college education. Warning: It's complicated.

We can help with your planning—with cost estimators, accumulation projections and sound investment guidance. Please come to us anytime with your questions.

There has been talk of restoring the estate tax for 2010 retroactively. There's been talk of boosting the exemption to \$5 million per person. So far, it's all just talk. If nothing is done, the federal estate tax returns in 2011 with a 55% tax rate and a puny \$1 million exemption. At those rates, eight times more estates will be subject to estate tax in 2011 than were in 2009!

That's the situation you need to plan for today.

Should you consider a trust?

When you meet with your estate planning advisors, you should give some consideration to including a trust or trusts in your estate plan. It sounds more complicated than it is in practice.

A trust is an independent legal entity used for the continuing care and management of property. The trust's creator, or grantor, transfers money or investment assets to a *trustee* to be administered in accordance with the *trust agreement*. The assets are managed for *beneficiaries*, which may include the grantor, family members, charities or others. The trust will last for a specified number of years, or for the life or lives of designated beneficiaries. The *income beneficiaries* have a financial interest in the trust during its existence, while the *remainder beneficiaries* receive the trust assets when it terminates.

What are the benefits of a trust?

For married couples, trusts provide the means to double the amount exempt from the federal estate tax. A "bypass trust," established at the first spouse's death, avoids estate tax when the second spouse dies. As the exemption falls to \$1 million, this will be vitally important to more and more families.

When a professional trustee, such as a bank trust department, is named to manage the trust, the most important benefit typically is sound asset management. The bank brings a trained and experienced staff to the job. This frees the grantor and beneficiaries from financial management worries.

The trustee is fulfilling the grantor's desires for his or her wealth. With some trusts, this involves making decisions about the distribution of income and principal among the beneficiaries, in accordance with the directions supplied by the trust agreement.

Are there different types of trusts?

Imagine a retired couple with adult children and some grandchildren. The husband has handled the finances throughout their married lives, and it has become a chore. They might decide to establish a living trust for financial management through their retirement years, freeing them from

investment concerns and protecting them in the event of incapacity.

When one spouse dies, the living trust could become a *marital deduction trust* to provide income and asset management for the life of the surviving spouse. The survivor, in turn, may direct that the assets continue in trust after his or her death for the benefit of their descendants.

If the couple had substantial assets, they might want to consider creating a *credit shelter trust* to increase the family's protection from federal estate taxes.

Couples with blended families often take advantage of the *Qualified Terminable Interest Property trust (QTIP trust)* to provide for a surviving spouse and an assured inheritance for children. Philanthropically minded individuals will want to look at the advantages of the *charitable remainder trust*. Grandparents might consider a trust for the management of an inheritance for their grandchildren. Trust solutions are as varied as the families for which they are crafted.

How can I learn more about trusts?

Just ask us—we are here to help you. If we don't have answers to your trust and estate planning questions, we know someone who does, and we'll be pleased to make the introduction for you.

Past and future for the federal estate tax

Year	Estate tax exemption	Gift tax exemption
2008	\$2 million	\$1 million
2009	\$3.5 million	\$1 million
2010	Unlimited	\$1 million
2011	\$1 million	\$1 million

Source: Internal Revenue Code; M.A. Co.

In recent years, an expanding exemption amount helped to target the estate tax to only the very largest estates. According to one research group, an estimated 5,500 estates were subject to the federal estate tax in 2009, when the exemption was \$3.5 million. Should the exemption fall to \$1 million in 2011 with the restoration of the federal estate tax, as the law now provides, a projected 44,200 estates will be hit by this levy.

College savings choices

According to a recent survey, two-thirds of today's undergraduates have to borrow to meet their education expenses. The average graduating senior has college debts approaching \$25,000, and those who go on to graduate education must shoulder a far higher debt load.

Fortunately, there are tax-advantaged plans to give families a boost as they accumulate capital for meeting education expenses. With each plan, there's no tax deduction for setting money aside, but taxes are deferred on earnings. Withdrawals used for qualified education expenses will be completely tax free.

Coverdell Education Savings Accounts

Up to \$2,000 per beneficiary per year may be set aside in a Coverdell Education Savings Account (ESA). Contributions may start when the child is born and continue to age 18. The funds must be drawn down by the time that the child reaches age 30 in order to avoid paying taxes and penalties. Alternatively, a different family member may be named as a successor beneficiary.

There are restrictions as to who may contribute to the Coverdell ESA, based upon the donor's income. Singles with adjusted gross income (AGI) of \$95,000 and marrieds filing jointly with AGI up to \$190,000 are permitted to make full contributions. However, one could make a gift to the child, who, in turn, could make a contribution to the ESA.

Over an 18-year period, \$36,000 may be set aside in an ESA. Investments are handled as they are in IRAs and Roth IRAs, and they can be changed as needed. One disadvantage of the ESA is that it will be counted as the



Compare and contrast: Tax-advantaged college savings plans

	Coverdell Education Savings Account (ESA)	529 plan
Benefit	No tax on earnings	No tax on earnings
Contribution limit	\$2,000 per year	None
Income limit for donor for full contribution (Phased out for higher incomes)	\$95,000 singles; \$190,000 marrieds	None
Investment control	Complete	Limited
Investment choices	No limits	Dependent upon plan

Source: IRS Publication 970; M.A. Co.

student's asset in the federal financial aid formula.

529 college savings programs

For maximum flexibility, it would be hard to improve upon the 529 college savings programs. There are no income limits as to who may contribute and no age limits on the beneficiaries. Every state now offers a 529 plan. You are not obligated to use the plan offered by your home state, but you may secure additional state income tax breaks by doing so. The amount that may be set aside for each beneficiary varies from state to state, but it can exceed \$200,000. The 529 plan can be an especially good choice for earmarking a lump sum, such as an inheritance, for educational purposes.

The donor stays in control of the assets in the 529 plan, deciding when withdrawals will be made and for what purpose. The named beneficiary does not acquire the rights to money upon reaching a certain age.

Accordingly, the 529 plan is treated as the parents' asset for financial aid purposes, not the student's. If withdrawals are not used for qualified education expenses, income taxes and a 10% penalty tax will be due.

The assets in the 529 plan are managed by a professional investment company or the state treasurer's office. Generally, the plan will offer a range of investment choices, and if the plan permits, the choice may be changed once each year.

Start today

The most important factor in achieving success in meeting financial goals, such as building an adequate college fund, is putting time on your side by starting early. Don't let doubt or uncertainty lead to indecision. Wondering which plan is right for you? Worried about making the right investment decisions? Let us help you sort through your choices, and you can implement your planning with a sense of confidence.

JUST ASK US

I've heard that the Roth IRA can be a good alternative for saving for college costs. Is that true?

Roth IRAs are intended for retirement, of course. However, some people look to Roth IRAs to do double duty, as a supplemental source for education funding. Contributions to the Roth IRA may be withdrawn without taxes or penalties. Earnings withdrawn before age 59½ to pay education expenses would be subject to income tax, but no penalty tax would be due.

The potential tax problem with Coverdell ESAs and 529 plans is that the tax exemption on earnings is dependent upon using the money for qualified education expenses, which is not an issue for Roth retirement distributions.

Roth IRAs have a higher contribution limit than the Coverdell ESA, and it applies on a per donor basis. If the money is needed for education, it is there; if not, it can remain in place for retirement.

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