A Newsletter from the Law Offices of Boyd & Boyd, P.C. November 2008

2008 ESTATE PLANNING YEAR IN REVIEW

NEW TECHNIQUES GIVE WEALTH CREATION OPPORTUNITIES IN A DOWN ECONOMY

A downturn in the economy creates opportunity for wealth creation. Sound investment strategies coupled with tested tax avoidance methods can create vast sums of wealth. It has been a very busy year with several new techniques available to our clients. We have been pleased to offer planning components that have brought about so much excitement among our clients. For this year's final edition of "The Beacon" we thought it best to recap some of these wealth creation techniques which are applicable to the overwhelming majority of our clients:

Technique #1: Defer Taxes

Deferring Taxes is not a new technique by itself. You probably been using it for years. Look at your retirement account - do you take as small a distribution as possible? Most people do. It doesn't matter whether you have an IRA, 401(k), 403(b), Roth, certain qualified annuities or many other qualified accounts. Deferring distributions defers the tax on those distributions and allows your investment, over time, to grow. That way you will have more to live on in you later years

when you are required to take larger distributions.

The same is true for your heirs. Structuring your plan to defer income taxes due from your heirs can create a significantly larger inheritance for your children or grandchildren. For most families,

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Qualified Retirement plans are the single biggest source of income tax liability. They may also represent the single largest asset your loved ones will inherit.

As you know, when an owner of a qualified plan becomes age 70½, he or she must soon begin to take required minimum withdrawals ("RMDs") and pay federal and state income taxes on those withdrawals at his or her highest rate brackets (unless the IRA is a "Roth", in which case, the withdrawals may be income tax free).

Effective January 1, 2003, the IRS changed its RMD rules for IRAs, allowing a non-spouse beneficiary (for example, a child) to take or "stretch-out" the taxable RMDs over a much longer period, using his or her own life expectancy rather than the shorter life expectancy of the original IRA owner (the parent). This means that the money inside an inherited IRA may now compound much longer, tax deferred.

For example, let's take a child age 45 (at the time of his parent's death) who inherits a $200,000 IRA and withdraws only RMDs. If the IRA grows, from both income and principal appreciation, at the rate of 6% a year, then 30 years later when the child is age 75, the child will have taken over $400,000 in RMDs and still have almost $300,000 left in the IRA to use over his or her later years or pass down to his or her children (the original IRA owner's grandchildren).

Effective January 1, 2007 the Pension Protection Act (PPA) gave those with company plans (401(k), 403(a), 403(b), 457, pension or profit-sharing plan, etc) a way to benefit from the stretch-out as well (previously, most company plans' own rules usually forced a non-spouse beneficiary to take the entire taxable distribution in 1 to 5 years, overriding the income tax "stretch-out" rules available to IRAs). The PPA permits non-spouse beneficiaries of company plans, or a Trust established on the beneficiaries' behalf, to do a rollover into an "inherited IRA" *after* the plan participant passes away.

But the IRA Stretch-out is not automatic. And what's worse, the Retirement plan benefits are subject to the claims of creditors and divorcing spouses. With over 50% of today's marriages ending in divorce, it is now more important than ever to plan in a way that protects the wealth you leave your loved ones.

So how do we get tax deferral ***and*** asset protection?

The new "IRA Inheritance Trust ™" now permits the IRA owner and his or her family to enjoy maximum "stretch-out" *and* protection benefits at the same time. The protective features of this trust have previously been tested and proven over many years of court decisions. And now, finally, the IRS has approved, through a private letter ruling the income tax "stretch-out" feature as well. This new standalone IRA beneficiary trust is not the "garden variety" that has existed for some time, but rather represents a huge breakthrough. The IRA Inheritance Trust™ is the most advanced "next generation" trust that solves many earlier, tricky drafting problems associated with maximizing both the stretch-out and protection benefits.

And a company plan participant can set up the IRA Inheritance Trust ™ now, make it the beneficiary of the plan and let the IRA rollover

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occur later. This way you may keep your company plan and still provide your family with a stretch-out.

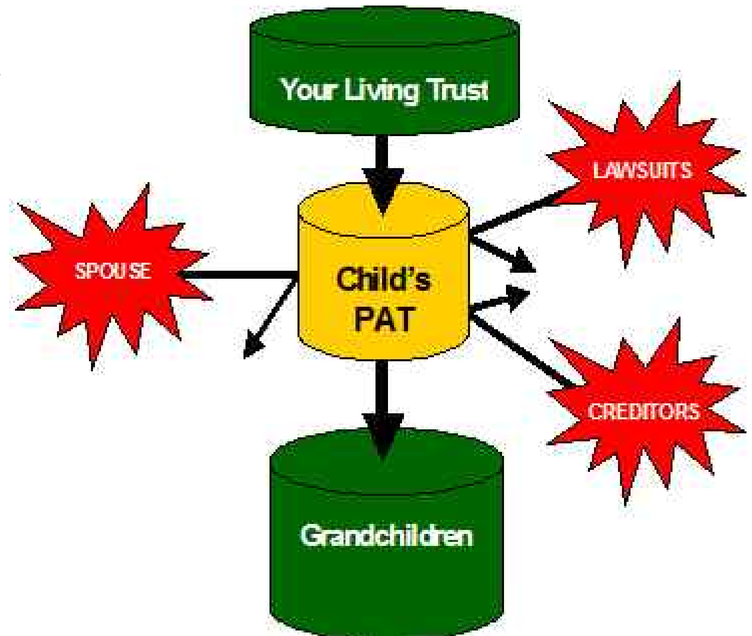
Technique #2: Never Leave Your Assets "To" Your Loved Ones, Instead Leave Them "For" Your Loved Ones!

In most Living Trusts, beneficiaries receive their inheritance "outright" - - either immediately after you're gone, or over a certain period of time, or at certain ages. In other words, your assets are distributed out of your Trust right into the names of your beneficiaries. However, by "owning" their inheritance, your beneficiaries are then exposed to the claims of ***spouses in divorce***, ***creditors***, ***lawsuits***, the loss of government needs-based benefits ***and estate taxes*** when their inheritance is handed down to the next generation of beneficiaries.

Instead of receiving their inheritance directly, each of your beneficiaries may instead receive their inheritance in a special trust, which springs out of your Living Trust. This continuing "Personal Asset Trust℠" (or "PAT") can be controlled by each beneficiary in such a manner as to virtually give him or her all of the same rights as ownership, without the liability exposures ownership brings.

How the "PAT" Works: The beneficiary may be his or her own initial Trustee in control of his or her own "Personal Asset Trust℠". The beneficiary may control the investing of his or her inheritance, how and when it is distributed and even who may receive it when that beneficiary passes away (if you wish, this right may be limited, such as only to your lineal descendants). The level of asset protection needed may be determined by the beneficiary after you're gone with the advantage of "20/20 hindsight", looking at the beneficiary's circumstances at that time. For example, if a moderate level of protection is appropriate, an independent Co-Trustee may be brought in to co-sign on distributions. Or, if a greater level of asset protection is needed, an independent "Trust Protector" can "lockdown" the Trust even more tightly from the attack of third parties. In either case, the beneficiary may continue to indirectly control his or her inheritance, while enjoying additional asset protection.

The "Personal Asset Trust℠" is based upon over 100 years of Asset Protection Law. We have merely adapted and "imported this technology" for



your Living Trust. This "Personal Asset Trust℠" is so unique that it is only offered by a small number of attorneys, who have taken the time to study it and the expense of updating their documents to include it.

Technique #3: Avoid Capital Gains Taxes

PART 1

Postponing Capital Gains recognition events is one of the easiest methods of avoiding capital gains taxes. Yet most revocable trusts are written with language that forces a recognition of capital gains upon the funding of marital trusts. For years lawyers across the country have relied upon a marital trust funding formula known as a

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"pecuniary" formula. The IRS has required that trusts using pecuniary formulas pay capital gains on assets when the Marital Trust(s) are funded based upon the difference between the asset's cost basis (usually the date of death value) and the asset's value on date of funding. Because the funding of Marital Trusts usually takes place within a year after the Donor's passing, the typical appreciation was minimal resulting in a small capital gains tax, if any. However, under the current tax code the step-up in basis to date of death value (or in some cases the alternate valuation date value) will go away with the estate tax repeal in 2010. This means that the cost basis of the assets used to fund a Marital Trust will typically be the Donor's cost basis. ***Consequently, the trust may face a significant capital gains tax in 2010.***

To avoid this problem we have developed an amendment for your trust. This Technical amendment changes the formula method to one that is tax-neutral. The Technical Amendment also improves your trust in a number of ways including:

- Opting out of the 2006 MA Principal & Income Act;
- Allowing you & your successor trustee to obtain a Reverse Mortgage, if desirable;
- Allowing your successor trustees to amend your trust if necessary;
- Allowing you successor trustee to do Medicaid Planning with trust assets if you end up going to a nursing home;
- Improving the HIPAA requirements for your trust;
- Improving your trustees powers relating to environmentally contaminated property;
- Allowing your trustees to accept gifts and to pay gift taxes; and
- Allowing your trustees the ability to defer payment to beneficiaries, providing some additional asset protection.

If you haven't already come in for your technical amendment this year, please call Bridgette and schedule your consultation.

PART 2

When a capital gain recognition event can not be avoided, our Capital Gains Avoidance Trust can provide significant tax savings and an increased income stream, especially in a low interest environment.

When a capital gains avoidance trust is established, a gift of cash or property is made to an irrevocable trust. This property is usually subject to a large capital gain, but because the property is donated to the Capital Gains Avoidance Trust the recognition of that gain can be avoided. The donor (and/or another non-charitable beneficiary) retains an annuity (fixed payments of principal and interest) from the trust for a specified number of years or for the life or lives of the non-charitable beneficiaries. At the end of the term, the qualified charity specified in the trust document receives the property in the trust and any appreciation.

Most gifts made to a Capital Gains Avoidance Trust qualify for income and gift tax charitable deductions (or in some cases an estate tax charitable deduction). A charitable deduction is permitted for the remainder interest gift only if the trust meets certain criteria. A trust qualifies as a charitable remainder annuity trust if the following conditions are met:

~ The trust pays a specified annuity to at least one non-charitable beneficiary who is living when the trust is created. Annuities can be paid annually, semiannually, quarterly, monthly, or weekly.

~ The amount paid, as an annuity, must be at least 5%, but less than 50% of the initial net fair market value of the property placed in the trust. The charity's interest at inception also must be worth at least 10 percent of the value transferred to the trust.

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~ The annuity is payable each year for a specified number of years (no more than 20) or for the life or lives of the non-charitable beneficiaries.

~ No annuity is paid to anyone other than the specified non-charitable beneficiary and a qualified charitable organization.

Here is an example of how it might work:

Sue is 77 years old and has a dividend reinvestment account, or DRIP, currently worth $65,000. She has not tracked her cost basis and was planning to leave the DRIP to her niece. Sue expected her niece would be able to take a step up in basis upon Sue's death. However, Sue has recently learned that step up in basis is scheduled to be repealed at the end of 2009. So she instead creates a Capital Gains Avoidance Trust (CGAT) and contributes the DRIP account to the CGAT. The CGAT may sell the underlying stock investment and not have to recognize the capital gain (thereby eliminating the problem of not knowing her basis). Sue will now receive an income of over $4,800 per year which she may use to pay for life insurance to replace the gift she planned to leave to her niece. Sue will also get a charitable income tax deduction of more than $28,000.

Technique #4: Remove Assets That May Appreciate From Your Estate & Still Keep Use & Control of Them

Yes, you can have your cake and eat it too! This technique is ideal for you if you have a taxable estate or you are a Florida resident (or a resident of any other state) and own real estate in Massachusetts thereby exposing your estate to death taxes levied by Massachusetts. There are a wide variety of other applications as well.

Through use of a special type of Irrevocable Trust known as a Beneficiary Taxed Trust, federal estate tax exposure may be frozen, dramatically reduced or, in some instances, federal and state estate taxes may be eliminated completely. With interest rates near historic lows, now is the right time to implement this wealth creation opportunity.

This technique will be covered in detail in our next issue of "The Beacon" to be published early next year.

If you have questions about ***any*** of the techniques discussed in this issue of "The Beacon," please call for a free consultation. If you wish to review past issues of "The Beacon" they are available on our website.

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