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Financial *Planning Strategies*

A Financial Planning Update

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Help Protect Your Earning Power with Disability Income Insurance

The possibility of sustaining a long-term disability from an accident or illness is something most of us would rather not dwell on. But, there is a way to help protect yourself and your family should you lose your ability to earn an income. **Disability income insurance** can play a key role in your overall financial plan and provide a benefit to help replace a portion of your income in the event you become too sick or injured to work.

Evaluating Your Needs

While most people understand the necessity and value of **life insurance**, many may overlook the valuable role disability income insurance can play in maintaining financial independence. How would you meet your everyday expenses if an injury or illness prevented you from working? For most people, Social Security Disability benefits cannot be solely relied upon to replace lost wages. You must meet very specific criteria to qualify for

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Charitable Giving—Good for the Heart and Your 1040

It may be better to give than to receive, but it is even better to give and see your generosity rewarded. Charitable donations can play a valuable role in your financial and tax strategies. A well-planned gift to charity could produce the following benefits:

- The chance to be more involved in charities close to your heart
- An income tax deduction or reduction
- A reduction (or avoidance) of estate tax

In addition, your donation could provide you with the ability to maintain financial security, the ability to exercise control over assets both during your lifetime and after death, and the opportunity to take care of your heirs in the manner you choose.

In order to accomplish all of these things, you will need a plan tailored to your individual circumstances. The following strategies can be mixed,

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Charitable Giving—Good for the Heart and Your 1040

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matched, and combined to provide a giving plan that is right for you.

Gifts of Appreciated Property

When properly arranged, gifts of appreciated property to charity may allow you to avoid the capital gains tax you would have owed upon the sale of the asset and to receive an income tax deduction usually worth the fair market value (FMV) of the property. Also, by removing that asset from your estate, you may reduce your potential estate tax burden.

Charitable Remainder Trust

If you wish to make a gift to a charity but also retain some control over the property, a Charitable Remainder Trust (CRT) may be the vehicle for you. A CRT is most effective when funded by an appreciating asset, such as stock in a family-owned business or real estate. After transferring the property to the trust, no income tax is imposed on income remaining in the trust, and you may take a current income tax deduction based on the future value when transferred to charity. Also, by removing the remainder value of the asset from your estate, you may reduce your potential estate tax liability. In short, you obtain the tax benefits of giving while postponing when the charity will receive the gift.

Charitable Lead Trust

If you wish to give to a charity without giving the asset away permanently, consider a Charitable Lead Trust (CLT). Through a CLT, you essentially give the charity the use of an asset and the right to any income generated for a period of years. After the specified period has lapsed, the asset can *revert* back to you or be given to whomever you choose. Possible assets could be income-producing stocks and bonds, your rare book collection, or a painting that you transfer to a museum for a certain length of time. You may receive a current income tax deduction for the value given to charity; however, the trust pays income tax on its income. If a CLT is created upon your death, potential estate tax may be reduced.

Give Away Your 401(k)

Instead of leaving your retirement plan assets to your heirs, think about leaving the balance in your 401(k), or other retirement plan, to a charity. A charity receiving plan assets is not taxed on the income, and your estate gets an estate tax deduction for the value of the assets passing to charity. Consider instead leaving your heirs something that won't be taxed, such as appreciated capital gain property for which they get a basis step-up at your death.

Early tax planning can help you make the most of your charitable giving opportunities. In doing so, you may be able to take advantage of added benefits. Consult your qualified tax, legal, and financial professionals for specific guidance.

Help Protect Your Earning Power with Disability Income Insurance

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disability benefits, and it is often necessary to wait several months for payments to begin. Also, Social Security benefits may not be sufficient to maintain your current standard of living.

As an alternative, you could self-insure. However, even if you save 10% of your salary each year, one year of disability could deplete many years of savings. Or, perhaps your employer provides a **salary continuance plan**. In general, employer-sponsored plans are 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, but only covers injuries that occurred on the job. Eligibility and benefits vary by state. The bottom line is that losing your ability to earn an income may make it difficult to make ends meet.

Types of Coverage

Depending on the terms of your policy, disability income insurance provides a benefit to replace a percentage of your income, in the event of a qualifying disability. The cost of coverage is based on such factors as your occupational risk level, age, medical history, and the scope of coverage you wish to purchase. Individual disability income insurance requires an application process and is subject to underwriting approval.

If your employer has a salary continuance plan, ask about the dollar amount of coverage, waiting period, and duration of payments, so that you can coordinate your personal coverage with your employer-provided benefits.

When examining the provisions outlined in a potential disability income insurance policy, remember to review the following:

- **Definition of total disability**: Does the policy provide coverage if you cannot perform the duties of your *own occupation* or the duties of *any occupation*? A policy that refers to your "own occupation" generally pays benefits if you cannot return to work in your field or if you return to work in a lower-paying job or a job in another occupation. A policy that refers to "any occupation" generally pays benefits only if you are unable to perform any job: your own job, a lower-paying job, or a job in a new occupation.
- **Length of benefits period**: Depending on your choice of coverage, the policy may pay benefits until you reach age 65, the age at which many individuals choose to enter retirement.
- **Waiting period**: Waiting periods (also called elimination periods) prior to receiving benefits are typically between 90 and 180 days, depending on your policy. While a shorter waiting period requires a higher premium, a longer waiting period may mean more out-of-pocket costs before benefits begin. The waiting period is determined when a policy is issued.
- **A noncancelable clause**: With a noncancelable clause, the insurance company cannot cancel or change your policy or increase the premiums before you reach age 65, provided the premiums continue to be paid.
- **Residual disability benefits**: With this rider, the policy pays benefits if you return to work while you are disabled and earn less (usually at least 20%) than your pre-disability income as a direct result of your disability.
- **Future insurability**: This rider allows for the purchase of additional coverage in the future without regard to medical insurability.

It is important to note that there may be an additional premium for adding any **riders**.

Disability income insurance can help protect your greatest asset—your ability to earn an income. Be sure to consult with a qualified insurance professional to determine an appropriate amount of coverage for your situation. $

Alphabet Soup: ILITs and the GST

With Federal estate taxes designed to tax assets transferred from one estate to another, planning to preserve wealth for your children, grandchildren and future generations can be challenging. In 2014, the Federal estate and gift tax rates are as high as 40%; therefore, wealthy individuals, as well as those of modest means, need to carefully formulate their financial and estate plans in order to help *minimize* taxes and *maximize* their financial legacies. As a result, the **irrevocable life insurance trust (ILIT)** has become recognized as a straightforward mechanism for funding future estate tax liabilities and creating the potential for leveraged gifts to family or charity. However, in such cases, estate planners should also be aware of the implications of **generation-skipping transfer (GST) taxes** and take special care to ensure this additional transfer tax is not incurred.

Annual gifts by a donor to an ILIT are typically used to make premium payments on a life insurance policy insuring the life of the donor(s). The size of the gift will determine the amount of insurance the ILIT will be able to purchase. Thus, it is not uncommon for grandchildren to be included as ILIT beneficiaries in order to maximize the use of the donor's **annual gift exclusion** ($14,000 annually per donee and $28,000 for gifts made by a married couple) and Crummey withdrawal powers.[1] The proceeds of a properly executed ILIT will not be included in the estate of the donor(s).

The GST tax is an additional tax imposed on all transfers (during one's lifetime or at death), either outright or in trust, to a skip person, where the transferred assets are not subject to estate taxes in the gross estate of the skipped generation. A skip person is an individual at least two generations removed from the generation of the transferor. For example, if a grandparent is a transferor, a grandchild qualifies as a skip person. The GST tax rate is currently equal to the maximum 40% Federal estate tax rate and is applied to the entire transferred amount. In addition, every individual has a **generation-skipping exemption** ($5.34 million in 2014) for transfers while living, as well as those at death, and the generation-skipping exemption cannot be transferred between spouses.

It should be noted that the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) has amended the GST tax exemption amount in any calendar year to equal the estate tax applicable exclusion amount in effect for such calendar year.

Dotting the "I" and Crossing the "T"

When properly drafted and implemented, an ILIT can be a creative tool for passing wealth to future generations while avoiding GST taxes. In many instances, this can be achieved without utilizing the donor's generation-skipping exemption. "Nontaxable gifts," such as those made under the annual gift exclusion, are excluded from the GST tax.[2] However, when nontaxable gifts are made to a trust, two additional vesting requirements must be met for the trust to be exempt from GST taxes.[3] First, the distribution of trust income and principal must be limited solely to the trust beneficiaries. Second, if a beneficiary predeceases the life of the trust, the deceased beneficiary's interest in the trust must be includable in his or her gross estate.

The use of ILITs is fairly commonplace in today's estate planning arena. However, the GST tax is typically underestimated as an issue. Thus, great care should be taken to help ensure generation-skipping transfer taxes do not undermine the benefits of an ILIT. $

[1] Crummey v. Comm., 397 F.2d 82 (9th Cir. 1968).
[2] IRC Sec. 2642(c)(3).
[3] IRC Secs. 2642(c)(2) and 2652(c)(3).