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FALL 2008 NEWSLETTER

To: Clients and Friends
From: Kel Long
Re: News from the Estate Planning World

ESTATE TAX STATUS.

With the election behind us, we have the beginnings of clarity on what the estate tax landscape will look like going forward.

Since my newsletter last spring, the law remains the same – under the Bush 2001 tax plan, the estate tax exemption equivalent will increase on January 1, 2009 to $3,500,000 (currently $2,000,000 for 2008). Under the Bush plan, the estate tax is scheduled to be repealed in 2010, meaning that for persons dying in 2010, no estate tax is due, regardless of the size of the estate. However, in 2011 the estate tax returns and the exemption will only be $1,000,000 (compared to the 2008 exemption of $2,000,000 and 2009 of $3,500,000).

Under the Obama proposed tax plan as set out on his web site, the 2009 estate tax exemption equivalent amount of $3.5 million will be made permanent (or a total of $7million for a married couple). We expect this to become law before 2010. The $3.5million per spouse is to be "portable," meaning that what the first to die doesn't use, the last to die can use so that a total of up to $7million would pass free of estate tax. The current estate tax rate of 45% would be retained permanently.

For planning purposes, I had been telling clients to expect a $3million exemption and a 50% estate tax rate. I am now revising that to a $3.5 exemption and a 45% estate tax rate, based on the published Obama plan; however that could change depending on tax revenue balancing requirements.

With these expanded exemption amounts, the estate tax saving opportunities have increased. If your plan has not been reviewed lately, you should do so, whether to achieve estate tax savings, to reflect a change in family circumstances or to achieve goals you have for your loved ones .

LIFE INSURANCE POLICIES AND THE STOCK MARKET.

Life insurance is often part of the estate plan, and can be used to provide for the support of a spouse and minor children, estate taxes or estate equalization between children. If you own a life insurance policy that is either considered a "Variable" or "Universal" product, you should have the policy reviewed promptly, given the recent stock market decline and the reduction in interest rates by the Federal Reserve. The performance of both of those life insurance policies depend on the investment rate of return. For example, if the cash surrender value of the policy is invested in mutual funds, then the cash value is likely to have decreased significantly in the last 60 days. If that is the case, then you may have to pay significantly more in future premiums in order to keep the life insurance death benefit in place. The same theory applies if the policy is interest rate sensitive (most are) in that the interest income will now be less than anticipated, resulting in additional premiums due.

To see how this can affect you, a basic understanding of life insurance is needed. Here is how I often explain life insurance to clients: As you age, the cost of life insurance, per $1,000 unit, increases. For example, a 40 year old can buy $1,000 of life insurance for about $1 per year, but that same $1,000 of insurance costs a 70 year old, say $30; and an 80 year old, say $70.

The insurance company charges you the cost of insurance for their exposure in that particular year if you were to die, based upon your age and the mortality tables. The insurance company's exposure in a given year is the difference between the cash value of the policy and the death benefit. For example, if you own a policy with a death benefit of $1,000,000 and a cash value of $300,000, then the insurance company's exposure is $700,000, or 700 $1,000 units. If you are 40 years old, then your cost of insurance for that year is $700; age 70 - $21,000; or age 80 - $49,000.

To carry this example further, if the annual scheduled premium payment is $10,000, and the policy pays 5% interest, then the 40 year olds cash value will increase at the end of the year to $324,300 which is the sum of the beginning cash value of $300,000 plus the interest income of $15,000 plus the premium payment of $10,000 less the cost of insurance of $700.

In the case of the 70 year old, the cash value will also increase, but only to $304,000 which is the sum of the beginning cash value of $300,000 plus interest income of $15,000, plus the premium payment of $10,000 less the cost of insurance of $21,000.

In the case of the 80 year old, the cash value will instead decrease by the end of the year to $276,000, which is the sum of the beginning cash value of $300,000 plus interest income of $15,000, plus the premium payment of $10,000 less the cost of insurance of $49,000. The following year, the cash value will decrease by an even greater margin since the interest income will be less (measured on a smaller cash value) and the cost of insurance will be higher and on a larger exposure amount (since the cash value has decreased). In this example, at about age 86, the policy will lapse – meaning that the policy is terminated, the cash value is $0 and there will be no life insurance benefit at death.

As you can see, the cost of insurance becomes very expensive when you are in your 70's and older. Unless the cash value of the policy is approaching the death benefit by the time you turn 70, most policies are destined to lapse.

Coming full circle, if the cash value of your policy is invested in the stock market, your cash value may be down significantly which will greatly affect the performance of your policy and it could unexpectedly lapse. The same applies if you were expecting to receive 7% interest annually on your cash value and you are now receiving only 4% - the policy will lapse sooner than you expected.

If you have concerns about your policy and would like an independent review, please let me know.

<u>PROFESSIONAL ACTIVITIES</u>.
Later in November I will give the annual update on Estate Planning for the Georgia Bar, which is seen by about 2,000 lawyers across the state. I also recently spoke to the Atlanta Bar Estate Planning Section on the use of long term trusts and how to amend or modify old trusts that are broken. And, last month, I spoke to a group of parents of autistic teenagers about using special needs trusts to help achieve their goals of independent living for their child.