



LIFE AND DISABILITY
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ESTATE PLANNING



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ANNUITIES

Estate Tax Update

As most everyone knows, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 gradually phases out the federal estate tax until its complete repeal in 2010. Without additional legislation, however, the federal estate tax will return in 2011 to the pre-EGTRRA days (with top rates of 55% and only \$1,000,000 exemption).

Since 2001, there have been several attempts in Congress to make the estate tax repeal permanent. Most recently, the House of Representatives voted in April 2005 to do so and that bill is now being debated in the Senate. If passed by the Senate (the vote most recently postponed again due to the Katrina disaster), the President will most likely sign it into law, as he has promised all along. It is worthy to note, however, the estate tax has been repealed 3 times in our history only to come back every time.

While 60 Senators (the number needed for the repeal to be passed) have supported repeal in some form in the past, the current budget environment and fiscal realities has resulted in some Senators reconsidering the feasibility of full repeal. Many Senators and the AALU, one the biggest lobbying organizations, continue to support estate tax reform, rather than repeal. For instance, reform at a \$2,500,000 level and a 45% top estate tax rate would eliminate any estate tax burden for 99.8% of estates! According to the AALU Washington Report (6/13/05, Bulletin No 05-64) "reform at this kind of level would still be a significant tax cut and would relieve the vast majority of estates

from estate tax liability while enabling the few subject to the tax to plan with certainty. In addition, reform at this level would preserve much needed revenue for impending national priorities."

One of the biggest consequences of estate tax repeal will be that the step up in basis will most likely be lost. Heirs will receive a carry over basis on inherited property, and will recognize the capital gain (or loss) when the property is sold at some point in the future. What will this change in the tax system mean for American families? The current estate tax only affects less than 2% of the most wealthy Americans. Capital gains tax, however, can affect anyone who owns capital assets. Therefore, unless the step up in basis remains, estate tax repeal is likely to result in creating a higher tax bill for perhaps far more less wealthy Americans. Further, repeal will certainly create a paperwork headache for heirs who will have to determine the decedent's tax basis in the property they've inherited. Imagine inheriting a \$2,500,000 property with a basis of only \$100,000.

Other potential disadvantages of repealing or reforming the estate tax is that there is evidence to support that charity contributions could go down. The estate tax encourages charitable giving by providing a full deduction for gifts and bequest to qualified charities.

Many individual states could impose their own estate tax to make up for the lost revenue.

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Bankruptcy Reform Act: Is Your IRA Protected?

The most sweeping changes to bankruptcy law in decades will go into effect for all bankruptcy cases filed after October 17, 2005. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which President George W. Bush signed into law on April 20, revises many areas of bankruptcy law, holding debtors more accountable and making it harder for them to use bankruptcy to clear debt.

While the tax-related provisions of the act primarily favor the IRS, there are a few ways in which the law gives taxpayers additional protection. One key area relates to the reach creditors have to Individual Retirement Accounts (IRAs) in the event of bankruptcy.

Prior to the new law, sometimes conflicting federal and state laws and court decisions created confusion as to whether an individual's IRA could be open to claims from creditors. The new bankruptcy act, which overrides state

laws, provides clarity in this area. The new law places a cap on the amount of money that can be protected in a traditional or Roth IRA. Only the first \$1 million is off limits to creditors. The \$1 million amount will be adjusted annually to account for inflation. Bankruptcy courts have the authority to increase the cap if it is in the "interest of justice."

"Rollover" IRAs enjoy greater protection. All assets rolled over from employee contributed plans into an IRA are protected from creditors regardless of their value. Keep detailed and accurate records of all rollovers and avoid mixing rollover funds with the traditional or Roth IRAs you are building from scratch. This will keep documentation and bookkeeping less complicated.

Education IRAs, pensions, Social Security and other benefits tied to disability, age or illness are fully protected from creditors in bankruptcy proceedings.

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In summary, no matter what happens when and if the vote on estate tax occurs, one thing is certain: dealing with the uncertain (and always changing) tax laws makes planning increasingly important. The changing estate tax and capita gains tax make it a challenges for both clients and advisors to adequately plan. Life insurance

and irrevocable insurance trusts remain as important as ever.

The above information is not intended to provide tax or legal advice. Please seek assistance from a tax advisor and/or attorney based on your individual situation.

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benefits for long-term care costs.

Since Medicaid is a federally funded program administered by the individual states, each state is pursuing its own avenues to prevent the transfer of assets in an attempt to qualify for Medicaid. Some examples:

At the time of this writing:

- 1) Virginia is considering a bill to increase the look back period for asset transfer from 36 months to 72 months.
- 2) Louisiana's Dept. of Health and Hospitals has issued an emergency ruling, which makes the state the heir to any remaining assets after the death of a nursing home resident.

And on the federal level, there have been attempts to both tighten up eligibility rules and to prevent planners from dispensing advice to clients on how to bypass Medicaid eligibility rules.

All this activity points to an increased need for long-term care insurance to help preserve one's assets and retain the ability to choose the type and quality of long-term care services should they become necessary. Putting off the decision may result in both fewer insurance options and higher costs due to the government's future actions and the natural increase in premiums due to age. A healthy 50 year-old will generally pay considerably less in annual premiums compared to a healthy 70 year-old for the same coverage.

Understanding the Need for Key Employee Insurance Protection

You have got a great group of employees working with you and business could not be better. You know much of that success is due to one or two people with both skills and personalities that are hard to match. Suppose they were injured and out of work for a while, or worse, suppose they died unexpectedly? Would your business survive?

At the death or disability of an owner or key employee of a closely held business, there are five separate groups that will be most concerned about the immediate financial health and future of the business:

- Employees will be concerned about the continuation of the business and their jobs.
- Creditors will be concerned about the effect of the key employee's death on the earning power of the business and its future ability to repay any outstanding debts.
- Suppliers will be concerned about the loss of a customer.
- Customers will be concerned about the ability of the business to continue furnishing its products and services. Will they need to look elsewhere to satisfy their needs?
- Tax collectors will be concerned, but only to the extent that there are sufficient funds to pay the various taxes, even if it means the ultimate sacrifice of the business.

Key employee life and disability insurance policies can help soften the impact of these contingencies.

Key Employee Life Insurance

Typically, your business purchases a life insurance policy on a key employee, pays the premiums and is the beneficiary in the event of the employee's death. As the owner of the policy, the business may surrender it, borrow against it and use either the cash value or death benefits as the business sees fit.

When determining how much insurance you'll need, coming up with a dollar value on a key employee's economic worth may be difficult. Although there are no specific rules or formulas to follow, several possible methods to determine the insurance amount may be used. The appropriate level of coverage might be the cost of recruiting and training an adequate replacement. Alternatively, the insurance amount might be the key employee's annual salary times the number of years a newly hired replacement might take to reach a similar skill level. Finally, you might consider the key employee's value in terms of company profits; the level of insurance coverage might then be tied to any anticipated profit or loss.

The premiums you pay for key employee life insurance are not a tax-deductible business expense for federal in-

come tax purposes, since your business is the recipient of the benefits. For the most part, the death benefits your company receives as the beneficiary of the policy are not considered taxable income. If your business is a C corporation, however, the death benefits may increase the corporation's liability for the alternative minimum tax. You should consult a tax professional for information on your circumstances.

Key Employee Disability Insurance

The death of a key employee isn't the only threat to your business. Suppose a key employee is injured or becomes ill and is out of work for an extended period. Disability insurance on such a key employee is another way you can protect your business against any resultant financial loss.

A critical part of key employee disability insurance policies is the definition of disability. Usually, these policies define disability as the inability of the employee to perform his or her normal job duties due to injury or illness. As with life insurance, your business buys a disability insurance policy on the employee, pays the premiums, and is named as the beneficiary. When the employee is disabled, the insurance coverage pays monthly disability benefits to your business. These benefits can equal a certain percentage of the key employee's monthly salary, up to either a maximum monthly limit or 100 percent of their salary. The benefits may be used to pay the operating expenses of the business and to cover the expense of finding a temporary or permanent replacement for the key employee.

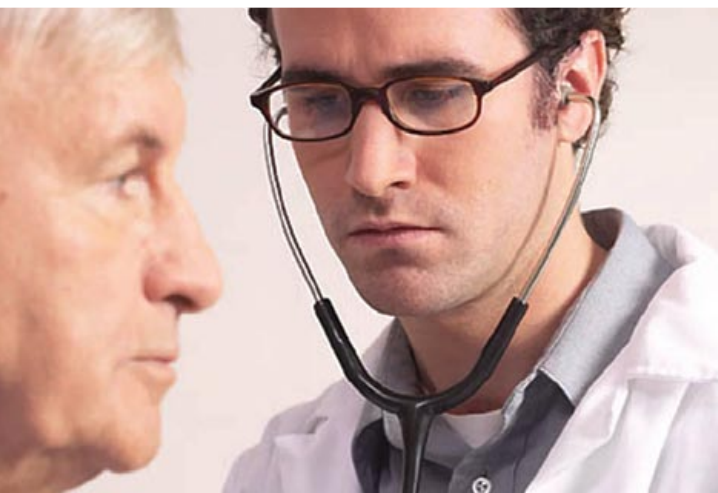
The policies typically offer elimination periods (i.e. the waiting period between the disability and when the benefits begin) ranging from 30 to 365 days. Depending on the policy, your business may receive benefits for 6 to 18 months, which would be long enough to allow the key employee to return to work or for the company to replace the key employee.

Depending on the type of coverage purchased, the premiums you pay for the key employee disability policy may or may not be a tax-deductible business expense. If the policy is considered business overhead expense insurance, then the premiums are a deductible expense. While the business would be responsible for paying taxes on any disability benefits received, the business expenses the policy indirectly pays for would result in an offsetting deduction.

Planning ahead can prevent a business from having to liquidate to raise cash and can assure families, employees, creditors, suppliers and customers that the future of the business is not in jeopardy. By purchasing life and disability insurance on the owner(s) and/or key employees, the business is letting everyone know the financial condition of the business will remain sound despite the loss of a key person.



Why You Need to Plan for Your Long-Term Care Needs



Most people understand that proper financial planning is the key to preserving assets and passing your estate along to heirs. It's not easy to make the time to plan without a pressing reason such as a personal illness or the unexpected death of a family member. The government has recently been sending out signals that the time to plan for long-term care is now.

With the aging of the Baby Boomer population, our nation is facing the prospect of increasingly large numbers of the elderly needing some type of long-term care. In an era of increasing federal deficits, Medicare and Medicaid have become a battleground in the budget arena as the cost of providing medical care for these growing numbers comes to the forefront.

In order to slash costs, the federal government is now closely examining the eligibility requirements for Medicaid. Financial planners and lawyers are working to preserve the assets of their clients while still meeting the guidelines for obtaining Medicaid

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