

# The Sgroi Financial

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Planning for Today and Tomorrow

## ESTATE PLANNING BASICS

*This article is the second in a two part series dealing with estate planning. This part deals with the tax advantages of proper estate planning and the use of trusts and insurances to protect your estate.*

**H. Joseph Sgroi and Associates** has been helping people with all aspects of their financial planning since 1971. The protection of those assets from estate taxes and other costs is a major part of our job.

Your estate is defined as the sum of all assets you possess. This includes your residence and other real estate, investment securities, annuity contracts, business interests, bank accounts and other personal possessions. Life insurance contracts which one owns or controls are also included in your estate.

Estate taxes are those taxes imposed by the State and Federal governments on assets left to your heirs. When one passes away, their will is presented to the Surrogates Court and an *executor* is appointed to carry out the terms of the will. This process, done under the direction of the judge is called probate. The term probate stems from the Latin *probare* which means to examine.

The executor (executrix, if female) is normally appointed in the will. The appointment is made official by the court with a Letter of Testamentary. If there is no will or the person named is unable or unwilling to perform their duties, the court then appoints an *administrator* to do so. The executor/administrator is responsible for filing the final personal income tax return and the estate tax return. The executor is also responsible for paying those taxes due along with any other debts or charges owed by the estate.

**Estate taxes** are defined as excise taxes charged to the assets of the estate for the *privilege of transferring property by reason of death*, not a tax of the assets themselves. **Gift Taxes** are taxes imposed on the giver if gifts in excess of \$10,000.00 per recipient per year are given. There may have been a constitutional issue here as the 5th amendment states "nor shall private property be taken for public use without just compensation." But this is a financial planning newsletter not a law journal.

The federal estate tax begins on every dollar of your estate over \$600,000.00. The New York State tax,

not surprisingly, begins at \$115,000. The federal rate of taxation starts at 37% and progresses ultimately to 55%. The New York State rate starts at 2% and goes up. The chart below illustrates some examples.

There are numerous steps which can be taken to

Estate Amount	State Tax	Feder Tax	Total	Tax Rate
\$115,000	\$0	\$0	\$0	0.0%
\$300,000	\$9,500	\$0	\$9,500	5.0%
\$600,000	\$25,500	\$0	\$25,500	6.0%
\$750,000	\$35,000	\$35,000	\$70,000	39.2%
\$1,000,000	\$54,500	\$119,800	\$174,700	43.4%
\$1,500,000	\$97,500	\$298,600	\$396,100	47.6%
\$2,000,000	\$146,500	\$488,400	\$634,900	51.8%
\$3,000,000	\$259,500	\$916,000	\$1,175,500	58.2%
\$5,000,000	\$541,500	\$1,806,400	\$2,347,900	58.8%

reduce or even eliminate estate taxes. No single approach handles everything, but certain basics are fairly universal.

The transfer of assets between a person and their legal spouse can be done at any time without estate tax or gift tax consequences. This is called the **unlimited marital deduction**. So if one of the partners passes away the entirety of the estate may pass to the remaining partner and no estate tax is incurred. Estate taxes at the federal level do not get charged to any estate less than \$600,000.00 (see the chart above). If the estate is less than this amount when a single person or the remaining spouse passes away, the estate will go to the designated heirs without having to pay any federal estate tax. The federal estate tax on \$600,000.00 without the exemptions would otherwise be \$192,800. Since this tax is not actually charged it is considered, in law, to be a tax credit and is called the **Unified Credit**. It is termed the unified credit because it is a combined credit for both the federal estate tax and federal gift tax.

# A personal letter from Joe

Dear Friend,

With spring finally here and the tax season behind us, thank goodness for both, I wanted to take this opportunity to address several issues with you.

Over this past winter, on a couple of different occasions, current clients of mine told me that they heard I no longer accept new clients. Another client even brought up my three day (Monday, Tuesday, Wednesday) work week. 😊😊😊 That last one could really get me in trouble with Betsy (my Bride and Best Friend for the past 31 years).

Well, the truth of the matter is that, thanks to you, our business is exploding. Our firm took on hundreds of new clients just last year alone (more new clients in one year than many of our friendly competitors have, in total). It's amazing what happens when you never compromise your personal integrity and do only what's best for your clients. Hence, the Joey three day per week client appointment schedule. The other four days per week are spent in research (hundreds of mutual funds, almost unlimited and ever changing insurance and annuity products, tax law, economic indicators, etc., etc.), studying existing client financial plans, training staff, extensive community and charitable involvement and planning for the future. We now have a staff of fourteen hard working and committed individuals whose primary goal here is to service you. There are now four other licensed financial planners in my firm - all personally trained by me. My son Patrick (our Channel 4 TV Star 😊) and John Clouden are veterans and they're not just good, they're awesome. Most new appointments go initially to John or Pat. If the grey haired guy (me) is needed, they consult me immediately or schedule the second appointment with the "old sage". They're so sharp that bringing me in is becoming less and less frequent (but they're stuck with me for another 50 years as I'll never retire 😊).

picture of  
Joey

Jeff Hahn (my Vice President of Operations) is also fully licensed, sees clients and handles the individual stock trading. Our newest financial guru, Frank Gengo, joined us in January and is doing great. These are all fantastic, high integrity people. However, if you have a referral that only wants to see me, fine. Have them call and ask for Jill, our wonderful receptionist, and she'll arrange it. Be assured that anyone referred to our firm will receive the highest quality, most comprehensive financial planning advice available. My goal is to have the finest financial planning firm on the planet, where an individual, group or business can come in and be assisted in any financial area with total integrity. I know of no firm in the country that has this as their primary goal. Our comprehensive financial planning fact-finder and financial planning system is proprietary and fully computerized. I personally developed this as I could not find a worthwhile system, at any price, that was comprehensive enough or structured in a logical financial planning sequence. It's so good, I've been offered a fortune to shrink wrap it and sell it globally. I haven't done this as the level of integrity of the industry is not at a point where I'd be willing to release it - at any price. This incredible, financial planning system is free to all of our clients. If you haven't been in for a bit, call Jill for an appointment.

Back to my point (I know, I'm rambling 😊). We're expanding and will continue to expand. Earlier this year, I purchased the building next door (just north). Our 2nd meeting with the architect was yesterday. While still in the planning stages, it looks like we'll be adding approximately 3,600 square feet with a conference room to accommodate 75 to 100 people. I'm really excited and can't wait 'till it's fully in place (fall '97 target). So the seven day work week is still in play and we will always continue to be here to help you. 😊😊😊

## ESTATE PLANNING CONTINUED

As the size of your estate grows in excess of \$600,000.00, other strategies may be employed. One of these is the **gifting of assets**. You are allowed to make gifts to any individual of up to \$10,000.00 per year per person. If you are married, you are hence able to gift \$20,000.00 per year to each of your children, their spouses, your grandchildren, friends etc. Amounts given in excess of the limits incur **gift taxes** which are paid by the donor. One is also allowed to make **direct tuition payment gifts** and **direct medical expense payment gifts** for the benefit of another in addition to gifts given directly to the recipient. Finally, gifts may be given to qualified charities without limit and free of gift taxes. These gifts enable the donor to pass assets to those they choose free of tax, and reduce the eventual size of their estate.

As stated earlier, a linkage exists between the federal gift tax and the federal estate tax. Should a person make a gift to another single individual in excess of \$10,000.00 in a single year, a gift tax would be assessed to the giver or the giver may use a portion of their unified credit. If the individual decides to use part of the uniform credit the amount given over the first \$10,000.00 is, in effect, deducted from the \$600,000.00 that may be passed federal estate tax free after death. Yes, we know this all seems complex and it is. But don't worry, it gets worse. And besides, you've got us. ☺☺☺☺

Every individual is eligible for a separate unified credit. This is where the **separation of assets** may be employed as a useful estate planning strategy. If, for example, a husband and wife had an estate of \$2,000,000.00, the assets would be placed in separate accounts under individual ownership. So each would own \$1,000,000.00 individually. At the time the first spouse passes away \$600,000.00 could go to any designated heir free of federal estate tax and the balance to the remaining spouse tax free. When the second spouse passes on, an additional \$600,000.00 could pass to those heirs free of federal estate tax. The remainder of the estate would be subject to taxation. But in this example the couple has successfully willed \$1,200,000.00 to their heirs without having it taxed at the federal level. Had the assets not been separated and transferred in this way, the total estate tax bill would have been somewhere in the neighborhood of \$240,000.00 more.

The separating of assets leads us directly into the use of **trusts**. There are large books written on this subject and we won't be able to cover anything more than some very basics. Hopefully this will give you some direction when you come in for your next appointment.

A **trust** is a legally and officially established relationship in which one person, **the trustee**, holds title to property for the benefit of another, **the beneficiary**. The agreement which establishes the trust, names the

powers of the trustee is called the **trust indenture**. (An indenture is simply a written agreement or contract). Because the trustee holds title to the assets, they have the ability to sell them and buy others. In short the trustee can legally manage the assets or hire someone to do so. But the management of those assets must be in accordance with the provisions of the trust and for the good of the beneficiary. The trustee may not manage the assets for his own benefit or profit.

Let us return to the example of the husband and wife worth \$2,000,000.00. The assets have been separated equally. When one spouse passes away, \$600,000.00 is placed in a trust as designated in that person's will. The trust indenture states who the trustee is, who the beneficiaries are (children, grandchildren, charity, friend etc.) and that the income generated by the trust (*interest, dividends and realized capital gains*) may go to the remaining spouse as long as that spouse is alive. Furthermore, the remaining spouse may have access to the principal if necessary for his or her health, education, support and maintenance. By establishing this trust the first spouse has provided for the welfare of the second while still maintaining both unified credits. This is called a **Credit Shelter Trust**, as it shelters the first spouse's Unified Credit. Because it is established by the person's will it is also termed a testamentary trust (created at death as instructed by you in your will). In order to accomplish its purpose (save estate taxes) the trust must be **irrevocable**. We are appalled at the number of "living" **revocable** trusts being set up that do not accomplish this primary tax saving objective, often too late and to the dismay of the beneficiaries.

When the second spouse eventually passes on the trust is often dissolved and the assets are transferred to the named beneficiaries free of federal estate taxes. Even if these assets have grown in value because of *unrealized capital gains* and now exceed \$600,000.00, they would not be taxed at the federal level.

Let's take just a moment to explain the difference between *realized* and *unrealized capital gains*. A capital gain occurs when an investment increases in value. If an individual (or trust in this case) invests in a particular investment (stock, bond, mutual fund...) and the price of that investment goes up and the individual then sells that investment the capital gain is received or *realized*. If the individual holds the investment the capital gains have not been taken, thus they are *unrealized*. In the case of a credit shelter trust, unrealized gains may be held in the trust and transferred to the beneficiary federal estate tax free. Income and realized capital gains should be distributed as they are received for tax purposes.

Life Insurance is almost always involved in the estate planning process. As mentioned earlier, if one owns or controls a life insurance contract, called incidents

## ***ESTATE PLANNING CONCLUDED***

of ownership, then the benefit amount is included in the estate. **Incidents of Ownership** are ownership rights including: naming or changing beneficiaries, borrowing against the cash value or surrendering the policy. So even though the beneficiaries may receive the money without paying income tax, there may be an estate tax liability. To help alleviate this burden an **Irrevocable Life Insurance Trust** or other special ownership arrangements may be established.

In this trust arrangement, the trust owns the life insurance policy. The life insurance is paid for by the trust normally with money gifted by the insured. The insured would make gifts to the trust, on an annual basis, which the trustee then uses to pay the premiums of the life insurance policy. The trust would then be referred to as *unfunded*. The individual could also transfer assets to the trust which the trustee would manage or sell to fund the insurance. This type of trust would be referred to as *funded* as it owns the needed assets to purchase the insurance. When the individual passes away, the insurance proceeds are paid to the heirs free of tax. The insurance proceeds may also be paid into the trust and then managed for the benefit of the heirs. This may be advisable in a case involving minor children or a spouse who needs help handling financial affairs.

**Survivorship Life Insurance**, which provides protection on two peoples lives, a married couple for

instance, with proceeds payable at the second death , is ideal for estate planning purposes. There are numerous other advantages to these type of policies regardless of whether a trust arrangement is needed or not.

An Irrevocable Life Insurance Trust is called *irrevocable* because it may not be changed. Once the policy has been established under the ownership of the trust it may not be controlled in any way by the insured.

Needless to say, this is a complex subject which has an immense amount of regulation associated with it. What we have touched on in this article are only the very basics. There are literally dozens of different types of trusts and a great deal more applications of life insurance. Establishing trusts and estate planning in general are team activities involving your attorney, tax advisor and your friendly professionals at **H. Joseph Sgroi and Associates**.

We know a lot has been covered here and hope this information gives you some guidance. We'll discuss it as it personally applies to you at your next annual appointment. 😊😊😊😊😊

### ***ESTATES OF FAMOUS PEOPLE\****

<b>NAME</b>	<b>GROSS ESTATE</b>	<b>TAXES/ EXPENSES</b>	<b>NET ESTATE</b>	<b>PERCENTAGE OF SHRINKAGE</b>
NELSON H. COSGROVE	\$55,910,373	\$1,030,415	\$54,879,958	2%
JOHN D. ROCKEFELLER JR	\$160,598,584	\$24,965,954	\$135,632,630	16%
CLARK GABLE	\$2,806,526	\$1,101,038	\$1,705,488	30%
WALT DISNEY	\$23,004,851	\$6,811,943	\$16,192,908	30%
FRANKLIN D. ROOSEVELT	\$1,940,999	\$574,867	\$1,366,132	30%
WILLIAM BOEING	\$22,386,158	\$10,589,748	\$11,796,410	47%
MARILYN MONROE	\$819,176	\$448,750	\$370,426	55%
ELVIS PRESLEY	\$10,165,434	\$7,374,635	\$2,790,799	73%

\* As you can see from these examples, planning really makes a big difference. We're interested in helping you conserve your wealth as well as create it. 😊