THE BERNSTEIN REPORT

Associates

Richard S. Bernstein, CEO
Robin S. Bernstein, President
Arthur L. Bernstein
Wayne G. Monek
Robert L. Williams, CPA, CFO
Steve Edmiston, CLU, FLMI, ACS

Published By: Richard S. Bernstein and Associates, Inc.

RSB

1551 Forum Place, Suite 300A
West Palm Beach, FL. 33401
561-689-1000
1-800-676-6601
rsb@rbernstein.com
website: www.rbernstein.com

- **Life Settlements**
- **Premium Financing**
- Estate Planning
- Survivorship Last-To-Die (2nd to Die)
- Group Health Insurance
- Business Life Insurance
- Annuities
- Disability Income
- Long Term Care

RICHARD S. BERNSTEIN

MARCH 2009

Dear Reader,

President Obama signed the massive economic stimulus package--*American Recovery and Reinvestment Act of 2009*--into law last month. There was significant debate concerning the spending components of the law, but the package included almost $300 billion in tax cuts. Some of the provisions for individuals that you might find useful are:

- *Making Work Pay Credit.* This credit applies against income tax up to the lesser of 6.2 percent of earned income or $400 for an individual ($800 for joint filers). The credit is phased out at a rate of two percent as modified adjusted gross income (MAGI) exceeds $75,000 for an individual ($150,000 for joint filers). Hence, the benefit is eliminated entirely for an individual with MAGI of $95,000 ($190,000) for joint filers.
- *Alternative Minimum Tax (AMT) Relief.* The AMT exemption was extended and increased from the 2008 level. The exemption will be $46,700 for individual taxpayers ($70,950 for joint filers).
- *First-time Homebuyer Credit.* The credit, first introduced in 2008, provided an interest-free loan from the government for the first 10 percent of the purchase price up to $7,500. The limit was increased to $8,000 and the requirement to repay was removed for buyers who close on their residence between January 1 and November 30, 2009. Hence, it is now a refundable credit. The credit is phased out for individual purchasers with adjusted gross income (AGI) of $75,000 ($150,000 for joint-filers).
- *New Car Sales Tax Deduction.* Purchasers of a new vehicle in 2009 will be permitted to deduct the state and local sales tax on the amount of the purchase price up to $49,500. This provision includes cars, SUVs, trucks, recreational vehicles and motorcycles with weight no more than 8,500 pounds. The credit applies in full for individuals with AGI up to $125,000 ($250,000 for joint filers).
- *Suspension of Income Taxes on Unemployment Benefits.* There will be no income taxation of unemployment benefits up to $2,400 in 2009.
- *American Opportunity Tax Credit.* This provision renames and expands the existing HOPE education tuition credit to add related educational expenses. A credit of up to $2,500 will be allowed for 2009 and 2010 with 40 percent of the credit refundable. The credit is 100 percent of the first $2,000 of expenditures and 25 percent of the next $2,000. It is subject to a phase-out for individual taxpayers with AGI of $80,000 ($160,000 for joint filers).

Cordially,

Richard S. Bernstein

A Second Opinion Costs You NOTHING, But Could Save You MILLIONS!

WHEN IT COMES TO YOUR HEALTH, YOU GET A SECOND OPINION, SHOULD YOUR FINANCIAL WEALTH BE ANY DIFFERENT?

ANNUITIES IN 2009

The gloomy recent history for stocks and mutual funds has many concerned about retirement planning. Annuity products provide a unique opportunity for planning retirement income protection. Annuity products and contract types are constantly evolving. The last decade has seen additional features added on to annuity contracts. Some of the additional features enhance product choices and benefits while others guarantee against specific contingencies that are very unlikely to occur. Changes and demand for annuities are more evident in 2009 than ever before, especially in an economic environment where consumers are searching for investment guarantees.

Annuity Fundamentals

While products have evolved; their taxation, classification, and expense structures largely remain unchanged. Annuity contracts are fundamentally a method of transferring longevity (the risk of outliving assets) and investment risk from a consumer to an insurance company through the payment of a premium and annual expenses.

Annuity contracts have four parties; owner, annuitant, beneficiary and the insurer. The contract owner controls funding and distribution options of the contract and establishes the annuitant and beneficiary at contract inception, typically retaining the ability to change beneficiaries through the life of the contract.

The role of an annuitant varies by insurer and type of annuity contract. Fundamentally, an annuitant is the individual upon whose life annuitization and product guarantee features are structured. The owner of a contract can be an entity or individuals other than the annuitant. Insurance companies will typically limit the availability of guarantees and contract features in cases where contracts have dissimilar owners and annuitants. Contract beneficiaries receive lifetime contract payments as well as any promised death benefits or residual income streams.

Policy Benefits

Annuity contracts are either deferred or immediate. A deferred contract puts off the annuitization decision and allows premium to accumulate and grow in a tax-deferred environment. Deferred contracts can be funded with either nonqualified or qualified dollars. Nonqualified (funds provided by after-tax dollars) deferred annuity withdrawals are taxed on a last in first out basis, with initial withdrawals being subject to ordinary income on any gains. Distributions from a deferred annuity before 59 1/2 may result in an additional 10 percent premature distribution penalty. If the annuity contract is funded from an IRA or qualified plan rollover, benefits will generally be subject to ordinary income taxes.

An immediate contract begins making annuity payments, typically annually or monthly, to the contract beneficiary. Taxation of immediate annuity contracts is a function of the source of premium dollars. Generally, all payments are taxable if the premium dollars are provided by funds from a qualified plan or IRA. A formula (provided by IRC Sec. 72) is applied if nonqualified dollars are used to make premium payments and, in this case, immediate annuity payments receive blended tax treatment with a portion of the payment being return of premium proceeds.

Annuity Charges and Returns

Deferred annuity contracts are generally fixed, variable or indexed. Most annuity contracts

are subject to a surrender charge. The surrender charge is a penalty charged to the contract owner to the contract value on withdrawals before a stated period. Most surrender charges diminish over a seven to ten year period, and range from 10 percent to 1 percent. Some deferred annuity contracts offer surrender free withdrawals up to a stated percentage of the contract value (generally 5 percent to 15 percent) on an annual basis. Surrender periods limit the liquidity of annuity products and have been a concern for regulators. Quite simply, if the consumer is looking to provide a stream of retirement income with a significant measure of security, annuity products are a good fit. If the consumer is unsure whether he or she will need a refund in the short-term, annuity products are not indicated.

A fixed annuity pays a stated interest rate over a guaranteed period or the life of the contract. The rate may contain a teaser bonus interest rate in initial contract years. Deferred fixed annuity interest rates are a function of the quality of the insurer, surrender period length, product commission structure, contract length, administrative costs and other product guarantees. In today's market, fixed annuity rates range from 2.5 percent for three-year products to 5.5 percent for fifteen-year products.

Variable annuities contract values are tied to subaccount performance rather than a fixed interest rate. The policy owner selects subaccounts (which mirror mutual fund performance with some additional costs) as investments. Subaccount values are adjusted on a daily basis and correspond to market performance. Variable contract reporting itemizes administrative, investment and mortality expenses. These contracts also offer subaccounts with fixed returns although interest rates in deferred variable contracts are less than their fixed counterparts.

Deferred annuity contracts will provide the contract owner with different death benefit options. These options and their pricing vary on a contract-to-contract basis. Death benefits have historically been equal to the initial premium amount, the initial premium with a guaranteed annual adjustment or the contract value at death.

Today's Product Features

The past five years have exploded with variation and product introduction. An indexed annuity merges the fixed return and market variability into a new type of product. Indexed annuities provide a floor (minimum return) and cap a maximum annual credit. The amount of the credit is tied to market performance. Indexed annuity crediting can be complicated, especially in bull markets. Crediting methods vary by contract, but are generally a derivative of monthly index crediting. A hypothetical indexed contract could potentially earn 12 percent annually, but in order to achieve that return its underlying index would need to perform with at least a 1 percent return every calendar month in a year. Rarely does the market perform with such consistency and variations result in diminished growth.

Deferred variable annuities have developed guaranteed income streams without contract annuitization. The policy owner pays an additional annual expense, in exchange they are promised a percentage of initial premiums over a period of years regardless of market performance. Death benefit guarantees have also evolved in variable products, most offering a "high watermark" approach, raising contract death benefits to the higher of contract value or the highest contract anniversary value.

Single premium immediate annuities now allow access to liquidity. Today's immediate annuity contracts generally contain the ability to pull out a portion of the present value of remaining

payments. The lump sum distribution reduces future annuity payments but does provide some element of liquidity. Immediate annuities are also available with inflation-protected benefits that offer lower initial payments than traditional annuities but inflate over time.

Conclusion

Annuity products will continue to change with consumer demand. The additional features that have become available over the past decade come with additional costs. Annuities are not liquid assets and should not be used as an emergency fund or cash savings. Deferred annuities generally carry a surrender charge and may have unfavorable tax implications for early retirees. Annuities do provide guarantees which are backed by the insurer. These guarantees come at an expense but can provide consumers with piece of mind not available in other investment settings.

Recent Cases and Ruling

Correction Permitted on Estate Tax Return for Attorney Error

The decedent's estate tax return included a trust that was designed to be divided by the executor into portions that would qualify and fail to qualify for the federal estate tax marital deduction. The amount qualifying for the marital deduction would be determined and effectuated by the executor under the provisions of IRC Sec. 2056(b)(7) (by making the so-called QTIP election). The Will provided directions to the executor to make the QTIP election based on the tax circumstances in effect at the time of the testator's death. In the year the testator passed away, the estate tax exemption amount was lower than the year the estate tax return was filed. For example, the exemption amount might have been $1.5 million in the year of death, but $2 million at the time the return was filed. The QTIP election would be appropriate for any amounts in the trust above $1.5 million at the time of death.

The attorney preparing the return mistakenly calculated the tax based on the higher exemption amount applicable in the year the return was prepared, rather than the exemption that was available for the tax year of the decedent's death. This reduced the amount of the QTIP election and the corresponding the marital deduction taken on the return. The IRS found the mistake and provided notice of underpayment of tax. The executor filed a supplemental return correcting the error. The IRS ruled (Ltr. 200832011) that the intent of the Will and the actions taken by the parties indicate use of the QTIP election to reduce the estate tax to zero in conjunction with the federal estate tax exclusion amount in effect at death and permitted the executor to make the appropriate adjustment.

This Tax Letter is intended to assist you to conserve your estate and to protect the interests of your family and business associates. Estate planning involves the joint services of a competent Trust Officer, Attorney, Accountant, and Life Underwriter. The experience and advice of each is generally essential.

This tax letter, prepared by a nationally recognized tax authority, is published monthly by

RICHARD S. BERNSTEIN AND ASSOCIATES, INC.

Insurance Consultants

561/689-1000
FAX 561/689-0745
TOLL-FREE 800/676-6601

1551 FORUM PLACE, SUITE 300A
WEST PALM BEACH, FL 33401

www.rbernstein.com