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Planning through Sunrises and Sunsets

Prior to EGTRRA in 2001, sunset clauses in tax legislation were rarely used. If Congress felt a particular change to the tax laws was necessary, they passed the law and it became a permanent part of the tax code (at least until new legislation was passed). There have been a number of tax “extenders” that have been enacted on a temporary basis with the idea being that they will be extended in the future, like the research and development credit. However, the majority of tax law changes were meant to be permanent changes. That all changed with tax Acts passed in 2001, 2002, 2003 and 2006. Many of the new tax provisions in these Acts sunset, and in some cases sunrise, at a future date. There are a number of reasons that sunset clauses have been included in recent tax legislation including the fact that these have largely been tax reduction Acts and having the provision sunset reduces the estimated “cost”. These sun-setting and sun-rising tax laws have created a period of great uncertainty that professional advisors will have to contend with in 2010, and possibly well into the future.

The best known example of this is the federal estate tax. After eight years of knowing that 2010 would be a year without an estate tax and that modified carryover basis rules would come into play, Congress failed to act, leaving professional planners and their clients in a temporary holding pattern. In addition to the estate tax issue, there are numerous other tax provisions that are either ending or beginning. The following is a brief discussion of a few of those provisions.

Over the past five to ten years we have seen a number of attempts by the federal government to make it easier for people to obtain long term care insurance. Considering our aging population, medical advances that have extended life expectancies, the dramatic increase in nursing home costs, and our substantial federal deficits, it appears the government recognizes that it is in the

country’s best interest to have people financially take care of their own long term care needs. The Pension Protection Act of 2006 contains a provision (Sec. 844) that permits

taxpayers to make a tax-free exchange, under IRC Sec. 1035, of an annuity contract or a life insurance contract for a qualified long term care insurance policy. One of the biggest hurdles people face in obtaining long term care insurance policies is finding the cash flow to pay the premiums. There are billions of dollars sitting in annuity contracts and cash value life insurance policies in this country that may now be tapped into on a tax-favorable basis to acquire long term care insurance. Even though the Pension Protection Act became law in 2006, this particular part of the Act did not become effective until January 1st, 2010.

Another good example of tax laws sun-setting and sun-rising is the tax treatment of conservation easements – a popular estate planning technique for landowners, farmers and ranchers. A conservation easement is essentially a restriction placed on the use of a piece of land. The owner of the land retains ownership but restricts how the land may be used in the future. In order to qualify as a conservation easement the future use of the land is restricted to providing open space for scenic enjoyment, preserving historic value, providing public education or a number of other conservation purposes. The owner “donates” the easement to a land trust which has the responsibility of seeing that the restrictions placed on the land are enforced. This donation creates a charitable income tax deduction for the land owner. Prior to the enactment of the Pension Protection Act of 2006 this income tax deduction was limited to 30% of the taxpayer’s adjusted gross income

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with the ability to carry the deduction forward for an additional five years. PPA 2006 contained a provision that increased the AGI limit to 50% (100% for qualifying farmers and ranchers), and permitted a 15 year carry forward. These enhanced tax benefits were set to expire December 31st, 2007 but were extended by the Farm Bill of 2008. The extension provided in the Farm

Bill expired December 31st, 2009 and it is uncertain whether or not there will be another extension.

There are many other rising and setting tax laws that we need to be aware of. Those familiar with the changing tax landscape will be best suited to help their clients avoid the pitfalls and plan accordingly.

The Importance of Gauging Carrier Financial Strength and Claims Paying Ability

When life insurance is purchased as part of a client's overall estate plan it is very important to look at the financial strength of the insurance company. An insurance company's financials can change in the blink of an eye. We have seen prime examples of this within the past year as the industry took a bit of a beating. Just because an insurance company is rated A++ doesn't guarantee their ability to remain profitable and solvent. Keeping up with the changes in the market and the financial well being of an insurance company is critical for existing policies as well as when new policies are being considered. There are several companies out there that stay atop of the ever changing market by compiling data on these insurance companies and presenting that information to potential consumers in a way they can understand. These rating companies act as independent, third-party sources that conduct thorough analysis reports based on the insurance company's ability to meet their financial and contractual obligations to their policyholders and shareholders.

We are often asked about Comdex, what it means and how it relates to the overall rating of an insurance company. So, what is Comdex? Comdex is a composite of all ratings that an insurance company has received. This composite is made up of ratings from A.M. Best, Standard & Poors, Moody's, and Fitch. The Comdex was formed to make up for the lack of a unified ratings system. Each rating company has compiled their own independent analysis on each insurance company. These rating often times do not match up very well with the others and how they define their individual ratings system. The Comdex solves this

problem by taking a look at these individual ratings and gauging each insurance company as to which company appears stronger than the other based on the average weight of each ratings company report by means of mathematical distribution. The Comdex ranks the companies, on a scale of 1 to 100, in relation to other companies that have been rated by the services (100 being the strongest score).

So what happens to a carrier if it falters? Insurance companies fall under state law and under state law, once an insurance company is unable to perform its obligations that company enters into a period known as rehabilitation where that particular state's insurance department gains control of the entity. The insurance department may find that the insurance company cannot recover and will begin the process to declare the insurance company insolvent. From there the liquidation process begins. However, this process very rarely occurs and is not the primary reason that analyzing a carrier's financials is important. The greatest concern is that a poor performing carrier may reduce crediting rates or increase mortality and other expenses on non-guaranteed products which may have a substantial effect on policyholder cash values and future premium requirements. Many products contain non-guaranteed expenses and crediting features and one possible recourse a struggling carrier has is to increase expenses and reduce crediting rates on old policies. Obviously this is a situation we wish to avoid for our clients and highlights the need for a strong analysis of carrier strength for existing and planned life insurance purchases.

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