



The Wealth Advisor

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Planning for the New "Zero Percent" Tax Bracket

There was a recent change in the tax law that you might not be familiar with - yet it may entitle you to significant tax savings. Beginning January 1, 2008 and continuing through December 31, 2010 (unless extended by Congress), a zero tax rate may apply to long-term capital gain and dividend income that would otherwise be subject to the lowest federal income tax rates, 10% and 15%.

The new zero tax rate creates the opportunity for eligible individuals to sell certain appreciated assets at no tax cost. By working with you to ensure that you take advantage of this new opportunity, if available, we can help you pay less tax and preserve more of your wealth.

The Zero Tax Rate

There are two questions we must ask to determine whether a taxpayer is eligible for the new zero tax rate.

1. Is the taxpayer an *individual* who has "adjusted net capital gain."
2. If yes, is the individual eligible for the zero tax rate?

Adjusted net capital gain is, in essence, long-term capital gain minus short-term capital losses, if any, plus dividend income.

Planning Tip: There are exceptions when calculating adjusted net capital gain. Therefore, it is important that a knowledgeable tax advisor assist you with this calculation.

Who Gets the Zero Tax Rate?

Not surprisingly, determining whether someone is eligible for the zero tax rate is a complex calculation. We have tried to simplify it as follows:

1. Add all of your income to determine your Adjusted Gross Income (AGI).

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2. Subtract exemptions and deductions from your AGI to determine your taxable income.
3. Subtract adjusted net capital gain from your taxable income to determine your "other taxable income."
4. Is your other taxable income **less than** the threshold of your 25% income tax bracket? If yes, subtract other taxable income from your 25% tax rate threshold.
5. The remainder is eligible for the zero tax rate.

Planning Tip: Your income does not have to be below the 25% tax rate threshold for you to be eligible for the zero tax rate. ***Even if your taxable income is significantly higher than your 25% rate threshold, some of your adjusted net capital gain may still be eligible for the zero tax rate.***

For 2008, the 25% tax rate threshold is:

- \$32,550 for single taxpayers and married taxpayers filing separate returns;
- \$65,100 for married taxpayers filing joint returns and surviving spouses; and
- \$43,650 for heads of household.

Example

Suppose in 2008 Mr. and Mrs. Taxpayer have \$105,000 of wages plus \$120,000 long-term capital gain from the sale of stock. Thus, their 2008 adjusted gross income (AGI) is \$225,000. If they have \$65,000 in personal exemptions and itemized deductions, their 2008 taxable income is \$160,000 (\$225,000 minus \$65,000).

From the formula above, the Taxpayers' other income, after exemptions and deductions, is \$40,000 (\$160,000 minus \$120,000 adjusted net capital gain). Subtracting this amount from their 25% threshold of \$65,100, the zero rate applies to \$25,100 of their adjusted net capital gain (\$65,100 minus \$40,000). Thus, the zero rate would save them \$3,765 ($\$25,100 \times .15$) of federal income tax. The balance of their adjusted net capital gain (\$120,000 minus \$25,100) would be subject to the 15% rate.

Planning Tip: If your taxable income is less than your respective 25% rate threshold, all of your adjusted net capital gain will be subject to the zero tax rate.

Planning Tip: Conversely, if your taxable income - other than adjusted net capital gain - is equal to or greater than your 25% rate threshold, you will not be eligible for the zero tax rate.

Planning Tip: You and your tax advisors should pay careful attention to year-end income and deduction timing. Careful planning may create eligibility for the zero tax rate.

Application of the "Kiddie Tax"

In establishing the zero tax rate, Congress was concerned that taxpayers would transfer appreciated assets to their young

children to avoid tax on the sale of those assets. Absent some limitation, the children could then sell the assets at the zero tax rate and avoid paying tax on the capital gain. A limitation comes from Congress in the form of the so-called "kiddie tax."

With the kiddie tax, a child must pay federal income tax at his or her parents' highest rate on the child's unearned income over \$1,800. For tax years before 2008, the kiddie tax applied only to children under 14. However, while the zero tax rate is in effect, the kiddie tax is extended to all children under 18. In addition, while the child is a full-time student, the kiddie tax now applies until the child is 23 years old if the child's earned income does not provide more than one-half of his or her support.

Planning Tip: The opportunity remains to transfer appreciated assets to children, grandchildren or other family members 24 or older to take advantage of the zero tax rate. The opportunity also remains with younger children, but is limited. We can help clarify your planning opportunities.

Conclusion

The zero tax rate presents a significant opportunity for those individuals whose income, other than adjusted net capital gain, is less than their 25% income tax rate threshold - no matter how high their total taxable income (including adjusted net capital gain). The zero tax rate may also be available through transfers to young adults and other low-income taxpayers. Like with so many other areas, your planning team should work together to ensure that you take full advantage of the zero tax rate without compromising your other planning goals and objectives.

The Need for Life Insurance

Chances are great that you should have life insurance. Whether you can afford to buy it and what kind you need are just two of the many issues that confront us when we consider life insurance.

There are few experiences more traumatic than trying to figure out one's life insurance needs. Many of us have a genuine fear of being underinsured, especially in the days of lengthening life expectancies and rising costs of living. How will my family pay the mortgage, pay for college, etc., and maintain the same standard of living should something happen to me? Insurance isn't a gambling proposition. But, alternatively, the insurance consumer frequently feels pressure to buy more than he or she needs.

"How much life insurance do I really need?"

Perhaps the soundest approach to purchasing life insurance is to consider personal "needs." There are three basic uses for life insurance.

Income Replacement ("How will my family pay the bills if I die?")

Life insurance can replace lost income for those of us who die

unexpectedly. For example, what funds will be available to pay everyday bills? In determining the amount of life insurance necessary for income replacement, consider the following needs:

- A "transition" fund to pay at least six months' bills during the grieving period;
- An "emergency fund" for a catastrophic illness or injury, sudden and unexpected accident or casualty, financial collapse or the like;
- Funds to pay off mortgages and other debts; and
- Funds to supplement or replace Social Security.

If you have young children, also consider an amount sufficient for child-rearing, college and post-graduate expenses, career help and even the cost of marriages.

Planning Tip: Consider life insurance to replace income from the premature death of a breadwinner spouse or parent. The amount of insurance necessary should take into consideration not only monthly living expenses, but also transition and emergency funds, plus child-related expenses.

Wealth Replacement ("How can my family receive the full value of my assets?")

The traditional wealth replacement use for life insurance was to replace wealth lost to the federal estate tax. However, in 2008 the exemption to the federal estate tax has increased to \$2 million per individual, \$4 million per married couple. As a result, fewer individuals are subject to federal estate tax, and thus few individuals need life insurance solely for the traditional wealth replacement need.

But life insurance also satisfies other wealth replacement needs. For example, many of our most significant assets are tax-qualified plans (such as IRAs, 401(k)s and pension plans). Because these are a special class of assets, they are subject to ordinary income tax when distributed to our beneficiaries. Given the statistics that beneficiaries often deplete these assets quickly, they will incur **significant income tax** in withdrawing these assets. Therefore, a million dollar IRA may be worth only \$650,000 after federal income tax, less after state income tax. Realizing this, many of us would benefit from life insurance designed to replace this lost wealth.

Other wealth replacement needs for life insurance include:

- Funeral and other last expenses; and
- Estate administration expenses, including medical bills, hospital costs, decedent's debts and bills, taxes, fiduciary's commissions, attorney's fees and probate costs;

Wealth Creation ("What if I die before I build an estate for my family?")

The third basic need for life insurance is the creation of wealth.

Examples of this need are families who wish to add to their wealth for future generations or to fund their philanthropic objectives. Wealthy families often use life insurance for the creation of additional wealth.

Other Uses for Life Insurance ("I didn't know there were so many other situations where only life insurance will assure me my goals will be reached even if I die!")

Many individuals use life insurance as a funding mechanism in other situations, including:

- buy-sell planning for business owners;
- key employee coverage;
- nonqualified deferred compensation;
- liquidity for *state* death taxes; and
- inheritance equalization (for example, where only one child works in the family business).

Planning Tip: Life insurance is often the *only vehicle that ensures that you will have the necessary liquidity when needed.*

Irrevocable Life Insurance Trusts ("A little planning can provide enormous tax savings.")

Life insurance proceeds are not subject to income tax. However, if the insured owns the insurance policy, these proceeds will be included in the insured's gross estate and, therefore, be subject to federal and/or state estate tax. One simple way to avoid this result is to use a properly drafted and maintained Irrevocable Life Insurance Trust (ILIT). An ILIT that owns the life insurance can avoid federal and estate tax on the life insurance proceeds. Such a trust can also ensure that the life insurance proceeds are available as you intended.

Planning Tip: Use an Irrevocable Life Insurance Trust to purchase, own and be the beneficiary of life insurance. This will ensure that the life insurance proceeds are not subject to estate tax.

Conclusion

Life Insurance is a unique asset that can provide the highest degree of flexibility for changes in the law or changes in your circumstances. Therefore the quality of the life insurance agent and the life insurance company you select are among the most important choices you can make. We recommend that this professional be part of your planning team to help ensure that your life insurance is an integral part of a comprehensive financial and estate plan.

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any questions about this or any matters relating to estate planning.

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