Wealth Planning Insights

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At some point in your life, the following issues may percolate and become items you and your family will need to address:

- Taxes
- Estate planning
- Asset allocation
- Insurance
- Education funding
- Liability management
- Financial and retirement planning
- Philanthropy

UBS can help you with each of these issues as they arise. Throughout the year, *Wealth Planning Insights* will touch on all of these topics. This month, we are focusing on estate taxes and financing strategies in today's low interest rate environment.

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Estate Tax Basics

Estate planning can be a complex subject, but it starts with a simple goal – deciding how you want your affairs to be handled should something happen to you. A successful estate plan should not only reflect your intentions on how you want your estate to be distributed, but should also take into account current legislation to ensure that transfers are structured in the most tax-efficient manner.

Transfer Tax Overview

Estate taxes, along with gift and generation-skipping transfer (GST) taxes, are referred to as "transfer taxes" because they are taxes on the transfer of property. The estate tax is a tax on the transfer of property at death and the gift tax is a tax on the transfer of property during life. The GST tax is an additional tax on transfers—either during life or at death—of property to family members more than one generation removed (such as grandchildren) or to any unrelated person with more than a 37.5-year age difference.

Effective transfer tax planning often begins during lifetime through gifts.

UBS

Annual Gift Exclusion

It may be surprising to realize that a gift could be subject to tax, but this does not necessarily mean that every birthday or holiday gift will need to be reported to the IRS. There is an annual gift exclusion that can be made every year. The current annual exclusion is $13,000 per recipient and can be made to an unlimited number of individuals. For example, if you give $13,000 to ten different individuals for a total of $130,000, the total amount would be eligible for the annual exclusion. If you give $130,000 to a single individual, then only the first $13,000 would qualify for the annual exclusion and the remaining $117,000 may be subject to gift tax. The annual exclusion is indexed for inflation so that it gradually increases over time, in $1,000 increments.

> In addition to the annual gift exclusion, there are also educational and medical exclusions.

Gift-splitting

A married person also has the ability to give twice the annual exclusion amount to a single individual by making the gift on behalf of both spouses (referred to as "gift-splitting") even if the gift itself comes from separate property of only one spouse. Gift-splitting requires the agreement of both spouses, as well as the filing of a gift tax return.

529 Plans and Front-loading

For contributions made to 529 plans, there is also the option to front-load up to five years' worth of annual exclusion gifts in one year. Front-loading allows you to give a larger amount away at one time without exceeding your annual exclusion amount, and a larger gift leads to greater potential appreciation outside of your estate. (If you die during the 5-year period, though, a portion of the gift may be brought back into your estate.) Whether gifts are made directly or through a 529 plan, it is important to keep track of who the recipients are so that you do not inadvertently make an annual exclusion gift more than once to the same individual.

Medical and Educational Exclusions

In addition to the annual gift exclusion, there are also educational and medical exclusions. Payments made directly to educational institutions or medical care providers on behalf of another person are generally not considered gifts, and can be made in addition to the annual exclusion gift.

Together, married couples may be able to transfer up to $10 million dollars tax-free for 2011 and 2012

Current Estate Tax Legislation

In addition to these exclusions, there is also a lifetime exemption amount. Legislation passed in December of 2010 under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRA 2010) increased the exemption for the estate tax and gift tax to $5 million, with a maximum tax rate of 35%. Unlike the annual exclusion, which is an amount per year and per recipient, the lifetime exemption is the total amount that any person can transfer during lifetime. Furthermore, the gift and estate tax exemptions are linked, so any exemption used for gifts made during lifetime reduces the exemption available for estate taxes at death. For example, if a person (the donor) gives away $1,013,000 to any individual other than a spouse, then the first $13,000 is not subject to tax under the annual exclusion and the remaining $1 million will reduce the donor's lifetime exemption amount. The donor's remaining exemption would be $4 million (the current $5 million maximum exemption less the $1 million gift) and would be available for additional gifts during life or bequests at death. Any transfers above $4 million during life or at death (other than transfers to a spouse or to charity) would be subject to tax at a maximum rate of 35%.

Portability & Reversion

Current law also includes a feature known as portability for married individuals, where any unused estate tax exemption at the first death may now be used at the second death by the surviving spouse. Together, married couples may be able to transfer up to $10 million dollars at death with no estate tax. However, all of these provisions (portability, exemption amounts and the 35% tax rates) apply only for 2011 and 2012. Beginning in 2013, absent further legislation, the exemption along with the maximum tax rate reverts back to pre-2001 amounts. The gift and estate tax exemption would go back to $1 million and the maximum tax rate would increase from 35% to 55%.

Estimating the Estate Tax

The first step in determining your potential estate tax is to look at your current net worth. Your net worth should include everything that you own or have an interest in, such as business partnerships, real estate, retirement plans, personal property, or life insurance. The value of these assets will be reduced by any outstanding debts such as mortgages, as well as for estate administration expenses. Once you have determined your net worth, deduct any bequests made to a spouse and to charity because there is an unlimited marital and charitable deduction, so these bequests would not be included in your taxable estate. After expenses and deductions are taken into account, any gifts made during lifetime (not including annual exclusion gifts) are added back into your estate to make sure the gift and estate tax exemption is properly taken into account. Once the gifts are added back and the estate tax is calculated, the tax is reduced by a credit based on the exemption amount.

Total Assets
- Total Liabilities
- Marital Bequests
- Charitable Bequests
Taxable Estate
+ Lifetime Gifts
Estate Tax Base
x Estate Tax Rate (Maximum 35%)
- Available Credit
Total Estate Tax

The first step in determining what your potential estate tax might be is to look at your current net worth

Depending on your state of residence, there may be an additional state estate and/or inheritance tax. Although you will be entitled to a deduction for any state taxes paid, consult with your estate attorney to discuss planning for state-specific laws.

Review Your Estate Plan and Next Steps

In addition to understanding current tax laws, it is important to review your estate documents regularly. Estate documents that are outdated may not take advantage of new exemption amounts and any formulas for funding trusts should be reviewed. There may also be opportunities for additional planning and wealth transfer that may require additional documentation, investment management and monitoring. Coordinate your planning carefully with your estate attorney and financial advisor.

--Bonnie Park
Senior Private Planner

Financing strategies that can help you take advantage of today's lower interest rates

When interest rates are near historic lows, like they are today, it may present certain opportunities for you. While some may appear obvious at first glance, such as refinancing your mortgage, you may

UBS is one of the few lenders to offer mortgages of up to $10 million. So when you factor in today's low rates and the diversity of products offered by UBS Mortgage, this could be the right time for you to discuss what opportunities are available to you today.

not be aware of other strategies that can help you save money on your current liabilities, and prepare for unexpected expenses down the road.

Liability management is a critical component of the investment strategy you have developed with your UBS Financial Advisor. Together, you can review your current liability planning strategy to see if it should be adjusted to take advantage of today's low rates. A few topics you may wish to discuss include:

- Fixed versus variable rate mortgage interest rates
- Advantages of combining a mortgage with a securities backed credit line
- Using credit in a volatile market

Is now the time to lock your rate with a fixed rate mortgage?

The age-old question of whether you should choose a fixed or a variable rate mortgage is especially relevant today. With rates still near historic lows, choosing a 30-year fixed rate mortgage might be a rare opportunity that you should jump on. But keep in mind that there are a lot of factors that should go into making your decision.

The average person buys a new home or refinances every 7.5 years. So if you have a relatively short time horizon, a variable rate mortgage might actually be the right choice for you. For instance, you may be planning to sell your home in a couple of years when your children graduate from college or when the real estate market picks up. In cases like these, a variable rate mortgage (or ARM) could result in lower monthly payments now, giving you greater flexibility with your cash flow.[1]

Determining when an interest-only mortgage is the right choice for you

You may also want to consider an interest-only loan. While they aren't right for everyone, some clients prefer them because they feel this feature gives them more control over what they pay (i.e., prior to maturity of the loan they can choose when and how much principal to pay). Generally, interest-only loans appeal to clients who have the means to repay their loan at any time, but choose to benefit from the tax advantages of a mortgage.[2]

If you are self-employed or receive a substantial amount of your income in a yearly bonus, prior to the maturity of the loan, an interest-only loan allows you to pay down the principal when your cash flow is stronger. And in turn, your next interest-only payment will be lower. That's not the case with a fixed rate mortgage. Paying down the principal for a fixed rate mortgage shortens the period of your loan, but does not affect your monthly payment, month in and month out.

Is it worth it to pay a point up front?

The practice of paying points up front, to lower the interest rate on a new mortgage or a refinancing, is always worthy of consideration. Paying for points may be a good idea if you are planning to stay in your home, without refinancing your mortgage, for a longer period of time. What you need to consider is how long it will take you to break even on the cost of the points paid.

For example, to pay 1 point on a $1 million mortgage, you would have to pay $10,000 up front or finance the cost into your mortgage. If that 1 point discounts your rate by 25 basis points (e.g., from 4.5% to 4.25%), then you would save $2,500 a year, but it will take you four years to break even on the cost of that discount. Considering that today's interest rate market is near historic lows, many clients are refinancing more frequently, even within two years' time. If you are planning to move or refinance in the near term, paying for points may not be right for you.

Another consideration is that the point value changes every day. So if you see that 1 point suddenly reduces your mortgage rate by 50 basis points (0.50%), instead of 25 basis points (0.25%), it may be worth greater consideration. And, if you do choose to pay for points, there may be a tax advantage to paying for the point up front.[2] Your Financial Advisor can put you in contact with a UBS Mortgage Specialist who can help you examine your options.[3]

The benefits of combining a mortgage with a Credit Line

Whether you are looking for a new mortgage or to refinance your current one, the benefits of combining your mortgage with a securities backed UBS Credit Line[4] can yield meaningful savings over time.

Refinancing your mortgage when your loan-to-value ratio has changed

Suppose you bought your property for $1.5 million in 2007. At that time, you took out a 5/1 adjustable rate mortgage (ARM) for $1,200,000 at a rate of 4.5%. Looking at current rates, you want to refinance, but unfortunately, your home value has dropped and can only support a mortgage of $1 million. In order to refinance this loan, you'll need to pay it down by $200,000. However, you also have $2 million in eligible assets at UBS, and you don't want to liquidate your portfolio to pay down the mortgage.

One option available to you is that you could pay down your mortgage with investment assets, but today's market may not be the right time to liquidate. Alternatively, you could borrow $200,000 against those securities at 2.989% (variable rate as of 9/30/11)[5] and use those funds to pay down your mortgage.[6] Now, you're more likely to be able to refinance, and your new 5/1 ARM of $1 million has a rate of 3.451% (rate as of 9/30/11).[7] So instead of paying approximately $54,000 a year ($1.2 million x 4.5%) in mortgage interest payments, your refinance brings that down to approximately $40,488 [($200,000 x 2.989%) + ($1 million x 3.451%)] or ($5,978 + $34,510)]. By combining a mortgage refinancing with a securities backed UBS Credit Line, you would *save over $13,000 in interest, annually.*

Note: This example is hypothetical and is intended only as an illustration of how a particular product may work for one particular client.

Accessing a convenient financing source for sudden real estate opportunities

A securities backed UBS Credit Line can also help you with a new real estate purchase. With a pre-approved UBS Credit Line your funding will be readily available up front and this can enable you to improve your position during the negotiation process. And in this current environment, there are more distressed sales where the buyer has to move fast, so a UBS Credit Line gives you the opportunity to act quickly when time is of the essence. Then, after you close on the property using funds from your UBS Credit Line, you could repay your securities backed loan with the proceeds of your mortgage. This new mortgage would offer the same pricing and guidelines as if you had secured it when you purchased the property. (Please consult your tax advisor prior to implementing this strategy to ensure that the new loan will meet the tax requirements for the deductibility of interest.)

Gaining financial flexibility in a volatile market

When interest rates are this low, it's natural to think about using a securities backed UBS Credit Line to consolidate higher interest debt to save money immediately. And, of course, a UBS Credit Line can be used for your personal needs and business expenses. Another advantage to a Credit Line is the financial flexibility it can give you during a volatile market.

Riding out market fluctuations with greater access to liquidity
You may be planning for a significant business or personal expense at a specific point in time. You have a $1 million portfolio and you're in a basket of 20 equities. If the markets are doing well, you can hang on to your assets until right before you need the liquidity and then sell. However, when the economy is uncertain, you run the risk of needing to sell on a down day.

With a UBS Credit Line, you may choose to ride out market fluctuations and use your securities backed Credit Line for your short-term liquidity needs. You and your Financial Advisor have put a lot of thought into your long-term investment strategy, because that's what it takes to reach your long-term goals. A short-term need for cash can disrupt those plans, and a Credit Line gives you another option. You can use it when you need liquidity and wait to sell assets when the market is more favorable.

Your Financial Advisor can help you better understand your opportunities
A lower interest rate market like this one doesn't come along every day. These strategies are just some of the ways you can use this market to your advantage. A liability planning conversation with your UBS Financial Advisor can unearth other possibilities that could impact you today, and for years to come.

-- *Stephen Dahlan*
Head of Mortgage Sales

--*Cinnamon Chaney*
Banking Products Consultant

[1] In contrast to fixed rate mortgages which bear interest at a set rate, adjustable rate mortgages (ARMs) bear interest that fluctuates in concert with a particular reference rate (e.g., the one-year London Interbank Offered Rate (LIBOR)). While in declining rate environments you may benefit from having an ARM instead of a fixed rate mortgage, in rising rate environments you may be at risk of paying higher rates of interest on your ARM than you would on a fixed rate mortgage. You should consider this, plus other differences between ARMs and fixed rate mortgages, carefully before deciding what type of mortgage is right for you.

[2] Neither UBS Mortgage nor UBS Financial Services Inc. provides legal or tax advice. You should consult your legal and tax advisors regarding your specific circumstances.

[3] UBS Financial Advisors are employees of UBS Financial Services Inc. UBS Mortgage Specialists are employees of UBS AG, Tampa Branch.

[4] Credit Lines are provided by UBS Bank USA, an affiliate of UBS Financial Services Inc., and are subject to credit approval.

[5] The interest rate for UBS Credit Lines is subject to change at any time at the discretion of UBS Bank USA.

[6] This assumes that you have margin-eligible securities with a lending value equal to at least $200,000. The lending value is determined by UBS Bank USA in its sole discretion.

[7] The mortgage interest rate is subject to change at any time without notice at the discretion of UBS Mortgage. 5/1 ARM: The first 60 months will be at a payment of $4,463.14 with an estimated simple interest rate of 3.451%; the next 300 months will be at a payment of $4,308.44 with an estimated rate of 3.125%.

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