

perspectives on  
**ESTATE &  
FINANCIAL  
PLANNING**

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## The Price of Estate-tax Repeal

UNDER CURRENT LAW, THE FEDERAL ESTATE TAX DOES NOT APPLY IN THE YEAR 2010.\* ALTHOUGH THAT MAY SEEM TO BE A POSITIVE CHANGE, ESTATE BENEFICIARIES WON'T NECESSARILY BE BETTER OFF IF THE REPEAL TAKES EFFECT AS SCHEDULED. AS IS SO OFTEN THE CASE WITH TAX LAW PROVISIONS, THE DEVIL IS IN THE DETAILS.

A look at the details of estate-tax repeal reveals that beneficiaries who inherit property in 2010 could owe a substantial amount of *capital gains* taxes if they sell their inherited property. Here's why.

### How It Works Now

While the estate tax is still in effect, the cost basis of inherited property is generally "stepped up" to the property's fair market value at the time of the owner's death. This basis step-up rule lets beneficiaries who sell inherited property avoid capital gains tax on appreciation that occurred during the owner's lifetime.

**Example.** In 2007, Jill inherits stock from Jack that he originally purchased for \$100,000. Instead of using the stock's \$100,000 cost when figuring her capital gain, Jill can use \$500,000, the stock's market value on Jack's date of death. So, if Jill sells the stock for \$500,000, her capital gain will be zero.

### A Big Shift

A big shift in the basis step-up rules takes effect in 2010 when the estate tax is repealed. The step-up available to an estate will generally be limited to \$1.3 million, plus another \$3 million for property passing to a surviving spouse. This change means that some beneficiaries could face large capital

gains tax bills when they sell the property they've inherited.

**Example.** Lou dies in 2010, leaving his entire \$3.5 million estate to his daughter Linda. The \$1.3 million basis step-up is allocated to three parcels of land that are included in Lou's estate. Like Jack, Lou also owned stock worth \$500,000 that he originally purchased for \$100,000. While

Jill escaped capital gains tax on the sale of her inherited stock, Linda will have a \$400,000 capital gain if she sells her stock for \$500,000.

... estate beneficiaries won't necessarily be better off ...

### A Trade-off

Given the change in the step-up rules, is estate-tax repeal the benefit it appears to be? In the previous example, Lou's estate pays no estate tax in 2010, but the same would be true in 2009 when a \$3.5 million effective estate-tax exemption applies. Because of the capital gains tax burden, repeal offers no overall tax benefit to Lou's family. Of course, in other situations, estate-tax repeal will be beneficial.

Are you wondering how all this could affect you and your family? Our professional planning assistance *before and after* repeal of the estate tax can help you successfully navigate the law's complexities.

\* Unless Congress makes a change, however, the estate tax will be restored in 2011 with a low \$1 million exemption.

## New IRA Rollover Opportunity

ROLLING OVER INHERITED RETIREMENT PLAN MONEY INTO AN INDIVIDUAL RETIREMENT ACCOUNT (IRA) CAN MINIMIZE INCOME TAXES BECAUSE DISTRIBUTIONS FROM THE IRA CAN BE STRETCHED OUT OVER MANY YEARS. BEFORE 2007, ONLY A SURVIVING SPOUSE COULD TAKE ADVANTAGE OF THIS DESIRABLE TAX STRATEGY.

A recent tax law change allows *nonspouse* beneficiaries to roll over money inherited from a qualified retirement plan participant into an *inherited IRA*, if the plan permits.

### Stretch Distributions

As a nonspouse beneficiary, moving money into an IRA generally lets you benefit from long-term tax deferral by taking your distributions in installments *over your life or life expectancy*. By keeping the money in a tax-deferred environment for as long as possible, you'll have a bigger pot of money for investment.

### Essential Requirements

To qualify for the tax advantage, you must have the retirement money directly transferred from the retirement plan's trustee to the trustee of your new inherited IRA *and* have the IRA set up with the specific title (naming the plan participant) that the law requires.

... roll over money inherited from a qualified retirement plan participant. ...

If for any reason the inherited IRA is mistitled or the transfer is misdirected — for example, if the transfer should pass into your own previously established IRA or a non-IRA account — the entire distribution becomes taxable.

### An Exception

Note that your ability to stretch out distributions will be limited if the participant died before reaching his or her required beginning date (RBD) for taking minimum distributions from the plan, *and* the plan calls for a five-year payout of the entire account. In that situation, you can stretch distributions from the rollover IRA over your life expectancy only if you make the rollover before the end of the year following the year of the participant's death. (The RBD for most participants is April 1 of the year after the participant turns age 70½.)

Please ask us if you want to know more about a nonspouse IRA rollover.

## Protecting Elderly Parents' Assets

YOUR PARENTS OR YOU MAY NOT WANT TO THINK ABOUT IT, BUT ADVANCING AGE STEADILY INCREASES THE RISK OF DISABILITY DUE TO A STROKE OR OTHER PHYSICAL OR MENTAL CONDITION.

If such a problem occurs, a court may step in to appoint a guardian to take charge of your parent's finances. A guardianship can be awkward, and the court could appoint someone that neither your parent nor you would choose.

A much better solution may be for each of your parents to execute a power of attorney in advance of any need. A power of attorney is a document giving another person legal authority to act *as specified* on the power giver's behalf. A power of attorney to manage your parent's financial affairs if he or she ever becomes incapacitated can ensure that assets will be well cared for.

### Flexibility

A power of attorney can be as broad or as narrow

as its creator wishes. Also, as long as the creator of a power of attorney remains competent, he or she can revoke or change it at any time.

### Who?

A person who is given a power of attorney should be trustworthy and capable of making prudent financial decisions. For example, that individual might be you, another family member, or a reliable professional. It may even be appropriate to appoint more than one individual.

... protection that must be arranged ahead of time.

### Timing

A power of attorney is protection that must be arranged ahead of time. Once someone becomes disabled, it's too late. Consult your attorney for more information.

# Constructing Your Portfolio

THE POSSIBLE PORTFOLIO VARIATIONS ARE ENDLESS. YOU MIGHT INVEST ONLY IN MUTUAL FUNDS. YOU MIGHT INVEST ONLY IN INDIVIDUAL SECURITIES. OR YOU MIGHT BUILD A PORTFOLIO THAT MIXES FUNDS AND INDIVIDUAL SECURITIES. HERE ARE SOME CONSIDERATIONS THAT MAY HELP YOU DECIDE HOW YOU WANT TO STRUCTURE YOUR PORTFOLIO.

## Management

When you invest in individual securities, you always stay in control. You're free to buy and sell your securities whenever you want based on your own reasons, including the impact of a capital gain or loss on your personal income-tax situation.

With a fund, there's much less control. While you're always free to sell your fund shares or buy more, the fund's professional managers make the other investment decisions, including when to realize taxable capital gains. These are automatically distributed to you and the other fund shareholders, along with the fund's other income.

Still, the professional management available with funds can be very advantageous if you don't have the interest or knowledge to choose your own securities. Alternatively, you could hire a professional investment advisor to help you create and monitor a portfolio of individual securities.

## Diversification

The amount you have to invest can be an important factor. Diversifying a portfolio of individual securities to help control overall risk is not very practical if you have only a limited amount to invest. With a mutual fund, even a small investment can be well diversified. Most funds invest in a large number of different securities. And you can diversify even more by investing in several funds that hold different asset classes or invest in different market sectors.

The amount you have to invest may also affect a funds-versus-individual securities decision in another way. Many mutual funds let you invest smaller amounts than are practical with individual securities.

## Costs

You typically pay brokerage fees whenever you buy or sell individual securities — either a per-trade or percentage fee that may be relatively high if you make small purchases. With a mutual fund investment, you pay an annual management fee and other expenses instead and — with some funds — also a sales charge called a "load." The fees and expenses that funds

## Evaluating Mutual Funds

You can't use a fund's past results to predict its future performance, but you can carefully examine the fund's consistency of performance over multi-year periods (market cycles), investment strategy, expenses, and management stability.

charge vary greatly, so examine the costs carefully before you decide to invest in a particular fund.

## Use of Time

Becoming a serious investor is time consuming. It's important to research individual securities before you buy or sell and to periodically monitor both your portfolio and overall market conditions. If you'd rather use your personal time for other activities, you may want to build your portfolio with mutual funds. Because they're designed to handle the securities selection, buying, selling, and recordkeeping for you, you can limit yourself to selecting the funds and periodically evaluating their performance — just as you would do if you hire a professional manager for a portfolio of individual securities.

The structure of your investment portfolio is always a personal choice that reflects many factors, including among others, your knowledge of and interest in investing, individual tax situation, goals, and risk preferences.

**With a mutual fund, even a small investment can be well diversified.**

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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## Planning Briefs

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### New Mortgage Insurance Tax Deduction

Congress has a new deal for mortgage borrowers. For qualified residential mortgage contracts issued in 2007, the cost of mortgage insurance premiums paid or accrued in 2007 is fully deductible, provided adjusted gross income (AGI) is \$100,000 or less (\$50,000 or less for married-separate filers).<sup>3</sup> Unless extended, the deduction ends after 2007.

### Social Security Wage Base Rises

Social Security taxes are up again for individuals with substantial incomes. In 2007, the earnings cap is \$97,500 for the 12.4% Social Security tax (payable half by employers, half by employees or 100% by the self employed). In 2006, the cap was \$94,200.

### Do Taxes Drive Charitable Giving?

Not according to a recent study by the Center on Philanthropy at Indiana University. Among responding households with incomes over

\$200,000 or assets over \$1 million, 52% would give the same amount *with or without* an income-tax deduction, 38% anticipated a minor decrease in contributions if they received no deduction, and only 7% expected a dramatic decrease without a deduction. Similarly, 56% of the respondents said that the amount they would leave to charity in their estate plans would not change if the estate tax were repealed.

### Can We Help?

As experienced professionals, we can provide you with a wide variety of services to meet your financial planning needs. These services include:

- Income-tax Planning
- Estate Planning
- Estate Valuation
- Retirement Planning
- Business Planning
- Accounting