



Toledo  
Community  
Foundation

Inspiring and Connecting Thoughtful Giving

# "Giving" Advice

## Toledo Community Foundation

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### About Your Foundation

Since 1973, the **Toledo Community Foundation** has provided individuals, families and businesses interested in the well-being of our community with an *efficient, effective, low-cost, professionally managed* mechanism to achieve their charitable goals.

For philanthropists wishing to maximize the impact and life of their charitable gifts, the Foundation provides *resources for thoughtful giving*. Using its expertise and personalized services, **Toledo Community Foundation** helps donors transform their philanthropic impulse to measurable community impact. Beyond the gifting of assets, the Foundation helps donors identify issues of importance to them and *inspires engagement* with community organizations addressing these issues, thereby maximizing the impact of charitable gifts and creating a greater sense of fulfillment.

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## Estate Taxes Remain in Flux

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Financial planners can use various strategies to navigate the estate-tax repeal. But, here's the burning question: Is the repeal is here to stay? Even if the repeal or reinstatement of the estate tax is resolved by the time you read this, there are long-term planning lessons you can learn.

On Feb. 2, Treasury Secretary Timothy Geithner and Senate Finance Committee Chairman Max Baucus (D-Mont.) said that they support extending the 2009 estate-tax rates to 2010, and that the tax increase should be retroactive to Jan. 1, 2010. Whatever happens, you can bet that the problems created by this legislative tax mess will forever change estate planning.

Investors often try to coordinate losses to offset gains by tracking tax basis. Until 2009, tax basis was relatively easy to determine on inherited assets-it was the fair value at death. But if the repeal remains real, the carryover basis rules require that the decedent's initial purchase price be determined. Determining tax basis will get harder for wealthy heirs who will need to consider far more holdings with lower basis than before. Even if the estate tax repeal is made retroactive, issues may remain.

Assume your client died in January 2010 while the estate-tax repeal was real. His children received distributions from the estate and some sold the securities they received. Now, say estate-tax repeal is made retroactive. They have to recalculate the tax basis. If you assumed no step-up when helping them decide, those decisions might turn out to be wrong. The children may be asked to refund money to the estate when they've already

spent the funds received.

### Gifting Challenges

Those born with a silver spoon in their mouth could also have a rude awakening, as parents and other benefactors may cut back on gifts. Even if the estate tax is reinstated, it will likely have a \$3.5 million exclusion. Very few clients will face a federal estate tax, which had been a major motivator to make gifts. If clients believe that the estate tax will remain repealed, they are likely to revisit their estate planning documents. Many may revise the gift provisions under all durable powers. Whichever scenario emerges, the purpose of gift clauses should be reevaluated. Clients should also assess whether they want to bear the risk of authorizing an agent to make gifts if the only tax benefit is a state estate tax savings that may not materialize. This all follows the reduction in family gifts and related planning triggered by the recession and stock market meltdown. Not the best time for trust fund babies.

### Tax Challenges

If the carryover basis remains law, affluent clients will have a much lower tax basis on inherited assets and much higher capital gains on tax rates on sales. So the old tricks that were popular before George Bush reduced the capital gains tax rate will be back again. Even if the estate tax is reinstated and the carryover basis deep-sixed, the almost certain increase in capital gains tax rates will reinvigorate the same planning. Such techniques as charitable remainder trusts, 1031 exchanges and exchange funds will become even more important.

### What To Do?

These new trends, coupled with the estate-tax changes contained in President Barack Obama's budget proposals and an eventual resolution of the estate-tax quagmire, are creating a fluid situation. Advisors should maintain regular communications with clients.

Also bear in mind that as a financial advisor you will, under the Prudent Investor Act, have to consider the tax consequences of investment options. How do you advise an executor on what to sell and what to hold when the state of the law, and the tax basis in the assets he has a fiduciary responsibility to manage, are uncertain? Clients, particularly if serving as executors and trustees, should make a more concerted effort to update investment policy statements (IPSs) regularly and confirm that the IPSs are consistent with the trust's or will's investment mandates.

Whatever the outcome, estate-tax repeal has created unfathomable complexity and problems for advisors and their clients. Waiting for Congress to act could cost your clients. It's time to reemphasize some points that customers tend to ignore:

\* Clients need to invest more time-and money-to have more complex documents that can anticipate a greater array of situations. Even if the estate tax is repealed, how many wills and trusts have well-thought-out investment provisions that coordinate the myriad issues a particular client faces? Too few do so. In many

documents, consider a more comprehensive use of investment advisors, trust protectors and other specialized fiduciaries.

\* Coordinating advisors is even more important. An estate planner can't reasonably advise a client about administering an estate, planning a trust or taking other common steps without coordinating with the financial planner and certified public accountant.

\* Annual meetings with all advisors, not just investment managers, are more important than ever. Once the current storm clouds roll by, new ones will appear. The clients who make the effort and incur the modest incremental costs to have all their key advisors communicate will be better protected.

### Estate Tax Limbo

How would an estate-tax limbo affect financial planners? General estate planning has dictated that assets should be divided 50/50 between spouses based on the value of those assets. That way, no matter which spouse dies first, there will be sufficient, or at least reasonable, assets in that spouse's name to fund a trust to safeguard his or her estate-tax exemption. This trust, a cornerstone of estate planning, is called a bypass trust (since it bypasses estate tax on the surviving spouse's estate) or a credit shelter, or applicable exclusion trust (after the tax terminology for the amount that could pass free of estate tax).

Of course, there is no estate tax-for the moment. Now, rather than maintaining equal accounts, each spouse should hold approximately equal amounts of unrealized appreciation. This is the only way to maximize the use of the \$1.3 million and \$3 million basis adjustments. Client accounts need to be reevaluated and juggled. Plus, if Congress reinstates the estate tax, do you then go back to dividing accounts 50/50 by value?

In a word, yes. But here's a simpler solution: Retitle all your clients' non-retirement investment accounts as "tenants in common," so no matter which spouse dies first, half the assets are in his or her name. When Congress makes up its mind, you can revert to your previous approach if you wish. But if you think you can ignore this mess until Congress cleans it up, how will you explain to heirs that they lost out on most of their tax benefits because you didn't want the administrative burden of changing an account title?

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