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"Giving" Advice

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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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Let the Tax Games Begin

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Financial Planning

The estate tax was repealed as of Jan. 1, 2010, and the impossibly arcane carry-over basis rules that succeed it are now law. But who knows? By the time you read this the estate tax may have been [select from the options below]:

- A) Reinstated
- B) Reinstated retroactive to Jan. 1
- C) Reinstated prospectively, but with the carryover basis rules retroactively repealed to Jan. 1
- D) Reinstated with different rates or different exclusions
- E) Who knows?

Since there have been estate planning articles and webinars galore on the general impact of estate-tax repeal, we'll focus on the specific implications of the estate-tax "limbo" on financial planners. If Congress has acted to resolve the uncertainty (wait, I'm rubbing my rabbit's foot) by the time you read this, the following analysis might still provide some insight into the relationship of the planning process to estate planning. If not, it will certainly

serve as a brain exercise, so you can skip your evening Sudoku puzzle.

TIME TO RETITLE

General estate planning has dictated that assets should be divided 50/50 between spouses. 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).

But wait! There is no estate tax-for the moment.

Estate-tax repeal brought with it a new concept called carryover basis. Instead of paying estate tax and/or getting a step-up in basis, heirs will inherit assets that retain the same tax basis the parent (or other benefactor) had. The likely result: large capital gains taxes when heirs liquidate the bequest. There are two important exceptions to this rule. First, on death, up to \$1.3 million in appreciation can be eliminated. Second, on assets passed to a surviving spouse, an additional \$3 million in appreciation can be eliminated.

Look how these varying laws alter the way you'd title clients' investment accounts. Before 2010, you divided assets 50/50 by value. Now, rather than 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.

But wait, there's more. If Congress reinstates the estate tax, do you then go back to dividing accounts 50/50 by value? Yep. Head spinning yet?

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?

OLD DOG, NEW TRICKS

In the good old days (2009 and before) most folks just named an executor to handle their estate. This may no longer suffice. If it is uncertain whether the estate tax will exist, or have an exemption of \$1 million, \$3.5 million or some other figure, how can you create a will that will be flexible enough to work? If the carry-over basis rules remain law, who will decide which assets get basis increases and which do not-and therefore bear greater future tax burdens? Hence, you really need an independent person to call the shots.

Consider an entirely new concept. Clients could designate a "special" executor whose sole function is to make certain tax determinations. Bear in mind that these "limited" tax decisions, considering the combination of

income, gift, estate and generation-skipping transfer (GST) taxes, could substantially affect the value of many estates. How can these decisions be coordinated with those of the surviving spouse? How far can the role of some type of special executor be carried? What would state law say? Despite the uncertainty, this approach may offer a practical solution while the estate-tax mess is sorted out.

A WILL, BUT NO WAY

Wills should also have express language authorizing the executor to allocate the \$1.3 million general basis adjustment and the additional \$3 million spousal basis adjustment. This power probably should be exercised by an independent person, not a beneficiary. This is far from a simple matter, as the possibilities are endless. For example:

- * If a property, such as a family cottage, is intended to remain in the family for generations, it is less in need of an allocation to increase basis than are other assets that are more likely to be sold.
- * Are there alternative ways to avoid, defer or minimize the potential future capital gains tax?
- * What will be the capital gains tax rate?
- * What will be the tax bracket and status of the beneficiaries receiving the property?

WHICH MUNICIPAL BONDS?

This decision will take a couple of steps, but it is worth the bother. Here goes: One of the big issues you've read about is that formula clauses-which are ubiquitous in wills-have entered the estate-tax Twilight Zone. Example: Joe is worth \$10 million. Joe's will provides that his children from his first marriage get the maximum amount he can bequeath without triggering estate tax. Wife No. 4 gets the remainder.

In 2009, the kids would have gotten \$3.5 million. Now the entire \$10 million estate will pass to the kids and Wife No. 4 gets zip. So what does this have to do with muni bonds? Hold on.

The new wife counters that the happy couple lived in New York, one of several states with an estate tax. So only \$1 million could pass tax-free. The children counter that no, the couple actually was domiciled in Florida, which has no estate tax, so the \$10 million goes to them.

When you select municipal bonds for wealthy clients, which state do you presume they live in? The estate-tax shenanigans may cause them to change domicile. So if you watch your assumptions and have the clients indicate in a new account form that they live in New York, the kids may view you as part of the plan to reduce their inheritance. Don't get caught in the soup.

LIFE INSURANCE-OR NOT?

Some clients may question the need for life insurance if the estate tax is no more. Few, perhaps no, tax advisors believe that we have really seen the end of the estate tax. So cancelling insurance is likely a mistake.

Whatever happens to the estate tax, income tax rates are expected to increase in coming years. The tax-favored status of insurance has never been put on the table, so this significant advantage not only appears intact, but is likely to become more valuable over time. Finally, if the carryover basis rules do persist, heirs may need insurance protection for the large capital gains taxes they will face-which will replace the estate tax, to a degree.

But this will raise a new problem. Insurance trusts have been structured to provide distributions to those likely to pay estate tax. The heirs that may face increased income taxes under the new carryover basis regime might be different people. Fun!

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