Gianno & Freda's Trusted Advisor

Summer 2016

Summertime – the kids are out of school, vacation time is upon us, and families are headed for their Cape Cod summer. This is an ideal time to reflect upon your accomplishments and review your planning to ensure a successful retirement and provide for the loved ones that surround you. I write to you as I prepare to participate in the AICPAs 2016 Annual Advanced Estate Planning Conference (in Washington D.C. this year). These days, this conference is significantly different than it was when I began my almost annual involvement in the late 1980s. A major reason is the enormous changes to the estate tax laws over the past decade. Thus, the planning techniques employed in the past will not succeed today. In fact, the estate planning world is tipped upside down. Now, let's consider the opportunities and pitfalls in today's estate planning, long-term care planning, and the importance of reviewing beneficiary designations.

Today's Federal Estate Tax

Currently, the first $5.45 million of assets you own escape federal estate taxes ($10.9 million for a married couple). This means that today roughly 2 in 1,000 estates will be subject to the federal estate tax. As recently as 8 years ago that limit was $2 million per person. In light of this major change in the tax laws, when was the last time you reviewed your estate planning documents (your will or revocable living trust, other trusts, health care proxy, durable power of attorney)? I see many individuals and couples that have not reviewed their plans in years, some in decades. **Failure to update your plans to reflect the current tax laws can result in repercussions and stress for the loved ones you leave behind.** For example, the typical estate plan of the past used formulas designed to both minimize the estate tax on the first spouse to die while maximizing that spouse's estate tax exclusion. **That same formula today would leave everything up to $5.45 million to a trust that restricts the surviving spouse's access, and leave nothing to the surviving spouse.** I suspect this is not what you intended.

What to do? In most cases, and certainly for any estate of a married couple with less than $2 million in assets (the Massachusetts exclusion amount), you want your estate to be subject to estate tax to achieve the lowest possible tax result. Why? Because capital gains taxes can be reduced on inherited assets received from a decedent's estate. These inherited assets receive what is referred to as a "step-up in basis".

> *Mr. Taxpayer owned an investment portfolio that included ABC stock that he purchased many years ago for $5 per share. When he died on April 15, 2016 (due to shock from his tax bill) the stock had appreciated in value to $40 per share. If he sold the stock prior to his death he would have paida tax on the $35 capital gain. Because the stock passed through his taxable estate, his beneficiaries' basis in the stock is "stepped-up" to $40 per share, the date of death value. Later sale will avoid tax on the $35 of appreciation over the years.*

Assuming Mr. Taxpayer's total assets were less than $1 million at death, there is no tax cost to allow his beneficiaries to avoid a capital gains tax (at a rate over 28%) on the sale.

What has turned the estate planning process upside down is the fact that the income tax today represents a much larger burden in proportion to the estate tax (for all but the "super rich"). This change is reflected in many of the expert presentations delivered to the Annual Estate Planning Conference over the past few years. It is also reflected in the strategies we've developed to include more assets in the taxable estate, vastly contrary to previous strategies designed to exclude assets from the taxable estate.

If you haven't reviewed your estate planning in a few years, chances are you will find that tax law changes have undermined your plan. Give me a call to get together and review your existing estate plans to ensure you are minimizing your exposure to combined estate and income taxes. I work with many qualified attorneys across the country that can assist you in updating your plan.

IRAs, Pensions and Beneficiaries

Bruce and Anne were married for 20 years when Anne, a retired school Principal died suddenly at 61 years old. Anne's Teachers Retirement System pension provided for a lump sum payment of over $900,000 at her death. The annual pension report sent to the couple stated that Anne had no named beneficiary on her pension plan. Naturally, it was assumed that Bruce, as her surviving spouse, would receive the pension lump sum at her death.

Not so fast. After Anne's death, pension officials found a beneficiary form signed 27 years earlier (before she met and married Bruce) listing Anne's mother, uncle and sister as beneficiaries. Only Anne's sister survived her, so she was awarded the lump sum payment. Anne's sister refused to talk with Bruce, who was left destitute by the loss of the pension income. The pension system legal representative, armed with the 27 year old beneficiary designation, flatly contended that it was complying with the law in paying the pension to the sister.

Bruce took the case to court and lost. On appeal, he lost again. His attorney, sobered by the setbacks, proffered this advice to couples,

"Make sure you update your pension beneficiary forms. If you don't, your spouse and family may end up with nothing".

Your pension and/or IRA accounts often make up the largest portion of your savings for retirement. Properly designating your beneficiaries can provide a tremendous tax advantage to your heirs. Done right, your heirs will have the ability to stretch out the distribution period over their lifetimes, effectively deferring tax for years if not decades (as opposed to 5 years without proper designation).

Some key points to keep in mind:

1. Don't leave the beneficiary designation blank or name a deceased person. If you do, the custodial agreement with the institution that holds your IRA controls the distributions, and those agreements differ widely. In one case, a custodian refused to stretch out the distributions over the life of the surviving spouse. In order to achieve the tax deferral of the stretch we had to change the financial institution that held the account. Ideally, you should name a primary beneficiary and alternate beneficiaries in case the first one dies. Name individuals because they have a life expectancy that can be used for deferring the tax by stretching the distributions over their lifetimes.

2. Make sure your beneficiary form is on file with the custodian, the financial institution that holds your IRA or retirement investments. Unfiled, it will have no effect.

3. Do Not Name Your Estate as Beneficiary. To begin with, estates have no life expectancy so that distributions cannot be stretch out beyond 5 years. Secondly, IRAs and pensions have special protection from creditors. If it passes into the estate the protection is gone, the funds can be applied to pay the decedents final bills, and the funds used to pay those bills are subject to income tax in the estate (taxed at a much higher rate than individuals). So, when did you last review the beneficiary designated to receive the balance of your IRA, annuity or other retirement plan? These accounts pass on without regard to the beneficiaries listed in your will or revocable trust. Failing to ensure that the right beneficiaries are named can leave your loved ones with much less than you intended. Call me to review your list of such plans and ensure that you know where they are going.

Long Term Care and Asset Protection

At a recent national conference we were treated to an extraordinary presentation on long-term care. Ben Neiburger, JD, CPA, noted Elder Law Attorney and Educator from Elmurst, IL, spoke to his publication "Helping Clients in Crisis" the debut guide in his " Caregiver Storm" series. The unusual aspect of his presentation was its total focus on planning for the personal and emotional strains related to long term illness. He opened

with the love story of his clients, Mike and Laura. Laura had developed Alzheimer's disease, and Mike was wearing down under the stress of her care. Like many caregivers, the stress on Mike put him at higher risk of death or serious illness than Laura. Ben worked closely with Mike and his sons to employ his "10 Guiding Principles" designed to ensure the best possible care for Laura while helping Mike and his sons keep their health, life, careers, marriages and, families intact.

For the balance of his presentation Ben discussed each of the 10 Guiding Principles at length. For each principle he provides a checklist of steps you can take to implement the principle for the benefit of all. The 10 checklists provide an excellent map through the stress and confusion of caring for a loved one in need.

I urge you to call me for a copy of Ben's handout and read his 10 Guiding Principles and follow the checklists. Share the information with your friends and family members. The time you invest with this piece will yield benefits for all involved for years to come.

I'll leave you with this…

Accuracy is important. This example shows the importance of accuracy in your tax return. The IRS returned the Tax Return of a man in New York City after he apparently answered one of the questions incorrectly. In response to the question ... "*Do you have anyone dependent on you*?" The man wrote: "*16 million illegal aliens, 1.1 million crack-heads, 4.4 million unemployable scroungers, 80,000 criminals in over 85 prisons, plus 450 idiots in Congress and a group that call themselves politicians.*"

The IRS stated that the response he gave was unacceptable. The man's reply to the IRS was ... "*Who did I leave out*?" Have a Great Summer! *Mark Gianno*

Gianno & Freda

The Right Direction For All Your Financial Decisions

Gianno & Freda Financial Center • 235 Barnstable Rd. Hyannis, MA 02601
800-698-TAXX • 508-778-5555 • Fax: 508-778-5556
email: mark@giannoandfreda.com • visit us at giannoandfreda.com

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