

Joseph Capital Management, LLC's

Perspectives for Wealth Advisors

May 4, 2009

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Mike Tringali,
Managing Director:
"Even with permanent estate tax exemptions, qualified estate planning counsel will be needed to ensure inherited wealth passes in the manner desired, at the time desired, and with the impact desired."



John Ceparano,
Director of Business Development:
"The challenges posed to attorneys and other professionals whose practices are devoted to estate tax planning will be many, but new opportunities exist for those with the courage to embrace change."

Federal Estate Tax Reform: Implications for Professional Practices

Overview: The 2010 Budget Resolution Passes

On April 29, 2009, the U.S. House (by a vote of 223 to 193) and the U.S. Senate agreed (by a vote of 53-43) to the Fiscal Year 2010 Concurrent Budget Resolution. This resolution serves as a blueprint for revenue and spending bills for Congress for the remainder of this year. \$764 billion in tax cuts were included in the conference agreement, including:

- \$512 billion to extend middle-class tax cuts, such as the 10 percent bracket, the child tax credit, marriage penalty relief, and education incentives, as well as the other 2001 and 2003 tax cuts extended in the President's budget for taxpayers making under \$250,000;
- \$214 billion for three years of AMT reform;
- \$72 billion to match the President's estate tax reform proposal – which would permanently extend the 2009 level of a \$7 million exemption for couples and \$3.5 million for individuals; and
- \$54 billion for two years of other tax extenders and \$9 billion of other tax cuts.

The U.S. Senate Finance Committee and the U.S. House of Representatives Ways and Means Committee now take up the legislation which gets into the specifics of each proposal.

Income Tax Provisions. The Concurrent Budget Resolution maintains the existence of the 10-percent marginal tax bracket, but calls for an increase in the high-end marginal tax brackets from 33 and 35 percent to 36 and 39.6 percent after 2010. The Resolution also allows for the continuation of the increased child tax credit and the enhanced education credit called the American Opportunity Tax Credit, as they exist for the 2009 tax year. Other tax-cutting features of laws passed in 2001 and 2003, which were set to expire in 2011, are also extended for five years.

The budget resolution also provides for a "patch" of the alternative minimum tax (AMT), but only for 3 years. Congress is still unwilling to "bite the bullet" to permanently fix the AMT. The AMT exclusion amount will be adjusted slightly each year for inflation, based on the exclusion amounts applicable in 2009. With this relief, millions of taxpayers (but not all) will remain out of the clutches of the AMT.

The "PAYGO" budgeting process will apply to any further budget adjustments (but not to the Budget Resolution just passed). Hence, any additional spending or tax relief, not already set forth in the Concurrent Budget Resolution, must be offset by new taxes or spending cuts.

See pages 2-3 for discussion of estate tax changes. See last page for ways Joseph can assist you.



About the Author.

Our Director of Research, Ron A. Rhoades, JD, CFP®, possessed a boutique estate tax planning law practice in Florida for over 20 years. He now serves as Director of Research and Chief Compliance Officer for Joseph Capital Management, LLC, where he frequently consults with CPAs, estate planning attorneys, and other professionals on how to better meet the holistic planning needs of clients.

Ron is a 1985 honors graduate of the University of Florida College of Law. He has authored several books, including *Estate Planning for the Florida Resident: Questions and Answers* (1995) and (with John Ceparano and Mike Tringali) *The Science of Investing: How to Use Academic Research to Reduce Risks and Increase Returns*. (2003). Ron is a frequent speaker at national conferences, and he is often quoted in national media.

Estate Tax Provisions of the FY 2010 Budget Resolution

Unlike the “temporary” fix for AMT, the budget resolution does provide for a *permanent* fix of the estate tax, by extending the provisions in effect in 2009 indefinitely into the future. Therefore, the amount of a gross estate exempted from estate tax, currently at \$3.5 million (in 2009), will remain in all future years. Also, the rate of estate tax applicable to the estate in excess of \$3.5 million will remain at 45 percent. There was widespread support among Democrats for this level of the estate tax exemption, making future reduction of the federal estate tax applicable exclusion amount unlikely.

A new feature of the federal estate tax will likely be the “portability” of the exemption of the first spouse whose lifetime ends, to

the second spouse. Under this provision the surviving spouse receives a \$7 million applicable exclusion amount (assuming all of the first spouse’s estate qualified for the federal estate tax marital deduction).

According to the Administration, the new estate tax exemption amounts eliminates the application of federal estate taxes to 99.7% of all estates. Various estimates project that only 6,000 to 8,000 estates for decedents passing away in 2011 will be subject to the federal estate tax. In contrast, 98,907 estates for returns filed in 1998 had taxable estates (source: IRS). With the passage of these measures, in recent years the number of individuals or married couples requiring estate tax planning declined *by over 90%*.

“Portability” of the Estate Tax Exemption: The End of “A-B Trusts”?

As indicated, above, it appears that the estate tax exemption of the first spouse to die is to be “portable” to the surviving spouse, at least to the extent of any assets that qualify for the marital deduction. We predict this is the change in the law will ultimately end up having the most profound impact on the average estate planning attorney’s day-to-day practice. “A-B Trusts,” long the center of most estate plans for married couples, may soon become a thing of the past.

However, this does not mean that separate trusts should necessarily be unwound, nor that “joint trusts” should be embraced for married couples. A number of different issues may suggest the continued need for “A-B type” trusts. For example, every estate planning attorney who has been in practice for more than a few years can tell you what happens if the wife’s lifetime ends first. Almost inevitably, the husband remarries

within a year or two. And often enough, even for elderly widowers, no prenuptial agreement is obtained. (Of course, this discussion is also applicable to widows; but due to the disproportionate number of widows compared to widowers, and the “I don’t want to have to take care of another man” syndrome, widows are far less likely to remarry, especially if their husband dies and they are in their 60’s or older.) Having an “A-B type” trust may protect not only the couple’s ultimate heirs, but also provide the surviving spouse with protection from a new spouse’s undue influence, marital claims (in the event of divorce), and creditor claims. Additionally, if the couple’s assets are likely to appreciate beyond a \$7 million amount by the end of lifetime of the second spouse, consideration may be given to “sheltering” the appreciation of the first-to-die’s assets from taxes through a “credit shelter-type” trust.

The Challenges for Today's Estate Planning Law Practice

Let's face it—clients are much more willing to pay attorneys' fees when the estate planning will save taxes. In the mind of the client, it is fairly easy to justify spend several thousand dollars (or much more) now, through proper tax planning, in order to save hundreds of thousands of dollars later. In contrast, when discussions turn to the use of trusts as "probate minimization" measures, or as a better vehicle to provide for financial management in the event of incapacity, the benefits are less "tangible" to the client and the willingness to pay reasonable attorneys' fees for quality work less prevalent.

This is not to say that planning, involving the use of either *inter vivos* or *testamentary* trusts, is not valuable when estate taxes are not present. In addition to desires to minimize probate costs, or provide a more cost-effective means of the management of financial affairs in the event of incapacity (provided the trustee is appropriately selected, and a durable power of attorney is also prepared), trusts can provide many substantial benefits to heirs. Just a few of these include:

- "Support" or "educational" trusts for minor heirs, or for adult heirs who are not yet "financial mature";
- "Spendthrift" and "special needs trusts" to provide protection against creditor claims and/or continued qualification of an heir for Medicaid or other government benefits, respectively; and
- "Beneficiary-controlled" trusts (to a degree, at least), to provide for creditor protection, or to not add to the size of a wealthy child's estate (*i.e.*, generation-skipping, or dynastic trusts).

Additionally, with so much wealth tied up in qualified retirement plans, traditional IRAs, and Roth IRAs, the use of IRA "conduit" and "accumulation" trusts as "qualified beneficiaries" of retirement plan accounts will continue, which requires significant drafting skill.

Another challenge is state estate tax laws. In an era where most states are facing substantial fiscal difficulties, what will the states which possess their own estate or inheritance taxes do? How will trust drafting continued to be affected by the existence of state estate taxes? Will "portability" also be inserted by state legislatures as to the state estate tax exemption amount of the first spouse to die?

Regardless of whether a trust is utilized, other tax and asset protection planning issues surface for the modern estate

planning attorney to address. Gift tax planning may still be an issue, depending upon the future levels of gift tax annual exclusions and gift tax lifetime exemptions. Also (at least in non-community property states), consideration should be given to issues involving stepped-up basis on the end of lifetime of the first spouse (*i.e.*, jointly owning property in such instances result in the elimination of only 1/2 of the gains in any jointly held asset, rather than a full stepped-up basis in the decedent's assets; *and* what is the income tax consequence when a "joint *inter vivos* trust" is utilized—this may be dependent on how it is drafted and funded.)

Proper ownership of property may be essential as a means of providing some form of asset protection planning (such as *tenancy by the entirety* ownership in many states, separating ownership to guard against the claims which might be asserted against one spouse, the use of LLC's and other business entities to provide limited forms of asset protection, etc.). Verifying ownership and beneficiary designations remains important. Customized beneficiary designations for retirement plan assets, to ensure coordination with the rest of the estate plan, should often be considered.

Indeed, trust and estate planning is not "dead." In many respects, greater knowledge is required of today's estate planning attorney than was seen just a decade ago. The greatest difficulty for attorneys will be getting adequately compensated for the greater expertise now required.

Many estate planning attorneys have already seen a fall in revenue in recent years, as the estate tax exemption amounts increased from \$1m in 2003 to \$1.5m for 2004-5, to \$2m for 2006-8, and now to \$3.5m. A short-term need has existed, and will likely exist for another year or so, to "undo" many "A-B Trusts" or other estate tax planning, at least for many clients. Conducting seminars for current clients on the impact of estate tax reform, the multiple uses of trusts (other than for estate tax planning), and the need to review their estate plans every 2-3 years, may generate immediate work and short-term revenue. But, longer-term, revenues are bound to decline for estate planning attorneys. Adding to a practice in other areas may meet with frustration due to established competition (*e.g.*, elder law) or reduced client legal needs in the current economic climate (*e.g.*, corporate practice).

Securing New Sources of Revenue from Established Relationships: How We Can Help

We can assist you to confront the revenue challenges confronting all of those who relied upon estate tax planning for much of their past revenue. We offer:

- **Joseph's "Affiliate RIA Program"** is our innovative program designed to offer select professionals the opportunity to enhance revenues and build equity as part owners of an independent, fee-only investment advisory firm, without the need for substantial investment of time or capital, and with no need to train or be licensed as a financial advisor.
- **Continuing education** for you and other members of your firm on **"Holistic planning — A New Approach To Serving Client's Needs, Comprehensively"** - including education in the selection of financial advisors, tax planning involving

investments and portfolio management, and the *two key questions* you should ask each and every client.

- **Seminar presentations for community and civic groups**, designed for joint presentation by one of our advisors and a professional member of your firm.
- **Investment advisor training**. For professionals seeking to become investment advisers, we offer a comprehensive back-office and training solution. See www.JosephCapital.com under "Professionals" for contact information.

Also, attorneys can check out Ron's article, *The Attorney As "Complete Advisor" - Fiduciary Ancillary Business Models* (Florida Bar Journal, March 2005), available upon request from any of our advisors, for a review of ethics considerations.

The Financial Advisors of Joseph Capital Management, LLC: Trusted Advice from Professionals Bound by Fiduciary Duties



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Check out our web site, www.JosephCapital.com, as well as our public advocacy web site, www.FiduciaryNow.com.



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* The CPA/PFS designation is regulated by the State of Florida. J.D. denotes Juris Doctor, or law, degree. The CFP® designation is awarded by the Certified Financial Planner Board of Standards, Inc. The CTFA is the professional Certified Trust and Financial Advisor certification from the ABA Institute of Certified Bankers.