ISSUE 27
AUGUST 1, 2006

Elder Client PLANNER

SpidellPublishingInc.

TAX, LEGAL & FINANCIAL SOLUTIONS FOR YOUR RETIRED CLIENTS

Transferring wealth to kids and avoiding the "kiddie tax" gets harder with new federal law

TAX: TIPRA '05 changes the "kiddie tax" age from 14 to 18, throwing a wrench in many asset-transfer plans.

By Karen Brosi, EA, CFP
ECP Guest Contributor

Parents and grandparents attempting to help finance college educations, or to just transfer assets to the next generations, took a blow with the recent legislative change to the "kiddie tax" age.[1] Retroactive to January 1, 2006, minor children under the age of 18 (formerly 14) pay tax at their parents' effective rate on unearned income of more than $1,700. The result has left planners scrambling to adjust wealth-transfer plans and, in some cases, has already caused higher tax bills because the change is retroactive.

The new law presents particular challenges for families hoping to fund college costs using appreciated assets. Take for example Grandma Cay, who owns $100,000 worth of XYZ Company stock with very little cost basis. She wants to provide for her 14-year-old granddaughter Deena's college education. If Grandma funds $12,000 a year for the next four years into a §529 plan for Deena, she has to sell the shares and pay the capital gains on the sale at her own tax rate of 15%. Under the old rules, Grandma could have given Deena $12,000 of XYZ stock each year. Deena could have sold the shares and, because she has no other income, paid capital gains on the sale at only 5% for 2006 and 2007, and 0% in 2008 and 2009.

This won't work under the new law if Deena's parents have other taxable income of more than $61,300 (the top of the 15% marginal tax bracket for 2006). Deena will owe capital gains tax at 15% for the next four years.

The first step most planners took after TIPRA passed in May 2006 was to contact all clients with children between the ages of 14 and 18 with existing wealth-transfer plans. While some had not yet sold assets in the children's accounts this year, others had, and they needed to be prepared for a much larger tax liability (see example).

See **Kiddie tax**, *page 2*

Teach your clients how to SURF – Advice for representatives helping with after-death needs

DEATH: What information is needed, where do you get it, and what do you do with it?

By Richard Malamud, CPA, J.D., LL.M.
ECP Guest Contributor

When someone dies, the designated representative often hasn't a clue. What needs to be done? Unfortunately, the answer is as varied as the person who died.

But a good place to start is to teach them to "surf."

Select representatives
Understand the process
Retrieve information and documentation (see "Post-mortem basics to discuss with your client" checklist on page 4)
Finalize the estate or trust

When someone dies, it is always difficult to figure out the process for gathering all documents, determining net worth, and administering the estate or trust of the decedent. That process is dependent on state law and on how the decedent kept title to assets. Will probate be necessary? What about an estate or inheritance tax return? Usually a final income tax return will be required.

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Surf, *continued from page 1*

A surviving spouse, the decedent's child, or another representative probably will not have a clue as to what they need to do. That is why they need to learn to surf. They need to get in touch with the proper professionals and they can only do that if they understand the process. Then they will have to gather all the necessary documents and information. At last, the estate can be finalized.

Select representatives

For a professional to even be involved, the decedent's representative will have to call. What professional services will be required will depend on numerous facts, such as the size of the estate, whether or not there is a will or trust, the title to the property, and the state of residence. Some matters, such as probate, will require the advice of an attorney. Some matters, such as estate taxes, can be handled by the CPA, EA, or the attorney. An appraiser may be needed. Final tax returns may require a CPA or EA. Selling property may require a real estate broker or salesperson. Collecting life insurance, employee benefits, etc. — well, you get the idea.

The representatives will need some basic information about the decedent:

- Name
- Social Security number
- Date of birth
- Date of death
- Citizenship and state of domicile (and residency if different)
- Relatives (if applicable)
  - Surviving spouse
  - Children
  - Grandchildren
  - Siblings

Important financial contacts

Professional	Name	Phone number
Tax professional		( ) -
Attorney		( ) -
Insurance – life		( ) -
Insurance – home/car		( ) -
Stock Broker		( ) -
Financial planner		( ) -
Banker		( ) -
		( ) -

Understand the process

The next step is to help explain the process. Initially, this may simply be explaining what needs to be done and referring matters to the appropriate representative for advice. This may entail explaining that they need to go into the "hunter-gatherer" mode, collecting the will, trust, and a general list of assets and liabilities. Once the will and trust have been reviewed and a basic understanding of the types and values of assets in the estate has been established, it should be clear what needs to be done and which professional should be in charge.

Explaining the process is often better done face-to-face if the estate can afford to pay for that level of service. The initial meeting is solely to provide the representative a Reader's Digest version of what probably needs to be done. This is the time to simply discuss the process, not necessarily to resolve all or even most of the questions. It is intended to give the representative:

- Answers to their immediate questions;
- A rough timeline for tax returns and other items that have deadlines; and
- The immediate steps that need to be taken, such as notifying life insurance companies, the Social Security Administration, employers, landlords, etc.

The most common discussion is the standard, "If the estate is valued at more than $2,000,000 gross we will have to file an estate tax return. If it is more than

See **Surf**, *page 4*

ELDER CLIENT PLANNER (ISSN No. 1550-0470) is published monthly on the fifteenth day of each month by Spidell Publishing, Inc., 1158 North Gilbert Street, Anaheim, California 92801-1401. Periodicals postage paid at Anaheim, CA, and additional entry office. Telephone: (714) 776-7850. Fax: (714) 776-9906. E-mail: subscriptions@spidell.com. Web site: www.elderclientplanner.com. The subscription price is $249 for 12 months. ©2006, Spidell Publishing, Inc. **POSTMASTER:** Please send address changes to **Elder Client Planner**, P. O. Box 61044, Anaheim, California 92803-6144. Federal law prohibits unauthorized reproduction of the **Elder Client Planner**. All reproduction must be approved in writing by **Spidell Publishing, Inc**. Publisher Emeritus: Robert Spidell. Publisher: Lynn Freer. Editor: Nathan Orme. Associate Editors: Renée Rodda, Tim Hilger, Gina Rodriquez. Copy editor: Megan Lasswell

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$2,000,000 net, then ….” Some states require an inheritance tax return and a tax, even if the estate is less then $2,000,000. For estates valued at more than $2,000,000 with a surviving spouse, it may be time to have a short discussion about the marital deduction and QTIP trusts (depending on the decedent's will or revocable trust).

The rest of the discussion will depend on how much they want to discuss at the first meeting. It is impossible to prepare a generic letter because of the differences in each estate.

The checklist below outlines some basic tasks that may need to be discussed.

Retrieve information

Now it's time for a decedent's representative to play detective. Often, even the surviving spouse can be unaware of the decedent's bank accounts, life insurance, or financial transactions, and let's not even discuss the decedent's debts. If the representative is the decedent's son, daughter, or close friend, that person may know even less. Gathering all of the assets and liabilities will be necessary, even if the estate is small. It is just more complicated if it is large or if there are multiple heirs because it may then require an accounting, tax returns, etc.

A list of the things that need to be done follows, although it may need a longer explanation, depending on the estate. It is presented in a timeline manner just as a reference.

When someone dies, it is always difficult to figure out the process for gathering all documents, determining net worth, and administering the estate or trust of the decedent.

Things to be done ASAP

- Deal with all funeral issues.

Things to do quickly

- Get 5 – 10 copies of the death certificate.
- Locate and review copies of:
  - Will
  - Trust
  - Birth certificate
  - Social Security card
- Notify the Social Security Administration
- If living alone:
  - Take care of any pets
  - Notify U.S. Postal Service to forward mail
  - Talk to the landlord
  - Where appropriate, cancel cell phones, newspapers, cable TV, magazines, extra telephone lines, etc.

If they have e-mail, you may want to keep it for a few months because many financial transactions may be sent to the decedent by e-mail rather than by regular mail.

Things that can wait a short while

- Call all advisors who may have relevant information to share:
  - CPA/EA
  - Attorney
  - Insurance agents
  - Stock broker/investment advisor
- As applicable, check with the employer/union/military about:
  - Final paycheck
  - Final benefits
  - Pensions
  - Other possible employer items, such as personal property at the office
  - Union benefits
  - Veterans' benefits (burial and insurance)
- Locate all assets and liabilities that are easy to find (often they will appear as monthly statements in the mail, but increasingly this information will be sent by e-mail)
  - Bank accounts
  - Brokerage accounts
  - Life-insurance policies (don't forget to notify the company)
  - Pink slips for cars
  - List of all real property
  - List of any securities or partnership interests not held at a brokerage account
  - Safe-deposit boxes and keys
  - All credit card and other liabilities

Things to do later

- Locate financial documents for use by whomever is preparing a Form 706 (assuming it is a taxable estate). In addition, the person preparing the return will often ask for:

See **Surf**, *page 5*

Post-mortem basics to discuss with clients

Item	Yes	No
Final tax return (Form 1040)		
Estate tax return (Form 706)		
Inheritance tax return (state)		
Life Insurance		
Joint tenancy property		
Living Trust (*inter vivos*)		
Funding of trust(s)		
Title to real estate/partnerships/autos		
Fund future trusts		
Pay debts		
Make distributions		
Fiduciary income tax return (Form 1041)		
So many others!		

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- Copies of prior gift tax returns
- Bank statement for the month prior to death and the next few months
- Brokerage account statements
- Last two years' tax returns
- Pensions – IRA, SEP, Keogh, Roth, 401(k), 403(b), 457, etc.
- Deeds for real estate
- Leases – for a car, mobile home, etc.
- Marriage certificate
- Death certificate
- Credit card statements
- Mortgage statement(s)
- Unpaid bills
- File claims
  - Any reimbursement for health-related final illness that can be repaid by health insurance
  - Life insurance
  - Any reimbursement for IRC §125 flexible-spending arrangements
- For attorney or accountant or both:
  - If there is a trust, determine who is the new trustee and what has to be done.
  - If there is a will, determine if probate needs to begin.

Things to do later still

- Pay debts that are due and payable – You may want to check with the attorney if the estate will be subject to probate or if it appears that there are insufficient funds to pay all creditors.
- Determine if any bank CDs should be closed, as most will not have a penalty for early withdrawal.
- Talk to your advisors before making any distributions to heirs!
- Determine if you are required to notify current and contingent beneficiaries of their potential inheritance.
- Gather all information for the final and fiduciary income tax returns.
- Gather all information for the estate and/or inheritance tax returns.
- Ask professionals what is missing from the list.

Finalize

In most cases, this will be the place for the professionals. They will need to prepare income, estate and/or inheritance tax returns or advise the representative that no returns are required. They will also advise the estate about paying off any creditors and how the net assets should be distributed. In many cases that will entail the allocation of the property into several trusts (exemption, marital, minor, charitable remainder, etc.). The possibilities are endless. Surf's up! §

About the author

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Military members may include combat pay for IRA contributions

TAX: A new federal law retroactively allows for IRA contributions going back to 2004.

By Lynn Freer, EA
ECP Publisher

The Heroes Earned Retirement Opportunities Act (P.L. 109-227), or HERO Act, which the president signed on May 29, 2006, treats excludable IRC §112 combat pay as compensation for purposes of determining maximum contributions to IRAs.

The bill also allows affected taxpayers to make traditional or Roth IRA contributions for years beginning in 2004 and 2005. Contributions for 2004 and 2005 must be made on or before May 28, 2009. Contributions made by that date are treated as if made on the last day of the applicable tax year. Spousal contributions are also allowed.

Therefore, a married couple may be eligible to contribute up to $6,000 ($3,000 for each spouse) for 2004 and $8,000 ($4,000 each) for 2005 if neither spouse has reached age 50.

A taxpayer who elects to make the contribution may choose to:

- Make a Roth IRA contribution, which would be advisable if the taxpayer's income is low enough that there is no tax benefit to making a deductible IRA;
- Make a traditional IRA contribution, which could provide a tax refund for the 2004 and previously filed 2005 return; or
- Make a nondeductible IRA contribution.

NOTE: We do not see a benefit to making a nondeductible IRA contribution unless the taxpayer was not qualified to make a deductible or Roth IRA contribution.

A taxpayer may file a claim for refund within the later of one year from making the contribution or the close of the normal statute of limitations (HERO Act §2(c)(2)(A)). We believe a taxpayer who makes a nondeductible IRA contribution must file an amended return to include IRS Form 8606, **Nondeductible IRAs**, and elect to make the contribution nondeductible.

See Examples 8-2 and 8-3. §

EXAMPLE 8-2: In 2004, Sid Sailor's only earned income was excludable combat pay. He had no other income. Sid, age 30, may contribute $3,000 for 2004 to a Roth (assuming he had at least $3,000 of combat pay). There would be no benefit to Sid to contribute to a deductible or nondeductible IRA. Sid need not file an amended return for 2004.

EXAMPLE 8-3: In 2005, Sid's only earned income was from excludable combat pay. However, he had capital gains of $200,000. Thus, he does not qualify to contribute to a Roth. Sid contributes $4,000 to a nondeductible IRA on July 1, 2006. He must file an amended 2005 return, including IRS Form 8606 to report the nondeductible IRA contribution.