Destination Financial Freedom

Getting you there

by: Amy Mahlen, CFP®

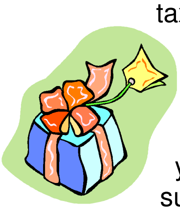
November 2006

Preparing Taxable Assets for Inheritance

No one looks forward to arranging for a loved ones passing. However, proper planning can save heirs not only significant dollars from lower attorney's fees and taxes, but also hours of headaches. This article will address some of the basic estate planning techniques, however, it is not intended to be interpreted as personal legal advice.

Property titled in a sole owner's name transfers at death by the individual's will and is subject to the lengthy, expensive, and tedious probate process. During this procedure ownership can also be deferred up to 9 months or more. Adding a Transfer Upon Death statement to the property is similar to appointing beneficiaries on a retirement account. The assets will then avoid probate and the heir will have access to the property immediately.

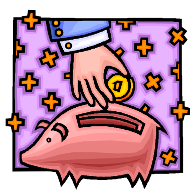
Joint assets titled as Rights of Survivorship will pass directly to the survivor on the account in the event of the joint owner's death. This transfer will avoid the nuisance of probate. Careful planning must be done before placing assets in a joint account with someone who is not your spouse because it can trigger gift taxes. If your mother decides to put $100,000 in a joint account with you, a $50,000 gift will have been made to you. This year gifts above $12,000 per individual (or $24,000 per individual if your spouse agrees with the gift) are subject to gift taxes.



An active annual gifting strategy is often used for people who are subject to estate taxes in an effort to reduce their tax liability. If your net worth (including home equity, business interests, investments and personal property minus outstanding debt) is above $2 million this year, any amounts over will be subject to nearly a 50% tax! In this case further estate planning should be implemented.

In order to determine what method is best for you, it is important to understand the tax ramifications <u>AFTER</u> the survivor has inherited the property. How will the cost basis and therefore capital gains taxes differ in each situation?

If property is transferred to heirs AFTER death, the cost basis will receive a 'step up' – meaning that a new cost basis is issued, valued as of the date of death. A significantly appreciated asset before death would be more beneficial to transfer after death. For example, Bob's original tax basis in his individual account is $100,000 and is currently worth approximately $400,000 today. Bob issued a Transfer Upon Death on his account to his son, John, so that he will have immediate access to the investments upon Bob's death and avoid probate. If Bob died yesterday, John *can* shortly thereafter sell the taxable assets with virtually no capital gains taxes! Because the assets transferred to John AFTER his father's death, John received a 'step up' in cost basis for the assets he inherited – he was issued a new cost basis valued at his father's date of death which was approximately $400,000. John now has a cost basis of $400,000 and he can sell the investments that are also worth approximately $400,000 and pay nothing in capital gains taxes!



Property that is gifted to an individual BEFORE death does not receive a 'step up' in cost basis at the time of the donor's death. Instead, gifted assets essentially inherit the original cost basis. If Bob would have gifted his account to John before he died, John would be issued his father's $100,000 cost basis. If Bob gifted the full $400,000 of the account to John in one year, Bob would also be responsible for gift taxes on $388,000 (the value, $400,000, minus the annual exclusion, $12,000). Not to mention, John would owe $45,000 in capital gains taxes if he sold the assets shortly after he received them at $400,000 ($300,000 capital gains x 15% capital gains tax rate = $45,000).

If the account was originally a joint account between Bob and John, after Bob's death John would receive a 'step up' in basis for only half of the account, producing a new cost basis of $250,000 (half of the original cost basis, $50,000, plus half of the 'step up' basis, $200,000).

Thought Swap

What matters most

Don't Forget to Vote, Nov 7th!

In honor of the election season, here are some memorable quotes from former leaders:

- **"The greatest leader is not necessarily the one who does the greatest things. He is the one who gets the people to do the greatest things." – Ronald Reagan**
- **"When the people fear their government there is tyranny; when the government fears the people, there is liberty." – Thomas Jefferson**
- **"That some should be rich shows others may become rich, and, hence, is just encouragement to industry and enterprise." –Abraham Lincoln**
- **"No arsenal, or no weapon in the arsenals of the world, is so formidable as the will and moral courage of free men and women." – Ronald Reagan**

Forget Penny Stock … The 3 Most Expensive Stock:

Bershire Hathaway A – shares closed above $100,000 per share at the end of October! Only 1.3 million shares are available compared to its B share counterpart with 12.42 million shares that is currently trading above $3,300 per share. If you would have invested $1,000 in A shares in 1965 and never sold it, you would have $3.05 million by December 2005. That is an average gain of 21.5% per year!

Lynch Interactive – headquartered in Rye, New York in the wire communications industry. The stock trades over $2,000 per share with only 25,290 shares outstanding – there are some days where no shares trade. The stock is ahead 33.4% so far this year.

First National Bank Alaska – with 344,000 shares issued it is now trading above the $2,000 per share mark. But the stock is down 9.5% year-to-date.

Where's **Google** on the list? Posting new record highs nearing $500 per share, it's listed at number 11.

What's Harder…

According to a study by Allstate "Retirement Reality Check" released last year, saving for retirement is viewed as almost just as difficult as quitting smoking. Of the 1,600 respondents, the following was listed as the hardest for people to accomplish:

32%
Quitting Smoking

31%
Saving for Retirement

25%
Losing Weight

10%
Working Out - Staying Fit

Take a Guess:

1) What percentage of summer vacationers had no travel budget according to The Wall Street Journal?
2) What percentage of taxpayers incorrectly report capital gains or losses on their tax returns due to confusion over how to calculate the number?
3) What is the average square footage of a new home in 2005 according to the Census Bureau?
4) What was the average square footage of a new home in 1973?

Answers: 1) 41% 2) 38% 3) 2,434 4) 1,660

Marathon Investment Management, Inc., 6565 S. Dayton St. #1200, Greenwood Village, CO 80111
Telephone (303) 708-0667, Toll-Free (888) 55-0645, Fax (303) 708-1462, http//:marathoninvestments.com