

# Death of a Fortune

By Neal Frankle, CFP®



**I**t was Tuesday, late March, earlier this year. Cheryl stepped into my office for the first time, a down-to-earth woman in her late fifties—she looked a little like Aunt Bee from *The Andy Griffith Show*. Cheryl had come to see me because her parent's CPA recommended it, and she looked upset. As we sat down together, she told me her story.

"My parents came to America in 1950, a few years after the war. They were hard-working immigrants that made good," she began.

"My mother worked two jobs scrubbing floors as my father built his accounting business. After many years of very hard work, they bought a small duplex. They kept working hard, saving, and buying buildings. By the time my father died earlier this year, they had acquired over \$4 million in real estate and saved over \$1 million in retirement accounts."

Clearly, Cheryl was proud of her parents and what they had accomplished, and she had every reason to be.

"Dad died earlier this year and mom died a year before that. Besides dealing with the heartache, my CPA told me that we're looking at huge estate-tax liabilities. Can you help me?"

All I could say was, "Cheryl, I'm afraid there isn't much I can do at this point." Of course, I wanted to scream, "What were you waiting for? Why didn't you come to see me three years

ago?!" But that wouldn't have been helpful, so I held my tongue.

As I told Cheryl there was little I could do, she slumped deeper into her chair, perhaps wishing she could disappear into it. She faced the real possibility of having to sell her parents' buildings and losing a tremendous portion of their retirement account savings to estate and income tax.

She was starting to realize that much of this could have been avoided with a little planning, but after her parents' deaths, it was too late.

Let's examine what Cheryl's tax problems are and what she and her parents could have done about it.

- The parents' estate of \$5 million owes approximately \$1.4 million in estate tax now that both people have died. To pay the tax, Cheryl will be forced to liquidate some of her parents' assets.

- If she cashes in the IRA to pay the \$1.4 million estate tax, the estate will also have to pay income tax on that \$1 million.

- If she sells the buildings, she'll incur a capital gains tax.

Are you seeing a pattern? Cheryl will sustain additional tax liabilities, either on income or capital gains, as she liquidates assets to satisfy her parents' estate tax obligation. It's a vicious and expensive cycle, which the IRS no doubt *loves*. This is the result of poor planning.

Think about all the time you spend on trying to grow your assets while you are alive. When you die, you want your family to benefit from all that hard work. In other words, what good is earning 15 percent (or more) on your money only to see over 80 percent of everything disappear when you die?

What could Cheryl's parents have done differently to slash their \$1.4 million estate tax liability?

The following actions would have been a good start:

1. **Set up a living trust while both partners are alive.** Besides providing a whole host of potential benefits, this one step alone would have shaved \$800,000 from Cheryl's parents' tax bill. That's \$800,000 more in Cheryl's pocket!

2. **Gift a portion of the real estate every year to reduce the size of the estate.** Of course, only gift a small amount of the real estate can be gifted each year, so the earlier this starts, the better.

3. **Consult an attorney about setting up a limited family partnership.** This one maneuver *alone* could potentially wipe out the estate tax issue! That's 1.4 million reasons for Cheryl to have looked into this before her parents died.

4. **Purchase life insurance using money taken from the IRA.** This would have created the cash their daughter needs now to pay estate tax.

I know what you're thinking: *It's a shame about what happened to Cheryl's parents, but it won't happen to my family—the estate tax is going away! After 2010, there will be no estate tax.*

Well, you are right . . . for 12 months. The estate tax does hibernate for one year, but then in 2011 it comes back in full force. So if you can guarantee me that your benefactors are going to pass away in 2010, you are right. But, my reasonable reader, consider this: Even if the estate tax does remain in hibernation after 2010, when you inherit property, it's likely you will have to worry about capital gains tax—something that's not a concern today, thanks to the step-up in basis.

Look, I've been in this business for more than 20 years. I've never met anyone who complained about their parents planning too much or having too much life insurance when they passed away. The four simple steps I outlined above may save your family a fortune, but of course you should speak with your attorney to see if and how these maneuvers may impact your financial situation. The important action is to plan now before it's too late.

*Neal Frankle is the author of Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, to do the same thing for their clients. For more information, visit [www.wealthresourcesgroup.com](http://www.wealthresourcesgroup.com) or email: [Neal@WealthResourcesGroup.com](mailto:Neal@WealthResourcesGroup.com).*