



RiceElderLaw

ELDER AND DISABILITY LAW

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*Certified as an Elder Law Attorney by the
 National Elder Law Foundation*

- Estate/Trust Administration • Guardianships
- Will Contest • Special Needs Trust
- Medicare, Medicaid, Long-Term Care
 & Disability Planning

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Nancy Rice Answers Questions About Retirement Assets, Savings Bonds And More

When we plan estates or advise executors and trustees who are handling estates and trusts, we need to consider both the income tax and the capital gain tax. *Why?*

• **Retirement assets** (IRA's, 401(k)'s, profit sharing plans, etc.), annuities and savings bonds all have one thing in common: as they grow in value over the years, you do not report the income earned and you do not pay income taxes on these earnings.

All of these assets grow "tax deferred." This is different, of course, than "tax free." An example of a tax-free investment would be a Roth IRA, which is funded with after-tax dollars (i.e., you do not get a deduction for the amount you put in a Roth IRA) but it grows tax-free. By contrast, a traditional or rollover IRA is tax deferred: you get a deduction for the money you put into a regular IRA, and you do not pay taxes on the money as it grows, but you do have to pay taxes when you take the money out.

• **Similarly, annuities and savings bonds** are tax deferred. You do not pay taxes on the money as it grows but you are required to pay tax on the increase in value (but not on the money you initially put in).

There are several reasons why we pay attention to the income taxation of these investments when we write Wills. We

need to make our clients aware of the fact that their beneficiaries will have to pay income taxes on the money they receive from certain types of investments, such as traditional IRAs, annuities, and US savings bonds.

• **Sometimes, we recommend that if a client is interested in leaving money to charity**, that they leave all or part of an IRA to charity, naming the charity as beneficiary of the IRA, because charities do not pay income taxes.

It is important to keep in mind that only a spouse may "rollover" an IRA. If you leave an IRA to children, they can create "beneficiary IRAs" which will defer the reporting of the income. In other words, they will not have to report all of the income in one year or over five years; they can "stretch it out" over their life expectancies.

• **US savings bonds** (E, EE and I Bonds) are also tax-deferred investments. You pay one half of the value of the bond at the time of purchase, and it increases in value over the years, such that it can actually grow to three or four times the stated value by the time it is cashed in (depending upon the interest rate). You can't tell by looking at a US savings bond what it is worth. You can, however, use a chart to value them, or enter the bonds into a website program located at www.treasurydirect.gov/indiv/tools/tools_savingsbondcalc.htm

When a person dies owning a significant number of US savings bonds, we have the option of reporting the accrued interest on the decedent's final income tax return (1040), which is something we discuss with the executor.

• **When we work with clients whose assets include IRAs annuities and savings bonds**, with a lot of "trapped interest," we encourage them to redeem these assets carefully, matching up deductions they might have (for example, if a spouse is in a nursing home and medical expenses are very high).

On a non-tax note, we emphasize to clients that IRAs, annuities, and life insurance are not governed by their Wills! We spent a good amount of time with clients confirming that the beneficiaries of their IRAs, annuities, and life insurance are consistent with their overall estate plan.

Capital gain tax is different from the income tax. It applies when you purchase a quote capital asset (such as a house, or stock in a corporation). When you sell a capital asset, the difference between the sales price and the purchase price is generally considered to be "capital gain." The gain can be "adjusted" by the costs of sale (such as realtor or broker commissions) and improvements you made to the property (e.g. a new roof on the house).

Many times our clients purchased their stock and their residence a long time ago and have quite a bit of capital gain, which

has not been taxed. Capital gain is not taxed until you sell the property. The big difference between income tax and capital gain tax is that capital gain tax can disappear at death (whereas income tax does not).

In other words, when a person dies owning a highly-appreciated house or stock, the estate/beneficiaries get a "stepped up" cost basis, meaning that if these assets are sold, the estate/beneficiaries report their "cost basis" as the value of the asset on the date of death! There are some limitations to this "step-up" in 2010 because of the one year repeal of the Federal Estate tax, but for most people, this tax rule results in them paying little or no capital gains tax when they inherit real estate or stock.

• **When we advise clients about estate planning**, we point out this rule when they want to make gifts during their lifetimes. We counsel against giving highly appreciated capital assets, because gifts of these assets during lifetime do not benefit from the "step-up" in basis at death, and the recipient gets the donor's basis ("carryover basis") and will have to pay capital gains tax when the asset is sold.

This tax stuff is tough to get through, but understanding it can really save a lot of money.

Nancy Rice can answer your questions and concerns, Call 609-398-3447.



Nancy Rice has been practicing Estate Planning and Elder Law in New Jersey and Pennsylvania since 1986. She was Certified as an Elder Law Attorney in 1997, and has maintained offices in Camden and Cape May counties, specifically in Cherry Hill and Ocean City. Call 609-398-3447.

Call to Schedule an Appointment

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