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Cut Estate Tax After The Stock Market Plunge

Settling an estate is never easy or fun. But even as family members try to come to grips with their loss, there are crucial decisions to be made, particularly if the person who has died left behind significant wealth. To calculate whether there are estate taxes to be paid, federal authorities normally look at the value of the assets owned on the date of death, and that could be especially painful in these days of plunging real estate and stock values. If the worth of assets has plummeted since the death, the family could find itself paying taxes on wealth that no longer exists. But there is a way to avoid this unhappy result. By electing a special "alternate valuation date" for the estate, an executor may be able to slash the estate tax bill or even wipe it out completely.

In 2009, the estate tax exemption can effectively shelter up to $3.5 million of assets from federal estate tax. (That's up from $2 million for 2008.) Assets in excess of the maximum exemption are taxed at a top federal rate of 45%. The estate tax is scheduled to be repealed for 2010, but it will be revived the following year with an exemption of just $1 million. That odd situation is the result of compromises made when the massive Economic Growth and Tax Relief Reconciliation Act was passed in 2001. And though Congress could decide to change the law and perhaps permanently repeal the estate tax, most observers expect it to remain in place in some form, probably with something near the current exemption level and estate tax rates. That's an outcome President Barack Obama has said that he favors.

But what of the estate of someone who died in 2008? Only $2 million in assets would be exempt from federal taxation, with any additional amount taxed at a 45% rate. And if the death occurred before the stock market meltdown, though the value of the estate may have been cut significantly, any taxes would ordinarily be based on the estate's earlier value.

That's where the special tax election can help. Instead of using the date of death for the estate tax valuation, the estate's executor could choose an alternate date of six months after the date of death. This is an unusually old tax break, first established during the Great Depression, but it can serve as a particularly useful estate-planning tool today.

Consider this example. Suppose that Deborah's father, Richard, passed away on August 1, 2008. Richard's estate comprised mainly real estate, stocks, and bonds. Deborah is the sole beneficiary of the estate. On August 1, 2008—the date of Richard's death—the estate was worth $3 million. After the $2 million estate tax exemption was applied, Deborah would still have to

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It Is Easy Bein' Green

In an effort to provide information more efficiently and do our part in "going green," we adopted a "less paper" office about three years ago. Since then we have reduced our printing substantially and have electronically archived over 150,000 pages.

If you want to receive less paper from us, some recent software upgrades now allow us to efficiently and confidentially send to you this newsletter via email; please call or send us an email at advisors@capfina.com to set this up.

Many clients have also asked about ways to avoid receiving paper copies of trade confirmations, shareholder materials (such as annual and semi-annual reports), account statements, and other documents by mail. We can easily set up electronic receipt for clients with assets at Schwab Institutional; again, please let us know if we can work with you in your "greening" efforts.

On an economic note, the market rally of the last few months has provided some welcome relief from the drubbing experienced in 2008. While it will likely take longer to get the economy back to where it had been, economists in a recent *Wall Street Journal* survey see an end to the recession in August of this year.

As always, please let us know if you have any questions or would like to talk about your specific circumstances.

Judy :

The Cost Of Missing A Market Rebound

Amid the recent stock market carnage and the severe downturn in the economy, the natural inclination of many investors has been to run and hide. But that kind of emotional reaction could work against your own long-term interests. Historically, the best time to invest in the stock market has been when the economy is in the dumps. Investors who wait for conditions to improve before buying stocks are likely to miss the first leg of a bull market—and that, over the long haul, could be extremely costly.

Past performance is no guarantee of future results, and this recession is already one of the worst in history. So it could be that this time will indeed be different. But during the past nine recessionary periods, beginning in the 1950s, the stock market has staged rousing comebacks that started while the economy was still struggling. If you pinpoint the statistical low point of each of those recessions and measure the performance of the Standard & Poor's 500 stock index until six months after the downturn's end, you'll find returns averaging 36%. And several rallies significantly exceeded that average. During and after the recession of 1953 to 1954, the S&P gained 51% in a little more than a year, and coming out of the recession of 1981 to 1982, the market surged 59%. It's too early to specify this recession's low point—that will be possible only in retrospect. Still, it officially began in December 2007, and so has already exceeded the average 11-month length of those previous post-World War II recessions.

A Burst Of Sunshine In A Cloudy Economy

These are the 10 best days, measured by percentage gains, for the Standard & Poor's 500 stock index. All came during recessions.

Date	Percentage change
Oct. 13, 2008	+11.6%
Oct. 28, 2008	+10.8%
Oct. 21, 1987	+9.1%
Nov. 13, 2008	+6.9%
Nov. 24, 2008	+6.5%
Nov. 21, 2008	+6.3%
July 24, 2002	+5.7%
Sept. 30, 2008	+5.4%
July 29, 2002	+5.4%
Oct. 20, 2007	+5.2%

Most of the market's best days, in fact, have occurred during economic downturns. The accompanying list of the top 10 one-day gains in percentage terms all came while recessions raged. You'll notice that most of those spikes came in late 2008, amid extreme market volatility, and while the broad market was losing almost 40%. Again, to judge by past events, missing the market's sharpest rallies could put a major dent in long-term performance.

Given that accurately timing market moves is virtually impossible, the best way to avoid missing out on a market rebound is to have a sensible, long-term investment plan that keeps you invested throughout the market's ups and downs. By staying invested, you will undoubtedly suffer on the down days, but you'll be sure to enjoy a share of the 80% to 90% of market gains that occur over less than 10 percent of the trading days.

During those aforementioned nine recessionary periods, looking at the performance of the stock market from six months before the recession until six months afterward, stocks averaged a gain of 8%*. So, as painful as it is to watch the value of your holdings tumble, you can take comfort in the fact that, over the long haul, the market recovers and moves higher than it was before the economy tanked. ●

Past performance is not a guarantee of future return.

Financial Plans Are Meant To Be Revised

One great benefit of a financial plan is that it gives you a feeling of certainty. Designed to take into account wide-ranging scenarios, it seemingly should be able to shrug off an uptick in inflation, a bear-market stretch for stocks, or a spike in interest rates. Yet there are some circumstances —such as the recent once-in-several-decades plunge of the economy and financial markets—that even the most carefully constructed plan can't fully anticipate.

Such events, as well as possible changes in your own situation, mean that every financial plan, sooner or later, will have to be revised. Preparing a financial plan is a process, not a one-time event, and making smart, timely alterations is crucial.

Consider how that process works. A financial advisor takes stock of an investor's overall financial situation and asks questions about goals, comfort level with investment risks, and the timetable for using investment proceeds. Then, the advisor establishes a plan designed to help achieve those objectives.

That requires several assumptions about how markets and the economy will behave. For example, an advisor might base a plan on a projected inflation rate of 3%, an 8% average annual return for stocks, and 4% yearly gains for bonds. Though some or all of those assumptions might miss the mark, the idea is that, taken together, they should be close enough to be useful. Yet even small inaccuracies, left uncorrected for 20 or 30 years, will leave a plan seriously out of whack.

Think of a ship setting out from New York for, say, Lisbon. The captain charts a course that should take the ship across the Atlantic to Portugal. But what if he makes a small miscalculation? Even if he's off only 1%, that could be a problem, and unexpected changes in winds and currents along the way are likely to

Working Longer To Fix The Retirement Mess

Are you willing to postpone retirement by two to four years? If you want to enjoy a secure, prosperous retirement, delaying it may be the best way to get there, according to a new book published by the Brookings Institution Press. *Working Longer: The Solution to the Retirement Income Challenge* offers a sobering yet hopeful message to Americans approaching retirement age at a time of soaring health care costs, declining pensions, severely weakened retirement accounts, and shaky prospects for Social Security.

Authors Alicia H. Munnell, professor of management sciences at Boston College, and Steven A. Sass, associate director of the Center for Retirement Research at Boston College, argue that raising the average retirement age from 63 to 66 would solve many of the financial problems retirees are facing. "The key is to avoid drawing on your Social Security benefits or 401(k) plan until age 67," says Sass. Allowing your retirement assets to grow just a few years longer can significantly boost your assets, and delaying retirement means a shorter period during which you'll have to depend on retirement savings.

The nice thing about this strategy is that it won't necessarily mean enjoying fewer years of post-work life. Because life expectancy has soared while the average age of retirement has fallen, merely moving back the start could still afford you decades of doing whatever you have planned. Consider these numbers:

- The average life expectancy for a 55-year-old man in 1965 was 20 years; by 2005, it had risen to 25 years.
- For women at 55, life expectancy rose from 25 years in 1965 to 29 years in 2005.
- About 19% of men and 33% of women who survive to age 65 today will live to age 90 or older.

Meanwhile, the average retirement age for Americans fell from 65 in the mid-1960s to 63 in the 1980s, where it remains today. A major reason is that workers may start receiving Social Security benefits at age 62, even though beginning then, rather than waiting until full retirement age, reduces the amount of the monthly payments you'll receive. And while Social Security's official retirement age is gradually rising from 66 to 67, the government has opted to leave the earliest eligibility age (EEA) at 62. Sass and Munnell believe the government should push back the EEA to age 64 to encourage people to remain in the work force longer.

The declining U.S. savings rate is another strong argument for staying on the job a few additional years, suggests Sass. "For baby boomers, it's getting a little late to save." They don't have that much money in their 401(k) plans. Working longer is probably the best option."

Sass notes that the amount of your Social Security benefit is calculated using the 35 highest-paid years of your working life. "By delaying retirement, very often you'll replace a zero- or low-earnings year and actually increase your benefit level," he says. Moreover, each year you wait before starting Social Security payments will boost the amount. Work four years longer, Sass estimates, and you'll increase your monthly check by a third.

Consider a man who made an average of $150,000 a year during his highest-paid 35 years at work. If, rather than retiring at age 62, he keeps going four more years at that same average salary, his benefits will go up more than 30% compared with what he would have received at 62, not taking inflation into account, Sass says.

If the same man had earned an average of $150,000 but had worked only 31 years, his 35-year Social Security average would be lower. (The exact figure is calculated based on the Social Security wage base limit, which changes annually and stands at $106,800 in 2009.) Retiring at age 66 instead of 62 would add four more years to the average (at the wage base limit), thus increasing his benefits somewhat more than the automatic 30%.

For a person earning an average salary of $40,000 a year, adding four more years to a 31-year average would make the increase in benefits rise from 30% to 45%, according to Sass. For higher earners to receive a similar extra boost, the wage base limit would have to be increased significantly above the $106,800 level.

The recent meltdown in the stock market just adds one more reason to think about delaying retirement by a few years. Most nest eggs have suffered, and to begin withdrawals from a beaten-down retirement account may sharply reduce the size of annual distributions that can be taken without depleting the account during a long retirement. We can revisit your retirement plan with you and help you choose a retirement age that will support your goal of a long and comfortable life after work. ●

make things worse. If he sticks to his original bearings, he could end up in Africa—or Ireland.

But that won't happen, because every good sailor understands the need for minor but constant course corrections. And a financial plan requires similar adjustments.

Look at the predictions of economists, market forecasters, or the government, and you'll see that no estimate extending more than a year or two into the future will be even close. So a financial plan written to predict the feasibility of a retirement 30 years away won't—and can't—be accurate. But it can establish a starting point. Reaching your goals requires frequent adjustments to compensate for the winds and currents you meet along the way.

Once you understand that basic certainty, you can prepare by discussing how, and under what circumstances, your plan will need to be altered. We would be happy to review your plan with you to make sure it continues to move you toward your long-term goals. ●

Cut Estate Tax

(Continued from page 1)

pay federal tax on the remaining $1 million in the estate. At the 45% tax rate, the tax bill would come to a hefty $450,000.

However, Richard's executor can elect to use the alternate valuation date instead. Suppose that the estate has lost 35% of its value and, six months after Richard's death—on February 1, 2009—it's worth only $1.95 million. That's below the $2 million exemption for 2008 (which still applies, because that's when he died). So there's no estate tax liability and Deborah's inheritance is worth $450,000 more than it would have been with the earlier valuation date.

This is an all-or-nothing proposition—you can't select some assets to be valued on the alternate valuation date and some to use the actual date of death, even though some property may be worth more on the later date. You'll need to consider the value of the full estate on the two dates and choose the one that's more beneficial.

Moreover, if you choose the later valuation date and some assets have been distributed before then, they'll be valued based on the date they were handed out. So it could make sense for the executor to distribute property that is appreciating in value and hold on to assets that are losing value.

You can use the alternate valuation election only if this tax break decreases the gross estate and the resulting estate tax bill. It can't be used, regardless of the estate's value, if all assets are to pass to a surviving spouse—and thus qualify for the unlimited marital exemption—or if the estate tax liability on the original date of death would be zero.

If you've recently inherited significant assets, we can work with you and your attorney to determine whether this election would reduce estate taxes and increase the value of your inheritance. ●

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