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Modest Living/Extreme Wealth

By Dan Searles

I recently lunched with a friend, Sean McCarron, a highly skilled financial planner. Sean related how he had been mesmerized by the gripping movie, “Superman,” and reminded of how much he had loved that series as a kid – and in fact he still does.

Sean explained, “Times have changed. As a kid I wanted to fly like Superman. As a teenager, I wanted his X-ray vision. But as an adult, all I now want is his Fortress of Solitude.”

Our needs change over time, and although nobody likes change except wet babies, we ignore change at our peril. For example, tax and inheritance laws are constantly changing.

This month’s question is from a couple who are smart enough to perceive the need for change and to look for guidance in adapting appropriately.

QUESTION: I’m 83, and my wife 78. We are both in good health. We have three children and want to treat them all alike in our wills. We have a farm that even in this down-turned market is valued at around 4.5 million bucks. We each have Social Security income, and I make some money from renting part of our farm, where my wife and I have lived for more than 40 years.

We have considered selling our farm now, so we can invest the net proceeds, after capital gains, in secure bonds, municipals and Treasury notes, in order to use the interest for living expenses as we age. When we are both gone, all of our money would then be divided equally among our three children. What is the best way to pass our assets to our children?

ANSWER: You are in the same situation as many people who have seen once-modest farms and businesses slowly increase in value until they are now land wealthy. A best selling book titled, “The Millionaire Next Door,” by Thomas J. Stanley, details your situation, which we will paraphrase as “modest living with extraordinary wealth.” With this wealth will come extra taxes for your kids, especially if you fail to act while you and your wife are living and in good health to make sound decisions.

You should not sell your farm now in order to later divide your wealth evenly among your children. If you sell the farm now, you'll owe tax on any gains over \$500,000 (\$250,000 for single taxpayers). State and local taxes may apply as well.

Instead, if you can, you should hold your farm until you and your wife die, and then it will pass income tax free to your children. When you and your wife die, your children will receive the farm at a stepped-up cost basis, which means, if they sell it then at the price at which they inherited it, there will be no capital gains tax due.

Notice that above I said income tax free and not estate tax free. In 2008, each person has a \$2 million exemption that allows him or her to pass that much money to his or her heir's estate tax free. If you have more than that, estate taxes apply and they are expensive. But if you establish a revocable living trust now, you can preserve \$2 million for yourself and \$2 million for your spouse, effectively raising your exemption to \$4 million. (However, in 2011, unless this law changes, this exemption reverts to \$1 million.)

You should seek professional guidance. Trusts are tricky, so find an experienced and knowledgeable financial planner who can direct you to a good estate attorney and get your planning done sooner rather than later. Your kids will benefit now and future generations may be able to, as well. Until next time, Your Money Matters, so treat it wisely.

Dan Searles, CFP®, is a financial planner and a Registered Representative offering securities and advisory services through National Planning Corporation, **member NASD/SIPC**, and a Registered Investment Adviser. **Send your questions to Dan.Searles@natplan.com, or call Dan at 1-800-878-9704.**

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