Through the Looking Glass:
The Future of Estate and Financial Planning

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THROUGH THE LOOKING GLASS:
THE FUTURE OF ESTATE AND FINANCIAL PLANNING

Mark B. Edwards

I. Prologue

A. “---and if you’re not good directly,” Alice added, “I’ll put you through into the Looking-glass House. How would you like that?”

B. So begins the adventure in Lewis Carroll’s classic children’s tale, THROUGH THE LOOKING-GLASS. In the Looking-glass House, things were familiar, but different in substantial ways. Nothing was quite what it seemed to be; the old rules did not reply.

C. I believe that planners of every profession - attorneys, accountants, trust officers, financial consultants, life underwriters - are now going “through the looking glass,” and they will find the world on the other side, while similar in appearance, to be quite different in reality from the one we now know.

D. This journey will be the result of forces now beginning to make themselves felt. Over the next 15 or so years, changes such as have never been seen in our lifetimes will come about, and what we do and how we do it will never be the same.

II. The Impact of Tax Reform (Repeal) - The First Force

A. The specific terms of the Economic Growth and Tax Relief Reconciliation Act of 2001 are well known to all estate planners, but for our purposes, the important thing is its ultimate goal.

B. The ultimate goal of EGTRRA is the abolition of the estate tax. Under its terms, the estate tax is repealed as of January 1, 2010. However, in the best tradition of Congressional statute-making, EGTRRA itself dies on December 31, 2010, allowing the estate tax to be resurrected on January 1, 2011, just as it was in May of 2001.

C. The current status of the estate tax is muddled. The House of Representatives has voted to make the repeal of the estate tax permanent, just as it has done on many occasions in the past.

D. The prospects for outright repeal in the Senate are cloudy.

1. A number of bills have been introduced in that chamber to increase the exemption substantially and to lower the applicable rate, creating a “virtual” repeal.

2. It would appear that many members of Congress, of both political
persuasions, are seriously contemplating exemptions in the $5,000,000 to $10,000,000 range as a solution to the current deadlock.

3. Any such exemption, even if postponed to 2010, would effectively repeal the estate tax for more than 99% of the population.

E. It is impossible to predict what form the resolution of this debate will take. But the mood of the deliberations by both political parties seems to presage some action that will result in the majority of people having no estate tax consequences upon the disposition of their estates.

1. If the repeal is made permanent, there will be no federal estate tax consequences to drive estate and financial planning.

2. If the tax is retained with the exemption set at some figure like $5,000,000 per person, a bare minimum of planning will result in eliminating estate tax consequences for all but the most wealthy of our clients.

3. To illustrate this point, the statistics from the IRS for estate tax returns filed in 2004 indicate that 73,340 returns were filed, and that about 36,000 returns reported taxable estates. If the exemption had been $5,000,000, only 3,600 returns would have been necessary.

F. Of course, if the ultimate answer is the permanent repeal of the estate tax under the provisions of EGTRRA, a whole new set of issues brought on by the elimination of the stepped-up basis at death will be upon us—but no one wants to talk about that.

III. But My Projection is for 15%! - The Second Force

A. In the first quarter of 2000, the longest and strongest bull market in the financial history of the United States reached its peak. All major indices reached record highs, but then turned down.

1. Here are the results of the S&P 500 index for the past 6 years:

   a. 1999    +19.53%
   b. 2000    -10.14%
   c. 2001    -13.09%
   d. 2002    -23.37%
   e. 2003    +26.38%
   f. 2004    +8.99%

2. Thus endeth the myth that the stock market always goes up!
3. As of May 15, 2005, the S&P 500 index was still about 17% below the high water mark established on March 24, 2001. And to add salt to the wound, five years of compounding have been lost.

B. What the future will bring is unknown. The economy continues to show signs of recovery, the slide in employment has abated, and deflation is not a current worry. On the other hand, enormous budget deficits, a falling dollar and the twin specters of inflation and higher interest rates appear to be clouds on the horizon.

C. But there does seem to be a growing consensus on two new facts of investment life:

1. First, the total return on U.S. equities in the next fifteen years will be considerably less than the returns of the 1990’s. Consider these predications made by well-respected names in the financial arena:
   a. Warren Buffett, in an article in the December 10, 2001, issue of Fortune magazine, said:
      (1) “I would expect now to see long-term returns run . . . in the neighborhood of 7% after costs.”
   b. In the March 5, 2003, issue of the Goldman Sachs Equity Research, the analysts spoke of the future:
      (1) “Future financial asset returns are likely to be much lower than during the 1982-1999 period. During that period, an investor who held a market portfolio of 60% equities and 40% bonds earned a compound annual rate of return of about 15% per year, according to Ibbotson Associates. In contrast, we estimate that the long-run return on such a portfolio today would be only about 6% per year.”
   c. In the April 2003 issue of the JPMorgan Portfolio (a publication for private banking clients), the anticipated returns on the United States equity market were characterized as follows:
      (1) “We believe that real returns—that is, returns minus the rate of inflation as measured by the Consumer Price Index—will average about 5.5% in the next seven to ten years.”

2. Second, the income generated by interest and dividends is the lowest it has been in over half a century.
   a. The yield on 10-year United States Treasury notes oscillates around 4.25%.
   b. The yields on 5 year Treasury notes are around 3.8%.
   c. The dividend yield on the S&P 500 index hovers around 1.9%.