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New Tax Bill Seen As Boon For Wealthy Clients—And Advisors

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Christmas came early for wealthy taxpayers this year. Thanks, Washington. Who knew the two warring factions could get anything done?

Last week's passage of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, the most far-reaching tax bill in a decade, turned out to be a grab bag full of welcome surprises and goodies for the high-net-worth set—and especially the ultra-high-net-worth individuals and families and, by extension, the wealth managers who help them.

(Dampening the mood are the expected tax increases when/if Obamacare takes effect; your clients may fear a huge tax bite after President Obama signed historic health care legislation into law earlier this year. After all, the legislation calls for taxes and fees on high-net-worth individuals and households to cover 22 percent of its $400 billion cost over the next 10 years, according to a report by Deloitte Tax LLP.)

"Nobody saw this coming," said Richard Behrendt, senior estate planner for Robert W. Baird in Milwaukee. "It's a tsunami of change, and opens up planning opportunities that we've never had before."

Wealth management professionals are particularly excited about the new law's surprisingly generous estate, gift and generation-skipping transfer tax exemptions of $5 million per individual (up from $1 million) and a maximum tax rate of 35 percent, effective through 2012.

"This is a huge opportunity for families of great wealth," said Carol Kroch, head of wealth and financial planning for Wilmington Trust. "Couples can give away a lot more money in their lifetime – up to $10 million – that's tax-free, and pay only 35 percent taxes after that, when many people were expecting the rate would be 55 percent."

Joan Crain, senior director, wealth strategist for Bank of New York Mellon in Boston, agreed. "For ultra-high-net worth couples, paying 35 percent on anything over $10 million is still a pretty low rate," Crain said. "I think the big question for those wealthy individuals is going to be 'How much can I give away and still feel comfortable about what I need for the rest of my life?'"

In addition to extending all the Bush-era tax cuts for another two years, the 74-page tax relief act also made the estate tax exemption "portable" for deaths after 2010, meaning that the unused exemption amount of a deceased spouse can be used by the surviving spouse; kept the 15 percent tax rate on capital gains and dividends; and extended the IRA charitable rollover (allowing individuals aged 70 ½ or older to transfer up to $100,000 directly from an IRA to a qualified charity).

The new tax law also keeps in place current rules for the popular grantor retained annuity trusts (GRATs), which, when used in conjunction with the new $10 million tax exemption, "can provide individuals with a particularly powerful estate planning tool," said Baird Allis, a tax attorney for Duncan Associates in Chicago.

What's more, after much uncertainty and speculation, the new tax bill finally clarified tax policy for the next two years, allowing wealthy clients and their advisors to proceed with planning issues they had put off. Indeed, said Chicago attorney and family office expert Tom Handler, "We expect families to move quickly to use the new-found gift tax exemption to make exempt gifts in order to remove future appreciation from their estates."

But the bill's limited life span also means much uncertainty for planning past 2012. As Handler put it: "The new law does little to assuage concerns regarding the ever-changing and erratic tax landscape and its concomitant chilling effect on investment, planning and business."

And while some advisors see clients anxious to get things done in the wake of the new law, others, such as BNY Mellon's Crain, think wealthy clients, upon hearing about all the favorable provisions in the tax relief act, may become complacent and not take action.

In either case, say industry executives, the new tax law is a golden opportunity for wealth managers to prove their mettle to clients and improve their prospects for additional business in the future.

"Anytime there's such major change, clients need guidance from their financial advisor," said Baird's Behrendt, who spent 12 years with the Internal Revenue Service as an estate tax attorney. "I think there will be an explosion of work for wealth managers that underscores the need for holistic advice. Clients will be looking to talk about the changes, and as we say around here, 'If you're not asking the questions, someone else is.' "