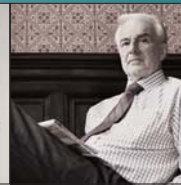


# Strategies for Wealth Management





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## PURSUING YOUR FINANCIAL GOALS

**C**ongratulations! You've successfully handled the challenges of running a business or managing a career, choosing investments, and building your wealth. Your challenge now, however, is perhaps even greater: astutely managing the assets you've accumulated to pursue your financial goals.

This booklet provides insight into the general concepts of personal wealth management, as well as specific strategies to help you pursue your goals. But successful wealth management also calls for professional guidance. So please review the ideas presented in this booklet, and then give your tax or financial advisor a call to discuss your situation.

### BUILD A FRAMEWORK

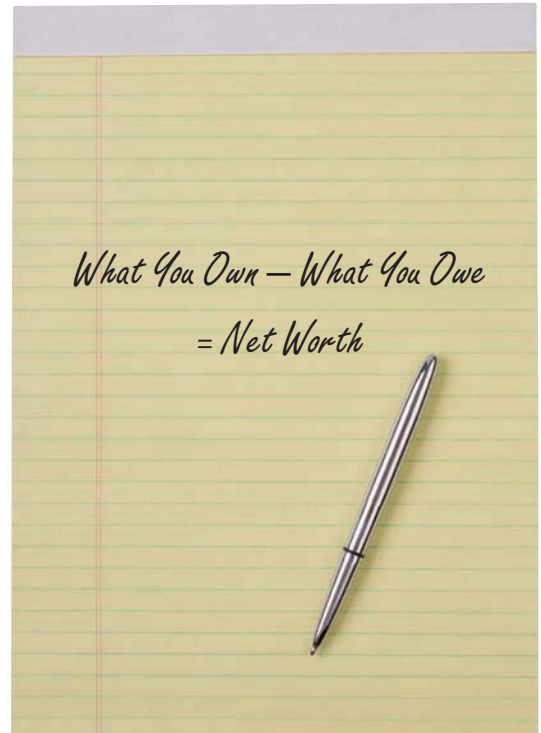
Having a realistic framework can help you better seize financial opportunities as they arise. To develop this framework for your financial decisions, follow the three D's:

1. **Determine** where you are today.
2. **Decide** where you want to be in the future.
3. **Develop** a plan to move toward your goals.

This process is ongoing; you must monitor the plan and adjust it as necessary to ensure that you're moving in the right direction. It's a simple concept — yet many who set the framework for a plan fall short when it comes to implementing it. Don't be one of them.

### MEASURE YOUR NET WORTH

Before you can create a wealth plan, you need to take a snapshot of where you are today financially. Net worth is measured as the excess of all your assets over all your liabilities. In other words:



The worksheet in Chart 1 will help you determine your net worth.

### DECIDE WHAT YOU WANT FROM THE PROCESS

Now that you know what you have, you must decide what you want from the wealth planning process. Would you like a comprehensive view of your financial future? This entails reviewing and analyzing all aspects of your finances (such as estate planning, retirement, insurance and investments) and creating a detailed, comprehensive plan for each area.

Or are you interested only in suggestions on specific financial issues? For example,

if you have just sold a business, you may need direction on how to invest the proceeds. Or you may want to calculate the required minimum distributions from your retirement accounts. Even if your immediate focus is on only one issue, be sure to understand how it affects other aspects of your wealth picture.

### SET YOUR GOALS

Next you need to set desirable and realistic goals. This means balancing financially prudent strategies with emotionally acceptable thresholds. What looks good on paper may not always feel right in your heart. Try to meet these objectives by setting short- and long-term goals and prioritizing them within each category.

Common goals include the following:

- To increase the assets going to your heirs by using various estate planning techniques,
- To tie in charitable desires with your own family goals,
- To be able to retire comfortably,
- To have sufficient funds and insurance coverage in the event of serious illness or loss,
- To develop an investment program that may provide growth and income within manageable risk parameters,
- To protect your assets from adverse financial circumstances, such as litigation, and
- To minimize income taxes.

When developing a plan, keep in mind the need for flexibility. Your personal and financial situations often change with the

## Chart 1 Net worth worksheet

### NET WORTH

A. Cash and cash equivalents (checking accounts, money market accounts, CDs, etc.)	\$ _____
B. Marketable investments (stocks, bonds, mutual funds, etc.)	\$ _____
C. Other investment and business assets (real estate, partnership interests, closely held businesses, cash value of life insurance, etc.)	\$ _____
D. Retirement assets (IRAs, 401(k)s, Keoghs, SEPs, etc.)	\$ _____
E. Personal assets (residences, autos, furnishings, jewelry, artwork, etc.)	\$ _____
<b>Total assets (A+B+C+D+E)</b>	<b>\$ _____</b>
F. Personal debt (credit cards, personal loans, 401(k) loans, taxes, etc.)	\$ _____
G. Investment debt (margin loans, real estate investment loans, etc.)	\$ _____
H. Personal mortgage debt (mortgages, home equity loans)	\$ _____
<b>Total liabilities (F+G+H)</b>	<b>\$ _____</b>
<b>Net worth (total assets less total liabilities)</b>	<b>\$ _____</b>

### WORKING ASSETS

Total working assets* (A+B+C+D above)	\$ _____
Investment debt (G above)	\$ _____
<b>Net working assets (working assets less investment debt)</b>	<b>\$ _____</b>

*\* Working assets are those that have the potential to grow and/or generate income and provide financial independence for you in the future. Personal assets shift to this category only when you plan to sell (and not replace) them.*

major and minor life events you experience. Births, deaths, illnesses and marriages can affect your goals profoundly.

Once you've set your goals, you can move toward the future. The rest of this booklet will discuss the key areas of any wealth plan and possible strategies for pursuing your goals.

## DEVELOPING YOUR ESTATE PLAN

**Y**ou may be surprised to discover how large your estate tax obligation turns out to be. Even with the scheduled estate tax repeal in 2010, the estate tax will be back in 2011 if no further legislation is passed.

But there are still many ways you can reduce your gift and estate tax obligations. With careful gifting and planning, you can maximize the amount of wealth that is transferred to your heirs. Consider your options today to ensure your assets are managed and passed on the way you intend.

### UNDERSTAND TRANSFER TAX RATES AND EXEMPTIONS

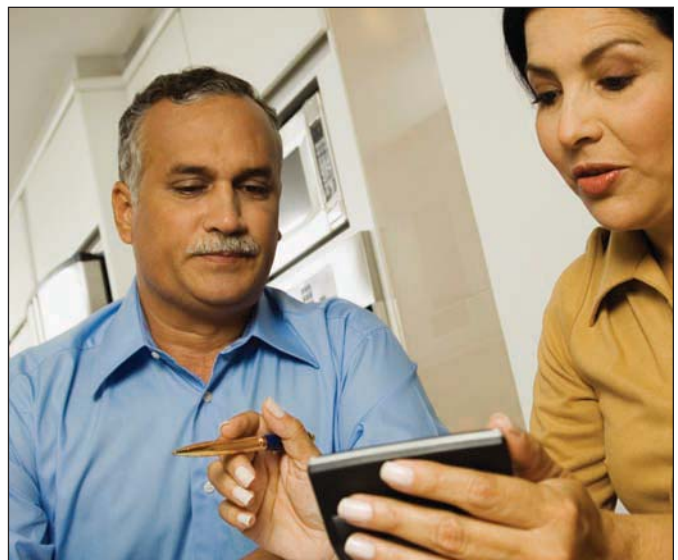
Here's a simplified way to compute your estate tax exposure. Take the value of your estate, net of any debts. Remember that this includes everything you own individually, including the face value of any insurance on your life. It also includes a percentage of the assets held jointly with your spouse (generally 50%) and others. (The percentage depends on various factors.)

Subtract any assets that will pass to charity on your death — such transfers are deductions for your estate. Then if you're married and your spouse is a U.S. citizen, subtract any assets you'll pass to him or her. Those assets qualify for the marital

deduction and avoid estate taxes until the surviving spouse dies. The net number represents your taxable estate.

During your life or at death, you can pass up to the exemption amount free of gift and estate taxes. See Chart 2 at right for the amounts, which depend on the year and whether the transfer is made during life or at death. Note that the gift tax exemption is scheduled to remain lower than the estate tax exemption through 2009, and even in 2010 the gift tax isn't scheduled to be repealed — so lifetime gifts of more than \$1 million will generally be subject to tax.

If your taxable estate is equal to or less than the exemption and you haven't already used any of the exemption on lifetime gifts, no federal estate tax will be due when you die. But if your estate exceeds this amount, it will be subject to estate tax. The top rate is scheduled to remain at 45% through 2009, but to be restored to pre-2001 levels in 2011, following the scheduled estate tax repeal in 2010. (See Chart 2.)



Also keep in mind that state estate tax law varies. It's possible there could be:

- No federal liability but still be state liability,
- Both federal liability and state liability, or
- Federal liability but no state liability.

Also, you could be subject to state estate tax in more than one state, such as if you own real estate in multiple states.

### USE THE UNLIMITED MARITAL DEDUCTION

Your estate generally can deduct the value of all assets that pass in a qualified manner from you to your spouse during your lifetime or at your death, provided your spouse is a U.S. citizen. The assets may pass either outright or in trust.

You could pass all of your assets to your surviving spouse tax free using your marital deduction, but your heirs could suffer. That's because, when your spouse dies, the assets will be included in his or her estate for tax purposes. And, to the extent your spouse's taxable estate exceeds his or her available exemption, your spouse's estate will be subject to tax. With a little planning you could reduce your combined estate tax liability. (See the credit shelter trust discussion on page 7.)

### MAKE LIFETIME GIFTS

Gifts you make during your lifetime are generally subject to federal gift tax. But you can exclude gifts of up to \$12,000 per recipient each year. If one spouse gifts \$24,000 to someone, both spouses can elect to split the

*Chart 2*  
**Transfer tax exemptions and rates**

Year	Estate and GST tax exemptions <sup>1</sup>	Gift tax exemption	Highest estate, GST and gift tax rate
2007	\$ 2 million	\$ 1 million	45%
2008	\$ 2 million	\$ 1 million	45%
2009	\$3.5 million	\$ 1 million	45%
2010	(repealed)	\$ 1 million	35% <sup>3</sup>
2011	\$ 1 million <sup>2</sup>	\$ 1 million	55% <sup>4</sup>

<sup>1</sup> Less any gift tax and GST tax exemptions used during life.  
<sup>2</sup> The GST tax exemption is adjusted for inflation.  
<sup>3</sup> Gift tax only. Equal to highest marginal income tax rate, which is currently 35%.  
<sup>4</sup> The benefits of the graduated estate and gift tax rates and exemptions are phased out for estates and gifts over \$10 million.  
**Source:** U.S. Internal Revenue Code

gift and treat it as if they each gave \$12,000. (The exclusion is generally adjusted every few years for inflation, so check with your advisor for the most current exclusion amount.)

To take advantage of the annual exclusion, you must give a “present interest” in the property. This usually means the recipient must have complete access to the funds. But a parent or grandparent might find the prospect of giving complete control of \$12,000 a year to the average 15-year-old a little unsettling.

Fortunately, you can get around this by setting up certain kinds of trusts, such as a Crummey trust (see page 7) or a minor's trust, where the gift will qualify for the annual exclusion even though the recipient doesn't have complete access to the gifted assets.

### SELECT THE BEST PROPERTY TO GIVE

Consider both estate and income tax consequences and the economic aspects of any

*Wealth planning tip 1*

## CONTROL ASSETS WHILE YOU GIVE THEM AWAY WITH AN FLP

Family limited partnerships (FLPs) can allow you to gift assets while maintaining some control of them. An FLP is created when two or more individuals contribute assets to a partnership in exchange for interests in it. Limited interests are then typically gifted to family members. The general partner controls all decisions regarding its operation and the ultimate distribution of its assets.

FLPs also offer asset protection. Because limited partners can't access the FLP's assets, their creditors also have difficulty doing so. While creditors can take over an interest in the partnership, they can't force the partnership to make distributions to them.

As a vehicle for transferring assets from one generation to the next, the FLP has many advantages. For starters, rather than having to make cumbersome transfers of individual securities or interests in real estate to several family members, you can use a one-page document to transfer a certain percentage ownership in an FLP that holds the securities or real estate. This is particularly convenient if you're making transfers to a number of family members over a period of years.

The ability to take valuation discounts has also driven much of the popularity of FLPs. Limited partners lack control over the FLP's management, and the market for their FLP interests is limited; therefore, their interests can be valued at a discount that reflects this lack of control and lack of marketability. But these discounts can expose FLPs to increased risk of IRS challenge.

The IRS may also attack an FLP by arguing that the donor of the gift is retaining an interest until death and thus that the FLP assets should be included in his or her taxable estate. If the donor doesn't retain sufficient assets to live on and legal formalities are not all strictly observed, an FLP may be vulnerable.

gifts you'd like to make. To minimize estate taxes, consider gifts of property with the greatest future appreciation potential. To minimize income taxes, consider gifting property that hasn't appreciated significantly since you've owned it. Why? Because

your basis in the property generally carries over to the recipient, who will owe taxes on any gain when he or she sells it.

On the other hand, you may want to hold on to highly appreciated property so it can be transferred at your death. Currently, when heirs sell inherited property, they don't pay capital gains tax on appreciation that occurs before their loved one's death. Their basis in the inherited property is typically considered the asset's value on the date of the loved one's death. So, it has made sense to wait to transfer highly appreciated assets until death.

This strategy may be less advantageous when, with the scheduled repeal of the estate tax in 2010, the step-up in basis to fair market value for inherited property will no longer be unlimited. But up to \$1.3 million in assets plus another \$3 million for assets going to a spouse will still be able to receive the step-up.

For property that's expected to decline or has declined in value, consider selling the property to take advantage of the tax loss. You might then consider gifting the sale proceeds.

### BEWARE OF THE GST TAX

The generation-skipping transfer (GST) tax was designed to limit an individual's ability to transfer wealth to successive generations without incurring a gift or estate tax at each generation. It's equal to the top estate tax rate and also scheduled to be repealed for 2010. (See Chart 2 on page 5.)

Fortunately, there's a GST tax exemption, which through 2009 is scheduled to be

equal to the estate tax exemption. (Also see Chart 2.) Gifts that skip a generation also may qualify for the annual gift tax exclusion under certain conditions. When properly used, this GST tax exemption allows some degree of long-term wealth building even when the estate tax is in effect.

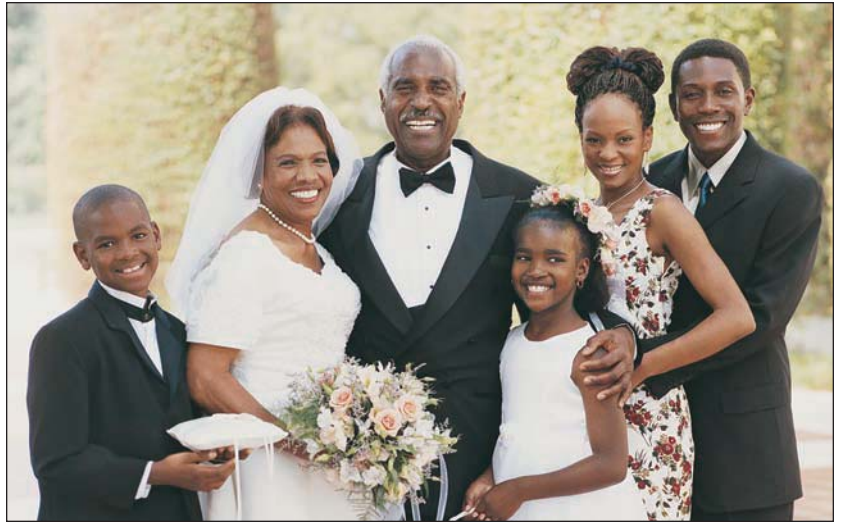
## PLAN WITH TRUSTS

Using certain types of trusts in an estate plan can provide significant tax savings while preserving some control over what happens to the transferred assets. Here's a look at some of the most common trusts:

**Credit shelter trust.** If you're married, you can use a credit shelter (or bypass) trust to take advantage of both your and your spouse's estate tax exemptions. When the first spouse dies, assets equal in value to his or her available estate tax exemption pass to a trust, from which the surviving spouse typically receives the income during his or her life, plus principal distributions at the trustee's discretion.

When the surviving spouse dies, the remaining principal usually passes to the children and, because the surviving spouse didn't control the trust, the trust assets bypass estate tax in the second estate. To use the trust, each spouse must own assets individually that he or she can pass into this trust upon death.

**QTIP trust.** In some circumstances, you may hesitate to leave property outright to your spouse, who would then have complete control over it during life and the ability to distribute it as he or she wished at death.



A qualified terminable interest property (QTIP) trust may be a viable alternative.

A QTIP trust can provide your spouse with lifetime income while preserving the principal for beneficiaries you choose, such as children from a previous marriage. And if your trust provisions permit it, the trustee may also make distributions from the principal for the surviving spouse's benefit during the trust term.

**QDOT.** Transfers to a noncitizen spouse generally don't qualify for the unlimited marital deduction unless property passes to the surviving spouse in a qualified domestic trust (QDOT). The rules for a QDOT are complex; consult your attorney and professional tax advisor.

**Crummey trust.** Normally gifts to trusts don't qualify for the annual exclusion because they aren't considered to be gifts of a present interest. But if beneficiaries have the right to withdraw the gifted assets during the tax year, the gift is considered a present interest. This is where a Crummey





trust can help. It generally gives beneficiaries the right to withdraw the assets, on notice, for a period of time during the tax year, usually for a 30- to 60-day window. This provides you with a way to make gifts for the future that qualify for the annual exclusion.

**GRAT and GRUT.** Grantor-retained annuity trusts (GRATs)

and grantor-retained unitrusts (GRUTs) are irrevocable trusts into which you place assets and then from which you receive payments for a defined number of years. At the end of the trust term, the principal passes to the beneficiaries. In a GRAT, the payments are in the form of an annuity based on the value of the assets on the date the trust is formed. In a GRUT, the payments are based on a set percentage of the value of the property as determined each year.

The present value of the income stream you receive reduces the present value of what ultimately will pass to your beneficiaries. This substantially reduces the value of the gift for gift tax purposes.

If you outlive the trust term, all of the remaining trust assets (plus appreciation) will be excluded from your estate, because you retained no interest in the trust assets at death. However, if you don't survive the trust term, the value of the assets is included in your estate.

**QPRT.** A qualified personal residence trust (QPRT) works similarly to a GRAT or GRUT,

except you gift your home, rather than other assets, to the trust. You retain the right to live in the home for a set number of years. At the end of this period, the residence is typically distributed from the trust to your children.

At the time of the transfer, your gift is the value of the home, less the value of your right to live in it for the designated period. As with a GRAT or GRUT, if you die during the trust term, the value of the home at the time of your death will still be included in your taxable estate. You also must be comfortable knowing that some day your family will have control of your residence. But if they agree, you can continue to live in the home after the end of the trust term as long as you pay rent at the market rate.

### TRANSFER BUSINESS OWNERSHIP

If you're a business owner, there are additional estate planning issues to consider. Transferring business ownership can preserve your business and accumulated wealth — if planned properly. Consider the following:

**Estate tax deferral.** Normally, estate taxes are due within nine months of death. But if



closely held business interests exceed 35% of the adjusted gross estate, your estate may qualify for a tax payment deferral. If so, your estate needs to make interest payments on only the estate tax owed on the value of the business until five years after the normal due date. The tax is then paid on the closely held business interest over 10 equal, annual installments. Thus, your estate can defer paying a portion of the tax for up to 14 years from the original due date. (See Case study I.)

**Section 303 redemption.** Under certain circumstances, your company can buy back stock from your estate without the risk of the distribution being treated as a dividend for income tax purposes. The distribution is treated as a sale or exchange of the stock. Because the basis is stepped up to fair market value, no income tax is due on the distribution. Generally, such a distribution must not exceed the estate taxes and funeral and administration expenses of the estate.

One caveat: The value of your holdings in the business must exceed 35% of the value of your adjusted gross estate. If the redemption qualifies under Section 303, this is an excellent way to fund payment of estate taxes.

**Buy-sell agreements.** Buy-sell agreements protect owners and their heirs in the event of death or disability, or at retirement. For closely held business owners, buy-sell agreements can also be structured to minimize estate taxes. If done properly, the valuation for the buy-sell agreement

## Case study I

### SAVING TODAY BY PAYING TOMORROW

Marjorie owned a small distribution company that accounted for 50% of her estate. When she died, her total estate tax liability was \$2 million. Half of the liability was due at the normal due date of her estate tax return (nine months after Marjorie's death). The other \$1 million of liability could be paid in 10 annual installments, starting five years and nine months after Marjorie's death. Marjorie's estate would, however, have to pay interest on the unpaid liability each year.

can set the value for estate tax purposes. Buy-sell agreements also typically restrict a shareholder's ability to transfer shares outside the current ownership group without the other owners' consent.

**Valuation discounts.** Your business may be your most valuable asset. But because a closely held business doesn't trade on the open market, arriving at an appropriate value for interests in it can be complex. Shares of closely held businesses often have a reduced value.

A minority interest discount is generally available if you gift less than a 50% business interest, because the recipient won't own enough to have control over business decisions. In addition, you may be able to claim a discount for lack of marketability, because the partial interest transferred generally won't have a ready market and would be difficult to sell at full value. An independent appraiser is essential for establishing an appropriate value that will hold up to IRS — and possibly court — scrutiny.

## GIVING TO CHARITY

**C**haritable giving helps you reduce your income or estate tax bill while aiding your favorite organizations.

*Direct bequests to charity are fully deductible for estate tax purposes. Lifetime gifts remove assets — as well as future appreciation — from your taxable estate and may be deductible on your income tax return. Contributing to charity also is a good way to leave a legacy in your community or give your heirs a sense of social responsibility.*

Outright gifts or bequests of cash or securities are generally the simplest way to donate. But in many situations using a charitable giving vehicle, such as a trust, annuity, foundation or donor-advised fund, offers more benefits.

### CREATE CHARITABLE TRUSTS

You can leave assets, or income from the assets, to both charity and family members. A split-interest trust is often used in this instance:

**CLT.** A charitable lead trust (CLT) provides income to chosen qualified charities during a specified term. When the term expires, the principal goes to the trust's designated beneficiaries — often family members. The trust must make payments to the charities at least annually. If you establish the trust during your lifetime, the amount subject to gift tax is reduced by the present value of the amount going to charity. You also may be entitled to a charitable

deduction on your income tax return, depending on how the trust is structured.

**CRT.** A charitable remainder trust (CRT) is basically the reverse of a CLT — you or your beneficiaries receive payments during the trust's term and the charities receive what's left when the term expires. You can use a CRT during your life to retain an income stream and then pass the principal to charity at your death.

Another benefit: After you make the gift, the trust can sell the trust assets free of capital gains tax because the gain is realized by a tax-exempt organization. Full sale proceeds are then available to buy income-producing securities, though you'll generally owe tax on the income you receive. You can take an income tax deduction when you create the CRT based on the present value of the assets ultimately passing to charity.

For both CLTs and CRTs, the annual payments can be either fixed, based on the initial fair market value of the trust (an



*annuity* trust — CLAT or CRAT), or variable, based on the fair market value of the trust each year (a *unitrust* — CLUT or CRUT). The term can be either a set term or for the life of the donor or donors.

### **CONSIDER AN ANNUITY**

Another option is a gift annuity, which works similarly to a CRT. You contribute an asset to a charity that agrees to make annual payments back to you (and/or another beneficiary) either for a specified number of years or — more typically — until death. You can take an income tax deduction on the value of the donated amount minus the present value of payments back to you or your family and limited to 30% of your adjusted gross income.

If the charity sells the asset, neither you nor the charity must pay capital gains tax on the proceeds. But you'll owe some tax when you receive payments.

### **CONSIDER A PRIVATE FOUNDATION OR DONOR-ADVISED FUND**

You or your family can form a private foundation to support your charitable activities or to make charitable grants according to your wishes. If the foundation qualifies for tax-exempt status, your charitable contributions to it are deductible, subject to certain limitations.

Deductions for donations of appreciated capital gains property to a private, nonoperating foundation are limited to your basis in the property, unless the property contributed is qualified appreciated stock. In this case, you

#### *Wealth planning tip 2*

### **SAVE MORE CAPITAL GAINS TAX BY GIVING COLLECTIBLES TO CHARITY**

When you're thinking of contributing to charity, consider giving from your gallery instead of your investment portfolio. Gains on collectibles are taxed at a top capital gains rate of 28% — not the 15% rate that applies to gains on most long-term property — so you save taxes at a higher rate. If the collectibles donated are consistent with the charity's purpose, you get a deduction for your gift's fair market value, subject to certain threshold limitations based on adjusted gross income.

can claim a deduction for the appreciated value of the stock, not just your basis.

As an alternative to using a private foundation, consider a donor-advised fund. This fund is essentially a small-scale private foundation that requires much less administration. Generally a large public charity or investment firm sponsors the fund, but you make a contribution that's used to create a pool of funds you advise. The IRS is scrutinizing these funds in light of perceived abuse of donor control, and the rules have been tightened. So get professional assistance when setting up a donor-advised fund.

Although you may have fewer tax incentives for creating a foundation or donor-advised fund in light of the uncertainty about future estate tax exemptions and rates, both are still useful options. Please contact your financial or tax advisor to discuss how a private foundation or donor-advised fund could fit into your plan.

# MAKING THE MOST OF RETIREMENT ACCOUNTS

**R**etirement accounts provide a favorable way to accumulate significant wealth.

The best known plans are probably IRAs and 401(k) plans, but others are also available. If you're self-employed or own your own business, you may have a profit-sharing plan. Small employers often establish Simplified Employee Pension (SEP) plans or Savings Incentive Match Plans for Employees (SIMPLEs) to contribute toward both their employees' and their own retirement.

*Wealth planning tip 3*

## ROTH 401(K) OFFERS HIGHER-INCOME INDIVIDUALS A GREAT WAY TO SAVE

Like the Roth IRA, the Roth 401(k) allows you to accumulate retirement savings that, upon withdrawal, can be completely tax free. Unlike its cousin, it has no income limitation for eligibility. So, those who were interested in, but precluded from, participating in the Roth IRA can now avail themselves of the Roth 401(k), as long as their employer offers it as an option. Although there are similar provisions that allow a Roth 403(b) account, Roth 457 plans aren't allowed.

The contribution limits, including the catch-up provisions, are the same as the traditional 401(k) limits. The 401(k) limit applies whether the contributions are made to a traditional or Roth account. You can allocate your entire contribution to a traditional 401(k) or to a Roth 401(k), or any combination that you want, so long as you don't exceed the maximum.

Is a Roth 401(k) right for you? To find out, you'll need to do an analysis of the current benefits that would be lost by not being able to offset your current income by the amount of your contribution against the future benefits that can be gained by the tax-free nature of the withdrawals.

*Nonprofit organizations can offer their employees 403(b) plans.*

## MAXIMIZE YOUR CONTRIBUTIONS

Usually it's beneficial to contribute as much as possible to retirement accounts because of their tremendous tax advantages. First, you may be able to deduct IRA contributions, depending on the type of IRA and your adjusted gross income (AGI), and other plan contributions are usually made pretax. Second, and probably more important, earnings and appreciation on retirement account funds compound tax deferred. In the case of a Roth IRA or Roth 401(k), qualified distributions are tax free. (See Wealth planning tip 3.)

The power of tax-deferred compounding is extraordinary and, over extended periods, can increase your wealth substantially. And you can put away more money if you're age 50 or older. Contact your financial advisor to determine how much you're eligible to contribute.

## MINIMIZE THE TAX CONSEQUENCES OF DISTRIBUTIONS

Age, health and, in some cases, life expectancy are all factors that can affect your retirement distributions.

Distributions from traditional IRAs and qualified plans are taxed as ordinary income. The key to minimizing income taxes is, as much as possible, to take distributions in years in which you have lower taxable income and, thus, will fall into a lower marginal tax bracket, or years you have

extremely high deductible expenses, such as medical costs or charitable contributions, to offset the distribution income.

### **AVOID EARLY WITHDRAWALS**

Generally, until you reach the age of 59½, you can't withdraw funds from your retirement plans without paying a 10% penalty tax. The 10% tax is in addition to regular income tax. There are, however, exceptions. For example, the 10% penalty doesn't apply to distributions made after the owner's death or disability.

Distributions from nondeductible contributions or that are part of a series of substantially equal payments over your life expectancy (or the life expectancy of you and your beneficiary) also aren't subject to the penalty.

### **TAKE MINIMUM DISTRIBUTIONS**

You must start taking minimum distributions by April 1 of the year following the year you turn 70½ or (if you aren't a 5% owner of a company plan sponsor) retire. This is known as the required beginning date. The starting point for determining the required minimum distribution (RMD) amount for a given year is the balance as of Dec. 31 of the prior year. For IRAs, all of your accounts must be aggregated to calculate your RMD, but you can choose the account(s) from which to take distributions. More and more people are withdrawing only the minimum required amounts to maximize continued tax-deferred growth.

Be careful when calculating the proper amount, because failure to withdraw the

minimum amount in any year could result in a 50% excise tax on the shortfall. This is particularly important in light of reporting rules that require IRA custodians to report your RMD amount to the IRS.

On your death, your surviving spouse beneficiary may roll over your IRA into his or her own IRA. For surviving spouses who haven't yet reached age 70½, this can further defer distributions.

### **STRETCH OUT DISTRIBUTIONS WITH FAMILY BENEFICIARIES**

Retirement plan assets held at death are the most heavily taxed assets. With large accumulations of retirement assets, income and estate taxes could easily take a substantial portion of your retirement plan assets, leaving only the balance for your heirs.

One way to help reduce the income tax bite on retirement plan assets is to encourage your children, as beneficiaries, to elect to receive distributions over their life expectancies (rather than shortly after your or your spouse's death). Thus, income taxes are payable over time, only as distributions are made to the beneficiaries, and more is left to grow tax-deferred.



## DETERMINING YOUR INSURANCE NEEDS

Insurance — whether it's life, disability, long-term care, or property and casualty — ultimately protects your family's future. But many people are underinsured. If you fall into this group, a premature death or disability, a large property loss, or a lawsuit could cost you a big chunk of your assets — or even leave you (or your family) financially devastated. To fully protect and provide for your family while minimizing your premiums and the tax consequences, you must carefully determine your insurance needs and then obtain the appropriate coverage from a financially strong insurance company.

### LEVERAGE LIFE INSURANCE

Life insurance may be the most powerful type of insurance because it can replace income, provide liquidity to equalize assets among children active and inactive in a family business, or be a vehicle for passing on leveraged funds free of estate tax — all in a single package. And though the estate tax is decreasing and scheduled to be temporarily



eliminated in 2010 (see Chart 2 on page 5), your estate may very well face at least some estate tax liability. Insurance can provide cash to pay these estate taxes.

Here are the three key steps you need to take when purchasing life insurance:

**1. Quantify your need.** To estimate the amount of life insurance you need, consider your current investments and the support your family will require. Ideally, life insurance should replace most or all of your wage contribution to the family for a readjustment period of several years after death. Life insurance should also cover the cost of funding children's education and paying off mortgages or other debts.

Then look at any liquidity problems your estate may have. Estates are often cash poor, and your estate may be composed primarily of illiquid assets, such as closely held business interests, real estate or collectibles. If your heirs need cash to pay estate taxes or for their own support, these assets can be hard to sell. For that matter, you may not want these assets sold.

#### Wealth planning tip 4

### CONSIDER A SPLIT-DOLLAR PLAN

Split-dollar arrangements provide for a life insurance policy's costs and benefits to be split between two parties — often the insured (or a trust for his or her family) and his or her employer. The arrangement typically provides for a buyout of the employer's interest in the policy at retirement or some other date.

Current tax law offers guidelines for such arrangements, aimed at reducing or eliminating the income tax benefits.

Even if you have a substantial estate, you may want to buy insurance simply to avoid the unnecessary sale of assets to pay expenses or taxes. Sometimes second-to-die insurance makes the most sense. Of course, your situation is unique, so please get professional advice.

**2. Choose the right form of ownership.** Choosing the proper form of ownership is just as important as selecting your beneficiaries. If you or your spouse owns the policy, the insurance proceeds could

be subject to estate taxes on the surviving spouse's death. If your children own the policy, the proceeds won't be included in your estate, and you may be able to use the annual gift tax exclusion (see page 5) for making gifts to them to pay the annual premiums. But you must be confident that your children will actually pay the premiums.

Other possible owners include an irrevocable life insurance trust (ILIT — see Case study II), a family limited partnership (FLP — see Wealth planning tip 1 on page 6) or limited liability company (LLC), or your business.

Generally, to reap maximum tax benefits you must sacrifice some control and flexibility as well as some ease and cost of administration. To choose the best owner, consider why you want the insurance. Do you want

## Case study II

### AN ILIT OFFERS AN ATTRACTIVE OWNERSHIP ALTERNATIVE

Jack decides to buy a life insurance policy to benefit his two college-age children, Melissa and Ben. He wants to keep the proceeds out of his estate without giving the policy outright to his children, who are still learning to be financially responsible. His advisor suggests a widely used form of ownership — the irrevocable life insurance trust (ILIT). After Jack sets up the trust, he simply needs to make gifts to it that the trustee can use to pay the premiums. Melissa and Ben, as beneficiaries, will still receive the proceeds, but the trust will control how they're paid out.

Jack's advisor also suggests the trust include a Crummey provision. The resulting Crummey power allows Jack's gifts to be free of gift tax under the annual exclusion. Normally, gifts have to be of a present interest to qualify, and gifts to a trust are considered to be of a future interest. But by providing the beneficiaries with the right to withdraw the gifted money within a short, set period, the Crummey power makes the gifts present interests for gift tax purposes. After that right lapses, the trust pays the insurance premiums. Jack should explain to Melissa and Ben that they will benefit more if they let the right lapse so the gifts can be used for premiums.

to replace income? To provide liquidity? To transfer wealth to your heirs? You'll also need to determine the importance to you of tax implications, control, flexibility, and ease and cost of administration.

**3. Pick the insurer.** In addition to selecting a financially strong insurance company, you'll need to critically evaluate a company's policy illustrations showing how your money will grow. Dividend assumptions, future interest rates, mortality costs and expenses all could significantly affect the amount of your future premiums.

### LOOK AT DISABILITY INCOME INSURANCE

Long-term disability insurance is one of the most overlooked areas of wealth planning. It replaces your wage income, or a major



share of it, if you suffer a disabling injury or illness. Most people will become disabled for 30 days or more at some point during their lifetimes. Although Social Security covers most employees, its benefits are generally inadequate for individuals with a high standard of living.

The definition of disability is the most important feature of the policy. You'll generally want a policy with the least restrictive definition possible. Other crucial matters include:

- The period you have to wait after becoming disabled before you are eligible for benefits,
- The length of time the benefits will be paid (to age 65 or for life), and
- The taxability of the benefits, which may be excludible if you pay the premiums with after-tax dollars.

The potentially devastating effects of disability increase if you're a business owner. To further protect yourself — and your business — consider overhead insurance and key person insurance as well.

Overhead insurance covers expenses like rent, wages, benefits, loan payments and taxes. Key person insurance protects against losses, including decreased sales, productivity and profits, from the disability of a key employee. Some key person plans pay benefits to the business. Others pay directly to the employee, freeing up the employee's salary. Key person premiums aren't tax deductible, but the benefits are tax free.

## **EVALUATE LONG-TERM CARE INSURANCE**

Although hard to face, there's a good chance you'll need some form of long-term care, and the resulting costs can be one of the biggest financial threats you face. Left unchecked, they can easily eat up a lifetime of built-up wealth.

Long-term care insurance has become very popular as a way to protect assets for heirs, rather than use them to fund nursing home costs. It may provide daily benefits for home health care, institutional care or both.

Determining a precise combination of benefit amounts, elimination periods and inflation riders to meet your future needs can be challenging. One way to deal with this decision is to determine how much of the long-term care risk you can reasonably cover and then transfer the balance of the risk to an insurer.

## **DON'T FORGET ABOUT PROPERTY, CASUALTY AND LIABILITY INSURANCE**

Property and casualty insurance provides coverage for your home and its contents, automobiles and personal property. Excess liability coverage, commonly referred to as umbrella coverage, kicks in where other coverage leaves off. Usually you can't buy excess liability coverage unless both your homeowner and auto coverage meet certain criteria. If you serve on corporate or non-profit organization boards of directors, you should also consider insurance to cover associated liability.

## REFINING YOUR INVESTMENT STRATEGY

**h**aving a well-thought-out investment strategy is critical. Your ideal strategy depends on your age, portfolio size, risk tolerance and desired rate of return, liquidity and cash flow needs, and income tax bracket. This means evaluating these elements and adjusting your asset allocation accordingly while considering the tax consequences. By sticking to your strategy and making refinements as necessary, you may be in a better position to ride out any stormy market periods.

### RATE YOUR RISK TOLERANCE

All investments involve a trade-off between risk and return. A certain amount of risk is inevitable if you want your money to grow. Understanding your personal risk tolerance will help you make investment decisions you feel comfortable with.

Although your personality influences your underlying risk tolerance, your stage of life and current wealth also affect it. As you move closer to retirement, you may be better off forgoing the highest potential returns and putting some of your money in more secure investments, such as bonds, because you would have less time to recover from a market downturn. But if you have a large amount of disposable income available for investing, you may be able to afford more risk — even under a shorter time frame.

### ALLOCATE ASSETS AMONG THE 3 MAIN CLASSES

Asset allocation is one of the most important aspects of investment portfolio management. The objective of any asset allocation plan is to find the appropriate mix of expected risk and expected return to achieve your goals.

Diversifying your funds among the three broad investment classes — stocks, bonds and cash — is an important way to help minimize your investment risks. The first



step is to decide how to distribute your resources among the three main classes. Then, within each asset class, you face additional choices. Here are some of the options to consider for each class:

**Stocks.** You can choose among various categories of stocks, such as by size (large cap, mid cap and small cap), function (growth, value, income), geography (domestic, international) and market sector (technology, energy, financial services, basic materials) — each of which may respond differently to economic changes. Over the short term, stocks can be a risky investment. But over the long term, they've generally earned higher and more consistently positive returns than any other financial investment.

**Bonds.** As with stocks, you can choose among various categories of bonds, such as by taxability (taxable, tax free), issuer (private, federal government, state government, municipal government), or time frame (short, intermediate or long term). Bonds, though generally less volatile than

stocks, also respond to economic changes. In particular, bonds are sensitive to market interest rate changes.

**Cash and cash equivalents.** These generally include short-term liquid instruments such as Treasury bills, commercial paper and money market funds.\* This class is usually allocated the smallest percentage of resources, because, though you face minimal risk, you also reap lower rewards. You may want to maintain sufficient funds to cover cash needs in an emergency — perhaps three to six months' worth.

### REMEMBER, TAXES TAKE A BITE OUT OF RETURNS

Although tax consequences shouldn't control investment decisions, you should recognize them as an important component of analyzing the true performance of your portfolio.

Reviewing after-tax returns enables you to better evaluate an investment's performance relative to its peers. In fact, some brokers, money managers and mutual funds report their historical performance on both a before- and after-tax basis. Remember: Past performance is no guarantee of future results.

The impact of taxes in any particular year may not be that significant. But over a number of years, the compounding can have a tremendous effect on a portfolio's growth. For example, the difference between a \$100,000 portfolio growing after tax at 8% a year vs. a less tax-efficient \$100,000 portfolio of equally risky investments

#### Wealth planning tip 5

### DOCUMENT YOUR STRATEGY IN AN IPS

Are you interested in steady growth or bigger opportunities for gains with more volatility? Do you have a current need for income? Once you evaluate these and other questions, you can develop your investment strategy and document it in an investment policy statement (IPS) based on your risk tolerance, desired asset allocation and other variables that can affect your portfolio structure. You can then use your IPS as a working model for monitoring your portfolio's structure and performance.

\* An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although these funds seek to preserve the value of an investment at \$1 per share, it is possible to lose money by investing in them.

growing after tax at 6% a year\* amounts to almost \$150,000 over 20 years.

### TIME THE RECOGNITION OF CAPITAL GAINS AND LOSSES

In a year when you have net capital gains, you can take losses to offset them. If you have net losses, you can lock in gains on appreciated securities by selling them and absorbing the losses. (Only \$3,000 of net capital losses can offset ordinary income, but you can carry forward excess losses indefinitely.)

Also consider that, through 2010, the top tax rate for long-term capital gains is currently set at 15% for most property held more than 12 months, compared with 35% for ordinary income, such as short-term gains. (See Chart 3.)

That's a significant difference. If you can generate net long-term capital gains instead of ordinary income, you'll save considerably on your taxes. As a result, investment strategies that emphasize capital appreciation over current income can significantly enhance after-tax portfolio returns. Of course, tax



\* These amounts are hypothetical and are used for example only.

Chart 3  
2008 capital gains tax rates

#### Maximum tax rate for assets held:

12 months or less (short term)

35%

More than 12 months (long term)

15%

#### Key exceptions to the 15% tax rate:

Gain on collectibles, such as artwork

28%

Gain attributable to certain prior depreciation on real property

25%

Gain that would be taxed at 10% or 15% based on the taxpayer's regular income tax rate

0%

Source: U.S. Internal Revenue Code

considerations are just one factor — if your investment strategy dictates selling a short-term security at a gain, don't let the taxes stop you. After all, you'll still net a significant percentage of your gain.

You can control the amount and timing of gains or losses recognized and whether the holding period is short-term or long-term on a securities sale by identifying which lots to sell. If you don't specify otherwise, your lots are considered sold according to first-in, first-out (FIFO). This could produce the highest taxable gains if those early lots were purchased at a price lower than later lots.

Identifying shares with greater-than-12-month holding periods will qualify gains for the lower rates, but may also force you to swallow



larger capital gains if the stock appreciated steadily while you held it.

### CONSIDER YOUR STOCK OPTIONS

If you hold stock options, you should be aware of the tax implications of receiving and exercising them and, finally, of selling the underlying stock. There are two distinct types of stock options:

**Nonqualified options.** When nonqualified options are granted, they aren't included in income unless the value is readily ascertainable.\* For the value to be readily ascertainable, the option usually needs to be actively traded on an open market. When you exercise the option, you recognize ordinary income for the

difference between the stock's fair market value and exercise price.

**Incentive stock options (ISOs).** You may exercise an ISO without recognizing any taxable income, but there still may be alternative minimum tax (AMT) consequences. If you meet certain holding period tests, the sale of the underlying stock will qualify for long-term capital gains treatment.

ISO holders often discover that they're not liquid enough to exercise the options and hold the stock for more than a year. Thus, they may have to immediately sell and forgo the favorable tax treatment. Proper timing when exercising options is vital.

### DEDUCT INTEREST EXPENSE

Interest on money borrowed to purchase or carry portfolio investments is deductible only against taxable investment income. Excess investment interest expense can be carried forward indefinitely and deducted against investment income in future years.

You may elect to treat net long-term capital gains or qualified dividends as investment income and give up the taxability of such income at the lower rate. This may make sense if you have excess investment interest expense that won't be used if you carry it over due to the lack of investment income in the next several years. Interest on funds borrowed to purchase or carry tax-exempt obligations isn't deductible. For commingled accounts, allocating the interest expense between taxable and tax-exempt securities usually is required.

\* Nonqualified stock options may be affected by rules relating to nonqualified deferred compensation. Consult your personal tax or legal advisor.

## PROTECTING YOUR ASSETS

**A** sset protection planning is the process of organizing assets to shield yourself from future adverse financial circumstances, such as litigation. An asset protection plan may be as simple as diversifying your stock portfolio or as complex as setting up foreign trusts. It's generally impractical to protect all your assets, but, by using asset protection planning, your entire net worth won't become fair game to future creditors. In addition to the techniques considered in this section, insurance and retirement plans also can serve as asset protection tools.

### TRANSFER ASSETS TO YOUR SPOUSE

With proper planning, a gift to your spouse can shield the gifted assets from your creditors. But if your marriage should end in divorce, your then ex-spouse would still own those assets. So you'll want to be confident in the stability of your marriage before making such a gift.

### SET UP AN FLP

Family limited partnerships (FLPs) can also be used in an asset protection plan. Most state laws protect the FLP's assets from creditors of the limited partners. Generally, FLPs can be formed without adverse tax consequences, and limited liability is provided to the limited partners. (See Wealth planning tip 1 on page 6.)

### ESTABLISH AN OFFSHORE TRUST

The main advantage of an offshore trust is that a provision in the trust instrument may shield the trust assets from creditors.

Although this provision can also be put into domestic trusts, it can be "pierced" when the beneficiary is also the grantor. This is due to state laws prohibiting grantors from establishing trusts for their benefit that block existing and future creditors' access to the trust assets. The provision, therefore, may be more effective in foreign trusts. But this is changing — see Wealth planning tip 6.

Another potential advantage of the offshore trust is that the foreign jurisdiction's trust law generally applies. These laws typically provide for a short statute of limitations, and offshore trust sites usually don't recognize foreign judgments. Additionally, foreign jurisdiction laws generally define benefits that a grantor may retain without subjecting the trust assets to seizure by creditors.

#### *Wealth planning tip 6*

### ALASKA AND DELAWARE TRUSTS MAY PROVIDE DOMESTIC ASSET PROTECTION

Domestic trusts in some states have been designed to provide the same benefits that traditionally have been the exclusive province of offshore trusts. The idea behind these domestic "offshore" trusts is that you are able to get the same benefits domestically that used to require you to go offshore. Presumably, the trusts will provide the same asset protection benefit as offshore trusts, but the reality is that they haven't been tested to the same degree. Whether a state — or offshore — trust is appropriate for you depends on several factors. Consult your personal legal or financial advisor to determine whether your situation warrants such a trust.

## REDUCING INCOME TAXES

**a**s with other aspects of your personal finances, income taxes can play a significant role in your ability to retain and increase your personal wealth. Reducing your income taxes, therefore, is a logical way to preserve that wealth. It's important to consider how changes such as marriage, divorce, the birth of a child, a promotion, relocation, retirement, illness or sale of major assets can easily alter your taxable income from year to year.

### ACCELERATE OR DEFER INCOME AND DEDUCTIONS

If you expect to be in a higher tax bracket next year, accelerating income into the current year and deferring deductions until

next year could save you taxes overall. If you expect to be in a lower bracket, the opposite approach — deferring income and accelerating deductions — could be effective. Even if your marginal bracket remains the same, deferring income to a later year generally will be advantageous. And by bunching certain deductible expenses into one year, you may be able to exceed the applicable “floors.”

Also be sure to take all of the above-the-line deductions — the income adjustments that determine adjusted gross income (AGI) — you're entitled to. Because AGI determines your eligibility for various deductions, exemptions and credits, this strategy can reduce your taxes even further.

### BENEFIT FROM HOME OWNERSHIP

Owning a home offers many tax-saving opportunities. Don't miss out on any — be sure to take advantage of all that apply to you:

#### **Maximize home-related deductions.**

You may deduct interest on debt on a first and second home, though limits do apply. Although you must include your main residence as one of the homes, you may choose any of your other homes as a second qualified residence, and you may choose a different home each tax year.

If you refinance, you must use any excess principal taken out to substantially improve the home; otherwise interest on only \$100,000 of such excess debt may be deductible. Thus, paying down your



mortgage and tapping into that equity at a later date could severely restrict your ability to deduct the interest as mortgage interest.

**Exclude gain from the sale of your home.**

You can exclude up to \$250,000 (\$500,000 if married filing jointly) of the gain realized on the sale or exchange of your principal residence. The home must have been your principal residence for at least two of the last five years, and additional rules apply. If you have more than one home, you can exclude gain only from the sale of your primary residence.

If you still incur a taxable gain on your home sale, examine your records from the last several years to determine whether you've overlooked any capital improvement expenses, such as from building additions. These costs will reduce your taxable gain when added to your basis in the home.

**Consider rental rules.** If you rent out all or a portion of any of your homes for less than 15 days, you need not report the rental income. But expenses associated with the rental aren't deductible. If you or a relative use the home for personal use for more than 14 days or for more than 10% of the number of days the property is rented, rental expenses are limited to rental income — you can't deduct a loss. However, any excess can be carried forward to offset rental income in future years.

If the home is classified as a rental property for tax purposes, you can't deduct any interest that's attributable to your personal use

*Wealth planning tip 7*

**AVOID PENALTIES AND DEFER LIABILITY WITH ESTIMATED TAX PAYMENTS**

You may be penalized if your withholding and estimated tax payments don't meet the minimum required amounts. To avoid such penalties, during the current year pay 90% of your current year's tax liability or 100% of your prior year's liability. (If your adjusted gross income exceeds certain levels, you have to pay 110% of your prior year's liability.) The second option can be beneficial if you expect your tax to increase, because you can defer any tax due in excess of last year's liability (or 110% of it) until April 15 of the next year.

of the home. But you can take the personal portion of property tax as an itemized deduction and deduct rental expenses, including losses (subject to the passive activity rules). Talk with your tax or financial advisor for more information.

**PLAN FOR THE AMT**

The alternative minimum tax (AMT) is a separate tax system that limits some deductions and doesn't permit others, such as state and local income tax deductions, as well as property tax deductions.

You must pay the AMT if your AMT liability exceeds your regular tax liability. Because the AMT can have a significant impact on your tax liability, be sure to consult your tax advisor to determine whether you may be subject to the AMT.

**FUND COLLEGE WITH A 529 PLAN**

Section 529 plans enable parents (or grandparents) to either secure current tuition rates with a prepaid tuition program or create tax-advantaged savings plans to fund





college expenses. 529 plans typically offer high contribution limits (determined by the sponsoring state or private institution) and there are no income limits for contributing. Plus, there is no beneficiary age limit for contributions or distributions.

For federal tax purposes, contributions aren't deductible, but distributions used to pay qualified expenses are income tax free. And you may also reap some tax benefits at the state level.

## PERSONAL WEALTH MANAGEMENT WORKSHEET

You can use many different strategies to manage your wealth. The ones that will work best for you will depend on your unique situation. To learn how to incorporate these strategies into your personal wealth plan, fill out the worksheet below. After you complete the checklist, send it to your tax or financial advisor.

*Please check all boxes that apply to your situation.*

### Do you have a wealth management plan in place?

- Yes (date last reviewed: \_\_\_\_\_ )
- No, but I would like to develop one

### My primary financial concerns are:

- Achieving my estate planning goals
- Charitable giving
- Funding retirement
- Protecting against loss/illness
- Strengthening my investment portfolio
- Protecting my assets
- Minimizing taxes
- Other \_\_\_\_\_

**Send this form to your tax or financial advisor.**

NAME \_\_\_\_\_

TITLE \_\_\_\_\_

ORGANIZATION \_\_\_\_\_

ADDRESS \_\_\_\_\_

CITY \_\_\_\_\_ STATE \_\_\_\_\_ ZIP \_\_\_\_\_

PHONE \_\_\_\_\_ FAX \_\_\_\_\_

E-MAIL \_\_\_\_\_

### I would like to learn more about the following:

- Using gifting as part of my estate plan
- Setting up a trust for my heirs
- Transferring ownership of my business
- Using trusts to achieve my charitable goals
- Setting up a private foundation
- Maximizing my retirement income
- Planning my retirement plan distributions
- Using insurance as part of my estate plan
- Choosing the right type of insurance
- Split-dollar insurance plans
- Long-term care insurance
- Creating an asset allocation plan for my investments
- Creating a capital gains strategy
- Asset protection planning
- Shifting or deferring income
- Other \_\_\_\_\_

### My greatest wealth management concern/need is:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_