The
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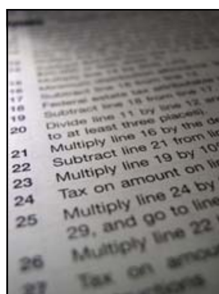
The Importance Of Year-Round Tax Planning

Chances are, you prefer to think about taxes as little as possible. But just avoiding the subject won't keep the Internal Revenue Service at bay. And paying attention long before tax season gives you time to implement strategies that could save you money. "You can't plan backwards," says Victoria Serles, partner and director of the Private Client Wealth Management Practice with the Seattle office of BDO Seidman, a national accounting firm. "But people who consider their taxes months ahead of time tend to be very satisfied with the results."



You could put these strategies into effect at any time (and sooner is almost always better than later):

Profit from tax losses. Call this the silver lining of a dark cloud. With markets struggling recently, you may be sitting on investment losses. But there could also be unrealized gains in your long-term holdings, and if you had planned to sell appreciated assets—but feared the tax bite—now could be the time to act.

You can offset gains with losses dollar for dollar. So a $50,000 loss will totally negate a $50,000 gain. If you sell a stock or fund at a loss, the loss is disallowed for tax purposes if you buy the same investment again 30 days before or after the date of sale; this "wash sale rule" is meant to discourage people from selling shares for tax purposes and then immediately repurchasing them.

However, you can jump right back into a similar investment—a stock in the same industry or another fund that tracks the same index, for example. If you sell, as a loss, a mutual fund of one investment objective, you could purchase a different fund with the same objective—therefore harvesting the tax loss without changing your overall allocation.

If your losses exceed your gains, you can use up to $3,000 in losses to offset ordinary income each year, and you can save leftover losses for future years.

Maximize retirement savings. In 2007 and 2008, annual contribution ceilings for retirement plans edged up to a maximum of $15,500 in pre-tax dollars going into a 401(k) and $5,000 for an individual retirement account. Catch-up contributions for savers 50 or older extend those limits by $5,000 a year for 401(k)s and $1,000 for IRAs. Any deductible contributions you divert into these accounts come off the top of your income, immediately reducing your taxes. So if you're saving less than the maximum, consider boosting your contributions now to spread the increase over the rest of the tax year. Wait until year-end and "you might not have the cash flow available to maximize that opportunity," says Serles.

Minimize the alternative minimum tax. The alternative minimum tax, or AMT, was originally designed to ensure that the very wealthy couldn't avoid taxes entirely by taking advantage of abundant tax

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The Monitor Group Fall 2008 Report

As we approach the holidays, our thoughts naturally turn to...taxes! Many of you have taken advantage of our tax planning service, typically conducted in November and December, but some of you may not know we do this. We created a questionnaire we use to identify potential tax savings opportunities. We also determine whether you need to make an estimated tax payment on January 15. If you are interested, please ask your Client Relations Manager. The article on this page discusses tax planning.

With few exceptions, every client of The Monitor Group should have a trust. Trusts serve various purposes and have several advantages. It is also important to re-title assets to your trust, once established. The article on page 2 explains this.

A Family Limited Partnership is an advanced estate planning technique which can save your heirs a significant amount of estate taxes. We generally recommend this device for clients whose net worth is well beyond the exemption amount. But, it must be set up properly to avoid IRS problems. Read about it on pages 2 and 3.

The equity markets have not performed well this year. However there are opportunities; these are explored on the top of page 3.

Finally, owning property jointly with your spouse is not always the best way to have assets titled. Please read the discussion on the back page.

We trust your holidays will be wonderful!

Cal Brown, MST, CFP®
Vice President

They Don't Call 'Em Trusts For Nothing

Maybe you heard the story about the 60-year-old oil heiress who died and left everything to her husband. He was 71 and died just two months after remarrying a much younger woman, who inherited his first wife's fortune. The heiress' children got none of it. Or perhaps you heard about the man who left his son $500,000, which he used to buy a house with his wife. Two years later, they divorced, and she got the house in the settlement.

Then there's the one about a couple that inherited $250,000 from an uncle but received none of it because the IRS exercised its right to take the inheritance to satisfy back taxes.

Obviously, these aren't the kinds of stories that you want people to tell about your family. To avoid the possibility of such trouble, you may need to establish a trust.

A trust is an agreement in which you transfer ownership of property to a trustee of your choosing, who then manages it for the benefit of your loved ones. The trust can be funded during your lifetime or at your death if your will provides for it. Typically, it costs between $1,000 and $2,000 to set up a trust, although you might spend more depending on where you live, the legal advisor you use, and the complexity of the trust.

Life is full of surprises, but experts say that you can trust a trust

Trusts have long been used by the wealthy to reduce estate and income taxes, but more and more middle-class people are finding trusts can benefit them, too. Appreciation in real estate values over the long term, stock market gains for astute investors, and the slow march of inflation have thrown many middle-class individuals into higher income tax brackets and left them facing the prospect of estate taxes that could decimate the value of bequests to their loved ones.

A bypass trust can ensure that a married couple maximizes its combined estate tax exemption of $4 million (for 2008); a charitable remainder trust can reduce estate taxes while allowing you to do good for your community; and a life insurance trust can help guarantee the amount your heirs will receive. You can also use a trust to direct how the assets you leave behind will be managed, and to ensure that your bequests end up with the intended heirs.

The oil heiress, who had thought she was too young for estate planning and had feared that her 25-year-old son and 27-year-old daughter would squander the money, could have used a trust. She might have set aside some assets in the trust for her children until they were older, or she could have appointed a trusted friend or advisor as trustee to disburse the assets.

A trust also would have left the divorcing son in a better bargaining position to keep his house. Had his father left the money in a trust, allowing a trustee to buy the house for the son, the wife wouldn't have been able to get it. And the IRS could not have seized the assets in a trust established for the beneficiary with tax problems.

Life is full of surprises, but you can trust a trust. ●

Limits Of Family Limited Partnerships

In recent years family limited partnerships (FLPs) have become an increasingly popular way to give assets to children. You can discount the value of assets you transfer to an FLP by 20%, 30% or even 50%. The less a gift is worth in the eyes of the IRS, the more you can pass along with little or no tax liability. Thus, you can transfer an interest in a business, real estate, securities, or other holdings to your children and pay lower gift and estate taxes.

One of the key attractions to FLPs has been the ability to give away discounted interests in your assets while continuing to manage them. Now, however, a U.S. Tax Court decision has called into question the ability of those who establish FLPs to retain management control

Typically, parents establish an FLP to hold a particular asset. They serve as general partners and manage the FLP, while the children are limited partners. Because the children couldn't easily sell their interests in this private vehicle managed by their parents, the IRS considers interests in an FLP to be worth less than the actual market value of assets it holds. So, for example, a gift of a 99% limited partnership interest in an FLP owning property worth $1.5 million might be valued at just $1 million for tax purposes.

For wealthy families with many children and grandchildren, an FLP can be a good way to move assets out of parents' estates. Because anyone can make annual tax-free gifts of up to $12,000 to an unlimited number of recipients, parents can slowly transfer assets to their family's younger generations without paying gift tax. An FLP can also be an effective way to transfer real estate incrementally without having to file a new deed every year.

The Tax Court decision in May

Finding Opportunities Amid The Wreckage

As the nation struggles through a severe financial crisis, you're undoubtedly worried about your financial security and the safety of your nest egg. But this is no time to sell stocks or make wholesale changes to a well-balanced portfolio that is aligned with your goals and investment time horizon.

Remember that short-term volatility isn't a big worry when you are invested for the long term. And though stocks have underperformed bonds during recent years, over many decades equity investments have almost always come out on top.

Even if the nation is in a recession, there is a lot in the economy that is doing pretty well. Unemployment, though rising, hasn't exploded, interest rates are still low, and inflation remains under control despite higher energy and food prices. The economy is resilient and the federal government is taking steps to get past the credit crunch.

As for stock prices, much of today's and tomorrow's bad news already has been factored into the market. Selling stocks or mutual funds after a decline simply means getting out at a low point. Nervously entering and exiting the market heightens your risks and lowers your returns.

So what should you do? Stay the course and remain diversified. The Chinese symbol for "crisis" consists of both "danger" and "opportunity." Here are several potential opportunities:

- Before their recent declines, global growth trends had sent commodity prices soaring for energy, agricultural products, and precious metals. Now, lower prices can give volatility-tolerating investors a good entry point for gains once the economy stabilizes. Commodities can also serve as a hedge against inflation.
- Yields on Treasuries dropped as shell-shocked investors fled to the safety of government bonds. But the market fallout should reiterate the importance of broad portfolio diversification—and that includes low-yielding treasuries. Allocation back into stocks and corporate bonds, while prices are low is also important.
- Though not quite as safe as Treasuries, municipal bond funds can deliver income that's not subject to federal and, sometimes, state income taxes. Muni prices have fallen and yields have risen, in some cases nearing the yields of corporate bonds even before figuring in munis' tax advantage. But tread with caution: there are concerns about the worsening financial health of local and state governments along with municipal bonds' lack of liquidity.
- Yields on corporate bonds, too, may be attractive today, when companies must offer higher rates in order to get the financing they need. Though default risks are also high, taking well-considered risks can improve potential returns.
- With the Federal Reserve likely to keep interest rates low, inflation could continue to be a concern, and Treasury Inflation-Protected Securities, or TIPS, can help insulate you against that risk. TIPS' principal increases in step with rises in the Consumer Price Index, and at maturity the buyer receives either the adjusted principal or the original principal, whichever is greater.
- Domestic stocks began their fall before international stocks and could be first to recover. Also, as overseas economies weaken, the dollar may resume its recent climb, reducing the value of foreign holdings for U.S. investors.
- European bonds may be a good bet as European countries drop interest rates in order to boost ailing economies. Declining interest rates favor bond holders.
- U.S. small-cap stocks may be preferable to large-caps because larger, multinational companies tend to have more exposure to international financial woes. Also, small caps tend to rebound first after a recession. ●

2003 invalidated an FLP established by Albert Strangi. The problem, the court ruled, was that Strangi, through his attorney, still had use of the assets he was transferring, and as general partner retained the right to determine who could enjoy them. The court threw the full, undiscounted value of property contributed to the FLP back into Strangi's estate for tax purposes.

Subsequently, the decision against Strangi was affirmed by the Fifth Circuit Court.

Despite this turn of events, FLPs are still very much alive, although some concessions may have to be made. For instance, parents transferring assets to children may have to give up management control of the FLP, say estate tax attorneys. One way to do that could be to name your spouse as general partner, says Gideon Rothschild, chairman of the American Bar Association International Estate Planning Committee. But you, and not your spouse, would have to transfer the assets, Rothschild says. Another approach would be to name a trust with an independent trustee as GP. Rothschild says that another recent court case confirmed the validity of FLPs when the transferring party didn't retain an interest in the assets. He maintains the Strangi case doesn't negate the benefits of FLPs; it just requires more careful crafting and a rethinking of the management structure. ●

These views represent an appraisal of possible events. Outcomes and performances are not guaranteed. The investments discussed may go up or down in value and are not suitable for all investors. The information provided is not specific financial advice or a recommendation to buy or sell. We must review your profile, needs, and accounts specifically to determine what is right for you.

You should consider any investments objectives, risks, charges, and expenses carefully before you invest. Information regarding potential investments, including a fund's prospectus, contains this and other information and should be read carefully before investing. Prospectuses and information may be obtained from our office.

Marriage Doesn't Mean Owning All Your Assets Jointly

Marriage is all about togetherness. Yet when it comes to owning assets, too much togetherness may not be financially healthy.

Owning assets jointly is more convenient than individual ownership, and it's the simplest way to avoid probate after a spouse's death. But couples often should consider separating their assets. Here's why:

Estate tax implications. Estate rules let spouses leave unlimited property to each other tax free. That's okay when the first spouse to die leaves everything to the second, but the second death could result in a whopping tax bill. Couples likely to have estate tax issues could acquire property individually to help maximize the value of each other's estate tax exclusion. While owning a house jointly is important for giving both spouses equal claim if they divorce, other assets can and should be held separately in roughly equal shares.

Dividing jointly owned property. How you take title also affects who can inherit your property. If you own it individually or jointly as "tenants in common," each of you may specify in your will that you want a particular asset or share of an asset to go to a designated heir. However, if you take title as "joint tenants" (with rights of survivorship) or "tenants by the entirety"—the most common form of ownership for married couples—you won't be able to say how assets are split. That may work if you and your spouse share the same beneficiaries. But it could be a problem if, for example, you're in a second marriage and want to divide assets among children from different marriages.

Consider John and Mary. Because they own their property as tenants in common, each holds 50%, and John can bequeath his share to children from a prior marriage. Mary won't automatically inherit John's interest.

But if they hold their assets as joint tenants or tenants by the entirety, the surviving spouse becomes the sole owner of everything the couple owned together. It won't matter that John's will names his children as beneficiaries; if he dies first, the title documents will govern, and Mary will decide how assets are divided when she dies.

Other considerations. Owning assets separately is especially important if your combined net worth is at or above the IRS estate tax exemption—$2 million in 2008 and $3.5 million in 2009. Once you approach those levels, it pays to consider ways to separate assets. Also, since joint-tenancy assets can be taken by creditors or lost in lawsuits once an individual's assets are exhausted, doctors or others who can be sued easily will want at least half of their assets in their spouse's name.

Deciding how to hold title to your assets is not a simple decision, as state laws differ and each situation is unique. We can work with your attorney to help decide what's best for you and your spouse. ●

Year-Round Tax Planning

(Continued from page 1)

loopholes. These days, though, almost anyone can get snared by the AMT. For non-business owners, several things can trigger AMT liability: claiming personal exemptions, paying state and local taxes, taking miscellaneous itemized deductions, deducting medical expenses, or exercising incentive stock options. Any combination of these could push you into AMT territory.

Sitting down early with your tax professional to run an AMT projection could help you see whether you'll pay the AMT this year. It could also give you a chance to head off some of your liability. "If you are going to fall into the AMT area, you want to be thinking about the possibility of timing some of your deductions," Serles says.

For example, if it looks like you'll have to pay the AMT this year, but not next year, you might push some of your state and local tax deductions into next year, when you'll be able to use them to full effect. Or you could think about delaying the exercise of your incentive stock options until later, or bunching charitable deductions in years that you won't have to pay AMT and will receive the full benefit of the deduction.

Manage your business taxes. If you're self-employed or receive income from a side business, mid-year is a good time to make sure you're on track with your estimated taxes. Check with your tax specialist to see whether you're sending the government the correct amount each quarter. The longer you wait, the shorter the time you'll have to pay what you owe, and if you end up underpaying estimated taxes, you could be hit with a penalty. To reduce business taxes, you might consider employing your children. "That provides a deduction to you, and their income is taxed in a lower bracket," say Serles. Or you could increase the tax-deductible benefits you provide to your employees or yourself. Acting well before the end of the year will let you maximize the amount you deduct.

Other tax planning strategies include Roth IRA conversions and the use of charitable trusts. However, many of these strategies are complicated, so you should seek the guidance of your financial advisor and tax professional.●

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