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WEALTH MANAGEMENT ADVISOR

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Preserve your retirement account and transfer more to your heirs

Wealth management 101:
Passive vs. active investing



PRIVATE EQUITY SOLUTIONS, LLC

PRIVATE EQUITY INSURANCE SERVICES

Orchestrating Creative Client Solutions

Brian A. Sullivan, CPA*

A Professional Corporation

office:(650)548-1120
cell:(650)703-3030
fax: (650)342-8258

e-mail: sullivan@4cpa.com

website: www.4cpa.com

Private Equity Solutions, LLC

Private Equity Insurance Services

office:(650)638-2310
cell: (650)703-3030
fax: (650)341-1395

e-mail: admin@pesllc.biz

website: www.pesllc.biz

Beware of the AMT

When Congress created the alternative minimum tax (AMT) in the late 1960s, it was to ensure that wealthy taxpayers who took advantage of tax loopholes, or tax preferences, paid their fair share. But as income tax rates have declined, the AMT has been affecting a soaring number of taxpayers.

Planning is essential to avoiding or reducing your AMT liability, and smart planning begins with understanding how the AMT works and its triggers.

AMT liability

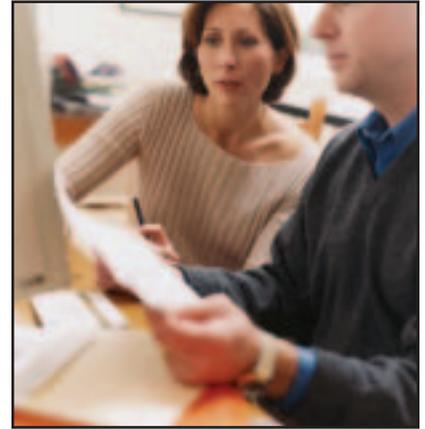
Before you can formulate your tax reduction plan, you need to estimate your AMT liability. This requires doing your taxes twice. First, you must project your taxable income and taxes for regular income purposes, then for AMT purposes.

Estimate AMT income and tax by adding various deductions (such as for state and local income and real estate taxes) and other adjustments (including tax-exempt interest on certain bonds) that aren't allowed for AMT purposes to your regular taxable income. You then can subtract the AMT exemption.

Fortunately, the Working Families Tax Relief Act of 2004 extends 2004 AMT exemptions through Dec. 31, 2005: \$58,000 if married filing jointly, \$40,250 if single or head of household, or \$29,000 if married filing separately. But without future legislation, in 2006 these exemptions will drop to \$45,000, \$33,750 and \$22,500, respectively. And if your AMT income exceeds certain limits, your available exemption is phased out.

Your first \$175,000 of AMT income (\$87,500 if married filing separately) is taxed at 26%; the excess is taxed at 28%. (Regular long-term gains rates apply to qualified gains and dividends.) If your AMT liability exceeds your regular tax, you pay the difference in addition to your regular tax.

AMT triggers
Essentially anything that reduces your regular tax liability but not your AMT liability could trigger the AMT. Sometimes special events,



such as stock option exercises, may trigger the AMT. But everyday situations, such as working in a high-tax state or having a large family, also may expose you to this stealth tax.

Other triggers may include the standard deduction, personal exemptions, the medical expense deduction, and state and local income taxes. Even large capital gains can be a trigger because they could increase your state income taxes, which in turn increases your state income tax deduction.

AMT strategies

After determining your AMT liability, you can try to reduce it. If you're subject to the AMT this year, defer deductions you can't claim for AMT purposes, by, for example, waiting until 2006 to pay expenses such as 2006 property taxes and fourth-quarter 2005 state income tax estimates.

If the AMT appears more of a certainty next year, defer income to 2006 and try to prepay state income tax this year, because that deduction may not help you next year.

AMT planning

As the AMT ensnares a growing number of taxpayers through the rest of the decade, carefully planning the timing of your income and deductions becomes important. The bottom line is that AMT planning is more critical than ever. ■

Casting your portfolio

Evaluate your core and noncore investments

Determining the right mix of investments for your portfolio can be complex. Your financial professional may suggest a strategy that splits your portfolio into core and noncore investments.

But what does that mean? Let's take a closer look at how these two investment types can complement each other to offer potentially higher returns with an amount of risk you're comfortable with.

The leading players

Core investments are the headliners of your portfolio. They are designed to generate solid performance and offer your portfolio long-term stability.

Your core holdings may include stocks of U.S. companies and businesses in developed foreign markets, and high-quality interest-paying securities, such as bonds and money-market funds. (Please note that bonds are subject to interest rate risk. Generally, as interest rates rise, bond prices fall.) (When investing in money-market funds note that they are neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency.)

Bear in mind that stocks generally provide the best growth potential, but at a greater risk than bonds and cash investments, such as money market funds and certificates of deposit. Thus, it's important to diversify your portfolio. Diversification through an asset allocation plan can reduce overall portfolio risk and volatility.

For example, because bond performance has limited correlation to stock performance — meaning bonds often do well when stocks are down — owning both can even out your investment performance over time. The same is true of owning foreign stocks, which provide similar growth

potential to U.S. stocks but generally move out of step with the U.S. stock market.

You may further diversify your portfolio by dividing your stock holdings between contrasting investment styles. For instance, you can pair a growth fund with a value fund or blue-chip stocks with up-and-coming small-cap stocks.

Your financial goals and risk tolerance will dictate the appropriate mix of investment types to include in your portfolio. Of course, keep in mind that past performance doesn't guarantee future results.

If, for example, you'd like to grow your savings quickly and aren't afraid of some risk, you may want to tilt your investments toward U.S. and developed-foreign-country stocks. But if you're risk-averse, consider devoting more of your savings to relatively stable fixed-income securities.

The supporting cast

Noncore investments act as supporting players in your portfolio, adding diversification and increasing its performance potential. Noncore investments might include specialized asset classes, such as real estate investment trusts (REITs) or high-yield bonds.

When investing in REITs, you buy shares of real estate ownership. REITs are a popular investment choice because they're similar to stocks but have limited correlation to U.S. stock markets. REITs must distribute at least 90% of their rental income as dividends to shareholders.

Thus, with their generous income stream, diversification benefits and potential for capital appreciation, they may be a good fit for your portfolio. But because of a REIT's long-term investment nature, lack of liquidity and fluctuating income

risk, contact a financial professional to determine if it's a suitable investment for you.

High-yield bonds, or junk bonds, are debt securities issued by credit-challenged companies. Though quite risky, they can generate significant income.

What other noncore investments might you consider? Your options include stocks from emerging markets, such as Russia, Indonesia, China and Mexico; and commodities, such as gold-based stocks, or mutual funds. There are special risks associated with international investing, such as increased political, social and economic instability. These risks are heightened in emerging markets. Even individual-sector mutual funds — for example, those that invest only in health care or

technology — can be part of the noncore portion of your portfolio.

On its own, each of these investments lacks diversification, thus introducing substantial risk. But owning them in small amounts surrounded by a strong group of core investments can help you build a successful portfolio for the long term.

The right cast of performers

While no one-size-fits-all solution exists for determining which investments belong in your investment portfolio, there are many strategies to consider. One is evaluating your portfolio in terms of core and noncore investments to help you achieve the mix that allows you to earn the highest returns possible at a risk level you're comfortable with. ■

Retirement savings made easy

Consolidate accounts to increase convenience, reduce risk

An old adage says that you should never put all your eggs in one basket. Although this may be good advice most of the time, one basket may make sense when it comes to your and your spouse's retirement accounts. Consolidating multiple retirement accounts into one or two offers several benefits, such as convenience, reduced risk and fewer fees.

Reasons to consolidate

Perhaps the most important benefit of consolidating accounts is that it can reduce your investment risk. Many investors mistakenly believe that splitting their money among several accounts is safer. In fact, it's riskier because ensuring you've properly allocated investments among multiple accounts is difficult.

When considering risk, you must take into account market risk (how well your investments will perform) as well as purchasing power risk (your investments' growth rate compared with the rate of inflation and cost-of-living increases).

Tracking and analyzing investments in several retirement funds can be daunting and time-consuming. Nevertheless, it's critical. Often older accounts are left basically unattended, even though they may be in investments that are no longer appropriate. For example, a 401(k) still sitting with your first employer whom you haven't worked for in 20 years may be invested too aggressively.

Ensure you can easily monitor your investments by consolidating the various accounts. Instead of receiving statements from multiple sources, you'll get all your information on one or two statements.

By getting rid of extraneous retirement accounts,



Beware of the tax bite, tax penalties and other fees

When you consolidate your retirement accounts, you must ensure that the money is rolled over directly into the new account, rather than sent to you to reinvest in a new account. Failing to roll over the funds properly could result in significant taxes and a tax penalty.

If the money does go directly to you, your plan manager must withhold 20% of the funds in your account as a tax on the income. Then to avoid any tax, you'll need to deposit 100% of the funds in your new account within 60 days of the withdrawal and replace the money that was withheld for the tax. You can then claim the amount withheld on your income tax return, in much the same way as you would claim withholding from your salary.

What if you don't roll over the funds into the new account within the 60-day limit? The lump-sum payment you receive will be taxed at your current income tax rate. The 20% your plan manager withholds will be applied toward this total. Also, if you receive the money before turning age 59½, you'll likely owe a 10% early withdrawal penalty.

In addition to possibly accruing taxes and tax penalties when rolling over accounts, you also may incur other fees, the size and type of which depend on the:

- Account type the money is coming from,
- Policies of the organization managing your plan, and
- Type of transaction you're conducting.

If the rollover requires stock liquidation, you could incur brokerage fees. If you conduct an in-kind stock transfer instead, you may incur a different sort of charge or no charge at all.

you'll also eliminate any fees associated with them, saving yourself possibly hundreds of dollars annually. And with a large enough consolidated account balance, your plan manager may waive fees on remaining accounts.

Types of accounts to use

When deciding which types of retirement vehicles to roll your other retirement accounts into, keep in mind that you generally need only one or two. If you're participating in your employer's retirement program, continue to do so — especially if your company matches your contributions. But you usually shouldn't consolidate all accounts into your company's plan because it limits your investment options to whatever your employer has selected.

In most cases, you'll want to consolidate your retirement accounts into a traditional or Roth IRA. That's because you can split your funds among a wider variety of vehicles, such as stocks, bonds, mutual funds and annuities, handpicked to help you achieve your goals.

But if you plan to borrow against your retirement funds, consider rolling over extraneous accounts into your employer's plan instead. For example, you may be able to borrow against your 401(k) plan to put a down payment on a new home. This isn't possible with an IRA, but in certain circumstances, you can make penalty-free withdrawals from an IRA before age 59½. For instance, you may deduct up to \$10,000 for a down payment on a first-time home purchase. But remember that you'll owe income tax on the withdrawal.

A simpler way

Saving and protecting your and your spouse's nest egg can be difficult enough. Why not simplify the tracking and analysis of the various accounts by consolidating them into one or two retirement vehicles? You'll likely be glad you did. ■

Second-to-die insurance can help resolve liquidity issues

With an estate worth \$10 million, Jim and Joan Johnson know that even with an estate plan, the survivor's estate will owe estate tax — unless Congress permanently repeals the tax. Furthermore, the couple's assets are mostly illiquid, including the family business. To combat their liquidity issue, the couple may want to buy second-to-die insurance.

Understanding the advantages

Owning second-to-die insurance is sometimes better than having individual policies. It covers two lives jointly, and pays a benefit after the survivor dies. It can be an attractive alternative to individual policies because the insurer spreads the risk over two lives instead of one; thus, the premiums typically are lower.

Moreover, if your spouse doesn't qualify for an individual policy, he or she may be insured under the second-to-die coverage, provided you're healthy. But keep in mind that the premium may not be much lower than it would be for you alone.

Planning for premium payments

It's wise to plan how the premiums will be paid for after the first spouse dies *before* you buy the policy. If the deceased spouse earned the income needed to pay premiums, the surviving spouse must be able to continue paying them.

To avoid this problem, you may add a rider to the second-to-die policy providing money to pay the surviving spouse's premiums. Or you can buy a second-to-die policy that builds cash value that can later help pay the premiums.

Approach this choice carefully. Determine whether policy provisions — especially premium or cash

value — will alter after the first insured dies. Why? Some policies boost premiums because the insurer's risk increases when the surviving spouse's life is insured. (Risk is no longer spread over two lives.)



Using an ILIT

When you own a second-to-die policy, its proceeds will be included in the surviving spouse's taxable estate. To ease your and your spouse's estate tax liability, you may hold the policy outside of the estate and avoid paying tax on the proceeds by acquiring the policy inside an irrevocable life insurance trust (ILIT).

If you transfer an existing policy to an ILIT, the transfer must be more than three years before the surviving spouse's death to realize the desired estate tax savings.

When you own a second-to-die policy, its proceeds will be included in the surviving spouse's taxable estate.

To fund the ILIT to pay premiums, you and your spouse make annual exclusion gifts (up to \$22,000 times the number of trust beneficiaries) to the trust. If you need to exceed that amount,

remember that you each have an additional \$1 million lifetime gift tax exemption that allows you to make gifts beyond the annual exclusion and not incur any gift tax liability. After your or your spouse's death, you may make only one exclusion gift of \$11,000 times the number of beneficiaries.

Analyzing your options

Although second-to-die insurance may have been a smart choice for the Johnsons, it may not make sense for all situations. To determine whether it's right for your estate plan, compare individual life insurance policy coverage and premiums with those of a second-to-die policy, and then make your decision. ■

Wealth management 101: Wills and living trusts

Wills and living trusts are the two most basic estate planning documents. On your death, these two document types can form the backbone of your estate plan to transfer assets to your family as you wish. Keep in mind that neither document, in and of itself, will reduce estate taxes — though both can be drafted to do this.

A will is the more traditional method for designating distribution of assets held in your name. If you use a will, your estate may have to go through probate, essentially a court-supervised process to protect the rights of creditors and beneficiaries as well as to ensure the orderly and timely transfer of assets.

Advantageously, a will provides standardized procedures and court supervision. In addition, the creditor claims limitation period can be shorter than for a living trust.

A living trust acts as a substitute for a will and avoids probate when you die. It avoids probate because the trust's successor trustee takes title to the trust assets and distributes them according to your wishes as you expressed in the trust document. Bear in mind that probate will be avoided only for assets in trust.

To avoid probate, you must transfer assets owned solely in your name to the trust. Generally, you as the grantor also are the trustee and sole trust beneficiary. And the living trust is revocable, meaning you can revise or cancel it at any time.

One thing wills and living trusts have in common is that you must choose someone to administer the disposition of your estate — an executor or personal representative and, if you have a living trust, a trustee. You may ask a family member, a friend or a professional advisor, or you may use an institution, such as a bank or trust company, to serve in these capacities. In fact, many people name both an individual and an institution to leverage their collective expertise.

Bear in mind, however, that this job requires substantial responsibility and not everyone will want to accept it. So be sure the executor, personal representative or trustee is willing to serve, and consider paying a reasonable fee for the services. It's also important to name an alternative in case your first choice is unable or unwilling to perform.

Tax-smart succession and wealth transfer strategies

You've worked hard to build your wealth. So don't let poor succession and estate planning keep you and your loved ones from enjoying the full benefit of your labors.



Instead, call on **Brian A. Sullivan, CPA**, a wealth management and transfer specialist with more than 20 years of experience in helping business owners, professionals and other individuals achieve their financial goals.

In addition to having extensive expertise in accounting and tax matters, Brian is credentialed as a Certified Valuation Analyst (CVA), a Certified Fraud Examiner (CFE), and an Accredited Estate Planner (AEP), and he holds a professional real estate license. Recently he became a member of the National Association of Estate and Financial Planners (NAEFP) and is certified as an estate advisor (CEA) with that organization. This specialized training and knowledge enables him to offer clients an exceptional combination of highly expert services, including:

- Succession, gift and estate planning
- Tax planning and support
- Business valuations
- Negotiation of business sales/purchases
- Financial projections and forecasts
- Employee stock ownership plan design
- Buy/sell agreements

- Life insurance review
- Charitable giving
- Litigation support
- Fraud detection and deterrence
- Troubled business consulting

A graduate from the University of California at Santa Barbara, Brian also has a master's in taxation degree from Golden Gate University. His professional memberships include the American Institute of Certified Public Accountants, California Society of Certified Public Accountants, National Association of Certified Valuation Analysts, Association of Certified Fraud Examiners, Certified Estate Advisor, and the National Association of Financial and Estate Planning. Additionally, Brian holds an insurance sales license.

Brian A. Sullivan, CPA, is a principal with Private Equity Solutions, LLC, an investment and insurance consulting firm. Private Equity Solutions orchestrates creative client solutions and assists clients accumulate wealth, tax efficiently. As a CPA, Mr. Sullivan, has more than 20 years of experience working closely with clients to develop individually tailored financial plans that are designed to meet your unique objectives. He can assist you evaluate achievable investment objectives, monitor financial performance, and assist in the creation of a workable exit strategy for successful business owners.

Brian welcomes the opportunity to put his expertise to work for you. Please call or e-mail him today to discuss your needs and learn how he can help meet them.

Brian A. Sullivan, CPA*

A Professional Corporation

office:(650)548-1120
cell:(650)703-3030
fax: (650)342-8258

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cell: (650)703-3030
fax: (650)341-1395

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One Valmont Plz. 4th Fl., Omaha, NE 68154 (888)337-4094

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