VESTPOINTEWEALTH
MANAGEMENT
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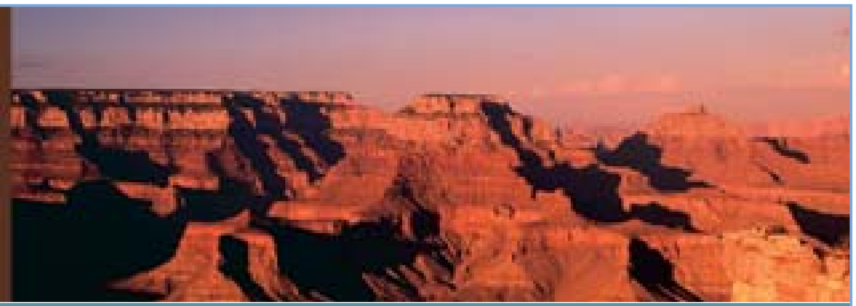


Planning Ahead A Couple Of Generations

U.S. estate tax laws have been in flux for most of a decade, and the biggest changes are yet to come. Unless Congress dictates otherwise, the individual estate tax exemption is due to jump from $2 million in 2008 to $3.5 million in 2009. The following year, there's an unlimited exemption (in other words, no estate tax at all), and in 2011, the exemption drops to $1 million. Yet as crazy as all of this may seem, a standard estate-planning tool—the "dynasty" trust—can help you avoid problems.

A dynasty trust, a type of generation-skipping trust, is an irrevocable trust that could benefit several generations of your family. Set up correctly, it can help you sidestep gift and estate taxes while also shielding trust assets from creditors. And the sooner you establish the trust, the longer its assets will have time to grow.

With a typical dynasty trust, you'll designate your children and grandchildren as discretionary beneficiaries. Then, when your children die, the trust remains in effect for their children, with payments continuing for generations. Because beneficiaries don't own the assets—instead, they receive income from the trust—there are no estate taxes when a beneficiary dies. That lets the principal keep growing, and assets may be shielded from divorcing spouses, court judgments, and other creditors.

When considering a dynasty trust, there are several tax rules and exemption amounts to keep in mind. The exemptions from estate tax also apply to something known as the generation-skipping transfer (GST) tax, which applies to gifts to generations beyond your children. Moreover, everyone is entitled to a $1 million lifetime exemption from gift tax liability, plus you can make yearly tax-free gifts of up to $12,000 to as many beneficiaries as you like, as long as a "Crummey" provision is diligently applied and executed.

In establishing a dynasty trust, it makes sense to embark on a simple wealth transfer program, making annual $12,000 gifts to all of your children and grandchildren. Your spouse can do the same. If you designate, say, eight yearly recipients, together you'll be able to move $192,000 out of your estate each year. In 10 years, that's almost $2 million.

Your next step could be to fund a dynasty trust with $1 million (or $2 million for a couple), using up your lifetime gift tax exemption. There's one catch, though. Gifts in excess of the $12,000 per year reduce your estate tax exemption dollar for dollar. So if you start a trust with a $1 million gift and then die in 2009, for example, your estate will be able to exclude only $2.5 million from estate taxes, not the $3.5 million otherwise allowed.

And if you'd like to begin the trust

(Continued on page 4)

How Many Years Should You Retain Your Tax Records?

The IRS says that the length of time you should keep a document depends on the action, expense, or event it records, but that, generally, you should keep all records that support an item of income or a deduction on a tax return until the statute of limitations for that return runs out.

The statute of limitations is the period in which you can amend your tax return to claim a credit or refund, or that the IRS can assess additional tax. For most taxpayers, this period is three years from the original due date of the return or the date the return is filed.

The statute of limitations is extended to six years if a return includes a substantial understatement of income. If a taxpayer commits fraud or fails to file a return, there is no time limit for the IRS to assess taxes and fees.

While it's good practice to maintain income and tax records for one year after the IRS statute of limitations expires, income records for nontax purposes may be useful years down the road due to insurance company and creditor requirements.

The burden is on you to prove the accuracy of your tax return, and with adequate records, this can be easy. Since the IRS permits electronic copies, converting your paper records could keep you better organized. If you have any questions regarding your specific situation, feel free to call our office.

Use FLPs To Transfer Assets And Cut Estate Taxes

Despite recent court rulings, the family limited partnership—or FLP, pronounced "Flip"—remains a useful tool for wealthy individuals. Yet with the Internal Revenue Service on the lookout for abuse, you must proceed with caution and good legal advice.

For a typical FLP, you set up a limited partnership and transfer income-producing assets—perhaps a business interest or investment real estate—into the partnership. Those who contribute assets are named either the general partner (GP) or limited partners (LPs). The GP has control over assets and distributions, but for exactly that reason, his GP interest is subject to estate tax—and so he shouldn't contribute the majority of the assets, and may want to consider a different estate planning vehicle altogether.

If you're married, though, you could have your spouse contribute all of the investment assets as a limited partner, while as GP you still get to make partnership decisions. Future transfers of assets to children or grandchildren will come from your spouse's shares.

Partnership earnings are paid out to the limited partners, who are taxed on the income. Assuming they're in lower brackets than you are, less money ends up going to the IRS. And if you handle things properly, the assets transferred to the FLP are removed from your taxable estate.

The asset transfer to the FLP is a potentially taxable gift, but you can minimize liability with your annual gift tax exclusion and lifetime exemption. Under the annual exclusion, you may make gifts valued at up to $12,000 per year ($24,000 if your spouse also gives) to each recipient. You could use these amounts over several years for a tax-free transfer of assets into the FLP. Plus, everyone is entitled to an additional $1 million or so (this number changes frequently) in untaxed gifts over a lifetime, and that exemption can cover gifts exceeding the annual exclusion. Potentially even better, the value of FLP interests can be discounted by as much as 30% for estate and gift tax purposes, because limited partners can't easily sell their shares. However, to be completely safe, you may want to keep annual gifts below the $12,000 threshold, because there's a chance the valuation discount could be audited later and disallowed.

Keep in mind, too, that the IRS is inherently suspicious of such arrangements, and if an FLP doesn't pass muster, all assets could end up back in your taxable estate. That's what happened in a landmark case in which Albert Strangi, an elderly entrepreneur, transferred most of his assets to an FLP and named his adult children as GPs together with him. He claimed quite generous discounts on the value of the transferred partnership interests, and distributions from the FLP were used solely to pay Strangi's personal expenses. The Fifth Circuit Court of Appeals eventually ruled that the FLP assets must be counted in Strangi's estate.

Despite the Strangi case, however, FLPs may offer potential benefits for your estate. We can work with your tax advisors to structure a partnership that strictly follows IRS rules. ●

Rolling Over A 401(k) To A Non-Spouse

If you participate in a 401(k) or other employer plan, you have to designate who receives the assets when you die. Typically, you'll name your spouse, though you might also choose a child, grandchild, or favorite niece or nephew. You can also decide to spread the wealth by designating multiple beneficiaries. Yet while the choice is yours, keep in mind that it could have tax implications.

In the not-so-distant past, tax rules clearly favored spousal beneficiaries. Then as now, a spouse could roll over inherited funds tax-free into his or her own IRA, and required minimum distributions (RMDs) would be based on that person's life expectancy. Until a recent rule change, though, anyone other than a spouse who inherited the account had much less palatable choices. Non-spouses had to take an immediate lump-sum distribution, often resulting in a massive tax bill, or empty out the account within five years, which was only slightly less punishing.

But then came the Pension Protection Act of 2006 (PPA). It lets a non-spouse roll over funds from the decedent's account, much as a spouse would, although there are a few extra wrinkles.

Initially, the IRS interpreted the PPA provision to mean that a non-spouse beneficiary who inherited a 401(k) could roll it over only if the plan sponsor agreed to accommodate the transfer. That's not what Congress had intended, though, and the IRS has acknowledged this by indicating that all plan sponsors must provide this option to non-spouse beneficiaries, effective January 1, 2008.

However, calling the post-death transfer of funds a rollover is a bit of a misnomer. It is actually a transfer from one account to another that must remain titled in the name of the decedent. For instance, suppose that Jack Hill inherits an account from

A Plot Twist In The 0% Capital Gains Rule

One of the biggest tax blockbusters ever is scheduled to debut in 2008: the 0% capital gains rate. Despite advance reviews suggesting it will only benefit individuals in the lowest tax brackets, this marquee tax break could play well with affluent families, too. But a last-second twist in the plot complicates matters for families with older children.

This intriguing tax saga began in 2003. The Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) lowered the maximum tax rate on long-term capital gains from 20% to 15% for taxpayers in most brackets. But for those in the 10% and 15% brackets, the tax rate was pushed even lower, to 5%.

And that's only part of the story. Under JGTRRA, the 5% rate drops to 0% for qualified filers in 2008, and the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) extended the 0% rate through 2010. Thus, taxpayers in the lower brackets can benefit from this unprecedented tax break in 2008, 2009, and 2010.

What does it have to do with you? Based on the inflation-indexed figures just released for 2008, the cutoff for the 15% tax bracket is only $65,100 for joint-filers, and $32,550 for single taxpayers. Short of taking a year-long, unpaid vacation, you're probably unlikely to squeeze under the bar. You'll probably be stuck with the 15% maximum capital gains rate.

But that doesn't stop your family members from benefitting from the 0% rate. For instance, you could transfer stock or other appreciated assets to a child or grandchild fresh out of school. Then, the child can sell the shares in 2009, or 2010, when the zero percent tax rate applies. If you were thinking of giving your son or daughter a gift, for a house down payment or to pay off college loans, this approach has the added benefit of cutting capital gain taxes.

What assets should you transfer? Highly appreciated ones. A block of stock you've been holding for years and that is now worth several times what you paid, for instance, would be a good gift to a child. If you were reluctant to pay a 15% tax on your gain, this would be a good way to get out from under that tax burden.

The current market value of the assets you transfer will be considered a taxable gift. But an annual exclusion lets you give $12,000 to any individual every year without paying any gift tax. This exclusion is doubled to $24,000 if your spouse consents to making a gift. So if you're married and have, say, two low-bracket children, you could give each child securities worth $24,000, for a total of $48,000, all completely gift tax-free. And you could repeat the strategy in 2008, 2009 and 2010. (Larger annual gifts would count against your lifetime $1 million gift tax exclusion.)

There is one complication. The Small Business and Work Opportunity Tax Act of 2007 expanded the reach of the "kiddie tax." Kiddie tax rules say that if a child receives unearned income (usually in the form of capital gains or dividends) that exceeds an annual threshold—$1,800 for 2008—the excess amount is taxable at the top tax rate of the child's parents. Prior to 2007 law, the kiddie tax applied only to children under age 18. Beginning in 2008, though, it affects any child under age 19, as well as full-time students up to age 24, if they don't have earned income that accounts for at least half of their support.

So if you have a dependent child in college or high school in 2008, you should be aware that gifting appreciated assets for them to sell could backfire. Your child's unearned income in excess of $1,800 could be taxed at your higher rate and undermine the gifting strategy. The amount of your gift, your child's earned income, and other numbers need to be considered and analyzed beforehand.

If you have a sizable amount of securities with significant unrealized gains, you may want to consider transferring them to a Charitable Remainder Trust to avoid capital gains, receive a charitable contribution deduction and lifetime income, and to benefit one or more charities.

Also keep in mind that it almost never makes sense to sell securities based solely on potential tax savings. Remember, this tax break is scheduled to last through the 2010 tax year. But if everything falls into place, this new tax rule could help your family enjoy the best of all possible tax rates. ●

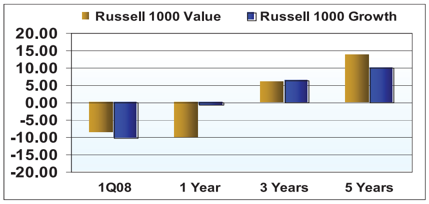
his aunt Jill. The name on the IRA should read, "Jack Hill as beneficiary of Jill Hill." In contrast, if Jack had been Jill's spouse, the IRA could have been titled as if he had owned it all along.

More significantly, the asset switch must be a direct "trustee-to-trustee" transfer. A non-spouse beneficiary can't touch the funds or take 60 days to redeposit them in an IRA the way a spousal beneficiary could. Also unlike a spousal heir, a non-spouse can't move the cash into an existing IRA. The funds must be deposited in a new IRA set up for this purpose. Finally, a non-spouse beneficiary can't wait until age 70½ to begin taking RMDs. This option is still available only to spousal beneficiaries.

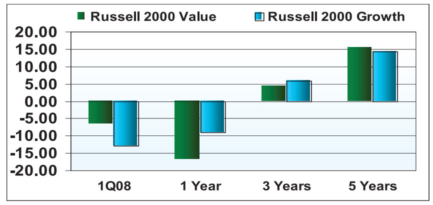
Despite these restrictions, non-spouse beneficiaries get a huge lift from the PPA. For example, if you've named your 50-year-old child as a beneficiary, he or she should be able to stretch out withdrawals from the account based on a life expectancy of 34 years, according to IRS-approved tables. That's a whole lot better than a forced five-year withdrawal.

The exact calculation depends on whether the IRA owner had started receiving RMDs before death. This is a complex area of tax law. But we are here to help you ensure that your heirs get the full benefit of your generosity. ●

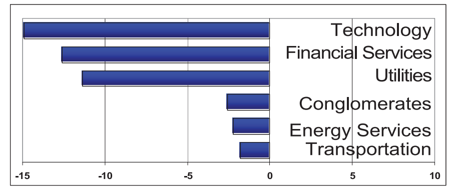
Market Data Bank: 1st Quarter 2008



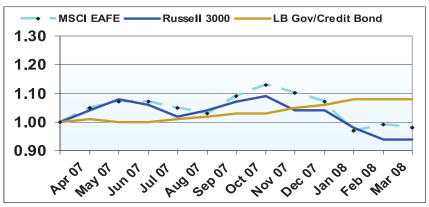
LARGE VALUE VS. LARGE GROWTH
A bearish quarter distributed losses throughout the stock market. Turmoil in the financial sector punished traditional value shares, and fears of a recession ahead made growth less attractive.



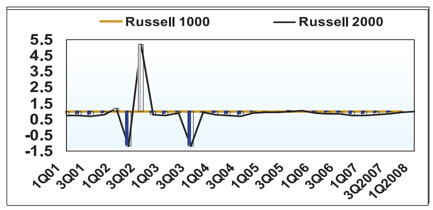
SMALL VALUE VS. SMALL GROWTH
The heightened sense of risk was especially hard on small growth-driven companies, down 12.83% in the quarter. Small-cap value stocks avoided the worst of the selling, but still lost 6.53%.



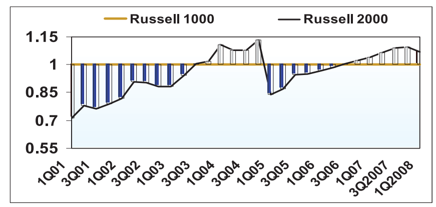
THREE BEST AND WORST SECTORS
All 12 of Russell's industry groups posted losses in 1Q08. Technology, a leader for much of 2007, gave up almost 15%, while the crisis in the credit markets pummeled financial companies.



FOREIGN, US STOCKS & US BONDS
$1 invested in high-grade bonds on April 1, 2007 was worth $1.08 on March 30, 2008, and just $0.94 if invested in broad Russell 3000 index, and $0.98 if invested in a diverse group of foreign stocks.



LARGE VS. SMALL STOCK EARNINGS
Large-cap and small-cap profits expanded at roughly the same rate in 1Q08 as earnings growth for the largest companies in particular slowed to the lowest rate since late 2002.



PRICE-TO-EARNINGS RATIO
As growth slowed, stocks became more expensive in relation to corporate profitability. Investors paid $17.50 for every $1 in large-cap earnings in 1Q08 and $18.70 for every $1 in small-cap earnings.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capital International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do not represent any specific investment. Foreign investing involves special risks, including political unrest, economic instability, and currency fluctuation. Past performance does not indicate future results.

Source: Russell/Mellon

Planning Ahead

(Continued from page 1)

with more than $1 million, perhaps using up the higher GST exemption of $2 million in 2008 (or $3.5 million in 2009), a lifetime qualified terminable interest property (QTIP) trust could help. A QTIP trust allows the surviving spouse to use the trust property with taxes deferred until his or her death, after which the trust property goes to the final trust beneficiaries, who were named by the first spouse to die.

The federal government imposed the GST tax in 1986 to prevent people from using trusts to circumvent estate taxes of the next generation of heirs. Now, you can take advantage of the recent increases in the GST tax exemption by making lifetime gifts to a QTIP trust of up to the GST exemption amount.

Then, through your spouse's will, stipulate that upon the spouse's death, any estate taxes on this money will be paid with funds from his or her estate, outside the QTIP. That would allow the trust assets to pass to future generations without being reduced by estate taxes.

The longer a trust continues in existence, the greater its potential appreciation. To extend the life of a dynasty trust as long as possible, set it up in a state that allows such trusts to continue for hundreds of years or in perpetuity—which is the point of a dynasty trust. Most states have laws forcing trusts to terminate 21 years after the death of the last beneficiary living at the time the trust was created, though more and more states are extending that time limit. If you don't reside in a state that has repealed or extended the maximum term for trusts, consider establishing your trust in another state with more favorable laws. That's permitted as long as the trust has some connection to the state. One simple way to meet that requirement is to choose a trustee there, which could be a corporate trustee. But, be aware there is not yet any case law sustaining the effectiveness of a dynasty trust established in a state other than the state of the beneficiaries' residence as it relates to asset protection.

We can work with your attorney to help you decide whether a GST, dynasty, or QTIP trust makes sense as part of your long-term financial and estate plan. ●

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