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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

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Clients Of FSA: Meet Greg Valliere

Last month we had the pleasure of having Greg Valliere, co-founder of Stanford Group Company's Policy Research, talk with our clients about some very timely topics – Government, Taxes, and the 2008 Election. He gave some insight on what to expect in the coming months (and years) from an economic, political, and stock market perspective. Mr. Valliere, having covered politics and economics for over 30 years, can be seen regularly on CNBC's Squawk Box, Power Lunch, Closing Bell, and Kudlow & Company.

Of those who attended, they found it extremely informative – possibly our best yet. If you were not able to attend, don't worry. We have made several links available on our website for you to view at your leisure. Go to www.fsainvest.com and click on "Resources" along the left side of the page to find them. If not wanting to go the web route, we have a limited number of DVDs available as well that we'd be happy to send along—just ask.

The articles in this issue continue along the same vein of responsible planning and good decision-making. Whether you're nearing retirement or planning ahead for future generations, you have a responsibility to make sure your bases are covered. If not for you, then for your heirs. Enjoy articles discussing the pros and cons about looking for that next new car – should you buy or lease? Should you go "green" with that small but trendy hybrid? These are all crossroads that you face in the journey of life. Just remember, we're here to help you in that journey.

Enjoy the summer!

Jim Joseph, CFP®
Vice President

Key Questions For Those Nearing Retirement

Life may begin at 40, but the countdown to retirement starts at age 55. Now is the time to take stock of your savings, goals, and timetable for moving into a phase of life that may last 30 years. These questions can help you gauge how you're doing.

When do you want to retire? This is a crucial variable. If you're planning to retire early—say, at age 55 instead of 65—you'll not only have to save more, sooner; you'll also need to have the money last an extra decade. On the other hand, if you expect to work well past normal retirement age, that reduces the burden on your nest egg. Another reason to keep working: While you normally can begin penalty-free withdrawals from an employer's qualified retirement plan at age 55, distributions from an IRA before age 59½ may result in a 10% penalty.

How is your money invested? Though there are no guarantees, a portfolio with most holdings in stocks holds the potential to grow more quickly than one emphasizing bonds or cash. But at this point, you may not have much time to recover from market losses and we need to review the investment objectives that you're currently invested in. That, in turn, could affect when you'll have sufficient savings to leave the work force.

What will you get from Social Security? Government payments may make up only a small percentage of your retirement income, but this variable, too, needs to be part of your retirement calculations. How much you receive depends on several factors, including when you were born and when you apply for benefits. Payments could start as early as age 62, but if you begin then, your checks will be smaller. Wait a couple more years (if you were born between 1943 and 1954, full retirement age is 66),

and your checks will be larger. If you live a long time, the bigger monthly checks will more than make up for the few years you did not collect up front.

How's your contingency planning? An unexpected job loss or serious illness could hurt your retirement plans, draining savings just when you need to be putting away as much as possible. If you have a cash cushion you can draw on in emergencies, it could stem the damage—but if you don't, build your reserves now. And you may want to invest in long-term care insurance.

How much will you need during retirement? Though rules of thumb suggest you'll need 70% to 80% of your current income to live comfortably after you leave the work force, the amount you should set aside depends on several factors, including the age when you expect to retire, your anticipated housing costs and other living expenses, and how healthy you are. To be effective, your retirement plan needs to take into account many interrelated variables. We can help you evaluate many possible scenarios, and if you're in danger of falling short of your goals, we can work with you to get on track before it's too late. ●

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

An Update On Hybrid Car Tax Credits

If you were planning to use a federal tax credit to cut the cost of buying a Lexus hybrid car or sport utility vehicle, you're out of luck. The same is true for Toyota Prius, Camry, and Highlander hybrids, and though the Honda Civic hybrid still qualifies for a credit, the amount is shrinking fast and will zero out on January 1, 2009. Such are the quirky rules of the hybrid tax credit law, which phases out the tax break once popular models hit specified sales targets. Yet several makes and models can still earn you up to a $3,000 dollar-for-dollar reduction of your tax bill. A few states offer their own tax credits along with other incentives. And corporate perks, some quite generous, are on the rise.

Gas-electric hybrid vehicles recycle energy from the braking process to run an electric motor that boosts and sometimes replaces power from a gasoline engine. This technology improves gas mileage, and as the price of gas has risen, hybrids have become increasingly popular. A recent survey by hybridcar.com found that four in 10 prospective car buyers now say they'd at least consider buying a hybrid, and in 2007, U.S. sales of hybrids topped 350,000, according to figures released by the manufacturers. That's a big gain over the 250,000 sold a year earlier and four times hybrid sales in 2005. Hybrid pioneer Toyota (including its Lexus nameplate) accounted for more than 70% of total sales, and its iconic Prius was the country's eighth-best-selling car, hybrid or not, in 2007. But Honda, Nissan, Ford, and General Motors also have hybrids on the U.S. market, and those vehicles have the advantage of still qualifying for federal tax credits.

Credits are helpful for offsetting the extra cost of buying a hybrid. Consider the popular Lexus RX SUV. The starting price for the 2008 gas-only model is $37,400, compared with $41,280 for the hybrid version. And the 2008 LS Hybrid sedan starts at $104,000, whereas the base price for a gas-only LS is just $62,000 to $72,000. While price differentials vary from model to model, the hybrid version always comes at a premium, and it can take several years for savings at the pump to make up for that elevated sticker price.

To encourage hybrid sales, the Energy Policy Act of 2005 lets manufacturers apply for "qualified hybrid" status that makes a particular model eligible for a federal tax credit. This is a credit, not a deduction, which means you get to subtract the amount of the credit from your final federal tax liability, making it several times more valuable than a deduction from income. Only the original owner may claim the credit, and if you lease a hybrid, the leasing company, not you, gets the tax break. But the toughest rule is the one that phases out the credit once a model has racked up 60,000 in sales. (The reduction actually starts in the second calendar quarter after the sales milestone has been achieved.) As a result, Toyota and Lexus models began to lose their favored tax status in October 2006, and their final credits ended a year later. The Honda Civic CVT, originally eligible for a $2,100 credit, qualifies for half that amount through June 30, 2008, and then a $525 credit for vehicles purchased through the end of the year. After that, nothing.

Several other vehicles still earn a federal credit, however. As of January 17, 2008, these included the Chevrolet Tahoe hybrid ($3,000 credit), the Ford Escape 2WD and Mazda Tribute 2WD hybrids ($3,000), the Nissan Altima hybrid ($2,350), and the Saturn Vue Green Line ($1,550) and Aura ($1,300) hybrids. To claim an "alternative motor vehicle" tax credit on these or other qualifying hybrids, you must fill out IRS Form 8910.

As the federal tax credits on many hybrid vehicles fade away, state and private sector incentives are taking up some of the slack. Colorado and Oregon offer state income tax credits on a few hybrids, and Connecticut waives state sales tax on hybrids that get at least 40 miles to the gallon. Several states also let solo drivers of hybrids use high occupancy vehicle (HOV) lanes on the highway, and Travelers gives hybrid owners a 10% break on their auto insurance. But the most generous financial rewards these days come from companies such as Bank of America, Google, and Hyperion Software. At those companies, employees who buy a hybrid may get a rebate of $3,000, $5,000, and $5,000, respectively. For more on these and other perks, go to http://www.hybridcars.com/incentives-laws.html. ●

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. ●

Consider Buying Instead Of Leasing A Nice Car

Wondering whether to lease or buy your next car? There are a lot of variables to factor into your decision—and not all of them are strictly financial.

Why lease? The conventional wisdom says leasing allows you to drive the industry's newest, hottest cars. (BMW recently led the list of the most requested vehicles at LeaseCompare.com.) You can have a new car for a lower monthly payment, and you could save or invest the difference. Moreover, if you use the vehicle for work, writing off a lease payment may be easier than the calculations for a vehicle you own. It's noteworthy, too, that car leases don't appear on your record as credit debt.

Basically, you rent the car for the duration of the lease, and pay only for depreciation. For example, if you lease a $50,000 car that will have an estimated resale value of $35,000 after two years, you're responsible for the $15,000 difference (the depreciation) along with finance charges and fees.

Because leased vehicles tend to be new or late model, you shouldn't face hefty repair bills. However, most leases cover only the first 12,000 to 15,000 miles per year; drive farther, and for each additional mile you'll owe as much as 25 cents when the lease ends. If you drive a lot—say, 20,000 miles or more each year—any benefit of a lease's lower payments is likely to be outweighed by mileage charges and you're probably better off buying. Breaking the lease—that is, returning the car early—comes at a great cost. And when you turn in the car, you'll be assessed for any wear and tear that's out of the ordinary.

Why buy? Again, according to the conventional wisdom, the overarching benefit of buying is financial. When a lease expires, you have to turn in the car or purchase it for its residual value. If you buy at the outset (or finance the purchase), the car's yours, and when interest rates are low, that's generally cheaper than leasing. And it's more flexible—you can sell or trade the vehicle whenever you want.

But what if your car seldom makes it out of the garage? You have a short commute to work, or to the train station. Yet you like to drive, and enjoy the thrill of piloting a high-end sports or luxury model. You could lease an expensive car, turn it in when the lease expires, and replace it with another leased vehicle, guaranteeing you'll always have a car payment. Buying could make more sense. Once any loan is paid off, no more payments, and your lightly driven favorite ought to last for years. And if you sell or trade, you should get a good price.

You may also want to consider buying a car that's just a year or two old. Much of the depreciation in a car's value occurs in its first year. So buying an almost new car often makes good financial sense.

The bottom line? The lease-versus-buy decision is as much a lifestyle choice as a financial one. You can run the numbers for yourself by using a calculator on the Web. For more details, including financial calculators, visit: www.cars.com, www.leaseguide.com, or www.edmunds.com. Or call and ask us for assistance. ●

Planning Ahead

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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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