Trusted Advisor

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Year End IRA Reminders:

- If you are over age 70 ½, or turned that age during the first half of this year, you should receive from us an estimate of your Minimum Required Distribution by month end November. Please return the IRA distribution form that we will enclose just as soon as possible to assure you are in compliance with Federal and State law.

- If you are eligible to fund an IRA (meaning you or your spouse have W-2 income in 2002), let us know – liberalized regulations may allow you to obtain a tax deduction, or save more than you thought you can, including savings for non-working spouses.

- Gifting: you can make a tax free gift up to $11,000 to each of your children, grandchildren or anyone. Couples can gift $22,000. You must complete the gift by year end, it cannot be "banked" for future use. (See next article for a more detailed explanation) This is the simplest estate tax reduction tool going, and you get to see the results of your largesse while you are still here to appreciate it and to be appreciated!

Lending to Children

Often members of the "older" generation want to help their children or grandchildren financially to purchase a home, pay for college, replace an old and untrustworthy automobile or to start a business. There are a couple of things for you to consider before you agree to provide funds.

First, is this a gift or a loan? If it's a gift, you need to be aware that there is something called the Unified Gift Credit. This is the Federal estate tax exemption amount, currently $700,000 per estate. The Credit applies to gifts made during one's lifetime as well as at death. As an example, If during your lifetime, you gave $300,000 to a child for the purchase of a home, then at your death, only a $400,000 Unified Credit remains to offset estate taxes. Congress has specified a maximum gift amount that can be made each year, without reducing your Unified Credit. Currently you can gift up to $11,000 to any number of people in a given year without reporting the gift or reducing your Credit. Two parents, for example, could gift up to $22,000 to each child or grandchild with no loss of the Unified Credit. When giving money to children, try to stay within the annual gifting limits.*

Often in an effort to teach responsible borrowing to our offspring or to protect their pride, we will call this gift a loan. Even if, in your heart of hearts, you know you'll never see this money returned, there are some good reasons to attach the trappings of a true loan to the arrangement. By formalizing the loan, certain gifting issues may be avoided, or at least delayed. Also a written agreement, with all terms clearly understood by parties to the agreement, may avoid uncomfortable misunderstandings within the family. Think about it: if you loan, rather than give money to one of your three children you may mitigate possible jealousy from those who have not benefited.

A legally enforceable note should clearly state the names of the parties to the loan, the amount of the loan and terms (date of repayment, form of repayment, interest rate, and payment schedule). A stationery store will often have pre-printed forms that you can use to fill in the blanks for this purpose.
Here is another good reason for making formal lending arrangements: The Internal Revenue Service looks askance at interest free "loans" over $10,000 and for more than one year. This is because the wealthy have, in the past, shifted net worth to their children, who are in lower tax brackets, as a tax dodge. If your interest free loan is discovered, IRS may ask you to pay taxes on hypothetical "imputed interest" income you never received! In fact this is rarely applied, because of an important exception: as long as the borrower doesn't have investment income (interest and dividends) over $1,000, and the loan is $100,000 or less, no imputed interest will be assessed. But it's still a good idea to be cautious, and if you feel uncomfortable telling your grandchild you want to have a written note, here's a reason you can give.

You need to consider any outstanding loans to children, grandchildren or relatives in your estate planning too. Specify the loan and indicate if it is to be forgiven at death or passed to your spouse as an estate asset. If you forgive a loan to one child upon your death, it is probably fair to reduce the amount of their inheritance by the same figure, so that all the kids receive equal treatment. An estate attorney can assist in the proper language within your will or trust.

*Some estate planning benefits from large planned gifts prior to death. Larger estates that hold appreciating assets, such as a rental property, may benefit by gifting the property to children before the parents' death thus avoiding inflation of the estate. For advanced estate planning ideas, contact us.

CFP CERTIFIED FINANCIAL PLANNER™

Gary Miller has over 28 years experience in the financial services industry as both an analyst and financial advisor. Currently he provides service to clients as a CERTIFIED FINANCIAL PLANNER™ practitioner. Gary holds a certificate in Personal Financial Planning from University of California, Irvine; and is a Board member of the Orange County Chapter of the Financial Planning Association.

If, while living, you decide to forgive the loan, you can avoid the loss of part of your Unified Gift Exemption by forgiving the loan in stages: no more than $11,000 per year, the current annual exempt gift amount. A revised loan, notarized to prove the date, and which references the first loan, is probably the best way to handle this.

Year End Gifting

Two great holiday gift idea that will keep on giving:

- Roth IRA's
- Qualified Tuition Plans

Why not use some idle cash or your required IRA distribution to open Roth IRA accounts for your grandchildren? Roth's are one of the few ways we have to save money tax free and take it out tax free. With compounding, a $10,000 gift to a 4 year old, growing at 7% is worth $22,520 by the time they want to buy their first car. If they wait until graduating from college, this same $1000 will have risen to about $50,000. Were you to fund smaller amounts, year after year, the Roth becomes a teaching tool, showing your offspring the power of regular savings and interest compounding over time.

This is also a good time to take a look again at a fabulous vehicle for funding college costs for the grandkids while reducing your taxable estate. Gifts can be made to "Qualified Tuition Plans" (also called 529 Plans). These funds are completely tax sheltered while they grow and when disbursed to pay for costs of education. Making the gift removes assets from your estate, an attractive feature, but you control investment of the funds and can even change beneficiaries. So gifting to a QTP achieves three desirable goals: saving for college in a tax free manner, reducing your estate, keeping you in control of the money!

Call us for more information.

Financial Commentary

As discussed in the last issue of Portfolio notes, it is tough to call the short term direction of this market. Evidence that treacherous pot holes lie ahead was shown by the 180 point (2%) Dow slump on November 7, a decline of Technology leader Cisco systems by 6% on this one day served to remind tech lovers that the stove is still hot and they may get burned if they reach for the cookies too soon.

Republican control of Congress no doubt strengthens President Bush's resolve to "Get Saddam", and reports of large scale shipments of battlefield machinery suggest American forces will be in place sometime early in 2003. Meanwhile, the press seems to have absolutely nothing else to talk about except war preparation, and this is not conducive to investor confidence building. Markets dislike uncertainty, and despite universal belief that we can oust the mustachioed tyrant, the cost of this effort makes the bond market nervous about implications for chronic budget deficits, and resulting inflationary pressures.

In addressing some of these concerns the Federal Reserve Open Market Committee approved a .50% Fed Funds rate cut on November 6. This in turn caused the dollar to weaken, and while it may have prevented a plunge in stock prices, it certainly helped many of our clients by pushing the value of American Century International Bond fund to $11.75, it's highest level in four years. This may become one of our better investments in coming years. There are many macro economic forces conspiring to send the U.S. Dollar lower on world currency markets over the coming decade. Our role as world's policeman is an expensive one. Our role as Terrorist Target requires expensive security expenditures.

Medicare exists only because the general fund covers the deficits of this "self funded" safety net. Medical costs are again soaring so the drain on the Federal deficit will grow proportionally along with these costs and the swelling number of people eligible for Medicare part A and B. Finally, the economic might of the United States is under assault by countries who pay their workers little, protect them little, pollute a lot and export by the ship load to these shores. American exports continue well below our imports as they have for the past twenty years or more. Along with lost exports are lost jobs. Lost jobs mean lost tax revenue to a government running a chronic budget deficit. We heard recently that the average manufacturing worker in China earns 40 cents per hour, while in the United States the same worker must be paid about $20.00/ hour. As you purchase your holiday gifts this year, read the boxes to see where they are made. We continue to include diversification into overseas investments for our clients.

Happy Thanksgiving to All!

Another reason to visit our web site.

With one stop, you can check our current thinking about the markets and view your accounts too. You can link to the Schwab Alliance web site through our website at www.trustedfinancial.net. Click on the ***Clients*** button, then again on the ***Charles Schwab*** button.