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Estate Planning Opportunities in a Down Market

A down market can mean tough times, but it can also present unique opportunities to minimize property transfer (gift and estate) taxes. While owning assets that are losing value might seem like a bad thing, it may actually be a great time to reduce your taxable estate by gifting those assets to beneficiaries. That's because current low asset values and interest rates enable you to make gifts at a lower gift tax cost. And, if and when the market rebounds, those assets will be growing in your beneficiary's estate and not in yours.

Here are a few gift-giving techniques that take advantage of today's economic climate.

Note: This article discusses federal tax rules only. Individual states impose their own property transfer taxes using rules that may be different from the federal rules.

Basic gifting

In 2009, you can make gifts of up to \$13,000 to anyone you want, to as many people as you want, tax free under the annual gift tax exclusion. You can give away twice that amount if both you and your spouse make the gifts together (this is called gift splitting). And, you can give away an unlimited amount if you pay tuition or medical bills on behalf of another person (just be sure to make these payments directly to the school or health-care provider).

Family loans

You can lend money to your children at the current IRS minimum interest rate (known as the AFR, which changes monthly), and then potentially forgive an amount equal to the gift tax exclusion each year. (The gift tax exclusion amount is adjusted for inflation; \$13,000 is the figure for 2009).

Grantor retained annuity trust (GRAT)

A GRAT is an irrevocable trust with a specified term (e.g., 10 years) into which you gift assets that you expect will greatly increase in value in the future. You receive annuity payments during the trust term, and at the end, your beneficiaries receive any remaining property.

The transfer of assets to the GRAT is a taxable gift to the trust beneficiaries. The value of the gift for tax purposes is determined based on the current IRS rate (known as the 7520 rate, which also changes monthly).

Tax savings are achieved because the annuity payments are calculated to result in a gift tax value near zero. It's anticipated, however, that the actual interest earned will be higher than the 7520 rate, leaving a substantial value in the GRAT at the end of the term. This remaining value is passed on to your beneficiaries tax free.

Intentionally defective grantor trust (IDGT)

An IDGT is an irrevocable trust that has a purposeful flaw (i.e., you retain some control over the trust) so that you, and not the trust entity, pays the income taxes on trust income (thus, an IDGT is ideal when you want to transfer income-producing assets). Even though you retain some control over the trust, IDGT assets will generally not be included in your taxable estate at your death.

You sell assets to the IDGT in return for an installment note, with interest calculated based on the current AFR. There is no gift tax because it is a "sale" (except for an initial gift that "seeds" the trust). However, because you and the trust entity are considered the same taxpayer, no gain is recognized on the sale, and interest you receive



About New Wealth Advisors.

New Wealth Advisors is an independent, fee-only, SEC-registered investment advisor, operating as a multi-family investment office. We work with newly wealthy individuals and families to protect, grow and manage assets.

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Tax savings are achieved because, hopefully, the value leaving your estate via the sale will exceed the value returned to your estate via the note. You also reduce your estate by paying the income taxes on IDGT income.

Charitable lead trust (CLT)

A CLT is an irrevocable trust with both charitable and noncharitable beneficiaries. It's called a lead trust because it is the charity that is entitled to the first or lead interest from the trust property. After the specified

term, the remaining trust property passes to you or another named noncharitable beneficiary.

At the time assets are placed into the CLT, you receive a current income tax deduction equal to the present value of the income stream that will be going to the charity. The interest rate used is based on the current 7520 rate. The lower the interest rate, the higher the deduction. As with a GRAT or IDGT, it is hoped that the CLT assets will appreciate beyond the 7520 rate, allowing the excess to pass tax free.

Conclusion

These gifting strategies, and others, can turn this economic downturn into a mixed blessing. New Wealth Advisors can work with you to determine what strategies would be most appropriate for you.

Estate planning tools that are generally less attractive when interest rates are low:

- *Qualified personal residence trust (QPRT)*
- *Charitable remainder annuity trust (CRAT)*

Changing Jobs? Take Your 401(k) and ... Roll It!

If you've lost your job, or are changing jobs, you may be wondering what to do with your 401(k) plan account. It's important to understand your options.

What will I be entitled to?

If you leave your job (voluntarily or involuntarily), you'll be entitled to a distribution of your vested balance. Your vested balance always includes your own contributions (pretax, after-tax, and Roth), and any investment earnings on those amounts. It also includes employer contributions and earnings that have satisfied your plan's vesting

schedule. In general, you must be 100% vested in employer contributions after 3 years of service ("cliff vesting"), or you must gradually vest 20% per year until you're fully vested after 6 years ("graded vesting"). Some plans have 100% immediate vesting. You'll also be 100% vested if you've reached your plan's normal retirement age.

Special vesting rules apply to certain plans, so make sure you understand how your particular plan's vesting schedule works. This is important, because you'll forfeit any employer contributions that haven't vested by the time you leave your job. If you're on the cusp of vesting, it may make sense to wait a bit before leaving, if you have that option.

Don't spend it, roll it!

While this pool of dollars may look attractive, don't spend it unless you absolutely need to. If you take a full distribution you'll be taxed, at ordinary income tax rates, on the entire value of your account except for any after-tax or Roth 401(k) contributions you've made. And, if you're not yet age 55, an additional 10% penalty may also apply to the taxable portion of your payout. Because of the 5-year holding period requirement, there won't be any tax-free qualified distributions from Roth 401(k) accounts until 2011 at the earliest. And special rules may apply if you receive a lump-sum distribution and you were born before 1936, or if the lump sum includes employer stock.

If your vested balance is more than \$5,000, you can leave your money in your employer's plan until you reach normal retirement age. In many cases, however, your best bet will be to roll the funds over to an IRA. Your investment alternatives will be almost limitless, and you'll have better control over when and how to take distributions from your account. The financial advisors at New Wealth Advisors can assist in choosing the appropriate investment alternative.



Your employer must allow you to make a direct rollover to an IRA. As the name suggests, in a direct rollover the money passes directly from your 401(k) plan account to your IRA. This is preferable to a "60-day rollover"--where you get the funds and then roll them over to an IRA yourself--because your employer has to withhold 20% of the taxable portion of a 60-day rollover. You can still roll over the entire amount of your distribution, but you'll need to come up with the 20% that's been withheld from other funds until you recapture that amount when you file your income tax return.

What if I have an outstanding plan loan?

In general, if you have an outstanding plan loan, you'll need to pay it back, or the outstanding balance will be taxed as if it had been distributed to you in cash. If you can't pay the loan back before you leave, you'll still have 60 days to roll over the amount that's been treated as a distribution to your IRA. Of course, you'll need to come up with the dollars from other sources. The financial professionals at New Wealth Advisors can assist with coordinating a rollover to an IRA.



Refinancing Your Mortgage: Is It Worthwhile?

Mortgage rates on 15- and 30-year fixed mortgages are at all-time lows. So, is now a good time to refinance your existing mortgage? That depends on several factors.

The first, of course, will be your loan-to-value ratio. In no-cash-out refinancing (where the amount of your new loan doesn't exceed the balance of your existing loan, plus points and closing costs, if applicable), you may be able to borrow as much as 95% of your home's value. However, if the value of your home has fallen below the amount of your existing mortgage balance, you may be unable to refinance at all, except through the American Recovery and Reinvestment Act of 2009's Home Affordable Refinance program (see sidebar). But let's assume your loan-to-value ratio is still "above water"--that is, the value of your home is still greater than your mortgage balance.

If you refinance your mortgage to a lower interest rate, you may save a substantial amount on your monthly mortgage payment--which will give you more money to put toward your savings goals or reducing your other expenses. This is one of the main reasons people consider refinancing their mortgages. But what other factors do you need to consider?



How much will it cost?

The cost of refinancing can include both points you pay and other expenses (called "closing costs") related to refinancing.

One point equals 1% of the amount to be financed. So, if the refinancing costs will include an up-front charge of 0.5 points and you're refinancing \$200,000, you will incur a charge of \$1,000 (special tax treatment applies to points).

Closing costs typically include an application fee, attorney's fee, appraisal fee, credit report fee, loan origination fee (which can be 1% or more of the amount you refinance), title search fee, and title insurance. These costs can vary from state to state. Get a "good faith estimate" from each potential lender and compare both closing costs and interest rates.

Be careful about lenders that advertise "no points, no closing costs" refinancing deals. Often these plans simply roll the closing costs into the amount to be refinanced, or come at a higher interest rate.

How long will it take to recoup the costs?

To determine your break-even point (the point at which you'll begin to save money after paying fees and closing costs), divide the amount of your monthly mortgage payment savings due to refinancing into the cost of refinancing; the result is your break-even point, expressed in months.

Example: If you're saving \$100 per month on your refinanced monthly mortgage payment, and your refinancing costs totaled \$1,800, your break-even point is in 18 months.

It makes sense to refinance if you're certain that you'll be able to recoup your refinancing costs while you're still living in your home. Ideally, you should recover your costs in one year or less.

A matter of term

In many cases, refinancing may mean taking out a mortgage with a new term equal to the original term of your refinanced mortgage, not equal to the remainder of the term on that mortgage. Depending on when you refinance, this can make a significant difference in the amount of interest you'll pay overall.

Example: You have a \$200,000 30-year fixed mortgage at 6%, with a monthly payment of \$1,199. After 6 years, you have paid \$69,131 in interest on that mortgage. At that point, you refinance your remaining principal balance of \$182,796 for a new 30-year fixed mortgage at 5% with a monthly payment of \$981. Over the life of that new mortgage, you will pay \$170,468 in interest. So, your total interest payment will be \$239,599 (\$69,131 + \$170,468). If you had stayed with your old mortgage at 6%, you would have paid a total of \$231,676 in interest. Instead, by refinancing when you did, you'll pay an extra \$7,923 (\$239,599 - \$231,676) in total mortgage interest.

Because of this, you may want to consider applying the monthly mortgage payment savings after refinancing toward additional principal payments. By doing so, you can reduce both the term of your mortgage and the total interest you'll pay.

Crunch the numbers first

In many cases, refinancing looks attractive in the short term because your monthly mortgage payment will be lower--and that can be important to your monthly budget. But will it really save you money to refinance, both in the short run and in the long run? That depends on many factors. Look at them all before you make your decision. The professionals at New Wealth Advisors can assist you with this decision.

Other considerations:

- The interest you pay on a no-cash-out mortgage refinancing is tax deductible only to the extent as was the interest on your original mortgage.
- Refinancing may allow you to switch to a different type of mortgage (e.g., from an ARM to a fixed rate mortgage) and/or a shorter mortgage term.

The Home Affordable Refinance program allows the refinancing of certain Fannie Mae or Freddie Mac mortgages so long as the new mortgage doesn't exceed 105% of your home's current market value. Additionally, if your existing mortgage payment doesn't include private mortgage insurance (PMI), you won't be required to buy it when refinancing.



How can I diversify in a difficult market?

For a while, it seemed as though there was no refuge from the stock market's problems. International stocks, real estate, commodities, bonds, and precious metals all got hit simultaneously. The phrase "diversification can't guarantee a profit or ensure against the possibility of a loss in a declining market" never seemed more true.

And yet heightened uncertainty underscores the importance of hedging your bets. The more uncertainty, the more important it becomes to be able to take advantage of whatever investments are working best. Even if all asset classes are struggling, some may struggle less than others. Also, some investments and strategies can be used specifically to offset potential problems with other investments.

Owning a variety of investments can improve your ability to navigate rapidly changing conditions. Here are some balancing acts to consider when analyzing whether your portfolio might benefit from additional diversification.

- **Deflation vs. inflation:** Many economists—including those at the Federal Reserve Board—are concerned about the potential impact of prolonged drops in stock or housing values. However, efforts to combat deflation also raise the specter of potential inflation. Your portfolio should take both possibilities into account.
- **Currency fluctuations vs. stability:** Risk aversion last year boosted the U.S. dollar. However, that trend could reverse at some point if investors tire of Treasuries' low returns or become more concerned about rising U.S. deficits. Balance that possibility against potential instability in overseas currencies and markets.
- **Income vs. growth:** A company's ability to provide stable dividends may assume greater importance. Balance the benefits of ongoing income against the fact that smaller, growth-oriented companies have led the market out of every recession since 1971.

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What are some alternatives to just waiting for a market bottom?

Are you waiting to invest until you're positive the market has hit bottom? You may be increasing your odds of missing much of the upturn when it comes. Though past performance is no guarantee of future results, a sizeable portion of the returns made during a bull market often occurs in its early days, usually before it's clear whether the upturn will last.

In a way, bear markets are tailor-made for dollar cost averaging--investing the same amount of money at regular intervals over time. Even though it's difficult to watch your portfolio balance decline, a bear market also can help cut your average cost per share. With dollar cost averaging, your money buys you more of a given asset when prices are lower. While this strategy can't protect you against loss in a declining market or guarantee that your investment will gain, it eliminates the need to time the market. However, you also need to consider your financial and emotional ability to continue to invest in a down market. If you stop buying when prices are low, you're not reducing your overall cost basis by as much as if you had stayed the course until prices improved.

Dollar cost averaging isn't the only avenue for investing in the face of uncertainty. Using a core and satellite approach, you could set a strategic course with core holdings that you plan to hold for the long term. You could then take smaller positions in opportunistic investments that seem likely to make the most of short-term conditions or that hedge your other holdings.

Still another approach is value averaging. Rather than investing a fixed amount at each interval, value averaging involves setting a target amount, by which you want your portfolio to grow, and then buying or selling the amount needed to maintain that figure. For example, let's say you wanted your portfolio to grow by \$1,000 a month. If the portfolio has increased in value by \$850 at the end of the month, you would invest an additional \$150. If it has dropped, you would invest enough to bring it back to the original amount plus \$1,000. And when it exceeds your target--let's say it's grown by \$1,250--you might even take profits by selling \$250 worth of shares. Those proceeds also could be reinvested later. (This example is for illustrative purposes only, and does not represent any particular investment.)

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