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Provenance Wealth Advisor



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Balancing act

Walk a fine line when creating a tax-efficient portfolio

Location, location, location

Placing life insurance in a qualified retirement plan

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**Wealth management 101:
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Balancing act

Walk a fine line when creating a tax-efficient portfolio

Your goals and performance as an investor, whether you're aiming for aggressive growth or capital preservation, should be measured in after-tax results. What you ultimately keep after paying the federal government is what really matters. But there's a delicate balance between investing and taxes.

Apply guidelines

Creating a tax-efficient portfolio includes setting risk parameters and maximizing your expected rate of return within those parameters. The following guidelines can help you walk a fine line when creating your portfolio:

Compare taxable accounts vs. tax-deferred accounts. Generally, consider putting investments taxable at your regular marginal rate, such as certificates of deposit (CDs), corporate bonds and U.S. treasury securities, in tax-deferred accounts (for example, qualified retirement plans or IRAs). Other taxable investments to place in tax-deferred accounts include certain hedge funds or short-term trading accounts, or any investment likely to generate ordinary income or short-term capital gain.

By contrast, keep long-term stock investments — whether dividend-paying or not — in taxable accounts where the favorable long-term capital gains tax treatment will work to your benefit.

If you'd like to include mutual funds in your portfolio, consider those managed tax efficiently.

Harvest tax losses where possible. Pay attention to capital losses you can realize to offset gains, particularly short-term gains. If you want to hold on to the investment, consider selling at a loss and

buying back after 31 days to avoid the wash sale rule. Under this rule, if you buy back within 30 days before or after the sale, your loss is deferred until you sell again. Alternatively, find a similar stock or fund to buy so you won't have to wait 31 days.



Use securities with large gains for charitable contributions. By contributing to charity securities whose tax basis is low in relation to the current value, you can avoid the capital gains tax and still get a tax deduction for the full value contributed. You may purchase the same stock again, but it will then have a higher tax basis.

Invest in tax-efficient securities. If your portfolio is large enough, consider buying individual stocks and bonds rather than a mutual fund. Generally, you'll pay less tax because you won't have capital gain distributions while you hold the investment as you might with a fund. In addition, from a larger group of individual securities you'll more easily be able to take losses to offset gains.

If you'd like to include mutual funds in your portfolio, consider those managed tax efficiently. They could include either index-based funds or exchange-traded funds, as well as actively managed funds whose managers are sensitive to taxes.

Understand your overall tax picture. If your income varies from one year to the next, you may be able to absorb more investment income or capital gains in a given year. If you are subject to the alternative minimum tax, beware of private activity tax-exempt bonds that may increase your taxes.

Take action

There are many ways to ensure taxes take as small a bite as possible out of your investment return.

Long term, these actions can help you achieve a significantly larger investment return when you measure what you actually get to keep. Of course, remember that every portfolio is different, as is everyone's income tax situation. In addition, consider factors such as risk tolerance, liquidity and time horizon when making an investment. Seek professional tax or financial advice before making changes to your tax portfolio. ■

Location, location, location

Placing life insurance in a qualified retirement plan

Have you thought of using your qualified retirement plan's assets to buy life insurance? Doing so has both advantages and disadvantages: On the one hand, you may use tax-deductible contributions to purchase the policy, and on the other, you'll lose the ability to pass policy proceeds estate-tax free to loved ones after you die. Before deciding whether this strategy is right for you, examine these issues.

Plan requirements

A profit-sharing plan, including those with 401(k) arrangements, can purchase life insurance if the policy provides a death benefit that is only incidental to the plan as a whole. This leaves more latitude than it may seem. To pass this test, the insurance must be:

- Less than 100 times the expected monthly benefit at normal retirement,
- Less than 50% of the total account balance in the case of ordinary (or whole) life or variable life, or
- Less than 25% in the case of term or universal.

But profit-sharing plans that use only seasoned funds (those funds that have been in the plan for

more than two years or all funds in which you have participated for five years) or rollover funds aren't required to meet this test.

Income and estate tax treatment

When using your qualified plan to purchase insurance, the income tax treatment is different than if you buy a policy outside the plan where there is no tax deduction for premiums paid, but no tax on proceeds either. Inside the plan, you use deductible dollars to pay for the policy, but there is a tax cost each year in addition to when policy proceeds are received.

You must annually include in income an amount from government tables that equates to the pure term insurance cost for the year. On your death, the proceeds, less the cash value, are income-tax free, and the amounts included in income over the years also are tax free.

The estate tax ramifications are different for insurance in a qualified plan as well. While it's usually possible to remove insurance proceeds from your and your spouse's estates by holding the policy in an irrevocable life insurance trust and making gifts each year to pay premiums, qualified plan accounts not passing to your surviving spouse generally are subject to estate tax.



Policy removal

It also may be possible to transfer a policy out of the plan, either by distribution or sale. Keep in mind that IRS-proposed regulations issued earlier this year take the position that the policy's value isn't its cash surrender value but its full cash value, without reduction for policy surrender charges

(built-in charges if you want to cash out of an insurance policy).

Such a transfer may work particularly well for second-to-die policies. If your spouse survives you, only the cash value will be included in your estate because the proceeds aren't yet payable.

A strategy worth considering

Before you decide to place life insurance policies inside your qualified retirement plan, carefully consider the advantages and disadvantages.

This strategy can be complex, and you shouldn't attempt it without sound tax, financial and insurance advice. ■

Under 40? Why you still need an estate plan

The motivation for creating an estate plan typically increases as you age, especially if your net worth is growing and along with it your estate tax concerns. But there is much planning that should be done sooner rather than later, and for most people, it's related to concerns other than the estate tax.

Distributing assets as you wish

Without a signed will or living trust, your estate will pass according to intestacy laws in your state of residence. In many states, your assets will be split between your spouse and children.

If you're single and have no children, assets will normally go to your parents — they'll go to siblings only if your parents are not living. So a will is important if you want to make bequests to siblings, other loved ones or charity.

Providing for minor children

Naming a guardian for a minor child often is the reason parents get motivated to create a will or living trust. At the same time, many procrastinate

on choosing a guardian because of this decision's emotional nature. The guardian will be responsible for maintaining a household for your children — he or she need not be the same person who is responsible for your financial assets.



Because large amounts of assets can pass to your children, a will or living trust should ideally provide for the creation of a trust for each child's benefit. Otherwise, your children would assume full control of assets they inherit once they reach age 18 or 21, depending on state law. Typical trust provisions, on the other hand, provide for principal payments to be made to each child in installments at specific ages. Additionally, you can create the trust to remain in effect to benefit your grandchildren.

Consider life insurance as part of your estate plan

For a young family, adequate life and disability income insurance may be even more important than a proper estate plan. Term life insurance, as the least expensive approach, often is a popular option for those purchasing policies at a young age.

While this insurance type provides a cost-effective financial safety net during peak earning years, most insureds survive the term so their policy never pays its death benefit. Therefore, it may be beneficial to consider permanent insurance. The premiums initially will be greater than for term, but you'll build up a cash value in the policy. Depending on the policy and its performance, you eventually may not have to pay premiums to keep the policy in effect.

Carefully consider who should own and be a beneficiary of the insurance policy. This coverage may end up being the largest item in your taxable estate, thus triggering the estate tax.

To reduce estate tax liability on life insurance, consult with your professional advisor to purchase a policy via an irrevocable life insurance trust (ILIT) to which you can make annual gifts to cover premiums. If the ILIT is properly structured, any proceeds will not be included in your taxable estate. For many, taking this step can be enough to eliminate potential estate taxes at least until later in life when other wealth has built up to higher levels.

Designating beneficiaries

Certain assets, such as qualified retirement plans and IRAs, aren't covered by a will or living trust and require their own beneficiary designations. When your account in the plan was originally established, you had the opportunity to designate both one or more current beneficiaries and one or more contingent beneficiaries. Because these designations are controlling regardless of your will or living trust, be sure they remain up to date, particularly as family changes occur, such as births, deaths or divorce.

Similarly, life insurance policy proceeds also are paid to the beneficiaries you designate in the policy, regardless of what your will or living trust says. You can designate one or more individuals or a trust as the policy's beneficiaries.

Giving gifts

Giving gifts is an excellent way to transfer assets out of your estate. Many younger people may think it's too early (or too costly) to take

full advantage of the \$11,000 annual gift tax exclusion. You may have a difficult enough time trying to build a nest egg for your children's college education. But by starting to give gifts at a young age, you can transfer a large amount of assets estate- and gift-tax free to future generations.

Early in life also may be an ideal time to transfer a portion of a business interest if the business is just getting started and its value is small. Once the business becomes a success, a transfer will use up more of your valuable gift tax exclusions and exemption.

Putting it in writing

Creating an estate plan may be an unpleasant thought, but if you have growing wealth or a growing family, it is important that you do so. There is much planning to consider at any age, even if your assets have not yet grown large enough to trigger the estate tax. Consider the estate planning basics discussed here when you meet with your professional advisor. ■

Tailor a retirement plan to fit your and your employees' needs

A small business isn't as likely as a larger company to have a retirement plan for its employees. Why? Perhaps the business is relatively new and still struggling to maintain a profitable overall cost structure. Or the owner feels too busy running the business to have time to investigate, create and administer a retirement plan.

Whatever the reason, as a small business owner, don't assume a retirement plan isn't feasible because it would be too complex or costly. You may be surprised to find that there is a plan that can fit your needs. And, perhaps best of all, you can participate in the plan and save for your own retirement, too.

Payroll-deduction IRA

The payroll-deduction IRA is a basic retirement plan that operates under IRA rules. Employees can choose the withholding amount from each payroll check that is deposited into the IRA. The employer doesn't contribute anything. It pays only for the minimal administration costs.

As contribution limits increase, the IRA becomes a more powerful tool for retirement savings — 2004 contribution limits are \$3,000 (\$3,500 if you are age 50 or over this year). The limits are scheduled to increase to \$4,000 in 2005 and \$5,000 in 2008.

401(k) plan

To gain flexibility, consider a 401(k) plan. As with payroll-deduction IRAs, your company isn't required to contribute other than covering the administrative costs of setting up and maintaining the plan, though you can choose to make matching contributions. Plus smaller-size plans can minimize your costs — especially if they're subsidized by the investment firm or mutual fund family operating the plan.

Contribution limits are much higher than for IRAs. In 2004, employees can contribute to a 401(k) up to the lesser of 100% of their income, or \$13,000 (plus an extra \$3,000 if they're age 50 or over). Keep in mind that 401(k) plan rules require testing of participant contributions to ensure they aren't too heavily skewed toward the owners and key employees.



If this is the case, those in the highly compensated group may have their contributions limited, and may get a portion of their contributions returned after the calculations are made at year end. Even with this limitation, you and other key employees on your staff with the highest salaries will be able to contribute the largest amounts to the plan.

Employer-contribution plans

Moving beyond an employee-contribution plan to an employer-contribution plan will increase participants' benefits but also boost the plan's complexity and cost. For instance, if you match some portion of workers' contributions, you'll provide greater incentive for employees to contribute more from their own salaries.

You may choose a savings incentive match plan for employees (SIMPLE), in which employees can contribute up to \$9,000 in 2004. (Employees age 50 or over can contribute \$10,500.) But your company also must contribute either a matching contribution for those who contribute or an across the board contribution for all employees.

A safe harbor plan will free you from the testing requirements, but not without what could prove to be a substantial company contribution. You must choose one of two employer contributions:

- A 3% of compensation contribution for all lower-paid employees (whether they contribute or not), or
- A matching contribution equal to 100% of the first 3% compensation and 50% of the next 2% (which could reach as much as 4% if every employee contributed at least 5%).

Which safe harbor choice will be less expensive will depend on the particular mix of employee contributions in your company. In addition, whether you decide to use a safe harbor plan hinges on how concerned you are about testing limits.



The right plan for your company

When considering the right retirement plan for your small business, don't let all of the choices stop you from taking advantage of this important wealth-building opportunity for you and your employees. Meet with an advisor to eliminate the plans you can't afford and zero in on the one that most closely fits everyone's needs. ■

Wealth management 101: Rental properties

Are you thinking of buying a rental property, perhaps a single family house or a small apartment building? While the financial rewards can make this a worthwhile venture, you not only have to learn to play the role of landlord, but also have to manage what will become a more complicated tax return.

Most important, you'll need to account for every item of inflow and outflow related to the property. All rental income is generally taxable — except for security deposits. But income can be offset by any expenses that relate to the property, including mortgage interest, real estate taxes, property insurance, management fees, condominium assessments, cleaning, repairs, supplies and utilities.

In addition, you can take depreciation deductions over a period of 27½ years on the cost of the building itself — 39 years for commercial property. That portion of the cost allocable to land cannot be depreciated. Certain costs — such as appliances, furniture and window treatments — may

be depreciated during a shorter time period, generally seven years.

Don't forget other depreciable costs, too. These may include closing costs such as attorneys' fees, transfer taxes and title charges, as well as capital improvements made after you purchase the property.

Once you've subtracted all expenses, including depreciation, from your rental income, you're likely to incur a net loss for tax purposes even if the cash flow is positive. But this doesn't mean the loss will be deductible. It's considered a passive activity loss, even though you actively participate in managing the property.

You may be able to deduct up to \$25,000 per year in losses as an active participant but only if your adjusted gross income (AGI) doesn't exceed \$100,000. For AGIs between \$100,000 and \$150,000, this limit phases down to zero. Passive losses that can't be used will carry over for future use.



Seated left to right: John F. Young, Richard A. Berkowitz, Barry M. Brant
 Back row left to right: Lee Hediger, Jeffrey M. Mutnik, Tom Young, Eric Zeitlin, Todd Moll,
 Terrence A. Schultz, Randi K. Grant, Richard A. Pollack, Kenneth J. Strauss, Gary E. Rosenthal.

“We believe in a comprehensive financial perspective.

*We provide our clients with an integrated approach to income, estate, business and investment planning.
 Upon completion of a comprehensive plan, we proactively implement the plan to achieve the desired outcome.”*

Provenance Wealth Advisors, an affiliate of Berkowitz Dick Pollack & Brant, Certified Public Accountants, LLP is a registered representative of Nathan & Lewis Securities, Inc. The Directors of Provenance Wealth Advisors are Investment Advisor Representatives with extensive experience in design, development, and implementation of sophisticated financial plans. We have both the expertise and the experience required to develop creative solutions for the complex issues faced in today’s constantly changing financial landscape.

Our clients consist of successful business owners, CEOs and entrepreneurs who often have the fundamentals of good planning in place, but lack the time, expertise, and most importantly the right team of advisors to create and implement comprehensive planning strategies.

Our experience tells us that having the work “done” does not necessarily mean “done right.” Rarely, very rarely, does it mean, “done best.” Our approach revolves around planning according to your established objectives, and to make sure your plan is properly implemented without infringement on your lifestyle.

Our Services Include:

- Comprehensive Financial Planning
- Estate Planning
- Insurance Planning
- Income Planning
- Investment Planning & Counseling
- Retirement and Distribution Planning
- Business Valuations and Succession
- Gift and Charitable Contribution Planning
- Employee Benefit Planning



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