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# Provenance Wealth Advisor

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**Take advantage of bonus depreciation and the expensing election this year**

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# Weighing your college funding options

A difficult decision you face as a parent or grandparent is how to finance your children's or grandchildren's college education. As with many facets of financial planning, the most important point may be that you have a plan and get started on it sooner rather than later. How it gets done is secondary. Nevertheless, you must consider and assess the array of financial options available.

## Section 529 plans

Section 529 plans have quickly become a popular college funding option since the 2001 tax act made plan distributions used for qualified education expenses tax-free. (Without further legislation, the tax-free provision will expire after 2010.)

These plans can offer estate planning benefits as well. For example, a special provision lets you use up to five years of annual gift tax exclusions at one time. (You can make no further annual exclusion gifts to the 529 plan beneficiary during the next five years.)

You can choose a plan offered by any state (not just your own), but in some states there are state income tax benefits if you use your own state's plan. Each plan is managed by an investment firm. For further information about 529 plans, including investment objectives, risks, fees and expenses, read the issuer's official statement, available from your financial advisor.

If you withdraw funds from your 529 plan and don't use them for qualified expenses, these amounts are subject to tax as ordinary income and also may be subject to a 10% penalty.

You may, depending on which 529 plan you choose and what your other investment options are, give up something in terms of investment fees and performance in exchange for the tax benefits 529 plans enjoy. An alternative education-saving tool, the Coverdell Education Savings Account (ESA), allows you complete investment flexibility.

But ESAs allow only a $2,000 contribution per year and are available only if your income is below a certain amount. Contribution limits begin phasing out for single filers with an adjusted gross income (AGI) between $95,000 and $110,000, and for married couples filing jointly with an AGI between $190,000 and $220,000.

## Holding on to assets

While 529 plans and ESAs offer the ultimate tax breaks for funding a college education, the tax on investment income from funds in your own name is relatively low. Most long-term capital gains and dividend income are now taxed at a 15% federal tax rate, and the capital gains tax may be deferred if you aren't "turning over" the account too often through trading.

## Curb irrational spending with a trust or FLP

If you have a large estate and intend to transfer to your children or grandchildren amounts in excess of what is necessary to fund their college education, consider using a trust or a family limited partnership (FLP) to ensure the money will be used according to your wishes.

In addition, a trust can provide creditor protection (or protection from ex-spouses), and safely maintain, and perhaps even build, wealth for as long as its terms provide. You may distribute funds for college or other purposes as they're needed.

Similarly, an FLP or a limited liability company (LLC) will be controlled by the general partner or managing member, and also will provide a level of protection as long as it remains in existence. You may also have the opportunity to take valuation discounts on gifts of interests in the partnership.

The two concepts can be combined by having a trust as limited partner in the partnership.

An advantage to keeping funds in your own name — if your income is below certain thresholds — is that you may qualify for various credits or deductions, such as the Hope and Lifetime Learning credits and the college tuition deduction. Plus, the annual gift tax exclusion is unlimited for qualified tuition and fees paid directly, so paying for your children's or grandchildren's tuition and fees won't use up any of your $11,000 annual exclusion.

*In some states there are state income tax benefits if you use your own state's plan.*

### Transferring assets to children or grandchildren

Bear in mind that your children or grandchildren are likely in a lower income tax bracket than you. If they're in the 10% or 15% bracket, their dividend and long-term capital gain income will be taxed at only a 5% federal income tax rate through 2007 and be tax-free in 2008.

Generally, these lower tax rates will apply only to children age 14 or older, as those below age 14 will be taxed at their parents' rate. But note that even children younger than 14 can get $800 of tax-free income, and the next $800 taxed at their own low rate, before their parents' rate kicks in.

With low interest rates and the ability to defer gains until later years, using your children's or grandchildren's 5% federal income tax rate can allow for substantial assets to build without generating much tax. Then, when they pay for their own college education, the Hope and Lifetime Learning credits and the college tuition deduction may apply to the extent that their income is large enough to absorb them.

To take advantage of this strategy, you will typically transfer funds to a custodial account. The downside to this strategy is that, when your loved ones turn 21, they may use the funds as they wish. (See the sidebar, "Curb irrational spending with a trust or FLP.")

### The choice is yours

When it comes to funding your children's or grandchildren's college education, you have many options. Your own financial situation will help dictate which choice (or combination of choices) best balances your tax and financial goals. ■

# What variables could affect your financial independence?

A sound financial plan incorporates many different aspects, such as income and estate tax planning, development of a well-balanced investment portfolio, risk management and asset protection. But the foundation on which your plan is based should be a calculation of how much money you'll need to gain financial independence. Financial independence is the ability to live on the resources you have saved for the remainder of your and your spouse's lives.

## Calculation variables

The variables in your financial independence calculation include your:

- Current investable assets,
- Projected rate of saving while you're employed,
- Qualified and nonqualified retirement plan assets,
- Investment rate of return,
- Unexpected cash inflows or outflows, such as gifts, weddings, second homes or inheritances,
- Income taxes,
- Life expectancy, and
- Spending level today and during retirement, plus additions for inflation.

When you take all of these factors into account, you can estimate whether you're headed in the direction of financial independence.

## Accounting for the variables

Because the information you enter into the calculation is an estimate and likely subject to change, regularly review and revise the calculation. Here are key variables that have changed for many people:

**Recent investment losses.** If you had substantial funds invested in the equity markets during the past four years, you probably incurred some losses even though 2003 was a good year. Thus, not only did you have a decrease in actual funds during a four-year period, but you lost four years' time during which you might have been expecting to post an increase. So the loss to your financial independence is more than the loss reflected in your monthly statements. Depending on your age and when you retire, you may never be able to make up for this shortfall.

**Projected future investment rates of return.** As if it weren't bad enough that many investors incurred heavy losses in recent years, there's a second part to this investment double whammy. Even after Fed rate hikes, interest rates are at near-record lows. So bond returns will probably be lower for the foreseeable future because, as rates inevitably continue to rise, bond prices will go down as investors seek new issues that pay higher rates. In fact, existing bond investments will decrease in value as rates rise. The bottom line is that a well-diversified portfolio is still likely to experience an overall rate of return going forward that is more historically typical than that of the '80s and '90s.

*When you take all of the calculation variables into account, you can estimate whether you're headed in the direction of financial independence.*

**Lower income tax rates.** Federal income tax rates have come down recently, and particularly so on most dividends and long-term capital gains, which are now taxed at 15%. Lower rates will allow you to keep more of your income and gains.

**Longer life expectancies.** This is good news, but it does mean that, on average, you will have to work longer, spend less money in retirement or build up more in investment assets to cover what may be a longer retirement. You can increase assets either by earning more while working or by achieving a greater return on your investments.

## Reviewing the variables

A financial plan is an excellent wealth management tool, but you should base it on a calculation of your financial independence. To keep the calculation viable, review its many variables to ensure they are up-to-date — especially in light of the past few years. ■

# Business equipment tax break deadlines loom

## Take advantage of bonus depreciation and the expensing election this year

As part of the tax act passed following Sept. 11, Congress, in an effort to encourage business spending, created bonus depreciation. This gave an upfront 30% tax deduction for qualifying new business equipment purchased during the three-year period beginning Sept. 11, 2001. Subsequently, the deduction was increased from 30% to 50% for purchases made after May 6, 2003, and through Dec. 31, 2004. Now, barring late action in Congress to extend this tax break further, it will expire at the end of this year.

In 2003 Congress also increased the maximum Section 179 expensing election significantly. This election lets businesses expense up to $102,000 in equipment purchases in 2004. This amount will be indexed for inflation in 2005 but return to the previous limit of $25,000 after Dec. 31, 2005.

### Benefits of each tax break

Under bonus depreciation, you can take a first-year deduction of 50% plus normal depreciation on the other 50% — even if you purchased the asset late in the year — rather than following normal depreciation rules that allow deductions to be spread over typically a five-to-seven-year period for most equipment. Thus, the first-year deduction on equipment subject to seven years of depreciation would be approximately 57% rather than as little as 14%.

The expensing election allows a deduction for the entire asset rather than just 50%, so it generally is more beneficial.

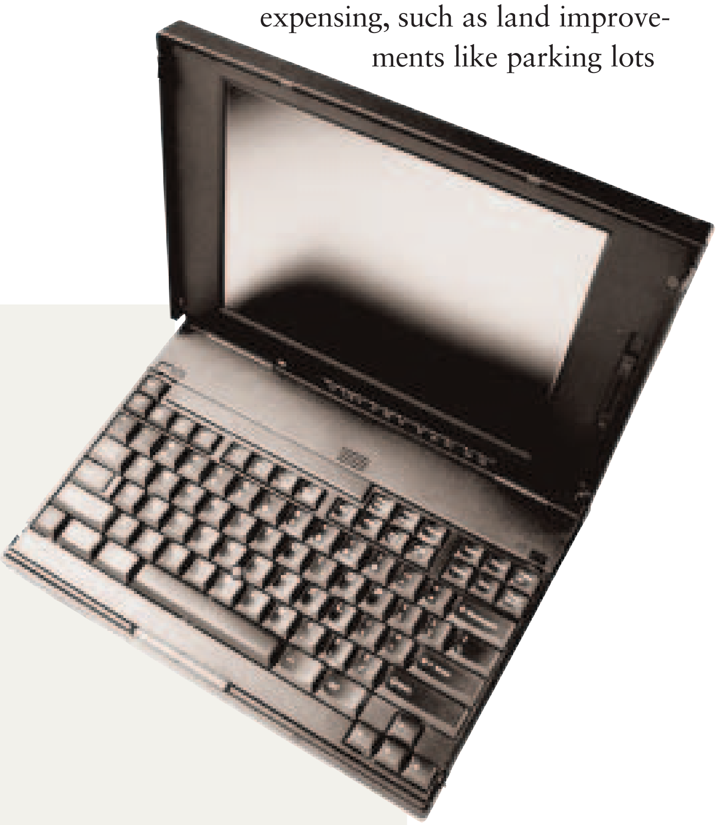
Of course, businesses with more than $102,000 of new purchases this year would then rely on bonus depreciation for any excess. And those with total purchases in excess of $410,000 in 2004 don't qualify for the expensing election, so they also would rely on bonus depreciation to increase their 2004 deduction for equipment costs.

*The expensing election allows a deduction for the entire asset rather than just 50%, so it generally is more beneficial.*

### How the tax breaks differ

There are other, subtle differences between the two tax breaks. For example, bonus depreciation applies only to new property, while the expensing election applies to both new and used.

On the other hand, bonus depreciation applies to some items that don't qualify for Sec. 179 expensing, such as land improvements like parking lots



and landscaping that would otherwise have a 15-year life, and tenant improvements made by a commercial landlord to an existing building more than three years old, otherwise depreciable over 39 years. It's important to get these items placed in service — the equipment must be in use or at least installed — before the end of the year, thus qualifying for bonus depreciation while it remains available.

### Time is running out

As you make year-end purchases, be aware of available tax breaks — such as bonus depreciation and expensing elections. Take care wherever possible to fit your purchases into the most advantageous tax position. ■

## Wealth management 101: Health Savings Accounts

**Health Savings Accounts (HSAs) went into effect on Jan. 1, 2004, but are only now beginning to hit the marketplace. They replace and improve on a similar iteration of the concept, the Archer Medical Savings Account (MSA) — a pilot program from 1997 through 2003.**

**HSAs are available to those with high-deductible health insurance plans (at least $1,000 for individual coverage, $2,000 for family), such as the self-employed, and allow for either excludable-employer or deductible-employee cash contributions.**

**Contributions are limited to the annual deductible amount, with a cap of $2,600 per year for an individual, $5,150 for families. (If you are between ages 55 and 64, you may contribute $500 more in 2004 and $600 more in 2005.) Once you reach age 65, you no longer may make contributions. Contributions are deductible in computing adjusted gross income. Therefore, you don't have to itemize to take advantage of an HSA, plus there is no expense minimum for deductibility, as there is for medical expense deductions.**

**As with an IRA, you must choose a qualified institution, such as a bank, insurance company or other financial institution, to serve as the HSA's trustee. You may make contributions anytime during the year and through April 15 of the following year.**

**Earnings inside the plan, and funds taken out to pay qualified medical expenses, are not taxed. But if you withdraw assets for any other purpose, they'll be subject to income tax plus a 15% penalty. You may name your spouse as the HSA's beneficiary, and should you die with funds remaining in the account after it pays for final medical expenses, he or she can roll over the funds to his or her own HSA. Other beneficiaries cannot roll over the funds and will have to pay tax (but not a penalty) on what they receive.**

**Because of the rising costs of health insurance and the widespread applicability of HSAs, consider whether one is right for you. They will fit best for those who have the cash available to pre-fund medical costs and who are healthy enough to not be using up the full deductible amount every year.**

**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 Walnut Street 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
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- Retirement and Distribution Planning
- Business Valuations and Succession
- Gift and Charitable Contribution Planning
- Employee Benefit Planning

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