

Provenance Wealth Advisor



PROVENANCE

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Don't forget wealth management when selling your business

Selling a business, particularly one you have built and nurtured over many years, is an important event with wide-ranging ramifications. It's also a time-consuming process, requiring you to find a buyer and negotiate a deal while still keeping your business up and running.

This leaves little time to think about wealth management considerations — including your future financial, estate planning and charitable giving goals. But, in fact, these objectives may dictate how you sell your business, and even whether you should sell at all.



What are your financial requirements?

Don't wait until the ink on your deal is dry to analyze your own future needs. Before you contemplate selling your business, know what you plan to do once you're no longer running the company. This will help you calculate how much you require to achieve financial independence for yourself and your family.

Make sure this figure includes any tax liabilities and covers all anticipated spending, including recurring expenses, one-time purchases and any charitable giving plans. Then calculate the level of return you require from your investable assets — both the proceeds of your business and other assets — to achieve these goals.

Should you sell for cash or stock?

How much you will have to invest may depend on the amount of cash you realize from the sale of your business. While you may not always be able to choose whether you sell for cash or stock, you should understand how each might affect your financial future.

Stock offers several advantages: You probably won't owe current capital gains taxes and you can continue to benefit from any growth of the business. The downside is that you may merely be trading the personal financial risk associated with owning your own business for the risk of being a minority shareholder in a company over which you have less control.

While under standard "lock-up" provisions you probably will be prohibited from selling your shares for only a short period of time, you may be reluctant to sell after that point because of your emotional ties to the company as well as the capital gains tax liability. Tying up most of your assets in one investment, however, is risky.

There are alternatives to simply negotiating an all-cash deal. You may be able to protect the value of the deal before closing by setting the price in dollar terms rather than by number of shares, or by setting a floor on the dollar value of stock you will receive.

You might also be able to negotiate a part-cash, part-stock deal in which you receive the cash up front and negotiate as short a lock-up period as possible on the stock.

Once you've converted stock into cash, you need to consider how you'll invest the funds. If you plan to retire instead of moving on to another venture, you may be more concerned with preserving your capital than with growth. Discuss your income and capital preservation needs with your financial and tax professionals.

What's your estate plan?

The sale of a business can quickly and dramatically change the value of a company. You may sell for more than you ever thought possible and more than a business valuation would have indicated the business was worth. This provides you with an opportunity to use gift tax exemptions to maximum advantage.

Minority interests in a business can be valued at a discount before it is clear that the shares are about to be sold; thus, transfers at that time can use up less of your gift tax exemption. And if the value may potentially rise quickly and dramatically when a sale occurs, the gift tax value may turn out to be doubly discounted.

Transferring shares in a business to children or grandchildren before its sale can thus be much more effective than a post-sale transfer. A trust, such as a grantor-retained annuity trust, can further enhance the tax advantages of such a gift. (See "Put stock in a GRAT.")



Put stock in a GRAT

A grantor-retained annuity trust (GRAT) is an ideal place to transfer stock in a business that is likely to be sold in the near future. Here's how it works:

You fund the trust with stock and receive annual payments. The beneficiary you name receives what is left at the end of the trust term. If the total present value of the annuity payments is equal in value to the fair market value of the transferred stock, you won't have made a taxable gift for gift tax purposes.

But if the value established at the time of the gift, including discounts for a minority interest, turns out to be significantly less than the ultimate sale price, the GRAT is likely to work very well. The trust may have funds left after completing its annuity payments, and a substantial transfer to the trust's beneficiaries can be made without having used any of your \$1 million lifetime gift tax exemption.

What are your charitable intentions?

If you intend to donate some of the wealth realized from the sale of your business to charity, and your own needs and those of your family are already covered, you might consider contributing appreciated stock. By donating the stock, you avoid capital gains tax and receive a current deduction for your charitable contribution.

You may also want to consider establishing a charitable remainder trust that will defer your capital gains tax and provide you with a partial charitable contribution deduction (based on the value projected to eventually go to charity). Charitable remainder trusts can also provide you with regular cash payments.

What are you waiting for?

Several major wealth management issues affect you and your family when you sell your business. Addressing those issues should be an important part of the process — before, during and after the sale — so don't let them become an afterthought. ■

Designing a laddered bond portfolio

Just like your stock portfolio, to reduce risk your bond portfolio should be diversified. This may mean investing in bonds of different types (for example, government and corporate), quality, countries of issue and maturities. One way to achieve some portfolio diversification by maturity is to create a laddered bond portfolio.

The impact of maturity

Generally, the longer the maturity — or time until the bond issuer is due to repay the investor's principal — the riskier a bond will be. This is because bond values (or the amount investors are willing to pay) are affected by interest rates. When interest rates rise, previously issued bonds typically decline in value because their fixed coupon rate is now less attractive relative to those of newly issued bonds.

The longer the bond's remaining term, the more pronounced this decline is likely to be. After a rate hike, investors are left holding a below-market-rate bond for a longer period of time. To compensate for this greater risk, long-term bonds typically offer higher coupon rates than short-term bonds.



Creating a bond ladder

To minimize interest rate risk without sacrificing too much potential return, you may want to consider creating a laddered portfolio. Laddered portfolios spread maturity dates over a period of years. As bonds with shorter maturities come due, they are replaced with new bonds at the longer end of the maturity spectrum. In the meantime, the remainder of the portfolio moves gradually closer to maturity. (For example, after two years, the five-year bonds have become three-year bonds.)

If interest rates rise, your longer-maturity bonds will probably suffer, but as shorter-maturity bonds come due you will be able to buy new bonds at current, higher coupons.

The overall strategy is to maintain, as closely as possible, a portfolio with a broad spectrum of maturities and a targeted average maturity. This kind of diversification generally dampens interest rate risk somewhat, though it never eliminates the risk of portfolio volatility. If interest rates rise, your longer-maturity bonds will probably suffer, but as shorter-maturity bonds come due you will be able to buy new bonds at current, higher coupons.

Tweaking the concept

Just because you use a laddered portfolio strategy doesn't mean you can't adjust it as economic events warrant. For example, if interest rates hit all-time lows, as they have in recent years, you may want to shorten the portfolio's average maturity — maintaining a ladder but shortening its "height." You will have less interest rate risk and more opportunities to buy higher-rate bonds as rates rise.

In fact, many professional investors avoid bonds with maturities longer than 15 years. They believe that the

longest-term bonds typically don't sufficiently compensate investors for the additional interest rate risk.

Alternative for the smaller investor

Building your own laddered bond portfolio means you must purchase a number of individual bonds, which generally requires a large initial investment. One alternative to this costly and complicated strategy is to invest in a bond mutual fund, which offers built-in

diversification. In fact, many bond fund managers follow a laddered strategy. Or you could invest in several funds with different average maturities.

If you decide you'd rather create an individual laddered bond portfolio, enlist the help of an experienced financial professional. Even if you're a savvy equity investor, you are likely to find building and maintaining a laddered portfolio on your own extremely challenging. ■

Should a trust be the beneficiary of your retirement plan?

If you participate in a qualified retirement plan (such as a 401(k) or IRA — traditional or Roth — you must designate who will receive the assets remaining in the account at your death. This designation determines the account's beneficiary regardless of any provisions in a will or trust.

If you are married, your spouse will typically be your beneficiary. But you also can name your children or even a trust. In certain situations, a trust as beneficiary can be very advantageous. But there are also complications and tax consequences to consider.

When a trust may make sense

If your and your spouse's combined estates are large enough to be potentially subject to estate taxes, you may want to take advantage of both of your estate tax exemptions — currently \$1.5 million each and scheduled to rise to \$2 million on Jan. 1, 2006 — by establishing a credit shelter trust. The trust receives an amount up to the current estate tax exemption upon the first spouse's death, and then shields it from estate tax upon the death of the surviving spouse.

Retirement plan assets, however, are generally not the best source of funding for credit shelter trusts because plan distributions are subject to income taxes, reducing the amount the trust beneficiary receives. Virtually any other asset is a better choice, because its tax basis can be



“stepped up” upon death, meaning beneficiaries receive the full value undiminished by income taxes. But if retirement plan money makes up the bulk of your estate, you may have no choice but to use at least some of those assets to fund your credit shelter trust.

It may also make sense to name a trust as your retirement plan beneficiary if you ultimately want your retirement plan assets to go to a minor, a disabled person for whom a special-needs trust is required or another individual who needs the asset protection advantage of a trust.

Possible complications

Trusts can make your estate plan more complicated, can be costly to set up and maintain, and are generally taxed more heavily than individuals. Also, a trust may not be able to allow distributions to stretch over as long a period as would be possible with an individual beneficiary. Income tax on these distributions therefore may need to be paid sooner, and the benefits of potential tax-deferred growth may be reduced.

But you may be able to draft your trust as a “look-through,” so that distributions are based on the life expectancy of the trust beneficiary. If the distribution

schedule is an important consideration, make sure you discuss this option with your legal advisor.

Benefit your heirs

Trusts can be useful as beneficiaries of a qualified plan or IRA. But, because of the tax consequences, carefully consider the decision and only name a trust as beneficiary if there is a good reason. After all, you don't need to establish a trust to pass your retirement plan assets to your heirs. You can leave your account to your children individually as multiple beneficiaries, or even divide an account, leaving one piece to a spouse and another to your children. ■

Twice as nice

Split annuities offer both immediate and deferred payments

Split annuities have grown in popularity in recent years, and for good reason. A combination of two separate investments, split annuities can provide you with a steady income stream while preserving your principal. Let's look at how they work.

Immediate and deferred fixed annuities

When you invest in a split annuity, a portion of your investment is used to fund a single-premium immediate annuity. After making the initial investment to fund

Split annuities can be a good choice if you're looking for a relatively conservative investment.

the annuity, you immediately begin to receive monthly payments. Over a set period of years, you get back your principal investment plus interest. The amount of the monthly payment is guaranteed for a fixed period and continues to be paid to your heirs even if you don't survive the term.

The term of your annuity payments can determine their amount. For example, an immediate annuity that earns



6.2% interest for an 8-year period may yield payments equal to 15% of your original investment each year. But, because more than half of this yield represents your principal, your income tax liability is relatively minimal. In fact, in this example, only around 18% of your annuity payments are taxable.

The second portion of your investment buys a single-premium deferred annuity. This annuity is designed

to pick up where the immediate annuity leaves off. While the immediate annuity makes payments, the deferred annuity builds up tax-deferred interest. And, once the value of your immediate annuity is depleted, the deferred annuity kicks in and starts making payments.

Putting them together

This two-pronged strategy is designed so that, when you start receiving deferred annuity payments, your investment in that annuity is likely to be equal to the amount of your combined original investment amount.

Split annuities allow you to supplement your income over a period of years without exposing your nest egg to the volatility associated with the stock and bond markets. But depending on the guarantees your annuity carries (for example, a guaranteed minimum interest rate), you may earn lower overall rates of return.

Split annuities can be a good choice if you're looking for a relatively conservative investment that provides you with regular income, but beware that fees may be higher than on other investment alternatives. These investments may come with a variety of options, so be sure to discuss your choices with your investment professional. ■

Venture abroad with international stocks

No matter how well you've diversified your equity portfolio — allocating among growth and value stocks, large and small companies and various industries — you can't achieve real diversification without also including foreign investments.

Many factors can significantly affect U.S. stock performance as a group. These include macroeconomic issues such as inflation, interest rates and the national deficit; currency fluctuations; and political issues such as war or terrorist threats.

Investing internationally is certainly no guarantee against market downturns. Worldwide financial markets can suffer similarly during the same time period, particularly large, developed markets that closely track the U.S. market. But investing a percentage of your portfolio overseas — such as between 10% and 20% — may offer some protection from U.S. market fluctuations.

As an individual investor, you may have trouble gathering information about foreign companies and evaluating their potential. For this reason, mutual funds may be your best option, even if you typically invest directly in U.S. companies. The built-in diversification

and professional oversight of foreign equity funds can take some of the guesswork out of investing internationally. Note, however, that mutual funds that invest in foreign securities often charge higher fees than funds that are limited to U.S. investments.

Even with mutual funds, international investing involves certain risks. Your foreign stocks' performance may be dramatically affected by company-specific, large economic and political events. Stocks in developing markets in places such as Asia, Eastern Europe and South America can be particularly volatile. The value of international stocks is also affected by fluctuations in the values of their currencies. And, as with any mutual fund, it's possible to lose money in these types of investments. So it's important to limit your foreign stock allocation to a relatively small percentage of your portfolio.

Mutual funds are sold by prospectus. Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. Please read the prospectus carefully before investing. For this and other information, call or write to us for a free prospectus.

Choose the Right Advisor to Make the Right Moves



“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.”

OUR SERVICES INCLUDE:

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- Gift and Charitable Contribution Planning
 - Employee Benefit Planning



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