Guide the Journey

Second Quarter 2009

A publication for Miller Gesko

Time for a Reality Check

Put aside the newspaper, turn off the television and take a moment to get the current financial situation back into perspective. Yes, the crisis is real and yes, it's global. That alone makes it very different from prior financial meltdowns. This isn't just a tech stock slide, or an Asian crisis. It's worldwide and it is going to change our lives. But it isn't the end.

There is cyclicality to everything - from life with its inescapable move from birth to death, to the financial markets with their unending cycles of bull and bear, to economies and business cycles. It seems as if we need those cycles to advance and to change. The good news is that if you look back throughout history, periodic crises catalyze a whole new epoch for society. And by and large those catalysts bring positive changes.

In the U.S., despite the erosion of net worth from declining values in homes and investments, we have tremendous resources to pull us through this crisis. Indeed, our greatest worry isn't what happens here at home, but what happens around the world where safety nets are thinner, or perhaps don't exist at all.

What should you do personally to get through this period? It sounds trite, but just do your best. Decide what matters the most to you and focus on keeping those elements whole and healthy. Personal relationships should be a priority. This is not the time to let stress destroy families, friendships

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Wealth Distribution on Your Terms

The current administration and Congress have made it pretty clear that wealth needs a bit of redistribution. The exemption for estate taxes is to be frozen for now at \$3.5 million. Effective 2011, taxes will rise for single individuals earning \$200,000 and more and couples earning \$250,000 and over. The *Wall Street Journal* reports this will generate \$656 billion over 10 years.

The problem is that isn't enough. The current economic stimulus plan exceeds \$780 billion in less than three years. And that's before we start talking financial bailouts. President Obama's plan to finance increased deficits with increased taxes on the wealthy is going to fall short even if the tax rate is raised to 100% according to many analysts. There just aren't enough people earning above \$200,000 (or \$250,000 for couples), and their numbers are falling with the economy.

Payoff plans under the proposed federal budget also rely on some fairly rosy economic forecasts. The White House budget assumes that the economy will decline only 1.2% this year, growing 3.2% next year. By 2010 to 2013, budget expectations are that the economy will average 4% a year.

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Spotlight on Fraud

At the very least, the current financial crisis is shining a very bright light on investment fraud. With more Ponzi schemes surfacing and the list of advisers on the lam growing, Warren Buffett's comment in his 2002 shareholder letter is coming true "…you only find out who is swimming naked when the tide goes out."

2009 Distributions NOT Required

The 2008 Worker, Retiree and Employer Recovery Act provides a one-year suspension of retirement account Required Minimum Distribution (RMD) rules in 2009. This allows people 70½ or older to skip taking distributions from IRAs and defined contribution retirement plans (such as 401(k) and 457(b) plans). It also applies to after-death distributions.

Waiving the 50% excise tax penalty imposed if minimum withdrawals are not taken after age 70½ is designed to ease requirements for pension plans that are having problems meeting funding requirements in the current economic crisis. But it can work to the advantage of individuals as well.

The main reason to skip a minimum distribution in 2009 is to give your retirement account more time to recover from the past 18 months. If you want to be able to pass retirement assets on to your beneficiaries, minimizing withdrawals from retirement accounts is a good strategy. Because distributions from tax-deferred accounts are taxed as personal income, withdrawals may be subject to higher tax levels than other income sources and could impact your tax bracket.

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That's optimistic even within the federal government. In mid-February, the U.S. Energy Information Administration reported that the U.S. real gross domestic product (GDP) is expected to decline 2.7% this year.

With values down for many investment classes, this could also be a good opportunity to transfer assets at a lower value, minimizing tax implications.

Before you do anything, identify how much you can afford to transfer. You don't want to jeopardize your lifestyle needs. Second, decide how much control you would like to retain over the assets. If you want to help finance a child's education, an outright gift might not be the best way to do so. There are other ways to transfer assets that give you more control over the use of those funds.

The Tax-Free Gift

Use tax-free gifts first to transfer wealth. There are three ways to do so: (1) the annual exclusion gift per recipient – currently $13,000 transferrable to as many beneficiaries as the donor wishes, (2) the $1 million lifetime gift-tax exemption per donor free of gift tax (this will reduce the amount of your estate that can pass free of taxes) and (3) certain gifts earmarked for educational and medical expenses.

If you pay someone's medical or education expenses directly to the provider, the gift is not included in your annual exclusion amount. With a 529 Qualified Tuition Plan, a grantor can elect to use five years of annual gift-tax exclusions at once as a contribution for a beneficiary.

Trusts and Other Tools

A number of types of trusts can help transfer wealth free of gift taxes while avoiding probate and reducing estate taxes. Make certain you work with a qualified attorney or tax adviser in establishing a trust, however. You want to know your trust will stand up in court and in the face of the IRS.

Other tools for wealth transfer are:

- Family Limited Partnership
- Private Annuities
- Asset sales/loans to family members.

Wealth transfer allows the future income and appreciation of the transferred assets to escape transfer taxes. The big caution is to make certain you work with qualified advisers when establishing wealth transfer plans. Your priority needs to be your own financial security first.

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or working relationships. In fact, these relationships are typically your greatest source of support and happiness.

This is a good time to be financially conservative, but remember that crises create opportunities. Rather than acquiring the latest, greatest toys, look for possessions with lasting value and ways you may be able to create wealth in the future with your spending. Try to set as much money aside as you can so you are positioned to take advantage of opportunities.

Like it or not, we are all being jolted out of the comfortable ruts we've traveled for the last 20-30 years. And the change can be very good if you take the time to rethink your life. We welcome the opportunity to talk with you, to explain our view of the future and where the financial markets might be headed. If your circumstances have changed, it may be time to change your investment approach. Perhaps there are ideas you would like to bounce off of us, or investment opportunities you would like to consider. As always, please feel free to call us with any questions or concerns.

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