

Personal Wealth Report

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Travers,
O'Keefe

11 Hanover Square
New York, NY 10005

T: (212) 742-7900

(800) 950-9477

F: (212) 742-9423

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Money Matters

What Makes the Stock Market Tick?

The stock market goes up ... the stock market goes down ... the stock market goes round and round. Over time, it's difficult to keep up with stock market "trends" that seem to change with every passing week or month. However, there are several basic principles that can help you understand the movements.

Keep in mind that this is just a general overview of factors affecting the stock market and is not intended as a guideline for investment strategies. While past performance is certainly significant, it is not a guarantee of future performance and should not be relied upon exclusively.

Now let's turn to some of the factors that often move the market:

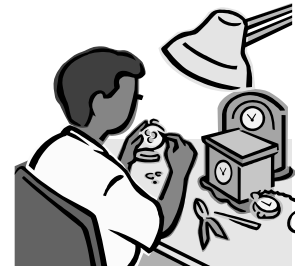
o Typically, investors seek to focus on companies that have traditionally provided solid earnings. Therefore, they are likely to pay more for shares in those companies, driving those prices even higher. In other words, a proliferation of companies with strong earnings records can give the market a boost.

o The rise or fall of interest rates is also a major factor. When interest rates are high, the price of stocks tends to decline, because investors often move to the sidelines or pursue other opportunities. Conversely, if interest rates drop or remain on the low side, stock prices tend to rise higher.

o If the economy is growing at a steady rate, this good news generally results in an upswing for the stock market, since more money is available for invest-

ments. However, if the economy turns sluggish, it usually has a dampening effect on the market overall.

o The stock market often reacts to publicity about companies. For instance, if a pharmaceutical company is about to release a highly touted new drug, the price of the company's stock will likely go up. On the flip side, a product failure can result in a significant drop in value of company stock.



o Naturally, events transpiring in this country and (continued on page 3)

Retirement Review

Make No Mistake About IRA Rollovers

You can roll over distributions from a qualified retirement plan to a regular individual retirement account (IRA). If all the re-

quirements are met, the rollover is tax-free and exempt from the usual 10% tax penalty on early withdrawals before age 59½. However, you can also roll over funds tax-free from one regular IRA to another regular IRA.

For instance, you may be dissatisfied with the IRA's investment return, interested in other investments or need cash in a hurry. If you redeposit the funds in an IRA within 60 days, there is no current tax liability. (continued on page 3)

Estate Analysis

Long Live FLPs

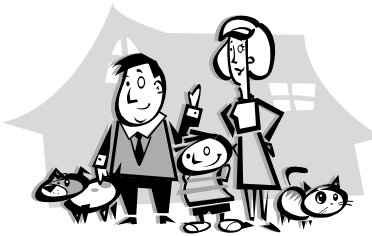
To paraphrase Mark Twain, the reports about the demise of family limited partnerships (FLPs) are greatly exaggerated. In fact, a new case decided by the Fifth Circuit Court of Appeals has provided a boost to this estate-planning technique.

Background: An FLP resembles other limited partnerships with one major exception -- all of the partners are family members. At least one family member serves as the "general partner" and maintains control over management of the business. The "limited partners" (i.e., the other family members) are passive investors without the right to make management decisions.

The FLP can be used to reduce the value of the general partner's taxable estate. By using the annual gift-tax exclusion, a general partner can give limited partnership interests valued at up to \$11,000 to each recipient each year without incurring any gift-tax liability. The income generated by the FLP is taxed proportionately to the limited partners. Younger family members may be in a lower tax bracket than the general partner, so the overall income tax liability for the family may be reduced.

Icing on the cake: The limited partner-

ship shares may be discounted in value, since there is no public market for these shares and limited partners do not share in control of the business. This enables the general partner to shift even more business assets to the younger



generation without any estate- or gift-tax consequences. The discounted value for limited partnership shares is often the driving force behind the deal.

Facts of the new case: Mrs. Kimbell established a limited partnership with her son and her daughter-in-law. She retained a 99% limited partnership interest in the venture. Under the partnership agreement, a 70%-or-more owner had the power to remove a general partner and choose a successor. When Kimbell died, the executor of her estate discounted the value of her interest by 49%. The IRS denied the discount and the trial court agreed with the IRS.

However, the Fifth Circuit upheld the discount. Reason: The transfer to the FLP was made for adequate and full consideration. The fact that the estate claimed a 49% discount in valuing the interest did not preclude the fact that the parties conducted "an arm's-length transaction."

Key points: An FLP does not affect operation of the business activity. The general partner can still "call the shots" without interference from the limited partners. In the event that the general partner dies or files for bankruptcy, the FLP agreement can give the limited partners the right to elect a new general partner. Also, the limited partners cannot remove assets from the partnership or force a liquidation of the business before the term is up. The costs associated with an FLP include attorney's fees for establishing the partnership, appraisal fees relating to the underlying value of the business and the discount factors, and annual accounting fees. Moreover, the state may assess an annual fee for doing business as an FLP located within its borders.

Advisory: Despite the new decision handed down by the Fifth Circuit, the IRS is expected to continue to challenge FLPs with significant discounts in value. Make sure that any such arrangement is handled by expert professionals.

Tax Talk

Don't Wash Out Tax Losses in 2004

Suppose you have realized capital gains from security sales earlier in the year, but now you are sitting on some paper losses. Normally, you can use capital losses at year-end to offset your capital gains plus up to \$3,000 of ordinary income. However, if you are not careful, you could get soaked by the "wash sale" rule.

How it works: Under the wash sale rule, you are not permitted to deduct a loss from the sale of securities if you buy substantially identical securities within 30 days of the sale. So you get no tax benefit from the loss on your 2004 return. It doesn't matter if the purchase takes place before or after the date of the sale.

When are securities considered to be substantially identical? One example is shares of common stock in the same corporation. On the other hand, bonds

that are issued by different obligors are not considered to be substantially identical. Whether the wash sale rule affects bonds from the same issuer depends on a number of factors such as interest rates, face amounts, issue dates, maturity dates and so on.

It is especially important to skirt around the wash sale rule at the end of the year. For instance, if you are going to wait 31 days to buy back the same stock, you must sell the original stock by the end of November.



Be aware that there is a way you can realize a current loss under the wash sale rule without waiting 31 days to repurchase the stock. This strategy commonly is referred to as "doubling up."

Example: You bought 100 shares of High-Tech Corporation stock at \$50 a share and now it is selling at \$40 a share. Instead of selling the original block of shares, which

would produce a \$1,000 loss, you double up by buying 100 more shares of High-Tech at \$40. Then you wait more than 30 days and sell the first 100 shares at \$42. **Result:** With doubling up, you have a deductible loss of \$800 offset by a gain of \$200 for a net loss of \$600. This puts you in a slightly less favorable tax position. But, either way, you wind up with new stock worth \$42. The real benefit of "doubling up" is your cash flow: \$200 of cash inflow (buy at \$40, sell at \$42) versus \$200 of outflow (sell at \$40, buy at \$42) -- a \$400 savings. **Note:** This is just a hypothetical illustration and is not indicative of any particular investment.

At least there is a silver lining if you have to forfeit a tax loss due to the wash sale rule. The amount of the loss is added to your basis (the cost for figuring gain or loss) in the new stock. Thus, when you sell the new stock in the future, a smaller amount of gain will be subject to tax. If the stock is sold at a loss, you can deduct a larger amount as a loss.

Final point: Consider all the relevant economic ramifications, not just taxes, when you make your investment decisions.

Make No Mistake About IRA Rollovers *(continued from page 1)*

Unlike the automatic 20% withholding requirement for transfers from qualified plans that do not go directly to the IRA trustee, 10% withholding applies to indirect transfers from one IRA to another, unless you elect otherwise.

However, be aware that there are several potential pitfalls with IRA-to-IRA rollovers. Here are five common mistakes you should do your best to avoid.

Mistake 1: You miss the 60-day deadline. The rollover must be completed within 60 days after the date you receive a distribution from the old IRA. Recently, the IRS has shown that it is more willing to grant a waiver under extenuating circumstances, but it's still best to play it safe.

Mistake 2: You don't roll over the

assets that were distributed. To qualify for a tax-free IRA-to-IRA rollover, the cash or other assets that are withdrawn from the old IRA must be transferred to the new IRA within 60 days. You can't "substitute" other property.

Mistake 3: You roll over to the wrong IRA. The tax break is valid only if you make a timely rollover to an IRA that you own. Therefore, if you mistakenly transfer the rollover funds to your spouse's IRA or some other account, the transfer is fully taxable.

Mistake 4: You roll over several times during the year. You are allowed to roll over funds from one IRA to another IRA only once a year. The one-year period begins on the date that you receive the distribution -- not the date on which you roll over the funds into the IRA. The one-year rollover rule applies separately to each IRA that you own.

Mistake 5: You roll over a mandatory distribution. The law requires you to begin minimum distributions from an IRA by April 1st of the year after the year in which you turn age 70½. You can't avoid the minimum distribution rule by rolling over the distribution into another IRA. Note: You may be able to avoid these required distributions from a qualified company retirement plan if you have not retired. However, this exception is not available for IRA distributions.



What about rollovers to Roth IRAs? In general, the rollover from a regular IRA to a Roth IRA is completely taxable, but the funds will then be tax-free if they are withdrawn after five years. Your tax advisers can help you make the best choice for your situation.

Insurance Ideas

Whole Life or Term? Compare and Choose

There are two basic types of life insurance to choose from: whole life insurance and term insurance. Depending on your situation, you may choose one over the other -- or perhaps even both.

Whole life insurance: When you buy whole life insurance (also called "permanent" insurance), the policy remains in force as long as the premiums continue to be paid. In addition to providing a death benefit, the policy builds up a cash value on a tax-free basis.

Term insurance: Term insurance is pure death protection. You buy term insurance for a "term" of years. Typically, you might acquire a policy to cover yourself until the time when you will retire. The policy expires at the end of the specified term unless you elect to renew at a higher premium cost. Due to its temporary nature, a term insurance policy is generally less expensive than a whole life insurance policy.

Side-by-side: In a nutshell, whole life

insurance can provide a death benefit with the added feature of a tax-free build-up of cash value. Term insurance provides a death benefit only at a lower premium cost.

Which type of life insurance is better for you? There is no definitive answer. It all depends on your needs and objectives. You can acquire a whole life policy to supplement a term policy or vice versa. In fact, it's fairly common to be covered by an employer-provided group term policy and a privately purchased whole life policy.



With professional assistance, you can make an informed decision about acquiring whole life insurance, term insurance or a combination of the two.

What Makes the Stock market Tick? *(continued from page 1)*

around the world often influence market movements. Social, economic and political issues may have an impact since investors typically react to activities in these areas.

Although none of these factors are foolproof, they may serve as indicators of which way the market is heading. Additional factors or more complex variations may come into play.

Reminder: No one can precisely predict the ups and downs of the market. Nevertheless, your financial advisers can help you pinpoint trends that can be factored into your investment decisions.

Give Us A Call!

Do you have any questions or comments about **Personal Wealth Report** or your individual situation? Please don't hesitate to contact our office. We would be glad to serve you in any way that we can.

