

RAUPC News

Inside this issue:

- 1 Are We Almost Through This?
- 2 Time to Begin Year-End Planning
- 3 Some Thoughts on Investing
- 4 A Few Words About Our Website
- 6 How Safe Is Your Critical Information?
- 9 Meet Fernando
- 10 Tax Events Calendar

Are We Almost Through This?

By Bob Underhill

Editor's Note: Bob was recently sworn in as President of the Washington Society of CPAs. The following is his introductory article that appeared in the WSCPA newsletter.

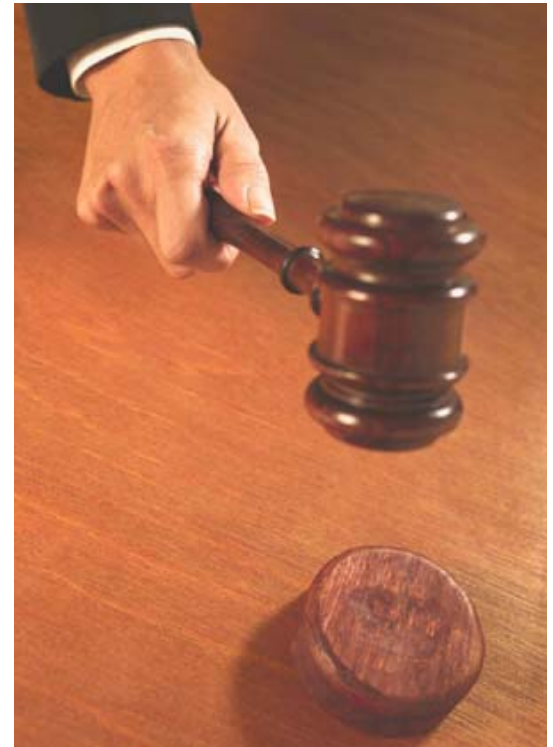
I was hoping that by the time Rob handed me the gavel we would be back to normal. Now I'm thinking we may have a new definition for normal. If we've learned one thing, it's this: Don't take anything for granted.

Some people in our profession, and in business and industry in general, have had their moral compasses re-set in the last few years. Where there have been problems in the profession, my sense is that the people involved, and particularly the people at the top, were absolutely convinced that what they were doing was right. But I learned a long time ago that the most dangerous people in business, the people to really avoid, are the ones who believe their own bull.

It seems that some people in the profession had completely lost sight of the fact that the real customers of an audit are the shareholders, lenders and employees of a company. In our focus on keeping the CFO happy, we neglected them. And one shouldn't be so naïve to believe that these problems were solely those of big firms doing SEC audits. The only difference is this: those failures are the ones that get reported and publicized.

From the public's perspective, what good is an audit if it cannot detect an \$11 billion accounting fraud? What good is an audit if it fails to advise shareholders that key management is stealing from the company in broad daylight? Or that the company is inflating customer or subscriber counts? Or ginning up revenue through swaps with no compelling business purpose? Or exaggerating acquisition costs or other one-time charges, knowing Wall Street's tolerance for them, leaving the excess to be reversed to bolster reported earnings in later quarters? Or parking debt in off-balance-sheet entities with scant or oblique footnote disclosure? And we went along.

Most of us own stock in public companies, either directly or through mutual funds and retirement plans. As investors, as "members of



the public," it is reasonable to ask, "Where were the auditors?" The response sometimes offered is "That's not what an audit is supposed to do." To me, that sounds like nonsense. If the focus is on what the shareholders want to know and need to know, the issue simplifies. And the question becomes: Can the accounting profession deliver it? If I can trust management to be honest and accurate 100% of the time, I don't much need an audit. But I can't. So isn't that where we come in?

We also hear that much of the blame lies with others—banks and investment banks, rating agencies, law firms, corporate boards, etc. Very true. And also very irrelevant to the responsibility that we have as CPAs and auditors.

Perhaps this is raising the bar, and if it is, we as a profession have a right to get something in return – rational tort liability rules that provide for responsibility that is fairly shared among anyone involved.

And the problems have not just been limited to bad audits. For the past few months, the headlines have been mostly about the accounting industry's participation in abusive tax shelters.

Continued on page 4

Time to Begin Year-End Planning

By Bob Underhill

Begin collecting information now

Take a rainy weekend to begin gathering preliminary tax information for 2004. We'll run tax estimates, which is fundamental for determining whether any planning can or should be employed before year-end. Let us know of any major transactions or capital gains taken year-to-date. For those whose tax estimates for 2004 are "safe" under so-called "exception one," there will be no change in your federal estimates due January 15. But a heads-up on what might be due in April is useful for cash flow planning purposes. Those not on safe payment tax estimates (due, for example, to higher income last year), a tax projection prior to year-end will help us re-set your fourth quarter payment. And for those in California and Oregon, pre-paying your fourth quarter state income taxes or expected balance due could (assuming you're not in AMT) provide tax benefit a year early.

Tax loss harvesting

We usually advise clients to begin this early, especially in years of weak or declining market performance like this. The reason is simple psychology: many people wait until the last minute, putting further downward pressure on stocks that have performed poorly. Consequently, you may get a bit more for your "losers" today, than if you wait until year-end to sell. So—take a hard look at your holdings and beat the rush. For securities you have some interest in continuing to own, you need to stay out for 30 days to avoid the wash sale rules. Many investors, including professional money managers, do this thinking that these stocks can be sold now and reacquired cheaper very near year-end or in early January. Some market followers attribute the "January effect" phenomenon to just this: tax loss selling late in the prior year pushing stocks down to where they are attractive buys in January.

As we're sure you know, there is no point in overdoing it—net losses in excess of \$3,000 can't be deducted and must be carried over to 2005. So start by getting a fix of where you stand currently. If in net gain territory, "begin the harvest." For those with interests in hedge funds, this can be a bit more challenging. A "fund of funds" hedge fund must collect information from a great many sub-funds and have a typically hard time providing accurate tax forecasts until after year-end. But hedge funds can be prodigious generators of short-term capital gain, and net short-term capital gains are still taxed at the maximum rate on ordinary income. Remember, *net long-term*

losses will offset net short-term gains, and as such, can provide significant tax savings.

Taxes are a major negative component of *real* investment returns. The impact of disciplined tax loss harvesting over time can be considerable on portfolio performance. Of course, the reverse is also true.

Are you in AMT?

If so, certain deductions taken this year will do you no good tax-wise. Examples are state income tax, property taxes and the new sales tax. Other examples are investment expenses and professional fees. To the extent possible, payment of these expenses should be deferred until next year.

Other deductions, such as charitable contributions, mortgage interest and investment interest, are "AMT neutral"—that is, they are deductible for both regular and AMT tax purposes. However, it is important to recognize that the AMT tax rate is only 26%. Thus, the rate of tax savings produced by AMT-neutral deductions is less than the rate on ordinary income of 35%.

Producing income taxed at ordinary rates will pull you out of AMT and, in a year otherwise subject to the AMT, will actually be taxed at the lower AMT rate (26% versus 35%). Consequently, adding ordinary income until the breakpoint between the AMT and the regular tax is achieved can save up to 9 percentage points of tax on such income. Taking (versus deferring) bonuses, accelerating deferred compensation, distributions from IRAs and retirement plans (if over age 59½) are good ways to flood ordinary income into an AMT year. Income taxed at preferential rates, such as long-term capital gains and dividends from domestic corporations, is also AMT neutral, and thus, will have no impact on your AMT planning.

Avoid the itemized deduction phase-out

In years of very substantial income, taxpayers can suffer from a bit of a political trick embedded in the tax law—a disguised tax increase on high-income taxpayers. Itemized deductions, such as state and local taxes and charitable contributions, undergo a phase-out based on adjusted gross income. As AGI goes up, your deductions go down, at the rate of three cents on the dollar. Consequently, a \$1 million capital gain or deferred comp payout will erode the deductibility of itemized deductions by \$30,000. To the extent certain non-controllable deductions, such as property taxes, are already above the phase-out amount, then discretionary deductions will effectively provide tax benefit. With very large income, however, it is likely that some discretionary deductions, such as charitable contributions, will get wasted in the phase-out computation. As a result, they should

Take a hard look at your holdings and beat the rush.

Continued on page 5

Some Thoughts on Investing

By Bob Underhill

Do you know how your hedge fund is doing? No, do you *really* know?

A great deal of money has flowed into “hedge funds” in recent years which, in and of itself, is perhaps cause for concern. But there are other issues as well. We put “hedge funds” in quotation marks because, to us, the term is a

bit generic. A lot of different things can go on under that moniker. And they lack transparency. Look in a managed equity account and you know exactly what you own. Not so in a hedge fund. And if you ask the fund manager what's in there, you're not likely to get back much in the way of specifics. Finally, they complicate the dickens out of your tax return.

Money has flooded into these funds for several reasons. One is availability. Funds of funds can assemble dollars from many investors, enabling smaller investors (minimums now as little as \$100,000) to gain access to managers with significantly higher mini-

mums. The same approach allows such investors to achieve reasonable diversification within the asset class, by effectively investing a portion of the dollars in each of many funds. The second reason is probably temporary—it's money chasing return in a market environment that is giving pitiful returns on fixed income and little or no return for years running on equities.

So, are they worth owning? Generally speaking, we say yes. As an asset class, it has a place—somewhere between fixed income and equities, delivering expected returns that lie between the two, and on a risk continuum higher than bonds and lower than most equities. In a very strong market, hedge funds might be expected to underperform equities somewhat. In a bear market, the goal is to break even. In very choppy markets, hedge funds can do quite well.

In terms of performance, however, peer comparisons are more complex, as funds are operated in substantially different fashions—some

with leverage, some without, some long/short or market neutral, some less so—meaning their risk levels are not comparable. In addition, what they invest in can be very different.

Many funds have performed impressively in recent years. However, the real cost of this performance is generally less well known. The hedge fund industry used to be the almost exclusive domain of institutional investors—foundations, endowments, large retirement plans. The admittance of higher net worth individuals is a more recent phenomenon. But the two types of investors are not at all the same. The circumstances and investment needs and objectives of the typical individual investor are dramatically different from those of a foundation or college endowment fund.

- College endowments and other institutions don't pay income tax
- Foundations and endowments don't die and they don't pay estate tax either
- The investment time horizon of an institutional investor is typically considerably longer than an individual or family (excepting “dynastic” wealth situations)
- Institutions typically have very little need for their investments to yield cash
- Institutions invest very large sums, which gives them both clout in negotiating fee arrangements and access to information

Two things to know about hedge funds: they are **very tax inefficient** and involve **very high fee structures**. Most fund managers will charge a base fee of 1% to 1½%. A fund of funds will overlay another ½% to 1% fee. On top of these is an incentive fee based on cumulative performance which awards the manager another 20% or more of the performance over and above a threshold (e.g., a 5% threshold return; not surprisingly, there is no payback if cumulative performance starts out above and subsequently falls below the threshold).

On the tax side, **most of a fund's investment return is delivered currently as ordinary, maximum rate taxable income**. Positions are frequently traded, meaning most gains are currently taxed as opposed to deferred through holding. The vast majority of a fund's gains are short term, taxed at the maximum 35% rate. A fund's other income consists mostly of interest and business income, also taxed at 35%, as opposed to dividends which are taxed at 15%. Many hedge fund investors face limitations on their ability to deduct their share of the interest expense of a leveraged fund, meaning effectively that **greater than 100% of their net investment return is being currently taxed**. The same is true with the fees and cost of fund management. Whether by virtue of the threshold on miscellaneous itemized deductions (how such expenses are classified for tax purposes) or the AMT (investment expenses are not deductible for the AMT), most tax-



Continued from page 1

As long as there have been taxes, there have been people figuring out ways to avoid paying them. Our system is complex, and built on voluntary compliance. It is in everyone's extreme interest that taxpayers believe that they are paying fairly—meaning that everyone is playing fairly. If faith in the system is undermined, the problems are obvious.

A bit of a paradigm shift (to use the pop lingo of the late '90s) took place in the way and manner in which tax planning was delivered to many clients. It used to be that a client would apprise his or her tax advisor of a contemplated business or investment transaction and the advisor would creatively identify ways to arrive at the overall best tax answer. Ad hoc. One deal at a time. Meaning the business of giving tax advice was not exactly a "high growth" business. So, rather than a creative idea based on a given set of facts, it became a given set of facts based on a creative idea. Or, instead of clients in search of ideas, it was ideas in search of clients.

In the final analysis, there were way too many of these deals sold (and bought by very willing investors). The cost to the Treasury was enormous and, without more effective enforcement, threatened to seriously undermine the integrity of the tax system. If some fantastic series of transactions can make basis appear in assets on the eve of their sale, or losses arise with little corresponding economic consequence, then the tax law truly isn't working right. Even as to lawyers, accountants and other practitioners, it is beneficial in the long run if clients have faith in the system. In the late '90s, it may have been that clients who brought "real facts" to the practitioner's desk got a more disciplined application of the tax code than clients who signed up for the latest tax shelter deal. (One thing is important to note: most of these strategies were smartly devised and very reasonable interpretations of the tax code. Had they been implemented with a handful of well-chosen clients, based on real fact situations and real expectations of profit or gain, independent of tax consequences, each and every one would likely prevail. But "mass marketing" the same idea to hundreds (or thousands?) of clients took a good idea too far.)

Being a professional means something other than gunning for the bottom line. Something beyond maximizing revenue. Those aims work well enough for commercial enterprises, but being part of the CPA profession, or any profession, must mean ultimately thinking about the public good. Sometimes it means saying "no" even when it costs you money.

Fortunately, the profession had a lot of reputational capital in the bank going into all of

this. Capital that was put there by the men and women in the profession before us, by those who built our firms with high ideals and the labor of their efforts across the length of their careers. Men and women who were mindful of their stewardship and of the meaning of the letter "P" in CPA. Certainly we have withdrawn a portion of that capital. In fact, we may have been selling some of our reputation, using it to back opinions and add credibility to tax shelter ideas. Charging for your reputation is fine. Selling it is quite another thing.

Now it's time to re-deposit. Many times that means delivering a hard message. It means thinking beyond the bottom line. Or, as the founder of my old firm said, and what became its motto: "Think straight. Talk straight." If only everyone had continued to follow that.



A Few Words About Our Website

By Amy Bockelman

If you have visited our website recently, you may have noticed that it's a bit bare. That's because we had a great idea—a brand-new website. We formed a committee (our first committee ever!) to help develop a site that would be informative, nice to look at, and easy to navigate.

So far, it's nice to look at.

You see, it seemed so easy in theory. We were full of ideas and thought how easy it would be to quickly and seamlessly transform those ideas into a stellar website. We figured two months at most. However, transforming our ideas into reality turned out to be more demanding than we thought. None of us had created a website from scratch before and we didn't realize how many questions would come up and how many details we would have to nail down. Then along came the summer months, and various vacations, and of course there were pressing client needs that were more of a priority. Now it's November and we're still pressing on.

The short of it is that our "two months to a new website" plan was a tad unrealistic. By no means have we abandoned our website endeavor, but it is going a little slower than we anticipated. Keep checking back in the next several weeks (we hope that's not overly optimistic), and we're pretty sure you'll see some changes. In the meantime, you can at least look up our contact info and driving directions. We apologize for the lack of content and we appreciate your patience as we kick our website committee into high gear. One of these days, we're confident our efforts will prove fruitful.



Being part of the CPA profession, or any profession, must mean ultimately thinking about the public good.

Continued from page 2

be deferred to the extent possible, if future years' income is expected to be down from current-year levels.

Take advantage of the 15% tax bracket

... because it probably won't last. Review your portfolio for dividend-paying companies whose payouts qualify for the 15% bracket (preferred stock dividends, REITS and foreign stock dividends do not). Where it makes investment sense, as always, hold gain securities at least 12 months to achieve long-term capital gain treatment. Non-qualifying dividends and short-term gains are taxed at a rate almost 2½ times higher.

Closely held corporation planning

Those with interests in closely held C corporations, or S corporations that are former C corporations with C corporation retained earnings, may wish to consider a special payout to pull earnings or excess assets out of the company. While there will be double tax (as the dividend is not deductible to the company), the second tax hit at only 15% should be tempting, especially if you believe the rate won't last. There may be other reasons for such a dividend:

- It can remove assets from creditor risk inside the business
- The assets may be more effectively deployed outside the company
- The company must respect the varying interests of all the shareholders, which may cause excess assets to be invested in more conventional ways, depriving certain shareholders of opportunities to invest the funds in ways more compatible with their personal needs or interests
- Clearing C corporation earnings from an S corporation through a dividend can provide significant other tax benefits (let us know—this is a topic in and of itself)

Such special payouts can often be combined with effective estate planning, by targeting the payout to elder generation shareholders, thereby reducing their stake in the enterprise and increasing the percentage interest of the next generation. If the company operates with a single class of stock, this can be achieved either through a prior recapitalization creating a second class of stock, or a redemption designed to be afforded "dividend treatment" under certain provisions of the tax code.

Do tax-free bonds continue to make sense for you?

There is one surprisingly good aspect of the 15% bracket on dividends and long-term capital gains. Ordinary deductions, such as busi-

ness losses and itemized deductions, first offset income taxed at the maximum rate. Many of our clients who are not actively employed with W-2 income have deductions and losses that exceed their ordinary income (taxable interest income, retirement income, business income). The surprising result is that their marginal tax bracket is 15%, which is low enough to question whether the after-tax yield of taxable fixed income investments exceeds that of municipals and other tax-free bonds.



Plan to make your family gifts soon

Don't let the year close without completing gifts to children/children's trusts to utilize your annual gift tax exclusion this year. As you know, the exclusion amount is \$11,000 per donor/per donee. Thus, a married couple with three children can gift \$66,000 tax free to their children each year. The power of this exclusion in estate tax planning should not be overlooked. A couple with three children who dutifully make annual exclusion gifts through each child's 21st birthday, can remove \$2,361,000 from their estate assuming asset growth rates of a modest 7%. At an estate tax bracket of 45%, the ultimate savings is \$1,332,000. Although Congress curtailed some of the tax advantage of income shifting among family members, there is still some benefit to be achieved by having income on gifted assets taxed at a child's lower rate.

One more thought: consider gifting **higher basis assets**. Tax basis carries over on gifted assets; consequently, a gift of cash or a bond is actually better at moving wealth than a gift of low-basis stock. For example, a gift of \$11,000 of zero-basis stock is reduced to \$9,350 through capital gains taxes upon a subsequent sale by the child (or trustee of the children's trust). To minimize estate taxes at your generation, the better strategy would be for you to sell the stock, incur the tax, and gift the proceeds.

How Safe Is Your Critical Information?

Would you live in a house that didn't have locks or deadbolts or some kind of security system? Of course not. Without basic security measures, your home and your prized possessions would be vulnerable to intruders. It only makes sense, then, that you would employ a security system to protect the personal and business information you might have on your computer. After all, while possessions can often be replaced, personal information in the wrong hands can cause significant damage. And the harm that comes from theft of information can continue for a long time.

In today's world, we rely on technology more than ever. Online shopping, banking, and bill pay are now commonplace for most of us. Many households keep a substantial portion of their financial information on personal finance software such as Money or Quicken. And you generate e-mail traffic containing sensitive personal information to financial institutions and advisors like us.

Considering that most individuals are connected to the Internet, have you ever thought about the risks? Large companies have specialized teams of experts to protect their electronic information (data) and computerized systems, but the rest of us are left to deal with these issues alone. This means we each need an understanding of information security.

By understanding the threats and risks, we are better able to make informed decisions about how to protect ourselves. We should understand what types of data and systems are at risk. These are primarily your:

- Online bank, investing, and credit card account files
- Electronic tax records or personal financial statements
- Electronic credit reporting file
- Other personal information including your Social Security Number, phone numbers, passwords, and even medical records.

The threats to this information vary:

- Stolen personal information leading to unauthorized banking, investment, and credit card transactions
- Stolen intellectual property
- Attacks that lead to systems and information being unavailable
- Attacks that lead to information being corrupt (incorrect or unusable)
- Inadequate backup procedures can lead to unrecoverable loss of information



Although we can never eliminate risk, there are a variety of methods for minimizing it. Many simple controls are very effective, but often overlooked. These include selecting unique and hard-to-guess passwords, and installing and maintaining current antivirus software on all systems. Network and host-based firewalls control access in and out of your network. For all remote connections, such as second homes and vacation residences, or personal assistants or family office employees working from their home, an encrypted tunnel (or VPN) protects data from eavesdropping. Most modern operating systems include effective built-in security access controls, and should be used whenever possible. A very important, but often neglected, function of security is data backup. A data backup to a tape or optical disk is an effective way to protect data loss from attack, hardware failure, or even natural disaster (fire, flood, etc).

The intent of this article is not to be an exhaustive list of risks and controls, but rather a summary of the most common elements, intended to get individuals and businesses thinking about security. Each situation is different and we recommend you complete a thorough risk assessment in order to minimize your risk.

If you are interested in a risk assessment to help evaluate the security of your electronic data, please contact us and we can put you in touch with our technology consultant, Mark DeVore.

Continued from page 3

payers get no deduction for these costs. The effect is the same: greater than 100% of your *net* investment return is being subjected to tax. Obviously, the original occupiers of hedge fund space, foundations and endowments, are oblivious to tax matters.

The answer to the tax drag on hedge fund performance is, to the extent possible, to hold such investments in rollover IRAs or other tax-exempt accounts (see “Location of Assets” article, below). Two caveats, however: it is generally NOT a good idea to hold hedge fund investments in charitable remainder trusts. Due to a piece of tax law minutia we needn’t get into here, this could cause an otherwise tax-exempt entity to pay tax on 100% of its undistributed income. If held in a private foundation or IRA, the business income often generated by such funds will cause a foundation to pay tax on “unrelated business income.”

The following chart compares the investment performance of a hypothetical account invested in 100% equities versus a hypothetical hedge fund investment. The assumptions, however, are very real world. We assume the equity account to deliver total returns (dividends and capital appreciation) of 9% over the long term. We further assume that 1% of that 9% return is dividend yield, taxed currently at 15%. We’ve set portfolio turnover (gains taken and reinvested) at 10%. And the fee structure of 0.60% (or 60 basis points) is typical of a large capitalization equity manager. As the chart indicates, the account shows an after-tax, after-fees return of 8.13%.

Investment Type	Tax Rate on Income/Gains	Annual Turnover	Annual Expenses	Nominal Return	After-Tax, After-Expense Return
Large Cap Equities	15%	1% annual yield 10% turnover	60 bps	9%	8.13%
Hedge Fund	35%	90%	160 bps	13.885%	8.13%

As can be seen from the chart, to compensate for the additional tax drag and fees involved, the hedge fund manager **must return almost 14%** just to break even with a hypothetical equity manager delivering 9%. Institutions are able to lower this break-even hurdle because the tax drag is zero, and their large commitments of investable capital arguably get them a better deal on fees (or no layered fees in a fund of fund environment).

Of course, hedge funds offer benefits of reduced overall volatility in a portfolio. And hedge funds can, indeed, deliver such outsized returns. But if you’re comparing performance with an equity manager—real net performance to you—you need outsized returns to get it.

The Location of Assets

We talk a lot about this concept, although many of our clients may not have viewed it as a separate area of planning. But how and where you own your key financial assets has a significant bearing on many things, including:

- Protection from creditors
- How income and gains on assets are taxed
- When income and gains on assets are taxed
- How assets will pass upon death
- Estate tax liabilities and where the growth in family assets will occur

Creditor protection

Assets held in ERISA-qualified retirement plans are viewed as safe from judgment creditors. Assets held in IRAs are viewed as relatively safe and assets held in family partnerships and LLCs are protected by provisions in partnership agreements and LLC operating agreements that prevent creditors from gaining admission as a partner or member in any proceeding to seize assets. Creditors have rights to charge any distributions from such entities, but no right to compel distributions or liquidation. Additionally, the tax law provides some disincentive even as to a creditor’s inclination to gain a charg-

Continued from page 7

ing order: by obtaining such, the creditor is viewed as a partner or member for tax purposes, and is thus allocated a share of taxable income, even though the creditor has no right to force distributions. From a tax standpoint, then, partnerships and LLCs held by a debtor make rather unattractive assets for seizure by creditors.

From a creditor protection standpoint, trust-owned assets require a bit more analysis. Assets held in trust settled by someone other than the debtor are generally viewed as protected, especially if spendthrift and other creditor protection provisions are contained in the trust agreement. For trusts settled by the person being sued, additional factors come into play:

- Was the trust created and funded prior to the time of the alleged wrong or act creating liability, or before litigation was viewed as possible?
- Is the trust irrevocable?
- Is the person who created the trust (the "settler") also the trustee, or is there an "independent trustee"?
- If the trustee is independent, is the state of domicile of the trustee a state that provides additional protection for trust assets?

How and where assets are held affects taxes

From an income tax standpoint, there are a number of general recommendations as to where investment or income-producing assets are held, although specific circumstances could overrule.

- Investments taxed at favorable rates (dividend-paying stocks) are best owned outright or in living trusts or family partnerships, leaving the incidence of tax with you. Putting tax-favored investments in tax-deferred accounts (such as deferred compensation plans, rollover IRAs, etc.) will cause the loss of the advantageous tax rates, as all eventual payouts (even those attributable to dividends and long-term capital gains) will be taxed at regular rates on ordinary income.
- Investments which produce large amounts of ordinary rate income (such as hedge funds and taxable fixed income) are best located in tax-deferred accounts, as the return and yield advantage can be obtained at no current tax cost and there is no "conversion" of tax-favored income to ordinary rates.
- Investment real estate and business assets which can produce tax-sheltered income or losses should be held through liability limiting entities whose interests are owned personally.

- Clients with charitable remainder trusts should generally pursue growth investments in those accounts. The tiering rules which apply to CRTs force out maximum rate income first, such as taxable interest and short-term capital gains. The goal should be to construct CRT assets such that virtually all distributions come out as 15% taxed dividends or long-term gains. Placing tax-free bonds in a CRT is a bad idea, as taxable income and accumulated gains come out first, thereby converting otherwise tax-free income to income that will bear some tax under the tiering rules. Additionally, for charitable remainder *unitrusts*, growth assets will also cause an increasing stream of payouts each year, making the long-term income tax benefits of such arrangements even more compelling.

How assets will pass on your death

Many people are surprised to learn (or their heirs may be very surprised to discover) that much of their estate will pass *outside their wills* on their deaths. Wills only speak to assets subject to probate. Assets payable to named beneficiaries (such as life insurance and beneficiary-designation accounts such as IRAs, employer benefit plans, etc.) will pass consistent with those designations (important to keep those up-to-date). Other assets held in joint tenancy with rights of survivorship (homes are often titled this way, and many financial accounts) pass *by operation of property law to the surviving co-tenant*. Consequently, no will language to the contrary can affect passage. Most of the time, these results are consistent with the decedent's overall dispositive wishes. There are situations, however, where unfortunate consequences can be created.

- While not included in one's probate estate, these assets are nonetheless included in the *taxable estate* and can thereby cause liquidity issues when it comes time to pay the estate tax.
- If the will sets up the mechanism for the creation of a so-called "children's bypass trust" (to carve out the estate tax exemption amount in a trust for the potential need of the surviving spouse), a funding problem can occur. If there are not sufficient assets passed by will to fund the bypass trust, some of the estate tax exemption amount is lost, resulting in higher taxes due at the surviving spouse's death.
- Assets passed by will often "pour over" into existing trusts, or there are trusts created under the will, to manage the wealth during children's minority or early adult years, with distributions based on need and/or the oc-

Partnerships and LLCs held by a debtor make rather unattractive assets for seizure by creditors.

Continued from page 8

currence of certain events (e.g., graduation from college).

Keep some of the growth out of your estate

Couples that are financially secure often experience growth in asset values over time, where spending and consumption is less than income or capital appreciation. When the growth in real wealth is not needed from a financial standpoint, Uncle Sam ultimately stands to benefit from almost half the value added. Effective estate planning often involves transferring assets to entities, trusts and other arrangements designed to push future growth to succeeding generations. And gifting of assets now removes both the asset and its future income and growth in value from one's estate.

☪

Meet Fernando

By Amy Bockelman

RAUPC welcomes the newest member of our team, Fernando Fish! Fernando is a Betta who joined us some months back. I learned through brief research that Bettas are known as fighting fish. Fernando, however, lives alone and therefore has not had the opportunity to test his fighting skills. Still, he did appear somewhat enraged the other day when I almost knocked over

his bowl. Fernando seems to enjoy swimming, eating blood worms, trying to be invisible, and floating completely motionless near the top of his bowl.

I don't know why, but I decided to sit down with Fernando for an interview to find out about his background, his philosophy, and his life so far.

Amy: Hi

Fernando. Let's get started. Why don't you tell me a little about yourself?

Fernando: I'm a fish. What more could you possibly need to know?

Could you just humor me? I had a really hard time coming up with a comical story idea for the newsletter.

So I take it that you're just going to make stuff up and pretend like I said it.

That's my plan, yes.

Are you sure you wouldn't rather, say, go away and leave me alone?

You're kind of surly for a fish, aren't you?

Get used to it.

Right. Well, how do you spend your time?

(Sighs) Well, I do a lot of swimming. Sometimes clockwise, sometimes counter-clockwise. And when you people remember to turn on the TV for me, I watch that as well. It's a riveting life.

What are your favorite shows?

I like reruns of *Baywatch* and *Hawaii 5-0*. And I like *The Apprentice*. Watching someone get fired always makes my tail wiggle with glee.

So you take joy in others' defeats.

Yep. A lot of joy.

Do you have a favorite movie?

Either *Finding Nemo* or *Pirates of the Caribbean*.

Favorite band?

Probably Phish. It's sad that they're breaking up, though.

What do you think about ABBA? You were named after an ABBA song, you know.

Oh, for the love of—who the &,\$%# named me after an ABBA song?!

That was my idea. Bob wanted to name you Larry, but I like the alliteration of Fernando Fish. Has a nice ring to it, don't you think?

Well, it did until just now. ABBA? Of all the bands that ever existed, you had to pick ABBA. I'm so embarrassed.

You're talking about being embarrassed? I'm the one writing this ridiculous thing.

Good point. It is pretty pathetic.

So what's your favorite sport?

Professional wrestling. Hey, stop laughing—it is too a sport!

Who's your favorite human?

Definitely that Bob guy. He's swell.

Wow, you actually said something nice! Anything else you'd like to share?

What do you think?

Well then, Fernando, I'll let you get back to your swimming. Thanks for taking the time to talk with me.

Whatever.

☪



Tax Events Calendar

Date	Taxpayer	Event
January 15, 2005	Individuals	Final installment of 2004 estimated tax is due (Form 1040-ES).
March 15, 2005	Corporations	Due date for domestic C or S corporations or foreign corporations with U.S. offices to file their 2004 income tax return (Form 1120 or Form 1120S). File form 7004, together with payment, to obtain an automatic six-month extension of time to file.
April 15, 2005	Individuals	Due date for individuals to file their 2004 income tax returns (Form 1040, 1040-A, or Form 1040-EZ). File form 4868 to obtain an automatic four-month extension of time to file.
April 15, 2005	Individuals	First installment of 2005 estimated tax is due (Form 1040-ES).
April 15, 2005	Partnerships	Due date for partnerships and LLCs to file their 2004 income tax returns (Form 1065). File form 8736 to obtain an automatic three-month extension of time to file.
June 15, 2005	Individuals	Second installment of 2005 estimated tax is due (Form 1040-ES).
June 15, 2005	Individuals	Due date for U.S. citizens and resident aliens living and working outside the U.S. and Puerto Rico to file income tax return (Form 1040) and pay any owed tax, interest and penalties.

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