

**12-Month Plan For Financial Management**

December 2002

Are you planning your financial future? Does the task seem to overwhelm your energies and provide an excuse to avoid the subject altogether? In order to manage your financial matters with increased efficiency and better results, organize them with a month-by-month program. Here are some suggestions.

**January Net Worth Statement**

To develop a net worth statement: first list your assets including real estate, investments such as stocks, bonds, and mutual funds, cash accounts, retirement plans, life insurance policies, and personal possessions. Include how these assets are titled. Determine the current market value of the asset and the cash surrender value for any life insurance policy. Next list all of your outstanding liabilities including mortgage debt, credit card debt, auto loans and other liabilities with the current amounts owed. Subtract gross liabilities from gross assets to determine your net worth.

**February Investment Strategy**

Devise a personal investment strategy. Write down your objectives: financing a child's education, planning for retirement or saving for a vacation home, for example. Determine whether your goals are realistic and how much you will need to achieve them.

Review your investments. Leave no more than 3 to 6 months of living expenses in ordinary savings or money market accounts. Place your extra cushion in other investments with higher yields. Select stocks, bonds or other investments that suit your ability to take or avoid risk. Always diversify investments to maximize yield and minimize risk.

Consider buying tax-free bonds issued by your home state that are free of federal and state income taxes. A municipal bond yielding 5% is the equivalent of a taxable investment yielding 7.75%. Treasury bonds are free from state taxes, but not federal tax.

**March Tax Reduction Strategies**

Plan to reduce taxes over the coming year. Review your withholding to make sure that the smallest amount necessary is being withheld from your paycheck. Consider selling an investment at a loss to offset a positive capital gain from another investment. Maximize deductible contributions to your retirement plan. Consider shifting income to family members in lower tax brackets through gifts, trusts and other income shifting vehicles.

**April Credit and Debt**

List all of the places that you owe money. If you are in debt because of credit cards, consider consolidating payments by taking a personal loan. Credit cards usually carry annual interest that is substantially higher than other loan rates.

Consider replacing consumer debt with a home equity loan or refinance your mortgage with cash out, if possible. Most home mortgage interest is deductible for those who itemize deductions. When considering whether to make additional principal payments on your home mortgage, determine whether the return you are receiving on investments is more or less than your equivalent interest rate paid. In other words, could you put the extra money in an investment that yields more than the amount you pay in interest after tax benefits?

**May Gifting Strategies**

Examine your income and assets to determine whether you have excess assets or income to gift to others during the year. Consider making direct gifts to children or grandchildren who are well above the age of majority. The current limitation for gifts is \$11,000 per person per year. A couple may give a combined \$22,000 per year per recipient. You may also pay for the education or medical care of a family member by directly paying the educational institution or provider of medical services. These payments are free of gift tax limitations altogether.

If you wish to make gifts to a minor or a person who has not fully matured, consider establishing an irrevocable trust to receive the gifts. You can set the conditions of distribution of any of the assets. You may also contribute money to a Coverdell education account or 529 plan for a child or grandchild.

Consider leveraging gifts of securities through grantor retained annuity trusts or gift a vacation property or other family real estate through a personal residence trust or family limited liability company. Gifts to charity are deductible on your current year tax return. Consider gifts of appreciated securities rather than cash. Your deduction is the full value of the securities, and no taxes are paid on the appreciation. A gift to charity through a charitable trust or gift annuity gives you the added benefit of receiving income from the gifted asset while retaining most of the charitable deduction.

**June Funding Education**

If you have children or grandchildren and are concerned about escalating costs of education, consider shifting assets for that purpose. A variety of ways to fund education are available, each with advantages and disadvantages to consider.

Give assets directly to the child, or in a custodial account (UGMA) in the child's name. Children under age 14 pay no tax on the first \$750 of income for the year and only 10% (or \$35) on the next \$350. Earnings above \$1,100 are taxed at the parents' rate until the child turns age 14. After age 14, all income is taxed at the child's rate, which will almost always be lower than the parents' rate.

Consider contributions to Coverdell Education Savings Accounts or Section 529 Accounts. We plan to include a newsletter in the coming months on these funding opportunities.

If you aren't sure whether the child will go to college, or if the funds will exceed education needs, consider an irrevocable trust to provide flexibility. Unlike custodial accounts that must be distributed outright when the child reaches age 21, irrevocable trusts can continue past that age. A trust allows for management of assets and provides specific instructions on how to distribute principal and interest to benefit the child. Those instructions may include payments for tuition and room and board during college as well as permission to assist the child when purchasing a home or starting a business. You choose the age when the child is to receive outright any excess funds in the trust.

**July Disability Planning**

A disabling event such as a severe accident or health problem occurs more often than most people realize. If you do not have long term care insurance, consider purchasing such a policy. If you have long

term care insurance, review the policy to ensure that the daily benefits are sufficient and that it will cover extended expenses if you are unable to perform two activities of daily living.

Provide for financial management and medical decision making in the event you suffer a disabling event. You should have a properly drafted and executed advance directive (Maryland and Virginia) or health care power of attorney and living will (District of Columbia) naming an agent to make your medical decisions if you cannot or to carry out your wishes in the event of a terminal condition. You should have a detailed durable power of attorney naming an agent to manage your financial affairs if you are unable. To provide maximum protection, establish a revocable trust. The successor trustee under the trust can manage all the assets in the trust for your benefit in the event you become disabled.

---

### **August Insurance Planning**

---

Review insurance policies. If you were to become disabled or die, what will happen to your family? Will your disability policy begin paying only after 90 days? Do you have enough life insurance to keep your family secure upon your death?

Life insurance that you own will be a part of your taxable estate. Consider transferring life insurance to an irrevocable life insurance trust. You name a trustee (other than yourself) to manage the insurance and pay premiums until your death. The trust owns the policy and sets up a plan for payments to your spouse, children or others according to terms you establish. When the trust is properly created and managed, your premium payments will qualify under your annual exemption for gift tax purposes. An irrevocable life insurance trust can save significant estate taxes.

---

### **September Retirement Planning**

---

Retirement planning is essential for everyone. Maximize contributions to your 401(k), 403(b) or traditional or Roth IRAs. Under the 2001 tax act, allowable contributions to all retirement plans increased and will continue to increase over the next several years. (For specific details, ask for our 6/2001 and 9/2001 newsletters).

If you are nearing retirement age, project your retirement income needs to determine how much you need to save. Consider shifting some of your aggressive positions into more conservative or income producing investments in anticipation of income needs.

If you are retired and taking minimum distributions from your retirement plans, make sure the minimums are calculated correctly. Major changes in the Treasury Regulations governing these withdrawals occurred in 2001 allowing for smaller minimum withdrawals for most individuals.

Review all death beneficiary designations under your plans. Make sure that the proper persons or trusts are named as beneficiaries to allow the longest possible withdrawal and tax deferral options. Improper beneficiary designations can cause adverse tax consequences and payment of large taxes for these accounts upon your death.

---

### **October Estate Planning**

---

Determine how your estate will be distributed in the event of your death. If you do not have basic estate planning documents in place (Revocable Trust and/or a Will, Durable Power of Attorney and Advance Directive), consult your attorney. Review your existing documents every year, and with your attorney every 3 to 5 years. Update whenever a change in your circumstances occurs or after any major tax changes.

If your taxable estate is greater than \$1,000,000, the excess will be taxed at rates from 41% to 50%. Estate assets passing to a spouse are free from federal estate tax – no matter how large the amount. But any couple with a combined taxable estate of more than the \$1,000,000 needs to preserve the credit of both spouses by using a credit shelter trust. Remember your taxable estate includes not only bank accounts and investments, but also real estate, home furnishings, life insurance proceeds, IRAs and pensions, jointly-held assets, certain trust assets, partnership interests and your business assets.

---

### **November Record Keeping**

---

Make sure that your records are accurate and complete. Collect all receipts necessary to prepare your taxes for the year. Organize your investment account statements and determine the basis of investments sold during the year.

Prepare a list that family members can use in the event that you become disabled or die. Provide the location of your estate planning documents, insurance policies, deeds to real estate, stocks, bonds and all other financial statements and documents. Include the names, addresses and telephone numbers of your attorney, accountant and insurance agent.

Records that are difficult to reconstruct if lost or destroyed should be kept in a safe deposit box at your bank or in a fire proof safe in your home. Any other records should be organized in a filing cabinet in your home that can be easily located by family members.

---

### **December Income and Expenses; Budgeting**

---

Review income and expenses for the year. Determine whether next year's income may be substantially larger or smaller than this year. If the years will be about the same, try to accelerate deductions and defer income. Consider year-end gifts to charity. Sell investments that have depreciated in value before the end of the year to help offset any capital gains and offset up to \$3,000 of additional income.

Draw up a budget for next year. Start with income projections: wages and other income received monthly and investment income paid quarterly or semi-annually. Next, project fixed expenses: mortgage payments or rent, utility estimates, income tax withholding and estimated tax payments, health and other insurance premiums, IRA payments, loan payments and auto insurance. Add estimates for expenses over which you exercise some control: transportation, medical care, entertainment, clothing and food. Set aside a portion for savings and charitable giving. Subtract the difference between income and expenses to determine your "discretionary" income – if any. Set aside a reasonable cash fund each week for out of pocket expenses.

---

### **Conclusion**

---

Everyone's situation is different, so consult with your legal and financial advisors before taking major steps. By performing some financial maintenance each month, you'll gain better control over your money.

In the summer of 2002, our office was reeling from two unrelated incidents. In early August, our office manager JJ Jones had an auto accident resulting in a number of broken bones and a long recuperation. A week later, Evelyn Betts Thomason fell at home and broke her ankle resulting in surgery and permanent metal implants. Both are recovering nicely and are back at work, catching up as quickly as possible. We appreciate your patience and expressions of concern, as well as the heroic efforts of our remaining