

# COHEN & BURNETT, PC LEGACY ANALYTICS, LLC



## FOUNDING PARTNER



**I. Mark  
Cohen,  
JD, LLM, &  
CFP™**

Some of you sharp-eyed readers noticed that I have been training for a triathlon. I finally ran my first one on April 18<sup>th</sup> in Bethesda. As triathlons go it was a short one, called a “sprint” – 500 meter swim, 10 mile bike and 2.5 mile run. I am pleased to say that I finished the race. If you are interested in my times, you can find them at [www.cantriathlon.org](http://www.cantriathlon.org). I have signed up for the Dewey Beach triathlon this fall. It is still a sprint but slightly longer in each category. As you read this we are coming up on summer, which means summer vacations. Wes and Barb are planning on going to China on Aug 1-18. Kathy and I are taking the kids to California for cousin’s wedding and then a tour of the state. We will be out from July 14 until August 2, 2004. Check our website later this summer for pictures.

## MANAGING PARTNER



**Weston D.  
Burnett, JD,  
M, FP™**

Wes’ father passed away on April 22, 2004. They celebrated his life of service at the Naval Academy Chapel on May 6, 2004. Wes’ wife, Barbara, for the fifth consecutive year is coach of the Virginia State Math-Counts Championship Team. Her top student finished third in the nation out of roughly 500,000 competitors and her team finished fifth in the nation. Their son, David, enters the University of Virginia Law School this fall. Their son, Edward, reports as a newly minted ensign to the Arleigh Burke class USS MITSCHER in Norfolk on June 1. Their daughter, Jennifer, is studying and working in Harrisonburg, VA, north of Rome, Italy and San Diego, CA this summer.

## Investing Consistently

As financial planners we are often asked whether timing the market really works. The last 10 years in the stock market may provide an answer. The ten-year period ended December 31, 2003 was remarkable from an investment point of view. It included the 1995-99 run, the best five-year stretch in U. S. history based on compound annual market (S & P 500) returns. The market AVERAGED a 28.26% compound annual return during that time.

At the other end of the scale, the 2000-02 period represented the first time we’d had three consecutive down years in the S & P 500 since 1939-41. The combined effect of -10%, -12%, and -24% returns wiped out trillions of dollars of market value for the economy. The market’s recovery in 2003 saw the S & P 500 gain in value by 28.7%.

The point is, after that ten-year roller coaster ride, where are we in terms of return over the full ten-year period? The surprising answer, at least to some, is that we’re about where we might have expected to be based on long-term returns in the market. The Vanguard organization’s “MoneyWhys” publication ([www.vanguard.com](http://www.vanguard.com)) reports that the average annual return on the S & P 500 Index for the ten years ending 12/31/03 was 11.07%. That’s a little bit above the long-term (1926-2002) average of about ten percent.

What does this mean? Two things: First, most investors would be better off keeping a steady course in investing for the long term. The long-term average (10%) is likely to be a pretty good predictor of what’s likely to happen over the next ten years as well.

Unfortunately, the second thing is that many investors just don’t get it. Their investment behavior is just of the opposite of the old cliché, “Buy low, sell high.” Recently, Fortune magazine ([www.fortune.com](http://www.fortune.com)) reported that mutual fund inflows, which had been falling sharply during the 2000-2002 period, were rising dramatically. The Investment Company Institute ([www.ici.org](http://www.ici.org)) noted that stock mutual funds took in \$43.76 billion in January 2004, the third largest monthly inflow in history. The two largest one-month inflows were \$55.61 billion in February 2000 and \$44.54 billion in January 2000. The market began its collapse in May 2000.

Conclusion: investors pour money into stocks when markets are high and rising, but not when they’re low and falling. It’s hard to make money that way. The best strategy is to invest consistently and not try to outguess where the market is going. A dollar-cost-averaging approach, coupled with regular dividend reinvestment, is almost a surely successful long-term strategy.

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## 529 Plans

We have discussed these educational-funding plans in a couple of previous columns, and they're now offered by all fifty states. Contributions are not tax-deductible, but principal and investment gains are tax free when used to pay college costs such as tuition, room and board, and books. Since you can pretty much invest in any state's plan no matter where you live, how do you pick the "best" one?

The research organization Morningstar ([www.morningstar.com](http://www.morningstar.com)) has studied all of the available plans and released a report that recommends five plans as being especially attractive. How were these plans selected? Morningstar states, "We built our lists around the factors that are crucial to a successful college savings plan: costs, quality of underlying investments, flexibility of investment options, and the fund company's record of treating shareholders well."

Here's the Morningstar list along with the plans' telephone numbers and web addresses:

- Utah Educational Savings Plan Trust, 1-800-418-2552, [www.uesp.org](http://www.uesp.org)
- Nevada Vanguard 529 College Savings Plan, 1-866-734-4530, [www.vanguard.com](http://www.vanguard.com)
- Virginia CollegeAmerica, 1-800-421-0180, Ext. 529, [www.americafunds.com](http://www.americafunds.com)
- Michigan Education Savings Program, 1-877-861-6377, [www.misaves.com](http://www.misaves.com)
- Alaska T. Rowe Price College Savings Plan, 1-800-369-3641, [www.troweprice.com/collegesavings](http://www.troweprice.com/collegesavings)

In addition to these plans, you should find out about your state's plan since they may offer some special advantages and benefits for in-state residents. There is useful information to be gleaned also from going to [www.collegesavings.org](http://www.collegesavings.org), which is sponsored by the National Association of State Treasurers.

The SEC recently announced plans to examine 529 plans sponsored by the states for their fees. That is good news for the investor and a recent Wall Street Journal article reported that some states were already reducing their fees or coming out with low cost plans.

## Great Quotes

*"I don't want to know what the law is, I want to know who the judge is."*

*Roy M. Cohn,  
American Lawyer.*

## Naming Your Trust as Beneficiary of Your IRA

We are often asked by our clients whether it is OK to name their trust as the beneficiary of their IRA. The issue is whether the IRA can pay out slowly to the beneficiary over their life expectancy or is required to pay out all the funds within 5 years. In the past, the IRS has taken the position if a revocable trust was named as the beneficiary of an IRA (or other qualified plan) the proceeds of the IRA would have to be paid out within 5 years.

All that changed with the final minimum required distribution regulations issued in April 2002. The final Regs apply to distributions for calendar years beginning on or after January 1, 2003. Under the new Regs, when a trust is named as the beneficiary of the IRA, you can look through the trust to the underlying trust beneficiaries, and use their ages to establish the minimum distribution requirements. Certain requirements must be met, including providing documentation to the plan administrator (or trustee or custodian) identifying the beneficiaries and their ages. You have until October 31 of the year following the employee's death to provide such documentation.

What if you have more than one beneficiary in the trust. Do you have to go with the oldest one's age for all beneficiaries?

No, but you have to do something about it. In order to determine the distribution period for the separate account by disregarding the beneficiaries of the other separate account, the separate account must be established no later than the end of the year following the year of the employee's death. The separate accounting must allocate all post-death investment gains and losses for the period before the establishment of the separate accounts on a pro rata basis in a reasonable and consistent basis among the separate accounts for the different beneficiaries and must also allocate any post-death distribution to the separate account of the beneficiary receiving that distribution. Once the separate accounts are established, the separate accounting may provide for separate investments for each separate account.

What is the bottom line? Naming your trust as the beneficiary of your IRA works fine, provided you follow up properly within a year following the IRA owner's death.

## Interest Rate Predictions

The *Wall Street Journal* publishes a Semiannual Economic Forecasting Survey of approximately 50 economists, and has done so since at least 1982. In this survey, these economists are asked, twice each year, to predict the future yields six months away on a common benchmark for interest rates (for example, U.S. Treasuries).

The results? A research firm tabulated that over the 1982-2002 period, the economists, on average, were wrong on each forecast by 84 basis points (0.84%). Put even more directly, the economists (as a group) usually failed to even correctly predict the *direction* of the change in interest rates over the next six months. In only 12 of 42 forecasts did they correctly figure that interest rates would go up when they in fact did go up subsequently, and down when in fact there was a decline.

## GE Center for Financial Learning

A recent study by the GE Center for Financial Learning, in the December 17th issue of The "Daily Plan-It" published by Southern California Institute, reports that more than sixty (60) percent of Americans do not have a will or a trust in place. You obviously do. For any of your friends or relatives in the area who do not have a will or trust, we would be delighted to see them and would appreciate knowing if you referred them to us.

The same report from the GE Center for Financial Learning found that, for those who do have a will or trust in place, nine out of ten are outdated with the laws as well as the client's personal and financial situation. With this newsletter keeping you generally apprised of changes in the law and your ability to consult with us over any potential changes, we hope that none of you have out dated document. If you have not consulted with us in five years, the odds are substantial though that your documents are outdated based on changes in your personal circumstances or the law.

## Creative Funding of Bypass Trust

In PLR 200403094, IRS has ruled that a husband's placement of assets into a revocable trust, a portion of which is subject to his wife's general testamentary power of appointment if she predeceases him, results in a gift from husband to wife at the time of her death. Further, if the wife exercises the power by placing the assets into a bypass trust for the benefit of the husband, the assets will not be included in his estate under Code sections 2036 or 2038.

Why did the taxpayers structure the estate plan in this way? It appears that the plan is designed to solve an age-old estate planning problem: finding enough suitable assets to fund the bypass trust. We typically advise married couples to divide their assets so that each spouse has enough to fund the trust upon his or her death. In that way, the trust can be fully funded on the first spouse's death, regardless of which spouse happens to leave this world first.

But often it is not easy to divide the assets in that way, even for couples that are wealthy enough to require estate tax planning. Assets of substantial value frequently are held in retirement plans, in the form of business interests, or for other reasons may not easily be transferred between spouses or placed in a bypass trust. The problem has become more severe as the estate tax exemption has increased to the current level, \$1.5 million.

By structuring their plan the way they did, the taxpayers in PLR 200403094 have given themselves the ability to use a single pool of assets to fund a bypass trust, regardless of which spouse dies first. Those assets, which were previously owned by Husband, will be kept in his revocable trust. If he dies first, the assets will be used to establish a bypass trust for Wife's benefit. If Wife dies first, however, those same assets will be used to establish a bypass trust for Husband. The ruling confirms that the trust will not be included in Husband's estate, even though the assets originally came from him.

The technique highlighted in PLR 200403094 will appeal to clients who crave control. The spouse who creates the revocable trust (Husband in the ruling) can maintain a tight grip on all the family wealth as long as both spouses are alive. Wife can direct the assets only through a power of appointment exercisable at her death. Although the plan described in the ruling allows her to appoint the assets to anyone, a general power can be more restrictive than that

Too Good to be True? Remember that a private letter ruling is not binding on the IRS, and cannot be cited as precedent. Only the taxpayer who obtained it can rely on it. We like the technique. You should be able to use a single pool of assets to fund a bypass trust regardless of which spouse dies first. But we are waiting to see more law in this area first.

## FDIC for RLT's

Recent revisions to the rules governing federal deposit insurance for bank accounts makes it easier to obtain broader coverage for accounts held in the name of a revocable living trust

As a general rule, accounts in a FDIC-insured bank are protected to the extent of \$100,000 for each depositor to the account. However, the rules determining the amount of FDIC coverage can be complex, especially in the case of funds held in the name of a revocable living trust (RLT). Under the current rules, each beneficiary of an RLT can be treated as separate depositor, multiplying the amount of coverage, but only if there is no "defeating contingency" that could deny the enjoyment of the trust assets by the beneficiary, and only if the names of all beneficiaries appear in the bank's records relating to the account.

FDIC Board of Directors voted on January 13, 2004 to eliminate the "defeating contingency" rule and the requirement that the name of each beneficiary appear in the bank's records. The changes are summarized in a press release on the FDIC Web site <http://www.fdic.gov/deposit/deposits/deposit/index.html>. According to the release, the new rules will become effective April 1, 2004, but the FDIC will apply the new rules to living trust deposits at any insured institution that fails before April 1 if doing so would benefit the affected depositors.

## Alternative Minimum Tax (AMT)

The AMT is that fiendishly complex shadow tax system originally designed to make sure millionaires with special tax breaks for things like oil wells paid at least some tax. Largely as a result of the tax cuts of 2001 and 2003, the AMT is now poised to devour the middle class. IRS National Taxpayer Advocate Nina E. Olson recently designated it the number one problem facing individual taxpayers and described it as a "time bomb on a short fuse." How short? Without the proposed one-year patch, nearly 13 million families would owe AMT for 2005, up from 2.6 million for 2003 and 1 million for 1999, the Tax Policy Center estimates. Among those hit in 2005 would be 54% of families with adjusted gross income of \$100,000 to \$200,000 and 27% of those earning \$75,000 to \$100,000. Those who have children or live in high-tax states will be particularly vulnerable. And by 2010, under current law, 33 million taxpayers, including 92% of those earning \$100,000 to \$200,000 and 73% of those earning \$75,000 to \$100,000 will pay AMT. The President has asked the Treasury to study the AMT problem and come up with a permanent fix to be proposed in next year's budget. The bottom line: Tax cuts without AMT relief are largely meaningless.

## Impenetrable Code Section

*"An amount paid as tax shall not be considered not to constitute an overpayment solely by reason of the fact that there was no tax liability in respect of which such amount was paid."*

*Code Section 6401*

## Financial Fact

*What's wrong with this picture? Time magazine reported recently that during 2003, stocks of companies that lost money rose 132%, while those of companies that posted a profit rose just 43%*

## Great Quotes

*"A judge is simply a lawyer who has been benched."*

*U.S. Court of Appeals judge*

*Lawyer to a potential client "You have a pretty good case, Mr. Pitkin. How much justice can you afford?"*

*Cartoon caption by J.B. Handelsman  
The New Yorker*

*"Nothing could be more boring than an absolutely accurate movie about the law."*

*Roger Ebert,  
American Film Critic*

*The business of the law is to make sense of the confusion of what we call human life—to reduce it to order but at the same time to give it possibility, scope, even dignity.*

*Archibald Macleish,  
American Poet*

## Strange Laws In Virginia

- You may not engage in business on Sundays, with the exception of almost every industry.
- If one is not married, it is illegal for him to have sexual relations.
- Driving while not wearing shoes is prohibited.
- Police radar detectors are illegal.
- No one may wash a mule on the sidewalk in Culpepper.
- Any person who owns a pool in Dayton, VA risks a \$2500 fine for not closing the gate to the pool when they get done swimming in it.
- Also in Dayton, a special license is required for persons wishing to sell such items as tableware and coins.
- In Lebanon, VA, it is illegal to kick your wife out of bed.
- In Norfolk:
  - Spitting on a sea gull is not tolerated.
  - A man may face 60 days in jail for patting a woman's derriere.
  - Women must wear a corsette after sundown and be in the company of male chaperone.
- In Prince William County:
  - It is illegal to cuss about another.
  - It is illegal to park a car on railroad tracks (it is also pretty dumb).
- It is illegal to flip a coin in a restaurant in Richmond to see who pays for a coffee.
- It is illegal to skate down the sidewalk of Main Street, Victoria, VA.
- In Virginia Beach:
  - If you are drunk and not driving your car, and the person who is driving the car is drunk as well, you may both receive DUI's.
  - It is illegal for a person to ride on the handlebars of a bike.
  - It is illegal to use profanity on Atlantic Avenue or the boardwalk.
  - It is also unlawful to drive by the same place within 30 minutes on Atlantic Avenue.

## Website & E-Mail Alerts

**W**e continue to encourage you to use our new website for Legacy Analytics, [www.legacyanalytics.com](http://www.legacyanalytics.com) or visit our law firm website at [www.cohenandburnett.com](http://www.cohenandburnett.com).

I offered in the last three Newsletters to put anyone that requested it on an email list. The idea was to keep clients advised electronically of changes to estate, tax and financial planning. I have received over 60 responses and have sent them several emails this quarter. For those who are interested, please send an email to [Wes@cohenandburnett.com](mailto:Wes@cohenandburnett.com) and I will add you to the list. There is no charge for this service, no obligation and I send the email blind copy to each addressee so that no one knows anyone else's email address.