

Cohen and Burnett, P.C. Legacy Analytics, LLC



SPRING 2007



FOUNDING PARTNER

I. Mark Cohen
JD, LLM & CFP™

It is spring again and one of my favorite times here in Virginia. All the trees are pushing out their flowers and then their leaves in a glorious display of slow-motion fire works.

Here at the office we are doing a spring cleaning of a sort. We are scanning and digitizing all of our legal and financial planning files and getting rid of most of the paper. (No, we are not shredding originals, but we have very few of those.) When we are done, sometime in mid-May, we will have converted nearly one-half million sheets of paper, and opened up a fair amount of floor space. But the real plus is that we will have instant access to all of our historical files, right here on our local network (plus backups in secure, undisclosed locations).

For my next adventure, I have been focusing on running. Kathy and I will be spending a week in Maui in mid-May celebrating our 25th anniversary, and on the way back, we are going to stop in San Francisco where I will run the famous Bay to Breakers race (it is really more of an event than a race). After the race we will spend a day visiting San Francisco, which has always been one of our favorite cities. I hope to continue running throughout the year and ultimately run in a marathon this fall.

Michael will graduate from Thomas Jefferson High School this June and is currently trying to decide between William and Mary and University of Chicago for his undergraduate degree.

Rachel, a junior at Marshall High School, is working hard on her IB diploma, and preparing for the SAT this May.

All in all, a busy but exciting time at the Cohen household.

Spring 2007

AMT is the new boogie man

Now that most of you are finished with your income tax returns, you may be interested to learn that unless changes are made by Congress, there is a good chance that the Alternative Minimum Tax (AMT) will catch you next year. AMT is a parallel income tax system that is designed to make sure that you pay a minimum amount of tax, (roughly 21% of your income) even if you have valid deductions that would reduce your regular income tax below that level.

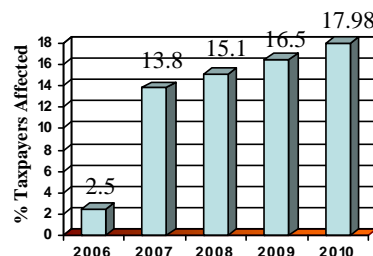
According to a recent study by the Joint Committee on Taxation, the percentage of taxpayers affected by the AMT is projected to jump from 2.5% in 2006 to 13.8% in 2007. It will increase to 15.1% in 2008, 16.5% in 2009, and 17.98% in 2010.

The principal reason for the sharp increase in the AMT's impact from 2006 to 2007 is that under current law, beginning this year:

1) the AMT exemption levels drop to where they were before 2001; and (2) nonrefundable personal credits (except for the adoption credit, the child credit, and the saver's credit) are no longer allowed against the AMT. The number of taxpayers affected by the AMT continues to rise through 2010 because the AMT exemption levels are not indexed for inflation while the regular income tax is. By 2010, almost 31 million individual income tax returns will have AMT liability and/or restricted use of credits totaling approximately \$119 billion.

The AMT will also reach down further to the lower incomes. For example, in tax year 2006, 170,000 taxpayers, or 1.6% of those with adjusted gross income between \$75,000 and \$100,000, are estimated to be affected by the AMT and will likely have an AMT liability or lost credits totaling \$290 million. However, for 2007, almost half of the taxpayers in this income group, nearly 5.7 million, would be affected by the AMT and experience AMT liabilities or lost credits totaling \$6.3 billion.

What happens in the year 2011? The tax reductions passed in 2001, known as EGTRRA, expire at the end of 2010, except for the AMT relief, which expired at the end of 2006. In the year 2011 the regular income tax will rise sharply, so fewer people will be exposed to the AMT.



Cohen & Burnett, PC and Legacy Analytics, LLC
7601 Lewinsville Road, Suite 460, McLean, VA 22102
Cohen & Burnett, PC (703) 847-8900
Legacy Analytics (703) 847-0965



The Problems with Golf

The only problem with golf is that the slow people are always in front of you and the fast people always end up behind you!

Why do sea-gulls fly over the sea?
Because if they flew over the bay they would be bagels!



A young businessman had just started his own firm. He'd rented a beautiful office and had it furnished with antiques. Sitting there, he saw a man come into the outer office. Wishing to appear busy, the businessman picked up the phone and started to pretend he had a big deal working. He threw huge figures around and made giant commitments. Finally, he hung up and asked the visitor, "Can I help you?" The man said, "Sure. I've come to install the phone!"



Wonderful Quotes

It is not enough to do your best; you must know what to do, and THEN do your best.
W. Edwards Deming

"Don't ask yourself what the world needs - ask yourself what makes you come alive, and then go do it. Because what the world needs is people who have come alive."
-- Harold Thurman Whitman, Philosopher and Theologian

If we had no winter, the spring would not be so pleasant; if we did not sometimes taste adversity, prosperity would not be so welcome
Anne Bradstreet (1612-1672)

The secret of a good life is to have the right loyalties and hold them in the right scale of values
Norma Thomas

Five New Schemes Added to the IRS's Dirty Dozen

In past issues of our Newsletter we have listed the IRS's top twelve notorious tax scams. The latest list has five new additions:

- 1. Telephone excise tax refund abuse.** Early filings show that some individuals have requested large and apparently improper amounts for the special telephone tax refund. For example, some taxpayers seem to be seeking a refund of their entire phone bills, rather than just the 3% long-distance excise tax.
- 2. Abusive Roth IRAs.** Be wary of advisers who encourage you to shift under-valued property to Roth Individual Retirement Arrangements (IRAs). For instance, some promoters have the taxpayer move under-valued common stock into a Roth IRA, circumventing the annual maximum contribution limit and allowing otherwise taxable income to go untaxed.
- 3. Identity theft.** IRS says that it's aware of several e-mail identity theft scams (so called "phishing") involving taxes. Fraudsters send bank customers fictitious correspondence and IRS forms in an attempt to trick them into disclosing personal financial data. A typical e-mail notifies a taxpayer of an outstanding refund, urging him to click on a hyperlink and visit an official-looking Web site where he is asked to give his Social Security and credit card number. IRS emphasizes that it does not use e-mail to initiate contact with taxpayers. A taxpayer who has any doubt whether a contact from IRS is authentic can call 1-800-829-1040 to confirm it.
- 4. Disguised corporate ownership.** IRS says that domestic shell corporations and other entities have been formed and operated in certain states to disguise the ownership of a business or financial activity. They are being used to facilitate income underreporting, non-filing of tax returns, listed transactions, money laundering, financial crimes and possibly terrorist financing.
- 5. Structured entity credits.** IRS says that promoters of this newly identified scheme set up partnerships to own and sell state conservation easement credits, and rehabilitation and other credits. The credits are the only assets and once they're fully used, investors receive a K-1 indicating the initial investment is a total loss, deductible on their return. IRS states that forming such an entity isn't a viable business purpose; the investments aren't valid; and the losses aren't deductible.

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555 South Renton Village Place, Suite 700 Renton, WA 98055

An investment in knowledge always pays the best interest.

Benjamin Franklin

Federal Appeals Court Strikes Down the “Merill Rule”

On March 30, 2007 the D.C. Federal Court of Appeals struck down the Securities and Exchange Commission’s now-infamous “Merrill Rule” which exempted certain broker-dealers from the fiduciary requirements of the Investment Advisers Act of 1940.



Prior to this decision, a broker-dealer, such as Merrill Lynch, could give investment advice to its customers, but not be held to the same high fiduciary standard required by the SEC for a Registered Investment Advisor, such as Legacy Analytics, LLC.

One of the important distinctions between a brokerage account and an advisory account is that the broker’s responsibility to the client essentially ends at the time of sale. On the other hand, an investment advisor has a continuing fiduciary responsibility. Being a fiduciary is important. It gives a client the legal right to trust you.

We never did understand why the SEC would permit the big wire house brokers to provide investment advice, charge an ongoing fee, but not take ongoing responsibility for such advice. Apparently the federal appeals court doesn’t understand either.

We applaud this ruling for requiring all companies that provide investment advice to meet the same high fiduciary standards set by the Investment Advisers Act.

New Friends, New Faces

Carol Ann Quarto, Administrative Manager



Carol Ann comes to us with an extensive Government and Government Contracting background, recently leaving a 14 year career as a Senior Analyst for the Military Health System.

Maeve McQuail, Receptionist



Maeve attended the Virginia Commonwealth University studying Psychology. She will continue her education with only two semesters shy of her degree. Maeve recently became engaged to her boyfriend, Will Mock

Get It All on Paper

Without Vital Documents, Aging and Incapacity Puts Families in a Bind

Legal Documents

Among Americans 50 and over . . .

60%

have a will

45%

have a durable
power of attorney

23%

have a living
trust

36%

have neither

17%

have all three

End-of-Life Wishes

Among all adults . . .

24%

have put them
in writing

19%

haven’t thought about
them at all

16%

have thought about them,
but haven’t told anyone their wishes



MANAGING PARTNER

Weston D. Burnett
JD, LLM & CFP™

Barb's Longfellow Middle School Math Team was once again the Northern Virginia Regional Champions in February and advanced to the State competition in March. They competed against the twelve other regional champions across the state and emerged victorious yet again as Virginia State Champion. She and her team head for Ft. Worth, Texas the second weekend in May for the national competition. Barbara claims that this is her final year and she will be helping a younger teacher at the school moving forward next year!

I was on the Norfolk pier on March 21 to see our son, Edward, whose ship left on deployment for six months. I enjoyed watching Edward for 3 hours before deployment, performing far above his rank and age as the ship's navigator (and longest serving officer on the ship by 1 year). Some sad news though, just before leaving, he and his fiancée broke off their engagement of over five years. They remain friends but we are no longer expecting a wedding next Christmas.

Our son, David, has two articles due for publication in law reviews and graduates from the University of Virginia Law School in May. He then studies for the New York Bar at the end of July. In early May he goes to Lima, Peru to visit a long time friend and hike in the high mountains. The highlight this quarter was to join him for a law school class, discuss property law with the two professors and then attend the Law Students Libel show in which they demonstrate how to make fun of themselves and others.

Our daughter, Jennifer, was thrilled to be offered and accept a full University of Louisville Fellowship that covers her tuition and a stipend for her PhD program in Clinical Psychology. She starts in August. Barb and I figure we will make it out for the Kentucky Derby one year.

I am tackling the Triathlon in Norfolk in early June.

Spring 2007

Sour Grapes *Estate of Hester*

The first time I read *Estate of Hester v. U.S.*, (2007, DC-VA) 99 AFTR 2d 1288, the famous sour grapes quote came to mind: "*The fathers have eaten sour grapes, and the children's teeth are set on edge.*" (Jeremiah 31:29-30 and Ezekiel 18:2). This is a case from Virginia where the sins of the father, Wendell Hester, were visited upon the children.



Wendell Hester, was the trustee and income beneficiary of what was probably a QTIP trust (worth about \$4.5 million in cash and a promissory note) set up by his wife upon her death. He breached his fiduciary duty by transferring all the trust assets to his own account, which also had about \$4 million.

He then engaged in several months of day trading, generating over \$2 million in losses, used the account to borrow on margin, withdrew over \$450,000 in cash and collected \$280,000 on the promissory note. The commingling became so complex that it was impossible for anyone to determine which interests in the combined whole belonged to Hester, and which interests in the combined whole belonged to his children.

Upon his death, his estate tried to claim that the misappropriated funds should not be taxed in his estate since they belonged to his children, not to him. Alternatively, the estate claimed that even if the misappropriated assets were included, there should be an offsetting deduction for claims against the estate caused by the misappropriation.

The district court said no to both. First, the court said the misappropriated funds were included in the father's estate because he was treating them as his own funds. Second, the deduction was disallowed because the children did not actually sue their father's estate before the statute of limitations ran out.

What can we learn from this case? It reminds us of something you have probably heard us tell you here at the office: If you treat the bypass trust money as your own (after your spouse has died) so will the IRS, and all the tax planning we have done will be lost. We usually set up the bypass trust so that the surviving spouse has as much use of the bypass trust as he or she wants. But there is a big difference between using the funds in the bypass trust as you need them, verses putting them all in your own account. If you ever have any question over how you should treat the bypass trust, please call us.

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