



# COHEN & BURNETT, PC LEGACY ANALYTICS, LLC



Founding Partner  
I. Mark Cohen,  
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As I write this, my wife, Kathy, is visiting her parents in Phoenix for the week, leaving me in charge of two busy but wonderful teenagers. We have been doing this every year now for several years and actually find ourselves looking forward to it. It gives Kathy some welcome time off to visit with her parents and it gives me a chance to learn and appreciate what she does every day in running the household. But it also gives me a special opportunity to spend quality time with the kids in the evenings as I drive them from one place to the next. This is a special week for all of us, and I expect the tradition will continue for many years. I hope all of you find regular opportunities to spend special time with your family.



Managing Partner  
Weston D. Burnett,  
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Wes recently passed the life, health and annuities examination and has received his insurance license. His son, David is now trying to decide among law schools for this coming fall. His son, Edward, completes his masters in international relations from John Hopkins in May and enters on active duty with the Navy shortly thereafter. His family reports great skiing at Snowshoe in December in West Virginia.

## Concerns of the Affluent

What are affluent investors concerned about today? A recent study by *U. S. Trust* revealed some interesting opinions. Last November, they surveyed individuals with at least \$5.9 million in net worth, which comprises the wealthiest 1% of the nation's families. Among the findings of the survey:

1. *This group no longer places much credence in the advice they receive from Wall Street firms and banks.*
2. *They are, however, generally optimistic about the prospects for investing.*
3. *Two thirds of those surveyed no longer trust corporate management.*
4. *More than 40% are wary of investing in public companies.*
5. *64% say that they will wait and see how the market develops before changing their investment strategies, which have largely become defensive over the past 3 years.*

There is some positive news however. Of those surveyed, 31% believe the market is less risky than it was a year ago, while 40% feel it is neither more nor less risky. So while over 70% of the respondents see no more, or even less risk in investing today, they are leery of taking the advice of Wall Street. An Executive VP with *U.S. Trust* says this has created a dichotomy where anxiety and fear are on the rise at the same time that confidence in the market is returning. It appears that there is still a long term belief in the equity markets, but confusion and trepidation as to how to take advantage of it.

The top 10 worries of the respondents are as follows:

1. *Terrorism will hurt the economy – 86%*
2. *Kids will have it tough, financially – 82%*
3. *Post 9/11 security fears – 77%*
4. *The U.S. economy will hurt finances – 71%*
5. *Educational costs will increase – 68%*
6. *Unpredictable long term returns – 67%*
7. *Taxes will rise steeply – 63%*
8. *Stock market gains will be lower – 59%*
9. *Inflation will eat at investments – 58%*
10. *Inability to maintain income level – 57%*

Please make an appointment to talk to Mark or Wes if we can help you with your financial planning concerns.

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## 403(B) ANNUITY PLAN NOT PROTECTED FROM CREDITORS IN BANKRUPTCY

Under federal law (ERISA), most people automatically assume that any employee's pension trust will be protected from claims of creditors in a bankruptcy. In a recent Sixth Circuit case, however, (*In re: Raymond Adams and Janet Adams*), the Bankruptcy Appellate Panel of the Sixth Circuit, reversed the Bankruptcy Court's decision, and held that the debtors' 403(b) annuity plans did not constitute trusts within the meaning of Section 541(c)(2) and thus were not exempt from the bankruptcy estate. In other words, the Sixth Circuit held that, not only does a plan need to have anti-alienation provisions and qualify under ERISA, but to provide exemption from creditors in bankruptcy, there must also be a trust. While this decision is controlling in the Sixth Circuit (which comprises Kentucky, Michigan, Ohio and Tennessee), it may not be followed in other Circuits. As a reminder, we are in the Fourth Circuit. The issue may ultimately have to be decided either by the Supreme Court or be a matter for Congress to address.

### Great Quotes

*"You don't always get what you ask for, but you never get what you don't ask for... unless it's contagious!"*

*Franklyn Broude*

## MARKET TIMING

There has been considerable attention focused recently on market timing, sometimes called rapid trading. The key is that when traders buy a fund whose net asset value (NAV) per share is based on stale stock prices, they can turn quick profits at the expense of long-term investors. Consider this simple hypothetical example involving an international fund.

**Start:** Fund holds \$50 million worth of stock. With 5 million fund shares, that's an NAV of \$10 a share

### Day 1

Overseas markets close 10% lower at 3 a.m. ET, causing the value of the fund's stocks to drop to \$45 million and the NAV to sink to \$9. Later, stocks rally in the United States, pointing to a rebound overseas. A trader invests \$10 million before 4 p.m., buying 1.11 million shares, at \$9 each. At the end of Day 1, the NAV of the fund totals \$6.11 million. (Holdings of \$45 million stock and \$10 million cash, with 6.11 million fund shares outstanding, equals \$9 a share.)

### Day 2

Foreign markets recover previous losses, but the fund manager is not able to invest the \$10 million immediately. Assets now equal \$60 million, divided among the 6.11 million shares, for an NAV of \$9.82. The rapid trader redeems shares, taking out original \$10 million plus \$911,000 profit. The fund is left with \$49.09 million in stock, with 5 million shares now outstanding equals an NAV of \$9.82 share.

Total loss to remaining shareholders: 18 cents per share.

## SPENDTHRIFT TRUSTS

Our revocable living trusts have virtually always included a spendthrift provision that protected trust assets from being invaded by creditors of your beneficiaries. A recent court decision in Maryland bears mention. The issue in *Duvall v. McGee* was whether a tort judgment against a felony murderer may be satisfied by invading the principal of a spendthrift trust held for the benefit of the felony murderer (tortfeasor). The Circuit Court, recognizing that Maryland law allows invasion of a spendthrift trust only by a narrow class of creditors, and, only in limited circumstances, declined to expand the class or the circumstances. The Court found that the spendthrift provision prevailed and the creditors of the felony murderer (tortfeasor) received nothing.

## GIFTING

Gifts to children or others who are in much lower income tax brackets can result in them qualifying for the 5% capital gains tax rate if they sell highly appreciated stock that you gifted to them under the \$11,000 annual gift exclusion.

The capital gains tax is now capped at 15% for sale of securities, while the capital gains tax rate for collectibles, such as stamps, coins, jewelry, paintings, sculptures, wines remains at 28%. This increases interest by some in gifting away the collectibles in their estate and selling the securities since the tax differential is considerable.

## HEALTH SAVINGS ACCOUNTS

Health Savings Accounts (HSAs) are an extension and expansion of the existing Archer Medical Savings Accounts (MSAs) which expired after 2003 for new MSAs (existing MSAs are grandfathered) which include:

- ◆ Annual individual or employer contributions up to \$2,600 individual/\$5,510 family to an IRA-like plan (deductible or excludible from income tax) that pays qualified medical expenses combined with
- ◆ A “high-deductible” health plan (\$1,000 individual/\$2,000 family, maximum \$5,000/\$10,000 annual out-of-pocket limit).

The only requirement for eligibility is that the individual must be covered under a high-deductible health plan. There is no restriction to small businesses, and in fact, HSAs do not have to be linked to a business at all, and can be adopted by any individual who qualifies. The individual covered under a high deductible plan is not eligible if he is also covered under a non-high deductible plan. For example, an individual is not eligible for HSA coverage if his spouse has a non-high deductible plan that covers him. An individual covered under Medicare is not eligible for an HSA. Thus, HSA contributions generally must cease after the attainment of age 65.

Contributions made by an individual are deductible “above the line” (that is, regardless of whether the individual itemizes deductions). (The individual can’t double-dip by taking an itemized medical expense deduction for contributions or benefit payments.) An individual can make contributions to an HSA for a family member who is eligible—for example, a son or daughter who needs some financial support. The eligible son or daughter in this case would take the deduction for the HSA contribution. However, an individual who may be claimed as a dependent on another person’s tax return is not eligible for an HSA.

HSA plans must be funded. Funds are held with a qualified trustee or custodian, similar to IRAs. The establishment of the fund requires no IRS permission or involvement of an employer. Contributions must be in cash. The HSA fund is not subject to income tax. The fund may not be invested in life insurance contracts, but otherwise investments are not restricted.

Amounts in the account can accumulate without limit. If they are not used each year for qualified medical expenses, they are not forfeited. Neither do unused amounts reduce the participant’s contribution limit in the future. Whatever amount remains in the HSA account when the participant reaches age 65 is treated much like an IRA accumulation thereafter, except that it can be used tax-free to pay medical expenses in the future (see below).

Participants in HSAs can use the funds in their plans to pay for qualified medical expenses for themselves, their spouses, and dependents. Distributions from the plan for this purpose are not taxable to the participants. “Qualified medical expense” means any expense eligible for an itemized medical expense deduction under Code Section 213(d). This is a very broad category of expenses including some items that are almost never covered under health insurance, such as special schools for children with psychological conditions, or heated swimming pools for arthritics. Cosmetic surgery, however, is not included. Distributions other than for qualified medical expenses are taxable and subject to a 10% penalty. However, the 10% penalty does not apply if the distribution is made after the account beneficiary’s death, disability, or attainment of age 65. There is no actual requirement that these funds be used to pay the participant’s medical expenses. An annual contribution of \$5,000 will grow to more

## DOMESTIC PARTNERS

One of the topics receiving considerable attention these days is benefits for domestic partners who may be the same- or opposite-sex couples. A recent Massachusetts court decision on gay marriage was the subject of considerable news coverage. An article on page F4 of the Washington Post for December 21, 2003 was entitled “No Gay Benefits at the Federal Level.” The article speculated that the next big news event will probably be tied to some one challenging the Defense of Marriage Act which was passed by Congress and signed by President Clinton in 1996. This subject also came up in the State of the Union Address and can be expected to continue to receive considerable attention. There was a recent news report in the Wall Street Journal that a high percentage of Fortune 500 companies were providing some benefits for domestic partners. Finally, there is an article at our website, [www.legacyanalytics.com](http://www.legacyanalytics.com), under Personal Finance entitled “Domestic Partners-A Legal Leg to Stand On.”

## IRS UPDATE ON TAX SCAMS

As promised in previous issues, here are the last of the top 12 tax scams on which the IRS focuses:

◆ **Social Security Tax Scheme:** This is a scam offering refunds of the social security taxes they have paid during their lifetimes. The scam works by the victim paying a “paperwork” fee of \$100, plus a percentage of any refund received, to file a refund claim with the IRS. This hoax fleeces the victims for the up-front fee. The con artist is long gone by the time the scammed individual finds out he/she was fleeced. There is no provision in the tax law allowing a refund for social security tax.

◆ **“I Can Get You A Big Refund...For A Fee!”** Refund scheme operators may approach someone wanting to “borrow” their Social Security number or give him, or her, a phony W-2 so it appears that the person qualifies for a big refund. They promise to split the refund with that person. These false refund claims seldom slip by the IRS and when they occasionally do, the participant usually ends up paying back the refund along with stiff penalties and interest. Two lessons to remember: 1) Anyone who promises someone a bigger refund without knowing their tax situation could be misleading them, and 2) Never sign a tax return without looking it over to make sure it’s honest and correct.

## Great Quotes

*Trying a case the second time is like eating yesterday morning’s oatmeal.*

## NEW WEBSITE AND NEW STAFF

We encourage you to use our new website for Legacy Analytics, [www.legacyanalytics.com](http://www.legacyanalytics.com). Its purpose first and foremost is to provide service to our clients. On the Welcome Page, you will see the following on the right-hand side: a market snapshot of the Dow Jones, NASDAQ and S& P 500; CNN headline news. On the left-hand side of the Welcome Page, the list starts with our company, including our mission statement, links to other web sites, pictures and biographies of our staff, our products and services, map directions, how to contact us or have a friend contact us. The information section has numerous topics and articles. The research section has market summaries, stock quotes, mutual fund quotes, and more news by sector or industry. Finally, you can click on Calculators and there are over 40 of them covering retirement, savings, education, taxes, mortgages, business or auto loans and insurance. For our fee-based clients, we expect to link them this year to their portfolios that they can access through our website.

Last Fall’s Newsletter announced that Linda Reyman was leaving after 3 ½ years to devote herself full time to family matters. She made a return engagement to assemble this newsletter. Her prospective relief is Olimpia Nowicka, an attorney from Warsaw, Poland, presently working to obtain her work visa.

## FOR OUR FINANCIAL PLANNING CLIENTS

For our financial planning clients, we are required by law to advise each of you that a copy of the current ADV (stands for Uniform Application for Investment Adviser Registration) is on file and available if you request it. Please call if you would like a copy.

## E-MAIL ALERTS

Offered in the last two 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 about 30 responses and have sent them several emails to date. 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.