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Happy Thanksgiving, Christmas and New Years! Though this is a busy time of the year in the office, we love this season as it gives us time with our far-flung children. Justin and Becky are homeowners in Nashville, while the countdown has begun for Stef in South Carolina and Mary Kate in North Carolina. Jack is studying (and surfing) in San Diego while Julia and Maggie miss their siblings (most of the time).

Throughout the year, we've been methodically " **taking some profits"** against the backdrop of the potential Fiscal Cliff and ensuing economic armageddon. In this edition, we discuss our "sell" philosophy as well as some ideas regarding gifting (one of John's favorite estate planning strategies).

Thank you for being part of our client family and allowing us to serve you. John and Dan.

Winter 2012

Buying is Easy, Selling is Hard.........

Easy to Buy

Most advisors focus on what securities to buy and when to buy them. They spend lots of time and money pouring over financial data and research reports in an futile effort to discover and buy undervalued securities.

You know our skepticism regarding the value of securities research and the alleged ability of advisors to buy the right securities at just the right time.

But Hard to Sell

But perhaps even more egregious is the **lack of discipline regarding when to sell an investment.** Selling an invest is a tougher call then the initial decision to buy. Advisors - and clients - really struggle with this.

Here's why. There are 2 powerful human responses involved in the decision to sell. First, if an investment has underperformed, many investors are inclined to **"wait until it comes back"** . Conversely, if an investment has performed well, there is a proclivity to **"hold a winner"** . Both are understandable and **both are wrong.**

We use a different approach. First, **we never pretend to be smarter than the market.** We don't read research reports, they are boring. Instead, we spend our time on **asset allocation** within a portfolio which can account for 90% of performance (Brinson, Hood, Beebower 2000).

Why Sell?

Just as importantly, we adhere to a "sell" discipline whereby we **"prune the portfolio"** in a fairly methodical way. Sure, it is emotionally difficult to reduce/sell a winner or admit defeat and bail out of a loser. But as we like to remind clients, stocks, bonds, CDs, annuities, etc. don't have emotions.

Pruning to Improve Yield

To be sure, we're not always correct and we often "leave some profit on the table". But that's fine with us. In our experience **pruning the portfolio on a regular basis, combined with thoughtful asset allocation, can result in a healthier yield over time.**

Our strategy may be boring, but Carol's recipe has a little kick to it!

Carol's Penne with Vodka Sauce
35 oz can of San Marzano plum tomatoes
1 lb penne pasta
¼ cup extra- virgin olive oil
7-8 garlic cloves, peeled
1 teaspoon crushed hot red pepper
¼ cup Vodka (your favorite variety)
½ cup heavy cream
2 tablespoons unsalted butter
3 tablespoons chopped fresh Italian parsley, salt, Locatelli grated cheese

Bring a large pot of salted water to a boil over high heat. Pour the tomatoes into food processor and pulse until finely chopped. Stir the penne into the boiling water. Cook the pasta, stirring occasionally.

Meanwhile, heat the olive oil in a large skillet over medium heat. Whack the garlic cloves with the side of a knife and add them to the hot oil and cook until lightly browned. Carefully pour the chopped tomatoes into the pan. Bring to a boil, season with salt and crushed red pepper. Boil for about 5 minutes. Pour in the vodka and simmer until the pasta is ready.

When the pasta is ready, take the garlic cloves out of the sauce and pour in the cream, add the butter and stir to incorporate into the sauce. Combine the drained pasta and sauce in one of the pots. Boil the pasta and sauce together to allow sauce to thicken. Sprinkle with parsley and grated cheese. Enjoy!

See disclaimer on final page

Should You Make Large Gifts in 2012?

Other gift considerations

- *While it might seem obvious, gifts should only be made if you can afford to part with the property.*
- *In general, it is usually preferable to make as many gifts as possible using the annual exclusion and the qualified transfers exclusion for medical and educational expenses before making taxable gifts that use up the gift and estate tax exemption. Annual exclusion and qualified transfer exclusion gifts do not use up the gift and estate tax exemption.*
- *When you make a gift of property, your income tax basis in the property (generally, what you paid for the property, with some up and down adjustments) is generally carried over to the person who receives the gift. When you transfer property at your death, the basis of the property is usually "stepped up" (or "stepped down") to fair market value at the time of your death.*

Currently, the exemptions for federal gift tax, estate tax, and generation-skipping transfer (GST) tax are at historic highs, and the gift, estate, and GST tax rates are at historic lows. But, in 2013, the exemptions are scheduled to substantially decrease, and the tax rates are scheduled to substantially increase. This raises the question of whether 2012 might be a good time to make large gifts that take advantage of the current exemptions while they are still available.

Looking into the future

When you transfer your property during your lifetime or at your death, your transfers may be subject to federal gift, estate, and GST tax. (Your transfers may also be subject to state taxes.) Currently, there is a basic exclusion amount (sometimes referred to as an exemption) that protects up to $5,120,000 from gift tax and estate tax, a $5,120,000 GST tax exemption, and a top tax rate of 35%. Unless new legislation is enacted, in 2013 the gift tax and estate tax exemption will decrease to $1,000,000, the GST tax exemption will decrease to $1,000,000 (as indexed), and the top tax rate will increase to 55%.

No one knows what the future holds for these taxes, but there is a lot of speculation about what Congress might do. Among the possible scenarios, tax rates could increase and exemptions decrease, tax rates could decrease and exemptions increase, or current tax rates and exemptions could be extended. The question then arises: "Should large gifts be made in 2012 to take advantage of the large $5,120,000 exemption while it is still available?"

To answer that question, you should generally consider the following: the size of your estate and the rate at which it can be expected to grow (or decrease), whether you can afford to make large gifts, what the future of the transfer taxes might be, and whether "claw back" would apply in future years.

Claw back

Claw back refers to a situation where the benefit of certain tax provisions is essentially recaptured at a later time due to changes in tax law. There is some split in opinion as to whether claw back applies to the estate tax. A couple of examples will illustrate the difference.

Example(s): *Assume the gift and estate tax change as currently scheduled in 2013 and claw back applies. Assume you make a taxable gift of $5 million in 2012 that is fully protected by your gift tax exemption and you have a taxable estate of $5 million when you die in 2013. Estate tax, after reduction by the unified credit but not the state death tax credit, is $4,795,000. The result is essentially the same as if you had not made the taxable gift in 2012 and your taxable estate is $10 million in 2013.*

Example(s): *Assume the same facts as above, but with no claw back. Estate tax, after reduction by the unified credit but not the state death tax credit, would be $2,750,000. So, the federal estate tax is $2,045,000 lower if there is no claw back.*

Guidelines for large gifts in 2012

If you expect that you can keep your estate down to around $1 million ($2 million total for both spouses if you are married) using annual exclusion gifts (generally, up to $13,000 per recipient per year; effectively, $26,000 for gifts by married couples) and qualified transfers exclusion gifts for medical and educational expenses, there may be no advantage to making taxable gifts in 2012. If you have a larger estate, you may wish to consider making taxable gifts sheltered by exemptions in 2012, depending on your evaluation of how the guidelines here apply to your particular circumstances.

If you make taxable gifts sheltered by the gift and estate tax exemption in 2012, and the gift and estate tax rates later increase, the exemptions decrease, and there is no claw back, you may save gift and estate taxes by making the gifts in 2012. Even if there is claw back, your gift and estate taxes will probably be no worse than if you hadn't made the gifts. And, if the gift and estate tax rates later decrease or stay the same and the exemptions increase or stay the same, your gift and estate taxes will probably be no worse than if you hadn't made the gifts.

If you make generation-skipping transfers sheltered by the GST tax exemption in 2012, and the GST tax rate later increases and the exemption decreases, you may save GST tax by making the GST in 2012. Even if the GST tax rate later decreases or stays the same and the exemption increases or stays the same, your GST tax will probably be no worse than if you hadn't made the GST in 2012.

In each of these scenarios, it has been assumed that values do not appreciate. If the property transferred by gift increases in value after the gift, there may also be transfer tax savings from removing the appreciation from the transfer tax system.

You'll want to consider how these guidelines for large gifts in 2012 might apply to your specific circumstances. An estate planning professional can help you evaluate them.

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Ways Grandparents Can Help with College Costs

Under federal law, tuition payments made directly to a college aren't considered taxable gifts, no matter how large the payment. This rule is helpful considering that annual tuition at some private colleges is now surpassing the $40,000 mark.

College is expensive. For some fortunate students, grandparents are stepping in to help. This trend is expected to accelerate as baby boomer grandparents start gifting what could be trillions of dollars over the next few decades. Helping to finance a grandchild's college education can bring great personal satisfaction and can be a way for grandparents to minimize potential gift and estate taxes. Here are some common strategies.

Outright cash gifts

One way to contribute is to make an outright gift of cash or securities to your grandchild or his or her parent. To minimize any potential gift tax implications, you'll want to keep your gift under the annual federal gift tax exclusion amount--$13,000 for individual gifts or $26,000 for joint gifts made by both grandparents. Otherwise, a larger gift may be subject to federal gift tax and, for a gift made to a grandchild, federal generation-skipping transfer tax, which is a tax on gifts made to a person who is more than one generation below you.

An outright cash gift to your grandchild or your grandchild's parent will be considered an asset for federal financial aid purposes. Under this aid formula, students must contribute 20% of their assets each year toward college costs and parents must contribute 5.6% of their assets.

Pay tuition directly to the college

If you are considering making an outright cash gift, another option is to bypass your grandchild and pay the college directly. Under federal law, tuition payments made directly to a college aren't considered taxable gifts, no matter how large the payment. This rule is helpful considering that annual tuition at some private colleges is now surpassing the $40,000 mark. Only tuition qualifies for this federal gift tax exemption--room and board, books, and fees aren't eligible.

Aside from the benefit of being able to make larger tax-free gifts, paying tuition directly to the college ensures that your money will be used for education purposes. However, a direct tuition payment might prompt a college to reduce any potential grant award in your grandchild's financial aid package, so make sure to ask the college about the financial aid impact of your gift.

529 college savings plan

A 529 college savings plan is a tax-advantaged savings vehicle that can be a smart way for grandparents to contribute to their grandchild's college education while paring down their own estate. Contributions to your account grow tax deferred and earnings are tax free if the money is used to pay the beneficiary's qualified education expenses (states generally follow this tax treatment as well). Funds can be used at any accredited college in the United States or abroad.

You can open a 529 account yourself and name your grandchild as beneficiary, or you can contribute to an already existing 529 account (e.g., a parent-owned 529 account).

Tip: *Under current federal financial aid rules, grandparent-owned 529 plans are not counted as a parent or student asset (only parent-owned and student-owned 529 plans count as assets), but withdrawals from a grandparent-owned 529 plan are counted as student income, which can affect student aid eligibility in the following year (withdrawals from parent-owned and student-owned 529 plans are not counted as student income).*

If you have a large sum to gift, 529 plans offer a big advantage. Under special rules unique to 529 plans, you can make a lump-sum gift of up to $65,000 ($130,000 for joint gifts) and avoid federal gift tax by making a special election to treat the gift as if it were made in equal installments over a five-year period (provided you don't make any additional gifts to the same grandchild during the five-year period). And if you happen to be the 529 account owner, you retain control over these funds. For example, if you should have unexpected medical costs, you can withdraw part or all of your lump-sum contribution (however, you will owe income tax and a 10% penalty on the earnings portion of the withdrawal). In addition, your lump-sum gift is considered removed from your estate even though you retain control over the funds as account owner (but if you were to die during the five-year period, a prorated portion of the gift would be recaptured by your estate for estate tax purposes).

Of course, you can contribute smaller, regular amounts to your grandchild's 529 account as well. If you have more than one grandchild, you can open an account for each and limit your annual contributions to each account to $13,000 or $26,000 for joint gifts. Come college time, if one grandchild gets a scholarship, you can change the beneficiary of his or her 529 account to another grandchild or you can withdraw an amount equal to the amount of the scholarship, penalty free.

Note: *Investors should consider the investment objectives, risks, charges, and expenses associated with 529 plans before investing. More information about specific 529 plans is available in each issuer's official statement, which should be read carefully before investing.*

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Do I need to file a gift tax return?

If you transfer money or property to anyone during any year without receiving something of at least equal value in return, you may need to file a federal gift tax return (Form 709) by April 15 of the next year. If you live in one of the few states that have a gift tax, you may also need to file a gift tax return with your state.

Some gifts aren't taxable and generally don't require a gift tax return. These exceptions include:

- Gifts to your spouse that qualify for the marital deduction.
- Gifts to charities that qualify for the charitable deduction. (Filing is not required as long as you transfer your entire interest in the property to qualifying charities. However, if you are required to file a return to report gifts to noncharitable beneficiaries, all charitable gifts must be reported.)
- Qualified transfers exclusion amounts paid on behalf of anyone, either directly to an educational institution for tuition or directly to a provider for medical care.
- Annual exclusion gifts totaling $13,000 or less for the year to any one individual. (However, you must file a return to split gifts with your spouse. But, if your spouse is not a U.S. citizen, the annual exclusion is increased to $139,000 in 2012 for gifts to your spouse.)

If your gift isn't exempt from taxation, you'll need to file a gift tax return. But that doesn't mean that you have to pay gift tax. Generally, each taxpayer is allowed to make taxable gifts totaling $5,120,000 (scheduled to drop to $1 million in 2013) over his or her lifetime before paying gift tax. Filing the gift tax return helps the IRS keep a running tab on that $5,120,000 basic exclusion amount (sometimes referred to as an exemption).

If you made a gift of property that's hard to value (e.g., real estate), you may want to report the gift, even if you're not required to do so, in order to establish the gift's taxable value. If you do, the IRS generally has only three years to challenge the gift's value. If you don't report the gift, the IRS can dispute the value of your gift at any time in the future.