



Charitable Giving Rules Changed By New Tax Act

Supporting charities just got more complicated. Beginning in 2007, all cash donations, no matter how small, must be documented by a bank record or a written communication from the charity providing its name, the date, and the amount you gave.

This new dictate is one of many provisions dealing with philanthropy in the Pension Protection Act of 2006.

(Charitable reform happens to be a key ingredient in this sweeping retirement savings law.) And it makes life a little more difficult for many charitably inclined individuals. For instance, take the case of Helen, who's accustomed to dropping cash in the collection plate at church and then claiming a tax deduction based on what she has contributed. Now, she may have to use a check, not cash. Or, because she is older than 70½ and has money in a traditional IRA, there is another option. Normally, IRA owners who've passed that age must take annual, taxable withdrawals. But for 2006 and 2007 only, the pension act authorizes "qualified charitable distributions" of up to \$100,000 that can go straight from an IRA to charity. Such distributions count toward your required withdrawals. Yet because they're charitable contributions, they aren't taxed. And because such a distribution wouldn't be included in Helen's income, it could ease the tax bite on her Social Security benefits, too. Under the old rules, a taxpayer such as Helen, who doesn't

itemize deductions, got no break for gifts.

Yet itemizers can benefit, too. Dave and Clara routinely deduct medical and miscellaneous itemized expenses, but because their income exceeds IRS thresholds, the value of those deductions is reduced. Giving directly from their IRAs keeps their earnings down and enlarges their deductions. Dave and Clara may give \$100,000 apiece.

Contributions must go directly from the IRA to the charity, with the account custodian transferring the money at the owner's request. But the IRA can't be a SEP or SIMPLE, and the money can't go to a donor-advised fund or private foundation.

Another rule change affects individuals who rummage through their homes periodically looking for items to give away. The pension act says that to deduct donations of used clothing and household goods, the items now must be in at least "good condition"

and have more than "minimal value"—inexact terms the law left undefined.

What is clear is that taxpayers claim \$9 billion annually for such contributions, and Congress wants to make sure donated items have bonafide uses. This rule went into effect on August 18, 2006, the day after President Bush signed the pension law, so the couple's 2006 tax return could be affected. Used items worth more than \$500 need not be in "good" condition if

(Continued on page 4)

The Latest News From Vestpointe

We are expanding to the point where we have recently moved to a new address, which is as follows:

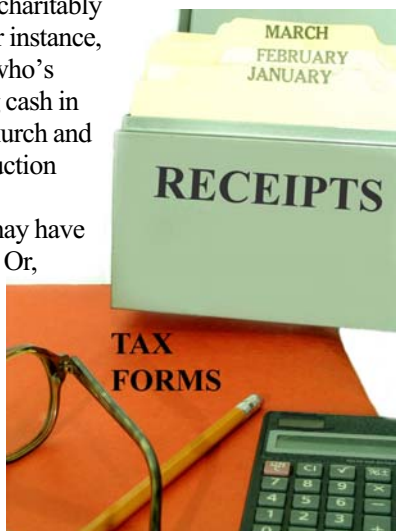
14358 N. Frank Lloyd Wright Blvd.
Suite 7
Scottsdale, AZ 85260

We are maintaining the P.O. Box, so if you have become familiar with using it, we will continue to receive mail there.

With the changes in the tax law last year and the ever-increasing complexity of the financial markets, we are continuing to work with our high-net-worth clients to grow their wealth. Tax season is often a period where individuals focus on their finances—and realize how much they pay in taxes. At Vestpointe, we specialize in reducing taxes and maximizing investment returns.

Thus far, our business growth has been entirely based on referrals, for which I thank you. There is no greater compliment than getting a referral from a current client. If there is ever anyone you think might benefit from our services, please feel free to give them our name and website address: www.vestpointe.com.

Thank you for your business!



A Skeptical View Of Variable Annuities

Variable annuities (VAs) soared from obscurity a decade ago to have \$1.3 trillion in total assets in late 2006, according to the National Association for Variable Annuities. However, many skeptics say VAs are popular not because they're great for investors, but because they're usually great for the people selling them. VAs are often laden with punishing fees that can drain the value of your account.

VAs are not all bad. Indeed, some individuals can benefit from a VA. It provides tax-deferral for investments, just as a 401(k) or IRA does. Unlike an IRA, there's no limit on contributions and no mandatory withdrawals. You can put your money in a wide range of professionally managed subaccounts, very much like mutual funds. And if you happen to lose money and die while the account is down, your beneficiaries could receive a death benefit. In addition, many VAs offer a "living benefit" rider that promises minimum lifetime income regardless of investment performance. With all these benefits, VAs make for a great sales pitch, and that makes it especially important to be aware of the drawbacks.

Bells and whistles can make a VA seem complicated, but the basic structure is simple. An insurance component provides a benefit upon your death and allows a VA its tax-deferred status under

U.S. tax law. You decide how you want your account invested, dividing money among a menu of mutual fund-like subaccounts. Like other tax-deferred accounts, VAs permit penalty-free withdrawals after age 59½. Before that, there's a 10% tax penalty on your policy earnings. All withdrawals of earnings, whenever they're made, are taxed as regular income.



The biggest problem with VAs is that fees tend to be extremely high. They impose insurance and administrative expenses on top of management fees for the subaccounts. Fees can be in excess of 2% of your assets annually. There may also be annual contract charges and sales loads on investment subaccounts.

Meanwhile, the death benefit isn't likely to be much. There are scenarios in which it would be valuable—for example, if you died shortly after making a large investment and the market had dropped sharply. But that just doesn't

happen very often. According to LIMRA International, an insurance research group, only three of every 1,000 VA contracts are surrendered because of death or disability.

Taxes are another shortcoming. When money comes out, it is taxed as income at rates of up to 35%. Compare that with the top rate of 15% on most long-term capital gains and qualified dividends in taxable accounts. Several states also impose additional taxes on VAs. And while the tax advantage for mutual funds may be partially offset by tax-deferred compounding within a VA, it could take many years of tax-deferral for a VA to come out ahead.

There's also the tax treatment of inherited VAs. Heirs, like any other account owner, are subject to tax at income rates on withdrawals. In contrast, the tax basis of an inherited mutual fund is stepped up to its value when it passes to your heirs, so that gains you earned during your lifetime aren't taxed at all.

The final indignity? If you experience buyer's remorse after purchasing a VA, you'll probably have to pay a surrender charge of as much as 7% to get your money back. While VAs may be right in some circumstances, we are here to serve as your trusted advisor in evaluating such sales pitches. ●

College Savings Clubs Can Boost Education Funding Plans,

Free money is always nice, and that's what you get from college saving clubs such as Upromise and BabyMint, says education funding expert Joe Hurley. "These programs just take what you normally spend and use it to generate rebate dollars for college savings," says Hurley, founder and CEO of Savingforcollege.com.

That's a nice deal, particularly when rebates flow directly into tax-advantaged 529 college savings plans. There are dozens of college saving clubs and rewards programs, with new ones popping up every year. Two of the largest are Upromise, with an estimated 6 million members, and BabyMint, with some 2

million. Though each club has its own rules, most follow the same general plan. You sign up, perhaps registering your credit card or using the program's own branded credit or rewards card, so that your spending is recorded. You may be rewarded for patronizing certain stores, brands, or even financial services companies and real estate brokerages. Some clubs offer additional perks, such as BabyMint's promise to reduce tuition at 150 participating colleges by \$1 for every rebate dollar you earn.

Though college savings clubs can help you save substantial amounts—Hurley says he and his wife have

used the programs to add thousands of dollars to 529 accounts for their two children—there are generally caps on how much you can earn. For example, the Fidelity 529 College Rewards Card from MBNA offers a 2% rebate on purchases, earmarking the money for Fidelity-managed 529 plans in Arizona, Delaware, Massachusetts, and New Hampshire, but annual rebates are capped at \$1,500. The Citi Upromise Card gives a 1% rebate on general purchases, with an annual ceiling of just \$300. However, when you use the card at Upromise partners, including gas stations, grocery stores, and drug stores, the rebates range as high as 10%, sometimes

Transferring The Family Business

If it were easy to hand off a business to the next generation, more than just one in three would successfully complete the trip. As it is, many factors contribute to a high mortality rate for family companies. Estate and gift taxes take a toll, and so do family conflicts about who will take over, how to compensate heirs who don't work in the business, and how to keep the company safe from divorcing spouses and creditors who want a piece of the action. A well-thought-out plan can head off many problems, but what works for one family may be wrong for another.

Gift and estate taxes kill many family firms. Though the first \$2 million of an individual's estate is currently shielded from estate taxes, inheritors of a company worth, say, \$4 million, might owe almost \$2 million in taxes, and coming up with the cash often means selling assets or the business itself. Meanwhile, giving away a business before death could trigger punishing gift taxes that kick in after you've used up a \$1 million lifetime gift-tax exclusion.

The simplest solution is to transfer ownership of a company gradually, or to fund a trust that helps reduce taxes. There's an annual gift-tax exemption that permits tax-free gifts of as much as \$12,000 to an unlimited number of recipients. Such relatively small gifts add up over many years, particularly if

you take advantage of techniques the IRS allows for discounting a gift's value. But a gradual transfer requires a sound succession plan and the right business structure.

You may want to begin plotting your exit from a business years before you leave. An early start lets you groom your successors and choose a business entity



that serves your ends. It also gives you a chance to see who among your heirs is interested in working in the business and perhaps one day taking the helm. Meanwhile, you can consider how to structure your estate to provide fair compensation to heirs who choose a different career.

You won't be able to transfer your business piecemeal if it's organized as a sole proprietorship, which must change hands all at once. Shares in most other business entities—so-called C and S

corporations, limited liability companies (LLCs), and limited partnerships (LPs)—can be broken out and given away a few at a time, and you may be able to retain management control even when you become a minority shareholder. Moreover, if children can't sell their stakes, the IRS considers the shares to be worth less than their full market value—so that, say, an \$18,000 piece of your business that you give to your daughter might count as a gift-tax-exempt transfer of \$12,000. But you'll need an entity that passes muster with an increasingly wary IRS. Owners who want to transfer value but keep management control must be particularly careful.

Various trusts can help reduce gift and estate taxes, deal with control issues, and shield personal assets from creditors. For example, you could sell the company to a grantor trust created for your heirs. You'd get an IOU, and the business would gradually pay for the shares transferred into it. Or you could set up a grantor retained annuity trust, or GRAT. If the company gains value at a rate exceeding an interest rate set by the IRS, you could end up with a major break on gift and estate taxes.

Regardless of how your business is constituted, and however you decide to hand it off to your heirs, you need a formal buy-sell agreement spelling out what happens if you die unexpectedly or simply choose to walk away from the company. Such an agreement obligates partners or heirs to purchase your share according to a specified formula, and it's typically funded with life insurance on you and other owners—likely the heirs to whom you've begun to transfer ownership. If you die, they get the proceeds and can buy back your stake.

Almost all of these strategies require an accurate fix on what your business is worth, and that means periodic assessments by a professional business appraiser. We can help you find one and work with you on a succession plan that reflects the make-up and goals of your family and business. ●

But What Can You Expect From One?

with no yearly cap. Uppromise 529 plans are administered in New York, Missouri, and Nevada. Like most other 529 plans, these are also open to out-of-state savers.

There are some potential drawbacks. If you don't pay off your credit card balance every month, interest charges could quickly exceed the value of the rebates you earn. And some people find themselves changing normal spending habits just to earn rewards. "You don't want rebates to drive your purchasing," warns Hurley.

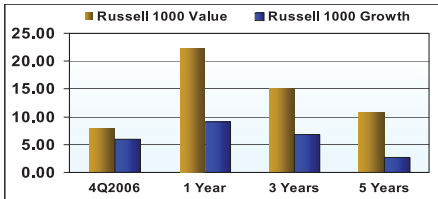
Still, if you're considering a big-ticket item—a large-screen television, say, or even a new car—it could pay to look into rewards programs offering rebates for

those purchases. Even if such programs aren't tied to college savings plans, you could deposit the cash you receive into a 529.

Finally, there are tax implications. Rebates that go into a child's 529 plan are technically gifts, and while your \$12,000 annual gift-tax exclusion per recipient will easily cover whatever rebates you earn, that money needs to be counted with any other gifts to the same recipient. ●

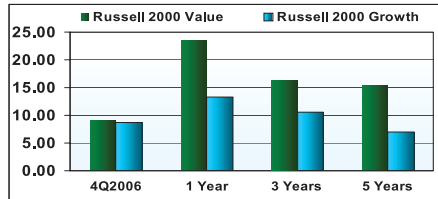
You should consider a plan's investment objectives, risks, charges and expenses carefully before you invest. The issuer's official statement contains this and other information about the plan, and should be read carefully before investing. Investors should consider whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investors in such state's qualified tuition program.

Market Data Bank: 4th Quarter 2006



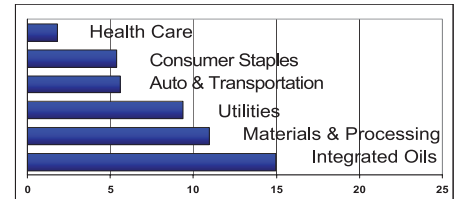
LARGE VALUE VS. LARGE GROWTH

Value-driven stocks remained dominant in 4Q06 while traditional growth sectors trailed the market. Among the biggest stocks, value gained 8.00% in the quarter; large-cap growth shares climbed 5.93%.



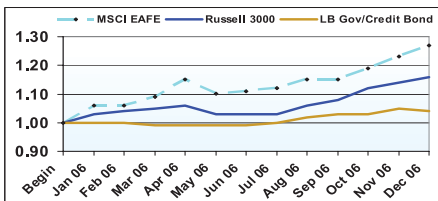
SMALL VALUE VS. SMALL GROWTH

Smaller stocks took the lead from their larger peers, but here, too, growth took a back seat to value. In the fourth quarter, small-cap value delivered a 9.03% return while small-growth gained 8.77%.



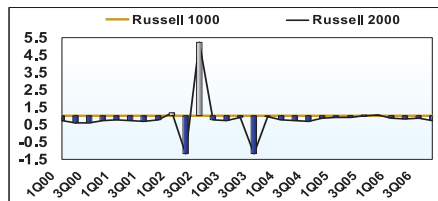
THREE BEST AND WORST SECTORS

Investors' appetite for value was bullish for oil producers and utilities but health care companies, usually associated with growth, languished. Still, none of the 11 Russell sectors lost ground.



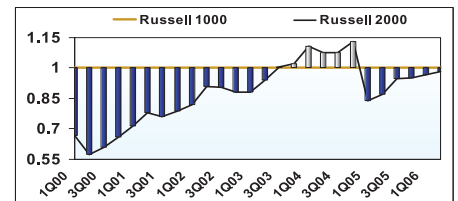
FOREIGN, US STOCKS & US BONDS

Overseas investments consistently outperformed their U.S. counterparts in 2006. For the entire year, foreign stocks gained 27%. By comparison, U.S. stocks and bonds gained 16% and 4%, respectively.



LARGE VS. SMALL STOCK EARNINGS

Corporate giants accelerated their earnings growth this quarter, with the average large-cap boosting its profits by 14.9%. Growth slowed slightly for smaller companies, following its recent trend.



PRICE-TO-EARNINGS RATIO

As small-cap shares outperformed despite slowing profit growth, the gap narrowed between the price-to-earnings ratio of small- and large-cap stocks. Large- and small-cap stock p/Es were about even.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capital International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do not represent any specific investment. Foreign investing involves special risks, including political unrest, economic instability and currency fluctuation. Past performance does not indicate future results.

Source: Russell/Mellon

Charitable Giving Rules

(Continued from page 1)

supported by an appraisal.

Very large non-cash gifts are also under fire. It may now be easier to trigger an IRS penalty for over-valuing a donation—even if you rely on an appraisal, which is required for gifts larger than \$5,000. Though there are several exceptions that would get you off the hook, if those don't apply you'll be penalized when the amount you claim turns out to be more than one-and-a-half times what the tax agency decides the gift is worth. Previously, you got in trouble only if the misstatement was at least double the value. And now appraisers, too, will be fined if they prepare an appraisal that supports a misstated valuation.

Who may conduct "qualified appraisals" is also subject to tougher

restrictions. Now, an appraiser must have demonstrated experience and education in appraising the particular type of property involved, as well as a professional designation and membership in professional associations. And the appraiser must follow generally accepted rules, such as the Uniform Standards of Professional Appraisal Practice.

The rule changes regarding appraisals could affect taxpayers who want to take advantage of another pension act provision, which provides new, more generous tax breaks for conservation easements. An easement is a permanent restriction that protects a habitat or preserves land, open space, or historically significant structures.

For example, an owner might seek an easement that would forever prohibit development on his wooded 35-acre hillside parcel and its miles of views.

Donating the easement to a conservation organization would provide the owner with a charitable income tax deduction because the restriction reduces the property's market value. "He would get a deduction for the decrease in value, and may also realize lower property and estate taxes," says Wesley Ward, vice president of The Trustees of Reservations, a Massachusetts preservation organization.

Deductions for easements donated in 2006 (even prior to the act's signing) or 2007 may be as much as 50% of income, or 100% for qualifying farmers and ranchers, and you can deduct anything exceeding those limits over the following 15 years subject to the same annual cap. Under the old law, you could deduct only 30% of income. ●

Information provided does not constitute individual tax advice. You should consult your tax advisor regarding your individual situation.

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