



Volume 2 Issue 2

August 2000

WEALTHWISE  
PLANNING  
BY DESIGN  
INVESTMENT  
CENTER  
TAXING MATTERS  
OF INTEREST

HOW MUCH MONEY SHOULD YOU PASS ON TO YOUR KIDS?

FINANCIAL PLANNING ISSUES FOR PEOPLE LIVING IN TWO STATES

INVESTING IQ / AFTER HOURS ONLINE TRADING

WATCH OUT FOR FIVE-YEAR IRA RULE

INTERESTING STATISTICS / ADDITIONAL WEB

TIP FOR USING THIS LETTER: [CLICK ON THE ARTICLE TO GO TO THAT PART OF THE LETTER. CLICK ON THE OAK TREE IN THE UPPER CORNER OF THE PAGE TO COME BACK TO THIS FRONT PAGE. YOU CAN ALSO LOOK FOR WEB LINKS THROUGHOUT THE LETTER AS A PATH TO OTHER RESOURCES YOU MIGHT ENJOY REVIEWING.](#)



## HOW MUCH MONEY SHOULD YOU PASS ON TO YOUR KIDS?

Warren Buffett, one of the world's richest men, is famous for his quote in *Fortune* magazine in 1986 saying that he was leaving the bulk of his fortune to charity because one should leave "enough money to your kids so they can do anything, but not enough so they can do nothing."

While few have fortunes resembling Buffett's, there are many families who wonder how much of their estate they should leave their children, and in what form. Many of these families are overnight millionaires—45 percent of today's millionaires are younger than 55. [August 2000 Observer] They worry about whether giving their kids a large amount of their wealth will undermine their work ethic. More and more wealthy are following Buffett's advice: they're giving more to charity and less to their heirs.

Many Certified Financial Planner practitioners have clients wrestling with these issues. Here's some of their advice for helping determine who, how and when to give away your estate.

**Start young.** Whether you already have a fortune or hope to have a fortune, or just want to help your kids, teach them about money when they are younger, the value of money and how to manage money. Beyond the direct teaching, many financial planners point out that the best way you can teach your children about money is to set a good example yourself in the way you manage money, give to charity, avoid excessive spending and so on. Teaching your children how to manage their money well may be the best gift you can give, say planners.



**Give during lifetime.** Passing money on to your children when they are young and middle-age adults offers several benefits. As long as estate taxes continue, there are tax benefits to lifetime gifting. With more and more people living well into their 80s and even 90s, waiting until death to pass on your wealth probably means your children are themselves retired or nearly retired, and the need for the gift may be greatly diminished. But more important here, say financial planners, lifetime gifting gives you an opportunity to see how your children handle wealth. If they handle it well, you may feel more comfortable in passing on more, whether during lifetime or at death.

**Communicate your intentions.** Planners can't stress this enough. Let your children know your plans while you are alive. This is particularly important if you plan to give much of your wealth to charity or you want to give more to one child than another. Perhaps one child has lifetime medical needs while the other is already well-off financially, or you want to pass the family business on to a particular child. By explaining your intentions and reasoning, you can diminish or eliminate misunderstandings or hard feelings that may cause squabbles among your heirs or angry memories about you.

**Work with professionals.** When communicating with your family, you may want to bring in your financial advisors to help explain the financial issues. You may want to have the family work with a therapist to air out the emotions that so often cloud money issues. The wealthy sometimes delay taking important estate planning steps because they fear dredging up these issues. You will also want to look at matters from the viewpoint of your children, as well. As surprising as it may seem, some young adults are uncomfortable inheriting wealth they



themselves haven't earned.

**Use estate planning tools.** Consider using trusts to help manage your wealth for the benefit of your heirs. There are many kinds, including incentive trusts which require an heir to accomplish specific tasks on their own (say earn a certain amount of money, complete college or even pass drug tests) before receiving assets from the trusts. What financial planners caution against is trying to over-control the child using trusts. It's one thing to use a trust to help a young adult who's not ready to manage money, and another to control the money until the child is in their sixties.

**Don't fail to plan.** Above, all create an estate plan. Otherwise, your estate will be distributed according to state law after your death, and it may not go where or how you want it to.



## FINANCIAL PLANNING ISSUES FOR PEOPLE LIVING IN TWO STATES

Do you live in two different states? Are you a “snowbird” who heads south to warmer climates in the winter? Do you own a vacation home in another state? Living in two different states raises numerous complex financial issues that should be addressed by careful planning.

One of the first and most fundamental issues to address is permanent residency, or domicile. This may seem simple in your mind. You know which state you consider “home,” and which one you visit. But the two states may view it differently. And their decisions could prove costly.

Here's a typical situation. Say you live in the state of Washington, but you vacation during the winter at your home in California. First, the fact that you own property in more than one state may subject your estate to probate in both states. Furthermore, California has a higher cost of probating an estate than Washington, and it has a high income tax, while Washington has no state income tax. How do you deal with these issues?

First, be clear about establishing or maintaining your residency. The common test for residency in states is 183 days—spend that or more in a state and that state is more likely to be viewed as your permanent residence.

This is not always as simple as it may sound. Appearances count for a lot. A Certified Financial Planner professional who works with Washington residents who winter in California recommends that they don't establish interest-bearing accounts or brokerage accounts with California banks or brokerages. Keep those in Washington. They also avoid having their paychecks forwarded to California, and he advises that





*Planning by Design*

they not earn any money in California. That helps avoid California income tax issues.

You can further establish domicile by registering to vote, maintaining a driver's license and automobile registration in your state, and establishing relationships with financial institutions and financial professionals in the state. Also maintain good financial records documenting your residency. Keep receipts of everything that shows where you were living on any given day—a trip to the grocery store, doctor's office or gas station. This may seem trivial and a nuisance, but ask homemaker queen Martha Stewart about the need. New York state auditors claimed she was a resident of New York in the early 1990s because of her home in East Hampton, and that she consequently owed New York income taxes, which are among the highest in the land. Stewart and her accountants fought the case in court, producing hundreds of receipts, diaries, phone records and other documents to show that she was instead a resident of Westport, Connecticut. New York is a tough state to fight residency. Even partial days spent in New York or a trip to the airport have counted toward residency. Stewart lost her case.

To minimize probate issues, many Certified Financial Planner professionals recommend putting any property you own in a nonresident state, such as a vacation home, into a revocable, or living, trust. The property will then pass to the trust beneficiaries free of probate.

The domicile issue may crop up in other ways you've never thought of. Say you have a child at a state college and you move to another state, but keep your old residence? Will the child lose residency status?

Beyond income and estate taxes, and probate issues, review your health insurance. Health care plans often limit coverage to a specific geographic area. You may need to own two policies, with one perhaps a short-term health policy to cover major emergencies. Or you may need to change policies, say from an HMO (health maintenance organization) which typically won't





*Planning by Design*

cover costs if you go outside its network, to a PPO (preferred provider organization) which would cover a portion of the out-of-network expense.

Also review your property insurance. A homeowner's policy coverage can change if the home is left unoccupied for an extended period of time. If you're renting in your nonresident state, have you remembered to carry renter's insurance to protect your personal property in the event of loss?





## WHAT'S YOUR INVESTING IQ?

We came across an interesting article in the August issue of Money Magazine entitled "What's Your Investing IQ?" The article includes a 20 question test of your "financial intelligence."

This test was originally given to 1,501 mutual fund investors by Money Magazine and the Vanguard Group. 40% of the individuals had been investing three years or less. Surprisingly when the results were reviewed, most flunked! The average score was 37% correct.

How well do you think you will do? An interactive version can be found at <http://cgi.money.com/cgi-bin/money/polls/vanguard/vanguard.plx>

Susan Wyderko, director of the SEC's Office of Investor Education and Assistance, wasn't surprised with the results. She stated that an investor's ability to easily trade online doesn't mean that they have done their homework. Ms. Wyderko added that investors are "flying blind" when they haven't done the necessary preparation. "Even Tiger Woods couldn't win at golf with a paper bag over his head."

Well, don't worry. The news isn't all doom and gloom. Thanks to the Internet, learning about investing can be almost as easy as online trading. Some interesting sites to check out are:

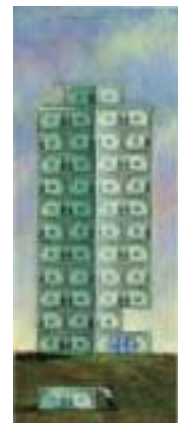
[www.money.com](http://www.money.com)

[www.morningstar.com](http://www.morningstar.com)

[www.fool.com](http://www.fool.com)

[www.401kafe.com](http://www.401kafe.com)

These are a few of the web resources that can help.





## AFTER HOURS ONLINE TRADING — GOOD OR BAD IDEA?

The Stock Markets are only open 6 1/2 hours each weekday. However, online investors can place trades even after the trading day has ended.

Trading after hours has some advantages. One advantage is that you can re-research potential investments without attempting to time the end of the trading day. Many companies release important news after trading has stopped and one way to capitalize of this is to get in line with the other investors before you go to bed.

While this sounds like an ideal situation, you may be setting yourself up for a problem. The first minutes of the trading day are typically the most volatile. Some brokers might be unloading their backlog, temporarily throwing off the supply and demand of various stocks. Many stocks open several dollars higher (or lower) than the previous night's close. NASDAQ middlemen (known as marketmakers) sometimes take advantage of the after-hours order information. If a marketmaker sees a large number of after-hour orders to buy a certain stock, he can load up in the pre-institutional market, driving the price up. When the market opens, he has a number of waiting customers to buy the higher priced stock. Marketmakers deny that they manipulate backlogs for their own gain. However, even if they admitted to manipulation of prices, technically they have done nothing illegal.

Even though the National Association of Securities Dealers is considering reforms to make the opening less chaotic, at the moment there are only vague proposals. **So, what's an investor to do?** If you place an after-hours trade, you can place a limit on the price you are willing to pay (limit order). This may not be the best solution in a very volatile market opening. Possibly the safest solution is to research your stocks after-hours but place your order the next day, after the early morning market traffic has cleared.



## WATCH OUT FOR FIVE-YEAR IRA RULE

Rules governing individual retirement accounts are a nightmare, and the five-year rule is one of the worst parts of the nightmare. Here are the basics of the five-year IRA rule and how to avoid costly mistakes.

The five-year rule is a requirement that an IRA's assets must be distributed to the beneficiary by December 31 of the fifth year following the owner's death. So if the owner dies January 1, 2001, the assets would have to be distributed no later than December 31, 2006. But exactly how and when the five-year rule applies depends on when the IRA owner dies and who is the designated beneficiary, if one is named.

Let's start with the most common situation: the spouse of the IRA owner is the beneficiary. Let's also assume the owner dies before he or she is required to start taking minimum IRA distributions, which is April 1 of the year following the year the owner turns 70 1/2. In this situation, the surviving spouse has three choices. One is to roll over the account into his or her name and take distributions based on the survivor's life expectancy (or combined with a newly named beneficiary). The survivor also could choose to leave the IRA in the decedent's name and start withdrawals by December 31 of the year the deceased would have turned 70 1/2. Or the survivor could empty the account within the five-year rule. But there is no real benefit to choosing the five-year option because you lose the tax deferral growth inside the IRA as well as creating a big tax bill in the year of withdrawal.

One word of caution, however. While federal law doesn't require the spouse to choose the five-year rule, the financial institution serving as custodian of the IRA may require a five-year payout. In that event, the owner should consider moving the IRA to another custodian, or the beneficiary can move the IRA after the owner dies.



In the event the owner dies after required distributions have begun, the spouse or non-spouse may have some distribution options, but the five-year rule does not apply. (Just be sure to check that the custodian doesn't have a five-year rule.)

What happens if the IRA owner names a person other than a spouse as beneficiary? This is where the rule gets more complicated, and costly mistakes often are made. Again, assuming the IRA owner had not started required distributions, the non-spousal beneficiary has three choices. One is to follow the five-year rule, but again, there is a loss of tax deferral and a big tax bill, especially if you wait until the fifth year to take out everything. A second option is to empty the account by December 31 of the year following the death.

The third option is the life expectancy rule. This means the beneficiary chooses to take minimum distributions based on the beneficiary's life expectancy. If the beneficiary is significantly younger than the owner, say a young adult, the tax benefits of this deferral can be tremendous, allowing the IRA to grow substantially in size.

The key here is that the beneficiary must choose the life expectancy option no later than December 31 of the year following the owner's death, which is when the first required distribution must be made. If the beneficiary doesn't choose that option by then, the five-year rule automatically goes into effect.

Some beneficiaries who feel they want or need the money within five years may ignore the life expectancy choice. However, it still makes sense to take that option. You may find that circumstances change, and you don't need or want the money, and then you can let it grow. If you do still need the money within five years, you can take it out of the IRA at any time anyway, even if you've made the life expectancy choice.





As in the case of the spouse as beneficiary, if required distributions have already begun before the owner dies, the five-year rule doesn't apply.

What happens if no one is named as beneficiary, or the estate, a charity or trust is named? Assuming distributions have not begun, the five-year rule applies automatically in the case of no beneficiary named, or the estate or a charity is named. A trust as beneficiary may avoid the five-year rule as long as several trust requirements are met.

If you wish to take advantage of these rules, legal counsel should be sought to determine if your trust meets these requirements.

*Taxing matters*



of interest

Here are some interesting statistics we came across that might be of interest to you:

- 51% of Americans think their finances will be better a year from now. However, 4% think they will be worse. (Source: Associated Press)
- 36% of investors think the market will be higher a year from now and 20% think it will be lower. (Source: Wall Street Journal/NBC News)
- 59% expect their standard of living will be lower when they retire. (Source: Consumer Federation of America/DirectAdvice.com)
- 68.8% of households with more than \$100,000 of annual income have "adequate" retirement savings. (Source: Consumer Federation of America/DirectAdvice.com)
- 2/3 of Americans indicated that they have not gained substantially from the bull run of the stock market. (Source: Keyport Life Insurance)
- 76% of investors do not have a financial consultant that they trust to manage their investments. (Source: American Century)
- 24% of America's high net worth individuals have a written financial plan (Source: Phoenix Home Life Mutual Insurance Company)
- 1,600 scam Web sites were caught in a March 2000 Federal Trade Commission sweep. (Source: Dow Jones Newswires)
- Congressional members and their staff are \$10.5 million in arrears on income taxes. (Source: IRS)
- 40,000 Americans have net worths of \$10 million or more. (Source: IRS)



In addition, here are a few more Web sites you might like to check out:

National Aging Information Center for reports, statistics and links about aging Americans: <http://www.aoa.dhhs.gov/naic/>

Internet Guide to Section 529 Plans for information on college savings plans, pre-paid tuition plans, and other 529 plans: <http://www.savingforcollege.com/>

Access America for Seniors to access government information and services for seniors: [www.seniors.gov/index.html](http://www.seniors.gov/index.html)

Nolo.com is the site of Nolo Press, a publisher of law books for laymen. There are lots of articles on estate planning (and lawyer jokes): <http://www.nolo.com>

Search engines can be very helpful in locating things on the Internet. Sometimes trying to locate something can be a nightmare. Try <http://www.google.com>. In spite of the strange name, google.com is easy to use and is highly accurate. It searches the web and finds pages that link to other pages. ("Google" is a mathematical term that means "lots and lots.")





## THE MISSION OF OAK TREE PERSPECTIVES

---

To assist, educate and expose you to information that makes a difference in your personal performance and in your financial future.

Oak Tree Perspectives is a publication of Oak Tree Advisory Services, Inc., 6601 Center Drive West, Suite 500, Los Angeles, California 90045. Oak Tree Advisory Services, Inc. is a registered investment advisor. Information contained in this publication has been obtained from sources believed to be reliable. However, the accuracy, completeness, and interpretations carry no guarantees or warranties, expressed or implied. The publisher, its employees and/or affiliates accept no responsibility for errors, omissions, or for any investment results obtained from the use of materials contained herein. We do not think that this publication, or any other single publication, should be relied upon as the sole source of information and opinions when making investment selections. This is not a solicitation nor is it intended to represent itself as an offering to sell or a solicitation to buy any services or investments. Oak Tree Advisory Services, Inc. or any of its affiliates do not receive compensation, directly or indirectly, for the mention of any particular investment strategy or security in this publication. All rights are reserved. No part of this publication may be reproduced or distributed in any form or by any means or stored in any database electronic retrieval system without prior written permission of Oak Tree Advisory Services, Inc. Annual subscription rate is \$24.50 U.S.. Foreign subscribers add \$10.00 U.S. for postage.

Copyright 2000

Oak Tree Advisory Services, Inc.  
6601 Center Drive West, Suite 500                      701 Palomar Airport Road, Suite 300  
Los Angeles, California 90045                      Carlsbad, California 92009

For information on how these, or other financial concepts  
may apply to your situation, call us at:

(310) 348-9539 / (760) 439-5616 / (800) 404-4545