VIGIL Strategies
Taking you where you want to be
Third Quarter Newsletter 2003

FINALLY!

After 3 years of the worst stock market since the Great Depression, including a nearly straight drop with little respite, signs of a return to normalcy appeared in the second quarter. The market experienced a solid recovery to a point where it has logged an average year's gain in just the first 6 months of 2003. Considering that the market was sitting with negative year-to-date returns at the end of the first quarter, the strength of the recovery is clear.

So what do you do now? If you have the proper amount of stock exposure for your situation, do the same as you should always do—stay the course, as statistics indicate that the market still has quite a bit of room to recover. Among the most compelling of these indicators is the fact that the real federal funds rate (federal funds rate minus inflation) has been hovering at zero or in slightly negative territory for the past few quarters; in the last 50 years, this condition has been a precursor to a strong market rally.

However, do not fall into the trap of being so happy that your portfolio returns are finally positive that you fail to make sure they are appropriately positive. This is the old "when the market is up, I'm doing good; when the market is down, I'm doing bad" general perception problem. In all cases, whether the market is up or down, your return *in relation to the market* determines how well you are doing, NOT simply whether the return number is positive or negative. For example, if your portfolio is entirely in stocks and you made 6% over the first 6 months of this year, the general perception would be that you did well because your return was positive. Actually, that return is terrible, because you should have gained at least about 12% the first six months of this year under these facts. Be sure to always compare your return to the market; if you are badly trailing it, you might think about making a change.

Finally, be careful about bond investing at this time, and particularly investment in bond mutual funds. Over the last few years, the returns of many bond mutual funds have looked attractive relative to stock fund returns because, in addition to interest on the bonds, their value has increased as interest rates have declined. If you were to invest this year in last year's best investment, it would probably be a bond fund of some sort. We are much more likely to see higher interest rates in the future, however, than we are to see further interest rate declines; indeed, interest rates cannot really decline much further. As the rates climb back up, the value of bonds held by bond funds will decline, causing such investments to perform poorly. If you have money targeted for bonds at this point, you are better off either buying individual bond investments where you are guaranteed to get your investment back or leaving money intended for bonds in money markets to participate in increasing interest rates as they rise over the next several months.

As always, if you'd like help assessing your strategy or the returns you are receiving, the objective assistance of a fee-only financial advocate may be exactly what you need.

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Selecting an Executor or Trustee:

Whether you choose a will or a trust, you will need someone to administer the disposition of your estate—an executor or personal representative and, if you have a trust, a trustee. Typically, personal representatives and trustees are family members, friends, a bank, or an independent trust company.

Selecting your personal representative or trustee is an important decision that deserves careful thought. There are many considerations, but first and foremost, make sure the person you name is willing to serve in this capacity. This is a difficult job and not everyone is equipped or willing to assume this responsibility.

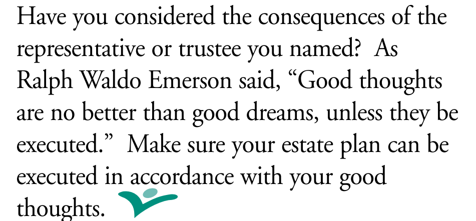
Note that naming a family member or friend to serve as a trustee is often not the best idea for several reasons. First, although this person may not charge to act in this position, often family and friends have little or no experience in trust administration, taxes, or investments. This inexperience often means the individual has to hire attorneys and accountants for assistance with these duties, often at a higher cost than simply hiring a professional to handle these duties in the first place. Further, acting without the support of experienced trust professionals, these representatives and trustees frequently make errors which may expose the estate to litigation and themselves to personal liability. Even if this person is able to otherwise handle the responsibility, grief or emotional ties to your estate may hinder his/her ability to think clearly and without bias.

Naming a bank to serve in this position may also present significant problems. With the mergers that the banking industry has seen, many banks will not accept trusts with difficult assets (like a closely held corporation) or less than $500,000-$1,000,000 in principal. Further, most banks do not administer the trust locally. This means that a beneficiary might need to contact trust administrators via an 800 phone number, is unable to speak personally with his/her trust administrator, and may be forced to wait days for the appropriate person to return the phone call. Additionally, because many banks sell their own financial products, investments within the trust may be limited to products of the bank, which may not be the best investment options available. This means that with the bank as your representative or trustee, your estate may have fewer, less appealing investment options available and limited local servicing capability, resulting in lower rates of return and comparably worse customer service than other local alternatives like an independent trust company.

On the other hand, independent trust companies, like Vigil, boast professionals experienced in trust administration, investment, and tax issues. Additionally, because an independent trust company does not sell financial products, the trust can be invested in any type of investment. Further, as an independent company, clients are able to deal directly with their trust administrators. Independent trust companies are highly regulated by the federal government—clients of independent trust companies can be assured that their money is invested in a company that meets the highest of regulatory standards.

As you review your estate plan, reflect on these important distinctions. Remember only independent trust companies are experts at handling estates and trusts, able to administer the estate without personal bias, completely free of any conflict of interest, entirely independent in suggesting and investing in financial products, and sensitive to but not hindered by emotional considerations.

Have you considered the consequences of the representative or trustee you named? As Ralph Waldo Emerson said, "Good thoughts are no better than good dreams, unless they be executed." Make sure your estate plan can be executed in accordance with your good thoughts.



Planning For Uncertainty: Reducing Taxes and Unintended Consequences-

Why You Should Consider Adding A Trust Protector Provision To Your Trust

Drafting a long term irrevocable trust is a little like looking into a crystal ball. Attorneys are expected to come up with a legal instrument that provides a framework to minimize current and future tax liability, serve the client's wishes for years–even generations–and assist with family needs. The crystal ball gets awfully cloudy when one considers the fact that tax laws and family needs are ever changing. Perhaps the client later decides he would like to include another beneficiary or the darling little toddler grows up to be an absolute terror. Most immediately, however, is the concern that if the estate tax is repealed certain provisions of existing trusts may be wholly inappropriate and even harmful to the financial health of trusts.

Unfortunately, irrevocable trusts pose a problem because retention of a power to change the trust in the future often causes the trust to become a "grantor" trust, thereby defeating any of the tax benefits the trust was designed to achieve. It is sometimes possible to amend irrevocable trusts by going into Court, but that is an expensive process and in many cases the kinds of changes that need to be made are not the kind that a Court can actually consider or make.

These are the situations where a trust protector may be advantageous. A trust

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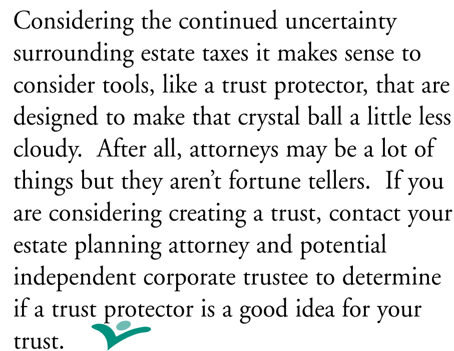
Planning For Uncertainty: Reducing Taxes and Unintended Consequences- *continued from page 2*

protector is not the same as a trustee. A trust protector can be a person or organization (like a trust company who is not serving as the trustee) who, if willing, has the power to make enumerated changes to the trust. The trust can make this power either broad or limited. So, for example, the power may be to remove or replace trustees, veto distributions, add or delete beneficiaries, change distributions, or to alter the manner in which beneficiaries receive property-either outright or in trust.

A growing trend among estate planning attorneys is to include a trust protector provision which would allow the protector to change the trust to implement various tax strategies. Of course, trust protectors aren't a good idea for everyone. Adding a third party to the trust will almost certainly make things a little more complicated, may increase the possibility of conflict, and require more time and money to solve disagreements.



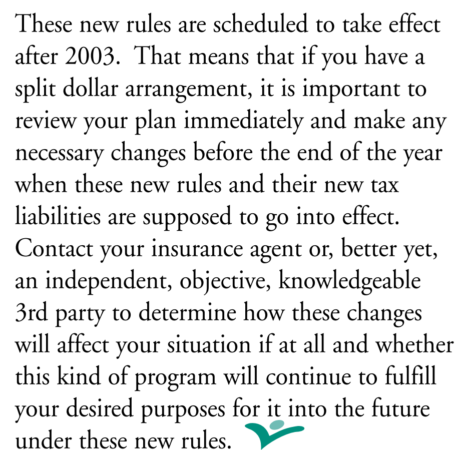
Considering the continued uncertainty surrounding estate taxes it makes sense to consider tools, like a trust protector, that are designed to make that crystal ball a little less cloudy. After all, attorneys may be a lot of things but they aren't fortune tellers. If you are considering creating a trust, contact your estate planning attorney and potential independent corporate trustee to determine if a trust protector is a good idea for your trust.

Are You Paying Attention to Your Split-Dollar Plan? The IRS is.

Split-dollar insurance plans ("plans") have been used to compensate key employees since the 1960s. These plans, which are not insurance plans but a benefit, work by "splitting" the premiums, cash values, ownership, death benefits, and dividends of a life insurance policy between and employer and a key employee.

In 2001, the IRS determined that many of these plans resemble interest free loans and decided to impose higher taxes on their economic value. Initially, the IRS suggested that it would tax proceeds heavily, and hold the employee responsible for paying the tax even if the cash went to the reimbursing employer. However, last year the IRS issued Notice 2002-8, which announced its intention to issue proposed regulations providing comprehensive guidance regarding the tax treatment of these plans, but offered new interim guidance as well.

As a result of this new scrutiny, we know that there are going to be new taxes imposed on these plans that were not contemplated at the time most of these plans were established. In all probability, the tax treatment of these plans will depend on who owns the plan—the employer or the employee. It appears that employees who own the policies will have to pay much higher taxes on the benefit the company is providing by paying the premium and that if the employer owns the policy, the entire cash value will be taxed to the employee when ownership is transferred from the employer to the employee.



These new rules are scheduled to take effect after 2003. That means that if you have a split dollar arrangement, it is important to review your plan immediately and make any necessary changes before the end of the year when these new rules and their new tax liabilities are supposed to go into effect. Contact your insurance agent or, better yet, an independent, objective, knowledgeable 3rd party to determine how these changes will affect your situation if at all and whether this kind of program will continue to fulfill your desired purposes for it into the future under these new rules.

The 2003 Tax Act: How Less May Mean More

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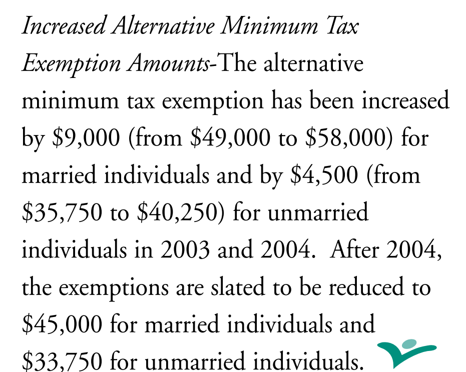
Reduction in Long Term Capital Gains Taxes- The maximum tax rate on long-term capital gains is generally reduced from 20% to 15%. These rates apply to both the regular tax and the alternative minimum tax. These rates apply through 2008 for long-term gains realized on or after May 6, 2003. In 2008, the rates revert back to 20% and 10%. Meanwhile, the rates of 25% and 28% continue to apply to recaptured Section 1250 gain and collectibles gain, respectively.

Reduction in Dividend Tax Rates- Under the Act, a dividend received by an individual shareholder from a domestic corporation is generally taxed at the same rates that apply to long-term capital gains. Essentially, the tax on dividends is reduced from almost 40% to 15%-a substantial tax savings for shareholders! However, in order to qualify for these low tax rates, the shareholder must hold the stock for more than 60 days during the 120 day window beginning 60 days before the ex-divide date. This treatment applies to both the regular tax and the alternative minimum tax. These new dividend rates are effective as of January 1, 2003, and continue through 2008, after which dividends will be taxed as they were before the rate.



*Increased Alternative Minimum Tax Exemption Amounts-*The alternative minimum tax exemption has been increased by $9,000 (from $49,000 to $58,000) for married individuals and by $4,500 (from $35,750 to $40,250) for unmarried individuals in 2003 and 2004. After 2004, the exemptions are slated to be reduced to $45,000 for married individuals and $33,750 for unmarried individuals.

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The 2003 Tax Act: How Less May Mean More

After much anticipation, Congress passed the Jobs and Growth Tax Reconciliation Act of 2003 (the "Act"). At only eight pages in length, the Act is arguably the shortest piece of major tax legislation in modern history. Contrast this Act with the Tax Reform Act of 1996 which enacted "tax simplification" in 1,200 pages! Yet, despite the Act's brevity, it provides substantial short-term tax relief for individuals and businesses.

An estimated $330 billion in reductions are contained within the Act and the IRS is in the process of implementing some basic but revolutionary tax changes advantageous for businesses, and exceptional for capital investors. Here are some of the highlights of the Act. Please contact your financial advocate for more specific information or questions that you may have related to the Act.

Reduction in Personal Income Taxes-The maximum federal personal income tax bracket has been cut from 38.6% to 35%, and the lower brackets have all been trimmed by 2%-3%, retroactive to January 1, 2003.

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