



October 2007

**MLM Financial Group**  
5 Burlington Woods Drive  
Suite 102  
Burlington, MA 01803  
(Tel) 781-273-1400  
(Fax) 781-273-1402  
info@mlmfinancialgroup.com

Dear Clients:

We hope you all had a wonderful summer and are enjoying the beginning of the Fall season.

As we head into the fourth quarter of the year, please be on the look out for a couple of items. First, we have hired an independent company to conduct a client survey. The survey will come via email if we have your address. Otherwise it will come by regular mail. We encourage you all to take a few minutes to complete the survey so that we may better understand what we can do to improve our service to you. Secondly, for those of you who need to take a required distribution from your IRA account, you should have received a form to complete and return to allow us to make this distribution for you.

Please let us know if we can assist you in any way. We look forward to talking to you or seeing you soon.

MLM Financial Group

**In this issue:**

How Much Annual Income Can Your Retirement Portfolio Provide?

The Power of a Dynasty Trust

Understanding the Alternative Minimum Tax (AMT)

Ask the Experts

## How Much Annual Income Can Your Retirement Portfolio Provide?

Your retirement lifestyle will depend not only on your assets and investment choices, but also on how quickly you draw down your retirement portfolio. The annual percentage that you take out of your portfolio, whether from returns or the principal itself, is known as your withdrawal rate. Figuring out an appropriate initial withdrawal rate is a key issue in retirement planning and presents many challenges. Why? Take out too much too soon, and you might run out of money in your later years. Take out too little, and you might not enjoy your retirement years as much as you could.

### Conventional wisdom

A seminal study on withdrawal rates for tax-deferred retirement accounts (William P. Bengen, "Determining Withdrawal Rates Using Historical Data," *Journal of Financial Planning*, October 1994), using balanced portfolios of large-cap equities and bonds, found that a withdrawal rate of a bit over 4% would provide inflation-adjusted income (over historical scenarios) for at least 30 years. More recently, Bengen showed that it is possible to set a higher initial withdrawal rate (closer to 5%) during early active retirement years if withdrawals in later retirement years grow more slowly than inflation.

Other recent studies have shown that broader portfolio diversification and rebalancing strategies can also have a significant impact on initial withdrawal rates. In an October 2004 study ("Decision Rules and Portfolio Management for Retirees: Is the 'Safe' Initial Withdrawal Rate Too Safe?," *Journal of Financial Planning*), Jonathan Guyton found that including additional asset classes, such as international stocks and real estate, helped increase portfolio longevity. Another strategy that Guyton used in modeling initial withdrawal rates was to freeze the withdrawal amount during years of poor portfolio performance. Taken in concert, Guyton found it was possible to have

"safe" initial withdrawal rates in excess of 5%. All studies were based on historical data, however, and past results do not predict future performance.

### Inflation is a major consideration

For many people, even a 5% withdrawal rate seems low. To better understand why suggested initial withdrawal rates aren't higher, it's essential to understand how inflation can impact your retirement income.

A simple example illustrates the problem. If a \$1 million portfolio is invested in a money market account yielding 5%, it provides \$50,000 of annual income. But if annual inflation runs at a 3% rate, then more income--\$51,500--would be needed the next year to preserve purchasing power. Since the money market provides only \$50,000 of income, \$1,500 must also be withdrawn from the principal to meet retirement expenses. That principal reduction, in turn, reduces the portfolio's ability to produce income the following year. In a straight linear model, the principal reductions accelerate, ultimately resulting in a zero portfolio balance after 25 to 27 years, depending on the timing of the withdrawals.

### Calculating an appropriate withdrawal rate

Your withdrawal rate, then, needs to take into account many factors, including, but not limited to, your asset allocation and projected rate of return, annual income targets (accounting for inflation as desired), and investment horizon. Ultimately there is no standard rule of thumb; every individual has unique retirement goals, means, and circumstances that come into play in planning, implementing, and adjusting a retirement income strategy.



### Why was the dynasty trust created?

*The dynasty trust came into being in the early twentieth century. During this time, the great industrialists, such as Rockefeller, Carnegie, and Ford, who had amassed enormous fortunes, sought a way to preserve their wealth and keep it in their families.*



### Income taxation of trust income

*Federal and state income taxes may be owed on income generated inside the trust. Depending on how the trust is structured, the grantor, the beneficiaries, or the trust entity may be liable for the taxes.*

## The Power of a Dynasty Trust

Early in the twentieth century, the United States began taxing wealth transfers under the gift and estate tax system. This system was designed to impose tax on each and every generation (father to son, son to grandson, etc.). The very rich soon began to thwart this system by transferring wealth directly to grandchildren, thus skipping a level of taxation. Congress eventually caught on to this strategy and responded with the generation-skipping transfer tax (GSTT). GSTT is an additional tax that's imposed whenever transfers are made to persons who are more than one generation below the taxpayer (e.g., grandfather to grandson). GSTT is a flat tax imposed at the highest gift and estate tax rate in effect at the time of the transfer (45% in 2007).

Furthermore, most states impose their own transfer taxes. Together, these taxes can take an enormous bite whenever substantial wealth is being handed down, and over time they can erode a family's fortune. This can be troublesome to individuals who would prefer to have their legacies benefit their own family members. It's from these circumstances that the dynasty trust evolved.

### How does a dynasty trust work?

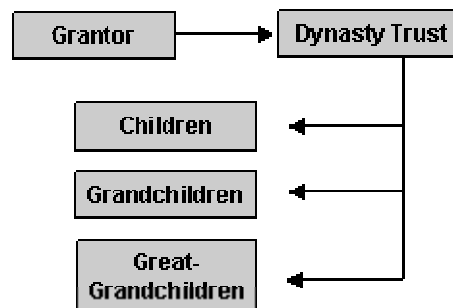
The law allows generation-skipping transfers to go untaxed up to a certain amount by providing a lifetime exemption (currently \$2 million per taxpayer, or \$4 million per married couple). Typically, a dynasty trust is funded with amounts that take full advantage of the GSTT tax exemption. The trust then provides for future generations for as long as it exists. Although the trust assets effectively move from generation to generation, there are no corresponding transfer tax consequences.

To enjoy this tax benefit, access to trust property by the beneficiaries must be limited. You can decide how narrow or broad a beneficiary's access will be within those limits. For example, if you wish to give a beneficiary as much control as possible, you can name the beneficiary as trustee, and give the beneficiary the right to all income and the right to consume principal limited by "ascertainable standards" (i.e., health, education, maintenance and support). The beneficiary can be given even more control by granting a special (or limited) testamentary power of appointment (i.e., the power to name successive beneficiaries).

On the other hand, if you want to restrict

access to the trust as much as possible, you can name an independent trustee who has sole discretion over distributions coupled with a spendthrift provision. The trustee will have full authority to distribute or not distribute income or principal to the beneficiary as the trustee deems appropriate. The spendthrift provision will prevent the beneficiary from voluntarily or involuntarily transferring his or her interest to another before actually receiving a distribution. The greater the restrictions, the less likely creditors or other claimants will be able to reach trust property.

### How a dynasty trust works



- ❶ Assets transferred to trust. Taxpayer exemptions may shield transfer from transfer tax.
- ❷
  - Trust provides for beneficiaries according to trust document until trust terminates
  - Trust may be liable for income tax on taxable income
  - Although assets may effectively pass from generation to generation, no transfer taxes apply

### How long can a dynasty trust last?

A dynasty trust can last as long as state law allows. In states that still have a "rule against perpetuities," the life of a trust is limited to 21 years after the death of the last beneficiary to die (which conceivably could be 100 or more years). Trusts in the states that have abolished their rules against perpetuities can, in theory, last forever.

### The bottom line

A dynasty trust can meet the objectives of high-net-worth individuals concerned about intergenerational planning.

A dynasty trust is not a do-it-yourself project. See an experienced estate planning attorney for more information.

## Understanding the Alternative Minimum Tax (AMT)

If you aren't already familiar with the individual alternative minimum tax (AMT), there's a good chance that you soon will be. Because its key figures aren't indexed for inflation, the AMT reaches further into the ranks of middle-income Americans each year. And because temporary legislative band-aids expired at the end of 2006, the stage is set for a dramatic rise in the number of individuals who are affected.

### What is the AMT?

The AMT is essentially a separate federal income tax system with its own tax rates and its own set of rules governing the recognition and timing of income and expenses. If you're subject to the AMT, you have to calculate your taxes twice--once under the regular tax system and again under the AMT system. If your income tax liability under

the AMT is greater than your liability under the regular tax system, the difference is reported as an additional tax on your federal income tax return.

### How do you know if you're subject to the AMT?

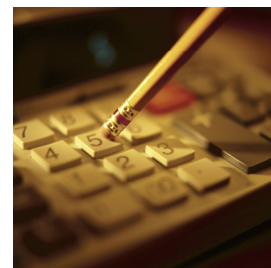
Part of the problem with the AMT is that, without doing some calculations, there's no easy way to determine whether you're subject to the tax. Key AMT "triggers" include the number of personal exemptions you claim, your miscellaneous itemized deductions, and your state and local tax deductions. So, for example, if you have a large family and live in a high-tax state, there's a good possibility you might have to contend with the AMT. IRS Form 1040 instructions include a worksheet that may help you determine whether you're subject to the AMT (an electronic version of this worksheet is also available on the IRS website), but you might need to complete IRS Form 6251 to know for sure.

### AMT adjustments

Differences between the regular and AMT calculations include:

- The standard deduction and deductions for personal exemptions are not allowed for purposes of calculating the AMT.

- Under the AMT calculation, no deduction is allowed for state and local taxes paid, or for certain miscellaneous itemized deductions.
- Under the AMT calculation, any deduction for medical expenses may also be reduced, and qualifying residence interest (e.g., mortgage or home equity loan interest) can only be deducted to the extent the loan proceeds are used to purchase, construct, or improve a principal residence.
- Special AMT treatment applies to the exercise of incentive stock options (ISOs) and to the treatment of certain depreciation deductions.



### AMT exemption amounts

While the AMT takes away personal exemptions and a number of deductions, it substitutes a specific AMT exemption amount. The AMT exemption amount that you're entitled to depends on your filing status and income (AMT exemption amounts are phased out for individuals with higher incomes). A patchwork of legislation since 2001 has, along with other AMT provisions, pumped up AMT exemption amounts to stave off a spike in the number of taxpayers caught in the AMT "net." The bad news, though, is that the last legislative patch expired at the end of 2006. Unless Congress passes new legislation, 2007 AMT exemption amounts return to pre-2001 levels, and the number of taxpayers subject to AMT is expected to skyrocket.

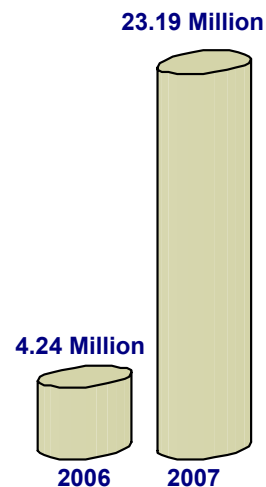
### Legislative outlook

Several bills have been introduced in the current Congress relating to the AMT. Proposals range from another one-year patch to full repeal. The problem with repealing the AMT is that it would leave a significant revenue gap (the Joint Committee on Taxation projects that the AMT will account for almost \$25 billion in revenue for the 2006 tax year). That means we're more likely to see another short-term fix than we are to see substantive reform.

### Summing up

Owing AMT can be an unpleasant surprise. It also turns a number of traditional tax planning strategies (e.g., accelerating deductions) on their heads, so it's a good idea to factor in the AMT before the end of the year, while there's still time to plan. If you think you might be subject to the AMT, it's worth sitting down to discuss your situation with a tax professional.

### How Many Taxpayers Will Be Affected by the AMT?



*Projection by the Joint Committee on Taxation, March 5, 2007*



The accompanying pages have been developed by an independent third party. Commonwealth Financial Network is not responsible for their content and does not guarantee their accuracy or completeness, and they should not be relied upon as such. These materials are general in nature and do not address your specific situation. For your specific investment needs, please discuss your individual circumstances with your representative. Commonwealth does not provide tax or legal advice, and nothing in the accompanying pages should be construed as specific tax or legal advice. Securities and advisory services offered through Commonwealth Financial Network, member FINRA/SIPC, a Registered Investment Advisor

## Ask the Experts



### **My home is worth a lot more than I originally paid for it. Does this affect my homeowners insurance?**

If your policy limits have not increased since you purchased your home, there's a good chance that you're now underinsured. However, it's not necessarily because the market value of your home has risen, but rather because construction costs have gone up.

For insurance purposes, the cost to rebuild your home is what counts, and that's probably very different than what you paid for your home, or how much you would pocket if you sold it today. For example, while the market value of your home includes the land it's built on, the rebuilding cost does not. On the other hand, if your home has features that would be expensive to replicate, is built of materials whose cost has skyrocketed, or is located in an area where labor costs are high, the market value of your home may actually be lower than the cost to rebuild it.

It's important to review your homeowners coverage with your insurer at least once a year. You should also call your insurance representative whenever you remodel your home or buy expensive items.

Although it's ultimately up to you to make sure you have adequate homeowners insurance, your insurance representative can help you estimate the cost of rebuilding your home, using information about construction costs in your area. Be prepared to answer questions about your home's features and square footage to help determine proper coverage limits.

And ask about adding an inflation guard clause to your policy (if available). An inflation guard automatically adjusts your policy limits over time to keep up with changing construction costs. Although you'll still want to review your homeowners coverage periodically, an inflation guard can help keep you from becoming significantly underinsured.