

WEALTH MANAGEMENT ADVISOR

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Is it time to sell?

Knowing when to get rid of a security requires strategy

Selling is essentially a negative decision — in a sense, it's turning our backs on an investment we formerly liked. So if an investment is doing well, the tendency is to want to stick with it to see if it does even better. If the investment is doing poorly, the inclination is to hang on until it's back to breakeven.

Both of these scenarios can turn out badly. In the first case, what if, instead of continuing to rise, the security's price begins to fall, perhaps even sinking below your original buy level? And hanging on to a loser until it returns to breakeven can be a dangerous game. So when is the right time to sell?

Reasons to say goodbye

Selling on a hunch generally isn't a good idea. What are the alternatives? In truth, most investors are better off not buying and selling frequently. For a long-term investor, there may be only a few reasons that would justify selling.

Perhaps the most clear-cut reason to sell a security occurs when the fundamental condition of a

company deteriorates. For instance, think about cell phone manufacturers.

Some previously successful companies fell behind in the smartphone race, losing significant market share. If you hold stock in such a company, you may still like its performance prospects — especially at a lower per share price. But you need to consider the company's changed competitive position when deciding whether to continue owning the stock.

Alternatively, some investors focus on stocks with increasing dividends. If a company suddenly stops boosting its dividend, that would be a warning sign. In such cases, the original reasons you bought the security no longer hold true.

An analogous situation can occur with mutual funds. Suppose you buy a fund to take advantage of a particular manager's expertise. If that manager leaves, and it's unclear how much continuity there will be when the new manager takes over, it might be time to jettison the position. That said, don't pull the trigger until you find out the details of the change. Some funds have a team approach and a relatively stable management philosophy.

Rebalancing your portfolio

Another reason to sell might be to rebalance your portfolio. For example, suppose you've settled on an asset allocation of 60% stocks and 40% bonds. If the stock



market advances smartly, pushing your allocation to 65% stocks and 35% bonds, your portfolio is now riskier than it was.

So you might want to sell some stocks and increase exposure to bonds to rebalance and get your allocation back to 60%/40%. Keep in mind, though, that in taxable accounts you benefit from a more favorable tax treatment of gains if you've held the investment for more than a year.

Seek advice before making a move

Selling securities should be done only after careful analysis. Your financial advisor can help you determine whether you should consider selling a particular security whose prospects may have changed or, if you need to sell some investments to achieve other goals, which securities are the best candidates. ■

Selling in tax-deferred vs. taxable accounts

Because of their tax-favored status, retirement accounts provide more flexibility in rebalancing your investments. A good rule of thumb with such an account is to rebalance once a year, using some combination of purchases (with new funds from annual contributions) and sales to bring your portfolio back to your target allocation.

Rebalancing in taxable accounts can be more difficult because of the tax liability created by selling profitable positions. If capital gains will be substantial, consider waiting until you can combine rebalancing with fund flows that might be occurring for other reasons.

For example, say you need cash from your investments to pay for your child's college tuition. If at the moment your portfolio is heavy on stocks relative to your target allocation, try to coordinate your selling so that you bring down the stock percentage in your portfolio.

The art of estate planning

Address your art collection using proper techniques

Even in a soft economy, paintings, sculptures and other pieces of fine art typically retain their value. If you own a valuable art collection, it's vital that you consider these assets in your estate plan.

Unique challenges

You can use traditional estate planning techniques to address your collection in your plan, but art can present a few unique challenges. A fundamental principle of estate planning is to remove appreciating assets from your estate

as early as possible to minimize gift and estate taxes. But art typically is more than just an investment, because most collectors wish to enjoy displaying these works in their homes and may be reluctant to part with them.

There are ways to ease the process of incorporating your collection into your estate plan:

Have your collection appraised. Regular qualified appraisals give you an understanding of how your collection is appreciating and can help you avoid unpleasant tax surprises. When you



Ask the IRS for an advance ruling. For transfers of art collections containing at least one item valued at \$50,000 or more, you can eliminate uncertainty over whether the IRS will accept your valuation by asking the agency for an advance ruling. You must make the request after you transfer the property and attach copies of IRS Form 8283 (“Noncash Charitable Contributions”) and a qualified appraisal to the request. The fee for obtaining an advance ruling is \$2,500 for the first three items and \$250 for each additional item.

donate, gift or bequeath artwork, a qualified appraisal can be a necessity:

- To support a charitable income tax deduction for art valued at more than \$5,000, you’ll need to include a qualified appraisal with your return.
- For gift tax purposes, the statute of limitations within which the IRS can challenge the valuation of a gift doesn’t begin until you adequately disclose the gift on a gift tax return. A qualified written appraisal is usually the best way to comply with this disclosure requirement.
- For estate tax purposes, an appraisal must be attached to your return for any items worth more than \$3,000 or for a collection of similar items worth more than \$10,000.

Most important, a valuation by a qualified appraiser will help substantiate an item’s value in the event of an IRS challenge, protecting you from back taxes and undervaluation penalties. Auditors are required to refer all gifts of art valued at \$20,000 or more to the IRS Art Advisory Panel, and the panel’s findings typically become the IRS’s official position on the art’s value. It’s to your advantage to provide the panel with the evidence it needs to make an informed decision.

Consider donating to charity. As with other assets you’ve held for more than a year, donating highly appreciated art to charity not only can provide a substantial income or estate tax deduction, but also allow you to avoid capital gains taxes.

Keep in mind, though, that the amount of your income tax deduction depends on whether the donation is related to the organization’s charitable purpose. If it is — for example, if you donate a painting for display at a tax-exempt art museum — you can deduct the art’s fair market value, up to 30% of your adjusted gross income (AGI). Deductions that exceed AGI limits can be carried forward for up to five years.

If donated art isn’t related to the organization’s charitable purpose — for example, if the museum sells the painting and uses the proceeds for operating expenses — your deduction is limited to your cost basis (but up to 50% of your AGI).

Give away a fraction. If you’re not ready to give up a piece of artwork, consider donating an undivided fractional interest to a museum or other charitable organization. For example, if you own a painting worth \$1.2 million and

you donate a one-twelfth interest to the local art museum, the museum gains the right to display the painting for one month of every year. You retain the right to enjoy the painting for the rest of the year and receive a \$100,000 charitable income tax deduction.

Bequeath to family members. If you decide to keep your collection in the family, it's best to make specific bequests. If you leave art to your heirs through residual gifts (that is, whatever is left in your estate after paying debts, expenses, and specific gifts), they may also inherit some unexpected income taxes. Specific gifts will also minimize conflict among your beneficiaries over who gets what.

A valuation by a qualified appraiser will help substantiate an item's value in the event of an IRS challenge, protecting you from back taxes and undervaluation penalties.

A beautiful picture

If you have a sizable art collection, it's important that your estate plan address it. With proper planning and regular appraisals, you may realize tax benefits while continuing to enjoy your collection. Of course, before you decide to take any action, be sure to consult with your own tax or legal advisor regarding your specific situation. ■

The tax lay of the land

Familiarize yourself with a new state's tax laws

Justin is purchasing a second home in another state to be closer to a sick family member. His employer, a major software developer, has no issues with allowing him to work out of his new home as needed, but Justin still expects to spend time during the year in his old home.

With much on his mind, Justin was surprised to receive a call from his tax advisor, who wanted to inform Justin about his new state's tax laws and the need to establish a domicile.

Learn the new laws

Each state has its own tax laws — some more favorable than others. In fact, some people move to a specific state solely because that state doesn't have an income tax or offers lower rates or other tax advantages.

In Justin's case, he's moving to be nearer his family during a time of crisis, so taxes aren't top

of mind. However, because he'll spend time, earn income and own property in the state and he has a significant investment portfolio, he needs to know whether his new state has income, property, sales and estate tax. In addition, he needs to be aware of other tax differences. For example, some states have an income tax but don't tax interest and dividends.

Determine your domicile

Because Justin will own homes in two states and plans to spend relatively similar amounts of time in both homes, he must establish his legal domicile. What this means is that he must choose which state he intends to make his "true, fixed and permanent" home and then take steps to support that choice. Justin's established domicile will determine which state's jurisdiction he'll be subject to in terms of state income and estate taxes.

Even though Justin will be a resident of two states, he can have only one domicile. So what are the deciding factors? A state's taxing authority determines domicile based on factors that demonstrate intent, such as:

- The amount of personal time Justin spends in the state,
- The amount of business he conducts in the state,
- The value of his property in the state, and
- Whether a stay in one state is expected to be merely temporary.

These factors are subjective, and more than one state can claim that Justin's domicile is in its state. With many states strapped for cash, this may be the case more times than not.

Clarify intent

To avoid becoming caught in a state taxing authority skirmish, Justin needs to make his domicile intentions clear. Relatively simple and controllable steps he can take include maintaining a driver's license in the domicile state, registering and voting in the domicile state, and using his home address in the domicile state for important documents, such as insurance policies, living trusts and power of attorney.

A few more-involved (and more-critical) steps Justin can take to establish domicile include physically spending more time in the domicile state and keeping records that he's done so, filing a declaration of domicile in that state, and maintaining bank and brokerage accounts in that state — and *not* holding such accounts in the other state.

After his domicile has been determined, Justin may still be subject to tax in the other state if he earned income working, or owned a business or a rental property, in that state. If so, he may be entitled to a credit in his domicile state for taxes paid to another state.



Proactively seek tax advice

With Justin's thoughts focused on his home purchase and his sick relative, he's thankful his tax advisor contacted him to explain the tax consequences of owning a home and spending significant time in a new state. If you're considering making a similar move, be sure to discuss domicile issues with your tax advisor. ■

Gain financial flexibility with a savings plan

If you've achieved some measure of earning power, you might be inclined to think that saving will somehow take care of itself. That would be a mistake. To start with, there's no telling when you might be blindsided by an unexpected turn of events, such as a job loss or an extended illness, that could quickly empty your bank account.

Consequently, the smartest strategy is to begin saving as much as you can, as early as you can. Doing so can grant you peace of mind and financial flexibility.

Emergency fund

One of your first priorities as a saver should be to build an emergency fund. Opinions differ

over how large an emergency fund should be, but three to six months of living expenses is a popular rule of thumb.

Keep this money in safe, liquid assets such as cash and cash equivalents. You don't want to lose your job and then learn that your emergency fund has lost a portion of its value because you invested it in stocks or other securities that are experiencing a downturn.

Using time in your favor

There are advantages to getting started early with a savings plan beyond being financially prepared to handle emergencies. Accumulating a retirement nest egg is easier when you allow your investments to compound over a longer period of time.

Jump-start your savings program

Regardless of your age, it's never too late to implement a savings strategy. The most important thing is to get started. Here are some ideas:

- If you and your spouse both earn a salary, consider saving part or all of the lesser of your two incomes while using the greater income to pay expenses.
- Automate your savings: Sign up for your employer's 401(k) plan so that part of your paycheck automatically is deposited in your retirement account.
- If you receive a salary increase, earmark part or all of it for savings. You won't miss money you're not used to receiving. Likewise, if you inherit money, a portion of it should go toward savings; don't use it up buying a new "toy" such as an expensive sports car.

The most important theme here is probably one you've heard before: Pay yourself first. Many



people fall into the trap of allocating money for bills and discretionary spending *before* attempting to set some aside for savings. Not surprisingly, there's often nothing left to save.

This can be true for affluent and less-fortunate individuals alike. Some high earners are especially poor savers because they've never had to develop the habit.

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Begin saving today!

If you haven't implemented a savings plan, *now* is the time to make the initial effort. The financial flexibility you'll enjoy is a gift that can carry you through tough times and move you closer to your goals. Your advisor can assist you on this path with ideas and encouragement, so don't hesitate to ask for help. ■