

Go Green and Reduce Your Taxes

It's a Family Act



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Most of us probably won't install solar powered hot water heaters this year, but here are a few ways to reduce your taxes while doing some routine home maintenance and repair work. The total lifetime credit is limited to \$500, and all expenses must be for your principal residence. The expenses must be incurred by the end of 2007, so if you have been postponing replacing the furnace, now's the time to move it to the top of your to-do list. Retain all of your receipts for supplies, material, labor and equipment, as well as any documentation from the manufacturer as to energy ratings/efficiency to substantiate your credit. (You can rely on the manufacturers' certification for everything but siding.)

You can claim a credit for 10% of the cost of energy efficient building envelope components (siding, exterior windows, exterior doors, and special metal roofs). The components must be expected to last at least 5 years (this is satisfied if the manufacturer offers a 2 year warranty) and only \$300 of the credit can be from windows.

A credit may also be claimed for other energy efficient property expenses, including the cost of labor for installation and preparation, as follows: up to \$300 for energy efficient central air, electric heat pumps or electric water heaters, natural gas or propane or oil water heaters, and geothermal heat pumps; \$150 for natural gas, propane, or oil furnaces or hot water boilers; and \$50 for advanced main air circulating fans.

So for example, if you spend \$7,000 on energy efficient windows, \$500 on an energy efficient door, and \$3,000 on an energy efficient natural gas furnace you would be able to claim the following credit: \$300 for the windows (10% would be \$700, but windows are limited to \$300), \$50 for the door (10% of \$500), \$150 for the furnace.

There is a second type of credit available to individuals using advanced energy efficient technology, including photovoltaic property (solar generated electricity), solar water heating systems, and fuel cell systems. The maximum total credit (if you were to install all three technologies) is \$4,500. If you think you may be interested in these technologies/credits, please let me know and I would be happy to send you more information.

If "all the world's a stage," and we each have our exits and entrances as Shakespeare proposed in *As You Like It*, then family-based investing might be compared to a three-part production.

- **Act One:** We are young investors, with much to learn, but time is on our side. Our definition of financial "success" is usually vague.
- **Act Two:** We are typically at the peak of our earning power even as our investment horizon shortens. We have thought about what it will take to achieve financial independence and sought advice to pursue our goals.
- **Act Three:** We have achieved financial independence. We now require specialized expertise on how to move from accumulation to withdrawal and wealth transfer.

Of course transition from one act to the next is rarely so consistent or obvious. But it can be helpful to consider some of the distinct challenges and opportunities we typically encounter along the way.

Recognizing these types of milestones is helpful in pursuing your own investment objectives. It becomes even more important if you also seek to build a multigenerational wealth strategy to span your immediate or extended family's long-term goals.

What are some of the characteristics for each generation of investor? How do they impact individual investment decisions? How can family discussions and planning maximize efficient wealth accumulation, enhancement and transfer among and across generations?

In this issue of *The Educated Investor*, we address these questions as we focus on investing across generations.

Act One — The Young Investor



Setting the stage

The biggest advantage of youthful saving and investing is being able to maximize the “snowball” effect of compounding during your long investment horizon — the ability to earn on your reinvested earnings. The rewards of starting young, even with modest amounts should not be underestimated.

Facing adversity

Saving when you are young can be difficult. Earned income is often minimal. Paying off college debt, purchasing a first home, starting a family — these and other more immediate goals make it difficult to set aside funds reserved for future wealth. In addition, a clear understanding of how to build wealth may not yet have formed.

Wealth strategies

- **Become better educated.** Consider some of the resources below. If possible, seek the advice of a fee-only registered investment advisor who espouses construction of low-cost, passively managed portfolios according to a disciplined investment strategy.
- **Develop a plan.** Determine how much you expect to save each month. By saving first and then spending what’s left, you’re less likely to miss what you’re setting aside. As part of your spending budget, include a cushion for emergencies, so your savings aren’t depleted by the inevitable unforeseen circumstances.
- **Start saving.** Find even small expenses you can eliminate. If you receive “found money,” (tax refunds, gifts, bonuses) save at least a portion. Familiarize yourself with your company’s retirement plan and take maximum advantage of it.
- **Move from saving to diversified, low-cost investing.** Investments are expected to earn more than savings and more than inflation, but you also risk losing some or all of your money. Diversification is a key ingredient to help minimize (not eliminate) the risk involved. Keeping costs low also helps maximize expected returns.
- **Plan as a family.** Participate in family meetings to discuss generational wealth strategies.

Additional resources for the Young Investor

- AICPA, 360 Degrees of Financial Literacy: www.360financialliteracy.org/
- *Worth*, “Teach Your Children Well,” an interview with Jamie Johnson, 24-year-old heir to the Johnson & Johnson fortune: www.worth.com. Search for “Jamie Johnson”.

Act Two — The Mid-Life Investor



Setting the stage

If you have managed to invest during your early years, act two of your investment performance should give your family portfolio a chance to shine. Your investment horizon remains relatively long. Your capacity for earned income grows. Wealth from parents, grandparents or other family members may be transitioning to you for stewardship. You may have increased opportunities to invest in company retirement plans as well as increased access to investment or wealth advisors. By now, you’ve probably selected your personal measurement of financial independence: what your portfolio size needs to be for you to feel like you could stop working whenever you wish, and still achieve your and your family’s objectives.

Facing adversity

Time. That pretty much sums it up. As the sandwich generation, you may find your time and energy divided among at least children and parents, if not an extended family, one or more careers, and philanthropic or community responsibilities. If you are accustomed to your spouse managing the family wealth while you focus on other priorities, you may be unsure how to proceed if you are required to assume the role.

Wealth strategies

- **Continue or start an investment plan.** If you already have a written investment policy, you’re one step ahead. But do revisit it periodically to ensure it still reflects your long-term goals and appropriate risk tolerances (your ability, need, and willingness to take on investment risk).

- **Continue or start to invest.** If possible, work with an investment advisor as described above. He or she can ensure that your assets are allocated to ensure proper diversification and located for maximum tax efficiency.
- **Continue your education.** In most cases, one spouse or partner tends to be the one to deal with family finances. While this may be the most practical day to day approach, each of the members of your immediate family should have an understanding of at least the initial steps he or she would take to assume the lead, such as how to contact your family's trusted advisor(s), and the location of your assets and key planning documents.
- **Initiate estate planning.** If you wish to transition your wealth to future generations and/or leave a charitable legacy, tools such as trusts, wills, living wills and durable powers of attorney should be prepared to reflect your goals.
- **Initiate risk management planning.** Risk management tools, such as life and long-term care insurance, can bridge the gap between your current wealth and how much you would need if unforeseen circumstances prevented you from achieving your goals.
- **Initiate vital dialogue.** Regular, carefully planned family meetings can move your wealth strategies beyond your immediate investment horizon and into the higher level of tax and investment efficiency made possible with multigenerational planning. As described by James E. Hughes Jr. in his book, *Family Wealth*, "Family stories are the glue that binds together individual family members. Every family I know that is successfully preserving its wealth sets aside time at its family gatherings for the sharing of its unique history. Both young and old tell the stories and in this way discover their common bonds and values."

Additional resources for the Mid-Life Investor

- *Family Wealth*, James E. Hughes Jr. Copyright 2004, Bloomberg Press.
- *Preparing Heirs*, Roy O. Williams and Vic Preisser. Copyright 2003, Robert D. Reed Publishers.
- *The Only Guide to a Winning Investment Strategy You'll Ever Need*, Larry E. Swedroe. Copyright 2005, St. Martin's Press.
- TIAA-CREF, "Charting Your Course: A Financial Guide for Women," www.tiaa-cref.org/pubs/pdf/take_charge.pdf.

Act Three — The Retiring Investor



Setting the stage

You have now reached your personal goals for financial independence and are ready to retire. That does not mean your journey is ended; it is merely shifting to exciting new directions where your opportunities, if anything, broaden.

Facing adversity

Many traditional benefit systems (Social Security, Medicare and pension plans) are eroding, even as health care and long-term care demands and costs are on the rise. Broad economic trends aside, you also face entirely new challenges within your investment portfolio. You may be an expert by now at putting assets in. But are you prepared to begin taking them out?

Wealth strategies

- **Plan for your retirement.** Consult with your advisor on how and when you hope to achieve your financial independence. You can use initial and ongoing Monte Carlo analysis to help you form and maintain realistic goals. As your goals shift, your portfolio allocation may also need to be reconsidered, potentially tilted toward protecting your assets rather than amassing more.
- **Plan for efficient wealth transfer.** If your wealth is divided among generations within your family, ensure that each portfolio is allocated properly for each generation's risk tolerances. If you transfer wealth from one generation to the next, ensure allocations shift accordingly and tax-deferred accounts are handled properly. To maximize the value and efficiency of your charitable gifts, the timing, amount and method of donation should be carefully planned.
- **Revisit risk management options.** Upon achieving financial independence, your risk management needs shift from filling the gap (now that you've already crossed it) to playing a key role in protecting against excessive withdrawal, estate tax management and related concerns. (*con't on page 4*)

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- **Finalize and share your wealth transfer objectives.** Openly discussed estate planning and risk management can make it easier for beneficiaries to form their own plans, help maximize tax efficiency during wealth transfer, and help protect hard-earned wealth while fostering your own worry-free retirement.

Additional resources for the Retiring Investor

- *The Birth of Plenty*, William Bernstein. Copyright 2004, McGraw-Hill.
- *Worth*, "100 Year Plan Introduction: Making Meaning of Wealth Across Generations," first of a multi-part series: www.worth.com (search for "100 Year Plan Introduction").
- *The MetLife Market Survey of Nursing Home and Home Care Costs*, September 2006. Search for "What's New?" in the MetLife Mature Market Institute® at www.metlife.com.

Founder's Day - November 22, 2006 - St. Michael's Church, Providence RI



For almost 20 years, the members of LGC&D have volunteered at St. Michael's Church on the day before Thanksgiving, helping to prepare a Thanksgiving meal for those less fortunate. Can you spot Jerry Dorfman there in the back row?

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- Fee-only investment management
- A disciplined investment strategy
- Access to institutional no-load passive asset class funds
- Fixed income expertise
- An investment approach based on research by Nobel Prize-winning economists
- Continued access to academic research
- A tax-efficient focus, with valuable tax and estate-planning ideas
- Risk tolerance assessment
- Periodic portfolio rebalancing
- Regular communications and state-of-the-art reporting

MOST IMPORTANT... A TRUSTED ADVISOR RELATIONSHIP



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