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THIS ISSUE...

The Fiduciary Standard and Why It Should Be Important To You

by William H. Noble

Noted *Wall Street Journal* author, Jonathan Clements, recently wrote an article discussing the key rules people should follow when hiring a financial advisor, including the differences between the brokerage industry's "suitability standard of care" vs. the "fiduciary standard of care." Here are a few of Mr.. Clements's quotes and our firm's comments on how they affect you and our business:

>> **Mr. Clements**: "Many advisors earn their keep by collecting commissions on the investments they sell. That means they have an incentive to get clients to trade and to buy the highest commission products. We are not arguing that these advisors are always hell-bent on squeezing the maximum commission out of their clients. Buy why risk it? Your best bet: Use fee-only advisors, such as those who charge an hourly fee, a percentage of your portfolio's value or a fixed annual retainer."

Trust Company's comments: *We agree wholeheartedly. We are compensated exclusively from fully disclosed client fees, with no sales commissions, thereby allowing us to work in our clients' best interest and solely for them.*

>> **Mr. Clements**: "Advisors don't necessarily act in their clients' best interest. This issue has been brought into sharp relief by the heated debate over the Securities and Exchange Commission's so-called Merrill Lynch rule. Under the rule, fee-based advisors at brokerage firms often *aren't considered fiduciaries,* meaning they are supposed to recommend products that are best for their clients. Instead, they are held to a lower "suitability" standard, which means they are only required to recommend products that are a reasonable choice for their customers. To protect yourself, avoid advisors who won't commit to acting as a fiduciary."

Trust Company's comments: *By definition, a fiduciary is required by law to act in their clients' best interest. Why would you want to work with anybody who would not commit to serving anyone in that capacity? At The Trust Company of the South, we are a chartered fiduciary and take that role very seriously.*

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NOTABLE QUOTE

"Price is what you pay, value is what you get."

Warren Buffett

The Trust Company of the South is a fee-only independent trust company and financial planning firm focused on serving the needs of affluent individuals, families, and non-profit institutions.

Trust Company of the South...because wealth management is more than managing money

Summertime Tax Musings

by John H. Slayton, JD, LLM-TAX, CFP®

Whether you find yourself on the beach basking in the sun or hiking in the mountains this summer, rest assured that our elected representatives in Washington have been, and continue to be, hard at work creating new and interesting tax rules to entertain all of us and guarantee gainful employment for our tax advisors. We will look at recently passed and currently pending legislation (that may already be finalized before you read this), and focus on an old favorite that will require all of our attention.

TIPRA

The Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA") was signed by President Bush on May 17, 2006. Of interest to individual taxpayers, TIPRA:

>> Extends the current 15% maximum rate on qualified dividends and long-term capital gains through 2010;

>> Extends favorable small business expensing of acquired assets through 2009;

>> Increases the age, from 14 to 18, under which the "kiddie tax" provisions apply -- no income shifting to children under age 18;

>> Eliminates the $100,000 adjusted gross income ("AGI") limit on conversions of Traditional IRAs to Roth IRAs after 2009. Tax on 2010 conversions can be paid in 2011 and 2012; and

>> Provides a one-year (2006 only) increase in the alternative minimum tax ("AMT") exemption, to $62,550 for married couples. More on AMT below.

Pending Tax Matters

Hopefully as you read this, Congress has already wrapped up action on two top tax priorities – **estate tax "compromise" legislation and a pension reform conference report.** Following the failure of full estate tax repeal legislation in the Senate in early June, negotiations are under way for a "bipartisan" compromise that can get 60 votes in the Senate and move swiftly through the House. Parameters under discussion include exemptions up to $5 million per person and rates up to 30-35%, depending on the size of the estate. Currently, the estate tax is scheduled to phase out until complete repeal in 2010. However, in 2011 and beyond, the tax will return to the 2001 levels, with an exemption level of $1 million and a rate as high as 60%. Clearly, something must be done.

Congressional conferees are negotiating broad pension funding and management reforms, but the pension bill is expected to also include several tax cut extensions (state and local sales tax deduction and the research credit) that did not fit into TIPRA, but expired at the end of 2005. Also included may be provisions enhancing charitable contribution deductions, such as the direct IRA contribution and the non-itemizer charitable deduction.

Certainly this is a busy time for tax legislation, but it is worthwhile to revisit a favorite matter that we have discussed previously on these pages, but merits further close attention.

AMT Planning

The Alternative Minimum Tax ("AMT"), fondly known as the "Awfully Mean Tax" or the "Accelerated Migraine Tax" by its aficionados, was created in 1969 to prevent the rich from enjoying so many tax breaks that they ended up paying no tax at all. Unfortunately, AMT limits and exemptions were not indexed for inflation, and the AMT has become "not so alternative and not so minimum." Experts predict that, barring a correction to the system, over one-third of all taxpayers could owe AMT in 2010.

The AMT is a fully separate, parallel, tax system, lurking in the shadows next to the regular income tax system. Calculating income tax payable takes two fully separate procedures. First, the regular tax must be calculated, taking into account all applicable deductions and exclusions. Then, the AMT must be calculated, eliminating various deductions and adding back certain excluded income. The actual tax owed is the higher of the regular tax or the AMT. Let us review the numbers:

>> The highest federal regular income tax rate is 35%, while AMT rates are 26% or 28%. Although the rates are lower, the amount of income subject to AMT (known as AMTI) can be significantly higher than the income subject to the regular tax.

>> TIPRA increased the AMT exemption for a married couple to $62,550 for 2006, but this exemption begins to phase out for couples at $150,000 of AMTI.

AMT planning requires multiple year tax projections. Many taxpayers find themselves in AMT in some years, but not in others. As AMT rates are lower than regular tax rates, it generally makes sense to accelerate income into AMT years and delay non-AMT deductions to regular tax years. This turns conventional tax planning on its head.

Key AMT triggers include:

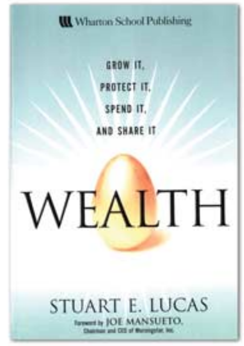
>> Living in a state with high income, property or sales taxes
>> Claiming many personal exemptions (children)
>> Claiming big miscellaneous deductions
>> Recognizing large capital gains (that are subject to a low rate of 15% under both regular tax and AMT), thereby lowering the regular tax bill while increasing AMTI above AMT exemptions and making AMT higher than regular tax
>> Receipt of tax-free interest from private activity municipal bonds (stadiums)
>> Exercising incentive stock options (ISOs)
>> Incurring large medical expenses (the AMT threshold for deductibility is 10%, rather than 7.5%)
>> Deducting home equity debt interest not used to acquire or improve your house

Assuming that Congress is unable to replace the tax revenue from AMT, estimated over the next decade to be between $600 billion and $1.2 trillion, what can we do to alleviate the pain and suffering of its continuing?

>> Initially, consult with a tax expert, with appropriate AMT planning software, to determine if you will be subject to AMT in the current year or the next few years.
>> If you are going to be subject to AMT, normal tax planning rules are reversed. Non-AMT deductions are worthless, and any AMTI is taxed at a flat 26% or 28% rate, rather than up to 35%. If this will raise your AMTI above exemption levels, however, you might instead decide to defer it. These calculations cannot be made in your head. Computer projections will be required to determine crossover points for the correct plan.
>> Work as an independent contractor rather than as an employee. Deduct expenses on Schedule C rather than as employee business expenses subject to the 2% of AGI floor on Schedule A.
>> Spread the exercise of ISOs out over several tax years.
>> Use your home equity loan only for home improvements, not college education expenses or purchase of an automobile.
>> Defer deductions to a non-AMT year.
>> Arrange for college-age children, with modest taxable income, to file their own tax returns, claiming their own personal exemption – it is of no value to you.
>> Do not buy private activity municipal bonds.
>> Time your capital gains.

Above all, maintain your sense of humor and do not let tax anxiety ruin your summer pursuits – feel patriotic as you pay your AMT.

BOOK REVIEW



Wealth: Grow It, Protect It, Spend It, and Share It

By Stuart E. Lucas

Most of our valued clients have heard me or my colleagues use the term "helping you to connect the dots" at some point during our discussions and this is exactly what I believe Stuart E. Lucas has done in his book, *Wealth: Grow It, Protect It, Spend It and Share It.*

Mr. Lucas delivers sage and thoughtful perspective on not only preserving and growing one's wealth, but straight talk about how to transfer values, like community service, entrepreneurship, and fiscal prudence from one generation to the next.

Mr. Lucas is uniquely qualified to provide his insights in that he is an heir to the Carnation Company family fortune (best known for Carnation evaporated milk and Friskees cat food) and also has been a practicing wealth manager for Wellington Management Company not to mention that he is a Harvard MBA.

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Behind the Scenes at Trust Company of the South

>> **Bill Smith** was recently named as a Director of the Burlington Downtown Corporation *(a revitalization organization for downtown Burlington, North Carolina).*

>> **John Slayton** and **Bill Noble** attended the North Carolina Trust & Estate Planning Conference sponsored by the N.C. Bar Association.

>> **Bill Noble** was recently elected as treasurer of the Investment Committee for the Nash Community College Foundation.

>> **Brandon Cook** and **Catie Iber** successfully completed the Cannon School for securities operations.

>> **Mike Palmer** and **Jill Johnson** recently attended the National Association of Personal Financial Advisors Conference (NAPFA) in Dallas, Texas.

Fiduciary Standard, continued from cover

>> **Mr. Clements**: "Many advisors offer investment advice and that's it. But there is much more to managing money than picking stocks and mutual funds. You might also want help with your mortgage, college costs, insurance, taxes and estate planning. If so, before you sign on with an advisor, make sure the advisor is committed to assisting you with these other areas."

Trust Company's comments: *Mr. Clements seems to have read our tagline "Because wealth management is more than managing money." We place significant emphasis on comprehensive financial planning – "connecting the dots" into a thoughtful, well-crafted blueprint that will help you meet all of your life and financial objectives.*

In closing, as a fee-only *fiduciary*, we will always be honest with you, even if it isn't what you want to hear. It is the core of our commitment to you, our client. A financial relationship should be built upon mutual trust, but only a fiduciary relationship provides you with the highest degree of care and commitment…. Bottom line – Who would you rather work with?

THE TRUST COMPANY OF THE SOUTH

Raleigh Office

Michael H. Palmer, II CFP®
Principal
919 781.8287
mpalmer@tcts.com

Burlington Office

John H. Slayton, JD, CFP®
Principal
336 538.1000
jslayton@tcts.com

William H. Smith CFP®
Principal
336 538.1001
wsmith@tcts.com

Rocky Mount Office

William H. Noble
Principal
252 451.8728
bnoble@tcts.com

BOOK REVIEW, *cont'd*

From a structural perspective, the book takes potentially dull topics and injects them with humor and easy to read candor. *Wealth* is structured around his eight principles of strategic wealth management:

1. Take charge and do it early.
2. Ally family and business interests around wealth-building goals and strategies.
3. Create a culture of accountability.
4. Capitalize on your family's combined resources.
5. Delegate, enable and respect independence.
6. Diversify but focus.
7. When possible, err on the side of simplicity.
8. Develop future family leaders with strong wealth management skills.

Whether it involves thinking about tax strategies, charitable bequests, children's values or investment management issues, Mr. Lucas evaluates every decision he makes based on these principles. Whether you are building your wealth or in the preservation mode, the book does a solid job of soul-searching and addressing the sometimes difficult family discussions and other related complexities of managing one's wealth.

As Mr. Lucas himself has been quoted, "Wealth without values is just money." This author believes that this is an appropriate read for anyone who wants to get the most from their wealth and leave their own unique legacy, financial or otherwise, to his or her heirs.