



[the *compass*]

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## The Nifong Paradox – Why Smart People Make Flawed Decisions

by Mike Palmer, CFP®

One of the traits I think helps me excel in several aspects of my life is my attention on learning lessons from the experience of others. The Duke lacrosse case has offered up such lessons in spades, but the one that I've found most interesting is the series of decisions that led to Mike Nifong's fall from grace.

The issues and facts and the resulting decisions and judgments surrounding the Duke case are too numerous to address in this context. Suffice it to say much could be learned about poor decision making and the resulting consequences for everyone involved in the case. But at the center of the controversy is one man who was in position to handle a very difficult situation justly – and his abject failure to do so has irreparably damaged the lives of several people, including his own.

I believe the key ingredient in Mike Nifong's flawed decision-making was an absence of a "personal board of directors." Not a board of directors in the corporate sense, but in a professional sense. From everything I've read, it appears that Nifong is a very introverted person, and that power, ambition, and the media scrutiny of the Duke lacrosse case combined to create a toxic cocktail that Nifong was poorly equipped to handle. It appears he had no professional peer to serve as a "sounding board," no network of unbiased, trusted confidants and certainly no personal perspective or awareness that allowed him to see the opposing view. Had he had a person or persons in this unofficial role, I suspect the outcome would have been dramatically different and more favorable for all concerned.

The phrase, "personal board of directors," I stole from a friend. We were at lunch recently with two young men who are contemplating careers in banking. My friend described the importance of building this "board of directors" to help guide one's career. I realized that I'd unknowingly created my own "personal board of directors" – the members changing as my career progressed and depending on the nature of the issue at hand. In my opinion it is an invaluable navigation tool for a successful life.

Interestingly, not only do I have a board, I also serve on several. Twice in the last month

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### NOTABLE QUOTE

**"Don't find fault, find a remedy."**

**Henry Ford**

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.

## Your Taxes/Your Money

by John H. Slayton, JD, LL.M.-TAX, CFP®

As you relax this summer, consider a few tax planning thoughts:

- >> **Alternative Minimum Tax (AMT)** – You have read AMT bemusing on these pages before, but the author was “privileged” to join the estimated 4 million taxpayers who paid AMT in 2006 and therefore revisits the issue with renewed ardor. Barring Congressional action, 23.4 million taxpayers are estimated to pay AMT in 2007 and half of all taxpayers in 2010. After last year’s mid-term elections, the new Democratic Chairs of both the House and Senate tax committees boldly stated that repairing the AMT “could not wait.” The AMT, originally aimed at multi-millionaires who were not paying any income taxes, is essentially a second income tax code that takes away a number of tax deductions for people earning above a standard deduction (that was not indexed for inflation and ensnares an increasing pool of taxpayers) and then imposes either a 26% or 28% tax rate. The one year “patches” that Congress has implemented in recent years make effective planning to avoid AMT, a complicated multi-year exercise under the best of circumstances, nearly impossible. No sensible politician defends the current unintended impact of the AMT, but Congress has been unable to replace the \$40 to \$50 billion annual tax revenue AMT produces. The current Congress is unlikely to consider spending cuts out of the approximate \$2.9 trillion (\$2,900 billion) federal budget adequate to fund repair of the AMT. Changes in tax rules for private equity or hedge firms are being discussed, but this will not be enough (particularly if many firms flee to offshore tax havens to avoid any tax imposed). It is unlikely that significant tax increase legislation will be passed in 2008, an election year. Should Congress discipline itself to take permanent AMT curative action in the short term, the reader can be fairly assured that the price tag for any fix will be borne in large part by high bracket taxpayers, many of whom pay regular income taxes at so high a rate that they are not subject to AMT currently. *As the Boy Scouts say... Be Prepared!*
- >> **Charitable Giving** – Due to last year’s Pension Protection Act, effective January 1, 2007, charitable cash contributions of any size now require a written receipt from the charity or bank records (cancelled check) as substantiation. No more dropping cash into the basket at church and then deducting an assumed total at the end of the year. Further, you can deduct the value of household items or clothes you give to charity only if they are in good condition or better (although I am not sure how this will be handled on audit). The law also allows people age 70 1/2 and older to make distributions from their IRAs directly to a charity in 2006 and 2007. Provisions are pending to continue this rule indefinitely. You do not receive a charitable deduction, but you do not recognize the amount transferred out of your IRA as income, either.
- >> **Long-term Care Costs** – A client recently inquired as to the deductibility of long-term care costs. Qualified long-term care expenses may be tax-deductible if they are for diagnostic, preventive, treatment or rehabilitative services, or for personal care services prescribed by a licensed health care practitioner for a chronically ill person – one who is certified by a physician as needing significant assistance to perform at least two activities of daily living (bathing, dressing, feeding oneself or mobility) for a 90-day period. A person may also qualify if he/she has cognitive impairment and must be supervised. The taxpayer must itemize on Schedule A of Form 1040 to deduct medical expenses and can deduct only those expenses that exceed 7.5% of adjusted gross income. This level might not be insurmountable for an elderly person on a fixed income.
- >> **Taxes on Home Sale Profits** – Please remember that if you have lived in your house two of the last five years, no taxes are due on the first \$250,000 (\$500,000 for joint tax return filers) of profits on the sale of your house. If you have lived in your house less than two years, this amount can be prorated if you move more than 50 miles due to a change in employment or for other approved reasons. Also, the old rules still apply for profits above \$500,000. Gains can be reduced by increasing your cost basis for major home improvements and closing costs. Gains are taxed at short or long term capital gains rates, depending on the holding period.

Enjoy your summer. We will “sweat the small stuff” on your behalf.



# got kids?

by Mike Palmer, CFP®

**F**unding college education for children or grandchildren is becoming more expensive than ever. The remaining months of 2007 provide a window of opportunity that could save you thousands of dollars toward college expenses.

2008 changes in the kiddie tax may make it more advantageous to accelerate the recognition of income into 2007. Starting next year the kiddie tax will be expanded to include dependents younger than 19 and dependent full-time students younger than 24. Here's an example of a gifting technique that we recently recommended to a client.

Jane Smith, age 82, has three grandchildren in college. Jane owns some highly appreciated stock. By gifting \$12,000 worth of stock (with basis of \$6,000) to each grandchild the grandchildren can sell the stock this year and pay 5% capital gains rate, resulting in a combined tax savings of \$1,800.

Please be sure to check with your tax advisor before implementing any strategy.

## The Problem with Investment Newsletters

By William H. Noble

We at Trust Company hope that *The Compass* provides tangible information and thoughtful perspective to help you achieve your financial objectives.

There are other types of newsletters that focus on the opposite – that of “making you money” or how to “outperform the market”. Author Larry E. Swedroe recently documented in his book, *The Successful Investor Today*, the ineptitude and fallacy of these so-called market timing newsletters.

>> Mark Hulbert, publisher of *Hulbert's Financial Digest*, studied the performance of thirty-two of the portfolios of market-timing newsletters for the ten years ending in 1997. During this period, the S&P 500 Index was up over 18% per annum. He found that the timers' annual average returns ranged from 5.84% to 16.9%, that the average return was 10.09%, and that none of the market timers beat the market.

>> MoniResearch studied the performance of eighty-five market-timing managers with a total of \$10 billion under management. They found that the timers' annual average return ranged from 4.4% to 16.9%, that the average return was 11.04%, and that *none of the market timers beat the market.*

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## Behind the Scenes at Trust Company of the South

- >> **John Slayton** and **Mike Palmer** attended the North Carolina Bar Association annual conference on Estate Planning and Fiduciary Law.
- >> **John Slayton** was a featured speaker at the NC Bar conference, giving a presentation on modern fiduciary investing.
- >> **Catie Iber** made the National Dean's List. It's a competition for all universities and colleges throughout the United States and less than 1% of students make it. Congratulations, Catie!
- >> **Linda Paul** was recently commissioned as a "Stephen" Minister through her place of worship.
- >> **Bill Smith** recently visited Dimensional Funds Advisors' international office in London, England.

### Nifong Paradox, continued from cover

I've had calls from young people with whom I have friendships and/or business relationships. In both cases they'd been offered a new career opportunity and wanted my insight (along with others no doubt) that might help them make the best possible decision.

Confidence, assertiveness, and intelligence are all critical attributes to success, but like many things in life, when taken to an extreme, can become liabilities. To value others' insights, and to have your insights valued, breeds sound decision-making in all facets of life.

### NEWSLETTERS, cont'd

>> **Two researchers, from Duke University and the University of Utah, respectively, collaborated on a study examining the performance of the stock selections of 237 market timing newsletters over the period of June 1980 – December 1992. An investor holding an equally weighted portfolio of all the newsletters would have earned an 11.3% rate of return. This compared to the rate of return of 15.8% earned by an S&P Index fund. If the costs associated with the trading recommendations of these financial tout sheets were considered, the results would look even worse as transactions costs would have to be subtracted; the negative impact of the taxes generated by all of the trading activity would have to be considered; and, adding insult to injury, the cost of the newsletters themselves would have to be subtracted from returns. Perhaps most telling is that only 5.5% (13 of 237) of the newsletters survived the entire period. How would an investor, at the start of the period, have known which thirteen would survive?**



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