



## September 2009 Hot Topics

### Michael Jackson Left the Eccentricities Out of His Estate Plan

*Much has been made of the King of Pop's extravagant spending and lifestyle, which left him as much as \$500 million in debt.<sup>1</sup> But when it comes to estate planning, Jackson's moves were as smooth as his legendary moonwalk.*

"The Last Will of Michael Joseph Jackson" was executed in July 2002, shortly after the birth of his youngest child.<sup>2</sup> Under the terms of the will:

- Jackson's mother is named as guardian of his three children. In the event she is unable to care for the children, the duty would fall to singer Diana Ross, Jackson's longtime friend.<sup>3</sup>
- Three co-executors are named, including two recording industry executives and Jackson's accountant.<sup>4</sup>
- The Michael Jackson Family Trust was created to hold all of his assets.<sup>5</sup> Jackson's children, mother, and some unnamed charities are the trust beneficiaries. He also named contingent beneficiaries.<sup>6</sup>
- Jackson's former wife is specifically omitted from the estate.<sup>7</sup>

#### What Jackson Did Right

**He had a will and an estate plan.** Among the most important steps Jackson took was to prepare a will and an estate plan while he was still in his early forties. One of the reasons why Jackson's death at age 50 garnered so much attention was because it was unexpected. It's a reminder that death can strike anyone, at any time, regardless of age or financial status. If Jackson had died intestate, the custody of his children and the fate of his estate would be decided by state law via the courts. You can imagine the chaos that would have ensued as any number of people tried to make claims against the estate, opening the door for years of costly litigation. Of

<sup>1, 6, 8-9</sup> InvestmentNews, July 13, 2009

<sup>2-5, 7</sup> The Last Will of Michael Joseph Jackson, July 7, 2009

course, a well-crafted estate plan can't prevent challenges. Jackson's will and trust will inevitably be challenged because he was Michael Jackson, one of the most famous and successful entertainers of our age, whose estate could be worth \$500 million or more.<sup>8</sup> But he did much to ensure that his final wishes would be carried out.

**He updated his plan after the birth of a child.** Birth, divorce, death, the acquisition or disposition of titled property, and other major life events all create the need to review your estate plan in order to make certain there are no loose ends. Jackson went a step further and specifically omitted an ex-spouse in order to help remove a basis for her claims against assets that he intended for his chosen heirs.

**He chose apparently competent executors.** The person or persons who act as executor have to make decisions about money, pay bills, and possibly sell assets. It's a good idea to choose someone you know who will be able to execute these types of tasks in a manner that you would approve of. In Jackson's case, the business savvy of his executors could come in handy as his estate faces lawsuits and claims from his creditors. Jackson also split up the duties of managing the estate and caring for the children, which some experts say is a wise move. Both tasks could require considerable time and energy. Putting all that responsibility on a single pair of shoulders could increase the potential for mistakes.

**He set up a trust.** A trust offers many benefits, but one in particular that Jackson craved: privacy. Because his assets are in a revocable trust, their division is shielded from public view. By contrast, a will is a public document, offers no privacy, and is subject to court scrutiny. If there are challengers to the trust, a lack of information may make their cases more difficult to build. Jackson also provided that any estate taxes that would be due on any of his property that passes outside his will are to be paid by the takers of said property. Experts said this was wise because, if Jackson owned property with others as joint tenants, the property would pass to the partners without

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his heirs having to pay estate taxes.<sup>9</sup> The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional before implementing such strategies.

### Learn from His Mistakes

Not everything Jackson did was worth emulating. Here are some lessons we can learn from his mistakes.

**Tell someone where the estate documents are stored.** It was several days after Jackson's death before his will was located.<sup>10</sup> Even after it was found, there remained a question about whether Jackson had filed a subsequent will. If a family is unable to locate a will quickly, it can complicate or delay final arrangements, leave the family without adequate cash flow or key pieces of information, foster disagreements among survivors, and create a host of other unnecessary complications. One caveat: Don't store your estate documents in a safe-deposit box. It takes a court order to open one after the owner dies. It's a good idea to keep your estate documents in a fireproof box at home. Until you obtain one, storing your documents in an airtight bag in your freezer at home will help protect them from loss from a fire or flood.

**Explain your arrangements to those affected.** Jackson's strained relationship with his father has been tabloid fodder and may be one reason why Jackson didn't name him in the will. Jackson's mother, apparently at the behest of her husband, is reportedly contemplating a lawsuit challenging the executors' control of the trust.<sup>11</sup> Even if Mrs. Jackson's lawsuit fails, the estate could incur legal fees that consume wealth intended for the heirs. It's a good idea to share copies of your will with your family and explain how and why you arrived at decisions about the division of your estate. It could help avoid hurt feelings and fights because heirs may be less likely to contest your arrangements if they understand your motives.

**Name appropriate guardians for your children.** Jackson's 79-year-old mother will be 90 by the time his youngest child turns 18. Ross is 65, and there have been reports that she was unaware that Jackson had named her as a contingent guardian in the will.<sup>12,13</sup> Neither is a particularly good candidate to care for young children. It's a good idea to name guardians who will be

willing and able to give your children the care they will need to move on to happy, well-adjusted lives.

**A solid estate plan is not just for the rich or famous.** Putting the appropriate documents in place can help family members put their lives back together and potentially avoid costly financial problems.

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## Municipal Haste

*Are you concerned about the possibility that tax rates will go up? If so, there's plenty of evidence to support this notion.*

The administration has stated that it intends to raise tax rates on people with incomes in the highest tax brackets in order to finance programs such as health-care reform.<sup>14</sup>

The current top federal income tax rate of 35% is low by historical standards but is scheduled to revert to its original 39.6% rate after 2010. Meanwhile, the national debt is \$11 trillion and growing, and the federal government is facing more than \$40 trillion in unfunded entitlement obligations for Medicare and Social Security.<sup>15, 16</sup>

When you consider these staggering figures plus the hundreds of billions of dollars that the government is borrowing this year to help stimulate the economy, it becomes difficult to imagine a future in which tax rates will not be significantly higher. Fortunately, municipal bonds offer an opportunity to earn an income that may be free of federal income tax.

### Breaking the Bonds of Taxes

Municipal bonds are sold by state and local governments. Some munis are designed to raise immediate capital to cover expenses and are backed by

<sup>10,12</sup> DelawareOnline, July 20, 2009

<sup>11</sup> MTV, July 21, 2009

<sup>13</sup> Daily Mail, July 2, 2009

<sup>14</sup> Office of Management and Budget, 2009

<sup>15</sup> Bureau of the National Debt, 2009

<sup>16</sup> U.S. Department of the Treasury, 2008

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the taxing power of the issuing government. Revenue bonds are issued to help fund infrastructure projects and are supported by the income the projects generate. Municipal bonds tend to have low default rates. Muni bonds offer a potential source of tax-free income that tends to be more valuable to those in higher tax brackets. The interest on municipal bonds is typically free of federal income tax. As a result, munis tend to pay lower interest rates than taxable bonds. Thus, the tax

## Income Now or Later

With the recent bouts of market volatility, it is normal for investors to worry about their retirement security and to wonder whether they could outlive the assets in their investment portfolios.

Fortunately, when it comes to retirement planning, there are more productive strategies than just worrying about the future. Immediate and deferred fixed annuities are insurance products that could help retirees safeguard some of their nest eggs and provide a steady income stream throughout retirement.

The type of annuity that may be appropriate for you depends on your personal circumstances.

### Ready to Collect?

Immediate fixed annuities are typically purchased with a lump sum. The insurance company immediately begins making fixed monthly payments for a specific term, for life, or even for a lifetime plus the life of a spouse. The income amount is based on a number of factors, including the amount of the initial contract, the contract's rate of return, and the number of years over which payments will be made. With a fixed annuity, the insurance company alone bears the investment risk.

### Prefer to Wait

A deferred fixed annuity can be funded with either a lump sum or a series of payments. The contract begins paying a guaranteed income at a specific date in the future, and the payments reflect added value from any tax-deferred growth.

Annuities have contract limitations, fees, and expenses. The guarantees of fixed annuity contracts are contingent on the claims-paying ability of the issuing company. Most annuities have surrender charges that are assessed during the early years of the contract if the contract owner surrenders the annuity. Withdrawals prior to age 59½ may be subject to a 10% federal income tax penalty. The earnings portion of annuity payments is subject to ordinary income taxes.

Annuity income can be used to supplement normal sources of monthly income (e.g., Social Security and pension payments) so you will have sufficient funds to pay essential living expenses such as food, housing, and health care.

In fact, purchasing a fixed annuity with a lifetime payout may help substantially reduce your risk

**Comparing Apples and Oranges**  
The taxable equivalent yield shows what an investor would have to earn on a taxable investment in order to match the yield on a tax-exempt investment.

	Example	Example	You
1. Enter the expected yield on a tax-exempt investment.	3%	3%	
2. Enter your federal marginal tax rate.	25%	35%	
3. Subtract your tax rate from 100%. (100% - line 2)	75%	65%	
4. To calculate the taxable equivalent yield, divide line 1 by line 3 and then multiply by 100. (line 1 ÷ line 3 x 100)	4%	4.62%	

This hypothetical example is used for illustrative purposes only and does not reflect the performance of any specific investment. Possible state taxes, capital gains taxes, and alternative minimum taxes are not considered. This formula is only one factor that should be considered when purchasing securities and is meant to be used only as a general guideline when calculating the taxable equivalent yields on municipal bonds and agency and Treasury securities.

benefits from a municipal bond are partially determined by your income level. The principal value of bonds will fluctuate with market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost. Bond interest paid by a municipality outside the state in which you reside could be subject to state and local income taxes. If you sell a municipal bond at a profit, you could incur capital gains taxes. In some cases, municipal bond interest could be subject to the federal alternative minimum tax. Although no one is sure when changes to the tax code may be made in the future, higher taxes may be inevitable. Call today to discuss strategies that may help lower your tax burden with municipal bonds.

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of running out of money. Now wouldn't that be one less thing to worry about?

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## Investors Without Borders

*Although the U.S. economy is the largest and one of the most stable in the world, it's projected that the U.S. share of the global economy will shrink in the future (see chart). As foreign markets step up to take their places on the international stage, investors content to stay at home may miss out on some opportunities. In 14 of the past 30 years, foreign stocks outperformed domestic stocks, bonds, and cash equivalents.<sup>17</sup> Of course, past performance is no guarantee of future results.*

If you want to spread your portfolio outside national boundaries, international mutual funds are one idea to consider. By investing in companies outside the United States, international mutual funds offer a way for you to diversify not only across industry sectors and securities but across countries as well. Yet juxtaposed to the opportunities afforded by international investing, there are risks associated with investing on a worldwide basis.

### Currency Concerns

Fluctuations in the exchange rate between foreign currencies and the dollar add an extra layer of risk, as well as possible upside potential. A weak dollar may make shares denominated in a foreign currency more expensive; but when you sell the shares, a weak dollar could strengthen your return.

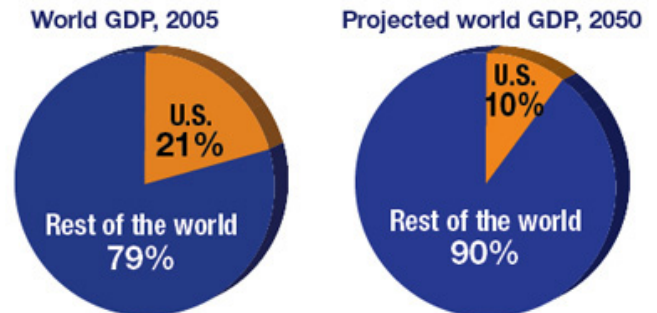
### Stability Stress

When you move money into foreign markets, it is important to consider a variety of factors, such as how foreign markets are valued compared with U.S. investments and how the financial and political climate of the region can affect your investments. Civil unrest, elections, terrorist attacks, and even the threat of such events can be enough to affect stock prices.

<sup>17</sup> Thomson Financial, 2008, for the period 1/1/1978 to 12/31/2007. Cash equivalents are represented by the T-Bill 3-Month Yield Index, bonds are represented by the Citigroup Corporate Bond Composite Index, stocks are represented by the S&P 500 Composite Index, and foreign stocks are represented by the Morgan Stanley Europe, Australasia, and Far East (MSCI EAFE) Index. These are unmanaged indexes that reflect the performance of these individual asset classes. Investors cannot invest directly in any index.

## Foreign Affairs

Staying at home could limit your exposure to the global economy in the future.



Source: Money, August 2008

Mutual fund shares fluctuate with market conditions and, when redeemed, may be worth more or less than their original cost. Diversification does not guarantee against loss; it is a method used to help manage investment risk. Mutual funds are sold only by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

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## Create a Personal Pension Plan

*"If you ask what is the single most important key to longevity, I would have to say it is avoiding worry, stress and tension. And if you didn't ask me, I'd still have to say it." – George Burns*

A steady stream of income will go a long way toward eliminating worry, stress and tension in one's life. The catch however, is how to create a no stress stream of income.

Many people have pensions earned while working for a corporation or a government entity. Others choose to buy an immediate annuity. This involves giving an insurance company a sum of money in exchange for a defined period of income. The defined period could be for a short term like 10 or 20 years or for life.

For those of us who do not have a pension and choose to not give up control of our money, one option is to create a personal pension plan. A personal pension is

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not something you buy, it's an investing strategy. And if planned properly the income from the personal pension can be tax free!

An individual investor has three choices for saving money. They are tax deferred, tax free and taxable accounts. Tax deferred accounts include IRAs and deferred annuities. There are significant differences between an IRA and a deferred annuity. An IRA is funded with pretax money and the invested amount along with the earnings is taxed upon withdrawal. A deferred annuity is funded with post tax dollars, but the earnings are tax deferred until withdrawal. Tax free accounts are Roth IRAs. With a Roth IRA, the invested money is taxed in the year earned but the growth is not taxed. Both tax deferred and tax free accounts have age limitations and other withdrawal consideration. Consult with your tax professional. The taxable accounts include bank savings account, CDs, money markets, checking accounts and similar type accounts.

### How to Create a Personal Pension Plan.

During the working years maximize your savings in a 401(k), IRA or Roth account. If you have the 401(k) option, try to invest at least 10-15% of your income. At a minimum, invest at least enough to meet the company's matching contribution.

If you don't have the 401(k) option, then your saving choice should probably be a Roth account. You can invest up to \$5,000 (\$6,000 for 50 & older) this year. You pay tax on the money but future earnings can be withdrawn tax free after reaching the age of 59½.

The tax free earnings are significant. For example, a single \$5,000 deposit growing at 8% a year for 20 years will create over \$18,000 of tax free income. Another example: Investing \$5,000/year for 20 years at an average annual growth of 8% will grow to over \$205,500. Upon reaching age 59½, this \$205,500 could be invested in a combination of government and corporate bonds earning an average return of 6%. This amounts to about \$1,025 of tax free income each month. Not bad for a personal pension in which the principal isn't touched and you don't have to retire to get it.

### Portfolio Organization

When creating a personal pension look at the tax deferred, tax free and taxable categories as a holistic portfolio with distinct parts but coordinated to work together. IRA assets can be withdrawn upon reaching the age of 59½ and reinvested in the Roth account. Or

the IRAs asset can be re-characterized into the Roth IRA at any time. Both the withdrawal and re-characterization are taxable events. The Roth account is invested for growth and to create a tax free cash flow. See your tax professional to discuss the re-characterization option.

### Portfolio Diversification

An investment portfolio should consist of three distinct allocations of stock funds, bond funds and cash. This applies to 401(k), IRAs, Roth IRA and investment saving accounts. This approach allows for growth and cash accumulation. Stock funds include investments in US and foreign stocks. Stock funds are volatile but over time will be the heavy lifers in a portfolio. Bond funds are the monthly income generators and investors have many choices from high yield corporate bond funds to Government issued bonds both foreign and domestic. Cash has a zero correlation with stocks and bonds and works very well to reduce the portfolio volatility. The allocation percentage is variable and should be discussed with your investment advisor.

Creating growth involves moving a portion of the stock equities capital appreciation into the bond allocation. The remaining portion and any dividends allow for growth in the stock equities. This is taking some of the profits and placing it in a lower risk investment while allowing for growth. Adding equity profits to the bond allocation will increase the monthly income generated by these funds. The bonds can retain the monthly dividends or put them in the cash account.

The cash can be used to adjust the portfolio allocation or possibly flow into another account. For example, the IRA cash could flow into the Roth IRA via re-characterization. Roth IRA cash account being fed by bond funds could create a tax free monthly cash deposit into a money market or checking account. See your tax professional to discuss the tax issues with IRA re-characterization

Creating a personal pension is possible but requires planning and a saving strategy. When is the best time to start planning for a personal pension plan? Today.

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- **Michael Jackson's Will** – What he did right, and wrong
- **Municipal Haste** – Investing for tax free income
- **Income Now or Later** – A discussion on fixed and deferred annuities
- **Investors Without Borders.** – Foreign economy growth may outpace the US in the coming years
- **Create a Personal Pension Plan** – A personal pension is not something you buy, it's an investing strategy. And if planned properly the income from the personal pension can be tax free!

USA Living Financial Group

1125 Yellowheart Way  
Hollywood, FL 33019