THE ADVISOR

FRAGASSO FINANCIAL ADVISORS

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Security - The Often Unaddressed Issues

Matters of security are often on our mind. We are justifiably concerned over national security. Will a terrorist act harm us or those we love? We also concern ourselves with personal safety. Are our home and place of business safe from violent intrusion? Can we walk the streets safely? While we muse over our risks in those serious areas, we may overlook the much more common risks that intrude on the lives of individuals with much greater certainty and dominance.

For example, the risk of death comes with a 100% certainty. The only question is when?
What will be the financial repercussions of our death? Who will have their lives adversley impacted because we failed to make adequate arrangements? Will a home need to be sold prematurely? Will a business be placed at risk? Will a business partner have to bear the brunt of a double workload while buying out the deceased partner's spouse and family? Will a child not make it through college because of inadequate funding? Will a spouse be forced to leave young children to go to work?

BOB FRAGASSO, CFP®
President

We have seen this occur over many decades. It doesn't just happen to someone else. It occurs when people fail to adequately consider the financial effects of death, disability, and nursing home stays. Many people fail to evaluate such risks and build appropriate defenses simply because they cannot see themselves and their families in those situations. Well, it is our job to make you realize that these things happen to otherwise good, hard working people just like you. And, the only defense is proper planning.

Please take the time to read through this quarter's issue of our newsletter where the theme is planning for uncertainty and protecting those you love. And then talk with your financial consultant here at Fragasso Financial Advisors. If you are not a client, call us and we will have one of our experienced, knowledgeable and salaried financial consultants help you think through the potential problems and the possible solutions. We prefer to help you now when it is a planning exercise and you have options rather than help your loved ones sort through the broken dreams and experience the upheaval this brings.

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Estate Tax Repeal Update

The Economic Growth and Tax Relief Reconciliation Act of 2001 gradually phases out the federal estate tax until its complete repeal in 2010. Without additional legislation, however, the federal estate tax will return in 2011.

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Since 2001, there have been a number of failed attempts to make the estate tax repeal permanent. However, there are still several bills in Congress that include provisions to eliminate this tax, and should one of these bills pass, it will go to President Bush who has said he will sign it into law.

Goodbye estate tax, hello capital gains tax

Repeal does not mean that tax on wealth transfers from one generation to the next will disappear. While currently a tax is imposed on estates, after repeal, a tax will be imposed indirectly on inheritances in the form of capital gains tax. Here's a simplified explanation.

Under the current tax system, property that is transferred to heirs at the owner's death typically gets a "step up" in tax basis. Generally, tax basis refers to the cost the owner paid to acquire the property, and is used to compute capital gains tax when the property is sold. For example, let's say Mr. Smith buys property for $50,000, which becomes his tax basis, and sometime later sells the property for $60,000. Mr. Smith's computed capital gain for tax purposes is $10,000.

When property is transferred by gift, the recipient receives a "carry over" basis; the tax basis in the hands of the person making the gift generally becomes the recipient's tax basis. So, let's say that Mr. Smith gives the property in the above example to his son, John. Mr. Smith's $50,000 tax basis carries over to John, and when John subsequently sells the property for $60,000, John recognizes the $10,000 capital gain.

However, when property is transferred because of the owner's death, the tax basis is stepped up to its current fair market value. Again using the first example, let's say that John receives the property through his father's will. John's tax basis is stepped up to $60,000, the property's fair market value. When John subsequently sells the property for $60,000, John recognizes no capital gain on the transaction.

One of the consequences of estate tax repeal will be that the step up in tax basis will be lost. Heirs will receive a carry over basis on inherited property, and will recognize the capital gain (or loss) when the property is sold at some point in the future.

The question is: Will permanent repeal become law, and if so, what are the political ramifications?

What will this change in the tax system mean for American families? The current estate tax affects 2% of the most wealthy Americans. Capital gains tax, on the other hand, can affect anyone who owns capital assets. Therefore, unless the step up in basis remains, estate tax repeal is likely to result in creating a higher tax bill for a greater percentage of less wealthy Americans. Further, repeal will create a paperwork headache for heirs who will have to determine the decedent's tax basis in the property they've inherited.

Impact on charitable contributions

The estate tax encourages charitable giving by providing a full deduction for gifts and bequests to qualified charities. Eliminating the estate tax will eliminate this incentive. Some experts theorize that estate tax repeal will result in a decline in charitable contributions.

Estate tax repeal is likely to result in creating a higher tax bill for a greater percentage of less wealthy Americans.

Studies predict annual giving could be reduced by at least 12% and as much as 40%. These studies, however, assume that donors are motivated to give exclusively or primarily for tax reasons. A key variable, that Americans give to charity for philanthropic reasons, will likely offset the estimated negative affect on charitable giving. In fact, another study posits that without the estate tax, Americans will have more wealth available to both satisfy heirs and make donations, causing donations to increase. If the estate tax is repealed, only time will tell whether charities will suffer, gain, or feel no significant impact from its absence.

Other pros and cons of permanent repeal

Proponents of permanent repeal regard the estate tax as morally unfair and an obstacle to family business continuity and growth. Critics call permanent repeal a boon to the mega-rich and fiscal suicide in a time of budget deficits, a Social Security and Medicare crisis, and war. The confusing reality is that there is statistical evidence both for and against the arguments presented by each side.

One thing is certain, however; dealing with the uncertainties of the current state of the estate tax is a burden on Americans and their financial planning professionals who must re-evaluate estate planning options every year. For many on both sides of the issue, sensible reform is a preferable alternative to the success or failure of permanent repeal.
Dealing with the uncertainties of the current state of the estate tax

The uncertainty about the long-term prospects of the estate tax is a conundrum. Whether you're willing to bet the estate tax will be permanently repealed or you believe the estate tax is here to stay, planning in advance is as essential as ever. Here are some important facts to keep in mind:

- Even without a federal estate tax, your state may impose a death tax of its own which you need to plan for.
- Though estate tax may be repealed, gift tax will remain. Gift tax planning is still critical to your overall estate plan.
- The estate tax phases out through 2010 by increasing exemptions and decreasing rates. Make sure your will and trusts include formula provisions that take care of these changes automatically.
- Your estate will incur other costs besides estate tax. Be sure your estate will have the cash available to pay expenses such as outstanding debts and liabilities, final medical bills, burial and funeral costs, and executor and attorney fees.
- Estate planning meets other goals besides tax avoidance. You still need to plan to take care of your surviving family members, avoid probate, distribute your estate according to your wishes, make charitable gifts, plan for incapacity, and meet many other objectives.

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Charitable Giving

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Charitable giving can play an important role in many estate plans. Philanthropy cannot only give you great personal satisfaction, it can also give you a current income tax deduction, let you avoid capital gains tax, and reduce the amount of taxes your estate may owe when you die.

There are many ways to give to charity. You can make gifts during your lifetime or at your death. You can make gifts outright or use a trust. You can name a charity as a beneficiary in your will, or designate a charity as a beneficiary of your retirement plan or life insurance policy. Or, if your gift is substantial, you can establish a private foundation, community foundation, or donor-advised fund.

Making outright gifts

An outright gift is one that benefits the charity immediately and exclusively. With an outright gift you get an immediate income and gift tax deduction.

Tip: Make sure the charity is a qualified charity according to the IRS. Get a written receipt or keep a bank record (cancelled check) for any cash donations, and get a written receipt for any property other than money.

Will or trust bequests and beneficiary designations

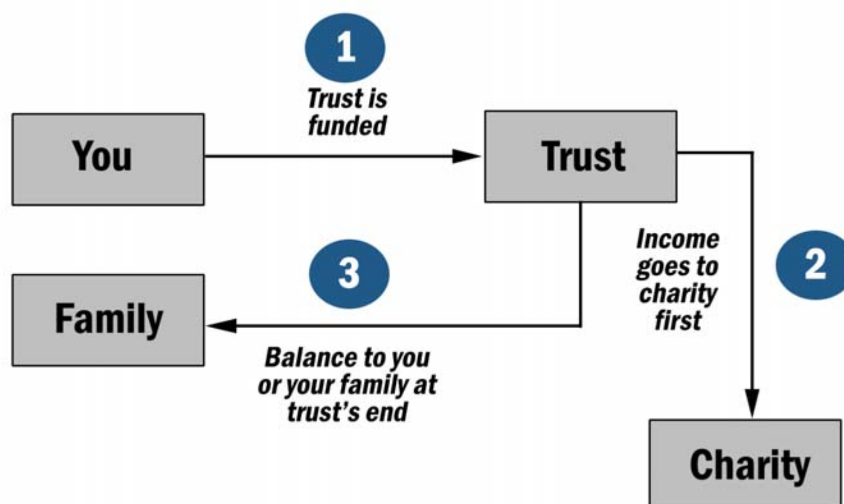
These gifts are made by including a provision in your will or trust document, or by using a beneficiary designation form. The charity receives the gift at your death, at which time your estate can take the income and estate tax deductions.

Charitable trusts

Another way for you to make charitable gifts is to create a charitable trust. You can name the charity as the sole beneficiary, or you can name a non-charitable beneficiary as well, splitting the beneficial interest (this is referred to as making a partial charitable gift). The most common types of trusts used to make partial gifts to charity are the charitable lead trust and the charitable remainder trust.

Charitable lead trust

A charitable lead trust pays income to a charity for a certain period of years, and then the trust principal passes back to you, your family members, or other heirs. The trust is known as a charitable lead trust because the charity gets the first, or lead, interest.



Example: John, who often donates to charity, creates and funds a $2 million charitable lead trust. The trust provides for fixed annual payments of $100,000 (or 5% of the initial $2 million value) to ABC Charity for 20 years. At the end of the 20-year period, the entire trust principal will go outright to John's children. Using IRS tables, the charity's lead interest is valued at $1,267,630, and the remainder interest is valued at $732,370. Assuming the trust assets appreciate in value, John's children will receive any amount in excess of the remainder interest ($732,370) unreduced by estate taxes.

A charitable lead trust can be an excellent estate planning vehicle if you own assets that you expect will substantially appreciate in value. If created properly, a charitable lead trust allows you to keep an asset in the family and still enjoy some tax benefits.

Charitable remainder trust

A charitable remainder trust is the mirror image of the charitable lead trust. Trust income is payable to you, your family members, or other heirs for a period of years, then the principal goes to your favorite charity.
A charitable remainder trust can be beneficial because it provides you with a stream of current income--a desirable feature if there won't be enough income from other sources.

Private family foundation

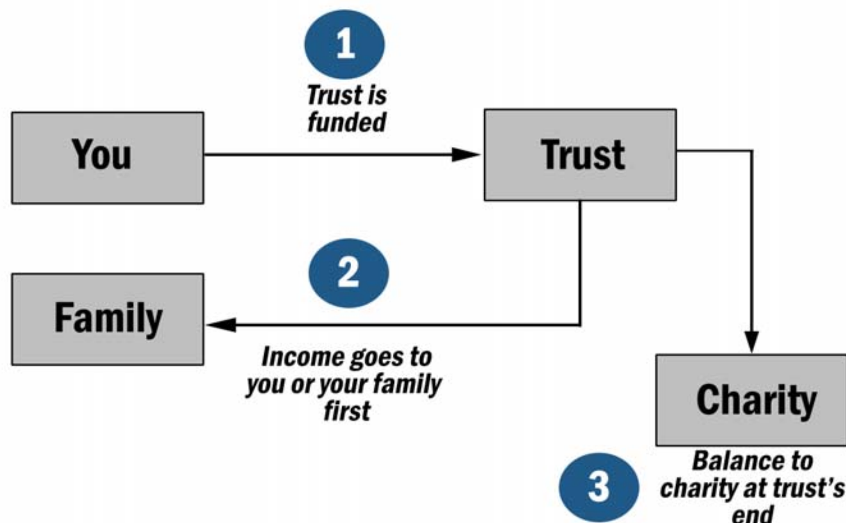
A private family foundation is a separate legal entity that can endure for many generations after your death. You create the foundation, then transfer assets to the foundation, which in turn makes grants to public charities. You and your descendants have complete control over which charities receive grants. But, unless you can contribute enough capital to generate funds for grants, the costs and complexities of a private foundation may not be worth it.

Tip: One rule of thumb is that you should be able to donate enough assets to generate at least $25,000 a year for grants.

Community foundation

If you want your dollars to be spent on improving the quality of life in a particular community, consider giving to a community foundation. Similar to a private foundation, a community foundation accepts donations from many sources, and is overseen by individuals familiar with the community's particular needs, and professionals skilled at running a charitable organization.

How a Charitable Remainder Trust Works



Example: Jane, an 80-year-old widow, creates and funds a charitable remainder trust with real estate currently valued at $1 million, and with a cost basis of $250,000. The trust provides that fixed quarterly payments be paid to her for 20 years. At the end of that period, the entire trust principal will go outright to her husband's alma mater. Using IRS tables, Jane receives $50,000 each year, avoids capital gains tax on $750,000, and receives an immediate income tax charitable deduction of $1,138,384, which can be carried forward for five years. Further, Jane has removed $1 million, plus any future appreciation, from her gross estate.

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Donor-advised fund

Similar in some respects to a private foundation, a donor-advised fund offers an easier way for you to make a significant gift to charity over a long period of time. A donor-advised fund actually refers to an account that is held within a charitable organization. The charitable organization is a separate legal entity, but your account is not--it is merely a component of the charitable organization that holds the account. Once you transfer assets to the account, the charitable organization becomes the legal owner of the assets and has ultimate control over them. You can only advise--not direct--the charitable organization on how your contributions will be distributed to other charities.

Betty Rich, Jeff Fisher and Don Kerrish - Swimming Against the Current, a Business Success Story

When Betty Rich, Jeff Fisher and Don Kerrish began their specialty pharmacy business, they did not expect to sell it to one of the largest healthcare insurers in the USA, Highmark Blue Cross. But that is exactly what happened! And they contradicted conventional thought that great businesses can't begin and flourish in Western Pennsylvania. They've created not one, but two successful business ventures, one sold and one kept.

Don Kerrish and Jeff Fisher attended Duquesne University's School of Pharmacy as did Don's sister, Jan. Jan married Jeff Fisher and everyone became more than classmates. Jeff owned Fisher's Pharmacy on Pittsburgh's North Side and Don worked there, offering unique, personalized service to their patients. Along came Betty Rich, fresh from her experience with a large, national specialty pharmacy. (Betty was a high school classmate of our own Debbie Sales Graver.) The three friends, Betty, Jeff and Don, felt strongly that patients would respond well to a high level of personalized service that they felt was lacking from the large chain pharmacies. That would be especially true; they felt, in those areas of pharmacy where patients require a high level of service and attention. They concentrated their pharmacy practice in the areas of infertility, HIV, compounding, and hepatitis B and C, under the moniker Fishers Specialized Pharmacy Services Inc.

Pat Kerrish, Betty Rich, Jeff Fisher, Paul Fagan, and Don Kerrish

Their perseverance and their quality products, coupled with a sterling level of quick service and physician, pharmacist, and patient information, garnered them a meteoric rise in sales and profits. The trail they blazed was bright enough to get the attention of Highmark Blue Cross/Blue Shield which selected Fisher's Specialized Pharmacy Services for Highmark's entry into the national specialty pharmacy arena.

In January 2000, the trio was joined by two other partners, Patrick Kerrish and Paul Fagan, and created a second company, Three Rivers Pharmaceuticals LLC, located in Cranberry Township.

After much research and development, prototype manufacturing and fending off the legal challenges of brand name manufacturers, they captured FDA approval for their first generic drug, Ribavirin. As a point of interest, their legal fees in defending against the brand name challenge were greater than the combination of research and clinical trail costs, according to Don Kerrish, and the legalities took three years. A lesser committed group of individuals might have folded, but Three Rivers Pharmaceuticals continued the battle and won.

Their spirit of entrepreneurship and customer service is evident by the way they offer their products. Amphotec is an injectable drug meant for treating fungal infections. In addition to the U.S., it is sold in 44 countries, notably in China, South America and Eastern Europe. Ribapak is a uniquely dosed hepatitis-

C drug, created for better patient compliance. This was created in response to pharmacists' experience and their desire to reduce their patients' "pill burden." The partners feel that Three Rivers Pharmaceuticals has the potential to become many times more successful than their first business. They have 30 products in various stages of development, testing and manufacturing. Their efforts were recognized by receiving the Ernst and Young Entrepreneur of the Year Award for 2006. See accompanying photo.

Betty Rich, Don Kerrish and Jeff Fisher, their families and their partners, are stereotypical Pittsburghers. Don recounts how it took him 10 years to pay off his pharmacy school loans and how Jeff bought a small pharmacy on the North Side after working for a national chain. Betty also worked her way through a labyrinth organization before becoming their partner. But they all felt the drive of their vision to create something more than others offered in their industry. And after months and years of scraping together capital, learning the FDA processes, holding clinical trials and fending off establishment legal challenges meant to derail them, they won. Yet, it wasn't ever about cashing out. They stayed, reinvested and created yet another, even larger, venture.

We can be proud of them as home town entrepreneurs and hold them up as examples when others offer negative views of our region's prospects. Fragasso Financial Advisors is proud to call them clients and friends.

Meet the Fragasso Team:
Ray Amelio

In each of our quarterly newsletters, we feature a profile of one of the members of the Fragasso team. In this edition we want to introduce you to Ray Amelio, Vice President, Seminars and Marketing.

Ray joined the firm in July 2005 to manage the Seminars and Marketing Department. The Seminar and Marketing Department is responsible for handling all aspects of both college and corporate seminars as well as handling a myriad of activities from maintaining the firm's various databases, publishing the quarterly newsletters and the monthly e-news, to coordinating all client events and activities.

Prior to joining the firm Ray had his own consulting practice and the Fragasso Group was one of his clients. Additionally, Ray has been a client of the firm since 1999 and will quickly tell you that having Fragasso Financial Advisors manage his finances was one of the best decisions he has made in his life.

Ray relates an interesting fact in that Bob Fragasso and he started Duquesne University on the same day many years ago. Bob went straight through and graduated on time, while Ray left after three semesters, joined the military serving both at sea with the Navy and with the Marines as a field corpsman in Vietnam. Upon return home he resumed his studies at Duquesne and graduated with a BA in Political Science. He received his master's degree in Human Resources Management from LaRoche College.

Ray is married to Paula and they have two children, Kaylyn who is married to Mark Talton and Marc who graduated from Duquesne University in December, 2006.

In his spare time Ray enjoys spending time with his family, working out at the Rivers Club, playing golf (his friends often question if the game Ray is playing can be called golf!), and doing work in the community. He serves on several non-profit boards.

Ray says that he is very pleased to be a part of the Fragasso team and that he works with the greatest group of people in the City of Pittsburgh. He is also very proud of the two women who work in his department, Joy Holden and Loriann Ostermueller. Ray states "We are a small group but we work well together and we get a lot done, while still having fun."

Leaving a Legacy

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You've worked hard over the years to accumulate wealth, and you probably find it comforting to know that after your death the assets you leave behind will continue to be a source of support for your family, friends, and the causes that are important to you. But to ensure that your legacy reaches your heirs as you intend, you must make the proper arrangements now. There are four basic ways to leave a legacy: (1) by will, (2) by trust, (3) by beneficiary designation, and (4) by joint ownership arrangements.

Wills

A will is the cornerstone of any estate plan. You should have a will no matter how much your estate is worth, and even if you've implemented other estate planning strategies.

You can leave property by will in two ways: making specific bequests and making general bequests. A specific bequest directs a particular piece of property to a particular person ("I leave Aunt Martha's diamond broach to my niece, Jen"). A general bequest is typically a percentage of property or property that is left over after all specific bequests have been made. Typically, principal heirs receive general bequests ("I leave all the rest of my property to my wife, Jane"). With a will, you can generally leave any type of property to whomever you wish, with some exceptions, including:

- Property will pass according to a beneficiary designation even if you name a different beneficiary for the same property in your will
- Property owned jointly with rights of survivorship passes directly to the joint owner
- Property in a trust passes according to the terms of the trust
- Your surviving spouse has a right to a statutory share (e.g., 50%) of your property, regardless of what you leave him or her in your will
- Minor children have certain inheritance rights
- State law may limit your ability to leave property to charity

Caution: Leaving property outright to minor children is problematic. You should name a custodian or property guardian, or use a trust.

Benefits of a will:

- Distributes property according to your wishes
- Names an executor to settle your estate
- Names a guardian for your children
- Can create a trust

Trusts

You can also leave property to your heirs using a trust. Trust property passes directly to the trust beneficiaries according to the trust terms. There are two basic types of trusts: (1) living or revocable, and (2) irrevocable.

Living trusts are very flexible because you can change the terms of the trust (e.g., rename beneficiaries) and the property in the trust at any time. You can even change your mind by taking your property back and ending the trust.

An irrevocable trust, on the other hand, can't be changed or ended except by its terms, but can be useful if you want to minimize estate taxes or protect your property from potential creditors.

You create a trust by executing a document called a trust agreement (you should have an attorney draft any type of trust to be sure it accomplishes what you want).

A trust can't distribute property it does not own, so you must also transfer ownership of your property to the name of the trust. Property without ownership documentation (e.g., jewelry, tools, furniture) are

transferred to a trust by listing the items on a trust schedule. Property with ownership documents must be re-titled or re-registered.

You must also name a trustee to administer the trust and manage the trust property. With a living trust, you can name yourself trustee, but you'll need to name a successor trustee who'll transfer the property to your heirs after your death.

Tip: A living trust is also a good way to protect your property in case you become incapacitated.

Beneficiary designations

Property that is contractual in nature, such as life insurance, annuities, and retirement accounts, passes to heirs by beneficiary designation. Typically, all you have to do is fill out a form and sign it. Beneficiaries can be persons or entities, such as a charity or a trust, and you can name multiple beneficiaries to share the proceeds. You should name primary and contingent beneficiaries.

Caution: You shouldn't name minor children as beneficiaries. You can, however, name a guardian to receive the proceeds for the benefit of the minor child.

You should consider the income and estate tax ramifications for your heirs and your estate when naming a beneficiary. For example, proceeds your beneficiaries receive from life insurance are generally not subject to income tax, while your beneficiaries will have to pay income tax on proceeds received from tax-deferred retirement plans (e.g., traditional IRAs). Check with your financial planning professional to determine whether your beneficiary designations will have the desired results.

Be sure to re-evaluate your beneficiary designations when your circumstances change (e.g., marriage, divorce, death of beneficiary). You can't change the beneficiary with your will or a trust. You must fill out and sign a new beneficiary designation form.

Caution: Some beneficiaries can't be changed. For example, a divorce decree may stipulate that an ex-spouse will receive the proceeds.

Tip: Certain bank accounts and investments also allow you to name someone to receive the asset at your death.

Joint ownership arrangements

Two (or more) persons can own property equally, and at the death of one, the other becomes the sole owner. This type of ownership is called joint tenancy with rights of survivorship (JTWRS). A JTWRS arrangement between spouses is generally known as tenancy by the entirety, and a handful of states have a form of joint ownership known as community property.

Caution: There is another type of joint ownership called tenancy in common where there is no right of survivorship. Property held as tenancy in common will not pass to a joint owner automatically, although you can leave your interest in the property to your heirs in your will.

You may find joint ownership arrangements are useful and convenient with some types of property, but may not be desirable with all of your property. For example, having a joint checking account ensures that, upon your death, an heir will have immediate access to needed cash. And owning an out-of state residence jointly (e.g., a vacation home) can avoid an ancillary probate process in that state. But it may not be practical to own property jointly where frequent transactions are involved (e.g., your investment portfolio or business assets) because you may need the joint owner's approval and signature for each transaction.

There are some other disadvantages to joint ownership arrangements, including: (1) your co-owner has immediate access to your property, (2) naming someone who is not your spouse as co-owner may trigger gift tax consequences, and (3) if the co-owner has debt problems, creditors may go after the co-owner's share.

Caution: Unlike with most other types of property, a co-owner of your checking or savings account can withdraw the entire balance without your knowledge or consent.

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SEMINARS AND SUMMER EVENTS

The fall seminar season is shaping up very nicely. We will be partnering with three local colleges to run our seminars – **Duquesne University, LaRoche College and Robert Morris University.** Our brochures with all the details should arrive in your mailbox or email box by mid to late August. If you haven't been to a seminar in a while you should register to attend. Laws and regulations change and it is important to keep up with these changes. Invite a family member or friend, they will thank you for thinking of them and will be grateful for the experience.

Additionally, plan on attending our **client picnic on July 28**. We are planning a fun filled day at a new venue. The picnic is being held at **Avonworth Community Park at the Mayernik Center located on Camp Horne Road**, in the North Hills. You should have received a save the date card recently, more details will follow.