Shaping Your Financial Future With Specific Personalized Advice You CAN Trust.

Financial to Practical

Published by Holmes & Associates, Chartered

Issue 1

Holmes and Associates Invites You to Profit from Their Experience

A Personal Message from Bob Holmes, CPA

As a person manages their financial life, there are three major resources which are available to protect and manage his financial resources. In general, they are a financial planner, an accountant and an attorney. Quite often these roles can be fulfilled by one or more people (an accountant could also be a financial planner or an accountant may also be an attorney) or there could be three or more people involved. Regardless, for our discussion purposes, it is easier to separate by functionality than by individual.

Thinking of these three functions as forming a three-sided figure, we can then call this The Professional Triangle of Power. One corner of the triangle includes a financial planner who provides planning and investment advice. The second corner includes a CPA who provides tax advice and compliance work on accounting and governmental issues such as income and estate taxes and other monetary considerations. The third corner includes an attorney who provides legal advice and production of legal documents such as wills and trusts and other contracts. If you agree that your ability to have choices in life expands as your certainty in your financial resources expands, this is an extremely important and powerful triangle which should be managed judiciously.

The question becomes, "How does a person go about expanding this triangle of power?" The simple answer is through increased communication with each corner. Increasing communication to and from each of the points will expand and strengthen the triangle which will, in turn, allow for a more powerful financial base to support your life's purposes. The trouble is that an average individual does not have the time, training or background to effectively communicate with these professionals at the level necessary to take maximum advantage of their skills. It is not that the average individual lacks ability; it is a simple question of nomenclature, the concepts within the subject and the time involved to learn what is not known.

> ***The real bottom line is not a dollar figure. The real bottom line is your purpose.***

You, as an individual, can manage and grow this triangle to the extent you have understanding, training and time. You can attempt to do this by yourself, which is the course that most people take, or you could delegate much of that responsibility to someone and ask them to get in the triangle with you and become your most trusted advisor or personal Chief Financial Officer (CFO).

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In this Issue

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Tax Law Changes

Could Make A Difference In Your 2004 Tax Return

With the stroke of his pen, President George Bush signed into law two significant and separate tax bills this year : The Working Families Tax Relief Act (October 4) and The American Job Creation Act of 2004 (October 22). As a result of this tax legislation, there are a number of significant tax law changes affecting you this year.

Both the 2003 and 2004 Tax Acts offer tax benefits and challenges for many taxpayers this year. One of the most complicated aspects of any tax legislation is reviewing the wide range of effective dates that apply. Some of the tax breaks are retroactive to January 1, 2004, or take effect at other times during the year. Other provisions become effective after 2004 and some immediately after President Bush signed the Acts into law. You may be aware through the media attention that many of the important tax law changes are scheduled to "sunset" (go away) at various dates – some sooner rather than later. You should think of the "sunset" issue as a future concern and take advantage of the opportunities that you have today.

The bulk of The Working Families Tax Relief Act is a series of tax cut extensions. One of the most important features of this decision is to extend for a period of several years certain tax benefits that were soon to be expired. The big three include: 1) the 10% tax bracket 2) the $1,000 child tax credit and 3) marriage penalty relief. However, the Act does restore the special deduction for out –of-pocket expenses for teachers for 2004 and 2005.

The American Job Creation Act of 2004 is substantially a corporations/manufacturers Act. This Act changes the rules for certain vehicle donations (effective 2005), closes the so-called SUV loophole (effective October 22, 2004), and creates a new itemized deduction for state sales taxes for 2004 and 2005.

The 2003 Tax Act has been described as a bumpy series of starts and stops - in some cases accelerating for brief periods some provisions of the 2001 Tax Act, providing short-term business investment incentives, and dramatically reducing income tax rates on capital gains and dividends for a short period of time.

As always your individual focus should be on how the tax law changes affect you and how the tax law changes may benefit you. If you have any questions concerning the tax law changes; please contact your tax professional and schedule an appointment.

The Prosperity Index:

Start the year off with a sound game plan.

When it comes to financial planning, people often ask the question… "How Much Money Should I Have?" A 1997 random survey of Americans posed the following question:

- Do you know that you should pay-off all of your consumer debt?
- Did you know you should participate fully in your 401K or IRA?
- Did you know that you should spend less money than you make?
- Do you agree that you should have a financial plan to provide for retirement?

With the respondents answering "Yes" to these four questions, the next question was: "Are you doing these things?" For the majority of those surveyed, the answer was "No". There are two primary reasons for this negative response: 1) People do not know how to get started; and 2) people are afraid they might do the wrong thing(s).

By choosing the right financial planning professional, the question "How Much Money Should I Have?" can be answered by preparation of a financial plan that is tailored to your specific situation. With the new year just beginning, now is the time to look at your current financial situation and take action to make your dreams come true.

In order to help you assess your current situation, you can use The Prosperity Index ™. This tool will help those that want to begin planning or want to measure the success of their existing plan. This simple measuring tool can also help you along the way to see, "How Am I doing?". Keep in mind that The Prosperity Index™ is not the same as a comprehensive financial plan, but it does

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serve as a good first step to setting, achieving and monitoring your financial goals. For the greatest benefit you should update your index at least semi annually.

Step #1: Calculate your Prosperity Index™ score.

Your score is calculated by dividing your financial assets by your family income. Fill out the chart below and determine your Prosperity Index™ score.

(Your home equity and 1st mortgage balances are excluded, as these are not future income assets.)

ASSETS

Cash, checking, Saving Account ______

Personal or Joint Accounts

Bank CDs ______
Savings Bonds ______
Life Insurance Cash Value ______
US Treasuries ______
Mutual Funds ______
Tax Def. Annuities ______
Employer Stocks ______
Individual Stocks ______
Individual Muni. Bonds ______
Individual Corp. Bonds ______

Retirement Accounts

IRAs ______
401k ______
403b (aka TSAs) ______
Pension Accounts ______

Other Assets ______

TOTAL ASSETS ______

LIABILITIES

Automobile Loan ______
Student Loans ______
Credit Cards ______
Second Mortgage (non RE) ______
Debt Consolidation Loans ______
Life Insurance Loans ______
Pension Plan Loans ______
Family Loans ______
Other Loans ______
Other Liabilities ______

TOTAL LIABILITIES ______

TIPS AND TRICKS

Four tips to help you take advantage of the recent tax law changes:

IRA Contributions

The maximum IRA contribution for 2004 is $3,000 and an additional $500 for taxpayers who are 50 years of age or older in 2004. Note that the contribution limits in 2005 will be increased to $4,000 and the additional $500 for catching-up.

Investors Win: Lower Capital Gains Taxed at 15% OR 5%

Investors came out very big winners under the 2003 Tax Act. The top capital gains rate was lowered from 20% to 15%. The lowest capital gains rate decreased to 5% from 10%. Note that the lower rates were effective for transactions after May 5, 2003. The lower rates are scheduled to expire after 2008. For 2004 and 2005, the rates are 15% or 5% respectively. Taxpayers in the lowest two brackets (10% and 15%) will get a one-year bonus in 2008 when they will pay no federal taxes on capital gains. The tax is reinstated after 2008

10% bracket Expanded and Extended

The 10% rate for taxable income up to $14,000 (married taxpayers) and $7,000 (single taxpayers) had been set to decline to $12,000 and $6,000 respectively. The Working Families Tax Relief Act of 2004 retains the higher amounts (and they are adjusted for inflation) through 2010.

Assistance To Military Families

Military personnel can elect in 2004 and 2005 to include tax-free combat pay as earned income for the purpose of figuring the Child Tax Credit as well as Earned Income Tax Credit.

These are a few tips that may or may not apply to you personally. Be sure to consult your CPA or tax advisor or investment advisor for specific, personalized advice.

PROSPERITY INDEX

Total Assets ______
(minus) Total Liabilities= ______
(divided by) family Income= ______

YOUR PROSPERITY INDEX SCORE

* Home value and mortgage are not included in the Prosperity Index. Only financial assets are listed.

Step #2: Align your score with the Prosperity Index Table.

With this number calculated, it is time to see how you are doing compared to the table.

PROSPERITY INDEX TABLE

Age	Recommended Score
35 and below	1
40	2
45	4
50	7
55	10
60	13
65 and above	16

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FAQ

The Child Tax Credit was increased to $1,000 in 2003, will this continue in 2004

As a result of the Working Families Tax Relief Act of 2004, the credit for a dependent child under age 17 will remain at $1,000 through 2009. The refundable credit, payable to low-income taxpayers, has been increased to 15% (up from 10%). The refund is 15% of earned income over $10,750 in 2004 and 11,000 in 2005.

What are Health Savings Accounts?

Effective January 1, 2004, Health Savings Accounts (HSAs) allow deductible contributions to be set aside to cover medical expenses that are not covered by a high-deductible medical plan in which the taxpayer-employer participates.

The contributor to the HSA - either the employee or the employer - gets a tax deduction for the contributions going into the HSA, and then the employee is allowed to withdraw the funds tax-free in the same year or in a future year to cover their unreimbursed medical expenses. Contributions that are not used in any tax year may be rolled over for future use. Upon reaching the age of 65, accumulated funds in an HSA can be withdrawn tax-free to cover medical expenses or they can be withdrawn penalty-free (but not tax-free) for any purpose.

How do the new Tax Law changes affect businesses?

There are several changes that could affect your business this year. Changes in the tax law have liberalized S corporation rules, making it easier for a business to qualify for S corporation status. Revised rules for start-up and organizational expenses have changed the amount of start-up expenses you can deduct. There is a new 15-year write-off for qualifying leasehold improvements and qualifying restaurant property. In addition, there is an extension of several expensing tax breaks for two more years and a new limit on company deductions for entertainment, etc. provided to officers and directors.

Please keep in mind that we've described only a few of the changes in the new law. Make sure you consult with your tax professional to get the most out of these tax changes.

Is there a new itemized deduction for State Sales Taxes?

The American Jobs Creation Act of 2004 authorized the sales tax deduction as an option for those who itemize deductions, letting them choose between deductions for state and local income or sales taxes. It may give a larger deduction to taxpayers in states who paid more in sales taxes than income taxes. For example, a retiree may owe no or low state income tax because his pension and social security benefits are exempt from state tax and he has little other income. At the same time, he may itemize federal deductions because he pays real estate taxes, has deductible medical expenses, pays mortgage interest, and makes charitable contributions. The new sales tax option may produce a larger deduction in this situation.

Do you need to see your CPA this week?

Take this simple test...

Simply place a check mark in the appropriate box. Once you are done, calculate the number of YESes and look at the results.

YES	NO	
❏	❏	I had a sale of an asset with a substantial gain.
❏	❏	I exercised stock options.
❏	❏	I got a bonus of 20% or more of my annual income.
❏	❏	My net business income is going to be 15% or more, higher than last year.
❏	❏	I started a new business.
❏	❏	The company that I work for promoted me and I'm receiving additional benefits.
❏	❏	I'm retiring this year.
❏	❏	I received a significant inheritance.
❏	❏	I want to plan for my child's education and I'm not sure what to do.
❏	❏	I got a nasty notice from the IRS that I owe money and I don't know why.
❏	❏	I got a notice I'm being audited by the IRS.

Results:

If all answers are "no" chances are you're in good shape.

If any one of these were answered "yes," you need to contact your CPA well in advance of year-end.

If two more of these were answered "yes," you need to call your CPA within the next couple weeks.

Three or more "yes" answers or any of the answers contain the word "IRS" run, don't walk to the phone and call your CPA.

Profit From Their Experience

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This personal CFO role is one that we have developed for many of our clients and is one of many things we do that makes us different. In our ideal scene as your CFO, we assist you in the management of the Triangle of Power. We help you develop values, goals and objectives which are the framework for your marching orders that are given to each of the corners of the triangle. Please keep in mind that this is not a one way communication. Rather, this is an interactive process; one that is done several times over until a desired result is achieved. We find that people often do not explore values, goals and objectives because they do not really know what is possible and trying to figure it out is overwhelming. This is another critical function of the CFO; helping you, the CEO, understand what is really possible and getting things into terms and concepts with which you can think. Once this is well fleshed out and understood, then a complete and proactive plan can be executed through clear and precise communication with the three corners of the Triangle of Power.

This plan would include identifying, growing, protecting and using your financial resources according to your wishes (values, goals and objectives) and would give you the highest probability of attaining those things. Additionally, this approach streamlines your responsibilities and duties, which in turn allows you to spend more time on your dreams, purposes and goals. After all, isn't that what true success really is?

Whether we work with individuals or businesses, one of the most important services we provide is to help people clarify their values, goals and purposes so that they have clearly defined purposes for producing money. This differs from the traditional approach of just making money, as it lines it up with those things you identify as more important than money. Remember finances are a 'means to an end,' and if people have no purpose for their money, they won't do anything purposeful with it.

Truly, wealth is not the whole story. People want wealth so that they may enjoy and support the things in life that are truly important to them. Don't lose sight of that fact or you could be in for a miserable existence.

What are your goals in life? Have you developed a plan to accomplish them?

—Bob Holmes, CPA

The Prosperity Index:

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In any scenario, knowing your index relative to your age gives you information you can act on. The Prosperity Index ™ indicates that an individual with typical income growth, getting the typical return on investment, and putting away at least 10% of their income towards retirement can be reasonably assured a comfortable retirement income at age 65.

Step #3: Calculate your Prosperity Ratio™

PROSPERITY RATIO FORMULA

Prosperity Index Score ______
(divided by)
Recommended Score ______

PROSPERITY RATIO % [ ]

The ratio quickly tells you how you are doing in relation to the index. For example, we will assume that the primary breadwinner of a family has a Prosperity Index™ of 1.35, and is 40 years old. Their recommended score is 2.0, but they scored 1.35. By dividing 1.35 by 2.0 we find that they have a Prosperity Ratio™ of 67.5%.

Step #4: Analyze your score and take action

<u>If your Prosperity Ratio™ is less than 100%:</u>

You need to take corrective action. If this is your issue, consider developing a plan that will put you on track for the next benchmark (i.e. age 45, 50, 55).

If you have been ineffective at building financial assets, consider these steps:

- Pay-Off consumer debt
- Reduce your personal expenditures
- Increase personal savings
- Reduce the interest rate you pay on all of your debt
- Maximize your 401k, TSA,IRA
- Look for higher but sensible investment returns
- Work together with your mate to regain financial control
- Consider professional guidance

<u>If your Prosperity Ratio is at or near 100%:</u>

Take a moment and breath easy. You are among a rare minority of Americans. By continuing to save at a moderate rate, you will be able to retire comfortably at age 65. However, if you desire to retire at age 60, simply add 5 years to your age to see what your Prosperity Index ™ and Prosperity Ratio™ would prescribe.

<u>If your Prosperity Ratio™ is well over 100%:</u>

Congratulations! You really are something. Sure you may be lucky, but typically you are just very skilled at converting earned income into financial assets. Now, look again at the adjustments listed below and consider any distortions. If applicable apply any discounts. Then, if your ratio is still above 100%, good for you.

<u>Adjustments/Discounts:</u>

There are a few distortions that are cause for concern. You may wish to dilute your score if any of the following apply to you:

- A majority of your assets are employer stock (25% discount)
- Much of your retirement accounts are unvested (10% discount)
- Your primary asset is stock or a closely held company (30% discount)
- You've recently come into a lot of money (15% discount)
- A short term drop in family income (dis count equal to income % drop)

Keeping these possible distortions in mind, we recommend you update your score at least semi annually.

Overall, having a good score is just part of the puzzle when developing a comprehensive financial plan. We believe wealth is a means to an end; it's a tool. If you have no purpose for money, then you won't do anything purposeful with it. We believe people want money so they can enjoy the things in their life that are really important to them. As your most trusted advisor we recommend that you complete The Prosperity Index™ and meet with us to develop a comprehensive plan. Start the year off on a good note. Make sure that your financial plan helps you identify the purposes that you have in your life, otherwise you will never fully answer the question "How Much Should I Have?".

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