

CERTIFIED FINANCIAL PLANNER

BOARD OF STANDARDS, INC.

Financial Planning Clinic
November 15, 2008
Hyatt Regency Miami

Financial Planning for Small Business Owners

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Bank of America Private Wealth Management

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FINANCIAL GOALS & CONCERNS

- Step 1 - Define your goals
 - Purchase a home/asset
 - Provide for financial security for life
 - Protect, educate children/grandchildren
 - Transfer wealth consistent with values and tax efficiency
 - Provide well being for others – aging parents, etc.
 - Pursue community/charitable goals
- Step 2 - Identify the risks to the achievement of your goals
 - Unexpected expenses
 - Running out of money
 - Disability/Illness/Death
 - Variability of investment returns
- Step 3 - Develop a plan to mitigate the risks

THE FINANCIAL PLANNING PROCESS

- Where are you now?
 - What do I own?
 - Which assets are liquid?
 - How much do I owe or What are my liabilities?
- Where would you like to be?
 - Financial independence → Retirement planning
 - Provide education funding → Education planning
 - Passing assets to heirs → Estate planning
 - Travel, dream home, etc. → Goal planning
- How will you get there?
 - Asset Growth – savings, asset allocation
 - Increasing Disposable Income – cash flow management, tax savings, credit management, etc.

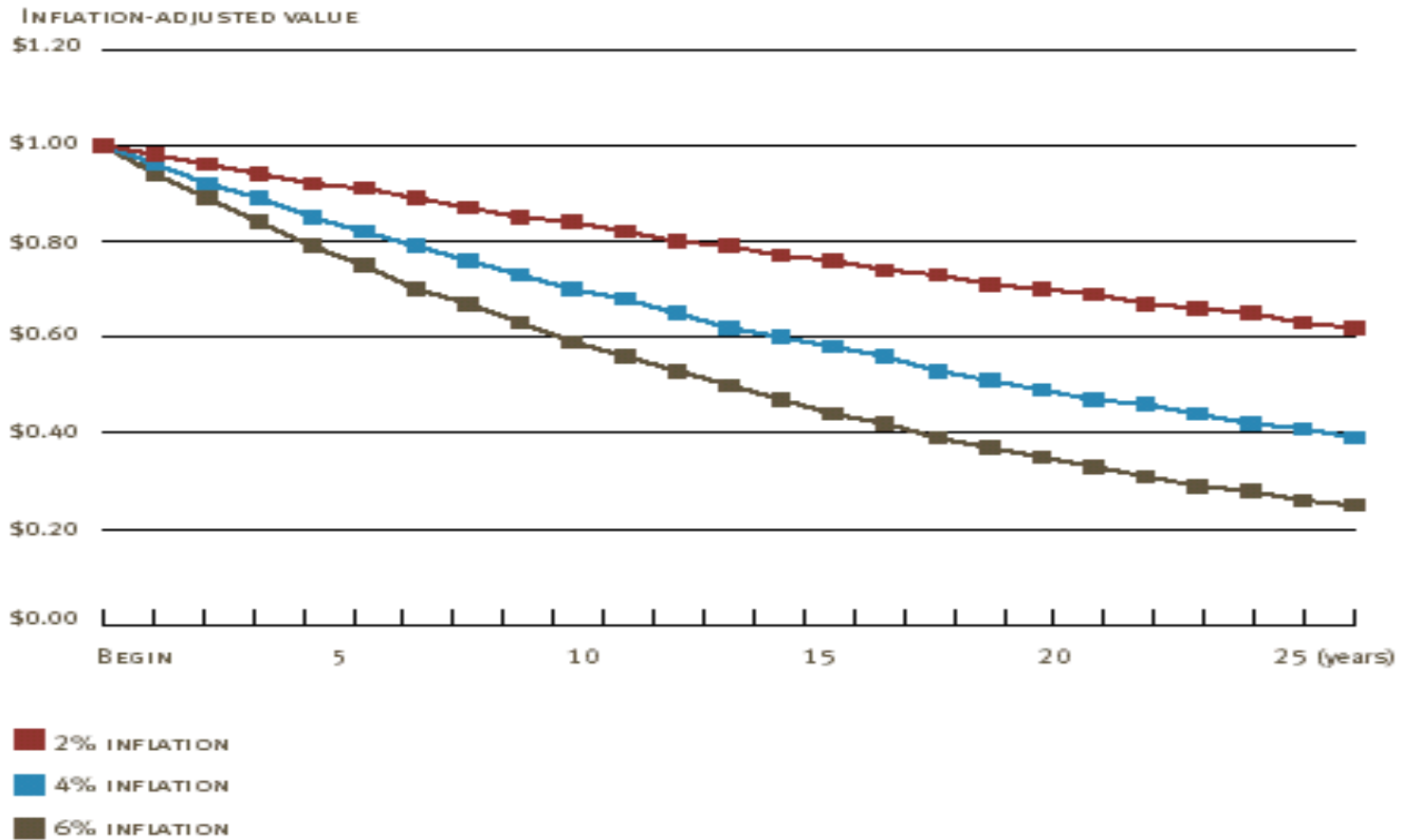
EDUCATION PLANNING

- Nurturing successful and independent children
- Analysis of savings required to meet goal
- Restraints to full pre-funding: Gift Tax
- Funding alternatives
 - Payments directly to education institution (gift tax exclusion)
 - 529 plans and Pre-paid tuition plans
 - Traditional trusts
 - Life insurance

RETIREMENT PLANNING

Effect of Inflation

Value of \$1 reduced by various levels of inflation



Source: U.S. Trust as of October, 2008

RETIREMENT PLANNING

Key Questions

- At what age would you like to retire?
- Where do you want to live during retirement?
- How do you want to spend your retirement?

Sources of retirement income:

- Social security
- Part-time employment/consulting
- Income from non-retirement investments
- Retirement plans

RETIREMENT PLANS – Evaluating your Options

To determine the right retirement plan for your organization, keep your most important goals in mind as you evaluate the various plans.

Here are seven key areas to consider:

- Maximizing yearly contributions/building retirement benefits for you as the owner.
- Maximizing/weighting contributions for you and other highly compensated employees rather than for lower-compensated employees.
- Flexibility in making contributions each year.
- Building retirement benefits for employees.
- Using the plan as a recruiting tool to attract employees.
- Using the plan to discourage employees from seeking employment elsewhere.
- Utilizing income tax deferral on plan contributions and investment earnings.

See Appendix A - Questions to consider when choosing a retirement plan

RETIREMENT PLANS – Qualified Plans

- Traditional Pensions, Solo 401(k), Profit Sharing Plan, New Comparability Plan, Keogh.
- Potentially significant tax advantages to both employers and employees.
- Subject to strict Internal Revenue Code (IRC) & Employment Retirement Income Securities Act (ERISA) guidelines.
- Can be expensive to establish and maintain.
- Significant asset protection under ERISA.
- Can provide larger benefit to higher-paid employees (integrating with Social Security).

RETIREMENT PLANS – Non-Qualified Plans

- SEP-IRA, Simple-IRA.
- Less tax advantageous.
- Generally not subject to same IRC and ERISA guidelines.
- Greater flexibility.
- Less expensive to establish and maintain.
- Lack asset protection of ERISA (but may be protected under state law).

CREDIT PLANNING

Motto: Keep Your Debt In Control Before It Controls You

- Avoid high interest charges on credit card debt
- My rule of thumb: No more than two credit cards
 - Will also help protect against fraud
 - Equifax and other credit protection services
 - Good debt vs. bad debt
 - Deductible debt almost always preferred
- Limit mortgage payments to no more than 30 percent of your monthly pre-tax income
- Two sides of debt: Financial and Personal

CREDIT PLANNING – Should I retain my debt?

- What is the true cost of your debt?
 - Pre-tax Cost: **6.50%** (Interest Rate)
 - Marginal Tax Bracket/Rate: 30%
 - After-tax Cost = Pre-Tax Cost X (1-Marginal Tax Bracket/Rate)
 - After-tax Cost = 6.50% X (1-30%) = **4.55%**

- What else could you be doing with the funds?
 - Pre-tax return: **7.50%** (Rate of Return)
 - Marginal Tax Bracket/Rate 30%
 - After-tax Return = Pre-Tax Return X (1-Marginal Tax Bracket/Rate)
 - After-tax Return = 7.5% X (1-30%) = **5.25%**

INCOME & ASSET PROTECTION

Some Primary Concerns

- Disability planning
- Survivor planning

Potential Roadblocks

- Long-term care
 - Nursing home care
 - Home health care
 - Adult day care services
- Creditors

DISABILITY PLANNING

- Greater than 45% of us will be disabled for 3 months or longer between the ages of 35 and 65.
- Almost 50% of all mortgage foreclosures occur subsequent to a disability.
- You should plan on replacing a minimum of 60% - 80% of our pre-disability income.
- Group plan (Employer provided benefit) vs. Individual policy (Employee purchase)
- What to look for in a policy:
 - Definition of Disability: Own occupation vs. Any occupation
 - "Residual" Benefits: Covers decrease in income resulting from disability
 - Size of benefit
 - Waiting Period: Increasing the waiting period lowers the cost
 - Length of Coverage: Benefits paid one year, two years, five years, to age 65, or for a lifetime
 - COLA Adjustment: increases benefit each year for inflation

LONG-TERM CARE NEEDS

- Odds of needing long-term care (2004):
 - 50% of us over 65 will spend some time there
 - Length of stays:
 - 50% less than 3 months
 - Other 50% average more than two and one half years
- Nursing home costs (2006):
 - National average rate for private room is \$206/day (or \$75,190/year)
 - Semi-private room is \$183/day (or \$66,795/year)
 - Average hourly rate for:
 - Home health aid is \$19/hour
 - Homemaker/companion is \$17/hour
- Probability increases with age:
 - At age 50, one in five need long-term care
 - At age 60, one in four
 - At age 70, seven in ten

LONG-TERM CARE INSURANCE – What to look for in a policy

- **Duration of Benefits:** The limitations placed on the benefits you can receive (e.g., a dollar amount such as \$150,000 or a time limit such as two years).
- **Daily Benefit:** The amount of coverage you select as your daily benefit (typical options range from \$50 to \$350).
- **Waiting Period:** Increasing the waiting period lowers the cost
- **COLA Adjustment:** increases benefit each year for inflation
- **Range of care:** Coverage for different levels of care
- **Prior hospitalization:** Whether or not a hospital stay is required before you can qualify for LTC benefits.
- **Exclusions:** Are certain conditions excluded from coverage?

SURVIVOR PROTECTION – Life Insurance

- If you were to die today, would your family have sufficient continuing income to cover expenses?
- How much is enough?
 - Funeral expenses
 - Short term emergency fund
 - Pre-fund education
 - Replace lost earnings
 - Replace lost retirement savings
- How should the insurance be owned?
 - Directly
 - Indirectly
 - Trust
- What type do I need?
 - Term
 - Universal/Whole Life
 - Variable

ASSET PROTECTION PLANNING

What it is:

- Planning that is:
 - Designed to discourage a potential lawsuit before it begins; or
 - Encourage a settlement most favorable to the debtor.
- Process of organizing affairs in ADVANCE to guard against FUTURE risks.
- Nest egg planning.

What it is NOT:

- Planning aimed to defraud legitimate creditors.
- Hiding of assets.
- Income tax planning.
- Planning in reaction to a lawsuit.

ASSET PROTECTION PLANNING

- There are various “levels” of asset protection planning.
- When considering a strategy to use, you must consider
 - the expense;
 - the ease of administering the strategy; and
 - the extent of protection the strategy offers.
- The strategy you choose must be suited to your particular needs.

ASSET PROTECTION PLANNING - Levels

- **Level 1 - Statutory Protections**

- Both Federal and state bankruptcy and non-bankruptcy laws must be considered.
- Homestead Exemption – Exemption for the value of the equity in a primary residence.
- Tenancy-by-the-Entirety - A form of joint ownership that applies only to a husband and wife while they are married that protects the asset from the creditors of *one* spouse.
- Retirement Accounts (and other tax deferred assets) - Retirement plans receive protection under both federal and state law.
- Life (and disability) Insurance – Life Insurance receives protection under both federal and state law.

- **Level 2 - Prefunding**

- Insurance

ASSET PROTECTION PLANNING – Levels cont'd

- **Level 3 – Asset Structuring**

- Transformation Strategies

- Equity Stripping - Stripping out the equity in a non-exempt asset by encumbering it with debt and investing the proceeds in an exempt asset.
 - Accounts Receivable Factoring - The sale of an account receivable and using the sale proceeds to invest in an exempt asset.
 - Family Limited Partnerships and Limited Liability Companies

- Disassociation Strategies

- Removing assets from your estate thereby breaking any connection between the assets and future creditors.

- Unbundling

- Separating the component parts of a business removing valuable assets from the liability-attracting operating business.

ESTATE PLANNING – What is it?

Estate planning is the process of documenting the assets you control and articulating how you'd like to transfer them at your death:

- To the people you want
 - Equitable and Equal may not be the same thing
- In the manner you want
 - Outright or in trust
 - There are many forms of ownership
- Reflecting your values
 - The non-tax issues can be the hardest
 - Family dynamics and special needs must be considered
- In a tax-efficient manner
 - Gift, estate, generation-skipping (GST) and income
- With ease and efficiency of administration

ESTATE PLANNING – Questions to Answer

- How much is enough?
- When should assets be made available?
- How should assets be made available and for what purposes?
- When should assets be withheld?
- Who are the beneficiaries? Multi-generational planning.
- Who will represent you and your values?
 - Executor
 - Guardian for your children
 - Trustee
 - Continuity, competence, attention, expertise
- How will your business be passed to the next generation?

BUSINESS SUCCESSION PLANNING

- Is my company positioned to sell?
 - Are my books and records in order?
- What is the value of my company?
 - Is the value in you or the company?
- What can I do to make it more valuable?
- What are my options?
 - Keeping your business in the family
 - Sell to a third party
- Once its sold, what do I do now?
- What do I do with the sale proceeds?

KEEPING IT IN THE FAMILY

- What am I transferring?
 - Ownership, Control or Both
- How do I want to transfer it?
 - Sell or gift your business to family?
- Are the family members ready to run and grow the business?
 - If not, what do I need to do to get them ready to run the business?
 - Is my management team ready to run the business?
- Are all the kids involved in the business?
 - If not, do I need to equalizing distributions to my other children?

SALE TO THIRD PARTY

- What do I sell?
 - Sale of company assets vs. stock company stock
 - Different tax consequences for buyer and seller
- What do I get?
 - Sale for cash vs. sale for stock
 - Investment planning vs. Tax planning
- Do I wish to do something for the employees?
- What am I willing to do for the new owners after the sale?

HOW DOES A BUY-SELL AGREEMENT WORK

- Company and shareholders enter into agreement
- Upon specified event(s), affected shareholder must sell stock to company and/or other shareholders
- Price is either set annually, or more likely, an appraisal process is outlined in the agreement
- Purchase is usually over some period of time
- Proper valuation of business – formula based on
 - Sales
 - Cash flow
 - Book value
 - Indexing

TAX PLANNING

- Requires **planning, knowledge** of how the tax laws work, and **appropriate action** taken on a timely basis.
- Contrary to popular belief, audits are not random.
- **Income that is never taxed:** Municipal bond interest (non-AMT), some gain from sale of personal residence, Roth IRA and 529 Savings Plans.
- **Income not taxed in the current year:** Tax-deferred income such as IRAs and other retirement plans.
- **Income taxed at a lower rate than normal:** Tax-favored income such as capital gains and some dividends (15%).
- **Maximize the use of deductions:** Combine deductions into the same tax year.
- Do not play “cat & mouse” with the IRS. A number of tax strategies use “smoke and mirrors” to gain a tax benefit. Walk away if it does not pass the smell test.

SUMMARY/Q&A

Important questions to consider

- Financial strategy balance between lifetime financial needs and legacy?
- How familiar are you with your portfolio?
- Are you living for today or do you want to maintain a long-term horizon, or both?
- Do you know if you have the right mix of stocks, bonds, real estate or alternative assets and cash?
- Do you understand your emotional and financial risk tolerance and have you found strategies to balance if there is a gap?
- Do you have enough to live out your retirement comfortably?
- Is your portfolio as tax-efficient as it can be without sacrificing your other goals?
- Have you developed strategies to help meet and maximize your philanthropic goals?

APPENDIX A – Questions to consider when choosing a retirement plan

As an employer, you may want to establish one or more retirement plans for yourself and/or your employees. Having a plan can provide significant benefits for both you and your employees (if any). There are many different types of retirement plans, however, and choosing the right one for your situation is a critical decision. You want a plan that will meet both your goals as the employer and the needs of any employees you may have. In addition, it is important to balance the cost of establishing and maintaining a plan against the potential benefits.

You can zero in on the key areas of importance and take the first step to finding the right plan by answering the following questions:

- What kind of a business entity do you have? Do you have a sole proprietorship, a partnership, a corporation, a limited liability company filing a corporate return, or a limited liability company filing a partnership return? Some plans are more appropriate for certain types of business entities than for others.
- How many employees do you have right now? How many do you expect to have in one year, three years, and five years from now? Some plans impose limits on the number of employees you can have.

APPENDIX A –

Questions to consider when choosing a retirement plan, cont'd

- What is your current compensation and the current compensation range for your employees? What do you expect your compensation and the compensation range for your employees to be over the next year, three years, and five years?
- How old are you, and what is the age range for your employees? Some plans allow contributions to be allocated based on age.
- How much do you want to put away in the retirement plan each year for yourself and/or your employees?
- Who do you want to fund the retirement plan contributions? Just you as the employer? Just the employees? Both the employees and you as the employer?
- If you as the employer are funding at least some of the contributions, what percentage of employee compensation do you want to contribute each year?
- How important is it for you to minimize the amount of contributions to rank-and-file employees, as compared to those for you and other executives?
- How stable or unstable have your company's profits been in the last few years?

APPENDIX A –

Questions to consider when choosing a retirement plan, cont'd

- How important is it for you to have flexibility in the amount of retirement plan contributions you make each year, as opposed to contributing a fixed amount or fixed percentage of employee compensation regardless of the company's bottom line?
- How important is it to you to delay vesting and employee control of contributions made by you as the employer?
- How important is it that the retirement plan be simple to understand?
- How important is it that the retirement plan be relatively inexpensive to set up and administer?
- How important is it for the plan to be competitive to attract and/or retain employees?
- How important is it to reduce the current taxable income of you and your employees through employer and employee contributions?
- Do you have a stable workforce, or a high turnover rate among your employees?