The
FINANCIAL UPDATE

DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING

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Wealth Transfer Strategies For Troubled Times

If you happen to die in 2010, your estate planning problems are over—at least they might be. For a year, at most, the federal estate tax is gone. But the tax is scheduled to return in 2011 in a much more punishing form than it took in 2009, and that prospect could motivate a congressional compromise, with new rules that may be applied retroactively to wealth transfers during 2010. That means there's really no holiday for wealthy families looking for tax-efficient ways to move assets to the next generation. And though there is no federal estate tax in 2010, there is a limited step-up in basis which could trigger capital gains for beneficiaries of large estates assuming they sell the assets immediately. Still, with stocks, real estate, and almost every other kind of asset worth less now than before the recession, you may be able to transfer more to your heirs at lower cost, and today's rock-bottom interest rates could also help. Consider these five strategies that attempt to take advantage of the current economic environment.

1. Get the most from the annual gift tax exclusion. This tried-and-true vehicle may be worth more now than ever before. In 2010, you can give up to $13,000 of assets to as many recipients as you choose—or a maximum of $26,000 for each gift if your spouse joins in—without gift-tax liability. The trick here is to give away something whose value has dropped but is likely to recover.

2. Take advantage of low interest rates to make a loan or asset sale to family members. Here, too, current economic circumstances can maximize the value of funds you transfer to the next generation. You could lend money to buy a home or start a business, charging interest based on today's low applicable federal rate (AFR)—in June 2010 just 4.30% on loans with a term longer than nine years. Or you might sell assets—whose value may be at a low point—to family members directly, or to an irrevocable trust set up for their benefit, with installment payments also based on the AFR rate.

3. Create a grantor trust with undervalued assets. This can be yet another way to capitalize on the temporarily depressed value of many assets. You can use your annual gift tax exemption—perhaps supplemented by some or all of the $1 million lifetime exclusion that individuals may employ to shield gifts from taxes—to transfer assets into the trust. Then, you'll be responsible for income and capital gains taxes on trust assets. Though those payments further reduce your taxable estate, they aren't considered gifts to the trust's beneficiaries, and they enable trust assets to continue to grow unencumbered by taxes, adding to the potential recovery of beaten-down assets.

4. Boost the benefits of a grantor retained annuity trust. A GRAT can preserve assets from the sale of a business interest or other holdings.

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Despite Concerns, Most Don't Have A Financial Plan

Even after one of the worst economic downturns in U.S. history, only 17% of Americans have a written and updated financial plan, according to a survey by Certified Financial Planner Board of Standards.

With the value of retirement assets slashed and incomes stalled, it would make sense for people to take steps to rebuild their financial futures. Yet the survey, taken eight months after the economic collapse of October 2008, shows most people don't have a blueprint for getting back on track.

According to the CFP Board survey, a majority of Americans of all incomes and asset levels are worried about managing retirement income, keeping health care insurance, managing debt, and building a retirement fund. When it comes to reaching financial goals and life dreams, it doesn't make sense to leave things to chance. A financial plan not only gives you a concrete direction, it helps you stay on course and change direction when necessary.

If you have yet to set up a financial plan, or if your plan is falling short, call our office today so that we can help you chart a solid path to a secure financial future. You can also feel confident that the advise you get from Day & Ennis is conflict free since we sell no products or take any commissions. We are fee-only advisors and have a fiduciary responsibility to you.

John R Day Bill Ennis

Beware Of Homeowner's Insurance Gaps

Disaster may strike your home when you least expect it. There could be damage from flooding, an earthquake, termites, or even mold—just to name a few possibilities. And though you probably assume repairs will be covered by your homeowner's insurance policy, they may not be. Your policy may exclude more events than you realize. Even when you are covered—for, say, flood damage—there may be "gaps" in your coverage that limit the amount you can recover.

The good news is that a typical homeowner's policy covers losses resulting from fires, tornadoes, and severe storms. But the list of what it normally doesn't cover may surprise you. For instance, coverage may not extend to floods and earthquakes, although you can usually add a policy rider for such events. The rider's cost will vary based on whether you reside in a high-risk area.

Similarly, if you have to clean up a mess created by a water or sewage backup, the expense won't be covered by standard homeowner's insurance. But here, too, you can purchase a special rider to avoid this headache, often for less than $100 a year.

The list of other types of damage that usually aren't covered range from mold to insect and termite infestations to acts of terrorism, war, and nuclear attack. Dig your policy out of your files and take a few minutes to assess your risk exposure for these events.

Even if you're covered for damage—through standard insurance or a rider—payments from the insurance company are based on the property's replacement cost, not its fair market value. Also, if your home is destroyed and it's insured for less than the replacement value, you'll have to pay some of the rebuilding cost. In addition, deductibles and maximum dollar caps may affect reimbursements for possessions that are destroyed or stolen.

In terms of liability exposure, one way to avoid dire consequences is to supplement your current coverage with an umbrella liability policy. As the name implies, the umbrella policy sits on top of your homeowner's and auto insurance policies to provide additional protection. For instance, if a neighbor slips and is injured on your icy sidewalk or a tree topples onto a car parked in front of your home, an umbrella policy may pick up the slack.

Just like other forms of insurance, you'll need to shop around for the best umbrella policy. And keep in mind that umbrella coverage kicks in only after other insurance is exhausted, and umbrella policies usually carry deductibles equal to the required underlying limits for the auto and homeowners policies. Still, the cost of umbrella coverage usually isn't prohibitively expensive. You may be able to obtain $1 million in liability coverage for $200 to $300 a year. And you may get a discount for using the same carrier. That could prove a small price to pay for plugging the gaps in policies. ●

Do You Know Estate Planning Basics?

With the future of the estate tax up in the air, you may be tempted to neglect estate planning. The federal tax on inherited wealth is currently scheduled to be repealed in 2010, only to return in 2011 under less favorable terms. Congress will most assuredly resolve this issue before year-end, perhaps exempting all but the wealthiest families from estate tax liability. Yet whatever the fate of the law, having a thoughtful, effective estate plan will continue to be crucial.

At a minimum, you need a legally enforceable will that lays out how you want your assets to be distributed. An accompanying, non-binding letter of instruction could further spell out your wishes. You may also want to establish one or more trusts designed to minimize taxes, manage assets for minors, provide asset protection for heirs, implement philanthropic plans, or protect assets from creditors. And a living will (or health care proxy) could provide valuable direction on end-of-life health care.

Are you familiar with estate planning basics? Use this quiz to test your knowledge.

1. Which of the following is true?

a) A will is legally valid only if drafted by an attorney.
b) You can transfer jointly owned property through a will.
c) A will may appoint a guardian for minor children.
d) Your property must go through probate if you don't have a will.

2. When can a will be changed and remain legally enforceable?

a) Only if the changes are recorded by an attorney
b) Only when the heirs named in the will provide their consent
c) Any time before your death or mental incompetence
d) Never

3. In 2009, the federal estate tax exemption was:

a) $1 million c) $3.5 million
b) $2 million d) Zero

New DB(k) Plans Could Be Tempting

As the owner of a small business, you can choose from a range of retirement plans. Yet while there are important variations among the many possibilities—401(k)s, simplified employee pensions (SEPs), defined-benefit pension plans, and others—they basically fall into one of two categories depending on who is responsible for funding and using the plan. With old-style pensions, your business promises employees a specific retirement benefit, generally a function of salary and years of service (as a lump sum or a lifetime annuity). In contrast, 401(k)s and other defined-contribution plans put the burden on employees to save and invest a retirement account and then decide how and when to tap it.

Beginning in 2010, a new hybrid—the defined-benefit 401(k) plan, dubbed the DB(k)—combines features of both types. A DB(k), authorized by the Pension Protection Act of 2006 and available to companies with two to 500 employees, provides a small but guaranteed company-paid lifetime monthly retirement benefit while letting workers also fund a 401(k). One major attraction is that DB(k)s are exempt from the strict nondiscrimination rules that normally apply to 401(k)s and other tax-advantaged retirement plans. But the fact that the DB(k) supplements employees' savings with guaranteed cash also has its appeal at a time when the bear market has cut deeply into 401(k) account values.

The 401(k) part of the DB(k) is subject to the same rules as normal 401(k)s. Employees can direct as much as $16,500 of pre-tax salary into the plan in 2010, and those age 50 and older may put away a maximum of $22,000. Participating workers can bolster these dollars with optional employers' matching contributions, with total yearly savings capped at $49,000 and $54,500, respectively, for those under and over the age 50 dividing line. Workers (and business owners) who achieve those maximums should, over a working lifetime, amass a reasonable nest egg. But how much participants save, and how they invest the savings, is left up to them, and there's no guarantee they'll have enough to fund a long, comfortable retirement.

Nondiscrimination rules can be another stumbling block for business owners and other high-income workers enrolled in traditional 401(k)s. Such plans must meet strict requirements to ensure that highly compensated employees (HCEs) don't receive a disproportionate share of retirement plan benefits. If lower-paid employees choose not to participate, those at the top of the compensation ladder may find their own contributions restricted.

The defined-benefit 401(k) uses a waiver of those rules to encourage business owners to adopt this new-style retirement plan, which supplements savings with a defined retirement benefit that's normally based on "final average pay." The plan must provide a benefit equal to 1% of an employee's final average salary multiplied by years of service, with a maximum annual pension equal to 20% of final pay. Meanwhile, the 401(k) part of the plan requires automatic enrollment of employees (who must opt out if they don't want to participate) and an employer's contribution equal to 4% of compensation. Your business's matching contribution rate for HCEs can't exceed the matching rate for non-HCEs, and you must immediately vest employees in their 401(k) accounts.

A second option for determining benefits is a cash balance approach that specifies annual minimum company commitments based on employees' ages. In this case, your business must set aside at least:

- 2% of compensation for participants age 30 and under
- 4% of compensation for participants between age 30 and 40
- 6% of compensation for participants between age 40 and 50
- 8% of compensation for participants age 50 or over

Plans that meet all of the requirements of a DB(k) need file only one document for the plan and one annual IRS Form 5500—even though this hybrid really consists of two separate plans. And no other testing is required.

Some experts expect the DB(k) to be particularly attractive to small professional groups—physicians, attorneys, accountants, architects. It can build up substantial retirement savings in a short time, and though it mandates a significant employer contribution, that could be an advantage for owners looking to fund their own retirements. Moreover, as the economy rebounds and businesses again compete for the best workers, offering a DB(k) could make your company stand out. The IRS is expected to announce more details about this new plan soon. ●

4. In 2010, the annual gift tax exclusion shelters gifts to individuals of up to:

a) $10,000 c) $1 million
b) $13,000 d) Zero

5. For estate tax purposes, the value of assets is based on:

a) Their fair market value on the date of the owner's death (or six months from that date)
b) The amount received from the sale of those assets
c) The assets' original cost
d) The value stated in the owner's will

6. A "power of attorney" is best described as:

a) A bequest in a legally validated will
b) A document authorizing an agent to act on your behalf
c) A document allowing life support systems to be shut down
d) The use of a lawyer in estate planning matters

7. Which of the following is not true?

a) The value of your principal residence is excluded from your estate.
b) The value of property transferred to your spouse is exempt from estate tax at your death.
c) A testamentary trust takes effect when you die.
d) A will normally determines who will care for minor children.

If you have questions about estate planning or need to refine your plan, please give us a call. We can work with you and your attorney to make sure all of your needs are met.●

Answers: 1-c; 2-c; 3-c; 4-b; 5-a; 6-b; 7-a

Caveat Emptor: Long-Term Care Policies

Most long-term care (LTC) insurance policies today are much better than those offered in previous decades. Still, there remain potential drawbacks, and would-be buyers need to make sure they know what they're getting and that it suits their needs.

Many early LTC policies paid benefits only for "skilled nursing home care" for a limited period of time. Moreover, there were often stringent requirements to qualify for benefits, such as having to spend three days in a hospital before going into a nursing home.

Most states now require LTC policies to provide benefits for all levels of care, and competition among insurers has led to innovations that make LTC insurance a significantly better value. Yet these policies remain complex and expensive, and getting the right mix of benefits means understanding the LTC landscape. Consider these factors:

Range of coverage. Most policies offer benefits for care in a variety of settings, including at home, in an assisted living facility, and adult day care as well as in a nursing home. Payment may vary with the setting, so make sure the specified amounts cover the cost of care in your area. And beware of hospitalization requirements, because only about half of nursing home admissions follow a hospital stay.

Benefit triggers. Usually, LTC benefits are available once the insured needs assistance performing a specified minimum number of activities of daily living (ADLs) —commonly including eating, bathing, dressing, "toileting," continence, and mobility. Better policies kick in when someone requires help with just two or three ADLs. Some policies also begin coverage when there is "cognitive impairment."

Waiting period. Most policies specify a 90-day waiting period between the time need is demonstrated and the beginning of benefit payments. However, it is important to check the policy's definition of a "waiting period," as it could refer to either calendar days or service days.

Premiums. The younger you are when you begin coverage, the lower the premium, which will also be affected by the range of policy benefits you choose, including type of policy (reimbursement, indemnity, or cash); health status; waiting period; and inflation factor chosen (simple, compound, or none).

Inflation protection. The cost of all health care, including long-term care, is rising much faster than the overall cost of living. So it's essential that a policy increase benefits as costs rise—particularly if it could be years or even decades before care is needed.

Desirable policies are guaranteed renewable for life and cover pre-existing medical conditions. Additional riders and options may be worthwhile, but it's important to weigh the costs of extra benefits. We can help you make sense of this complicated insurance market and help you find a suitable policy at a reasonable price. ●

Wealth Transfer Strategies

(Continued from page 1)

Essentially, you transfer assets to an irrevocable trust, but retain the right to receive distributions over the trust term. The annuity is based on the amount transferred and the prevailing interest rate set by the government under Section 7520 of the tax code. (The 7520 rate as of June 2010 is 3.2%.) The lower the rate, the lower the payout, resulting in more asset preservation for your heirs—particularly if the assets rebound in value. It's also possible to "zero out" a GRAT, effectively eliminating any gift tax on the transfer to the GRAT. (Keep in mind that Congress may modify the rules affecting these techniques.)

5. Use a charitable lead trust (CLT) to help charities and your heirs. With a CLT, income on trust assets during the term of the trust goes first to the designated charity and then to your heirs, who also ultimately inherit trust assets. Most nonprofits have suffered during the recession, and they'll welcome this annual infusion of cash. And if the CLT earns more than the specified yearly payment—based on a fixed amount or percentage of assets—the excess is added to principal. If an economic recovery increases the value of trust assets, your beneficiaries could benefit.

One or more of these strategies could help you and your heirs benefit from an otherwise dismal economic environment. Yet uncertainty abounds. No one knows what will happen to the estate tax or to tax rates on gifts and income, and there's no guarantee that stock prices or real estate values will soon recover what they lost during the long downturn. We can work with you and your attorney to consider your wealth-transfer goals and to create a plan that makes sense for you in these troubled times. ●

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