volume 35, number 6

assets

a business, tax, and financial newsletter

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Executive Compensation ■ Succession ■ Wealth Transfer Planning

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Offset the Effects of Inherited Wealth with Incentives

For many affluent individuals, estate planning extends well beyond tax planning and involves very personal decisions about the distribution of future wealth. In more traditional estate plans, the **spendthrift trust** is used as a vehicle for distributing trust income, while limiting immediate access to trust principal.

A spendthrift trust can help provide a financial head start for minor children and protect adult heirs from certain creditors and limitations in financial judgment. However, such trusts may provide heirs with little incentive to expand their own professional, academic, or philanthropic horizons. Thus, affluent individuals who are particularly sensitive to the potential ramifications of "handing over" considerable wealth to heirs may choose to establish an *incentive-based* estate plan.

One of the cornerstones of an incentive-based estate plan is the **family incentive trust (FIT)**. Like typical trusts associated with estate planning, a FIT helps trustees implement an affluent grantor's expectations about the uses of his or her estate. Similarly, a FIT can help ensure proper care and financial support if an heir falls on hard times or has special needs. However, a FIT is somewhat unique in that the general distribution of trust income is based on a series of predetermined "incentives."

Promoting Success and Reinforcing Values

The incentives outlined in a FIT are at the discretion of the grantor. Each incentive provides the grantor with the opportunity to encourage specific future behavior. For instance, the trust could have provisions that pay each heir \$10,000 on acquiring a bachelor's degree, \$25,000 for a master's degree, and \$50,000 for a doctorate. A FIT can also be an ideal tool to reward family members who pursue and/or distinguish themselves in a career path of the grantor's choosing, such as the family business, music, the arts, research, or teaching. A FIT can reward younger heirs for academic success or community involvement. In addition, the trust can match certain levels of income for heirs who are younger than a specified age.

A FIT may also be an appropriate vehicle for education funding. Unlike a custodial account, which generally becomes the property of the child once

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Maintaining a Successful Banking Relationship

Your bank constantly evaluates you and your business. They examine your financial statements, but also notice subtleties, such as your current financial health and well-being.

Remember, the nature of the banking business is to *evaluate risk*. As a business owner, your bank needs to know that all is well with your personal and business finances. If you provide them with information or signals that suggest you are having financial difficulty—and you do nothing to make them think otherwise—you might as well ask them to turn down your next loan request, raise your interest rate, or call your loan.

Appearances Matter

Obviously, your bank wants to continue a positive relationship, and they look to you to provide assurance for doing so. The fact is that while you or your business may be prospering, you may be sending them conflicting information. The following are some signals that may attract attention:

Making the Daily Review Lists. Most banks review daily lists of checks drawn on uncollected funds, overdraft accounts, and large transactions. If your account regularly appears on one of these lists, it could suggest that you are out of cash or otherwise headed for trouble.

They also review daily lists of past-due loans, loans with incomplete collateral documentation, and late financial statements. You may not consider late statements significant, but bankers do. They have learned that people are seldom late when they have good news. If you are slow to pay, banks may assume the worst.

Experiencing Cash Flow Problems. When you frequently request small loans to cover incidental expenses, banks may begin to assume that your business is not generating enough cash. Or, if you maintain high balances on your bank credit cards, a banker has the right to wonder why you are willing to pay high interest rates rather than pay off the balances. When your financial statement shows a large net worth and a small amount of cash, banks may worry that your debt service is exceeding your cash flow.

Changing Your Proposal. When you change your mind too often in your dealings with a bank, you may leave a negative impression. One fairly common situation that bankers encounter is a customer coming to the bank with a request for a specific loan amount. The banker gets it approved, and the customer then says more money is needed. Thus, the loan officer may need to take a proposal back to the loan committee.

Becoming Rough Around the Edges. When bankers evaluate the risk of a loan, they take a long, hard look at the borrower's current condition. In loan committee meetings, it is important to make certain you are sending the proper message. If loan officers notice a drastic change in your appearance or behavior, they may justifiably wonder what is wrong.

In addition, if the company's building site looks run-down, with peeling paint or disheveled landscaping, someone from the bank may notice. To the bank, it may look like you are not paying attention to the details of running your business or that you are unable to pay for basic maintenance.

Reflect, Then Act

If any of these descriptions sound uncomfortably familiar, consider developing a strategy for implementing changes now. Maintaining a good relationship with your bank is crucial to executing your business's financial plan. Whenever possible, eliminate minor problems today that could become roadblocks on your path to success tomorrow.

Why Should You Start Saving for Retirement Now?

You are busy dealing with life's day-to-day issues. To you, retirement may seem like a long way off. But preparing now for your financial future is essential because what you do *today* can help ensure a secure retirement *tomorrow*.

Although time may be on your side, there are four factors you will need to consider when planning for your retirement.

1) **Inflation.** You may be aware that, over time, inflation can erode your savings. But, many people don't realize the potentially serious effects of inflation. At 3% inflation, $100 today will be worth only $67.30 in 20 years—a loss of one-third of its value. At 35 years, this amount would be further reduced to just $34.44. Thus, it is important to seek retirement savings vehicles that have the best chance of outpacing inflation.

2) **Taxes.** Your present income level, tax bracket, and the types of tax-deferred retirement savings plans that are available can all play an integral part in how much money you can save for retirement. By maximizing your pre-tax contributions to employer-sponsored plans and **Individual Retirement Accounts (IRAs)**, you can take advantage of the tax-deferred benefits of such plans.

3) **Compound Interest.** Becoming a disciplined saver is one of the key components of retirement plan success. By making regular contributions to your employer-sponsored retirement plan and your IRA, you can maximize the power of **compound interest** (the interest earned not only on the initial principal, but also on the accumulated interest from prior periods). With consistent contributions, your retirement savings have a greater chance of accumulating to meet your long-term goals.

4) **Personal Savings.** Considering the effects of inflation, it is possible that your retirement plan income may fall short of your needs, especially during a long retirement. Furthermore, Social Security generally provides only a base level of retirement income. Thus, to avoid a potential shortfall, start planning to supplement your retirement income with personal savings.

While understanding these principles is no guarantee of future success, they can get you started down the right path. The sooner you recognize the effects that economic forces can have on your retirement income, the more likely you may be to adopt strategies that can help you achieve your long-term objectives. Being proactive today can help increase your retirement savings for tomorrow. ■

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he or she attains the age of majority (determined by state law), a FIT can dictate that some trust assets be used to help cover education costs. Thus, the trust—rather than a young, inexperienced adult—can maintain control of monies earmarked for education.

Another interesting use of a FIT is treating the trust principal as a "family bank." The FIT can offer low-interest-rate loans for start-up business ventures or the purchase of a primary residence. To minimize risk to the trust, a lending process similar to that of a traditional lending institution can be established.

Philanthropy creates another possibility for an incentive-based estate plan. Certainly, many affluent individuals consider philanthropic pursuits to be important endeavors. A FIT can be used to match the charitable contributions of a beneficiary. Also, the FIT's matching contribution can be arranged as a distribution to the beneficiary, who then contributes it to the charity. Thus, the beneficiary can reap the benefits of a charitable deduction for his or her contribution, as well as the FIT's matching contribution. As an alternative, any remaining trust income that has not been distributed through incentives may be used to make a charitable contribution. Such contributions can also be arranged to be made on behalf of trust beneficiaries.

Sometimes, inherited wealth can have a negative impact on the motivation of heirs. For instance, when some heirs receive a substantial inheritance, they may be content with a life of leisure. Thus, the reasoning behind incentive-based estate planning is fairly straightforward. Assets and income are distributed to assist heirs who are realizing career or academic goals and/or whose actions are consistent with the expectations of an affluent grantor. By adopting some of the principles of incentive-based estate planning, the affluent grantor can promote a family legacy of excellence and productivity for generations to come. ■

Living Value: The Other Side of Life Insurance

Many of us think of **life insurance** as a means of providing funds to cover financial obligations, such as a mortgage, or to replace income in the event of the death of a family breadwinner. In general, the **death benefit** under a life insurance policy is often the most-well-understood feature.

However, not all policies are the same. A **permanent life insurance** policy contains a cash value feature that allows cash to accumulate, which may be used to help supplement important financial goals, such as funding a child's college education. So, permanent life insurance has a "living value" in addition to the traditional death benefit feature. Let's take a closer look.

Cash Value

The cash value in this type of life insurance policy accumulates on a tax-deferred basis in the same way that money does in an Individual Retirement Account (IRA). Because of this tax-deferred accumulation, there may be some income taxes due upon withdrawal. But, you are usually only taxed on amounts that exceed the *total* amount of premium payments you have made over the course of the policy.

One of the key benefits of permanent life insurance is that you can access the accumulated cash values through policy loans. Typically, the loan interest rate is stated in the policy and is comparable to traditional lending rates. Keep in mind that borrowing or partial surrenders can reduce the policy's cash value and death benefit, increase the chance that the policy will lapse, and may result in a tax liability if the policy terminates before the death of the insured.

Another key feature of a permanent life insurance policy is that, unlike a traditional IRA or another qualified plan, you may make premium payments after age 70½, and there are no rules that stipulate required withdrawals of cash values by age 70½. This feature may provide an opportunity to continue making premium payments while receiving the benefits of tax-deferred accumulation.

With a life insurance policy, there are few rules that limit the amount of premium payments. Therefore, the higher the death benefit, the higher the premium will be. Some forms of permanent life insurance allow you to make premium payments in addition to what is specified under the terms of the policy. This may increase the cash value, but could lead to adverse tax consequences. Normally, policies are written to help avoid this possibility.

Dual Purpose Protection

Life insurance can serve many purposes. Through its death benefit, life insurance helps to protect and secure your family's future in the event of your death. At the same time, life insurance with a cash value may provide you with the opportunity to use the benefits of your policy during your lifetime.

Be sure to review your options with the help of a qualified insurance professional to see how permanent life insurance can help meet your overall financial objectives. ■

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