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assets

a business, tax, and financial newsletter

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If you're a small business owner, you've invested a great deal of time and effort into building your company. With day-to-day demands, it may be difficult to imagine your eventual transition into retirement. Yet, if you want to build personal financial security and ensure business continuation, it is important to plan ahead. **Business succession planning** can help create retirement income for a retiring business owner and facilitate the transfer of operations and/or ownership to family members or another entity. A succession plan can also provide a strategy to handle unforeseen events, such as death or disability.

Laying the Foundation

It is never too early to begin planning for succession. An early start can allow you ample time to develop an appropriate exit strategy, choose the right person to be your **successor**, and train your successor to manage the daily operations of your company. Consider the following points to create a foundation for a successful plan:

Valuate Your Business. A key aspect of planning for continuation is calculating the worth of your business. There are a variety of techniques for business valuation, and the most appropriate will depend on your business circumstances. A qualified professional can help you choose strategies for valuation.

Plan Your Exit Strategy. It is important for a retiring business owner to plan his or her departure from the day-to-day operations of the business. A solid plan can help ensure this transition will go smoothly, as well as facilitate the transfer of ownership.

Choose a Successor. If you plan to keep ownership and control of your business within your family, start by assessing your family members' interests and qualifications, and how well they match the needs of the business. Discuss with family members who will participate in the company and in what capacity. Then, determine how working members will be compensated and what will be given to nonparticipating members.

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Your Credit Report: A Clue to Identity Theft

Identity theft is a serious crime, with increasingly greater numbers of consumers being affected every year. As part of a protection strategy, the Federal Trade Commission (FTC) and other consumer-credit organizations recommend a proactive approach to safeguarding your identity: checking your **credit report** annually.

A credit report records information about your bills and loan and repayment history, available credit, and outstanding debts. It is typically used by lenders when deciding to accept a loan or credit application. In addition, credit reports can alert you to accounts that have been fraudulently opened in your name, unauthorized charges made to your existing accounts, and other crimes committed by someone using your personal information.

According to the **Fair Credit Reporting Act (FCRA)**, you can request a free copy of your credit reports from each of the three major credit bureaus (Equifax, Experian, and TransUnion) once a year. For your convenience, you can access all three agencies through a single website, www.annualcreditreport.com. The FTC suggests that you order all three reports, even if you choose to stagger your report requests throughout the calendar year, as the information may differ from each bureau. This is because credit reporting is voluntary, and therefore creditors may subscribe and report information to just one agency, or all three.

Reviewing Your Reports

Usually, a credit report is divided into four major sections: identifying information, credit history, public records, and inquiries. The **identifying information** on your report will include your name, current (and previous) address, Social Security number, driver's license number, telephone number, birth date, current and previous employers, and your spouse's name, if applicable.

The **credit history** section details your payment history with banks, retail stores, finance companies, mortgage companies, and others who have given you credit. Each account, sometimes called a trade line, will appear with the following information: name of creditor, account number, type of credit (i.e., installment loan or revolving credit), account participation (e.g., joint owner, individual account, or authorized user), date opened, last activity (date of last payment or charge), high credit (the credit limit or original loan amount), terms (number of installments or amount of monthly payments), balance at the time of reporting, past due balance at the time of reporting, status of the account (open, closed, inactive, etc.), and date of last report. It is in this section that accounts opened or affected by identity thieves may become apparent.

The **public records** section includes documents that reflect your history of meeting financial obligations, such as bankruptcies, collection accounts, judgments, and tax liens. Since public records can have a serious, negative effect on your credit, verify that the information belongs to you, not someone who used your personal information.

Finally, the **inquiry** section lists all the businesses that have received your credit report during the last 24 months. Inquiries are categorized as hard or soft. Hard inquires are those you initiate by filing a credit or loan application. Soft inquiries often come from marketers who want to sell you something. If you do not recognize a listed business, be sure to find out the nature of the business and why they are looking at your credit report.

A Mistake or Identity Theft

If you find a mistake on your credit report, immediately contact the credit bureau that issued the report using the form provided or by following that particular agency's instructions. If the error is serious, and you suspect that your identity has been stolen, contact the FTC's Identity Theft Hotline at 1-877-IDTHEFT (877-438-4338). Be sure to keep detailed documentation of all communications with creditors, agencies, and the FTC.

You can help safeguard your identity by continually monitoring your credit reports. For more information about identity theft, visit the FTC's website at www.ftc.gov. ■

An Overview of Asset Protection with A/B Trusts

Asset preservation goes hand-in-hand with wealth accumulation. The Federal estate tax law makes planning your estate and staying abreast of legislative changes essential. Every estate may exclude a certain amount of property from estate tax, and in 2013, that amount is $5.25 million for individuals and $10.5 million for married couples (adjusted annually for inflation).

Thanks to the unlimited marital deduction, assets that are passed to a surviving spouse do not incur any estate taxes. But, estate taxes would be owed on the portion of the estate that exceeds the applicable estate tax exemption amount, which is $5.25 million in 2013. To maximize the exemption for both spouses, an **A/B Trust** would preserve the estate exemption of the first spouse to die while allowing the surviving spouse to use the exemption, in effect increasing the amount exempted from the estate tax.

With the American Taxpayer Relief Act (ATRA) of 2012 passed into law in January 2013, however, the exemption amount was permanently extended to $5 million (indexed annually for inflation), and the Federal estate tax rose to 40% in 2013, excluding many married couples from having to pay the Federal estate tax. In addition, the ATRA allows a surviving spouse to use the deceased spouse's unused exemption amount, along with his or her own exemption amount up to $10.5 million in 2013.

But you may still want to consider an A/B trust as a viable option because many states have their own estate and/or inheritance taxes. An A/B trust could preserve a married couple's state estate tax exemption, shelter appreciated assets, offer creditor protection, as well as benefit children from a previous marriage.

Setting Up A/B Trusts

After the death of the first spouse, two separate trusts would be set up. The assets of the surviving spouse would be transferred to the A trust, and an amount up to the estate tax exemption of the deceased spouse's assets would be transferred to the B trust; therefore, setting up two taxable trusts, with each trust entitled to use the exemption.

The B trust is subject to estate taxes, but with the applicable exemption, no taxes would be owed. The surviving spouse manages the A trust's assets and receives income from the B trust. Upon the death of the surviving spouse, the A trust would be subject to Federal estate taxes, while the B trust may continue for the benefit of the grantors' family. For example, assets may be divided into separate equal trusts for the grantors' children, who can then receive net income, and at a specified age, receive the principal.

In certain circumstances, the A/B trust arrangement can be an effective estate planning technique to help *both* spouses use their estate tax exemptions. But A/B trusts, tax rules, and regulations are also complicated. This is but one of a variety of strategies available to help protect family assets. Be sure to consult your estate planning team of advisors for more information about A/B trusts. ■

Safe Harbor: The New Option for Home Office Deductions

The Internal Revenue Service (IRS) announced on January 15, 2013, that owners of home-based businesses and some home-based workers will have the option of using a new safe harbor method when calculating their tax deduction for the business use of their home, also known as the home office deduction.

The new option, which will be available starting with the 2013 tax return, provides eligible taxpayers with an easier way of claiming the home office deduction under Section 280A of the Internal Revenue Code. Under current rules, taxpayers are generally required to fill out the 43-line Form 8829, *Expenses for Business Use of Your Home*. Completing the form often involves complex calculations of allocated expenses, depreciation, and carryovers of unused deductions.

But taxpayers claiming the new optional deduction will complete a streamlined form in which they simply have to multiply the square footage of the area of their home used for business purposes by the prescribed rate of $5 per square foot up to 300 square feet, or $1,500 per year. Taxpayers will, however, have to continue to satisfy the existing criteria for claiming the home office deduction, such as the requirement that a home office must be used *regularly* and *exclusively* for business. For a full explanation of

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retiring business owners and succession planning

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If you expect unrelated parties to carry on the business, meet with the key people involved for an in-depth discussion about the company and its future. If succession involves the sale of the business, be prepared to address such issues as what the purchase price will be, how it will be paid, and when the succession plan will be activated.

Develop a Business Plan for the Future. Through your business plan, you can outline clear-cut, short-, medium-, and long-term business goals for your successor, along with an action plan for achieving them. Include budgets and financial forecasts that can be modified according to changing conditions in both the industry and the economy.

Choose a Transfer Strategy. Depending on the type of business, its value, and your personal financial situation and goals, determine the best ownership transfer strategy for your business. There are a variety of ways to structure and fund **buy-sell agreements**. For transfers to family members or charity, **gifting** may be an appropriate option. Consult your tax and legal professionals for specific guidance.

Plan for Contingencies. Regardless of your intentions for succession, it can be helpful to compile current information in case an unforeseen event, such as a death or disability, occurs before you have finalized your succession plan. This information should include the following:

- A copy of your current business plan.
- Job descriptions for all positions within the company, including details regarding areas of responsibility and delegation of duties.
- A list of potential successors.
- A plan to ensure extensive "hands-on" training for your designated successor.
- An estate plan that addresses any Federal and state estate tax obligations.

Other Considerations

A comprehensive succession plan involves strategies to handle a number of financial, legal, and tax issues. For instance, how will a successor secure funds to buy out a retiring, deceased, or disabled owner's share of the business? What are the estate planning issues? How can an owner minimize gift taxes resulting from the transfer of company stock to family members? Such situations can be addressed in a succession plan, with the guidance of qualified legal, tax, financial, and insurance professionals.

You owe it to yourself to ensure that your business will continue to flourish after your retirement, as well as in the event of death or disability. Proper planning through a business succession plan can help provide long-term security for your retirement, your company's future, and your family. ■

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eligibility requirements and tax deductions for your home office, see the IRS Publication 587, *Business Use of Your Home*.

While homeowners using the new safe harbor method cannot depreciate the portion of their home used in a trade or business, they are permitted to claim allowable mortgage interest, real estate taxes, and casualty losses on the home as itemized deductions on Schedule A. These deductions do not have to be allocated between personal and business use, as is required under the regular method. Meanwhile, business expenses unrelated to the home, such as advertising, supplies, and wages paid to employees, are still fully deductible.

Be sure to consult your qualified tax professional for more information on the safe harbor method and your home office situation. ■

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