The Abel Advisor

a Financial Stewardship Newsletter

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Hi Everone,

The articles in this month's edition are centered on strategies and government actions in this election year and beyond. So many seemingly unrelated issues relate to the performance of our investments / retirement savings.

So far this year we've seen the markets improve when they apparently should not and vise versa. The volatility has subsided from last fall's crazy times but volatility has remained at a smaller scale. One day up 1% and the next day down 1%. We have a market that can't commit to moving ahead or pulling back. However, as we've seen in the past this will all work itself out over the long term. It's kind of a forest for the trees issue.

Stay tuned and call me with any questions.

God Bless,

A.W.

April 2012

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Supercommittee Failure Sets Stage for Election Year Debate

As part of a last-minute agreement ending August's debt ceiling standoff, legislation was signed into law calling for the creation of a deficit reduction "supercommittee." The Joint Select Committee on Deficit Reduction, comprised of 12 members (6 Democrats and 6 Republicans) from both the House and Senate, was charged with finding ways to reduce the federal deficit by at least $1.2 trillion, and directed to report its findings by November 23, 2011. Of course, the outcome was well publicized--the committee announced that it was unable to reach a deal, and subsequently disbanded. Seen by many as the last best hope to reach a compromise, the committee's failure casts the debt ceiling as one of several major issues that will ultimately be addressed by the coming election.

Automatic cuts

Built into the legislation that gave birth to the supercommittee was a default provision--with the committee's failure to reach agreement, $1.2 trillion in broad-based spending cuts are automatically triggered over a nine-year period beginning in January 2013 (the term for this is "automatic sequestration"). The automatic cuts are split evenly between defense spending and non-defense spending. Although Social Security, Medicaid, and Medicare benefits are exempt, and cuts to Medicare provider payments cannot be more than 2%, most discretionary programs including education, transportation, and energy programs would be subject to the automatic cuts.

The threat of the automatic cuts was conceived as a way to encourage the supercommittee to reach a compromise. With the failure of the supercommittee to reach agreement, however, these imminent cuts are now the source of concern. Parties on both sides find the cuts too broad, and efforts to short-circuit the automatic cuts, at least those affecting defense spending, have already begun--though the President has suggested that he would veto any such legislation.

New debt ceiling crisis possible in 2013

The legislation that established the supercommittee also put in place what amounted to a piece of political theater that allowed for temporary, short-term incremental increases to the debt ceiling limit. Effectively, the President was able to get additional borrowing authority, while allowing Congress to go on record opposing it by voting for disapproval--but without really being able to prevent the debt ceiling increase from taking effect. The last debt-ceiling increase made under this legislation was calculated to carry us through the current election cycle. It might not be long after the election is decided, however, that the debt ceiling limit will again need to be addressed.

Same basic divide remains

The supercommittee failed in its mission because the parties involved have fundamentally different visions of how to address our country's debt problem. It's a gross oversimplification, but the debate largely boils down to what degree deficit reduction efforts should focus on increasing revenue (and how to accomplish that), or on reducing government spending, including addressing the long-term costs associated with entitlement programs such as Social Security, Medicare, and Medicaid.

Of course, these approaches aren't mutually exclusive; for example, the bipartisan Bowles-Simpson commission (the National Commission on Fiscal Responsibility and Reform) issued a December 2010 report that recommended a combination of both approaches. The fact that we're in an election year complicates matters, however, and may make compromise less likely, if not impossible. That's because each element of a potential compromise will have significant political ramifications. In the end, the course taken may depend entirely on the post-election political landscape.

See disclaimer on final page

Business Owner Succession Planning

What will happen to your business when you become disabled, retire, or die? You will generally need to identify someone to transfer your ownership interest to family members, co-owners, key employees, or an outside party. There are many options for you to consider.

Every successful business owner must eventually face the question: What will happen to my business when I become disabled, retire, or die? Sooner or later, you will generally need to identify someone to transfer your ownership interest to family members, co-owners, key employees, or an outside party. Without a succession plan, the business may need to be liquidated.

Successor management

One of the first questions that should probably be addressed is: Do you have successor management readily available to run your business? Without it, the business may fail. You might look among co-owners, family members, and key employees for candidates. It may be necessary to train successor management, helping others develop their skills or even bringing in new talent. Of course, if you sell to an outside party, that party may provide their own management. It should be noted that successor management can, but need not, be the same as the successor owners.

Co-owners

If you have co-owners, you and your co-owners may wish to keep ownership limited to a select group. One way to do this, while providing a market for your interest in the business, is for you and the other owners or the business entity to enter into a buy-sell agreement. A buy-sell agreement is a legally binding contract in which the owners of a business set forth the terms and conditions of a future sale or buyback of a departing owner's share of the business. Specifically, buy-sells control when owners can sell their interests, who can buy an owner's interest, and at what price.

Family members

Keeping the business in the family can present many issues that may contribute to the success or failure of the business as it is transferred to the successor generation. Do you wish to sell the business to family members, make gifts or bequests of interests, or perhaps use some combination of these? Do you need income for retirement, for your surviving spouse, or for the payment of final expenses? You may need to provide compensation to family members working in the business and profits to family members retaining an ownership interest, while cashing out some family members or otherwise providing for them.

Gifts you make are generally subject to federal gift tax. But you can make gifts of up to $13,000 per recipient per year free from gift tax using the annual exclusion. You can effectively double that amount by splitting gifts with your spouse. You can often obtain significant valuation discounts by making gifts of interests in a family limited partnership or a family limited liability company.

In 2012, you can also make gifts or bequests of up to $5,120,000 that are sheltered from federal gift tax and estate tax by the basic exclusion amount. This limit applies to all gifts you make during life and to your estate at your death. Under some circumstances, spouses may be able to effectively double the limit by splitting gifts with a spouse or by using the unused exclusion of a deceased spouse (portability). Note, though, that unless Congress acts, in 2013 the exclusion will be reduced to $1 million and portability expires. Similar exclusions or exemptions apply for generation-skipping transfer (GST) tax purposes, an additional tax imposed when the transfer is to someone two or more generations younger than you. There may also be state gift, estate, or GST tax to consider.

Sales to family members can utilize buy-sell agreements and installment sales. Installment sales allow the family member to make payments over time.

Key employees

You may have some key employees working for you, who provide some unique skills and value to your business, and who have an interest in owning the business. You may be able to sell the business to them utilizing buy-sell agreements and installment sales. A business can also be sold to an employee stock ownership plan (ESOP), a tax-favored retirement plan for employees.

Outside party

In some cases, succession is not practical using transfers to co-owners, family members, and key employees. Or it may be that you need to obtain the highest possible price for the sale. In that case, selling to an outside party may be the answer.

Income tax consequences

Generally, the sale of your interest in a business will result in capital gain or loss tax treatment. You generally receive a tax basis stepped up (or stepped down) to fair market value for property you own at your death. Therefore, there will generally be no capital gain if your estate sells your interest shortly after your death. Also, if you sell your interest in an installment sale, capital gains (if any) are generally not taxed until installment payments are received.

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Asset Protection Strategies Beyond Insurance

These asset protection strategies generally involve transferring legal ownership of assets to other persons or entities, such as corporations, limited partnerships, and trusts. The logic behind shifting ownership of assets is fairly straightforward: your creditors can't reach assets you don't own.

You've worked hard to accumulate your assets and property; that's why it's so important to take measures to protect your wealth. Often, the simplest way to protect assets is by shifting the risk to an insurance company. But insurance may not provide all the protection you need or it might not be available, so you may need to consider other strategies.

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Shifting assets to a C corporation

The law views a C corporation as a separate legal entity. As such, business assets owned by a C corporation are considered separate from your personal assets, which will generally not be at risk for the liabilities of the business.

However, protection from liability may be lost if the business does not act like a business, such as when the business acts in bad faith, fails to observe corporate formalities (e.g., organizational meetings), has its assets drained (e.g., unreasonably high salaries paid to shareholder-employees), is inadequately funded, or has its funds commingled with shareholders' funds.

Shifting assets to other entities

A limited liability company (LLC), limited liability partnership (LLP), or family limited partnership (FLP) is a legal entity that can be used to separate business assets from personal assets.

An LLC is generally taxed like a partnership with income and tax liabilities passing through to its members (and not double-taxed as a C corporation), but it is viewed as a separate legal entity and can be used to own business assets, protecting your personal assets from business claims against the LLC.

If you have business partners, an LLP may protect you from the professional mistakes of your partners. That is, if one of your partners is sued for negligence, and the LLP is also named in the lawsuit, the partner sued may be liable personally for any judgment, but the LLP should protect your personal assets from the reach of any judgment creditor of the LLP.

An FLP is a limited liability partnership formed by family members only. Generally, a creditor can only obtain a charging order against the FLP, which allows the creditor to receive any income distributed by the general partner (who is usually a family member). It does not allow the creditor access to the assets of the FLP. Although each of the entities discussed above are alike in that they can protect your personal assets, they are very different in other ways. Make sure the entity you choose satisfies all of your needs.

Shifting assets to a trust

There are many different types of trusts that can be used to protect assets. A protective trust may protect assets intended to eventually pass to another person. For example, you transfer assets to a protective trust naming yourself and another as beneficiaries. The trust allows you to receive only income from the trust, with no access to the trust principal. At your death, the assets are to pass to the other beneficiary. If you're sued, the creditor can only receive your right to trust income, but not the assets of the trust. These trusts usually contain a spendthrift provision that makes it difficult for creditors to reach trust assets to satisfy claims against trust beneficiaries.

The laws in a few states, such as Nevada, Alaska, and Delaware, enable you to set up a domestic self-settled trust. You can create this type of trust, transfer assets to the trust, and name yourself as beneficiary. The trust gives the trustee discretion over whether or when to distribute trust property or income to beneficiaries. Creditors can only reach property that the beneficiary has a legal right to receive. Therefore, the trust property will not be considered the beneficiary's property, and any creditors of the beneficiary, including yourself, will be unable to reach it.

Many foreign countries have laws that make it difficult for creditors to reach trust assets held in that foreign country. In order for a creditor to reach assets held in a foreign or offshore trust, a court must have jurisdiction over the trustee or the trust assets. Because the trust is properly established in a foreign country, obtaining jurisdiction over the trustee in a U.S. court action will not be possible. Thus, a U.S. court will be unable to exert any of its powers over the offshore trustee.

Protecting assets doesn't include fraud

Protecting your assets by legally repositioning them does not extend to actions intended to hide assets or defraud creditors. So, make sure you implement any asset protection strategy before there is any hint of trouble, and be sure to carefully document that you are doing so for sound business or other reasons.

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What is an e-closing?

An "e-closing" refers to a real estate closing process where the parties to the transaction (e.g., sellers, buyers, brokers, and attorneys) can access closing documents online so that they can be reviewed and electronically signed prior to the actual closing date. And, instead of receiving a huge stack of papers, the parties get copies of pertinent documents on a CD or other media. Electronic closings can make the process easier, faster, and greener.

E-closings (as well as other paperless transactions) are possible for two reasons. First is the acceptance by federal law (under the Electronic Signatures in Global and National Commerce Act, or E-SIGN) of electronic signatures in lieu of pen and ink (or wet) signatures. Second, new technology is being offered by several companies that allows for a safe, secure, and password-protected process that prepares, transmits, and stores legally binding documents, such as disclosures, loan instruments, and settlement statements. For example, members of the mortgage finance industry (including Freddie Mac) are implementing this technology because it can save time, money, and trees.

E-closings allow the parties to review documents beforehand, facilitating communication among the parties, and reducing the chance of mistakes or other problems on closing day. Once all of the documents have been approved, the parties affix their signatures through a digital pad or stamp, or other device that automatically encrypts it so that it can't be altered. Each party signs once, and the captured signature is automatically applied to all the signature blocks (so, no more hand cramps or scribbled signatures). Documents that require a witness and/or notary can also be signed electronically.

If all goes well, the parties may not even need to actually meet on closing day. Deeds and mortgages can be sent electronically to the proper registry for recording. Any disbursements can also be made electronically. And finally, the documents can be digitally archived for future use.

My office has gone paperless. How do I go paperless at home?

Since the start of the computer age, business offices have been going paperless because it saves time, space, and money; it's easier to stay organized; and there's less impact on the environment. So, how can you go paperless at home? Here are some tips.

First, though it may seem overwhelming, start slowly making easy changes that will move you towards less and less paper.

First arrange to get your bills electronically, and pay them online. Set up automatic payments with your bank for recurring payments, or consider a bill-paying service. Otherwise, you may need to create a system reminding yourself to pay bills on time so that you don't incur past due fees or interest charges.

Sort through your existing paper. Scan all documents you need to keep and save to PDF. Make sure to name your e-files so they're easily identifiable and accessible, and keep them well-organized. Shred (and recycle) documents you do not need to keep, especially if they show personal information, such as account numbers or your Social Security number. Invest in a good scanner and shredder.

Keep your e-files safe and secure by adding a firewall and using software that provides adequate security. Back up your computer at least once a month using a CD, external hard drive, or an online remote back-up service (i.e., in the "cloud"). Use logins and passwords that are secure, and try to suppress the urge to repeat them. There are online tools that store this type of information.

Keep things like calendars, address books, recipes, and photos digitally. Toss things you tend to keep for sentimental reasons, like holiday cards and ticket stubs. Purge magazines, newspapers, journals, and books from time to time, and get them online if possible.

Contact senders of junk mail and catalogs you don't want and ask them to remove your name from their mailing list. They may not do it, but you can try.

Remember, though, there are paper files you should keep, such as medical records, Social Security cards, warranties and manuals, and tax, legal, and insurance documents. Keep these vital records in one safe location.

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