



## KNOPINSKI & FAUVER FINANCIAL ADVISORS

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# Five Financial Planning Ideas For Business Owners

**W**ith all the time required to run your business, it can be difficult to step back and take the long view—evaluating how your business fits into your estate plan, for example, or gauging whether you're adequately protected from potential liabilities. Yet the importance of financial planning doesn't stop at the office door. These five ideas could get you started.

**Use trusts to transfer business assets.** If you intend to leave part or all of your business to family members, gradually transferring shares during your lifetime may reduce or eliminate potential gift and estate taxes. But rather than give assets directly to your children, you may want to make them beneficiaries of a trust holding shares of the company for a specified term.

One trust type—the grantor-retained annuity trust, or GRAT—could work particularly well for growing businesses, and today's low interest rates make it especially appealing. Here's how it works:

- Gift-tax liability is determined when the trust is established, by computing what trust assets would be worth at the end of the trust's term if they grew at an IRS-determined interest rate. That hypothetical value is reduced by the value of annuity payments you receive.
- Suppose you transfer \$1 million in company stock to the GRAT. You set the annuity payments so they cancel out the hypothetical growth of the assets—as far as the IRS is concerned, this remains a \$1 million gift, and you avoid tax by using your \$1 million lifetime gift-tax exemption. If your company's value appreciates

faster, and the trust remainder is actually, say, \$3 million, you get to transfer the entire amount without gift or estate taxes.

**Diversify your wealth.** Your business may occupy all of your time but it shouldn't have all of your assets. If you Enronize yourself—like the unfortunate employees who lost both their jobs and their savings when the energy giant collapsed—you'll have no safety net if your company's fortunes take a turn for the worse. So as soon as your business is generating sufficient cash to pay you a reasonable salary, begin to accumulate personal assets that aren't tied to your business. You may want to avoid investing in other companies in your industry. If yours is a young, volatile business, consider being more conservative with the rest of your portfolio. View your business much the same as an investment asset.

**Don't mix business and personal accounts.** It may seem a minor bookkeeping detail, but keeping your personal and business accounts separate could have a profound impact if creditors lay claim to your assets. So avoid using your business accounts to pay personal expenses, and if you need to use a personal credit card to pay a business cost, be sure to file an expense report and get reimbursed by the company. Without clear segregation of personal and business assets, a creditor might be able to collect from you personally on a claim against your company.

**Don't forget disability insurance.** If you were temporarily or permanently disabled, your company's operations

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## You Should Find A New Home For An Orphan 401(k)

**I**f you've "abandoned" a 401(k) account from a past employer, of course you can still get those funds. But if you continue to ignore the account once your mandatory distributions begin at age 70½, you could lose much of it to IRS penalties. Instead, make the most of this orphan 401(k) plan.

Consider consolidating all of your former employer accounts in a single IRA. A tax-free transfer to a traditional IRA will make your assets easier to manage, and should broaden investment choices and reduce fees. Also, distributions on inherited IRAs can be stretched over a beneficiary's lifetime.

Alternatively, you might think about converting old accounts to a Roth IRA. You'll pay income tax on the amount you transfer, but withdrawals during retirement won't be taxed, and your heirs could enjoy a lifetime of tax-free income from the account.

For now, there's a catch. You may convert to a Roth only during a year in which your adjusted gross income is \$100,000 or less. But that ceiling disappears in 2010, and if you convert a 401(k) or traditional IRA to a Roth IRA that year, you can spread your tax on the conversion over two years

*Colleen & Rob*

# Is It Time To Buy Municipal Bonds?

**M**unicipal bonds don't normally make news. But the past year's credit crisis dragged even the most staid investments through the mud, and munis were no exception. The good news is that the rap on these bonds' reputation has led to the best muni buying opportunities in a long, long time.

The problem wasn't the municipal bonds themselves, which are used to finance public projects such as bridges and roads, but the bond insurance that many bond issuers purchase. Provided by companies such as Ambac and MBIA, this insurance gives any muni bond, regardless of underlying credit quality, an AAA rating. Investors like insurance because it adds another layer of protection against default; issuers like it because using it reduces borrowing costs. (Higher-rated bonds can offer lower interest rates.) At one point, about half of the municipal market was insured.

If bond insurers had insured only munis, there would have been no problems, because municipal bonds have miniscule default rates—just 0.1% from 1970 through 2006, according to a Moody's Investors Service study. (Corporate bonds, in

contrast, have a 9.7% default rate.) But it turned out bond insurers had gone beyond the municipal bond market to insure collateralized debt obligations built around dubious subprime mortgages, and subsequent losses put the companies on unstable financial footing. Municipal bond prices plummeted and their yields rose after Ambac was downgraded by one rating service and put on notice by two others.

At one point, AAA-rated munis yielded about 0.5 percentage points more than comparable Treasury bonds. Ordinarily, munis' yields are lower than Treasuries', because municipal bond interest is exempt from federal income taxes. "It was clearly an anomaly for munis to yield more," says Thomas Doe, chief executive officer of Municipal Market Advisors, a municipal bond strategy firm.

While the muni crisis may have passed—and that screaming buying opportunity with it—municipal bonds still are attractive to many investors, particularly those in high

tax brackets.

When muni yields approach those of Treasuries, muni investors come out ahead, keeping more income after taxes. The advantage can be even greater on bonds that are also exempt from state and local taxes. The higher an investor's tax bracket, the higher the value of the bonds' yields. "Munis are still attractive on a

relative basis," says Doe. "They give you more yield than should be available for a particular level of risk." If the government raises income tax rates in the future, tax-free municipal bonds will become even more attractive.

Contact our office if you would like to discuss whether this might be an opportune time to add municipal bonds to your portfolio. ●

**The information provided is not specific financial advice or a recommendation to buy or sell. We must review your profile, needs, and accounts specifically to determine what is right for you.**



## If You And Your Spouse Fight About Money, You're Not Alone

**S**omewhere, there must be a couple whose attitudes about money are in perfect alignment. They agree about when to save and when to spend. Their budget is a picture of harmony. They're moving smoothly toward all of their financial objectives. For almost everybody else, however, the reality is different. And whether you battle openly about money or simmer silently, fiscal tensions are bound to take a toll. Yet while getting on the same page about money isn't easy, a gradual, commonsense approach may bring you closer

together in this crucial part of your relationship.

Step one toward a better money relationship is to carve out time each month for a financial summit meeting. The typical talk might be 30 minutes long. The ground rules: talk without casting blame or straying to other subjects. Every time you reach an agreement, write it down, sign it, and date it.

Use the meetings to talk about your money history. Chances are, any hang-ups about money were inherited from your parents. It can be tough to shake ingrained attitudes. But with knowledge

comes understanding. Learning your spouse had to work three jobs to get through college is likely to make you more sympathetic about her insistence that you save more for a child's education.

As important as it may seem, developing a budget may not be your first order of business. Start there, and you could find yourself arguing about who's to blame for the current state of your financial affairs. Instead, focus on where you're going, where you want to be 20 years from now. Once you've settled on common long-term goals, compromise on near-term problems

# What Else Should Be In Your Will?

**W**hen writing a will, most people focus on big assets—real estate, securities, and bank accounts. Often overlooked are smaller items, such as jewelry, paintings, and family heirlooms, as well as other instructions that have nothing to do with assets—whether you want to be buried or cremated, for example, or who should clean out your house after you're gone. This begs the question: Exactly what, beyond the obvious, should be in your will?

According to Mary Randolph, author of *The Executor's Guide: Settling a Loved One's Estate or Trust* (Nolo, 2006), "you can do pretty much whatever you want in your will." The question is, will what you want benefit your descendants—or only add to the confusion?

Many people writing wills indicate exactly who should receive specific big-ticket items—a car, a boat, the summer house—then stipulate that the rest of the estate be divided equally among all heirs. That's nice and simple, says Randolph, but it could spark family disputes. "Even in families in which everyone gets along fine, in times of stress, disagreements can bubble up," Randolph says.

Your goal should be to leave specific instructions without getting too complicated. Attaching conditions to a gift, for example, can be problematic.

Suppose you'd like to provide your daughter with a financial reward only if she attends college—but what does "going to college" really mean? Does she have to attend full time, or can she take night classes? Does she have to enroll in a four-year university, or is a community college or unaccredited online program acceptable? And is there a specific time frame? What if she attends college in 50 years—does the estate have to reserve enough money to pay her then?

Randolph recommends you think about what material goods are particularly important to your family—your grandmother's china, a favorite painting, an 18th century armoire—and make specific bequests of those items. But those instructions don't necessarily have to be in your will. About half of U.S. states accept a "property memorandum"—a list, outside your will, of personal items you want to leave to certain people. If you choose this route, your will can simply indicate that you wish your personal effects to be divided according to the attached memorandum. This approach saves you the hassle of rewriting and re-notarizing your will if you acquire additional items you want to give away or change your mind about

who gets what.

For the remainder of your personal effects, try to come up with a way for heirs to divide things up among themselves. For example, you might let each descendant pick one item and then another, until everything is accounted

for. Or, you might assign everyone a certain number of points, which can be used to bid on individual items. "That way, your children can decide what's important to them," Randolph says. "John may want to spend his

100 points on furniture, while Mary prefers to spend hers on a snow globe."

You can also make specific instructions in your will—for example, that your son gets the job of cleaning out your house, or that you want to be cremated, not buried. But here you may find yourself in tricky legal territory.

First, you need to make such a request in language suggesting it is legally binding. "Saying, 'I want my son to clean out my house,' is not binding," says Randolph. "But saying, 'I appoint my son as executor and direct that he shall sort and divide my personal belongings as he sees fit'" is.

Next, consider when your will is likely to be read. If you want to be cremated, it's better to make that request in a final arrangements document or a similar form, because your will probably won't be reviewed until after the funeral.

Finally, realize that whether you make such requests in your will or another document, they may not have the weight of law. Most state laws don't say anything about how to make final instructions legally binding. Those that do require a form that must be witnessed and notarized—and even then, the instructions have to be followed only if they're reasonable. "You probably can't say you want to be buried in a Cadillac," says Randolph. "Your best bet is to write down what you want according to the laws of your state, and hope for the best." ●



## And Here Are Some Tips To Help You

may be smoother.

A budget needs to be part of the picture, but don't view it as a prison; rather, consider it a means to making choices that support your values and future dreams. Agree on what is a "me" decision and what is a "we" decision, but leave a certain amount of money in individual slush funds for the sake of freedom and flexibility.

When it comes to creating an investment blueprint, keep in mind that every plan has aggressive and conservative elements. Use that to your advantage, putting your different attitudes about money

to work in crafting a balanced approach. Put your investment policy in writing, sign off on it, and commit to regular reviews.

In the end, your monthly money meetings should help you zero in on what's most important to you, individually and as a couple. You'll connect emotionally, and come away with a fresh resolve to improve your rapport about money and move toward shared goals. You may never achieve perfect harmony about every financial issue, but you're bound to feel better about this essential part of your relationship. ●

# Downsizing A Home Could Bring Savings

**W**hen your family shrinks, should the square footage of your castle follow suit?

As the population ages, that's a question more and more couples face. Replacing a suddenly oversized home with a smaller house or condo could mean much lower outlays for everything from monthly mortgage and tax payments to maintenance, insurance, and utilities. And considering how much your home may have appreciated in value since you bought it, you might walk away with a nice chunk of change. But this good fortune could also push your home-sale profit above the amount you can exempt from capital gains tax liability.

Much depends on home prices in your area, and your gain will also be affected by how long you've been in the home and whether you pulled out any equity through refinancing. But the basic rule is this: You may claim a capital gains exclusion of up to \$250,000 of your profit on a home

you've occupied for at least two years; for a couple, the maximum exclusion is \$500,000.

If your gain is less, downsizing could pay off nicely. Suppose you put your 5,000-square-foot home on the market. Currently, you pay a total of \$4,750 a month for your mortgage



and property taxes. If the house brings \$1 million and you clear

\$500,000—after retiring your mortgage and paying a real estate commission and closing costs—you would owe nothing in taxes. You could spend the proceeds on a much smaller place nearby. If your taxes dropped by half—say, to \$750 a month—and you didn't need a new mortgage, you'd save almost \$50,000 a year. You'd also spend much less on homeowner's insurance, utility bills, and upkeep.

But what if you live in an area where that home fetches much

more—say, \$3 million? Your mortgage would probably also be larger. But suppose you made \$2 million on the sale. After excluding \$500,000, you'd owe \$225,000 in federal capital gains tax. Downsizing still might make sense, but if you hate handing over so much to the IRS, it may be better to stay put. If the house is sold after the death of one or both spouses, the tax bill should be much lower.

When the first spouse dies, the tax basis on his or her share of the property will be "stepped up" to the home's current fair market value. The profit on a sale then drops to half what it was when both spouses were alive. Under the new mortgage law passed in 2007, and if the house is sold within two years of the death, the surviving spouse can still take the full \$500,000 exclusion. After that, the exclusion drops to \$250,000. After both spouses have died, the full tax basis will be stepped up, leaving heirs with little or no capital gains exposure if they sell the house. They might, however, owe estate taxes. ●

## Financial Planning Ideas

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would undoubtedly suffer, and the impact on your personal finances might be even worse. If your business is suffering, it may be able to spare little cash for you—or, if you must have the money, the company's downward spiral could gain speed.

The solution may be disability insurance that provides you with monthly payments, beginning 30 to 180 days after you become unable to work because of physical or mental disability. True, disability coverage can be pricey, though it's cheaper to obtain the younger and healthier you are. But payouts aren't taxed—because you pay premiums with after-tax dollars—and you can customize coverage to fit your

needs. Accepting a longer waiting period before benefits start or doing without inflation protection could reduce the cost. Keep in mind, however, that these benefits are backed by an insurance company, and you are dependent on its claims-paying ability.

### **Divorce-proof your business.**

Nobody likes business issues to enter their marriage, but the harsh reality is that your business could be finished if your marriage ends and you have not planned properly. Your business partners may not want to be partners with your spouse in the event your marriage dissolves. With the divorce rate so high these days, it's only prudent to consider asking your spouse to sign an agreement stipulating that, in the event of divorce, the spouse's company stock would

automatically lose its voting rights and be offered for sale at a predetermined price. You could set the price yourself or have an outside appraiser determine it. A similar separation agreement with business partners could minimize disruptive effects of a partner's departure or death. Dealing with this kind of delicate matter can be difficult and emotional, and this is the kind of issue you may want to call on us to help you with.

Running a business demands so much of your time and energy that taking care of your personal finances can sometimes take a backseat to other priorities, especially since these matters are important but not urgent. It's wise, however, not to wait until these issues become urgent. ●