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Planning for the Life Stages of Your Business

Innovation. Perseverance. Accomplishment. Every business owner committed to success starts with an idea, works hard to make it happen, and believes in the potential for great things.

As an entrepreneur, you must manage your business for growth, as well as your personal wealth for accumulation and preservation. Building your financial freedom, while growing your business, is a process that begins in a business's infancy and continues throughout its maturity. Depending on the stage of your business, you will have different needs and priorities. For example, startups often must raise capital or secure financing, while owners of more established businesses may be focused on developing exit strategies and funding retirement.

Surviving Infancy

While most young companies are born on a wave of energy and enthusiasm, it is challenging to survive infancy. Financially, this phase is usually the most difficult. Oftentimes,

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Private Foundations: An Alternative to Charitable Giving

For many individuals with accumulated wealth, occasional gifts to a favorite charity may satisfy their charitable inclinations. The added incentive of an often substantial tax deduction, coupled with various estate planning benefits, can be the driving force behind such charitable gifts. However, for some individuals, philanthropy is a far more serious endeavor, often involving a *succession* of substantial gifts of at least $5 to $10 million, which may necessitate the need for control and general oversight. In these situations, a **private foundation** can be an ideal venue for managing a large, continuous charitable giving program.

The Basics

In its simplest form, a private foundation is a charitable, grant-making organization that is privately funded and controlled. When properly arranged and operated, a private foundation can be an income tax-exempt entity, whereby tax deductions are permitted for individuals (or donors) who donate to them.

Contributions to a private foundation are deductible for gift and estate tax purposes. However, the income tax deduction of gifts to a private foundation is a bit more complex. Generally, the deduction is based on the fair market value of the gift (at the time of the gift), and it is limited by the donor's **adjusted gross**

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Is Your Student Budget-Wise?

Your child may soon be ready to take his or her first step on the journey toward independence: college enrollment. The checklists are being prepared, boxes and bags are filled to the brim, and cautionary words about life away from home have all been spoken. However, one area that many parents may overlook or hesitate to bring up with students amid the excitement and chaos of preparing for college is personal money management.

Typically, students do most of their day-to-day spending on a spontaneous basis, where overspending is the norm, rather than the exception. During a school year, the average college or university student will spend nearly $5,000 for books, supplies, transportation, and personal expenses while at school (*Trends in College Pricing 2012*, The College Board). However, there is often room for economizing, and the first place to look is food and entertainment, especially when ordering pizza with a smartphone is just a "touch" away.

Sooner or later, the conversation about living arrangements takes place. While many students believe it costs less to live off campus than in a dorm, they may be misinformed. In college towns with a high demand for off-campus housing, accommodations within walking distance of the campus can be expensive. Some landlords may require a one-year lease—a period longer than the school year. If a student does choose to live off-campus, he or she can save money by sharing housing and eating in.

There are steps you can take to help your student understand the financial picture. Consider the following:

- Before your child leaves for college, discuss both of your expectations.
- Explain when checks or money transfers can be expected, the amount that will be received, and any rules concerning use of the funds.
- Consider providing a lump sum each semester, with guidelines on how long the money must last, and allow your child the freedom to make day-to-day financial decisions.

Whether students rely on parental subsidy, use their own money, or combine funds, most have savings and checking accounts. Therefore, it is important for them to know how these accounts work. Their ability to balance an account and spot any errors is of utmost importance.

Many undergraduates tend to keep their checking accounts in hometown financial institutions. However, managing finances long-distance can create challenges. Verifying a balance quickly with an out-of-state bank can be difficult and time-consuming. In addition, trying to get money to college students in different locations can be frustrating. Even with the convenience of online banking, it may be a good idea to open a smaller account on or near campus.

While some parents may hesitate to promote the use of credit cards, especially for a student who has difficulty managing money, others may believe a credit card can help provide a useful backup, especially in an emergency. A credit card can be helpful for car rentals, plane fares, and train tickets.

Ideally, college students will be able to take full responsibility for each semester's spending. Life can become easier for parents whose college-age children can manage their own finances, and students can learn valuable life skills in the process. $

Taxes and Your Estate: Reconcile Your Domicile

Increased mobility in today's society has changed the ways in which we live, work, and play. Compared to previous generations, it is now quite common for work and recreational activities to cross state lines, resulting in ownership of property and formal relationships in more than one state. However, the expanded opportunities created by mobility may come at a price: the increased likelihood that several states may be able to tax your estate when you die. If *you* were to die today, do you know if more than one state would attempt to levy taxes on your estate?

The term **domicile** generally refers to the place intended to be your *permanent* home, as distinguished from the term residence, which could be any place you live. Although you could have simultaneous residences in several states, in theory, you can have only *one* state of domicile at a time.

A problem may arise when theory and reality part company: when separate states reach different conclusions by applying different definitions of domicile to the same set of facts. This may result in the apparent inconsistency of more than one state claiming the deceased was a "domiciliary," and each taxing that person's estate accordingly.

Under the Uniform Interstate Compromise of Death Taxes Act, the states involved may be able to reach a compromise in a specific situation. However, if the states involved have not adopted the Act or cannot agree on a solution, the estate in question could be fully taxed in *multiple* jurisdictions.

Establishing Your Domicile

Fortunately, there are steps that can be taken to establish your state of domicile. If you have moved, your "true" domicile may hinge on the *number* and *significance* of the contacts you have in your former and present state. Consider the following significant factors:

- **Retention of "historical" home.** If you have moved, have you sold your long-time residence in a former state?
- **Business relationships.** In which state are your significant business contacts located?
- **Location of property.** Where is most of your significant real and tangible personal property located?
- **Social connections.** Where do you maintain political, civic, religious, and family connections?
- **Time spent.** Where do you spend the majority of your time?

While you may feel your *intent* is clear, it is most likely that your *actions* will be viewed as the evidence of your intentions. Consequently, simple acts such as changing your voter registration to the new locale, changing your automobile registrations and driver's license, formally resigning from organizations in your former state, and formally joining organizations in a new state may be viewed as evidence of your intent to change your domicile.

Under some circumstances, the lines may not be so obvious. For example, if you moved to another state but maintained significant business and social relationships in your former state, where is your domicile? Where conflicting evidence exists, you might want to first determine which state appears most advantageous for estate taxes and learn how domicile is defined there. You can then focus on the factors that will be the most significant in reconciling your domicile.

Estate taxes may be one factor in choosing a state of domicile. For guidance on your unique circumstances, be sure to consult your tax and legal professionals. $

Benefit Trade-Offs in Property Titling

A fairly common occurrence among married couples is the holding of most, if not all, of their property as **tenants by the entirety**. Quite often, couples are unaware of the alternative methods of titling, as well as some of the trade-offs involved in selecting a particular form of holding property.

There are four primary ways to hold property:

In your own name. Anyone may choose to own property in his or her own name. Owning property outright gives the owner complete control over the property, but such property is generally included in the owner's gross estate for estate tax purposes and will usually have to pass through the **probate** process.

As tenants in common. This method allows two or more parties to own property together, with each owner maintaining the right to sell his or her interest without the consent of the other co-owner(s). Generally, such ownership interests must be bequeathed through a **will** and do not pass automatically to the co-owner(s) at death. Consequently, such property typically will be subject to probate.

As joint tenants. Also called **joint tenancy with right of survivorship**, this form of ownership provides each "tenant" with an undivided interest in the entire property. An owner may not sell without the consent of the other co-owner(s). If one owner should die, the surviving owner(s) automatically inherits the decedent's interest (i.e., the property passes "by law" and does not go through probate). *Caveat*: A creditor may force the sale of such held property to satisfy the debts of only *one* owner.

As tenants by the entirety. This is a special form of joint tenancy solely for married couples with one significant difference: The property *cannot* be sold to satisfy the debts of one of the owners.

Benefit Trade-Offs

Each form of property ownership has specific implications and, when using one particular method, the benefits gained must be balanced against the benefits lost.

Consider Simon and Ellen who have two college-aged children, Andrea and Jason. Life has been good to the couple, and they have built an estate worth $10.5 million, with all of their assets jointly held as tenants by the entirety. (For the sake of simplicity, we will not consider retirement plan assets, which cannot be held jointly.)

While on vacation, Simon and Ellen are involved in a fatal accident. Simon dies instantly; Ellen lives for four days and then dies. In this unfortunate set of circumstances, what are the estate tax implications for their jointly-held $10.5 million estate?

At Simon's death, his interest in all jointly-held property automatically passes to Ellen free of Federal estate taxes by virtue of the **unlimited marital deduction**. For the four intervening days that Ellen is alive, she is the sole owner of the previously joint $10.5 million estate. At her death, $5.25 million of the estate would be offset by her **applicable exclusion amount** in 2013. Because all property was jointly held, Simon's $5.25 million exclusion amount was lost. Failure to plan for Simon's exemption ultimately decreased the amount passing to Andrea and Jason.

"Bypass" to a Solution

Had Simon and Ellen "equalized" their estate (i.e., each owned $5.25 million outright), each could have set up a **bypass trust** with $5.25 million. In this example of nearly "simultaneous" deaths, the assets in Simon's bypass trust would pass to the children free of estate taxes (the $5.25 million exemption offsets the assets in the trust). Since Simon died first, Ellen's bypass trust effectively terminates. When Ellen dies four days later, the assets that were in her bypass trust would also pass to the

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startup entrepreneurs funnel their personal savings into the company and use their assets as collateral for loans. All this may be at stake, and the business may not be generating profits. But this is the risk business owners take on their quest for success. Like most of the challenging phases we experience on the road to maturity, this too shall pass—more easily with a solid business plan.

An important complement to your business plan is a fine-tuned marketing strategy. In order to promote your company and generate business, you must make your product or services known. Then, when the money comes in, cash flow management becomes crucial. Even profitable businesses may flounder if they fail to have cash on hand to meet their financial obligations. If you need more incentive, know that wise cash flow management may help you attract potential lenders and investors. Success in these areas will help you achieve a measure of stability and get on track for the next phase: growth.

Managing the Adolescent Growth Phase

With a growing client base, steady income, and profitability at hand, the potentially successful business owner faces various decisions. Should you offer new products and services? What role should investors play in the company? Do you need to hire more staff? What benefits are best for attracting and retaining valuable employees? All of these questions have answers, but the most appropriate solutions for your business will depend on your unique situation.

During the formative years, it's important to keep an eye on your personal financial future when reinvesting in your business. One area of concern is asset protection. Businesses often start out as sole proprietorships or partnerships, but it may be in your best interest from both a tax and liability perspective to consider structuring your business as an S corporation or a limited liability company (LLC).

In the early stages, employee benefits can be a significant cost burden, but they play an important role in your company's success and your own financial security. In addition to providing you with the resources you need personally, robust benefit plans will help you attract and retain qualified employees.

Qualified retirement plans offer tax-advantaged opportunities for both your business and participating employees. There are many options, including Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees (SIMPLEs), which are relatively cost effective and easy to administer. More flexible plans that allow you to save more annually are 401(k)s (with variations including Safe Harbor and Solo 401(k)s), profit sharing plans, and defined benefit plans. To enhance benefits for key employees, you may want to consider nonqualified plans such as deferred compensation or executive bonus plans, which can help you selectively reward and retain your best and brightest.

As you accumulate wealth, protecting your earnings and lifestyle is paramount. Planning for life's uncertainties with proper insurance coverage may help minimize your risk of loss. Life insurance offers financial protection for your family after your death, and disability income insurance replaces a portion of your income should you experience a qualifying injury or illness and be unable to work for a period of time. You may also wish to consider long-term care insurance, which can help pay for extended care costs should the need arise. In all three areas, group coverage is available for your employees.

If you have key employees or business partners, weigh the benefits of key person life insurance and key person disability income insurance to protect your business. To cover business expenses, such as salary or benefit costs if you or a partner experiences a disability, consider business overhead expense insurance.

Reaching Maturity

As your business matures, it may be time to shift your focus from wealth accumulation to wealth preservation. Two areas of focus are key: business succession and estate planning. With the appropriate strategies, you can minimize estate taxes and maximize the amount passed to your heirs.

A well-developed succession plan can help you smoothly transfer or sell your company. If you wish to keep ownership and control of your business within your family, assess the interest and qualifications of potential parties and develop a transition strategy. If you plan on selling your business, it is important to properly valuate your business and prepare for the sale. A buy-sell agreement can formally prearrange a buyer for your business and stipulate the price that buyer will pay. The

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Spousal IRAs

Because IRAs are, by definition, individual, they cannot be jointly owned and must be held in the name of one spouse or the other. However, a married couple filing jointly is generally entitled to contribute to a **spousal IRA** for a non-working spouse under age 70½, provided certain requirements are met. Contributions are limited to $5,500 in 2013 ($6,500 for those age 50 and older). If the working spouse is covered by an employer-provided qualified retirement plan, spousal IRA contributions are phased out for couples with modified adjusted gross income (MAGI) between $178,000 and $188,000 in 2013. If neither spouse is covered by a qualified retirement plan, both spouses are entitled to make a full contribution, regardless of MAGI. $

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deal may be funded with a life insurance policy to ensure that cash will be available to purchase the business when necessary, should you die unexpectedly. At every developmental stage, professional guidance can help you survive the growing pains and make the most of your opportunities. For more information, be sure to consult your legal, tax, and financial professionals. $

Benefit Trade-Offs in Property Titling

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children free of estate taxes by using her $5.25 million exemption. With equalized estates, $10.5 million in 2013 passes to the children free of Federal estate taxes.

Now the "trade-off" may be more apparent. By owning their property as tenants by the entirety, Simon and Ellen achieved creditor protection (remember, for a married couple who title assets this way, a sale cannot be forced to satisfy one spouse's debts), but they also exposed their joint estate to the possibility of higher estate taxes. On the other hand, had they chosen to minimize estate taxes (Ellen and Simon each making use of their $5.25 million exemption), the property that each held outright (or as tenants in common) might have been exposed to claims by creditors.

The hypothetical example of Simon and Ellen demonstrate one of the dilemmas of property ownership: If you want maximum estate tax reduction, you must usually sacrifice maximum creditor protection, and vice versa. How important is creditor protection? It depends. Unfortunately, there are no easy answers in this area of estate planning. However, examining the trade-offs involved in using various forms of property ownership may be a good first step toward developing a strategy that most benefits *your* family. In addition, be sure to check with your attorney for applicable state laws concerning methods of property titling. $

Private Foundations: An Alternative to Charitable Giving

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income (AGI). The charitable deduction will also be limited (to 20%, 30%, or 50% of AGI) depending on the type of charitable organization that is ultimately receiving the gift from the private foundation *and* the type of gift being made. Gifts that are not cash or publicly traded securities, and that are valued at more than $5,000, require adherence to additional rules in order to ensure deductibility.

In addition to the advantages of a tax deduction (which is usually not exclusive to private foundations), private foundations may also offer an array of other benefits. Because a private foundation is typically established to manage a long-term charitable gifting program, it may in turn highlight the philanthropic presence and identity of the donor within the community and/or a particular charitable cause. It can also serve to create a family charitable legacy while, at the same time, protecting individual family members from the pressures of other charitable appeals. Finally, a private foundation can serve as an appropriate mechanism for controlling distributions to charities, as well as determining which charities the foundation will benefit.

The Technicalities

When a private foundation is established, there are two important questions that need to be asked. First, what type of private foundation should the donor establish? And second, how should the private foundation be structured? There are generally three types of private foundations: 1) **nonoperating**, 2) **operating**, and 3) **company-sponsored**. Each type of foundation has specific characteristics that make it appropriate for a particular situation. There are also strict requirements and guidelines that must be followed for each type of foundation.

The most common type of foundation is *nonoperating*. Essentially, a donor, or group of donors, makes contributions to the foundation, which in turn, makes grants to a charity. In this case, the donor has no direct participation in any charitable work. There are several variations of this type of foundation.

On the other hand, in an *operating* foundation, the foundation may have direct involvement in charitable causes (e.g., an inner-city youth center) while retaining the tax benefits of a "private" foundation (in some respects, operating similarly to a "public" charity). In order to qualify as an operating foundation, several requirements and tests need to be met.

A *company-sponsored* foundation can be used when the majority of contributions are from a for-profit corporate donor. Typically, this type of foundation operates similarly to a nonoperating foundation. It is usually managed by corporate officers, and it has the added benefit of allowing some contributions to accumulate over time. This can help the foundation make continual grants when corporate profits are low.

After careful thought is given to the type of foundation to be established, the decision for which structure is next. There are three ways in which a foundation can be structured: 1) a **nonprofit corporation**, 2) a **trust**, or 3) an **unincorporated association**.

There are a number of factors to consider for determining which structure is best. Generally, if the donor intends to keep the foundation in existence permanently, a nonprofit corporation or trust may be a better choice. Additional considerations include state and local laws governing private foundations, the type of foundation, the type of donor, the need or desire to make future changes or delegate responsibilities, and personal liability issues.

The Cost

Creating and maintaining a private foundation is much more involved than the use of more traditional charitable giving vehicles (e.g., CRTs). Therefore, legal and accounting professionals who have experience with private foundations must play a significant role in such an endeavor. In addition, due to the added complexity and need for highly specialized legal and tax expertise, the expenses for design, set-up, management, and grant administration in a private foundation will generally be substantial. Typically, a private foundation is only viable for individuals who intend on making periodic gifts in excess of $5 million.

Certainly, the private foundation allows today's philanthropist the opportunity to manage substantial charitable gifts, as well as the ability to actually become involved in charitable work if he or she so chooses. It also affords the donor the opportunity to be recognized for charitable giving, while solidifying his or her philanthropic legacy. As with all advanced estate and tax planning, consult with your team of qualified legal, estate, and tax professionals to help ensure that you meet the goals and objectives of all involved parties. $

Disability Income Insurance: Knowing Your Options

Prospective insurance buyers may often get confused about **disability income insurance** because the features and benefits can vary widely from one policy to another. Essentially, there are a few key elements that could make a difference when you choose a policy. If you are in the market for disability income insurance, here are some points you may want to consider:

Definition of "total disability." Does the policy define total disability as a condition during which you cannot perform the duties of your *own* occupation or *any* occupation? A policy that refers to your own occupation generally pays benefits if a sickness or injury prevents you from working in your occupation, even if you could work in a different job. A policy that refers to any occupation typically pays benefits only if you are unable to perform *any* job: your own job, a lower-paying job, or a job in a new occupation.

Duration of benefits. Even if you have to choose a smaller benefit amount to keep the premiums affordable, look for coverage that protects you until age 65. Note that there are policies available that offer benefits only for a limited period (such as a maximum of two or five years), and the nature of your occupation may affect the duration of coverage.

Amount of coverage. Policies usually set a limit on the percentage of income you can insure—usually 50% to 70% of your total gross earnings. If you have an employer-provided plan that offers only limited group coverage, you may want to supplement this coverage with individual disability income insurance.

Elimination period. The waiting or "elimination" period is the amount of time you must be disabled before disability benefits begin to be paid. While a shorter waiting period requires a higher premium, a longer waiting period may mean you will have to rely on your savings until benefits begin. Keep in mind that the waiting period is determined when a policy is *issued*, not when you sustain the disability.

Taxation of benefits. Benefits may be tax free if you pay the premiums using *after-tax* dollars. If you receive benefits under an employer-provided plan, they may be taxable if the premiums are paid with pre-tax dollars. Consult your tax professional for specific guidance on this matter.

Partial or "residual" coverage. After a serious disability, many people are able to return to work only on a part-time basis. Partial or "residual" benefits allow you to receive partial disability benefits, as well as your part-time income, until you fully recover. Without this feature, your benefits may stop as soon as you return to work, even if only part time.

Portable coverage. Policies that allow you to carry your coverage from one job to another have an obvious advantage. Examples include coverage from a professional association providing portable coverage that is not tied to your place of employment, as well as any individual disability income policy that you might purchase independently.

It is important to determine the amount of coverage needed that best suits your situation before shopping for a policy. Review your insurance coverage and needs on a regular basis with a qualified professional to make sure that you are adequately protected. $