RS WEALTH MANAGEMENT W

HOW FAMILIES FAIL TO PROTECT THEIR WEALTH

… And How You Can Protect It

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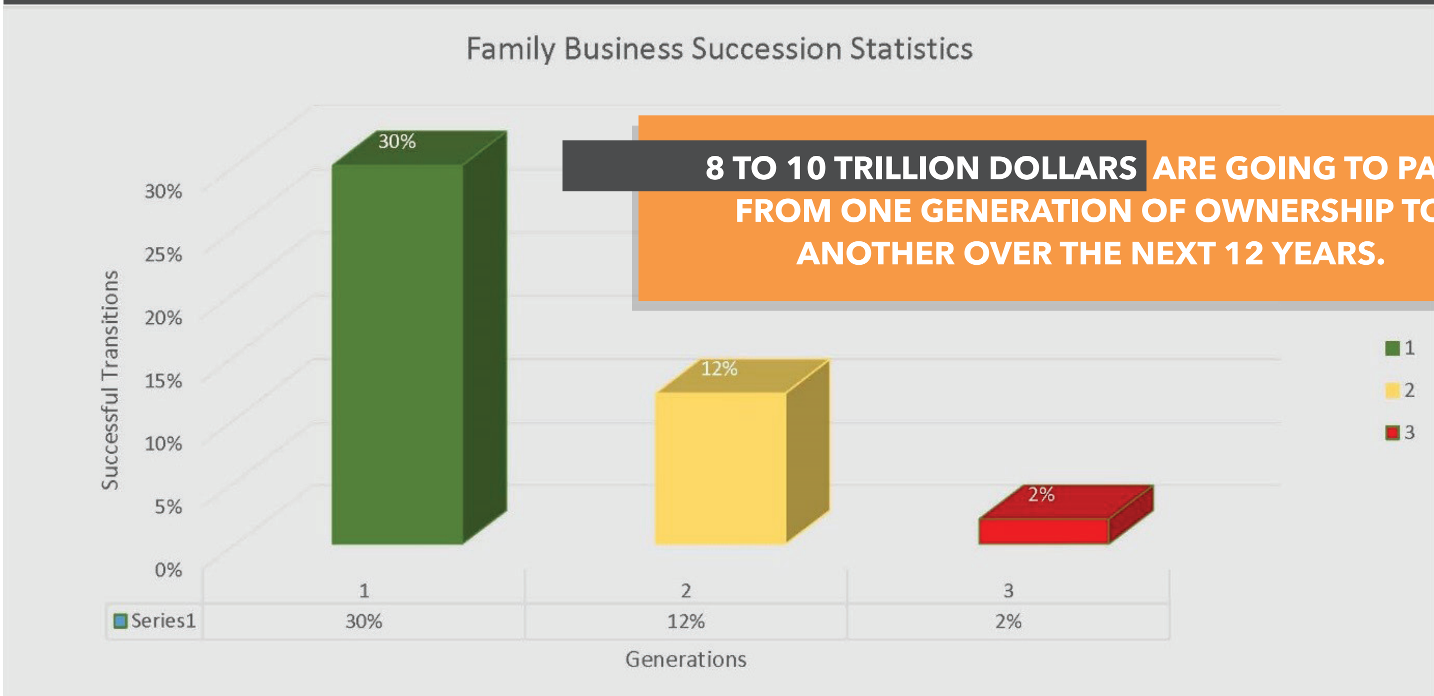
TOPICS COVERED

Poor Business Succession Planning
Investment & Credit Traps
Tax Planning Mistakes
Creating An Action Plan

".. as **Warren Buffett**, the legendary investor said that the first rule of investing is to never lose money.

The second rule is to **remember the first rule.**"

A FEW STATISTICS...



8 TO 10 TRILLION DOLLARS ARE GOING TO PASS FROM ONE GENERATION OF OWNERSHIP TO ANOTHER OVER THE NEXT 12 YEARS.

FAMILY FIRM INSTITUTE AND STATISTICS SHOW THE FOLLOWING:

88% of Family Business owners' believe that in the next five years they will **transfer ownership** to the next generation

Actual statistics of survival rates are that only **30% of family businesses** survive to the second generation while just **12% make it to the third.**

FAILURE TO PROTECT WEALTH... THE MATH:

An investor who suffers a 33 percent decline in portfolio value at age 30 will have decades to make up the loss, but by age 60 the individual has a much smaller window of opportunity and would need to achieve **a 50 percent gain** to recover that loss.

THE COMPLICATED IRS TAX CODE:

S Corporations have been targeted for IRS Audit for more than a decade. The IRS has focused on audits to determine reasonable compensation of shareholders. Shareholders need to make sure they are taking adequate compensation to avoid this headache.

Common personal deductions audited by the IRS which include miscellaneous deductions such as Gambling Losses and unreimbursed employee business expenses. If these deductions fall outside of normal IRS ratios/ ranges, the deductions could trigger an audit!

POOR BUSINESS SUCCESSION PLANNING

BUSINESS OWNERS' COMMON GOALS:

- Exit strategies that **optimize value** to the seller.
- **Minimize** seller's taxes on sale.

The key to exit strategies in which the seller negotiates with outside buyers are in the terms of the deal. A great price may not be ideal to the net proceeds after tax to the seller. Tax consequences and optimum value need to be considered hand in hand. For example, with many small and lower, mid-size companies, buyers prefer to buy the assets of the company, not the stock of the company. The seller would prefer to sell the stock of the company. Why? The stock sale is taxed at a lower rate in many cases. If the seller must sell the assets, it is important to allocate the assets sold appropriately. Assets such as Inventory are taxed at higher, ordinary tax rates, than equipment and goodwill. Equipment and goodwill are taxed at capital gains rates.

Wherewithal to Pay of Successor(s)

In some cases the SBA, Small Business Administration, is a funding source for buy sell arrangements for family businesses. As Tom Traficanti of Heritage Bank mentioned in our discussion, it is best to discuss financing plans and management transition with the company's lender as early as possible.

Alternative plans to lending sources include an extended buy-sell agreement (installment sale over time) with owner and successors with or without insurance as funding vehicle upon the disability or death of the owner. The insurance strategy requires that the owner is insurable and that the business and / or successors are financially able to afford the insurance premiums. The installment sale usually is contingent upon the financial success of the business. In effect, with the growth in profitability, the business pays off the owner over time. The insurance vehicle would be available with the event of the disability or death of the owner.

Satisfying Lender Requirements in the Succession

Collateral on lending relationships is an important consideration in the succession of the company as well as Personal Guarantees on company loans at transition time. In general, providing the lender confidence in new management and ownership commitment will allow for a smooth transition of the company. As Tom Traficanti suggested, having discussions with your lender early and often in the transition process is a best practice in maintaining a strong and healthy relationship with your lender.

INVESTMENT AND CREDIT TRAPS

One critical step to determine your investment post-retirement needs:

Prepare Financial Analysis of your post-retirement financial plan... and a "Money Barrels" analysis.

A Barrels analysis separates the owner's financial resources into various barrels, one of which is a safe bucket that is invested in fixed income, safe investments that is protected from volatile stock and bond markets. Another bucket would be an investment fund bucket invested in the stock and bond market that has an objective that is high return with a high risk objective; and a third bucket with the objective to keep for entrepreneurial pursuits. The entrepreneurial pursuits return objective is very high with a very high risk profile. The barrels analysis will allow the owner to consider how much to allocate for safety, investment.

BEST PRACTICES TO AVOID INVESTMENT TRAPS:

Lack Of Investment Plan

Best investment strategies include an overall well-conceived plan that you follow in good and not-so-good times.

Long-Term Investment Strategy

The best strategies are long-term. Long-Term strategies have the highest likelihood of reaching your financial goals. Short-Term Goals are not reliable in general. As an example, the S & P 500 Index group, a group that identifies the largest stocks of companies in the U.S., conducted a survey of mutual fund managers in 2015. They surveyed how well the managers performed compared to their respective benchmarks in the 2014 year. In that year they tallied the managers who outperformed their benchmark in that year. How many managers do you suppose outperformed their benchmarks? .... Well, 21% outperformed their benchmarks.

Diversify Your Risk

Another best practice is to diversify your risk. The opposite of this strategy, concentrating your risk can be catastrophic with investing. Putting all of your eggs in stocks or stock funds or bond funds that focus on a sector such as healthcare, technology, utilities or other concentrated investment has not been wise over time. Diversifying in stocks and bond funds in the U.S. and internationally is wise as well. From approximately 2002 to 2009, international stock funds outperformed the U.S. stock funds. Again, for long-term best practices, it is best to consider diversifying worldwide.

Evidence-Based Strategies

Academic Research: the evidence from academic research has shown that investing in index based strategy that includes a strategy that focuses on achieving market returns with the least amount of risk is a best practice. There are many studies that support this strategy including studies cited in the book, "Your Complete Guide To Factor Based Investing", by Andrew L. Berkin & Larry E. Swedroe. As these authors discuss, there are no guarantees in investing in the past or in the future. The evidence as noted in their book illustrates that there are best practices such as using a long-term strategy that is diversified in risk and that implements a multi-style approach that integrates an approach to investment in small size companies, using value strategy to investments compared to growth style investments, and includes investments that use a momentum strategy.

Not Monitoring Your Business or Personal Credit

The wealth protection includes adequately monitoring your credit history and how you manage it. Having too much credit or too little credit could hurt your ability to invest such as in real estate investment or other investments. Like it or not, we are all monitored in how we manage how debts and payments. It is preferable to not have to use debt capital in some circumstances. In other circumstances such as in investment, debt capital can be considered a good option that will eventually expand and grow your net worth.

The Creditor/ Lender's View

It is best to understand the lender's view when they are evaluating a debt capital relationship with you. They are looking at the Three C's: Your Capital, Your Credit, and Your Character. Your Credit includes your history and the amount of credit you are carrying or have carried in the past.

TAX PLANNING MISTAKES AND HOW TO AVOID THEM

A) Mis-allocating investments in taxable vs. tax deferred accounts

Certain investments are best allocated to tax deferred accounts for tax purposes. For example, in IRAs, 401K's etc. It is best to have income producing investments as compared to nonincome producing investments when possible. Investments that when sold, or you receive long-term capital gain distributions, it is best to include these investments in taxable accounts. Long-term capital gains are taxed at a lower rate than ordinary income tax.

B) Ignoring the Alternative Minimum Tax (AMT).

The AMT law was passed many years ago to prevent people from paying little or no tax. – the AMT which is a minimum tax that is between 20 and 25% may be triggered when you sell an investment for a very large gain above your usual tax rate. Taxpayers have been rudely surprised with the AMT. It is important to consider tax planning when selling an investment with a very large taxable gain. Here are a few plans to avoid this tax.

Consider selling the gain over several tax years to avoid the AMT tax. Consider charitable donation of the large unrealized investment gain if you have charitable goals and desires.

C) Planning for IRA investments and distributions

Timing of required minimum distributions (RMD) - RMDs if not taken correctly could cause a 50% tax penalty. It is important to make sure you are taking minimum distributions if you are the owner of an Inherited IRA or you must take RMDs because you are 70 ½ years old or older and have a traditional IRA.

IRA Trusts- If you own an IRA and wish to change beneficiaries to allow grand children or great grandchildren or relatives

to benefit from your IRA when you pass away, the IRA trust is a good planning option. The IRA Trust could extend the benefit of your IRA to the next generation or the generation after your children. It is important to have a qualified estate planning attorney to draft these changes to your IRA.

D) Year-end tax issues (loss harvesting, timing dividends)

In year-end planning, loss harvesting is a plan to either offset your investment gains to losses or re-balance your portfolio, or to take losses and re-balance your investments with similar investments and reduce your tax due at filing time. Losses only can be taken as deduction when investments are sold. Dividend timing is another year-end plan that can reduce your taxes due at filing time. By purchasing your investments after they declare their dividends, you will not be surprised with additional income tax by your initial investment purchase.

E) Planning real estate investments

Consider real estate strategies that minimize tax:

a) Like-Exchanges - this strategy defers tax by selling and then purchasing a similar investment with no tax impact. There are strict IRS rules to follow. Be sure to seek advice from your tax professional on your facts and circumstances.

b) Installment sale – this strategy stretches out your tax due based on the sale terms. In the example of an installment sale terms that allow the buyer to make payments over five years, the seller receives partial payments and his / her taxable gain is spread out over five years as well.

c) Gift strategies – this strategy eliminates tax due on unrealized / unsold investments. If you give the investment to another individual during your life, you can deduct your cost basis in that year on your tax return. If you give the investment upon your death. Your loved one has receives the gift at fair market value at your death, which is also referred to as a stepped-up basis at your death.

d) IRAs and Real Estate - Be aware that the best way to invest and avoid IRS headaches is to invest in Real Estate in IRAs as either real estate investment trust investments or as Limited Partnership investments. The IRS considers these types of investment appropriate for IRAs. The IRS is recently objecting to direct real estate investment, and they are auditing and filing lawsuits against taxpayers with regard to issues involved in direct real estate investments. Some of the IRS's arguments involve their claims that direct real estate investments can be characterized as self-dealing by the investor or considered prohibited transactions due to related party violations of the IRS code.

WHY DO YOU NEED TO CONSIDER THESE BEST PRACTICES IN INVESTMENT PLANNING?

+ To **secure** retirement plans.
+ To take care of your family's **financial future.**

READING RECOMMENDATIONS

The New Retirementality by Mitch Anthony

Get What's Yours by Laurence Kotlikoff

Strangers In Paradise by James Grubman, Ph.D.

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