Why You Need a Power of Attorney and Medical Directive

It's late at night and you're waiting for your husband to arrive home from a business trip. Suddenly the phone rings and the voice on the other end informs you that your husband was in a terrible car accident and has been rushed to the hospital. You arrive to find several doctors awaiting permission to operate on your unconscious husband. They ask if he has a medical directive that authorizes someone, preferably you, to make health-care decisions on your husband's behalf.

A few days pass and your husband survives the accident, but he's going to be laid up for several weeks or months. Household bills need to be paid, but the primary source of income is your husband's business and you're not named on any of the business bank accounts. The bank representative asks whether your husband has a durable power of attorney naming you as his agent for financial matters.

These are everyday examples that highlight the importance of a medical directive and a durable power of attorney. Without these documents in place, you and your family could face personal and financial disaster.

What is a medical directive?

A medical directive lets others know what medical treatment you would want, and allows someone to make medical decisions for you, in the event you can't express your wishes yourself. There are two basic types of advanced medical directives--a durable power of attorney for health care and a living will--which generally vary by state. So be sure your documents comply with the laws of your state of residence.

A durable power of attorney for health care (known as a health-care proxy in some states) allows you to appoint a representative (health-care agent) to make medical decisions for you if you are unable to do so yourself. You can appoint almost anyone as your agent (as long as they are of legal age, usually age 18 or older). You decide how much power your representative will or won't have.

A living will allows you to approve or decline certain types of medical care, even if you will die as a result of that choice. In most states, living wills take effect only under certain circumstances, such as terminal injury or illness. Typically, a living will can be used to decline medical treatment that "serves only to postpone the moment of death." In those states that do not authorize living wills, you may still want to have one to serve as an expression of your wishes.

What is a durable power of attorney?

A durable power of attorney (DPOA) can help protect your property in the event you become physically unable or mentally incompetent to handle financial matters. If no one is ready to look after your financial affairs, your property may be wasted, abused, or lost. A DPOA allows you to authorize someone else to act on your behalf, so he or she can do things like pay everyday expenses, collect benefits, watch over your investments, and file taxes.

A DPOA may be effective immediately (this may be appropriate if you face a serious operation or illness), or it may only become effective upon the occurrence of an event, such as your incapacity (sometimes referred to as a springing power of attorney).

Caution: *A springing power of attorney is not permitted in some states, so you'll want to check with an attorney for its availability in your state.*

Additional things to consider

When creating either a DPOA or medical directive such as a durable power of attorney for health care (HPOA), it is important that you choose an appropriate agent. While you may select the same person to serve as agent in both documents, you are not compelled to do so. And be sure the person you select as agent is aware of that fact. Also, let them know where you keep these documents (you may want to give a copy of your HPOA to your agent and primary care physician as well).

Once you have these documents, review them periodically to be sure they still accomplish what you intend them to do.

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In this edition of Lesemann & Associates PLLC CPAs newsletter, we are focused on PROTECTION

PROTECTION via healthcare power of atty
PROTECTION via family succession planning
PROTECTION via life insurance
PROTECTION via asset allocation

*As we have stated in the past, **a Client referral is one of the best compliments a professional services firm can receive** . If you know of anyone that would benefit from the expertise we offer please let us know.*

There are not many small firms, such as ours, where you get the experience level, knowledge, understanding and care. Please let us know how we are doing.

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All in the Family: Transferring a Business to Your Children

With a grantor retained annuity trust (GRAT), you receive a fixed dollar amount that does not change even if the value of the trust property (corpus) increases or decreases. Some other types of trusts are a grantor retained unitrust (GRUT) and a rolling or cascading GRAT. A GRUT allows you to retain the right to receive a fixed percentage of the trust corpus (determined annually), while a rolling or cascading GRAT is a technique that involves creating a series of short-term GRATs (typically two or three years) with each successive GRAT being funded by the annuity payments from the previous ones. This technique can minimize the risk of the grantor dying during the GRAT term, and can also minimize interest rate risk.

You've spent years building a family business that's a source of pride and income for both you and your family, and now you may be thinking of handing over the reins to your children. If so, consider that transferring your business interest to your children may have income, gift, and estate tax consequences. Careful planning can help prevent the need to sell some (or all) of the business assets to pay those taxes.

Some common strategies for minimizing taxes are discussed briefly below. Remember, however, that none of these strategies are without drawbacks. Before you act, consult a tax professional as well as your estate planning attorney.

Gifting or bequeathing your interest outright

If you don't need continued income from the business and you don't want to retain some control, you can simply give the business to your children outright. For example, you can begin a systematic program of making annual gifts to your children in amounts that equal the annual gift tax exclusion ($14,000 per year per recipient in 2013). By transferring your interest in this manner, you may be able to transfer all or a significant portion of the business free from federal gift tax (although these transfers may still be subject to state gift tax). The disadvantage here is the amount of time that may be needed to transfer your entire interest.

If you can wait and transfer your business at your death, Section 6166 of the Internal Revenue Code allows any estate taxes incurred because of the inclusion of your family business in your estate to be deferred for 5 years (with interest-only payments for the first 4 years), and then paid in annual installments of interest and principal over a period of up to 10 years. This will allow your beneficiaries more time to raise sufficient funds to pay the taxes or obtain more favorable interest rates if they need to borrow the money. Be aware that the business must exceed 35% of your gross estate and other requirements must be met.

Selling your interest outright

If you need income from your business, you can sell your business interest (for full fair market value) to your children. This will avoid gift and estate taxes, but you may owe capital gains tax.

Using a buy-sell agreement

If you want to sell your business interest to your children but retain control over the business for a period of time, consider using a buy-sell agreement. This is a legal contract that states that the sale will happen when a specific event occurs, such as your retirement, disability, divorce, or death. When the triggering event occurs, the children will be obligated to buy your interest from you or your estate. The price and sale terms will have been predetermined by the contract. Remember, however, that you will be bound under a buy-sell agreement: you won't be able to sell or give your business to anyone except the buyers named in the agreement (unless they consent).

Using a grantor retained annuity trust (GRAT)

A GRAT is a trust into which you transfer your business interest, and from which you receive income for a period of time. The value of the gift is determined using the IRS's current interest rate (published monthly by the IRS). The trust must terminate at a specified time (e.g., 10 years). You receive annuity payments during the term of the trust, and at the end, your children will receive the business. If the business has appreciated beyond the IRS's interest rate, the excess can pass tax free. Be aware, however, that if you die during the GRAT term, your entire business interest will be included in your gross estate for federal estate tax purposes. You will have failed to transfer your business interest and lost the tax advantages of the GRAT. Plus, you will have incurred the costs of creating and maintaining the GRAT for nothing. For these reasons, be sure to structure your GRAT carefully.

Creating a family limited partnership (FLP)

An FLP is a type of business entity. First, you establish a partnership with both general and limited partnership interests. Then, you transfer the business to this partnership. You retain the general partnership interest for yourself, allowing you to maintain control over the day-to-day operation of the business. Over time, you gift the limited partnership interests to your children, leveraging your lifetime gift tax exemption and the annual gift tax exclusion. You also save taxes because the value of the gifts may be eligible for valuation discounts, such as the minority interest and lack of marketability discounts.

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It's Time to Review Your Life Insurance Needs

Regularly reviewing your life insurance can help it keep pace with your changing needs, and your financial and family obligations.

Your life insurance needs may change without you even realizing it. You may have purchased life insurance years ago, and never gave it a second thought. Or, you may not have life insurance at all--and now you need it. When your life circumstances change, you have a fresh opportunity to make sure the people you love are protected.

You're tying the knot

When you were single, you may not have thought much about life insurance. But now that you're getting married, someone else may be depending on your income. If one of you should die, the other spouse may need to rely on life insurance benefits to meet expenses and pay off debts.

The amount of life insurance coverage you need depends on your income, your debts and assets, your financial goals, and other personal factors. Even if you have some low-cost life insurance through work, this may not be enough. To be adequately protected, you may each need to buy life insurance policies from a private insurer. The cost of an individual policy will be based on your age and health, the amount of coverage you buy, the type of policy (e.g., cash value or term insurance), and other variables.

You've become a parent

When you become a parent, it's time to take another look at your life insurance needs because your family's financial security is at stake. Married, single, and stay-at-home parents all need life insurance. Life insurance proceeds can help your family meet both their current expenses (such as a mortgage, child care, or car payments) and future expenses (such as a child's college education). Even if you already have life insurance, it's time to review your policy limits and beneficiary designations.

You're contemplating divorce

During a divorce, you'll have a number of pressing financial issues to address. Make sure that one of these is life insurance. You'll want to think about what protection you need, and what protection your children (if any) will need in the future. For example, if you'll be paying or receiving child support, you may want to use life insurance to ensure continuation of those payments. During a divorce, you may also need to negotiate ownership of life insurance policies. Life insurance ownership and obligations may be addressed in your divorce settlement, and state laws vary, so ask your attorney for advice and information. Finally, you'll want to evaluate your own life insurance needs to make sure your family is protected in the event of your death.

Your children have left the nest

If having children was the reason you originally purchased life insurance, you may feel that you no longer need coverage once your children are living on their own. But this isn't necessarily the case. Before making any decision, take a look at the types and amounts of life insurance you have to make sure your spouse is protected (if you're married). And keep in mind that life insurance can still be an important tool to help you transfer wealth to the next generation--your children and any future grandchildren.

You're ready to retire

As you prepare to leave the workforce, you should revisit your need for life insurance. You may find that you can do without life insurance now if you've paid off all of your debts and achieved financial security.

But if you're like some retirees, your financial picture may not be so rosy. You may still be saddled with mortgage payments, tuition bills, and other obligations. You may also need protection if you haven't accumulated sufficient assets to provide for your family. Or maybe you're looking for a way to pay your estate tax bill or leave something to your family members or to charity. You may need to keep some of your life insurance in force or even buy a different type of coverage.

Your health has changed

If your health declines, how will it affect your life insurance? A common worry is that if your health changes, your life insurance coverage will end if your insurer finds out. But if you've been paying your premiums, changes to your health will not matter. In fact, you should take a closer look at your life insurance policy to find out if it offers any accelerated (living) benefits that you can access in the event of a serious or long-term illness.

It's also possible that you'll be able to buy additional life insurance if you need it, especially if you purchase group insurance through your employer during an open enrollment period. Purchasing an individual policy may be possible, but more difficult and more expensive.

Of course, it's also possible that your health has changed for the better. For example, perhaps you've stopped smoking or lost a significant amount of weight. If so, you may want to request a reevaluation of your life insurance premium--ask your insurer for more information.

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What is asset allocation?

Each type of investment has specific strengths and weaknesses that enable it to play a specific role in your overall investing strategy. Some investments may offer growth potential. Others may provide regular income or relative safety, or simply serve as a temporary place to park your money. And some investments may even serve to fill more than one role. Because you likely have multiple needs and desires, you probably need some combination of investment types, or asset classes.

Balancing how much of each asset class should be included in your portfolio is a critical task. That balance between growth, income, and safety is called your asset allocation, and it can help you manage the level and types of risks you face.

The combination of investments you choose can be as important as your specific investments. Your mix of various asset classes, such as stocks, bonds, and cash alternatives, generally accounts for most of the ups and downs of your portfolio's returns.

Ideally, your portfolio should have an overall combination of investments that minimizes the risk you take in trying to achieve a targeted rate of return. This often means balancing more conservative investments against others that are designed to provide a higher potential return but that also involve more risk. However, asset allocation doesn't guarantee a profit or eliminate the possibility of investment losses.

Someone living on a fixed income, whose priority is having a regular stream of money coming in, will probably need a very different asset allocation than a young, well-to-do working professional whose priority is saving for a retirement that's 30 years away. Even if two people are the same age and have similar incomes, they may have very different needs and goals, and your asset allocation should be tailored to your unique circumstances.

And remember, even if your asset allocation was right for you when you chose it, it may not be right for you now. It should change as your circumstances do and as new ways to invest are introduced. A piece of clothing you wore 10 years ago may not fit now; you just might need to update your asset allocation, too.

SHE'S GOT AN INTERESTING TAKE ON ASSET ALLOCATION.

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