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Planning Potpourri

House Closings. Perhaps for the first time in memory banks have reneged on funding mortgage commitments they had approved. Buyers should protect themselves by having real estate counsel address this risk in the mortgage contingency clause in purchase contracts. Thanks Kenneth J. Gould, Esq. White Plains, NY.

Legal Fees for Docs. There's a website where docs can go to see what legal fees should cost for "standard" legal work like an employment agreement. Yeah, that makes a lot of sense. How about doing it the good old fashion way? Get references to find a lawyer who is reputable and skilled in the expertise you need. Then pay them hourly for the amount of work that is necessary to help you accomplish your goals. If you want to control costs there are real ways to do so. Looking at numbers on a website is not on the list! Try these steps: 1) Vet the attorney before you hire; 2) Ask what can be done to control costs and do it; 3) Review detailed bills to monitor the process; 4) Cooperate and stay focused to minimize meeting and other controllable time; and 5) Do your homework. Inform your attorney of the business aspects of the deals, your goals, etc. Make concise lists. No attorney can know the intricacies of a particular practice, or the dynamics of the deal, until informed. The real measure of the "cost" of legal help is not the upfront cost. It's the results over the course of the deal. A cheap price up front can easily be outweighed by the costs of litigation on a sloppy deal later. Didn't mom warn you about being "penny wise and pound foolish"? While all this may be obvious, remember that millions of patients run to their physicians asking for the "purple pill." People love simple answers. If life were simple.....

Care Taker Contracts. The home health aide hired to take care of gramps also took care of herself by becoming a primary heir. If this might sound like a TV script, it's for a reality show! Gramps may well become attached to his caregiver. Once the caretaker is in gramps house, it's tough to manage the situation. Your efforts to protect gramps from a manipulative caretaker might be viewed by him as a lack of caring. Have an elder or family law specialist address the issues in an employment agreement before the caretaker starts. Thanks to Pravin J. Philip of www.biz4nj.com. PP

Practical legal stuff...
in plain English

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PRACTICAL PLANNER

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Thoughts About a Tough Year

Summary: It's been a tough year. This article is not meant to trivialize the pain that many have suffered, nor to imply that recent economic events could have been planned around. Recognizing this, and that hindsight is always 20-20, lessons can still be learned from the carnage. Although some of the observations following are simplistic, they hopefully provide some useful ideas.

■ Time Horizons. Too many investors accepted asset allocations that were out of sync with the time frame that was appropriate for them. Asset allocation can reduce risk and increase return, but it was never intended as a two dimensional decision. The mechanistic application of what some advisers passed off as investment planning too often ignored the investor's time horizon to his peril. This same essential lesson is again being ignored by investors. Some have abandoned equities because of the risk they now associate with them. That decision too should consider the time horizon. Just as many investors were hurt by assuming too long a time horizon, they may be hurt in future years from now ignoring the length of their time horizon.

■ It's Not One Investment Pot. One lesson from the carnage of the 2008 meltdown seems to be that too many investors viewed their investment assets as a single pot for asset allocation purposes. Many investors had a financial planner run a boilerplate financial analysis and apply an allocation to their entire portfolio. Too simplistic an approach. Assume that your overall allocation was 60% stock: 40% bonds. If you have a college fund for your children, an allocation to cash and near cash investments, such as laddered CDs and money market funds, might be appropriate for those funds. Your rainy day money to get you through a job layoff, health emergency, and so forth, could be cash. Funds saved for the purchase of a vacation home in five years warrant a less aggressive allocation because of the short time duration, but certainly not the allocation to cash as the college or rainy day funds. If your remaining portfolio is $10 million and you're spending about $350,000/year. $8 million might be used to support your expenses assuming a withdrawal rate of a bit over 4%/year. The remainder of your portfolio is really being held to bequeath and has a long time horizon. Thus, breaking up your overall portfolio into separate pots for specific purposes will yield more appropriate asset allocations for each category, and will better reflect the time horizon and risk for each category. Does 2008 undermine the integrity of asset allocation theory? No, but a more carefully crafted approach should have been used.

■ Budget is not a Four Letter Word. You're rich, you don't need to budget! Wrong. Budgets are for everyone. A successful entrepreneur sells the family business. The family is on easy street. Or is it? Family spending grows to $750,000/ year. While the $10 million net feels substantial, if you're spending 7.5% on your investment assets (even forgetting the recent market meltdown) you'll outlive your money. Prepare a balance sheet. Subtract all the "B's": bungalow, boat, and bling. What's left is your investment assets. Multiply by 5%. If you're spending more, you likely have a problem. If you want real assurance that you won't outlive your money, spend closer to 3.5%. Your spending must reasonably correlate with your assets. Too many wealthy investors simply don't control the relationship of spending to their investable

(Continued on page 2)

Checklist: Collectibles

Summary: Art and collectibles raise a host of unique income tax, insurance, estate and charitable planning issues. The topic is so broad that this brief checklist can at most highlight a few of the myriad of points.

Recordkeeping for Art and Collectibles: Maintaining proper documentation of your collection is vital. It's the first step to other aspects of planning. You cannot insure, appraise, plan or sell a collection without information:

√ Type of collectible (e.g., painting, sculpture).
√ Name or title of the work.
√ Artist or other creator
√ Dimensions (with and without frames, bases, etc.).
√ Signatures? Iis it signed? How? Where?
√When was it made?
√ Composition? What is it made of?
√ Ownership history (Provenance).
√ When did you acquire it?
√How did you acquire it? (self created, purchase, gift, inheritance, auction).
√ How much did you pay?
√How did you pay (save proof: receipts, bill of sale, cancelled check, certificate of authenticity, etc.).

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...Thoughts About a Tough Year

(Continued from page 1)
wealth. Read The Millionaire Next Door (Stanley and Danko). The surest way to become a millionaire is to live below your means. The surest way to fall from the ranks of the wealthy to the middle class (other than having invested with Madoff) is to spend beyond your means.

■ Annual Meetings are Vital. To assure the success of your planning meet with your advisers annually. Meeting with your wealth manager quarterly is prudent. Meeting with your accountant to review and sign your tax return is essential. But an annual meeting of all your advisers and key family members is crucial. The above don't substitute for it. Your annual review can range from a large board meeting spanning a day, to a consultation with your estate planner who calls your other advisers. It depends on your budget and the complexity of your situation. The annual meeting will assure that the expertise of each of your advisers is marshaled for your interests. An annual review assures that no one looses sight of your planning "big picture." This is especially important during economic turmoil.

■ Coordinate your Adviser Team. Too many people are realizing that investment, spending and other decisions were not optimal. But many of those people did not have all of their key advisers: accountant, estate planner, business attorney, insurance consultant, wealth manager, trust officer, etc. coordinated and fully informed. A team approach can identify gaps in planning, an adviser who is not following through, miscommunications between advisers that can result in duplication of efforts on your dime, or worse, dropped balls. To succeed, your advisers should work in concert. Backstabbing or one-upmanship don't help you. Foster an atmosphere that welcomes identification of opportunities for improvement, and even mistakes. If the first thing that happens when a mistake is identified is one adviser blames another, you loose. Be certain each adviser has the opportunity to voice their concerns. Don't let your longest, or loudest, adviser dominate. Typically one of your advisers assumes the quarterback role. Be certain it is clear to everyone who it is, and that your quarterback has the authority to do what he or she believes needs to be done to protect you. Calling your estate planner "quarterback," but not providing her with current details of your affairs, or leaving her off key memorandum from your other advisers, won't work. A good team can mollify the harshness of economic problems, and position you for the future.

■ Your Accountant is more than a Bean Counter. Use your accountant as more than a bookkeeper and tax preparer. Without intent to second guess the many shrewd investors taken in by history's biggest Ponzi scheme, your accountant might have identified concerns if you had brought a proposed Madoff investment to him for review. Your accountant might have raised concerns over the use of a small accounting firm, in a small town, operating from a storefront office. Your accountant might have determined that the auditor had not had a peer review since 1993. While this is all past history, using each of your adviser's abilities to the fullest, in the context of a proactive and collegial team, might help you avoid pitfalls in the future.

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■ The Key Planning Question Too Many Forgot. "What if." Simple, obvious, but that is the key to all planning. Too many people just stopped asking enough "what if" questions in their planning. "What if" you were disabled tomorrow and couldn't work again? "What if" you were diagnosed with a debilitating disease that will restrict you to working part-time and increase your costs of daily living? Millions of people face just such tough news every year. What if you were hit by a major lawsuit? Your savings could be jeopardized. If you had asked the unpleasant "what if" questions, would you have fared differently through the economic turmoil?

■ Count Your Blessings. "…Count your many blessings Money cannot buy…" (Johnson Oatman, Jr.). Focus on what is really important. PP

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Review: Andrew Wolfe, CPA, JH Cohn LLP, Roseland, NJ.

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...Checklist: Art & Collectibles—Part I

(Continued from page 1)
√ Location. where do you keep it? If multiple locations provide details as to when it is moved and how.
√ Photographs. Take good quality photographs, or better, hire a professional appraiser. Include any inventory number on the photograph.
√ Inventory details. If you have an inventory explain your numbering system, where each item is tagged, whether bar codes are used, etc.

Income Tax Considerations: There are a host of income tax considerations to holding art and collectibles. The following is a smattering of them:

√Are you a dealer in art or collectibles? There are substantial tax implications. A dealer will realize ordinary income on sale, not capital gain, but will be able to deduct expenses a non-dealer cannot. If there is any gray in how this determination applies to you, you should carefully plan and document support for the conclusion that is optimal for you.
√ If you sell collectibles at a loss, your tax deduction is limited to: (1) losses incurred in a trade or business, which means your being a dealer; (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business, if you can demonstrate this; and (3) , losses of property not connected with a trade or business or a transaction entered into for profit, if the losses arise from fire or other casualty, or from theft. IRC Sec. 165.
√ You might be able to engage in a tax deferred exchange of some of your collectibles for others, but only if you can demonstrate that they were held for investment. IRC Sec. 1031.
√ If your holding artwork or collection activities are not engaged in for profit, no deduction attributable to that activity will generally be allowed. IRC Sec. 183. If the gross income derived from your collecting for 3 or more years in the preceding 5 exceeds the deductions attributable to your collection activity, it will be presumed to be engaged in for profit.
√ The top capital gain rate for sale of assets held for at least one year is usually 20%, but a 28% top rate applies to gains from the disposition of collectibles held for more than one year. "Collectibles" means art, rugs, antiques, metals, gems, stamps, coins, and alcoholic beverages. IRC Sec. 1(h)(6)(A) , 408(m).
√ Interest expense incurred to carry investments is generally limited to net investment income. Net investment income excludes dividends and net capital gains unless you make a special tax election. Sec. 163(d)(4)(B). Whether or not it's advantageous for you to make this election may depend on the capital gains tax rate you'll pay. Consider the impact ongains on collectibles otherwise subject to the 28% rate.
√ Depreciation generally cannot be claimed on collectibles because collectibles are not adversely affected by the passage of time, or by your use. Rev. Rul. 68-232, 1968-1 CB 79. There are a few exceptions. Inexpensive paintings used as furniture (e.g., to decorate a medical office) might qualify for depreciation if you can demonstrate a limited life. Depreciation is permitted if the collectible sustains wear in its use, e.g. antique violin

Recent Developments

S Corporation Compensation Games. Mr. Big only gets paid $500/week, but gets a distribution of $1 million/year form his S corporation. Why? Might it have something to do with minimizing payroll taxes? Mr. B, the IRS wasn't born yesterday! Distributions and other payments by an S corporation to an officer must be treated as wages to the extent the amounts are reasonable compensation for services. Factors considered by the courts include: • Training and experience • Duties and responsibilities • Time and effort devoted to the business • Dividend history • Payments to non-shareholder employees • Timing and manner of paying bonuses to key people • What comparable businesses pay for similar services • Compensation agreements • The use of a formula to determine compensation. FS-2008-25; IRC Sec. 1362. Corroborate the basis for your salary, and most importantly do what Dr. Phil, CPA says "Get Real"!

Continuous Representation. A law firm's former client's claims concerning offshore trusts the firm helped the client form to avoid taxes were not barred by the three-year statute of limitations. The court held that the firm continued to represent the client after the trusts were formed. The continuous representation theory is to protect clients, not help attorneys. De May v. Moore & Bruce LLP, D.D.C., No. 08-845 (ESH), 11/06/08.

Taking an IRS Audit too Hard. You thought that the 1993 movie Falling Down with the character William "Bill" Foster (played by Michael Douglas) was a movie. But the script sounds like a documentary about Randy Nowak. Randy, the owner of a construction company, took a recent IRS audit in Bill Foster style. Randy hired a hit man to bump off the IRS agent and burn down the local IRS office. Well, who needs a tax attorney! Unlike Bill, however, Randy will have lots of time to contemplate his misdeeds during his long prison term. US v. Nowak,