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## *Estate Planning and Your Family Business*

**I**f you are like most entrepreneurs, you do not want the business you worked so hard to establish to fall apart when you are no longer able to run it. But when business owners die without leaving wills or estate plans, that is often what happens as their families struggle to carry on. Sometimes, the business must be liquidated to pay the tax liability, or the company collapses because family members have not been sufficiently prepared to run it. If you own a family business, consider taking steps now to help ensure this valuable asset will remain intact for your children, grandchildren, and beyond.

### *Business Succession Planning*

Business owners often fail to establish formal succession plans because broaching the subject of business continuation can be difficult. It may trigger strong personal or emotional conflicts among family members.

In addition, business owners may find it difficult to groom a family member for succession due to conflicting personal and professional relationships. In some cases, business owners may feel pressured by long-standing sibling rivalries or family disputes.

As difficult as business succession planning may be, the consequences of not establishing a continuation strategy may be even more costly. Here are some suggestions for developing a formal succession plan that can help ensure the continued success of your business after your death:

- Appoint a successor to take over as head of the company while you are still involved in the business, so that he or she can learn the ropes from you. Provide your successor with the mentoring and education needed to do the job, but remember to give him or her room to develop an individual leadership style.
- Consider your options for transferring business interests and control in the company to the next generation, such as making gifts of ownership interest, selling stock to your successors, setting up a stock redemption deal, or even starting a new business for your children.
- Prepare now to minimize the tax liability of your estate upon your death. While the Federal estate tax is being gradually phased out under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), it

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## Understanding Life Insurance Beneficiary Designations

In the language of life insurance, a **beneficiary** is the recipient of the proceeds of a policy when the named insured dies. The owner of a life insurance policy has a great deal of flexibility in naming beneficiaries and can generally name anyone he or she chooses. When making beneficiary decisions, it is important to ensure that the wishes of the policyowner are fulfilled and that legal complications are avoided.

### Types of Beneficiaries

Beneficiaries are typically categorized as either **primary** or **contingent**. A *primary* beneficiary is entitled to the proceeds of the policy upon the death of the insured, but such rights expire if he or she dies before the insured. A *contingent* (or secondary) beneficiary is entitled to the policy proceeds if the primary beneficiary has predeceased the insured. One fairly common arrangement might stipulate that, if a primary beneficiary dies before collecting the entire proceeds of the policy, then the remaining amount will be payable to the contingent beneficiary. It is often desirable to have several levels of contingent beneficiaries.

A beneficiary can be either **specific** (a person identified by name and relationship) or a **class designation** (a group of individuals such as “children of the insured”). While the naming of specific beneficiaries is usually clear-cut, unintended complications can arise when designating *classes* of beneficiaries.

For example, if you plan to name your children as beneficiaries, you will need to clarify if you intend to include adopted children or children by a former spouse. If your children

are minors, it is also important to determine if the insurance company will pay the proceeds to a minor beneficiary. Generally, insurers insist on paying proceeds to a legal guardian rather than to a minor.



Consider the following situation in which the policyowner’s intentions appear straightforward, but could become complicated. Harriet, who is seventy years old, has planned for the proceeds of her life insurance policy to be paid to her children (Sam, Carole, and Jill) or her grandchildren. Now, suppose Sam and Carole die before their mother. Sam leaves four children and Carole has no children. How will the proceeds of the policy be distributed when Harriet dies?

### Methods of Distribution

**Per stirpes** and **per capita** are terms that describe methods of distributing property to family members and heirs. *Per stirpes* means “branches of the family,” and *per capita* means “by heads.” In the example above, under a *per stirpes* distribution, Jill (one branch) would receive one-half of the proceeds and Sam’s surviving children (the other branch) would divide the remaining half among themselves. Under a *per capita* distribution, Sam’s four children, along

with Jill, would each receive one-fifth of the proceeds. Remember, if any of Sam’s children are still minors when Harriet dies and legal guardians have not been appointed, there may be complications.

### Revocable vs. Irrevocable

Consequences may also vary according to whether beneficiary designations are revocable or irrevocable.

If a beneficiary designation is **revocable**, the policyowner reserves the right to change the beneficiary. A person designated as a revocable beneficiary has only an “expectation” of benefits, since the owner of the policy can exercise any of the policy rights without the consent of the revocable beneficiary.

On the other hand, an **irrevocable** beneficiary designation cannot be changed without the consent of that beneficiary. While this arrangement is sometimes desirable for estate planning purposes, the legal status of an irrevocable beneficiary is uncertain. Some may regard an irrevocable beneficiary as a “co-owner” of the policy; therefore, the beneficiary’s consent is needed to exercise any policy rights. On the other hand, others may contend that an irrevocable beneficiary’s consent is needed only for exercising a change of beneficiary.

The latter position can create the somewhat puzzling situation of compromising the beneficiary’s rights if the policyowner exercises other rights, such as surrendering the policy or permitting it to lapse. Due to the vague legal status of an irrevocable designation, it is usually preferable to use revocable beneficiary designations.

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## Securing Future Care with a Special Needs Trust

Caring for a child or adult with special needs can be emotionally challenging for parents, family members, and other caregivers. In addition, the economic issues that result from providing special care often strain current and future family finances. This is further complicated by the potential loss of government benefits if finances are improperly managed. Therefore, families with dependents with special needs must carefully plan, to the best of their ability, for both present and future care. Often, an important part of such a plan is a **special needs trust**.

A special needs trust can be invaluable in providing care for a child or other dependent with special needs. Such a trust can be used to help with finances, often without affecting eligibility for government benefits. However, in order to maintain the child's eligibility for **Supplemental Security Income (SSI)** and **Medicaid**, trust assets can be used only for "extras," such as transportation, therapy, or day care—not for essentials, such as housing, clothing, or food.

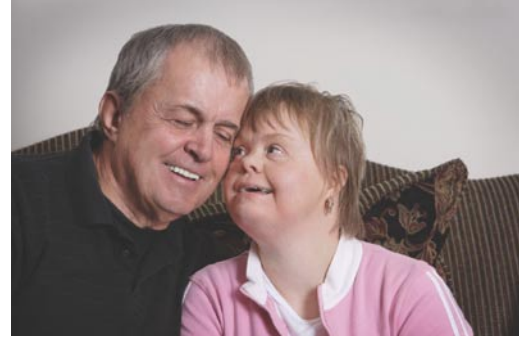
### What about Funding?

There are no limitations on how much money or what type of assets can be put into a special needs trust. In this respect, a properly written and executed special needs trust can be used to receive inheritances and gifts.

Usually, the parents of the trust beneficiary are **co-trustees** and actively manage trust assets. Generally, income from trust assets is taxable to either the trust (if the income remains in trust), or to the trust beneficiary (if income is paid out).

Special needs trusts are generally funded with gifts made to the trust by parents or others. Under current tax law, a taxpayer can make a gift of up to \$13,000 in 2009 to as many individuals as he or she chooses (\$26,000 for a married couple) without incurring any Federal gift taxes. This is known as the **annual gift tax exclusion**. Although the annual gift tax exclusion generally cannot be used for gifts made to trusts, there are exceptions that may warrant further exploration. In addition, the **applicable exclusion amount** (\$1 million for lifetime gifts, \$3.5 million for bequests in 2009) could be used by an individual to fund a special needs trust. However, using the applicable exclusion amount during one's lifetime reduces the amount available to the estate at the donor's death.

Besides making gifts to a special needs trust, it is also common to have a **life insurance** policy (or policies) transferred to, or purchased by, the trust. When the insured (typically a parent) dies, the policy's death



benefit proceeds become part of the trust and are used for the ongoing support of the trust's beneficiary (the dependent with special needs).

Another benefit of a special needs trust is that it avoids **probate** when the parent/trust donor dies. Also, if the parents are the trustees, they can name **successor trustees** to manage trust assets, including any inheritance.

### Providing for the Future

A special needs trust can help ensure that a child or adult with special needs will be provided for beyond the limitations of government benefits. This can provide peace of mind for parents and caregivers, knowing that their child or other loved one will be cared for now and in the future. Finally, bear in mind that the laws affecting the usage of special needs trusts vary from state to state. Be sure to consult a qualified professional before making any definitive arrangements. ■

## understanding life insurance beneficiary designations

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A further complication can arise when one's estate is named as a beneficiary of a life insurance policy. The policy proceeds may be tied up in the probate process or reduced by the claims of creditors.

The distribution desired by the policyowner must be clearly set forth in the beneficiary designation. A change in family circumstances after a policy is initially written, such as a divorce, could leave unintended beneficiaries,

so it is important to review your insurance policies whenever such changes occur. If you are unsure about your beneficiary designations, check your policies, and take the steps necessary to make appropriate changes. ■

## Lean-Burn Vehicles Qualify for Tax Credit

The Internal Revenue Service (IRS) has declared certain lean-burn technology vehicles eligible for the alternative motor vehicle tax credit enacted by the Energy Policy Act of 2005. Lean-burn is an innovative and environment-friendly technology in which engines are designed to operate on a very lean air/fuel mixture. The more lean the air/fuel mixture, the more economical the engine. Until recently, only hybrid, fuel cell, and alternative fuel vehicles qualified for the alternative motor vehicle tax credit, as lean-burn technology was still under development.

Available credit amounts vary by vehicle, according to fuel economy compared to the 2002 model year city fuel economy rating and the vehicle's lifetime fuel savings. In order for a taxpayer to claim the tax credit, the original use of the vehicle must

begin with the taxpayer and the vehicle must be acquired for use or lease by the taxpayer.

However, there is a limitation on the number of fuel-efficient vehicles eligible for the tax credit under the Energy Act of 2005. The tax credit begins to phase out once a manufacturer sells more than 60,000 qualifying vehicles. Toyota Motor Corporation hit the phaseout threshold in May 2006, and American Honda Motor Company also surpassed the ceiling in July 2007. Since that time, credits for Toyota, Lexus, and Honda models have phased out completely. Fuel-efficient vehicles by other manufacturers, such as Chevrolet, Ford, GMC, Mazda, Mercedes,

Mercury, Nissan, Saturn, and Volkswagen, are at this time still eligible for full credits, based on vehicle weight class, fuel efficiency, and lifetime fuel savings.

To learn more about tax credits for advanced lean-burn and other environment-friendly vehicles, visit [www.irs.gov](http://www.irs.gov) or consult your tax professional. ■



## estate planning and your family business

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will not be suspended completely until 2010. And, as of January 1, 2011, the gift, estate, and generation-skipping transfer taxes will revert to 2001 levels if Congress does not intervene. Keep in mind, too, that changes in capital gains taxes will likely be of concern to your heirs. It is essential that you seek professional advice on how

best to plan your estate with regards to changing tax laws.

- Draw up a buy-sell agreement, which clarifies to whom, and at what value, your business should be sold in the event of your death or sudden departure. This agreement should be funded, usually with a life insurance policy, savings, or a loan.

Business continuation can be a complex and emotional issue for business owners. A dual strategy of open and honest communication with family members and the guidance of an experienced team of estate planning professionals may be all you need to help maintain the success of your business and preserve your family's business ownership. ■

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