



# Parker Financial Services, LLC

## Helping Biz Owners & Professionals Retire On Time

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The information contained in this newsletter is derived from sources believed to be accurate. You should discuss any legal, tax, or financial matters with the appropriate professional. The cost and availability of life insurance depend on such factors as age, health, and the type and amount of insurance purchased. Before implementing a strategy involving life insurance, it would be prudent to make sure that you are insurable by having the policy approved.

### **In this issue:**

Retirement Plans for Your Small Business

Why a GRAT can be GREAT

How Much Do You Know about Flood Insurance?

Ask the Experts

## Retirement Plans for Your Small Business

A retirement plan can be a critical part of a competitive benefits package. Although small business owners can sponsor a qualified retirement plan like a 401(k) or profit-sharing plan, these plans can be expensive to maintain and difficult to administer. Luckily, there are a number of simpler alternatives.

### **SIMPLE IRA plans**

This savings option is for employers with 100 or fewer employees who earn \$5,000 or more. A SIMPLE IRA plan lets your eligible employees contribute a percentage of their salary on a pretax basis, up to \$10,000 in 2006



(\$12,500 for employees age 50 and older). You either match each employee's contributions dollar for dollar--up to 3% of the employee's compensation--or make a fixed contribution of 2% of compensation for all eligible employees. All contributions to the plan are fully vested

(that is, immediately owned by your employees), and your contributions are fully deductible.

SIMPLE IRA plans are easy to set up, easy to administer, and inexpensive to maintain. You fill out a short IRS form to establish the plan, and ensure that SIMPLE IRA accounts (to hold plan contributions) are set up for each employee. You can let each employee set up a SIMPLE IRA account at a financial institution of his or her choosing, or you can select the financial institution that will serve as trustee and initially hold all plan contributions.

### **Simplified employee pension (SEP) plans**

A SEP plan allows small business owners to set up traditional IRAs, called SEP-IRAs, for

themselves and each employee. You must generally contribute a uniform percentage of pay, up to 25%, for each eligible employee (up to \$44,000 in 2006), but you don't have to make contributions every year. Your employees don't directly contribute to the SEP plan, although they can make their regular annual IRA contribution to their SEP-IRA if they choose. As with SIMPLE IRAs, all contributions to the plan vest immediately, and your contributions are fully deductible.

Most employers, regardless of size, can establish a SEP plan. SEP plans have low start-up and operating costs, and can be established using a two-page IRS form.

### **But don't rule out a 401(k) plan ...**

No employees? Then there is one qualified plan you should consider--the individual 401(k) plan (also known as a solo 401(k) plan).

An individual 401(k) plan is a regular 401(k) plan combined with a profit-sharing plan. You can elect to defer up to \$15,000 of your compensation to the plan for 2006 (\$20,000 if you're age 50 or older), just as you could with any 401(k) plan. In addition, as with a traditional profit-sharing plan, your business can make a maximum tax-deductible contribution to the plan of up to 25% of your compensation. Total contributions to your account can't exceed \$44,000 (or, if less, 100% of your compensation). If you're self-employed, compensation is your earned income from your business.

Since an individual 401(k) plan can cover only the business owner and his or her spouse, it isn't subject to the often burdensome and complicated administrative rules and discrimination testing that are generally required for regular 401(k) and profit-sharing plans.

A financial professional can help you select the plan that best fits your small business.



## Why a GRAT Can Be GREAT

### Property appropriate for a GRAT:

- *High-yield or high-growth investment portfolio*
- *Commercial rental property*
- *Closely held stock*
- *Family limited partnership (FLP) interests*
- *Any property with appreciation potential, such as real property, precious metals, and artwork*

*A GRAT that is structured so that the annuity payments to you are high enough to result in a gift valued at zero is known as a "zeroed-out" GRAT. With this type of GRAT, no gift tax is due.*

If you have property that's rapidly appreciating or generating high earnings, and you're ready to hand it down to your children or other heirs but want to continue receiving income from the property for a period of years, a GRAT may be a great strategy for you. The goal of a GRAT is to transfer property with minimal gift tax.



A GRAT, which stands for grantor retained annuity trust, is an irrevocable trust into which you make a one-time transfer of property, and from which you receive a fixed amount each year for a specified number of years (the annuity period). At the end of the annuity period, or at your death if earlier, the property remaining in the trust (the remainder interest) is distributed to the beneficiaries you've named in the trust document.

### Potential tax benefits of a GRAT

A transfer of property to an irrevocable trust is a taxable gift. The value of the gift on which gift tax is imposed is generally its fair market value. However, because you retain an interest in a GRAT, the value of the transfer is discounted; gift tax is imposed only on the remainder interest (and any gift tax due may be sheltered by your \$1 million lifetime gift tax exemption).

This taxable value is calculated using an interest rate provided by the IRS (known as the discount rate or Section 7520 rate), which is based on current interest rates and changes monthly. This interest rate assumes the GRAT property will earn a certain rate of return during the annuity period. Any actual return that exceeds the assumed return passes to the remainder beneficiaries free from gift and estate tax. Investment performance, therefore, is central to this strategy.

### ... and the catch

The catch to this strategy is that you must outlive the annuity period. If you die before the annuity period expires, the value of the property in the trust on the date of your death will be included in your estate for estate tax purposes. This, however, merely puts you in the

same position you would have been in had you not used the GRAT (except for the costs to create and maintain the trust).

Note: It may be advisable for the remainder beneficiaries to buy life insurance on your life (the life of the grantor) so that funds will be available to pay the estate taxes in case the GRAT property is included in your estate due to your early death.

### The risk

The key to this strategy is investment performance. If the trust property does not outperform the discount rate, there will be no excess return, and no tax savings will be achieved.

### ... and other drawbacks

Gifts of present interests qualify for a \$12,000 (per recipient) exclusion from the gift tax. But, because the gift to the remainder beneficiaries is a future interest, not a present interest, transfers to a GRAT do not qualify for the exclusion.

Additionally, a GRAT is generally not appropriate for making gifts to grandchildren or other skip persons (persons who are more than one generation below you). That is because there are rules that disallow you from allocating your \$2 million lifetime exemption for generation-skipping transfers until the annuity period expires. Because you cannot effectively leverage your exemption, a GRAT should not be used for generation-skipping transfer tax planning.

Finally, property transferred by reason of your death will receive a step-up in income tax cost basis (i.e., the property's value will be increased to its fair market value on the date of your death); property that is transferred during your lifetime by gift does not receive a step-up in basis. Losing the step-up in basis may mean significant capital gains taxes for the remainder beneficiaries.

### Other considerations

A GRAT is usually considered a grantor-type trust for income tax purposes. All income, gains, deductions, and losses flow through to you on your personal income tax return.

The GRAT document must be precisely drafted for the property to receive GRAT tax treatment. You should consult an experienced estate planning attorney if you are considering this strategy.

## How Much Do You Know about Flood Insurance?

The devastation caused by recent storms has generated a surge of interest in flood insurance. Learn how flood insurance can help you protect your home and belongings by taking a look at the questions and answers below.

### Does homeowners insurance cover flood damage?

No. As many people have found out the hard way, homeowners policies do not cover most flood damage. To obtain broad flood protection for your home and its contents, you'll need to purchase a separate flood insurance policy. Fortunately, flood insurance is widely available from insurance companies that participate in the National Flood Insurance Program (NFIP), a partnership between the Federal Emergency Management Agency (FEMA) and the insurance industry. A handful of insurance companies also offer excess flood insurance policies that can supplement NFIP coverage.

### Should you consider purchasing flood insurance even if you don't live near a body of water?

Yes. You may want to purchase flood insurance even if the threat of flooding in your area seems remote. According to FEMA, approximately 25% of all flood insurance claims come from low to moderate risk areas. Torrential rain storms, melting snow, overloaded drains, and storm surges from hurricanes can cause sudden and serious flooding.

### Can you purchase flood insurance even if you live in a high-risk area?

Yes. Anyone who lives in a community that participates in the NFIP (high risk, or not) can purchase flood insurance. According to FEMA, homes in high-risk areas are three times more likely to be damaged by flooding than by fire during the course of a 30-year mortgage. If you're buying a home in a high-risk flood zone, and are obtaining a federally backed mortgage, your mortgage lender will require you to purchase flood insurance.

### Do coverage limits apply to NFIP policies?

Yes. Under the federal program, homeowners can insure their homes for up to \$250,000, and their belongings for up to \$100,000. Renters can also purchase up to \$100,000 of coverage for their belongings, while nonresidential property owners can purchase up to \$500,000 of both building and property coverage.

If your home's value exceeds the coverage limits of the federal program, you may want to look into purchasing excess flood insurance through a private insurer. Excess flood insurance covers amounts above the \$250,000 federal limit, and, unlike NFIP insurance, may cover your home for its full replacement cost. You may be able to purchase an excess flood insurance policy even in a high-risk flood zone. A few insurance companies have also begun offering policies designed to replace NFIP coverage, but these are generally available only in low- to moderate-risk flood zones.

### Does flood insurance cover basement flooding?

Yes. Although it doesn't cover everything, flood insurance offers broader protection against basement flooding than standard homeowners insurance. It ordinarily covers items like furnaces, water heaters, foundation elements, and appliances such as washers, dryers, and freezers. However, basement improvements, such as finished walls, floors, and ceilings, and personal belongings are excluded.

### Is flood insurance too expensive for most homeowners?

No. Flood insurance purchased through the NFIP is subsidized by the federal government, so it's less expensive than you might think, especially if you live in an area where the risk of flooding is low. According to FEMA, flood insurance premiums in low-risk areas start at \$112 per year, and the average yearly premium for a \$100,000 policy is a little over \$400. But because the cost of flood insurance depends on many factors, including the type of occupancy (e.g., single family, nonresidential), the amount of coverage, and the location and design of your home, only your insurance representative can give you an accurate premium quote.

### Can you buy flood insurance right before a major storm?

Yes. You can purchase an NFIP policy at any time if you live in a participating community, even if a major storm has been predicted. However, a 30-day waiting period generally applies before a flood policy becomes effective, so it's not a good idea to wait until flooding seems imminent before purchasing the coverage you need.

### Did you know?

*According to FEMA, flooding is the most common natural disaster in the U.S.*



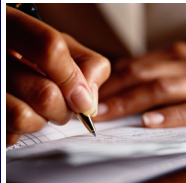
### How to obtain flood insurance

*Although NFIP policies are backed by the federal government, they're sold by private insurers. To obtain flood insurance, start by calling your homeowners insurance representative. You can also call the NFIP Telephone Response Center at (888) CALL FLOOD for more information.*



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## Ask the Experts



### **I'm expecting a large income tax refund--what should I do with it?**

If you're anticipating a sizable federal income tax refund, you're not alone. According to the Internal Revenue Service, over 100 million individuals received federal income tax refunds last year, and the average refund check exceeded \$2,000. How you spend your refund check is up to you, but before you call a travel agent or splurge on a new plasma television, consider whether there might be better ways to put this sum of cash to work for you.

For example, if you have outstanding credit card balances, give thought to applying some or all of your refund toward these balances, starting with the credit card that carries the highest interest rate. Consider this: Applying \$2,000 toward a credit card with an APR of 14.9% (instead of letting the \$2,000 accrue interest for a year) could save you almost \$300. If you don't have outstanding credit card balances, think about using your refund dollars to pay down other high-interest debt.

Alternatively, consider saving or investing the funds. A sudden infusion of cash, particularly if it's unexpected, can provide the perfect opportunity to start an education fund for your children or grandchildren. And investing funds in a tax-advantaged savings vehicle like a 529 plan today can pay off handsomely in the future. For example, if you contribute \$2,000 today to a 529 plan or a Coverdell education savings account for your 2-year-old child, assuming a 6% annual rate of return, your \$2,000 will have grown to \$4,793 after 15 years. If you're eligible, also consider the benefits of using your refund dollars to contribute to a Roth or traditional IRA.

In the end, it's your money, and your decision. If you want to splurge, go ahead. Just try not to spend on impulse. And keep in mind that there's no rule that says you have to spend it all. One idea is to spend half your refund dollars, and to invest or apply the balance.