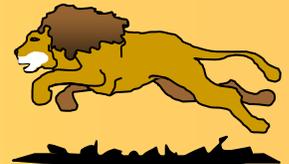


## OUTRUNNING THE FINANCIAL LIONS



### *The Lion and the Gazelle*

Every morning in Africa, a gazelle wakes up. It knows it must run faster than the fastest lion or it will be killed. Every morning a lion wakes up. It knows it must outrun the slowest gazelle or it will starve to death.



#### The moral:

**It doesn't matter if you are a lion or a gazelle. When the sun comes up, you better be running.**

You've probably read that story before. (In fact, it's probably been made into a poster in the "Successories" store at the mall.) The story is supposedly an old African proverb. But for most Americans, this illustration defines the competitive, unrelenting nature of making a living. Every morning you gotta get up and run.

**Oh...when it comes to money, you're one of the gazelles.**

As a gazelle, did you ever think about the economic "lions" that are chasing you? Ever wonder how you'll stay out of their clutches? Here are three of the bigger ones, and what it takes to out-run them.



#### **TAXES**

Of all the economic lions that can run you down, taxation is the one that never stops. Every government in history has collected taxes, and there's no reason to expect it will ever change. But while taxation may be forever, it's also a lion that's easy to keep at bay – as long as you pay attention.

A lot of contemporary taxation is so automatic and pervasive, you just get used to it. As a consumer, sales taxes are collected by merchants at the point of purchase. If you are an employee, income taxes are paid through mandatory withholding from each paycheck. (Hey, if you play it right, you'll even get a refund!) Knowing that no one likes to pay taxes, smart governments find ways to take the responsibility for paying them out of your hands.

But once you start to "get ahead" financially, taxation can become a little more complicated and dangerous. If

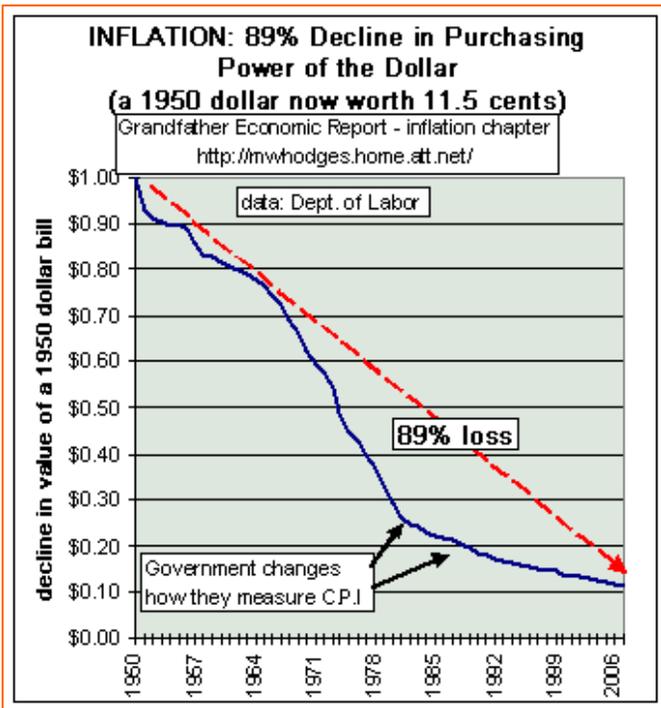
you buy a house, there are property taxes. If you own a business, you may incur "business taxes." If you make a profit from any financial activity (real estate, stocks, bonds, interest, dividends, etc.), there may capital gains or other taxes. And even if you think you have all those tax issues addressed, you could find yourself subject to the Alternative Minimum Tax!

As the number and variety of your financial transactions increase, so does the possibility that the accompanying taxes can catch you financially off-balance. And if you can't pay your taxes when they are due, the resulting penalties and interest can really stagger your financial world. So as you begin to get ahead, you're probably going to require expert assistance to guard against being caught by the tax lion.

#### **INFLATION**

Remember when a six-figure annual income was the mark of a high achiever? Today, a lot of households find \$100,000 a year doesn't do much more than pay the bills. That's because of inflation; today's dollar doesn't have the same purchasing power it did in the past.

Noted economist Henry Hazlitt defines inflation as "an increase in the quantity of money and credit, with the consequence of soaring prices." Hazlitt adds "inflation...is caused by the printing of more money. For this, the government's monetary policies are responsible." Central banks of each country (such as the Federal Reserve Bank in the United States) attempt to manage the money supply to "control" it, but the general trend of all national banks is toward inflation.



Here is a graph that shows the cumulative long-term impact of inflation. Using the Consumer Price Index (CPI) as a benchmark, the graph shows the decline in the purchasing power of one dollar from 1950 to 2006.

Several items stand out: First, since 1950, the US dollar has experienced an **89% reduction value**. Today's dollar is worth only 11.5 cents in comparison to a 1950 dollar. Restated, an average CPI item costing \$10 in 1950 costs \$89 today.

Over this period of 50-plus years, the **average annual inflation rate is about 4%**. 4% doesn't sound like a big number. However, when you compound 4% over 50+ years the problem adds up.

In 2002, using the same CPI information, an Oregon State University study calculated this inflation question: For each year from 1850 to 2002, what amount would equal \$1 million? In 1850, today's "millionaire" would only be worth \$45,000. For most of the 1950s, the comparison was about \$150,000. If \$100,000 a year is just a middle-class income today, then being a millionaire isn't what is used to be either.

Because inflation is primarily government-created, and has been so prevalent over the past century that most of us consider it to be a given of modern financial life; the only variable we consider is how much inflation will increase each year. But whether inflation averages 4% or 14%, it is a financial lion beyond your control. You can't hope to keep it at bay simply by paying attention to it. Your only recourse is to out-run it.

This means you must consciously plan to make more money or add to your savings at a rate that will outpace inflation. How much more? Think of your current income and/or your current savings and compare it to

last year. Are the numbers for this year more than 4% higher than last year? If not, inflation is probably gaining on you. And if you know you have been losing ground, you'll need to run even faster to catch up. Roger Ibbotson, a Yale professor, posits that a 50-year-old with an \$80,000 annual income and no retirement savings "must save **30% a year** (emphasis added) until retirement to maintain the same standard of living" (from a *Journal of Financial Planning* report, excerpted in the Feb. 1, 2008 *Bottom Line Personal*). When you need to save 30% a year, that's not just running to stay ahead, that's sprinting!



## DEBT

Of the three, Debt is the only financial lion over which individuals have complete control. And ironically, it's probably the one that devours the most people.

All the headlines and all the statistics say the same thing: As a group, Americans are a debt-ridden nation. One can argue about the causes for this ubiquitous condition (a slumping economy, predatory lending practices, instant-gratification mentality, etc.), but whatever the reason, the consequences of getting caught by debt are financially crippling.

The biggest problem with debt – whether it's a sub-prime mortgage or a new credit card with a zero-interest introductory rate – is that most people make their borrowing decisions based on best-case projections of their financial future. Do you recognize any of these conversations?

- "Well, if we both keep working, and I get the same bonus I got last year, we can make the payments."
- "Interest rates are down. As long as we don't have to move in the next year or two, we should build enough equity to get into a fixed-rate loan. After all, the housing market always trends upward."
- "If we can scrape through the next three months, it'll be easier to make the payment on the Hummer because the Jeep will be paid off."
- "Let's take the 60 days same as cash offer. If we don't sell the old stuff on e-Bay, we'll cash out some of the stocks in my 401(k)."

Borrowing isn't necessarily bad. In the current economy, some borrowing is almost inevitable (how else are you going to buy a home?). And if everything goes the way it is supposed to, most responsible people make their monthly payments. Used prudently, debt can be an instrument of leverage to secure a better financial life.

But not all borrowing is inevitable and not all of it is

prudent. Debt is a creeping predator, especially consumer debt like credit cards. Incrementally the monthly minimums get higher, the budget gets tighter. Then seemingly all of a sudden, people with good incomes, nice homes and good credit scores get run down by their debt.

Think about the proliferation of ads on TV for credit card relief. Read about the skyrocketing rise in foreclosures and bankruptcy filings. As the economy has staggered, consumer debt is starting to gobble the weaker gazelles. In order to keep this lion at bay, you must be ruthless about containing or eliminating debt. Too many people let the lion get too close, and when they try to out-run it, it's too late.

## TWO WAYS TO OUT-RUN THE LIONS

The proverb at the beginning of this article doesn't make a comment about the justice of the arrangement between the gazelles and the lions. It just states the way things are, and what either party has to do to survive.

In similar fashion, there's no value judgment in this text on taxes, inflation or debt. They are what they are. As a financial gazelle, the only thing that really matters is outrunning the lions. And there are only two ways to do it.

1. Out-earn the lions.
2. Out-save the lions.

If you keep earning enough money, you can survive taxation. (Sure, your tax rates may go up as you earn more, but wealthy people are golden-egg-laying geese for taxing authorities – they want as many eggs as possible, but they don't want to kill you.) Remember too, that inflation not only affects the costs of the things you buy, it can inflate your earnings as well. And finally, if you keep earning enough money, you can either avoid debt, or manage to pay for it.

And saving is just another way to earn more money. Savings can replace earnings, take care of taxes, grow at rates equal to inflation, and be used to either pay off or avoid debt.

Sure, there are a lot of details that go into making either option successful, but the fundamental activities don't change. Will a particular tax strategy help? Can you buy inflation-hedging investments? Is refinancing a good idea? Maybe. But those actions are of marginal value if you don't have the fundamentals of your earning and saving programs in shape.



### How fast is your savings plan running?

**Are you in shape to out-run the lions?** Your financial professional should not only be able to provide the details for some of your saving objectives, but may also be able to help you find ways to save more. Remember, the only way to stay ahead is to keep runnin'.

## Buy-Sell Agreements

Two or more individuals come together to form a business partnership. Through their combined efforts, the business survives, and eventually prospers. So what happens if (or when) one of these key people is no longer part of the business? For example:

- What if someone wants to pursue other business opportunities? Is there a non-compete clause? Do the remaining partners buy out the departing partner, or can the departing individual sell his/her interest to another party? How do the parties arrive at determining a price?
- What if the owner/partner wants to retire?
- If someone dies, do the deceased partner's heirs inherit the ownership share? In other words does the partner's spouse or child now become a full partner?
- What happens if one of the owner/partners is disabled?
- How might a divorce or bankruptcy of one of the owner/partners affect the rest of the partners?

The answers to all these questions can be clarified with one document: A Buy-Sell agreement. Sometimes called a "business will," a buy-sell agreement is a binding contract between business partners or shareholders about the future ownership of the business. Any closely-held business with more than one owner should consider a buy-sell agreement an absolute necessity. The failure to establish a buy-sell agreement *in advance* threatens all parties with financial uncertainty and hardship.

A buy-sell agreement may be part of a company's organizational documents, or it may be a separate agreement. While every buy-sell agreement is structured to reflect the unique circumstances of the business in question, most agreements will contain the following features:



### Triggering Events

A key part of any buy-sell agreement is defining what type of situations will cause a mandatory or optional buyout of an owner's interest by the other

owners or by the business itself. Some typical triggering events are:

- Death or disability.
- Desire to sell the interest to a third party.
- Retirement of an owner.
- Owner/partner's divorce, bankruptcy or legal problems.

## Terms of the Buy-Sell

Surviving owners usually desire a continuity of ownership and management, and don't want the departing owner/partner's successor (a spouse, child or new partner) thrust upon them. They also don't want a buy-out to financially compromise the business by forcing the remaining owners to take on more debt or liquidate assets. On the other hand, disabled or deceased owners would want their families compensated fairly for their share of the business.

The terms of the buy-sell agreement spell out the way all parties will respond to a triggering event. It will stipulate whether an owner/partner's interest must be sold to the company, the remaining owners, or an outside party. It will establish the process for determining the value of the owner/partner's interest. It may also provide a timeline for the execution of the terms.

## Funding the Buy-Sell

Establishing the trigger events and the terms of the buy-out are primarily theoretical "paper" decisions. But in order for the buy-sell agreement to perform, funds must be available. Sufficient funding is usually the greatest challenge for any buy-sell agreement.

The simplest way to address the funding issue is to establish a "sinking fund" and set aside excess funds expressly for fulfilling the buy-sell agreement. But very few businesses have an abundance of excess capital. And if they do, the money could probably have a more productive application than sitting in reserve for an event that might not occur. Since a death or disability is usually a trigger event, some forms of insurance can be a very effective and efficient answer to some of the funding question. In fact, a well-structured insurance program can not only solve the buy-sell funding challenge in the event of death or disability, but over time may also provide retirement compensation or the capital for a buy-out.

## LIFE INSURANCE + CREATIVITY + DETAILS = BUY-SELL SUCCESS

A cash value life insurance policy is a unique financial product that can be configured in countless variations, and knowledgeable life insurance professionals are constantly finding new ways to use it in buy-sell agreements. But even the simplest application of life insurance in a buy-sell context must be made with an awareness of both the legal and tax regulations that also come into play. The most creative idea can be undone by improper implementation, so establishing a fully functioning buy-sell agreement usually requires the cooperative input from a team of competent financial professionals.

Does your business have a buy-sell agreement? Is it properly structured and appropriately funded? Looking for creative ways to make a buy-sell agreement deliver more value? Start the discussion by asking a trusted life insurance agent about how a custom-tailored buy-sell strategy could work in your situation.

## A Trend in Identity Theft: Filing False Tax Returns



The type of identity theft most people are aware of usually involves credit cards or bank accounts. A thief gets enough personal information to either open a new account, or obtains access to an existing one. Unless your bank or credit card company notices some unusual or suspicious transactions, you might not even be aware of the theft until the next bill arrives in the mail.

But besides breaking the law, buying stuff with someone else's credit card creates some other problems for thieves. The purchases leave a significant paper trail. And while it's easy to ring up a bicycle at a "big-box" department store and a dinner at a major chain restaurant on someone else's credit card, there are limitations. Some merchants don't accept credit cards. Some transactions for goods and services come at higher prices, or require financial verification. If you're going to steal, there's nothing like cold hard cash.

Which is why enterprising ID thieves have come up with the idea of using stolen information to claim tax refunds on phony tax returns. A special release on the IRS web site ([www.irs.gov](http://www.irs.gov)) provides some detailed information and preventive measures for what National Taxpayer Advocate Nina Olson says is one of the "most serious problems" facing taxpayers, according to a March 13, 2008 *Wall Street Journal* article. Ms. Olson notes the Federal Trade Commission received more than 20,000 complaints on tax-related identity theft in 2007, and she believes this number underreports the problem.

In a typical tax refund situation, the IRS delivers a check within three to four weeks. That's a long time for a false tax filer to wait before getting the money, so many thieves use refund anticipation loans from tax preparation services. Since most of the large tax-prep services process high volumes of returns and have fairly high employee turnover, the chance of an ID thief being caught by the preparer is minimal. The ID thief simply presents a name, Social Security Number, phony W-2, then e-files the return on the spot, and stops by the next day to pick up his loan check.

(The *Wall Street Journal* article also reported a much more extensive and brazen scam in which a woman acting as a Girl Scout troop leader created fake medical-release forms to secure Social Security Numbers of other children. The woman then filed multiple false returns for refunds totaling more than \$187,000, receiving more than \$85,000 from the government before being caught.)

A false tax return on file causes havoc for the “real” taxpayer. IRS computers will reject a second return, especially if it involves a refund, and it may take awhile for the problem to be relayed to the taxpayer. Of course, once the IRS has an inkling of a swindle, it wants to get all the facts before “correcting” a mistake by giving more refund money to the “real” taxpayer. Consequently, “victims of identity theft often receive more scrutiny from the IRS than the perpetrators of identity theft,” says Ms. Olson.

## Outside-the-Box Concept: Developing an “Inheritance Portfolio”



Sometime in the past 50 years, a financial expert came up with this witticism: “The ideal financial plan would be to spend your last dime on the day you take your last breath.” There are two ideas behind this comment: One, the value of accumulated assets is revealed only when you spend them. Two, maximum value is achieved when you spend all your assets.

It might be a witty saying, but we all know it doesn’t reflect reality.

First, you don’t know when your last day will be, so you don’t know when to spend your last dime.

Second, there might be other things in your “ideal financial plan” besides spending it all.

One of the other things in your financial plans might be the desire to leave an inheritance. For some, an inheritance is simply “you can have whatever I don’t get a chance to spend.” But for those who have a stronger desire to leave a legacy or make an impact on future generations, you might want to put a bit more thought and planning into the items that comprise your “inheritance portfolio.”

The following are some examples of assets that might make good inheritance items.

**A vacation home.** If you can afford it, what would it mean to provide a place for your family to gather for reunions and special occasions? What would it mean not only to you and your children, but future generations? Resort type properties may not always be a good short-term profit opportunity, but the intangible benefits are often priceless.

**Undeveloped property.** Even if you don’t think you can swing the purchase of a large vacation home, you might consider buying undeveloped land for its future potential. Depending on the type and location of the property, all sorts of future profit opportunities could develop. It might be a great place for recreation – hunting, fishing, camping. Perhaps it’s on the edge of a commercial corridor; 20 years from now it’s the new Wal-Mart. Or maybe it’s 100 acres that can be parceled for a new housing development.

**Other long-term investments.** The life cycle of a tree farming business can run 20 years or longer, depending on the type of trees and their uses. But once you start selective cutting, new trees can be added each year to create a steady stream of revenue. The tough part is committing the capital and resources to get started. An inheritance plan might lay the groundwork for an investment that can perpetuate itself far into the future.

**Paid-up life insurance policies on children and grandchildren.** There may not be a current need for life insurance, but younger applicants stand a better chance of obtaining coverage at favorable rates. Securing insurability for heirs may help preserve and perpetuate financial well-being. As owner of the policies, you would maintain access and control over the cash values.

Several cautionary comments: Any of the items named above (and others not named) could have unique tax, estate and gifting consequences. Some of the tax issues are dependent on details like the form of ownership, so any consideration of these transactions should only be made after consulting qualified advisors. And while many of the items in an “inheritance portfolio” could also generate retirement income before being passed on to heirs, you must evaluate your ability to establish an inheritance in light of current financial needs.

One other thing: Developing an inheritance portfolio isn’t something you typically accomplish by making maximum contributions to a retirement plan. If you have aspirations to create an inheritance portfolio in the future, you may need to change the way you save today.

If the idea of an inheritance portfolio intrigues you, why not check with your financial professionals to see if your current strategies will make those legacy aspirations possible?

## The Soda Game



In a December 17, 2007 article for the *Wall Street Journal* titled “12 Ways to Make Your Kids Financially Savvy”, the first item on the list for author Jonathan Clements was teaching the idea of “Waiting

Until Later.” He said “If children are to grow up to be successful savers and investors, they need to learn two key skills: How to delay gratification and how to take risks prudently. The first is easily the most important.”

Clements then shared an experience regarding his two children:

*“One of my early tricks was the soda game, which I learned about from a reader. When my children were young, I would give them a choice: They could have a soda or they could have \$1.*

*Henry and Hannah ended up drinking a lot of water.”*

Interesting, huh? If you have kids, this might be a worthwhile strategy to adopt when you’re eating out. And with the price of soft drinks often more than \$1, you might actually save money by encouraging your kids to save!

The soda game prompted two other thoughts:

**Thought #1:** What if you don’t pay your children right away? Instead you tell them, “I’m adding it to your account. It’ll be there when you need it, just let it build up.” You carry a sheet in your wallet, and keep adding tally marks for every time they choose to forgo a soda.

This goes on for several years. One day one of your children says, “Can I have my soda game money? I think I have close to \$100 now.”

You pause, then say “Well, you know what? How ‘bout we use that money to pay your Soccer League entry fee?”

If you play the soda game this way, do you think your children are going to be fired up about saving? No, because even though saving is taking place, and the saving is applied for their benefit, the saving isn’t experienced by the children. When you don’t put a dollar in their hand, there is no positive reinforcement of the habit. Saving remains abstract; without a tangible payoff and it’s hard for kids to embrace any delayed gratification. In order to effectively ingrain the habit, you need to pay the \$1 each time your children choose to drink water instead of soda.

**Thought #2:** What if you played the game as an adult? If you decided to skip a drink, not have dessert, or pay \$10 for (warm) beer at a sporting event, how much money would you save?

You’ll only know if you pay yourself just like you would pay children! With no way to keep score, and no “saved” money to spend, you really can’t appreciate the value of what you gave up.

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