



[the compass]

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THIS ISSUE...

## Is "Suitable" Good Enough For Your Financial Security?

by Mike Palmer, CFP®

I recently attended a large conference for financial advisors sponsored by a prominent brokerage custodian. The firm does business with both traditional brokers as well as registered investment advisors and over 500 were in attendance. It was the first time I'd attended this particular conference, and while the speakers and agenda were informative, what struck me most was how different the practices of the attending advisors were. It seemed that every lunch or breakfast conversation was about 12b-1 fees or the commissions on various variable annuity products. This was foreign turf for me, because our firm is fee-only. Unlike most of the advisors attending the conference, we are never paid by the provider of the product (i.e., annuity company or mutual fund) and are thus never conflicted about investment recommendations we make to clients. I've never understood how advisors justified recommending Fund A paying a 3% commission over Fund B paying just 2%, and why more clients don't question the advisor about his/her compensation from the recommendations they make.

The second defining takeaway for me was the kickoff speech from the CEO of the sponsoring firm. As he spoke of his firm's accomplishments from the past year he said, "...and we are committed to providing you (the attending advisors) with suitable investment products for your clients." In what other facet of life would one settle for suitable? Perhaps suitable works for the purchase of a shovel at Lowe's, or maybe even a used car for my sixteen year old son, but is suitable really the best I can hope for in building my financial future?

Imagine if you were diagnosed with a potentially life threatening disease. How would you feel if the doctor's only obligation was to prescribe a suitable treatment of care? Not the best, or most effective, it only had to be suitable. Most people I know would never settle for such a low standard when it comes to their physical health, why would they do so with their fiscal health?

If you are a client of our firm, take comfort from knowing you work with an advisory firm that is required to put your interests ahead of our own. If you are not a client, perhaps it's time you reconsider whether suitable investment products are good enough to secure the financial future you deserve.

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### NOTABLE QUOTE

**"Talent is God given. Be humble. Fame is man-given. Be grateful. Conceit is self-given. Be careful."**

- John Wooden

# Taxing Health Care Changes

by John Slayton, JD/MBA, LL.M.-TAX, CFP®, AEP, CTFA

**T**he recently enacted 2,400 page health care bill gradually takes effect over the next eight years, with many of the benefits front-loaded during this election year and many of the costs arising later. In 2010, pre-existing medical conditions are covered by a temporary high-risk pool, our children are allowed to retain dependent coverage through age 26 and Medicare beneficiaries who reach the infamous “doughnut hole” in drug coverage receive a \$250 rebate. In light of these early benefits, for budgeting purposes, what are the major tax costs we can expect and when will they hit?

- >> Effective this July 1, **indoor tanning booth** services are subject to a 10-percent excise tax. While this early tax may not be unduly burdensome to most, I mention it first because it is already being effective and to highlight the selfless sacrifice and sharing of pain by House Minority Leader John Boehner (R-OH), an obviously avid consumer of such specialized services. You may already be subject to this tax, so it is worthwhile to “shine some light on it.”
- >> Perhaps of more financial impact to the reader, in 2013 couples filing joint returns with adjusted gross incomes (“AGIs”) over \$250,000 (not indexed for inflation) will be subject to:
  - An **additional Medicare tax** of 0.9% on earnings over \$250,000, and
  - A new **Medicare tax on investment income** (e.g., interest, dividends, capital gains, rents, passive income, etc.), of 3.8% of the lesser of net investment income or AGI greater than \$250,000.
  - A couple with \$350,000 AGI, including \$90,000 investment income, would pay 0.9% of \$100,000 + 3.8% of \$90,000, an additional \$4,320 in Medicare taxes.
- >> In 2011 employers will be required to disclose the **value of health benefits on workers’ W-2** IRS forms and an annual market share based fee will apply to drug companies.
- >> In 2011, **Health Savings Accounts (“HSAs”)** will **no longer reimburse over-the-counter drug expenses** and the penalty tax for HSA distributions not used for qualified medical expenses doubles from 10% to 20%.
- >> In 2013, the **threshold** above which medical expenses can

be deducted on Form 1040, Schedule A, rises from 7.5% to 10% of AGI. Taxpayers 65 and over will be exempt from this change through 2016.

- >> Also in 2013, contributions to **Flexible Spending Accounts** for medical expenses are capped at an inflation-adjusted annual level of \$2,500 and an excise tax on the sale of medical devices (except retail purchases by the public) is imposed.
- >> All U.S. citizens and residents must have health insurance by 2014, or be subject to a phased-in tax penalty starting at the greater of \$95 or 1% of income, and rising to the greater of \$695 or 2.5% of income in 2016.
- >> Also in 2014, fines of \$2,000 per employee will be imposed on employers with 50 or more workers who fail to provide employee health insurance coverage (exempting the first 30 employees).
- >> A **40% surtax on high-cost (“Cadillac”) health insurance plans** (costing an inflation-adjusted \$10,200 for individual and \$27,500 for family coverage) starts in 2018.

None of these various taxes or fees is egregious on its own, but with the significant increase in income and capital gains tax rates next year (back to 2001 levels), some of these new taxes will be material and painful. The 5% increase in long term capital gains and dividend tax rates effective January 1, 2011, together with an additional 4.7% Medicare tax on investment income from the Health Care Bill represents a 65% increase over the current 15% rate. An increase in tax on investment income from 15% to 24.7% will not be positive for our fragile financial markets. Limiting HSA distributions for non-prescription drugs and increasing the threshold for medical deductions from 7.5% to 10% of AGI both act to reduce tax benefits of medical expenses.

Run-away deficits and a free-spending Administration and Congress will result in significant additional taxes, starting in 2011. Whether this additional tax burden will be limited to those earning over \$250,000 per year (as promised) and the impact of additional taxes on our slowly improving economy, both remain to be seen. For those readers who remember the daily admonition from the desk sergeant in the television show Hill Street Blues... “be careful out there.” We are here to answer your questions.

# Is Long Term Care Only for the Wealthy?

by Jay Eich, CPA, CFP®

As life expectancy increases, the need for skilled assistance, either at an assisted living facility or personal residence, also increases. Long term care insurance covers the risk that one will need skilled facility or home care coverage at some point in their life. It is projected that forty percent of the population will need this type of care for a minimum of one to three years. Many high net worth individuals believe they can self-insure and therefore do not desire coverage. Traditionally, long term care coverage has been for the middle class who do not want their net worth completely wiped out by medical costs. While it may be true that high net worth individuals can afford to self-insure, coverage is worth consideration for those high net worth individuals who desire to preserve a large estate.

Assume a currently healthy 60 year old husband and wife with two children are considering purchasing coverage. Their home value is \$1,000,000 and they have \$5,000,000 of assets in a diversified portfolio. The couple can either pay long term care annual premiums of approximately \$5,000 or use a portion of their \$5,000,000 for care. Assume that at age 80 their assets have increased to \$7,000,000 and the husband needs custodial care. The current cost of care at a reputable facility is roughly \$90,000 a year. Assuming an inflation rate of 4%, the cost of one year of care in twenty years will be approximately \$200,000. Assume that only one spouse will need care and this care will be needed for three years. The total cost of custodial coverage would be \$600,000. Note the 4% inflation rate, length of stay, and the fact that only one spouse needs care could be higher in twenty years due to medical advances and cost of care increases. If you chose not to purchase long term care coverage (and invested the \$5,000 premium earning 5% a year for twenty years) you would have roughly \$175,000 at the end of twenty years. If you purchase a standard policy and care is not needed you would be out of pocket \$175,000 (note that in exchange for an increased premium payment there are policy features that allow your heirs to receive all or a portion of the unused premium). However, if care is needed your estate would be reduced by a minimum of \$600,000.

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## Do You Have A Financial Sherpa?

A recent meeting with a prospective client illuminated a mistaken belief many people have about the marriage between a financial plan and a financial planner. The prospective client, who I'll call John, came to our initial meeting with a large, impressively bound financial plan one of the large brokerage firms produced for him in late 2007. During our meeting we discussed some of the data in the binder and what I found to be a disconnect between elements of the plan and the goals and behaviors of John. John, it turns out, had sold nearly all his equity positions in February 2009 during the depths of the Great Recession, with the approval of his brokerage advisor, and was now at sea about what to do.

I explained what I believe to be some fundamental truths about what our firm delivers to our clients which provided a clear contrast to how John was currently being served by his broker:

- >> Financial plans are of a moment in time, financial planning is a process that's ongoing and incorporates changes over time.
- >> Managing client emotions (during both good times and bad) is every bit as important as having great technical expertise or investment strategies.
- >> My favorite analogy is valuable financial planners are like sherpas. A map (think financial plan) provides a two-dimensional route to get to one's desired destination, but the actual climb requires knowledge of the terrain, the weather conditions, and the wisdom of experience to overcome adversity that can occur along the way. The perils of attempting serious mountain climbing with nothing more than a map in hand are obvious. Unfortunately, the danger of trying to achieve financial security with only a financial plan is often discovered after it is too late.

## Behind the Scenes at Trust Company of the South

- >> **Mike Palmer** was quoted in the May 23 issue of *Investment News* on the benefits of multi-office advisory practices.
- >> **David Paul**, son of Mitchell and Amy Paul, received a full four-year scholarship to attend The McCallie School. Candidates were selected on the criteria of academic excellence, leadership potential, and extraordinary character. Congratulations David!
- >> **Mike Palmer** recently attended the Pershing INSITE advisory conference in Fort Lauderdale, FL.
- >> **Jay Eich** has been reappointed to chair the Queen's University Estate Planners Day.
- >> The Trust Company of the South is a proud sponsor of Mike Lassiter's documentary film "Our Vanishing Americana – A North Carolina Portrait", premiering on WUNC-TV (PBS) at 10:00 PM on Thursday, July 1, 2010.

**S**uppose you'd be given a tip on April 17 that within days the US would experience the worst oil exploration disaster in history, and that capping the well would take months. Chances are you'd have believed that gasoline prices would increase as a result of such catastrophe, perhaps dramatically. Since the Deepwater Horizon explosion the national average price for a gallon of gas has fallen from \$2.87 to \$2.65. We view this as just another example of the dangers of trying to predict the future. Even with perfect information, drawing the right conclusions and separating correlation from causation is a difficult exercise.

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Other individuals are further convinced by the illustration of an estate tax example. If the individuals above opted for long term care coverage and had yet to use their \$1,000,000 gift tax exemption, they could gift the \$600,000 gift and estate tax free to a trust for their children. On the other hand, if the assets were needed to self-insure, they would not have the financial freedom to gift the \$600,000. In this case assume the \$600,000 (assuming a 5% return) grew to \$2,000,000 at the individuals' deaths at age 85. At death, as opposed to having \$2,000,000 set aside in an estate and gift tax free trust for their children, the \$2,000,000 would be taxed at an estate tax rate of 45% or \$900,000.

Once you make the decision to consider coverage there are numerous factors to analyze that will impact the cost of the coverage. These include the company you choose, whether or not your benefit will be covered by inflation, your medical situation, the age at which you purchase the coverage, the time period the benefit is to be paid, events that trigger coverage, if there is a tax benefit for premiums paid, the elimination period, and the daily benefit you receive.

Please note that the Trust Company of the South can evaluate your need for coverage; however, we do not sell policies. If you'd like to further discuss your need for long term care coverage please contact us.



### Raleigh Office

**Michael H. Palmer, II CFP®, Principal**  
919 781.8287  
mpalmer@tcts.com

**William H. Noble, Principal**  
919 781.8287  
bnoble@tcts.com

### Burlington Office

**William H. Smith, CFP®**  
Managing Principal  
336 538.1001  
wsmith@tcts.com

**John H. Slayton, JD, CFP®, Principal**  
336 538.1000  
jslayton@tcts.com

**Mitchell H. Paul, CPA, Principal**  
336 538.1001  
mpaul@tcts.com

### Charlotte Office

**Jay D. Eich, CFP®, CPA, Principal**  
704 936.4302  
jeich@tcts.com

**Christopher N. Sutherland, CPA**  
Principal  
704 936.4303  
csutherland@tcts.com