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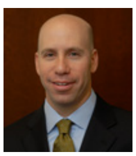
Investment Outlook 2013: Don't Put Bonds in the Hall of Fame

By Michael Goodman and Steven Malin



Investment managers in search of new opportunities and challenges will find them in 2013. For the first time in a decade, the outcome of the most pressing U.S. and international economic and financial issues appears to be approaching resolution. However, until the details of that resolution become known, meaningful risks remain that can result in temporary, yet significant, volatility across global financial markets.

Unlike any year in recent memory, this year's outlook *may not* depend first and foremost on

Chairman's Corner

It was a pleasure kicking off 2013 in Las Vegas at the Advanced PFP Conference with many of you, my PFP/PFS colleagues. This year's conference attracted more than 1,100 participants—a record breaking year for attendance.

The conference continues to exceed expectations and bring in nationally recognized speakers, timely and technical sessions, and excellent networking opportunities. With recognition from industry thought-leaders, such as Bob Veres, the conference has transformed into *the* technical financial planning event of the year. This year's conference featured industry heavyweights, including Carl Richards, Dr. Larry Sabato, Dr. David Kelly, Mel Schwarz, and Reva Bhalla, as well as conference favorites Robert Keebler, Michael Kitces, Ted Sarenski, James Shambo, Bill Winterberg, and Dan Rubin. In addition, the Investment Track this year included equity, fixed income and alternative strategy investment panels moderated by Scott Burns and Nadia Papagiannis of Morningstar. Find out what all the buzz was about by searching *#AICPAPFP* on Twitter.

Although the conference has concluded, there are still opportunities to catch sessions you may have missed. Video and audio recordings, as well as presentation materials from the conference, will be available soon at AICPA Conferences. Registered conference attendees will have complimentary access when they log in to the site, while others can create an account to purchase recordings and presentation materials.

It's never too early to begin planning for next year. Register for the 2014 conference, January 19-22 at the ARIA Resort and Casino, Las Vegas.

Scott Sprinkle, CPA/PFS, CGMA, CFP®
Advanced PFP Conference Chair

WHAT'S INSIDE

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macro and geopolitical developments. Instead, the outlook may hinge disproportionately on the passage of laws and implementation of central bank policies.

Investors will be wise to avoid responding to the flow of legislative actions and market developments, particularly during the first half of 2013. Instead, a more prudent strategy calls for maintaining a long-term investment strategy. That means adopting a global approach to wealth management and rebalancing portfolios back to intended asset allocations.

Markets Will Benefit From a Stronger, Though Risk-Laden Economy

Macro developments will exert an important influence on 2013 financial market performance. Strength in U.S. manufacturing, for example, will play a key role by stimulating profit growth and, eventually, increases in output across sectors. Meanwhile, service sector industries will continue to be the focus of most job gains.

Implementation of aggressive policies by the European Central Bank promises to halt the continent's downward economic spiral and patch up lingering sovereign debt issues. In Japan, a new regime committed to economic growth through monetary easing appears likely to spur that country's lumbering cyclical expansion. Demand for goods, services, and resources in China and several other emerging market economies promises to augment domestic U.S. and global output growth, albeit at a decelerating pace.

Despite the many positive economic signs in the 2013 outlook, major risks to investment performance remain very real. These include the following:

- Eventual tightening of monetary policy by the Federal Reserve will rely on unproven tools and methods that can have serious unintended consequences.
- Actions by Congress and the Obama administration to address federal budget and debt issues can curtail real economic growth domestically, perhaps by 0.3% to 0.5% annually, and abroad by 0.1% to 0.3%.
- Steps taken by European governments, central banks, and official international organizations have not yet solved chronic underlying fiscal problems across the continent's periphery and weaknesses among major banks.
- Effects of China's deepening structural problems spilled over to that country's trading partners.
- Several emerging market countries now have uncomfortably high inflation rates.
- Geopolitical discord, particularly in the Middle East and Asia, pose a threat to peace that can disrupt trade flows and cause untold economic and financial problems.

As in 2011 and 2012, disappointments will lead some investors to seek shelter in cash and other assets thought to be safe. As in 2009 and 2010, especially, giddy headline developments will induce relieved investors to take imprudent risks. As a result, sharp, but temporary, swings in investment performance across and within asset classes cannot be ruled out.

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Fiscal Reform Dominates the Investment Outlook

In 2013, the most critical drivers of financial market performance will be the scope and scale of U.S. fiscal austerity and regulatory reform.

By mid-year 2013, Congress and the Obama administration can be expected to enact a patchwork of tax increases and government spending cuts rather than a comprehensive package. Experience in Europe suggests that market reactions to each step in the legislative process will be unduly emotional, swift, and strong.

Once it becomes clear that the fiscal reform process will take years instead of months to fully unfold, volatility in financial markets will likely settle down for an extended period. If so, by the third quarter, fundamentals will replace emotions in a more enduring way as the main determinant of stock and bond prices. Until then, a substantial, though shrinking pool of money will remain on the sidelines in cash or in search of yield.

Once the specific terms of the new fiscal austerity and reform start to take shape, the business sector will take the leading role in promoting U.S. real economic growth. Greater pricing strength and the last vestiges of cost cutting will raise total profits, even as margins narrow. Investments in manufacturing plants and equipment, delayed for years by uncertainty, will be supported by abundant cash on balance sheets and continued record-low interest rates.

On the flip side, fiscal austerity will dampen consumer spending, though only marginally. Some firms and government agencies will be forced to temporarily revise hiring plans downward and keep a lid on payroll growth. However, job growth can be expected to return to, or exceed, its 3-year trend pace by roughly mid-2013 when gross domestic product growth reaccelerates and the outlook for profit improves.

In the interim, households will likely continue to spend cautiously and reduce their debt. Two exceptions to this are the automobile and housing markets, where record low interest rates and competitive pricing may spur sales. As in the business sector, once the targets of government spending cuts and tax increases become better known, consumers can be expected to spend more comfortably.

Safety May Be the New Tail Risk

On the monetary policy side, the Federal Reserve plans to keep liquidity abundant and interest rates very low until the U.S. unemployment rate falls to about 6.5%. In late 2012, financial market participants reacted positively to this commitment, optimistic that monetary policy can successfully stimulate real economic growth. As long as the annualized inflation rate remains at or below 2% to 2.5%, the inflation premium built into long-term yields will remain negligible, and the Federal Reserve can keep its policy in place.

How investors cope with record-low yields on "safe" securities may well determine the overall performance of the equities and fixed-income markets. For three years running, risk-averse retail investors fled to the safety of government bonds, even though interest rates fell to record levels. Persistently low yields, in turn, induced institutional investors, including banks, insurers, and pension funds, to grab safe-looking, income-producing assets to hedge their liabilities while meeting regulatory and capital requirements.

All over the world, relatively higher-yielding bonds racked up impressive annual gains in 2012 as a result of the quest for yield. Had interest rates spiked, yields on U.S. corporate bonds, municipal bonds, and emerging market debt offered a safety cushion against loss of principal. Meanwhile, dividend-paying stocks became the prized purchases of otherwise cautious equity investors.

However, the simultaneous attempt to protect wealth and earn income can become an expensive strategy. Staying in cash and incurring opportunity costs, investing in longer-term securities and incurring duration risk, or investing in securities outside of the AAA realm and incurring credit risk exposes a portfolio to potential losses, as does investing for dividend income rather than total returns. Typically, the extra yield on bonds and income from dividends does not compensate fully for the risk that holdings cannot be liquidated when needed or wanted, except at a deep discount.

With yields so low on Treasury bonds and other bonds perceived to be safe, the mere expectation of a small interest rate rise might be enough to trigger a sea change in investor attitudes. Suddenly, investors might shy away from bonds and move sharply in favor of growth and deep-value stocks and other risk assets. As a result, safety can become the new tail risk.

However, a panicked bond sell-off, though logical at current yields, does not appear imminent, and investor attitude toward stocks remains fickle. Nonetheless, in 2013, fixed-income returns will most likely come only from yield and not capital appreciation. That's especially likely for high-yield and municipal bonds that tend to be held to maturity.

Risk Assets: Back in Vogue?

Meanwhile, the full-year forecast for stocks has a positive slant, despite the risks in the forecast. In 2012, major U.S. stock market indexes closed for the year between 11% and 18%, despite two significant pullbacks and still-pervasive risk aversion among many investors.

This year, the approaching resolution of macroeconomic and policy issues lifts a major obstacle to a still-larger stock market advance. In addition, stock valuations can get a boost if money rushes out of bonds. In that environment, selected risk assets shunned since 2010 by many investors may again become investment darlings.

If the markets again reward risk taking, investors would be well-advised to diversify broadly within and between asset classes, rebalance their portfolio back to targeted allocations, and maintain a long-term perspective. Investors also should cast off their home-country bias and build a diversified portfolio consisting of U.S., international developed market, and emerging market securities. Doing so would take advantage of pervasive values in the stocks and bonds of fiscally distressed countries largely overlooked during the most turbulent episodes from 2010-2012.

In the end, investors who base their decisions on solid research will have a meaningful advantage in making asset allocation decisions. Yet, financial markets are volatile and unpredictable, rendering market timing a futile and often costly practice. Over the past half century and longer, investment managers who implemented and adhered to a long-term asset allocation, regardless of the phase of investment cycles, outperformed managers who moved in and out of positions opportunistically. Empirical evidence also shows that timely rebalancing back to intended asset allocations increases performance.

With markets in 2013 likely to experience episodic spikes in volatility, unwavering adherence to a well-reasoned, long-term strategy will give investors the best opportunity to match investment returns with their expectations.

Planning Implications of the American Taxpayer Relief Act of 2012

By Robert S. Keebler

Now that a fiscal cliff deal has finally been reached, we can start thinking about what it means for tax and financial planning. After summarizing the key provisions in the new law, this article will offer some preliminary thoughts.

On January 1, 2013, Congress enacted the American Taxpayer Relief Act of 2012 (ATRA). The law extends most of the favorable income and estate tax provisions enacted in 2001 as part of the Bush tax cuts but also raises the rates on some high-income taxpayers.

Income Tax

ATRA made the Bush tax cut rates permanent for most individuals. It does increase the 35% rate to 39.6%, however, for ordinary income above the following threshold levels (note that these amounts will be adjusted for inflation). (See the Editor's Note at the end of this article.)

Single taxpayer	$400,000
Head of household	$425,000
Married filing jointly or surviving spouse	$450,000
Married filing separately	$225,000
Trusts	$11,950

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When the 3.8% Medicare surtax is factored in, the tax rate for these taxpayers could be as high as 43.4%.

Long-Term Capital Gains and Qualifying Dividends

The maximum rate on this income stays at 15% for most taxpayers but increases to 20% on income above the thresholds listed previously. If the 3.8% surtax applies, the top rate would increase to 23.8%.

Phaseout of Deductions and Exemptions

Prior to the Bush tax cuts, personal exemptions were phased out by 2% for every $2,500 of income above certain threshold amounts. In addition, itemized deductions were reduced by 3% of adjusted gross income above the threshold amounts, up to a maximum reduction of 80%. The most important itemized deductions are for mortgage interest, state and local taxes, and charitable contributions. The personal exemption phaseout and the itemized deduction limitation (Pease) are reinstated beginning in 2013 for income above the following amounts (again, the amounts will be adjusted for inflation):

Single taxpayers	$250,000
Head of household	$275,000
Married filing jointly or surviving spouse	$300,000
Married filing separately	$225,000

Roth 401(k) Conversions

Under prior law, taxpayers had to be at least 59 ½ or leave their employer to convert a traditional 401(k) to a Roth 401(k). ATRA lifts these restrictions and allows participants to transfer vested amounts from a traditional 401(k) into a designated Roth account if permitted by the plan. Taxpayers who take advantage of this provision will pay tax on the deemed distribution but will avoid the early distribution penalty tax.

Alternative Minimum Tax

ATRA permanently increases the alternative minimum tax exemption amount to $50,600 for single filers and $78,750 for married taxpayers filing jointly for 2012. These amounts are indexed for 2013 and later years.

Transfer Tax

Under sunset provisions, the following changes were scheduled to go into effect in 2013:

	2012	2013
Top estate, gift, and GST tax rate	35%	55%
Estate and gift tax exclusion amount	$5.12 million	$1 million

ATRA creates a permanent $5 million exclusion for the estate, gift, and generation-skipping transfer (GST) taxes with inflation adjustments after 2011. With the inflation adjustment, the amount for 2013 is $5.25 million ($10.5 million for a married couple). ATRA also creates a 40% tax rate, higher than the 2012 rate, but still much lower than the 55% rate that would otherwise have gone into effect.

Estate Planning Provisions Not Enacted

The Obama Administration's Green Book tax proposals suggested a number of changes that would have severely curtailed estate planning opportunities. These included a minimum term for grantor-retained annuity trusts, a maximum term for dynasty trusts, new rules for valuation discounts, and the inclusion of the value of a grantor trust in the grantor's estate at death. None of these provisions were incorporated into ATRA.

Extension of Tax Benefits

ATRA extended numerous tax benefits. Some of the most important benefits include:

- Bonus depreciation
- Enhanced Section 179 expensing
- Accelerated depreciation for qualified leasehold, retail, and restaurant improvements
- The Work Opportunity credit
- The Research and Development credit
- Home- and energy-related tax breaks

Significantly, ATRA did not extend the 2% reduction in the payroll tax rate.

Planning Implications

The following points present some initial thoughts on how ATRA will affect tax and financial planning:

Three New Podcasts on the Resolution of the Fiscal Cliff

In this series of new podcasts, Robert S. Keebler discusses various aspects of the fiscal cliff settlement and planning opportunities under the American Taxpayer Relief Act of 2012:

- 2013 Income Tax Aspects of the Fiscal Cliff Settlement
- Estate, Gift and GST Planning Under the Act
- Trusts and Estates and the Impact of the 3.8% Surtax and the Fiscal Cliff Tax Increases

- Higher tax rates should make income tax planning more important.
- Income tax deferral strategies, such as life insurance and deferred annuity products, should become more popular; this includes tax-free build-up and smoothing income to stay in lower tax brackets.
- Other income-smoothing strategies will become more important for managing tax brackets on large capital gain sales, including charitable remainder trusts and installment sales.
- Loss harvesting and managing income from year to year will become more important because of added progressivity in the tax rates.
- Buy and hold investment strategies may become more popular.
- Low or no tax investments, for example, SPIDERS (Standard & Poor's Depositary Receipts) or tax-exempt bonds, may become more popular.
- Asset location decisions will be affected; taxpayers will be encouraged to transfer more to qualified plans, IRAs, and 529 education plans.
- Charitable lead trusts might be used to reduce the limitation on itemized deductions.
- Income-shifting strategies should become more popular.
- Increased income tax rates on individuals may affect the choice of entity decision; C corporations may become more favorable relative to S corporations.
- Estate planning will become less important for many taxpayers because of the higher exclusion amounts.
- Fewer taxpayers may need life insurance to pay estate tax.
- The income tax basis step-up at death will become more important; here, there will be higher capital gains rates, fewer taxpayers will be subject to estate and gift tax, and more taxpayers will simply die with assets rather than trying to remove them from their estates.
- Taxpayers who will not be subject to estate tax because of the increased exclusion may try to unwind existing estate planning strategies, for example, qualified personal resident trusts.
- Taxpayers may consider additional strategies, including charitable remainder retirement trusts, IRA trusts, capital gains trusts, and income tax rate trusts.

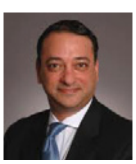
Expect quite a bit of continued discussion about ATRA, especially now that we are several weeks into the new year. As the year progresses, stay tuned for updates and more information from the AICPA.

Editor's Note: In mid-January, the IRS updated its inflation adjustments; read this article from the *Journal of Accountancy* for more information.

Fiscal Cliff Settlement: What CPAs Need to Know to Advise Individual Clients

On January 9, Bob Keebler and Mel Schwarz provided an overview of the planning implications of the American Taxpayer Relief Act in the web seminar, "Fiscal Cliff Settlement: What CPAs Need to Know to Advise Individual Clients." Listen to the archived recording and download the slides.

Roundtable Discussion: Using Annuities in Planning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Laura Kuntz
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James Shambo
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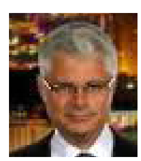

Leonard Wright
CPA/PFS, CFP®, CLU, ChFC

In August 2012, the AICPA Personal Financial Planning (PFP) Section presented the second in a series of CPA/PFS Perspectives Web seminars designed to address the decisions, motivations, concerns, and practical implementation aspects of topics that CPA financial planners face. In each session, a panel of experienced CPA Personal Financial Specialists (CPA/PFSs) shared their experiences.

"Using Annuities in Planning" was moderated by Marc Minker, CPA/PFS, of CBIZ MHM, LLC, and included the following panelists:

- Jonathan Gassman, CPA/PFS, CFP®, The Gassman Financial Group
- Laura Kuntz, CPA/PFS, MBT, Laurel Wealth Planning
- James Shambo, CPA/PFS, Lifetime Planning Concepts, Inc.
- Leonard Wright, CPA/PFS, CFP®, CLU, ChFC

Recently, Minker reconvened the panelists to hold a deeper discussion into the annuity topic. PFP section members may access the August 13 seminar recording and presentation materials for more information.

Marc Minker: What factors go into the thought process of selecting a fixed versus variable annuity?

Jonathan Gassman: Knowing the differences between a variable annuity and a fixed annuity can be the difference between what protects your retirement from financial loss and, possibly, buyer's remorse. The consideration to purchase an annuity is probably one of the most important decisions you can make about your retirement. There are no other retirement vehicles that will offer you the options, features, benefits, and advantages that annuities can offer.

If you are looking for a conservative, reliable investment vehicle to help grow your savings and provide a steady stream of income when you retire, a fixed annuity should be considered. Conversely, a variable annuity is a tax-deferred retirement vehicle that allows you to choose from a selection of investments and then pays you a level income in retirement that is determined by the performance of the investments you choose.

Unlike a fixed annuity, a variable annuity is designed to pump up your savings by giving you a chance for long-term capital growth. It could be a great addition to your overall investment portfolio because it provides for tax-sheltered growth on the earnings, as well as exposure to stock market-like returns, but it is a more complex vehicle to understand.

Jim Shambo: I view fixed immediate annuities, also known as single premium immediate annuities (SPIA), as a longevity product designed to protect against those who may live beyond life expectancy during drawdown. Variable annuities are tax deferral devices used during the accumulation phase. I really like these vehicles to fund a testamentary charitable bequest because all growth in the contract avoids income and estate taxes. Until recently, the variable annuity with living benefits was too costly to work in drawdown situations. However, Vanguard recently introduced a living benefit with costs under 2%, making this a possible drawdown product after age 70. I don't recommend locking into this product before age 70 because the payout rate is simply too low (5% single, 4.5% joint) at younger ages.

Leonard Wright: In order to be properly diversified, both fixed and variable annuities play an important role in retirement income. How it typically shakes out is that during accumulation years, variable annuities with the downside and death benefit guarantees play a large role. In retirement, fixed annuities play the larger role.

Today, there are many choices, even within the fixed and variable options. There are fixed annuities that provide for an increasing income stream over time and so many other options. In retirement, the annuity choices should reflect the risk tolerance of the individual who is electing to purchase an annuity. Generally, traditional fixed income annuities provide for a lifetime payment stream in exchange for a lump sum payment. That is a guarantee regardless how long the annuitant lives. The variable annuity guarantees a lifetime distribution of units in which the units are based on the underlying value of the investments made. Depending on the risk profile of the client, it may be appropriate to consider an allocation between fixed and variable annuities.

Marc Minker: Are annuities appropriate for everyone?

Laura Kuntz: Of course, the easy answer is no. No investment tool is appropriate for everyone. In general, among other uses, annuities might be considered for the following:

- A portion of a client portfolio where the client has no pension. With an annuity, the client can create his or her own pension.
- A client with an expectation of longevity.
- A part of a client portfolio where the client is very hesitant about investing in the stock market and is willing to pay generously for guarantees.
- Income tax deferral for particular situations.
- An investor who understands the benefits, risks, and costs of his or her selected annuity contract and insurer.

Jonathan Gassman: Annuities are right for most everyone. I don't know of any other vehicles that can provide guaranteed income for life. Who doesn't want that?

No matter how much you're worth, there is typically a concern about either running out of money or loss of wealth. An annuity can provide the fundamental retirement foundation needed to build on for everyone.

However, we must first understand the client's needs, wants, and goals. We sit with the client and learn about them by taking a full fact find (similar to a doctor who takes a full medical history) that includes their age, income, financial situation and needs, financial experience and objectives, possible intended use of the annuity, time horizon, existing assets, net worth, risk tolerance level, and tax status.

Jim Shambo: I really prefer the SPIA I mentioned in your first question, so my answer relates to that product. I believe there are four reasons to consider this product:

1. Fund basic living needs during drawdown
2. Reduce the initial withdrawal rate on the remaining portfolio
3. Reduce overall volatility
4. Provide lifetime income

I would not recommend the product to sickly clients who have a low risk of longevity or to those who would not benefit from one of my four reasons listed above.

Leonard Wright: I think there are many factors that go into the selection of an annuity.

For some, it may be an asset protection opportunity because a number of states shield from creditors' assets in an annuity. For example, an annuity is a valuable asset accumulation tool for doctors and other individuals who face a high risk of litigation in their business. For those who are concerned about running out of money during retirement, it may be appropriate that between 10% to 50% of their portfolio consist of annuities in retirement. Given the volatility of the markets, many consumers today crave a cash flow strategy they can hang their hat on that provides a guaranteed stream of payments.

Since defined benefit plans are becoming less of a factor in retirement, the annuity is becoming far more important today. There is a perception that guaranteed income payments have a lower risk to the annuitant. Annuities may also be appropriate for those who want a certain income stream for a portion of their annual cash stream, but for most, the annuity should not be the entire income stream.

Annuities are also essential for those who have had a history of not staying within a budget and may just be appropriate for a majority of their retirement savings. Exceeding their budget and spending more than should be spent during retirement years puts retirees at great peril of running out of money.

The adviser should work closely with those in retirement who spend more than will last over a period of time. If the client demonstrates behavior that spends down his or her retirement assets more quickly than expected, it may be appropriate to suggest shifting a substantial portion of retirement assets to an annuity. Those who have not accumulated enough and will continue to work should consider setting aside assets that would produce a payment stream that would complement income when they can no longer work in retirement.

Finally, retirees should consider how much they don't want to leave to heirs as part of the process. Most annuities do not provide for a cash value after a stipulated period of time, usually between 10–20 years of payments if that provision is elected. While wealthy families may not need an annuity, if long-term care insurance is purchased, an annuity can provide a vehicle to pay for the long-term care insurance on a tax-free basis through an annual 1035 exchange into a long-term care insurance policy. This comes with the caveat that it may be preferable to 1035 similar amounts from a life insurance policy. When the life insurance policy pays at death, it is ultimately tax free.

Editor's Note: Be sure to read Michael Kitces' article on long-term care insurance on page 12.

Marc Minker: Tell me about the true downsides of annuities. Aren't they expensive contracts for a consumer?

Jim Shambo: Of course there are downsides. There is the conversion of all income to ordinary income and the loss of step up at death. More practical issues include low living benefit payout rates at younger ages and step ups that will not keep pace with inflation and likely will not occur after withdrawals have been in place for years. The cost of the product is my biggest concern, however, as it often approaches the client's entire safe withdrawal rate of 4%, making the living benefit option of most products too rich for my taste.

There are also downsides to immediate annuities or SPIAs. Here, an irrevocable decision is not reversible, and funds are no longer accessible after purchase except for monthly payouts that end when the annuitant dies. In addition, current low interest rates result in low payout rates at this time. Because of these low payouts, if you decide to buy one of these annuities, you should consider adding a refund feature or a term certain payout to increase the likelihood that they will recover their investment.

Jonathan Gassman: The issues are few, so for the most part, annuities are good tools and strategies if the annuity contract is offered by a solid carrier that has strong financials and will be there to pay out the annuity contract from the womb to the tomb. It's important to remember that variable annuities are considered securities, and they are complex investments contracts that require consumers to read the fine print to fully understand what they are getting into, as well as the pros and cons. As for costs, annuities tend to carry higher costs than a typical mutual fund, but with that comes the benefit of certain guarantees that mutual funds do not.

Laura Kuntz: Annuities vary widely in features and benefits, and any combination of these can have a particular upside or downside. But, on a macro, highly conceptual level, I think there are two downsides of annuity guarantees:

1. Will the insurer be around to make good on the promise 30–40 years from now, or if that insurer struggles, will another take its place? This downside is similar to what Jonathan mentioned.
2. Once an investor annuitizes, that is, the investor largely relies on the promises of the insurance company, there generally is not the flexibility to take the "pot of money" and go elsewhere if the insurer starts to struggle. The investor essentially is locked in and subject to the forces at play.

The risks above are mitigated by a variety of factors. First, insurers are subject to a level of regulation and certain capital requirements. These do not create a failsafe, but they do help.

Second, generally speaking, if a U.S. insurer fails, the state insurance commissioners intervene to help transition the promises to another company. In an orderly transition, you might hope that the worst that might happen would be that there may be a haircut on some promises, but that the promises as a whole would largely remain intact. Note, though, that AIG, a significant purveyor of annuities, was too large to be easily transitioned. Had the federal government not intervened, the repercussions may have been serious.

Given these reasons, I think it is possible, from a risk management standpoint, that an individual would have been better served by a diversified portfolio with no annuity company as the middleman. A lot can happen over 30–40 years. That said, the risk management provisions related to annuities above are significant and worth consideration.

Putting aside the risk management considerations above, are annuities "too expensive?" As is true in so many areas of life, the answer is "it depends."

Leonard Wright: In addition to what's already been said, fixed and variable annuities may carry a number of costs that play into the fears of seniors. Variable annuities carry a number of costs, including asset management costs of separate accounts, mortality costs, commission costs, surrender charges, and other costs for a variety of riders. It's possible to approach 5% or greater in all of the different costs of the riders, separate account money management, and mortality and expense costs contained in a variable annuity contract.

While fixed annuities do not have costs for separate accounts, they do have substantially all of the other costs. Insurance companies are creative in their new annuity product offerings. For example, there are fixed annuities that provide for an increasing income stream over time. Morningstar is a good resource to use as a guide for separate account and separate account costs filtering through annuities.

Marc Minker: Are there any specific situations where annuities do or do not make sense?

Laura Kuntz: This is a really big question, and I won't try to answer it holistically as the others are likely covering various areas. What I will build on is what I see as a potential new use of annuities due to the 3.8% surtax, and the increase to 20% for federal capital gains and qualified dividend income. With tax rates going up, annuities as a tax deferral tool gain more consideration.

For example, I serve a young surgeon who makes $700,000. He'd like to retire in 20 years and he is saving enough to achieve this. He is not attracted to a high-risk portfolio; therefore, we need to invest in some bonds. In today's tax environment, should we do all his bonds in municipals? He has no individual retirement accounts to speak of—all the savings are in taxable accounts. What about the risks in municipals, tax risk with regard to whether the interest should ever be taxed at some level, interest rate risk, and credit risk?

Wouldn't the client be better off with a diversified bond portfolio? Yes, he would, but for him, a taxable corporate bond yielding 4.5% will put him in about a 50% federal and state tax bracket. However, what if we thought that the client's income in retirement might be under the surtax level and what if we used a low cost annuity that offered diversified bond options: inflation adjusted, emerging markets, global, high yield, and senior bank loans? I am currently looking into this for this client.

Jim Shambo: Addressing the SPIA, this product is a no brainer for a male who is 65 years old or older with no heirs because he has the highest payout rate and has no legacy concerns. The product would replace a portion of the bond holdings and improve cash flow with no downside, given the lack of legacy concerns. Today's payout rates are more than 200 basis points less than payouts in 2008, so timing of your purchases is important.

Leonard Wright: For those who desire flexibility of assets, accumulated significant assets, and will not use the 1035 exchange features for long-term care insurance or feel more comfortable using the 1035 opportunity with a life insurance policy rather than an annuity, the annuity may not make sense. For those who accumulated significant assets, who will distribute sufficient income and maintain a diversified basis during retirement, the need is not for a guaranteed income stream, but rather, for adequate life insurance for estate preservation purposes. For clients who desire flexibility of investments and have significant asset accumulation, a guaranteed income stream may not be necessary, particularly when the income stream generated from various assets exceeds the need to live on.

Marc Minker: Can you explain the costs of an annuity contract?

Jonathan Gassman: Yes, I can explain the costs associated with an annuity contract, but it would take me days. Instead, here's a brief summary:

Typical costs include mortality and expense charges, administrative charges, contingent deferred sales charges, tax penalties, and investment management fees. The total can range from 0.5% to 4% per year, while commissions to the sales agent can run from 1% to 7%, depending on how the annuity is set up.

Leonard Wright: I can add to Jonathan's answer by saying the costs that are levied on an annuity contract depend on the type of contract. Some costs may not be listed as a charge, but as an exclusion of a return and not be that direct.

For example, an equity-indexed annuity has a variety of these different costs. A key example of the exclusion of return that may seem rather innocuous, but is quite significant, is how an index is defined. It is typical to define the index ex-dividend. During volatile and low return periods of time that can extend out over 15 years, the dividend may account for up to 60% of the return of the index investment.

Another feature consumers need to be aware of is the participation rate. This is not a charge, but a limitation of returns in an equity-indexed annuity. Often, the first year may be about 100% or greater of the index return. However, the language in the policy generally stipulates that the insurance company has the right to change the participation rate annually. The company may be able to lower the participation rate to as low as 30%.

Another noncharge portion of the equity-indexed annuity is a cap rate. Many equity-indexed annuities cap a monthly rate of return at a specified number with no downside cap. Capital markets are volatile. Markets can rise 6% in a month and drop by 4% or 8% the next month. If the rise is capped at 1.75%, and the market drops by 6% the next month, it is entirely possible that the contract may not yield a return, even if the market is up by 30%. It all depends on how the ups and downs during the year played out.

In terms of surrender charges, close attention needs to be paid to how much of a surrender charge will be paid should the insured want to shift the allocation of the portfolio elsewhere. The surrender charge can be fairly close to the commission paid to the agent and the general agent. It is not uncommon to have surrender charges approaching 15% over a number of years, and then reduced over a 10- to 15-year period of time. While other aspects of the equity-indexed annuity may provide for specific return guarantees, many insurance companies are trying to determine how best to buy out insureds from their obligation to make good on certain features in the equity-indexed annuity.

Marc Minker: Are there any features you find either really good or really bad from a consumer's point of view?

Jim Shambo: A good point for variable annuities is that the contract value is available if the client decides to change his or her mind. A feature I like in the Vanguard product is the ability to turn the rider on and off. You only need wait one year after cancelling the rider before adding it back to the contract. This can be particularly useful if you bought at age 65 with a 5% payout and now are age 70 when the payout would be 6%. It is important to understand, however, that only the contract value is available, not the potentially higher benefit base.

In terms of variable annuities with living benefits, the "really bad items" include the following:

- High cost—Contracts begin with high costs, and when the contract values dip below the benefit base, the costs as a percent of the contract value begin to soar.
- Long surrender periods and often high surrender charges.
- Complexity—Confusion between contract value and benefit base misleads many investors.
- Income and estate tax negative impacts.
- Lack of transparency in contracts—These can be as thick as a book, and costs are never easy to identify or understand.
- Sales staff's misunderstanding of the product or intentionally avoiding telling all.
- Payout rates at acquisition increase as one gets older only every five years.
- The uninformed can, and often do, void the living benefit by taking excess withdrawals.

Conversely, an SPIA's advantages include the following:

- They are easy to understand.
- They can add inflation protection, but keep in mind this reduces payout by about 2% per year.
- This is the best product to reduce the initial drawdown rate on the remaining portfolio if bought when the SPIA payouts are in the 7% to 8% range we saw prior to 2008.
- If the client lives past life expectancy, this product could actually increase the legacy bequest.
- Payout rates increase each year as one ages, making it likely that the payout rate for a particular year will always be higher than a payout from a variable annuity with living benefits.

Of course, there are disadvantages of SPIAs. They may not recover the entire investment with early death, and you have to consider the irrevocable decision. This really doesn't make it bad by itself but may make it inappropriate for some clients.

Jonathan Gassman: All companies have their own spin on products and product designs. That's why it comes down to a few features for the consumer. The features that are good are the guarantees provided by these types of products, as well as the life income options that are offered. Depending on the type of annuity—variable vs. fixed—consumers should take the time to understand several points: (1) how a rollup works for income purposes in a variable annuity; (2) the frequency of step ups to lock in market gains for income purposes; (3) the payout options that are offered by the carrier, that is, lifetime or a certain period; and (4) whether the payout is for a single life or joint life.

These are the features I really like and are extremely beneficial and important to consumers. What tends to understandably rub consumers the wrong way are the overall expenses and fees associated with these contracts, as well as the lack of liquidity if you need to get out of the product early.

In a nutshell, annuities are good for clients and investors who are looking for the basics and want to enhance their investments, as well as protect their heirs. They are also good choices if you are looking for lifetime withdrawals to meet specific goals, lifetime withdrawals and choices to meet specific goals for clients and their spouses, and stock market-like returns.

Leonard Wright: My view is that the more benefits there are, the greater the cost and the lower the rates of return. Several companies today are attempting to buy out the promises they made on the annuity contracts that were issued. This has been widely reported by *Bloomberg* and *The Wall Street Journal*. Persistent low interest rates and rich promises have left insurance companies in a quandary about some of their offerings they made over the last decade.

The old adage, "if it looks too good to be true, it is too good to be true," is what consumers and professionals should be aware of during the evaluation process. Again, consumers need to pay particular attention to the clauses within the contracts of the equity-indexed annuity. The equity-indexed annuity purports to provide either a minimum guaranteed income—as low as zero percent—or a market rate of return. It is important to remember that each contract should be evaluated on its merits, and you cannot apply a blanket generalization across an entire spectrum of product offerings. Still, I have not yet seen a contract that I feel is in the best interest of my client. It may exist, but I have not seen it.

Big Changes Are Underway in the Long-Term Care Insurance Marketplace

By Michael Kitces

The long-term care insurance (LTCI) marketplace has struggled tremendously over the past decade as premiums have risen on both existing and new policies, and companies have become increasingly more stringent in their underwriting process.

Over the past two years, however, the pace of change accelerated; major players such as Prudential and MetLife stopped offering LTCI entirely. And, with low interest rates continuing to persist, a new round of changes is underway with industry leader Genworth announcing the elimination of so-called "limited pay" options (10-pay and pay-to-65 policies) and declaring that it will no longer offer unlimited (that is, lifetime benefits) on policies.

Although Genworth has not been the first or only company to make these changes, this news is notable when even the top carrier feels the need to cut back on its exposure to LTCI policies. Ultimately, this is probably not the beginning of the end for LTCI, but it's also not clear if, or when, clients will ever be able to get policies as generous as those offered in the past.

The Tumult Continues

Genworth's announcement made waves because it is the biggest LTCI carrier. Yet, the company is hardly alone in these kinds of changes. John Hancock and Mass Mutual had already ceased to offer unlimited benefit periods when Genworth made its announcement. Shortly thereafter, Transamerica announced that it, too, would reduce discounts, suspend limited pay options, and eliminate the unlimited benefit period.

And, in spring 2012, Prudential announced it was leaving the individual LTCI marketplace altogether, after Unum announced its exit a month earlier. With all of this exit-activity taking place, remarkably few major carriers remain that still offer coverage at all.

Over the past several years, long-term care insurers also had to raise premiums on at least some block of prior policies, which is permissible given LTCI's "guaranteed renewable" treatment, as long as it's done on an entire segment of policies and approved by the state insurance commissioner.

Accordingly, LTCI seems to be under assault from all directions at once—rising premiums on new policies, rising premiums on older policies, and fewer carriers willing to write LTCI at all.

About the Author
Michael Kitces, MSFS, MTAX, CFP®, CLU, ChFC, is a partner and director of research for Pinnacle Advisory Group in Columbia, Maryland. An active writer and speaker, he publishes *The Kitces Report* and the blog, Nerd's Eye View, through his website, Kitces.com. A version of this article originally appeared on Nerd's Eye View.

Those still offering coverage are only willing to offer far more limited benefits.

Low Lapse Rates

These dramatic shifts raise the question: What's the big problem? Did insurance companies really misjudge *that* badly how sick people were going to get and how much long-term care they need?

As it turns out, the answer is not exactly. Claims experience for insured individuals in need of LTCI has actually not been the biggest problem, although clearly, in retrospect, some companies were a bit too optimistic regarding likely claims patterns or too lax in their underwriting, or both. Instead, the biggest challenges for the LTCI industry have been surprisingly low lapse rates and a very problematic low interest rate environment.

Low lapse rates are problematic because a fundamental part of pricing insurance is anticipating how many people will decide not to renew their policy and let it go before ever making a claim. For example, if the lapse rate is 5% (typical in many other lines of insurance), then after 10 years, nearly 40% of policies are expected to have lapsed from nonrenewal alone (in addition to those no longer in force due to death of the insured). Instead, lapse rates were no more than 1% to 2%. As a result, instead of cumulatively lapsing 40% over the past decade, only about 10% to 20% of policies have not been renewed, and the insurance companies still have far more exposure than originally anticipated.

The low lapse rates are further complicated by the current low interest rate environment. After all, insurance works because the insurance company takes in premiums, invests them for a (conservative) return, then uses the accumulated premiums plus growth to pay future benefits. When interest rates fall from 5% to 1%, the 80% relative decrease in income results in far less money accumulated, especially when compounded over many years.

This, alone, explains the bulk of premium increases on existing policies in recent years. Insurance companies simply don't have as much money as expected to pay out current benefits because the ongoing premiums have not been able to grow nearly as much as anticipated. In addition, because lapse rates have been so low, insurance companies find themselves earning not only unexpectedly low and insufficient returns but facing claims on a much larger number of policies.

Cutting Back on New Policies

Given the realization that lapse rates and interest rates are as low as they currently are, insurance companies issuing LTCI not only raised premiums on prior policies where absolutely necessary but also significantly raised premiums on new policies, too. For some policies, the cost to buy one in today's marketplace is 50% to 100% more than an equivalent policy would have cost 10 years ago for someone at the same age. That's simply the reality of trying to buy low lapse insurance in the midst of such a low interest rate environment.

Unfortunately, though, even this has not been the only constraint on LTCI carriers. Most insurance companies that issue LTCI do so as a part of a larger company that issues many different types and lines of insurance. As a result, the companies must also manage their overall business as a "business," which includes managing the profits of their various lines of insurance and the insurance risks to which they are exposed.

Accordingly, many of the insurance companies are making adjustments to manage the profits and risks of their insurance exposure. In this context, the decision of many companies to raise premiums on new policies, as well as eliminate discounts, represents a goal of improving the profitability of the insurance or giving more of a margin for error in the future, or both. Companies that have dropped offering LTCI entirely are the ones that have decided the risk and return opportunity is just not worthwhile. Eliminating limited pay options is a way to ensure that, if ultimately necessary, the company *can* raise premiums on all future policyholders because they'll all still be paying premiums as long as they keep their policies.

Beyond this, the reality is that some companies have increased prices on policies specifically as an attempt to have consumers buy fewer policies, while not exiting the LTCI business altogether. By analogy, think of the insurance company's lines of business like a portfolio: If risky equities become too large a portion of the overall portfolio, you stop allocating as

Long-Term Care Resources

On January 31, Michael Kitces presented "Latest Trends & Developments in Long-Term Care Insurance." The web seminar recording and presentation materials are available in the PFP Web Seminar Library. Listen to a short podcast from Kitces on the long-term care landscape. Download two articles on the long-term care landscape from *The Kitces Report* (see "PFP News" on page 18 for more information). Further, Theodore J. Sarenski, CPA/PFS, CFP®, AEP, wrote "Long-Term Care Insurance: Is There a Need?" which appeared in the July/August 2012 Planner.

many of your new dollars to that investment, instead, shifting to other investments or lines of business.

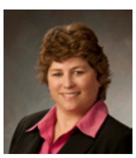
Unfortunately, the reality seems to be that all of the insurance companies are seeking to reduce their LTCI exposure at the same time and affecting one another. When some companies began to eliminate limited pay options or unlimited benefit pools, the result was a competitive advantage for companies that were still offering the policies. The problem? Some of those companies quickly received business than they wanted, ultimately leading them to respond by cutting their own offerings to keep from being overloaded on risk exposure.

The Bottom Line

Ongoing developments in the LTCI marketplace do not necessarily indicate that the insurance companies are broken, failing, or that LTCI isn't viable. It does indicate, though, that the companies are struggling to generate reasonable profits in the low interest rate environment. Similarly, the companies do not necessarily need to be "too good" of a deal in today's marketplace because they risk taking on more exposure than necessarily intended.

The changes are a sign that some of the generous benefits of the past may be gone for the foreseeable future. Until—and unless—the interest rate environment improves substantially or LTCI somehow becomes significantly more profitable, limited pay policy options will not return. It's also not entirely clear whether unlimited benefit pools will be back in the foreseeable future. On the other hand, it's worth noting that because unlimited benefit pools have always been expensive, many clients have already been using more limited policy benefit periods anyway—a "short-fat" policy design approach to LTCI that is highly effective given most clients' limited budgets.

CPA/PFS Profile: Kara Kessinger



Kara Kessinger, CPA/PFS, MTax, is one of those rare individuals who uses the left and *right sides of her brain. As a partner and the* Northeast Private Tax leader at *CliftonLarsonAllen LLP*, Kara *provides a variety of financial and tax planner services to her clients, but also spends time developing presentations, marketing materials, newsletters, and other communications and collateral for her firm and for the profession. As a strong financial planning advocate, she recently joined the AICPA Personal Financial Planning (PFP) Executive Committee.* Planner *sat down with Kara to talk about her background, investment philosophy, how CPA financial planners can put their marketing hats on more often, and even a bit about the PFP Executive Committee's new authority to set standards.*

Planner: *You have worked for two Big 4 firms, several large regional firms, and even owned your own financial planning firm. What are some key differences between owning your own firm and working for someone else?*

Kara Kessinger: Small firms have limited resources. A large firm is able to provide immediate access to information via the firm's intranet, coworkers, and outside research resources such as BNA, RIA, CCH, and PPC. With a large firm, you can pick up the phone and run complicated fact patterns by nationally-dedicated professionals. A small firm has restricted capital, so research tools can be limited.

When I was with the small firm, the buck truly stopped at my desk. Networking with prior coworkers and other professionals was a priority. However, as CEO of the small firm, I also had the ability to make quick decisions and implement change without the red tape. Given the billing rate structure, I was able to spend more one-on-one time with my clients, which built strong relationships.

Planner: *What is your investment philosophy?*

Kara Kessinger: Individual portfolios should be designed to deliver targeted returns and consider an acceptable level of volatility in order to optimize the clients' ability to meet financial goals. High net worth individuals should have exposure to alternative solutions such as private real estate, private equity, hedge funds, and private credit funds. Fortunately, my firm has an independent advisory arm that I rely on to deliver investment services. Our financial advisors have an understanding of the global economic, political, and capital market landscape, which is critical, because we are living in a world that has become one large global economy. My team has global knowledge and insight that allows them to make informed recommendations regarding the allocation of my clients' balance sheets.

Planner: *The PFP Executive Committee just received standard-setting authority. Why is this important for the profession?*

Kara Kessinger: The standard-setting authority will be beneficial not only to our profession but to our clients as well. Guidelines regarding the formulation and delivery of personal financial plans will result in a well-thought-out, more consistent end product for our clients. Whether CPAs are new or seasoned at providing PFP services, we will now have the AICPA framework to follow.

In light of the economy, longer life expectancies, increased college costs, changing tax laws, and retiring baby boomers, more of our clients are seeking PFP advice. CPAs will benefit by informing clients that an AICPA PFP standard is being followed. This empowers us to truly be in the position of a trusted advisor. Anyone can call themselves a financial planner, so the standard will differentiate the CPA.

Planner: *How has the Personal Financial Specialist (PFS) credential helped you and how does it help your firm?*

Kara Kessinger: I have used the title of PFS as a way to set myself apart from others who provide planning services. When clients ask about the designation, I explain there is a separate testing process to become a PFS, and there are continuing education requirements that must be on point. The certification separates myself from other PFP providers and reflects that I am an expert in my field.

Members of the PFP section, inclusive of PFS credential holders, have a Resources' link on the AICPA's website that has been invaluable to me. I started using Forefield many years ago, and it is a great resource. I use the materials as a starting point when I have speaking engagements or writing articles. The breadth of topics is amazing, and using the site has saved me time and money. Even though I am now with one of the nation's 10 largest CPA firms, I rely on the website, and it benefits my firm through increased efficiencies.

Planner: *You spend a good deal of time on marketing. What is the one key mistake CPA financial planners make when it comes to marketing what they do? How can they overcome this obstacle?*

Kara Kessinger: I think that the biggest mistake is not using the AICPA's link to Forefield. There are presentations that can be customized, articles available for distribution to the press or clients, marketing brochures, and simplified pieces on almost every planning technique and topic. The pieces are easily understood and suitable for educating clients and staff.

Planner: *It's now a new year and a fresh start, but changes in tax legislation continue to be on the minds of most Americans. Tell us 2-3 ways CPAs can use their knowledge and influence to help their clients understand the impact of future legislation.*

Kara Kessinger: Over the last few years, advising clients about changing tax laws has been exhausting! There were many tax provisions that expired at the end of 2011 and aren't available for the 2012 tax year. There are tax provisions that expired at the end of 2012 and won't be available in the future, while we have "new tax rates" that represent "old tax rates" that will be effective for 2013.

I advised clients that we would never have a year without an estate tax. Not only did we *not* have an estate tax in 2010, we could have elected to have estate taxes apply. The only thing I am sure of is that tax rates will rise. I don't know who is more frustrated, the clients or the CPAs. Most everyone believes that tax rates *will* rise, but when and how much is still being debated. My crystal ball isn't as shiny as it used to be since I have polished it so many times trying to get a better view. My advice is to sit and wait. Do we really have a choice at this point?

Planner: *Do you have a favorite quote?*

Kara Kessinger: *"In three words I can sum up everything I've learned about life. It goes on." — Robert Frost*

Clark Blackman Receives AICPA's 2012 PFP Distinguished Service Award

Clark M. Blackman II, CPA/PFS, founder of Alpha Wealth Strategies in Houston, is the recipient of the 2012 Personal Financial Planning (PFP) Distinguished Service Award.

He was presented the award by Lyle Benson, CPA/PFS, chairman of the AICPA PFP Executive Committee and a past recipient of the same award, during the 2013 *Advanced* Personal Financial Planning Conference in Las Vegas. The PFP Distinguished Service Award is presented annually to an AICPA volunteer who significantly contributes to the advancement of personal financial planning as a practice discipline.

"Clark is a role model for financial planners," said Jeannette Koger, the AICPA's director of member specialization and credentialing. "Through many years as a volunteer on the AICPA's financial planning committees and those in his home state of Texas, Clark has worked tirelessly to enhance the role of the CPA financial planner and has pushed young CPAs to follow in his footsteps."

Blackman has been active in the PFP division for two decades and is the immediate past chair of the PFP Division's Executive Committee. He has worked to strengthen ties with state societies, enhance the AICPA's annual financial planning conference, and develop tools and guides to help CPAs effectively expand their practices to include financial planning services. Under his leadership, the PFP Executive Committee received standard setting authority from the AICPA's Governing Council last fall.

Blackman has written or co-authored more than 50 articles on financial planning topics published over the past 15 years. He has been a featured speaker at numerous national conferences and was named to *Accounting Today's* list of 100 most influential people of 2011. Blackman was recognized by *Worth* magazine as one of the "Best Financial Advisors in America" from 1996 through 2004 and in January 2004 he was selected by *Robb Report Worth* publishers as one of "The Nation's 100 Most Exclusive Wealth Advisors." He was presented the "Distinguished Service to the Profession" award by the Houston CPA Society in 2004 and was inducted into the AICPA's Hall of Fame in October 2005.

Planner Article Library – 2012

In case you missed an issue of *Planner* during 2012, here is an issue-by-issue recap, along with a link to each issue on the PFP website. In addition to the articles listed, each issue included PFP News and a PFP Calendar of Events. Any article written by the staff does not specify an author.

January/February 2012

Collaborative Divorce: Helping Your Clients Avoid Financial Disaster
Authors: Tracy B. Stewart and Kevin Fuller

The Future of the Domestic "Asset Protection" Trust After Mortensen
Author: Daniel S. Rubin

CPA/PFS Profile: James A. Shambo

March/April 2012

New Cost Basis Rules for Mutual Funds
Author: Sheryl Rowling

What You Need to Know About Your Client's Homeowners Policy
Author: Bob Donnelly

Discover the Best Practice Management Ideas
Roundtable Discussion With Deborah S. Fox, Michelle Golden, Angie Herbers, and Bill Winterberg

CPA/PFS Profile: Karen Goodfriend

Karen Goodfriend Presented With 2011 PFP Distinguished Service Award

May/June 2012

Proactive Planning Ideas and Practice Management Trends
Roundtable Discussion With Beth C. Gamel, Robert S. Keebler, and Steven G. Siegel

Best Planning Ideas for 2012

How Soon Will States Close Their Estate Tax Loopholes?
Author: Michael E. Kitces

CPA/PFS Profile: Jean-Luc Bourdon

July/August 2012

Long-Term Care Insurance: Is There a Need?
Author: Theodore J. Sarenski

The Whole Truth About Variable Annuity Guarantees
Author: Michael E. Kitces

Pay Taxes Now to Buy Savings Later
Author: Robert S. Keebler

Planning for Medicare Benefits Prior to Retirement
Author: Thomas N. Tillery

CPA/PFS Profile: Linda Crouse

September/October 2012

Expanding and Broadening Your Planning Practice: CPAs Respond to an Aging Population
Author: James Sullivan

3.8 Percent Medicare Surtax . . . Explained
Author: Robert S. Keebler

The Medicare Surtax and Flow-Through Entities
Interview With Martin Finn

Five Steps to Increase Revenues by Eliminating Chaos in Your Practice
Author: Deborah Fox

How CPA Financial Planners Can Use a Tablet for Productivity
Author: Joel Bruckenstein

CPA/PFS Profile: Steven Levey

Plan to Attend the Advanced Personal Financial Planning Conference

November/December 2012

Winding to a Close: Gift Planning for Clients Who Did Not Act Earlier
Author: Martin M. Shenkman

What Does it Take to be a Trusted Advisor to a Family?
Author: Robert ("Bobby") A. Stover Jr.

"Passing Through" the New 3.8 Percent Medicare Surtax
Author: Martin Finn

Cost, Security, and Risk: The CPA Financial Planner's Journey to the Cloud
Author: Bill Winterberg

CPA/PFS Profile: Lyle K. Benson, Jr.

AICPA *Advanced* Personal Financial Planning Conference

PFP News

2012 AICPA Personal Financial Planning Division Year-In-Review

With unprecedented uncertainty in 2012, coupled with the unique opportunity for CPA financial planners to affirm their value by proactively planning for their clients, the AICPA PFP Division has sought to provide the latest information, tools, and advocacy to support PFP section members, inclusive of CPA/PFS credential holders. We kicked off 2012 with a celebration of the 25th anniversary of the CPA/PFS credential at the Advanced PFP Conference in Las Vegas. In October, the PFP Executive Committee was granted authority to set enforceable PFP standards. **For a recap of, and direct links to, the various milestones, as well as all member benefits released or revised in the past year, see the** 2012 PFP Year in Review.

American Taxpayer Relief Act

Pulling back from the fiscal cliff at the 13th hour, Congress preserved most of the George W. Bush-era tax cuts and extended many other lapsed tax provisions, passing the American Taxpayer Relief Act of 2012 (ATRA) on January 2. The bill was signed by President Obama on January 3. Notable items for financial planners include the following:

1. All the individual marginal tax rates under the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 are retained (10%, 15%, 25%, 28%, 33%, and 35%). A new top rate of 39.6% is imposed on taxable income over $400,000 for single filers; $425,000 for head-of-household filers; and $450,000 for married taxpayers filing jointly ($225,000 for each married spouse filing separately).
2. The personal exemptions and itemized deductions phaseout is reinstated at a higher threshold of $250,000 for single taxpayers; $275,000 for heads of household; and $300,000 for married taxpayers filing jointly.
3. A 20% rate applies to capital gains and qualified dividends for individuals above the top income tax bracket threshold; the 15% rate is retained for taxpayers in the middle brackets. The zero rate is retained for taxpayers in the 10% and 15% brackets.
4. The exemption amount for the alternative minimum tax (AMT) on individuals is permanently indexed for inflation. Relief from AMT for nonrefundable credits is retained.
5. The estate and gift tax exclusion amount is retained at $5 million, indexed for inflation ($5.12 million in 2012), but the top tax rate increases from 35% to 40% effective January 1, 2013. The estate tax "portability" election, under which, if an election is made, the surviving spouse's exemption amount is increased by the deceased spouse's unused exemption amount, was made permanent by ATRA.
6. If an employer offers a designated Roth 401(k) plan, ATRA will now allow individuals to convert their existing 401(k) to a Roth 401(k), regardless of whether the individual is allowed to take a distribution from the plan.

Read more details from the *Journal of Accountancy* and Michael Kitces. Forefield's new *video alert* and text client alert provide highlights of the legislation that you can send to your clients. Listen to the archived recording of the January 9 webinar with Bob Keebler and Mel Schwarz, "Fiscal Cliff Settlement: What CPAs Need to Know to Advise Individual Clients," a series of three podcasts from Bob Keebler discussing various aspects of the fiscal cliff settlement and planning opportunities under ATRA, and a 60-second clip from Leimberg Information Services that covers an important planning point for estate fiscal year elections under ATRA.

IRS Proposes Detailed Regulations on Medicare Surtax

On November 30, 2012, the IRS and Treasury issued proposed regulations regarding the new 3.8% Medicare surtax on net investment income (Medicare surtax), as well as proposed regulations on the additional 0.9% Medicare tax. The IRS also issued FAQs on the 3.8% Medicare surtax proposed regulations and posted Q&As to provide employers and payroll service providers information that will help them as they prepare to implement the additional 0.9% Medicare tax.

The proposed regulations on the 3.8% Medicare surtax (REG-130507-11) provide much anticipated guidance under new Internal Revenue Code Section 1411, as added by the Health Care and Education Reconciliation Act of 2010. Section 1411 imposes a 3.8% tax on some net investment income of individuals, estates, and trusts that have income above the statutory threshold amounts (MFJ $250,000, S/HOH $200,000, MFS $125,000, estates and trusts $11,650). The Medicare surtax will start to apply in 2013 (tax years beginning after December 31, 2012). However, the regulations generally are proposed to be effective for 2014 and future tax years (tax years beginning after December 31, 2013). The special computational rules for charitable remainder trusts are proposed to apply to 2013 and future tax years (tax years beginning after December 31, 2012). Taxpayers may rely on the proposed regulations for purposes of complying with Section 1411 until the effective date of the final regulations. The Treasury and the IRS intend to finalize regulations under Section 1411 in 2013.

For more information on the proposed regulations, read articles on the 3.8% Medicare surtax and 0.9% additional Medicare tax proposed regulations from the *Journal of Accountancy*. For more resources and tools on the Medicare surtax, see the Proactive Planning for 2013 Toolkit. Listen to the archived recording of the January 17 webinar with Bob Keebler and David Kirk, "Compliance and Planning Issues with the 3.8% Medicare Surtax," and a podcast from Bob Keebler discussing the impact of the 3.8% surtax and fiscal cliff settlement for trusts and estates. Read a two-page summary from Bob Keebler covering some of the most important clarifications in the proposed regulations. The AICPA Tax Division will be developing comments on the proposed regulations, which are due by March 5, 2013. We will keep you informed.

IRS Postpones Effective Date of New Procedures for Consents to Disclose

Rev. Proc. 2013-19, issued Feb. 6, delays the date that taxpayer consents to disclose and consents to use tax return information must contain the mandatory language recently issued in Rev. Proc. 2013-14. The original effective date of Jan. 14, 2013, has been moved back to Jan. 1, 2014. Read more from *Journal of Accountancy*.

Court Ruling on Preparer Registration

On January 18, the United States District Court struck down the IRS registered tax return preparer program and enjoined it from enforcing the regulations. This ruling also prompted the IRS to close the PTIN system. However, the IRS reopened its PTIN registration system shortly thereafter, following an AICPA letter urging the IRS to address the issue and clarification from the district court that struck down the IRS' return preparer registration program. The court refused the IRS' request to suspend its injunction on the program, but it did clarify that the injunction does not affect the IRS's requirement that preparers use a preparer tax identification number. Read more from *Journal of Accountancy*. The AICPA is closely monitoring this situation as it evolves and will update members on developments. Visit the Tax Division's resource page that includes JOA articles and links to the case, as well as more background and history on the PTIN program.

Five New Whitepapers Available for PFP/PFS Members

Download four complimentary newsletters from Michael Kitces on safe withdrawal rates and long-term care and a whitepaper on systemizing your PFP practice from Deborah Fox:

- *The Kitces Report:* 20 Years of Safe Withdrawal Rate Research (March 2012)
- *The Kitces Report:* Is the Safe Withdrawal Rate Sometimes Too Safe? (May 2008)
- *The Kitces Report:* The Changing Marketplace For Long-Term Care Insurance (July/August 2012)
- *The Kitces Report:* The Rising Popularity Of Hybrid Long-Term Care Policies (September/October 2012)
- Whitepaper from Fox Financial Planning Network on Systematizing PFP Practices (December 2012)

PFP/PFS members are eligible to receive a 10% discount on The Kitces Report. Listen to the archived recordings of the 2012 three-part web seminar series *Understanding Safe Withdrawal Rates*. Also, learn more about resources and training to assist CPA financial planners to work more efficiently, increase revenues, and deliver a higher level of service to their clients through the PFP Division's partnership with Fox Financial Planning Network.

New! The CPA's Guide to Investment Advisory Business Models

The CPA's Guide to Investment Advisory Business Models provides an overview of the various investment advisory business model options, as well as assists you in understanding if you have crossed the line when providing investment advice and determining if you need to be registered as an investment adviser. Additionally, two popular CPA's Guides on *Social Security Planning* and *Financing Retirement Healthcare* have been updated for 2013.

Moving Your Firm to the Cloud: The CPA's Guide to Technology in a PFP Practice

Cloud computing is fundamentally changing the nature of business. For many CPA financial planners, the process of moving to cloud computing will be a gradual one, but make no mistake: cloud computing will play an ever increasing role in your business. Learn more in the recently updated The CPA's Guide to Technology in a PFP Practice by Joel Bruckenstein, which now includes a new chapter on cloud computing. You will learn about the characteristics of cloud computing, cloud deployment models, benefits and industry trends, and more.

Podcast on Key 2013 Planning Considerations

Listen to this podcast, hosted by Lyle Benson, Michael Kitces, Ted Sarenski and Scott Sprinkle, to get practical ideas that you can discuss with your clients over the coming months. Now that we have some clarity on the income and estate law with the enactment of ATRA and the new 3.8% Medicare surtax, it is important to educate clients and create multi-year plans to manage the multiple income tax thresholds, varying sources of taxable income and the return of the phase-out in deductions at certain income levels. For more tax season resources, including client communication tools and a CPA/PFS press release for tax season, visit *aicpa.org/PFP/TaxSeason*.

Tax Practitioner's Toolkit

How can CPAs deepen relationships with current clients and build new ones in the midst of increased competition, potential consumer confusion over the IRS registered preparer designation, and a difficult economy? Set your firm apart from other tax preparers and project a clear, consistent message about your unique qualifications and the value you provide current and prospective clients. The Tax Practitioner's Toolkit (free for AICPA members) offers many resources to help you do just that position yourself as the premier providers of tax services. This toolkit includes resources customized for small, medium, and large firms and covers preparing your firm to understand and articulate the value of your tax services, engaging with clients to stay top of mind, and promoting your firm to attract new clients.

PFP Calendar of Events

Note: PFP section members, including PFS credential holders, attend Web seminars free without CPE unless otherwise noted or for a discounted price with CPE. View the complete list of Web seminars and registration links.

Event Title	Format/Location	Dates	Links/More Info
Taking a Fresh Look at Reverse Mortgages with Michael Kitces	Online Web seminar	April 24, 1:00-2:15p.m. ET	Register now. Free without CPE; Discounted CPE available.
Advertising and SEC Examinations with Ellen Bruno	Online Web seminar	TBD	Registration information will be available on the PFP website. Free without CPE; Discounted CPE available.
AICPA Conference on Tax Strategies for the High-Income Individual	AICPA Conference Las Vegas, NV	May 20-21, 2013	Register now. PFP/PFS members save an additional $100 off of the early bird AICPA member price.
AICPA Advanced Estate Planning Conference	AICPA Conference Baltimore, MD	July 15-17, 2013	Register now. PFP/PFS members save an additional $100 off of the early bird AICPA member price.

Is there a cutting edge or hot topic you would like covered in a Web seminar, or have you heard a fantastic speaker we should invite to speak on behalf of AICPA PFP section members? Share your ideas with the PFP team.