Farmington Observer

Business

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Boost 401(k) to cut taxes

By Alan Ferrara and Dan Boyce
special writers

Local financial planning experts reviewed the data of the family profiled here and made general recommendations based on the participant's resources and goals. The information is for educational purposes only; references are not intended as discrimination or endorsements by Observer & Eccentric Newspapers or the advisers interviewed.

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"Old age may seem a long way off. But on a day it doesn't, it will be too late to do anything about it." Our financial profile this month centers on the situation of Tom Porter, who is concerned about his retirement planning.

Porter is a quality control supervisor at a small manufacturing company. He makes $45,000 per year and is 46 years old. Divorced four years ago, he lives in Livonia with his two teenage sons.

"I'm just beginning to recover from my divorce financially," Porter said. "I'm really beginning to worry about my long-term financial security. My company's pension plan is very modest, so I know I will be responsible for the majority of my future needs."

HIS INVESTMENTS include three utility stocks and a 401(k) plan offered by his employer. He is currently adding 2 percent of his income into the 401(k) plan. His employer matches 25 cents for each dollar that he puts into this plan.

His cash reserves total $4,000. We would like to see this increased to the $5,000 to $10,000 range. Generally, it is desirable to have two months of income in cash reserves, as well as having other liquid assets upon which to draw in case of an emergency.

He has $45,000 of life insurance at work and $100,000 of personally held term insurance. He plans to terminate the term insurance after his children are through college. We believe that his coverage is adequate in his current situation.

His auto insurance and his homeowners insurance each require one small, but important, adjustment. The auto insurance includes only $50,000 of liability coverage, which covers him in the event of a lawsuit. Porter should raise this amount to at least $200,000. The additional cost is negligible.

A SERIOUS hobby for Tom and one of his sons is stamp collecting. A recent appraisal put the value of his collection at $3,500. Most homeowners policies will cover such collections only for $500 to $1,000 unless a special rider is attached. This "personal property floater" should be added to his policy as soon as possible.

The most important gap in his insurance program is the lack of a long-term disability policy. His employer sick pay plan would carry him financially for six months, but subsequently he has no coverage. This is not unusual for employees of small companies. Statistically, only 25 percent of small businesses carry long-term disability insurance — the percentage is far higher at larger companies.

Because his income would cease after six months if he became ill or if he had a serious accident, he could be placed in an extremely difficult financial situation.

He should buy a personal policy that would dovetail with his sick pay at work. The coverage should begin after six months and last until he is 65 years old. It should cover him if he is unable to perform the duties of his "own occupation" and it should have cost-of-living adjustments built into the policy. Any benefits would be received tax-free because he pays the premiums himself.

WHEN HE was divorced, Porter and his ex-wife agreed to set aside adequate funds for the children's educations. This amount, which is not included in his personal balance sheet, was invested in growth mutual funds that have performed very well during the last four years. This aspect of his financial planning is in good shape.

Porter had a will drawn up 10 years ago that he has not updated despite his change in his circumstances. He realizes that he should see an attorney to bring this up to date.

We would suggest that he consider incorporating a testamentary trust into his will. He wants his assets to go to the children at his death. This testamentary trust would provide that the money would be managed for the benefit of his children until he deems it appropriate to have it distributed to them outright.

Without such a provision, the assets in his estate would normally be distributed when the children reached the age of majority, which is 18 in Michigan. This may not be the ideal or desired time for them to have full access to any inheritance.

PORTER IS interested in reducing his income tax bill. This is one of the reasons he likes real estate investment — it provides him with tax deductions. He asks for other suggestions we might have.

Our first suggestion for reducing taxes it to increase his 401(k) contribution. We suggest 10 percent of his income be allocated to the plan. This is the quickest and easiest method of reducing taxes because anything contributed is not reported as income on his tax return.

An extra bonus is the 25 percent added to his contributions by his employer. Where else can he get an immediate 25-percent no-risk return on his investment? Also, if he decides to make additional real estate investments, this will help balance his total portfolio.

He is considering taking a home equity loan and paying off his car loan. Even though he has dealer-financing at 6.9 percent, he wonders whether the full deductibility of the home equity loan interest would be more advantageous.

We might agree with this if he were paying 12 percent or 14 percent on his car loan. But with such a low finance rate, it is definitely to his advantage to keep his current financing in place despite the lower tax benefit.

PORTER IS interested in real estate as a mean of accumulating assets. Just over two years ago, he bought a rental house for $40,000 by borrowing the $20,000 down payment from his parents and assuming a land contract of $20,000 from the seller.

The property is beginning to provide good cash flow after all expenses, and it has already grown in value to $55,000. His appetite thus whetted, he wonders whether he should begin buying other properties.

Our assessment is that his plan might very well provide a good method of building his assets and net

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Financial Position

INVESTED ASSETS

Checking and Savings	$1,500
Money Market	$2,300
Savings Bonds	$200
Stocks	$12,300
Mutual Funds	$2,700
Investment Property	$55,000
401(k) Plan	$3,500
Stamp Collection	$3,500
Total	$81,000

NON-INVESTMENT ASSETS

Residence	$70,000
Automobile	$9,000
Other personal assets	$10,000
Total	$89,000
Total Assets	$170,000

LIABILITIES

Home Mortgage	$16,000
Note to Parents	$20,000
Land Contract Due	$15,000
Auto Loans	$6,000
Charge Accounts	$500
Total Liabilities	$57,500
Net Worth	$112,500

FAMILY FINANCES

The Bottom Line

Financial strengths

- College fund is growing steadily.
- Adequate life and medical insurance.
- Desire to work on building solid financial situation.
- Owns home and an investment property.

Financial weaknesses

- No disability insurance.
- Inadequate retirement savings.
- Need to build somewhat greater cash reserves.
- No estate plan.
- Stamp collection inadequately insured.

Would-be entrepreneurs savor experts' pointers

By Mary Rodrique
staff writer

Florine Mark made it sound so easy.

Recalling her transformation from an overweight housewife afraid to leave home to a svelte and savvy businesswoman steering a $30 million empire, her story of courage and spunk was just the right medicine for this audience.

One hundred twenty mostly fledgling business people heard Mark's address on day two of Entrepreneurship Forum '89, sponsored by the Greater Detroit Chamber of Commerce and the state Department of Commerce.

From the makers of Mexican food to a mortician interested in expanding other business interests, they came from all walks of life to the Mercy College conference center in Detroit last weekend. While most participants were from the metro area, some came from as far north as Alpena and Saginaw.

FOR JOAN Sharp of Troy, a former banker currently working in financial services, it was an opportunity to seek advice from the assembled pros — accountants, attorneys, insurance representatives — and to soak up motivational success stories from people like Mark, the biggest single owner of Weight Watchers franchises in the world.

"I'm looking for my niche, and this is helping me discover how the real world works," said Sharp, who has an MBA degree with a major in finance.

That is precisely the intent of the forum, according to Dennis Koons, vice president of economic development for the Greater Detroit chamber and an organizer of the eight-year-old event.

"We're providing motivation, inspiration and education," Koons said.

Participants broke into small workshops and were given the opportunity for one-on-one counselling.

SPEAKERS INCLUDED Don Barden, president of Barden Cablevision, holder of the Detroit cable television contract; John Psarouthakis, founder of J.P. Industries, manufacturer of durable goods with annual sales of more than $500 million; and keynote speaker Scott McNealy, a Detroit native who is chief executive officer of Sun Microsystems of California, which is expected to gross nearly $2 billion in sales this year.

"There are two great aspects to this forum," said Ian Pesses, a Southfield attorney who made a presentation on legal matters.

"It's really nice to crank people up, to motivate them. It also assembles some of the finest experts in the state to talk one-on-one, free of charge. They'll answer the same questions over and over again."

Florine Mark: "If you're not having some fun, then it's not worth doing."

Pesses was one of 35 presenters from the fields of law, insurance, marketing and public relations lending time and advice to the forum.

His talk was laced with self-depreciating humor, potshots at the legal profession, and tips on how to get around expensive legal fees.

HE SUGGESTED business people ask their insurance agent for the latest ruling on the cumbersome and confusing IRS Section 89 dealing with discriminatory employment tests.

"Call the Department of Naturalization regarding hiring legal and illegal aliens," he said. "They're a wonderful source of free information."

Regarding employee benefit packages, "Every bank and insurance company has standard plans they're willing to share at a modest price."

Pesses stressed the importance of environmental issues in business.

"They're growing by leaps and bounds with new local, state and federal laws. Call the EPA and the DNR for free advice. They can sure save you a lot of money.

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