The Sensenig Capital
Advisor Letter

May 2014

Providing clients with peace of mind, through smart financial decisions.

Succeeding at Business Succession

TOPIC
Wealth Transfer

© 2014 SENSENIG CAPITAL ADVISORS, INC. ALL RIGHTS RESERVED.

In early 2012 Legal Zoom, an online legal resource, reported that 75% of small business owners had no formal business succession plan.[1] In addition, the Family Business Institute says that only 30% of family businesses survive into the second generation, 12% are still viable into the third generation, and only about 3% of all family businesses operate into the fourth generation or beyond.[2] The chief culprit, as you would imagine, is ineffective succession planning by the business owner. These numbers may come as a surprise to many but the simple fact is that most business owners are consumed by the responsibilities of running the day-to-day operations that they have little time to plan for succession. Nevertheless, business owners who ignore succession planning do so at significant risk to themselves, their employees, and their heirs.

Just as you would draft a will and other necessary documents to ensure suitable management of your personal estate, you need to create a succession plan to give your company the best chance for success after you exit. In fact, the absence of a proper plan may result in a decline in the value of the business in the event of the owner's death or unexpected disability. Failure to plan can also lead to a loss of control over the final disposition of the company. Having a plan not only provides the ability to maintain such control

> Engaging in succession planning now, affords you more options, ***especially when it comes to mitigating tax liability.***

over your company's destiny, but can also help to avoid family infighting, which goes a long way to ensuring a smooth transition.

Naturally, every succession plan is different, but here are a few basic things for any owner to consider when thinking about succession.

Begin the process early on: Planning now affords you more options, especially when it comes to mitigating tax liability. The earlier you start transfer-

Disclaimer: The information contained herein is intended to be educational and informational in nature only and has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Readers are encouraged to consult with their accountant, financial advisor, attorney or other professional. The opinions expressed herein are dated and subject to change over a period of time. Neither the information presented nor any opinion expressed constitutes a representation by Sensenig Capital Advisors, Inc. or a solicitation of the purchase or sale of securities. No professional services are deemed rendered to the readers of this newsletter.

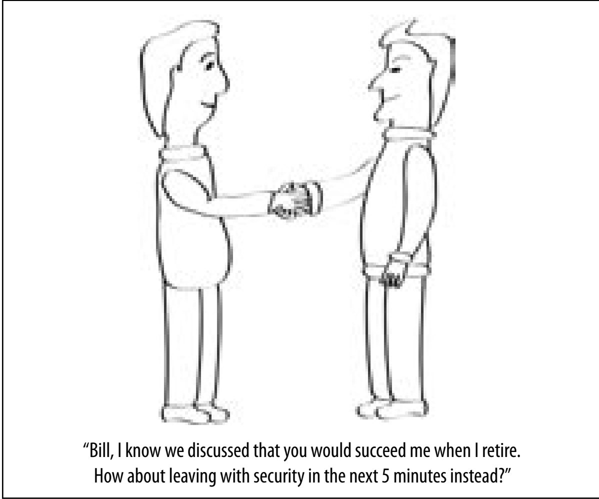
© 2014 SENSENIG CAPITAL ADVISORS, INC. ALL RIGHTS RESERVED.

ring ownership, the smaller the estate tax bill will be after you die. Early action also allows you time to correct your course. When you know your objectives it becomes easier to develop a plan to pursue them. Consider the following questions: Do you want future income from the business for you and your spouse? What level of future involvement do you want in the business? Do you want to create a legacy for your family or a charity? What are the values that you want to ensure, perhaps as they relate to your employees or community?

Remain objective: Determine what your business requires to survive and grow and be prepared to admit, if necessary, that key members of the team may not ultimately be up to the task. For family businesses, keep in mind that what is best for the family may not always be the best option or consideration for the future direction of the company.

> At Sensenig Capital, we have found that working together with a CPA and attorney that have specific knowledge in this area is ***crucial to the longer-term success of the plan.***

Enlist the help of qualified experts: Business succession is a complicated exercise that involves a multifaceted set of tax rules and regulations, as well as estate planning concerns, and beyond. Before moving forward with a plan, consider working with legal and tax professionals who are familiar with the process and can guide you each step of the way. At Sensenig Capital, we have found that working together with a CPA and attorney that have specific knowledge in this area is crucial to the longer-term success of the plan. These professionals often have advanced knowledge of tools such as buy/sell agreements, the proper way to gift shares, how to establish a variety of trusts, or even creating an employee stock ownership plan.



"Bill, I know we discussed that you would succeed me when I retire. How about leaving with security in the next 5 minutes instead?"

Consider loyal employees: Your plan should also address the vested interests of company officers and loyal employees; overlooking their contributions and value to the business could turn into a problem in the long-term. Don't risk the possibility that they could leave and take your best customers with them.

Communicate, communicate, communicate: Discussing a succession plan clearly and honestly will help to effectively convert your ideas into action. Once implemented, you should revisit the plan regularly to make sure it remains relevant in the face of changing circumstances. Actively involving the key stakeholders (whether they are younger family members or key employees) will allow everyone to remain abreast of the original thoughts and reasoning of the succession plan. S

1. Entrepreneur, February 15, 2012
2. Family Business Institute. *Succession Planning.* http://www.familybusinessinstitute.com/index.php/Succession-Planning/

Disclaimer: The information contained herein is intended to be educational and informational in nature only and has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Readers are encouraged to consult with their accountant, financial advisor, attorney or other professional. The opinions expressed herein are dated and subject to change over a period of time. Neither the information presented nor any opinion expressed constitutes a representation by Sensenig Capital Advisors, Inc. or a solicitation of the purchase or sale of securities. No professional services are deemed rendered to the readers of this newsletter.

Expensive Mistakes

NOTE: *This article uses an example of an event that occured in Australia, however similar parallels can be drawn to situations that have occured in the domestic U.S.*

✦ TOPIC ✦
Investment Consulting

© 2014 SENSENIG CAPITAL ADVISORS, INC. ALL RIGHTS RESERVED.

There are two ways of learning: You can be taught how to do something correctly, or you can be shown the consequences of doing it wrong. In the world of investment, it's a lot cheaper to learn from others' mistakes.

A recent edition of a television current affairs program[1] detailed how elderly Australians, many of them with only modest nest eggs, had lost up to $15 billion in recent years through dubious investment schemes.

Most of these schemes involved the provision of high-risk finance to property ventures, some involving speculative residential projects. Yet, the program found, these investments were often promoted as safe, secure, and bank-like.

In some cases, the promoters of the schemes extracted high fees (as much as 5%) from the vehicles, and engineered related-party transactions that cost the clients millions—without giving them any say in the matter.

The program found that end investors often had their entire life savings in a single investment product, which meant there was no safeguard when things went wrong. On top of all this, the schemes were promoted by financial "advisors," who earned commissions on their sales.

The wonder is that these dubious schemes continue to fleece thousands of people five years after the financial crisis exposed the folly of structured and highly conflicted mortgage finance vehicles and securities firms masquerading as banks.

In one heartbreaking moment in the program, a widow with an autistic son told how she lost $330,000 in compensation from the death of her husband after she was advised to put the money into a fund linked to a finance company that later failed.

The woman is now unable to afford the special education the boy needs and has called on her in-laws to provide emergency childcare while she works full time.

New regulations in Australia are about improving disclosure to investors and removing conflicts of interest around advice. But they have clearly come too late to help the thousands of people hurt by these collapses.

So, barring a further change in the law to protect against fraud, how can individual investors protect themselves? First, understand risk and return. If someone is offering a "low-risk" investment with a regular return well above the risk-free rate, alarm bells should go off. Return rarely comes without risk, but not all risks are worth taking. So always ensure you understand what you are investing in.

Most importantly, get truly independent advice. That means avoiding recommendations of someone who is receiving a financial or other incentive from the provider whose product he is promoting.

Second, diversify. It is the only free lunch you will get as an investor. Sinking your life savings into a single property scheme or mortgage fund is not diversification. That is taking a massive, speculative bet on a single asset.

It is far better for your long-term wealth to spread risk across a range of asset classes—domestic and developed markets equities, emerging markets, local and global bonds, listed property, and cash. And within each asset

Disclaimer: The information contained herein is intended to be educational and informational in nature only and has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Readers are encouraged to consult with their accountant, financial advisor, attorney or other professional. The opinions expressed herein are dated and subject to change over a period of time. Neither the information presented nor any opinion expressed constitutes a representation by Sensenig Capital Advisors, Inc. or a solicitation of the purchase or sale of securities. No professional services are deemed rendered to the readers of this newsletter.

© 2014 SENSENIG CAPITAL ADVISORS, INC. ALL RIGHTS RESERVED.

class, you should diversify as much as possible.

Third, fees matter. The difference made by a 1%, 2%, or 3% fee can run into hundreds of thousands of dollars over the years. Time after time, we see the rewards in these heavily marketed schemes going not to the end investors but to the promoters.

Finally, and most importantly, get truly independent advice. That means avoiding the recommendations of someone who is receiving a financial or other incentive from the provider whose product he is promoting.

A good advisor will work for you. That means understanding your risk appetites, your situation, and your investment and lifestyle goals. It means structuring a diversified portfolio that reflects your needs, not what a product provider has to sell.

The losses suffered by Australians in these schemes are tragic. Liquidators interviewed by the program had little hope that people would get much of their money back, if any. Questions were raised about the adequacy of regulation.

Ordinary investors can't control those outcomes. But they can learn from these lessons and steer clear of anything that smells of conflicted advice, promises of high returns and low risk, lack of diversification, high fees, and slick marketing.

If we don't learn these lessons from the experiences of others, we risk having them taught to us directly. In those cases, the tuition bills can be substantial. S

---

1. "A Betrayal of Trust," *Four Corners,* Australian Broadcasting Corp. Television, March 4, 2013.

This material may refer to resident trusts offered by DFA Australia Limited. These resident trusts are only available in Australia. Nothing in this material is an offer or solicitation to invest in these resident trusts or any other financial products or securities. All figures in this material are in Australian dollars unless otherwise stated.

About the Author: Jim Parker, a vice president in the Communications Group of Dimensional Fund Advisors presents strategies to communicate Dimensional's philosophy and process in ways that engage clients, prospects, regulators, and the media. Jim holds an economic history degree from Deakin University and a journalism degree from Auckland Technical Institute.

Disclaimer: The information contained herein is intended to be educational and informational in nature only and has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Readers are encouraged to consult with their accountant, financial advisor, attorney or other professional. The opinions expressed herein are dated and subject to change over a period of time. Neither the information presented nor any opinion expressed constitutes a representation by Sensenig Capital Advisors, Inc. or a solicitation of the purchase or sale of securities. No professional services are deemed rendered to the readers of this newsletter.

There's More to a 401(k) Plan than Savings

✦ TOPIC ✦
Wealth Enhancement

© 2014 SENSENIG CAPITAL ADVISORS, INC. ALL RIGHTS RESERVED.

We all are aware that 401(k) contributions provide a tax-deferred vehicle as a means of saving for retirement. Often overlooked is that the predominant type of plan that includes 401(k) contributions is a profit sharing plan, and 401(k) contributions are one of several possible types of contributions to a profit sharing plan. In addition, many of us know about matching contributions, but there are various other different ways to structure profit sharing plan contributions to help meet retirement goals of your business and personal financial plans.

First, some quick facts:

- **A business does not have to have profits to make a profit sharing contribution.** The term "profit sharing plan" was part of the vocabulary in common use when the rules were written and the term persists today even though the requirement to have profits has long since been removed.
- **The decision to make a profit sharing contribution for any year can be totally discretionary.** You can wait until plan year end to decide whether to make a contribution to the plan, and if so, how much to contribute. This discretion allows you to set aside more for retirement in good years and to set aside less or even skip a contribution in other years.
- **A profit sharing plan can have more than one allocation formula to determine how much each employee shares in the contribution.** As we will see below, different formulas can satisfy different business and personal objectives.

Being aware of the demographics of your business and of your personal retirement goals are crucial to optimizing profit sharing plan design. Here are some selected examples.

Acknowledging Ownership – Your business started with a great idea, a few owners, and limited capital. It grew with some good planning, good fortune, and personal sacrifice. At the same time, your children grew up, college tuition blew up, and what seemed like a long time until retirement is not so long any more. You have a strong group of employees who generally are younger. The plan could allow the owners to make up for lost time in accumulating retirement assets.

Acknowledging Payroll Costs – Your business is subject to large variances in year-to-year revenues. All employees are relatively close in age, and generally the owners earn above $150,000 a year in good years and employees on average earn under $75,000. The plan could consider that the business already pays a lot in payroll taxes for each employee.

Acknowledging Common Interest – The business communicates to all employees that everyone is expected to contribute to the success of the business and everyone can expect to participate in that success. The plan could be a pure profit sharing plan where more profits equals more for retirement.

With so many alternatives available and different ways a profit sharing contribution can be shared among owners and employees, it is reasonable to ask whether the IRS will have concerns about whether the plan discriminates in favor of owners or highly paid employees. The IRS is concerned primarily about whether the contribution is shared fairly among employees. The flexibility in plan design stems from the fact that the IRS allows for different methods of determining what is fair. Broadly speaking, a plan can be considered fair if the contribution to each employee when expressed as a percent-

Disclaimer: The information contained herein is intended to be educational and informational in nature only and has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Readers are encouraged to consult with their accountant, financial advisor, attorney or other professional. The opinions expressed herein are dated and subject to change over a period of time. Neither the information presented nor any opinion expressed constitutes a representation by Sensenig Capital Advisors, Inc. or a solicitation of the purchase or sale of securities. No professional services are deemed rendered to the readers of this newsletter.

© 2014 SENSENIG CAPITAL ADVISORS, INC. ALL RIGHTS RESERVED.

age of each employee's compensation is within the IRS rules, i.e., a **"compensation based formula".** Or, a plan can be considered fair if the amount of retirement income that can be bought today for each employee with the contribution made for each employee is within the IRS rules, i.e., a **"new comparability formula".**

Here are some illustrations. Assume that Betty is age 60 and earns $170,000, and Bob is age 35 and earns $50,000.

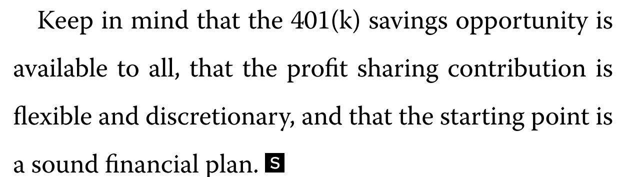
If the contribution formula is a compensation based formula that says each employee gets 5% of compensation, then the company would contribute a total of $11,000 to the plan (5% of $220,000). Betty would get $8,500 (5% of $170,000) and Bob would get $2,500 (5% of $50,000).

If the contribution formula is a new comparability formula that says the total $11,000 company contribution will be used to buy the same amount of benefit for each employee payable at age 65. Betty would get $9,734 and Bob would get $1,266. Why does Betty get more than Bob? The amount of benefit payable at retirement includes an assumption that the contribution made today will grow investment income up to age 65. Betty has only 5 years for her contribution to grow until retirement, while Bob has 30 years.

In a variation on the compensation based formula, the profit sharing plan can recognize that businesses contribute 6.2% of an employee's compensation to fund the OASDI portion of Social Security. This portion of FICA taxes essentially funds a retirement benefit for the employee. But, the 6.2% is capped at the Social Security Taxable Wage Base (SSTWB - $117,000 for 2014) and Social Security retirement benefits also are capped based on these limits. The plan's formula can be **"integrated with the SSTWB".** Under this formula, each employee gets a contribution equal to a fixed percentage of compensation. An employee that earns more than the SSTWB gets an additional contribution on compensation that is above the SSTWB. In our example, if the plan formula was integrated with the SSTWB, then $11,000 total company contribution would be shared with Betty receiving $8,985 and Bob receiving $2,015.

This brings us back to the primary question of how best to use the power and flexibility of a profit sharing formula to meet business and personal retirement objectives. Using our examples from above:

- To **Acknowledge Ownership after years of sacrifice,** consider a new comparability formula.
- To **Acknowledge Payroll Costs,** consider a formula integrated with the SSTWB.
- To **Acknowledge Common Interest,** consider a compensation based formula.



Keep in mind that the 401(k) savings opportunity is available to all, that the profit sharing contribution is flexible and discretionary, and that the starting point is a sound financial plan. S

A. Paul Protos
ATR, Inc.

Paul is a founding Principal of ATR, Inc., a defined contribution plan consulting and third party administration firm. ATR, Inc. was founded in 1990 and takes its name from a commitment to provide accuracy, timeliness, and responsiveness to their clients. They take a consultative approach to client service where the first step in the relationship is to listen. Prior to ATR, Inc., Paul worked 15 years with one of the Big Four accounting firms, rising to Partner and the role of the National Practice Leader for Defined Contribution Services.

Disclaimer: The information contained herein is intended to be educational and informational in nature only and has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Readers are encouraged to consult with their accountant, financial advisor, attorney or other professional. The opinions expressed herein are dated and subject to change over a period of time. Neither the information presented nor any opinion expressed constitutes a representation by Sensenig Capital Advisors, Inc. or a solicitation of the purchase or sale of securities. No professional services are deemed rendered to the readers of this newsletter.

the Sensenig Capital Advisory Team

Carl B. Sensenig
President

Carl Sensenig earned his Bachelor of Science degree in Business Management from York College of Pennsylvania and his Certificate of Professional Studies in Finance from Ursinus College.

Carl served as Vice President and Portfolio Manager for nearly twenty years at Arthur E. Spellissy & Associates (Wayne, PA) before founding Sensenig Capital Advisors in April, 2007. From 1972 to 1987, he held sales and marketing management positions with two public companies. A veteran, he also served four years in the United States Air Force.

In addition to being active in church leadership, Carl currently serves on the boards of several non-profit organizations in the local community, including Advanced Living Communities, The Center for Loss and Bereavement, and The Schwenkfelder Library and Heritage Center. S

Jeremy C. Brenn, MBA, CFP®
Vice President

As Vice President, Jeremy Brenn is responsible for many of the firm's client relationships, as well as managing the strategic direction and wealth management process for Sensenig Capital. Jeremy earned his Bachelor of Arts degree from York College of Pennsylvania, as well as his MBA in Finance from Hood College, Frederick, MD.

Jeremy is an active member of the Financial Planning Association (FPA). He also holds the distinguished CERTIFIED FINANCIAL PLANNER™ professional designation. He has been quoted in the Philadelphia Inquirer and other personal finance related sources. In addition, Jeremy currently serves on the Board of Directors at Meadowood Senior Living, a non-profit continuing care retirement community located in Worcester, PA. He lives in Montgomery County with his wife and three sons. S

TOPIC GUIDE

Genuine wealth managers use a consultative approach to construct solutions that encompass all types of financial needs. At its core, our wealth management approach is comprised of the subject matter areas listed below. We organize our newsletter around these topics and highlight each one for your benefit. Each article is tagged with the specific topic so you can relate the information to your own unique situation.

Investment Consulting — Maximizing the probability of investment success

Wealth Enhancement — Tax mitigation and cash flow planning

Wealth Transfer — Transferring wealth effectively to heirs

Wealth Protection — Transferring & mitigating risk through insurance

Charitable Giving — Maximizing the charitable impact

Relationship Management — Building deep, fulfilling relationships with our clients

GET A

SECOND OPINION

…AT NO OBLIGATION

LEARN MORE AT:

sensenigcapital.com/getting-started

Phone: (610) 584-9700 \ **Fax:** (610) 577-2899 \ **Email:** info@sensenigcapital.com \ **Web:** www.sensenigcapital.com

Disclaimer: The information contained herein is intended to be educational and informational in nature only and has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Readers are encouraged to consult with their accountant, financial advisor, attorney or other professional. The opinions expressed herein are dated and subject to change over a period of time. Neither the information presented nor any opinion expressed constitutes a representation by Sensenig Capital Advisors, Inc. or a solicitation of the purchase or sale of securities. No professional services are deemed rendered to the readers of this newsletter.

FOLLOW US ON:

To be removed from our mailing list please email info@sensenigcapital.com

Discover the difference with a Registered Investment Advisor.

SENSENIG
Capital Advisors, Inc.
3100 Mill Road
P.O. Box 245
Fairview Village, PA 19409