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Why You Need a Power of Attorney and Medical Directive

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Why You Need a Power of Attorney and Medical Directive

It's late at night and you're waiting for your husband to arrive home from a business trip. Suddenly the phone rings and the voice on the other end informs you that your husband was in a terrible car accident and has been rushed to the hospital. You arrive to find several doctors awaiting permission to operate on your unconscious husband. They ask if he has a medical directive that authorizes someone, preferably you, to make health-care decisions on your husband's behalf.

A few days pass and your husband survives the accident, but he's going to be laid up for several weeks or months. Household bills need to be paid, but the primary source of income is your husband's business and you're not named on any of the business bank accounts. The bank representative asks whether your husband has a durable power of attorney naming you as his agent for financial matters.

These are everyday examples that highlight the importance of a medical directive and a durable power of attorney. Without these documents in place, you and your family could face personal and financial disaster.

What is a medical directive?

A medical directive lets others know what medical treatment you would want, and allows someone to make medical decisions for you, in the event you can't express your wishes yourself. There are two basic types of advanced medical directives--a durable power of attorney for health care and a living will--which generally vary by state. So be sure your documents comply with the laws of your state of residence.

A durable power of attorney for health care (known as a health-care proxy in some states) allows you to appoint a representative (health-care agent) to make medical decisions for you if you are unable to do so yourself. You can appoint almost anyone as your agent (as long as they are of legal age, usually age 18 or older). You decide how much power your representative will or won't have.

A living will allows you to approve or decline certain types of medical care, even if you will die as a result of that choice. In most states, living wills take effect only under certain circumstances, such as terminal injury or illness. Typically, a living will can be used to decline medical treatment that "serves only to postpone the moment of death." In those states that do not authorize living wills, you may still want to have one to serve as an expression of your wishes.

What is a durable power of attorney?

A durable power of attorney (DPOA) can help protect your property in the event you become physically unable or mentally incompetent to handle financial matters. If no one is ready to look after your financial affairs, your property may be wasted, abused, or lost. A DPOA allows you to authorize someone else to act on your behalf, so he or she can do things like pay everyday expenses, collect benefits, watch over your investments, and file taxes.

A DPOA may be effective immediately (this may be appropriate if you face a serious operation or illness), or it may only become effective upon the occurrence of an event, such as your incapacity (sometimes referred to as a springing power of attorney).

Caution: *A springing power of attorney is not permitted in some states, so you'll want to check with an attorney for its availability in your state.*

Additional things to consider

When creating either a DPOA or medical directive such as a durable power of attorney for health care (HPOA), it is important that you choose an appropriate agent. While you may select the same person to serve as agent in both documents, you are not compelled to do so. And be sure the person you select as agent is aware of that fact. Also, let them know where you keep these documents (you may want to give a copy of your HPOA to your agent and primary care physician as well).

Once you have these documents, review them periodically to be sure they still accomplish what you intend them to do.

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The best benefits are those that meet the needs of your employees. Before making any assumptions, survey your employees to see what benefits they value the most.

Show Them the Love: Low-Cost, High-Value Employee Benefits

As a small business owner, you are probably aware of the importance of offering a basic employee benefit package that includes health and disability insurance, and a retirement savings plan. However, recruiting and retaining top talent often requires going above and beyond the basics. By offering creative, low-cost benefit programs, you can differentiate your business from other potential employers.

Flexible work environments

In today's hectic world, time is nearly as valuable as money. Consider the following statistics from the Families and Work Institute (Source: National Study of the Changing Workforce, 2008):

- 59% of employees don't feel they have enough time for themselves
- 61% believe they don't have enough time for their spouses/partners
- 75% (more than 7 out of 10) feel they don't have enough time for their children

For these reasons, one of the most popular and appreciated employee benefits available today is a flexible work environment. Once the hallmark of only small and "hip" technology companies, flexible work arrangements are now offered by larger, more established organizations. Some examples of flexible work programs include:

- Flex schedules: work hours that are outside the norms, such as 7 a.m. to 4 p.m. instead of 8 a.m. to 5 p.m.
- Condensed work weeks: for example, working four 10-hour days instead of five 8-hour days
- Telecommuting: working from home or another remote location
- Job-sharing: allowing two or more employees to "share" the same job, essentially doing the work of one full-time employee. For example, Jan works Monday through Wednesday noon, while Sam works Wednesday afternoon through Friday.

Allowing your employees to tailor their work schedules based on their individual needs demonstrates a great deal of respect and can generate an enormous amount of loyalty in return. Even if your business requires employees to be on-site during standard operating hours, having a process in place that supports occasional paid time off to attend to outside obligations such as doctors' appointments or family commitments and even unexpected emergencies can have enormously positive effects, too. In some cases, these benefits have no costs associated with them, while in others, the costs may be minimal (e.g., the price of a smartphone or laptop to help employees remain productive on the go).

Free food

Another popular perk at smaller companies is a well-stocked kitchen. Soft drinks, snacks, and inexpensive meal items such as cereal and bagels can go a long way toward fostering good will (and keeping energy up!). Providing healthy options, such as fruit, nuts, and smoothies, is a subtle way to show employees that you value their well-being.

Social activities

Sponsoring periodic activities can help workers relax and get to know one another. Such events don't need to take much time out of the day, but can do wonders for building morale. Bring in lunch or schedule an office team trivia competition or group outing. Perhaps your employees would like to share their little-known skills through an art exhibition or talent show. If you work in a particular industry in which colleagues share a common passion, consider organizing events around that interest. For example, a sporting goods retailer could close up early on a slow-business afternoon and go for a hike or bike ride.

Concierge services, discounts

You may also be able to negotiate with other local companies for employee discounts and services. Laundry services, dry cleaning pickup/drop-off, and meal providers that can deliver hot, family-sized take-home dinners may help employees save both time and worry--and stay focused on the job.

Financial planning/education

For many people, money worries can be distracting and time consuming. Consider inviting a local financial professional into your office to provide counseling sessions for your employees. While you don't necessarily have to pay for any services provided, simply offering the opportunity to get such help during work hours will be appreciated by your workforce.

Survey your employees

The best benefits are those that meet the needs of your employees. Before making any assumptions, survey your employees to see what benefits they value the most. Then, respond to the most commonly identified concerns and desires with creative solutions. That can encourage employees to respond in kind through hard work and dedication.

Estate Planning and Income Tax Basis

Income tax basis can be important when deciding whether to make gifts now or transfer property at your death. When you make a gift of property, the recipient generally receives your basis in the property. When you transfer property at your death, the recipient generally receives a basis equal to the fair market value of the property. The difference can substantially affect the amount of taxable gain when the recipient sells the property.

Income tax basis can be important when deciding whether to make gifts now or transfer property at your death. This is because the income tax basis of the person receiving the property depends on whether the transfer is by gift or at death. This, in turn, affects the amount of taxable gain subject to income tax when the person sells the property.

What is income tax basis?

Income tax basis is the base figure you use when determining whether you have recognized capital gain or loss on the sale of property for income tax purposes. (Gain or loss on the sale of property equals the difference between your adjusted tax basis and the amount you realize upon the sale of the property.) When you purchase property, your basis is generally equal to the purchase price. However, there may be some adjustments made to basis.

What is the income tax basis for property you receive by gift?

When you receive a gift, you generally take the donor's basis in the property. (This is often referred to as a "carryover" or "transferred" basis.) The carried-over basis is increased--but not above fair market value (FMV)--by any gift tax paid that is attributable to appreciation in value of the gift (appreciation is equal to the excess of FMV over the donor's basis in the gift immediately before the gift). However, for purpose of determining loss on a subsequent sale, the carried-over basis cannot exceed the FMV of the property at the time of the gift.

***Example:** Say your father gives you stock worth $1,000. He purchased the stock for $500. Assume the gift incurs no gift tax. Your basis in the stock, for the purpose of determining gain on the sale of the stock, is $500. If you sold the stock for $1,000, you would have gain of $500 ($1,000 received minus $500 basis).*

Now assume that the stock is only worth $200 at the time of the gift and you sell it for $200. Your basis in the stock, for purpose of determining gain on the sale of the stock, is still $500; but your basis for purpose of determining loss is $200. You do not pay tax on the sale of the stock. You do not recognize a loss either. In this case, your father should have sold the stock (and recognized the loss of $300--his basis of $500 minus $200 received) and then transferred the sales proceeds to you as a gift. (You are not permitted to transfer losses.)

What is the income tax basis for property you inherit?

When you inherit property, you generally receive an initial basis in property equal to the property's FMV. The FMV is established on the date of death or on an alternate valuation date six months after death. This is often referred to as a "stepped-up basis," since basis is typically stepped up to FMV. However, basis can also be "stepped down" to FMV.

***Example:** Say your mother leaves you stock worth $1,000 at her death. She purchased the stock for $500. Your basis in the stock is a stepped-up basis of $1,000. If you sold the stock for $1,000, you would have no gain ($1,000 received minus $1,000 basis).*

Now assume that the stock is only worth $200 at the time of your mother's death. Your basis in the stock is a stepped-down basis of $200. If you sold the stock for more than $200, you would have gain.

Make gift now or transfer at death?

As the following example shows, income tax basis can be important when deciding whether to make gifts now or transfer property at your death.

***Example:** You purchased land for $25,000. It is now worth $250,000. You give the property to your child (assume the gift incurs no gift tax), who then has a tax basis of $25,000. If your child sells the land for $250,000, your child would have taxable gain of $225,000 ($250,000 sales proceeds minus $25,000 basis).*

If, instead, you kept the land and transferred it to your child at your death when the land is worth $250,000, your child would have a tax basis of $250,000. If your child sells the land for $250,000, your child would have no taxable gain ($250,000 sales proceeds minus $250,000 basis).

In addition to income tax basis, you might consider the following questions:

- Will making gifts reduce your combined gift and estate taxes? For example, future appreciation on gifted property is removed from your gross estate for federal estate tax purposes.
- Does the recipient need a gift now or can it wait? How long would a recipient have to wait until your death?
- What are the marginal income tax rates of you and the recipient?
- Do you have other property or cash that you could give?
- Can you afford to make a gift now?

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What return are you really earning on your money?

If you're like most people, you probably want to know what return you might expect before you invest. But to translate a given rate of return into actual income or growth potential, you'll need to understand the difference between nominal return and real return, and how that difference can affect your ability to achieve financial goals.

Let's say you have a certificate of deposit (CD) that's about to expire. The yield on the new five-year CD you're considering is 1.5%. It's not great, you think, but it's better than the 0.85% offered by a five-year Treasury note.*

But that 1.5% is the CD's nominal rate of return; it doesn't account for inflation or taxes. If you're taxed at the 28% federal income tax rate, roughly 0.42% of that 1.5% will be gobbled up by federal taxes on the interest. Okay, you say, that still leaves an interest rate of 1.08%; at least you're earning something.

However, you've also got to consider the purchasing power of the interest that the CD pays. Even though inflation is relatively low today, it can still affect your purchasing power, especially over time. Consumer prices have gone up by roughly 1% over the past year.**

Adjust your 1.08% after-tax return for inflation, and suddenly you're barely breaking even on your investment.

What's left after the impact of inflation and taxes is called your real return, because that's what you're really earning in actual purchasing power. If the nominal return on an investment is low enough, the real return can actually be negative, depending on your tax bracket and the inflation rate over time. Though this hypothetical example doesn't represent the performance of any actual investment, it illustrates the importance of understanding what you're really earning.

In some cases, the security an investment offers may be important enough that you're essentially willing to pay someone to keep your money safe. For example, Treasury yields have sometimes been negative when people worried more about protecting their principal than about their real return. However, you should understand the cost of such a decision.

*Source: Department of the Treasury Resource Center (www.treasury.gov) as of April 2013.

**Source: Bureau of Labor Statistics, Consumer Price Index as of April 2013.

Will interest rates rise this year?

The Fed hasn't yet raised its target interest rate from less than 0.25%, and it has promised not to do so before unemployment reaches roughly 6.5%, which it doesn't expect to happen until next year. However, some interest rates have already begun to go up. For example, according to Freddie Mac, the average interest rate on a 30-year fixed-rate mortgage shot above 4% last June for the first time since late 2011, hitting its highest level in almost 2 years. In the same month, the yield on the 10-year Treasury bond went above 2.5% for the first time since August 2011.

Why are interest rates rising even though the Fed's target rate hasn't? Because bond investors are concerned that higher interest rates in the future will hurt the value of bonds that pay today's lower rates. Immediately after the Fed's June announcement, investors began pulling money out of bond mutual funds in droves, reversing a multiyear trend. If there's less demand for bonds, yields have to rise to attract investors.

Aside from bonds, why are investors concerned about a possible Fed rate hike? Bonds aren't the only financial asset that can be affected by potential future interest rate changes. Dividend-paying stocks with hefty yields have benefitted in recent years; more competitive bond yields could start to reverse that dynamic. Shares of preferred stock typically behave much like those of bonds, since their dividend payments also are fixed; their values could be affected as well.

Also, higher mortgage rates could potentially slow the housing market recovery, though historically they remain at relatively low levels. And if a Fed rate increase were to bring on higher interest rates abroad, that could create even more problems in countries already struggling with sovereign debt--problems that have provoked global market volatility in the past.

The Fed has said any hikes in its target rate will occur only if the economy seems strong enough. If higher rates seem likely to halt the recovery, the Fed could postpone a rate hike even longer. It also will take other measures before raising rates. Even though the timing and size of any Fed action is uncertain, it's best to be aware of its potential impact.