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Objective Advice On The Road Of Life

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Financial Planning Issues For Retirees With No Kids

If you're a retiree or pre-retiree with no children, you may not be very worried about an estate plan. You may just plan on spending everything you've got. But retirees without kids—known as RINKs, for retired, independent, with no kids—still need financial planning. RINKs have all the same planning concerns as retirees with children, except RINKs in their later years can't count on offspring for any help.

As a RINK, because you haven't been encumbered with the costs of raising children, you likely have been able to save more, and may have a large retirement portfolio. A conservative wealth preservation plan might seem to be all you'll need as you gradually draw down your nest egg. But in reality things may not be quite so simple.

Though RINKs often assume they'll need less retirement income than other retirees, they could end up needing more. You'll have to pay for things some people get free from children who live nearby—such as transportation to and from doctors' appointments and help mowing the lawn. Moreover, you may have developed more expensive tastes than those whose budgets were always stretched thin

by the cost of raising children. In addition, since you may not have a safety-net—children who can care for you—you may feel the need to keep a larger nest egg than retirees with children.

Just how much of a nest egg you need for retirement depends on your lifestyle and age. You'll require enough

of a nest egg to meet all of your expenses without running out of money through your mid-80s or perhaps your 90s, depending on your family history and preferences.

One mistake RINKs sometimes make is investing too conservatively, sticking with fixed-income securities. Though such investments may avoid the fluctuations of the stock market, historically they have provided lower returns and have been outpaced by inflation, leaving you with less buying power as the years pass.

It's usually wise for RINKs to consider a broadly diversified portfolio that includes stocks as well as bonds and cash. For example, consider the case of John and Jane Jones, a fictional couple. They retired with the bulk of their assets in a 401(k) plan that didn't have many investment choices. Since the Jones' were risk-averse, they left the bulk of their 401(k) in the plan's most conservative fixed-income options. What's the problem with that?

The broad stock market, as measured by the Russell 3000 stock index, gained 7.2% annually during the five years ended December 31, 2006, while the Lehman Bros. Government Bond Index gained just 4.6% annually.* That substantial difference in returns between stocks and fixed-income securities was magnified by the effect of compounding.

There are never any guarantees when you invest in stocks, and just because stocks in the past performed well does not mean they will continue to do so. In

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Smarter Spam Abounds, But Don't Fall For It

Even with anti-spam software on your computer and your e-mail server, spam still gets through. And there's more of it. Spam volume climbed 30% in 2006 and was estimated to account for more than 50% of all e-mails being sent, according to Symantec Corp, a Cupertino, California company that makes anti-spam software.

Spammers now outsmart anti-spam systems with new tricks. Instead of sending emails with text, which can be filtered out automatically by email server-based systems, they send emails containing pictures with words embedded in the images. This clever new form of spam now runs rampant across the Internet and floods email systems.

The proliferation of new spam techniques has been accompanied by solicitations for many new products. Most disturbing perhaps is the proliferation of stock-related spam, offering investors "the chance of a lifetime."

An Oxford University professor, Jonathan Zittrain, and a Purdue University assistant professor, Laura Frieder, recently studied spam stock schemes and reached a surprising conclusion: they work. Spammers often make a 5% to 6% return in just days. Meanwhile suckers who buy the stock—and some inevitably do—lose 7% of their investment.

A bit of advice: While you probably can't avoid receiving some spam, don't make matters worse by responding to these offers. If you get spam email that you think is deceptive, forward it to spam@uce.gov, and investment scam spam can be reported to enforcement@sec.gov.

A Skeptical View Of Variable Annuities

Variable annuities (VAs) soared from obscurity a decade ago to have \$1.3 trillion in total assets in late 2006, according to the National Association for Variable Annuities. However, many skeptics say VAs are popular not because they're great for investors, but because they're usually great for the people selling them. VAs are often laden with punishing fees that can drain the value of your account.

VAs are not all bad. Indeed, some individuals can benefit from a VA. It provides tax-deferral for investments, just as a 401(k) or IRA does. Unlike an IRA, there's no limit on contributions and no mandatory withdrawals. You can put your money in a wide range of professionally managed subaccounts, very much like mutual funds. And if you happen to lose money and die while the account is down, your beneficiaries could receive a death benefit. In addition, many VAs offer a "living benefit" rider that promises minimum lifetime income regardless of investment performance. With all these benefits, VAs make for a great sales pitch, and that makes it especially important to be aware of the drawbacks.

Bells and whistles can make a VA seem complicated, but the basic structure is simple. An insurance component provides a benefit upon your death and allows a VA its tax-deferred status under

U.S. tax law. You decide how you want your account invested, dividing money among a menu of mutual fund-like subaccounts. Like other tax-deferred accounts, VAs permit penalty-free withdrawals after age 59½. Before that, there's a 10% tax penalty on your policy earnings. All withdrawals of earnings, whenever they're made, are taxed as regular income.



The biggest problem with VAs is that fees tend to be extremely high. They impose insurance and administrative expenses on top of management fees for the subaccounts. Fees can be in excess of 2% of your assets annually. There may also be annual contract charges and sales loads on investment subaccounts.

Meanwhile, the death benefit isn't likely to be much. There are scenarios in which it would be valuable—for example, if you died shortly after making a large investment and the market had dropped sharply. But that just doesn't

happen very often. According to LIMRA International, an insurance research group, only three of every 1,000 VA contracts are surrendered because of death or disability.

Taxes are another shortcoming. When money comes out, it is taxed as income at rates of up to 35%. Compare that with the top rate of 15% on most long-term capital gains and qualified dividends in taxable accounts. Several states also impose additional taxes on VAs. And while the tax advantage for mutual funds may be partially offset by tax-deferred compounding within a VA, it could take many years of tax-deferral for a VA to come out ahead.

There's also the tax treatment of inherited VAs. Heirs, like any other account owner, are subject to tax at income rates on withdrawals. In contrast, the tax basis of an inherited mutual fund is stepped up to its value when it passes to your heirs, so that gains you earned during your lifetime aren't taxed at all.

The final indignity? If you experience buyer's remorse after purchasing a VA, you'll probably have to pay a surrender charge of as much as 7% to get your money back. While VAs may be right in some circumstances, we are here to serve as your trusted advisor in evaluating such sales pitches. ●

Tax Law Now Allows Those Inheriting Retirement Plan Assets

Most 401(k)s and other employer-sponsored retirement plans are bequeathed to spouses, and with good reason. Until a recent change in rules, only a spouse could inherit a retirement plan other than an IRA and avoid immediate taxes. Now, although the process must be handled carefully, any beneficiary should be able to receive a retirement plan and enjoy the same tax-postponing benefits that a husband or wife always could.

Under the old rules, if your husband got the money, fine; he could roll over the windfall into his own IRA and make withdrawals over the course of his expected lifespan. Though each year's

required distribution would add to his taxable income, the rest of the account would continue to compound, and there might be a sizable balance left at his death.

But your daughter? Most employer plans require an account to be emptied within five years of an employee's death. She would have had to take the money and, not being allowed to move it into an IRA, would have been stuck paying income tax immediately—and likely would have lost a third or more of her inheritance to taxes in the process.

The new rules are much kinder to non-spouse beneficiaries. Now, should you choose to leave your 401(k) to a

child, a same-sex partner, or anyone else, that person may roll over the inherited plan to an IRA. But the law is prickly about the process. To make a successful rollover, your heir must:

- Open an inherited IRA to take the money. A spouse who inherits a 401(k) can merge the account with her own IRA, but others must set up a new account specifically created to receive funds transferred from the deceased's retirement plan.

- Be sure to title the new account correctly. For instance, Dad IRA (Deceased) FBO Daughter.

- Make sure the money goes directly from the company plan to the

Coordinating A Couple's Retirement Plans

Back in the days of Ozzie and Harriet, retirement decisions were simple: the husband's retirement plans were the couple's retirement plans. Today, you and your spouse may both work, and retirement timing and coordination is a challenge. While leaving the work force at more or less the same time may seem ideal, issues of age, health, job satisfaction, and pension and other employment benefits can make that tough to pull off.

For most couples, joint retirement decisions mean weighing the benefits of having more leisure time to spend with each other against the cost of one or both of you leaving work. That can be difficult to gauge, particularly when spouses are different ages, work for different employers, and face conflicting retirement incentives. Richard W. Johnson, a researcher for the Center for Retirement Research at Boston College, cites the example of a couple in which the husband has a company-sponsored retirement plan that lets him retire at age 62. His

wife is three years younger, and the retirement age in her employer's plan is 65. For the husband, retiring at 62 may be financially beneficial. Yet by the same token, if the wife waits until her financially optimum retirement date, she could end up working six years longer than

spouses is thinking about retiring before age 65, when Medicare coverage begins. For example, consider what would happen if our couple went ahead and retired when he was 62 and she was 59. Assuming both had health coverage at work but neither had retiree

health benefits—an increasingly common situation, according to Johnson—for three years, until the husband reached Medicare age, they would both need to buy private, non-group insurance. That tends to be prohibitively expensive, and she would continue to need coverage for an additional three years after her husband qualified for Medicare. They



her husband, giving away a substantial portion of the time they could have spent together during retirement.

Health insurance coverage may be another sticking point, particularly when one or both

would be much better off financially if she kept her job and benefits.

There are also questions of job satisfaction and health. Many people today choose to keep working past normal retirement age, at least in part because they enjoy what they do. Yet when both spouses have jobs, one may love going to work every day while the other is counting the days until retirement. Meanwhile, health problems may force the issue, pushing a spouse into retirement regardless of financial consequences.

Still, despite all of these issues, in about half of all couples, both spouses manage to retire within two years of each other, according to Johnson's calculations, and for two-thirds of couples, it happens within four years. Give us a call if you and your spouse would like to review your retirement plans and make sure you're on track to retire on your own terms. ●

To Retain Tax Deferral Much Longer

heir's new IRA. If your beneficiary touches the money, he or she will be immediately taxed.

Keep in mind that it doesn't matter when the account owner dies as long as the beneficiary postpones the rollover until 2007. So if the account owner died in 2006, an heir can benefit from the new rules as long as the rollover is made in 2007.

If you've ever changed jobs, you may already have transferred retirement funds from your former employer to an IRA. Until the rules changed, that was the only way to ensure favorable tax treatment for a non-spousal heir. And even now, a rollover

is often advisable. IRAs tend to offer a wider range of investment options than you get in a typical 401(k), and it's easier to monitor investments in a single account.

There is at least one advantage to keeping money in a 401(k), however. If you retire after age 55, you may begin taking distributions from an employer plan without incurring the 10% early withdrawal penalty you would owe for withdrawing assets from an IRA before age 59½. Under the new rules, you can have the penalty-free early access of a 401(k) while also accommodating non-spousal heirs. ●

Why To Consider Selling Assets Before 2011

If you're wavering about whether to sell your grandmother's home or an investment that may still be gaining value, now you can take your time making the decision. Congress recently extended the 15% maximum tax rate on long-term capital gains, a move that is expected to bring a total of \$149.7 billion in tax savings to investors. The provision had been set to expire at the end of 2008, but now will remain in effect through 2010.

A long-term capital gain is the profit you earn selling an asset you own for at least one year. If, for instance, you purchased stock for \$1,000 and sold it years later for \$1,000,000, taxes are calculated based on a \$999,000 gain. Until 2003, you'd have owed Uncle Sam as much as 20%—\$199,800 in this example. At a 15% rate, you pocket an extra \$49,950, owing taxes of only \$149,850.

Homeowners who sell enjoy an additional tax break. You can exclude from capital gains up to \$250,000 (\$500,000 for married couples) of profit on the sale of your home. To qualify, your home must have been your principal residence for at least two of

the five years prior to the sale.

What about assets I own for less than a year? When you sell these "short-term" assets, profits are taxed as ordinary income, at a rate of up to 35%. The same rule applies to collectibles such as coins or art

An extension of lower tax rates on long-term capital gains could save taxpayers a total of \$149.7 billion

regardless of how long you own them.

What if I lose money on a sale?

Losses on the sale of long-term assets can offset capital gains, plus you can deduct up to \$3,000 in losses from your income each year. Excess losses can be carried forward to future tax returns.

Things may get trickier if you sell inherited assets. Currently, the

value of assets you inherit is stepped up to the market value at the death of their owner. When you sell, you're taxed only on profits exceeding what the assets were worth when you received them. For example, if your Uncle leaves you \$5 million in stock for which he originally paid \$100,000, you're taxed only on sale proceeds exceeding \$5 million.

But that tax break ends in 2010, along with the estate tax. If you inherit and sell assets that year, your tax bill will take into account the assets' purchase price. But inheritors will be able to increase the tax basis of total inherited assets by a maximum of \$1.3 million. (Surviving spouses can further inflate the basis by up to \$3 million.) So if you inherit that \$5 million stock your uncle purchased for \$100,000, your capital gains will be based on a new tax basis of \$1.4 million (\$100,000 original basis + \$1,300,000 step-up).

If you've hesitated to sell certain assets whose value may still be rising, remember to factor in the new rules on capital gains, which could affect your ultimate tax bill. ●

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In addition, anyone who remembers the bursting of the technology bubble in 2000, and subsequent plunge in the stock market, is sure to be a bit hesitant about investing in stocks, especially a risk-averse RINK. However, avoiding stocks altogether has historically been a mistake when you are planning to invest over a long period of 10 or 15 years.

Another consideration for RINKS is rolling their 401(k) assets into an IRA. Often, 401(k) plans offered by employers do not offer a broad array of investment options. Without triggering a taxable event, you can roll plan assets into an IRA, which offers a new universe of investments covering the full spectrum of asset classes.

RINKS may also want to consider long-term care insurance, which can cover the high cost of a stay in a nursing home or nursing care at home. Many RINKS assume they'll take care of each other, but you can't depend on that. If something happens to both spouses, there are no children to provide care or help pay for it. LTC insurance can offer a safety net and provide psychological comfort, but you must carefully choose your insurer and the type of coverage.

RINKS should also consider whether to consult an attorney to draw up documents in case they become mentally or physically incapacitated. A limited power of attorney can be granted to a friend or relative to take care of your financial affairs if you become incapable of doing it yourself.

You may also want to draw up a living will or health care proxy empowering someone you trust to make decisions about your medical care in the event you are unable to do so yourself.

Finally, estate planning is also important, even if you plan to spend all you're worth. There may well be something left when you and your spouse die, and proper planning can ensure it goes, not to the government, but to a favorite charity, relatives, or any other recipient. ●

*The Russell 3000 Index is an unmanaged index of the largest 3,000 U.S. publicly-held companies by market capitalization, representing approximately 98% of the U.S. market. The Lehman Brothers Government Bond Index is unmanaged and is composed of the Treasury and Agency Bond Indices, the 1-3 year Government Index and the 20+ year Treasury Index. An individual cannot invest directly in an index. Your return may be worse than an index's.