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Take the Long View for a Successful Retirement

You have worked a lifetime to reach the point when you can retire. However, retirement planning does not end when retirement begins. What you do next, and how you navigate the array of tax issues and regulatory pitfalls, can make a big difference in the long-term success of your retirement plan. Here's a brief review of some of the more "taxing" issues you may encounter:

- **Early retirement and early withdrawals.** For many, early retirement represents a lifelong dream. However, there is one issue you should keep in mind. If you take withdrawals from your qualified plan assets before age 59½, you may be subject to a 10% federal income tax penalty. To avoid this penalty, you can elect to take your annual withdrawals in a series of substantially equal periodic payments. The payments must continue for at least five years, or until you reach age 59½, whichever comes later.

There are a few circumstances in which early withdrawals may be taken without penalty (e.g., death and disability). At 10% the penalty tax can be significant, and prevention should be planned whenever possible.

- **Waiting too long.** You must begin taking required minimum distributions from your traditional Individual Retirement Account (IRA) by April 1st of the year after you reach age 70½. (Distributions from an employer-sponsored qualified plan can be postponed until retirement if you continue working past age 70½, provided you are not an owner-employee.)

If you ignore the required minimum distributions, or do not take out enough from your IRA, you will be subject to a 50% penalty tax. The tax will be incurred on the difference between what you *should* have taken out of your IRA and the *actual* amount you withdrew from your IRA. Your minimum withdrawal amount will be based on the previous December 31st balance, divided by your life expectancy (or the joint expectancy of you and your spouse, if applicable).

- **Working while receiving Social Security.** If you receive Social Security and also continue to work, a portion of your benefits may be taxable. For more information, you can refer to Internal Revenue Service (IRS) Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*, or consult with your tax professional.

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A Short Course in Insurance: Term vs. Permanent

When faced with the wide range of **life insurance** coverage available, you may wonder which type is best suited to your needs. As the years go by, it will be important to review and update your plans, as you will likely find that your coverage needs will evolve with your changing life goals. There are two basic types of coverage—**permanent** (sometimes referred to as **cash value**) and **term life insurance**. A closer look can illustrate the short-and long-term benefits that each provides.

Permanent Life Insurance—Value for Your Dollar

Permanent life insurance not only helps provide financial security for



surviving loved ones at the death of the insured, but it also serves as a “living” savings vehicle for the policyholder. Premium payments first pay the cost of the policy coverage itself. Then the insurance company, in order to build the cash values of the policy, invests the “leftover” dollars. Permanent insurance links protection with savings, as assets and earnings accumulate throughout the life of the

policy, which the policyholder can access for any purpose.

Some permanent policies provide policyholders with annual **dividends**, which are not guaranteed. These dividends are the result of higher investment returns and lower expenses than were originally predicted when premium amounts were set. Dividends can be used in many ways, including as a means of paying future premiums, and they can even be reinvested into the policy to generate additional cash values.

Premium amounts owed are contractually guaranteed and will not change as long as premiums are paid in accordance with the schedule set forth in the policy. Payments may continue for a predetermined period chosen by the policyholder, typically ranging anywhere from ten years after the date of purchase to the number of years until a person reaches age 100. The length of the payment period and the amount of coverage will affect the premium cost. Permanent life insurance protection is guaranteed. As long as premiums are paid, the insured is guaranteed coverage for life in accordance with the terms of the policy. Evidence of insurability will never be necessary as long as the original policy remains in force, and benefits will never decrease.

Another feature to consider is its value as a “creditor.” Funds may be borrowed against the cash value of the policy at a predetermined loan interest rate. Loan approval comes from the insurer, but it is generally granted. No repayment schedule is set beyond regular payment of interest on the loan, with outstanding loan balances deducted from the death benefit. These loans are generally tax free, and there are no restrictions on their use.

Term Insurance—Pure Protection for Your Dollar

In a term insurance policy, there are three basics to consider: first, the period of protection is for a predetermined, specified term; second, policies do not accumulate cash values like permanent insurance; and third, premiums may initially be substantially lower than cash value premiums.

Nonrenewable, nonconvertible term insurance for one, five, or ten years may provide the most inexpensive protection available, and this option may be advantageous for those who want to be covered while their children are underage, to back a business loan, etc. Premiums will, however, increase over the period of protection. Term insurance is also available for longer durations (e.g., to age 95), but increasing premiums may result in higher overall costs than permanent insurance in the long term.

Term insurance may be ideal to help cover a specific need, such as an outstanding mortgage. These goals can be met by purchasing coverage for a specified period of time and at the lowest premium outlay. In fact, many companies offer decreasing term insurance in which the death benefit proceeds diminish over time (for instance, to cover a decreasing mortgage balance).

Which Product When?

A thorough review of your insurance needs can help you choose the right policy for *your* individual situation. It is important to determine the short-term and/or long-term nature of your needs, your current cash position, and the coverage you can afford. ■

Preserving Your Legacy with a Solid Estate Plan

Watching a house under construction offers a fascinating, learning experience. Each element builds on the next, working up from the foundation to the floors, walls, and finally, the roof—until the building is safe from the elements and provides security for a family. Constructing an estate plan is a similar process. If you “construct” your estate on a solid foundation, according to a well-designed plan, it can securely “shelter” your loved ones for the future.

Just as all house styles do not suit all families, neither do all estate plans. A “one size fits all” approach to estate planning should be avoided. Your estate plan should be customized to fit *your* specific needs and those of your spouse, your family, and, if applicable, your business.

A solid estate plan should, among other things, specify and provide for the distribution of your property after your death, provide for the care and financial security of your dependents, and include sufficient funds to help pay for final expenses and estate taxes. A major part of any estate plan is a strategy to minimize or reduce the estate tax burden.

Minimizing Estate Taxes

Many couples are familiar with the **unlimited marital deduction**, which allows the spouse who dies first to leave his or her estate to the surviving spouse free of estate taxes. However, a married couple with assets exceeding \$2,000,000 may face a sizeable estate tax liability.

This is because each individual's assets above the \$2,000,000 **applicable exclusion amount** (in 2008) are subject to estate taxes. (Note: The applicable exclusion amount will

increase to \$3.5 million in 2009. Federal estate taxes are currently scheduled for repeal in 2010, but will be reinstated in 2011 without further legislation from Congress.) Without a proper estate plan in place, the first spouse to die may be unable to use his or her respective applicable exclusion amount.

A number of estate planning techniques, including credit shelter provisions in a will and trusts, could be used, depending on the circumstances, to take advantage of both spouses' applicable exclusion amounts. To illustrate, let's consider the hypothetical case of Fred and Melanie Moore, whose combined assets total



\$4,000,000. Fred's estate is worth \$2,800,000, while Melanie's is worth \$1,200,000. Due to the unlimited marital deduction, if Fred dies first (in 2008), his assets will automatically pass to Melanie free of estate taxes.

Melanie's estate will then be worth \$4,000,000 (Fred's \$2,800,000 plus her \$1,200,000). However, at Melanie's death (also in 2008), the maximum amount she may transfer to their surviving children free of estate taxes is \$2,000,000 (her applicable exclusion amount). The remaining amount of assets over the applicable exclusion amount (\$2,000,000 in 2008) will be subject to estate taxes, which can be as high as 45%. This tax can take a sizable chunk out of

an estate, unwittingly making Uncle Sam a significant beneficiary.

However, if Fred had a properly structured trust (which must be established while he is still alive), he could place his entire \$2,800,000 estate into the trust. (This would require retitling his assets to be owned by the trust.) At his death, Fred's trust would be able to fully utilize his \$2,000,000 applicable exclusion amount. This \$2,000,000 would still be available to Melanie for income and support and would ultimately pass to her children free of estate taxes.

Fred's remaining \$800,000 (his original \$2,800,000 estate minus the \$2,000,000 used to offset the applicable exclusion amount) would pass directly to Melanie at his death. This would leave her with a total estate worth \$2,000,000 (her original \$1,200,000 plus the \$800,000 Fred left her). At Melanie's death, her \$2,000,000 applicable exclusion amount will allow her to pass her entire estate to her surviving children free of estate taxes. In this case, proper planning can allow the Moores to pass their entire combined estate of \$4,000,000 to their children free of federal estate taxes.

This estate planning technique may enable a couple to use both of their applicable exclusion amounts, and it is just one example of how a solid estate plan can help you and your family. Just as you would consult a contractor when building your house, it is important to consult your experienced legal, financial, and tax professionals to help ensure your estate plan is appropriate for your circumstances and will achieve your objectives. With a well-constructed estate plan, you can rest easier knowing you have done all you can to preserve your financial legacy. ■

take the long view for a successful retirement

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You may also be subject to the so-called Social Security “give-back.” Recent tax law changes eliminated the “give-back” for working Social Security income recipients who have attained **full retirement age** (age 65 to 67, depending on the year you were born).

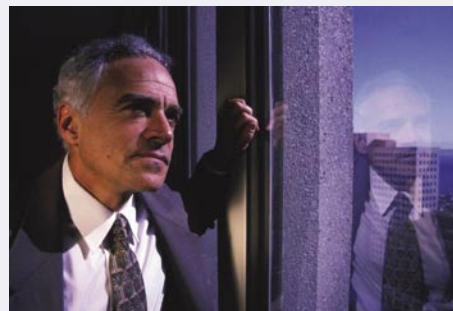
Previously, the law required Social Security income recipients between the ages of 65 and 69 to return \$1 for every \$3 earned in excess of a predetermined earnings limit. Now, the law requires a give-back of \$1 for every \$2 earned above \$13,560 (in 2008) for individuals who are between the ages of 62 and 64 and are receiving a reduced Social Security benefit. For the year in which an individual attains full retirement age, the give-back is

\$1 for every \$3 earned in excess of \$36,120 for 2008. The month in which the individual attains full retirement age, the give-back is eliminated. Therefore, it is important for anyone who is thinking about taking Social Security benefits while still working to understand the potential tax consequences and to plan accordingly.

- **Where you live can make a difference.** Some important tax issues must be addressed when you select your retirement haven. Each state has its own rules on income, estate, sales, and property taxation. Your accountant can help you become familiar with the tax advantages and disadvantages of your retirement destination.

Planning Doesn't End When Retirement Begins

Your personal retirement plan most likely involved building a nest egg with regular savings over the years. However, once you reach retirement, your planning should continue. You will always benefit from maintaining a savings plan consistent with your changing goals and objectives. ■



Which Came First, Basis or Gain?

At some point, we've all contemplated the paradox about the “chicken and the egg.” But, what about **basis** and **gain**? You probably know that when you sell a certain asset for a profit, you will be required to pay **capital gains tax**. But, you may be interested in knowing that *how you acquired* the property and *what you have done with it* since acquisition will affect the determination of “basis” and, ultimately, the “gain” on which the tax is paid.

Basis is the starting point for determining gain upon the disposition of any asset. In its simplest form, basis is an owner's investment in the asset. For purchased property, starting basis is the *original* price paid. Basis can be *increased* (e.g., by making improvements to real property) or *decreased* (e.g., after a casualty loss reduces the value of an asset), and it can change according to how it was acquired and the nature of the eventual disposition.

For example, suppose you gift some appreciated stock to your child. Your child will assume your original basis in the stock. On the other hand, let's say your child receives the same appreciated stock as part of his or her inheritance. In this case, the basis is adjusted to the **fair market value (FMV)** of the stock at the time of your death. This is commonly referred to as a “step-up” in basis. ■

The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any Federal tax penalties. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.