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A Trust Primer

Many people perceive **trusts** as a complex subject better left to their attorney. When stripped of all its “bells and whistles,” however, a trust can be viewed simply as a contract wherein a grantor agrees to transfer assets to a beneficiary, or multiple **beneficiaries**, who then receives the assets as stipulated in the contract. A **trustee**, who may or may not be the grantor, manages the trust assets and ensures the stipulated terms of the trust are faithfully carried out.

With an understanding of these fundamental trust building blocks, you can begin to see that trusts are simply very powerful tools designed to help individuals handle a variety of family and tax-related issues. The following list will give you an idea of a few ways in which trusts can be put to work:

Revocable Living Trust

A revocable living trust is an estate planning trust that deeds property to heirs but permits the grantor to retain control over the property during his or her lifetime. Upon the grantor’s death, the property passes to the beneficiaries avoiding

probate, which is the judicial process wherein a court appoints an executor to carry out the provisions of a will. Many people who have had firsthand experience with the expense, delay, and publicity of probate have sworn never to allow their estate to undergo that process. While the



revocable living trust does not provide tax savings for the grantor during his or her lifetime, the trust becomes “irrevocable” upon his or her death, and the beneficiaries are thus entitled to the tax advantages an irrevocable trust receives.

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Trimming Your Taxes While Saving for Retirement

Contributing to tax-advantaged retirement plans is one of the most effective planning strategies available to U.S. taxpayers: Saving money in a 401(k), IRA, or a Roth account can cut your tax bill, while helping you prepare for the future. Even if you are already contributing to a retirement plan, you should re-view your retirement savings strategy regularly to ensure that you are making the most of the tax breaks for which you qualify.

When you contribute money to a traditional individual retirement account (IRA) or an employer-sponsored defined contribution plan, such as a 401(k) or a 403(b), the adjusted gross income (AGI) figure that is used to calculate your income tax liability is lowered by the amount saved. Depending upon your income and the amount contributed, depositing funds in an IRA or 401(k) can substantially reduce your tax bill. While taxes must be paid on distributions from these accounts, most savers come out ahead because they are in a lower marginal tax bracket in retirement than they are while working. Investment growth within these retirement plans is also tax deferred. Even savers whose marginal tax bracket is not lower in retirement usually benefit by allowing money they would otherwise have paid in taxes to grow over time.

The advantages of saving in tax advantaged retirement plans are clear, but selecting the types of accounts that are best for your individual circumstances may be less straightforward. If your company offers a 401(k) plan with matching contributions, start by having your employer deduct from your paycheck at least the amount necessary to take advantage of the full match. If the plan

allows it, consider contributing beyond the matching limit, up to the maximum of \$15,500 (\$20,500 for people age 50 and older) in 2008. Depending upon your income, you may also have the option of contributing to an IRA in addition to your workplace retirement plan.

People who do not have access to a retirement plan at work, either because they are self-employed or because their company does not offer one, have a number of options when choosing a tax-advantaged savings account. If you have earned income, you and your spouse may be eligible to each make pre-tax contributions of up to \$5,000 (\$6,000 for those over age 50) to an IRA in 2008. There are also a number of tax-advantaged defined contribution plans designed specifically for the self-employed or small business owners, including simplified employee pension (SEP) plans, SIMPLE IRAs, and owner-only 401(k) plans. These plans are relatively easy to set up and administer, and can help both owners and employees lower their taxes and build their retirement savings.

While they do not immediately reduce your taxable income, Roth IRAs and Roth 401(k)s can be useful

tax planning tools over the long term. The contribution limits for Roth savings vehicles are the same as for traditional IRAs and 401(k)s, but the contributions made to Roth accounts must be in after-tax dollars. Investment growth within Roth accounts is tax free, and no taxes are owed on qualifying withdrawals. Roth IRA eligibility phase-out ranges are \$101,000–\$116,000 for single filers, and \$159,000–\$169,000 for married filers.

Unlike retirement plans funded with pre-tax dollars, Roth accounts do not require savers to begin withdrawing funds after the age of 70½, making it easier to pass on a retirement nest egg to the next generation. A Roth savings plan may also be a good choice for people who do not expect to be in a lower marginal tax bracket in retirement, and wish to maximize their retirement income.

The ideal financial plan may involve contributing to a variety of different tax-advantaged retirement accounts. Because changes in your income or in tax law can affect your eligibility for some plans, be prepared to regularly review and adjust your tax and retirement planning strategies. ■



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Irrevocable Living Trust

An irrevocable living trust is an estate planning trust wherein the grantor does not retain control of assets or property; but through the transfer of assets or property into the trust, the grantor may be eligible for certain tax savings. An irrevocable living trust may also be used to avoid probate.

Irrevocable Life Insurance Trust (ILIT)

An irrevocable life insurance trust is a trust that seeks tax savings through the ownership of a life insurance policy. Assets in the trust are generally not considered part of the grantor's estate. ILITs may be either funded or unfunded. With a *funded* ILIT, income-generating assets are transferred into the trust, and the generated income is then used to pay the premiums on a life insurance policy. With an *unfunded* ILIT, the grantor makes yearly gifts to the trust, and this money is then used to pay the premiums on a life insurance policy.

Credit Shelter Trust

A credit shelter trust, also referred to as a bypass trust, is a popular estate planning tool used to protect assets from successive estate taxes. While current laws permit an unlim-

ited amount of assets and property to pass to a surviving spouse without being subject to federal estate taxes, children and other beneficiaries must pay taxes for inheritances valued in excess of \$2,000,000 in 2008. A



couple taking advantage of a credit shelter trust generally arranges for certain assets to pass into a trust for the benefit of a surviving spouse, rather than passing all assets directly to the spouse. This trust, which would not be considered part of the surviving spouse's estate—and generally does not exceed the \$2,000,000—may pay the surviving spouse income for life and then, upon his or her death, may pass to a beneficiary, such as a child, free of estate taxes if under the exclusion limit. In addition, the gross estate of the surviving spouse upon his or her death could also pass to the same beneficiary, and up to \$2,000,000 would be free of estate taxes.

Charitable Remainder Trust (CRT)

A charitable remainder trust can be a highly effective financial and estate planning tool. It can allow the grantor to avoid capital gains taxes on highly appreciated assets; receive an income stream based on the full **fair market value (FMV)** of those assets; receive an immediate charitable deduction; and ultimately, benefit the charity(ies) of his or her choice.

Dynasty Trust

This trust is often used by high net-worth individuals who want to pass their wealth to their grandchildren *free* of one of the most costly taxes in existence—the **generation-skipping transfer tax**.

Using a trust can be an excellent method of accomplishing your long-term estate planning goals. As these trusts may involve complicated tax laws, you should consult with your tax and legal professionals concerning your particular situation. The proper legal guidance can help you share your financial successes with family, friends, and charities, according to your wishes. ■

“Living Value”—The Other Side of Life Insurance

many people may think of **life insurance**—in its simplest form—as a means of securing funds to cover financial obli-

gations, such as a mortgage, or to replace income in the event of the death of a family breadwinner. It's no wonder that the **death benefit** under

a life insurance policy is often its most important and most well-understood feature.

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“living value”—the other side of life insurance

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However, not all policies are the same. With a **permanent life insurance** policy, there is typically a component that allows cash to accumulate, and it may be used to help supplement a number of financial objectives, such as additional retirement income or a child's education. Because permanent insurance may be used to supplement a savings program, it has a “living value” in addition to the traditional **death benefit** feature. Let's take a closer look.

The Value of Cash Value

The cash value in this type of life insurance policy accumulates on a tax-deferred basis. Because of this tax-deferred accumulation, there may be some income taxes due upon withdrawal. However, you are generally only taxed on amounts that exceed the *total* amount of premium payments you've made over the course of the policy's existence.

One of the key benefits of permanent life insurance is that you can access the accumulated cash values through policy loans without the worry of taxes or penalties. Generally, the loan interest rate is stated in the policy and is comparable to traditional lending rates. Bear in mind, any cash value that is not repaid will reduce the policy's death benefit amount (unless, of course,

the policy makes specific provisions to cover the policy loan at death, thus providing 100% of the death benefit).

Another interesting aspect of a permanent life insurance policy is that you may make premium payments well into your senior years, and there are no rules that stipulate you must begin mandatory withdrawals of cash values by an early age. This feature may provide you with an excellent opportunity to continue making premium payments and receiving the benefits of tax-deferred accumulation of cash values.

With a life insurance policy, there are rules that limit the size of premium payments. Simply stated—the higher the death benefit, the higher the premium. Some forms of permanent life insurance allow you to make premium payments in addition to what was stipulated under the terms of the policy.

Often, paying additional premiums may increase the cash value.

Care should be taken to avoid “overfunding” a life insurance policy, because that may lead to some adverse tax consequences. Generally speaking, however, policies are issued so they avoid this possibility altogether.



Dual Purpose Protection

Life insurance serves many purposes. Through its death benefit, life insurance aims to help protect and secure your family's future in the event you suffer an untimely death. At the same time, life insurance with a cash value component may provide you with the opportunity to use the benefits of your policy during your lifetime. In

this respect, life insurance can be a ready source of cash to help supplement an array of retirement needs. A review of your current coverage may help show you how permanent life insurance can fit into your overall retirement plans. ■

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.

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