Bob Carlson's

RETIREMENT WATCH

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Dear Reader:

Too often retirement planning doesn't pay attention to the big issues and big risks. Mitch Anthony, an advisor to financial advisors, summed these risks in the acronym L.I.V.E.

Longevity, believe it or not, is a risk. People underestimate how long they are likely to live or don't give it much thought. They plan for retirements of five to 10 years when the twenty to thirty year retirement is commonplace.

The duration of retirement dictates the rate at which you safely can spend money. A long retirement also increases the probability of expensive surprises, such as new cars, home repairs, medical care and long-term care.

A related risk is **inflation**. The long-term path of the general price level is upward. In retirement your income isn't likely to have automatic cost of living increases. Ensuring that your income keeps pace with the cost of living suddenly becomes a major issue.

Even modest 2% or 3% annual inflation over 15 years and longer has a dramatic effect. You'll need 20% or more income than you pull in today to have the same standard of living.

Volatility still isn't factored into many plans despite recent experience. While working, many people generally are aware the markets fluctuate, and the values of their portfolios change. But since they're not depending on their portfolios for income, it's not a major concern.

That changes as you approach or enter retirement. Stocks routinely give up half of their bull market gains in bear markets, and bear markets occur regularly. How will you react when your stock holdings decline 50% in a short term and the headlines are negative? Most investment plans assume a steady rate of return, but that doesn't happen in the real world.

The "E" stands for the catch-all of **events**. Things happen. A retirement plan is only a plan, because we can't predict the future. Either spouse could have serious and expensive health problems. A child might need financial help. The list of possible outside, uncontrollable events could go on and on.

Most of these risks can be minimized with planning. You can buy insurance for some. You can adjust your spending and investment strategies. But you need to recognize the risks, build some flexibility into your plan, and review the plan regularly. It's better to make small adjustments frequently instead of having to make a substantial and unsettling overhaul well into retirement.

"Following the best giving strategies is important whether you're in a position to give away $5 million or an amount with substantially fewer zeroes."

Wise Ways to Make Family Gifts

We're entering the traditional gift-giving season. The tax rules still are important. Too many people believe that with the estate tax exemption set at $5 million per person, they don't need to worry about shrewd, tax-wise ways to give wealth. (The exemption is indexed for inflation; it is $5.25 million in 2013.) They couldn't be more wrong.

Of course, Congress always can change the law, and your wealth could grow faster than expected and create a taxable estate. More importantly, paying attention to the income tax effects of gifts is critical. Giving the wrong way can cost your family a bundle in unnecessary taxes. Here's another point to keep in mind. Even when your gifts aren't taxable, you still are responsible for filing a gift tax return in many cases. See the box on page 2 for details.

Following the best giving strategies is important whether you're in a position to give away $5 million or an amount with substantially fewer zeroes.

The basics. Your lifetime gift tax exemption is the same amount as your lifetime estate

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tax exemption, $5 million indexed for inflation or $5.25 million in 2013. But each dollar of the lifetime gift tax exemption that you use reduces your estate tax exemption.

Not all gifts are potentially taxable or use the lifetime exemption. **The most important exemption for many people is the annual gift tax exclusion.** This also is indexed for inflation. In 2013 you can give up to $14,000 of cash or property per recipient and not have it count toward the lifetime exemption. A married couple can give up to $28,000 in joint gifts in 2013. You have a separate annual exemption for each person to whom you give. A married couple with three children can jointly give each of the kids $28,000 in 2013, or a total of $84,000, tax free and without reducing their lifetime exemptions. This exclusion starts fresh each year, though you can't carry forward unused amounts from previous years.

There also are opportunities to give unlimited tax-free gifts when you help someone with medical and education expenses. To qualify, you must pay the provider of the services directly. The medical expenses must meet the definition of deductible medical expenses. Qualified education expenses are tuition, books, fees, and related expenses but not room and board. You can find the detailed qualifications in IRS Publications 950 and the instructions to Form 709, all available free at www.irs.gov

Gifts that exceed the annual exclusion amount to a person begin to reduce the lifetime exemption. Only after the lifetime exemption is exhausted are gifts taxable.

Give early. The traditional gift-giving season is around the end of the year. That's partly because it is the holiday season and partly because it is the end of the calendar year and people are wrapping up their finances for the year.

I'm not discouraging you from making year-end gifts this year, but consider doing next year's giving earlier in the year. One advantage of early gifts is that any of the

When a Gift Tax Return is Required

Don't think making a tax free gift means a gift tax return isn't due. The general rule is you need to file a gift tax return for any gift that exceeds the annual gift tax exclusion ($14,000 per recipient in 2013). A gift that exceeds the annual exclusion either reduces your lifetime estate and gift tax exemption or is taxable. The IRS requires a gift tax return so that it can track both reductions in your lifetime exemption and lifetime gift taxes paid.

A few years back the IRS realized it could collect a lot of penalties and interest with better enforcement of the gif tax return requirements. It started programs to identify unfiled gift tax returns and impose penalties. For example, it obtains real estate title records from states and localities. It then uses those records to identify title transfers apparently made without compensation, and then sends letters to the original owner reminding them of gift tax reporting rules.

You also should consider filing a gift tax return when one isn't required if you transferred property without a readily-determinable market value or claimed a discount on a property's value. When a return is filed, there's a three year statute of limitations (seven years if the IRS thinks there was a significant understatement of value). But there's no statute of limitations when no return is filed. The IRS can come back years or decades later, argue that the property was undervalued, and impose a lot of penalties and interest on you or your estate. It's safer to file a return.

The gift tax return is Form 709. It and the instructions are available free at www.irs.gov.

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appreciation for the year is out of your estate. Also, by giving assets before they appreciate for the year, you are increasing the amount of property and future wealth you give tax-free. Suppose a mutual fund is priced at $20 per share on Jan. 15 and $25 on Dec. 31. With a $14,000 annual gift tax exclusion you can give a loved one 700 shares on Jan. 15 but only 560 on Dec. 31. When you compound the future appreciation of those shares over years, you moved a lot of future value out of your estate by giving early in the year.

Gifts early in the year also remove from your income tax return any income generated by the investment during the year. The whole family benefits when you use this strategy to shift income to a lower-tax-bracket family member.

An alternative is to make gifts of investment property during a market downturn instead of by the calendar. You probably think about making portfolio changes when the market moves, trying to buy low and sell high. Also consider making gifts after prices drop. You can give away far more shares of property when the price is down, so market panics are a good time to make gifts.

Give more. Most people want to give only the annual exclusion amount. But if you own appreciating assets, it makes sense to give more of them now to the extent you can live without them. Remember the lifetime estate and gift tax exemption is indexed only for the Consumer Price Index. If your assets are appreciating faster than that and your estate value is at or close to the lifetime exempt amount, you're losing ground. Eventually your estate will be more valuable than the exemption and the annual exclusion won't be enough to keep significant wealth from being taxed.

In those cases, it makes sense to use the exempt amount with gifts. Put appreciating assets in the hands of loved ones early. You don't have to give them direct control. Assets can be removed from your estate using trusts, limited partnerships, and other vehicles.

Give property you expect to appreciate. Too many people make cash gifts with their annual exclusion. When your goals are to establish a legacy, provide for loved ones, and reduce estate and gift taxes over the long-term, there's a better approach.

Give property you expect to appreciate over time. By giving the property now, you are removing all the future value from your estate tax free. You are transferring that future value to your loved ones. The appreciation and future value are what will provide financial security for them.

Cash is very likely to be spent, not invested. Giving appreciating assets might discourage some loved ones from selling them and spending the proceeds. As I said earlier, you can give through trusts, partnerships, and other vehicles to reduce the chance donees will sell the assets.

Retain property with big gains. Most of the time you don't want to give property in which you've earned big gains. When you give appreciated property, the recipient's tax basis is the same basis you had in the property. The recipient will owe capital gains taxes on all the appreciation that occurred during your lifetime when he or she sells it, because capital gains are paid on the price received for property minus its tax basis.

When the recipient is in the 0% capital gains tax bracket, the gift of appreciated property can be a good idea. Otherwise, it is better to hold the asset for your estate. The person who inherits it can increase the basis to the current fair market value. All the appreciation during your lifetime won't be subject to capital gains taxes.

Ideally, you want to give property you expect to appreciate but that hasn't appreciated substantially in your hands.

Keep loss property. It's almost always a mistake to give property that's declined below its tax basis. The donee's basis in the property would be the lower of the current value and your basis in it. So, when you give loss property, the donee's basis will be the current fair market value and no one will deduct the loss that occurred while you held it.

It's better for you to sell the property, deduct the loss on your tax return, and give the cash proceeds. Or find other property to give.

Consider income taxes. Fewer estates are subject to the estate tax, and income taxes are a bigger expense to many people. That's why you should consider income taxes and capital gains taxes in your giving strategies. Consider giving to loved ones assets that generate ordinary income that you don't need to maintain your standard of living, if those loved ones are in lower tax brackets. Reducing the income taxes that are extracted from you now will leave more wealth available to your loved ones.

When you make gifts to minors, pay attention to the Kiddie Tax. It was tightened a few years ago, so in more cases investment income earned by minors will be taxed at their parents' highest tax rate. Generally, the Kiddie Tax kicks in when a child's investment income exceeds $1,900 for the year and the child was

"The whole family benefits when you use this strategy to shift income to a lower-tax-bracket family member."

under age 19 (or under 24 if a full-time college student). It doesn't matter if the parents claim the child as a dependent. You can find details about the Kiddie Tax in IRS Publications 17 and 929 and in the instructions to Form 8615 available free at www.irs.gov.

Maximize trust gifts. A gift to a trust qualifies for the annual exemption if the gift is direct and immediate. To meet these requirements, the trust should have a *Crummey* clause, which gives the beneficiary the right to withdraw the gift from the trust. A beneficiary must be aware of the withdrawal right. The right to withdraw can expire after a period of time, such as 60 days. If the gift is not withdrawn in the time period, it stays in the trust and is subject to its limits. Of course, if a beneficiary does withdraw a gift from a trust, there is no obligation to make future gifts.

A gift to a trust with a valid *Crummey* clause qualifies for the annual gift tax exclusion. It removes the property from your estate, but it does not give the beneficiary unfettered control of and access to the wealth. Once the right to withdraw the gift expires, the property is subject to the terms of the trust. You can use trusts to remove property from your estate, provide income to beneficiaries, but impose some restrictions and professional management on the property.

Add contingent beneficiaries. The annual gift tax exemption amount can be contributed for each beneficiary of a trust. If there are three beneficiaries, $42,000 can be contributed tax free when the trust has a *Crummey* clause. Contingent beneficiaries also increase the tax free gifts when the trust is properly drafted. For example, your children can be the main beneficiaries of the trust and the grandchildren contingent beneficiaries. You can make gifts that qualify for the annual exclusion for each of the grandchildren. Your estate planner should know how the trust must be written for contingent beneficiaries to increase the annual exempt amount.

Make discounted gifts. A discounted gift is one in which the value of the property for tax purposes is less than the current value of the property. The value is discounted because there are some restrictions or defects that reduce the value to the beneficiary.

For example, you can transfer real estate or shares of a business to a limited partnership and give your children limited partnership interests. The value of the limited partnership interests will be less than a pro rate share of the property in the LP, because there isn't a ready market for the ownership interests and the limited partners are minority owners with restricted influence and control over management. Discounted values often are 20% or more, depending on the details of the arrangement.

Discounted gifts can be made through some trusts, limited partnerships, corporations, and other vehicles. Work with your estate planner to devise the best strategy for you. RW

"They want higher yields than can be earned in the safest investments, but they don't want their principal to decline if interest rates rise."

Guaranteed Returns, Lifetime Income

Most of those approaching retirement or in its early years share several goals. They want to avoid the volatility and periodic steep losses of the stock indexes. They want higher yields than can be earned in the safest investments, but they don't want their principal to decline if interest rates rise. Down the road they'd also like guaranteed lifetime income.

An impossible combination? No, it's not. If those are your goals, considering allocating part of your nest egg to a fixed index annuity.

A fixed index annuity is a deferred annuity. You contribute money to the annuity, usually in a lump sum, and don't plan to withdraw money for a while, usually at least five years. During the accumulation phase, the annuity earns a return. In a traditional fixed deferred annuity, the annual earnings rate is fixed by the insurer and usually is close to the intermediate bond yield. But in a fixed index annuity the account's yield is determined by the returns of one or more investment indexes that the insurer offers within the annuity.

These annuities usually have a guaranteed minimum annual return or at least a guarantee that they won't lose money. Furthermore, any previous gains can't be reduced due to a subsequent market downturn.

Let's take a look at a specific fixed index annuity that has a twist and is very attractive today.

Security Benefit's Total Value Annuity has high guarantees and a high income payout rate, and also has two valuable options from which you may choose (since these options are mutually exclusive, you may select only one). First, there's a guaranteed lifetime withdrawal benefit rider, that guarantees a lifetime stream of income (the income rider), and second,

there's a guaranteed minimum death benefit rider, which you would choose when your goal is to leave the funds to loved ones. I'm going to focus on the income rider, because it's an excellent vehicle for someone who wants to earn safe income for over five or more years and then plans to take a lifetime stream of income.

When you make a deposit to the annuity and select the income rider (which incurs an annual charge of 0.95% of the benefit base), you receive several benefits. You receive an immediate bonus on the account value (5% to 10% depending on your state of residence) and a bonus of up to 10% on the income rider amount.

In addition, you choose how the annual return on your account is calculated from four index options offered by the insurer. The first option is the traditional annual interest rate, which is determined by the insurer but with a minimum rate of 1% to 3% for the life of the annuity, depending on the state you live in.

A second option is based on the S&P 500, but really isn't an attractive option because of the way returns are computed and the 3.25% annual maximum earnings cap on the returns.

The two other options offer much more upside potential and are more attractive.

There's the Transparent Value Blended Index. This index is balanced between stocks and bonds, with the allocation changing with the markets. As one of the components becomes more volatile, it is reduced and the allocation to the other is reduced. The stock index used is the Transparent Value Large-Cap Defensive Index, and the bond index is the S&P 2-Year U.S. Treasury Note Futures Total Return Index.

The other index is the Annuity Linked Trader Vic Index (ALTVI). This is the only commodities-based index offered in these types of annuities, providing true guarantees, upside growth potential and inflation protection not available elsewhere. The index is based on 24 futures contracts spread among physical commodities, global currencies, and U.S. interest rates. This index also tends not to be correlated with stock and bond indexes.

You can choose how the annuity is allocated among the four different options. When you select one or more of the index options, your account increases in value when the index increases, but you are guaranteed there won't be a decline in your account if an index declines. Both your deposits and previously credited interest to your account won't be reduced if there's a subsequent decline in one or more of your selections. But for the Transparent Value Blended Index and Annuity Linked Total Value Index the no-loss guarantee applies only over a five-year period, and your returns are credited and fully vested only after five years.

The annuity has two separate values for you to track. The first is the account value, sometimes called "walk away money." This is the sum of your deposits in the annuity, plus the upfront bonus and interest earned from the performance your chosen Index. You're also guaranteed there won't be a loss at any time.

The higher value is the benefit base, and this is what's important when you select the income rider and plan to receive lifetime income from the annuity. This value is based on the interest from the investment options you selected plus an extra 4% per year that is stacked on top. The benefit base value assumes you'll take annual or monthly payouts from the annuity for life.

Let's look at how the numbers work out in an example. Suppose Max and Rosie Profits both are age 60 and deposit $100,000 in the annuity. They split the account evenly between the three index options and let the returns compound for 10 years. Then, they start to receive regular income. Todd Phillips of Phillips Financial Services ran this example through 200 hypothetical historical scenarios and produced these results for me.

Looking back historically over the past 30 years, the best-performing of the 200 iterations of 10-year periods, would have grown the Profit's $100,000 to an income base worth $303,164, giving them a joint lifetime income of $16,729. Their account value "walk away money" would have grown to $200,581.

The median case would have grown their benefit base to $286,626, for a joint lifetime income of $15,764. The account value grew to $189,542.

And over the worst-performing period their benefit base grew to $239,302 with a joint lifetime income of $13,162, and walk away money worth $158,877.

If we assume the Profits earned only the contractual minimum guarantee of zero for the 10 years, their income benefit base would have grown to $162,827, with a joint lifetime annual income of $8,955. Their account value, or walk away money grew to $110,000 because of the 10% signing bonus.

Security Benefit is a 120 year old company rated B++ by A.M. Best and B by Weiss Ratings. It is a subsidiary of Guggenheim Partners.

You are allowed to include this annuity in your an traditional IRA.

If you fund the annuity with after-tax money, withdrawals are treated as though you are withdrawing all earnings first, so they are fully included in taxable income. After all earnings are withdrawn, you are withdrawing principal tax free.

There are other advantages to this annuity. One of my favorites is the long-term care feature. If you selected the income rider and become unable to perform at least two of the six activities of daily living, you can double the income withdrawal rate for up to five years. After the five years have passed, the annual income withdrawal returns to the original rate. The income doubling kicks in two years after you purchase the annuity, and you must be able to perform all the ADL's when you acquire the annuity in order to have this option. Only one spouse can use this option. The income withdrawals won't qualify for tax-free treatment, even when used to pay for long-term care.

Another benefit is that after the first year, the annuity allows you to withdraw up to 10% of the account value each year without a penalty. But withdrawals above that amount might be subject to surrender charges and the loss or reduction of bonus interest. There also might be a

market value adjustment to your account value. You are guaranteed to receive at least 87.5% of your purchase payments in a full withdrawal. Of course, withdrawals will reduce the amount of earnings on the remaining value and the eventual income you can receive.

In my opinion the most attractive feature of the Security Benefit Total Value Annuity is the lifetime income guarantee benefit. It has the highest income payout rate around and also a higher upside than other annuities with high payout rates. Even the worst-case scenario, in which you earn only the minimum guarantees, the return is solid.

If you have money you want to earn a solid decent return for the next five years or more, and with a guaranteed minimums return, and then convert it to a lifetime stream of income, you should seriously consider this annuity.

Fixed index annuities can be complicated products as you can see, and they're not for everyone. But they are valuable when a person is matched to the right annuity. To help guide you and to learn more about this annuity, including where to find several helpful video links, I recommend you contact Todd Phillips at Phillips Financial Services by calling 888-892-1102. RW

Avoiding Taxes on Your IRA

"The potential for an IRA or other qualified pension plan to owe taxes has been in the law for a long time."

Yes, your IRA could be hit with income taxes, even if it's a Roth IRA. This is nothing new. The potential for an IRA or other qualified pension plan to owe taxes has been in the law for a long time. It hasn't affected many investors, because it is only in the last few years that many investors sought investments other than traditional stocks and bonds and related mutual funds.

Keep in mind that an IRA is a separate taxpayer and is subject to different rules than you are. Most of the time IRAs are tax-exempt and have more favorable rules than you do, but there are a few exceptions.

The trap IRAs are most likely to fall into is what the tax code calls unrelated business taxable income (UBTI). When an IRA earns gross UBTI exceeding during a year $1,000, it must file a Form 990-T and pay income taxes at the corporate tax rates. An IRA also must pay estimated income taxes during the year if the tax is expected to exceed $500. The return is filed by and the taxes are paid by the IRA, not by the owner or beneficiary, and the custodian or trustee of the IRA is supposed to be responsible for filing the return and paying the taxes from the IRA. But the custodian might not receive the Form K-1 reporting the income or might not file the return. As the IRA owner and beneficiary you ultimately bear the cost of any taxes and penalties, so be sure to check with your custodian and coordinate who will file the form and pay the taxes. Most trustees and custodians will charge for filing the return.

The $1,000 limit applies to the IRA, not to each investment in the account. If all the UBTI earned by the IRA during the year exceeds $1,000, the tax obligation is triggered. Also, the $1,000 limit applies to the IRA, not per taxpayer. When you have more than one IRA, each IRA has its own $1,000 UBTI limit.

You want to avoid UBTI, because the IRA owner essentially is taxed twice on it. The IRA will be taxed on the income. Subsequently, the owner or beneficiary will be taxed on distributions of that income. No deduction or credit is available to the owner for UBTI paid by the IRA and the tax is not added to the tax basis of the IRA.

An IRA potentially has UBTI if it does any of the following:

- operates a trade or business unrelated to its tax-exempt purpose,
- receives certain types of rental income,
- receives certain passive income from a business entity it controls,
- invests in a pass-through entity, such as a partnership, that conducts a business, or
- uses debt to finance investments.

Any business is considered unrelated to the exempt purposes of an IRA or other retirement plan. Fortunately, the tax code specifically excludes from the definition of trade or business income interest, dividends, capital gains, and profits from options transactions. Royalties also are generally exempt. Some types of rent are exempt; others aren't.

Controlling a business entity can convert exempt income into UBTI. When an IRA has greater than 50 percent control of a business entity, rent, interest, or royalties paid by the entity to the IRA generally are UBTI.

An IRA is most likely to run afoul of the UBTI restriction when it owns an interest in a pass-through business entity (partnership or limited liability company), because income from these entities is UBTI even if the IRA

doesn't own a controlling interest. Master limited partnerships (MLPs) most often trip up IRA owners.

MLPs are traded on major stock exchanges, and many people think of them as being the same as corporate stock. In fact, these are partnership units, and the income and expenses of the partnerships pass through to the owners at tax time. Owners receive K-1 statements each year instead of 1099s to use in completing their tax returns. The K-1 states the amount of UBTI and other income and expense items attributable to the IRA.

Individuals generally are urged not to purchase MLPs through IRAs, but it isn't illegal to own an MLP through an IRA. Owning an MLP through an IRA or other qualified plan is discouraged because of the potential for the IRA to be taxed and have to incur the expense of filing different tax returns.

Owning an MLP through an IRA creates UBTI and possibly the requirement to file a Form 990, pay taxes, and pay estimated taxes during the year. Once the $1,000 income threshold is crossed, there is no tax advantage to owning MLPs through an IRA. (When MLPs generate more than $1,000 of UBTI in an IRA, some tax advisors recommend taking the easier and cheaper route of reporting any IRA-owned pass through items on the individual tax return instead of taking the time and expense to file a separate return for the IRA. It's not clear this satisfies tax code requirements, and if you choose this route be sure your custodian is not also filing and paying the taxes from the IRA.) Also, remember that UBTI is taxed at corporate rates, not individual rates. That makes holding a large amount of MLPs in an IRA unattractive.

There is another reason to make MLP investments outside of a tax-deferred or tax-free account. Most MLPs already have tax advantages. Their operations generate depreciation deductions or other write offs that make a high percentage of income distributions tax free. These tax benefits are diminished when the MLP is owned inside a tax-favored account. (Though the tax advantages of owning an MLP outside an IRA can diminish after an MLP is owned for about 10 years or so.)

Another time an IRA is very likely to have UBTI is when debt is used to finance investments. Any type of income can become UBTI when debt is used to finance the property that generates the income. For example, if an IRA receives a margin loan from the custodian or broker, income generated by the securities purchased with the loan proceeds would be UBTI. An IRA can own real estate and earn rental income, and that rental income will be tax deferred. If the real estate is financed with a mortgage, however, the rental income becomes UBTI.

What about when an investment that generated UBTI is sold? Suppose, an IRA has a substantial investment in master limited partnerships that generated a few thousand dollars of UBTI each year. The IRA sells the MLPs at a gain. Is the capital gain UBTI? No. Only the business income generated by an investment is UBTI. Any capital gains from selling that investment are not UBTI.

When property that was financed with debt is sold, however, the capital gain from that sale is taxed as capital gains to the IRA. If the MLPs were purchased with margin loans, for example, the capital gains would be UBTI.

The UBTI rules are broad and extensive. You have to be especially careful of debt-financed investments, business ownership, and ownership of pass-through entities. You can find more details in my report *IRA Investment Guide: A Road Map for Avoiding the Traps and Penalties for IRA Investments*. It's available through the Bob's Library tab at www.RetirementWatch.com. RW

Simple, Low-Cost Ways to Help Grandchildren

Grandkids' Watch

For many of my readers, helping the grandkids is a high priority after ensuring their own financial independence. There are so many ways to help beyond making cash gifts and setting up Uniform Gifts/Trusts to Minors Accounts. In fact, those two widely-used methods often are far from the best ways to help.

Most people have two additional goals when helping the grandchildren. They want as many tax benefits as possible, and they want to ensure the money isn't wasted. Here's a review of the best ways to help grandkids that meet those goals.

529 plans. College savings plans authorized under section 529 of the tax code are one of the best giving vehicles. Most states now offer multiple 529 plan options, and any person can set up an account and contribute to it for the benefit of someone else. Contributions qualify for the annual gift tax exclusion. In addition, up to five years' worth of exclusions can be used in one year for a tax-free lump sum contribution of up to $70,000 ($14,000 times five) per beneficiary. The gift is excluded from the donor's estate unless he dies within five years of making the gift. Under many state plans the owner has some choice over how the account is invested.

Income and gains in the account compound tax free. Withdrawals are tax free when they are used for qualified education expenses of the beneficiary.

A distinct advantage of the 529 plan is the owner can retrieve assets from the account for any reason. There is no tax penalty if the owner asks for the return of the assets, though the plan sponsor can impose a penalty of up to 10%. The owner also can change the plan beneficiary at any time. So, if a grandchild turns out not to be college material or interested in college, a different grandchild or any other person can be named beneficiary.

Some states limit the duration of an account to a number of years or to the 25th or 30th birthday of the initial beneficiary. Others have no time limit. Check out details of different plans and the rules at www.college-

savings.com. (Ignore the hyphen.)

Bill paying assistance. You can give by making direct payments on behalf of the beneficiary. The grandchild (and the parents) never touches the money, and the gifts pay for what you intend. Some people pay directly for education, vacations, summer camps, furniture, clothing, cars, and other expenses.

Direct payments qualify for the annual gift tax exclusion. As mentioned in this month's Estate Watch, qualified education and medical expense payments made directly to the provider qualify for an unlimited gift tax exclusion.

Home equity match. This works for adult grandchildren who have accumulated some home equity and credit. It's worth considering when a grandchild has a significant expense coming up. You want to help, but you don't want to pay the entire amount at once or want to stay within the annual gift tax exclusion. Or you want to help improve the grandchild's credit rating.

The strategy is for the grandchild to make the purchase with a home equity loan. You tell the grandchild you'll make all or part of the loan payments. You can make payments directly to the lender or to the grandchild. But you aren't on the loan documents or legally liable for it. A bonus for the grandchild is that, since the loan is his or her legal obligation, he or she deducts the interest.

Expense matching. You're aware that some donors to charities make challenge matches. They offer to match, up to a maximum amount, whatever gifts the charity raises from other donors for a specific purpose or within a time frame. Parents can do the same with children. If the children need or want a car, for example, the parents can offer to match whatever amount the children spend. The match does not have to be dollar for dollar. You can offer to pay fifty cents for every dollar the children pay or some other ratio.

This approach allows the grand children to buy more than they could on their own, but they have "skin in the game" so are more likely to make the purchase carefully and take care of the item.

A variation, to give youngsters some incentive, is to match income and earnings up to a level. RW

Distinguishing Value from Price

Monthly Windup

I like to begin my days with a bicycle ride, preferably outdoors but I'll use the stationary bike when the weather isn't cooperative. Last December Elaine snuck my bike off to the local shop to be overhauled as a Christmas present. I bought the bike almost 20 years ago. It was riding well but rode great after the adjustments. When I bought the bike, I cringed at the price, though I was buying at a substantially discounted end-of-season sale. It was a quality bicycle, and it wasn't cheap despite the discount.

The experience shows the important difference between value and price. The price wasn't low, but the value was substantial. It's lasted a long time, and I've ridden it many miles. Despite the miles, the bike needed only a few tweaks and replaced parts over the years. I haven't looked with envy at current models or felt the urge to upgrade with a new purchase. If I'd purchased a less expensive bike it likely wouldn't have lasted nearly as long and wouldn't have been as enjoyable. I probably would have had to buy two or three cheap bikes in the time I've owned this one.

Price versus value often comes into play in the financial world. Many people look for the lowest cost, whether they're looking at mutual funds, insurance, an estate planning attorney, or any other aspect of their finances. As I mention from time to time, the lowest cost today often isn't the lowest cost or best deal in the long term. Today's price or cost is only one factor to consider. There's a big difference between value and price, and quality is worth paying for.

It's time to wrap up this month's visit. Of course, I'm watching what the policymakers are doing in Washington in Europe and evaluating how that will affect our finances. I'm also on top of the latest for your estate plan, medical insurance, income taxes, annuities, and more. Next month I'll be back with the results and recommendations from my latest research.

Bob

P.S.: Don't forget to visit the members' web site regularly to read updates in Bob's Journal, see the latest issue shortly after it is sent to the printer, update your membership, view back issues, and see more features.

Members-Only Web Site

www.RetirementWatch.com: Click on "Member login" and follow the instructions to view our member-only features, including Bob' Journal, which provides updates and fresh advice between our monthly issues.

Robert C. Carlson is America's leading independent advisor on financial strategies for retirement and retirement planning. Bob's latest book is *Personal Finance for Seniors for Dummies* (with Eric Tyson; Wiley, 2010). He serves as Chairman of the Board of Trustees of the Fairfax County (Va.) Employees' Retirement System (a $3.0 billion portfolio) and served on the Board of Trustees of the Virginia Retirement System (a $42 billion portfolio in 2005) from 2000-2005. He also is an instrument-rated private pilot and was educated at the University of Virginia School of Law and Clemson University.