Bob Carlson's
RETIREMENT WATCH

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Dear Reader:

Retirement planning often focuses too much time and other resources on the wrong things. This is true even for many people who use financial advisors.

Retirement plans shouldn't focus first on the numbers. How much money have you saved? How much more should be saved? How much income or cash flow will your assets generate?

Even worse is when people focus first on which financial or investment products they should or shouldn't have. Too often I hear people ask if they should own a particular annuity, life insurance policy, mutual fund, or other product.

Your retirement plan should start with your retirement goals and priorities. By that I mean your personal and lifestyle preferences.

Think about and establish goals regarding your family, home, work (paid or volunteer), health, leisure, giving, and finances. Only after careful thought has been given to these areas can a good financial plan be developed. When you're using a financial advisor, the advisor should discuss these goals with you before developing the financial aspects of the plan.

For example, are you expecting or hoping to be able to support one or more family members during the retirement years? Do you want to be able to provide support in case an adult child or other loved one suffers a setback? Do you want to make annual gifts to your children or help pay for the education of your grandchildren?

You need to consider such questions. Then, it is time to look at the numbers, strategies, and products. Often, the goals to a large extent determine the details of the financial plan.

Most people find they have to adjust their goals and ambitions after examining the numbers. Your finances might not support all the goals, or some of the goals might conflict. Then, you make choices.

You first have to know the lifestyle you want. Only after that can you decide the financial details. Of course, you still need to revisit both the goals and finances on a regular basis and make adjustments as needed.

Retirement planning isn't about money. It's about the type of life you want to lead. Money and financial strategies are tools for achieving that. When a retirement plan is done right, you spend more time considering those other factors than you do the money side. The result will be a more successful retirement in which you have more peace of mind, less stress, and are more confident, healthier, and happier.

"There is more to a complete estate plan than many people and even many lawyers realize."

Building the Complete Estate Plan

Many people think they have estate plans but really don't. I'm not talking about the many people who haven't done any planning and don't have even a basic will. I'm talking about people who have taken action on their estate plans and yet have plans that are woefully incomplete. There is more to a complete estate plan than many people and even many financial professionals realize.

Of course, prime goals of an estate plan are to allocate your assets to the loved ones you want to have them in a way that minimizes time, expenses, and taxes. But there is much more to consider.

A complete estate plan addresses some additional goals. Achieving those goals requires some documents and other tools. I sometimes call the key elements the **Financial Emergency Kit**. The kit keeps difficult times from becoming much worse for your loved ones and can help avoid some problems. A good estate planner focuses on these tools in the planning process, and the wise estate owner insists they be part of the plan.

Many elements of this part of the estate plan

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often can and should be completed even when there is difficulty deciding on the complete plan. An estate plan might be completed in stages over months for someone who has a valuable estate, owns a small business, or has other complications. There's no reason for the decisions on difficult issues to delay completion of most important elements, such as the Financial Emergency Kit. We've covered the details of these elements in past visits, and those discussions are in the Archive on the members' section of the web site. In this visit we highlights all those that form the essential elements of your estate plan.

● A **financial power of attorney** (POA) is essential. This gives someone the legal authority to manage your finances and assets if you become disabled or are otherwise unable to manage your assets. If there is no power of attorney, loved ones must spend time and money to have a court appoint someone, and it might be someone you wouldn't have picked. Likewise, when you have a revocable living trust, the trust should have a disability clause that states who will take over in case of a trustee's disability and how the disability will be determined.

It often is not enough to simply execute a POA for it to be effective. Most financial institutions accept only their own forms and want to have the forms in their files before the owner becomes disabled. They might not accept other forms or might take time to review them before allowing transactions. Some firms also require the forms to be executed again or reaffirmed after a certain amount of time has passed.

● Related to the financial power of attorney are the **health care documents**. These are essential, naming one or more people to make medical decisions in case of your incapacity. There are several choices. The simplest is the living will. It gives general instructions about which medical procedures are and are not to be used in different circumstances. Some studies show, however, that living wills have little effect. Often the doctors don't see them until after decisions have been made, or the instructions are too vague to be useful in many situations.

A better document is the health care power of attorney. This gives an individual or group of individuals the right to make decisions. For it to be effective, all of your regular doctors must have the current document in the front of their charts along with information on how to reach the agents. Also, each agent should have a copy.

Many estate plans now combine a health care power of attorney, living will, and perhaps a letter of your preferences and call the combination an advanced health care directive. This combination allows you to give your agents and medical professionals statements of your intent while allowing them the discretion to apply that to particular circumstances.

● **Beneficiary designations** need to be reviewed for the many assets not transferred by a will and the probate process. These assets include IRAs, employer retirement plans, life insurance, and annuities. For all these assets, the next owner is determined by the beneficiary designation form, not by your will. Always keep copies of these forms (which usually are a part of the account application) and review them periodically to be sure they still express your wishes and that a beneficiary hasn't passed away. It also is a good idea to be sure each asset has contingent beneficiaries in addition to the primary beneficiary. The beneficiaries of any trusts also should be reviewed, if the terms of the trust allow beneficiary changes to be made.

● **Funeral and burial instructions** take a burden off heirs. In most states, these have limited legal effect, but heirs generally follow them.

● Other **letters of instruction** also can be valuable, though they also have no legal effect. If the will places property in a trust for someone's benefit, you might write a letter to the trustee stating the reasons for establishing the trust, suggestions for the investment policy, and the standards for making distributions. If the will gives the executor of the estate discretion, a letter can provide some guidelines for the executor. An instruction letter is particularly helpful when the estate has a business, real estate, or special items such as collections.

● **Insurance policies** should be up-to-date and well-organized. In addition to the usual property and casualty policies, in today's litigious society a personal umbrella liability policy is essential low-cost protection against many possible claims. Most people should consider $3 million to $5 million of liability coverage, costing a few hundred dollars per year.

Many people overlook disability insurance. The odds of being disabled from work depend on one's occupation and health. Most people should buy a policy that triggers coverage when they are unable to perform their current jobs. Less expensive policies provide benefits only to those who are unable to perform any job. Those policies have a much lower probability of paying benefits.

● A **cash flow plan** is a big help to your executor and also when developing your plan. An estate might be valuable but have few liquid assets. Bills need to be paid while the estate is being settled, and people might be dependent on you. The executor and holder of a power of attorney should know where the liquid assets are, where income might flow from, life insurance that might pay benefits, and any other sources of cash. Medical and other insurance is another source of cash flow, especially for late-in-life expenses. Be sure you executor has the details

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of any medical insurance (including your Medicare information), long-term care insurance, and any other coverage you have.

● Having **a source of credit**, such as home equity line or reverse mortgage line of credit, arranged also isn't a bad idea. Loved ones might need it to pay emergency medical bills or other unexpected expenses. The alternative might be to sell valuable assets in a hurry and at an inopportune time. The fewer liquid assets you own, the more valuable this source of cash is. Other good sources of credit are no-fee credit cards with fairly large credit limits and brokerage accounts that allow margin loans or lines of credit. Verify which of these sources of cash would survive you. Some automatically terminate on your passing.

● Entrepreneurs need a **business succession plan**. The plan can involve either long-term successors or caretaker managers who run the operation until it is sold or there is another long-term solution. Some business owners name key employees who can be trusted to keep the operation going. Others name a trusted outsider who knows the business generally but well enough to oversee it for a while.

The succession plan should be in writing and reviewed with everyone involved. Bankers, creditors, suppliers, and other important contacts should know about the plan and any role they would have in implementing it. Preparing the plan might take longer than other parts of your estate plan. Don't delay the other elements while waiting to develop the succession plan, but be sure you are working on the succession plan

● All of these documents and strategies should be brought together in what I call the **beneficiary book**. It can take any form but it contains all the items discussed, plus any other items that might be helpful to the estate executor or loved ones. It could be a three-ring loose-leaf notebook, a large file folder, or some other way of organizing these documents. It also might be a letter or other short statement that identifies all the key elements and exactly where to find them. The book is designed primarily for the executor, but it also will be useful to others if the owner becomes incapacitated. Putting the book together and keeping it up to date also can help you better manage your finances. The executor and key loved ones should know about the book and where it is stored.

Essential records that should be added to the book include recent income tax returns (both personal and business), the latest will, any trusts, insurance policies (all types of insurance), financial account statements, personal financial statements, loan documents, deeds, property titles, and a list of advisors used. Be sure to list jointly-owned property, partnerships, and other shared property. The organizational documents and other details of businesses should be included.

It might be more convenient to reference some records instead of including them in the notebook. For example, financial account statements could be kept in a filing cabinet. Then, the beneficiary book should have a section listing the accounts and where the documents can be found.

The notebook should be well-organized and up-to-date. I often refer to this as the best gift someone can leave heirs. It reduces both the cost and emotional burden of dealing with estate administration. You can start by using my workbook, *To My Heirs: A Book of Financial Wishes and Instructions*, available as a PDF file through the Bob's Library tab on the web site at www.RetirementWatch.com. RW

Avoiding Frequent IRA Rollover Mistakes

IRA rollovers at first seem commonplace and easy. There even are television commercials about them. Yet, there is a lot more to rollovers than many people realize. When you don't know the details, you risk losing money to taxes, penalties, and bad decisions.

There are 31 different types of rollovers in the tax code, says CPA Ed Slott. For example, converting a traditional IRA to a Roth IRA technically is a rollover. Rollovers can occur at times other than retirement. While these choices provide a number of potential benefits, they also are fraught with traps for the unwary or careless. You want to avoid making the most common rollover mistakes with your money.

The 60-day IRA rollover. In this rollover you physically receive money (usually a check) or property from a traditional or Roth IRA and plan to roll it over to another IRA. When you physically receive a distribution from an IRA, you have to deposit the same amount with the trustee of a different IRA, the same IRA, or an employer qualified retirement plan within 60 days. Fail to meet the 60-day deadline and the distribution is included in your gross income. You might owe a 10% early distribution penalty

"You want to avoid making the most common rollover mistakes with your money."

if you are under age 59½.

While often advertised as a 60-day interest-free loan, the 60-day rollover is fraught with peril. You can be hit with the taxes and penalties for unintentional mistakes and oversights that cause the deadline to be missed, even if others are at fault. It's best not to try the 60-day rollover at all. Instead, to move IRA funds use the trustee-to-trustee transfer.

In 2014, the IRS amended its rules to allow the 60-day transfers only once per year per taxpayer. That limit is once per 12-month period, not once per calendar year. It also applies to all types of IRAs. If you make a transfer from one traditional IRA to another, you can't make a transfer from your Roth IRA during the same 12-months. Excepted from this limit are conversions of traditional IRAs to Roth IRAs, rollovers between qualified plans and IRAs, and direct transfers between IRA trustees.

IRA trustee-to-trustee transfer. The safest way to move funds from one IRA to another is to have it transferred between the trustees or custodians. You don't touch the money. You tell the trustee of the IRA you want to receive the money to have it transferred from the other IRA. After you complete the paperwork, the trustee handles the transaction.

You still need to be vigilant. There are numerous cases of financial firms mistakenly transferring money from an IRA to a taxable account, making the transaction a taxable distribution. Other mistakes also can be made. The IRS has limited discretion to correct or provide waivers for these mistakes. Closely review the paperwork and have errors fixed quickly.

401(k) to IRA rollovers. This is the most common type of rollover and the one mentioned in the television commercials. There are several pitfalls to avoid.

Financial services firms work hard to convince people to transfer their 401(k) balances to IRAs after leaving an employer, whether for retirement or for other reasons. The first mistake many people make is not considering their other options.

"The first mistake many people make is not considering their other options to rolling their 401(k)s to IRAs."

The money can remain in the 401(k) under most plans. You might want to do this if the plan has good investment choices, low expenses, and if the employer will continue to communicate well with and offer full plan services to former employees who left their accounts with the plan. The 401(k) also provides more protection from creditors than an IRA does. Another 401(k) benefit is you might be able to take loans from a 401(k), but not from an IRA. Some 401(k) plans, however, allow loans only to active employees. Consider all these factors before deciding to move from the 401(k).

Another option, when you left to take another job, you might be able to roll the balance to your new employer's plan. If the new plan has attractive features and you want to consolidate most of your funds in one place, this could be a good choice.

When the account includes employer stock, you probably don't want to roll this over to an IRA. The tax code provides breaks to employer stock when it is distributed to a taxable account instead of being rolled over to an IRA in certain circumstances.

The account balance also could be taken as a lump sum. For those born before 1930, there are some tax benefits to that, but not many people today are likely to qualify. Those who take the account in a lump sum and don't qualify for the special treatment will include the entire lump sum in gross income.

Finally, there's the option of rolling over the 401(k) balance to an IRA. This gives you full control over the money and the option of investing in all the assets available through the IRA custodian. If the custodian is a brokerage firm, you can invest the IRA in almost anything in the markets. Fees might be lower, depending on the fees charged by your 401(k) plan. The IRA rollover also has the potential of allowing you to consolidate all your financial accounts at one firm. The IRA rollover also gives you more flexibility at required minimum distribution time than a 401(k) does.

You also can roll over the IRA to a true self-directed IRA custodian that will let you invest in unconventional assets such as real estate, small businesses, and loans to individuals.

The rollover from the 401(k) to the IRA is tax free. You can do either a trustee-to-trustee transfer or take the account balance in a check and personally deposit the amount in an IRA or the new employer's plan. But when you take a check, 20% of the account balance will be withheld as taxes. To make the rollover tax free you have to come up with cash to replace the 20% and be sure your entire pre-distribution account balance is rolled over.

Inheritances by non-spouses. Some of the biggest rollover mistakes are made by beneficiaries of IRAs and 401(k)s. The most common is to roll over the inherited account to an IRA owned by the beneficiary or a new IRA set up in the beneficiary's name. This causes the entire account balance to be treated as distributed, even if it still is sitting in an IRA.

To continue deferring taxes on an inherited IRA, the beneficiary must have the account retitled to indicate it is inherited. That means including the name of the original owner, an indication that he or she is deceased, and a

statement that it is an IRA "for the benefit of" (or FBO) the beneficiary.

The beneficiary might want to roll over the account to a financial services firm where his or her other accounts are maintained. To do this properly, the inherited account first must be renamed as just described. Then, a new IRA must be set up at the desired firm with the exact same title as on the inherited IRA. Only then can a tax-free rollover occur.

Non-spouse beneficiaries also can't do a 60-day rollover in which they take possession of the money. Only a trustee-to-trustee rollover is allowed. If the beneficiary receives cash, check, or property from the inherited IRA, it is included in gross income. If the beneficiary takes possession for even a moment, it is a distribution and can't be reversed.

When the beneficiary takes money out of the IRA or 401(k), he'll be taxed the same as the original owner would. So, taking a lump sum distribution causes the entirety of after-tax amounts to be included in gross income.

The spousal rollover. When a spouse inherits an IRA or 401(k), he or she can take the same actions a non-spouse beneficiary can. The spouse also has the option of rolling the account into an IRA in his or her name and receiving a "fresh start." It will be treated the same as an original IRA of the spouse.

One potential mistake is that an inheriting spouse can't do the spousal rollover until he or she is at least age 59½. Younger surviving spouses have to wait until after age 59½ to do the rollover or face penalties. The inheriting spouse also has to remember to name new beneficiaries of the IRA, because the contingent beneficiaries named under the deceased spouse's IRA or 401(k) won't automatically apply to the new IRA.

Rolling over after-tax money. The tax law limits the amount of income that can be tax-deferred into a 401(k) plan each year. Additional contributions are allowed, but the additional amounts are included in gross income. These additional amounts are after-tax contributions. You have a basis in them equal to the amount that was included in gross income. When the account is distributed, the basis, or after-tax amounts, aren't included in income. Many plans allow these additional after-tax contributions to be made, but not all do. You need to check plan rules.

The IRS issued rules in 2014 that show how after-tax 401(k) contributions can be turned into Roth IRAs. When you decide to rollover your 401(k) to an IRA, you can separate the pre-tax and after-tax contributions. The pre-tax contributions can be rolled over to a traditional IRA tax-free as is usually done. The after-tax contributions can be rolled directly to a Roth IRA, and there are no additional taxes paid.

To receive this treatment, you must roll over the entire IRA in the same year. The after-tax contributions go to a Roth IRA, and the pre-tax contributions go to a traditional IRA. These rollovers also must be done trustee-to-trustee. You can't receive the funds personally and then try to roll them over. The new rules make it easier for higher-income employees to eventually have Roth IRAs. RW

Determining the Best Age to Buy Long-Term Care Insurance

What's the best age to buy long-term care insurance? I hear that question a lot. Let's run through the factors.

Most people are considering the lifetime trade off between the premiums paid and the benefits eventually received. They want coverage but they don't want to begin paying premiums too long before care is needed. For most people, buying LTCI before age 50 is too early. The odds are you'll pay premiums for a very long time before needing coverage, and both insurance and LTC will change a lot over the years. The policy you buy today might not be what you want in 30 or more years.

Insurers generally want to sell to people in their early 50s, especially married couples, and design policies to appeal to them. That probably makes ages 50-55 the sweet spot for buying LTCI. You receive the best value. (It is less expensive for a couple to buy a joint policy than to buy two individual policies. Married couples should strongly consider joint policies.)

There's a good reason not to wait much past age 55 to buy LTCI. The older you are, the less likely you are even to qualify for a policy, and especially to qualify for preferred or even standard rates.

LTCI Applicants Denied

Age Group	% Declined
55-59	37%
60-64	39%
65-69	46%
70-74	50%
75-79	63%

The box nearby shows the percentage of LTCI applicants who are declined LTCI coverage within different age groups. It would be nice to avoid paying premiums from your 50s through your 60s, but the risk of doing so is that you might lose the opportunity to buy any coverage at all. Insurers are becoming much more careful when underwriting LTCI. By avoiding a few years of LTCI premiums people run the risk of not being able to buy any coverage.

This shouldn't discourage those older than 55 from considering LTCI. By all means explore coverage options and see if your application is accepted and with a reasonable premium. But if you're 50 or older don't consider delaying the purchase of LTCI with the thought that you'll receive a better trade off between lifetime premiums paid and eventual benefits received. You take an escalating risk of losing the opportunity to obtain coverage.

Of course, there are options to stand-alone LTCI policies. When you are denied coverage or the premiums are too high, consider one of the hybrid policies. These are annuities or life insurance with long-term care riders. Most insurance experts I've heard from say that the annuity hybrids have less rigorous medical underwriting than life insurance hybrids. We've discussed the hybrids in detail in past visits, and those discussions are in the Archive on the members' section of the web site.

Minimizing Taxes on Annuity Payouts

Annuities offer several benefits when you begin receiving distributions. You receive guaranteed income that lasts for life, no matter how long you live. The insurance company takes on the risks of low investment returns and a long life. You don't have to worry about scheduling distributions or deciding which assets to sell to raise cash. The regular checks show up on schedule. The certainty and risk transfer are why many people are taking a shine to annuities, especially immediate annuities.

The benefits are enhanced when you know the tax breaks annuities offer and how to maximize them on your income tax return. While the income distributed to you is taxed as ordinary income, all of each payment isn't ordinary income to you. For most people, a large portion of the annuity distributions is tax free. Only a small portion of each distribution is taxed.

"The benefits are enhanced when you know the tax breaks annuities offer and how to maximize the benefits on your income tax return."

Let's look at how to maximize the tax-free portion of each annuity payment. We're talking about the tax treatment of monthly or other periodic payments from a commercial or nonqualified annuity. These are annuities that are not paid from qualified retirement plans, such as IRAs, 401(k)s, and employer defined benefit plans. Payments from qualified plans have different tax rules. Commercial annuities generally are those sold by insurance companies outside of qualified retirement plans.

Commercial annuities are taxed under what the IRS calls the General Rule. (Other annuities are taxed under the Simplified Method). The General Rule applies to contracts that have been annuitized. That means you have elected to take a series of payments made at regular intervals and that last for longer than one year. The most common election is for the payments to be received monthly and paid for life or the joint life of you and your spouse, known as a joint and survivor annuity. Other payment periods are available. If you do not receive regular, periodic payments, the tax rules are different than those discussed here.

Under the General Rule your investment in the contract (also called the basis) is returned tax free over the period the payments are received. Part of each payment is a return of your investment (or net cost) and part is a payment of taxable income.

First, determine your net cost or investment by adding the total premiums, contributions, and other amounts you paid into the contract. Only after-tax amounts are included. If a contribution was deductible or excluded from your income, it is not part of the net cost. Employer contributions to the annuity are included only if they were included in your gross income.

From this total subtract refunded premiums, rebates, dividends, and unpaid loans as of the annuity starting date. Also subtract any additional premiums paid for double indemnity or disability benefits and any tax-free amounts received before the annuity starting date. Other adjustments might be required if the annuity has death benefit features and refund features of the annuity. The standard immediate annuity isn't going to have these features, but some of you might own annuities with one or more of them. Your insurer should be able to tell you if you have any of these amounts or features and how the basis needs to be adjusted.

The tax-free amount of each payment is the ratio between your investment in the contract and the total expected return. So your next step is to determine the expected return. This is the amount that you and any beneficiaries are expected to receive over the life of the contract.

When the payments are received over a fixed period of years, the expected return calculation is simple. If the payments are monthly, multiply the amount to be received each month by the number of months the payments are to be received. The result is your expected return.

When the annuity will make payments for life, the calculation is a bit different. The calculation also differs when the payments are for one person's life, for two lives with the payment remaining the same after the first death, and for two lives with the payment changing after the first death.

We'll start with the most common situation: an annuity that pays the same amount monthly over the lives of two people, usually a married couple. The expected return is computed based on the combined life expectancy. To find the life expectancy you go to IRS Publication 939 (free and available on the IRS web site or by calling 800-TAX-FORM).

First, you need to know your ages. The ages to use are your ages on the birthdays nearest the annuity starting date. That's the date the regular payments began.

Most people will use Table VI in Publication 939. If you didn't make contributions to the annuity after June 30, 1986, then you would use

Table II. In the table you'll find a factor that is based on your two ages. Multiply the annual payment by the factor in the table. The result is your expected return. If payments are made quarterly, semiannually, or annually instead of monthly you'll need to make adjustments using instructions in the publication.

After computing the expected return, divide the investment in the contract by the expected return. The result is your exclusion percentage. This is the percentage of each payment that is excluded from gross income. You multiply this percentage by the amount of each payment and exclude the result from income on your tax return. You do this until the total exclusions over the years equal your investment in the contract. After that, the entirety of each payment is included in gross income.

Example. Max Profits is 70 as the annuity starting date nears, and his wife Rosie is 67. The annuity in which Max has an investment of $50,000 will pay $500 monthly over the lives of both Max and Rosie. The factor from the table is 22.0. The annual payment is $6,000. The annual payment is multiplied by 22, for an expected return of $132,000. Max divides the $50,000 investment by $132,000 to determine an exclusion ratio of 37.88%. From each $500 payment, Max and Rosie exclude $189.40 until the have recovered Max's $50,000 investment, which will take 264 months or 22 years.

When the annuity is paid for the life of only one person, Table V from IRS Publication 939 is used. The rest of the calculation is the same as before.

Example. Max Profits is 66 at his birthday nearest the annuity starting date and will receive $500 monthly from an annuity in which his investment is $50,000. His annual payment will be $6,000. The factor from Table V for his age is 19.2. The expected return for Max is $115,200. Max divides $50,000 by $115,200 to determine an exclusion ratio of 43.4%. From each $500 monthly payment, Max excludes 43.4%, or $217.01. The exclusion continues until Max recovers his investment, which will take 230 months or 19.2 years.

The calculation has more steps if the payment continues after the owner's death but the amount declines. There also are other payment schedules possible, and the methods for calculating their expected returns are discussed in IRS Publication 939.

If you and any beneficiary die before the full investment is recovered, any unrecovered investment is a loss that qualifies as a miscellaneous itemized deduction on the final tax return of the last payee.

The insurer making the annuity payouts is required to withhold income taxes from each payment unless you request zero withholding. You also can request higher withholding. As we have discussed in past visits, having taxes withheld might save you the burden of computing and paying estimated taxes each quarter and make it easier to avoid penalties for underpayment of estimated taxes. Consider estimating your total income taxes for the coming year and requesting this amount be withheld from the year's annuity payouts. RW

Getting Longevity Right

Underestimating longevity is one of the most common and costly retirement planning mistakes. People consistently underestimate how long they are likely to live.

Your plans should have a realistic estimate of life expectancy. You should be conservative, meaning have a bias in favor of a longer life span.

The life expectancy tables from the Society of Actuaries, while authoritative are hard for many people to work with. A better option is to use the free life expectancy calculator at their web site www.soa.org.

Another good free source is the blog of Nobel Economics Prize laureate William Sharpe. Though it has the disadvantage of using older, broad-based mortality tables, it has a number of useful features. It offers a link to free software that allows you to compute the probability of living to a certain age for an individual or a married couple. It also gives detailed instructions on the software and discussions about longevity. Go to RetirementIncomeScenarios.blogspot.com.

Summer Strategies to Help Grandkids

Grandkids' Watch

We're rolling into summer, and that's a time to consider tax wise strategies for helping the youngsters in your family, whether they are children or grandchildren. The tax code provides a number of opportunities to build the wealth of future generations with a minimal tax bite. The strategies aren't restricted to summertime use, but that often is when the benefits can be maximized.

We start with a strategy almost any family can use.

Offer to match any income a child or grandchild makes from a paying job. But don't match it by giving money directly to the youngster. Instead, make a contribution to a Roth IRA in the child's name.

Anyone can contribute to someone's IRA. But all IRA contributions made for a person during the year when combined can't exceed the annual contribution limit. Maximum IRA contributions can be up to the lower of the grandchild's earned gross income for the year and $5,500. Your contributions plus any made by the grandchild or someone else on his or her behalf all count toward the limit. Any contributions you make on behalf of the grandchild should be free of gift taxes thanks to the $14,000 annual gift tax exclusion.

The benefits of a Roth IRA, especially one started at a young age, are substantial. The earnings of the account compound free of taxes as long as they remain in the IRA.

After age 59½ all distributions are free of income taxes and penalties. The grandchild won't be forced to begin required minimum distributions at any time, so the account can compound for as long as he or she wants.

There also are advantages if the grandchild wants or needs the money before 59½. The contributions can be withdrawn at any time free of income taxes. So, after some years have passed and income and gains have compounded to a decent amount, the grandchild can withdraw some or all of the contributions and leave the remaining income and gains to compound for the future.

In addition, when the grandchild is ready to purchase a first home, the contributions plus up to $10,000 of income and gains can be withdrawn tax free.

When you own a business, there are tax advantages to hiring a grandchild or child.

No matter who employs a grandchild, he or she avoids federal income tax withholding if no income taxes were owed last year and none are expected to be owed this year. When the youngster is a dependent on someone else's return, earnings are tax free when total income is no more than $6,200 and unearned (investment) income is no more than $350. When unearned income is more than $350, total income must be no more than $1,000 to avoid taxes.

Of course, you deduct the wages and other payments when you pay a child or grandchild reasonable compensation for the work done.

When a child is employed by the business of one or both parents, no FICA taxes are due when the child is under age 18 and the business is either a sole proprietorship, a husband and wife partnership owned by the parents, or an LLC that elects to be disregarded for tax purposes. Federal unemployment tax isn't owed on children's salaries until they are age 21.

There should be at least one strategy here for every family this summer. RW

Ode to a Pay Phone

Monthly Windup

I've frequented the same post office for a number of years. One constant was the pay telephone outside the front of the building. Almost always there was someone using the phone. Long after even young children had their own cell phones, this pay phone remained and was in regular use most of the day and week. Recently, however, I noticed that it was gone. I didn't see any announcement of the removal, and the removal was so complete there's no sign a pay phone ever was there. It seemed like the end of an era.

Even in retirement, we have to be ready for change and adapt to it. It's hard to believe that it's been over 10 years since the hardcover of *The New Rules of Retirement* was published. In it I discuss how many traditional retirement planning rules no longer applied. Since its publication, a lot more has changed about retirement and retirement planning. Your finances simply aren't a set-it-and-forget-it activity, no matter how old you are. You used to be able to rely on a pay telephone being nearby almost whenever you needed one. Not any more. Likewise, you can't rely on financial rules and strategies that once could be taken for granted. That's why I every month I visit with the latest changes, developments, and strategies to ensure your financial independence and security in retirement.

We have to wrap it up for this month. I'll be back next month to discuss estate planning, tax reduction, lifetime income, and more. Don't forget to visit the members' section of the web site between our visits for updates and other features.

Bob

P.S.: There's still time to make your free reservation for the Las Vegas MoneyShow at Caesar's Palace. Register free online here: https://secure.moneyshow.com/msc/LVMS/registration.asp?sid=LVMS15&scode=038392. Or call 800-970-4355 and mention *Retirement Watch*.

I'll also be at the San Francisco MoneyShow July 16-18.

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Robert C. Carlson wrote the book on retirement and retirement planning twice–*Personal Finance for Seniors for Dummies* (with Eric Tyson; 2010) and *The New Rules of Retirement* (Wiley, 2004). He also 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 is an instrument-rated private pilot and was educated at the University of Virginia School of Law and McIntire School of Commerce (M.S.) and Clemson University.