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Getting to the Bottom of Inherited IRAs

Naming a beneficiary for your *traditional Individual Retirement Account (IRA)* need not be a difficult task. Most people choose their spouse, if married, or another loved one. However, the rules governing the distribution of IRA assets to beneficiaries are not so simple. With this in mind, here is a quick look at the Internal Revenue Service (IRS) rules for inherited IRAs.

Taking a Closer Look

The IRS stipulates that an IRA owner must begin taking *required minimum distributions (RMDs)* by April 1st of the year following the calendar year during which he or she reaches age 70½, commonly referred to as the “required beginning date.” IRA beneficiary rules involve two separate issues: 1) the *age* of the IRA owner at the time of death; and 2) the *identity* of the IRA *beneficiary* (the rules for spousal beneficiaries differ from those for non-spousal beneficiaries).

Spousal Beneficiaries

If an IRA owner dies *before* RMDs have begun, a spousal beneficiary can choose to withdraw all IRA assets within five years, maintain the IRA under the deceased spouse's name, or treat the IRA as his or her own. Suppose Jim Bradshaw (a hypothetical case) dies and his wife, Linda, is the beneficiary of his IRA. If Linda maintains the IRA in Jim's name, minimum distributions do not have to begin until December 31st of the later of: 1) the year following the year of Jim's death; or 2) the year in which Jim would have reached age 70½. However, distributions would be based on Linda's life expectancy. If Linda chooses to treat the IRA as her own, she is entitled to name new beneficiaries, and the rules governing RMDs would be the same as if the IRA were originally her own. Therefore, distributions would have to begin by April 1st of the year after the year in which she turns 70½, and the required amount would be based on her life expectancy.

If Jim were to die *after* RMDs had begun, the options for Linda would be different. She could choose to either continue receiving distributions based on Jim's life expectancy, or her own life expectancy. As a third

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Retirement Savings Worksheet

If you are approaching retirement age, or are just beginning to plan for it, you might be interested to learn that retirement may require 70%-90% of your current annual income in order for you to maintain the quality of life you presently enjoy (American Savings Education Council (ASEC), 2003). Setting goals—such as where you might like to live and the activities you plan to pursue—is an important factor in any savings plan. How do you determine the total amount needed for retirement, and calculate the amount of savings you'll need to accrue each year? Answering the questions below (based on calculations developed by the ASEC) may help you get started. Enter your information in the worksheet on page three.

As an example to help you along the way, consider the hypothetical case of Henry Foster: At age 50, Henry earns \$50,000 per year. He estimates that during retirement he'll need 70% of his income (\$35,000 per year) to maintain his current standard of living. While he does not have a traditional employer pension, he does expect to earn \$5,000 annually as a part-time writer. In addition, he estimates he'll receive approximately \$14,500 annually from Social Security.

1. *Required Income.* How much money will you require per year in order to live the lifestyle to which you have grown accustomed? Enter 70% of your current annual income as a basic minimum.

2. *Social Security.* Project the amount you expect to receive from Social Security. Obtaining a Social Security statement from the Social Security Administration (SSA) will enable you to enter a more accurate estimate. You can obtain a statement by calling 800-772-1213 or on the

web, at www.ssa.gov. For a rough estimate, enter \$8,000 if you earn less than \$25,000; \$12,000 if you earn between \$25,000 - \$40,000; or \$14,500 if you earn \$40,000 or more. If you are married and earn less than your spouse, enter the *greater* of either your own benefit or 50% of your spouse's benefit.

3. *Traditional Employer Pension.* Enter the amount you expect to receive in today's dollars.

4. *Earned Income.* Enter your estimated annual part-time income.

5. *Retirement Shortfall.* Subtract lines 2, 3, and 4 from line 1. This is an estimate of the amount of money you'll need from savings each year, in addition to the above sources of income.

Now that you've determined the amount you'll need in retirement, as well as your shortfall, it's time to figure out how much you'll need to save. Assuming a 3% constant real rate of return after inflation, a life expectancy of age 87, and Social Security benefits beginning at age 65, performing the following calculations can help you estimate the total amount you'll need on your retirement day. These calculations do not represent the performance of any particular savings vehicle, and are for illustrative purposes only. Bear in mind that the *full retirement age* (the age at which one is eligible to receive full Social Security benefits) is gradually increasing to age 67 for individuals born in 1960 and later.

For comparison purposes, let's return to Henry Foster, who plans on retiring in 15 years at age 65 and has managed to save \$45,000. Based on his income requirements and his income resources, Henry will need to save a total of \$254,200 by retirement, or \$9,474.40 per year.



6. To estimate how much you need to save, *multiply* line 5 (the amount of your retirement shortfall) by the appropriate factor below:

<i>Anticipated retirement age:</i>	<i>Multiply by:</i>
55	21.0
60	18.9
65	16.4
70	13.6

7. Enter the current total of your savings including any funds in retirement plans such as a 401(k) or *Individual Retirement Account (IRA)*.

8. *Multiply* line 7 by the appropriate factor:

<i>Retiring in:</i>	<i>Multiply by:</i>
10 years	1.3
15 years	1.6
20 years	1.8
25 years	2.1
30 years	2.4
35 years	2.8
40 years	3.3

9. *Subtract* line 8 from line 6 to reach the estimated amount of savings needed at retirement.

10. To estimate the amount you need to save each year *multiply* line 9 by the appropriate figure:

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retirement savings worksheet

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Retiring in:	Multiply by:
10 years	.085
15 years	.052
20 years	.036
25 years	.027
30 years	.020
35 years	.016
40 years	.013

(Source: ASEC, 2003)

This worksheet is intended to be used as a starting point estimate of what you will need to save for a financially secure retirement. For specific guidance, consult a financial professional. Learning what you must save in order to reach your retirement goals is an important aspect of retirement planning, and the sooner you do so, the closer you will be to fulfilling your dreams. ■

Your Figures	Henry's Figures
1. \$ _____	\$ 35,000
2. \$ _____	\$ 14,500
3. \$ _____	\$ 0
4. \$ _____	\$ 5,000
5. \$ _____	\$ 15,500
6. \$ _____	\$ 254,200
7. \$ _____	\$ 45,000
8. \$ _____	\$ 72,000
9. \$ _____	\$ 182,200
10. \$ _____	\$9,474.40

Continuing Care Retirement Communities: The Answer to Aging?

Imagine yourself as a retired person enjoying safety and independence in comfortable surroundings and having few worries about bills or catastrophic illness. A dream? Yes, but one already coming true for thousands of people who live in *continuing care retirement communities* (CCRCs).

For a one-time payment plus a monthly fee, you can get a contract that entitles you to an apartment or home, meals, medical service and, if necessary, nursing home care until you die. According to the American Association of Retired Persons (AARP), the one-time entry fee can range from \$20,000-\$400,000, depending on the type of residence and its location, while monthly fees can average \$200-\$4,000 for maintenance, household work, and other personal services (AARP, 2005). In return, all forms of *long-term care* are guaranteed and typical amenities include meals, recreational and educational activities, scheduled transportation, and emergency help.

Communities Vary in Appearance

A CCRC can range from a high-rise building in an urban center to an apartment complex located within a small town. They can be found in virtually every state; however, California, Florida, Pennsylvania, Oregon, and Washington tend to be pacesetters in this area—either in terms of number of facilities available, or having state legislatures that are highly supportive of long-term care facilities.

Continuing care retirement facilities are not new. The oldest were established before 1900, with the vast majority having appeared since 1960. Many CCRCs are run by nonprofit groups, while some are affiliated with religious or fraternal organizations.

Seek Legal Advice

If you are considering this retirement option, legal advice is a must because CCRC contracts are complex. You should investigate if the facility is accredited by the Commission on

Accreditation of Rehabilitation Facilities, an organization that checks the quality of health care offered, the facility's financial stability, and what type of consumer protections it has in place. The Commission is located at 1730 Rhode Island Avenue NW, Suite 209, Washington, DC 20036 (www.carf.org). Its telephone number is (866) 888-1122.

Additionally, you can ask for biographies of the community's principal owners and operators to assess their expertise. In most states, the insurance commission regulates CCRCs, so you can call that agency to request a copy of the facility's latest audit report. You can also request the names of current residents and interview them about their experiences living at the facility.

For more information about continuing care retirement communities, contact the American Association of Homes and Services for the Aging (www.aahsa.org), and the American Association of Retired Persons (www.aarp.org). ■

getting to the bottom of inherited IRAs

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option, Linda could opt to *roll over* Jim's assets into her own IRA. (This option is not available for IRAs that have been annuitized.)

Non-Spousal Beneficiaries

Non-spousal beneficiaries have fewer options than spouses. Unlike spousal beneficiaries, non-spousal beneficiaries may not treat IRAs as their own, and cannot name additional beneficiaries. Some IRA custodians allow subsequent beneficiaries. A beneficiary can name a subsequent beneficiary to receive an inherited IRA over the beneficiary's lifetime. If the owner dies before the required beginning date, all assets in the account must be distributed by

the end of the fifth anniversary year of the owner's death. Alternately, the beneficiary may elect to receive distributions over his or her life expectancy. The amount of distributions is based on the *beneficiary's* life expectancy, and must begin by December 31st of the calendar year immediately following the calendar year of the owner's death.

If the owner dies on or after the required beginning date, the assets must be distributed over a period not exceeding the larger of the owner's or the beneficiary's life expectancy.

Parting Thoughts

Under regulations proposed by the IRS in 2001, and finalized in

2002, beneficiaries may be named as late as September 30th of the year after the IRA owner's death. Furthermore, a *primary beneficiary* can disclaim an inheritance, allowing it to pass to a *contingent beneficiary*. In response to the increased longevity of the American population, the IRS has increased life expectancy figures, which essentially reduces required distributions.

If you are an IRA owner or beneficiary, the wide variety of beneficiary arrangements can easily lead to confusion. It is important to be aware of your options and the tax consequences that may apply in your situation. ■

Estate Planning—It's a Team Effort

The fact is, proper estate planning takes into account the coordination of all property transfer methods. Choosing the appropriate strategies will be easier with the assistance of professionals who are knowledgeable in legal, financial and tax matters. However, a great deal of personal involvement should also be expected because estate planning goes beyond legal



documents and tax strategies. Taking initiative and regularly reviewing your estate plan can help ensure your needs and concerns will be properly addressed.

Estate planning can help ensure your assets are transferred to your heirs according to your wishes. Through preparation you can help minimize your estate tax liabilities and maximize the amount that ultimately passes to your beneficiaries. Certain estate planning techniques, such as the use of trusts, can help facilitate property transfers. ■