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## Take the Long View for a Successful Retirement

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

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

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

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

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

*Working while receiving Social Security.* If you receive Social Security and also continue to work, a portion of your benefits may be taxable. For more information, you can refer to Internal Revenue Service (IRS) Publica-

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## Life Insurance and Your Estate—Adding It All Up

It's easy to underestimate your net worth. After all, without a crystal ball, the future value of your home and savings is hypothetical. What's not hypothetical, however, is the fixed amount of the *death benefit* provided by your *life insurance* policy. Adding this often significant

Taxpayers should be aware that federal estate taxes are scheduled for full repeal in 2010. However, EGTRRA contains a "sunset" provision, whereby all provisions automatically expire in 2011, effectively reinstating the prior levies unless Congress acts in the interim.

Although the *unlimited marital deduction* allows spouses to transfer assets between them without assessment of estate taxes, nonspousal heirs face the possibility of seeing a life insurance policy inflate an estate's value past the scheduled *exemption amount* in the year of death.



sum to your asset pool could expose your estate to the federal *estate tax*, and in 2006, the top tax rate is 46%. Fortunately, there are *trusts* that can exclude life insurance from an estate.

Many people assume that because death benefit proceeds from a life insurance policy are generally not considered taxable income to the beneficiary, a life insurance policy is out of the reach of the Internal Revenue Service (IRS). However, when the policy's death benefits are added to the appreciated value of your home and savings, it may come as a shock to find that the value of your estate may exceed the \$2,000,000 *applicable exclusion amount* for 2006 (scheduled to rise to \$3.5 million by 2009 based on the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)).

### One Strategy: A Credit-Shelter Trust

One way to get the life insurance policy out of your estate is to use a type of *bypass trust* known as a *credit-shelter trust*. Essentially, a trust is a legal contract between a named *donor*, a managing *trustee*, and a *beneficiary*.

For estate conservation purposes, a trust could be set up to maximize each spouse's applicable exclusion amount, perhaps sheltering more assets from estate taxation than may be possible through use of just the unlimited marital deduction. At the death of one spouse, an amount equal to his or her applicable exclusion amount could pass to a trust to benefit the surviving spouse, with the remainder of the assets passing outright to the

spouse. Then, at the death of the surviving spouse, assets in the credit-shelter trust could be paid to the couple's children—without being subject to federal estate tax. Any assets outside the trust upon the surviving spouse's death, and therefore potentially subject to estate tax, could be further sheltered by the second spouse's applicable exclusion amount for that year.

### Another Approach: An ILIT

When children are the beneficiaries of a life insurance policy and the owner wants to exempt the policy from the estate's total worth, an *irrevocable life insurance trust (ILIT)* is another approach. Keep in mind, however, the term "irrevocable" means beneficiaries may *not* be changed and loans may *not* be paid out from the policy once it is put into the trust. Putting a hefty life insurance policy into such a trust could help beneficiaries finance the purchase of a family business or pay estate taxes. However, funding an ILIT may result in gift taxes due.

### Park Your Policy in the Right Spot

A trust, depending on the type, can help reduce or defer taxes on high-value assets such as a life insurance policy. More broadly, a trust can be the means to help ensure the policy's benefits go directly to the intended beneficiary. With the flexibility of trusts, however, comes complexity. It is always best to consult with an estate attorney who is experienced in tax matters before proceeding. ■

## Hatching Your Retirement Nest Egg

**m**uch of the focus on retirement planning centers around accumulating a nest egg large enough to help provide income to fund a comfortable retirement lifestyle. However, some complex tax laws prevent direct access to funds in retirement plans, such as employer-sponsored *401(k) plans* and *traditional Individual Retirement Accounts (IRAs)*, providing two potential tax traps for the unsuspecting. The trick, therefore, is to be able to crack these tax law “shells” without damaging the egg inside.

### Tax Shell #1

The first “shell”—the *too soon* tax trap—comes into play if you withdraw money from your qualified retirement plan or IRA before age 59½. Not only will any such withdrawals be taxed as regular income, but a 10% federal income tax penalty may also apply, unless you qualify for an exception to the penalty.

For example, if you are retiring or being terminated from your job after age 55, you can take a lump-sum distribution from a qualified plan, e.g., a 401(k), without penalty. This

provision, however, does not apply to traditional IRAs. Keep in mind that such a distribution would still be subject to taxes at your ordinary income tax rate.

A second exception to the penalty is allowed when withdrawals are taken in “substantially equal periodic payments.” There are three IRS-approved methods—the *life expectancy distribution method*, *annuitization method*, and the *amortization method*. Distributions must continue for at least five years or until age 59½, whichever comes later.

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## Sharing Important Financial Information with Loved Ones

**S**uppose you are in the middle of your workday and you receive an urgent telephone call from the local hospital. The caller informs you that your spouse has been the victim of a serious car accident and is unconscious. The shock of finding a loved one in such a dire situation can make it difficult to cope with normal, everyday matters.

Now, suppose your loved one, who has handled all the family finances, were to suffer an untimely death as the result of the accident. While you are grieving, it will be even harder to tackle the difficult job of identifying and gathering important financial records and documents. Will you be able to quickly identify the numbers of bank accounts and *insurance* policies? Can you locate the whereabouts of *wills* and other key documents?

Unfortunately, this situation is not uncommon. To avoid finding

yourself in this predicament, it is important to take the time to sit down with your spouse and prepare an inventory of pertinent financial information. Update it regularly as changes occur and share this information with family members or other trusted associates who will need to know where this list can be found. This document will help a surviving spouse, or any other family member or close friend who must manage your financial affairs after your death, carry on smoothly and without undue delay.

### What Information Should You Include?

The following information will give you a good start on what to record:

- **Basic Data.** Include your full name, maiden name, date of birth, and Social Security number.

- **Financial Contacts.** List the names of your lawyer, accountant, insurance agent, and other financial representatives, along with their contact information.
- **Financial Assets, Liabilities, and Account Numbers.** Identify all financial assets, including bank accounts, insurance policies, and company benefits, along with relevant identifying numbers. Also, note any *outstanding* liabilities, such as mortgages, loans, and credit card debt.
- **Location of Key Documents.** Finally, identify the location of your will, *trust* documents, tax returns, and insurance policies.

Handling the death of a loved one is never easy. However, leaving an updated inventory of vital financial information can help ease the process for those who are left behind. ■

## hatching your retirement nest egg

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### Tax Shell #2

The second “shell”—the *too little tax trap*—involves *required minimum distributions (RMDs)*, which generally begin at age 70½. Individuals (other than certain owner-employees still working beyond age 70½) are allowed to delay distributions from their qualified plans and *tax-sheltered annuities (TSAs)*—but not from

traditional IRAs. If you fail to withdraw the required amount, a 50% penalty is assessed on the shortfall. New rules finalized by the Internal Revenue Service (IRS) in 2002 simplify the calculation of RMDs and decrease the required distribution amounts. As always, there is no penalty for withdrawals in *excess* of the required minimum.

Individuals who have accumulated substantial assets for retirement may want to calculate various income scenarios to help project future withdrawals from their retirement account(s). “Running the numbers” in advance may also help enable retirees to avoid potential tax traps as they prepare to hatch their retirement nest eggs. ■

## take the long view for a successful retirement

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tion 915, *Social Security and Equivalent Railroad Retirement Benefits*, or consult with your tax professional.

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

Previously, the law required Social Security income recipients between the ages of 65 and 69 to return \$1 for every \$3 earned in excess of a predetermined earnings limit. Now, the law requires a giveback of \$1 for every \$2 earned above

\$12,480 (in 2006) for individuals who are between the ages of 62 and 64 while receiving a reduced Social Security benefit. For the year in which an individual attains full retirement age, the give-back is \$1 for every \$3 earned in excess of \$33,240 for 2006. The month in which the individual attains full retirement age, the giveback is eliminated. Therefore, it is important for anyone who is thinking about taking Social Security benefits while still working to understand the potential tax consequences and to plan accordingly.

*Where you live can make a difference.* Some important tax issues must be addressed when you

select your retirement haven. Each state has its own rules on income, estate, sales, and property taxation. Your accountant can help you become familiar with the tax advantages and disadvantages of your retirement destination.

### *Planning Doesn't End When Retirement Begins*

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

*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 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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