

21st century retirement



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Congress Delivers Sweeping Pension Reform

The Pension Protection Act of 2006, signed into law on August 17, delivers a long-awaited package of reforms aimed at strengthening employer-provided defined benefit plans and encouraging defined contribution plan participation. The most comprehensive pension legislation in three decades, the act also includes provisions relating to hybrid retirement plans and charitable giving, and it makes permanent the Roth 401(k) and higher contribution limits for IRAs and 401(k)s.

Stabilizing Defined Benefit Plans

Drafted in response to a wave of high-profile corporate bankruptcies that forced the federal insurer PBGC (Pension Benefit Guaranty Corporation) to pick up the tab for underfunded pension plans, the measure requires employers operating traditional pensions to fund the plans fully. The law compels companies outside of the airline industry to cover 100% of the liabilities in their pension plans over seven years, up from the current minimum funding level of 90%. Sponsors of plans that remain underfunded below certain levels face stricter funding requirements, restrictions on benefit offerings and payouts, and limits on executive deferred compensation. New disclosure and reporting requirements have also been imposed to ensure that plan participants and company shareholders receive regular updates on the funding status of pension plans. Additional funding rules and heightened notice requirements for multi-employer plans are also included in the legislation.

To ease the burden of higher minimum funding levels, the law permits larger tax deductions for contributions to pension plans—employers may deduct up to 150% of current plan liabilities. However, the measure also reduces the predictability of funding requirements by restricting the smoothing of investment returns and averaging of interest rates.

Clarifying Cash Balance Regulations

The legislation addresses the legal status of cash balance plans and other types of hybrid plans. Cash balance plans combine elements of both defined benefit and defined contribution plans. The measure shields companies with cash balance plans from lawsuits by older workers who claim they do not have time before retirement to save enough money to cover their benefit

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Retirement Planning: Actions You Can Take Now

does your retirement seem light-years away? While it may appear a long way off, you owe it to yourself to look toward the future and begin giving some thought to what you can do today to help ensure a bright retirement *tomorrow*. Although time may be on your side, if you quiz some of the retirees you know, they will probably tell you that saving for retirement is not as simple as it may initially appear.

Here are four key factors to consider that may ultimately influence the type of retirement you will enjoy:

Inflation. You are probably aware that, over time, inflation can erode your savings. But, just how seriously do you take inflation? At 3% inflation, \$100 today will be worth only \$67.30 in 20 years—a loss of one-third of its value. Thus, it is important to seek retirement savings vehicles that have the best chance of outpacing inflation.

Taxes. Your present income level, tax bracket, and the types of tax-deferred retirement savings plans that are available to you can all play an integral part in how much money you can amass for your retirement. By maximizing your pre-tax contributions to employer-sponsored plans and **Individual Retirement Accounts (IRAs)**, you can help take advantage of the tax-deferred benefits of such plans.

Discipline. Becoming a disciplined saver is one of the key components of retirement plan success. By making *regular* contributions to your employer-sponsored retirement plan and your IRA, you can maximize the power of **compound interest** (the interest earned not only on the initial principal, but also on the accumulated interest from prior periods). With a steady flow of contributions, your retirement savings have a greater chance of accumulating to meet your long-term goals.

Personal Savings. Taking into account the effects of inflation and taxes, there is a distinct possibility that your retirement plan income may eventually fall short of your needs, especially during a long retirement. Also, Social Security generally provides only a percentage of most retirees' income, and its future is in question. Thus, to avoid a potential shortfall, it is essential to start planning today to supplement traditional retirement income sources with your own personal savings.

Of course, understanding these principles alone is no guarantee of future success. However, the sooner you begin to recognize the effects that economic and financial forces can have on your retirement income, the more likely you will be to adopt current strategies that can help you achieve your long-term objectives. By taking action *now*, you can help increase your chances of brightening your "golden" years ahead. ■

Updated Wills Can Contribute to a Relaxing Retirement

Whether you're decades or months away from retirement, it's always a good idea to review your will whenever your family circumstances or finances change. To stay current, revisit your will about every five years to help ensure your estate tax strategies are appropriate and your assets are distributed exactly as you wish.

With a comprehensive estate plan, you can relax during your retirement knowing your financial house is in order.

A will should be drawn up by a lawyer, even though legally you could draft one on your own. Besides the

inherent complexity of estate planning, states have different standards and often require specific language



that must be included in order for the document to be valid. At the very least, you should have a will *reviewed* by a lawyer so you can be assured statutory requirements are being met.

Husbands and wives have the option of writing their wills jointly or separately. However, you may want to consider separate wills because they help specify *who* owns *what* property. The portion of your estate covered by a will includes *tangible* assets, such as your home or car, as well as *intangible* assets, such as savings accounts held in your name. (Property owned jointly with right of survivorship will pass directly to the surviving owner, while other assets, such as life insurance death benefits, will automatically pass to your designated beneficiaries.)

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The Nuts & Bolts of Required Minimum Distributions

Given the uncertain future of Social Security and the decline in popularity of traditional pensions, taking initiative to save for retirement is more important than ever. Individual Retirement Accounts (IRAs) and employer-sponsored qualified retirement plans provide valuable, tax-favored opportunities. However, along with the benefits come certain rules.

The Internal Revenue Service (IRS) governs the distribution of these savings during retirement with the required minimum distribution (RMD) rules. The RMD is the minimum amount that must be distributed to retirement plan owners beginning in the year the owner turns age 70½. Rule changes finalized in April 2002 simplified many of the RMD regulations.

Required Beginning Date

Minimum distributions must be made on or before December 31st of each year. However, the first required minimum distribution may be postponed until April 1st of the calendar year following the year the IRA owner reaches age 70½. This is the “required beginning date.”

For example, Amanda (a hypothetical case) turned 70 on March 5, 2006 and 70½ on September 5, 2006. Her first RMD is due December 31, 2006, but it may be postponed until the “required beginning date” of April 1, 2007. Her second RMD would then be due on December 31, 2007.

Any participant in a qualified retirement plan who is not a 5% owner may postpone the required beginning date until April 1st of the calendar year following the year of retirement, if so allowed in the plan document.

Just as there are penalties for withdrawing money too soon, there are penalties for not taking the RMD. A 50% excise tax is imposed for failing to take these required distributions.

A Simpler Table

The final regulations produced a simpler table for calculating the life expectancies that determine RMDs. Known as the uniform lifetime table, it reflects longer life expectancies, decreases the required minimums, and generally results in larger tax-deferred account balances.



Consider this hypothetical example: Joshua’s required beginning date was April 1, 2005. He is 71 and his wife is 72. The combination of his IRAs that total \$1,000,000 results in distributions of \$51,546 under the 1987 joint life expectancy table and \$37,736 under the reformed uniform lifetime table.

The joint life expectancy table is still available to use if the sole beneficiary is the participant’s spouse and the spouse is more than ten years younger than the participant. This combination would result in an even smaller required minimum distribution.

Distributions upon Death

With the reform, the single life expectancy table is generally used regardless of who is the designated beneficiary. Distributions must begin

by December 31st of the year following the year of death and are based on the beneficiary’s life expectancy. If there are multiple beneficiaries, the life expectancy is based on the oldest beneficiary, or separate accounts may be established for each beneficiary.

Spousal beneficiaries may elect at any time to treat the owner/participant’s IRA as their own, and only spousal beneficiaries may **roll over** death benefits to their own IRAs. A spousal beneficiary may also delay the first distribution until the owner/participant would have reached age 70½.

Under the old rules, the beneficiaries were “fixed” as of the required beginning date. Under the new rules, beneficiaries have until September 30th of the following year to determine how the death benefit should be distributed.

IRS Eases Up on Rules

Taxpayers who take IRA distributions in a series of “substantially equal periodic payments” may be able to change the method of calculating these payments without incurring a 10% early withdrawal penalty tax. Due to market downturns, the account balances of taxpayers who chose the “fixed” methods are depleting more rapidly than they had expected. The IRS now allows a one-time election to switch to the RMD method without incurring any penalties. The RMD method permits the taxpayer to recalculate the payment using the life expectancy tables and the account balance each year.

Failure to follow IRS regulations could be costly. Knowing the rules can help you plan ahead and take full advantage of the important tax benefits qualified retirement plans offer. ■

congress delivers sweeping pension reform

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losses after their employers moved them from a traditional pension to a cash balance plan. The clarification of the rules governing the transition from defined benefit to cash balance plans could make the hybrid option more attractive to some employers.

Retirement Saving Incentives

The measure includes provisions designed to encourage employee participation in defined contribution plans. The law settles outstanding legal issues by explicitly allowing automatic enrollment of workers in 401(k) plans by employers. Employees who have been automatically

enrolled in a plan retain the right to opt out, but they must take action to do so. In addition, employers are permitted to make default contribution decisions on behalf of 401(k) plan participants who have made no investment choices. For the first time, plan sponsors are, under certain conditions, allowed to provide personalized investment advice to participants.

The law also makes permanent incentives for qualified retirement savings contained in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). These provisions, many of which were due to expire in 2010, include higher contribution limits and catch-up

amounts for IRAs and 401(k) plans, accelerated vesting of employer matching contributions, and higher deductible amounts for employer contributions to employee retirement accounts. By making the newly available Roth 401(k) a permanent part of the tax code, the legislation is expected to encourage 401(k) sponsors to add a Roth option to their plans. Furthermore, the law puts an end to uncertainties surrounding 529 college savings plans by mandating that qualified withdrawals will remain tax-free in the future. The law also allows through 2007 tax-free distributions from IRAs to charities, up to a limit of \$100,000. ■

updated wills can contribute to a relaxing retirement

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Whenever you update your will, the new document should include the date, a statement revoking all previous wills, provisions for trusts (if any), names of guardians and alternates for minor children (if necessary), and specific bequests. A specific bequest calls for the transfer of a *particular piece* of property to a named beneficiary, while a general bequest does not specify from which

part of an estate the property is to be taken. The updated and signed document should also include your full name, a statement that the document is a will, and names of the executor and substitute executor.

Once you have reviewed and updated your will, you can make photocopies for yourself, members of your family, or others who may

need the information. Be sure the original is kept in a secure place, such as a bank safe-deposit box or lawyer's office. You should also make sure your family and friends know where to locate the will. Once this is completed, you may feel free to enjoy your retirement knowing that your wishes will ultimately be fulfilled upon your death. ■

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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