

21st century retirement



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in this issue:

Taxes and Your
Retirement Destination

Choosing Your
Pension Payout Option

Fighting Inflation
with Life Insurance

Racing to Retirement: You Can Finish First

With all of the little chores necessary to get through each day, most of us spend our free time trying to complete routine tasks that are just a part of life. The few waking hours that work does not consume can easily be filled with duties such as cleaning, grocery shopping, and caregiving, amongst many others. It's a small wonder then that most people rarely pause to think about the quality of life issues they will face in 20 or 30 years at retirement.

Choose to Save®, a national public education and outreach program, reports that while the average American can expect to live 18 years after retirement, 30% have still not yet begun to save. This is in direct contrast to the tremendous power of saving early and often. Choose to Save® reports that even saving a low annual sum of \$2,000 can add up after a number of years. Earning a modest 4% interest rate, saving this amount would be worth \$24,012 in 10 years, \$59,556 in 20 years, and \$112,170 in 30 years.¹

Based on the example above, we can see that even a relatively small effort can have a significant impact over time. With ongoing daily concerns, many people give little thought to planning for financial security in retirement, or they think they will get to it later; but time is on your side if you start now. So how can you get on the retirement savings track and watch your efforts grow? Starting today, consider taking the following steps.

Educate yourself. Ignorance is not always bliss. It's very important that you learn as much as you can about the retirement options that are available to you. Make sure you understand the negative effect inflation can have on your savings, the tradeoffs between risk and return, and the tax implications of your various financial decisions.

Set a goal. Most figures indicate that you will need 70%–90% of your current annual income in order to live comfortably in retirement. To meet that percentage goal, you will need to know the minimum amount you must save. Your financial professional can help you develop savings strategies tailored to your needs.

continued on page four

¹“Top Ten Ways to Beat the Clock and Prepare for Retirement,” Choose to Save®, <http://www.choosetosave.org/brochures/index.cfm?fa=facts> (accessed November 2006).

Taxes and Your Retirement Destination

What will you look for as you approach your “golden” years? Do you want an affordable condo on the golf course with room for visiting grandchildren? Would you like to remain in a community surrounded by old friends and family, or would you prefer living in close proximity to new friends? Is access to excellent medical facilities a priority?

As you decide where your retirement haven will be, in addition to considering these lifestyle questions, you should research the effects of state tax structures on your projected retirement income. Here is a look at the following key tax areas:

Earned and unearned income taxes. If you plan on continuing to work, some states treat seniors like everyone else on their income tax rolls, some specifically give seniors tax breaks on earned income, and others do not tax earned income for any of their residents. Tax rates on unearned income may also vary from state to state. Be aware that several states tax former residents on **Individual Retirement Account**

(IRA) distributions. Thus, if you move, you may have to file income tax returns in *two* states—and watch out for unexpected local income taxes.

Pension income taxes. In many cases, one key to financial survival for seniors is income from military, government, and private pension plans. Some states exempt all pension income from taxation, while others exempt certain types and/or amounts of pension income.

Social Security benefit taxes. Some states do not tax Social Security benefits at all, while others follow federal tax formulas for determining their tax on such benefits. Still others have developed their own formulas to determine the income tax on Social Security benefits.

Property taxes. This is another area where some states offer advantages to seniors. Familiarize yourself with the relevant personal property tax laws, especially on cars and boats.

Sales taxes. Many states—and sometimes localities within each state—tax clothing, gas, household goods, and sometimes even food and prescription drugs. When you

look at what you have budgeted out of your fixed income for these items, remember to add sales taxes if they will apply when you move to your retirement haven.

Estate taxes. While they do not *directly* affect your cost of living as a senior, do not overlook estate taxes when determining the feasibility of settling in one state over another. In some states, your spouse may be taxed on a portion of his or her inheritance that, in another state, would pass to him or her free of state estate tax. Changes in state estate tax codes should be watched carefully as states study ways to make their financial environments “friendlier” to seniors.

No *single* tax consideration should be used to determine the most favorable tax environment for your retirement years. You need to analyze your *overall* financial situation and then look at all of your retirement options. Your main goal should be to spend your senior years where you will be relatively free from financial stress—to live the happy, healthy life you have earned. ■

Choosing Your Pension Payout Option

Many couples find themselves confronted with a dilemma as retirement nears. If you plan to collect your **pension** on a monthly basis (rather than in a lump sum), you must decide whether you would prefer to receive a higher payment during your lifetime alone (the **life option**) or a lower payment that will span the lifetimes of both you and your spouse (the **joint and survivor option**).

In choosing between these options, you will need to consider such things as the current and anticipated health of both you and your spouse, and how long you each expect to live, as well as your financial situation and income requirements. Here is a brief look at how each of these options works:

Life Option. With this option, let’s assume you receive \$1,700 per

month. This will be higher than the amount you would receive with joint and survivor benefits, say by \$475. If you live to a ripe old age, this extra \$475 per month will undoubtedly come in handy. On the other hand, once you die, payments to your surviving spouse, who may live for many more years, will stop. This could have a significant impact on his or her standard of living.

continued on page three

choosing your pension payout option

continued from page two

Joint and Survivor Option. If, like many people, you select joint and survivor benefits, suppose you receive \$1,225 per month (\$475 less than with the life option). If you die first, payments to your surviving spouse will continue. This may help provide critical income for your surviving spouse, especially if he or she outlives you by many years. However, if your spouse dies before you, you cannot go back and change your decision, even though your reason for choosing the lower monthly benefit—to protect your spouse's long-term income—no longer exists.

The Best of Both Worlds

Deciding between these options may leave you and your spouse feeling as though you are betting on each other's lives. But, you need not be locked into an "either-or" dilemma. With proper planning you can have it both ways—a higher monthly benefit now, *plus* continuing income for your surviving spouse in the event you die first.

In structuring this approach, you would select the life option and use a portion of the higher monthly benefit to purchase a **life insurance** policy on yourself. If you should die first, your surviving spouse can manage the insurance proceeds to help generate the monthly income he or she needs. On the other hand, if your spouse should predecease you, you can simply cancel the policy and continue receiving the higher monthly benefit.

This strategy also offers some added benefits: 1) you can tap the policy's cash value while you are alive; 2) after your death, your spouse can manage the insurance proceeds according to his or her needs; and 3) you can change the policy's beneficiary if you so choose.

Despite its advantages, this strategy requires *disciplined* money management to achieve the desired results. First, your life insurance policy may lapse if the premiums are not paid. Second, a lump-sum death benefit must be properly managed to yield

the anticipated income. Third, by waiving the spousal provision, your spouse may lose other pension-related benefits, such as cost-of-living adjustments or company-sponsored health insurance. Fourth, the issuance of a life insurance policy is not guaranteed. You should proceed carefully with this approach until a policy has been issued in your name. Finally, the issuance of a policy at a reasonable premium (which would depend on your age and health condition) is not guaranteed. If the premium takes up too much of your monthly benefit amount, this strategy may not make sense.

Consider All Your Options

When faced with the dilemma of choosing between the life option or the joint and survivor payout options, coupling the life option with an insurance policy may provide the best of both worlds. It is always important to consider your overall retirement plan to help determine which approach may work best for you. ■

Fighting Inflation with Life Insurance

Inflation can essentially take the "muscle" right out of your future purchasing

power. It may similarly affect your **life insurance** and can trigger the need for additional coverage to help protect your current lifestyle and

future objectives. In the interest of protecting against the eroding effects of inflation, here is a quick look at



three common reasons to strengthen your life insurance coverage:

Home mortgage costs. The days of staying in one home forever may be long gone. Americans seem to be constantly on the move—perhaps the increased mobility may stem from factors such as greater employment opportunities, dual incomes, and changing

family dynamics. These factors may be contributing to today's growing trend of purchasing "more" house than in the past. Likewise, escalating real estate prices have translated into larger mortgage loans. So, if you have recently purchased a home, you may consider obtaining *additional* life insurance to help cover your new mortgage.

College tuition bills. If you are planning on sending your children to college, you may be concerned

continued on page four

racing to retirement: you can finish first

continued from page one

Participation is key. If your employer offers a retirement plan, sign up! Many employers offer to match contributions by 25%, 50%, or 100%. That is basically like an immediate return on your investment that didn't cost you one penny. Contribute as much as you can, up to the amount allowed by law.

Look around. If you are in the market for a new job, in addition to salary, the retirement benefits offered by your employer will be extremely important. Select a new position with care and only after evaluating the benefits, which will have a great impact on your future.

Know what's coming to you.

Each worker over age 25 receives an annual mailing from the Social Security office entitled, "Your Social Security Statement." This projects your future benefit amount. Since Social Security typically only replaces approximately 40% of pre-retirement income, it's wise to be aware that it will not be a major source of retirement funding. Learn the estimate, and plan around it. If you didn't receive the mailing (approximately three months before your birthday), call 800-772-1213 to request a free copy.

What's the rush? A lot of people enter retirement only to discover

that they want to be back in the workforce. With that in mind, consider delaying retirement by a couple of years. This will give you the opportunity to delay withdrawals, earn more raises, save more, extend your earnings horizon, and increase your Social Security benefit.

Running the rat race every day requires lots of effort. Even so, take the time to learn about your retirement options and what you must do to reach your goals. One day, the rat race will be behind you. Planning today makes you most likely to have the financial stability to sit on the sidelines and enjoy your well-earned leisure. ■

fighting inflation with life insurance

continued from page three

about the rising costs of higher education. For the school year 2006–2007, the average annual cost of a four-year private college increased 5.9% from the prior year to \$22,218. The average annual cost for a four-year public school was \$5,836, which increased 6.3% from the previous year (The College Board, 2006). Because of rising costs, it may be prudent to develop a contingency plan, such as utilizing life insurance in the event of an untimely death. Having this coverage in place can help ensure the educational funding will be there for your children, even if you're not.

Everyday expenses. Groceries. . . gas. . . movies. . . family vacations. . . or home improvements. Whatever the outlay, inflation will greatly affect the costs associated with maintaining your family and lifestyle. And, if your life insurance needs are based on your current income and today's cost of goods and services, you may potentially short-change your family's future. Your insurance strategy should include an assessment of both your current and *future* needs, as well as objectives to help you manage these expenses.

Staying Ahead of the Game

Determining your current and future life insurance needs may require you to pay careful attention to inflation and its potential effect on your lifestyle objectives. You may want to consider battling this erosion factor by reviewing your insurance coverage annually to help ensure your life insurance policy remains a contender in the continuous fight against inflation. ■

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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