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Planning for Your Financial Future

Regardless of the path your life takes, money will play an important role at every turn. Certain events, especially graduating from college, entering the work world, getting married, having children, and retiring all require targeted financial strategies. Good habits developed *now* can go a long way toward helping you achieve your financial goals.

From Campus to the Workforce

If you're just starting your career, set some goals for making the most of your disposable income. Consider the following three rules: 1) budget your money; 2) keep an emergency fund to cover up to six months of living expenses; and 3) avoid unnecessary debt.

Paying off any college loans is important. Also, try to avoid spending too much on housing by limiting rent or mortgage-related expenses (principal, interest, insurance, property taxes, and/or condo fees) to between 28% and 30% of your gross monthly income. When other short-term debt, such as car payments, student loans, and credit card bills are included, the debt limit guideline may rise to 36% of your gross pay.

For younger workers, retirement is often last on the list of financial concerns. However, if your employer offers a retirement plan with tax benefits, such as a **401(k)**, you may want to make the most of the opportunity. Pre-tax payroll deductions make contributing relatively painless. Try to contribute the maximum amount allowed—especially if your employer *matches* some, or all, of your contribution. If you don't have a retirement plan at work, consider opening an **Individual Retirement Account (IRA)** that can provide for *tax-deductible* contributions and *tax-deferred* earnings.

Settling Down

If settling down means marriage, you now have two financial situations to reconcile. Keep in mind that marriage establishes a *legal* relationship, and your spouse may have his or her own debt. Ideally, attempt to begin your new life together with a clear balance sheet.

Whether single or married, financial goals take on greater importance as you assume more responsibilities. You and your spouse may choose to name each other as **beneficiaries** of **retirement accounts**, **annuities**, or **life insurance** policies. Also consider the protection offered by disability

continued on page three

Non-Working Spouses and Roth IRAs

For many married couples, retirement planning has become not only a personal responsibility but a financial necessity. Since Americans are living longer, retirement funding may need to span several decades beyond the normal retirement age. When you consider the escalating costs of health care, the uncertainty of **Social Security** and **Medicare**, and the pace of inflation, it is more important than ever to explore tax-advantaged saving options that can fit into you and your spouse's overall financial plan for retirement. Let's take a closer look at some of the benefits of a **Roth Individual Retirement Account (IRA)**.

Roth IRA contributions are made on an *after-tax* basis from earned income only, and no income tax is due when distributions are taken. Distributions from a Roth IRA are free of income taxes after the account has existed for five years *and* you have reached age 59½. If you take withdrawals prior to age 59½, you may be subject to a 10% Federal income tax penalty. However, certain situations qualify as exceptions, such as early withdrawals for qualified education expenses or first-time homebuyer expenses.

In addition to tax-free withdrawals, a Roth IRA has two other important features: 1) There are no Internal Revenue Service (IRS) restrictions on *when* you must begin taking withdrawals (e.g., age 70½ with traditional IRAs), and 2) You can continue to contribute to a Roth beyond age 70½ if you have earned income. Over the long term, this can lead to the potential for additional savings, especially if you plan to work past age 70½, or if you have other sources of retirement income and do not expect to rely heavily on your Roth IRA.

Who Is Eligible?

While earned income is one of the requirements for opening up a Roth IRA, a married couple with only one income may open and contribute to a Roth IRA under certain guidelines. The Roth IRA eligibility rule allows married couples to make contributions, as long as at least one spouse has taxable earned income from working *and* a joint tax return is filed. Under the IRS provision for married taxpayers filing jointly in 2013 with one earned income, and who have $10,000 in **modified adjustable gross income (MAGI)** or more, you and your non-working spouse can each contribute the maximum amount of $5,500, or $6,500 (if you are *both* age 50 or older and have at least $12,000 in MAGI) to a Roth IRA.

When a joint tax return is filed, the IRS regards a married couple's income as **joint income**, even with a non-working spouse. A married couple's total income is considered to equally belong to each spouse. Since both of you are joint recipients of the total income earned, you are both eligible to open a Roth IRA in your own names. You can each contribute up to the maximum contribution limit of $5,500 (or $6,500, if 50 or over) in 2013.

Income Limits

The Roth IRA income limits for a married couple filing a joint tax return with both spouses earning taxable income are the same for a married one-income couple filing jointly. The **adjustable gross income (AGI)** limit for maximum contributions is $178,000 or less for joint filers in 2013. If joint filers earn between $178,000 and $188,000, the allowed contribution amount is phased out per IRS guidelines.

The Roth IRA is a retirement savings vehicle that may offer multiple advantages for one-income married taxpayers, including tax-free distributions with no age restrictions. Be sure to consult your qualified financial and tax professionals to determine what is appropriate for your unique circumstances.

planning for your financial future

continued from page one

income insurance. In the event that you or your spouse should become unable to work due to an accident or illness, disability income insurance can provide a certain level of replacement income.

Although children present new and immediate demands on your time and financial resources, having dependents may motivate you to plan for the future. Two essentials include adequate **life insurance** and a **will** that names **guardians** for minor children.

You may also want to establish an education funding plan to help finance higher education. Many parents feel torn between saving for their children's college education and their own retirement. Starting early may allow you to do both.

Nearing Retirement

For many people, a comfortable retirement may require 75% to 80% of their pre-retirement income. The three-tiered components of retirement income consist of Social Security, employer-sponsored plans (e.g., 401(k)s, pensions), and personal savings. If you anticipate little or no income from Social Security or a traditional company pension, you will need to prepare early to make up the difference with savings and an employer-sponsored retirement plan.

A comprehensive estate plan, to minimize potential estate tax liabilities and to help ensure that your assets are transferred to your heirs according to your wishes, is also important.

It is never too early to begin building the foundation for your financial future. Good habits developed *now* can go a long way toward helping you achieve your financial goals. Regardless of your stage in life, be sure to consult a qualified financial professional to help determine appropriate strategies for your unique circumstances.

To Buy or Rent: That Is the Question

The decision to rent or buy a home is generally based on three factors: cost, investment, and personal preference. Initially, home ownership may be more expensive than renting due to the upfront costs associated with buying a home, such as closing costs and a down payment. But in the long run, homeowners may build equity and save on taxes.

Many homeowners qualify for tax savings by deducting mortgage interest and property taxes, which may represent considerable savings in regions where property taxes are high. On the other hand, renters miss out on these tax savings, but generally don't pay for emergency repairs or general maintenance, which can be expensive for today's homeowner. Renting also offers more flexibility for those who anticipate relocating for work or other reasons.

Here are some calculations that may help you decide whether to buy or rent a home:

1. Investigate the purchase price and financing terms for the type of house or condominium you would like to purchase in your target location. Be sure to include the down payment, closing costs, and any points.
2. Estimate your gross monthly costs as a homeowner, including utilities, maintenance, and repairs. If you are considering buying a condominium or townhouse, also factor in any applicable association fees.
3. Calculate your net monthly outlay. This figure is computed by taking into consideration any tax savings you may receive by deducting mortgage interest and property taxes.
4. Project what the proceeds would be after selling the property in five, 10, or 20 years.
5. Calculate your total rent for the same period.
6. Finally, compare the two sets of figures. What would your financial results be if you saved the money you would spend on a down payment, closing costs, and points (assuming a reasonable growth rate)? What is the difference between your rent and the "net outlay" as a homeowner?

In addition, you may also need to determine all of the other nonfinancial advantages that home or condominium ownership provides. Analyzing your short- and long-term goals can help you decide whether renting or owning best suits your lifestyle and your financial situation.

Is Estate Planning Still Necessary?

The estate tax is generally paid by the most affluent Americans, however, it can also hit families with smaller assets, especially if they fail to plan for a possible estate tax liability. If the combined value of all of your property, including real estate, investments, insurance policies, savings, pensions, and valuable items, such as jewelry, artwork, and antiques, exceeds the estate tax exemption amount, your family members may have to pay both Federal and state taxes on the inheritance.

Under current law, the estate tax exemption for an individual is set at $5.25 million for 2013. While it may be impossible to predict whether, or to what extent, your estate will be subject to taxation at the time of your death, creating and maintaining an estate plan provides essential legal and financial protection for your heirs. If you fail to leave behind a well-structured plan for the distribution of your assets, disagreements between family members may arise, and your estate could end up in probate court.

You can reduce the size of your estate by giving away some of your assets to family members during your lifetime. Gifting is especially beneficial from a tax perspective when income is shifted to a recipient in a lower tax bracket. The annual gift tax exclusion in 2013 allows a donor to give away up to $14,000 per year, per recipient, without incurring a gift tax liability. If you are married and your spouse consents to "splitting" the gift, the annual gift tax exclusion increases to $28,000, even if only one spouse actually makes the entire gift. No gift tax is paid out of pocket until taxable gifts exceed the lifetime gift exemption, currently set at $5.25 million through 2013.

Trusts are also valuable tools for minimizing taxes and protecting your assets from the potentially expensive probate process. A **bypass trust** is particularly useful for married couples, who can choose to make children or grandchildren, rather than each other, the beneficiaries of the estate. In what is commonly referred to as an A/B arrangement, the bypass trust is combined with a **marital trust**. Used together, these trusts can help minimize estate taxes on transfers to the next generation, while still allowing the surviving spouse to withdraw funds from the trust for reasonable living expenses. To preserve family harmony and avoid future conflicts over inheritances, you may choose to supplement A/B trusts with a **qualified terminable interest property (QTIP) trust**, which gives you greater control over the distribution of your assets after your death.

The **irrevocable life insurance trust (ILIT)** is also frequently recommended as a means of shielding a life insurance policy from Federal taxes. When properly implemented, the proceeds of an ILIT will not be included in your estate and will, and will be paid out to the trust's beneficiaries without incurring any estate tax consequences. The trust may be used to finance your children's education or to provide a staggered income for your heirs.

Clearly, these trusts do more than simply protect your family's assets from taxation. By planning your estate, you can resolve potential inheritance disputes prior to your death.

Unresolved questions about the future of estate tax rates, exemptions, and the tax basis of assets can make estate planning challenging. Therefore, be sure to consult regularly with your tax and legal professionals to help ensure that your strategies remain consistent with your financial and personal objectives.

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