



# FINANCIAL *Planning Strategies*

A Financial Planning Update

**WestPoint** *Private Client*  
G R O U P



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## Traditional IRAs vs. Roth IRAs

In today's busy, financial scene, two popular **Individual Retirement Accounts (IRAs)** vying for your attention are the *traditional IRA* and the *Roth IRA*. While both are long-term savings vehicles with tax benefits, each treats contributions, age, and income differently.

### Contributions

Perhaps the biggest difference between traditional IRAs and Roth IRAs is the nature of the contributions and how they are ultimately taxed. Contributions to traditional IRAs may be *pre-tax* (deductible on the taxpayer's income tax return). Therefore, although contributions and earnings accumulate on a tax-deferred

basis, income taxes are due when distributions from the IRA are taken. On the other hand, contributions to Roth IRAs are *after-tax*, contributions and earnings accumulate tax-free, and no income tax is due when distributions are taken from Roth IRAs. For 2006, contributions to traditional IRAs, Roth IRAs, or both are limited to the lesser of \$4,000 (\$5,000 for individuals age 50 or older) or 100% of compensation included in gross income.

### Age Restrictions

Contributions to traditional IRAs may be made in years an individual receives compensation, prior to attaining age 70½.

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## Early Retirement—Is It Viable?

Today, many people contemplate, or are forced into, taking an early retirement. With life expectancies steadily increasing, the chance of an individual spending one-third of his or her lifetime in retirement is a distinct possibility. Naturally, the sooner you begin planning, the greater your chances are of achieving a comfortable, early retirement.

To maintain your quality of life during your non-working years, you may have to supplement your qualified retirement

plans and Social Security benefits with personal savings. With a disciplined, long-term savings plan, you may help increase your chances of reaching your retirement goals.

There are important planning considerations specific to early retirees. For example, individuals who retire before the age of 59½ may incur certain penalties on early withdrawals from retirement plans. Also, inflation will most likely have a direct impact on how long you

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## Traditional IRAs vs. Roth IRAs

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**Required minimum distributions (RMDs)** must begin by April 1<sup>st</sup> of the year *after* reaching age 70½ (or a 50% tax penalty may apply). In contrast, Roth IRAs have neither an age limit for contributions nor minimum distribution requirements. However, *both* traditional and Roth IRAs have a minimum age for distributions—59½. Distributions taken prior to age 59½ may be subject to a 10% federal income tax penalty. Certain situations qualify as exemptions, such as distributions to pay for first-time homebuyer expenses or qualified education expenses. Furthermore, before tax-free distributions can be received from a Roth IRA, the account must be five years old.



### Income Eligibility Limits

Depending on your tax-filing status, your income, and whether or not you participate in a qualified

employer-sponsored retirement plan, you may be eligible to take an income tax deduction for contributions to a traditional IRA. If you are a single taxpayer, do *not* participate in a qualified employer-sponsored plan, and earn a minimum of \$4,000, contributions are deductible regardless of your **adjusted gross income (AGI)**. However, if you do participate in an employer-sponsored retirement plan, income limits apply. Deductions in 2006 phase out for single taxpayers with AGIs between \$50,000 and \$60,000 and for married couples filing jointly with AGIs between \$75,000 and \$85,000.

The income eligibility requirements are different for Roth IRAs. If you participate in a qualified employer-sponsored retirement plan, you may contribute to a Roth IRA; however, if you are also contributing to a traditional IRA, your contributions may not exceed the annual

contribution limits. You are eligible to make a full contribution to a Roth IRA if your modified AGI does not exceed \$95,000 for single taxpayers or \$150,000 for married taxpayers filing jointly (contributions phase out for single filers with modified AGIs between \$95,000 and \$110,000 and for joint filers with modified AGIs between \$150,000 and \$160,000). A Roth IRA is often a favored choice for those who participate in a qualified employer-sponsored retirement plan and exceed the income limits for a deductible IRA, but meet the income eligibility requirements for a Roth IRA.

### Analyze Your Situation and Objectives

An analysis of your personal financial situation and retirement objectives can help you decide which IRA—or combination of IRAs—best meets your specific needs. Studying the details *now* may save you time and money in the future. \$

## Assigning Your Life Insurance Policy

**G**etting approval on a loan can sometimes depend on one or two very important issues. For example, lenders often ask borrowers the question, "How will this loan be repaid in the event of your death?" Your answer may be to suggest **assigning your life insurance policy**.\* This useful feature of a life insurance contract can help provide the necessary comfort level and security for a lender.

You can freely assign your life insurance policy unless some limitation is specified in your contract (your insurance company can furnish the required assignment forms). Through an assignment, you can transfer your rights to all, or a portion, of the policy proceeds to an **assignee**. The extent to which these rights are transferable depends on the assignment *provisions* in the policy, the

*intention* of the parties as expressed in the assignment form, and the *actual circumstances* of the assignment.

### Types of Assignments

There are two types of conventional insurance policy assignments:

1. An **absolute assignment** is normally intended to give the assignee every right in the policy that you possessed prior to the

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## Assigning Your Life Insurance Policy

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assignment. When the transaction is completed, you have no further financial interest in the policy.

The terminology of absolute assignments differs from contract to contract. In essence, it states that you transfer all rights, title, and interest in the policy to the assignee. Some insurance companies use an "ownership clause" to accomplish this transfer.

2. A **collateral assignment** is a more limited type of transfer. It is a security arrangement to protect the assignee (lender) by using the policy as security for repayment. After the indebtedness is repaid, the assignee releases his or her interest in the policy.

In other words, the assignee will release to you the rights transferred by the assignment. Under the usual procedure, if the collateral assignment is still in force at your death, the assignee informs the insurance

company of the remaining indebtedness, including interest, and receives that amount in a lump sum. Any excess proceeds are then payable to your named **beneficiary** in accordance with the beneficiary designation in your policy.

To fully protect the assignee, notice must be given to the life insurance company that the assignment has been made. If a company with no notice of assignment makes payment of the proceeds to another assignee, or to a named beneficiary, the insurance company cannot be made to pay a second time.

### Policy Provisions

Some typical policy provisions concerning assignments may include the following:

1. The assignment will not be binding until the original, or a duplicate thereof, is filed at the insurance company's home office.

2. The insurance company assumes no obligation as to the effect, sufficiency, or validity of the assignment.

3. The assignment is subject to any indebtedness to the insurance company on the policy.

Thus, it is important to ensure that an assignment is made properly, regardless of whether it is absolute or collateral.

*\*Although loans generally are not taxable, there may be tax consequences if the policy lapses or is surrendered (even as part of a **1035 exchange**) with a loan or assignment outstanding. The taxable income from the surrender, 1035 exchange, or lapse of the policy may exceed the cash proceeds received from it. If the policy is a **modified endowment contract (MEC)**, pre-death distributions from the policy, including loans and assignments, are taxed on an income-first basis, and there may also be a 10% federal income tax penalty for distributions prior to age 59½. \$*

## Early Retirement—Is It Viable?

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can live comfortably on your retirement income. Bear in mind that over time, the purchasing power of the dollar typically decreases. Due to financial necessity, or sometimes just an overabundance of leisure time, part-time work while retired may be worth serious consideration as an important part of your overall financial plan.

One often overlooked aspect of retirement plan-

ning is money management, especially once retirement has started. Periodic reviews of your financial affairs can help ensure you get on—and stay on—the right track. In addition, you'll have a greater appreciation for how many more years you'll have to enjoy your retirement than previous generations. It is fairly easy to predict that further gains in life expectancy will create a need for more income. \$



## Taxes and Your Estate—Reconcile Your Domicile

Increased mobility in today's society has changed the ways in which we live, work, and play. Compared to previous generations, it is now quite common for work and recreation arrangements to cross state lines, resulting in ownership of property and formal social relationships in more than one state. However, the expanded opportunities created by mobility may come at a price—that is, the increased likelihood that several states may be able to tax your estate when you die. If you were to die today, do you know if more than one state would try to levy death taxes on your estate?

The term **domicile** generally refers to the place intended to be your *permanent* home, as distinguished from the term "residence." Although you could have simultaneous residences in several states, in theory, you can have only *one* state of domicile at a time.

A problem may arise when theory and reality part company—that is, when separate states reach different conclusions by applying different definitions of "domicile" to the same set of facts. This may result in the apparent inconsistency of more than one state claiming the deceased was a "domiciliary," and each taxing that person's estate accordingly.

Under the Uniform Interstate Compromise of Death Taxes Act, the states involved may be able to reach a compromise in a specific situation. However, if the states involved have not adopted the Act, or cannot agree on a solution, the estate in question could be fully taxed in *multiple* jurisdictions.

### Establishing Your Domicile

Fortunately, there are steps that can be taken to establish your state of domicile. If you have moved, your "true" domicile may hinge on the *number* and *significance* of the contacts you have with your former and present state. Among the significant factors used to make the case are:

- **Retention of "historical" home.** If you moved, but did not sell a long-time residence in a former state, your intention to change your domicile may be questioned.
- **Business relationships.** In which state are your significant business contacts located?
- **Location of property.** Where is most of your significant real and tangible personal property located?
- **Social connections.** Where do you maintain political, civic, religious, and family connections?

- **Time spent.** Where do you spend the majority of your time?

While you may feel your *intent* is clear, it is most likely that your *actions* will be viewed as the evidence of your intentions. Consequently, simple acts such as changing your voter registration to the new locale, changing your automobile registrations and driver's license, formally resigning from organizations in your former state, and formally joining organizations in a new state may be viewed as evidence of your intent to change your domicile.

However, it is easy to imagine that under some circumstances, the lines may not be clear-cut. For example, if you moved to another state but maintained significant business and social relationships in your former state, where is your domicile?

In such situations where conflicting evidence exists, a good strategy might be to first determine which state appears most advantageous in terms of death taxes and to determine how domicile is defined in that state. You can then focus on the factors most likely to make the various states involved look favorably upon your domicile. Since these matters involve interpretation of the law of each state, the advice of your attorney is highly recommended. \$

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