



# FINANCIAL *Planning Strategies*

A Financial Planning Update

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



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## Understanding the Consumer Price Index

The highs and lows of the economy affect people and markets in a variety of different ways. While some sectors of the economy are thriving, others may be sluggish. One economic indicator used to gauge the state of the American economy is the **Consumer Price Index (CPI)**, which measures the rate of inflation in the U.S. Inflation, which is defined as the rise in the average price level of all goods and services, can have a significant impact on the American economy and your financial affairs. Understanding the CPI, and the ways it measures inflation, can provide a strong foundation for understanding not only market and economic swings, but also the ways

in which fiscal and monetary policies affect America's finances, and your own. To begin, let's look at the information used by the U.S. Bureau of Labor Statistics (BLS) to compile CPI data.

### Determining the Market Basket

Each month, the BLS surveys prices for a "market basket" of goods and services in order to create an economic "snapshot" of the average consumer's spending, which is quantified as the CPI. Actual expenditures are classified into more than 200 categories and eight major groups. These include the following, defined by a sampling of items included within each group:

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## Practical Uses for Practical Trusts

Trusts are valuable tools that can help you and your family achieve a variety of financial and estate planning goals. As you plan your long-term strategies, you may find many practical ways to use trusts to manage your investments, retirement, children's education, and your estate. Let's look at several types of trusts that may be helpful to you.

**Revocable Trusts.** Assets in a revocable trust avoid probate, which is

the judicial process that determines the validity of a will and ensures it is faithfully executed. Incorporating a revocable trust into your estate plan may save your heirs time and money, as well as preserve your family's privacy. Furthermore, with advance planning, these trusts can also be used to help married couples minimize estate taxes.

**Irrevocable Life Insurance Trusts (ILITs).** When properly implemented, the proceeds of an ILIT will not be

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## Understanding the Consumer Price Index

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- **Food and Beverages**—common groceries, alcoholic beverages, and full-service meals
- **Housing**—rent, furniture, and utilities
- **Apparel**—clothing, shoes, and jewelry
- **Transportation**—vehicle lease and purchase costs, gasoline, auto insurance, and airfare costs
- **Medical Care**—doctor's visits, hospital care, and prescriptions
- **Recreation**—cable television, pets, events, and sporting equipment
- **Education and Communication**—school tuition, postage, telephone service, and computer equipment
- **Other Goods and Services**—tobacco, haircuts, personal services, and funeral expenses.



Because the CPI looks at expenditures in these fixed categories, this index is a valuable tool for comparing the current prices of goods and services to costs last month or one year ago.

### Using the CPI

As a measure of inflation, the CPI has three main uses. First, the CPI often serves as an indication of the health of the economy and the effectiveness of government policy. To a certain extent, some inflation is the sign of a healthy economy; however, too much inflation, or no inflation at all, can be a sign of troubling economic times. In fact, one of the

primary U.S. economic policy goals is to maintain an inflation rate ranging from 1% to 3% each year.

Constant fluctuations in the CPI will cause Congress and the Federal Reserve Board (the Fed) to take measures to control the amount of inflation and stimulate economic growth. As a result, business executives, labor leaders, and other private citizens may change their spending and saving patterns. For example, the Fed may attempt to curb rising inflation by raising short-term interest rates; this increase in the cost of borrowing money is likely to slow personal and business spending. Conversely, if the economy is not growing, the Fed may attempt to stimulate inflation by lowering short-term interest rates; in this case, lowering the cost of borrowing may trigger increased spending among businesses and individuals.

As a second use, the CPI helps determine the "real" value of a dollar over time by removing the effects of inflation. As prices increase, the purchasing power of a dollar decreases; in other words, more dollars are needed to purchase the same amount of goods and services. Comparing inflation-free wages and prices also allows economists to determine the actual earning and spending patterns of the American consumer.

Lastly, the CPI is used as a means of adjusting salaries and government

benefits to account for price changes. For example, as a result of collective bargaining agreements, the wages of over 2 million workers increase according to the amount of change in the CPI. The CPI is also used to determine the benefits of almost 80 million people covered under government programs, including Social Security beneficiaries, military and Federal Civil Service retirees and survivors, and food stamp recipients. In addition, changes in CPI can be seen in the price of school lunches, as well as through rents, royalties, alimony payments, and child support payments as determined by private firms and individuals. Finally, the CPI has been used to adjust the Federal income tax structure to prevent increases in taxes caused solely by inflation.

### For More Information

Inflation can have a serious impact on the American economy as it affects both government policy and the spending and saving patterns of businesses and individuals. Understanding and following changes in the CPI can help you know how the value of the dollar changes and estimate how inflation may affect your future plans. The U.S. Department of Labor (DOL) publishes current information on the CPI each month through the BLS. For more information, visit their website at [www.bls.gov/cpi](http://www.bls.gov/cpi). 💰

## Riding the Carousel to Retirement

**Y**ou're certainly not alone if the variety of **Individual Retirement Accounts (IRAs)** causes you to wonder which type of IRA, or which combination of IRAs, would work best to meet your goals. You have several options, including the **Roth IRA**. Let's take a moment and explore the IRA carousel.

### **Traditional IRAs.**

Contributions to these IRAs may be tax deductible and are limited to \$4,000 in 2006 and 2007. However, the deductibility of contributions is generally dependent upon one, if not all, of the following factors: whether or not you (the IRA owner) are participating in an employer-sponsored retirement program, your tax-filing status, and your **adjusted gross income (AGI)**—taxable gross income less any possible deductions. If you withdraw money before age 59½, you pay a 10% federal income tax penalty (on top of any income tax due) unless an exception applies. Qualified situations include first-time home purchases, disability expenditures, medical expenses exceeding 7.5% of your AGI, and qualified higher education expenses. At age 70½, contributions cease, and mandatory minimum withdrawals must begin by April 1<sup>st</sup> of the year following attainment of age 70½.

**Roth IRAs.** Similar to the traditional IRA, contributions to a Roth IRA are limited to \$4,000 per

year in 2006 and 2007. However, contributions to a Roth IRA are not tax deductible. (Note: The \$4,000 limit applies to the total of all IRAs that a person may hold in a given tax year.) The 2006 AGI limit for Roth IRA eligibility for single filers is \$95,000 to \$110,000, and for joint filers, it is \$150,000 to \$160,000. These amounts will be adjusted for inflation in 2007. Contributions may be made for life (i.e., need not stop at age 70½), and no withdrawals are required until one year following the death of the participant. In addition, qualified distributions, including earnings, are tax free if you've maintained your account at least five years and are older than age 59½. Withdrawals made prior to age 59½ may subject you to a 10% federal income tax penalty, unless certain qualified exceptions apply.

**SIMPLE IRAs.** Many small businesses have found the popular **401(k) plan** costly to administer. A more affordable alternative may be the Savings Incentive Match Plan for Employees (SIMPLE), under which an eligible employee can defer up to the lesser of 100% compensation or \$10,000 per year for 2006 (\$10,500 in 2007). A SIMPLE IRA must provide immediate **vesting**, and an employer can either *match* employee annual contributions on a percentage basis, up to 3% of compensation, or provide a **nonelective contribution**

for all employees of 2% of compensation. There are no annual tax filing requirements and no need for **anti-discrimination tests**. In addition, both owners and employees can put away more than they could with a regular IRA.

**SEP IRA.** The Simplified Employee Pension (SEP) is also simple to administer. Only employers contribute to a SEP. Congress created the SEP primarily so small businesses could provide a retirement plan without burdensome administrative costs or government paperwork. Contributions to a SEP are limited to 25% of compensation (earned income for self-employed) of up to \$220,000 in 2006 or a maximum of \$44,000 (in **sole proprietorships** and **partnerships** the limit to the owners' contributions is 20%). In 2007, the compensation limit is \$225,000, and the maximum contribution limit is \$45,000.

Annual IRA contributions for tax year 2006 can be made up until the filing deadline, April 17th, 2007. In a world where many clamor for tax simplification, you may find that retirement planning is quite complex. Therefore, an IRA can be attractive for its versatility and ease of implementation. Because Congress has provided many options for individuals and small businesses to establish retirement plans, you may discover it's easier than ever to find the "right" IRA to fulfill your objectives. \$



## *Practical Uses for Practical Trusts*

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included in your estate. They will be payable to the ILIT's **beneficiaries** (generally, children and grandchildren) without incurring any estate tax consequences. In more advanced uses, an ILIT can be a useful strategy to help ensure continuity in a closely-held business. Passing a family-owned business of substantial value to heirs may be hampered by potentially large estate taxes. These taxes, in some instances, may require a forced sale of the business in order to raise the necessary cash to pay them. However, an ILIT can purchase a life insurance policy on the owner, with the death benefit providing the cash needed to help meet estate tax obligations and keep the business in the family.

**Qualified Residence Trusts.** Putting your home in a trust can help reduce the potential estate or gift taxes on your personal residence.

**Education Trusts.** If you hope to help fund your grandkids' college education, you know how challenging it can be to determine how much each grandchild will need. You could simply give money directly to your children, with instructions for them

to use the money for that purpose, but that doesn't guarantee the money will be available when your grandchildren need it. To help ensure this objective is met, consider establishing a trust and give the trustees (possibly your children or a financial institution) discretion to allocate the funds among your grandchildren as appropriate to provide incentives for them to pursue their higher education.


**Trusts for Creditor Protection.** Many parents have had the unfortunate experience of making large gifts to a married child who subsequently gets divorced and much of those assets go to the former in-law. In other instances, the child may be subject to claims from a lawsuit. A trust can be an excellent vehicle for making gifts to your children in a way that makes the assets available for their use but prevents them from being depleted to satisfy the claims of potential creditors.

**Spendthrift Trusts.** You may have a child or relative who needs your financial support but cannot effectively manage the assets. A trust can be established that will help assure both you and your

intended beneficiary that the funds will be available when they are truly needed. The trust can be structured to distribute assets when the beneficiary reaches a certain age or to allow the beneficiary to become a co-trustee. With the latter approach, the beneficiary may participate in, but not have sole responsibility for, management of trust assets.

**Trusts for Medicaid/SSI "Supplemental Needs."** If your child has disabilities that may qualify for government assistance, the receipt of an inheritance or gift normally will disqualify them from such benefits until the gift is "spent down" and only exempt resources remain. In that situation, it's critical to leave assets in a carefully drafted discretionary trust that permits the trustee to expend needed resources for the child's benefit in a manner that supplements, but does not replace, governmental resource payments.

There are numerous ways for those of more modest means to use a trust in their estate planning and normal life circumstances. For specific guidance, consult your financial, tax, and legal professionals. \$

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