

STRATEGIC Planning

The Fee Based Financial, Investment, & Tax Report

WestPoint *Private client*
G R O U P



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Pension Act Boosts Retirement Savings Opportunities

After years of debate, Congress has finally passed sweeping pension legislation—the Pension Protection Act of 2006 (the Pension Act). While intended to stabilize traditional pension plans, this large, complex bill also makes permanent many of the tax-saving retirement and education opportunities established on a temporary basis by reform passed in 2001. In addition, this measure tightens some of the rules governing charitable donations.

Traditional Pension Reform

Traditional pensions, or defined benefit plans, promise an employee a retirement benefit typically based on salary and

years of service at a company. When troubled pension plans fail to meet their obligations, such as some in the airline industry, a greater burden falls on the Pension Benefit Guaranty Corporation (PBGC), the federal corporation that insures defined benefit plans.

To help alleviate pension-funding problems, this legislation raises the deduction limits for employer contributions and requires higher funding levels. This bill also stipulates that employers with at-risk plans adhere to stricter funding requirements and clarifies regulations for cash balance plans, which are hybrid plans incorporating aspects of traditional pensions and savings plans.

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The Pros and Cons of Probate

The responsibility of the probate court is to determine that a will is valid and to ensure that it is faithfully executed. Although most states have exemptions for smaller estates, a will ultimately falls under the jurisdiction of the probate court.

A trust is similar to a will in that it deals with the transfer of assets. Testamentary trusts are subject to probate because they are created by a will at

death. If you wish to avoid probate, one way is to use a “living” or inter vivos trust.

The probate process has advantages and disadvantages. Here are some points to consider in determining how probate could affect your estate.

Advantages

- **Fair Estate Value.** If your heirs believe your property has been overvalued, thus potentially increasing the

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The Pros and Cons of Probate

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estate tax, a lawyer or executor can bring in an independent appraiser. The judge may approve the new appraisal or take a position between that of the independent appraiser and one appointed by the court.

- **Protection from Creditors.** Once an estate has been probated and its assets distributed, creditors cannot make any further claims against the assets.
- **Lower Legal Costs.** Drafting a will is often less expensive than drafting a living trust or other legal document in an attempt to avoid probate.

Disadvantages

- **Higher Costs to the Estate.** Probate can be a costly process. Fees are

set by law in some states, and they may be based on gross, rather than net, values. They generally cover only "ordinary" services. If an attorney performs "extraordinary" work, the fees may be even greater. The executor may also charge fees, and unless those fees are waived, the cost to the estate may double.

- **Delay Transferring Assets.** Settling an estate in probate can take as long as one or two years. During the settlement period, assets in probate often suffer from the lack of, or overly conservative, management. In some states, it can take a month or more simply to receive court permission to sell an asset.

This may often prevent an executor from being able to respond to sudden changes in market conditions. Executors may also tend to act conservatively during probate, since they may be financially liable if they are judged to have been less than prudent.

- **Public Knowledge of the Estate.** The probate process is a matter of public record. Thus, a will is open to public scrutiny.

Probate laws vary from state to state. It is best to meet with a qualified legal professional to determine how the probate process may affect your estate, and whether you might wish to consider a living trust as an alternative. \$

What Causes Inflation?

Inflation, defined as the increase in the average price level of *all* goods and services, is often caused by changes in supply and demand on a broad scale. For example, suppose business is booming, unemployment is low, and the average worker's wages are increasing. As a result, consumers have more disposable income available and will, therefore, be able to purchase more goods and services. Average prices will tend to rise due to the increase in *demand* for all goods and services.

On the other hand, suppose the economy is suffering. As unemployment rises and wages remain stagnant, consumers will be unable to purchase additional goods and services. In response, producers will slow down production and raise prices in order to cut losses. In this case, average prices will rise due to a decrease in the *supply* of all goods and services. This can be a vicious circle.

In addition to creating higher costs for goods and services, inflation creates depreciation in currency

values. As prices increase, the purchasing power of your income—dollar for dollar—decreases; in other words, more dollars are needed to purchase the same amount of goods and services. As time goes on, one of your greatest financial challenges will be that your personal savings and investments will have to work harder to exceed inflation. Therefore, it's always important to take inflation into consideration as you save and make purchasing decisions. \$



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Tax Breaks for Retirement Savings

In 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) enhanced retirement opportunities, but these favorable provisions were set to expire in 2010. Thanks to the Pension Act, many of these valuable savings options are now permanent, including the following:

- **Higher IRA contribution amounts:** For 2006–2007, you may contribute a maximum of \$4,000 to an IRA, or a combination of IRAs, and this amount rises to \$5,000 in 2008. For 2009 and later years, this amount will be adjusted annually for inflation.
- **Higher salary deferral limits for defined contribution plans:** In 2006, you may defer as much as \$15,000 to a 401(k), 403(b), or 457 plan. You may contribute up to \$10,000 to a SIMPLE plan. These amounts will be adjusted for inflation in the future.
- **Additional “catch-up” contributions:** Those age 50 and older have an opportunity to accelerate their retirement savings with certain vehicles. The IRA catch-up is \$1,000, and this amount will not be adjusted annually for inflation. The current \$5,000 401(k) catch-up and the \$2,500 SIMPLE catch-up will be adjusted annually for inflation in \$500 increments.

- **The Roth 401(k):** EGTRRA permitted employers sponsoring traditional 401(k)s and 403(b)s to begin offering a Roth option in 2006. Contributions are made with after-tax dollars, earnings grow tax free, and distributions are tax free, provided the owner has reached age 59½ and has owned the account for at least five years. Thanks to the Pension Act, the Roth option is here to stay.
- **Higher benefit levels for defined benefit plans:** The annual benefit limit for defined benefit plans (\$175,000 in 2006) will continue to be indexed for inflation annually.

In addition to making these EGTRRA provisions permanent, the Pension Act creates some new opportunities, including permitting employers to automatically enroll employees in 401(k) plans. However, employees must have the option to opt out of their company's 401(k) plan. The Pension Act also allows 401(k), IRA, and retirement plan providers to offer personalized investment advice to accountholders.

Under the new law, 401(k) participants are now able to make hardship withdrawals on behalf of any listed beneficiary. The old law limited this option to spouses and dependents.

The Pension Act also permits any beneficiary to roll over his or her interest in a qualified retirement

plan, tax-sheltered annuity (TSA), or government plan to an IRA, upon the death of the account owner. Taxes will only be due when normal distributions are taken. Formerly, only spousal beneficiaries were permitted this option.

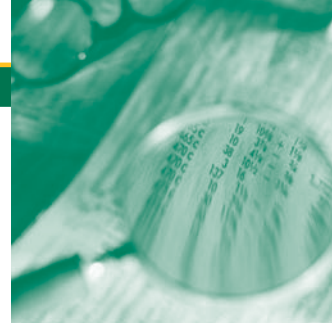
Beginning in 2008, you may roll over funds from a qualified retirement plan, TSA, or government plan directly into a Roth IRA, and the rollover will be treated as a conversion. You must satisfy all conversion requirements, including having income less than \$100,000. In 2010, this income restriction will be eliminated.

Charitable Giving Incentives and Restrictions

There is good news for those who wish to donate their IRA assets to charity. Through 2007, taxpayers may exclude from gross income up to \$100,000 of IRA distributions that would otherwise be included, provided the distributions are given to qualified, tax-exempt organizations. Both traditional IRAs and Roth IRAs are eligible.

Cracking down on some abused loopholes, the Pension Act requires taxpayers to substantiate any cash or monetary gift donated to charity. Acceptable documentation includes a bank record or written communication from the charity, which specifies the amount and date of contribution, as well as the name of the charity. This change

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Identity Theft and Your Taxes

Identity theft is one of the fastest growing crimes in the United States, with as many as 750,000 Americans becoming victims every year, according to government estimates. Identity theft is a type of fraud in which a thief uses your personal information to conduct transactions in your name. Criminals may, for example, use your identity to open or empty bank accounts, obtain credit cards, or take out loans. In addition to fraud directly concerning your finances, thieves can also use your information to commit crimes that may affect your taxes.

Types of Fraud

With your identifying information, an undocumented worker or another individual may use your Social Security number on job applications and employment paperwork. The employer would then report the thief's W-2 wages earned to the IRS using your information, and as a

result, when you file your tax return, it will appear to the IRS that you did not report all of your income.

An identity thief may also file a tax return using your name and Social Security number in order to obtain a refund. When you later file your return, the IRS will believe that you already filed and received a refund; therefore, the return you submitted would be considered a second copy or duplicate.

Protecting Yourself

If you receive a notice from the IRS that leads you to believe that your personal information has been used to commit tax fraud, contact the IRS by phone or in writing as directed in the notice. Possible triggers indicating you may have been the victim of identity theft include statements that you received wages from an employer unknown to you or that more than one tax return was filed in your name. IRS tax examiners can then work with you and other agencies, such as

the Social Security Administration, to resolve these discrepancies. It is important to note that the IRS will not initiate a request by e-mail for taxpayer information in this, or any other, situation. If you do receive such a request, it may be an attempt from identity thieves to obtain your tax information.

In addition to other precautions you may take to protect your identity from thieves, the IRS recommends that you be extremely careful when choosing someone to assist you with tax preparation. Because this person will have access to your personal financial records, be sure to research their credentials and experience. Avoid preparers who guarantee results, base fees on a percentage of the amount of refund, or claim they obtain larger refunds than other preparers.

For more information about identity theft and ways to protect yourself, visit the FTC's website at www.ftc.gov. \$

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emphasizes the importance of getting a receipt for all charitable contributions. The Pension Act also tightens the rules governing noncash donations and stipulates that donations of clothing and household items must be in "good condition."

No Sunset for 529 Plans

More and more taxpayers have been investing in 529 plans to help fund a college education. Contributions are made with after-tax dollars, but earnings grow on a tax-deferred basis. Distributions for qualified

education expenses are currently tax free, but the provisions permitting tax-free distributions were set to expire at the end of 2010. The Pension Act permanently continues the favorable tax treatment for 529 plans. \$