

Spotlight on Wealth Transfer and Retirement Planning
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Planning for retirement is first and foremost about assuring that you have enough to retire on. But for many it's also about planning to preserve assets for heirs and charity. If you and/or your spouse are a business owner, professional, or highly compensated executive, chances are you would like to have enough wealth to not only provide for yourself during retirement, but also to create a lasting legacy. The key to achieving this goal often lies in structuring payments from tax-qualified retirement plans (QRPs) and individual retirement accounts (IRAs) in a tax-efficient manner, making lifetime gifts of non-retirement assets, and creating wealth and liquidity through the use of life insurance.

Structuring Payments from QRPs and IRAs

Basically, distributions from QRPs come in two forms—lump sum and periodic payments. Couples who need QRP benefits to meet day-to-day living expenses are most likely to choose periodic payments. Joint and survivor annuities are popular with married couples because a joint and survivor annuity guarantees that benefits will be paid for as long as one of the spouses remains alive. More affluent couples are likely to find lump-sum distributions more attractive. These distributions may be rolled over income tax-free into IRAs, where the IRA owner has considerable flexibility in the form of the payout and often a wider range of investment options than offered under a QRP.

Most advisors recommend that non-QRP/IRA assets be tapped for living expenses during retirement years before QRP and IRA assets are spent. The reasoning is straightforward—assets in QRPs and IRAs continue to accumulate tax-deferred even after you retire or die. The idea is to stretch-out payments for as long as the law allows. One obstacle to “stretch-out” planning is minimum distribution rules that require distributions to begin on a specified date and to be at least a minimum amount. In general, you can defer taking payments from your IRA until April 1 of the year following the calendar year in which you turn age 70½. For your QRP distributions can be deferred until April 1 after you retire, if later, unless you are a 5% or greater owner. At that time, you can elect to spread the payments over your lifetime or the joint lifetimes of you and your spouse or some other beneficiary. The longer the spread-out, the greater the deferral. Although amounts distributed to beneficiaries are included in income, amounts left in an IRA continue to grow tax-deferred, even during the pay-out phase.

A second obstacle to stretch-out planning is federal estate taxes. Although QRP and IRA distributions to a surviving spouse generally qualify for the marital deduction and are not subject to estate taxes at the death of the first spouse to die, the value of distributions to children and grandchildren are subject to estate taxes at rates as high as 45 percent on taxable transfers of

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\$2 million or more in 2007. The amount of total estate tax at the applicable rate is reduced by a credit--\$780,800 in 2007 to determine the actual amount of tax payable. The credit translates into an applicable exclusion in 2007 of \$2.0 million.

Consequently, only taxable estates in excess of \$2.0 million are subject to estate taxes. The exemption amount increases to \$3.5 million by 2009. (The federal estate tax is scheduled to be repealed for one year in 2010 and reinstated in 2011 unless Congress takes additional action.) Under the current law, at that time, the applicable exclusion amount will revert to \$1 million and the top estate tax rate will be 55%. As discussed below, life insurance can be a cost-effective way to provide the cash for tax payment for those individuals caught in the estate tax net.

While your beneficiary will be able to offset a portion of the distributed income with a deduction for the estate tax paid on the QRP or IRA, between income taxes and estate taxes, that is a huge bite out of the legacy you hope to leave.

Lifetime Gifts of Non-Retirement Assets

If, after stretching-out QRP and IRA benefits, you still have more than enough income to live on in retirement, you may want to consider lifetime gifts to family and charity. Don't miss out on the several tax breaks that encourage lifetime gifts.

First, you and your spouse using your annual gift tax exclusions can join together to make outright gifts of up to \$24,000 (2007 indexed for inflation) per family member entirely free of estate and gift taxes.

Second, lifetime gifts and any future appreciation associated with them escape estate taxation at your death—and, that translates into less estate taxes.

Third, outright gifts to charity may be deductible with certain limitations against income and gift taxes and the value of the gift also escapes estate taxes.

Finally, any future income earned by the transferred assets is taxed to the donee, not you.

There are non-tax reasons for lifetime gifts as well. By making the gift while you are still alive, you get to see the beneficiary, family member or charity, use and enjoy the gift. You can even offer advice about how to manage the gift. If you think a child or grandchild isn't quite ready for the responsibility, or if the donee is a minor, consider creating a trust to manage the asset for him or her.

Life Insurance

Life insurance is the cornerstone of many retirement and wealth transfer plans. When you're accumulating for retirement, life insurance helps protect your family from your premature death. During your retirement years, when wealth transfer is a focus, life insurance provides the cash to help pay estate taxes and other death costs and helps assure that everything goes according to plan. Many individuals take advantage of irrevocable life insurance trusts as a way to remove the policy

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proceeds from their taxable estate. An irrevocable life insurance trust avoids estate taxes because it is a separate legal entity in which the individual retains no interest or control. With proper planning, an irrevocable life insurance trust shelters the death proceeds from both income and estate taxes.

Life insurance can be especially important if you own a business and/or have significant amounts in QRPs and IRAs.

Closely-held businesses are often highly illiquid—hard to convert to cash. Unless you have cash from another source to pay the estate taxes, you may have to sell or liquidate your business at a discount to pay the tax man. Similarly, with respect to QRP and IRA assets, even though the plans will pay out over the life expectancy of the beneficiary or as an annuity over many years, estate taxes on such assets are due within nine months of death. The need to pay taxes on “phantom income”—income that has not yet been received—can create a hardship. That’s where life insurance comes to the rescue.

Conclusion

You’ve probably spent a lot of time and effort accumulating your retirement assets and building an estate. Take the time to meet with a licensed financial professional to help make sure that you not only enjoy the income you want during retirement, but also leave your loved ones and favorite charities with a lasting financial memory.

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