

Bob Carlson's RETIREMENT WATCH

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Actions to Create the Retirement You Desire™

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Dear Reader:

Investors cycled through a series of emotions during the financial crisis. Early on, most were confused, stunned, and surprised by the extent of the debt problems and their widespread effects. Even seasoned traders were shocked at the way the markets all but seized and stopped functioning in the fall of 2008. Depression and then acceptance followed. Recently, however, I've noticed a very different emotion prevailing, and it's one I don't often see in investors.

Many investors now are angry. With some, it borders on rage. In past market plunges, I didn't see this level of anger. Many investors accepted they were at least partly to blame for their losses.

As the cliché goes, this time is different. I, and others, believe people realize the extent to which they're being forced to pay for the mistakes and misdeeds of others. The innocent victims and bystanders of economic malpractice are paying in higher taxes, more government debt, near-zero interest rates, excessive regulations, volatile markets, and a very slow economy. Only recently have many Americans realized how much of their bailout money is going to European bankers.

Bankers foolishly made subprime loans to people who had no hope of paying them, and then kept those loans on their books. Or they bought packages of loans originated by others as investments. Bankers also lent money to irresponsible European governments. The banks, and the creditors who foolishly lent money to the banks, created giant, precarious, leveraged institutions. Yet, the banks and their creditors are being made whole by the rest of us.

The bankers and their creditors took the risks and huge rewards when the bets paid off. When things don't work out they transfer the losses to taxpayers, employees, shareholders, and retirees living off interest on their nest eggs. We're also all at risk of paying more in the future through higher inflation. Compensation for bankers has returned to its pre-crisis levels, while savers suffer.

Government's role should be to shepherd these failed institutions through bankruptcy in a way that protects many of the innocent parties. It did a version of this with GM and Chrysler. But with the banks, it seeks to preserve them intact and allow the people who ran them to continue to run them or to gracefully exit with very generous pay packages. No wonder people are angry.

"A properly-structured gift now can provide you or loved ones with income or wealth while helping charity."

Benefiting from Charitable Gifts Now



Most people have estate planning goals beyond leaving a legacy for loved ones. Many also hope to leave something to charity. Unfortunately, they often don't know about all the tools available to make those charitable gifts, or that there are good reasons to make charitable gifts now instead of waiting to transfer wealth through your will.

When you make charitable gifts now, you see how the gifts are used and can change your

mind about future gifts if the money isn't used as you intended.

Current giving also provides income tax benefits. With so many estates currently exempt from estate taxes, the income tax benefits are more valuable to many people than the estate tax deduction.

Most importantly, a properly-structured gift can provide you or loved ones with income or wealth while helping charity. The strategies we discuss in this visit are for those who already are charitably inclined. You can select the strategies that will maximize the wealth available to you, your family, and charity.

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Of course, you can make a **simple cash gift** to a charity. You'll receive an income tax deduction, and the charity will benefit from the gift.

A more effective strategy might be to give **appreciated investment property**. You receive a charitable contribution deduction of the property's current fair market value. The charity can sell the property and spend the proceeds. No one pays taxes on the appreciation that accrued while you owned the property. Giving appreciated property can put more after-tax cash in your hands than if you sold the property or used other after-tax cash for giving or spending. The gift of appreciated property can be especially useful with difficult to sell property.

Or consider a **charitable gift annuity** to fulfill multiple goals. You transfer cash or property to a charity. In return, the charity promises to pay you a fixed income for life or a period of years. The annuity payments will be less than you'd receive from a commercial annuity. The difference is a gift, and you receive a tax deduction for it.

Most charities agree to pay the same amount on their annuities, so you aren't likely to gain anything by shopping among charities to see what they pay on gift annuities. IRS regulations are used to determine the amount of your tax deduction, and it's based on your age and current interest rates. Your estate planner and tax specialists with the charity will be able to determine your deduction.

Most major charities offer gift annuities. Keep in mind that all you receive is a promise from the charity to pay you income for life. You need to ensure a charity is well-managed and financially strong before making a gift annuity transaction.

Many community foundations offer gift annuities and to some extent will let you direct the charities that benefit from your gift.

The charitable gift annuity provides three benefits: guaranteed income for life, a current income tax deduction, and a gift to charity.

A **charitable remainder trust** also provides multiple benefits.

In a CRT, you give appreciated property to a trust you created. The trust sells the property and reinvests it. Since the trust is a charitable one, it isn't taxed on the sale. All the sale proceeds can be reinvested. You also aren't taxed on the appreciation that accrued while you owned the property, because you're giving it to a charitable entity.

The CRT begins paying you, or a beneficiary you named, annual income. The income can be a fixed annual amount, known as a charitable remainder annuity trust (CRAT). Or it can be a percentage of the trust value, known as a charitable remainder unitrust (CRUT). The advantage of the CRUT is that the income can increase with the value of the trust. Of course, payments can decrease if the

investments do poorly.

You can add some variations to the distribution formula. You can say the trust makes distributions only to the extent it has income and realized capital gains, so it doesn't have to sell property to make a distribution. You also can say that a missed distribution is made up in a later year when there is enough income.

The tax code puts some restrictions on CRTs. Among them are that the annual annuity must be least 5% of the trust assets but can't be more than 50%. The term can't be longer than 20 years, unless it is based on the life of one or more noncharitable beneficiaries.

Once the trust term ends, the charity receives whatever property is remaining in the trust.

With a CRT, you receive an income tax deduction for transferring property to the trust. IRS regulations are used to determine the amount of the deduction, which equals the present value of the amount the charity is expected to receive in the future. As with a gift annuity, the amount of the deduction varies with your age (or that of whoever receives the income distributions) and current interest rates. If your loved ones receive the income distributions, the present value of that income stream is a gift, and you'll likely receive a discount on that when are computed.

The property you give to the CRT is out of your estate, so for people with taxable estates it reduces the tax while providing income.

The CRT is very handy when you own property that isn't paying much income but is highly appreciated. You can maintain some control of the property by being trustee of the CRT. You'll need to manage the trust carefully and have any illiquid assets appraised annually to avoid problems with the IRS.

The **charitable lead trust** is considered the mirror image of the CRT, because the charity receives income first under the CLT. Then, after the income term expires, the remaining trust property can revert to you or can be transferred to your loved ones, such as adult children. When the trust is created you take a charitable deduction for the present value of the charity's stream of income payments. When your loved ones are the final beneficiaries, you compute the present value of that for gift tax purposes, and it's likely to be a discounted value to what they'll actually receive.

One major difference is the CLT is not a tax-exempt trust. All of its income and gains are taxed to someone. You can set it up as a grantor trust. In that case, you pay all the taxes on the trust income and gains. You'd want to do this because paying the taxes is a way of reducing your estate and giving maximum benefits to the charity and your loved ones. It is especially beneficial when the charitable gift deduction and other tax breaks you have reduce the taxes

you have to pay.

An alternative is to set up the CLT as a nongrantor trust. In that case you won't receive the charitable gift deduction. The trust pays taxes on its income and gains and takes a deduction for distributions it makes to charity.

The CLT can reduce current taxes when set up as a grantor trust. It also is a good way to remove an asset and its future appreciation from your estate while retaining some control of it by acting as trustee. It's especially good for an asset that has a low value today but you expect to appreciate.

Today's low interest rates also make a CLT attractive to people with taxable estates if the assets in the trust will appreciate faster than the interest rate the IRS uses to compute the present value of the gift to your loved ones. Because today's interest rates will be used to compute the value of your gift, your loved ones will receive far more in value than the amount on which you paid taxes.

Of course, if you're wealthy enough you can create a **private foundation** to receive your contributions. You and your family can serve as the officers and board and decide over time

which charities receive the money. Private foundations have a lot of rules and regulations. That's why you need to be fairly wealthy for one to make sense. You'll need experienced tax counsel guiding all your actions if you want to avoid problems with the IRS, which has been more aggressive in this area in recent years.

Always keep in mind that there are limits on charitable contribution deductions. In most cases, the annual limit is 50% of adjusted gross income. Contributions you can't deduct can be carried forward to future years. But sometimes the limit is 30% or even 20% of adjusted gross income. There also are specific requirements to achieve the results I described generally here. Because of these two factors, you want to work with one or more experienced advisors when considering these strategies.

When giving to charity is part of your long-term plan, you might not want to wait to give through your estate. You, your family, and the charity all might benefit more if you give today, especially when you use one of these strategies. You could receive a tax deduction and income today while reducing your estate and benefiting the charity. **RW**

Solving Couples' Retirement Problems

Retirement Watch

Your retirement isn't all about your finances. I regularly try to stress that point. Financial security and knowing you have a plan increase your options and peace of mind. But how you spend your time is

critical to whether you are happy and have a successful retirement.

Another key "soft" aspect of your plan is your spouse or significant other. Coordinating retirement thoughts and goals could be the most important part of your plan.

It's logical to assume that couples are planning for the future together, but often they're not, according to Fidelity Investments. The Couples Retirement Study conducted for Fidelity the last few years reveals many couples don't agree on, and often don't even talk about, key retirement issues.

Only 41% of couples handle investment decisions together, according to the most recent study. That's not necessarily a bad thing. Some couples believe in division of labor and that one spouse does some things much better than the other. But one third of couples either can't agree on or don't know when they'll retire. Half don't agree on whether they'll work after "retire-

ment." Two-thirds don't agree on the age they'll retire, and 73% don't agree on whether they've completed a detailed retirement income plan. You would think they'd be able to agree about whether or not they've completed a plan. Only 17% of spouses are confident that the other spouse could handle their joint retirement finances alone.

A lot of couples would be more confident as they approach retirement and be in better shape if they talked about some key issues. You need to talk with your spouse about more than retirement finances, though finances are a key issue. Of course, you don't have to agree on everything, but you should know what each knows and is thinking and try to establish some joint goals and procedures.

One tool you can use is *The Couple's Retirement Puzzle* by Roberta K. Taylor and Dorian Mintzer (a *Retirement Watch* subscriber) (Lincoln Street Press 2011). The authors are experienced therapists who counsel couples and give workshops on managing "the second half of life." The book identifies 10 "must-have conversations" couples should have about those post-career years. As with all retirement planning, ideally you begin these discussions some years before retiring, but it's never too late to begin. Even those already well into retirement could improve their lifestyles with some conversation.

"Coordinating retirement thoughts and goals with your significant other could be the most important part of your plan."

Retirement brings major changes. Conversations couples should have include the timing of retirement (if, when, and how to retire), finances, how your roles and identities will change, intimacy, family, and health and wellness. You also need to discuss where and how to live, your social life, and your purpose or overall goals in retirement.

People who haven't had these discussions probably don't know how to begin them or aren't comfortable having them. In the book, you benefit from the authors' experiences and those of other couples they've worked with. Each chapter has an extensive discussion of different aspects of the topic that need to be considered and examples of thoughts other have had about them. The chapters end with questions or points a couple should consider and discuss.

I think many couples don't have these discussions because most people haven't considered the issues and really don't know what they think about them. That's where the book really can come in handy. It gives you

Finding Safe, Guaranteed Income

"Investors are looking to protect the nest eggs they've worked hard to accumulate and ensure they don't run out of income."



Protect my principal, and guarantee my income. Those are the goals of many investors today, especially those in or nearing their post-career years. Now that the equity markets no longer are rising steadily upward, investors aren't looking for ways to match or beat the indexes. They're looking to protect the nest eggs they've worked hard to accumulate and ensure they don't run out of income.

There are a number of ways to protect your nest egg. But there also are perils in the market for safe, guaranteed income.

When you're in the spending years and looking to convert part of your nest egg into a stream of income, the immediate annuity is the conventional, reliable strategy. You give a lump sum to an insurer, and it promises you a stream of income for life, or whatever other period you select. The payments to you include both income and principal. But you don't have to worry about outliving the money. That's the insurer's worry.

There are some disadvantages. You have limited or no ability to dip into the principal when spending needs exceed the regular payments. That's one reason not to put all of your nest egg into immediate annuities. Another downside is there's nothing left for your heirs or

ideas and stimulates thought by revealing what others have thought and discovered during the process.

Many people don't realize how their retirement can affect others. For example, I was working with an organization that hired its recently-retired CEO for a specific project. He wrapped up the project and was invited to the annual holiday party. At the party, his wife was quietly pulling aside key staffers and board members to ask, "Can't you find something else for him to do?"

It seems his full-time presence at home was interfering with her routine and causing tension. That's something I've heard from other spouses of the retired. The newly-retired spouse either is underfoot or expects to be entertained all day.

Retirement is not a point in time, and a retirement plan is not fixed. Both are processes. You learn or circumstances change, and the plan needs to change. Couples go through the process. If they're working together and talking the process and results will be better. **RW**

charity after the income payments end. That's another reason to use only part of your nest egg to buy an annuity.

The amount of the income payments is fixed. Over time, inflation likely will erode their purchasing power. You need other income or assets to allow your spending to grow as the annuity's purchasing power declines. Or you can buy an inflation-indexed immediate annuity instead of a standard annuity. Your initial payment will be lower with the inflation-indexed annuity. Normally it's about 20% to 33% lower. But the payment will increase over time if there is inflation.

When you're still in the accumulation and saving years, there are other options to guarantee your principal and minimum returns.

You can look at the traditional plain vanilla deferred fixed annuity. With this annuity, you pay a lump sum to the insurer. In return your account is credited with an income return each year. The return usually changes annually in line with either intermediate bond yields or the investment returns of the insurer.

Some insurers complicate these annuities with bonus interest, teaser first-year yields, and other features. Remember these will cost you in some way. Also, weak insurers sometimes use these features or above-market yields to attract investors and gain market share. In those cases, you often pay for the higher yields with below-average returns in the long term.

When you want to try for a higher yield,