

PERSONAL WEALTH REPORT

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DON'T FORGET ABOUT INFLATION FACTORS

Due to technological advances in health care, people these days are living longer than ever. Naturally, that's good news for most folks. But there is a potential complication to longer life expectancies when it comes to preparing for your retirement. Reason: You don't want to outlive your retirement savings.



This recent trend indicates a critical need to develop a long-range plan to last through your retirement years. Caution: When you figure out how much money you will need to retire, don't forget to factor inflation—the dreaded “I” word—into

the equation.

For simplicity, say you want to have accumulated \$500,000 (not counting income from pensions and Social Security benefits) when you stop working 20 years from now. If you assume that inflation will average a relatively modest 4% a year, you will have to save almost \$1.1 million in today's dollars—or more than twice the projected amount of \$500,000—to meet your current objectives. On the other hand, the inflation rate could reach double digits as it did back in the 1970s and 1980s. With an average inflation rate of 10%, you would need to save more than \$3.3 million in today's dollars.

Of course, these figures are hypothetical and are subject to changing economic conditions. Furthermore, this projection does not take into account other factors such as the fluctuation of principal and tax consequences.

Nevertheless, the chart on the first page can be used to give a quick calculation on the possible effect of inflation on your retirement savings. Simply multiply the amount you figure you will need to save

by the appropriate inflation “factor.”

Bottom line: The worst thing to do is to completely ignore the effect of inflation on your retirement. With professional assistance, you can develop a strategy that takes all the critical factors, including inflation, into account.

Factoring in inflation

Years to retirement	Annual inflation rate		
	3%	4%	5%
5	1.16	1.22	1.28
10	1.34	1.48	1.63
15	1.56	1.80	2.08
20	1.81	2.19	2.65
25	2.09	2.67	3.39
30	2.43	3.24	4.32
35	2.81	3.95	5.52
40	3.26	4.80	7.04

Source: WPI Communications, Inc.

MONEY MANAGEMENT

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FOUR PLAN OPTIONS FOR SMALL-BUSINESS OWNERS

At one time, small-business owners and self-employed individuals had few choices when it came to qualified retirement plans. Not anymore.

For example, consider these four basic opportunities.

1. Simplified Employee Pensions (SEPs): A SEP is generally exempt from the reporting

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requirements for other qualified plans. With a SEP, you must make contributions on behalf of all employees age 21 or older who have worked for a company during three out of the preceding five years (absent any union agreement).

For 2006, you can make a deductible contribution up to the lesser of 25% of compensation

or \$44,000 (the defined contribution plan limit). The maximum amount of compensation taken into account for this purpose is \$220,000. Contributions are discretionary, so you are not locked into a figure for the year.

As with other qualified plans, distributions must begin by (continued on page 3)



Should You Turn Down a Bequest

According to an old saying, “It is better to give than to receive.” But in some instances, it may be better to “disclaim” than to receive. In other words, your family might be able to reduce its federal estate-tax bill with a qualified disclaimer. Furthermore, it may be possible to use a disclaimer to correct an earlier estate-planning error.

What is a disclaimer? Generally, it is a written, irrevocable decision on the part of an estate’s beneficiary to refuse all or part of a bequest. To be effective, a beneficiary generally must make the disclaimer within nine months of the decedent’s death and before the property has been received.

Why would you need a disclaimer? Typically, a disclaimer may be used to allow a family to take full advantage of the breaks in the federal estate-tax law. It could come into play if a married couple has overlooked estate-tax complications.

For instance, this often occurs if one spouse leaves all of his or her assets to the other spouse. When the surviving spouse dies, the federal estate-tax exemption is insufficient to cover the estate-tax liability for assets passing to the children.

Currently, the exemption can be used to shelter up to \$2 million from estate tax. This figure will increase to \$3.5 million by 2009 before the estate tax is eliminated in 2010. However, under a “sunset” provision in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)[†], the tax is scheduled to be revived in 2011 with a tax exemption shelter of only \$1 million (based on the exemption prior to EGTRRA enactment). In other words, unless Congress takes subsequent action, the law reverts to pre-2001 law after 2010.

Note: Usually, assets that are passed down to a grandchild are subject to a double estate-tax bite: once in the grandpar-

Estate Analysis

ent’s estate and then again in the parent’s estate. One potential way around this problem may be to have the parent disclaim the bequest. As a result, the property can then go directly from the grandparent to the grandchild while being taxed in only one estate. Note that amounts above a specified amount passed through a generational “skip” may be subject to a special generation-skipping tax.

Make sure you understand all of the possible repercussions. Consult with your personal legal, tax and/or financial counsel for specific questions.

[†]The EGTRRA contains a “sunset” provision that repeals this Act as of December 31, 2010. Consequently, all tax code changes made under the Act will revert to their status prior to enactment once again on January 1, 2011. Unless there is future legislation, the Act will only be effective through the year 2010.

Insurance Ideas

Obtaining Coverage for a Married Couple

the “man of the house” in? That certainly is an outdated phrase. In most families, both spousal members share numerous responsibilities, including the requisite financial burdens.

If both spouses are working, there could be an increased need for life insurance coverage for each spouse. And even if one spouse isn’t working at a salaried job—be it the husband or wife—that person is likely performing valuable services at home. Result: The loss of either spouse can be a devastating financial, as well as emotional, loss.

Furthermore, more single females are supporting families than they have in the past. The need for life insurance coverage in this situation is obvious.

Which type of coverage should a spouse opt for? There are many alternatives, but the two main types of life insurance policies are permanent insurance and term insurance. Each has its own advantages. In brief, a term life insurance policy offers coverage at a reasonable cost and is designed to be in force for a stated period of time.



Is Permanent insurance, while typically more expensive than term, offers lifetime protection if you make your premium payments or cover policy charges as required by the policy. Permanent insurance and its ability to accumulate cash value offer an additional tax advantage. The policy’s cash values accumulate tax-deferred, meaning you do not pay taxes each year on any gain. You have access to those values on a tax-favored basis through partial surrenders or policy loans.*

While you may be covered by a group term policy at work, in many cases, the group policy by itself may not provide sufficient protection (especially if you have a growing family). Supplementing the coverage with a cash value policy often makes sense over the long run.

Practical advice: Of course, everyone’s situation is different. When you feel you are ready, set up a meeting with a professional to tailor life insurance coverage to your family’s needs.

*Policy withdrawals are not subject to taxation up to the amount paid into the policy (your cost basis). If the policy is a Modified Endowment Contract, policy loans and/or withdrawals will be taxable to the extent of gain and are subject to a 10% tax penalty. Access to cash values through borrowing, partial surrenders or withdrawals can reduce the policy’s cash value and death benefit, increasing the chance the policy will lapse, and may result in a tax liability.



Tax Talk

WHY YOU NEED HOME IMPROVEMENT RECORDS

One of the biggest tax breaks for individuals is the home-sale exclusion. However, due to the appreciation in value over the years, you may still have a sizeable tax to pay when you finally sell the place.

That is why it is important to keep good records of home-related expenses. These expenses often can increase your tax basis for home-sale purposes, reducing the

taxable amount of a gain—if any.

Background: If you have owned and used your home as your principal residence for at least two of the previous five years, you can elect to exclude from tax up to \$250,000 of home-sale profit if you are a single filer; \$500,000 for joint filers. There are no limits on the number of times you can claim the exclusion.

The taxable amount for purposes of the exclusion is the difference between the selling price and the home's adjusted ba-

sis. For example, certain home improvements can increase the basis to cut down the taxable gain.

Practical approach: Maintain a logbook, ledger or other record of expenses

you are adding to your basis. Keep the information stored in a safe place and make backup copies of the electronic files.

Four Plan Options for Small-business Owners (continued from page 1) April 1 of the year following the year in which you turn age 70½. If you take a distribution prior to age 59½, you will trigger a 10% tax penalty, unless a special exception applies.

2. Savings Incentive Match Plans for Employees (SIMPLEs): A SIMPLE is only available to employers with 100 or fewer employees. Like SEPs, SIMPLEs are exempt from most reporting rules. Key difference: A company cannot contribute to a SIMPLE in a year in which it maintains another qualified plan.

For 2006, an employee may elect to contribute up to \$10,000 to the plan. If you are age 50 or older, you can add a "catch-up contribution" of \$2,500. As a general rule, the employer may provide matching elective contributions subject to nondiscrimination rules.

The rules for mandatory distributions after turning age 70½ also apply to SIMPLEs. However, the usual 10% penalty tax is increased to 25% for early withdrawals within the first two years of participation.

3. Keogh plans: To set up a Keogh plan, you must qualify as a self-employed individual. It doesn't matter if you have any other employees or not.

The amount you can contribute annually depends on whether the plan is a defined contribution or defined benefit plan. For 2006, the maximum amount you may contribute and deduct for a defined contribution Keogh is the lesser of 20% of earned income or \$44,000. With a defined benefit Keogh, contributions

are actuarially computed. You can provide an annual retirement benefit of the lesser of 100% of earned income for the three highest-paid years or a specific dollar amount adjusted for inflation (\$175,000 for 2006). The rules and penalties for distributions from other qualified retirement plans also apply to Keogh plans.

4. Solo 401(k) plans: For years, small-business owners and sole proprietors typically avoided 401(k) plans, mainly because of the administrative costs. But now 401(k)s are widely available to this group as well.

A 401(k) plan generally combines elective deferrals with matching contributions by the employer. The contributions are made on a pretax basis. The rules for contributions and distributions from qualified plans generally apply to solo 401(k) plans.

Assuming you are the only employee of the business, you don't have to worry about nondiscrimination rules. There is an annual dollar cap on the elective deferrals that can be made to a 401(k) plan. For 2006, the limit is \$15,000, plus you are allowed to make an extra catch-up contribution of up to \$5,000 if you are age 50 or older. Employer contributions may be made up to the limits for defined contribution plans.

Which type of plan is best for you? Discuss your situation with a financial services professional who specializes in retirement funding.