

TO the WISE

TIPS, TECHNIQUES AND STRATEGIES FOR A WELL-PLANNED RETIREMENT

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GETTING OLDER WITH NO RETIREMENT SAVINGS IN SIGHT?

Are you getting close to retirement age without a substantial nest egg? You are not alone, and millions of Americans are faced with the same need to save enough and retire comfortably.

Our priorities shift throughout our lives. Early in the life cycle, home ownership is a priority, which is usually followed by raising and educating children.

However, as retirement approaches, the focus needs to shift towards retirement funding. By the time most people are 45 or 50, the children are on their own, the mortgage is close to being paid off, and there is more discretionary income to set aside for retirement.

Determine your approximate income needs and calculate the amount of money you will receive aside from your savings. These other sources could be your Social Security benefit, a pension, or a 401(k) plan. Using a conservative rate of growth, calculate its expected value at your planned retirement age.

Add up all the funds that will come from your Social Security benefit, pension, etc. and set a reasonable savings target. Start figuring out how to make up for the difference. Here are some suggestions:

1) Check to see if your employer offers a 401(k), a 403(b), or some other type of voluntary contribution retirement plan. Participate right away and make the maximum contribution allowed, which for 2005 is:

- \$14,000 for taxpayers below 50 years of age, and
- \$18,000 for taxpayers 50 years of age and over.

Keep in mind that if your employer matches a percentage of your contribution, that is free money for



you. Between both contributions, you can look forward to a huge lump sum by retirement age. In addition, you might want to contribute to a Roth IRA since the earnings will be tax-free in retirement.⁽¹⁾

2) There's always the option of acquiring a second job to generate more income. Invest your additional earnings or use it to pay off any outstanding debts. By getting rid

of credit card balances, you also avoid unnecessary interest charges and free up your money for retirement savings.

3) Consider moving to a smaller home, especially if the children have moved out. By selling your property, you can save on utility bills, repairs, and perhaps property taxes. Take those savings and put them towards retirement. You might even think of relocating if you live in an area with a high cost of living. Needless to say, proceeds from the sale that aren't needed to pay off the old mortgage, other debt, etc., or used to purchase the new home, should be put into savings for your retirement years.

4) For those age 50 and over, the tax laws now allow a higher contribution amount to 401(k)s, IRAs and other retirement plans. This will help those individuals catch up as retirement age draws closer. If you fall in this age group, be sure to take advantage of it!

Don't be discouraged. There are a number of ways to save and many sources of retirement income. Please call our office so we can help you assess your financial resources and plan for a financially secure retirement.

⁽¹⁾ Eligibility for contributing to a Roth IRA depends on AGI and filing status; check with our office to see if you qualify before making a contribution.

PAYING OFF YOUR MORTGAGE: WHAT'S IN IT FOR YOU?

A common concern among homeowners is whether they should pay their mortgage off and risk losing the deduction for home mortgage interest.

The first thing to consider is the tax benefit derived from the interest deduction. Let's say that you are in the highest tax bracket of 35% and have a \$5000 deduction from a mortgage of \$100,000 on which you pay 5% interest. With that interest tax deduction, you save \$1,750 in income tax. Thus, your net cost of the home mortgage interest is \$3,250.

The \$100,000 that will be used to pay the mortgage off is invested at an annual return of 6%. It produces an investment income of \$6,000, which after taxes, leaves you with \$3,900. So on one hand, the mortgage costs you \$3,250, but is offset by the \$3,900 after-tax income the 100K is earning for you on your investments. As a result, you are netting \$650 by not paying off the mortgage.

As this simple example illustrates, it is generally better to keep paying on the mortgage if the funds you would use to pay it off will produce a higher rate of return than the interest on the mortgage.

However, tax-related matters are not always that simple and there are usually other issues to consider. Is the return on your investment providing you with tax-free income, or are dividends and capital gains taxed at the more favorable 15% rate? If so, that would tilt the scale in favor of keeping the mortgage, even if the investment return is somewhat less than the mortgage interest rate. How far above the standard deduction for your filing status does the mortgage interest deduction push you? You may be benefiting substantially less from the deduction than you think.

This situation can be complex and requires a professional mathematical analysis of your particular situation that our office can provide.



WHAT WILL RETIREMENT COST YOU?

Several factors will affect the amount of money you will need for a comfortable retirement. According to the rule of thumb, it will take anywhere from 70% to 80% of your current household income to maintain your present lifestyle when you retire. In reality, you would need to evaluate your personal retirement goals and current financial situation to estimate your income needs.

Inflation will definitely make its impact. As the years go by, the rising inflation rates will reduce the purchasing power of your money; therefore, an inflation factor needs to be included in your estimation. One way to offset the effects of inflation is to adjust your current investment strategy to ensure meeting your retirement goals.

What other aspects of your life will change by the time you retire? Consider the following:

- Will you have any commuting costs or work expenses?
- Are the children out of the house and living on their own?
- How many vehicles will you have?
- Are you paying for any tuition expenses?
- Do you plan to downsize and sell your house?
- Will you be traveling extensively?
- Do you plan to retire outside the United States?
- Are there other expenses you foresee having, such as medical insurance or additional uninsured health care costs?

Assess your sources of income once you have determined your income needs. If you are planning to retire within ten years, you should be able to determine with a reasonable amount of certainty how much money you will need and where it will come from. Remember that the sooner you act the better chance you will have to accumulate the needed funds through your investments. It is never too early to start preparing for retirement.



GET COVERAGE WITHOUT BREAKING THE BANK

Has the rising cost of homeowner's insurance coverage put a dent in your annual budget? In some areas of the country, the cost of a policy has gone up two or three times the amount it was a couple of years ago. Here are some ways to save money on your homeowner's insurance.

Maximize All Insurance Discounts

Find out about the discounts your insurance company offers. Make sure you take advantage of all the ones that apply to you. There are usually discounts available for smoke detectors, deadbolt locks, security system, and other items in your home. In addition, you may be entitled to an additional 10% discount if you are retired and age 55 and over.

Purchase Homeowner's and Auto Policies Together

Most companies usually offer both homeowner's and automobile insurance. Try to purchase all your insurance policies from one company that offers discounts for purchasing them together. Just make sure that the prices are competitive for both types of coverage and that the prices are lower than if you were to buy them separately. Do your homework and shop around.

What Does Your Policy Cover?

For most of us, our home is our biggest investment. Make sure that you are adequately covered for risks that you cannot afford to cover on your own. On the other hand, don't purchase coverage that you don't need. For example, if you don't live in an earthquake zone, there is no reason to purchase earthquake coverage.

Opt For a Higher Deductible

Raising your deductible to \$500 or \$1,000 could significantly lower your premiums by as much as 25%. With the high cost of homeowner's insurance, it is worth taking a little more risk on your end. If you have a low deductible of \$50 to \$100, this may be a move you should seriously consider.

Make Your Home Less of a Risk

There are certain risks that insurance companies try to avoid. For example, having a particular breed of dog such as a pit bull or Doberman pinscher could limit your policy or raise the premiums. Another common concern is a backyard swimming pool, especially if there is no fence around it. To find out all the items that are excluded from your policy, check under the "Conditions and Coverages" section. This will help you decide if you need to buy additional coverage for things that your policy does not cover. You can also call the insurance company directly to find out how to minimize the risks in your home.

Any Policy Changes Needed?

Reevaluate your policy annually to make sure that you still have the coverage that you need. Let the insurance company know of any changes in your situation that occurred during the year.

Keep Your Credit Score Healthy

Some insurance companies use your credit score to determine the price of your insurance policies. Try to maintain a good credit score so you won't have to pay dearly to get coverage. The insurer is required to notify you if your credit affected your policy in any way, per the Federal Fair Credit Reporting Act. If you believe your policy was impacted by your credit and you didn't receive advance notice from the insurer, get a copy of your credit report to see if the insurer is listed as making an inquiry as to your credit history. If so, you can file a complaint with your state insurance commissioner.

The states of Hawaii and Maryland have banned credit scoring for setting rates on homeowner's policies. California and Hawaii don't allow this practice for setting auto insurance rates. Other state legislatures are considering similar bills.

With the rising costs of home ownership, try to find ways to minimize the impact of insurance, taxes and other expenses. Please call our office for assistance.

REVERSE MORTGAGES: A SALVATION FOR SENIORS

Some retirees are faced with mounting debt and inadequate incomes. What option do these people have, especially if they own a home and can barely make their mortgage payments?

A popular trend in recent years is the "reverse mortgage" which allows homeowners to borrow against the equity they have built up over the years. The loan is not due until the homeowner passes away or moves out of the home. If the homeowner dies, the heirs can pay off the debt by selling the house and any remaining equity goes to them. If at that time the loan balance is equal to or more than the value of the home, the repayment amount is limited to the home's worth.

In order to be eligible for this loan, the borrower must be at least 62 years of age and have equity in the home. The loan amount will depend on factors such as the borrower's age, the value of the home, interest rates and the amount of equity built up. The borrower has the option of taking the loan as a lump sum, a line of credit, or as fixed monthly payments. In addition, the money can be used for any purpose, without restrictions imposed.

Reverse mortgages have brought financial security to many seniors so that they can live a comfortable life. If you are struggling with your finances, carefully explore your options, including the possibility of a reverse mortgage.

Tax

CALENDAR



September 15, 2005:

- Third installment of 2005 Individual Estimated Taxes due.

October 17, 2005:

- Last date to timely file your 2004 Individual Tax Return (Form 1040) if you are in the United States and filed an extension with Form 2688.

September – December 2005:

- Time for 2005 Year-End and 2006 Tax Planning. Contact this office to schedule a consultation appointment.
- Taxpayers who began their Minimum IRA Distributions before 2005 must withdraw their 2005 Distribution by December 31.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

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SINCE YOU ASKED...

Question: My wife and I have owned our home and a rental property for several years. We would like to sell our home and move into the rental. What are the tax implications of such a move?

Answer: If you sell a home that you have owned and lived in for two out of the past five years, you will be entitled to exclude up to \$500,000 of gain from the sale of the home. If there is gain in excess of the exclusion, it will be taxable as long-term capital gain. There is no taxable event associated with converting a rental to a home. However, there are implications when and if the converted rental is ultimately sold. Any gain from that property would be measured from the depreciated basis of the rental at the date of the conversion to a home, plus any subsequent improvements. If the converted property is occupied as the main home for two years before it is sold and it has been more than two years since a prior home was sold, the \$500,000 exclusion of gain would apply again. However, any gain to the extent of depreciation taken on the rental property after May 6, 1997 may not be excluded.

Question: I am considering purchasing long-term care insurance. My insurance agent has indicated it will be tax-deductible and a portion

of the premium will come back to me in the form of reduced income taxes. Can you provide some guidance?

Answer: Long-term care insurance premiums are an allowable medical deduction, but that does not guarantee that you will receive any tax savings because you paid the premiums. Unless you are self-employed, you must itemize your deduction in order to have a medical deduction. If you take the standard deduction, purchasing a long-term care policy will not provide any tax benefit. Secondly, even if you do itemize your deductions, medical expenses are only allowed as a deduction to the extent that they exceed 7.5% of your income (AGI). If you are taxed by the alternative minimum tax, that limitation increases to 10%. And finally, the amount that you (and your spouse if he or she also purchases coverage) can deduct for the insurance is limited to an amount based upon your age. The deductible premium amount is annually inflation adjusted, and for 2005 ranges from \$270 for taxpayers age 40 or younger to \$3,400 for those 71 or older. However, if you are self-employed, part or all of the insurance may be deductible as self-employed medical coverage whether or not you itemize your deductions.