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# Caught in the Middle

At a time when baby boomer couples should be saving for their own retirements, many feel squeezed by competing financial needs. Having started families later than past generations, their children may just now be entering college or still living at home. At the same time, aging parents may need financial assistance. It is a dilemma that is likely to become more common.

## Caring for Parents

As life expectancies continue to rise, it becomes increasingly likely that you may need to help an aging parent. Some financial precautions you should consider now include:

✔ Investigate long-term-care insurance for your parents. If they can't afford the insurance, you may want to purchase it for them.

✔ Have your parents prepare a listing of their assets, liabilities, and income sources, including the location of important documents. This can save time if you need to take over their finances.

✔ Make sure your parents have legal documents in place so someone can take over their financial affairs if they become incapacitated. They may also want to delegate health care decisions.

✔ Understand the tax laws if you provide financial support to your parents. You may be able to claim them as dependents if you provide more than half their support. Additionally, you may be able to deduct medical expenses paid on their behalf.

✔ Find out if your employer offers a flexible spending account for elder care. This may allow you to set aside pretax dollars to pay for up to $5,000 of elder-care expenses for a dependent parent.

## Assisting Your Children

For many families, college is a significant financial cost. While you may want to pay all college costs for your children, it may not be feasible with competing needs to save for retirement and to assist parents. Some strategies to consider include:

✔ Shift some of the burden to your children, requiring them to work part-time during college or to take out student loans.

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## Estate-Planning Benefits of Roth IRAs

If you don't need the entire balance in your individual retirement accounts (IRAs) during your lifetime, a Roth IRA offers estate-planning advantages not available with a traditional IRA. Those advantages relate primarily to the following features of a Roth IRA:

✔ **The account owner is not required to take withdrawals after age 70 1/2.** With a traditional IRA, minimum required distributions must be made after the latter of age 70 1/2 or retirement, based on the account owner's life expectancy. With a Roth IRA, you can leave the funds in the Roth IRA to continue accumulating on a tax-free basis.

✔ **Withdrawals made by beneficiaries are received income-tax free.** With both Roth and traditional IRAs, the IRA's value at the date of your death is included in your taxable estate and may be subject to estate taxes. However, the income tax treatment is substantially different. Withdrawals from traditional IRAs are subject to ordinary income taxes, while qualified withdrawals from Roth IRAs can be taken income-tax free. If beneficiaries elect to take withdrawals over their life expectancy, the funds in the Roth IRA will continue to grow on a tax-free basis and withdrawals will be free of federal income taxes. ○○○

## Caught in the Middle

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✔ Understand the financial aid system, investigating all financial aid sources. Search for scholarships that are not based on need. Apply to several different colleges, looking for the best financial aid package. Negotiate with your child's preferred college to see if you can increase the financial aid package.

✔ Look for ways to reduce the cost of college. Your child can start at a community college, which is often cheaper than a four-year college, especially if the child commutes from home, or consider a public university in your state, which will generally be more affordable than a private university.

Once your child graduates from college, don't assume your financial responsibilities are over. Adult children may return home for a variety of reasons — they can't find a well-paying job, they have too much debt to live alone, or they divorce and need financial support. If your child returns home, realize there are increased costs — additional food, phone bills, utilities, etc. Consider charging rent and imposing a deadline on how long he/she can stay.

### Don't Forget Yourself

When faced with the competing needs of children and aging parents, it's easy to neglect your own need to save for retirement. But don't feel guilty about your retirement needs. One of the best gifts you can give your children is the knowledge that you will be financially independent during retirement. Consider the following:

✔ Calculate how much you need for retirement and how much to save on an annual basis to reach that goal. Don't give up if that amount is beyond what you're able to save now. Start out saving what you can, resolving to significantly increase your saving once your parents' or children's needs have passed. Also consider changing your retirement plans, perhaps delaying your retirement or reducing your financial needs.

✔ Take advantage of all retirement plans. Enroll in your company's 401(k), 403(b), or other defined-contribution plan as soon as you're eligible. Also consider investing in individual retirement accounts. All provide a tax-advantaged way to save for retirement.

✔ Reconsider your views about retirement. Instead of a time of total leisure, consider working at a less-stressful job, starting your own business, or turning a hobby into a paying job.

Please call to discuss these issues in more detail. ❍❍❍

## A Budget for Your College Student

Many students will first handle money without parental supervision during college. To help keep expenses down and avoid conflicts, you might want to develop a budget to guide your child's spending. As you go through the process, consider the following:

✔ First consider all potential expenses, including food, travel, clothing, entertainment, phone, periodicals, computer expenses, medical and dental expenses, and insurance.

✔ Develop a preliminary budget for the first couple of months of college. You may find that you forgot about certain items. After your child has lived on his/her own for a couple of months, you can develop a more realistic budget.

✔ If your child has trouble sticking with the budget or can't account for large sums, have him/her keep a journal for a couple of weeks that details all expenditures. Go over the journal together to determine how expenses can be reduced.

✔ Consider providing your child with a debit card rather than a credit card. Since your child's spending will be limited to the amount on deposit, it is harder to overspend.

✔ Explain the basics of credit cards. Make sure your child doesn't use a credit card as a means to overspend. Go over which types of items your child can use the credit card for and which items should not be charged. Make sure your child understands that if the balance isn't paid in full each month, a significant amount of interest will be paid on the outstanding balance. If you teach your child nothing else, try to instill the concept of paying credit card balances in full every month.

✔ Have your child provide you with a written monthly comparison of his/her actual expenses to budgeted amounts.

While the entire process might seem like a lot of work, keep in mind that you are teaching your child money basics that will help him/her for a lifetime. ❍❍❍

# Using Portfolio Losses

Capital gains on investments held for one year or less are short-term capital gains taxed at ordinary income tax rates. For investments held over one year, the maximum long-term capital gains tax rate in 2010 is 15% (0% for taxpayers in the 10% or 15% tax bracket). While the 15% rate is significantly below the maximum ordinary income tax rate of 35%, it still takes a major chunk out of your investment portfolio.

To help minimize your capital gains tax bill, you should actively harvest any losses in your portfolio. Some strategies to consider include:

**Recognize losses to at least offset $3,000 of ordinary income.** Keep in mind the tax rules regarding gains and losses — capital losses offset capital gains, and an excess of $3,000 of capital losses can be offset against ordinary income. If you are holding stocks with losses in your portfolio, you should probably take advantage of this tax rule.

If you still want to own the stock with the loss, you can sell the stock, recognize the tax loss, and then repurchase the stock. You just have to make sure to avoid the wash sale rules. These rules state that you must repurchase the shares at least 31 days before or after you sell your original shares to recognize the loss for tax purposes.

**Consider recognizing all, or a substantial portion, of any losses in your portfolio.** Realize that no one likes to sell investments at a loss. And since you can only offset an excess of $3,000 of capital losses against ordinary income, you might wonder why you should incur excess losses that can't be used currently, even though you can carry them forward to future years. There are a couple of advantages to this strategy.

First, it gives you an opportunity to totally reevaluate your portfolio. If you are convinced all your investments are good ones, you can sell them, recognize the tax loss, and then repurchase the stocks, being sure to avoid the wash sale rules. But it's probably more likely that you own some investments you wish you didn't.

Second, it gives you more flexibility when recognizing gains in the future. Until you use all your capital losses, you can recognize capital gains without worrying about paying taxes. Even if your losses are long term, you can use them to offset short-term capital gains.

**Use stock losses to offset other capital gains.** If you have capital gains from the sale of another type of asset, such as a business or real estate, stock losses can be used to offset those gains.

**Don't gift stocks with losses.** If you are planning a large charitable contribution, it makes sense to donate appreciated stock held for over a year. You deduct the fair market value as a charitable contribution, subject to limitations based on a percentage of your adjusted gross income, and avoid paying capital gains taxes on the gain. If the stock has a loss, however, you should first sell it and then send the cash to the charity. That way, you get the charitable deduction and recognize a tax loss on the sale. ❍❍❍

# Don't Forget about Inflation

Inflation has been tame for so long that it's easy to forget how much it can affect your purchasing power over a long retirement. Over the past 10 years, inflation, as measured by the consumer price index, has averaged 2.5% (Source: Bureau of Labor Statistics, 2009). At 2.5% inflation, $1 is worth 78¢ after 10 years, 61¢ after 20 years, and 48¢ after 30 years. Thus, you need to look for strategies to lessen inflation's impact during retirement:

✔ **Use a conservative inflation rate when planning for retirement.** You don't want to run out of money during retirement. So when calculating how much to accumulate by retirement age and how much to withdraw during retirement, use a conservative inflation rate. While inflation has averaged 2.5% over the past 10 years, it has averaged 3.9% over the past 30 years (Source: Bureau of Labor Statistics, 2009).

✔ **Determine how much of your retirement income is indexed for inflation.** Social Security benefits are currently indexed for inflation, but most defined-benefit pension plans do not make adjustments for inflation. Thus, other income sources will have to fill an increasing income gap over time.

✔ **Invest in tax-advantaged retirement vehicles.** Look into 401(k) plans, individual retirement accounts, and other retirement vehicles. While each has different rules for taxing contributions and earnings, all provide some tax-free or tax-deferred benefits. Since you aren't paying income taxes on earnings during the years, that typically means you'll have a larger balance at retirement.

✔ **Choose investments carefully.** To avoid losing purchasing power, your after-tax rate of return should be higher than the inflation rate. Review your investments annually to make sure you aren't losing purchasing power.

Please call if you'd like to discuss inflation and the impact it might have on your retirement plans. ❍❍❍

# Selecting a Trustee

One of the more critical decisions you'll make when setting up a trust is selecting a trustee. Depending on the trust's provisions, the trustee can serve for decades with broad discretion in managing assets and distributing income and principal. The trustee's performance can significantly impact your beneficiaries' distributions. Some thoughts to consider include:

✔ **Decide whether to choose a family member, friend, or professional trustee.** You want an honest individual with some basic financial aptitude. You could decide to name two trustees, perhaps a family member and a professional. The professional could handle investment decisions, while the family member could oversee those decisions and make distribution decisions. Before naming a trustee, obtain that individual's consent.

✔ **Don't rule out a professional due to the fees involved.** While friends and family may serve without compensation, consider whether they could handle these financial decisions as well as a professional could. The trustee's duties can be complex and time-consuming.

✔ **Name a successor trustee.** If your trustee dies, becomes incapacitated, or decides he/she doesn't want to serve as trustee, you should have a successor trustee named or at least describe how one should be selected, such as by a majority vote of the beneficiaries.

✔ **Set up performance guidelines.** That way, if the trustee does not meet those guidelines, your beneficiaries will have a means to change trustees.

✔ **Write a letter to your trustee explaining your wishes.** This letter should explain your objectives for the trust, information about the beneficiaries, and other factors that will help the trustee make decisions. ❍❍❍



# Encourage Estate Planning

Even when your children are grown, there will probably be lessons you'll want to teach them, such as the need for estate planning. Some items to include are:

✔ **Explain why estate planning is important.** Your role is not to dictate what they should do with their estate, just to emphasize the need for estate planning. When your children encounter major life events, remind them to review their estate plans.

✔ **Make sure all important estate-planning documents are in place.** At a minimum, every adult should have a will, a durable power of attorney, and a health care proxy. A durable power of attorney designates an individual to control their financial affairs if they become incapacitated, while a health care proxy delegates health care decisions to a third person when they are unable to make those decisions.

✔ **Coordinate estate planning across generations.** If you have a substantial estate, you may want to coordinate your estate-planning efforts with those of your children. A coordinated effort can help minimize estate taxes. ❍❍❍

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