

Dialogues » WEALTH STRATEGIES FOR DISCUSSION



Baby Boomers are redefining retirement, and we take a fresh approach to helping clients plan for this new set of values and associated challenges. We advise clients at every stage of retirement planning to be financially prepared in order to live fully during their retirement years.

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How Much Money Do You Need for the Next Phase?

IT DEPENDS ON THE KIND OF RETIREMENT YOU ENVISIONED.

These days, “What’s my number?” is a question millions of baby boomers are asking themselves, as in, “How much money do I need to stop worrying about retirement?” Figuring out that magic number has never been more challenging—or more important.

You have to figure out how to fulfill your retirement goals without sacrificing a comfortable life. Your money has to last, but you don’t know how long your retirement will last (today, the average American can expect to live nearly 78 years). And longevity isn’t the most remarkable aspect of baby boomers heading toward retirement—it’s what they plan to do with those years. Golf and grandchildren still have their place, but people retiring today are just as likely to be balancing tee times and family visits with a second career, entrepreneurship, world travel or pursuing an advanced degree. How can a person possibly fit it all in—and afford it?

Talking is a good start. You may be surprised to learn that your retirement expectations differ from your spouse’s. Perhaps you want to stay put in your suburban house, while your spouse envisions a move to the city. As you work out compromises, each decision will help you assess how much money you will need to finance your retirement.

Identifying your shared goals is vital to successful planning; but crunching the numbers definitely plays a role since the amount of income you’ll need in order to live comfortably once you retire may be higher than you think. So, doing the math and finding your number sooner rather than later are definitely key steps.

Your number is as unique as your set of aspirations and needs. Together, we can work to clarify your priorities and calculate your number—and then help convert this number from a daunting prospect to the retirement you always wanted. ■

Do You Know Who Your IRA Beneficiary Is—and Why It Matters?

Deciding whom to designate as a beneficiary for your IRA might seem like a no-brainer—you probably want your money to go to someone near and dear to you.

» But is the person (or people) you're thinking of actually the one(s) you named on the IRA beneficiary form all those years ago when you opened the account? To be certain, it's wise to review your beneficiary designation form at least every few years, or whenever you've had a change in circumstances, such as a divorce. Changing your beneficiary is easy—you simply complete a new beneficiary designation form. Keep in mind that a will or trust does not override this form unless you name your estate or trust as your beneficiary;

however, spouses may have special rights under state law (community property statutes vary by state). Because beneficiary designations are important estate-planning documents, you may want to review them with your attorney before filing them with your IRA custodian.

Beneficiary designation forms offer the option of naming primary and contingent beneficiaries. The primary beneficiary is your first choice to receive your retirement benefits and can be more than one person or entity. If you choose more than

one primary beneficiary, you may specify a percentage to be paid to each person and indicate whether a beneficiary's share will be void if he or she predeceases you or if that share will pass to his or her children. This situation typically comes into play when you designate equal shares to all your children. (See below for more information on primary beneficiaries.) You also can name a minor as a direct beneficiary of an IRA, but your local probate court may require the appointment of a guardian for the minor.

A Primary Beneficiaries Primer

When naming a primary beneficiary, some designations to be familiar with are all my children, per stirpes and per capita. Terminology and definitions may vary from state to state, however, so you should consult with an attorney before making a final decision.

All My Children: If you use this term or name each child specifically, your IRA assets will be divided among your surviving children only. If one of your children dies before you, the remaining children will share equally in the deceased child's portion.

Per Stirpes: Also known as “rights of representation” in some states, per stirpes means that the children of a beneficiary who predeceases you will share equally in the portion of your IRA originally left to the now-deceased child.

Per Capita: This method divides your IRA assets among your beneficiaries and the descendants of any beneficiary who dies before you. For example, if you name your three daughters as your primary beneficiaries and one of them dies before you, each of her own three children will receive a share equal to that of your other two daughters—splitting the IRA into five equal parts.

A contingent beneficiary is someone you designate to receive your IRA only if all primary beneficiaries predecease you, die simultaneously with you or disclaim their rights to the IRA assets. These are the only circumstances under which a contingent beneficiary would be entitled to the assets in your IRA.

If you have special circumstances (for example, you would like to leave dollar amounts rather than percentages to your beneficiaries), it is possible to customize a beneficiary designation. We can provide more information on this and guide you toward the resources available to you as our client.

A tax advisor can work together with you and your Financial Advisor to help you weigh the pros and cons carefully in order to make sure your wishes are executed in a tax-efficient manner.

Selecting your IRA beneficiaries can be challenging, both emotionally and financially, given the potential tax implications. Remember to look at your IRA assets in context with the rest of your estate before making any decisions. To help ensure that your wishes can be executed as you intended, discuss your beneficiary designations, wills and other estate matters with your tax and legal advisors, as well as your Financial Advisor.

“Distributions from an IRA may have tax consequences for your beneficiaries. While taxes shouldn't be the primary determining factor in naming your beneficiaries, ignoring the impact of taxes could have significant consequences for your family.”

Why Use Customized Beneficiary Forms?

With traditional beneficiary designation forms, you can generally choose individuals as the primary or contingent beneficiaries. While these choices are sufficient for many account owners, for others additional choices may be necessary. You may want to use a customized beneficiary designation form:

- If you want to retain a degree of control over the IRA assets after your beneficiaries inherit the IRA;
- To facilitate the use of disclaimers (this may allow your beneficiaries to transfer assets out of their estate);
- In situations where you wish to use actual dollar amounts rather than percentage shares;
- Where the beneficiaries are charitable organizations.

Preparing a customized beneficiary form can help ensure that your ultimate wishes are carried out.

The Changing Landscape of Financing Education

One of the greatest gifts you can give a child is to pay for his or her schooling. Make this loving gesture financially savvy as well.

By Brendan Coffey

» Helping to pay for your child or grandchild's education is an act of love, an expression of pride and affection. But it's one that pays more than just emotional dividends. It is, of course, an investment in a young person's future. And increasingly, it's part of a complex financial strategy with many moving parts. "Historically parents have put money in the child's name or transferred appreciated property to them before selling it in order to take advantage of a child's low tax brackets," says Joe Hurley, CEO of SavingForCollege.com. "However, the expansion of the kiddie tax twice in the past three years has really put a stop to a lot of that activity. A lot of the old methods really aren't very good anymore."

The first step toward any sound financial plan is knowing the end goal. Getting a sense of what education costs will be for your children or grandchildren is a must. Over the past 30 years, total charges have risen an average of seven percent a year. While that rate of increase appears to be slowing slightly, it's estimated that for a child born today, four years of a private university will cost over \$350,000. With the cost of education consistently rising faster than the rate of inflation, it makes sense to put your money to work rather

than see it lose ground until your student matriculates. Odds are that even the affluent will need to draw upon several resources to foot the bill.

TAX-ADVANTAGED SAVING

Historically, financing college often involved putting money into a child's name or transferring appreciated assets to minors to take advantage of the lower tax rates. Twice in the past three years, Congress has closed the loopholes that made such strategies attractive, taxing the assets of children up to age 23 (if enrolled in college) at the parents' tax rate.

At the same time, the government has been strengthening the appeal of other strategies, especially **529 College Savings Plans**, according to Hurley. "For most parents and grandparents, a 529 plan is a no-brainer," Hurley notes.

These "Qualified Tuition Programs" were created in 1998, exploding in popularity in recent years thanks to their unique tax advantages. Available in every state, 529s allow tax-deferred investing for college. In 2006, Congress made permanent the tax-free treatment of withdrawals used for educational expenses. Funds in a 529 can be used for everything from tuition to fees to expenses such as textbooks, room, and

board. And any 529 savings plan can be used to fund attendance of a school anywhere in the country as well as accredited foreign institutions.

Many features of 529s are appealing. For one, while 529 plans are for a student, the account owner controls the funds, with a few exceptions. The owner decides how to invest the money within the available options, when to withdraw, and who the beneficiaries are.

When a 529 plan is in the parents' name, federal regulations require that schools treat it as a parental asset. This is significant, since under the current financial aid formula, schools calculate that 20 percent of a student's assets will go to college costs, but only a maximum of 5.64 percent of a parent's assets will. And if a grandparent wishes to help out, 529 assets in their name will not be taken into consideration *at all* when figuring out aid. "Grandparents' possession of a 529 isn't going to show up on radar anywhere," making them excellent tools, says Hurley.

TAX BENEFITS AND ESTATE LEGACIES

The tax-deferral and tax-free withdrawal features aren't the only potential tax benefits; in 32 states, there is an additional state income tax deduction for

529 contributions. The tax structure of 529s make them attractive investment vehicles even for those who could easily fund college education with cash, adds Hurley. “If you have that cash invested and you’re paying tax on the earnings, then why not have it in a 529 and save on income taxes?” Many states also have a **529 Prepaid Tuition Plan**, allowing tuition at a state institution to be paid at once in a lump sum, locking in current tuition rates.

Contributions by anyone to 529 savings or prepaid tuition plans are treated as outright gifts to the student, subject only to the annual gift exclusion (\$12,000, or \$24,000 from a married couple. But even then, the IRS gives a favorable exception, allowing a lump-sum gift of five years’ worth of annual exclusions. While the donor surrenders the ability to make a tax-free gift to the child for five years, this exclusion allows for a gift large enough to realistically meet a good chunk of the cost of college. (There is a caveat: if the donor dies within the five-year gifting period, a portion of those assets must be put back into the donor’s estate.)

People often worry about what will happen with the money in a 529 account should a child need to spend less than the account value for education. Rather than withdraw the funds and pay taxes and a penalty, you can simply change the beneficiary to another relative (most plans limit how often you can change beneficiaries). “Theoretically, the account could last for generations,” explains Hurley.

MORE TOOLS TO CONSIDER

For all their advantages, 529 plans aren’t the sole option for saving for college. Here are some other strategies:

Coverdell Education Savings Accounts.

Money in an ESA grows tax-deferred and may be withdrawn tax-free to pay any tuition, from kindergarten to graduate school. Unlike 529s, which have set investment choices, money in an ESA can be invested according to your wishes. One downside is that contributions are limited to \$2,000 and you must meet income requirements in order to contribute.

However, other individuals can contribute to the account even if the parents aren’t eligible. The account must be depleted when the beneficiary reaches 30 or a new beneficiary is named. Otherwise, gains are taxed and a ten percent penalty is levied.

UTMAs and UGMAs. In many states, minors have no legal right to own securities, annuities or life insurance policies.

Teaching Dollar Values

Most people don’t think twice about paying for a loved one’s education. But many parents and grandparents worry that the advantages of affluence, like having an expensive education paid for, could dull a recipient’s sense of the value of a dollar.

“More and more options to use money have bombarded all of us,” says J.M. Seymour, author of *Stock Market Pie: Grandma Helps Emily Make a Million*, a beginner’s book on financial literacy. “As a result of this growing financial smorgasbord, many young consumers don’t know whether—or how—to spend, save, invest, or borrow money.”

Here are three tips from Seymour on how to help your children or grandchildren get started:

- » **Walk the Talk:** Kids learn to spend and save from watching you. Include kids in discussions of family finances, letting them hear how major purchases—including education—are made.
- » **Get Real:** Open a savings or investment account together, then help your kids find good investments and use a simple way to keep track of ups and downs.
- » **Make It Fun:** The earlier you practice good investing habits, the better. But it has to be fun and rewarding so that kids stick with it. For example, discover a publicly traded company by searching for new products at the mall or online. Or have your kids explore Smith Barney’s Young Investors Network (www.smithbarney.com/yin).

Bonds are subject to interest rate risk. When interest rates rise bond prices fall; generally the longer a bond’s maturity, the more sensitive it is to risk. Bonds may also be subject to call risk, which allows the issuer to retain the right to redeem the debt, fully or partially, before the scheduled maturity date. Proceeds from sales prior to maturity may be more or less than originally invested due to changes in market conditions or changes in the credit quality of the issuer. Municipal bonds may be subject to state and local taxes, and/or the alternative minimum tax.



Your child can borrow for education, but you can't borrow for retirement.

Custodial accounts like UTMA and UGMA allow children to take ownership of assets without having to create a trust. With the recent closing of the “kiddie tax” loopholes, custodial accounts like these have become much less attractive for those seeking tax advantages, but they still may have a place in an overall strategy.

Zero-coupon bonds. “Zeroes” are bonds that pay no interest as they mature and instead pay it all at maturity. In exchange for foregoing the interest, or “coupon,” the bond is purchased at a substantial discount to face value. Consider laddering the bonds to mature over the time the child is in college.

IRAs and Roth IRAs. These aren't just for retirement planning. These accounts can be used for educational purposes without incurring distribution penalties. A child with earned income can fund an IRA in his own name that can be used for education expenses, if desired. Withdrawing funds from a parent's IRA to fund a child's education isn't recommended (even though

it's allowed without the ten percent penalty) since it may jeopardize their own plans for retirement. (The value of a child's education cannot outweigh your financial security, though. Quite simply, your child can borrow for education, but you can't borrow for retirement.)

Asset-based borrowing. If you don't want to liquidate securities or sell other appreciated assets, you can tap a securities-secured loan or home equity line of credit to pay tuition. Checks written directly from either account to an educational institution incur no gift tax. Even for nonqualified expenses like off-campus housing, a car, or other expenses, the tax-deductibility of home equity loans may provide an attractive option.

BALANCE YOUR GOALS

Education is a worthy goal in and of itself; however, there's also hard data that college graduates earn more than nongraduates. “When you compare the cost of education to the salaries graduates make, it puts college

costs in context,” says Mark Kantrowitz, founder and publisher of FinAid.org, a website on financing education.

No matter what your needs and resources are, we can help offer insight into what options may work best for your situation. We can also provide an Education Funding Analysis, which will estimate costs for a specific institution based on its historical tuition inflation rate, or for general categories, like private or public colleges. And of course we're in a perfect position to help you integrate college savings into your overall financial plan. ■

529 funds not used for qualified educational expenses are subject to applicable taxes and penalties. Please consider the investment objectives, risks, charges, and expenses associated with municipal fund securities before investing. The offering statement contains this and other important information. To obtain an offering statement, please call your Financial Advisor or visit www.smithbarney.com to locate a Financial Advisor in your area. Read the offering statement carefully before investing. Before investing, investors should consider whether tax or other benefits are only available for investments in the investor's home-state 529 college savings plan.

Addressing the Wealth Planning Needs of Women Investors

» Despite the fact that the great majority of women will be in control of their household finances at one point in their lives, some women may lack the confidence or knowledge to make wise financial decisions alone.

Although patterns are changing, a woman will generally spend more time out of the workplace, earn less and live longer than her male counterpart. With less money needing to last longer, women need to be prepared to handle all of their own financial decision-making.

GETTING STARTED

It's never too late—or too early—to start taking an active role in your finances. If you haven't been involved in your family's finances to this point, becoming organized is a good place to start. Everyone, both men and women, should keep an organized, updated record of all assets owned in their name, their spouse or partner's name and their minor children's name. This record should contain account numbers, institutions where accounts are held, approximate value and legal ownership. This information will be helpful should an unexpected event occur, such as the death of a spouse or divorce.

In addition to keeping an organized record of assets, you should begin reading financial publications and meeting with your Financial Advisor. Your Financial Advisor can help answer any questions you might have about your individual circumstances.

WHEN THINGS DO NOT WORK OUT

A sad fact of American life is that the majority of married couples will at one point separate or divorce. With this in mind, it is important to try to keep a clear head when it comes to finances, even during this emotionally trying time. Your organized record of family finances should help make the process of dividing property a little smoother. Some steps to consider once a divorce seems inevitable:

- » Set up your own checking, savings and credit card accounts if you did not maintain these separately during your marriage. Many experts advise husbands and wives to maintain some separate accounts during their marriage.
- » Close or freeze joint accounts.
- » Update your will and any beneficiary designations that will change because of your divorce.

“Everyone, both men and women, should keep an organized, updated record of all assets owned in their name, their spouse or partner's name and their minor children's name.”

PREPARING FOR THE UNEXPECTED

While death is an inevitable event, no one likes to think about it. Having a plan in place will make handling financial arrangements much easier should you find yourself suddenly widowed. Again, the key to a good plan is knowing what you and your husband have. An organized record of all accounts, including retirement, insurance and Social Security benefits will help you quickly settle accounts and continue to receive the income you

are entitled to. For most communication with institutions that your husband had accounts with, you will need to provide a copy of his death certificate. Some important steps to take right away include:

- » Keep all accounts current. Pay all of your husband's bills on time.
- » Complete paperwork for multiple copies of death certificates.
- » Notify the administrator of his IRA accounts, your insurance agent and his employer if he was still working or had a pension through them.
- » Contact Social Security. They will need to be notified of your status as a widow to continue receiving benefits.
- » Change ownership on all accounts and real estate. Any assets that were held jointly will need to be changed to sole ownership in your name for future estate planning.

TAKING CONTROL OF YOUR FINANCES

Taking an active role in your finances is an important step for many women. While preparing for the unpleasant possibility of divorce or becoming a widow is not something you want to do, it can help ease some of the stress should one of these events occur. Continuing to work with a Financial Advisor you can trust can help you prepare for the unexpected and gain confidence in your financial decision-making. ■

Early IRA Withdrawals Can Be Costly

If you are thinking of taking early IRA withdrawals to fund a new venture, consider the consequences first.

» People often want to tap their IRAs prior to age 59½ to change careers or fund other endeavors that require a good chunk of money. But be forewarned: It's generally unwise to take early IRA withdrawals. Not only will early withdrawals likely cost you money, but they also could adversely affect your retirement plan.

For starters, most early withdrawals from a traditional IRA incur income taxes and a 10% penalty. (Withdrawing nondeductible contributions only triggers the penalty.) And while certain strategies and situations allow you to avoid early withdrawal penalties, you will still pay income tax on the money you take out. For example, you can take annuitized distributions—often referred to as “substantially equal periodic payments”—for

at least five years or until age 59½, whichever is longer—but you must adhere precisely to the Internal Revenue Service's formula. So, it's important to consult a professional before setting this up.

Still, it's best to avoid withdrawals even if you won't be penalized, because any money you pull out of your IRA today will lose its ability to generate potential tax-sheltered gains. Such moves will make it much harder for you to meet your financial goals in retirement.

“Early withdrawals likely cost you money, but they also could adversely affect your retirement plan.”

You can also make early withdrawals penalty free for a first-home purchase (up to \$10,000 total), in case of complete disability, to pay education costs, to put toward high medical expenses (more than 7.5% of your adjusted gross income) or to cover health insurance premiums while unemployed.

We understand the risks and the challenges involved in growing and protecting your wealth. We can guide you in developing an overall financial plan that takes into account all of your personal goals and needs. ■