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Trust UPDATE

July 2013

Retirement planning checklist

Retirement is an emotional transition as well as a financial transformation, a declaration of financial independence. Here are some questions that one must face, and issues to sort through.

Is the time right? After a long career, it may be time for a change, time for a rest. Even if that is the case, it's important to enter retirement with a plan for staying mentally and physically active, in contact with other people.

Are there more compelling things to do? Career demands may have caused the deferral of some activities or pursuits, and retirement provides the time needed for exploration and enjoyment.

Is your job changing? Especially during periods of economic transition, the needs of an employer may be evolving in ways that demand too great an adjustment by older employees. That's why many will accept an offer of early retirement during a reorganization or downsizing.

But one also should check for reasons *not* to retire, because they may indicate that more emotional preparation is needed before taking the retirement plunge.

Is work enjoyable? The daily routine can be full of habits that are hard to break. For jobs that are not physically taxing, one can continue to be productive until age 70 and beyond.

What about the pleasures of camaraderie? Some people feel a sharp sense of loss after retiring. They may miss the workplace and colleagues.

Are there better options? Without a good plan for retirement, one runs the risk of loneliness and depression. Being a couch potato may be temporarily relaxing, but it isn't very satisfying.

Continued on next page.

How much will you need?

Developing a realistic retirement budget is an important exercise, one that requires an examination of values as much as resources. Some people enjoy living rather modestly during retirement. But one retiree we know says, "Life is too short to drink cheap wine." The retirement budget needs to be understood from three perspectives.

How long should you plan for?

In 1900 life expectancy at birth in the United States was just 49.24 years. Thanks to dramatic strides in medical science, as well as better nutrition and less hazardous occupations, Americans born in 2008 (latest data) could look forward to living 78.2 years, to 2086, on average. That's fine information for the youngest generation, but for those planning a retirement, the more pertinent question is, how long must my money last? The longer one lives, the longer is one's life expectancy. According to the most recent available data, the life expectancy for men age 65 in 2008 was 17.4 years (to age 82), and for women 19.5 years, nearly to age 85. Many retirements will last for 25 or 30 years. The table shows expected years of life remaining at various points during retirement.

Age	Men	Women
65	17.4	20.0
70	13.9	16.1
75	10.7	12.6
80	8.0	9.4
85	5.7	6.7
90	4.0	4.6

Source: National Vital Statistics Reports, Vol. 61, No. 3

Essential versus discretionary spending. Which expenditures could be curtailed, even eliminated, in the event of financial reversals? Food is essential; restaurant dining is not. Is there room in the budget for savings?

Structural versus peripheral expenses. Some costs are binding, not subject to modification, and failure to meet them means a structural change in retirement. If you own real property, you must pay the taxes. If you have a mortgage, you must make the payments. If you own a car, you have to pay for routine maintenance. Trips, vacations and gifts, in contrast, are peripheral expenses.

Fixed versus inflation-prone costs. Inflation has been very mild in recent years, but this may not be a permanent condition. Most retirement expenses are vulnerable to inflation, while retirement income generally is fixed. The response to inflation may include cutting back on optional purchases or substituting less expensive items for those that become unaffordable.

Understand also that long, modern retirements typically include three phases:

- active retirement, filled with travel and pursuit of deferred dreams;
- passive retirement, typically beginning in the mid-70s, when activities gradually are reduced; and
- final retirement, a period often marked by failing health and a need for long-term care.

A different retirement budget applies to each of these three periods.

Put us on your team

We specialize in two areas of personal financial management:

- Helping clients to achieve financial independence, using tax-sensitive techniques as appropriate.
- Helping clients to maintain financial independence by providing unbiased investment advice and trusteeship.

For specifics on how we might help you, see our asset-management specialists. ☐

Our services for retirees

You don't have to be retired to benefit from these financial services, but if you have started your retirement (or plan to soon), you should give them some careful consideration. At your request, we'd be happy to tell you more.

• **IRA rollovers.** When you receive a retirement plan payout, you may preserve tax advantages for your retirement capital by arranging for an IRA rollover. Do you already have such an account with another firm, but feel lost in the shuffle? We'd be happy to help you move your IRA so that you can begin to benefit from our personalized investment management.

• **Personal investment accounts.** After careful study of your goals and circumstances, resources and risk tolerances, we recommend, implement and monitor a personalized investment program for you. Because we charge annual fees linked to market value, our best interests and the best interests of our clients are linked clearly.

• **Living trusts.** The same personalized investment guidance is available to clients who wish to set up their investment programs as revocable living trusts. A trust-based financial plan doesn't impair the client's control of his or her investments, but it does offer such added benefits as probate avoidance, integration with the estate plan and financial management in the event of prolonged illness or incapacity.

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Should the ex-spouse get the money?

When someone dies without a will, the state provides an alternative plan for heirs, the law of intestate succession. Generally, the property goes to the surviving spouse and children, or to more remote relatives in their absence. However, the intestacy laws normally don't cover property that is not included in the probate estate, such as retirement accounts or life insurance. Inheritance of these is governed by beneficiary designations, signed when the account is created or the insurance policy is purchased. One may change a beneficiary designation at any time, as circumstances change.

Some states have statutes that come into play for non-probate property, but their effectiveness is mixed. A June decision by the U.S. Supreme Court is a timely reminder of how important it is to include one's beneficiary designations in the course of any review of estate plans.

A marriage, a divorce, and a death

Warren Hillman worked for the federal government. He had insurance coverage through the Federal Employee Group Life Insurance program (FEGLI). In 1996, when he was 54 years old, Warren designated his second wife, Judy, as the beneficiary of that insurance. Two years later, the couple divorced. The divorce decree did not mention the insurance, and Warren did not file a new beneficiary designation. Perhaps he actually wanted Judy to get the money, or perhaps he was relying on his state's (Virginia's) law that beneficiary designations in favor of a spouse are revoked automatically by a divorce.

Warren married a third time in 2002, but he didn't revisit the insurance beneficiary designation. Nor did he take a look at it when he was diagnosed with leukemia, the disease that took his life at age 66 in 2008. The third wife, Jacqueline, expected to get the $124,558.03 of insurance proceeds, but Judy was still the named beneficiary. The proceeds were paid to Judy, in accordance with the beneficiary designation, because federal law trumps state law.

The Supremes speak

The Virginia statute also included an end-around for this situation. In the event that an ex-spouse received death benefits, they would be owed to the surviving spouse. On that basis, Jacqueline filed suit against Judy to recover the money. The lower court sided with her, but the Virginia Supreme Court reversed. A unanimous U.S. Supreme Court agreed that federal law preempts the entire Virginia statute. Congress could change the result for cases such as this, but the courts and the Virginia legislature cannot. The ex-wife is entitled to the insurance proceeds.

Lessons

Estate planning is easy to put off, but it is vitally important. If having Judy get the insurance money was not the outcome that Warren wanted or expected, he could have altered it by executing a simple change of beneficiary form. If Jacqueline knew about the insurance, she should have insisted on reviewing the beneficiary designations when they married, or certainly when Warren's illness was diagnosed. We can't truly know what Warren's testamentary wishes were, but we can be reasonably confident that he didn't foresee or desire litigation that would last for five years and go all the way to the U.S. Supreme Court. ☐

First-time homebuyer requirements not met

Taxpayer withdrew $20,000 from her retirement account, planning to use the funds to acquire a home. She did not report the withdrawal on her income tax return. One important exception to the 10% penalty for premature retirement plan withdrawals is that up to $10,000 may be withdrawn by first-time homebuyers to use as a down payment within 120 days of the withdrawal. However, the waiver of the penalty does not waive the income tax on the withdrawal. Taxpayer believed that she qualified for the penalty avoidance, but the Tax Court held to the contrary because:

- the purchase documents, loan documents and deed conveying ownership listed her brother's name, not hers;
- her payments for repairs of the property did not make her an equitable owner of it; and
- she had owned other residential property within two years of the purchase of the subject property.

With the additional tax due, Taxpayer's understatement of tax liability was enough to trigger an additional accuracy-related penalty. Taxpayer argued that she had relied upon a professional tax preparer, but the Court held she had failed to provide the information required for an accurate tax return. The accuracy penalty was sustained as well *(Laura Ung v. Commissioner;* T.C. Memo. 2013-126).

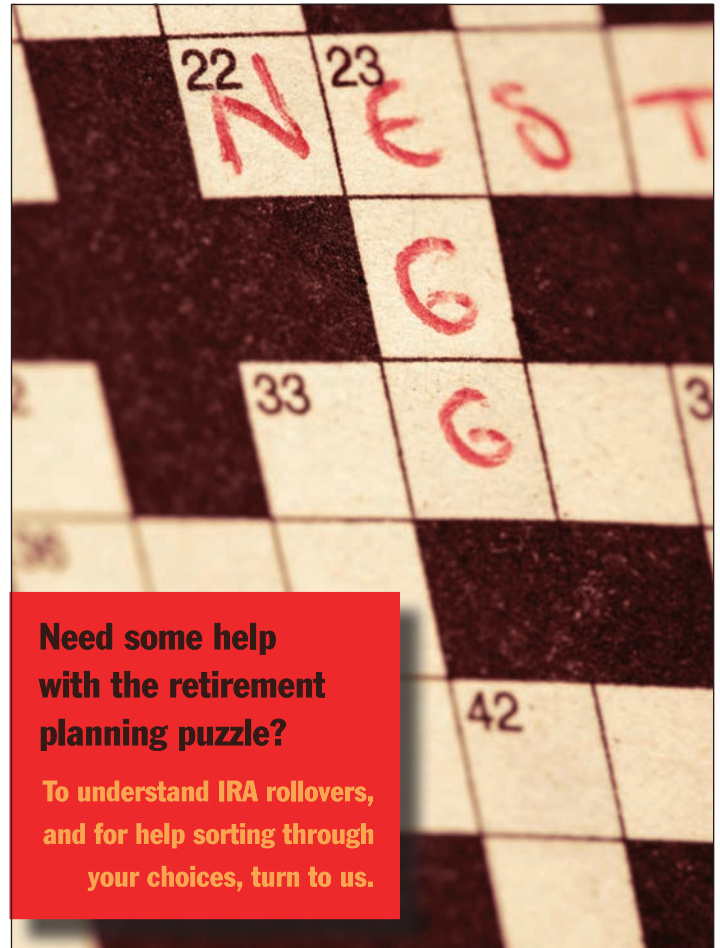
No innocent spouse relief

Taxpayer and his wife began operating a pharmacy in 1974. They were successful for many years, but began suffering financial reversals in 2002. For the next five years, they failed to file federal income tax returns and withdrew money from their IRAs to help support the floundering business. After an IRS audit, they filed late returns, but didn't pay all the taxes due. On September 3, 2009, the Georgia Department of Revenue seized the pharmacy's assets. The next day, Taxpayer died.

Taxpayer's wife received $1.3 million in insurance proceeds on Taxpayer's life. In December 2009 she filed for innocent spouse relief from the tax liabilities due on the years before Taxpayer died. She claimed that Taxpayer had promised to use the IRA withdrawals to pay the taxes. The Tax Court denied the relief because:

- she had received a significant benefit from the unpaid taxes;
- she had not made a good-faith effort to comply with the tax laws; and
- part of the liability related to her withdrawal from her own IRA.

The wife's testimony was inconsistent, unreliable and unconvincing to the Court. She had worked for the pharmacy for many years, including as its Chief Financial Officer, and knew enough of the financial realities that she could hardly be an "innocent spouse" (*Judith T. Marzullo v. Commissioner;* T.C. Memo. 2013-120). ☐



Need some help with the retirement planning puzzle?

To understand IRA rollovers, and for help sorting through your choices, turn to us.

Kirk Hosler
Senior Vice President & Trust Officer
(815) 332-8872
kirkh@stillmanbank.com

Jeffrey Hartle
Vice President
(815) 332-8843
jeffh@stillmanbank.com

Stillman BANK
Trust & Asset Management
8492 E. State Street • Rockford, IL 61108
815-332-8100
www.stillmanbank.com