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An economic and investment update

THE FINANCIAL INSIDER

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Life Insurance Beneficiaries: Making Your Heirs Apparent

In the language of life insurance, a **beneficiary** is the recipient of the benefits of a policy when the named insured dies. The owner of a life insurance policy has a great deal of flexibility in naming beneficiaries and can generally name anyone he or she chooses. When making beneficiary decisions, it is important to ensure that the wishes of the policyowner are fulfilled and that legal complications are avoided.

Types of Beneficiaries

Beneficiaries are typically categorized as either **primary** or **contingent**. A *primary* beneficiary is entitled to the benefits of the policy upon the death of the insured, but such rights expire if he or she dies before the insured. A *contingent* (or secondary) beneficiary is entitled to the policy benefits if the primary beneficiary has predeceased the insured. One fairly common arrangement might stipulate

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Safeguarding Your Financial Privacy on the Web

Consumers are conducting financial transactions in cyberspace more and more frequently. Consequently, they may become vulnerable to tracking, hacking, identity theft, phishing scams, and other online risks. While nothing can guarantee *complete* safety in cyberspace, much can be done to understand and minimize your exposure to risk.

Here are some basic ways to help maintain privacy on the web:

Understand privacy policies. Before conducting any financial transactions online, carefully read the privacy policies of each institution with which you plan to do business. Find out how the business intends to maintain and secure your financial information. If you don't understand the legal jargon, ask questions. You can always email or call a business and request a simplified explanation of its privacy policies.

Avoid using easily decipherable PINS and passwords. When deciding on PINS, passwords, and other log-in information, avoid using your mother's maiden name, your birth date, the last four digits of your Social Security number, or your phone number. Avoid other obvious choices, like a series of consecutive numbers or your home town. Also, avoid using the same PINS and passwords on

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Life Insurance Beneficiaries: Making Your Heirs Apparent

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that, if a primary beneficiary dies before collecting the benefits of the policy, then the amount would be payable to the contingent beneficiary. It may be necessary to have several contingent beneficiaries.

A beneficiary can be designated as a **specific** beneficiary (a person identified by name and relationship) or a **class** beneficiary (a group of individuals such as "children of the insured"). While the naming of specific beneficiaries is usually clear, unintended complications can arise when designating *classes* of beneficiaries.

For example, if you plan to name your children as beneficiaries, you must clarify if you intend to include adopted children or children by a former spouse. If your children are minors, it is important to determine if the insurance company will pay the benefits to a minor beneficiary. Generally, insurers pay benefits to a legal guardian rather than to a minor.

Consider the following situation in which the policyowner's intentions appear straightforward, but could become complicated. Harriet, who is seventy years old, has planned for the benefits of her life insurance policy to be paid to her children (Sam, Carole, and Jill) or her grandchildren. Now, suppose Sam and Carole die before their mother. Sam leaves four children and Carole has no children. How will the proceeds of the policy be distributed when Harriet dies?

Methods of Distribution

Per stirpes and **per capita** are terms that describe methods of distributing property to family members and heirs. Per stirpes means "branches of the family," and per capita means "by heads." In the example above, under a *per stirpes* distribution, Jill (one branch) would receive one-half of the proceeds and Sam's surviving children (the other branch) would divide the remaining half among themselves. Under a *per capita* distribution, Sam's four children, along with Jill, would *each* receive one-fifth of the proceeds. Remember, if any of Sam's children are still minors when Harriet dies and legal guardians have not been appointed, there may be complications.

Revocable vs. Irrevocable

Consequences may also vary according to whether beneficiary designations are revocable or irrevocable.

If a beneficiary designation is **revocable**, the policyowner reserves the right to change the beneficiary. A person designated as a revocable beneficiary has only an "expectation" of benefits, since the owner of the policy can exercise any of the policy rights without the consent of the revocable beneficiary.

On the other hand, an **irrevocable** beneficiary designation cannot be changed without the consent of that beneficiary. While this arrangement is sometimes desirable for estate planning purposes, the legal status of an irrevocable beneficiary is uncertain. Some may regard an irrevocable beneficiary as a "co-owner" of the policy; therefore, the beneficiary's consent is needed to exercise any policy rights. On the other hand, others may contend that an irrevocable beneficiary's consent is needed only for exercising a change of beneficiary.

The latter position can create the somewhat puzzling situation of compromising the beneficiary's rights if the policyowner exercises other rights, such as surrendering the policy or permitting it to lapse. Due to the vague legal status of an irrevocable designation, it is often preferable to use revocable beneficiary designations.

A further complication can arise when one's estate is named as a beneficiary of a life insurance policy. The policy benefits may be tied up in the probate process or reduced by the claims of creditors.

The distribution desired by the policyowner must be clearly set forth in the beneficiary designation. A change in family circumstances after a policy is initially written, such as a divorce, could leave unintended beneficiaries, so it is important to review your insurance policies regularly. If you are unsure about your beneficiary designations, check your policies, and take the steps necessary to make appropriate changes. $

Unmarried Couples and Property Ownership Issues

When it comes to owning property, unmarried couples face some unique financial and estate issues. For example, if one partner dies, property does not automatically pass to the surviving partner, as it would to a spouse. And, if one partner transfers property to the other partner, there could be tax consequences. Understanding these issues is the first step in protecting your property. Consider the following information concerning three types of property: 1) income, 2) property with a deed of title, and 3) untitled possessions.

Income

When you first enter a relationship, you have the sole right to your personal income. However, in certain states, a spoken or implied agreement to share income with your partner may support his or her claims against you if you separate. This is the basis for many palimony suits. Without a written contract, you could spend a great deal of time and money contesting your rights in court.

Property with a Deed of Title

Unmarried partners who share property with a deed of title—such as real estate, bank accounts, vehicles, and securities—may choose between two legal forms of ownership: **joint tenancy with right of survivorship** or **tenancy in common**.

Joint Tenancy with Right of Survivorship. When you own property as joint tenants, you share equal rights to the entire property. Unless you have divided the cost equally, it is wise to document how much you have each contributed. Otherwise, there is no proof if one partner paid more than the other. According to the law, you are both equal owners, and if the relationship ends, you could each receive half of the property. On the upside, because you don't own separate shares, creditors may find it difficult to claim joint property, although laws vary from state to state.

Most states recognize the right of survivorship, although some may require that it be stated explicitly in the title or deed. This means that, upon the death of one partner, the property would automatically pass to the surviving joint owner, thereby avoiding **probate**.

Joint tenancy is easy to establish. You simply state both names on the title or deed and note that ownership is by joint tenancy with right of survivorship. Both signatures are required to sell the property, which could create problems if the relationship ends or one partner becomes incapacitated without having named a **durable power of attorney**.

Of course, jointly owned property has tradeoffs, as well. It may be subject to both estate and gift taxes. The entire value of the property is included in the estate of the first to die, unless records can prove the surviving partner contributed to the cost. In addition, any property one partner transfers to the other partner could be subject to gift taxes. Be cautious about adding your partner's name to an existing deed. Unless there has been a fair exchange of value, the Internal Revenue Service (IRS) may consider this a gift, and tax it accordingly.

Tenancy in Common. In most states, property purchased by two or more co-owners automatically creates a tenancy in common, unless the title or deed states otherwise. A tenancy in common allows you to own unequal shares of a piece of property. Because percentages are stated on the title or deed, property held this way might be an easier target for creditors, since a claim can be issued against a specific share of the property.

Tenancy in common allows you to give or sell your share to anyone at anytime without the co-tenant's consent, although property transfers without a fair exchange of value may be subject to gift taxes. Unlike joint tenancies, tenancies in common are subject to the probate process when one owner dies.

Untitled Possessions

Who gets the TV? Who gets the microwave? To avoid these questions, it's best to own personal possessions separately. Keep records of your receipts. If you do purchase items together, document who owns each item. Written records provide the best evidence of ownership, should the relationship end.

Protect Yourself—Put It in Writing

Without the laws to guide the division of your property, keep detailed records and put all agreements in writing. While you may feel ambivalent about broaching the issues of property ownership, taking these steps now can help avoid tax problems later and ensure fair disposition of your property in the event of separation or death. $

Navigating Your Business through Its Life Stages

Innovation. Perseverance. Accomplishment. Every business owner committed to success starts with an idea, works hard to make it happen, and believes in the potential for great things.

As an entrepreneur, you must manage your business for growth, as well as your personal wealth for accumulation and preservation. Building your financial freedom, while growing your business, is a process that begins in a business's infancy and continues throughout its maturity. Depending on the stage of your business, you will have different needs and priorities. For example, startups often must raise capital or secure financing, while owners of more established businesses may be focused on developing exit strategies and funding retirement.

Let's take a look at some important considerations and opportunities at the various life stages of your business.

Surviving Infancy

While most young companies are born on a wave of energy and enthusiasm, it is challenging to survive infancy. Financially, this phase is usually the most difficult. Oftentimes, startup entrepreneurs funnel their personal savings into the company and use their assets as collateral for loans. All this may be at stake, and the business may not be generating profits. But this is the risk business owners take on their quest for success. Like most of the challenging phases we experience on the road to maturity, this too shall pass—more easily with a solid business plan.

An important complement to your business plan is a fine-tuned marketing strategy. In order to promote your company and generate business, you must make your product or services known. Then, when the money comes in, cash flow management becomes crucial. Even profitable businesses may flounder if they fail to have cash on hand to meet their financial obligations. If you need more incentive, know that wise cash flow management may help you attract potential lenders and investors. Success in these areas may help you achieve a measure of stability and get on track for the next phase: growth.

Managing the Adolescent Growth Phase

With a growing client base, steady income, and profitability at hand, the potentially successful business owner faces various decisions. Should you offer new products and services? What role should investors play in the company? Do you need to hire more staff? What benefits are best for attracting and retaining valuable employees? All of these questions have answers, but the most appropriate solutions for your business will depend on your unique situation.

During these teenage years, it's important to keep an eye on your personal financial future when reinvesting in your business. One area of concern is asset protection. Businesses often start out as sole proprietorships or partnerships, but it may be in your best interest from both a tax and liability perspective to consider structuring your business as an S corporation or a limited liability company (LLC).

In the early stages, employee benefits can be a significant cost burden, but they play an important role in your company's success and your own financial security. In addition to providing you with the resources you need personally, attractive benefit plans will help you attract and retain qualified employees. Areas to consider are insurance and retirement plans.

Health insurance is a key benefit for both you and your employees. There are a number of different types of health insurance plans available, including Fee-for-Service Plans, Preferred Provider Organizations (PPOs), Point of Service (POS) Plans, and Health Maintenance Organizations (HMOs). While not a health insurance plan, employers may choose to offer employees a Health Savings Account (HSA), which allows employers and employees to set money aside on a tax-favored basis when coupled with a high-deductible health plan (HDHP).

As you accumulate wealth, protecting your earnings and lifestyle is paramount. Planning for life's uncertainties with proper insurance coverage may help minimize your risk of loss. Life insurance offers financial protection for your family after your death, and disability income insurance replaces a portion of your income should you experience a qualifying injury or illness and be unable to work for a period of time. You may also wish to consider long-term care insurance, which can help pay for long-term expenses should the need arise. In all three areas, group coverage is available for your employees.

If you have key employees or business partners, weigh the benefits of key person life

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Career Transitions and Your Retirement Savings

Nowadays, individuals may change jobs many times throughout their working lives. If you are starting a new phase in your career, be sure to carefully consider how you will handle your finances while making the transition. One important area of consideration is your retirement funds. If you have accumulated savings in a 401(k), 403(b), or similar employer-sponsored retirement account, you must decide how to manage those funds upon leaving your current position.

Generally, you will have the choice of reinvesting, transferring, or cashing in your retirement plan savings. The choice you make will depend on both your short- and long-term goals. Let's explore the options.

A simple way to consolidate your savings is to transfer funds from your previous employer's retirement plan into your new company's plan. You may also choose to leave your money in your former employer's plan, but depending on the terms, you could be subject to service fees or limited contribution and distribution options. If, however, you have an outstanding loan from your previous employer's plan or if you stand to lose certain retiree benefits by exiting completely, you may want to remain invested for a period of time after leaving your job.

Taking a cash distribution is another option, but consider the ways this may negatively affect your retirement strategies. Besides owing potentially significant income tax on pre-tax contributions, you will be subject to a 10% penalty if you are under the age of 59½. In addition, you will forfeit the long-term benefits associated with tax-deferred earnings, potentially making it more difficult for you to accumulate the resources you will need in retirement.

To keep your retirement savings on track and avoid an immediate tax bite, consider rolling your 401(k) assets into an Individual Retirement Account (IRA). There are two ways to roll over funds.

Option 1: With the first method, known as an indirect rollover, your former employer makes the distribution payable to you, less 20%, which is withheld in Federal taxes. You

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Navigating Your Business through Its Life Stages

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insurance and key person disability income insurance to protect your business. To help cover business expenses such as salary or benefit costs if you or a partner experiences a disability, consider business overhead expense insurance.

Qualified retirement plans offer tax-advantaged opportunities for both your business and participating employees. There are many options, including Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees (SIMPLEs), which are relatively cost effective and easy to administer. More flexible plans that allow you to save more annually are 401(k)s (variations include Safe Harbor and Solo 401(k)s), profit sharing plans, and defined benefit plans. To enhance benefits for key employees, consider nonqualified plans such as deferred compensation or executive bonus plans, which can help you selectively reward and retain your best and brightest.

Reaching Maturity

As your business matures, it may be time to shift your focus from wealth accumulation to wealth preservation. Two areas of focus are key: business succession and estate planning. With the appropriate strategies, you can minimize estate taxes and maximize the amount passed to your heirs.

A well-developed succession plan can help you smoothly transfer or sell your company. If you wish to keep ownership and control of your business within your family, assess the interest and qualifications of potential parties and develop a transition strategy. If you plan on selling your business, it is important to properly valuate your business and prepare for the sale. A buy-sell agreement can formally prearrange a buyer for your business and stipulate the price that buyer will pay. The deal may be funded with a life insurance policy to ensure that cash will be available to purchase the business when necessary, should you die unexpectedly.

At every developmental stage, professional guidance can help you survive the growing pains and make the most of your opportunities. For more information, be sure to consult your legal, tax, and financial professionals. $

Safeguarding Your Financial Privacy on the Web

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multiple sites. Then, if your PIN or password is discovered on one site, the others will not be compromised.

Look for secured web pages. Use only secure browsers when shopping online to guard the security of your transactions during transmission. There are two general indicators of a secured web page. First, check that the web page url begins with "https." Most urls begin with "http;" the "s" at the end indicates that the site password will be encrypted before being sent to a third-party server. Second, look for a "lock" icon in the window of the browser. (It will not be in the web page display area.) You can double-click on this icon to read details of the site's security policy. Be cautious about providing your financial information to websites that are not well known. Larger companies and well-known websites generally have developed policies to protect the rights and financial information of their customers. So, resist the temptation of providing personal information to companies that are unfamiliar to you.

Keep your operating system up-to-date. High-priority updates are critical to the security and reliability of your computer. They also offer the latest protection against malicious online activities. When your computer prompts you to conduct an update, do it as soon as possible.

Use updated antivirus software and spyware. Viruses and spyware are two kinds of potentially malicious software from which you need to protect your computer. Keep both your antivirus and your spyware programs updated regularly.

Keep your firewall turned on. A firewall helps protect your computer from hackers who might try to delete information, crash your computer, or steal your passwords or credit card numbers. Make sure your firewall is always turned on.

Do your homework. To learn more about securing your computer and protecting your personal information, visit www.getnetwise.org, www.onguardonline.gov, or www.wiredsafety.org. These websites provide valuable tips to help you protect your private information when conducting financial transactions online.

In addition, the Federal Trade Commission (FTC) works for the consumer to prevent fraudulent, deceptive, and unfair practices in the marketplace. To file a complaint or to obtain more information, visit www.ftc.gov or call 1-877-FTC-HELP (1-877-382-4357).

While maintaining anonymity on the web can be challenging, it's important to protect your financial information and the financial information of your family. As time goes on, the Internet continues to evolve. As new risks arise, additional protective measures will be established. Therefore, it is up to you to safeguard your financial information in cyberspace through education and awareness. $

Career Transitions and Your Retirement Savings

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must then reinvest the distribution into an IRA or other qualified plan within 60 days. In order to achieve a tax-free rollover with this method, you must reinvest the full distribution amount, which includes the 80% you receive in cash, as well as 20% from your own funds to account for the amount withheld. Your withheld funds will be refunded after you file your tax return, provided your rollover occurred within the 60-day time limit. Failure to reinvest the 20% withheld will result in income tax and a 10% income tax penalty if you are under the age of 59½.

Option 2: To avoid the 20% withholding requirement, you may request a direct trustee-to-trustee transfer to an IRA set up in your name or another qualified plan. Be aware that not all qualified plans accept this type of transfer. Because this method is considered a distribution option, spousal consent and other similar participant and beneficiary rules of protection will apply.

There are many factors to consider when deciding how to manage your retirement plan funds during a career transition. Bear in mind that your decisions in the short-term can have a major impact on your long-term plans. For specific guidance, consult your financial and tax professionals. $

Preparing to Work with Your Estate Planning Team

Estate planning often involves the coordinated efforts of an estate planning *team* consisting of your attorney, accountant, and financial professional. However, whether establishing a new estate plan or revising an existing one, only *you* can provide the guidance, direction, and information needed to develop an effective plan. Most estate planning teams begin by requesting that you complete a questionnaire and asset inventory. Although this may seem an arduous task, the more comprehensive the information you provide, the better your team may be able to help you achieve your goals.

Although some questions may seem intrusive, each has a specific purpose. When formulating an estate plan, you may be asked to provide any or all of the following information:

Family and Other Beneficiaries

- The names, ages, relationships, and special needs of family members and other beneficiaries.
- Copies of property settlements, other financial agreements, and court decrees relating to your family.

Health

- Information on your current health and the health of your beneficiaries.
- The average health and life span of your ancestors.

Assets and Liabilities

- A list of your assets, their estimated net value, and documentation of ownership.
- Identification of your liabilities and those of your spouse.

Existing Plans

- A copy of your current will, including information on contractual or legal restrictions on the disposition of your assets.
- Documentation of survivorship provisions and beneficiary designations on insurance policies, retirement plans, employee benefit plans, business buy-sell agreements, and other similar assets.

Objectives and Purposes

- Your goals for yourself and each beneficiary.
- An assessment of each beneficiary's ability to manage assets.

Benefits of Estate Planning

Once fully informed, your estate planning team may help you work toward the following goals:

- Analyze your assets to determine which should be disposed of during your lifetime and which should be retained, as well as whether special expertise will be required to value and dispose of your assets.
- Identify which assets will be subject to probate and estate taxes, and estimate the potential cost to your estate.
- Estimate and plan for the liquidity needs of your estate, your surviving spouse, and other family members and beneficiaries to cover estate taxes, probate costs, and future living expenses.
- Guide you in selecting the best domicile, if applicable, to help reduce the net effect of taxes on your estate.

No Plan Is Final

Bear in mind that no estate plan is final. Marriages, remarriages, births, deaths, professional changes, and new legislation may necessitate adjusting an existing plan or creating a new one. Also, the composition of your assets may change over time. To keep your estate plan up-to-date, notify your estate planning team of any relevant changes as they occur, and work with them if they alert you to any relevant legislative changes. $

Choosing Your Retirement Destination

How would you like to spend your "golden" years? Do you want an affordable condo on a golf course with extra room for visiting grandchildren? Would you like to remain in your community surrounded by old friends and family? Or would you perhaps prefer living close to new friends? Is easy access to certain medical facilities a priority?

Besides considering these issues, you might also research the effects of state tax structures on your projected retirement income as you decide where you will live during your retirement. Let's take a look at some key tax areas:

Earned and unearned income taxes. Do you plan to continue working during retirement? If so, it is important to realize that some states treat seniors like everyone else on their income tax rolls, some give seniors special tax breaks on earned income, and others do not tax earned income for any of their residents. Tax rates on unearned income may also vary from state to state. Be aware that several states tax former residents on **Individual Retirement Account (IRA)** distributions. Thus, if you move, you may be required to file income tax returns in *two* states—and be prepared for unexpected local income taxes.

Pension income taxes. In many cases, a key to financial survival for seniors is income from military, government, and private pension plans. Some states exempt all pension income from taxation, while others exempt certain types and/or amounts of pension income.

Social Security benefit taxes. Some states do not tax Social Security benefits at all, while others follow Federal tax formulas for determining the tax on such benefits. Still others have developed their own formulas to determine the income tax on Social Security benefits.

Property taxes. This is another area where some states and localities may offer advantages to seniors. Familiarize yourself with the relevant personal property tax laws, especially for cars and boats.

Sales taxes. Many states—and sometimes localities within each state—tax clothing, gas, household goods, and sometimes even food and prescription drugs. When you consider your retirement budget, remember to add state and local sales taxes, if applicable, when you move to your retirement haven.

Estate taxes. While they do not *directly* affect your cost of living as a senior, do not overlook estate taxes when determining the feasibility of settling in one state over another. In some states, your spouse may be taxed on a portion of his or her inheritance that, in another state, would pass to him or her free of state estate tax. Be sure to monitor changes in state estate tax codes as states seek ways to attract seniors.

While no *single* tax consideration will determine the most favorable environment for your retirement years, an analysis of your *overall* financial situation and options can help you choose a retirement destination that is most appropriate for your needs, allowing you to optimize your "golden" years. $

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