Investor Insights and Outlook

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Tips for Minimizing Taxes on Retirement Assets

For many investors, a large percentage of their assets are held in tax-advantaged accounts such as 401(k)s and IRAs. While these accounts can be ideal for sheltering retirement savings from taxes pre- and post-retirement, because these assets are included in the account holder's gross estate, they can be highly exposed to tax issues in an estate if managed improperly. In short, the combined estate and income taxes owed by beneficiaries could potentially erode the lion's share of the value of these assets.

Proper Naming of Beneficiaries—Many problems that arise when transferring retirement plan assets occur around the naming of beneficiaries. Consider these tips to help avoid problems in this area:

- Be sure to have a named beneficiary. Naming the account holder's estate as the beneficiary will trigger the "five-year rule," which states that retirement plan assets must be paid out immediately or by the end of the five years following the account holder's death.
- Review and update beneficiary designations. Life situations change frequently and those changes can affect your beneficiary designations. For example, many times after a divorce, participants forget to update their beneficiary designations.
- Make sure one or more contingent beneficiaries are named. Without contingent beneficiaries you may face the same consequence as not naming a beneficiary at all -- particularly when a primary beneficiary is no longer living.

Spousal vs. Non-Spousal Beneficiaries

Retirement plan assets that pass to a surviving spouse may qualify for the unlimited estate tax marital deduction, whereas retirement plan assets that a non-spouse beneficiary inherits may be subject to estate tax upon the account holder's death.

In addition, after the account holder's death, the surviving spouse may roll over retirement plan assets to an IRA in his or her own name or elect to treat the retirement plan as his or her own. If the spouse chooses the latter option, he or she may defer taking required minimum distributions (RMDs) until he or she turns age 70½ -- a distinct advantage from an asset accumulation and taxation perspective.

A surviving spouse may also "disclaim" -- or refuse -- his or her interest in an IRA. Once disclaimed, the spouse will not receive any interest in the retirement plan and it will

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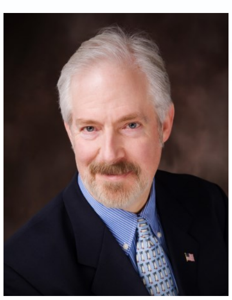

Advisor Corner

Thank you for the opportunity to serve as your advisor.

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Planning Spotlight: Special Needs Trusts

The purpose of a special needs trust is to provide funds to enrich a disabled individual's quality of life without jeopardizing his or her eligibility for government assistance.

Millions of American families face the emotional and financial challenge of caring for a child with special needs. For these families, financial and estate planning must go beyond traditional goals to include for the child's current and future well-being.

In most cases, severely disabled children receive government assistance in the form of Supplemental Security Income (SSI) and/or Medicaid to help cover medical and long-term care costs. Such funding -- while a welcome benefit -- can complicate parents' ability to provide their own financial support. For instance, if a disabled individual receives an inheritance, he or she is likely to be disqualified from receiving federal government benefits until the inherited assets are depleted -- at which point there may be nothing left to pay for the extras, such as a vacation or a specially equipped vehicle. This is where a planning technique called a special needs trust can provide a flexible solution.

The Trust Solution

The purpose of a special needs trust is to provide funds to enhance a disabled individual's quality of life without jeopardizing his or her eligibility for government assistance. For this reason, care must be taken when drafting the trust document to specify that trust assets are to be used to meet the supplemental needs of the individual -- needs that go beyond food, shelter, clothing, and medical services.

A special needs trust can be established by a parent, grandparent, or other third party during his or her lifetime and/or at death. Such a trust can be incorporated into a will or established as a separate trust document. In the case of an accident resulting in a disability, a special needs trust can be created as a result of a court settlement.

In addition to providing a safe funding mechanism for supplemental expenses, a special needs trust offers other advantages -- namely professional investment management. Assets are typically invested and monitored for the exclusive benefit of the disabled individual.

The Trustee Question

Selecting a trustee of a special needs trust is a critical part of the planning process. As such, an individual (or institution) will be given significant discretion over the distribution of trust fund assets and must administer the trust properly to ensure that its purpose is carried out. In cases where parents may no longer be available or able to attend to their child's affairs, a corporate trustee can serve a valuable role in the management and oversight of trust assets.

Some banks and trust companies can serve as trustee of a special needs trust. Prior to hiring a corporate trustee, however, it is important to determine that the institution has both financial expertise in managing trust funds as well as experience working with individuals who have disabilities. A good solution may be to combine a sibling or other close family member with a corporate trustee. This approach helps to ensure that the personal needs of the child will be fulfilled and that the assets earmarked for his or her care will be properly managed.

In addition to including a special needs trust in the parents' plan, it is recommended that a clause be included in the parents' wills stating their preference as to whom the court should appoint as guardian if one becomes necessary once they are deceased. Often times, informal arrangements that worked while one or both parents were living need to be formalized after the parents pass away.

If you need help planning for the current and future well-being of a child or dependent with special needs, contact your financial advisor. Together with a qualified legal professional, they can help create a plan that provides quality lifetime care for your loved one.

This article offers only an outline; it is not a definitive guide to all possible consequences and implications of any specific trust option. For this reason, be sure to seek advice from knowledgeable legal and financial professionals.

You may have a friend or family member who has questions regarding special needs trusts.

Call Jim for a consultation.

Don’t be a Pig!

“Bulls make money, bears make money, pigs get slaughtered” is an old Wall Street saying that warns against excessive greed and impatience.

One way to be a “pig” is to run in and out of the market chasing performance — a good way to incur a lot of costs and anxiety, while probably reducing your odds of meeting your financial goals.

Staying invested in the market for the long term has provided handsome returns for those investors patient enough to ride through the ups and downs1. With the market hitting new highs this year and seeing five straight years of gains, we’ve seen an increase in the number of headlines questioning whether this rally can continue.

With the belief that history is our best guide, we wanted to put some perspective around the question of how long should a bull market last? We looked back at the S&P 500 performance over the last nearly 90 years and isolated bull market runs and bear market runs, as defined by cumulative performance of greater than +/- 20%, using monthly returns.

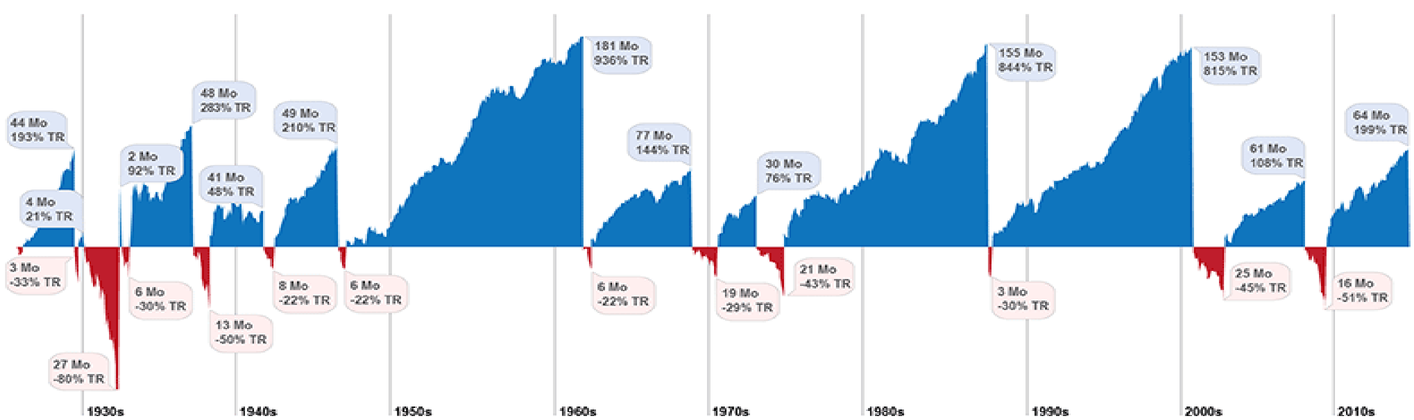
The findings were notable; the average bull market lasted for six years and saw cumulative gains of over 300%. These tremendous returns didn’t come without downside; the average bear market lasted just over a year and saw losses of 38%.

What does that mean for our current bull market? Through the first half of 2014, we’ve seen a bull market last just over five years with a cumulative gain of nearly 200%. Perhaps that means we’re nearing the end of this bull market?

What I find most interesting about the chart below is the variance among results. Whereas the current bull market is fairly close to the average, it’s far below several historical bull markets that lasted over a decade and saw gains of over 800%, and yet it’s well above the smaller gains we saw in the most recent mid 2000s bull market. So which is it? Is this bull market past its prime, or just getting started?

In my view, here are the biggest takeaways from this chart: Bull and bear markets tend to be of random length and do not follow a pattern. Bear markets tend to be severe but also short term in nature

Nobody knows what the next day, month or year will bring in terms of market returns. But what we do know is that those investors willing to stomach the down markets have been able to experience the upside whenever it occurs. Instead of making a bet on the short-term direction of the stock market, find the right portfolio allocation for your risk tolerance, and then when turbulent markets come, you’ll be able to view them as stocks going on sale.



Source: Morningstar Direct 2014. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. All investments involve risk, including loss of principal. Foreign securities involve additional risks, including foreign currency changes, political risks, foreign taxes, and different methods of accounting and financial reporting. Fixed income investments are subject to interest rate and credit risk.

Tips for Minimizing Taxes on Retirement Assets (continued)

pass to contingent beneficiaries (typically children or grandchildren). Distributions to the contingent beneficiaries must then be made under the RMD rules that apply to non-spouse beneficiaries.

Tips for Non-Spouse Beneficiaries—Unlike a surviving spouse rollover, an IRA inherited by a non-spousal beneficiary must remain in the name of the deceased account holder.

Any distribution to a non-spouse beneficiary is a taxable event. Therefore, any check delivered by the deceased's retirement plan trustee should be made payable directly to the inherited IRA custodian or trustee.

A non-spouse beneficiary must begin taking RMDs from the inherited IRA by December 31 of the year following the year of the account holder's death.

Other Considerations — Other strategies to help make qualified retirement plan assets more tax efficient include:

The Stretch IRA -- A distribution strategy that can extend the tax-deferred status of IRA assets across multiple generations. The strategy aims to avoid large distributions and allows only RMDs to occur for as long as possible.

Retirement Plan Trust or IRA Trust -- These instruments allow for the stretching out of distributions combined with the benefits and protections of trusts.

Charitable Remainder Trust -- This type of trust may be named as beneficiary of a retirement plan in order to obtain an estate tax deduction. The trust will provide income to the non-charitable beneficiary -- usually the surviving spouse -- during his or her lifetime, and will distribute remaining assets to the charity at the spouse's death.

An Irrevocable Life Insurance Trust -- If the retirement assets are not needed, using after-tax withdrawals from the retirement plan to purchase life insurance owned by the life insurance trust can be a strategy that transforms a twice-taxed asset into a tax-free one.

This article offers only an outline; it is not a definitive guide to all possible consequences and tax implications of any strategy. For this reason, be sure to seek advice from knowledgeable legal, tax, and financial professionals.

Summer vacation is drawing to a close. We are currently scheduling appointments with Jim for September and October. Be sure to call early to schedule your meeting.

Stacey, our Operations Manager and Registered Paraplanner, is available on short notice to meet with you regarding any administrative needs.

Hallett Advisors
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