



RETIREMENT INCOME PLANNING

OVERVIEW

What is Retirement Income Planning?

Most people, up until the point of their retirement generally are able to live off the wages earned from employment. However, when you retire it is now time to start living off of the income you have set aside for your retirement income flow. In other words, it's now time to live off of the savings you have accumulated to replace the wages you can now no longer earn.

There is a three-legged stool which generally will provide the sources for retirement income: individual savings, business sponsored retirement plans, and social security.

Individual savings in general have been dropping steady for the past several years. We live in a society which is mostly focused on today and living for now. Many choose not to think about the reality, that one day they will not be able to or are eligible to work. Instant gratification rules, instead of a disciplined lifestyle of savings. Going forward, the majority of retirement income will ultimately come from one leg of the stool – individual savings. We must work diligently to understand how to save and invest our money today, for a better tomorrow.

Welcome to Retirement Income Planning

Simply put, Retirement Income Planning is a process of planning that creates a predictable income stream from one's assets that when combined with other sources of income is designed to meet a person's individual or family financial needs through the retirement years.

It is important that the planner understands the various risks and challenges that our clients now have, and is skilled in the methods to both reduce and manage that risk.

When planning for retirement income, there is always the concern over whether or not the money should be invested. What are the risks? What are the levels of risks? What are the rates of return? How much income will be needed? Retirement income planning can be extremely complex and there is a large variety of investment, tax and other strategies to be employed.

Make sure you become versed in this skill set or make sure you can give a professional referral to your clients for this type of planning. We will in the following pages give overviews to some of the key concepts that we feel are of benefit to you in discussing retirement income planning with your clients.



Funding Sources

In general there are three sources for funding retirement income: social security, formal retirement plans and packages, and individual savings. This is what is often referred to as the three legged stool for funding retirement income.

Many in our society today believe that their fallback safety net for retirement income will come from social security, but this is not so. As we can see now, the funding for the program is under great duress. With today's economic conditions of shrinking employment, this impacts the funding of social security for tomorrow because the program is funded by providing benefits to current retirees from the social security taxes paid from current workers, and thus the ratio of current workers to the ratio of retirees is widening every day.

Social security was passed by Congress as part of the New Deal. The act was an attempt to limit what were seen as dangers in the modern American life, including old age, poverty, unemployment, and the burdens of widows and fatherless children. By signing this act on August 14, 1935, President Roosevelt became the first President to advocate federal assistance. To date, the social security plan is the largest government program in the world, the single greatest expenditure in the federal budget, with Medicare/ Medicaid as the runner up.

In recent estimates, social security is currently the largest social insurance program in the U.S., constituting 37% of government expenditure and 7% of the gross domestic product, and is currently estimated to keep roughly 40% of all Americans age 65 or older out of poverty. While this program is an effective tool to be used in retirement income planning, it cannot be the sole fallback. Consumers *must* be educated to understand that retirement income will truly be a plan and one that consists of multiple income streams, with social security being one of them.

For the business sponsored retirement plan leg of the stool, in the past many employees received benefits from employer-sponsored qualified plans. Employers contribute to qualified plans an average preset amount yearly. Often, the employer would bear the investment risk and the employee would know what income they could expect from the plan in retirement. However, again due to the new economic environment, there has been a dramatic decline in such qualified plans, as well as concerns over whether these plans can even continue to be adequately funded.

There has been increasing emphasis on plans that shift the burden to the employee, such as 401(k) plans. In these types of retirement savings vehicles the employee is responsible for savings rates, investments and returns. Some of these plans do offer an employer match percentage, given on a per year basis, however, long vesting times and with an unstable employment rate as we have seen since 2006, have put tremendous pressure and uncertainty on these types of retirement income planning resources.



With the concerns over social security and the drastic change in the employer-sponsored qualified plans, the third leg of the stool, which is the individual savings leg, has now become of an even greater importance. There are wide choices available for various investment vehicles for individual savings: stocks, bonds, mutual funds, money markets, home equity, life insurance strategies, annuities, income laddering, etc.

Social Security

An individual is entitled to a retirement benefit if they (1) are fully insured (2) are at least 62 throughout the first month of entitlement and (3) have filed application for retirement benefits.

If your full retirement age is older than 65 (that is, you were born after 1937), you still will be able to take your benefits at age 62, but the reduction in your benefit amount will be greater than it is for people retiring now.

Here's how it works if your full retirement age is 67.

If you start your retirement benefits at age 62, your monthly benefit amount is reduced by about 30 percent. The reduction for starting benefits at age

- 63 is about 25 percent;
- 64 is about 20 percent;
- 65 is about 13.3 percent; and
- 66 is about 6.7 percent.

The NRA (Normal Retirement Age) for spouse's benefits moves upward in exactly the same way as that for workers.

If you start receiving spouse's benefits at age 62, your monthly benefit amount is reduced to about 32.5 percent of the amount your spouse would receive if his or her benefits started at full retirement age. (The reduction is about 67.5 percent.) The reduction for starting benefits as a spouse at age

- 63 is about 65 percent;
- 64 is about 62.5 percent;
- 65 is about 58.3 percent;
- 66 is about 54.2 percent; and
- 67 is 50 percent (the maximum benefit amount).



Spouse's Benefits

An individual is entitled to spouse's benefits on a worker's social security record if: (1) the worker is entitled to retirement or disability benefits, (2) the spouse has filed an application for spouse's benefits, (3) the spouse is not entitled to a retirement or disability benefit based on a primary insurance amount equal to or larger than one-half of the worker's primary insurance amount, and (4) the spouse is either age 62 or over, or has in care a child under 16, or is disabled, who is entitled to benefits on the worker's social security record.

The spouse of the worker must also meet *one* of the following conditions: (1) the spouse must have been married to the worker for at least one year just before filing the application for benefits, or (2) the spouse must be the natural mother or father of the worker's child, or (3) the spouse was entitled or potentially entitled to spouse's surviving spouse, parents, or childhood disability benefits in the month before the month of marriage to the worker, or (4) the spouse was entitled or potentially entitled to a surviving spouse, parents or child's (over 18) annuity under the Railroad Retirement Act in the month before the month of marriage to the worker.

A spouse is potentially entitled if he or she meets all the requirements for entitlement other than filing of an application and attaining the required age.

This is just a small snapshot of the benefits available and the guidelines. There are also divorced spousal, mother or fathers, widow or widowers benefits available.

There are also many guidelines for working while drawing social security, cost of living increases, working after retirement and income taxation of benefits that the income planner must be familiar with and aware of.

INCOME RISK MANAGEMENT

Defining and Reducing Risk

Most discussions of retirement income planning usually will presume that many general theories will automatically apply and there are general and conventional risks that do apply thus we will briefly review them in this section.

First however, in order to understand the risks facing retirees there are two core economic terms – utility and opportunity cost, that we should define and we will review them with retirement income planning in mind.



Utility is the measure of satisfaction or pleasure resulting from an action. This presumes that people will always want as much utility as they can get, but that also people differ in preference and with varying degrees.

Opportunity cost is the amount of other things that must be given up or sacrificed to produce the utility.

Utility then would be the satisfaction experienced, and the *opportunity cost* is the satisfaction forfeited to gain the utility of an alternate choice.

Advantages to Understanding Income Planning Concepts

Understanding the risks now will make it easier to address the risks in the future.

Understanding the meaning of diversifiable and nondiversifiable risks may encourage the use of asset allocation and/or other strategies designed to minimize diversifiable risks in funds to be used for retirement income.

Recognize risks such as longevity and mortality may enable planning utilizing annuities and life insurance to secure that funds will be available for retirement income if one should live too long or die too soon.

Understanding will enable a person to make wiser decisions regarding tradeoffs between current spending and savings, and future spending and saving.

Understanding inflation risks and uses, and the different strategies to use to minimize risk such as utilizing annuities with increasing payments.

Understanding all the variety of risks will lead one to understand the need for overall planning.

Disadvantages

Failure to recognize and consider the risks will lead to overall retirement income failure.

Fear can also lead to failure because one might be tempted to act over-conservatively.



Defining General Risk Factors

Longevity Risk – The risk of living longer than expected

This is a risk because if a person lives even one day after spending their last dollar they are now subjected to drastic changes in their standard of living. Similarly, a retiree who depends wholly on systematic payments that do not increase with the person's actual cost of living or inflation exposure then their standard of living would have to be continually be adjusted downward to offset the long term impact. Maybe the worst part of this risk is for people who are fortunate enough to live a long and healthy life, but later realize that they regret past choices that have contributed to the eroding away of their assets.

Life expectancy of an individual age 65 is about another 21 years, to age 86. For two individuals age 65, joint survivor life expectancy is another 26.2 years, to over age 91. Another factor to consider is due to the advancing medical technology now available life expectancy is growing and this will suggest additional planning in upcoming decades. Thus as longevity rises, so do the risks associated with it like the reality of outliving income. Up until this point historically, retirees have depended on pension payments and social Security to provide more than two-thirds of their income for a retirement that typically did not last more than 10 years. Now in this decade the declining of defined contribution plans, the uncertainty of the future for social Security combined with increasing life expectancies demand our attention to the possibility of outliving retirement assets.

Mortality Risk – The risk of living shorter than expected

Unfortunately, many people will spend their lives working and saving for a retirement that they will never experience. If a person knows exactly how long they had to live, easy decisions could be made concerning work, spending and life time dreams. It is safe to assume that not all clients will live to retirement age and unfortunately many will not make it to their retirement.

The advisor should engage clients in discussion of the risk of premature death and the need to enjoy life now, with the balance of expected future obligations and goals.

Default Risk – The risk of a financial institution defaulting on an obligation to the retiree. Especially in today's economic environment, this has become a forefront concern with people investing their hard earned savings. Examples of these types of risk categorizes are: pension fund obligations, government entitlement programs such as social security, Medicare, financial institutions, family expectations, such as inheritance and financial assistance, bonds and traditional borrowing investments.



Illiquidity Risk and Inflexibility Risk – The risk of excess opportunity cost when generating needed cash. The risk of excess opportunity cost when modifying investments, income or planning decisions. These two risks are often interrelated. For example, the need to avoid illiquidity may lead to less flexibility.

Inflation Risk – The risk of continual loss of purchasing power from savings. This is relative because if the cost of goods and services increases at a similar rate to the increase of income, then the effect is minimal. But in the event of loss of purchasing power, this effects retiree's mostly because their income is exclusively from savings only. Thus, it should be generally accepted that going forward inflation will always be a risk and thus a major factor to be considered in retirement income planning.

Investment Risk – The risk of an investment or portfolio not achieving the return necessary to fund every planned distribution. For many years, practitioners have debated on specifically how to measure investment risk and compare reward. For the past quarter of a century the mean-variance has survived as a viable approach. For the purpose of this writing we will not explore this approach because our overall objective is to give you a high level overview. For a more detailed analysis you might want to invest in some recommended retirement income planning guides.

Now that we have looked at the general risks let's attempt to categorize them.

Categorizing of Risk Factors – Categorizing risks contextualizes possible solutions or neutralizers for those risks ,without discussing each risk individually in-depth but will give you a high level over view.

Diversifiable Risks - are those risks that may be protected against by using the law of large numbers. For example, investments. Some risks are diversifiable by the institution such as the many services and products offered by insurance companies.

Longevity Risks – Diversified through insurance companies through lifetime payment of annuities. Without having to refund premiums to those who do not live to life expectancy, the insurance company is able to fund the payments to annuitants who live beyond their life expectancy. So in this way on the average, annuitants are able to take advantage of all the storied utility, without having to worry about what would happen if they individually live longer than expected. This is a great example of the benefits of diversification.

Mortality Risk – The insurance industry also can help to diversify mortality risk – life insurance for the survivors. The life insurance industry has some amazing products that can not only help fund the future needs of heirs, but maximize utility for the 10-15 percent of workers who may pass away before retirement age.



Non-diversifiable Risks – A non-diversifiable risk is one which is not able to be reduced by spreading the risk over larger pools of insured.

Investment Risk – This is a consideration if the investment is diversified across large risk pools. Insurance companies have begun offering products that offer a measure of guarantee against investment losses, but the risk factors are highly correlated to actually being insurable.

Thus, when considering insurance companies and the living benefits now offered on variable annuity contracts, it is important to note the financial viability of the company to pay under certain scenarios.

Default Risk – Defaults on obligations would be diversifiable only if they are independent of each other.

Inflation Risk – The only possible method of diversification against inflation would be by investing. However, this is a challenge because it is extremely difficult to buy an asset to protect against inflation without increasing risk or volatility within the time horizon.

Illiquidity and Inflexibility Risk – While nondiversifiable, illiquidity and inflexibility are risks that can usually be protected against by thoughtful financial planning, having a reasonable amount of liquid cash available is wise if needed as an escape hatch.

Loss Utility Risk – Also nondiversifiable, this risk highlights the necessity of fully engaging the client's emotions as well as their finances.

In summary, a comprehensive understanding of the many risks involved is a prerequisite to planning for mitigating those risks.

One of the best solutions may be the merging of professions to achieve the desired goals. Historically, the insurance and the investment communities have long looked at financial issues from alternate viewpoints; both however presume decisions as a balance of risk and reward.

The investments communities generally base decisions on expected but unknown returns and the supposedly known risk required to achieve it. The insurance communities weigh possible risk and a definite known cost (from the client's viewpoint – in premiums) to insulate against the risk. The insurance industry seeks to remove inherent risks of life and the investment industry willingly accepts a minimal amount of risk to achieve anticipated future goals. Thus, these industries are in opposition to each other. In this new world economy that we find ourselves in, we might have to utilize a collaboration of both industries in research, development and eventually distribution.



As you can see Retirement Income Planning requires a highly specialized set of skills and involves many complex aspects. Here are some of the addition factors to be considered in coordination with the above:

Sustainable Withdrawal Rates – How much can be safely withdrawn/spent on a regular basis without an undue risk of running out of money or needing to reduce the future standard of living.

Asset Allocation Issues – Historically, asset allocation for retirement income has often revolved around increasing the percentage of assets producing income and reducing longer term non-income producing investments, as the time for retirement approaches, and the retirement horizon decreases. However, as with any strategy there are many alternative approaches available.

Stochastic Modeling – related to financial planning, stochastic modeling is a broader term that describes various methods used to simulate a range of outcomes. There is a variety of stochastic modeling methods and the planner of today should learn each of the various methods and the possible usefulness of each.

INSURANCE / INSURANCE SOLUTIONS

Utilizing Annuities

Why utilize an annuity?

Risk management and income for life.

As we all know individuals and institutions alike can only handle so much exposure to risk. Annuities offer varying degrees of risk relief for people with varying levels of risk tolerance as it pertains to their financial resources.

In the end, despite bad press and possible misunderstanding of this very useful tool the risk management features of annuities have value, provide for peace of mind for the consumers as well as many investment advisors, and often the purchasers feel the fees are an acceptable trade off for the security that an annuity contract can provide.

Annuities for Income

Annuities provide systematic liquidation of principle and interest over a given period of time. Regular annuities provide payments based on the crediting of a fixed guaranteed interest rate. Variable annuities can be invested in various investment accounts that may or may not produce higher returns, but the annuity holder will bear a risk. Annuities generally will provide tax deferral until annuity payments or other amounts are received from the annuity.



Fixed Annuities – have payments that are either immediate or deferred. A fixed immediate annuity may be called a pure annuity, a payout annuity, single premium annuity (SPIA) or longevity insurance. These annuities are often payable for one or more lives, for a fixed period of years or for a fixed amount, or some combination.

Indexed Annuities – People have realized that stock market declines are happening more frequently to a more drastic degree, thus the utilization of an Indexed Annuity has become attractive. Realizing that a 50 percent decline in a portfolio value will require a 100 percent gain to get back to even, investors are now utilizing index annuities linked to an equity index, such as the S&P500. This means the insurance company will provide interest based upon part of the gain if the market index goes up, but protects against principle decreased if the index goes down.

Variable Annuity – This annuity is intended to overcome the loss of purchasing power, as a result of ever increasing inflation, that is an inherent risk in a fixed life-contingent annuity. Thus, anyone dependent upon the income from a fixed annuity for a lifetime will experience a decreasing standard of living in an inflationary economy. The risks of variable immediate annuitization are that income can go down, no one ever can be certain that the variable annuity, tied to the performance in equity markets, will produce an increased income equivalent to inflation increases. Nor does a variable annuity satisfy a demand for a maximum consistent monthly income that many people who annuitize are often seeking.

Times to consider the use of an Annuity

- The retiree wants to provide for a fixed income stream of retirement income that they, and possibly their spouse, cannot outlive.
- The retiree wants to provide for a fixed stream of retirement income that can be used to relieve the stress from trying to provide income from other assets.
- The retiree would like to have an investment that provides for payments that include the systematic liquidation of principle.
- The retiree wants to transfer some investment and risk management to another – for example, the insurance company.
- When a tax-deferred accumulation of interest is a goal.

Advantages of Utilizing an Annuity

- Annuities can provide an income stream that is guaranteed for life and cannot be outlived.
- Annuities can provide for income tax deferral.
- A regular annuity can moderate an investment risk.



Disadvantages of Utilizing an Annuity

- Depending on the product and the riders, an annuity may not keep up with inflation.
- If the annuity is liquidated before the surrender period there are expenses that can be substantial.
- The certain amount of the monthly income produced by an annuity can be taxable as ordinary income.
- With a variable annuity, much of the investment risk is assumed by the annuitant.

Qualified and Non-Qualified Annuities

Non-qualified funds into an annuity are annuity contracts into which investors put their *after tax* funds that otherwise would reside in a taxable environment. And for this reason they are also considered or referred to as after-tax annuities.

Non-qualified or after-tax annuities will provide:

- Tax-deferred treatment of earnings.
- Death benefits.
- Other contractual features that can provide peace of mind in dealing with an uncertain future.
- Annuity payout options that can provide guaranteed income for life or a specified period of time.

Qualified funds into an annuity are annuity contracts that are purchased with funds that are already qualified – such as funds in retirement accounts. Qualified money, by its nature is tax-deferred.

Qualified annuities will provide:

- Death benefits.
- Payout options that can provide guaranteed income for life or a specified period of time.

The tax deferred nature of annuities is a result of the contract and the I.R.S. Code Section 72, Annuities; Certain Proceeds of Endowment and Life Insurance Contracts, which defines when and how income from an annuity will be taxed. Section 72 provides that taxation is generally an issue only when money comes out of an annuity contract. The tax deferral benefit for investments while held inside of the contract is a part of the generic nature of annuities, and not something for which insurance companies can charge.



Important to Note

An annuity contract is not an investment. It is an insurance contract around investments. The owner of the annuity contract may *wrap* the annuity insurance contract around many different investments. And again, generally speaking there are two basic investment media that annuities are *wrapped* around in order to impart the annuity insurance features to the investment.

Fixed annuity – an annuity wrapped around an interest bearing account.

A Variable annuity – An annuity wrapped around variable investment options or subaccounts similar to mutual funds.

A History of Annuities

Early History

Annuities are not a new recession proof financial tool. The basic reason annuities were developed is because even in previous centuries people had a need for security in an unsecure world. Times have changed but the world really hasn't, that much.

There is evidence that annuities existed as early as 2500 BC in Babylon. The Roman Empire issued "annual" payments made once a year over the person's lifetime. In the middle ages in Europe, individuals would pay a lump sum of money to a hospital or church in exchange for lifetime payments in order to secure their futures.

In France in 1653, there was a system of annuities in which benefits would pass to the surviving subscribers until only one person was left. This was developed by Lorenzo Tonti, a Neapolitan banker, and called a *tontine*. Each subscriber to the *tontine* paid a sum into the fund and in return received dividends from the capital invested. As each person would die, the deceased's portion of the income was divided among all of the survivors until only one person was left who reaped all of the benefits. Originally, the capital reverted to the state when the last subscriber died. This idea was continued in France, Britain and the USA, where it was originally used to fund buildings and other public works.

In the US the concern for life income involved not only tontines but also the National Pension Program for Soldiers that was signed in 1776. By 1894, 37 percent of the federal budget was going for military pensions.

In the US one of the first people to propose an attempt at retirement security was Thomas Paine, he had a pamphlet, published in 1795 and it was a controversial call for the establishment of a public system of economic security for the new nation. It was titled Agrarian Justice, and it called for a creation of a system where those inheriting property would pay a 10 percent inheritance tax and this would be used to create a special fund.



Out of this fund a onetime amount of fifteen pounds sterling would be paid to each citizen upon attaining the age twenty-one, to give them a start in life and annual benefits of ten pounds sterling to be paid to every person age fifty and older, to guard against poverty in a person's old age.

Following the Civil War there were hundreds of thousands of widows and orphans and disabled veterans. This posed a significant challenge because following the Civil War there was suddenly a much higher proportion of the population that was disabled or were survivors of deceased breadwinners. This was the first time in American history that the country was faced with a challenge like that. This eventually led to the development of a Civil War pensions program that had similarities to later developments in social security. It was with this development of Civil War pensions that a full-fledged pension system developed in America for the first time.

This Civil War Pension program had its first legislation in 1862 providing for benefits linked to disabilities "incurred as a direct consequence of ...military duty". This further developed and in 1906, old age was a sufficient qualification for benefits. By 1910, over 90 percent of the remaining Civil War veterans were receiving benefits under the program.

In 1875, it was American Express that established the first private pension plan for its employees. In 1889, it was then 74 year old German Chancellor, Otto Von Bismarck, who instituted the concept of social security on Germany. A social insurance program was provided for retirees at age seventy that was funded by the employer, employees and the government. The retirement age was dropped to age 65 in 1916.

In 1905, it was the United States own Andrew Carnegie who wanted to benefit two of his favorite causes, higher education and pensions and he did this by giving ten million dollars and set up the Teachers Pension Fund for professors, which is now known as TIAA CREF, the College Retirement Equities Fund, evolved from an in depth economic study conducted by TIAA in an effort to determine how a combined fixed-income and variable annuity program would work.

The study covered the years from 1880-1950 and also analyzed different periods of fund accumulation and benefit payments within those seventy years to determine if a hypothetical annuity amount could have resulted. This study examined common stock and fixed-income investment experiences in comparison with the history of consumer prices, covering the periods of depression, prosperity, war, peace, inflation and deflation, short and long working lifetimes and short and long periods of retirement.

This study supplied critical information, and that was that this historical data showed that an individual would have fared better from participation in a diversified annuity program rather than a fixed-income annuity alone. As a result of this study TIAA developed CREF in 1952, and was created to provide a variable annuity fund (the CREF Stock Account) to compliment TIAA. In short, it ushered in the variable accounts to complement the fixed income accounts strategy.



Now let's get back to social security, which was enacted in 1935. The first payment was made to Ida May Fuller in 1940 and was paid for a period of thirty-five years. Ida May died at the age of 100 in 1975, and after having paid into the social security system \$22.54 she received \$22,888.92 in benefits.

Why Annuities?

As we can see from the early history review above that the ages show one common theme – they demonstrate that annuities are not necessarily about taxes or tax deferral, they are about an age old concern of running out of money before running out of life. Annuities have been, and will continue to be about retirement security. We can never forget that with the good news of humans being able to live longer lives comes the reality of the bad news that we can and often do outlive income.

The wrap up: the need to accumulate capital to provide lifetime income has never been greater. Here is a great illustration: the increase in the number of people living to 100, from 1990 to 2000 was 38,000. The increase in people living to 100, from 2000 – 2010 was estimated to be about 95,000.

Annuities Now

In summary, it has become obvious that the financial industry must rise to the occasion of demand and provide products that can help manage retirement income for the baby boomer generation, who has now just started to approach retirement. This group of future retirees alone is to the tune of 74-78 million, and that's just the beginning of the new wave of longer life spans that is positioned to hit this country and many others. Retirees, and soon to be retirees, have now learned that it is not the size of their savings that will ensure their financial survival but rather the ever needed income stream that makes one secure and able to focus on a happy and fulfilling life.

Overview of Annuities

The marketplace has spoken very clearly to the insurance companies about what products consumers will, and will not buy. The market has also often avoided the subject of annuitization, but yet still demands income security and flexibility. The insurance industry and its representatives are trained to discuss all of the pros and cons to a consumer's use of an annuity. Also, many insurance companies have responded to consumer feedback and put into place "minimum guarantee" features.

Annuities are generally purchased with either a single premium or with a series of payments (flexible premiums). Payouts from an annuity may start immediately (an immediate annuity) or at some future date (which is a deferred annuity). Annuities are usually categorized as either fixed or variable. A variable annuity is invested in certain subaccounts and value of each annuity payment will usually vary with changes in the value of the underlying subaccounts.



For our purposes we are going to review the Fixed Annuities. A Fixed Annuity is an annuity that is payable for a fixed period of time or until a fixed amount has been paid out. The payment is a periodic check issued to the annuitant in a fixed amount for the duration of the payout period, whether the annuitant lives or dies.

The payout period is determined by the contract owner who stipulates to the insurance company either the period of time during which the checks are to be distributed, or the specific amount and the interval of distribution of each check.

There are also different ways in which to be paid. For example:

Installment payment-fixed amount. The potential buyer of the contract tells the insurance company how much they would like each annuity payment to be, based on the amount of the initial investment and then the insurance company can calculate how long the payments can be made.

Installment payment-fixed period. The contract owner would indicate the period of time that they want periodic payments to be made for and also the initial investment amount. The insurance company does its calculations based upon the interest it expects to earn and the length of time chosen and will then tell the investor what the amount of the fixed monthly payments can be.

Different Fixed Annuities

Fixed Annuities for Life

Annuities can be payable for the life of one or more persons. A single life annuity is payable for the life of one person. A joint annuity is payable while all annuitants are alive. A joint and survivor annuity is payable until the last annuitant dies. These annuities usually come with guarantees that payments will be made for some specified period of years whether or not the annuitant is alive.



Fixed Annuity for Fixed Period or Amount

<i>ADVANTAGES</i>	<i>DISADVANTAGES</i>
Assured income for time/amount selected	Not life contingent
Income tax minimized as a result of return of capital exclusion ratio	Continued payments dependent upon the continuing good financial health of the insurance company
Defers the life contingent annuitization decision to a later date when potentially higher lifetime income is available	Deferred life annuitization could be lower as a result of age related increases being more than offset by decreasing interest rates and or increasing longevity estimates
May leave a legacy of unused income and an applied capital	Legacy subject to estate and inheritance taxes

Fixed Single Life Annuity

The simplest annuity for life is the fixed annuity for a single life. For this type of strategy, a straight life annuity will provide the largest monthly payment based on a given deposit. A Fixed Single Life Annuity is low in cost because there is a high risk of loss of capital. The high risk to the capitol is that if the annuitant dies prior to the time the deposit for the annuity has been used up, the balance of the deposit is forfeited to the insurance company, or pension plan from which it was being paid. Keep in mind this can occur even if you are not too “deep into” the annuity, meaning even if only one check had been issued.

The calculations for a fixed, immediate annuity are: the age of the annuitant, life expectancy, and interest rate expectations. Thus, each annuity payment received is a return of a portion of the capitol invested, interest on the capitol not yet paid out, and amounts that are available as a result of annuitants dying prior to their life expectancy and thus forfeiting principle back into the annuity pool of capitol available.

On the other hand, the immediate annuity is like an insurance policy that protects annuitants from the economic consequences of living too long.

For example, buying insurance creates a pool of capital from which claims can be paid to those who experience losses of an insured person’s life and thus a life contingent annuity will continue to pay the claims of those who live an extra long life.



Living TOO Long...

...is now a real risk. With the gift of technology and its impact on health care we are now living longer lives, but what comes with this longer life is the risk of outliving one's income. An annuitant can protect against the risk of running out of income during their lifetime by utilizing a life-contingent annuitization, rather than periodic withdrawals.

Fixed Joint and Survivor Annuity

The joint and survivor life annuity is designed to function as an assured payout vehicle during the lives of two or more people; it is designed to continue the payments through the life of the last-to-die. This type of plan or annuity is usually utilized by married couples to insure that an income stream will not terminate at the death of the first annuitant.

Here is a chart to help you see the advantages and disadvantages at a glance.

Fixed Annuity for Joint and Survivor Life

<i>ADVANTAGES</i>	<i>DISADVANTAGES</i>
Assured lifetime income for all annuitants	Early death loss of capital if all should die early
Maximum income for a given investment of capital	Inflation diminishes the value of the income over time
Xx	Continued payments dependent upon the continuing good financial health of the insurance company since the only guarantee is based upon the claims paying ability of the insurance company.
Legacy for a survivor	Possible estate of inheritance tax
May be salable in an open market - maybe	Inflexible and illiquid



Fixed Annuities for Life with Guarantees

Immediate annuity buyers may consider the possibility of losing all their capital investment, and potentially after only one payment too great of a risk, in short, beyond their risk tolerance. If this is the case then they may want greater safety and assurance that the payout stream will continue in some fashion, in the event of an early death. Thus, for this reason annuitants can request certain guarantees. Below are *a few* examples of life payout variations.

Life annuity (straight life / pure life annuity) – A life contingent annuity. The capital is invested at a specific time, and a specified income payment starts within a year and will continue until the annuitant's death. There is NO minimum guarantee other than the regularly scheduled income payment for the life of the annuitant.

Life and Period Certain (5, 10, 15, 20 year) – This is a life contingent annuity in which the company is instructed that, in the event of the annuitant's death prior to the end of the minimum guarantee period selected; the company is to make the payments to a named beneficiary for the remainder of the guarantee period.

Joint and Survivor Life Annuity –The annuity pays for the whole lives of two individuals. It continues to provide level payments until death of the second-to-die annuitant, at which time payments would terminate. There are also different options for payments available for this scenario. There is a joint and 75 percent to survivor annuity in which the surviving annuitant receives 75 percent of the original monthly payment. The percentage continuations after the death of the first annuitant are anywhere from 100 percent to 75, to 66.6 to 50 percent to the survivor.

Fixed Annuity Costs

The cost of a fixed annuity is dependent upon:

- Prevailing level of interest rates at the time the annuity is purchased.
- The age or ages of the annuitant.
- The length of a period certain (longer period means a lower payment).
- The amount of payment requested (higher payment means higher cost which equals lower overall payment).
- Insurance company expenses associated with the product.



Here is a chart to help you see the advantages and disadvantages at a glance.

FIXED ANNUITY for LIFE WITH GUARANTEES

<i>ADVANTAGES</i>	<i>DISADVANTAGES</i>
Assured lifetime income with guarantees to prevent the loss of capital in the event of an early death	Cost exceeds life contingent only – Less income per capital invested than life contingent only
May tailor guarantees to needs	Inflation diminishes the value of the income over time
Xx	Continued payments dependent upon the continuing good financial health of the insurance company
Possible legacy	Limited legacy subject to estate and inheritance taxes
May be salable in the open market - maybe	Inflexible and illiquid

Fixed Indexed Annuities

Now that the public has realized the stock market does not always go up, the insurance industry has been able to respond by supplying products that will help producers meet changing public demands. Due to the recent turbulent times, the public now understands that a 50 percent loss in stock portfolio funds, specifically those targeted towards retirement will require a 100 percent gain just to “make up” the original loss. That’s not addressing the effect of inflation and the loss of interest potential that should have been gained.

Fixed indexed annuities are one of the responses to the public’s recognition of the volatility of the stock market. The attraction point of a fixed index annuity is that the insurance company will provide interest based upon part of the gain if the underlying index goes up but provides safety of original principle if the index goes down.

Index annuities are not registered products, and since they are not considered a security they are not under the regulation of the SEC or various state securities departments.



When choosing a fixed index annuity product the advisor and the consumer will need to determine: the underlying index, the initial investment, and the time period over which the product will be invested, time period over which interest will be credited, and also making sure to discuss the issues around surrender charges and withdrawal fees.

When choosing a fixed index annuity, also make sure you understand all the characteristics of the product and how the interest rate earned is credited, along with understanding minimum underlying guarantees, etc.

Here is a Basic Chart on Fixed Index Annuities (FIA)

<i>ADVANTAGE</i>	<i>DISADVANTAGE</i>
Possible positive index results, acceptable maturity dates, and liquidity provisions may provide long term increasing income.	Possible negative index results, unacceptable maturity dates, and lack of liquidity provisions may provide no income
If possible, income from earnings only	Cost of premature distribution penalties
Possible legacy	Complexity and ongoing management
	Potential disappointing results
	Continued payments dependent upon the continuing good financial health of the insurance company
	Inflexibility and lack of liquidity

The Role of Income Annuities in Planning

Income annuities are just one of the tools used to bring income to clients in retirement. Typically, annuity contracts are used by those who need and want some insurance features in addition to the retirement income. Many also utilize annuities to accomplish a specific purpose.

Some of the General Tax Implications of Annuities

Generally annuities are not taxed until distributions are made from the annuity, thus annuities can provide a long-term deferral of income tax on earnings in the annuity. Earnings on an annuity contract are taxable as ordinary income when included in income.



Taxes on a Lump Sum Distribution: If you make regular payments to the insurance company which handles your annuity, that annuity upon your retirement, could be worth xxx. The IRS will consider the difference between what you invested and the current value as ordinary income subject to taxes rather than as a capital gain.

Taxes on Installment Payments and Variable Annuities: If you receive your annuity pay-out in installments, taxes must be paid on each installment according to formula established by the IRS. Taxes are owed on the difference between the amount invested and the amount of the monthly payments. The amount of each payment that won't be taxed is computed by establishing an "exclusion ratio" that's determined by dividing your investment in the contract by the total amount you expect to receive during the payout period.

According to current tax laws, any gains you incur as a result of selling your annuity are subject to ordinary income tax.

If the sale of your annuity occurs prior to reaching age 59 ½, any gains may be subject to a 10% federal tax penalty.

IRS Publication #939 covers the rules on Pensions and Annuities

The Role of Life Insurance in Providing Living Benefits

Overview of Life Insurance

Generally speaking, in return for a payment of premiums on a life insurance policy, an insurance company agrees to pay death benefits to a named beneficiary if the policy is still in force when the insured dies. This is an excellent vehicle to help provide income replacement when someone dies and can also be used to provide retirement benefits to a surviving spouse. If the policy is carrying cash values then they also could be used to provide living benefits while the persons are still alive, which again can help provide retirement income.

Types of Life Insurance

There are general categories we can put life insurance policies in: term, whole life, universal and variable. Life insurance in general is often offered, at a cost, with various guarantees.

Term Life Insurance

With a term insurance policy, the insured would need to die before the term is up in order for any benefits to be paid. For example, a five year term policy would pay benefits only if the insured died during that five year term.



Premiums will generally increase as the insured gets older, if they keep taking out a term policy. There is no cash value and no ability to build up a cash pool within this vehicle. One use of a term policy would be if a person wanted some type of insurance coverage but could not afford the generally higher premiums associated with a whole life policy. Another use of a term policy would be to provide possible retirement income for a surviving spouse if nothing else is in place.

Whole Life

Whole life insurance is generally referred to as permanent life insurance, the premiums are made for life, or also available are shorter time periods, for example in a single premium policy.

With this policy premiums are generally level, with a portion of premiums being used to pay the current cost of life insurance and a portion creating a cash surrender value. This policy pays a predetermined amount at death, so long as all the premiums have been paid. The policy owner can obtain lifetime available benefits from surrendering the policy for cash values or from borrowing against the policy cash values.

Universal Life

Universal life insurance provides for flexible premiums and the owner can increase or decrease premiums, or possibly even skip some premiums, if the built up cash value is adequate to cover the current charges. The amount of the death benefit might be adjustable, but keep in mind an increase in the death benefit may require proof of insurability. As with the other policies, the built up cash surrender values can be used for retirement income in general or for a surviving spouse.

Variable Life

A Variable life insurance permits the policy owner to invest the cash values in a variety of different investments. Keep in mind that there may be various guarantees available for additions premium costs, the policy owner will bear the investment risk. Cash surrender values and death benefit values can go up or down. Again, this policy can help provide retirement funds for a surviving spouse.

Whole Life, Indexed Whole Life, Universal Whole Life and Indexed Universal Life, offer risk in an ascending fashion and offer opportunities for enhanced interest accumulation. While Variable Life, Variable Universal Life with Guarantees, and Variable Universal Life, policies offer the most risk with enhanced interest accumulation based upon market performance and control.

In summary, the role that a life insurance policy can play in providing lining benefits and the tax advantage of death benefits makes these products very appealing.



TAX CONSIDERATIONS

Retirement Income Vehicle Basics

Qualified Plans

A qualified plan is established by an employer to provide retirement benefit opportunities for employees. Keep in mind that a qualified plan is not subject to the same regulations as IRA's and qualified plans are often more complex in management terms. In general distributions from a qualified plan will almost always be treated as ordinary income in the year received.

A qualified plan may be a defined benefit plan or a defined contribution plan. Qualified plans allow the employer a tax deduction for contributing to the plan, and employees typically do not pay taxes on plan assets until these assets are distributed; furthermore, earnings on qualified plans are tax deferred.

Defined Contribution Plan

A defined-contribution plan does not promise a specific amount of benefits at retirement. Employees and/or employers can contribute to these plans and typically, the contribution will be a percentage of compensation up to a certain dollar amount. The contributions are invested on the employee's behalf, and the benefits paid to employees are based on contributions and any earnings or losses. Employers are not required to make up for any loss on investments, thus in these types of plans, the employee bears the investment risk.

A defined-contribution plan can be a profit-sharing plan, an employee stock ownership plan (ESOP), a 401(k) plan or a money-purchase pension plan. In general, the amount contributed to the plan is not included in the employer's income for income tax purposes and taxation of benefits is generally deferred until a distribution is made.

Defined Benefit Plans

In a defined benefit plan, the employer contributes to the plan amounts sufficient to fund future retirement benefits for the employee. Under this plan, the employee is promised benefits at retirement based on compensation and length of service. For example, the plan may determine that upon retirement the employee will receive 3% of his or her average salary for the last 7 years of their employment and for every year of service with the employer. The plan may state the benefit as an exact dollar amount, such as \$xxx per month at retirement. Although not as common as they used to be, government agencies and some private employers offer these plans. One of the best features of this plan is that often pension plans are guaranteed and somewhat less dependent upon investment success than the defined contribution plan. In general, the amount contributed to the plan is not included in the employer's income for income tax purposes. Taxation of benefits is generally deferred until distributions are made.



Individual Retirement Accounts – IRA

A person can make a deductible or non-deductible contribution to an IRA account. According to the IRS website, 2011 Combined Traditional and Roth IRA Contribution Limits:

If you are under 50 years of age at the end of 2011: The maximum contribution that can be made to a traditional or Roth IRA is the smaller of \$5,000 or the amount of your taxable compensation for 2011. This limit can be split between a traditional IRA and a Roth IRA but the combined limit is \$5,000. The maximum deductible contribution to a traditional IRA and the maximum contribution to a Roth IRA may be reduced depending on your modified adjusted gross income.

If you are 50 years of age or older before the end of 2011: The maximum contribution that can be made to a traditional or Roth IRA is the smaller of \$6,000 or the amount of your taxable compensation for 2011. This limit can be split between a traditional IRA and a Roth IRA but the combined limit is \$6,000. The maximum deductible contribution to a traditional IRA and the maximum contribution to a Roth IRA may be reduced depending on your modified adjusted gross income.

See Publication 590, Individual Retirement Arrangements (IRAs) for additional information

Deductible Contributions to Traditional IRA's

Deductible contributions to a traditional IRA, a tax favored account, creates the opportunity for retirement funds to accumulate faster than they would in a taxable account because of the deferral of income tax. All earnings and asset growth accumulates on a tax-deferred basis during the build-up period, which typically lasts many years.

For 2011 the allowable traditional IRA contribution amount is \$5,000 if the individual is under 50 and \$6,000 if the individual is over 50, utilizing the \$1,000 catch up limit.

The fundamental advantages of a traditional IRA are its tax-deferred nature with the secondary advantage being the ability to deduct the contributions. Another advantage of placing assets in a traditional IRA, as opposed to a taxable account, may be that assets can grow at a higher rate of return. The tax savings that results from the tax deduction, on the contribution, can be invested in a taxable account and earn growth, thus increasing the overall benefit of the contribution to a traditional IRA.

Non-deductible Contributions to Traditional IRA

When non-deductible contributions are made to a traditional IRA, even though they are non-deductible, the earnings and growth accumulate tax deferred. A non-deductible contribution to a traditional IRA can occur if the person or a spouse actively participates in an employer sponsored qualified retirement plan and the individual and or with spouse, has MAGI that exceed the threshold amount.



Earnings on a traditional IRA are distributed as taxable ordinary income, and the non-deductible contributions are returned free of tax as principle or basis. Thus again the main advantage in the case of a non-deductible contribution to a traditional IRA is that it enables the accumulation of funds to grow at a higher effective rate of return than assets in a taxable account yielding the same rate of return.

Contributions to a Roth IRA

When contributing to a Roth IRA there is no income tax deduction available for the amount contributed. However, the good news is that the qualified distributions received by a person from a Roth IRA are not subject to federal income taxation.

For 2011, the allowable contribution amount for a Roth IRA is \$5,000 if the individual is under 50 and \$6,000 if the individual is over 50, utilizing the \$1,000 catch up limit.

Because of the tax free nature of the funds in a Roth IRA, they may grow at a higher after tax rate of return than funds in a traditional IRA. Worth mentioning is that because the distributions are received tax free, they will have no effect on a person's marginal tax bracket during retirement years.

Another great feature of a Roth IRA is that a person can continue to make contributions to a Roth IRA *after* the person has reached age 70 1/2. With a traditional IRA contributions cannot be made after the age of 70 1/2. Also unlike a traditional IRA, which requires minimum distributions (RMD) upon reaching the age of 70 1/2, a Roth IRA does not require an individual to take RMD's. One note however, is that upon the death of the Roth IRA owner the RMD rules generally will apply.

Outside Taxable Accounts

These are generally investments of securities and mutual funds that are not contained within a qualified plan and which will receive no preferred income tax treatment based on being within a retirement plan. Thus, generally the earning received from these investments, such as interest, dividends; capital gains, etc. are taxed in the year received.

Sometimes because there is no tax deduction available on the earnings the taxable investment accounts can be subject to "tax drag". Which is basically, the reduction in the portfolio's rate of return due to the annual tax liability on the return, therefore when comparing retirement options for clients, make sure that if you have this scenario that you compare retirement options on an after-tax basis. Make sure you are versed in the differing tax breaks and strategies available for your client or advise your client to consult with a tax planning expert.



Early Distribution Planning Techniques

Early distribution of funds received from a retirement vehicle such as distributions from a qualified plan or IRA, carries a 10% penalty tax. The tax applies to the amount of the distribution that is included in income. Generally an early distribution is on made before the age of 59 ½, death or disability unless another exception can apply. However, there is one important exception to note and that are payments made via SEPP – payments that are part of a series of substantially equal periodic payments.

When would this type of planning be necessary?

Whenever a plan participant or IRA owner is under the age of 59 1/2, has qualified plan or IRA assets and needs additional funds for expenditures. Let's review some of the advantages and disadvantages:

Advantages

- Planning to utilize an exception to the 10% early distribution penalty tax can avoid the penalty tax.
- If there isn't an exception available keep in mind that the penalty tax applies only to the portion of the distribution includable in income.
- The penalty tax can be partially or wholly offset over time by the tax benefits, such as a tax deduction or exclusion and tax deferral or the tax favored retirement plan.

Disadvantages

- The early tax penalty will apply to distributions made before age 59 1/2, death or disability and significantly reduce the net amounts received from the distribution.
- This is not a good "habit" to engage in as, over time, it will reduce accumulations set aside for retirement.

Early Distribution Planning

We've mentioned that taking a distribution from a qualified plan, such as an IRA or another qualified plan often results in a 10% additional tax for the early distribution. This is in accordance with IRS Section 72(t). This regulation was set up to encourage savings and build discipline for retirement savings by discouraging the taking of early distributions. Thus the 10% penalty applies, absent of meeting a specific exemption, when an individual receives a distribution from an IRA prior to attaining age 59 ½ or from a pension plan if the individual separates from service before the year in which they turn age 55.



This 10% penalty is assessed if the distribution is included in the gross income. Distributions which are not included in the gross income (i.e., distributions that represent a tax-free return of basis, tax-free trustee-to-trustee transfer, or otherwise taxable distributions that are rolled over into an eligible retirement plan within the prescribed 60-day period) will not be assessed the additional 10% tax.

Exceptions to the IRA Section 72(t) Penalty

The IRS Section 72(t) (2) provides the following exceptions:

- Attainment of age 59 ½.
- Death.
- Disability.
- Series of equal periodic payments.
- Early retirement – attainment of age 55 or older in the year of separation from service (N/A to IRAs).
- Medical expenses – exceeding 7.5% of agi.
- QDRO – pursuant to a qualified domestic relations order.
- Payment of health insurance premiums by unemployed individuals.
- Payment of qualified higher education expenses (IRAs).
- First time home purchase.
- Section 404(k) stock dividends.
- Tax levies.
- Individuals called to active duty-qualified reservist distribution.

Since the first five listed above are the most commonly utilized we will give a brief overview of each of them.



Attainment of age 59 ½

The 10% penalty does not apply to any distributions which are *made on or after the date* that the account owner attains the age of 59 ½. However, as an educated advisor you would want to remember that this amount is still subject to income tax, to the extent that it is included in the gross income.

Death

The 10% penalty does not apply to early distributions which are made to a beneficiary (or the estate) on or after the death of the individual. This exception applies regardless of the beneficiary's age and the type of plan involved, whether it is an employer sponsored plan or an IRA.

Be aware of the spousal rollover trap. If a surviving spouse takes the death benefits inherited from the deceased spouse and rolls the funds over into their own IRA, then these rolled over funds *do not* qualify for the 10% early withdrawal penalty exclusion based on the first spouse's death. This is because once rolled into the surviving spouse's name, the funds are no longer considered death benefits, instead they are treated as part of the surviving spouse's own IRA and any early distribution from the surviving spouse's IRA is subject to the 10% penalty rule.

Unless they qualify for an exception, a good alternative planning method would be to have the surviving spouse leave some or all of the funds in the deceased spouse's plan until they reach age 59 ½. Another method might be to take systematic substantially equal periodic payments to withdraw the funds.

Disability

If a taxpayer makes pre-59 ½ withdrawals after they have become disabled there is relief from the 10% penalty. Disabled is defined as "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment, which can be expected to result in death or to be of long-continued and indefinite duration." In order for a person to be considered disabled they must present proof of the existence of it in a form the IRS requires.

Early Retirement

The 10% penalty does not apply to distributions made to an employee after separation from service after attainment of age 55. Basically, this means that the 10% early withdrawal penalty does not apply to distributions which are made to an employee who has retired after turning 55. Keep in mind that this exception does not apply to IRA's but only to an employer's qualified retirement plan. The employer must be the plan sponsor of the plan from which the separated employee is now making withdrawals. The employee does not need to be 55 in the year he separates from service; rather *they need to turn 55 in the year in which they separate*. Again the employee needs to turn 55 in the year in which they separate from service. Keep in mind this exception does not apply to IRAs.



Series of Substantially Equal Periodic Payments

This exception can prove to be the most beneficial one out of the above list. Generally speaking when a person retires prior to age 59 ½ and rolls their funds into an IRA, they qualify for the IRS 72(t) penalty. The SEPP exception applies to qualified plan assets, but it applies only if the participant has separated from service. Thus, an employee can use a strategy to convert their qualified retirement assets into an IRA and then take the IRS 72(t) exception. By utilizing this strategy the employee is able to make pre- 59 ½ withdrawals from their retirement assets without incurring the 10% penalty.

The SEPP exception states that a taxpayer is able to withdraw equal or substantially equal amounts from a deferred account (IRA) on an annual basis, for a period based on the IRA owner's life expectancy or the joint life expectancy of the owner and their designated beneficiary, without having to pay the 10% penalty. Lastly, the amount taken as a withdrawal cannot be modified until the later of the taxpayer attains age 59 ½ or five years elapses.

Required Minimum Distributions

The laws that regulate retirement funds allow the primary benefit of tax-deferred savings to provide a major incentive for people to save for retirement and thereby allowing those funds to grow in a tax deferred situation during the taxpayers working years. However, the law does not allow this delay in taxation to continue indefinitely. The law requires that the distribution of these funds from a qualified plan or IRA upon the occurrence of certain events, such as the plan participant or IRA owner attaining a certain age or following the participants or IRA owners death. The main purpose for these distribution requirements is to assure that previously untaxed retirement funds will be taxed at some point.

General Guidelines for RMDs

RMDs may not have to begin until age 70 ½ or death. An important element to note, is that one needs to have a designated beneficiary to insure that the right beneficiary is named and that distributions are stretched and taxes can be deferred as long as possible.

RMD's Must Be Considered When:

- A plan participant or IRA owner reaches age 70 ½, however, RMD doesn't apply to Roth IRA's until after the death of the IRA owner.
- When a plan participant retires, if that is later than reaching age 70 ½.
- After a plan participant or IRA owner dies.



Advantages

- Planning for RMDs enables a plan participant or IRA owner to stretch distributions over as long of a period of time as possible, thereby deferring tax on amounts that have been distributed.
- Planning for RMDs needs to be coordinated with overall retirement, financial and estate planning.

Disadvantages

- Failure to make RMDs can result in a 50% penalty tax; therefore, it is important that RMDs be made in accordance with the guidelines.
- Not planning for RMDs may require that distributions be made sooner than otherwise required, and tax deferral shortened.

Distributions

RMDs generally are minimum amounts that a retirement plan account owner must withdraw annually starting with the year that he or she reaches 70 ½ years of age or, if later, the year in which he or she retires. However, if the retirement plan account is an IRA or the account owner is a 5% owner of the business sponsoring the retirement plan, the RMDs must begin once the account holder is age 70 ½, regardless of whether he or she is retired.

Retirement plan participants and IRA owners are responsible for taking the correct amount of RMDs on time every year from their accounts, and they face stiff penalties for failure to take RMDs.

When a retirement plan account owner or IRA owner dies before RMDs have begun, different RMD rules apply to the beneficiary of the account or IRA. Generally, the entire amount of the owner's benefit must be distributed to the beneficiary who is an individual either (1) within 5 years of the owner's death, or (2) over the life of the beneficiary starting no later than one year following the owner's death. **See Publication 590 , *Individual Retirement Arrangements (IRAs)*, for complete details on when beneficiaries must start receiving RMDs.**

What types of retirement plans require minimum distributions?

The RMD rules apply to all employer sponsored retirement plans, including profit-sharing plans, 401(k) plans, 403(b) plans, and 457(b) plans. The RMD rules also apply to traditional IRAs and IRA-based plans such as SEPs, SARSEPs, and SIMPLE IRAs.

The RMD rules also apply to Roth 401(k) accounts. However, the RMD rules do not apply to Roth IRAs while the owner is alive.



When is the deadline for receiving a RMD from an IRA?

An account owner must take the first RMD for the year in which he or she turns 70 ½. However, the first RMD payment can be delayed until April 1st of the year following the year in which he or she turns 70 ½. For all subsequent years, including the year in which the first RMD was paid by April 1st, the account owner must take the RMD by December 31st of the year.

How is the amount of the RMD calculated?

Generally, a RMD is calculated for each account by dividing the prior December 31st balance of that IRA or retirement plan account by a life expectancy factor that IRS publishes in Tables in Publication 590, Individual Retirement Arrangements (IRAs). There are three separate tables:

The Joint and Last Survivor Table is used by an account owner whose sole beneficiary of the account is his or her spouse and is more than 10 years younger than the account owner;

The Uniform Lifetime Table is used by account owners whose spouse is not the sole beneficiary or whose spouse is not more than 10 years younger; and

The Single Life Expectancy Table is used by a beneficiary of an account.

See the available worksheets to calculate required minimum distributions.

Can an account owner just take a RMD from one account instead of separately from each account?

An IRA owner must calculate the RMD separately for each IRA that he or she owns, but can withdraw the total amount from one or more of the IRAs. Similarly, a 403(b) contract owner must calculate the RMD separately for each 403(b) contract that he or she owns, but can take the total amount from one or more of the 403(b) contracts.

However, RMDs required from other types of retirement plans, such as 401(k) and 457(b) plans have to be taken separately from each of those plan accounts.

Who calculates the amount of the RMD?

Although the IRA custodian or retirement plan administrator may calculate the RMD, the IRA or retirement plan account owner is ultimately responsible for calculating the amount of the RMD

Can an account owner withdraw more than the RMD?

Yes.



What happens if a person does not take a RMD by the required deadline?

If an account owner fails to withdraw a RMD, fails to withdraw the full amount of the RMD, or fails to withdraw the RMD by the applicable deadline, the amount not withdrawn is taxed at 50%. The account owner should file Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, with his or her federal tax return for the year in which the full amount of the RMD was not taken.

Can the penalty for not taking the full RMD be waived?

Yes, the penalty may be waived if the account owner establishes that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall. In order to qualify for this relief, you must file Form 5329 and attach a letter of explanation. See the instructions to Form 5329 for all the rules on how to apply for this waiver.

****The above information was obtained from the IRS.gov web site 3/16/11.**

The Future Trends in Retirement Planning

2011 ushers in the beginning of the baby boomers entering into retirement, estimates state that now about every 7 seconds a person turns 65 in the USA. This means many trend changes over the next few years, and these trends will continue to impact the economic landscape as well as the way we plan for retirement income.

One of these “trends” is the definition of retirement itself, no longer do we see people make it till 65 and then retire and pass away a few years later. In the past retirement meant a complete separation from employment, a possible relocation to a warmer location, and a sedentary lifestyle. Like other landscapes, the baby boomers have changed this definition to mean working longer, more working independence and an active lifestyle completed by a longer lifespan. These factors heighten the need for meticulous retirement income planning and strategies. Retirement now means financial independence. This shift in demographics and longevity means managing retirement income is distinguished from managing wealth accumulation.

The Financial Services Industry

The big question we all probably have is what will this industry look like in 10 years? Well we don't really know, but what we do know is what it looks like now, and what the newer trends are. We understand that the financial services industry is traditionally defined as an industry that helps people to plan for and deal with complex financial decisions that will directly impact their lives.



Clients now need advisors who are skilled in several areas, such as:

- Investment Management.
- Risk Management.
- Tax.
- Estate Planning.
- Income Planning.
- Accumulation and Loss Prevention.

Clients will now typically choose a trusted advisor in one of these fields as the initial go to person. We also see a strong trend suggesting people are seeking out advisors associated with a firm of professionals rather than an individual. Financial planning firms, risk management firms, banks, lawyers or even CPAs are seeing an increase in demand from the individual client sector.

Resources

www.socialsecurity.gov

www.Medicare.gov

www.IRS.gov