Considerations for Getting and Keeping Your Financial House in Order

How should I manage my retirement plan?

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Tips from the Trenches features practice management issues, and is written exclusively for PM by members of the Institute for Podiatric Excellence and Development (IPED). IPED's mission is to motivate, inspire, and synergistically bridge the gap between students, residents, new practitioners, and seasoned veterans in the field of podiatric medicine. They are committed to the idea that mentors with passion to share and mentees eager to learn make a powerful combination that allows IPED to bring and renew a full life to podiatric physicians, their practices, and their well-being throughout the U.S. and beyond. Visit www.podiatricexcellence.org.

Employer-sponsored retirement plans are more valuable than ever. The money in them accumulates tax deferred until it is withdrawn, typically in retirement. Distributions from a tax-deferred retirement plan such as a 401(k) are taxed as ordinary income and may be subject to a 10% federal income tax penalty if withdrawn prior to age 59½. And contributions to a 401(k) plan actually reduce your taxable income.

But figuring out how to manage the assets in your retirement plan can be confusing, particularly in times of financial uncertainty.

Conventional wisdom says if you have several years until retirement, you should put the majority of your holdings in stocks. Stocks have historically outperformed other investments over the long term. That has made stocks attractive for staying ahead of inflation. Of course, past performance does not guarantee future results.

The stock market has the potential to be extremely volatile. The return and principal value of stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Is it a safe place for your retirement money? Or should you shift more into a money market fund offering a stable but lower return?

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And will the instability in the markets affect the investments that the sponsoring insurance company uses to fund its guaranteed interest contract?

If you're participating in an employer-sponsored retirement plan, you probably have the option of shifting the money in your plan from one fund to another. You can reallocate your retirement savings to reflect the changes you see in the marketplace. Here are a few guidelines to help you make this important decision.

Consider Keeping a Portion in Stocks

In spite of its volatility, the stock market may still be an appropriate place for your investment dollars, particularly over the long term. And retirement planning is a long-term proposition.

Since most retirement plans are funded by automatic payroll deductions, they achieve a concept known as dollar-cost averaging. Dollar-cost averaging can take some of the sting out of a descending market.

Dollar-cost averaging does not ensure a profit or prevent a loss. Such plans involve continuous investments in securities regardless of the fluctuating prices of such securities. You should consider your financial ability to continue making purchases through periods of low price levels. Dollar-cost averaging can be an effective way for investors to accumulate shares to help meet long-term goals.

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Diversify

Diversification is a basic principle of investing. Spreading your holdings among several different investments (stocks, bonds, etc.) may lessen your potential loss in any one investment.

Do the same for the assets in your retirement plan.

Keep in mind, however, that diversification does not guarantee a profit or protect against investment loss; it is a method used to help manage investment risk.

Find Out About the Guaranteed Interest Contract

A guaranteed interest contract offers a set rate of return for a specific period of time, and it is typically backed by an insurance company. Generally, these contracts are very safe, but they still depend on the security of the company that issues them.

If you're worried, take a look at the company's rating. The four main insurance company rating agencies are A.M. Best, Moody's, Standard & Poor's, and Fitch Ratings. A.M. Best ratings are based on financial conditions and operating performance; Fitch Ratings, Moody's, and Standard & Poor's ratings are based on claims-paying ability.

Periodically Review Your Plan's Performance

You are likely to have the chance to shift assets from one fund to another. Use these opportunities to review your plan's performance. The markets change. You may want to adjust your investments based on your particular situation.

How Can I Upgrade My Insurance—Tax-Free?

Responding to the changing needs of consumers, the life insurance industry has developed some alternatives that go much further in satisfying a variety of financial needs and objectives than some of the more traditional types of insurance and annuities.

Advancements

Modern contracts offer much more financial flexibility than traditional alternatives do. For example, universal life and variable universal life insurance policies allow policy owners to adjust premiums and death benefits to suit their financial needs.

Modern contracts can also provide much more financial control. Whereas traditional vehicles, such as whole life insurance and fixed annuities, provide returns that are determined by the insurance company, newer alternatives enable clients to make choices that help determine returns. For example, variable annuities and variable universal life insurance allow investors to allocate premiums among a variety of investment subaccounts, which can range from conservative choices, such as fixed-interest and money market portfolios, to more aggressive, growth-oriented portfolios. Returns are based on the performance of these subaccounts.

There are contract limitations, fees, and charges associated with variable annuities and variable universal life insurance, which can include mortality and expense risk charges, sales and surrender charges, investment management fees, administrative fees, and charges for optional benefits. Withdrawals reduce annuity contract benefits and values. Variable annuities and variable universal life insurance are not guaranteed by the FDIC or any other government agency; they are not deposits of, nor are they guaranteed or endorsed by, any bank or savings association. Any guarantees are contingent on the claims-paying ability of the issuing company.

Withdrawals of annuity earnings are taxed as ordinary income and may be subject to surrender charges plus a 10% federal income tax penalty if made prior to age 59½. The investment return and principal value of an investment option are not guaranteed. Because variable annuity subaccounts fluctuate with changes in market conditions, the principal may be worth more or less than the original amount invested when the annuity is surrendered.

The cash value of a variable universal life insurance policy is not guaranteed. The investment return and principal value of the variable subaccounts will fluctuate. Your cash value, and perhaps the death benefit, will be determined by the performance of the chosen subaccounts. Withdrawals may be subject to surrender charges and are taxable if you withdraw more than your basis in the policy. Policy loans or withdrawals will reduce the policy's cash value and death benefit and may require additional premium payments to keep the policy in force.

There are differences between variable- and fixed-insurance products.

Effective estate planning should address wealth transfer from a practical and cost-effective approach.

Variable universal life insurance offers several investment subaccounts that invest in a portfolio of securities whose principal and rates of return fluctuate. Also, there are additional fees and charges associated with a variable universal life insurance policy that are not found in a whole life policy, such as management fees. Whole life insurance offers a fixed account, generally guaranteed by the issuing insurance company.

A Dilemma

So, what should you do if you want to cash out of your existing insurance policy or annuity contract and trade into one that better suits your financial needs, without having to pay income taxes on what you've accumulated?

One solution is the "1035 exchange," found in Internal Revenue Code Section 1035. This provision allows you to exchange an existing insurance policy or annuity contract for a newer contract without having to pay taxes on the accumulation in your old contract. This way, you gain new opportunities for flexibility and tax-deferred accumulation without paying taxes on what you've already built up.

The rules governing 1035 exchanges are complex, and you may incur surrender charges from your old policy or contract. In addition, you may be subject to new sales and surrender charges for the new policy or contract. It may be worth your time to seek the help of a financial profession-

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al to consider your options.

Variable annuities and variable universal life insurance are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the variable annuity and variable universal life contract and the underlying investment options, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

Could My Family Benefit from a Family Limited Partnership?

Effective estate planning should address wealth transfer from a practical and cost-effective approach. One estate planning strategy that families with closely held businesses should consider is the family limited partnership.

What Is a Family Limited Partnership?

A family limited partnership is a partnership agreement that exists between family members who are actively involved in a trade or business. The partnership divides rights to income, appreciation, and control among the family members, according to the family's overall objectives. Under family partnership rules, the "family business" can include real estate or investments.

How Is This Arrangement Achieved?

Under the most common form of family partnership, you would begin by creating general and limited partnership interests in your business. Once the partnership is established, you then gift the limited partnership interests to your children.

By holding the general partnership interest, you are considered the "general partner" and maintain control over the enterprise. Your children are the "limited partners," and the limited partnership interest lets them share in the ownership of your business as well.

A Sound Strategy for Transferring Ownership

A family limited partnership enables you to provide your children with an interest in your business while achieving many goals. First, you can gauge whether or not they possess suitable ownership abilities by involving them in the business. Second, it removes the asset from the parents 'estate, thus lowering the estate tax liability, if properly executed. In addition, you can transfer the limited partnership interests in increments over time, resulting in a gradual, systematic transfer of ownership. Finally, and perhaps most importantly, there may be immediate income tax benefits.

Estate Tax Savings

The interests transferred to your children, including all appreciation since the transfer, escape inclusion in your estate when you die. Only the value of the taxable gift(s) will be included. This can result in estate tax savings down the road.

The Benefits of Leverage

By giving the partnership interests in increments over time, you can take maximum advantage of the $14,000 annual gift tax exclusion. The exclusion increases to $28,000 if you're married and if each spouse elects to give the maximum amount. The gift tax exclusion is indexed for inflation.

In addition, "minority discounts"—allowable reductions to the value of the gift because it is a minority interest—can lead to greater leverage of the annual exclusion and the unified credit. For instance, you may be able to discount the value of the gift up to 30 percent or more. However, in order for the discount to be valid, there must be a legitimate business reason for the partnership.

Generally, your wish to keep the business in the family is a legitimate reason to set up a partnership agreement—as long as you are joined together for the purpose of enterprise and not just to avoid taxes.

Income Tax Benefits

Aside from the estate planning advantages, the family limited partnership can result in substantial income tax savings. By including your children as partners and sharing partnership income with them, total family taxes may be reduced.

You should be aware, however, that if the income is unearned and the recipient is under age 14, "kiddie tax" rules will apply.

Other Opportunities Can Serve Your Family

In addition to family limited partnerships, there are other arrangements that can serve family interests:

Family partnerships are arrangements under which each partner must play a role in the management and day-to-day operations of the business. Many of the benefits are similar to that of a limited partnership, but the family members accept more liability and will be more involved in the business. As managing partner, however, you must always receive a minimum income share that is proportional to the value of your services.

In addition, minors typically cannot be partners unless there is someone who controls the interest for the minor.

Investment partnerships are partnerships that hold nonbusiness assets such as securities and real estate that are likely to grow in value. Families can base a limited partnership on an investment partnership. In some cases, however, the arrangement would be considered an investment company, and gains and losses will be realized on the transfer of property to the partnership. Normally, under partnership rules, gains and losses are not realized when transferred to the partnership.

Seek Professional Guidance

The benefits of the family limited partnership can be significant. But they can only be realized if the arrangement is valid under the requirements of the IRS. There are costs and expenses associated with the creation of these legal instruments. Consult a qualified legal or tax advisor if you think your family could benefit from a family limited partnership. **PM**

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