Charlene K. Dolan
CERTIFIED FINANCIAL PLANNER™
978.388.3468
43 Paige Farm Road, Amesbury, MA 01913
plan@dolanfinancialservices.com
www.focusonfinancialfreedom.com

FOCUS ON FINANCIAL FREEDOM℠

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The Basics of Estate Planning

Don't let the changing estate tax laws prevent you from getting your estate in order. Even if you don't think your estate will be subject to estate taxes, there are other reasons to plan your estate, such as to make sure your assets are distributed according to your wishes and to name guardians for minor children. While most people will need the help of professionals to develop a formal estate plan, you can aid the process by organizing information and making some basic decisions. Consider these steps:

Calculate your estate's value. In addition to assets you currently own, include assets your estate will acquire after your death, such as life insurance proceeds and pension benefits. For each asset, list the estimated current market value, how the asset is titled, and any beneficiaries. Also list any debts that will have to be paid from those assets. Subtracting the debts from the assets will give you an estimate of your estate's current value.

Determine your estate planning objectives. Decide who should inherit your assets and how and when those assets should be distributed. You can bequeath assets outright, giving heirs immediate control, or you can place assets in trust, so you control how and when they are distributed. Business owners should also consider succession planning for the business.

Decide who will assist in carrying out your estate plan. Several individuals will be key:

❍ An executor (or personal representative) administers your estate through probate court, locates and values all assets, pays your

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Welcome!

Welcome to the first issue of Dolan Financial Services' quarterly newsletter, *Focus on Financial Freedom*℠.

Whether you handle your financial affairs independently or in conjunction with a financial professional, successful management of your finances today is the key to enjoying your ideal lifestyle tomorrow.

At Dolan Financial Services, we take the time to guide you toward your personal vision of financial freedom. Together, we establish meaningful and realistic financial goals that provide focus for the future while balancing your needs in the present. These goals are the foundation for a customized financial strategy designed to help you realize the financial future you envision.

We take a holistic approach to financial services and recognize that change is constant and inevitable. Our personalized, adaptive approach allows us to uniquely tailor your financial strategy as changes arise in your health, family, personal, and professional life. By establishing an open and honest dialogue early on, Dolan Financial Services helps to ensure that your personal path to financial freedom can withstand the impact of these changes.

Change is also a constant in the financial services field. We strive to provide you with timely information and analysis on key topics and issues relevant to you. This newsletter is just one way that we facilitate an open and informed dialogue.

Your input and questions are welcome and will help frame the content of future issues. I look forward to hearing from you.

Charlene K. Dolan

Estate Planning

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estate's obligations, and distributes assets to your heirs.

- ❍ A trustee manages your trust and distributes the income and principal to heirs.
- ❍ A guardian cares for your minor children. You may decide to elect one guardian to physically care for your children, while another guardian manages their assets.
- ❍ Consider a durable power of attorney, which gives an individual you select the power to take over your finances if you become incapacitated.
- ❍ Consider a health care proxy to delegate health care decisions to a third person in the event you are unable to make those decisions.

In all cases, name your first choice and at least one successor.

Review options to minimize estate taxes. With the estate tax exclusion amount and the maximum estate tax rate changing significantly over the next few years, the amount of estate taxes your estate will owe depends on the year you die. Since that can't be predicted, your estate plan will need to provide flexibility. Consider the following strategies:

- ❍ Trusts are versatile estate planning tools that can be used for a variety of purposes, including to reduce estate taxes, to control asset distribution, to make gifts to charities, to provide for the possible incapacity of the creator, to protect heirs, to avoid probate, to provide professional management of assets, or to make provisions for minors. There are a wide variety of trusts, so you should review which ones may be appropriate for your circumstances.
- ❍ The unlimited marital deduction allows you to leave any part of your estate to your spouse without paying estate taxes. That doesn't mean that leaving all your assets to your spouse is the best strategy for your estate. Your estate may reduce estate taxes if you distribute some assets to other heirs, either outright or through a trust, to utilize some or all of your estate tax exclusion.
- ❍ You can make annual tax-free gifts (up to $12,000 in 2008 or $24,000 if the gift is split with your spouse) to each of any number of individuals. These annual gifts are not counted as part of your lifetime gift tax exclusion of $1,000,000. Over a number of years, an annual gifting program can remove significant assets from your estate.
- ❍ If you can't totally avoid estate taxes, make provisions for the payment of those taxes. Many large estates are cash poor, making it difficult for heirs to pay estate taxes. You may want to obtain a life insurance policy to help fund those taxes. If properly structured, your beneficiaries may receive the proceeds free of income and estate taxes.

Please call if you'd like to discuss your estate planning situation in more detail. ❍❍❍

Your Estate Plan

Usually, a great deal of thought and effort goes into estate planning documents. However, your work isn't over once you've signed those documents. Some problems to look out for include:

- ❍ **Your assets aren't titled properly to fund trusts.** A common estate planning strategy used to preserve your estate tax exclusion is to set up a credit shelter or bypass trust. Assets up to the estate tax exclusion amount ($2,000,000 in 2008, scheduled to increase to $3,500,000 in 2009) are placed in a trust. Your spouse can then use the income and even some of the principal, with the remaining assets distributed to your beneficiaries after your spouse's death. To fund the trust, however, you need sufficient assets titled only in your name. Assets jointly owned with your spouse will typically pass directly to your spouse and cannot be placed in the trust. However, you may want to split assets so each of you individually owns assets designated to go into the trust. Residents of community-property states should review their state laws carefully, since they typically have more flexibility when using assets to fund trusts.
- ❍ **Beneficiary designations contradict your estate planning documents.** Assets like life insurance, annuities, 401(k) plans, and individual retirement accounts pass directly to named beneficiaries. Provisions in your will and other estate planning documents cannot change those designations. Thus, review all your beneficiary designations to ensure those designations are compatible with your estate plan. Also review contingent beneficiaries, in case a beneficiary dies before you.
- ❍ **Owning assets jointly with just one child.** Often, a widow or widower will add one child to bank accounts, brokerage accounts, deeds, and titles so that child can help manage the assets if he/she becomes incapacitated. The widow or widower expects the child to share the assets with his/her siblings. However, the asset is considered a gift to the one child. For that child to split the asset with his/her siblings, he/she will have to make gifts to those siblings, possibly raising gift tax implications. Instead, consider using a power of attorney, so the one child can help with your financial affairs. Or, make a provision in your estate planning documents that adjusts distributions for any assets that pass to one heir through joint ownership. ❍❍❍

Stretching Your IRA

Individual retirement accounts (IRAs) are usually viewed as retirement planning vehicles. But with increased contribution amounts and the ability to roll over 401(k) balances to an IRA, many IRA owners are finding they won't use the entire IRA balance for retirement. Thus, IRAs are increasingly becoming major estate planning tools. When used for estate planning, the goal is to extend the IRA's life as long as possible so that beneficiaries can benefit from the t ax-deferred (for traditional IRAs) or tax-free (for Roth IRAs) growth. How can you accomplish that?

Assume you have a large traditional IRA balance, which includes a rollover from your 401(k) plan. You don't have to start taking distributions until age 70 1/2. Then, you only take required minimum distributions calculated based on your life expectancy. When you die, you leave the IRA to your spouse, who rolls the balance over to his/her own IRA and names his/her own beneficiaries, perhaps your children or grandchildren. Your spouse delays distributions until age 70 1/2 and then only takes required distributions. When your spouse dies, your children inherit the IRA, which can be divided into separate IRAs for each child. Each child can then take distributions based on each of their life expectancies and can name their own beneficiaries. When your children die, their beneficiaries cannot reset the distributions based on their life expectancy, but the beneficiaries can continue to take distributions based on the previous owner's schedule until the IRA is depleted. By using this strategy and only taking minimum distributions when required, the balance can continue to grow on a tax-deferred basis for years or even decades.

The concept can be expanded further by converting a traditional IRA to a Roth IRA. Although income taxes will have to be paid on any amounts that would have been taxable when withdrawn (contributions and earnings in a deductible IRA and earnings in a nondeductible IRA), the income taxes can be paid with funds outside the IRA, leaving the IRA balance intact. While your adjusted gross income must be less than $100,000 (not counting the rollover) to convert, this requirement will be eliminated in 2010, allowing all taxpayers to convert from a traditional to a Roth IRA. Once the funds are in the Roth IRA, you do not have to take any withdrawals during your life. Since your spouse can roll the balance over to his/her own IRA, he/she would also not have to take withdrawals during his/her lifetime. When your spouse dies, his/her beneficiaries would then have to take distributions over their life expectancies, but qualified distributions could be taken free of federal income taxes.

Don't lose sight of the fact that your IRA's main purpose is to fund your retirement. It should only be used for estate planning purposes if you don't need the funds for retirement. Please call if you'd like to discuss this concept in more detail. ❍❍❍

Being Named a Guardian

When asked to serve as the guardian of someone's minor children in the event of his/her death, it is usually meant as a compliment. However, don't accept this role without giving it serious thought. Consider the following:

- **Are your lifestyles compatible?** Go over all details involved in raising the children. Will the children have to relocate far from their current home? It is difficult to lose parents, but it becomes even more traumatic when the children must relocate away from friends and school. What are the parents' preferences regarding education, religion, lifestyle, and other factors? How well does your family get along with their children? Consider the impact on your children, including the fact that you will probably have less time available for them.
- **How much financial support will be available?** This involves more than making sure money is available for college and other expenses directly attributable to the children, such as clothing, medical expenses, and entertainment. Additional children in your house will increase many of your bills, including food, utilities, transportation costs, etc. Your house may now be too small, requiring an addition or moving to a larger home.
- **Are you comfortable taking on responsibility for the children's finances?** Just because you agree to take physical custody of the children does not mean you have to handle their finances. You may feel more comfortable with another person involved to review how money is spent.
- **Has a contingent guardian been named?** Find out if a contingent guardian has been named in case you cannot serve. However, don't use this as an excuse to say yes when you really want to decline. It is better to indicate that you do not want to take on this responsibility now, so another guardian can be chosen. Also, if your situation changes in the future, inform the parents immediately. ❍❍❍

Taking Care of Your Children Financially

When caught up in the day-to-day routine of raising your children, it's easy to forget to take care of other financial decisions involving them, including:

- **Naming a guardian for your minor children.** If you and your spouse both die without naming a guardian in your will, the courts will appoint one and will supervise your children's property. You may want to consider naming two guardians — one to take physical care of your children and one to manage their assets. As your children grow, review your guardian choice every couple of years.
- **Purchasing sufficient insurance.** You should obtain enough life insurance to provide for your children until they are adults. Determine how much is needed for living expenses, hobbies, medical expenses, and college. Consider other items as well. For instance, will your guardian's home comfortably accommodate your children, or should you leave funds for an addition to the house? Include a financial cushion so there is plenty of money for unanticipated expenses. Also ensure you have adequate disability income insurance, so your family's lifestyle won't be disrupted if you have an injury or illness.

- **Saving for college.** Determine how much you need to save for your children's college educations. You may have difficulty saving the amount needed to fully fund a college education. However, there are other sources to help fund those costs, such as borrowing and financial aid. Thus, your goal may be to accumulate 30%, 50%, or some other percentage of the total cost of college. Take a look at education savings accounts and Section 529 plans, both of which offer significant tax advantages.
- **Teaching money basics to your children.** In a society that has difficulty managing money, teaching your children good money skills is a lesson that will benefit them for a lifetime. As you teach these lessons to your children, keep in mind that how you treat money is probably the most significant influence on your children's views about financial matters. If you make large purchases only after careful research and price comparisons, your children will learn to be careful before making a purchase. If you use credit cards cautiously and explain how to select a card, what items to charge, and how to pay off the balance every month, your children will learn not to abuse credit cards.
- **Saving for your retirement.** Don't feel guilty thinking about your own retirement when your children still need your help. One of the best gifts you can give your children is the knowledge that you will be financially independent during retirement.
- **Gifting assets to your children.** If you plan to leave assets to your children after your death, you may want to start making annual gifts, up to $12,000 in 2008 ($24,000 if the gift is split with your spouse), to any number of individuals without paying federal gift taxes. You can then teach your children how to handle those gifts and share in their joy from the gifts.
- **Calling for help.** The financial responsibilities involved in raising a child can seem overwhelming. Please call if you'd like assistance with these decisions. ❍❍❍

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Did You Know?

At the end of September 2007, nearly 4% of prime mortgages were past due or in foreclosure, the highest rate since 1998 (Source: *The New York Times*, February 2008).

Since 2005, the U.S. dollar has declined 36% against a basket of foreign currencies (Source: *Money*, 2007).

According to a recent report, the IRA audited 9.2% of taxpayers with incomes of $1 million or more in 2007, compared with 6.3% in 2006. However, fewer than 1% (0.9%) of tax returns filed by those earning less than $100,000 were audited, a nominal increase compared with 2006 (Source: Plansponsor.com, January 2008).

Grandparents earning $46,000 a year spend $600 annually on grandchildren, while those earning $75,000 or more annually spend $1,332. (Source: *Journal of Financial Planning*, January 2008).

When a recent survey of affluent households asked how much money it takes to be rich, 45% chose $5 million, 25% selected $25 million, and 8% picked $100 million. Only 22% said $1 million is enough to be rich (Source: Millionairecorner.com, 2008).

Only 26% of parents with children age five and older feel well prepared to teach their children basic personal finances (Source: Lenox Advisors, 2008). ❍❍❍