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Client Update

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Avoid Common Life Insurance Mistakes

Owning life insurance means protecting your loved ones from financial hardship. But some common mistakes may undermine your plan.

Most life insurance mistakes fall into three categories: thinking short term, owning the policy improperly, and failing to designate individual beneficiaries.

Thinking short term. Term insurance can fill specific short term financial needs, such as covering the years a mortgage will last or until children are finished with college. “Life insurance is best when it provides lots of options in the future,” says Jeffrey Marks, director of Northwestern Mutual’s Life Product department. You can build flexibility into life insurance while keeping initial costs down by buying term insurance that can be converted into permanent life insurance later on.

Ownership. If you personally own all of the insurance on your life, the proceeds will be included in calculating your potentially taxable estate. In 2005, the federal estate tax exemption is $1.5 million. Leave more, including any life insurance you own, and your estate will be subject to the estate tax. This potential tax trap can be sidestepped by having an irrevocable life insurance trust or a grown child own the policy on your life.

Beneficiary designations. If policy proceeds go to your estate, your heirs may face two problems. First, the proceeds may be subject to state inheritance taxes. Second, the proceeds will probably have to go through the time-consuming probate process instead of being paid directly and immediately to designated beneficiaries. To avoid both problems, designate both primary and contingent (“backup”) beneficiaries. That way, insurance proceeds will bypass your estate even if the primary beneficiary dies before you do.

Reviewing life insurance regularly will go a long way toward avoiding these problems and making sure coverage is adequate and up-to-date to meet your family’s needs.

Creative Living, Spring 2005

Revising Your Financial Plan Should Never End

If you haven’t done a formal financial plan, it’s time to do one.

But even if you have gone through the procedure, it may be time for a reassessment. Financial planning is an evolving process. Let’s assume for the sake of argument that:

- You’ve taken stock of what you have. You’ve assessed your assets, investments, retirement plans, debts, commitments, etc.
- You’ve set goals. You have a targeted retirement date and an estimate of your retirement needs.
- You’ve quantified the needs of your family in the event of your premature death or disability. You’ve estimated the cost of your children’s education and weddings.
- You’ve established a plan for achieving your goals, and you’re sticking with your plan. You have a budget. You save regularly, and you invest your savings in a tax-favored manner.
- You have sufficient insurance to cover your health needs, long-term care needs and disability income protection. You’ve insured your home and other valuable assets. Your life insurance is sufficient to

cover costs in the event of your death and to produce an investment portfolio sufficient to maintain your family in its customary style.

- ♦ You've written a will that disposes of your assets in the appropriate manner and restricts the government's role as a beneficiary of your estate by limiting the impact of estate and inheritance taxes.

If you can honestly say that the decisions you made the last time you revised your personal financial plan are still valid, you are in the minority. Most of us find that the simple passage of time causes our personal and family situations to change enough to warrant revisiting our earlier decisions.

And if you've experienced a "life event" since the last time you reviewed your plan, a current update is critical. Life events include birth, adoption, death, marriage, divorce, disability, retirement and job change within your family.

Has your employer made changes to its benefits package? Are your elections current? When was the last time you checked the beneficiary designations on your insurance, 401 (k) plan, etc.?

If you have a cafeteria plan, are your selections optimized? If both you and your spouse work, have you optimally coordinated your selections between the two employers?

Don't forget that the government has been active, even if your family hasn't been. Major changes to the income tax, estate tax and gift tax laws over the last few years call aspects of many personal financial plans into question.

If your will was drafted before 2001. It might as well be a hundred years old. It needs to be reviewed. We are ready to help you analyze your personal financial plan. Call us for assistance.

Financial Insights, Fall 2004

FSAs Get More Flexible

The Treasury Department and IRS are allowing employees an additional 2 _ months to use the money in their flexible spending accounts (FSAs) for health-care and dependent care expenses, provided employers amend their plans to allow the grace period. This concession, announced in Notice 2005-42, follows pressure from Congress to modify the FSA use-it-or-lose-it rule, which until now required employees to forfeit any salary-reduction contributions that were not used by the end of the plan year to reimburse qualifying expenses.

The use-it-r-lose-it rule was criticized for discouraging participation in FSAs and encouraging participants to incur unnecessary expenses at the end of the year to avoid forfeiture of unused contributions. When Senator Charles Grassley, Chairman of the Senate Finance Committee, asked Treasury Department Secretary John Snow to soften the impact of the use-it-or-lose-it rule, such as by allowing a $500 floor, the Treasury Secretary responded that only Congress could provide a dollar exception, but he signaled that Treasury might allow a brief grace period into the next plan year before forfeiture would take effect. This is what the Treasury and IRS have now done by issuing Notice 2005-42.

The grace period will apply to the current plan year if before the end of the plan year the employer amends the cafeteria plan document (which includes the FSA option) to allow it. The maximum grace period is 2 _ months following the end of each plan year. If the maximum is allowed, participants who have unused contributions of benefits at the end of the plan year will be able to apply them toward expenses incurred during the first 2 _ months of the next plan year. For example, if a calendar-year plan is amended before the end of 2005, employees with unused health FSA funds at the end of 2004 may use them to reimburse qualified medical expenses incurred during the grace period, from January 1 through March 15, 2006. If the expenses incurred by March 15, 2006, did not cover the unused amount from 2005, the balance would be forfeited to the employer. Unused health FSA amounts may only be applied to health expenses incurred during the grace period and not to dependent care or other expenses.

J.K. Lasser's Monthly Tax Letter June 2005

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