This Publication Brought to You Courtesy of:
LAURENCE M. SOBIN, CLU®, ChFC®
Sobin Financial Group
2100 Rachel Terrace, Suite 15
Pine Brook, NJ 07058-9329
Tel: (973) 276-9235
Fax: (973) 276-9234
Email: service@sobinfinancial.com
Web: www.sobinfinancial.com

An economic and investment update

THE FINANCIAL INSIDER

Securities and advisory services offered through Packerland Brokerage Services, Inc., an unaffiliated entity, Member FINRA & SIPC

Volume XXXIII, Number I

Choosing a Retirement Home: Location Matters

Retirees have many options when choosing where to live. While climate, proximity to family, and the cost of housing will likely factor into the decision about where to retire, prospective retirees should also take into account the amount of taxes they will owe in the state and town where they have their primary residence.

While not having to pay state income taxes may sound like a good deal, seniors who are thinking about relocating to states with low or no individual income taxes should keep in mind that these states usually collect other types of taxes, including property taxes, sales taxes, excise taxes, or taxes on investment income. Thus, in addition to looking at the income tax rate of their prospective destination, retirees should also factor in state taxes on pension and Social Security income, as well as state estate and inheritance taxes, state and local property taxes, and state and local taxes and fees on goods and services.

A recent study on the taxation of retirees in different states by accounting services provider CCH noted that, in 2011, seven states did not tax individual income: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. Meanwhile, New Hampshire and Tennessee impose income taxes only on dividends and interest, and a number of other states have relatively low income tax rates, including Arizona, New Mexico, and Pennsylvania.

In addition, while some states provide exemptions on all pension income or on all Social Security income, others have only partial exemptions, and still others tax all retirement income. According to the CCH analysis, Arizona, California, Minnesota, and Wisconsin

(Continued on page 6)

Checkpoints for Taking an Early Retirement

Have you ever entertained thoughts of taking an early retirement? Suppose you're age 55 and could take home a pension income that amounted to 60% of your pay if you retire now. If your income is high, it may seem that you would be able to retire in reasonable comfort. However, before calling it quits, weigh all of the facts *carefully* to be sure an early retirement makes financial sense for you. Here are eight rules to consider if you're thinking about taking an early retirement:

Rule #1: Weigh the pros and cons of retiring now or in the future. Retiring at age 55 with, hypothetically, 60% of your income may seem like a good deal at first. But if you wait until full retirement age, you will have another 10 years of full earnings under your belt, along with any pay increases from promotions, merit raises, and inflation. This will provide you with more money to save for retirement,

(Continued on page 8)

An Introduction to Split-Dollar Insurance

Contrary to what you may think, "split-dollar life insurance," is not an insurance policy, at least not in the classic sense. This type of arrangement allows two parties, typically an employer and an employee to "split the difference" of life insurance protection costs and benefits. The premium payments, rights of ownership, and proceeds payable upon the death of the insured are often split between the company and a key employee, or in many situations, the employer pays all or a greater part of the premiums in exchange for an interest in the plan's **cash value** and **death benefit**. Cash values accumulate, becoming security for repayment to the employer who is paying the majority of the premium. In this scenario, business owners have the opportunity to provide an executive with life insurance benefits at a low cost to the employee. Another option for companies to consider is to use split-dollar plans in place of insurance-funded **non-qualified deferred compensation plans**.

The split-dollar arrangement is attractive to employers because it provides a way to recruit and retain top performers. In turn, employees have the opportunity to acquire future protection with a flexible plan to meet their needs. In addition, this type of plan can also be used as a viable wealth transfer and estate planning strategy between a parent and child.

There are two basic types of split dollar life insurance plans: **Endorsement,** in which the employer owns the policy and reaps the benefits, while the employee chooses the beneficiary(ies) and how the death benefit is paid out; and **Collateral**, in which the employee owns the policy. In this situation, the employer's payments toward premiums are treated the same as interest-free "loans." The employee assigns the policy to the employer as collateral for these loans. Upon the employee's death, the loans are paid from the face value of the policy. Any proceeds that remain are paid to the beneficiary(ies).

The Way It Was

Split-dollar arrangements date back to the 1930s. Over time, the Internal Revenue Service (IRS) came to view any gain or equity from a split dollar plan, known as **equity collateral assignment split dollar**, as an interest-free loan, and therefore, taxable. The IRS regarded equity benefits as being profitable mainly for the party paying the lowest amount of the premium cost and sought more overall transparency by introducing new regulations.

In 2003, the IRS finalized the new regulations on split-dollar plans, which are still in effect today. While validating the use of split-dollar plans in estate planning between donors and donees, the changes have curbed the use of equity collateral assignment split dollar for funding non-qualified executive compensation.

Variations on a Theme

The following two tax regimes emerged from the 2003 IRS rulings and affect the structure of a split-dollar plan for business owners and estate plans, depending on who owns the plan:

1. An **economic benefit (**or **equity) regime** allows the business owner/employer or the donor of an estate to pay the annual premium as the owner of the insurance plan. Or, an **Irrevocable Life Insurance Trust (ILIT)** can be the plan owner whereby the gift of an economic benefit is made annually to the trust.

If an employer owns the plan, the employer's premium payments would provide equity or economic benefits that are taxable. For example, benefits could include an interest in the policy cash value or the cost of life insurance protection, and others.

2. In a **loan regime** business arrangement, if the employee owns the policy, the employer's premium payments are considered loans to the employee. Therefore, the employee would be taxed on the difference between the actual interest amount and the market rate of interest.

Look Before You Leap

It is important to note that a split-dollar life insurance arrangement requires specific adherence to complex tax rules and regulations. Be sure to consult with your team of qualified insurance, legal, and tax professionals to determine how split-dollar life insurance may benefit you, your company, or your key employees before establishing the plan. $

Financial Recordkeeping for Tax Purposes

Keeping thorough and accurate financial records is one of the less exciting tasks that business owners face, but it is a necessary one. In addition to enabling you to monitor the progress of your business and make informed decisions on a daily basis, keeping good accounting records is essential when it comes time to prepare your tax returns. While the smallest businesses may be able to get by with the "shoebox method," having in place a reliable and comprehensive financial recordkeeping system is crucial if you want your business to grow.

The types of accounting records you must keep are not mandated by law, but the Internal Revenue Service (IRS) demands that your recordkeeping system clearly shows your business' income and expenses. A failure to keep good financial records could result in underpayment or overpayment of taxes, penalties for filing late or for underpayment, and additional fees for tax preparation. Incomplete records can also present problems if your return is audited by the IRS.

Rather than relying on handwritten journals or ledgers, many businesses now use small business accounting software to keep track of their revenues and expenses. Relatively easy to use and generally affordable, a basic accounting software application will help you generate balance sheets, categorize transactions, track sales, record cash disbursements, manage payroll, create invoices, set up budgets, conduct your banking, and monitor tax liabilities. Your tax professional may be able to recommend an accounting software program that provides the level of functionality appropriate for your business.

But even the best electronic bookkeeping system does not eliminate the need for filing and storing paper receipts that may be necessary to substantiate deductions. In addition to recording transactions electronically, keep any printed documents that show the amounts and sources of gross income, such as invoices, cash register tapes, and credit card charge slips. The IRS may also want to see documents that show the amounts paid for purchases, such as canceled checks, credit card sales slips, and invoices.

It is especially important to have a paper trail when claiming deductions for certain types of expenses, such as business-related gifts, entertainment, travel, and meal expenses. In addition to keeping paper receipts, maintain a diary or calendar to record details of business meetings, including who was in attendance and what was discussed. While you are not required to keep receipts for entertainment and meal expenses of less than $75, you should still maintain written records of any meetings for which expenses are deducted. If you use your personal car for business part of the time, keep a log in the car that records mileage, tolls, and parking fees incurred in the course of business usage.

Documents relating to the purchase price of any assets owned by the business should be securely stored, as these will be needed to determine gain or loss when the assets are sold or to compute annual depreciation. Businesses with employees have additional obligations to keep track of all employment taxes, employee Social Security numbers, and W-4 certificates, as well as a history of wages and benefits paid.

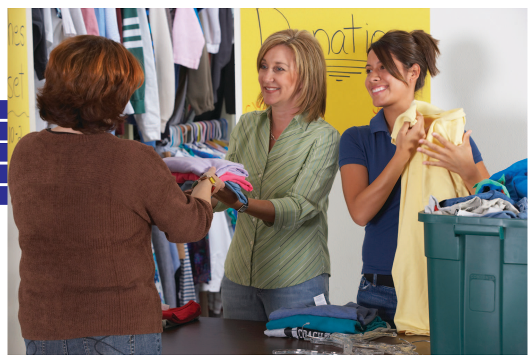
When a business-related transaction is conducted online, you may want to print out a record of the transaction and keep it on file. If you choose to store this data electronically, make sure backup copies of all important information are made and stored in a secure location.

Setting up a financial recordkeeping system for tax purposes may, at least initially, demand some extra effort on your part. But, in addition to maximizing your opportunities for deducting business expenses, getting into the habit of maintaining thorough and accurate accounting records can help you run your business more efficiently and make it easier to obtain additional financing when needed. $

What You Should Know about Charitable Giving

When you give $100 to your favorite charity, you are probably not overly concerned about how your donation is spent, as long as it advances the mission of the charity. On the other hand, if you are making a large donation, it is more likely that you have specific goals in mind, whether to fund a particular program or support another endeavor. This desire to specify exactly where your donation dollars will go may jeopardize your ability to claim an income tax deduction. Therefore, proper planning is essential.

If you want more control over how your donation is used, consider either **donor advised funds** or **private foundations**. Let's take a closer look at these two options.



Donor Advised Funds

Many larger public charities, particularly those that support a variety of different charitable activities and organizations, offer donor advised funds. This type of charitable giving vehicle is based upon an agreement between the donor and the charity stating that the charity will consider the donor's wishes with respect to the ultimate use of the donated funds. However, the agreement is non-binding, and the charity will exercise final control over the disposition of the funds, consistent with the organization's mission.

Private Foundations

A private foundation is a non-profit organization that typically has been created via a single donation from an individual or a business, and whose funds and programs are managed by its own trustees or directors. Through the choice of directors or trustees, the donor has greater control over the specific use of funds, rather than relying on a public charity. Private foundations generally fit into two categories: private operating foundations and private non-operating foundations. Private operating foundations actually run the charitable activities or organizations they fund, while private non-operating foundations simply disburse funds to other charitable organizations. A private foundation can also serve as a "family enterprise," whereby members of the family can work together in supporting charitable causes over the long term.

However, the benefit of increased donor control through the use of a private foundation may come at a price. The following rules are designed to ensure that private foundations serve charitable interests and not private interests:

- Private foundations are generally required to pay out for charitable causes at least 5% of their asset value annually or be subject to a penalty.
- Substantial penalties are imposed on transactions between the foundation and its donors or managers, although payment of reasonable salaries is permitted.
- Private foundations are generally prohibited from benefiting a private individual.
- A private foundation is responsible for ensuring that the funds it distributes to a private charity are expended properly. (Schools, hospitals, and religious institutions are examples of public charities, to which this does not apply.)
- An excise tax of up to 2% of investment income is imposed annually on investments.
- There are restrictions on the types of investments made by private foundations.

The deductibility of contributions to private foundations is more limited than for contributions to public charities. Depending upon whether cash or property is being donated, deductions to private foundations are limited to 20% to 30% of adjusted gross income, whereas deductions to public charities have higher limits of 30% to 50%. Finally, the administrative and legal costs of creating and managing a private foundation need to be considered.

Depending on the circumstances, a private foundation may allow for greater control over how your charitable donation is spent. It can be highly rewarding to be involved in charitable endeavors, however, be sure to consult your tax and legal professionals for specific guidance. $

Dividing Your Assets: A Practical Approach

When planning the division of your assets, you may believe in a policy of "share and share alike." This is perhaps the easiest method to avoid conflicts or complaints of favoritism. But does *equality* necessarily equate with *fairness*? Especially when you consider such factors as age, talents, skills, interests, needs, and degrees of material success.

An alternate approach to estate equalization is a division of assets that recognizes and supports the uniqueness and differences in the abilities and needs of your children, even at the risk of creating conflict. Through your estate plan, you have a chance to provide a degree of thoughtful and calculated support that your children may not otherwise experience.

Let's look at the following scenarios:

1. Disparity in Age: Assume you have two children, ages 22 and 14. Should you split your estate in half, even though your 22-year-old son has a private school education and college degree, while your 14-year-old son has just started high school?

2. Income and Net Worth: Your daughter becomes a partner in an investment banking firm and quickly builds up significant assets, while your son becomes an artist who is dependent on the sale of his artwork to make a living. Should you leave your estate in equal parts to your son and daughter?

3. Previous Giving: You have given your 24-year-old daughter $100,000 worth of stock in your business as an inducement for her to work with you. You have not, however, given your 18-year-old daughter a similar gift. Should you still divide the assets in your estate equally?

4. Investments Given to Children: You have given one child stock in Company ABC that has risen in value to $300,000, and another child stock in Company XYZ, which has gone bankrupt. How should you then allocate the balance of your assets?

In all of the above examples, an equal division of property has the potential to create or perpetuate unequal results. Of course, you may choose to divide your assets equally; however, it's important to be aware of all your options in estate planning.

Listen First

There are ways for you to achieve more equitable results. First, communicate with your children. You may choose to speak with each child individually or hold a family meeting. (You may serve as proxy for your young children.) Help them to express their hopes, dreams, and expectations, as well as their concerns and frustrations. By listening, you may gain the valuable insight needed to divide your estate without causing undue conflict or resentment. The decisions may be difficult, but in the long run, your estate plan may provide a certain degree of thoughtful support for your children. $

Your Family Business and Estate Planning

If you are like most entrepreneurs, you don't expect the business you worked so hard to establish to falter when you are no longer here to run it. But sometimes, when business owners die without leaving wills or estate plans, the business must be liquidated to pay the tax liability, or the company collapses because family members have not been sufficiently prepared to take over operations. If you own a family business, consider taking steps *now* to help ensure this valuable asset will remain intact for your children, grandchildren, and beyond.

Business Succession Planning

Business owners often fail to establish formal succession plans because broaching the

(Continued on page 7)

Choosing a Retirement Home: Location Matters

(continued from page 1)

are among the states that generally tax pension income. Along with the states that have no individual income tax, Pennsylvania and Mississippi fully exempt retirement income, and a number of other states offer partial exemptions, including Arkansas, Colorado, Georgia, and New York. Age restrictions may apply to these exemptions. However, some states specifically exempt U.S. military, Federal civil service, or state or local civil service pensions from income tax.

Although the majority of states tax pension benefits, the study found that only 14 states levy taxes on Social Security income, including Colorado, Connecticut, Kansas, Minnesota, and New Jersey. These states either tax Social Security income to the same extent as the Federal government, or they offer exemptions for taxpayers with lower adjusted gross incomes (AGIs). In addition, some states exclude portions of Social Security income from taxation based on the age of the taxpayer.

Property taxes and sales and use taxes vary widely depending on the state or locality, and can change substantially over time, especially as recession-hit states and towns raise taxes in an effort to fill holes in their budgets. All states except Alaska, Delaware, Montana, New Hampshire, and Oregon collect sales taxes. To complicate matters, state and local taxes may be levied not just on consumer goods, but on specific services, including landscaping, tax preparation and other professional services, medical care, and even personal services, such as haircuts and beauty treatments. A number of states exempt certain categories of food, drugs, and clothing from sales tax, but not others. According to an analysis of 2011 state tax rates by Vertex, Inc., Indiana, Mississippi, New Jersey, Rhode Island, and Tennessee had the highest sales tax rates at 7%, followed by Minnesota with a sales tax rate of 6.88%. Gas and other fuel taxes, as well as cigarette and alcohol taxes, can also vary widely, so retirees should factor in the amount of driving they expect to do, as well as their lifestyle, when choosing a retirement home.

Although property taxes can make up a substantial portion of a retiree's overall tax bill, many states and local jurisdictions offer breaks on property taxes to homeowners over the age of 65. States offer various forms of property tax relief to senior homeowners, such as "circuit breakers" that put a cap on the percentage of a taxpayer's income that must be paid in property taxes, and programs that lock in the assessed value of the property after the owner reaches a certain age, or that allow elderly homeowners to defer taxes until they move or die. Because property taxes can be volatile, particularly in areas with fluctuating home prices, retirees should examine carefully the development of property taxes over time, and the types of property tax relief available, in the area where they plan to settle.

For higher-income seniors, state estate taxes may also play a role in their choice of residence. A number of states levy estate taxes on top of the Federal estate tax, and several states also have an additional inheritance tax. New Jersey and Maryland have both estate and inheritance taxes. Retirees should also bear in mind that, in many states, these taxes are assessed on much smaller estates than those subject to taxation under Federal law. $

Naming a Trustee for Your Living Trust

A **trustee** is a person or institution selected to administer a **trust**. A trustee's role is to comply with the terms of the trust and fulfill its objectives. In selecting a trustee, you must weigh personal, financial, and professional concerns, according to the nature and the purpose of the trust. Since a **living trust** is intended to be in effect during your lifetime so that you can maintain control over your assets, you and your spouse may be ideal candidates for being named as trustees. Grown children may also be appropriate candidates.

There are numerous ways to use trusts to accomplish a variety of estate planning and financial objectives. For specific guidance, be sure to consult your financial, tax, and legal professionals. $

Your Family Business and Estate Planning

(continued from page 5)

subject can be unpleasant. Grooming a family member for succession can be equally challenging due to conflicting personal and professional relationships. In some cases, business owners may feel pressured by long-standing sibling rivalries or family disputes.

Developing a Formal Strategy

As difficult as business succession planning may be, the consequences of not establishing a continuation strategy may be even more costly.

Here are some suggestions for developing a formal succession plan strategy:

- Appoint a successor to take over as head of the company while you are still involved in the business, so that he or she can learn the business from you. Provide your successor with the mentoring and education needed to do the job, but also the opportunity to develop an individual leadership style.

- Consider your options for transferring business interests and control in the company to the next generation, such as making gifts of ownership interest, selling stock to your successors, setting up a stock redemption deal, or even starting a new business for your children.

- Prepare now to minimize the tax liability of your estate upon your death. Keep in mind that future changes in the tax laws will likely be of concern to your heirs. It is essential that you seek qualified professional advice on how best to plan your estate.

- Draw up a buy-sell agreement, which clarifies to whom, and at what value, your business should be sold in the event of your death or sudden departure. This agreement should be funded, usually with a life insurance policy, savings, or a loan.

Communication and Guidance

Business continuation can be a complicated and emotional experience for business owners. A dual strategy of open and honest communication with family members and guidance from a team of estate planning professionals may help maintain the success of your business and preserve your family's business ownership. $

Checkpoints for Taking an Early Retirement

(continued from page 1)

and ultimately, it may boost your Social Security and pension benefits. Also, if you consider the difference in the percentage you will receive now and in 10 years for example, 60% if you retire now versus 80% if you retire in 10 years, retiring now may not seem as attractive.

Rule #2: Remember to factor inflation into your decision. If you think you could manage on 60% of your income, remember that inflation will erode your pension. If you retire today and let's say you receive a pension income of $1,600 per month for life, in 20 years at a 4% rate of inflation, you'll have the equivalent of $707 in today's dollars.

Rule #3: Prepare for longevity. The longer you live, the more money you'll need in retirement. Due to increased longevity, an early retirement plan must include a budget to meet the financial needs of several decades beyond the normal retirement age of 65.

Rule #4: Evaluate other retirement income resources. If you already have a sizable nest egg, or if you expect to collect a pension from a previous employer, the amount of your *current* employer-sponsored retirement plan may not be as robust. If so, perhaps you can exit the labor force earlier because you have other sources of retirement income.

However, don't expect Social Security to provide most of your retirement income. The Social Security Administration (SSA) projects that benefits will replace about 40% of the average worker's pre-retirement income and retirees may need 70% or more of pre-retirement earnings to live comfortably (SSA, 2012). Also, since the future of Social Security and **Medicare** is uncertain, you may have to provide more funds for future health care expenses.

Rule #5: Part-time work. If you decide to leave your present job, will you be securing employment elsewhere until you permanently retire and start collecting your pension? Keep in mind that it may be difficult to find another equally high-paying position. Although the prospect of part-time work may make it possible to consider an early retirement option, be sure you can depend on a reduced part-time income until full retirement.

Rule #6: Be aware of the early retirement impact on Social Security benefits. If you are under full retirement age and continue working after you begin collecting Social Security benefits, you may have to "give back" a portion of your benefits. In addition, if you continue working after you begin collecting Social Security, a portion of your Social Security benefits might be taxed. The calculation to determine how much of your benefits will be included in your gross taxable income can be accessed online at the Social Security Administration's (SSA) website at www.ssa.gov.

Rule #7: Taking an early retirement before downsizing or layoffs occur. Is there a chance your company will lay you off if you do not elect to leave on your own? Many companies now lay off high earners as part of their cost-cutting measures. If your company is experiencing financial difficulties and downsizing appears imminent, you may get a better deal through early retirement than through the company's severance package.

Rule #8: Understand the potential tax consequences of early retirement. If you opt for early retirement, in some cases you may incur a 10% Federal income tax penalty for early withdrawals from a qualified plan. Keep in mind that withdrawals taken from an **Individual Retirement Account (IRA)** before age 59½ may also be subject to a penalty.

Early retirement may be a long-held dream and a financial possibility. But, before calling it quits, assess your situation carefully. You will have to live with the effects of your choice for the rest of your life. Take the time now to make sure it will be a smart decision in the long run. $