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financial strategies

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Financial Pathfinders
FOR ALL AGES

Regardless of the path your life takes, money will matter at every turn. Certain events, especially graduating from college and entering the world of work, marrying, having children, and retiring, all require *targeted* financial planning. Financial planning can involve tax and legal technicalities depending on how much money you have and its source, for example from a business, investments, or inheritance. If this sounds like your situation, you may benefit from some professional help.

Financial goals such as buying a house, often accompany significant life events, and should be in sync with some commonsense principles. These one-size-fits-all principles apply regardless of where you are in your life. Even better, when life throws you a curve ball, you'll be glad you stuck to these three simple rules:

1. Budget your money.
2. Keep an emergency fund. (One rule of thumb suggests three months' living expenses.)
3. Avoid debt.

From Campus to Cubicle

If you're a young adult starting your career, make paying off college loans a priority. And avoid the temptation of spending too much on rent: Some professionals suggest a limit of spending 30% of your gross monthly income on rent. For car payments and other short-term debt, including credit card bills or loans, the limit drops to 20% of your take-home pay.

At this stage, retirement is likely last on your list, but if your employer offers a retirement plan such as a **401(k)**—contribute. Payroll deductions make contributing relatively painless. Try to contribute the maximum allowed, especially if your contribution is matched by your employer. No retirement plan at work? Consider opening an **IRA** (Individual Retirement Account), if you're self-employed, that provides for *tax-deductible* contributions and *tax-deferred* earnings.

On the plus side, set some goals for making the most of your disposable income: You'll feel good when you've

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Ten Common ESTATE PLANNING MISTAKES

Whether your estate plan is simple or complex, many details can get overlooked and may undermine your plan's effectiveness. The following is a list of the 10 most common estate planning mistakes to avoid:

1) Titling property jointly with your children as a substitute for a will. Unlike a will, a transfer of an interest in your property is irrevocable, which may prevent you from changing the disposition if circumstances change before your death. Also, titling your personal residence jointly can result in partial loss of the capital gain exclusion if it is sold before your death.

2) Failing to plan for the possibility of children getting divorced or having problems with creditors. Parents often have cause to regret having made outright gifts to their child when the child subsequently divorces and the ex-son- or daughter-in-law is awarded an interest in the gifted property by a court, or when the property is taken pursuant to a legal judgment against the child. Such problems can be minimized through proper use of trusts or a business entity, such as an LLC.

3) Failing to make sure that all your assets will be passed on in accordance with your wishes after you die. Many types of assets (life insurance, IRAs, brokerage accounts) can pass to your heirs or others based on beneficiary designations. The provisions of your will cannot change a beneficiary designation. Remember to account for things you've already designated. You should review your will, as well as all beneficiary designations, when formulating your estate plan.

4) Underestimating the true value of your estate for Federal estate tax purposes. For instance, many people are unaware that the proceeds of life insurance on their lives are includable in their taxable estates if they own the policy. This could bring the total value of their estates to more than the amount sheltered from estate tax by the estate tax exemption—$10.86 million per married couple in 2015, which is annually adjusted for inflation.

5) Failing to consider state death taxes in light of recent changes in the law. Many states have "decoupled" their death tax from the Federal estate tax, which means your estate could be subject to death tax in a state even if no Federal estate tax is due. This could result in an unpleasant surprise at your death, one that might be avoidable with proper planning. The laws of each state where you own property should be carefully reviewed to determine the potential exposure to state death taxes and how to minimize them.

6) Being uninformed about recent legislation affecting the gift tax and estate tax amounts. As of January 2013, the American Taxpayer Relief Act (ATRA) provides a 40% tax rate and a unified estate and gift tax exemption of $5.43 million per individual and $10.86 million per married couple (adjusted annually for inflation). You can make yearly gifts up to the annual exclusion amount ($14,000 per person for gifts made by an individual and $28,000 for those made jointly by husband and wife) that don't count against your $5.43 million estate and gift tax exemption.

7) Failing to maximize the benefits of the income tax basis "step-up" at death. Low-basis/high-value assets should generally not be given away during your lifetime, since the basis for capital gain computation purposes will be increased to fair market value at death. If the asset is given away, the basis remains at the property's original cost.

8) Failing to indicate your desired funeral arrangements. A prearranged funeral can greatly relieve family members from additional stress after your death.

9) Failing to plan for disability. In the absence of adequate medical care directives, powers of attorney, or trusteeship of assets, costly and time-consuming court proceedings may be required in order to appoint a guardian or conservator to act on your behalf if you become disabled.

10) Not reviewing and updating your estate plan on a regular basis. Changes in the law and in your personal financial and family situation over time make it essential that you periodically review your estate plan to make sure it still carries out your wishes.

Be sure to consult with your qualified team of tax, legal, and financial professionals. Early and thorough planning can help you avoid these common mistakes, meet your financial goals, and leave a lasting legacy for your loved ones. **20/20**

You've Graduated: NOW IT'S PAYBACK TIME

It takes four years, on average, to graduate from most colleges and universities. During that time, students can accumulate a large amount of debt. For most, the degree is worth the burden of paying off student loans long after graduation. However, these questions remain: How should the debt be repaid? Are there any plans that can help make "payback" easier? What if a student can't find a job right away?

There are plans available that offer flexible payment schedules. Students applying for a Federal student loan can choose a **graduated repayment plan** that will allow them to make smaller payments upon graduation, and larger payments when they are earning more money in the workplace.

Students also have the choice of an **income-contingent repayment plan**. This plan requires them to pay a fixed percentage of their postgraduate income toward their student loan. This percentage could be approximately 5% to 10% of anything above the poverty level of a single person, which is $11,670, according to the Department of Health and Human Services poverty guidelines (HHS, 2014).

A third choice is an **extended repayment plan** that offers monthly payments and allows graduates to extend their loan payment schedules from 10 to 15, or even 20, years.

Deferment or forbearance may also be a temporary option for graduates in a financial bind due to unemployment or other extreme hardship. In select situations, borrowers may qualify for other repayment alternatives through their loan servicers.

Consolidation Offers Flexibility

For students who already carry a substantial amount of debt, existing loans can be *consolidated* with a direct loan from the government under the Student Loan Reform Act of 1993. This plan offers a more flexible repayment schedule while interest rates remain the same.

To be eligible for this plan, student loan recipients need to ask their original lender for an "income sensitive" repayment option. The plan adjusts the monthly payments for the loan's capital, but not the interest, to annual income. If the original lender will not agree to this option, the student may then be eligible for a direct loan from the government.

Two advantages of a direct government loan are as follows: First, the monthly installment payments of principal and interest are contingent upon income. Because the payments are withdrawn from wages, there's less paperwork. Second, as wages increase, the percentage withdrawn from pay will also increase, allowing the loan to be paid off more quickly and with less accrued interest.

For students who need to borrow for the current school year, direct loans (and the income-adjusted repayment plan) are also available if they're attending one of the schools participating in this plan. Parents may also be able to obtain a Direct PLUS loan for up to the entire cost of their children's college education.

For more information, contact the Federal Student Aid Information Center at 800-433-3243, or visit online at www.studentaid.ed.gov. **20/20**

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saved, rather than borrowed, for that ski vacation or sound system.

Settling Down

If settling down means marriage, you may now have two financial plans to combine, or at least reconcile. Budgeting, saving, spending, borrowing, investing—they all involve attitudes developed during childhood that may, or may not, be amenable to change. Keep in mind that marriage establishes a *legal* relationship and when you take on a spouse, you may be taking on debt. Ideally, you should start your new life together with a clear balance sheet.

You and your spouse will likely want to name each other as **beneficiaries** of **retirement accounts**, **annuities**, or **life insurance** policies. Agree where you'll keep such documents naming beneficiaries in the event of an emergency. If you have anything left after contributing the maximum to your retirement account, consider buying an annuity. Annuities can also let you defer taxes on earnings until some time in the future when you are not working and may be in a lower tax bracket.

Whether single or married, meeting financial goals such as buying a house or saving for retirement takes on greater importance as you take on adult responsibilities. The 30% rule for monthly rent payments also applies to that portion of your gross monthly income allocated to a mortgage payment.

Kids Up the Stakes

Although children present new and immediate demands on your time and your financial resources, having dependents will motivate you to focus on the future. In particular, you should have some type of plan to help finance college costs. The **529 savings plans** offered by some financial institutions allow you to defer taxes on earnings from money earmarked for a beneficiary's college costs. Many middle-aged adults feel torn between paying for their children's college education and saving for their own retirement. Starting early on both will help avoid this dilemma.

More immediate needs will be adequate life insurance and a will that names guardians for your minor children. And, consider talking with an attorney about an **estate plan** to avoid owing the Federal government too much in taxes and depriving your survivors of money they may need to live.

Taking Care of You

As you near retirement, think about the *type* of retirement you want to have—will it include travel, a part-time job, a second home in a better climate? And, what about the costs? Financial professionals counsel that maintaining a comparable lifestyle in retirement may require an income equal to about 70%-90% of your pre-retirement income. You will then need to compare that figure to income you can expect from retirement plans, savings, and Social Security.

Pre-retirement is also the time to look at your **investment strategy**. Given that you or your spouse may live into your 90s, you may need to invest some of your assets for growth. Relying on fixed income investments, such as bonds or certificates of deposits (CDs), may mean you risk running out of income.

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