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January 2019

THE OTHERS IN YOUR RETIREMENT

Congratulations! You've done a great job saving and planning for the future. The retirement that you envision is just over the horizon, so close you can almost taste it.

Uh, wait a minute.

It seems you may need to recalibrate.

Apparently, your retirement plans left out a few people. You may have thought you needed to save enough to provide an income for yourself, or if you're a couple, for the two of you. But more and more, it's possible that your savings may have to take care of others as well. According to a November 17, 2018, *Wall Street Journal* article:

> **There is a growing number of baby boomers who find themselves caring for both their elderly parents and their adult children, rather than kicking back at retirement age. They face the strain of constant caregiving and derailed dreams, as well as added expenses…**
>
> **A 2014 study by the Pew Research Center found 52% of U.S. residents in their 60s – 17.4 million people – are financially supporting either a parent or an adult child…(A)bout 1.2 million support both a parent and a child."**

What's Going On?

In the long view of human history, retirement, and planning for it, is relatively new. Until the early 20th century, most people worked as long as they had to, and then they died. The few who outlived their working years experienced something called "old age" – not "retirement" – and usually ended up being cared for by their extended families. In fact, the earliest nationally-administered pensions (beginning in Germany in 1889), were characterized as "old-age social insurance." They were intended to protect from poverty the few elderly who had exceeded life expectancy, not to fund a retirement filled with golf, grandchildren, travel, and volunteering.

But as more people lived longer, 65, once well past average life expectancy, became the age when you stopped working to enjoy your golden years. In the last half of the 20th century, this thing called "retirement" usually featured Social Security and an employer-funded pension. Personal savings was a supplement to retirement, not the source of it.

Besides having their retirement funded for them, this first generation of true retirees by and large didn't have to consider their parents; as a generation with shorter lifespans, many of them had already passed away. In contrast, the current retirees or about-to-be-retirees of the Baby Boom generation find a different scenario as they approach 65: many of their parents are still alive, and are now in old age, with the attendant need for support and assistance. And their numbers are growing each year. (See Fig. 1)

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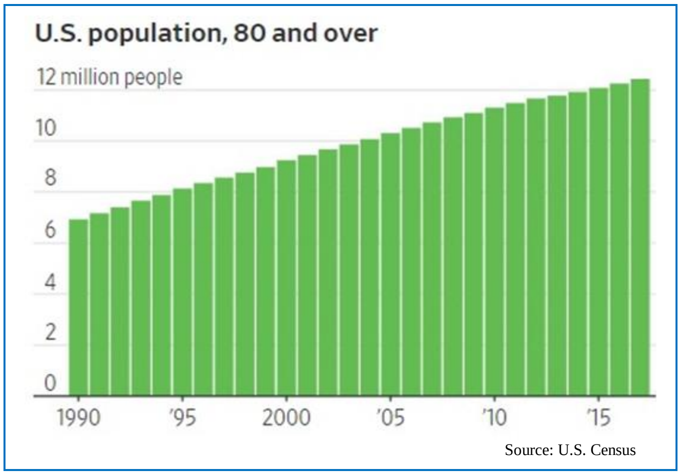
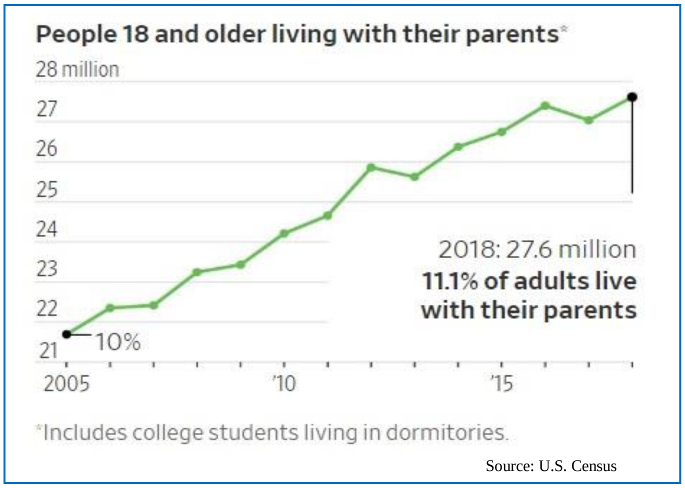
* The title of this newsletter should in no way be construed that the strategies/information in these articles are guaranteed to be successful. The reader should discuss any financial strategies presented in this newsletter with a licensed financial professional.



Source: U.S. Census

FIG. 1

At the same time, there has been a much slower transition to adulthood for the generations following the Boomers. For both social and economic reasons, these younger cohorts are slower to settle into careers, get married, or achieve financial self-sufficiency. Consequently, many Boomers have boomerang children: once sent out, they've come back. (See Fig. 2)



Source: U.S. Census

FIG. 2

Additionally, a growing number of retirees find themselves providing more than shelter and financial assistance for their adult children: In a second round of parenting, they either raise or provide regular child care for grandchildren.

Real Life: 10 Years of Plans Overwhelmed by Others

The *WSJ* article relates the circumstances of Barb and Brian, an Arkansas couple who meticulously mapped out a 10-year transition to retirement. The couple planned to convert their large home to a bed and breakfast, with a sound studio in the garage where Brian could record and produce music. After ten years of diligent preparation, they were almost ready to live their retirement dream.

But Barb's mother Marlene was in failing health and didn't have the financial resources to afford an assisted-living facility. Shortly before their anticipated retirement date, Marlene moved in with Barb and Brian, occupying a basement unit that had been renovated to a luxury suite with a kitchen, two bedrooms, and a living area.

Four months later, Barb's 25-year-old daughter Rebecca also returned home because of deteriorating physical and mental health. Rebecca receives only a small monthly Social Security disability payment, leaving Barb and Brian to "pay for clothes, housing, food, car insurance, and everything else that is beyond Rebecca's meager income."

To keep the family afloat, Barb has postponed her retirement indefinitely, while Brian stays home to be a "day-shift caregiver." Any retirement aspirations are on hold. "I can make all the plans in the world right now, and it doesn't mean anything," says Barb.

How Could This Change Your Retirement Planning?

The example above is unique, but not extreme. How many retirement plans are designed to accommodate the inclusion of other people? How many retirees could absorb these additional financial costs without incurring significant emotional and financial stress?

The very real possibility that others might impact your retirement might prompt a reassessment of your saving strategies and retirement plans. For example:

- **How much you save.** A retirement calculator can give you an estimate of how much you'll need to provide a regular income. But under these "other" scenarios, you might need more money, and perhaps the flexibility to spend chunks of it instead of just drawing a monthly check.

- **Where you save.** For savings in tax-deferred accounts like IRAs or 401(k)s, every dollar withdrawn in retirement adds to taxable income. That means unusual expenditures, like a large withdrawal to pay for an adult child's medical care, may also have large tax costs. And these extra withdrawals also increase the possibility of bumping into a higher marginal tax rate.

- **The percentage of saving you allocate to providing retirement income.** Every retirement plan has to consider irregular expenses and the reserves required to handle them. If you have saved $1 million, you can't allocate all of it to produce income; something has to be set aside for the unexpected. But how much? Adding another person to your retirement almost certainly lowers the amount available for retirement income.

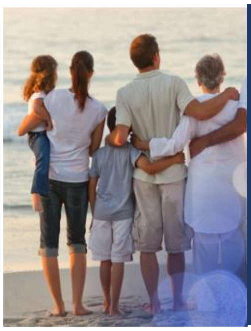
- **Where you live.** The retirement ideal of downsizing to a two-bedroom condo to rid yourself of homeowner responsibilities might not be the best plan if you end up adding others to your living arrangements. Staying in your current home might be more expensive, but also the most practical place to accommodate extended family.

You Must Look Downstream and Upstream

Narrowly-focused financial strategies sometimes overlook the fact that a household economy often has connections to others further downstream (parents) or upstream (children). This is especially true of retirement planning, where the emphasis is on saving enough to be able to retire. But beyond hitting your accumulation objectives, there may be other conditions lurking in your retirement future that must be addressed.

If you're over 50, you probably have a good idea as to whether your retirement could potentially include others. If it does, the financial challenges can be daunting. Adding others to your retirement could change everything – even your ability to retire.

And for most of us, saying "no" to others isn't an option. Because most likely, the others are family members. Love and loyalty usually compel us to forgo personal comfort to help them. Which is what good families do. ❖



In your particular circumstances, what does your downstream and upstream look like? If the view makes you uncomfortable, it might be a good reason to consult with your financial professionals about ways to make things flow more smoothly.

YOUR 2018 TAX RETURN:

Will you pay MORE or LESS?

Sometime before January 31st, annual tax statements, like W-2s, 1099s, and K-1s will fill your mailboxes (both real or digital). And shortly thereafter, you will find out whether the new tax laws which became effective January 1, 2018, will results in a bigger or smaller tax bill.

You may remember that last year's rewrite of income tax rules was considered the most significant change since the 1980s. If you receive a regular paycheck, you might have noticed an adjustment to your withholdings. And if that adjustment resulted in more take-home pay, you probably assumed your tax bill will be lower. For most taxpayers, that's a correct assumption. But not for everyone.

A recent analysis published by the Tax Policy Center projects about 5 percent of households will pay more taxes this year. The reasons why these might end up paying more? Well, like anything related to income taxes, it's complicated.

First, marginal tax rates are lower, and the thresholds for bumping up are higher. Lower rates and higher thresholds should mean less tax due. Here's a comparison, between 2018 and 2017, using the numbers for a married filing jointly household:

However…The calculation of deductions and credits that reduce taxable income has changed dramatically. The standard deduction from taxable income has nearly doubled to

$**24,000** for joint filers
$18,000 for heads of household, and
$**12,000** for single filers.

As a result, experts conclude that only 10 percent of all households will itemize deductions on their 2018 tax returns (in 2017, the number was 30 percent).

But the higher standard deduction has been offset by limiting or eliminating other deductions. For example:

- Deductions for state and local taxes, including property taxes, are capped at $10,000.
- Personal and dependent exemptions have been eliminated, although the child credit has increased.
- Interest deductions for home equity loans and real estate taxes for properties outside the U.S. have been eliminated.

For households whose finances are relatively simple (one or two salaries, a mortgage, and 2.1 children), the larger standard deduction will probably exceed last year's exemptions and itemized deductions. Thus, a slightly lower tax bill. But for those whose financial picture is a bit more complex, the results won't probably be known until their returns are completed.

Who Could End Up Paying More?

A September 2018 *USNews* report offered examples of households who might end up paying more taxes under the new rules. Among them:

- **Households with significant itemized deductions in 2017** may not realize a similar tax reduction under the new rules. For those who previously qualified for substantial reductions due to property taxes, mortgage interest and other write-offs, the elimination of, or limitations on itemized deductions may result in a higher tax liability – even with a higher standard deduction.
- For similar reasons, **large families could pay more.** The loss of personal exemptions for dependents may not be offset by the new standard deduction plus child tax credits. Further, for children over 17, the child tax credit is reduced. It seems counter-intuitive that more dependents would mean higher taxes. But in higher income brackets, more dependents have a smaller tax-reducing effect, compared to previous years.
- **Homeowners with high property taxes.** Itemized deductions for personal, state and local property taxes and income taxes are limited to $10,000 for households filing a joint return. For high-income households in affluent neighborhoods, state and local tax deductions often exceeded $20,000 last year. Combined with the elimination of deductions for mortgage interest paid on properties outside the U.S, and some limitations on deductible interest from large mortgages, this is a group that could see its tax bills rise substantially.

Use Your 2018 Return as a Benchmark

If a few of these scenarios sound like yours, don’t panic. “Because of the complexity of the changes, one cannot be sure just how their situation will be affected without running the numbers,” says Steven Weil, an enrolled agent and tax planner from Florida. But once you complete your 2018 return, you should know precisely how these changes have impacted your income taxes, and have an idea of things that you might want to adjust going forward. ❖

COVERING YOUR (SMALL BUSINESS) ASSETS

“People are our greatest asset.”

This phrase has been recited so often by businesses it has acquired a French flavor: it’s a cliché that’s passé. Cynical business consultants write articles that begin “Stop Telling Me People Are Your Greatest Asset.”

The completion of your return is also an ideal time to schedule a consultation with your financial professionals. The details of your tax situation are fresh in your mind, and the return gives you a baseline for evaluating the changing tax landscape.

And yet…it’s true. Especially for small businesses.

The efforts and skills of the people working in a business – the owners, the partners, the employees – are critical to its success; no amount of automation or systems management can replace essential human capital.

If people are the most important assets in a business, losing them also presents its greatest risk. Businesses can manage this risk in several ways. To protect the business from losing a key person to a competitor, it may offer attractive compensation and benefit packages, provide paths to ownership, or insist on non-compete agreements. And in the event of a disability or death, the business can obtain insurance to protect its financial interests.

Particularly in small businesses, where a few individuals can have an outsized impact on the company’s overall health, key person insurance should be a primary consideration.

Defining Key Persons

While every person working in a business can be a great asset, not all are so critical they should be insured; some vacancies can be easily replaced. The emphasis is on insuring key producers. Some criteria for defining key-person status:

- **Which individuals have skills, knowledge or connections that would be difficult to replace?** These could be partners, high-performing sales reps, or technical experts like engineers or programmers, whose absence would seriously impact business.
- **Does the company’s operation depend on just a few people to generate a substantial portion of its income?** “Rainmakers” who snare big clients, or reps who are responsible for the majority of sales, fit this category.
- **Does the business carry debt that would have to be paid off if a key individual were to die or become disabled?** Loans for many small businesses often require personal guarantees of the owners, and may be due in full if one is no longer active in the business.
- **Is the business seeking additional capital or planning to go public?** Banks or investment firms may refuse to lend or make an investment unless the business has key person coverage. And in the event of a public offering, key person coverage may be required for top executives and board members before a merger or IPO.

Key Person Life Insurance: A Brief Overview

When a business purchases key person life insurance on an important individual, the business is both the policy owner and beneficiary. The employee is the insured; under most circumstances, the employee does not receive any benefits from the policy.

Key person life insurance can be either a term or permanent policy. With term insurance, a benefit is paid to the business if the insured dies during the term. Besides a death benefit, permanent life insurance includes a cash value component.

A key person life insurance program offers several attractive benefits to the business.

- **Control.** In the event of a claim, the business, as owner of the policy, can use the proceeds however it wants. Funds can be used to hire and train new personnel, settle debts, smooth out cash flow as the business adjusts to the loss, or however else management deems beneficial.
- **Cost Efficiency.** If term insurance is selected, most businesses can achieve a high level of immediate protection at a very reasonable cost. If the business chooses a permanent policy with cash value, it is carried on the firm’s books as an asset because the company owns the policy. Cash values can be an attractive strategy for the business to accumulate long-term on a tax-deferred basis.*
- **Security.** The company’s standing with banks, creditors, and valued customers is enhanced because these parties know that in the event of the death of a key person, the business is positioned to continue uninterrupted.
- **Flexibility.** The company may change the purpose and function of a permanent life policy over time. In the policy’s early years, the death benefit may be primary. Over time, as cash values accumulate, other options may appear. For example, the policy could provide the funding for a Non-Qualified Deferred Compensation (NQDC) agreement in which the insured employee becomes either the owner of the policy or a recipient of a stream of income from the cash values.

In this context, there are many creative options where key person insurance not only protects against the physical loss of an important individual, but also insulates the business from losing this person to a competitor.

Moving from Idea to Implementation

Despite the clear advantages to securing key person insurance, it's common for a business to let the idea slide. A recent survey of small businesses by the National Association of Insurance Commissioners revealed the following:

- **71% of respondents indicated they were very dependent on one or two key people for their success.**
- **Only 22% of respondents indicated they have a key person life insurance policy in place.**

This lack of implementation isn't necessarily a result of negligence or disinterest on the part of ownership. Implementing a key person insurance program requires a knowledge of policy options, ownership arrangements, tax laws, and reporting requirements. Getting a plan in place may involve retaining the services of several financial professionals to make it happen. ❖

* Dividends are not guaranteed. They are declared annually by the company's board of directors.

Are you in a business that needs to move from "That's a good idea!" to getting something done about key person insurance? Then contact us about how we can begin implementation.

IRA. 401(k). SEP. 457. You may recognize these numbers and letters as short-hand for various employer-sponsored retirement plans. Here's another acronym to add to the list: The YOYO plan.

In terms of popularity, the 2015 National Compensation Survey from the Bureau of Labor Statistics provided the following breakdown of retirement plans available to employees in the private sector:

14%: have a… Defined Benefit Plan (Pension)
26%: have a… Defined Contribution Plan (401(k)), with employer contribution
25%: have a… Defined Contribution Plan (401(k)), no employer contribution
35%: have… No plan

"Take a moment and let this sink in."
Those are the words of Tim Todd, an insurance and retirement specialist, in an October 2018 blog post, as he points to the sobering reality that ***60 percent*** of private companies "**do not contribute *1 cent* to their employees' retirement**…" Todd concludes: "Welcome to the 21st Century YOYO Retirement Plan — also known as, 'You're on Your OWN!'"

Regardless of what other letters or numbers you use for your long-term saving plans, the bottom line is you bear the lion's share of the responsibility for funding your retirement. Yes, you might get something from Social Security, for which your employer provided half the funds. But for most workers, that won't be enough to sustain a stable and comfortable retirement. In the private sector, nobody's saving for your retirement if you're not.

Even Pensions Have Been "YOYO-ed"

And as for the "lucky" workers, particularly government employees, who have employer-funded pensions? Well, get acquainted with the word "underfunded," because it's the explanation for why your corporation, municipal government, school district or state administration hasn't set aside enough to ensure you'll get what you were promised. Today, a fully-funded pension is as rare as a unicorn.

Whether it's a private sector pension or one administered by a government (and that includes Social Security), too many plans have too many retirees living too long. And that combination has made most pensions too costly to maintain. Businesses don't have the excess revenues, and governmental units can't collect enough taxes to keep their pensions afloat. Whenever possible, both private and public sector employers are looking to either terminate or offload their pension responsibilities, and are replacing them with defined contribution plans that transfer the funding and investment responsibilities to the individual.

Some employers who continue to offer a pension have modified the format by making employees responsible for keeping the plan solvent.

In 2017, the State of Michigan adjusted its pension option for incoming teachers by having them make a one-time decision to enroll in a pension or a defined contribution plan. If they opt for the pension, teachers are required to contribute 4 percent of their annual salary to the plan, which is matched by their employer. The obligation of the teachers to fund half the pension is openended: if at any time the plan becomes underfunded, both teachers and the school district will have to increase their contribution percentages to address the shortfall.

This bleak YOYO scenario is even more discouraging when you realize that in 1960, 50 percent of the private sector workforce had a defined benefit retirement plan; i.e., an employer-funded pension that promised a regular retirement check, based on average salary and years of service. How did this change?

The short explanation: retirement models, particularly pensions, have no good answers for increased life expectancy and slowing population growth in developed countries. John Mauldin, writing in a November 2018 investment newsletter, expands on this problem.

“We are simply not prepared for a world in which old people outnumber the young. But it may be coming, thanks to life extension at the upper end and falling fertility rates below. National pension systems – what we call Social Security in the US but similar elsewhere – are not designed for that combination. They presume a high ratio of working young to retired old citizens. That is no longer happening and is increasingly hard to ignore.”

Safety Tip: Don’t YOYO Alone

The YOYO trend is clear: it is becoming less likely that employers, either in the private or public sector, will fund retirement benefits for their employees. The math just doesn’t work.

Policy wonks and economic experts can continue to pursue that elusive pension unicorn, the one that guarantees a pension for all without exorbitant contribution commitments. Maybe they’ll find it. In the meantime, YOYO is the one practical alternative.

But just because the funding is YOYO, doesn’t mean you have to do it all by yourself. Guidance from financial professionals is not only available, but recommended. If you’re serious about making a YOYO retirement plan work, you should also be serious about professional assistance. ❖

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