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The Importance of Planning

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Even with the stock market hitting new highs and the economy showing signs of improvement, workers and employers in the U.S. are bracing for a retirement crisis. In its 2013 Retirement Confidence Survey released last week, the Employee Benefit Research Institute (EBRI) provided stirring details in support of two facts that most of us are already aware of; that Americans are living longer; and that they have not saved near enough for retirement.

Nearly half of those responding to the survey said they have little or no confidence that they will have enough money in retirement. This makes sense when you consider that 57% of the respondents said they had less than $25,000 in total household savings, with 28% having saved less than $1,000. How can this be? Do people mistakenly assume Social Security is a retirement program that will cover them completely in their post-work lives? It's hard to believe given the negative public opinion about the future of Social Security. They most likely won't be relying on a corporate pension, since only 3% of private sector employees are covered by a traditional "pension" plan these days.

The lack of confidence in having enough savings may be a result of the large savings targets that a noticeable number of workers cited. Of the respondents, 20% said that they needed to save between 20% and 29% of their annual income while nearly a quarter said that they needed to save 30% or more. And while these targets are indeed high, they may not be based on any plan or analysis of individual circumstances. Only 46% report that they have tried to calculate how much they will need to have saved in order to have a comfortable retirement. This means that 54% are just guessing.

To be sure, there are a few things that are more important to Americans than planning for retirement. Approximately 1/3 of those surveyed identified job uncertainty as the most pressing financial issue and a little over 10% said that making ends meet was most important to them.

But it's not just individuals who are readying themselves for this oncoming "retirement storm." Corporate pension funds are beginning to feel the effects of retiree longevity. When retirees live longer, corporate pension liabilities increase. And people are indeed living longer. A male turning 65 in 2013 is expected to live to an average of 85, and a female of the same age is expected to live until she is almost 88. This is weighing on corporate balance sheets to the tune of $97 billion in added pension liabilities, an increase of up to 5%.

While it may not seem like it, there is some good news from all of this; and that is that it is never too late to start planning. I know that for many people my age (late 40s or younger) planning for retirement usually takes a back-seat to planning for kids' college education or a new home purchase, but the importance of starting early can never be underestimated. Every time I look at my retirement totals, I thank my first boss who persuaded me to participate in the 401(k) plan that the company offered. I started very small, but she told me that the most important thing was that I started. Beginning at the age of 22 was great and I would encourage any young person to find a way to do the same, but at the risk of repeating myself; it is never too late to start and no amount is too small, no matter what your age.

Planning cannot only better prepare you for retirement, but it can also help you to avoid making irrational investment decisions when market conditions are poor. This concept was illustrated recently in a New York Times article written by Nicholas Popper. The article is about traditionally risk-averse investors who suffered steep losses on complex investment products that until just a few years ago were reserved for only the most sophisticated of investors.

In the wake of the 2007 financial crisis, many individuals started searching for ways to make better returns than those being offered by bank deposits and government bonds, investments that they were traditionally most comfortable with. Interest rates were low and the stock market was on less than solid footing, so aggressive financial advisers pitched them on speculative investments that included private loans to small companies and shares in commercial real estate properties. The investments promised attractive rates of return and appeared to pose little risk. Unfortunately, many of these investments ended in a total loss to the investor. Not what a "risk averse" investor would be expecting.

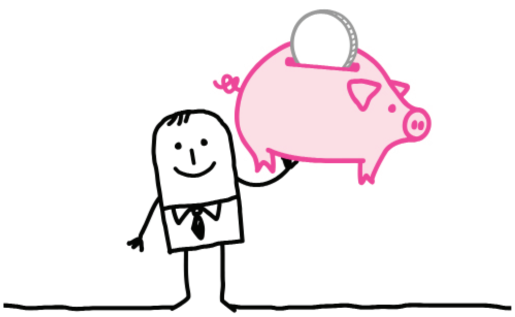
While the investments themselves were not illegal or unethical, it was the way that they were sold and to whom they were sold that raised regulator's eyebrows. These were not individuals looking to get rich quick or what are known as "qualified investors". These were traditional, unsophisticated retirement savers looking to get more than they could get from their local bank CD. It is easy to get caught up in these types of schemes if you don't have a plan, or if your plan is faulty.

A good plan should have a reserve fund of some kind that an investor can draw on during times of capital market uncertainty. The victims of this fraud probably relied too much on interest and dividend income and did not allow for extended periods of low interest rates and stock market volatility. It's hard to blame them, since we have never seen interest rates this low for this long. But it's just these types of situations that a good plan can help you to overcome. Any investment will have some kind of risk associated with it, and while a careful plan will not help you to avoid all of them, it will at least help you to avoid the ones that you can't afford to take.

TCV Estate Planning Alert

Jack Davidson

The American Taxpayer Relief Act of 2012 (Act) was enacted on January 2, 2013. The Act for the most part extended the tax benefits for larger estates in existence before the cliff. We have put this Alert together to highlight the main estate, gift, and generation-skipping transfer (GST) tax laws included in the Act.



Estate Tax Exemption. The Act permanently maintains the $5 million estate tax exemption indexed to inflation. In 2012, the exemption was $5.12 million and in 2013, the inflation-adjusted estate tax exemption amount is $5.25 million. This means that married couples can plan their estates to avoid all federal estate taxes for estates under $10.5 million. Furthermore, "Portability" of this exemption is now permanent. In the past, the challenge in planning larger spousal estates was twofold. First, planners often used sophisticated documents to ensure both spousal exemptions, such as credit shelter trusts. The second step was the continual monitoring of how assets were held. For example, if all assets were held in joint name, assets would bypass a trust designed to use the first exemption thereby losing part or all of the first exemption. Fortunately the recent passage of "Portability" gives to the second spouse the unused exemption, thus restoring lost exemptions, regardless of errors in titling assets.

Vermont, however, did not change its exemption of $2.75 million. Vermont's tax bite above the exemption can be as high as 35%

Basis Adjustment for Property Acquired From a Decedent. The Act did not change the law regarding basis adjustment for property acquired from a decedent. Stepped up (or down) basis will continue to eliminate all pre-death capital gain or loss on the property.

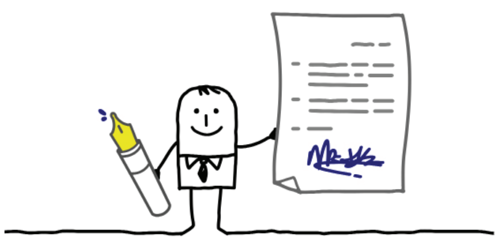
Gift Tax Exemption. The Act makes permanent the unification of the gift and estate tax exclusion amounts. This means that in 2013 each person can make lifetime gifts up to $5.25 million without paying gift tax. However, all gifts above the annual gift exclusions ($14,000 per person or $28,000 per married couple) will still be subtracted from Estate Tax Exemption.

GST Tax Exemption. The Act makes permanent the unification of the estate tax and GST tax exemption amounts. In 2013, grandparents can make transfers to grandchildren (or generation trusts) of up to $5.25 million without paying a GST tax.

Maximum Estate, Gift and GST Tax Rates. The Act did increase taxes for estates above the exemption(s). The maximum rate in 2012 was 35% and, moving forward, it will be 40%.

Vermont residents should take a second look at their estate plans. The generous federal exclusions and exemptions may create less urgency for a plan review and this may be a mistake. And my advice to those who wanted clarity before revisiting their plans, clarity has arrived. It's time to revisit the plans if you have not already done so recently, for two significant reasons: the Vermont Estate Tax and the cost of the infrastructure of a Credit Shelter Trust (a/k/a Trust B, Family Trust, etc.) whose only purpose was estate tax savings.

For example, if the marital assets amount to $3 million, the Vermont tax could be as high as $87,500 without planning. If the estate were held jointly, the tax would be due upon the second death.



We have many trusts that were drafted when the federal exemption was $1 million. The classic document first created a credit shelter trust equal to the federal exemption, with the balance passing to the spouse either outright or in a marital trust. If the $3 million were held in this type of trust, the Vermont tax would become due on the first death. Pre-existing documents can be easily amended to save all estate taxes, both federal and Vermont, on spousal estates under $5.5 million.

The infrastructure of a trust can be beneficial for many reasons, such as probate avoidance and management when beneficiaries or donors want to avoid guardianships. That said, if the only objective of the trust is to escape taxes, an existing trust should be revisited. For example, if a married couple's assets total $2 million, all in the name of the decedent, the typical credit shelter trust would surface upon death. The $2 million would be trapped in the trust for the surviving spouse, who would then encounter, in most cases, limited control for the balance of his or her life. Plus, there is the cost of the infrastructure of a trust. Fortunately for our clients, there are no additional costs. However, those who might use managers who are not designated as trustee managers, the cost of the fiduciary accounting, legal advice, and the tax return could be expensive.