



# THE PERSONAL PLANNER

Personal Financial Planning Tips for Today and the Rest of Your Life

August 2010

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Markets going to the sky and buckets of water falling from it... that was July in a nutshell. Equity markets shook off their June gloom and soared to unexpected levels in July for, again, not all that much in the way of reasons. So we're getting invested again because most category benchmarks had worked their way back above their 12-month moving averages by the end of July.

July's flooding reminds us to review our homeowner's insurance policies with our insurance agent from time to time to avoid nasty surprises.

Please remember to spend some time with the white paper I've sent to all clients with this month's newsletter titled "Cake and Eat It" Investing. It describes the portfolio risk management process we've begun employing in client portfolios. August is the last full month of summer so get out, enjoy this remarkable weather, and bank some memories to see you through next January and February.

Bruce Heling, CFP CPA

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## What You Should Know about Trusted IRAs

The tax code allows IRAs to be created as trust accounts, custodial accounts, and annuity contracts. Regardless of the form, the federal tax rules are generally the same for all IRAs. But the structure of the IRA agreement can have a significant impact on how your IRA is administered. This article will focus on one type of trust account commonly called a "trusted IRA," or "individual retirement trust."



### Why might you need a trusted IRA?

In a typical IRA, your beneficiary takes control of the IRA assets upon your death. There's nothing to stop your beneficiary from withdrawing all or part of the IRA funds at any time. This ability of your beneficiary to withdraw assets at will may be troublesome to you for several reasons. For example, you may simply be concerned that your beneficiary will squander the IRA funds.

Or it may be your wish that your IRA "stretch" after your death--that is, continue to accumulate on a tax-deferred (or in the case of Roth IRAs, potentially tax-free) basis--for as long as possible. Your intent to stretch out the IRA payments may be defeated if your beneficiary has total control over the IRA assets upon your death.

Even if your beneficiary doesn't deplete the IRA assets, in a typical IRA you normally have no say about where the funds go when your beneficiary dies. Your beneficiary, or the IRA agreement, usually specifies who gets the funds at that point. So, in a typical IRA, if you name your spouse as your primary beneficiary, your spouse could name children from a previous marriage, or a new spouse if he or she remarries, as the ultimate beneficiary of your IRA assets. A trusted IRA allows you to control the ultimate beneficiaries of your IRA, by letting you specify contingent beneficiaries that cannot be changed by your primary beneficiary.

With a trusted IRA, you can't stop the payment

of required minimum distributions (RMDs) to your beneficiary but you can restrict any additional payments. You can direct the trustee to pay only RMDs to your beneficiary. Or you can provide the trustee with discretionary authority to make payments to your beneficiary in addition to RMDs, e.g., for your beneficiary's health, welfare, or education. Or you can impose restrictions on distributions that last only until your beneficiary reaches a specified age. Trusted IRAs can also be set up to qualify as marital, QTIP, and credit shelter (bypass) trusts, potentially simplifying your estate planning.

A trusted IRA can also be a valuable tool during your lifetime. It can be structured so that if you become incapacitated, the trustee will step in and take over the investment of assets and distribution of benefits on your behalf, ensuring that your IRA won't be in limbo until a guardian is appointed.

### Is a trusted IRA right for you?

While trusted IRAs can be as flexible as a particular trustee will allow (not all provide the same level of IRA planning services), they aren't right for everyone. The minimum balance required to establish a trusted IRA, and the fees charged, are usually significantly higher than for other IRAs, making trusted IRAs most appropriate for large IRA accounts. You may also incur attorney's fees and other costs.

And in some cases, another approach might be more appropriate. For example, you may be able to assure that your IRA "stretches" after your death by instead naming a trust as the beneficiary of your IRA. If specific IRS rules are followed, RMDs can be calculated using your trust beneficiary's life expectancy (this is commonly called a "see-through" trust).



See-through trusts are generally more expensive, and more complicated, than trusted IRAs. It's important that you consult an estate planning professional who can explain your options and make sure you choose the right vehicle for your particular situation.

## Student Loan Repayment Options



At one time, there was only one student loan repayment option--the standard 10-year plan. Now, there are an assortment of flexible repayment options to help borrowers meet their loan obligations. And it couldn't have come at a better time. According to an analysis of

the government's National Postsecondary Student Aid Study by financial aid expert Mark Kantrowitz, the average federal student loan debt load was \$23,186 last year--a figure that doesn't include private student loan debt, which has exploded in recent years along with the cost of college.

### Standard plan

Under a standard repayment plan, you pay a certain amount each month over a 10-year term. If your interest rate is fixed, you'll pay a fixed amount each month; if your interest rate is variable, your monthly payment will change from year to year (but will be the same each month for the 12 months that a certain interest rate is in effect).

### Graduated plan

Under a graduated repayment plan, payments start out low in the early years of the loan (presumably when a new college graduate has the lowest earning potential), then increase in the later years of the loan. With some graduated repayment plans, the initial lower payment includes both principal and interest, while under other plans, the initial lower payment includes interest only.

**Example:** Assume you have a \$20,000 student loan at a fixed 6.8% interest rate. Under a standard 10-year repayment plan, your monthly payment would be \$230, and your total payment over the term of the loan would be \$27,619, of which \$7,619 is interest payments. Under a graduated 10-year repayment plan, if you chose a 4-year interest-only option, your monthly payment would be \$113 for the first 4 years, then \$339 for the remaining 6 years, for a total payment over the term of the loan of \$29,852, of which \$9,852 is interest payments.

### Extended plan

Under an extended repayment plan, you extend the time you have to pay the loan, typically anywhere from 15 to 30 years. Your monthly payment is lower than it would be under a standard plan, but you'll pay more interest over the life of the loan because the repayment period is longer.

**Example:** Assume the same facts as before--a \$20,000 loan at a fixed 6.8% interest rate. Under an extended repayment plan, if the term were increased to 20 years, your monthly payment would be \$153 (lower than the \$230 monthly payment under the standard 10-year plan), but your total payment over the term of the loan would be \$36,640--\$9,021 more interest than under the standard plan.

### Income contingent plan

An income contingent repayment plan is for federal student loans (including graduate Direct PLUS Loans) made under the government's William D. Ford Direct Loan program only. Monthly payments are based on the student's income, family size, and amount of loans. After 25 years of repayment (not counting time spent in deferment or forbearance), any remaining balance on the loans will be discharged (you may have to pay taxes on the amount discharged, however). A public service loan forgiveness component will discharge any remaining debt after 10 years of full-time employment in public service. Borrowers with federal student loans obtained via private lenders under the Federal Family Education Loan program can ask their lenders about an income sensitive repayment option.

### Income based repayment plan

The federal government's new Income Based Repayment (IBR) program went into effect July 1, 2009. Monthly payments are based on the student's income and family size. Borrowers pay 15% of their discretionary income to student loan payments, with any remaining debt forgiven after 25 years. According to Lauren Asher, President of the Project on Student Debt and the Institute for College Access and Success, a student will generally qualify if he or she owes about as much in federal student loans as the student's current annual salary.

This program is open to graduates with a Stafford Loan, graduate PLUS Loan, or consolidation student loan made under either the Direct Loan program or the Federal Family Education Loan Program. The loans can be for undergraduate, graduate, or professional studies, as well as for job training. The Department of Education has an IBR calculator on its website at <http://studentaid.ed.gov>.

And thanks to recent legislation, borrowers who take out a federal student loan after July 1, 2014, will pay just 10% of their discretionary income to student loan payments, with any remaining debt forgiven after 20 years.

### Praise for IBR

According to Lauren Asher, President of the Project on Student Debt and the Institute for College Access and Success, "[income based repayment] was supported by a broad coalition of student, parent, loan industry, and higher education groups to make college more affordable and accessible," and the President's budget proposal is "a way to make the program even more helpful to responsible borrowers."



## Avoiding Probate: Is It Worth It?

When you die, your estate goes through a process that manages, settles, and distributes your property according to the terms of your will. This process is governed by state law and is called probate. Probate proceedings fall under the jurisdiction of the probate court (also called the Surrogate's, Orphans', or Chancery court) of the state in which you are domiciled at the time of your death. This court oversees probate of your personal property and any real estate that is located in that state. If you own property located in a state other than the state in which you are domiciled at the time of your death, a separate "ancillary" probate proceeding may need to be initiated in the other state.

**Note:** "Domicile" is a legal term meaning the state where you intend to make your permanent home. It does not refer to a summer home or a temporary residence.

Items that are subject to probate are known as probate assets. Probate assets generally consist of any property that you own individually at the time of your death that passes to your beneficiaries according to the terms of your will. Nonprobate assets include all property that passes outside of your will. Examples of nonprobate assets include property that is owned jointly with right of survivorship (e.g., a jointly held bank account) and property that is owned as tenants-by-the-entirety (i.e., real property owned jointly by a husband and wife). Another example is property that passes to designated beneficiaries by operation of law, such as proceeds of life insurance and retirement benefits.

### Why avoid probate?

Most wills have to be probated. The rules vary from state to state, but in some states, smaller estates are exempt from probate, or they may qualify for an expedited process.

**Probate can be slow.** Depending on where your executor probates your estate and the size of your probate estate, the probate process can take as little as three months or as long as three years. Three years can be a long time to wait for needed income. It can take even longer if the estate is a complicated one or if any of the heirs are contesting the will.

**Probate can be costly.** Probate costs usually include court costs (filing fees, etc.), publication costs for legal notices, attorney's fees, executor's fees, bond premiums, and appraisal fees. Court costs and attorney's fees can vary

from state to state. Typically, the larger the estate, the greater the probate costs. However, if a smaller estate has complex issues associated with its administration or with distribution of its assets (e.g., if the decedent owned property in several states), probate can be quite costly.

**Probate is a public process.** Wills and any other documents submitted for probate become part of the public record, something to consider if you or your family members have privacy concerns.

### Why choose to go through probate?

For most estates, there's usually little reason to avoid probate. The actual time and costs involved are often modest, and it just doesn't make sense to plan around it. And, there are actually a couple of benefits from probate. Because the court supervises the process, you have some assurance that your wishes will be abided by, and, if a family squabble should arise, the court can help settle the matter. Further, probate offers some protection against creditors. As part of the probate process, creditors are notified to make their claims against the estate in a timely manner. If they do not, it becomes much more difficult for them to make their claims later on.

In addition, some states require that your will be probated before the beneficiaries under your will can exercise certain rights. Among the rights that may otherwise be limited are the right of your surviving spouse to waive his or her share under the will and elect a statutory share instead, the right of your surviving spouse to use your residence during his or her remaining life, the right of your surviving spouse to set aside certain property, and the right of your surviving spouse to a family allowance.

### How to avoid probate

An estate plan can be designed to limit the assets that pass through probate or to avoid probate altogether. The major ways property is passed outside of probate are by owning property jointly with rights of survivorship; by ensuring that beneficiary designation forms are completed for those types of assets that allow them, such as IRAs, retirement plans, and life insurance; by putting property in a trust; and by making lifetime gifts.

See your financial professional or attorney for more information.

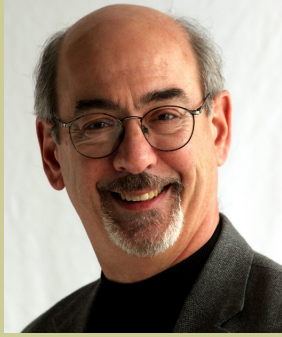
### Why avoid probate?

- *It can be slow; getting needed assets into the hands of your heirs may be delayed*
- *It can be costly, especially if an estate is large or complex, or ancillary probate is needed*
- *It is public; documents that you wish to remain private can be accessed by the public*



### How to avoid probate

- *Own assets jointly with rights of survivorship*
- *Own assets that pass by beneficiary designation, such as life insurance and retirement plans*
- *Use a trust*
- *Gift assets during your lifetime*



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## Ask the Experts



### What is a Medicaid compliant annuity?

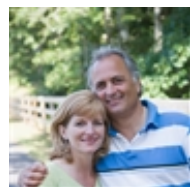
A Medicaid compliant annuity is a single premium immediate annuity (SPIA) purchased on or after February 8, 2006, that meets the guidelines

described in the Deficit Reduction Act of 2005 (DRA). Because the income from this type of annuity is not considered a countable resource, purchasing a Medicaid compliant annuity may help an individual or a couple, who would otherwise have too many resources, to qualify for Medicaid.

Generally, in order to qualify for Medicaid, you must meet your state's impoverishment rules. Also, if you transfer assets for less than their fair market value, such as through gifts, you may be disqualified from receiving Medicaid benefits for a period of time. However, according to federal law, the purchase of a Medicaid compliant annuity by the applicant or the applicant's spouse is not deemed a transfer that creates a disqualification period under Medicaid, nor is the income from such an annuity considered a countable resource.

The Medicaid compliant annuity may be an individual retirement annuity, or it may be purchased with cash or with proceeds from certain retirement assets, such as an IRA. Also, it must be non-assignable and irrevocable, actuarially sound, provide for benefit payments in equal amounts with no deferred or balloon payments, and name the state Medicaid program as the primary beneficiary (with some exceptions). An annuity is actuarially sound if the original cost of the annuity will be paid within a term equal to or less than the actuarial life expectancy of the annuity owner.

Although federal law permits the use of Medicaid compliant annuities, some states have taken the position that the income from a Medicaid compliant annuity is a countable resource, and that the purchase of such an annuity is a transfer for less than fair market value resulting in a disqualification period. States differ in their application of annuity rules, so check with an attorney experienced with Medicaid planning before buying a Medicaid compliant annuity.



### What are long-term care combination policies?

In most instances, a combination policy is a base life insurance or annuity contract with a long-term care insurance (LTCI)

benefit rider. The long-term care benefit works like basic stand-alone LTCI. Benefits are paid after an elimination period if the owner is unable to perform at least two activities of daily living or suffers from severe cognitive impairment. Combination insurance contracts allow policyowners the ability to address multiple risks through one insurance policy, thereby potentially reducing some of the cost associated with buying separate insurance policies.

Combination life insurance/LTCI policies often combine cash value life insurance with an accelerated death benefit rider or an extension of benefits rider that allows either a percentage or multiple of the death benefit to be used to pay for long-term care expenses.

Deferred annuity/LTCI policies may provide an LTCI benefit based on a multiple of the annuity balance, such as two or three times the annuity cash value. Immediate annuity/LTCI policies

usually offer an increased payout for long-term care expenses. For example, if the monthly annuity payout is \$1,000, the LTCI benefit may increase to \$3,000 per month for a fixed period of time, such as four years.

The Pension Protection Act of 2006 (PPA) made insurance and annuity policies that combine with LTCI benefits more tax favorable. Before the enactment of the PPA, the cost of LTCI paid from the cash value of a combination life insurance/LTCI policy was treated as taxable income to the policyowner. LTCI payments from combination annuity/LTCI contracts were considered distributions from the annuity and taxed on an "earnings first" basis.

As of January 1, 2010, the PPA generally treats LTCI benefits paid out of life insurance or annuity combination policies as nontaxable distributions to the policyowner. In addition, the PPA now allows Internal Revenue Code Section 1035 tax-free exchanges of life insurance or annuity policies for combination life/LTCI policies, annuity/LTCI policies, or stand-alone LTCI policies.