focus

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Accurately estimating retirement expenses

Make sure you're saving enough to support your desired lifestyle

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Just how much are your golden years likely to cost? Sure, it's easy to find rules of thumb that attempt to estimate this. For instance, some models state that most retirees will need 60% to 70% of their current income.

While these generic guidelines are fine as a starting point, most Americans could benefit from a little more precision as they try to make sure they'll have enough to see them through retirement. Underestimating yearly expenses by even a few percentage points can have a significant impact over a 20- or 30-year retirement time frame.

Start from scratch

Coming up with a reasonably accurate expense forecast typically requires projecting each expense individually, taking into account how it might change in retirement. On the bright side, some current expenses should drop.

While it's tempting to assume that most expenses will drop in retirement, that's not always accurate. A few are more apt to increase — some significantly.

You probably won't need to spend as much on job-related costs such as commuting and work clothes. If you plan to pay off your mortgage before you retire, you won't have that expense either. And, once you're fully retired, you'll no longer need to put away money for retirement (though you still may need to save some money each year).

Some retirees may also be able to reduce the amount of life insurance they carry. After all, they no longer need it to replace the income they were earning while they were employed.

Child-rearing expenses also tend to wind down. Most parents hope that, by the time they retire, their children will be out of the house and supporting themselves.

Expenses likely to rise

While it's tempting to assume that most expenses will drop in retirement, that's not always accurate. A few are more apt to increase — some significantly.

One of the most important expenses is health care. According to Fidelity Benefits Consulting, a couple that retires at age 65 can expect to spend an estimated $220,000 on health care costs during retirement. What's more, this is *after* accounting for expenses covered by Medicare. The estimate assumes that the husband will live to age 82 and the wife to age 85, which means their costs will average $11,000 annually.

Moreover, some housing-related expenses likely will increase:

- Property taxes tend to head in only one direction … up. Even modest annual increases can be significant over time. A tax bill of $1,000 will jump to nearly $1,500 over 20 years with an annual increase of just 2%.
- You may need to hire others to take over chores that can become difficult to handle as you age, such as shoveling snow or mowing the lawn — or even cooking and cleaning.
- You may find it necessary to modify your home to make it easier to navigate or maintain.
- Even if you downsize, you may need to do some renovations at your new home or condominium. You also might need to pay association fees.

Also keep in mind that, even though you're no longer working for a living, you still may have to pay income taxes. Some IRA withdrawals and Social Security benefits can be taxable, and of course income from assets held in non-retirement accounts is also generally taxable. Yet you may lose some tax deductions. For example, if you pay off your mortgage before retirement (which typically is a wise move), you no longer will have mortgage interest payments to deduct on your tax returns.

Finally, although having more time to travel and become involved in hobbies and other pastimes is a true benefit of retirement, these activities almost always require some money. So, make sure you include an allocation in your budget.

Projecting (and protecting) your future

Carefully projecting retirement expenses offers several benefits. Most important, it can help you determine how much you need to save *now* to ensure a comfortable retirement. The exercise also can help you think through just how you'd like to spend your time, once you're no longer on the job 40+ hours per week.

Your financial advisor can help you develop reasonable projections of your expenses in retirement. He or she also can help you determine the amount you need to be saving for retirement, and suggest ways to help you achieve this. ◈

Don't let "surprises" drain your coffer

When it comes to expenses that are unpredictable — such as the inevitable car and appliance repairs — it makes sense to budget an annual allowance. To start the process, total up the money you've spent on such repairs over the past few years to arrive at an average. Then you may want to increase the number over time, given that repairs tend to become more frequent as products age.

Also be aware of the potential for more significant surprises. For instance, if you would want to help an adult child who needs financial support due to a divorce or job loss, make sure you consider this in your planning.

Most critical, consider the "bite" that inflation can take on your budget. A monthly food budget of $400 jumps to nearly $600 in 10 years, given a 4% annual inflation rate.

Collectibles and taxes: Be prepared for the consequences

If you are one of the 5 million-plus viewers of the TV show "Pawn Stars" or an avid "Antiques Roadshow" fan, you know that a random collectible — say, the first issue of the Superman comic books or one of the five 1913 Liberty Head V nickels known to exist — may be worth a great deal of money. Of course, Uncle Sam knows this as well. So the IRS has developed guidelines that govern the taxes imposed on sales of collectibles and the deductions allowed when collectibles are donated to qualified charities.

Gains and losses on collectibles

The IRS views most collectibles, other than those held for sale by dealers, as capital assets. As a result, the gain or loss on the sale of a collectible that you've had for more than one year generally is treated as a long-term capital gain or loss.

If you inherited the collectible, your basis is its fair market value at the time you inherited it.

However, while long-term capital gains on many types of assets are taxed at either 15% or 20%, capital gains on collectibles are taxed at 28%. (As with other short-term capital gains, the tax rate when you sell a collectible that you've had for one year or less typically will be your ordinary-income tax rate.) Moreover, the IRS generally won't allow you to deduct any losses when you sell collectibles that you've held for your personal use.

Determining the gain or loss on a sale requires first determining your "basis" — generally, your cost to acquire the collectible. If you purchased it, your basis is the amount you paid for the item, including any brokers' fees.

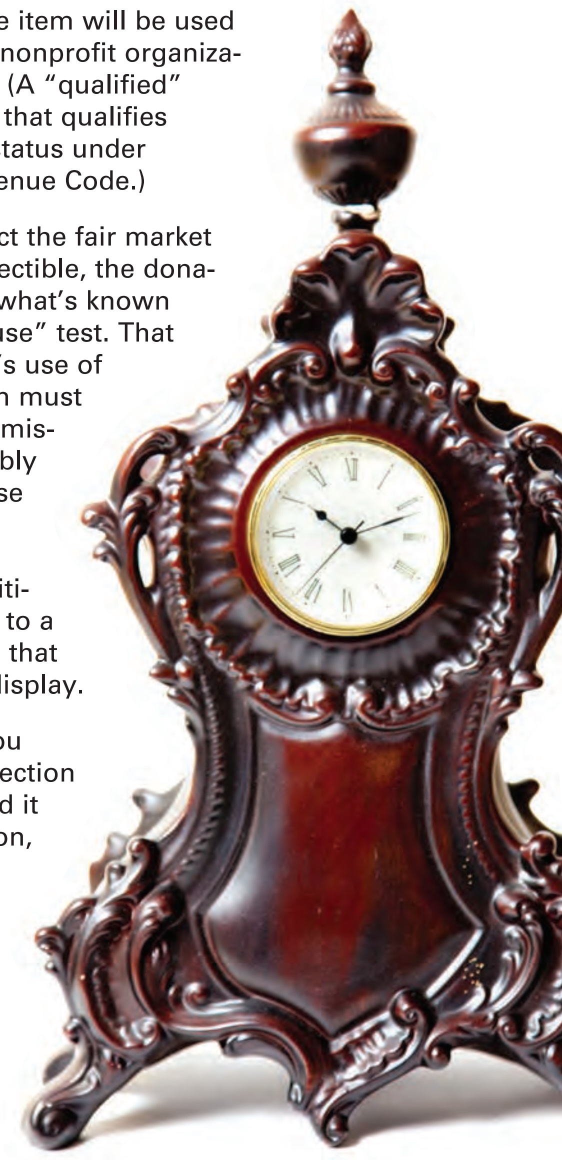
If you inherited the collectible, your basis is its fair market value at the time you inherited it. The fair market value can be determined in several ways, such as by an appraisal or through an analysis of the prices obtained in sales of similar items at about the same time.

Donations of collectibles

If you want to donate a collectible, the tax treatment of the donation will likely depend both on its value and on the way in which the item will be used by the qualified nonprofit organization receiving it. (A "qualified" nonprofit is one that qualifies for tax-exempt status under the Internal Revenue Code.)

For you to deduct the fair market value of the collectible, the donation must meet what's known as the "related use" test. That is, the nonprofit's use of the donated item must be related to its mission. This probably would be the case if, for instance, you donated a collection of political memorabilia to a history museum that then puts it on display.

Conversely, if you donated the collection to a hospital, and it sold the collection, the donation likely wouldn't meet the related-use



test. Instead, your deduction typically would be limited to your basis.

There are a number of other rules that come into play when making donations of collectibles. For instance, the IRS generally requires a qualified appraisal if a deduction for donated property tops $5,000. In addition, you'll need to attach Form 8283, "Noncash Charitable Contributions," to your tax return. With larger deductions, additional documentation often is required.

Work with your financial advisor

The tax implications of selling or donating collectibles quickly can become complicated. Your tax advisor can help you determine how to properly handle these transactions. ◈

How family businesses can benefit from an advisory board

All businesses can benefit from outside advice. But it can be especially valuable to family businesses, which tend to be more insular. After all, in many cases management is made up of family members who've worked in the business for decades, perhaps never having been employed elsewhere. In addition, family dynamics can create conflicts that are tough to settle when all of the players have both a professional and personal stake in the outcome. If these issues sound all too familiar, your family business should consider setting up an advisory board.

Harness the wisdom

An advisory board serves in a consulting capacity and isn't bound by the fiduciary responsibility to the company and shareholders that a public company board of directors must observe. So an advisory board can feel freer to think creatively to develop solutions to business problems and identify new business opportunities.

Advisory boards also can address differences among family employees on issues such as what direction the company should move, how to expand and diversify the business, succession and retirement planning, and performance management and compensation.

What value can an advisory board bring to your company? Most important, it provides impartial, independent perspective on problems, as well as collaborative solutions to business and family issues. In addition, it can offer professional talent and expertise your company may be lacking and broaden thinking to stimulate fresh ideas and identify new opportunities.

To fully realize this value, you must be open about every aspect of your operations, your business challenges and family dynamics.

Start planning

If you believe your family business could benefit from an advisory board, you must first define the board's purpose and goals. Generally, an advisory board focuses on addressing major or strategic issues such as succession planning, compensation, growth and expansion — tackling one or a couple of important matters at a time. But to be more effective, you may want to outline the board's objectives based on your business's goals and needs.

You'll also need to determine the role of leadership. It may be more practical for you to serve as the advisory board's leader. But as your business grows in size and complexity and demands on your time increase, delegate this responsibility to a board member.

Handpick members

To provide a more complete perspective, you'll want a mix of professionals from varying fields, demographics and backgrounds. An effective way to recruit advisory board members is to network with business, industry, community, academic and philanthropic organizations. You also may want your professional advisors, such as your accountant, financial advisor or lawyer, to participate because they're already knowledgeable about your company's goals, issues and staff.

Specify the mix of traits and qualifications — executive or leadership skills, years of experience, competencies, education, affiliations or achievements — needed in members to fulfill the board's purpose. But also look for individuals who are willing to be frank with their observations and provide constructive advice while observing confidentiality agreements and maintaining discretion with sensitive business and family issues.

An advisory board can feel freer to think creatively to develop solutions to business problems and identify new business opportunities.

Determine schedule and compensation

How often your board should meet and the degree of formality for conducting meetings and recording minutes depend on the number

of members and the board's purpose and responsibilities. Generally, meeting at least monthly initially will help the group establish and maintain rapport and relevance to the business. Once it has been established for a while, quarterly meetings may be sufficient.

You should cover costs that advisory board members incur in traveling to and from meetings and pay them for their time. Cash compensation makes sense for family businesses that want to remain closely held, while companies that are planning to become listed may want to issue stock.

Make the move

Whether your family business is small or large, you likely will benefit from bringing in trusted business people from outside of the family to serve on an advisory board. They can act as impartial advisors, thus enabling your company to function at a higher level with minimal infighting. ◈

Do you know about the new IRS regulations on EINs?

Last year, the IRS issued final regulations on Employer Identification Numbers (EINs). The regs are intended to improve the IRS's ability to maintain accurate information on people assigned EINs and became effective Jan. 1, 2014. If your company already has, or is planning to obtain, an EIN, you'll need to take note of the new regs.

The responsible party

The biggest difference under the new regs is that they require disclosure of an EIN applicant's "responsible party." Just who can be a responsible party? For private companies, the responsible party is the individual(s) who can control or manage the entity and its assets.

While this requirement may seem like common sense, some EIN applicants have listed what the IRS calls "nominees" as responsible parties. Nominees typically are individuals who have limited authority to act on behalf of an entity; often, their authority extends only through the company's start-up phase. In addition, nominees usually have little or no authority over the company's assets.

When businesses list nominees, rather than the actual responsible parties, in their EIN applications, it can become more difficult for the IRS to identify and contact the appropriate person to resolve tax questions. In some cases, the use of nominees has facilitated applicants' noncompliance with tax regulations, according to the IRS.

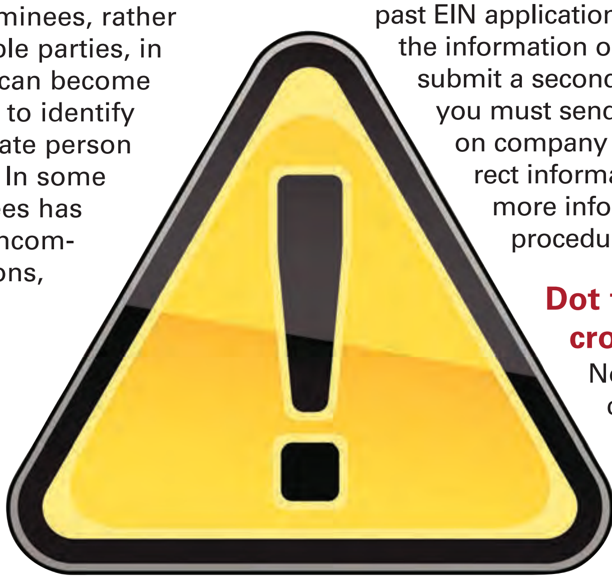
Information needed

When applying for an EIN, a business must complete Form SS-4, "Application for Employer Identification Number," and provide the responsible party's name, signature and taxpayer identification number. This may be a Social Security number, Individual Taxpayer Identification Number (ITIN) or another EIN.

If you prefer, you can skip Form SS-4 and apply for an EIN online. (Search for "EIN" at the irs.gov site to reach the link.) But keep in mind that the IRS currently can't process an online application if your responsible party previously received an EIN via the Internet.

When businesses list nominees in their EIN applications, it can become more difficult for the IRS to identify and contact the appropriate person to resolve tax questions.

What should you do if you used a nominee on a past EIN application and now want to correct the information on file with the IRS? Don't submit a second EIN application. Rather, you must send the IRS a letter written on company letterhead with the correct information. Again, you can find more information on the correct procedures on the IRS website.



Dot the i's and cross the t's

Nothing is easy when it comes to dealing with the government. But it's crucial that you abide by the new regulations set forth when applying for an EIN. ◈