



LIVE LONG AND PROSPER

by William D. Starnes, CFP®, Hockessin, Delaware

Death comes to each of us in our own due time. No one can avoid it. To generate sensible financial planning recommendations, mortality must be considered. In fact, I quickly think of life expectancy when I hear questions such as:

- Should I take the lump sum or the pension income option from my employer?
- What survivor option should I elect with my pension?
- How much can we spend in retirement?
- When should I begin taking Social Security?

How Life Expectancies Will Change

Life spans are increasing annually by about one percent. Developments in medical science lead to longer and healthier lives. But how long is long?

Futurist Peter Schwartz, in his book *Inevitable Surprises*, says that life expectancy changes due to medical advances will begin having a significant impact beginning in 2007. He says, "It is certainly plausible that a significant number of human beings might live to age 150 by the year 2125. More likely, we will find ourselves able (with some medical interventions) to live to 120, and our children to live to 150. Even if none of this comes to pass, however, it is

inevitable that a significant number of people in industrialized countries will live to 100. A society in which millions of people routinely live past 100 or 110 would be significantly different from any society that human beings have ever previously known."



How a Longer Life Expectancy Will Affect You

How will a longer than anticipated life expectancy affect you? Consider the following:

- Will you want to "fully retire" at 55, 60, 65, or 70? In the 1970s when the average life expectancy was 70, it made sense to retire fully to enjoy a few well-earned years of rest and relaxation. But what if you can expect to live vigorously until age 100 or beyond? Retirement will no longer be about just rest and relaxation but will be filled with

education, adventure, alternative employment, and activity.

- Can your pension stay funded if recipients live longer than expected?
- How will longevity affect the already faltering Social Security and Medicare systems?
- Will you have to keep working past "retirement" to supplement your savings?
- Will annuitizing all of your assets (with a very secure insurance company) end up being the best investment of your life?

Estimating Your Own Life Expectancy

What is your life expectancy? No survey, actuarial table, questionnaire, or even your family history can predict your lifespan. "The genes you inherit determine about 20 percent of your life span; your lifestyle choices decide the rest," says Dr. Walter M. Bortz, past president of the American Geriatrics Society.

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THE FAST TRACK TO TROUBLE

by Stewart Farnell, Ph.D., CFP®; Boulder, Colorado

A few months ago I received a solicitation for something called the Home Ownership Accelerator. It promised to let me save tens of thousands of dollars in interest and pay off my mortgage in half the time without changing my spending habits (compared to a conventional mortgage). I was skeptical, knowing that what seems too good to be true generally is. When I saw that the plan involved drawing on a home equity line of credit (HELOC), I let the matter drop, since drawing on HELOCs can be dangerous unless approached very carefully.

However, some of my Cambridge colleagues (Tedd Oyler, Mike Lynch, and Mike Cummings) were more curious. Here's what they found.

The Home Ownership Accelerator replaces a conventional 30-year mortgage with a two-part 30-year mortgage. The first part (years 1 – 10) of your mortgage is held in a HELOC; the second part (years 11 – 30) is in a conventional mortgage. Every month you deposit your paycheck into the HELOC account. This money contributed to the account, before being used to cover checks, reduces your outstanding principal balance, meaning you pay less interest.

Assuming you make a slightly larger mortgage payment each month than you would on your conventional mortgage, the additional principal payment - along with the reduction in your mortgage interest due to the deposit of your paycheck into the account - means the mortgage gets paid more quickly.

The problems with this approach are numerous. For starters, the interest rate floats; you lose the inflation protection and stability of being able to lock in your rate for 30 years; if interest rates go up, you're sunk. Furthermore, you get into the habit of routinely accessing your HELOC (the accelerator account) simple to pay monthly bills. And if you want to buy something and don't have ready cash, no problem; just write a check on the accelerator account (the

HELOC)! The discipline of having to have the money before you spend it just went out the window.



Even if you were prepared to forego the considerable benefits of locking in your mortgage rate for 30 years, you would need iron discipline to both make an extra-large mortgage payment each month and refrain from drawing on the line of credit for purchases you couldn't afford. Perhaps some of my ultra-frugal Scots ancestors could have handled this arrangement, but I don't recommend it for the likes of you or me. ■ ■ ■

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One rule of thumb (if you are male) is to take your father's age at death and the age of your father's father at death (if they died of natural causes), average the results, and add 10 years. If you are female, use your mother and your mother's mother.



There are also some "fun" online life expectancy surveys on the internet. I recently visited the following page on the MSN website (http://moneycentral.msn.com/investor/calcs/n_expect/main.asp) which suggests that I will live to 84.

Ask yourself (after reflecting on your survey results, own lifestyle, and family history), "What is the longest I could see myself living?" Then you will likely have a reasonably conservative estimate of your own life expectancy. You and your advisor can then plan for your prosperous longevity. ■ ■ ■



THE FAMILY THAT WORKS TOGETHER . . . MIGHT SAVE SOME MONEY

Many self-employed people want to hire family members to work for them. But there's a right way and a wrong way to do this. Doing it right can promote family togetherness **and** tax savings.

How so? In essence, you are shifting business income to a relative. And your business can take a deduction for reasonable compensation paid to an employee, which reduces the amount of taxable business income that flows through to you according to the American Institute of Certified Public Accountants' financial literacy web site, <http://www.360financialliteracy.org>.

Of course, you have to do it right. The IRS can, for instance, question compensation paid to a family member if the amount doesn't seem reasonable considering the services actually performed. Also, the AICPA says to be sure that your business complies with child labor laws when hiring a family member who's a minor.

There are other benefits to hiring a family member. As a business owner, you are responsible for paying Federal Income Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes on wages paid to your employees. FICA is the law requiring employers and employees to pay Social Security and Medicare taxes. FUTA is the law that establishes federal unemployment taxes.

As with wages paid to all employees, wages paid to family members are subject to withholding of certain taxes in some states. Typically, the payment of these taxes will be a deductible business expense for tax purposes. But if you hire a family member – a child, spouse, or parent – to work for your business, you may not have to pay FICA and/or FUTA taxes.

For instance, you don't have to pay FUTA taxes for services performed by your child who is under 21. And you need not pay FICA taxes for your child who is under 18 and works in your trade or business or a partnership owned solely by you and your spouse, according to *Working for Yourself* (Nolo Press, \$39.99). For family members under age 18, the parent does not have to withhold for FICA, Medicare, FUTA, and state unemployment taxes. If your spouse is employed, you do not have to withhold for unemployment (federal and state), but you must withhold for FICA and Medicare.

For example, Jacob, age 15, proofreads press releases for his mother's public relations business, which is operated as a sole proprietorship. Jacob is his mother's employee, but she doesn't have to pay FUTA taxes until Jacob turns 21 and need not pay FICA taxes until he reaches 18.

These rules don't apply if you hire your child to work for your corporation, and they don't apply to partnerships if anyone other than the child's parents is a partner. In other words, you must pay both FICA and FUTA taxes in the aforementioned cases. For example, Jack works in a landscaping business that is half owned by his father and half owned by his father's brother. FICA and FUTA taxes will have to be paid because it's a partnership and not all the partners are Jack's parents.

Also note that if your child has no unearned income (dividend income or interest), then you must withhold income taxes from your child's pay only if it exceeds the standard deduction for the year. The standard deduction for 2007 is \$5,350; (it's adjusted every year

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Family Member	FICA (Social Security & Medicare)	FUTA	Federal Income Tax Withholding	SUTA	State Income Tax Withholding
Child under 18 ¹	No	No	Maybe, depending on unearned income and total income	No	Maybe
Child age 18 through 20 ¹	Yes	No	Maybe, same as above	Check with your state	Maybe
Child age 21 or over ¹	Yes	Yes	Maybe, same as above	Yes	Maybe
Spouse ²	Yes	No	Yes	Check with your state	Yes
Parent ²	Yes	No	Yes	Yes	Yes
Siblings or other family members	Yes	Yes	Yes	Yes	Yes

¹ Applies only to sole proprietorships and partnerships or limited liability companies where the only owners are the child's parents.

² Applies only to sole proprietorships.



STORMY WEATHER AHEAD?

by Stewart Farnell, Ph.D., CFP®; Boulder, Colorado

As I write this, the stock market has been climbing for almost four years. Many of us have become accustomed to this rise and unconsciously are expecting it to continue indefinitely. As we comfortably note the gratifyingly high values of our investment portfolios, it might just be time to reflect that what goes up also comes down, that the markets are cyclical, and that now is the time to prepare ourselves for the next market downturn.

I don't know what will be the cause of the downturn, but I know it will come. The market is driven by human emotions, by greed and fear. Right now there is not a lot of fear around, compared to what there was four years ago after the tech bubble burst. That leaves a lot of room for greed. Greed ultimately leads to stocks getting overvalued as optimistic investors push prices higher and higher. Overvalued stock prices, sooner or later, start going down rather than up. That's just the way the roller coaster works.

What can we do? Although we can't stop the roller coaster, there are steps we can take to make the ride more comfortable.

First, we can recognize that declines in the stock market are normal parts of the cycle, which is made up of downs as well as ups. Knowing that a decline is coming and that it is part of the overall picture can make it easier to live with when it happens.

Second, when the stock market goes up, we can systematically take off the table some of our stock market profits and put them into safer investments like



bonds and money market funds. (This is something you and your advisor do automatically each year when you rebalance your portfolio.)

Third, we can keep the risk level of our portfolios from climbing by rebalancing the portfolios each year to their target allocations. (Again, this is something you do with your advisor automatically, as part of your annual investment portfolio meeting.)

Finally, as our portfolios grow and the number of working years we have ahead of us diminishes, we can revise our asset allocations so they are more conservative and less subject to the impact of stock market fluctuations. (This reallocation is not something you do on an annual basis; instead, it is done less frequently, when your portfolio has grown substantially since you last revised its asset allocation or when some other change in your life situation prompts such a revision.)

These steps won't entirely immunize any of us against a stock market decline. We can't eliminate this risk without exiting the stock market completely, which in turn would subject us to different risks - but risks nonetheless. To the extent we are invested in the stock market, our portfolios will decline with it. But taking these steps will reduce the pain of such a decline, both psychologically and in the hit that our portfolios take.

It's good for us to know that the cycles of the market are natural and good for our portfolios and that our financial planning systematically tempers our exposure to market downturns. ■ ■ ■

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for inflation). Children who are paid less than this amount need not pay any income taxes on their earnings. You must, however, withhold income taxes if your child has more than \$250 in unearned income for the year and his or her total income exceeds \$750. If you pay your child more than \$600 during the year, you must file a Form W-2 reporting the earnings to the IRS. Regardless of how much you pay your child, each year you should fill out and have your child sign IRS Form W-4, Employee's Withholding Allowance Certificate, and keep the form for your records.

For small business owners who are engaged in what is often called succession planning, hiring children can provide non-tax benefits as well. Children who play a role in a business can help it survive past the owner's involvement.

Meanwhile, if you employ your spouse to work in your trade or business, the payments are subject

to FICA taxes and federal income tax withholding, but not FUTA taxes. This rule doesn't apply if your spouse works for a corporation, even if you control it, or a partnership, even if your spouse is a partner along with you. In that case, you will have to pay FUTA taxes.

If you employ a parent in your trade or profession, meanwhile, his or her wages are subject to income tax withholding and FICA taxes, but not FUTA taxes.

Since the rules governing the hiring of family members are complex, those considering this should consult with their Cambridge Advisor.

This article was produced by the Financial Planning Association, a membership organization for the financial planning community and is provided by Karen F. Folk, CFP®, an FPA member in Urbana, Illinois.