April/May 2003

Trendlines

New Directions in Business and Personal Planning

Your retirement plan: Building a solid foundation for your financial future

How to safely hire independent contractors

Long-term care insurance — Definitely worth considering

Plus!

FREE supplemental report on the ins and outs of Roth IRAs *(see response form inside)*

F&D

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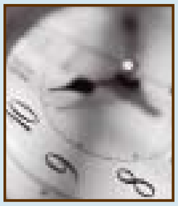


The Essential Basics Of Retirement Planning

Building a Solid Foundation for Your Financial Future

Many retirement discussions sound strikingly similar. They usually begin with a brief mention of retirement planning's importance before launching into lengthy, detailed descriptions of the seemingly countless savings vehicles involved. Although the technicalities of how to save are undeniably important, focusing solely on them may mislead you into overlooking some essential basics — specifically, when you want to retire and how much money you'll need.

These issues matter because blindly trying to amass as much retirement money as possible is a dangerous game. In your drive to succeed, you might lean too heavily on a high-risk investment that doesn't pay off. Or you might skid into unexpected — and unpleasant — tax circumstances. So let's back up and review the "how," "when" and "how much" of retirement planning, instead of just the "how to."

How and When Do You Intend To Retire?

Asking how you intend to live during retirement may seem ridiculous. Most people would simply reply, "Comfortably, of course!" But remember that a wide range of financial and lifestyle goals exists. Your retirement plan must account for your specific needs and desires. For example, if you want to retire early and travel extensively, you'll need a considerably larger retirement nest egg than someone who plans to continue working part-time until age 79 and retire to a locale with a low cost of living.

Pondering what you'll do in retirement will quite naturally lead you to thinking about when you

wish to retire. Current federal statistics place most Americans' life expectancies at more than 80 years old. So a 50-year-old hoping to retire now has another three decades to live while spending increases with inflation. And with modern medical miracles extending our lives by leaps and bounds, you may want to consider even a 40-year retirement. That means your nest egg will need to last a long time. And if you plan accordingly, you'll be able to make sure it does.

How Much Money Will You Need?

When you have a good idea of what you'll be doing in retirement, and when you'll be doing it, you can start getting more specific financially. For instance, assuming you wish to simply maintain your current lifestyle, you'll likely need about 60% to 75% of your current annual income. But don't forget to consider inflation. This adds perhaps another 2% to 3% per year or more to the equation. And if, like many retirees, you decide to move to a warmer climate, you also need to consider the cost of living in that state — and whether you plan to maintain two homes. Plus, some retirees find they can spend as much or more because they have additional time for hobbies and other leisure activities.

On the bright side, you may be able to reduce or eliminate some expenses during retirement. These might include:

- Buying a home and home furnishings, and making home improvements,
- Financing a child's education,
- Paying for weddings or other family celebrations, and
- Maintaining a business wardrobe and vehicle.

Unfortunately, some expense categories will likely increase — most notably healthcare. A recent U.S. Department of Health and Human Services study shows that people age 65 or older face at least a 40% lifetime risk of needing to enter a nursing home. And about 10% will stay there five years or longer.

Even if you stay healthy enough to avoid a nursing home, you should at least expect to incur significant prescription drug costs. (To learn more about planning for potential nursing home costs, turn to "Make a Healthy Choice About Long-Term Care Insurance" on the reverse side of this newsletter's response form.)

When Should You Begin?

Getting started is often the most difficult part of retirement planning. Because retirement seems so distant, people often procrastinate. But your best bet is to begin today — forgive the cliche, but time truly is of the essence. For an example of just how important it is to start your retirement planning as early as possible, see "Time Makes the Difference" below.

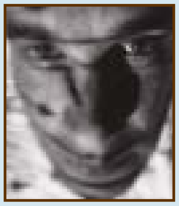
If someone were to ask you about your retirement plan, you might not be able to answer as confidently as you'd like. That's why you should give us a call. We can get you started with some of the basics we mention in this article and then help you select just the right investment vehicles to carry you safely into your golden years. ❑

Time Makes the Difference

Say you'd like to retire at age 65 and you're currently contributing $2,000 a year to a qualified retirement plan. How much will you have in your account when you're ready to retire? Well, the answer depends on the rate of return, including investment appreciation and the length of time the money is invested. Nevertheless, the chart below shows what a difference a few years' change in starting time, as well as different rates, can make to the value at age 65:

Contributions Begin at Age	Value at Age 65 by Rate of Return	
	6%	10%
20	$309,524	$885,185
30	$222,870	$542,049
40	$109,729	$196,694
50	$46,552	$63,545

As you can see, if you begin contributing at age 20 and earn a 10% rate of return, you will have $885,185 in your account when you reach age 65. But if you wait to begin saving until you're 30 under the same conditions, you will end up with only $542,049. That's $343,136 of retirement funds lost by waiting 10 years and not contributing $20,000 ($2,000 per year for 10 years). Does that mean all hope is lost if you've waited beyond age 30 to start saving? Of course not — it just means you may need to save more and be all the more precise and thorough when devising your retirement plan.



Is It Safe?

Learn the Rules Before Hiring Independent Contractors

In terms of profitability, few businesses wouldn't want to follow in the footsteps of Microsoft Corp. But one area where you definitely wouldn't is worker classification. Not too long ago, the IRS reclassified a number of the software giant's independent contractors as employees, costing Microsoft millions in penalties as well as back employment taxes and benefits. This case shed a chilling light on the once-seemingly harmless practice of hiring independent contractors to cut employment costs. Here's a closer look at how to keep your company safe from the dangers of misclassifying workers.

Upsides and Downsides

Some might say that avoiding Microsoft's dire fate is simple: Just don't hire independent contractors. However, some undeniably good reasons exist for doing so. For starters, you don't have to withhold income and Social Security taxes from their pay or owe matching Social Security taxes. You also may forgo including them in employee benefit arrangements, such as profit-sharing plans, qualified pension plans or stock-purchase plans. Nor must you give them vacation and sick days, or pay for insurance and other fringe benefits.

The downsides? Well, as the Microsoft case showed, the IRS often challenges companies it believes are trying to circumvent payroll taxes by classifying actual employees as independent contractors. And if it can prove you're misclassifying workers, you may be subject to serious consequences.

First, you'll need to file and pay the back payroll taxes. The IRS can also hold you liable for several different fines or penalties, ranging in severity from 1.5% to 3% of wages paid to a criminal penalty of $100,000 and/or five years in prison for willfully or intentionally misclassifying workers to evade employment taxes. And, like Microsoft, you may be required to pay the full amount (both the employee's and employer's share, as applicable) of contributions owed to pension plans — retroactive to the date the person was first paid as an independent contractor instead of an employee.

IRS Guidelines

The best way to avoid these harsh effects is by going straight to the source. Although statutes don't define "employee" for income tax purposes, the IRS applies a common-law test embodied in Treasury Regulation (31.3121(d)-l(c)(2)) to classify workers. In fact, the agency issued new guidance just last year on when and how you can ask the Tax Court to review your case. This guidance is called Notice 2002-5, "Notice of Determination of Worker Classification."

The IRS classifies workers primarily based on whether the employer controls what they do and how they do it. To clarify this often fuzzy distinction, the IRS has traditionally published a list of 20 factors derived from the common-law test. These factors ask you to contemplate various aspects of an independent contractor's relationship with you, such as whether the worker:

- Works for more than one company at a time,
- Offers services to the general public,
- Supplies his or her own tools and materials, and
- Hires, supervises and pays assistants.

Independent contractors do these things, regular employees don't. Conversely, you also need to look at activities that would disqualify an independent contractor, such as whether he or she received training at — and appears integrated into — your company. In addition, does he or she follow work sequences you set and personally provide these services on your premises? Do you require the independent contractor to work full time, and do you pay him or her hourly, weekly or monthly wages? Answering "yes" to any of these questions doesn't necessarily indicate the worker is an employee. But it could mean trouble, depending on your situation.

Bear in mind, the 20 factors are guidelines — not hard-and-fast rules, and not all factors are relevant in every case. The IRS has the discretion to make conflicting decisions, using the factors to support its choices. And some IRS examiners view them differently than others, depending on the job and circumstances.

Compliance Tips

Your safest course of action is to establish clear procedures for how your company controls an independent contractor's activities and compensates him or her for them. Pay these workers by the job and only when they submit invoices to you. Don't pay them a weekly or monthly salary. Each year end, file a Form 1099 for each independent contractor to whom you paid at least $600 during the year.

Moreover, familiarize yourself with the professionals who customarily act as independent contractors. For instance, practitioners such as doctors, lawyers, architects, accountants and consultants commonly perform as short-term workers for specific kinds of cases and projects. Similarly, creative freelancers (such as editors and programmers) and tradespeople (such as carpenters and plumbers) are usually accepted as independent contractors. If

your company hires these types of workers, you're more likely to convince the IRS that they're not really your employees. But don't rely on that alone.

Also check to see whether businesses similar to yours have successfully defended themselves against IRS worker reclassification. In some circumstances, a safe haven rule — dealing with only employment taxes — exists. It protects taxpayers that consistently treat workers as independent contractors, but doesn't apply to technical workers. To qualify, you must meet certain tests — such as having a reasonable basis for treating workers as independent contractors. One defense is a long-standing practice in your industry. But watch out: The IRS may come calling if your company reports significantly more independent contractor compensation than is standard in your line of business.

Classification Confusion

If you find the worker classification rules confusing, or at least intimidating, you're not alone. Many companies struggle with this issue. What's worse, the IRS isn't alone in its scrutiny of independent contractors. Your state's labor department may have rules all its own. What can you do to avoid repeating Microsoft's mistake? Call us: We'd be happy to review your independent contractor agreements — or help you create new ones. ❑

Make a Healthy Choice About Long-Term Care Insurance

Sheila is concerned about going into a nursing home. Not right now, of course — she's a healthy 50-year-old. But she read that nursing home costs can average between $50,000 and $105,000 annually. What's worse, Sheila recently watched helplessly while her mother was forced to spend down her assets to qualify for Medicaid. With these fears swirling in her mind, Sheila visited her financial professional to inquire about a possible cure for her future medical care woes: long-term care insurance.

Essentially, long-term care insurance offers an alternative, albeit an expensive one, to employer health insurance (which often falls short of complete coverage) and Medicaid (which comes with some nasty finance-draining requirements). These policies cover medical, skilled-nursing and nonmedical services for people who suffer from chronic illnesses — defined as conditions that require care for at least 90 days.

Covered services typically include home care; assisted living for tasks such as bathing, dressing, taking medication and grocery shopping; adult day care; and nursing home residence. Keep in mind, long-term care policies may limit coverage for pre-existing conditions, but may not exclude coverage based on treatment type, accident or non-pre-existing conditions.

Consider Your Circumstances

As mentioned, long-term care insurance isn't for someone on a tight budget. Those who need it the most may have difficulty affording the premiums. Thus, you must weigh your ability to save for retirement against your potential healthcare needs. Also factor in alternatives, such as relatives who may be able to care for you or whether you have adequate assets to insure yourself. Be aware that new elder-care communities are being built where all potential costs are covered once you move in and pay the admission fee.

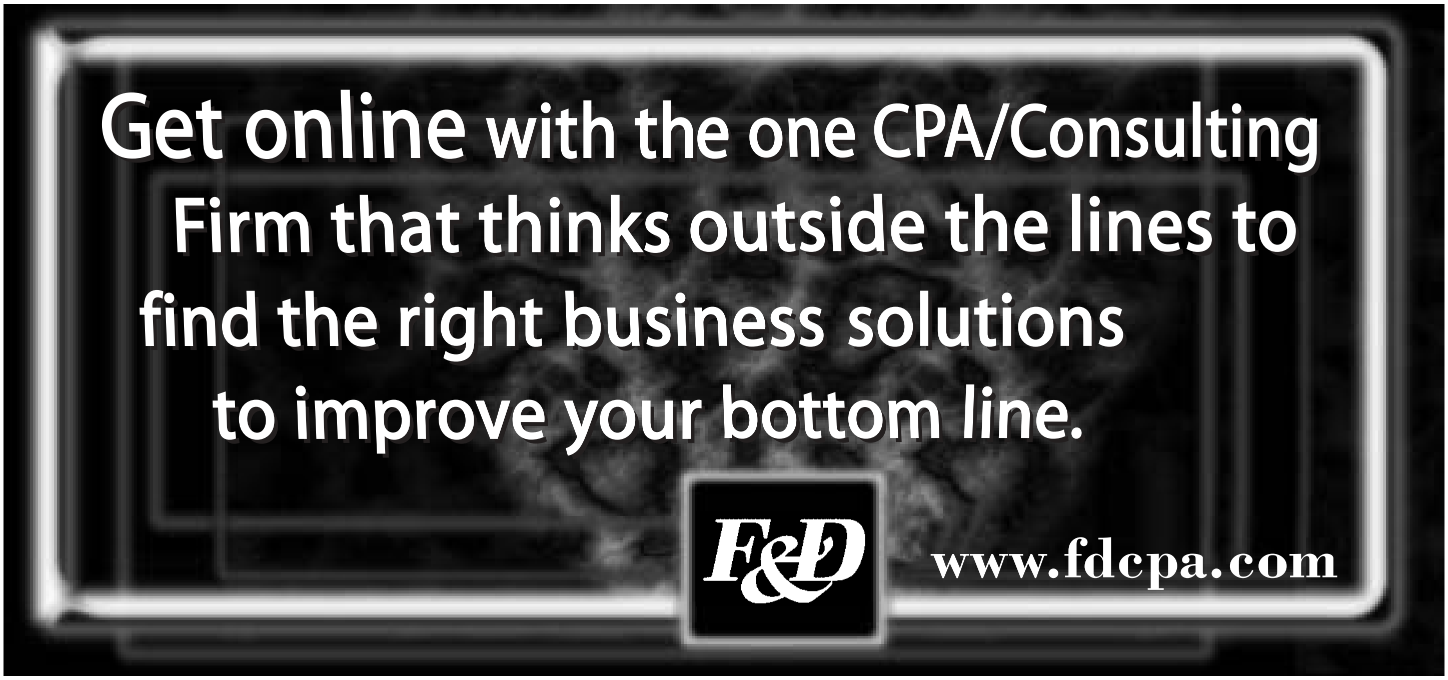
Another important consideration is your age. The younger you are when you buy long-term care insurance, the lower your monthly premiums will be. For example, premiums starting at age 60 can be more than twice as expensive as premiums for the same coverage starting at age 50. So at her age and health, Sheila has picked an ideal time to consider a policy. Sadly, people already in poor health, and those over age 84, will have difficulty qualifying for long-term care coverage. Also note that the cost of monthly premiums varies depending on the state in which you live and the amount of coverage you want.

Besides the obvious healthcare benefits, long-term care insurance can offer some tax advantages as well. Under the Health Insurance Portability and Accountability Act of 1996, the IRS will treat qualified policies the same as health and accident insurance. Policyholders can — if they itemize their medical and dental expenses — deduct premiums up to a limit based on their age. Keep in mind, to qualify for the deduction, total annual medical and dental expenses must exceed 7.5% of your adjusted gross income.

Ask for Help

Deciding whether to buy long-term care insurance isn't something to do alone. These policies can be prohibitively expensive for those not equipped to pay for them. On the other hand, if one does suit you financially, a long-term care policy can drastically cut your healthcare costs later in life and plug a potential gaping hole in your retirement plan. So please call us; we'd be happy to guide you through this critical decision. ❑

See other side to order your FREE report on the ins and outs of Roth IRAs . . .



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Is worrying you'll have enough for retirement giving you a headache?

You may find some relief in the form of a Roth IRA, which allows you to put money away today and never pay tax on any growth. ***To learn more about Roth IRAs, just complete this form and fax or mail it back — or CALL US today!***

EXPRESS RESPONSE FORM

❑ **Yes!** Please send me a copy of your informative report, **"Building a Larger Nest Egg With a Roth IRA: Tax-Free Growth and Other Advantages Provide a Powerful Savings Opportunity."**

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