Jepsen Financial
Les Jepsen
8075 9th Street Way N
Saint Paul, MN 55128
651-264-1979
jepsenfinancial@gmail.com
JepsenFinancial.com

"The greatest use of life is to spend it for something that will outlast it." — William James

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Investments | Insurance | Retirement | Planning | Advice

Financial Update

Ideas and Action Steps for Achievers

Saving for Retirement and a Child's Education at the Same Time

You want to retire comfortably when the time comes. You also want to help your child go to college. So how do you juggle the two?

Know what your financial needs are

The first step is to determine what your financial needs are for each goal. Answering the following questions can help you get started:

For retirement:

- How many years until you retire?
- Does your company offer an employer-sponsored retirement plan or a pension plan? Do you participate? If so, what's your balance? Can you estimate what your balance will be when you retire?
- How much do you expect to receive in Social Security benefits?
- What kind of lifestyle do you hope to have in retirement? For example, do you want to travel extensively, or will you be happy to stay in one place and live more simply?
- Do you or your spouse expect to work part-time in retirement?

For college:

- How many years away is college?
- Will your child attend a public or private college? What's the expected cost?
- Do you have more than one child?
- Does your child have any special skills that could lead to a scholarship?
- Do you expect your child to qualify for financial aid?

Figure out what you can afford to put aside each month

After you know what your financial needs are, the next step is to determine what you can afford to put aside each month. To do so, you'll need to prepare a detailed family budget that lists all of your income and expenses. Once you've come up with a dollar amount, you'll need to decide how to divvy up your funds.

Retirement takes priority

Though college is certainly an important goal, you should probably focus on your retirement if you have limited funds. With generous corporate pensions mostly a thing of the past, the burden is primarily on you to fund your retirement. But if you wait until your child is in college to start saving, you'll miss out on years of tax-deferred growth and compounding of your money. Remember, your child can always attend college by taking out loans (or maybe even with scholarships), but there's no such thing as a retirement loan!

Help! I can't meet both goals

If the numbers say that you can't afford to educate your child or retire with the lifestyle you expected, you'll have to make some sacrifices. Here are some things you can consider.

Defer retirement: The longer you work, the more money you'll earn and the later you'll need to dip into your retirement savings. Or, consider working part-time during retirement.

Make changes to your lifestyle now or in retirement: You might be able to adjust your spending habits now, or you may consider cutting back in retirement.

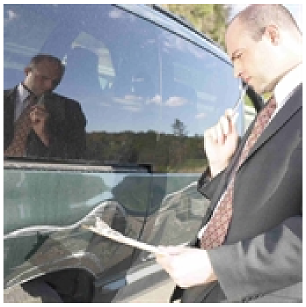
Increase your earnings now: Consider increasing your hours at your current job, finding a new job with better pay, taking a second job, or having a previously stay-at-home spouse return to the workforce.

Invest more aggressively: But remember that aggressive investments mean a greater risk of loss.

Send your child to a less expensive school: Don't feel guilty--a lesser-known liberal arts college or a state university may provide your child with a similar quality education at a far lower cost.

See disclaimer on final page

Are There Gaps in Your Insurance Coverage?



If you own a condo, your association's property insurance may leave gaps in coverage. For example, most association insurance doesn't cover your furniture, wall coverings, electronics (e.g., televisions, radios), interior walls, and structural improvements made to the interior of your unit. Review your condo documents, particularly the master deed, which may describe those parts of your unit the association insurance covers, and which parts you may need to insure.

Buying insurance is about sharing risk. For example, health insurance will cover some of the cost of getting and staying healthy. Homeowners insurance will assume the risk of loss in case your home is damaged or destroyed. But oftentimes, we think we're covered for losses by insurance when, in fact, we're not. Here are some common coverage gaps to remember when reviewing your own insurance coverage.

Life insurance

In general, when coupled with savings and income, you want to have enough insurance that will allow your family to continue to live the lifestyle to which they're accustomed. But changing circumstances may leave a gap in your life insurance coverage.

For example, if you have life insurance through your employer, changing jobs could affect your insurance coverage. You may not have the same amount of insurance, or the policy provisions may differ. Your coverage may have decreased, or the type of insurance may have changed. Where your prior employer may have provided permanent life insurance, now you may have term insurance that will expire on a predetermined date. Review your income, savings, and expenses annually and compare them to your insurance coverage. Changing circumstances may require more insurance. Your financial professional can help you determine if you have enough coverage to meet your family's future income needs.

Homeowners insurance

Homeowners insurance can be tricky as to what perils are covered and how much damage will be paid for. Clearly, it's important to know what your homeowners policy covers and, more importantly, what it doesn't cover.

You might think your insurer would pay the full cost to replace your home if it were destroyed by a covered occurrence. But many policies place a cap on replacement cost up to the face amount stated on the policy. You may want to check with a building contractor to get an idea of the replacement cost for your home, then compare it to your policy to be sure you have enough coverage.

Even if your policy states that "all perils" are covered, most policies carve out many exceptions or exclusions to this general provision. For example, damage caused by floods, earthquakes, and hurricanes may be covered only by special addendums to your policy, or in some cases, separate insurance altogether. Also, your insurer may not cover the extra cost of rebuilding attributable to more stringent building codes, or your policy may limit how much and for how long it will pay for temporary housing while repairs are made.

To avoid these gaps in coverage, review your policy annually with your agent. A face-to-face meeting is always best with the policy right there in front of both of you. Also, take heed of notices you may receive. While it looks like boilerplate language, it could actually be changing your coverage significantly. Don't rely on your interpretations--seek an explanation from your insurer or agent.

Auto insurance

Which drivers and what vehicles are covered by your auto insurance? Most policies provide coverage for you and family members residing with you. So your child who is living in a college dorm is probably covered, but living in an off-campus apartment might exclude your child from coverage. If you and your spouse divorce, which policy insures your children who are living with each parent at different times during the year? Notify your insurer about any change in living arrangements to avoid a gap in coverage.

Other gaps include no coverage for damaged batteries, tires, and shocks. And you might not be covered for stolen or damaged cell phones or other electronic devices (e.g., MP3 players). Your policy may also limit the amount paid for a rental while your vehicle is being repaired.

In fact, insurance coverage for rental cars also poses many gaps in coverage. For instance, your own collision coverage may apply to the rental car you're driving, but it may not cover all of the damages alleged by the rental company, such as loss of use charges. If you're leasing a car long-term, your policy may only cover the replacement cost if the car is a total loss or is stolen. But that amount may not cover the outstanding balance of your lease. Gap insurance can cover any difference between what your insurer pays and the balance of your lease.

Policy terms and conditions aren't always well defined, and you may not understand what's covered until it's time to file a claim. So review your insurance coverages with your financial professional to be sure you've filled all the gaps in your coverage.

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Life Insurance Policy Loans: Tax and Other Implications

What is a MEC?

A life insurance policy purchased after June 20, 1988, is a modified endowment contract if the accumulated premiums paid at any time during the first seven years exceed the sum of the net level premiums for a policy that would be paid up after seven years. A single premium policy is one example of a modified endowment contract. (Your life insurance company or life insurance agent can tell you if a policy is a modified endowment contract.)

As the owner of a life insurance policy, you can generally borrow the policy's cash surrender value and use the proceeds for any purpose. Before you take a policy loan, be sure you understand the implications of the loan on the policy itself as well as any tax implications, now and in the future.

Effect of policy loan on policy

You can generally borrow an amount up to the policy's cash surrender value (less an adjustment for interest) from the insurer. The insurer will charge you interest on the loan. Generally, interest is not actually paid, but is added to the amount of the loan. Interest charged on a policy loan is not generally deductible for income tax purposes. There could be other adjustments as well under the contract; for example, a participating policy may restrict the payment of dividends to you while a loan is outstanding.

You are not required to repay a life insurance policy loan. But you can generally repay a life insurance policy loan at any time while the insured is alive. If you do not repay the loan, the cash surrender value paid to you or the policy proceeds at death will be reduced by the amount of the loan (plus interest). Thus, a loan generally reduces life insurance protection.

If the amount borrowed plus interest ever equals or exceeds the cash surrender value, the policy can terminate if additional amounts are not paid into the life insurance policy. Life insurance protection could be lost.

If you have any incidents of ownership in a life insurance policy on your life, proceeds paid at death are includable in your gross estate for federal estate tax purposes. The right to obtain a policy loan is an incident of ownership. Generally, life insurance proceeds received at death by your beneficiary are received income tax free.

Taxation of policy loan

You can borrow against your life insurance policy, and the loan proceeds are generally not taxable to you (unless the policy is a modified endowment contract (MEC), see sidebar).

A loan from a MEC is treated as a distribution from the MEC. A distribution from a MEC is subject to the income-out-first rule. As amounts are distributed, they are treated as consisting of taxable income to the extent that they do not exceed the excess of the cash surrender value of the policy over the investment in the contract (generally, premiums paid less tax-free distributions). The taxable income will also be subject to a 10% penalty tax unless the distribution is made after age 59½, on account of disability, or as part of a series of substantially equal periodic payments.

Example(s): *You have a MEC with a cash surrender value of $100,000. You have paid premiums of $50,000. You take a policy loan for $60,000. The first $50,000 ($100,000 cash surrender value - $50,000 investment in the contract) of the loan is taxable income to you.*

Lapse or surrender of policy

An outstanding loan is generally treated as an amount received if a policy lapses or is surrendered and may result in taxable income. A policy can lapse if premiums are not paid and the policy terminates when any policy benefits are exhausted as a result. Also, as noted above, if the amount borrowed plus interest ever equals or exceeds the cash surrender value, the policy can terminate if additional amounts are not paid into the life insurance policy. You can cash in a policy by surrendering the policy to the insurer in return for the policy's cash surrender value (as reduced by the amount of the loan plus interest).

If you surrender your policy to the life insurance company or the policy lapses, any gain realized is taxable at ordinary income tax rates. The gain is the excess of the amount you receive over the net premium cost. The net premium cost is the total premiums you paid less any tax-free distributions received. An outstanding loan is generally treated as an amount received if a policy is surrendered or lapsed and may result in taxable income.

Example(s): *You have a life insurance policy with a cash surrender value of $200,000. You have paid premiums of $75,000. You also have an outstanding policy loan of $175,000. There have been no distributions from the policy. You surrender the policy to the insurer for $25,000 cash. You have taxable ordinary income of $125,000 ($25,000 cash + $175,000 loan - $75,000 premiums). If you have not prepared for it, it may come as quite a shock.*

Example(s): *You have a life insurance policy with a cash surrender value of $200,000. You have paid premiums of $75,000. You also have an outstanding policy loan of $200,000. There have been no distributions from the policy. The policy lapses. You have taxable ordinary income of $125,000 ($200,000 loan - $75,000 premiums). Once again, if you have not prepared for it, it may come as quite a shock.*

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Ask the Experts

Jepsen Financial
Les Jepsen
8075 9th Street Way N
Saint Paul, MN 55128
651-264-1979
jepsenfinancial@gmail.com
JepsenFinancial.com

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I'm buying a laptop online--will I have to pay sales tax?

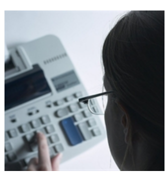
There are currently five states that do not have a sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon. If you live in one of the other 45 states, or in the District of Columbia, you're probably legally responsible for paying some form of sales or use tax on your laptop purchase. And, to complicate matters even further, many municipalities assess a sales tax as well.

That doesn't mean an online merchant will collect the tax on your purchase from you, though. States can only force a merchant to collect state sales tax if the merchant has a significant enough physical presence in the state (think stores, distribution centers, corporate offices). This isn't unique to online merchants--the same rules apply to any out-of-state company that you purchase goods from.

So, it's entirely possible that you could order a laptop online from Company A, a company with an in-state sales staff, and have to pay sales tax as part of the purchase, but order the same laptop online from Company B, a company with no in-state connection, and not have to pay sales tax as part of the transaction. Of course, a merchant can voluntarily collect sales tax for a state, even if they're not required to do so.

Just because the merchant doesn't collect sales tax doesn't necessarily mean that you're off the hook, however. Most states that impose a sales tax also have a related use tax. Essentially, a use tax means that if you should have paid sales tax on a purchase, but didn't because the merchant wasn't required to collect the tax, you're responsible for reporting the purchase yourself and paying the appropriate amount of tax.

The details vary from state to state--some states include the use tax calculation on state income tax returns, while others use separate forms. Of course, because the use tax relies on individuals self-reporting their purchases, and states have a limited ability to enforce compliance, it probably isn't surprising that many consumers simply do not report their online purchases.



Can I deduct state sales tax on my federal income tax return?

If you itemize deductions on Schedule A of IRS Form 1040, you are generally able to deduct state and local taxes, including income tax, real property tax, and personal property tax. For 2011, if it works to your benefit, you can elect to deduct state and local general sales tax in lieu of state and local income tax. One thing to keep in mind: if your total itemized deductions don't exceed your standard deduction amount (for 2011, as an example, a married couple filing a joint federal income tax return would typically be able to claim a standard deduction of at least $11,600), you generally won't get any additional tax benefit from deductions you claim on Schedule A.

When claiming a deduction on Schedule A for state and local sales tax, you have two options. You can deduct the amount that you *actually paid* in sales tax, as evidenced by receipts that you have accumulated showing amounts paid. Alternatively, you can use tables published by the IRS that are based on average consumption in each state, and factor in modified adjusted gross income and number of exemptions. Even if you use the optional tables, you're still generally able to deduct the sales tax on certain specified items, like cars and boats.

One caution here: special rules apply to married couples who file separate federal income tax returns. If both you and your spouse elect to deduct state and local sales tax in lieu of income tax, and your spouse elects to use the optional state sales tax tables, you'll have to use the tables as well.

Things can get a little more complicated if you lived in more than one state during the year, or if the sales tax rate for the state in which you live changed during the year. Currently, the ability to deduct state and local sales tax in lieu of income tax expires at the end of 2011. And, if you're subject to the alternative minimum tax, the AMT rules may limit the deductions available to you, including the deduction for state and local taxes.

For additional information, talk to a tax professional, and see IRS Publication 600, *State and Local General Sales Tax,* and the instructions for IRS Form 1040, Schedule A.