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How Much Life Insurance Do You Really Need?



Having adequate life insurance is particularly important if you have dependents and your estate is modest. But buying too much insurance is a needless expense. There are two steps you should take to assure adequate protection at the lowest possible cost.

First, you must determine the amount of insurance that will satisfy your specific needs. Second, you must choose the type of insurance that's best for your situation.

How to determine the amount you need

The traditional rule-of-thumb was that you should purchase coverage equal

to five times your salary, but today's financial advisors recommend a simple four-step method to pinpoint exactly how much life insurance you need.

- 1. Determine your family's living expenses.** Be sure to include food, clothing, housing, utilities, transportation, insurance, education, medical care, and taxes.
- 2. Calculate the portion of your family's expenses that are attributable to you.** As a general rule, it takes about 70% of current income to maintain a family's standard of living if one spouse dies.
- 3. Divide the annual income your family will need by 7%.** This will give you the amount of money that would have to be invested at 7% to receive the annual income you determined in step two.
- 4. Deduct your income-producing assets from the amount needed.** This will tell you the amount of insurance you need.

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CLIENT'S tax & financial UPDATE

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taxPOINTS

Bequests. These are tax free to recipients, and all taxable gain on bequeathed assets is eliminated at the owner's death through "stepped-up basis." This resets the basis of inherited property at its market value as of the date of the owner's death. **Example:** A parent owns appreciated investment real estate that would produce a \$1 million taxable gain if he sold it. If he instead bequeaths the property to his children, they can sell it tax free for its value at the date of his death.

Roth IRA and Roth 401(k) earnings.

Contributions to these retirement savings accounts aren't deductible, but all investment returns earned in them and distributions from them can qualify to be totally tax free.

Long-term planning: There is a real risk that tax rates will increase in coming years due to the large budget shortfalls and surging costs of Medicare and Social Security. If tax rates do rise, tax-free income from Roth IRAs and Roth 401(k)s will become even more valuable compared with retirement income taxed at ordinary rates when received from traditional IRAs and other kinds of retirement plans.

Loss carrybacks. When expenses from a trade or business exceed your revenues for the year, you may have a net operating loss. If you had a loss in 2010, you can use it to get an immediate infusion of cash. You can generally carry back a net operating loss for two years. The loss carryback will offset your income in those years so that you can get a tax refund. **Added bonus:** You can elect to waive the entire carryback period and carry the loss forward to the 20 years following the loss year.

Why A 401(K) Plan Is Better Than an IRA

If you have to choose between investing in a company 401(k) plan and investing in your own IRA, the 401(k) is a hands-down winner. Here's why:

	IRA	401(k) PLAN
Maximum amount you can contribute	\$5,000	100% of earned income not to exceed \$16,500
Maximum catch up contribution	\$1,000	\$5,500
Ability to borrow from the plan	No	Yes, if the plan's terms provide for it
When you can withdraw your money	Age 59 /2. Earlier withdrawals incur a penalty	After age 55 without penalty if your employment is terminated
Employer contributions	Not allowable	Tax free employee fringe benefit and amount determined by the plan's terms

Furthermore, because contributions to a 401(k) plan can often be greater than an IRA, it reduces your Adjusted Gross Income by an even greater amount than an IRA. This effectively increases the amount you can deduct for your medical expenses, miscellaneous itemized deductions, and casualty and theft losses because these items are only deductible to the extent that they exceed a certain percentage of your Adjusted Gross Income.

The lower your Adjusted Gross Income, the greater your allowable deduction for medical, casualty, theft and miscellaneous expenses.

Additional Bonus:

If your company's 401(k) plan reduces your Adjusted Gross Income to less than \$110,000 on a joint return (or \$66,000 on a single return), you may then be allowed to contribute to both a 401(k) plan and a fully deductible IRA under the tax laws.

Cutting Costs

A business can sometimes save money by contracting out certain work to its own employees. For example, one firm was about to use a private janitorial service when several of its employees offered to do the work

on their own time for less money. The company lowered its costs and got a better job as well, since the employees were more familiar with the premises than an outside janitorial service.

Companies can often lower the cost of insurance by improving their security systems. A business that reduces the risk of property damage can usually earn substantial discounts from regular premium rates. It's best for companies to check with their insurance company to determine premium reductions for various types of security systems before installing them.



How to Head Off a Financial Crisis

Many financial crises can be avoided if businesses pay attention to certain warning signals. Here are the most common signs that a financial crisis is approaching:

- Sales and profits consistently fall short of projections over a period of time.
- Inventories show a steady growth pattern.
- Indebtedness climbs.
- Available capital declines as cash flow problems mount.

Each of these problems indicate that a company is heading for real trouble and that prompt and decisive action must be taken.

Institute cash flow controls. Isolate the areas of the business which are draining cash from the company. Don't get bogged down on small items that prevent you from seeing the big picture. It's not uncommon for a company to encounter cash flow problems because a major segment of the business simply isn't profitable. If you discover that situation in your business, don't hesitate to scale down, or even elimi-

nate, the unprofitable segment.

Slim down fat inventories. High inventory levels mean that sales are off or that purchasing is mismanaged. Cure this situation by selling excess inventory and installing controls to make sure that purchasing levels are based on current sales, not projected sales.

Speed up collections. Improved billing procedures mean faster invoicing and earlier collections, so if your company can ship most of its orders promptly, prepare invoices before the goods are shipped. Invoice more frequently. Accumulating large batches of invoices before billing slows down cash flow. Finally, negotiate extended terms of payment with major vendors.

Review all product lines. Consider discounting any products that are not profitable. Many businesses fail to realize that a deliberate reduction in sales can mean a return to profitability.

Reduce overhead immediately. Cut the workforce to the lowest level possible. Make sure that employees who remain can make a direct contribution to solving the company's problems.

Lowering the Estate Tax

The federal estate tax has been given a short reprieve. The exemption has been raised to \$5 million and the top rate reduced to 35% through December 31, 2012. After 2012, the exemption will be lowered back to \$1 million and the maximum rate will be raised to 55%.

The estate tax exemption is now portable between spouses, allowing a surviving spouse to elect to take advantage of the unused portion of the estate tax exclusion of the predeceased spouse, thereby providing the surviving spouse with a larger exclusion amount.

Example. A husband dies and leaves \$2 million to his children and the remainder to his wife, the wife is now able to use the \$3 million unused exemption, giving her an \$8 million estate and gift tax exemption.

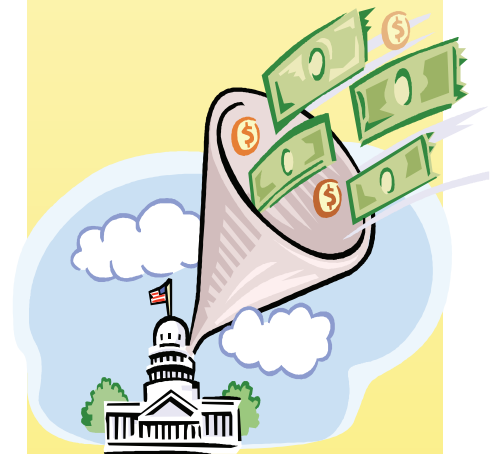
This change is for people dying in 2011 and 2012, as the law currently reads. Review your wills this change may eliminate the need to have married couples set up trusts in their wills for the sole reason to save estate taxes.

Tax Tip: Don't give your home to your child

If you give your home to your child while you're still living, the IRS will consider the child to have received it on a "carryover basis", which is your original cost plus certain adjustments.

When the house is later sold, the child will be taxed on the difference between the adjusted carryover basis and the sale price.

On the other hand, if you will your home to your child, the tax consequences will be more favorable. You and your spouse can will up to \$10,000,000 in assets free of estate taxes, and if your child sells the inherited house, the taxable gain will be based on the difference between a stepped-up basis and the sale price – usually a substantial savings.



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Example	
Your family's present yearly expenses	\$100,000
Your family's yearly expenses if you die (\$100,000 x 70%)	70,000
Amount of capital needed to earn \$70,000 annually ($\$70,000 \div .07$)	\$1,000,000
Less income producing assets	200,000
Amount of insurance needed	\$800,000

When you need temporary insurance

If your life insurance needs are temporary, buy term insurance. Term insurance is cheaper than permanent insurance because it protects you for a limited number of years rather than for your lifetime. It also does not build up a cash value.

Term insurance can be the right choice if you can't yet afford the permanent coverage you need, or if you have short-term debt that you don't want your family to be responsible for.

When you buy term insurance, consider the following features:

Guaranteed renewability. This is a must. Although it increases the premium, it lets you renew your insurance at a guaranteed rate without having to pass a medical examination.

Re-entry privilege gives you the option of taking a medical exam at the time of renewal. If you pass the exam, it can mean a lower premium than your policy's stated guaranteed renewable rate.

Convertibility lets you convert your term insurance to permanent insurance up to a specified age without taking a physical exam.

When you need permanent insurance

There are many types of permanent insurance. The most common types are:

Whole life insurance, which provides a guaranteed death benefit and a cash value with a guaranteed minimum interest rate.

Universal life insurance, which combines insurance coverage with investing. The policy's return fluctuates, depending on the performance of the insurance company account in which you invest. Cash value isn't guaranteed, but can increase if the investment account does well. The death benefit also fluctuates, but usually not below a guaranteed minimum.

Universal variable life insurance combines the premium option of the universal life insurance with the investment features of variable life insurance.

Single premium life insurance provides relatively low death benefits because most of the premium payments go into the investment portion of the policy, which is primarily a tax-sheltered investment vehicle.

Job Hunting Deductions

When you search for a new job in your current line of work, your search costs are deductible as an employee business expense. This is true whether or not you are currently employed, and whether or not your job search is successful. Deductible items include...

- Employment agency and outplacement agency fees incurred to find a new job.
- Resume costs, including expenditures for typing, printing, mailing, and distributing copies of your resume
- Travel expense when you travel in search of a job. You can deduct the cost of travel to a distant location if the primary purpose of the trip is to look for a new job, even if the trip has a secondary pleasure element.
- Transportation expenses incurred in job-search-related travel in your local vicinity. Examples: Taxi cabs, buses, etc.
- Meal and entertainment expenses incurred as part of a job search.

