



SOCIETY FOR FINANCIAL EDUCATION AND PROFESSIONAL DEVELOPMENT

Enhancing financial and professional growth.

1212 New York Avenue NW, Suite 310
Washington, DC 20005
(202) 842-3807 • (301) 203-0289 Fax
www.sfedp.org

financial



U C C E S S

FEBRUARY 2007

Retirement Planning throughout Your Life

After working 40 or 50 years, you could find yourself retired for another 20 or 30 years. To support yourself without a job for 20 or 30 years, you should probably be planning for retirement during your entire working life. However, your concerns and strategies for retirement will change as you age. Consider these tips:

In Your 20s

While you may just be getting started in your career, don't squander the long time period before retirement that can help your retirement funds grow and compound. Some strategies to consider include:

✓ Start saving for retirement now. Saving even small amounts can help you accumulate significant sums by retirement age. For instance, if you invest \$2,000 per year from age 25 to age 65 in a tax-deferred account earning 8% per

year, you could accumulate \$518,113 by age 65. *(This example is provided for illustrative purposes only and is not intended to project the performance of a specific investment vehicle.)* Try to save at least 10% of your income, but if you find that difficult to do, at least start saving something. Get in the habit of saving at a young age, before you get used to spending all your income.

✓ Investigate different retirement savings vehicles. If your employer offers a 401(k) plan, start contributing as soon as you can. You should at least contribute enough to take full advantage of any matching contributions offered

by your employer, which can significantly increase your savings. For instance, assume you earn \$50,000 per year and your employer matches 50 cents on every dollar of contributions up to 6% of your salary. If you contribute 6%, you will make a contribution of \$3,000 and your employer will contribute \$1,500. If your employer doesn't offer a 401(k) plan, contribute to an individual retirement account (IRA), either traditional or Roth. Investigate the differences to determine which is better for your situation.

Continued on page 3

Clarification on IRA Disclaimers

An important estate planning option for inherited individual retirement accounts (IRAs) is the ability to disclaim all or a portion of the IRA. If a beneficiary disclaims an IRA within nine months of the decedent's death, the disclaimed IRA is not considered a gift when it is received by the contingent beneficiary. However, the nine-month deadline often comes after the deadline for taking the required minimum distribution (RMD). Since the primary beneficiary is not supposed to receive any benefit from the IRA before disclaiming it, there was a question as to whether the IRA had to be disclaimed before the date for the RMD.

The Internal Revenue Service (IRS) issued a revenue ruling in 2005 clarifying this situation. It allows the primary beneficiary to take the RMD before the December 31 deadline and still disclaim the balance of the IRA within the nine-month deadline. The primary beneficiary cannot direct who will receive the disclaimed IRA, since that is controlled by the decedent's designation or the terms of the IRA agreement itself.

○○○



Who Is Affected by the AMT?

The alternative minimum tax (AMT) was originally designed to ensure wealthy taxpayers paid at least a minimum amount of tax. However, due to the tax calculation, more and more taxpayers are becoming subject to the AMT. For instance, 3.6 million taxpayers paid the AMT with their 2005 tax returns, with that number projected to increase to 30 million, or 20% of all taxpayers, by 2010.

To calculate AMT, you add several common deduction items to your taxable income, subtract the AMT exemption amount (\$62,550 for married taxpayers filing jointly, \$42,500 for single taxpayers, and \$31,275 for married taxpayers filing separately in 2006), and multiply the result by the AMT rates — 26% of the first \$175,000 of income and 28% on amounts over that. If the AMT exceeds your regular income tax, the difference must be paid as the AMT.

Why are so many taxpayers becoming subject to the AMT? A primary reason is that ordinary income tax brackets are adjusted for inflation annually, while the AMT exemption amounts are not adjusted for inflation. Another reason is that regular income tax rates were recently reduced, while the AMT tax rates remained the same.

Low-income taxpayers are typically not subject to the AMT because the AMT exemption amounts shield them from the tax. Very wealthy taxpayers are also not typically affected because their overall tax rates are higher than the AMT tax rates. The Congressional Budget Office estimates that taxpayers earning between \$50,000 and \$200,000 will be the hardest hit by the AMT in the near future. It is estimated that if the AMT is not revised, it will affect 17% of taxpayers with income between \$50,000 and \$75,000, 53% of those with income between \$75,000 and \$100,000, 81% of those with income between \$100,000 and \$200,000, and 94% of those with income between \$200,000 and \$500,000 (Source: Urban-Brookings Tax Policy Center Microsimulation Model, 2005). By 2007, the U.S. government will receive more tax revenue from the AMT than from regular income taxes. ○○○

Reviewing a Company's Annual Report

Whether you're researching a stock to purchase or monitoring a stock you own, the company's annual report should be central to your analysis. Annual reports generally contain three key sections — management's message to shareholders, a discussion of the company's operations, and the financial statements. Keep these points in mind when reviewing the annual report:

 **Read the independent auditor's report.** In most cases, you'll find an unqualified opinion stating the financial statements were audited in accordance with standards of the Public Accounting Oversight Board and present fairly, in all material respects, the financial position of the company for the last three years. You'll want further details if the report indicates problems, concerns about the company's ability to stay in business, or incidences where the financial statements do not follow generally accepted accounting principles.

 **Review management's discussion carefully.** You want to feel comfortable that management is candid and straightforward about the company's results and is not glossing over problems or concerns. You should get a feel for the company's future prospects, its competitive position, and any significant risks to business operations.

 **Look for important facts in the footnotes.** Information about outstanding litigation, class action suits, derivative exposure, environmental problems, and unfunded pension liabilities can be found here, alerting you to potential problems. Changes in account-

ing policies will also be discussed, which may indicate that management is making changes to improve financial results. You can also find important information about the company's business, including whether any customer accounts for more than 5% to 10% of sales, how much is spent on advertising and research and development, what shareholders' rights plans are in effect, how many stock options are outstanding, information on acquisitions and divestitures, and details on business segments.

 **Analyze financial trends over at least a three-year period.** Review whether sales and profits are increasing or decreasing. Also, calculate the profit margin (net income divided by revenues) and the return on equity (profits divided by average shareholder equity), comparing these to prior years and to ratios for other companies in the same industry.

 **Review the company's financial solvency.** Calculate the current ratio (total current assets divided by total current liabilities) to track the company's ability to pay creditors over the short term. Longer-term solvency can be measured by dividing total liabilities (the total of current liabilities, long-term debt, other liabilities, and deferred income taxes) by total assets. Compare these numbers to the company's figures from prior years and to other companies in the same industry to see if there is cause for concern.

It takes time and careful analysis to get a complete picture from the information presented in an annual report. Please call if you'd like help with this process. ○○○

Retirement Planning

Continued from page 1

In Your 30s

Typically, even though your income is rising, your expenses are also growing as you buy a house and start a family. However, don't lose sight of retirement, since you still have significant time before retirement to help your funds grow. Consider these tips:

✓ **Start thinking about retirement.** Give some thought to how you want to spend your retirement and how much it will cost. While you may feel that retirement is too far away to gauge these things, putting a rough price tag on your retirement and calculating how much you need to save can provide significant motivation in saving for that retirement.

✓ **Devise strategies to keep saving.** Look for ways to remain committed to saving, even as your expenses are increasing. For instance, whenever you receive a raise, put some of it into your 401(k) plan so you don't get used to spending the money. Before incurring a large new expense, such as a new car or home, look at the impact the additional expense will have on your retirement.

In Your 40s

While you still have quite a while before retirement, it's time to get serious about saving. Especially if you haven't saved much during your 20s and 30s, you need to really commit to saving for retire-



ment. Some tips to consider include:

✓ **Contribute the maximum to your 401(k) plan.** Don't make excuses; just make sure you are saving the maximum in your 401(k) plan. Also look at saving in an IRA.

✓ **Review your investment strategy.** Take a look at all your investments, both inside and outside of retirement accounts. Does your strategy make sense, and will it help you reach your retirement goals?

In Your 50s

Retirement is no longer that far away. It's time to assess where you stand and whether your retirement plans are realistic. Consider these tips:

✓ **Look seriously at your retirement plans.** Make sure you have an accurate assessment of how much money you'll need in retirement and compare that to your estimated retirement income sources. If you are short, consider revising your plans. You may need to work longer, scale back your retirement plans, or save more.

✓ **Take advantage of catch-up contributions.** In addition to making the maximum contributions to 401(k) plans and IRAs, take advantage of catch-up contributions once you turn 50. In 2007, you can make a \$5,000 catch-up contribution to a 401(k) plan, if permitted by your plan, and a \$1,000 catch-up contribution to an IRA.

✓ **Try to ratchet up your savings.** By now, hopefully, some of your large expenses will be behind you, such as funding a child's college education, and you can divert those sums to your retirement savings.

In Your 60s and Beyond

This is the period when people



typically transition from a working life to retirement life. Some strategies to consider include:

✓ **Finalize your retirement plans.** Go through your expenses and expected retirement income sources one more time to make sure you haven't forgotten anything. Determine when you can start drawing retirement benefits, such as Social Security, Medicare, and pension plans. Before you leave your job, make sure the timing is right and you'll be able to comfortably support yourself during retirement.

✓ **Plan before withdrawing your retirement savings.** Before you start taking withdrawals from 401(k) plans and IRAs, consider all relevant factors. You don't want to drain those funds too quickly.

✓ **Consider working on at least a part-time basis.** Even if you think you have sufficient funds for your retirement, consider working at least part-time during the early years of your retirement. This will help keep you active, while also supplementing your retirement savings. It is better to work now than to find out late in retirement, when your health may not permit you to work, that you have run out of retirement savings.

To ensure adequate retirement savings, you need to plan for retirement throughout your life. Please call if you'd like help with this process. ○○○

The Dangers of Delaying Saving

It's a common problem. Even though we know it's best to start saving for retirement at a young age so our savings have long periods to grow and compound, it's difficult to find money to save when we are getting established and raising families. Thus, it's easy to postpone saving, waiting until your children are grown to start saving significant sums for retirement. However, if you wait until your 40s or 50s to start saving, it can be very difficult to save a large enough portion of your income to ensure adequate savings for retirement.

There may also be other obstacles that could derail your savings for retirement, based on a recent study of individuals who were between the ages of 51 and 61 in 1992. During the 10-year period ending in 2002, 40% of those individuals were diagnosed with a major medical condition, 33% developed work disabilities that curtailed employment, 20% were

laid off, 10% became widowed, and 3% were divorced.

If a spouse's health problems and job loss were also factored in, 87% of married adults between the ages of 51 and 61 experienced a major problem (Source: *Older Americans' Economic Security*, January 2006). Especially hard hit were individuals with limited education.

The financial repercussions of these types of events can be serious. For married individuals, it was estimated that a serious medical condition reduced household wealth by 13%, a work disability by 14%, a job layoff by 19%, widowhood by 11%, and divorce by 38%. For single individuals, a serious medical condition reduced household wealth by 18%, a work disability by 30%, and a job layoff by 23% (Source: *Older Americans' Economic Security*, January 2006).

If you'd like to discuss your retirement savings, please call.
○○○

Copyright © 2007. This newsletter intends to offer factual and up-to-date information on the subjects discussed, but should not be regarded as a complete analysis of these subjects. Professional advisers should be consulted before implementing any options presented. No party assumes liability for any loss or damage resulting from errors or omissions or reliance on or use of this material.



Working Longer

With increasing longevity and fewer retirement income sources to count on, personal savings will become an increasingly important component of retirement income. However, personal savings rates have not increased, which means that many people may have to discard traditional views about retiring at age 65 and continue to work for longer periods.

With improved health and less physical jobs, this may not be such a burden for older individuals. By working longer periods, individuals will be able to save more, increase their benefits with Social Security and pension plans, and start to withdraw savings at a later age.

One study looked at annual income after taxes and health insurance premiums for a typical man at age 75 who retires at various ages. If he retired at age 62, he could expect annual net income of \$17,338, compared to \$22,920 if he retired at age 65, \$27,256 if he retired at age 67, and \$34,790 if he retired at age 70 (Source: *Working Longer to Enhance Retirement Security*, September 2005). ○○○

Financial Thoughts

Couples without employer-sponsored retirement health benefits will pay approximately \$200,000 out of pocket for health care after age 65 (Source: *Journal of Financial Planning*, July 2006).

Approximately 43% of companies offered company stock as an investment option in their 401(k) plans in 2005, compared to 55% in 2001 (Source: Hewitt Associates, 2006). At the end of

2004, 15% of total 401(k) plan assets were invested in company stock, compared to 19% in 2001 (Source: Employee Benefit Research Institute, 2006).

In a recent survey, 40% of retirees said that their living expenses in retirement were higher than they had expected prior to retirement (Source: *The Wall Street Journal*, 2006).

A recent study found that 22%

of 401(k) plan participants do not contribute enough to obtain the full employer match. An additional 30% of 401(k) plan participants contribute just enough to obtain the full match, but do not contribute more. Participants with higher incomes and longer tenure on the job contributed higher percentages of their pay to their 401(k) plan (Source: Hewitt Associates, 2006). ○○○