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Should You Contribute to Retirement Plans and IRAs?

If you're eligible to contribute to an employer-sponsored retirement plan, should you? Should you contribute to an individual retirement account (IRA)? How about contributing to both? The answers are: Yes, yes, and yes. If this comes as a surprise, it's probably because there are so many rules about eligibility for contributing to IRAs and workplace retirement plans that it's easy to become confused about what is allowed and what isn't.

But whatever rules there are, one thing is never ruled out: you can always contribute to both a workplace retirement plan — like a 401(k) or 457 plan — and an IRA, as long as you have earned income. What's open to question are how much you can contribute, to which type of account, and whether your contributions are tax deductible. Keep these three important points in mind:

Point 1: There are limits to your annual contributions. Every year, the IRS sets limits on how much you can contribute to retirement plans, and the amounts are different for different kinds of plans. The one rule common to them all is this: you can't contribute more than your earned income (except for contributions to a spouse IRA for a spouse who does not work).

Let's say your employer sponsors a 401(k) plan. If you participate in the plan by a) making contributions of your own, b) your employer makes contributions for you, or c) you and your employer both contribute to your account, then you can still contribute to your own IRA outside the workplace. If you're 49 or younger, in 2012, you can contribute $17,000 to a 401(k) plan and another $5,000 to an IRA, for a total of $22,000 in retirement plan contributions. If you're 50 or older, those numbers are $22,500 for the

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Insurance Tips

- ✔ Make sure you have insurance in all key areas, including life, health, disability, homeowners and renters, automobile, personal liability, and professional liability and malpractice insurance.
- ✔ Read your insurance contracts carefully. Ask about any provisions you don't understand.
- ✔ Review your policy limits to ensure that the amounts are still adequate. Don't pay for duplicate coverage or riders you don't need.
- ✔ Don't overinsure. The purpose of insurance is to prevent financial hardship that results from a tragedy, not to get rich.
- ✔ Consider increasing your deductibles, which can significantly lower your premiums.
- ✔ Check your insurance companies' financial rating to make sure that their financial status has not weakened.
- ✔ Review your policies at least every couple of years, immediately if there is a major change in your life. ❍❍❍

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Should You Contribute?

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workplace plan and $6,000 for an IRA, for a total of $28,500.

Point 2: Your income can affect the tax treatment of IRA contributions. Originally, there was only one kind of IRA: the kind that enabled you to reduce your taxable income by the amount of your contributions when you file your income tax return. Today, it's referred to as a "traditional" IRA, to distinguish it from a Roth IRA, to which you can only contribute after-tax money.

There are good reasons to choose either the traditional or Roth IRA, but if you participate in a workplace retirement plan *and* have income above the IRS limits, your ability to take the tax deduction for a contribution to a traditional IRA is limited. In 2012, tax deductibility begins to phase out if you're a single filer and earned more than $58,000, and disappears altogether at $68,000. For joint filers, the ranges are higher: $92,000 to $112,000.

Take note, however: if you make too much to be eligible for the up-front income tax benefit in the year you contribute to a traditional IRA, you can still make contributions to it *and* to your workplace retirement plan. In this case, you might want to consider contributing to a Roth IRA instead. But here, too, you might be limited by income: for 2012, eligibility to contribute to a Roth IRA phases out for single filers with AGIs above $110,000, joint filers with AGIs above $173,000, and disappears completely for those earning more than $125,000 and $183,000, respectively.

Point 3: Doing either can build assets faster — both, faster yet. The complexity of the rules regarding whether IRA contributions are tax deductible has obscured the most important benefit of qualified retirement plans: they compound free of annual taxes. This gives them a distinct advantage over taxable savings accounts, because at the same rate of return, assets grow faster when returns are not taxed.

For someone with an effective federal tax rate of 25%, an annual contribution of $5,000 to a taxable account that returns 6% a year grows to almost $223,000 in 25 years. But that same contribution to an IRA, at the same rate of return, grows to more than $274,000 — a difference of more than $50,000, regardless of whether the contributions were tax deductible. Increase the contribution to $20,000 a year, and the IRA grows to nearly $1.1 million after 25 years — and the advantage over a taxable account exceeds $200,000. *These examples are provided for illustrative purposes only and are not intended to project the performance of a specific investment vehicle.*

The bottom line: you should contribute as much as possible to tax-advantaged retirement plans. For many people who work, there are multiple retirement savings options available, including dividing your IRA contributions between both a traditional and a Roth IRA. There are even IRA options open for nonworking spouses. To make sure you're taking full advantage of the options open to you, please call. ❍❍❍

You're Never Too Old for a Roth IRA

Even if you're retired, consider contributing to a Roth individual retirement account (IRA), provided you have some earned income. In 2012, single taxpayers with modified adjusted gross incomes (AGIs) less than $110,000 and married taxpayers filing jointly with modified AGIs less than $173,000 are eligible to make a nondeductible contribution to a Roth IRA. Contributions are phased out for married couples filing jointly with modified AGIs between $173,000 and $183,000 and for single taxpayers with modified AGIs between $110,000 and $125,000. In 2012, the maximum annual contribution is the lesser of $5,000 or earned income. Individuals age 50 and older can make an additional $1,000 catch-up contribution.

Roth IRAs are a flexible way to save. Contributions can be withdrawn at any time with no tax consequences. Earnings and capital gains can be withdrawn on a tax-free basis if a qualified distribution is made at least five years after your first contribution and you have attained age 59½, or due to death, disability, or to pay up to $10,000 of first-time homebuyer expenses.

Other characteristics of a Roth IRA may make it an attractive investment for retirees:

✔ You can make contributions as long as you have earned income, no matter how old you are. With traditional deductible IRAs, you must stop making contributions when you reach age 70½.

✔ Mandatory withdrawals after age 70½ are not required. You can take out as much or as little as you want, whenever you want, after age 59½. If you don't need the money, the balance can continue to grow on a tax-free basis.

✔ Qualified distributions from Roth IRAs are not included in AGI. Thus, these distributions will not affect income taxation of your Social Security benefits.

✔ Roth IRAs can provide a tax-advantaged way to accumulate assets for heirs. Both traditional and Roth IRAs are subject to estate taxes. However, the beneficiaries of a traditional IRA must also pay income taxes on the proceeds, while beneficiaries of a Roth IRA receive qualified amounts income-tax free. ❍❍❍

Financial Harmony in Marriage

Financial stress can come from many sources, but one of the most difficult is when one spouse is a spender and the other a saver.

We come into marriage with attitudes toward money deeply engrained in our psyche, and those attitudes are not easily changed. But don't despair — if you find yourself engaged in a struggle with a spouse who is your opposite when it comes to saving and spending, there are steps you can take to achieve balance and harmony.

1. Agree to be a team. You got married to spend your lives together, so it shouldn't be difficult to start with this understanding, even if it may seem hard to reconcile with your money behavior.

To be a team you have to act like a team, and that starts by giving up individual possessiveness about money: there's no "your money" and "my money." It needs to be "our money."

2. Agree on your goals. Start your teamwork by articulating your long-term goals; they're the most important and the easiest to agree upon. Long-term goals might include living the lifestyle you want in retirement and educating your children.

Be sure to be specific. A goal isn't a dream, like "a comfortable retirement" or "a good school for the kids." Articulating specific long-term goals involves knowing

how much those dreams are going to cost and precisely when they will occur. You need dates and dollar figures.

Once you've reached an agreement on your long-term goals, try to set out the same kind of specific plans for your intermediate- and short-term goals, like your next vacation and your savings and retirement account balances for the end of the year.

3. Practice full disclosure. Being a team means each of you is empowered to act on behalf of the other with implicit approval. That requires that each of you has full command of the facts: how much money you make, how much you owe, and how much you spend.

Share the balances in any individual accounts you may hold, like checking and credit cards. You need to be completely honest with each other, even if you make a mistake now and then.

4. Budget and pay bills together. Create a monthly budget (spreadsheets are ideal for this) that compares the total of your bills and expected out-of-pocket expenses with every penny of incoming and available cash.

Include an itemized list of your debts and scheduled payment amounts, as well as your asset accounts and their balances.

Thoroughness is a key determinant of your success, so don't overlook anything, especially significant one-time expenses like gifts or big nights out.

Create a catch-all category called "miscellaneous" for the little things you might forget — or those that are small and hard to pin down.

Pay your bills at the same time at the same place, and then update your budget spreadsheet as you do. This means revisiting your monthly budget at least once a month. Print

out two copies and keep them where you can each easily glance at them whenever the need arises.

5. Update your checkbook(s). One way spenders rationalize their behavior is by keeping themselves in the dark about how much they really have to spend.

If you're going to be faithful to the budgeting process, you have to keep careful track of your cash on hand, and that means being sure your checkbook entries are up to date.

6. Agree on spending rules. You and your spouse need to agree on how much you can spend on purchases without consulting the other. Beyond this preset amount, you should talk about the purchase in advance and adjust your budget accordingly.

7. Create a financial plan. Everybody should have a professionally prepared plan, but for couples with polarized spending and saving habits, it's especially important.

Apart from the fact that a professional can provide the expertise and tools you may lack, he/she will serve as an impartial third party to help you defuse your money debates.

Make sure your marriage is based on financial balance and harmony. For help creating that financial plan or putting any of these other financial steps into practice, please call. ❍❍❍

Insurance Basics

It's not uncommon to purchase insurance in a haphazard manner. You are offered a policy that seems like a good one, so you purchase it and never review it again. Then you buy another policy a couple of years later. In the end, you haven't systematically evaluated your insurance needs, so you may find yourself overinsured in some areas and underinsured in others. To help prevent this from happening, consider these tips:

✔ **Review all your policies every couple of years.** You want to make sure you have adequate coverage in all major areas, while also evaluating whether revisions are needed due to changes in your personal circumstances. For instance, your need for life insurance is likely to change drastically over your life as your lifestyle and the number of people dependent on your income change. Review your homeowners policy to make sure the policy limits are sufficient to pay for rebuilding your home. As your financial situation improves, you might need more personal liability insurance. The amount of disability income insurance you need is likely to change as your income changes. As you get older, you should investigate long-term-care insurance.

✔ **Purchase insurance wisely.** The primary purpose of insurance is to protect you from financially devastating losses, not from every minor loss you might incur. Thus, review all the riders and options in your policies, only retaining those that are important to you. Check if you qualify for discounts offered by your insurance companies. Consider increasing your deductible periodically — this is typically a good strategy for reducing insurance premiums.

✔ **Avoid insurance you don't need.** Don't purchase insurance for minor items you can easily cover yourself, such as extended warranties on small household appliances. When reviewing your policies, make sure you're not paying for duplicate coverage. For instance, you may have disability income insurance at work and through a personal policy. Review the policy limits on both to ensure you aren't paying for benefits that can't be collected because you've exceeded the policy limits.

If you'd like help evaluating your insurance needs, please call. ❍❍❍

Bonds and Interest Rate Changes

Basically, interest rate changes affect bond prices as follows:

✔ **Interest rates and bond prices move in opposite directions.** The price of a bond will decrease in value when interest rates rise and increase in value when interest rates fall. The price of an existing bond changes to provide the same return as an equivalent, newly issued bond at prevailing interest rates. Since you receive the full principal value at maturity, holding a bond until maturity eliminates the impact of interest rate changes.

✔ **Interest rate changes have a more dramatic effect on bonds with longer maturities.** Since long-term bonds have a longer stream of interest payments that don't match current interest rates, their price must change more to compensate for those interest rate changes.

✔ **Bond price changes are less significant for bonds with higher coupon rates.** Bonds with coupon interest rates near or above current interest rates will experience the least amount of price fluctuation.

Please call if you'd like help with your bond portfolio. ❍❍❍