

# **A Roadmap for Your Retirement Planning**

## **27 Facts and Actions to Use Today**

- **Timing, Tax Deductions, and Rollovers**
- **Contributions, Limits, and Withdrawals**
- **Taxation and Reporting**
- **Receipt of Retirement Money**
- **Legal Compliance**
- **Selection of Beneficiaries**
- **The Rules on IRAs**
- **Role of the Roth IRA in Your Planning**

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**The current health of you and your spouse —  
and thus your life expectancies — will affect  
the retirement payment option you select.**

## Maximizing and Protecting Your Retirement Money

*Our advice:* Routinely schedule annual or biannual reviews of your retirement fund along with the rules for making contributions, assuring deductibility, withdrawing money, and complying with filing requirements. Failure to follow any one of the many, complicated regulations could result in disqualification of your retirement plan, with disastrous results.

When a plan is disqualified:

- (a) the money is considered taxable income today and there could be substantial penalties,
- (b) you lose the tax-free growth of the money currently in the plan, and
- (c) you are prohibited from making future tax-deductible contributions.

Disqualification could reduce your overall retirement fund by more than 50%. So read this **Resource Report** carefully. *Note:* Although we principally refer to regular, Roth, and spousal IRAs in this Report, most of the regulations and ideas apply to *all* retirement plans.

\* \* \*

□ *Timing and tax deductions:* For a 2007 tax deduction, IRAs must be set up by Apr. 15, 2008 and the contributions made by Apr. 15, 2008. No filing extensions are allowed. For Keoghs, the plan must be established by Dec. 31, 2007 and the contribution made by Apr. 15, 2008, or later with a tax-filing extension.

□ *Rollovers:* To avoid any problems or confusion with the 60-day rollover requirement, effect *trustee-to-trustee* transfers. Also keep in mind that you are allowed only one rollover a year per IRA account if you do not use trustee-to-trustee transfers.

□ *Earned income:* Retirement plan contributions are based on *earned* income, such as wages, salaries, tips, professional fees, bonuses, commissions, and self-employment income. What does not qualify as earned income? Such items as rent, interest, dividends, capital gains, pension or annuity income, etc. *Note:*

Alimony and separate maintenance payments are included in the category of earned income and thus are eligible for determining contributions.

## **Types of IRA Contributions**

□ *IRA contributions:* In 2007, you can make all or part of the annual tax-deductible IRA contribution of \$4,000, \$8,000 with a spouse, if your adjusted gross income is less than \$83,000 to \$103,000 (married) or \$52,000 to \$62,000 (single) and even if you're covered by an employer pension plan.

If you don't qualify to deduct the \$4,000 or \$8,000, you still can make nondeductible contributions each year. In addition, consider the following:

- #1 — A nonworking spouse can contribute a tax-deductible \$4,000 annually to an IRA regardless of his or her spouse's participation in a retirement plan.
- #2 — The Roth IRA allows you to make an annual, nondeductible \$4,000 contribution. The income grows tax-free and you can withdraw the money tax-free if the Roth IRA is held for at least five years and you are at least age 59½ at the time of withdrawal. The \$4,000 Roth limit per taxpayer is reduced for amounts contributed to a regular IRA.
- #3 — If you are age 50 or older, the \$4,000 IRA limit per taxpayer increases to \$5,000 for both the regular and the Roth IRA.
- #4 — The Education IRA — now called the Coverdell Education Account (CESA) — allows you to contribute \$2,000 a year for each child under age 18. Although the \$2,000 per child is *not* tax deductible, the income grows tax-free and future distributions are also tax-free if the money is used for educational purposes.

*Phase-outs:* Eligibility for the Roth IRA phases out at income levels of \$156,000 to \$166,000 for married taxpayers and \$99,000 to \$114,000 for single taxpayers. For the Coverdell Education Account, the phase out is \$190,000 to \$220,000 (married) and \$95,000 to \$110,000 (single).

## **Limits on Contributions and Investments**

□ *Limit on contributions:* For most retirement plans, when computing the maximum amount you can contribute each year, earned income in excess of

\$225,000 is not considered in the calculation.

□ *Tax penalty on excess contributions:* Contributions in excess of the annual amount allowed (e.g., \$4,000 a year for IRAs) incur a penalty tax of 6% of the excess amount for each year the excess continues. If you contribute too much in one year, you should reduce the next year's contribution by the same amount to eliminate the excess and stop the penalty tax from accumulating.

□ *Investments:* Your IRA is not allowed to invest in collectibles such as art work, antiques, gems, etc. You may invest in gold and silver coins minted by the Treasury Department, subject to certain limitations. In addition, you can invest in certain platinum coins and in certain gold, silver, and palladium bullion.

### **Rules on Withdrawals**

□ *Begin withdrawals:* You usually must begin receiving your retirement distributions by Apr. 1 of the calendar year following the year you reach age 70½. Thereafter, you must make withdrawals of a specified minimum amount by Dec. 31 of each year. Age 70½ is also the cut-off age for continuing to make contributions to IRAs (except the Roth IRA) and Keoghs.

□ *Withdrawal penalty:* If you withdraw funds (say, from your IRA) prior to age 59½, there is a 10% penalty on all taxable amounts withdrawn and the amounts distributed to you are taxable income in the year you receive the funds. There are exceptions to the 10% penalty, including hardship situations, such as disability or high medical expenses. In addition, if the withdrawn money is used for educational purposes or a first-time home purchase, the 10% penalty is not assessed. *Two alerts:*

#1: If you are still working at age 70½, the requirement to start withdrawing the money is extended until you stop working. However, for business owners who own 5% or more of a business and are still employed by that business, there is no extension; the withdrawals must start at age 70½.

#2: Be careful; not all penalty exceptions apply to all retirement plans, so check with your tax adviser before withdrawing any retirement money.

□ *Employer withholdings:* Employers are required to withhold 20% of all

lump-sum distributions from qualified retirement plans to cover federal taxes. You can avoid this 20% federal tax withholding on a distribution by asking your employer to make a *trustee-to-trustee* transfer directly to your IRA or another qualified plan and thus never taking possession of the funds.

Check out the tax repercussions in advance. *Reason:* If you roll over only 80% of the distribution received, you will be taxed (at personal income tax rates) on the 20% distribution *not rolled over* and, unless you meet one of the early-withdrawal exceptions (e.g., you are at least age 59½), the amount not rolled over also will be subject to a 10% penalty.

## **Taxation and Reporting**

□ *Tax reporting:* All deductible and nondeductible IRA contributions must be reported on your personal tax return, Form 1040 or 1040A, for each year a contribution is made. For nondeductible contributions, you must complete and attach Form 8606 to your tax return.

That's the form the IRS uses to keep track of nondeductible IRA contributions. *But don't count on the IRS keeping track.* Save your tax return for that year and also put copies of the filed Form 8606 in both your retirement and tax files. Also file all annual forms sent to you by your employer regarding voluntary 401(k) and other pension plan contributions.

□ *Year designations:* To establish your tax deduction, you must tell your sponsor for which year the contribution is being made. This is particularly important for contributions made between Jan. 1 and Apr. 15. If you *do not* tell the sponsor which year it is for, they *must* report to the IRS that the contribution is for the year it received the money. For example, if you make a \$4,000 IRA contribution for 2007 on Mar. 31, 2008 and don't specify that it is for the year 2007 (not 2008), you could lose the \$4,000 tax deduction for 2007.

□ *Changing your residence:* After you retire, you may consider moving to another state, but first check with your advisers on the new state's tax rates and rules. For example, some states don't allow itemized deductions and estate tax rates are high. So be careful; you don't want unexpected additional taxes.

□ *Personal contributions:* Money that you *personally* contributed to a

retirement plan with your after-tax income is not taxable income when it is withdrawn, e.g., nondeductible IRA and voluntary 401(k) contributions. However, the income growth is taxable, except for the Roth IRA where all distributions are received tax-free if the Roth IRA is held for at least five years and you are at least age 59½ at the time of withdrawal.

## **Receipt of Retirement Money**

□ *Methods of distribution:* You can receive your distribution using any one of the following methods: (a) total (lump-sum) distribution, (b) distribution over a specific period (e.g., ten years), (c) purchase of an annuity contract, (d) according to distribution methods provided by an insurance annuity contract held under your plan, (e) according to IRS life expectancy tables, or (f) in a series of monthly payments for the remainder of *both* your life and your spouse's.

□ *Selection of payment terms:* Be careful; the selection decision is usually *irrevocable* and should not be made lightly. How you choose to receive the payments can have a big impact on how much you collect. There also are many financial, tax, and personal considerations, including the present health of you and your spouse. The best approach is to get professional advice from two sources before making your selection.

□ *Rollovers by Nonspouse Beneficiaries:* Beginning in 2007, nonspouse beneficiaries of employer-sponsored retirement plans can roll distributions directly into a *beneficiary* or *inherited* IRA, which enables them to keep the assets tax-deferred for longer periods than previously allowed. Both spouse and nonspouse beneficiaries will be able to stretch distributions and taxes over their lifetimes.

## **Legal Compliance**

□ *Spousal approval:* In most cases, you need the approval of your spouse to effect certain distributions from your own retirement account, usually for amounts of \$5,000 or more.

□ *Recordkeeping and compliance:* Because of the variety of IRAs available today, it is critical to keep detailed, complete records of your annual contributions,

rollovers, transfers, etc. Be sure to record the date of each transaction and keep copies of all statements, correspondence, checks, and deposits.

□ *Communications and confirmations:* Don't give verbal instructions to your bank, broker, or others on rollovers. Put the instructions in writing and send them by certified or registered mail. Then make sure you get confirmation of the transaction *and* that it appears on your next monthly statement. *Why?* If there's a problem, it's easier to clear it up at that time, rather than a year later. You don't want a broker's or banker's oversight making you liable for income taxes and penalties or lost tax deductions because of improper handling of your retirement contributions and rollovers.

□ *Prohibited transactions:* A 15% penalty tax may be assessed in prohibited transactions such as any sale, exchange, or leasing of property between you and your retirement plan. **Such transactions also can result in the retirement plan being disqualified.** If that happens, the amount in the plan may be treated as if distributed to you on the first day of the year in which the prohibited transaction occurs.

## **Selection of Beneficiaries**

□ *Beneficiary designations:* Review your beneficiary designations regularly, particularly if the beneficiary, say your spouse, has health problems and thus a shorter life expectancy. Poor health status also could affect the payment option you elect. *Example:* If your spouse has serious medical problems, you may wish to elect the lump-sum option and roll over the funds into an IRA so they can be withdrawn as needed *or* you may wish to choose the higher monthly payments until your death only.

□ *Estate as beneficiary:* Never name your estate as beneficiary of your retirement money or the amount may be taxed as income at personal tax rates up to 35% and the total value (after the income tax payment) subject to federal estate taxes at tax rates up to 45%.

□ *Beneficiary Designation Form:* For commonly asked questions on making beneficiary designations, please see *Exhibit 2*, page 15.

## **Growth of Voluntary Contributions**

If you are *not* currently making annual \$4,000 nondeductible contributions to your IRA (\$8,000 with a spouse), you should start doing so for the following reason: An annual \$4,000 contribution at an 8% annual return grows to \$62,600 in 10 years and \$197,700 in 20 years. If the annual contribution is \$8,000 with your spouse, the numbers double to \$125,200 in 10 years and \$395,400 in 20 years. Remember also, you can make IRA contributions against earned income to age 70½; there is no age limit with the Roth IRA.

*Reference:* For more information on the benefits of making deductible and nondeductible contributions, please see *Exhibit 4*, page 19.

## **Role of a Roth IRA in Your Retirement Planning**

There are many complex tax and retirement planning considerations to be addressed before making the decision to transfer or convert part or all of your regular IRA money to the Roth IRA.

If your adjusted gross income is below \$100,000 (single or married), you have the option of making the transfer or conversion to a Roth. The big selling point is that you will *never pay tax* on any future increase in the value of the money deposited in the Roth. The downside is that you *must pay tax now* at your current income tax rate on the money moved.

Basically, you are trading a current, immediate tax liability on the full amount of the Roth deposit for an exemption from all future taxes on what that Roth deposit is worth when you finally start making withdrawals.

With that in mind, you have to start by crunching some numbers. *First*, you need to know how much immediate tax will be due on the money you move to the Roth, based on your current tax bracket. *Second*, you need to project the value of the Roth account at the time of your retirement or whenever you plan to begin withdrawals. Then, you project the tax savings on that value, based on your projected tax bracket at that time. *Third*, you have to calculate the value of those future tax savings in terms of today's dollars and compare those tax savings with the immediate tax you would pay on the money transferred to the Roth IRA.

But the numbers are just the beginning. Here are some additional considerations in working through the Roth decision. Review *all* of them carefully with your advisers.

- **Your age.** The older you are, the less you will benefit from moving money to the Roth IRA since the tax-free growth will cover fewer years. You don't want to pay taxes in your *current* tax bracket (up to 35% tax rate) on the money moved to the Roth IRA when you expect to be in a much lower tax bracket (probably 15%) when you retire. That's a potential tax-savings difference of 20 percentage points.

- **The tax law.** There is always the possibility that Congress will change the tax laws regarding the Roth in the immediate future or, worse, 10 to 20 years from now, just when you begin withdrawing your retirement money. *And state laws:* Does your state recognize the Roth IRA and its tax-free withdrawals? Will you be living in a different state when you retire?

- **Current liquidity.** Do you have the personal financial resources available now to pay the tax on the money moved to the Roth IRA? How difficult will it be to raise the money to pay the current tax bill? You don't want to deplete retirement savings or sell other valuable personal assets that could increase substantially in value in the future just to meet the immediate tax liability.

- **Time until retirement.** Five years is the minimum holding period to have the Roth IRA money received tax-free. If you're going to be retiring within five years, you won't be able to tap into the Roth money without losing the tax advantage.

- **Your current tax bracket.** If you're currently in a low tax bracket or you expect to pay little or no tax for the year, this might be the time to move money to the Roth IRA. *Reason:* Converting to a Roth IRA in that year of low income (and low tax bracket) will result in a *permanent* tax savings since no or little taxes are payable on the money transferred to the Roth IRA.

- **Value of IRA holdings.** If the investments in your regular IRA are depressed, but you expect them to recover in the future, there are two benefits to switching to the Roth IRA: (a) the investment amount subject to personal taxes in the year you switch is low (i.e., the value of the depressed portfolio), and (b) the increase in the Roth IRA's value in future years (i.e., after your investments recover) is *not* taxable.

Don't rush into transferring your money to the Roth IRA until you have considered all of these factors. Keep in mind that for the same tax year, you can change your mind and switch back to your regular IRA, i.e., undo the Roth IRA. There are technical rules to follow, but it helps to know the Roth decision *is* revocable. Also, get expert advice from two sources. Ask each adviser to prepare a written memo for you that presents and analyzes the tax and cash flow consequences of moving your IRA money to the Roth IRA. The greater the amount to be transferred, the more analysis and advice you need.

### ***Tax Law Changes: More Benefits and Options***

**#1 — *Contribution Limit Increases Made Permanent:*** Increased retirement plan contribution and benefit limits due to expire in 2010 have been made permanent, and the limits will increase over time with cost-of-living adjustments. This affects IRAs, 401(k)s, and other retirement plans.

For 2007, the Roth contribution is \$4,000 (single) and \$8,000 (married, filing a joint tax return). If you are age 50 or older, the base limit of \$4,000 increases to \$5,000. The phase-outs are adjusted gross income levels of \$99,000 to \$114,000 (single taxpayers) and \$156,000 to \$166,000 (married taxpayers).

**#2 — *Direct Roth IRA Conversions:*** Beginning in 2008, individuals whose adjusted gross income (AGI) does not exceed \$100,000 and who are eligible to make a rollover can roll distributions from an employer-sponsored retirement plan *directly* into a Roth IRA. Currently, in 2007, the employee must roll the distribution into a traditional IRA, then convert the traditional IRA to a Roth IRA.

**#3 — *60-Day Requirement:*** The IRS can waive the 60-day rollover period if failure to make a waiver is against *equity* or *good conscience*, e.g., serious illness or an error by the financial institution or brokerage firm receiving the rollover.

**#4 — *Charitable Distributions:*** For 2006 and 2007, individuals over age 70½ can make tax-free distributions of up to \$100,000 from their IRAs directly to a qualified charity and count the contribution toward that year's IRA Requirement Minimum Distribution. This provision does not apply to distributions from employer-sponsored retirement plans, including SEP IRAs and SIMPLE IRAs.

**#5 — \$100,000 Eliminated:** Starting on Jan. 1, 2010, the \$100,000 adjusted gross income requirement to roll over a regular IRA to a Roth IRA has been repealed; anyone will be able to convert their IRA to a Roth IRA. Also, you can make the required income tax payments on the converted amounts to the Roth IRA as follows: 50% in 2011 and 50% in 2012.

\* \* \*

You maximize the value of your retirement money by knowing the basic rules and options and by planning well in advance. A bad or improper decision can greatly impact the amount of retirement money you have, how it will be withdrawn by you, and what the tax bill will be. So review this Report carefully and save it for future reference. □

**Exhibits —**

*Exhibit 1 — Know Other IRA Rules, see next page*

*Exhibit 2 — Beneficiary Designations, page 15*

*Exhibit 3 — Free Information to Help You in Your Retirement Planning, page 17*

*Exhibit 4 — The Power of Tax-Deferred Compounding, page 19*

*Exhibit 5 — Retirement Cash Flow Model, page 20*

## **Know Other IRA Rules**

An IRA is a trust account set up for your exclusive benefit or for the future benefit of your beneficiaries. Different types of IRAs are available from a variety of organizations. You can set up an IRA at a bank or other financial institution, or with a mutual fund or life insurance company, or with your stockbroker. All IRA investments must meet Internal Revenue Code requirements. Here are the principal requirements for the various arrangements.

**1.** The trustee or custodian must be a bank, a federally insured credit union, a savings and loan association, or an entity approved by the IRS to act as trustee or custodian.

**2.** The trustee or custodian generally cannot accept IRA contributions of more than \$4,000 a year. However, rollover contributions and employer contributions, say, to a Simple Employee Pension Plan (\$10,500 a year in 2007), can exceed the \$4,000 annual limit, as well as taxpayers age 50 or older, who can contribute \$5,000 a year.

**3.** Your contributions must be in cash, check, or money order, except rollover contributions, which can be investments and property other than cash.

**4.** The amount in your account must be fully vested (you must have a nonforfeitable right to the amount) — *at all times*.

**5.** Money in the account cannot be used to buy a life insurance contract or invest in art work, antiques, gems, and collectibles.

**6.** Assets in the account cannot be combined with other property, except in a common trust fund or common investment fund.

**7.** You must start receiving distributions from your account by April 1 of the year following the year in which you reach age 70½.

*Annuity Contracts:* You can set up an individual retirement annuity by purchasing an annuity contract from a life insurance company. An individual

retirement annuity must be issued in your name as the owner, and either you or your beneficiaries who survive you are the only ones who can receive the benefits or payments. An individual retirement annuity must meet the following requirements:

- Your entire interest in the contract must be nonforfeitable.
- It must specify that you cannot transfer it to someone else.
- It must have flexible premiums so that if your compensation changes, your payment may also change.
- It must restrict you from contributing more than \$4,000 in any year, and require you to use any refunded premiums to pay for future premiums or to buy more benefits before the end of the calendar year after the year you receive the refund.

*Association Trust Accounts:* An employer, labor union, or other employee association can set up a trust to provide IRAs for its employees or members. The rules in this *Exhibit 1* also apply to employer and union-established IRAs. □

## ***Beneficiary Designations:*** **Commonly Asked Questions**

Here are commonly asked questions on execution of a Beneficiary Designation Form (BDF). We used an IRA as our example, but it does apply to most assets, including other retirement funds and life insurance policies. Check with your advisers *before* executing any BDF; there are potential legal and tax consequences to consider.

Now to the questions and answers.

### **What if I want to designate more than two primary beneficiaries or several contingent beneficiaries?**

You may designate as many primary and/or contingent beneficiaries as you wish. You can do this by attaching an additional sheet of paper to your IRA Beneficiary Designation Form. Be sure to include all of the information requested on the form including the percentage of the IRA assets the beneficiary will receive. You must sign and date the attachment for it to be effective.

### **Why would I want to designate contingent beneficiaries?**

Naming a contingent beneficiary allows you to choose who should receive your IRA assets in the event that your primary beneficiary dies before you or very near to your death or in a common disaster.

### **Isn't my IRA covered by my will?**

Generally no. An IRA is a “non-probate asset” meaning that it passes outside the directions of your will unless you designate your estate as beneficiary. Therefore, the distribution of your IRA assets depends solely on who you name as beneficiaries with your IRA custodian. Special rules may apply in community property states.

## **What does “proportionately” mean in contingent beneficiary designations?**

*Proportionately* means to adjust an amount relative to another amount in order to maintain a consistent ratio.

*Example:* Mary chooses to leave 50% of her IRA to John and 25% to each of their two children. If one child dies before Mary and she had elected to distribute her IRA assets proportionately, John will get 66.7% of her IRA and the child will get 33.3% of her IRA.

## **Does my spouse need to sign the IRA Beneficiary Designation Form?**

In most cases, your spouse does not need to sign this form. However, if you live in a community or marital property state and have named someone other than your spouse as primary beneficiary of more than 50% of your IRA, your spouse **must sign** the IRA Beneficiary Designation Form.

*Example:* You live in California and have left 40% of your IRA to your spouse and 20% each to your three children. Your spouse will need to give his or her approval for the 60% given to the children.

## **Do I need to list my beneficiaries in any particular order?**

No. While naming your beneficiaries in the proper primary or contingent section is critical, the order in which you list your beneficiaries within each section has no effect on how the IRA will be distributed to them.

## **Can I name my estate as beneficiary?**

Yes, you can name your estate as your primary or contingent beneficiary. However, when your estate is the beneficiary, the executor of your estate is required to distribute the IRA assets as provided under the terms of your will, or if no will exists, under state law. *Caution:* If you wish to name your estate as beneficiary, get good advice. There could be tax implications.

We thank UBS Financial Services , Inc. for its assistance in preparing this advisory. □

## **Free Information to Help You in Your Retirement Planning**

To help in your retirement planning, you may want to obtain copies of the following *free* booklets from the IRS:

<u>No.</u>	<u>Title of Publication</u>
525	Taxable and Nontaxable Income
530	Tax Information for First-Time Homeowners
552	Recordkeeping for Individuals
554	Tax Information for Older Americans
560	Retirement Plans for Small Business
575	Pension and Annuity Income
590	Individual Retirement Arrangements
915	Social Security Benefits

*How to order:* Call 800-TAX-FORM, or visit the IRS website at [www.irs.gov](http://www.irs.gov).

### **From the Social Security Administration:**

- Understanding Social Security (No. 05-10024)
- Supplemental Security Income (No. 05-11000)
- Disability (No. 05-10029)
- Retirement (No. 05-10035)
- How You Earn Credits for Social Security (No. 05-10043)

*How to order:* These publications can be obtained *free* at any Social Security office or by calling 800-772-1213 or by visiting [www.ssa.gov](http://www.ssa.gov).

*Important:* If you visit the website above, the Home Page will have a comprehensive listing and automatic access to all of the Social Security and Medicare booklets. **Click** Publications.

*Verification of income:* To verify the income credited to your Social Security account, review Form SSA 7004, *Request for Social Security Statement of Earnings*, which is automatically sent to you each year. *Important:* If you find errors in the income amount listed, which is indicated by year, you will need your W-2 forms from the years in which the errors were made in order to have them corrected.

*Recordkeeping:* If you haven't kept your W-2 forms, check your tax returns. A copy of your W-2 is usually attached to it. If you don't have a Social Security file yet, set one up now to keep track of all Social Security correspondence and copies of the benefits and checks you receive. □

## The Power of Tax-Deferred Compounding Within and Outside Retirement Plans

Here’s why it’s so important to make annual retirement contributions even if the amounts are **not** tax deductible. The illustration below applies to all deductible **and** nondeductible contributions to regular IRAs, the Roth IRA, the Coverdell Education Savings Plan, the 529 College Savings Plan, and company retirement plans, including a 401(k), SEP, Keogh, SIMPLE, Money Purchase, and Profit Sharing Plan.

*Illustration using an IRA:* If you are *not* making annual \$4,000 deductible **or** nondeductible contributions to your IRA (\$8,000 with your spouse), you should start doing so now to obtain the tax-deferred compounding illustrated below. The example assumes an annual contribution of \$4,000 growing at 8%.

<u>Years</u>	<u>Value Within an IRA</u>	<u>Value Outside an IRA</u>	<u>The IRA Advantage</u>
10	\$ 62,600	\$ 55,100	\$ 7,500
15	\$117,300	\$ 96,700	\$ 20,600
20	\$197,700	\$151,700	\$ 46,000
25	\$315,800	\$224,400	\$ 91,400
30	\$489,400	\$320,600	\$168,800

*The power of tax-sheltered compounding:* As shown in the table above, if you contribute \$4,000 each year for 20 years to an IRA and earn an 8% average return, your IRA would grow to \$197,700. That same \$4,000 annual investment over 20 years earning the same return would be worth only \$151,700 outside an IRA after taking into account an average federal and state tax rate of 28%.

That’s \$46,000 more value — **30% more cash for your retirement** — if you save **within** an IRA instead of outside one. Double the value to \$92,000 if *both* you and your spouse annually invest \$4,000 in IRAs. □

## ***Retirement Cash Flow Model:*** **How to Project Your Retirement Money**

Shown on the next page is a sample *Worksheet* for projecting your retirement income *and* the money (withdrawals) needed to meet your annual cash needs. To simplify the mathematics and the *Worksheet*, we have made the following assumptions:

- You are now age 64 and plan to retire at the end of 2007.
- Your annual cash need is \$40,000, which will grow by 3% a year. (The \$40,000 includes living expenses and income taxes. If you wish, you can separate and set up another column for income taxes.)
- Your liquid assets are projected at \$250,000 (\$150,000 retirement money and \$100,000 personal funds).
- Your after-tax return on the \$250,000 assets will be 8%. (Remember, your \$150,000 retirement money continues to grow tax-free until withdrawn.)
- Social Security income is projected at \$12,000 annually, which will grow by 3% a year. (Add your spouse's income if applicable.)
- No other income or cash was assumed, such as continued part-time employment, salary paid under a deferred compensation arrangement, or money received from refinancing your home.

In the projections, we intentionally have not considered other personal assets which can be converted to cash, such as the equity in your home and life insurance policies. All we wanted to do is illustrate how to perform cash inflow and outflow analysis. The *Worksheet* will help you do your own Retirement Model. See the *Deficit* column, which is the amount of money you need to withdraw from your retirement money each year.

**Beginning Retirement Position is \$250,000.** For our readers who are not ready to retire, determine where you are today and project how much money you will have at retirement. Then build your Retirement Model.

## Projected Cash Inflow and Outflow Worksheet

<u>Year (Age)</u>	<u>Income at 8%<sup>(1)</sup></u>	+	<u>Social Security</u>	-	<u>Living Expenses</u>	=	<u>Deficit<sup>(2)</sup></u>	<u>Ending Cash Position</u>
2008 (65)	\$19,667		\$12,000		\$40,000		\$ 8,333	\$241,667
2009 (66)	18,937		12,360		41,200		9,903	231,764
2010 (67)	18,076		12,731		42,436		11,629	220,135
2011 (68)	17,070		13,113		43,709		13,526	206,608
2012 (69)	15,904		13,506		45,020		15,610	190,998
2013 (70)	\$14,564		\$13,911		\$46,371		\$17,896	\$173,103
2014 (71)	13,032		14,329		47,762		20,401	152,701
2015 (72)	11,290		14,758		49,195		23,146	129,555
2016 (73)	9,318		15,201		50,671		26,152	103,403
2017 (74)	7,095		15,657		52,191		29,439	73,964
2018 (75)	\$ 4,596		\$16,127		\$53,757		\$33,034	\$ 40,930
2019 (76)	1,796		16,611		55,369		36,962	3,968
2020 (77)	159		17,109		57,030		39,762	-35,794

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<sup>(1)</sup> We computed the 8% return on the average beginning and ending cash balances.

<sup>(2)</sup> *Deficit Column:* This is the amount you must withdraw annually to meet your living expenses.

\* \* \*

**Summary.** Your \$250,000 is fully depleted in the thirteenth year after retirement, at age 77. The cash position at the end of year 2020 is a deficit of \$35,794. □

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