

# Wealth Accumulation and Taxes

## IRAs—TRADITIONAL VS. ROTH (2011)

	Traditional	Roth
<b>Contributions:</b>		
Limit, under age 50	\$ 5,000 <sup>1</sup>	\$ 5,000 <sup>1</sup>
Limit, age 50 or older	6,000 <sup>1</sup>	6,000 <sup>1</sup>
Deductible	Yes, but may be limited if taxpayer (or spouse) participates in an employer retirement plan.	No
Income (AGI) phase-out:		
Applies to:	Deduction <sup>2</sup>	Contribution
Married filing joint return	\$90,000 – 110,000 <sup>3</sup>	\$169,000 – 179,000
Single or head of household	56,000 – 66,000	107,000 – 122,000
Maximum age	Age 70½	No age limit
<b>Distributions:</b>		
Taxation	All ordinary income (unless nondeductible contributions).	Nontaxable if qualified distribution
Distributions must begin	Age 70½	At owner's death
10% penalty before age 59½	Yes, subject to certain exceptions.	Yes; NA to withdrawal of contributions

<sup>1</sup> Or earned income (compensation), if less.  
<sup>2</sup> No income limits if taxpayer (or spouse) is not a participant in employer retirement plan or for nondeductible contributions.  
<sup>3</sup> \$169,000 – 179,000 for nonparticipating spouse.

## SMALL BUSINESS RETIREMENT PLANS (2011)

Provision	SIMPLE IRA	SEP
<b>Eligible employers</b>	Generally 100 or fewer employees earning at least \$5,000 in the preceding year and having no other retirement plan.	Any size employer. The employer may also sponsor a qualified retirement plan.
<b>Eligible employees</b>	1) Earned at least \$5,000 from employer in any two prior years and 2) Expected to earn \$5,000 or more in current year. Can have less restrictive requirements.	1) At least age 21, 2) Worked for the employer three or more in the last five years and 3) Received at least \$550 of compensation in the current year. Can have less restrictive requirements.
<b>Deadline for setting up plan</b>	Generally, October 1 of the year to which plan first applies.	Due date (including extensions) of employer's return for the year the plan is established.
<b>Employer contributions required?</b>	Yes	No
<b>Maximum annual contribution per participant</b>	<i>Employee:</i> Up to \$11,500 (\$14,000 if age ≥ 50). <i>Employer:</i> Either (1) match employee contributions up to 3%* of compensation or (2) contribute 2% of compensation (up to \$245,000) for all eligible employees.	<i>Employee:</i> None allowed. <i>Employer:</i> Lesser of: 1) 25% of compensation (up to \$245,000) or 2) \$49,000.

**Note:** Other types of retirement plans are also available, but SEPs and SIMPLE IRAs are often used.  
\* Can be reduced to as low as 1% in any two out of five years.

## IRA FOR A CHILD

- Reasons for funding a child's IRA:
  - Establish a long-running retirement fund.
  - Shelter income from taxes (but Roth IRA may be better choice).
- Contribution limits for 2011 are the lesser of (1) \$5,000 or (2) 100% of earned income.

**Example:** Eve, age 15, has \$2,000 of earned income so she makes a \$2,000 IRA contribution. Eve retires 50 years later at age 65. Assuming the account earned 7% per year, the balance in year 50 based solely on the single \$2,000 contribution would be \$58,914. If the account earned 10% annually, the balance in year 50 would be \$234,782.

If Eve contributes \$2,000 a year for the next four years (and none after that) and earns 7% or 10% annually thereafter, the balances when she reaches age 65 are as follows.

	Annual Return	
	7%	10%
Total IRA contributions (\$2,000 in years 1 – 4).....	\$ 8,000	\$ 8,000
IRA balance (year 50).....	213,523	818,649

## EARLY SAVER WINS—TIME IS KEY

Investors with modest lifetime annual incomes can retire in comfort, if a retirement plan is started early. The example below shows that a late saver will never catch up with an early saver due to compounding interest.

**Early Saver:** Saves \$1,000 per year at 8% for 10 years.

**Late Saver:** Saves nothing for 10 years and then begins a \$1,000 per year savings program for 40 years.

Year	Early Saver	Late Saver
	Deposits \$1,000/year at 8%	Deposits nothing
1	\$ 1,083	\$ 0
5	6,397	0
10	15,939	0
	Deposits nothing, grows at 8%	Deposits \$1,000/year at 8%
11	\$ 17,267	\$ 1,083
20	35,471	15,939
30	78,934	51,939
40	175,656	130,344
50	390,895	306,000

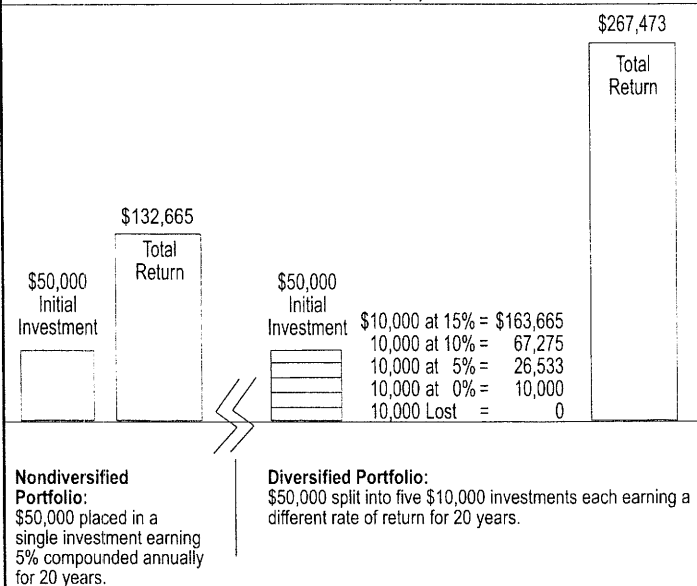
## PRICE OF PROCRASTINATION

The amount to be invested each month to accumulate \$250,000 (assuming earnings of 8% compounded monthly) is shown below for different time periods.

Time Period	Investment	Savings Goal
5 Years	\$ 3,402 per month	\$ 250,000
10 Years	1,367 per month	250,000
20 Years	424 per month	250,000
30 Years	168 per month	250,000

## PORTFOLIO DIVERSIFICATION

**Example:** A diversified portfolio could produce a far greater total return than a nondiversified portfolio even if an investor completely lost one \$10,000 investment and received a 0% return on another \$10,000 investment. See below.



## SOCIAL SECURITY

	2011	2010	2009
<b>Cost-of-living (COLA) adjustment</b>	0.0%	0.0%	5.8%
<b>Maximum amount a person can earn and still receive full benefits:</b>			
Under full retirement age .....	\$14,160	\$14,160	\$14,160
Year FRA reached <sup>3</sup> .....	37,680	37,680	37,680
Full retirement age (FRA) ....	No Limit	No Limit	No Limit
<b>Maximum earnings subject to:</b>			
Social Security tax .....	\$106,800	\$106,800	\$106,800
Medicare tax .....	No Limit	No Limit	No Limit
<b>Rate of tax:<sup>1,2</sup></b>			
Social Security .....	12.4%	12.4%	12.4%
Medicare .....	2.9	2.9	2.9
<b>Maximum tax paid by:</b>			
<i>Employee</i>			
Social Security .....	\$6,621.60	\$6,621.60	\$6,621.60
Medicare .....	No Limit	No Limit	No Limit
<i>Self-Employed</i>			
Social Security .....	\$13,243.20	\$13,243.20	\$13,243.20
Medicare .....	No Limit	No Limit	No Limit
<b>Amount needed to earn one quarter of coverage</b>	\$1,120	\$1,120	\$1,090

<sup>1</sup> Employees pay 50% of the rate shown.  
<sup>2</sup> Self-employed individuals pay 100% of the rate shown.  
<sup>3</sup> Limit applies only to months prior to attaining full retirement age.

## MORTGAGE PAYMENT CALCULATION

Determine monthly principal and interest payments using the table below by multiplying the number under the term and opposite the rate by the number of thousands of the mortgage amount.

**Example:** Monthly principal and interest payment on a \$72,000 mortgage at 8% for 15 years = \$688.32 (72 × 9.56).

For a 30-year term the payment would be \$528.48 (72 × 7.34).

**Note:** Taxes and insurance are not included in these calculations.

Interest Rate	15 Years	20 Years	30 Years
4.00%	7.40	6.05	4.77
4.50	7.65	6.32	5.07
5.00%	7.91	6.60	5.37
5.50	8.17	6.88	5.68
6.00%	8.44	7.16	6.00
6.50	8.71	7.46	6.32
7.00%	8.99	7.75	6.65
7.50	9.27	8.06	6.99
8.00%	9.56	8.37	7.34
8.50	9.85	8.68	7.69

## ESTATE PLANNING DOCUMENTS

Estate Planning Goal	Alternatives
Dispose of property at death	<ul style="list-style-type: none"> <li>Will.</li> <li>Revocable (living) trust.</li> <li>State intestacy laws (if no will).</li> </ul>
Name personal representative and guardians for minor children upon death	<ul style="list-style-type: none"> <li>Will.</li> </ul>
Financial management during disability	<ul style="list-style-type: none"> <li>Durable power of attorney.</li> <li>Revocable trust.</li> <li>Court-supervised guardianship or conservatorship.</li> </ul>
Health and personal care during disability	<ul style="list-style-type: none"> <li>Health care power of attorney or proxy.</li> <li>Living will and other advanced directives.</li> <li>Decision left to family members.</li> <li>Court-appointed guardian.</li> </ul>
Help explain will and disposition of personal property	<ul style="list-style-type: none"> <li>Testamentary letter.</li> <li>Memorandum disposing of personal assets.</li> </ul>

**Note:** Consult with legal counsel for drafting of legal documents.

## HOW LONG WILL SAVINGS LAST?

Use the chart below to determine how long savings will last after retirement.

- Locate the number of years savings will be withdrawn in the left-hand column and the anticipated annual return in the top row. Where the two figures intersect is the amount needed to draw \$100 a month.
- Divide accumulated savings by that amount and multiply by 100 to see how much money will be available per month before depleting savings.

**Example #1:** Assume savings of \$100,000. The plan is to make withdrawals for 20 years and earn an average return of 8%. The year and annual return columns intersect at \$11,955. The fund is 8.36 times larger (\$100,000 ÷ \$11,955), so withdrawals of \$836 per month (8.36 × \$100) can be made.

**Example #2:** Assume the need for \$1,000 per month for 20 years and an anticipated earnings of 7% on the starting capital. The 7% and 20-year columns intersect at \$12,898, which is the amount needed in order to draw \$100 a month for 20 years. Ten times that amount, or \$128,980, would be needed to draw \$1,000 per month for 20 years.

Years	Annual Return							
	2%	3%	4%	5%	6%	7%	8%	10%
5	\$ 5,705	\$ 5,565	\$ 5,430	\$ 5,299	\$ 5,173	\$ 5,050	\$ 4,932	\$ 4,706
10	10,868	10,356	9,877	9,428	9,007	8,613	8,242	7,567
15	15,540	14,481	13,519	12,645	11,850	11,125	10,464	9,306
20	19,767	18,031	16,502	15,153	13,958	12,898	11,955	10,362
25	23,593	21,088	19,945	17,106	15,520	14,149	12,956	11,005
30	27,055	23,719	20,946	18,628	16,679	15,030	13,628	11,395

**Note:** The chart can also calculate how much capital is needed to yield \$100 per month for the period indicated.