volume 7, number 3

21st century retirement

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Roth IRAs for Kids

It may be difficult for you to convince your teenage children to actively participate in their financial future, but if you can persuade your youngsters to deposit at least part of their babysitting or after-school job money into a Roth Individual Retirement Account (IRA), they may thank you later.

Although it is a retirement account, anyone with earned income below $110,000 for single filers, and $160,000 for joint filers, can open a Roth IRA. Contributions are nondeductible, but account earnings and qualifying distributions accumulate tax free. Because children seldom make enough to owe income tax, children are usually better off with a Roth IRA instead of a tax-deferred Traditional IRA. From 2005 through 2007, your child can contribute $4,000 (or earned income, whichever is less) annually to a Roth IRA. In 2008, the deposit limit increases to $5,000. Thereafter, the IRS will index contribution limits annually for inflation.

Saving for retirement early can generate substantial results. Suppose your 15-year-old daughter used $1,000 to purchase a Roth IRA. If she makes no additional contributions and the funds grow 8% annually, she will have more than $50,000 to withdraw tax free at age 65. Or suppose your son opens a Roth IRA when he is 15-years-old, and contributes $2,000 for 10 years. The estimated value of his tax-free fund balance at age 65 will exceed $700,000, if the annual growth rate is 8%.*

A Roth IRA offers the greatest growth potential if the account is left untouched until the holder reaches the age of 59½. At that age, the holder can withdraw earnings tax free provided he or she has owned the account for five years. The IRS does permit penalty-free early withdrawals to pay for education or to help with a first-time home purchase. Taxes will be levied on nonqualified early withdrawals.

Before you rush to open a Roth IRA for your child, bear in mind that you cannot stop your child from withdrawing money from the account whenever he or she wants after the child reaches the age of majority, 18 in most states. If you are uncertain about your child's ability to handle money, opening an account in his or her name may not be the best choice.

You should also be aware that the only income sheltered tax free in a Roth IRA is taxable compensation income. In general, paying your children for doing chores around the house does not qualify as compensation

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A Woman's Guide for Building a Strong Financial Foundation

Many women juggle competing demands, such as family, career, and a household, and may feel tempted to relegate retirement planning to the bottom of their "to do" list. But by putting off preparations for retirement, they run the risk of becoming one of the large number of women who spend their golden years struggling just to get by. Nobody wants to be in that group—especially since it can be avoided with the right planning.

Saving enough money to pay for a comfortable retirement can be a challenge for most Americans and it can be especially challenging for women who, when compared with men, may have earned less, spent fewer years working, and live longer. These concerns are often more acute for women who are divorced, widowed or otherwise single, or who have spent all or a significant portion of their adult years caring for children and other family members.

According to a recent report by the Institute for Women's Policy Research, nearly half of men receive income from pensions, but fewer than one-third of women do; and women's pensions are smaller on average than men's.[1] This is hardly surprising given that women typically spend nearly 12 years out of the workforce while taking care of children or elderly parents, and the average woman in the U.S. in full-time employment earned 75.5 cents for every dollar a man made in 2003, according to the Census Bureau. Women are further disadvantaged when their jobs are part-time or with smaller firms that do not offer substantial retirement benefits.

Because of shorter careers and possible lower incomes, a substantial proportion of women currently do not receive enough in Social Security benefits to meet even their basic needs. According to the Social Security Administration, women's average monthly retirement benefit at the end of 2003 was just $798.[2] And married women often do not realize that the retirement benefits their husbands have accrued may fall away if they are widowed or divorced. A current project[3] by the Center for Retirement Research at Boston College warned that 45% of baby boomer women will be single when they reach retirement age, putting them at high risk for poverty as they age if they don't do the needed planning now.

Clearly, most women will need to build up their own retirement savings if they wish to maintain a reasonable standard of living in their later years. Here are some strategies to use to get started:

- If an employer does not offer a good retirement plan, women should consider their options for securing better benefits. While companies with defined benefit plans that replace a percentage of income (based on salary and years of service) are becoming increasingly rare, due consideration should be given to the long-term consequences of a job with a firm that does not at least match contributions to a 401(k) or other defined contribution plan. Those who are lucky enough to be employed by a company with a traditional pension plan should find out what their benefit is likely to be, and at what age they can collect the maximum benefit.
- Take advantage of the tax benefits of qualified retirement plans and traditional Individual Retirement Accounts (IRAs). Depending on an individual's financial situation, many people find that making pre-tax contributions to a retirement account does not significantly reduce the amount of money they have available to spend. Contributions may decrease current taxable income (and, consequently, an individual's ultimate tax bill) and earnings are tax deferred. Taxes will be due when distributions begin. If money is withdrawn prior to age 59½ a 10% federal tax penalty will be due in addition to income taxes.
- Consider the role a Roth IRA or annuity may play in a long-term plan. Contributions to Roth IRAs must be made with after tax dollars, but earnings grow tax deferred, and qualified distributions made after age 59½ are tax free provided the account has been owned for five years. Certain income limits apply. Annuities offer the opportunity to save money on a tax-deferred basis and offer a variety of options for

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a woman's guide for building a strong financial foundation

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managing assets and receiving retirement income. All guarantees of income are dependent on the claims-paying ability of the issuer.

- Plan to work longer if necessary. Even a few extra years spent working will provide the chance to save more money toward retirement. Costs may also be substantially lower if retirement is put off until the individual qualifies for full Social Security and Medicare benefits.
- Arrange to pay off mortgage and other debt as quickly as possible. Owning a house outright in retirement not only ensures a place to live, it can also serve as a valuable source of equity, should it be needed. As an incentive to pay off credit cards, resolve to turn monthly credit card payments into retirement account contributions, when the debt is gone.
- Married women should assess the capacity of their husbands' retirement benefits to meet their future needs. Given that half of marriages end in divorce, and the average age of widowhood is 56, it is essential to plan for the possibility of managing alone. Women who stay at home while their spouse is working should set up an IRA in their own name. Women should also find out what rights they may have to their spouse's pension in the case of death or divorce, and the effects that divorce and remarriage would have on their Social Security benefits.
- If the family budget is tight, women might want to carefully evaluate the benefits of putting extra funds into their own IRA or 401(k) versus putting money in a savings account for their children's college education. Children may be able to get financial aid or low-interest loans to help pay for college, but there are no grants or scholarships for retirement. Also bear in mind that some funds may be withdrawn from a retirement account before the age of 59½ penalty free if used for qualified education expenses.

- Business owners should consider implementing a retirement plan for themselves and their employees. It will help ensure a comfortable retirement and is fully deductible now, thereby reducing the business's current tax liability. If the business already has a retirement plan, it should be reviewed with an advisor every few years to make sure it is still the best plan for the business and that the owner is taking advantage of all potential tax benefits.
- Executives whose companies offer the opportunity to participate in a non-qualified deferred compensation plan should take advantage of the opportunity. Again, it will decrease current income tax liability while providing an additional pool of money to draw upon in retirement.

Women need to make saving for their own financial futures a priority, even when there are bills to pay and the wants and needs of children and other family members feel pressing. While taking care of others is important, so is securing a solid financial foundation.

[1] "Social Security: The Largest Source of Income for Both Women and Men in Retirement," by Heidi Hartmann and Sunhwa Lee, April 2003.

[2] SSA Fact Sheet "Women and Social Security," September 2004.

[3] "The Effect of Social Security Reform on the Income Security of Older Women," by Courtney Coile.

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income, as this is an intrafamily transaction not usually reported to the IRS. If you own your own business, you are permitted to hire your minor children to do certain jobs. Provided you pay your children a fair market wage for the services performed, their earnings would be considered compensation income and could be deposited into a Roth IRA.

It is essential to keep careful records of how the money placed in a Roth IRA was earned, even if a teenager's working arrangements were informal (e.g., babysitting or lawnmowing for neighbors), and he or she did not earn enough to owe income tax. Severe penalties could apply if the IRS determines the funds deposited into a Roth IRA were not compensation income.

The good news is that if your teenager goes out and blows his paychecks on a new cell phone and skateboard, all is not lost. If, for example, your son earned $2,500 over the course of the summer but spent the money, you could still deposit the amount equivalent to his taxable earnings into a Roth IRA on his behalf, thereby ensuring he has a little something set aside when he retires and has long forgotten how to skateboard.

**The hypothetical examples are for illustrative purposes only. They are not intended to reflect an actual security's performance. Investments involve risk and may result in a profit or a loss. Seeking higher rates of return involves higher risks.*

What Can I Expect from Social Security?

S*ocial Security* offers a retirement benefit to workers and their spouses. You can start receiving benefits as early as age 62 (considered early retirement), or wait until you reach *full retirement age* of 65 to 67 (depending upon your year of birth). The benefits you receive are based on the income you have earned over the course of your life, subject to a maximum amount. You can find out how much you can expect to receive by contacting the Social Security Administration (SSA) or visiting their website at www.ssa.gov.

For most people, Social Security provides only a base level of income. The average annual benefit for a person who retired in 2004 at the age of 65 was $21,408; the benefit for a non-working spouse is only 50% of that amount. These benefits will most likely *not* meet all of your retirement needs. Most people rely on a well-rounded retirement plan that includes additional sources of income.

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