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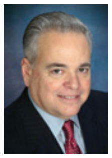
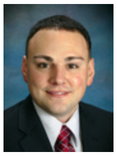
21st century retirement





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FIVE STAR WEALTH MANAGER
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in this issue:

Playing by the IRA Rules

Individual Retirement Accounts (IRAs) offer favorable tax-deferral benefits to individuals who are saving for retirement. But with those benefits, there are certain rules about when distributions may be taken to avoid penalty taxes. Contributions to a traditional IRA, depending on your income and participation in employer-sponsored plans, may entitle you to certain current income tax deductions. Further, because your funds are not taxed until distributions begin, your savings have the potential for tax-deferred growth. Generally, IRAs are designed to work as long-term savings vehicles, but you may be able to withdraw funds early and without penalty, provided your situation qualifies as an exception.

The Age 59½ Rule

The age 59½ rule provides that, if you take distributions from your traditional IRA before you reach the age of 59½, you may be subject to a 10% Federal penalty tax in addition to regular income tax. However, you may not have to pay the penalty tax if your early distribution meets certain requirements.

Exceptions

You may be eligible for penalty-free qualified distributions, if one of the following exceptions applies:

1) You are taking distributions as the beneficiary of a deceased IRA owner. Generally, if you inherit an IRA, you are required to take required minimum distributions (RMDs) over a period no longer than your life expectancy. For nonspousal beneficiaries, RMDs must begin in the year following the year in which the IRA owner died. Spousal beneficiaries may have additional time to begin taking RMDs, depending on certain factors, including whether they opt to treat an inherited IRA as their own. This penalty tax exception does not apply to spousal beneficiaries who opt to treat the account as their own IRA.

2) You are paying for certain first-time homebuyer expenses, generally referred to as qualified acquisition costs, such as buying, building, or renovating a first home. Distributions, which may not exceed $10,000, may be used to cover qualified costs for you, your spouse, your children, or your grandchildren.

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Retirement Planning: Let the Journey Begin

The sage advice that a journey of a thousand miles begins with a single step, also applies to saving for your retirement. It's up to you to take that first step. If you wait until you have "enough" money to begin saving, you may never start at all. Instead, focus on the first step. Then, you can begin transforming that thousand-mile journey to retirement into smaller, more manageable goals.

In order to start saving, you must spend less than you earn. If you feel that this is easier said than done, you're not alone. But, it's time to manage your personal finances and begin saving for your future. The concepts are simple: Monitor where your money actually goes and plan ways to spend it carefully. In other words—prepare a budget.

If the mere thought of a budget makes you feel deprived, think of it as a personal spending plan instead. Rather than focusing on what you should not spend, a personal spending plan can help you redirect the money you do spend.

The first rule of saving is to pay yourself first. Even if you start small, with patience and persistence, you can find ways to reallocate your money over time and watch your savings grow.

Not sure how to get started? Consider the following steps:

1. Track your expenses for one month. Record your daily expenses for at least one month. Categorize them as fixed, variable, or discretionary. *Fixed* expenses include those for which the cost remains the same every month, such as your mortgage or rent, car payment, and insurance premiums. *Variable* expenses are those you pay on a regular basis, but for which the amounts vary, such as food, utilities, childcare, travel expenses, and credit card debt. *Discretionary* expenses are those you could forgo if necessary, such as dining out, vacations, and entertainment. After tracking your expenses for one month, you can begin to see exactly where your cash is going.

2. Calculate each expense as a percentage of your income. This exercise helps identify how each expense relates to your total income. For instance, if you lease a new vehicle for $320 per month and your monthly income is $3,200, you are spending 10% of your income on your vehicle. Aim to trim these percentages wherever possible. You may be able to make large gains in savings by reducing many expenses by small percentages.

3. Prioritize your expenses. Rank each expense as "important," "moderately important," or "unimportant." Carefully scrutinize each item, starting with the unimportant ones. Eliminate those items you can do without. You may have the most leeway when it comes to discretionary expenses. The savings you generate in this area alone may be enough to begin a modest savings program. Then, look for opportunities to trim expenses that fall into the moderately important and important categories. For instance, you may be able to find a less expensive Internet provider if you shop around. Or, perhaps you could find a less expensive or more fuel-efficient vehicle when your auto lease is up.

4. Pay yourself first. Here's the key to success—once you've explored all potential savings, write yourself a check for the amount you saved and "pay yourself first." How you manage your money depends on how much you have and your future goals. As you plan for retirement, consider contributing on a regular basis to an **Individual Retirement Account (IRA)** or employer-sponsored **401(k) plan**. If you're also saving to send a child to college, you might develop an education funding plan.

By paying yourself first, along with your other expenses, you'll be a lot more successful at saving money for your future. As you see your funds accumulate, you'll be glad you took that first step. So, what are you waiting for? Your retirement will be here before you know it, so let the journey begin. ■

Entrepreneurship and the New Retiree

For many people who are nearing retirement or recently left their job, retirement signals not the end of a career, but rather the beginning of a new phase—entrepreneurship. Baby Boomers, in particular, may view retirement as an opportunity to start a new chapter in life, and hope to use their hard-earned skills and knowledge to create their own independent businesses.

Regardless of personal motivation, there are many advantages that those age 50 and older possess when starting their own business ventures. By retirement, mortgages have often been paid and children have graduated, or are soon to finish college. With fewer financial obligations—and perhaps a cushion from a lifetime of saving—the new retiree may have the opportunity to take his or her time in developing a strong business plan. Retirees also have the ability to utilize the many business contacts and skills garnered over their working years to further product development, marketing, and sales. This can prove extremely useful for those who wish to use their experiences in a particular field to strike out on their own.

Many retirees find the opportunities of their dreams during their "golden years." The chance to be

one's own boss, experience the payoff of hard work, and take advantage of the limitless financial and personal growth potential, all combine to make entrepreneurship an exciting and educational adventure. ■

playing by the IRA rules

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3) You, your spouse, or dependents have unreimbursed medical expenses that total more than 10% of your adjusted gross income (AGI). If a medical expense for you, your spouse, or a dependent qualifies as an itemized deduction on your income tax return, it will generally qualify for this penalty tax exception.

4) The distributions are part of a series of substantially equal periodic payments (SEPPs) made at least annually that meet certain additional requirements. The Internal Revenue Service (IRS) currently recognizes three methods for calculating SEPPS: the required minimum distribution method, the fixed amortization method, and the fixed annuitization method. Once SEPPs begin, they must be made for five years or until you reach age 59½, whichever is later.

5) You qualify with certain physical and/or mental conditions as being disabled, determined by a physician and if the disability can be expected to result in death or continue for an indefinite duration.

6) You are paying medical insurance premiums due to unemployment. If you lost your job, and received unemployment compensation for 12 consecutive weeks, you may take distributions from your IRA account, penalty tax free, during the year in which you received unemployment compensation, or in the following year, but no later than 60 days after you have been re-employed.

7) You are paying for higher education expenses, such as tuition, fees, and books at an eligible educational institution (generally all accredited postsecondary institutions). The distributions may not exceed your qualified education expenses, or those of your spouse, your children, or your grandchildren.

8) The distribution is attributable to an IRS levy of the IRA.

9) Reservists qualify while serving on active duty for at least 180 days.

IRAs are strictly regulated to ensure that they are used as vehicles for retirement savings. Therefore, they generally work best as long-term savings vehicles. However, if you do need income from your IRA before you reach age 59½, it is important to know if your situation excuses you from the penalty tax levied on early distributions before making a withdrawal. Playing by the rules may save you money and help preserve your savings for retirement. Be sure to consult your tax advisor to determine whether your individual situation will qualify as an exception. ■

Optimal Retirement Plan Design Can Increase Savings

Adding automatic features to 401(k) and other defined contribution (DC) retirement plans can significantly boost the retirement savings of middle-income workers in particular, but older workers remain vulnerable to retirement shortfalls, according to a white paper published on July 25, 2017 by the Defined Contribution Institutional Investment Association (DCIIA).

The paper, "Design Matters: The Influence of DC Plan Design on Retirement Outcomes," presents the first set of findings of an ongoing project that explores the current state of retirement readiness in a post-Pension Protection Act of 2006 (PPA) defined contribution environment. Based on data analytics and simulation analysis provided by the Employee Research Benefit Institute (EBRI), researchers looked at the positive effects of automatic plan features and the negative effects of asset "leakage" on the retirement income adequacy of DC plan participants, as well as at opportunities for improving DC plans without additional legislative regulatory action.

The authors stressed the importance of recognizing that today's DC system is dramatically different from the system that existed prior to the PPA, as the PPA facilitated the introduction of many enhancements to DC plans, including automatic enrollment, automatic escalation, and qualified default investment alternatives (QDIAs). They cited research showing that currently, 60% of large DC plans have automatic enrollment, 80% of plans with automatic enrollment also have automatic escalation, and 85.5% of plans use target date funds as the default investment alternative for non-participant-directed monies.

The report pointed out that the difference in retirement savings for workers in plans with automatic features, and those whose plans do not have automatic features, is dramatic, as middle-income workers who spend their entire careers in plans with automatic enrollment and automatic escalation are projected to experience significantly better outcomes than middle-income workers in plans without automatic features.

Researchers recommended, however, that plan sponsors also take steps to limit asset "leakage" through early withdrawals or loans, especially given that the risk of default on such loans is high when an employee terminates employment with an unpaid loan outstanding. The authors therefore advised plan sponsors to limit plan loans, hardship withdrawals, and cash-outs, noting that doing so has been estimated to increase projected retirement assets and income by almost 10% for participants who otherwise take advantage of these features.

The study thus concluded that since the DC system is already equipped with many of the tools it needs to drive better retirement outcomes, the current system can be improved even without additional legislative or regulatory action. The authors observed that even among employers that already sponsor DC plans, wider and more consistent adoption of tools such as automatic features and adequate initial savings rates could make a significant difference in the retirement income adequacy of current participants.

However, the authors also counselled plan sponsors to keep in mind that younger workers are, on average, in better shape than older workers; particularly older workers who did not have access to a defined benefit plan, and were participants in a DC plan that did not include automatic features and other savings-boosting measures prior to the PPA. They therefore stressed that the recent implementation of an optimal DC plan design will not necessarily ensure that workers who did not enjoy the benefits associated with automatic features over their entire careers will have adequate retirement savings.

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