Destination Financial Freedom

Getting you there

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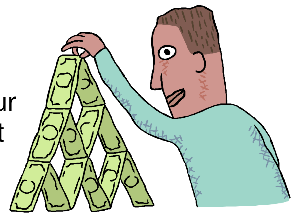
Savings Pyramid



Think you're on top of your game because you put money aside in your retirement plan at work? Granted any type of savings, regardless of where you stash it away, will always be the most essential component in achieving financial bliss. This article is in no way trying to downplay the critical role that savings plays in building a harmonious financial future. What it is trying to point out is that there is a science to savings; just like the science of nutrition - eat cruddy food, feel cruddy OR eat right, feel good and healthy. Everyone has to eat and everyone has to save. The question this article is trying to address is what is the best way to save? Let's review some account basics and next month we will plunge further into the subject matter.

There are several buckets that you can keep your savings in until you are ready to use the funds. There are 4 major tax differences between each bucket. The following chart shows the differences:

	Taxable Accounts	401(k), Simple, IRA, etc.	Roth Accounts
Contribution Tax Deductible?	NO	YES	NO
Tax-Free Investment Growth?	NO	YES	YES
Taxable Withdrawal? After age 59 1/2	Yes, Investment gains taxed	YES, as ordinary income	NO
Required Withdrawals?	NO	YES, mandatory withdrawals at age 70 1/2	NO

Which bucket, or account, should you put your money in? Most people feel the best place for their savings is in a retirement plan at work; it's easy, convenient and several employers match contributions instantly creating a 50% or 100% return (each plan is different and you should contact your employer to find out how much they contribute to your retirement plan).

Depending on your circumstances, you may need to consider when you can take the money out of these plans. Maybe you need to make a withdrawal to pay for you or your child's college. If you are considering leaving a corporate job to start your own business, you may want to keep your financial options open in case you need some extra capital for the first few years. The possibilities are endless. Each account has different rules for withdrawals before you are 59 ½.

In a **taxable account**, you can take money out for any reason you would like and not be penalized. These accounts are appropriate for people who need financial flexibility that retirement accounts generally cannot offer.

Roth contributions can be withdrawn at any time with <u>no</u> penalty or income tax

Employer plans vary considerably from company to company. The important thing to note is that Profit Sharing and 401(k) accounts *<u>generally</u>* can offer plan loans. This means that you can take up to 50% of the account value (before the age of 59 ½) and repay the loan, plus interest over 5 years. This is beneficial because the payment and interest go into <u>your</u> account and not to a bank.

IRA accounts, Simple IRAs or SEP IRAs also have a similar loan provision; however, the maximum period is only 60 days. If the loan is not repaid within 60 days, the full amount withdrawn from the account will be taxable - and depending on the size of the withdrawal, can bump you into higher tax brackets. Generally, we do not recommend this loan because it is too short of a period to be able to realistically pay back to loan.

Roth IRA accounts provide significantly more withdrawal flexibility. Because contributions have already been taxed, the contributions can be withdrawn at *<u>any</u>* time with *<u>no penalty or income tax</u>*. Keep in mind that there are several different rules regarding the earnings produced from the contributions and penalties and taxes attributed to them.

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Thought Swap

What matters most

Another Sale… I Am Saving So Much Money!

41%

Of Americans surveyed say, "It feels like I'm putting money into savings" when they purchase an item on sale.

-1.7%

Is the U.S. personal savings rate. So while Jimmy Choos fell good, you need a better way. An IRA, perhaps?

It feels wonderful to buy items sale; it's like your saving money, right? Wrong! Regardless if it is a $10 item on sale for $5, you are still spending $5. Even though it feels like saving $5 dollars, the fact of the matter is that no one takes that $5 savings and puts it into savings or retirement account. The fact that Americans are saving less than ever before shows this psychological outlook is decreasing our saving habits and increasing our spending.

Pension Reform Bill Changes Charitable Donations

• **Goodwill, ARC, etc. Donations in 2006?**
In order to claim any <u>non-cash donations</u> made to Goodwill or other similar charitable organization after August 10, 2006 the IRS is requiring the items be in good used condition or better. In other words you cannot dump junk off and claim a deduction. In addition, **IRS Form 8283** detailing item donations will be **<u>required</u>** to be filled with your tax return in order to get a deduction. If you don't file Form 8283 with your taxes can you still get a deduction? Probably… but you will be much more likely to be audited, at which point you will need to provide proof detailing the value of the donations.

Effective in 2007, for any charitable cash donations, you must be able to furnish a bank record or written communication from the charity detailing the gift. These records are not required to be sent in with your return but should be kept with a copy of your return because they will be required as proof if you are ever audited.

• **Benefits From Direct IRA Cash Donations**
If you meet the following conditions, you may be able to significantly capitalize with this change:

- **Over 70 ½ years old**
- **Own an IRA**
- **Make Cash Donations**

Currently, only available during the 2006 & 2007 tax years, the above taxpayers will be able to transfer their annual required minimum distributions - or any withdrawal - to a qualified charity and receive a tax deduction. Think this is no big deal? Here's why and who it can be beneficial for:

1. Taxpayers who take the standard deduction do not itemize and therefore do not benefit from any charitable donations. However, by having mandatory taxable distributions from an IRA go directly to a charity, the withdrawal becomes tax-free and thus will not be included as gross income.

2. Taxpayers who do not receive additional tax deductions for donations more than 50% of their adjusted gross income will be able to exclude any amounts donated from their IRA from their gross income (regardless if it is above the 50% AGI limit).

Take a Guess:

1) If both spouses reach the age of 65, what is the probability that one of them will reach the age of 95?
2) How many different designations are in the financial planning, investment advisory, and tax advice industry?
3) What is the recommended percentage of retirement savings that a retiree can withdraw safely every year without running out of money?
4) What is the percentage of working-age house-holds that are "at risk" of being unable to maintain their pre-retirement standard of living during retirement?

Answers: 1.) 28% 2.) 35 3.) 4% 4.) 45%
*Source- Journal of Financial Planning, August 2006