

Personal Finance

Class 10: Controlling Your Financial Future

Starting early: retirement planning

Estate planning

Why Retirement Planning?

- MISCONCEPTIONS ABOUT RETIREMENT PLANNING
 - My expenses will decrease when I retire
 - My retirement will only last 15 years
 - Social Security & my company pension will pay for my basic living expenses

Why Retirement Planning?

- My pension benefits will increase to keep pace with inflation
- My employers health insurance plan and Medicare will cover my medical expenses
- There's plenty of time for me to start saving for retirement
- Saving just a little bit won't help

Why Retirement Planning?

- THE IMPORTANCE OF STARTING EARLY
 - To take advantage of the time value of money
 - If from age 25 to 65 you invest \$300 a month (@ a 9% return), then at age 65 you'll have a nest egg of *\$1.4 million*
 - Wait ten years until age 35 to start \$300-a-month investing and you'll have about *\$550,000* at age 65
 - Wait twenty years to begin investing \$300-a-month at age 45 and you'll have only *\$201,000* at age 65
 - See Exhibit 18-1

Why Retirement Planning?

- People are spending more years (16-30) in retirement
 - A private pension and Social Security are often insufficient to cover the cost of living
 - Inflation may diminish the purchasing power of your retirement savings
-
- THE POWER OF COMPOUNDING
 - Compounding investment earnings is what can make even small investments become larger given enough time
 - Earning interest on previously earned interest

Why Retirement Planning?

- THE BASICS OF RETIREMENT PLANNING:
 - First analyze the current assets and liabilities, and then estimate the spending needs and adjust for inflation
 - Next evaluate the planned retirement income
 - Finally, increase income by working part-time if necessary

Conducting a Financial Analysis

- REVIEW YOUR ASSETS

- **Housing**

- If owned, probably your biggest single asset
 - If large equity, a **reverse annuity mortgage** could provide additional retirement income
 - You could sell your home, buy a less expensive one, and invest the difference



Conducting a Financial Analysis

- **Life Insurance**

- Life insurance cash value can be converted into an annuity

- **Other investments**

- Review investments, such as stocks & bonds. Consider taking the income from them

Conducting a Financial Analysis

- YOUR ASSETS AFTER DIVORCE
 - Retirement assets are affected by divorce
 - Pension benefits are considered a marital asset to be divided, depending on the length of the marriage
 - There are tax implications of the divorce settlement

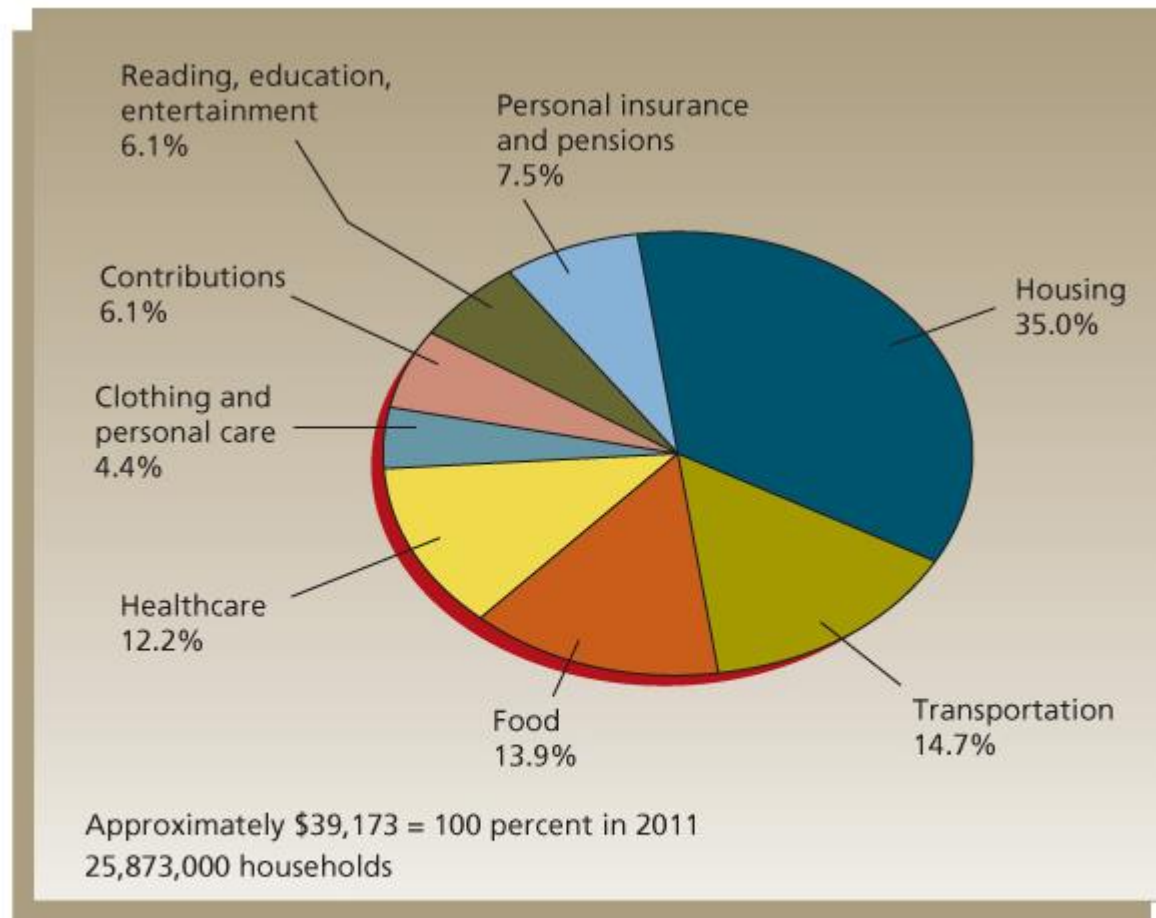
Retirement Living Expenses

- Spending patterns, where & how you live will probably change
- **SOME EXPENSES MAY GO DOWN OR STOP**, such as 401(k) retirement fund contributions
 - *Work expenses* - less for gas, lunches out
 - *Clothing expenses* - fewer and more casual
 - *Housing expenses* - house payment may stop if your house is paid off, but taxes and insurance may go up
 - *Federal income taxes* will probably be lower

Retirement Living Expenses

- ESTIMATE WHICH **EXPENSES MAY GO UP**:
 - *Life and health insurance* unless your employer continues to pay them
 - *Medical expenses* increase with age
 - *Expenses for leisure activities* may go up
 - *Gifts and contributions* may increase
 - See Exhibit 18-5
- INFLATION will cause your expenses to increase over the course of your probable 16-30 years in retirement

How an “Average” Older (65+) Household Spends its Money



U.S. Bureau of Labor Statistics, *Consumer Expenditure Survey*, Consumer Expenditures in 2011, April 2013, Table 4, www.bls.gov/cex/csxann11.pdf, accessed May 2, 2013.

Planning Your Retirement Housing

- Think about where you want to live
- Consider the cost of living, taxes & moving
- Consider the social aspects of moving (proximity to children or relatives)



Planning Your Retirement Housing

- TYPE OF HOUSING

- 92% prefer to stay in their own home
- A universal designed home is built to allow for potential physical limitations
- If not built using universal design, home may need to be retrofitted
- Continuing care retirement community provides increasing levels of care

Planning Your Retirement Housing

- AVOIDING RETIREMENT HOUSING TRAPS

If you plan to move when you retire...

- Write the local chamber of commerce to learn about property taxes and the economic profile
- Check on state income, sales, and inheritance taxes, and special exemptions for retirees
- Call a local CPA to find out what taxes are rising

Planning Your Retirement Housing

- Subscribe to a local Sunday paper
- Estimate what your utility, health care, auto insurance, food, and clothing costs would be in the area
- Rent for a while instead of buying immediately

Planning Your Retirement Income

- SOCIAL SECURITY

- Most widely used source of retirement income, covering almost 97% of U.S. workers
- Meant to be part of your retirement income, but *not* the sole source
- Check the Earnings & Benefit statement you receive each year for accuracy
- Full retirement benefits at age 65 to age 67, depending on the year you were born, but reduced benefits at age 62

Planning Your Retirement Income

- Up to 85% of your benefit may be subject to federal income tax for any year in which your AGI plus your nontaxable interest income & one-half of your Social Security benefits exceed a base amount. Publication 554
- Social Security payments are reduced if you earn above a certain income
- Cost of living adjustment each year
- Spouse's benefit is one-half of the retired worker's benefit
- See www.ssa.gov

Planning Your Retirement Income

- FUTURE OF SOCIAL SECURITY
 - Many people are concerned about the future of Social Security
 - Longer life expectancies means retirees collect benefits longer
 - People are retiring earlier and entering the system sooner and staying longer
 - The baby boomers will begin retiring soon and the ratio of workers to retirees is doing down
 - In 1945 there were 42 workers per retiree,
 - In 2013 there are 2.8 workers per retiree, by 2033 it is estimated to drop to 2.1 workers per retiree

Planning Your Retirement Income

- OTHER PUBLIC PENSION PLANS
 - The Veterans Administration provides pensions for many survivors of men and women who died while in the armed forces, and disability pensions for eligible veterans
 - The Railroad Retirement System

Planning Your Retirement Income

- EMPLOYER PENSION PLANS – DEFINED CONTRIBUTION PLANS
 - Individual account plans
 - *Money-purchase pension plans* – Your employer sets aside a percent of your earnings each year
 - *Stock bonus plans* – Your employer's contribution is used to buy stock in your company for you
 - *Profit-sharing plans* – Your employer's contribution depends on the company's profits

Planning Your Retirement Income

- *Salary reduction or 401(k), 403(b) or 457 plans*
 - Employer makes non-taxable contributions and reduces your salary by the same amount
 - Employee contributions are tax-deferred
 - Some employers match a portion of the funds you contribute
 - See Exhibit 18-10 for comparison between defined contribution and defined benefit plans

Planning Your Retirement Income

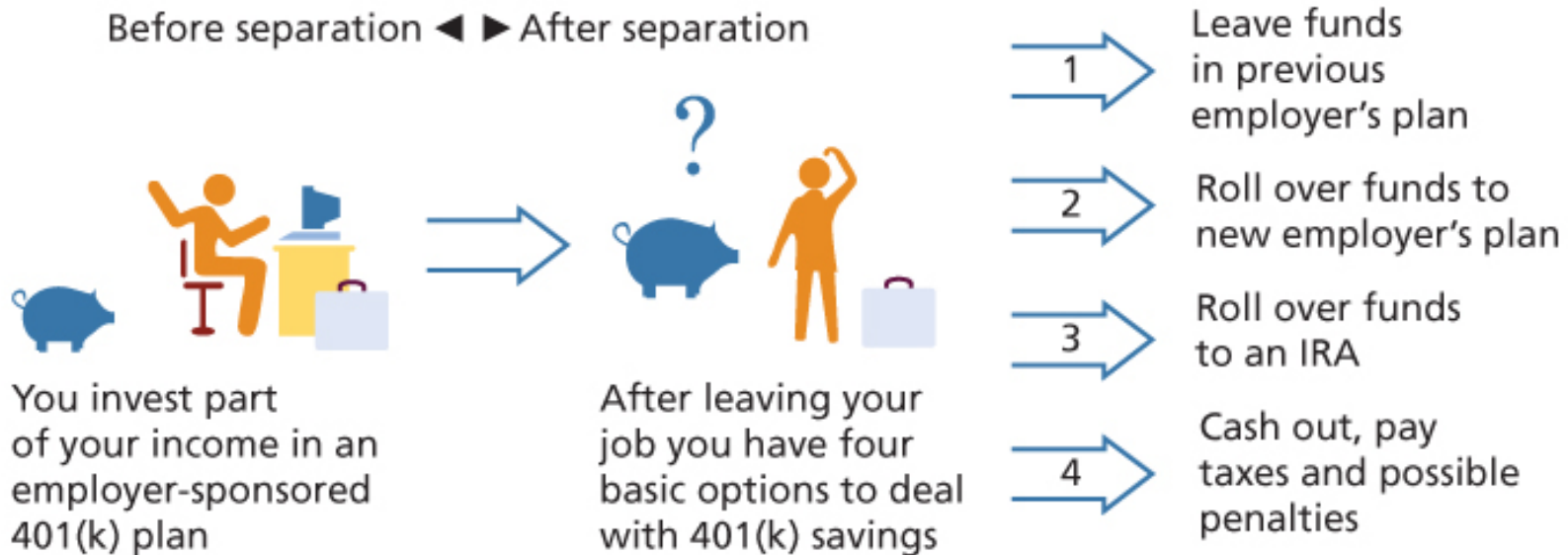
- EMPLOYER PENSION PLANS – DEFINED BENEFIT PLANS
 - Employer will pay you a certain amount per month when you retire based on your pre-retirement salary and number of years of service
 - Employer makes the investment decisions for your and their contribution, but your benefit amount stays the same regardless of how the investments perform

Planning Your Retirement Income

- PLAN PORTABILITY AND PROTECTION:
 - You can carry earned benefits from one employer's pension plan to another's when you change jobs
 - **Vesting** is your right to at least a portion of the benefits you have accrued under an employer pension plan, even if you leave before you retire

Planning Your Retirement Income

When you change jobs, generally you have four choices about what to do with your 401(k) plan savings:



GAO analysis, accessed April 3, 2013. United States Government Accountability Office

Planning Your Retirement Income

- PERSONAL RETIREMENT PLANS

Individual Retirement Accounts

- Regular (traditional) IRA
 - Lets you contribute up to \$5,500 in 2013 (\$6,500 if over 50 years of age)
 - Depending on your tax filing status and income, your contribution may be tax-deductible
 - The earnings accumulate tax free until you start taking it out
 - You pay taxes on the money as you withdraw it once you are retired but must begin to withdraw funds by age 70 1/2

Planning Your Retirement Income

– Roth IRAs

- Contributions are not tax deductible, but earnings accumulate with distributions tax free if the money is in the account for at least five years and withdrawals take place after age 59 1/2
- In 2013, if you are a single taxpayer, your Roth IRA contribution limit is reduced when your adjusted gross income is more than \$112,000 (178,000 if filing jointly). You cannot contribute when your AGI reaches \$127,000 (\$188,000 if filing jointly)
- You may convert your traditional IRA to a Roth IRA

Planning Your Retirement Income

- **A Rollover IRA:** Traditional IRA that accepts rollovers of your taxable distribution from a retirement plan or other IRA
 - You decide where your money is invested.
 - Can invest IRA money in a savings account, CD, or growth investments such as stocks, bonds, or mutual funds
- **Education IRA**
 - Give \$2,000 a year to each child
 - Accounts grow tax free and invested any way you choose
- **SEP-IRA's** are funded by employers

Planning Your Retirement Income

- **IRA Withdrawals**
 - Lump sum –Taxed as ordinary income
 - Installments based on life expectancy
 - Withdrawals prior to age 59 ½ are subject to a 10% tax in addition to the ordinary income tax
- **Keogh Plans** -for self-employed people

Planning Your Retirement Income



- ANNUITIES
 - An annuity provides guaranteed income for life
 - If you have fully funded all other retirement plan options, including your 401(k), 403(b), Keogh, and profit-sharing plans but still want more money for retirement you may want to buy an annuity
 - You can buy an annuity with the proceeds of an IRA, company pension, or as supplemental retirement income
 - You can buy one with a single payment or with periodic payments

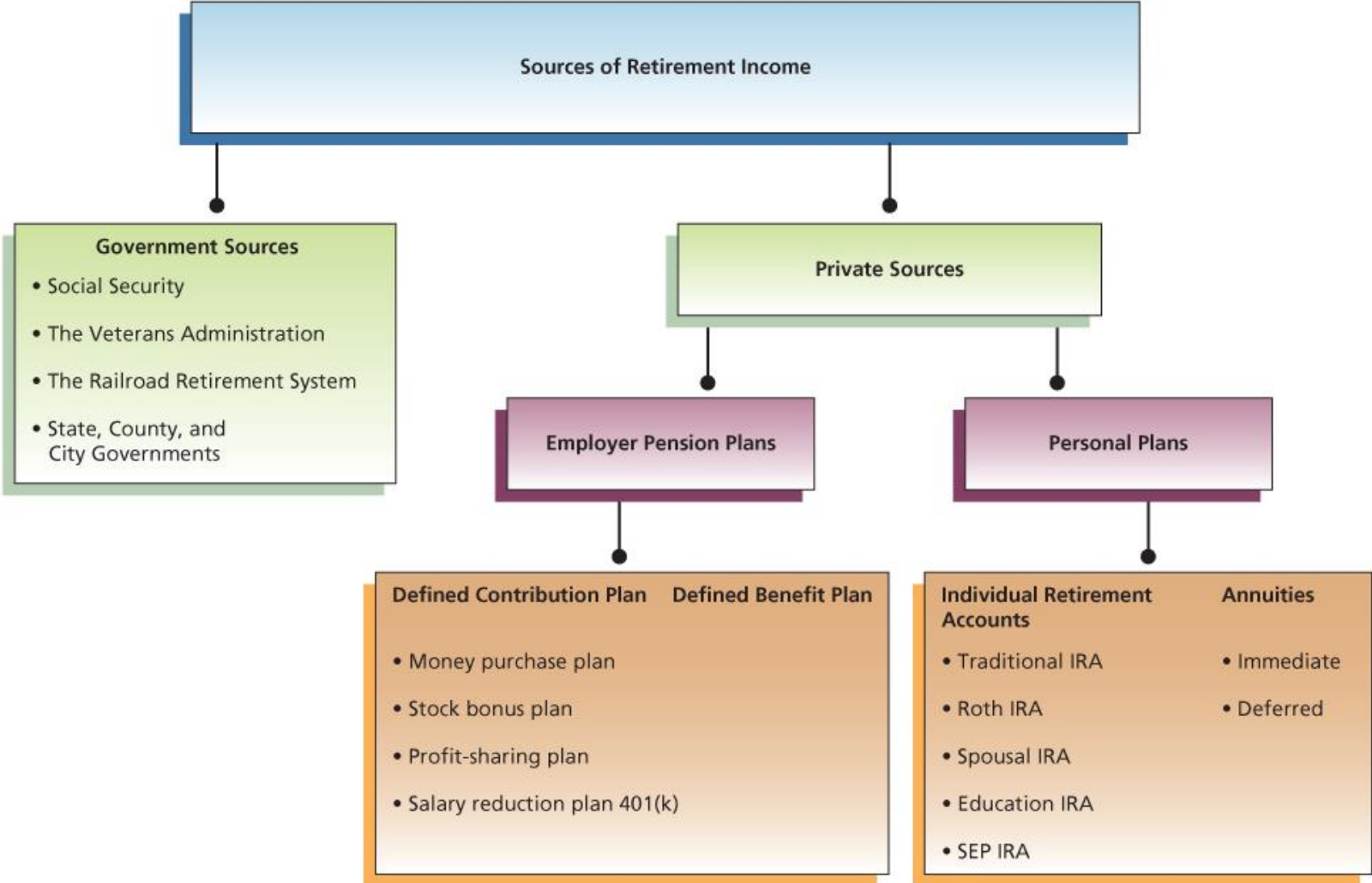
Planning Your Retirement Income

- You can also buy an annuity by converting the cash value of your life insurance policy into an annuity
- Interest accumulates tax free until payments begin
- **Immediate annuities:** payments begin right away
- **Deferred annuities:** income payments begin at some future date. Contributions, and the interest they earn, are tax-deferred until you begin drawing the money out

Planning Your Retirement Income

- **Options in annuities** allow you to decide which is best for your situation
- A **straight-life annuity** provides more income than any other type, but payments stop when you die
- The **life-with-period-certain option** guarantees the number of payments
- A **joint-and -survivor annuity** pays until the last survivor you designate dies
- Do you want a guaranteed fixed return or a variable annuity with a minimum guaranteed and the rest depending on how your investment choices for your annuity dollar are performing?

Sources of Retirement Income



Living on Your Retirement Income

- Make sure you receive all retirement income to which you are entitled
- Develop a spending plan for retirement
- If you have the skills and ability, do some things yourself that you used to hire others to do
- **Tax Advantages**
 - Take advantage of all **tax savings** for retirees
 - *Tax Benefits for Older Americans* (IRS office)

Living on Your Retirement Income

- **Investing for Retirement**
 - Monitor your investments
 - Invest some of your retirement income for growth, to allow for inflation and increased health care costs
- **Dipping into Your Nest Egg**
 - Dip into savings with caution, since you do not know how long you will live



Why Estate Planning?

- WHAT IS ESTATE PLANNING?
 - Estate planning is a definite plan for the administration and disposition of one's property during one's lifetime and at one's death
 - Estate planning is an essential part of retirement planning and has two components
 - Build your estate through savings, investments, & insurance
 - Transfer your estate as you wish at death

Why Estate Planning?

- If **married**, include spouse and children in estate planning process
- If **unmarried**, make sure beneficiaries have information about your estate that they will need
- Newer lifestyles means different challenges, which means plan early and get expert help

Why Estate Planning?

- OPPORTUNITY COST OF RATIONALIZING
 - Many people give little or no thought to putting their personal and financial affairs in order for their families that survive them
 - Demands of daily living can keep people from thinking about death
 - Plan while you are in good health
 - Estate planning is especially important for nontraditional households
 - LIMRA International booklet, *What Do You Do Now?*

Legal Aspects of Estate Planning

- **GATHER NECESSARY DOCUMENTS**

- Birth and marriage certificates
- Legal name changes
- Social Security documents
- Military service records
- Insurance policies
- Transfer records of joint bank accounts
- Safe-deposit box records
- Registration of automobiles
- Title to stock and bond certificates

Legal Aspects of Estate Planning

- WILLS

- A **will** is the legal declaration of a person's mind as to the disposition of his or her property after death
- Transfers property according to your wishes at death
- State law determines distribution of assets if you die **intestate** (without a will)
- Marriage and divorce affect your will
 - Review your will with an attorney
 - Marriage may revoke your will
- **Legal costs** of a will vary. A standard will costs between \$300 and \$400

Types and Formats of Wills

- A SIMPLE WILL leaves everything to your spouse
- A TRADITIONAL MARITAL SHARE WILL leaves half to spouse and half to children or heirs. Avoid probate
- An EXEMPTION TRUST WILL passes to your spouse except for an amount equal to the exemption, which passes into a trust. The trust can provide a lifelong income
- A STATED DOLLAR AMOUNT WILL
 - a) Should use percentages, not actual dollar amounts

Types and Formats of Wills

- FORMATS OF WILLS

- **Holographic will**

- A will that you write, date and sign, entirely in your handwriting
 - May not be recognized in some states

- **Formal will**

- Usually prepared with attorney's assistance
 - You must sign & have two witnesses, neither of whom can be beneficiaries (people named to receive property)

- **Statutory will**

- Type of formal will on a pre-printed form. Has rigid provisions, may be not meet current laws, and may be invalid if you change provisions

Types and Formats of Wills

- WRITING YOUR WILL
 - Selecting An Executor
 - This person follows your instructions
 - Find out if the person is willing to accept this major responsibility
 - Find out if he or she is capable of the complicated tasks involved
 - Person could be a family member, friend, attorney, accountant, or a bank representative
 - If you don't name one, the court will
 - Executor's fees are set by state law

Types and Formats of Wills

- Major Responsibilities Of An Executor
 - Take control of assets of the estate
 - File an inventory of assets and liabilities with the court
 - Liquidate assets if necessary to pay claims
 - Distribute assets, based on the instructions in the will
 - Make a final accounting to the court

Types and Formats of Wills

– Selecting A Guardian

- If you have children, you need a will to name their guardian and/or trustee
- A **guardian** assumes the responsibility for providing the children with personal care and managing the estate for them
- Trustee will manage property for benefit of children
- Be sure the person would be willing to raise them and that their values match yours

Types and Formats of Wills

- ALTERING OR REWRITING YOUR WILL
 - Review your will if there are major changes
 - If you have sold property mentioned in the will
 - If the size and composition of your estate have changed
 - If you have married, divorced or remarried
 - If new potential heirs have died or been born
 - Add a **codicil**
 - A document that explains, adds or deletes provisions in your existing will. Consider a new will if making major changes

Types and Formats of Wills

– **Prenuptial agreement**

- Agreed upon prior to marriage
- Often waive a right to receive property under the other's will or under state law
- You agree on a settlement if you should divorce
- Consult an attorney

Types and Formats of Wills

- LIVING WILL AND ADVANCE DIRECTIVES
 - Not a substitute for a traditional will
 - Advance directives include the following:
 - A living will
 - Provides for your wishes if you become physically or mentally disabled
 - Discuss your living will with those close to you and your family doctor
 - Sign and date it before two witnesses
 - Give copies to those close to you
 - A health care proxy (durable power of attorney)
 - Letter of last instruction (after-death wishes)

Types and Formats of Wills

- ETHICAL WILL

- New type of will that is a way to pass on emotional and spiritual wealth to your heirs
- It is not a legally binding document
- A way to pass on your values and beliefs
- Share lessons you've learned in life
- Address any regrets
- Requires self-examination
- Writer and recipients say the results are an invaluable legacy

Types and Formats of Wills

- DURABLE POWER OF ATTORNEY
 - also known as a health care proxy
 - Legal document authorizing someone to act on your behalf
 - Can be limited or gives a great deal of power
 - If you are unable to make decisions regarding your health care, this authorizes someone to do it for you

Types and Formats of Wills

- SOCIAL MEDIA WILL
 - Helps determine what happens to the online content/identity that you created once you die
 - can appoint someone as an online executor
- LETTER OF LAST INSTRUCTION
 - After death wishes
 - Not legally enforceable (in some states)
 - Provides heirs with information

Types of Trusts and Estates

- A **trust** is a legal arrangement through which a trustee holds your assets for your benefit or that of your beneficiaries
 - Takes care of or manages your property
 - Distribute your assets to your heirs from the trust according to your will
 - All assets are taken out of your name and put in the name of the trust

Types of Trusts and Estates

- Trusts are either **revocable** or **irrevocable**
 - With a **revocable trust** you retain the right to end the trust or change its terms during your lifetime
 - May avoid the lengthy probate process
 - Does not provide shelter from federal or state estate taxes
 - With an **irrevocable trust** you cannot change the terms or end the trust
 - For tax purposes the trust becomes a separate entity
 - If a large estate, used to reduce estate taxes and avoids probate

Types of Trusts and Estates

- **BENEFITS OF TRUSTS**

- Reduce estate taxes
- Avoid probate and transfer your assets immediately to your beneficiaries
- Free you from managing assets
- Provide income for a surviving spouse
- Ensures property serves desired purpose after death

Types of Trusts and Estates

- TYPES OF TRUSTS

- Credit-shelter (also called bypass trust, a residuary trust, an A/B trust, an exemption equivalent trust, or a family trust)
- Disclaimer Trust
- Living or Inter Vivos (property management arrangement established while you are alive)
- Testamentary (established by your will)
- Life Insurance Trust

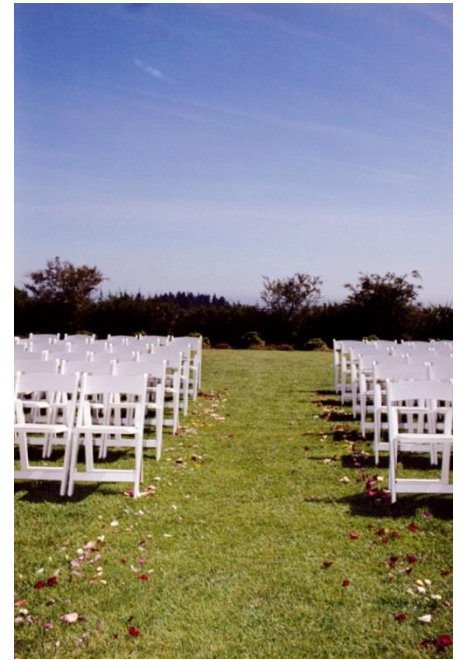
Types of Trusts and Estates

- MAKE AN INVENTORY OF YOUR ESTATE
 - Bank accounts, CDs, money market funds
 - Stocks, bonds and mutual funds
 - Life insurance, employee benefits and annuities
 - Your home and any other real estate
 - Business interests and farm assets
 - Money owed to you
 - Interests and trusts
 - Antiques, art, jewelry, collections, cars, and personal effects

Types of Trusts and Estates

– **Community property states**

- Community property is any property that has been acquired by either spouses during the marriage, but not by gift, bequest, or inheritance



Types of Trusts and Estates

– **Joint ownership**

- Spouses often own property as Joint Tenants With Right of Survivorship (JT/WROS)
- The property will automatically pass to your spouse upon your death with no estate tax paid at the first death
- Estate tax is paid when surviving spouse dies

Types of Trusts and Estates

– Life Insurance and Employee Benefits

- Life insurance proceeds are free from probate and income tax
- Unless payable to the estate, death benefits from qualified pension, profit sharing, or Keogh plans are excluded from your estate

Federal and State Estate Taxes

- Federal estate tax
- Estate & trust federal income tax returns
- State inheritance tax
- Gift taxes
- Tax avoidance and evasion
- Charitable bequests
- Calculating tax, debts and liabilities
- Probate and administration costs
- Paying tax owed