RETIREMENT

WHAT'S AVAILABLE ?

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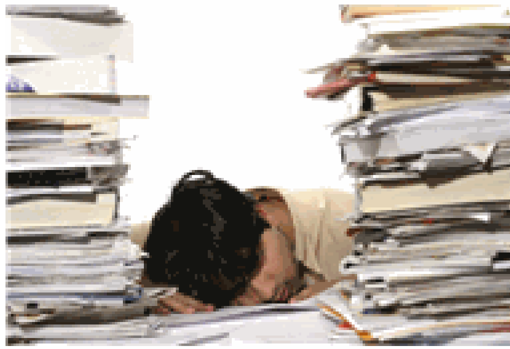

The time when one could be wholly self-sufficient, if there ever was such a time, may be over. I encourage you to consider individual savings and investment programs as the best preparation for retirement. The problem is that those who save and invest are asked to provide for those who don't. (Remember the fable of the grasshopper and the ant?) The ever-increasing burden of local, state and federal taxes reduces even the willing ant's ability to save and invest. Unfortunately the prudent way to provide adequately for one's retirement is to rely on (1) self, (2) employment related plans and (3) government programs (social security). In this workbook individual IRA and Keogh plans are introduced.

PENSION PLANS

Pension plans are a way of distributing an employee's compensation over his entire lifetime, even after he has stopped working. In the past, most pension plans were not separately funded, which meant that retired employees were paid benefits out of a company's current earnings. Presently the majority of pension plans are funded, the funds being set aside in a trust to grow and accumulate enough assets to take care of already retired workers and those getting ready to retire. Some plans provided for early retirement with reduced benefits. Usually benefits are not increased if one elects late retirement and some plans even mandate retirement at a certain age. A qualified plan is one which meets certain minimum standards established by ERISA (Employee Retirement Income Security Act of 1974). The employee defers taxes until benefits are actually received upon retirement and meanwhile they continue to multiply in a tax-sheltered environment. The employer takes a current tax deduction for his contributions as they are made.

VESTING

In plans where the employee pays a portion of the cost, if he should terminate his employment before retiring he is entitled to a refund in the amount of his contribution. What, if any, portion of his employer's contribution he is entitled to depends upon the vesting provisions of that particular plan. (Vesting means the employee has been employed long enough to earn the right to benefits.) Some plans provide full vesting after ten years on the job and others allow for twenty-five percent vesting after five years, and an additional five percent per year for the next five years followed by five years of ten percent vesting per year. It takes fifteen years for full vesting instead of ten but at least if you terminate your employment at the end of nine years you've got something to show

for it.. Another option is referred to as the *rule of 45*. After a minimum of five years employment the employee is awarded fifty percent of his pension rights when the number of years of employment plus the employee's age equals 45. Example; six years of service by a 39-year old employee would result in fifty percent vesting. Another way to achieve fifty percent vesting is by ten years of employment with no regard to age. For example, a thirty-year-old who had been with the company ten years would be fifty percent vested. Everyone is considered fully vested after fifteen years under the rule of 45. These are all the minimum acceptable vesting provisions allowed by ERISA but more liberal plans exist.

DISABILITY

Many private pensions provide for disability. Some grant benefits at an actuarially reduced rate if an employee is forced to retire early form his job because of a permanent disability. Others allow benefits to accumulate just as if the employee were still on the job and then pay full retirement benefits when the disabled employee reaches normal retirement age. Another way to handle the situation is to pay so much a month for each year of service or to provide an immediate benefit as a percentage of the salary the employee was receiving at the time of his incapacity. These provisions should be checked in your own plan as there is a great deal of variation and eligibility requirements; it is not standardized.

THREE BASIC TYPES

Pension plans may be divided into three main categories: (1) the defined-benefit plans which are most attractive from the employee's point of view because they commit the employer to provide determinable, specific benefits; (2) the money-purchase plans in which there are definite mandated employer contributions and the employee receives whatever benefits his pension account will purchase at the time of his retirement and (3) the target-plans which make no firm commitments or enforceable promises buy try to provide certain benefits.

Defined-benefit plans promise fixed benefits under various formulas. Under the flat-amount formula all employees meeting some minimum qualifications receive the same exact benefits. The flat-percentage formula relates benefits strictly to a percentage of earnings where the flat-amount-unit-benefit formula concerns itself with years of service. A predetermined flat amount is given for each year of employment. A variation of this, called the percentage-unit-benefit formula

awards a percentage of one or two percent and of one's former salary instead of a flat amount for each year of service.
With the enactment of ERISA the commitments demanded of employers were expanded to the point where a failure to live up to such a commitment threatened the life of a company. ERISA demanded among other things, earlier eligibility, faster vesting, minimum funding, amortization of funding deficiencies, insurance of benefits and contingent liability of up to thirty percent of the entire net worth of a company if a company ever wanted to terminate a plan. Such legislation naturally discouraged defined-benefit plans by making the cost prohibitive.
An analogy comes to mind: Everyone would agree that purified water is desirable and worth paying a high price for, but at some point removing the last bit of relatively harmless impurities would be so costly that a company could not stay in business and water would be denied completely to such demanding consumers. The standards set by ERISA are also desirable but wouldn't defined-benefit plans with a few *impurities* have been better than none at all? Many employees now think so. Because of ERISA's exaggerated demands, almost thirty percent of all plans were terminated in the 1970s. More and more companies switched to target and money-purchase plans where the employee is at the mercy of the investment market. Decreases in trust assets are now the employee's risk not the employers' who under the defined-benefit plan had to increase their contributions if trust assets decreased in value below a certain level.
I'm reminded of something Winston Churchill once said: "Some see private enterprise as a predatory target to be shot, others as a cow to be milked, but few are those who see it as a sturdy horse pulling the wagon." Too bad.

PROFIT SHARING PLANS

Business with fluctuating income often prefer to relate their retirement plans to profits rather than payroll. Profit sharing plans are believed to give the employees a personal interest in the business and to draw management and employees closer together.
The employer takes a tax deduction for all contributions made to the plan and the employee gets full a hundred percent credit for all such contributions which compound tax free until withdrawn.
Several years ago profit sharing plans were responsible for making many employees fairly well-off. It was a combination of large contributions by both employer and employee plus the

appreciation of the fund's capital and the forfeiture of unvested portions of accounts of ex-employee participants. But lately no one has gotten rich from profit sharing plans. In a great majority of cases employer contributions have trickled to almost nothing, the employee has been hard pressed to make ends meet let alone put aside for his retirement and on top of that the funds have done poorly showing losses rather than gains in the unsteady market of the past five years. A desirable feature of most contributory plans is that they offer either loan or withdrawal benefits or a combination of both. Distributions are legally permitted after two years but each plan has its own unique restrictions. Some plans only allow withdrawals of employee contributions, others restrict withdrawals to a percentage of the amount vested and then only in an emergency situation. A loan rather than a withdrawal is preferable because borrowed funds are not considered income and are therefore not currently taxed as withdrawals would be. Not only that, the employee can deduct from current income taxed the interest paid on the loan.

STOCK PURCHASE PLANS

Under one version of this plan all employees meeting certain qualifications are permitted to buy company stock at a discount of up to fifteen percent.
Under the Economic Recovery Tax Act of 1981 (ERTA) incentive stock option plans can also be made available on a discriminatory basis to certain employees. Highly paid executives would prefer the tax benefits such a plan offers over an increase in current compensation which would be taxed as ordinary income. These incentive plans have requirements which must be met: The option price is not a discount (as in the non-discriminatory plans) but must equal or exceed the value of the stock as of the option date; the option must be exercised within ten years and the value of the stock for which options are granted cannot exceed more than $100,000 in any one year. Taxes are paid only when the stock is sold and usually at a capital gains rate which means a goodly portion is tax-free.

SERPS

Supplemental Executive Retirement Plans (SERPS) are another form of deferred compensation which was initiated to pay additional benefits to top level executives in order to increase the level of retirement income beyond that contemplated by the basic retirement benefit plan formula.

EMPLOYEE STOCK OWNERSHIP PLANS (ESOPS)

In order to encourage use of ESOPS, ERTA provided a tax credit against payroll for companies adopting them. A corporation establishes an employee stock ownership voting trust which borrows money on the employers' guarantee and uses that money to buy company stock. The corporation made tax-deductible contributions to the trust which in turn covered the loan payments. In this way the company ESOP could raise capital by purchasing company stock with borrowed funds. The company then paid off the loan with tax deductible dollars. Beneficial ownership of the stock passed to the employees according to a set vesting plan but actual possession remained with the trust to grow in a tax-free environment until retirement. Employees might be required to grant a first right of refusal to the company at fair market value before selling outright to a third party and the trust or employer company might be required to purchase securities that could not be sold at a fair price based on a time and valuation formula on the open market; in reality a *put option*.

The idea behind ESOPs may be best expressed by an anecdote. A wealthy capitalist employer put up with the outspoken radial politics of a certain employee because that employee did an excellent job. The employee continually attended meeting of fanatical groups and reported their activities and spouted slogans to everyone in the office following such meetings. One Thursday after attending the usual Wednesday night communist group session, the employee was strangely silent. The employer questioned him and discovered the employee would no longer be attending those meetings. "What happened?" asked the employer. "A speaker told us that if all the wealth in this country were equally distributed tomorrow, each person would have $5,000." "Well?" prompted the employer. "I have $10,000 saved," blurted the employee.

A large portion of our society is deprived of power because they find themselves living at the mercy of other people. Louis Kelso, the originator of ESOPs, believed that this fact is one of the most destructive forces working against the overall economic health of our nation. People who have no real stake in producing wealth, beyond wages, are not living up to their potential. The ESOP theory holds that if everyone had a piece of the action, in this case a capital investment in the company, our entire economy would benefit. What do you think?

TAX-SHELTERED ANNUITIES (TSA)

TSAs are excellent programs for retirement planning but unfortunately they are available to only a few people. To participate one must be employed by a public school or tax-exempt institution organized specifically for educational, scientific, religious or charitable purposes. The participants can purchase annuity contracts, retirement income insurance policies or mutual funds all with before-tax dollars. Up to twenty percent of an eligible employee's salary can be contributed to a TSA. When withdrawn at retirement or sooner the benefits from a TSA are taxed at ordinary income rates.

THRIFT OR SAVINGS PLANS

The thrift or savings plan is a derivative of the other employee benefit plans. The employer's contributions are based either on company profits or the employee’s own after-tax contributions. Often the employer's contribution escalates with length of service. For instance, $.50 on the dollar for the first five years and then matching dollars from then on. Remember the employee is not taxed on the employer’s contributions so that amount together with his own contributions compound in a tax-free environment. The employee's contribution is mandated by the plan and should be set at less than six percent of compensation. A higher percentage and the employer has to refute the Internal Revenue Service presumption that the plan discriminates in favor of highly compensated participants in the plan. The reasoning here is that many lower paid employees may have trouble just making ends meet and if contributions are set at too high an amount they will not be able to participate and the plan will benefit only the top salaried employees.

SIMPLIFIED EMPLOYEES PENSIONS - SEPs

In 1978 Congress decided pension plans needed to be simplified so they came up with an IRA format subject to special rules. An employer can contribute the lesser of 25 percent of compensation or $49,000 for 2009.

There are also limits applied to the aggregate contributions an employer makes for its employees to all defined contribution plans, which includes SEPs. In 2009 the maximum is $245,000 which must be made in cash. Property cannot be contributed Thse amounts are subject to annual cost-of-living adjustments in later years.

SALARY REDUCTION PLANS

If you should happen to work for a company that has a salary reduction plan, you might just have the best of all possible worlds. Like the savings plans, a portion of pre-tax dollars are withheld from your salary and invested for your benefit by the employer.
Each company sets its own limits on how much an employee can contribute and most companies do some form of matching. Although the name doesn't imply this, the fact is it is possible to take home more dollars after the deduction because the investments may put you in a lower tax bracket with less withholdings required from your adjusted pay check. This plan is especially good if you expect to leave the company in a few years because there is a penalty for withdrawal in such a case although you cannot withdraw sums for other reasons without a tough proof of financial hardship. You must take the money with you when you leave the company and you can use the ten year averaging or roll over within sixty days.

KEOGH OR HR-10 PLANS

Under the Keogh Act of 1962, amended by ERISA in 1974 and then again in 1981, a self-employed, unincorporated individual may set up his own retirement plan. In an employer-sponsored plan the employer pays half the payroll taxes (FICA) and in a Keogh the self-employed person pays both the employer's and employee's share. To compensate the net income under HR10 plans is adjusted to remove the double FICA.

The money in self-directed plans can be invested in almost anything except hard assets such as diamonds and precious metals for instance. Mutual funds are a popular choice. Many banks and brokerage houses have investment plans set up especially for Keogh accounts. You are not taxed on the capital or its earnings, which compound in a tax-free environment, until the funds are withdrawn, which cannot be before age 59½ without penalty and must begin by age 70½. Distributions may take the form of an annuity but lump sum distributions may avoid the alternative minimum tax by electing a special 10-year averaging option. Alternative minimum tax and 10-year averaging are discussed elsewhere.) Defined-benefit Keogh plans have been

available since 1974 but because of actuarial costs and complications they are rarely used.
The following example illustrates how great an advantage it is to be able to invest with before-tax dollars:
Mr. Dim and Mr. Bright, both age 45 and in the 39% tax bracket, decide they can afford to put $6,000 a year aside for their retirement. They both anticipate a 10% earning on their investment. Mr. Bright uses a Keogh Plan and Mr. Dim does not. The chart below shows who will have the more carefree retirement.

MR. DIM

age	contribution	taxes	earnings	worth
45	$3,660	$143	$366	$3,883
50	3,660	998	2,559	27,155
55	3,660	2,148	5,509	58,446
60	3,660	3,695	9,474	100,517
65	3,660	5,774	14,805>	157,084

MR. BRIGHT

age	contribution	taxes	earnings	worth
45	$6,000	$0	$600	$6,600
50	6,000	0	4,629	50,923
55	6,000	0	11,119	122,306
60	6,000	0	21,570	237,268
65	6,000	0	38,401	422,416

Without the benefit of a Keogh, poor Mr. Dim immediately had to pay $2,340 (39% of the $6,000 he put aside for retirement) in taxes so he began his investment program behind Mr. Bright who was always able to invest the entire $6,000 he chose to put aside without its first being subject to taxation. On top of this all the interest Mr. Dim earned was taxed each year at the 39% rate the end result being that Mr. Bright had $265,332 more than Mr. Dim to ease his retirement years entirely thanks to his Keogh Plan.
Perhaps you should try to qualify! If you are self-employed in even a part-time business as long as you don't incorporate you may be eligible. A Keogh is an addition to any employer-sponsored plan you may have. It's worth discussing with your attorney or other adviser, don't you think?

IRA- INDIVIDUAL RETIREMENT ACCOUNTS

In 1975 IRAs were available to employees whose companies did not have a retirement or pension plan they could join. Thanks to the ERTA (Economic Recovery Act of 1981) now every working person can contribute to a tax-deferred IRA. The only requirement is that the income be earned, i.e. a salary as opposed to interest, dividend or legacy income. The beauty of the IRA is the chance to have interest compounding over time with no taxes due until the money is withdrawn.
Most accounts are opened by people in the 45-54 age group but an IRA is the best deal for those in their twenties because the further you are from retirement the more the IRA's tax-deferred compound interest can do for you. For example: if X opened an IRA at age 25 and began investing just $38.46 a week, at 12 percent compounded annually he would have $1,718,285 by the time he was 65 years old. That's the miracle of compounding over a forty- year period!! If on the other hand, Y waited until he was 50 years old to open his IRA, even though he were to make the same contributions of $38.46 a week at 12 percent interest compounded annually, by the time he was 65 he would have $83,507. It is not necessary to contribute every year nor is it essential to contribute the same amount.
The advantage of starting early cannot be overemphasized when it comes to tax-deferred compounding. Of course a fluctuation in interest rates and inflation were not taken into account in the hypothetical. In 2008 12 percent is an unrealistic interest rate and inflation in recent years has been low. A change in inflation rates might mean that bread will cost over $20 a loaf, but even then, although you may not live like a king, thanks to your IRA you may be able to remain at your pre-retirement level of comfort.
Some companies have payroll plans where so much is automatically deducted from your pay check and put into an IRA. This is an excellent way for someone to save who otherwise would not have the discipline to do so. It is relatively painless and very convenient.
The IRA fund must not be disturbed until you reach age 59½. If money is withdrawn before that time there will be taxes due on the amount withdrawn plus a ten percent penalty. However, IRA funds may be transferred from one qualified institution to another as often as you wish with no penalties. If you wish to move the funds yourself they must be placed in another IRA account within sixty days or the above mentioned penalties will be assessed. Moving the funds yourself rather than having an institution arrange the transfer is called a *roll-over* and only one roll-over is

permitted each year. Uncle Sam has not forgotten about his share of all that money accumulating in your IRA and to make certain he gets his share you must start withdrawing your funds when you reach age 70½. The withdrawal can be made all at once in a lump-sum, in which case Uncle Sam is right there to levy taxes on the entire amount. There is a minimum amount which must be withdrawn when you reach 70½ and on a schedule, which according to actuarial tables, would assure the depletion of the fund during your life span. Of course, the amounts withdrawn can be reinvested in any number of entities but not another IRA. Failure to withdraw the proper amount results in a penalty equal to half the amount you should have withdrawn.

In spite of these stiff penalties, which you should take care to avoid, an IRA is an extremely good investment. You can open IRAs at banks, savings and loans, credit unions, brokerage houses, mutual funds and insurance companies and also at some work places. You cannot invest in precious metals, life insurance or collectibles, but that leaves bank certificates, money-market funds, bond annuities, treasury notes, real estate limited partnerships, stocks, mutual funds, and many, many others; a pretty wide choice. However, like the purchase of life insurance when there are numerous choices it is time for self-analysis, preferably with some professional help. I will attempt to give you briefly some guidelines. Your own personal objectives will depend on your age, financial circumstances and temperament.

Prior to 2008 banks, savings and loans and credit unions were places where you could put your funds free from worry and decision making. It may take a while for some to gain confidence in banks and savings and loans again. They have professionals managing the funds and if the institution has an FDIC sign that means your account is insured by the government up to $250,000. In that case the only decision that must be made is whether you will choose a fixed or variable interest rate. You should consider a fixed interest rate if you feel interest rates will fall during the term your funds will be locked in. That way you will be assured of the high rate of return you anticipated when you invested your money.

The only meaningful way to comparison shop is to request the effective annual yield. Interest is compounded in many ways; yearly, quarterly, monthly, weekly or daily. For instance, a simple (not compounded) interest rate of 14.375% might yield the same income as a 13.25% rate which is compounded daily. The effective annual yield is very important so shop carefully. Don't open an IRA any place where they won't tell you the annual effective yield.

The main drawback to opening an IRA with a bank or savings and loan, is that if you should need to withdraw your funds for an emergency there are heavy withdrawal penalties. These penalties are on top of the taxes which become due on withdrawal and the IRS ten percent penalty previously mentioned.

Even though money market IRAs are not insured they are relatively secure, especially if invested in treasury bills or government bonds, Not only can the account be moved around without penalty, but the charge to manage your IRA in a money market would only amount to a few dollars per year.

With a mutual fund group you can speculate and if you are young enough, afford to make some bad judgments knowing you have the time to recoup any losses. The advantage here for someone

who has, or wants to acquire the skill and has the time and temperament, is that you can switch the funds as the economy and your own personal finances change. You avoid getting locked into one type of investment by joining a large fund group with ample diversity. In a no-load fund you deal directly with the company or transfer agent with no commissions involved as opposed to a load fund where shares are sold through a broker who charges a commission.
An insurance company IRA is an annuity and you must carefully weigh the safety, fees involved and investment potential.
You can always open a self-*directed* IRA but it must be with a brokerage house with an IRA Trustee. The only people who might benefit from a self-directed IRA are professional investors who believe they can handle the investment funds better than another manager. However, they would have to pay commissions and themselves for the energy and time involved in self-managing.
In the final analysis it is possible to discover an IRA is not right for you. If you have only limited funds you must choose what to do with your savings dollars and it might be that a savings plan where you work is the best idea. If the company matches more than 25 percent of your contribution then even if the savings is accomplished with your after-tax dollars you would be ahead of the typical IRA. Remember brokers and financial advisers don't get commissions by recommending your own company's savings plan. Look out for yourself and check it out.

MUNICIPAL AND OTHER TAX-EXEMPT BONDS

The final alternative to an IRA is open to everybody; municipal and other tax-exempt bonds and funds. Of course, they pay less interest than the taxable investments but they are great if you are in a high enough tax-bracket so that being tax-exempt weights the investment. This type of investment might be a winner if you are pretty certain to withdraw the savings before age 59 ½ .

SUMMARY

Many pension plans today are money-purchase or target plans where the ultimate benefit to the participants depends on investment experience. Consider yourself one of the lucky ones if yours is a defined-benefit pension plan.
Because business has been *off* lately, profit sharing plans have not been very attractive. In many

instances, management struggled heroically just to keep employees on the job without worrying about sharing non-existent profits. Still the fact that benefits are permitted to be withdrawn or borrowed against after only two years participation in a profit sharing plan is an intriguing feature. The various stock ownership plans, deferred compensation plan, specialized TSAs and Thrift plans all have their good and not-so-good features. The best ideal of all is to have an IRA and the tax exempts and company or Keogh plans if you have that much money you can just put aside for savings. Most of us have to make a choice because we're lucky to be able to get $2,000 each year that isn't sorely needed for creditors or necessities currently. Just remember you can have an IRA and these other plans if you should ever have more than $2,000 to save. Never, never again think of the old piggy bank or pass book savings account when there are so many place to let your money work for you! The laws are changing constantly and the ceilings and rules applicable to the plans discussed in this workbook may be outdated when you read this, so use the Internet and if anything isn't crystal clear consult a professional.

If you are an employee, the main thing for you to remember is that ERISA, the Employee Retirement Income Security Act was enacted thirty-five years ago for your benefit. You should use it to your advantage. The questions below should be the ones you address when choosing your retirement plans. Those who already have plans should be able to get from your pension plan administrators a special summary in easy-to-understand language. It should be useful as you tackle the worksheet which follows.

Worksheet

What You Should Know About Your Employment-Related Retirement Plans

This will take some research on your part but the answers to these questions will simplify your planning in this area. Write all the information you come up with in your notebook.

1. How many years on the job are required before you qualify for a pension?
2. Will the time you put in before the plan was initiated count towards determining the number of years worked?
3. Can these years be cumulative (leave or lay-offs OK) or must they be continuous years worked?
4. How long do you have to work each year to have the year included as credited service?
5. Is there an age requirement?
6. How do you apply for benefits?
7. How are your benefits determined?

fixed amount?
number of years worked?
amount of compensation received
combination?

8. Are you obligated to contribute a part of your salary to the plan on an annual basis?

9. How much will the employer contribute? Does the contribution involve your savings as well as the company's profits?
10 Can you invest the savings and the company's contributions in different types of investments? Company stock? A portfolio of growth stocks or long-term bonds?
11. Are you able to withdraw the full value of your own savings and the accumulated income whenever you want?
12. How long must you wait until you can withdraw your portion of the company's contributions? Are you penalized for withdrawals? Must you wait until you leave the company?
13. What are your benefits if:
job terminated now due to lay-off, fired or company bankruptcy?
you change jobs now?
you become disabled?
you retire early?
you reach retirement age?
14. Are benefits tied in some way to cost-of-living? How?
15. Is your plan insured? Fully?
16. Is your plan integrated with social security? What is the formula?
17. What kinds of survivor's benefits does your company offer? Can your beneficiary receive benefits guaranteed until his or her death?
18. Is it necessary to give up a part of your normal pension in order to receive survivors' benefits in case of your death?
19. Must you opt for survivors' benefits before your retirement? How long before retirement must you choose?
20. What benefits are available to your beneficiary if you die before retirement?

Recommendations

http://www.themoneyalert.com/Retirement-Plan-Limits.html

The ultimate resource on the Internet for financial planning
http://www.irs.gov/

The following Internal Revenue Service addresses are especially relevant

IRA Online Resource Guide—Information for Individuals
http://www.irs.gov/retirement/article/0,,id=137268,00.html

Retirement plans for small business
http://www.irs.gov/publications/p560/ch04.html#d0e2737

Retirement tips for individuals

http://www.irs.gov/retirement/participant/article/0,,id=133069,00.html

Retirement plans for individuals
http://www.irs.gov/retirement/article/0,,id=137268,00.html