



# Destination Financial Freedom

Getting you there

by: Amy Mahlen, CFP

October 2006



## Savings Pyramid Part II

Last month we reviewed some basic savings mechanisms to help us determine how to put away money in the most efficient manner based on our individual circumstances and priorities. Taxable accounts offer the most withdrawal flexibility yet do not receive favorable tax benefits and therefore should be used for non-retirement priorities. Retirement options can be more involved because of all the available savings possibilities and government restrictions. Should you only use your 401(k) because of the employer's match, and the added convenience of having your contributions drafted straight from your paycheck? Generally, there are three retirement savings options for people; an employer plan, an IRA, or Roth.

If you have a company plan, it is very important that you understand how much your employer contributes. There are generally 3 different ways that employers add to your account. The method used should help to determine how much money you should be putting in the plan.

1. **Mandatory contributions** – are made regardless of whether or not you put money into the account;
2. **Matching contributions** – are made *based* on how much money you contribute into the plan (up to a certain amount). If you don't participate, neither will your employer. This also means that your deposits above a certain amount- usually based on your salary- do not receive any added employer benefits;
3. **No contributions** – The employer will not make any contributions to the plan.

Keep in mind that one of the biggest disadvantages of most employer plans is that they typically offer very limited investment choices. Some plans may only have five or six, average-to-sub par investment options. This can ultimately hinder your bottom line. Because of this major drawback, if your employer either makes *mandatory* or *no contributions* at all, it may be more prudent for you to be saving in a regular IRA or Roth. Even though you might have access to

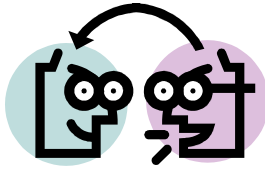
an employer plan, if your investment options are not superior, than you should first consider an IRA or Roth; capitalize on these accounts first, then make any additional retirement contributions to your employer plan. On the other hand, if the company provides matching contributions, first contribute enough to fully maximize the company match, after which time, if the investment choices are not excellent, you may want to consider a Roth or IRA.

Now the question becomes should you contribute to an IRA or a Roth? There are a few ways to think about this option. First, if you absolutely cannot forgo the tax deduction benefit from an IRA contribution, then you should by all means contribute to the IRA. Keep in mind the lower your effective rate is, the less of a tax benefit you will receive from the IRA deduction. On the other hand if utilizing a ROTH account will not dramatically affect your situation, the Roth is absolutely the way to go. In order to qualify to make contributions to these plans, your adjusted gross income (AGI) must be below the following amounts in order to deposit the full \$4,000 this year or \$5,000 if you are over 50 years old:

Participation Income Restrictions

Tax filling status	IRA with no employer plan	IRA and available employer plan	Roth
Married Joint	no restrictions	\$75,000	\$150,000
Single	no restrictions	\$50,000	\$95,000

The biggest difference between these two accounts that will affect how much money you can accumulate overall is the taxability of the contributions and withdrawals. Generally, the Roth can accumulate more because taxes are paid on the contribution amount before any growth occurs. For example, let's say over thirty years an investor contributes \$50,000 and the account at age 60 has a total value of \$200,000 where all withdrawals are tax-free. Assuming a 25% tax rate this investor would have only paid \$12,500 on the original \$50,000 contributions into a Roth account. At the age of 60, even if funds in an IRA are not all withdrawn at once, a pending \$50,000 tax bill (or more depending upon the future growth of the account) would remain. Paying taxes upfront can be powerful!



# Thought Swap

What matters most

**“The best prescription is knowledge.”** - Dr. C. Everett Koop, Former Surgeon General

+ 6.5%

**Lipitor**

10 mg

Treats High Cholesterol

+ 6.5%

**Celebrex**

200 mg

Treats Arthritis

+ 4.9%

**Actonel**

35 mg

Treats Osteoporosis

## Plan D Rx Rising

“A recent AARP survey found that wholesale prices for the 200 most common brand-name drugs rose 3.9% in the first three months of this year, the largest quarterly increase since the study began six years ago and three times the rate of inflation.” (source: September 2006 of *Money Magazine*). About 85% of Part D plans require participants to cover all drug costs between \$2,250 and \$5,100 each year. Because

many seniors could find themselves being pushed into this “doughnut hole”, *Money Magazine* recommends the following:

- **Don't Automatically Reapply** - With open enrollment beginning in mid-November, check to see if your plan has dropped any of the drugs you take or raised the prices significantly. You can comparison shop at [medicare.gov](http://medicare.gov).
- **Watch the Doughnut Hole** – It is estimated that 25% of all Medicare beneficiaries will have drug costs that sore above the \$2,250 gap in coverage. If you believe that you will fit that bill, it may be worth switching to a plan that offers doughnut hole coverage.
- **Go Generic** – Inquire about finding a generic equivalent that is essentially the same medication, just cheaper. Another AARP study found that the price for the 75 most commonly prescribed generic drugs actually fell in the first three months of the year.
- **Shop Around** – Different pharmacies offer medications at various prices, and some other generic drugs that other's don't. A combination of price and pharmacy shopping could cut your prescription spending substantially!

## Tax Gains Back From Vacation

The huge losses incurred from 2000 through 2002 have aided in the past few years' recovery efforts by offsetting gains since 2003. Well, according to a recent Lipper study it looks as though the loss reservoir has run dry this year. It is anticipated that mutual fund shareholders will begin to feel the drought this year where returns could lose about 1% of their asset value to taxes and approximately 1.5% in 2007.

## The Next Reality TV Show!

Are you sick of reality TV yet? Well, if you still enjoy this entertainment, have your remote nearby because Hearst Entertainment and Atchity Entertainment International are planning on starting a reality financial planning show.

They are currently searching nationwide for people with “unusual, extreme, and entertaining” stories that lead to episodes about:



- Being a shopaholic
- Wanting to start a business
- Having oceans of debt
- Newlyweds and their dramatic monetary differences

Currently, I am not aware when this new show will air, but it might be interesting to watch ☺

## Take a Guess:

- 1) How many U.S. seniors are financially abused each year through investment scams according to the SEC?
- 2) 57% of workers looking for a new job feel they are underpaid. What percentage actually are underpaid according to Salary.com?
- 3) What percentage of new car loans in 2005 were for longer than 60 months according to the Consumer Bankers Association?
- 4) Out of 10 wealthy families, how many will lose their fortune by the end of the third generation according to Christian Science Monitor?

Answers: 1) 5 million 2) 19% 3) 55% 4) 9