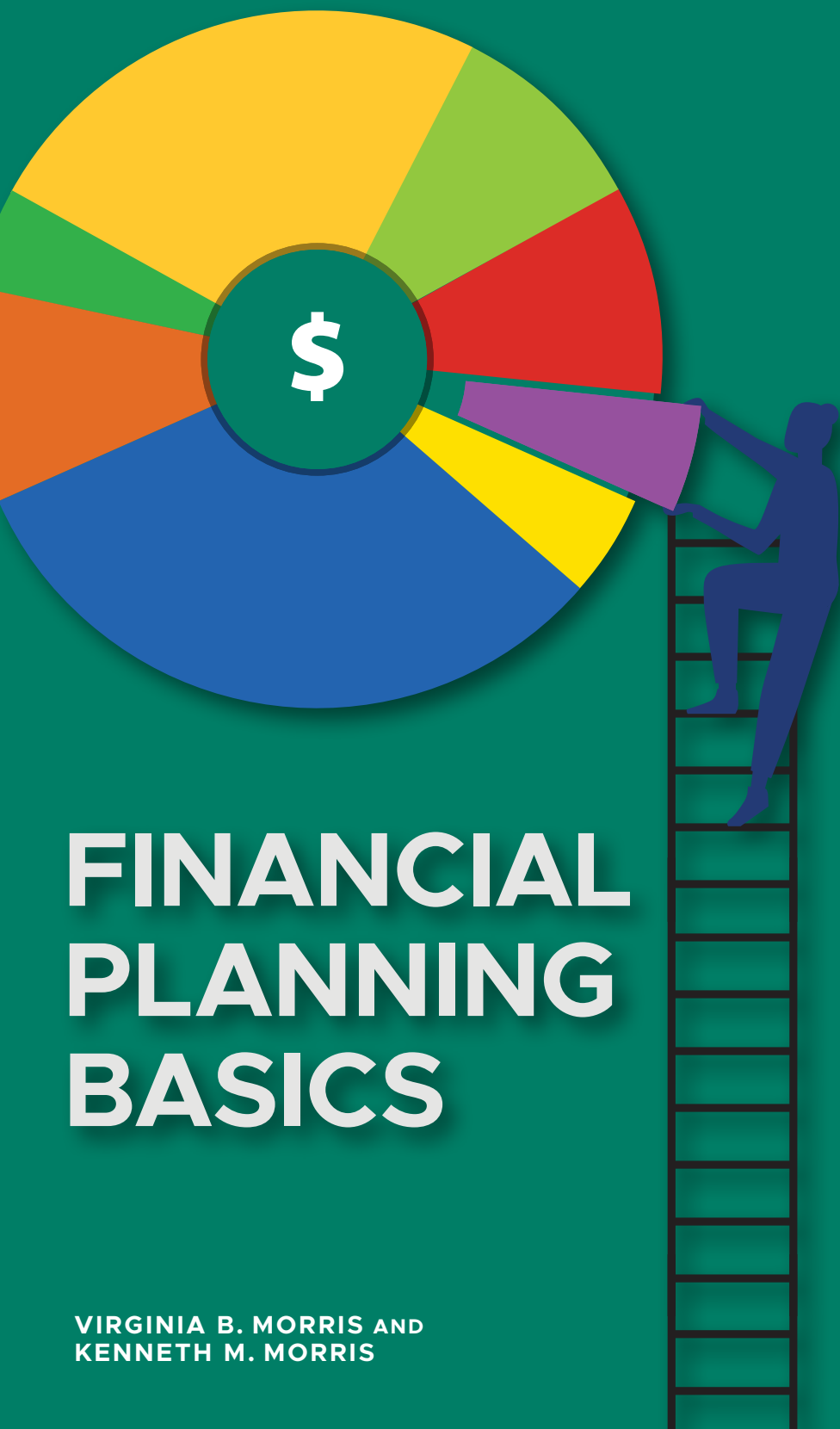




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FINANCIAL PLANNING BASICS

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FINANCIAL PLANNING BASICS

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Moving Ahead Toward Your Goals

If you know where you want to be, you can plan the route and set the pace.

Staying focused on the financial goals that are really important to you can inspire you to increase the amount you're adding to your saving and investing accounts each pay period. And it can provide the motivation you need to keep on top of the progress you're making toward those goals.

Some of your aspirations may be ones that other people share. You may want to buy your first home or trade up to one that better meets your needs. If

you have children, one of your primary goals may be ensuring that you'll be able to afford tuition at the colleges or universities where they really want to go. And, if you're thinking about retirement at all, you probably know that you want to be financially secure enough to be able to live comfortably and to do the things that are important to you.

One of the challenges in trying to balance these potentially competing goals—and others that may be more uniquely your own—is figuring out how you can shift the emphasis to focus on one or the other at a certain time without losing sight of your big financial picture.

10% HERE AND 10% THERE

You think you can't afford to invest 10% of your income? Try calculating it this way:

1. Multiply your annual income by 10% (0.10)
2. Divide the answer by 52
3. Divide the answer by 7

That's the amount you need to set aside each day to invest 10%.

If you're participating in a retirement savings plan where you work, you could identify that percentage as the amount you want to contribute. It will be deducted automatically from your salary or wages. If you're investing through an IRA or a taxable account, you could arrange to have the amount debited from your checking account every payday or have your custodian or brokerage firm withdraw the amount via the Automated Clearing House (ACH). You'll probably never miss the money. And, at the end of the year, you'd have something to show for your efforts.

MAKING DREAMS A REALITY

Your financial goals don't have to be limited to big-ticket items or meeting family responsibilities. If your dream is taking a year off to travel around the world, there's no reason not to pursue it. If what you want to do most of all is get an advanced degree and switch careers, saving enough to cover tuition may take center stage. Or if you want to be able to plan your daughter's wedding or your parents' 50th wedding anniversary without having to count every penny, your focus may be on short-term investing.

SPECIALIZED INVESTMENTS

Because the income taxes you're responsible for paying require a significant percentage of your income—perhaps some that you would otherwise invest—the federal government offers some tax benefits as an investment incentive.

Taxes on earnings in certain retirement savings plans are deferred until you withdraw the money. In other retirement plans, earnings are totally tax free if you follow the withdrawal rules and satisfy other requirements.

Earnings in designated education investments, including 529 plans, Coverdell education savings accounts (ESAs), and, in some cases, US savings bonds, are also tax free if you use the money to pay for qualified education expenses and meet the other requirements.

And while investments you make to accumulate money for a down payment on a home don't get special tax treatment, you may be entitled to deduct some or all of your mortgage interest and local real estate taxes on your federal tax return, reducing what you owe.

While these breaks may not make you feel any better about paying taxes, they may encourage you to invest more.

MAJOR FINANCIAL GOALS



Buying a Home



Paying for College



Planning Retirement

Financial Planning

When you plan, you identify financial goals and develop strategies to meet them.

When you do financial planning, you're looking toward the future, specifically at building the kind of financial security you'd like to have and being able to afford the life you want to live. But to plan successfully, you also have to evaluate the present, including the financial choices you're making now. Otherwise it's too easy to find yourself making random decisions that won't move you toward your goals effectively, or that may even interfere with achieving them.

It's never too soon, or too late, to begin. Financial planning is important, whether you've just started working or are thinking seriously about retirement. And it should be a continuing process, so that you can evaluate your progress, revise your goals, and update your strategies.

Without planning, you run greater financial risks. You may not have enough money in reserve to meet expenses you're expecting, like the down payment on a home or the price of a college education. You may have to revise your retirement plans. Or you might leave your family without enough to live comfortably if something happens to you.

PLANNING STRATEGIES

In financial planning terms, creating a strategy means defining the steps you'll take to have the money you need to pay for the things you want.

To begin, you need a clear sense of what your goals are, and what they will cost. You have to evaluate the assets you already have and find ways to increase the amount you're saving and investing. While planning doesn't guarantee success, failing to plan is virtually certain to bring disappointment.

DEFINING YOUR GOALS

Planning is important because it helps you identify a range of goals that you're working to achieve:

Short-term goals

You may focus on things you hope to have in a couple of years, like a new car or a new home.

Mid-term goals

You may have expenses to meet several years in the future, like tuition payments or a vacation home.

Long-term goals

You probably have hopes for a comfortable retirement, the opportunity to go places and do things you've always wanted, or a chance to provide security for your heirs.

A financial plan is a game plan that evaluates your current assets and debts, identifies the things you want (or need) to provide for, and lays out a strategy to pay for them. Developing the plan is one thing. Sticking to it is another.

SIX OUT OF TEN AMERICANS rate a steady source of retirement income as their primary financial goal.

A DEFENSIVE BACKUP

Planning is also important because it helps you anticipate and handle the obstacles that come between you and your goals.

BEAT INFLATION

If your investments provide a return higher than the inflation rate, you'll be in a much better position to afford the things that are important to you.

Inflation has averaged 3% since 1926.

Seek a strong return on your investments

MINIMIZE TAXES

You can take advantage of tax-deferred investments to postpone taxes and make tax-exempt investments to avoid them. Trusts may also reduce the taxes your heirs will owe down the road.

Tax planning can help to reduce what you owe.

Choose tax-deferred and/or tax-exempt investments

PLAN FOR THE UNEXPECTED

With an emergency fund plus adequate health and life insurance as hedges against unexpected expenses and illnesses, you're less vulnerable to potential hardship.

Liquid investments are those you can quickly turn into cash.

Create an emergency fund with investments you can liquidate easily

SEEKING ADVICE

The biggest danger isn't making a mistake by choosing the wrong approach. It's in doing nothing. Many people take advantage of professional advice in drawing up a financial plan and putting it into action. You can work with an adviser from the beginning, consult a number of different advisers, or choose someone to execute the decisions you make on your own.

In fact, a major advantage of working regularly with an adviser is the added incentive it can provide to get started and stay focused. Help is increasingly available, too, as all types

of financial institutions compete to provide the services their customers are looking for.

Among the places you can turn to for help with financial decisions are:

- Registered investment advisers (RIAs)
- Certified public accountants (CPAs)
- Certified Financial planners (CFP)
- Insurance brokers
- Brokerage firms
- Lawyers

Managing Your Cash Flow

With planning, you can manage your spending to cover immediate needs and still invest for long-term goals.

Your finances are in constant motion. Even as money comes in from employment and other sources, it goes out for regular living expenses like food and shelter, and for periodic bills like taxes and insurance.

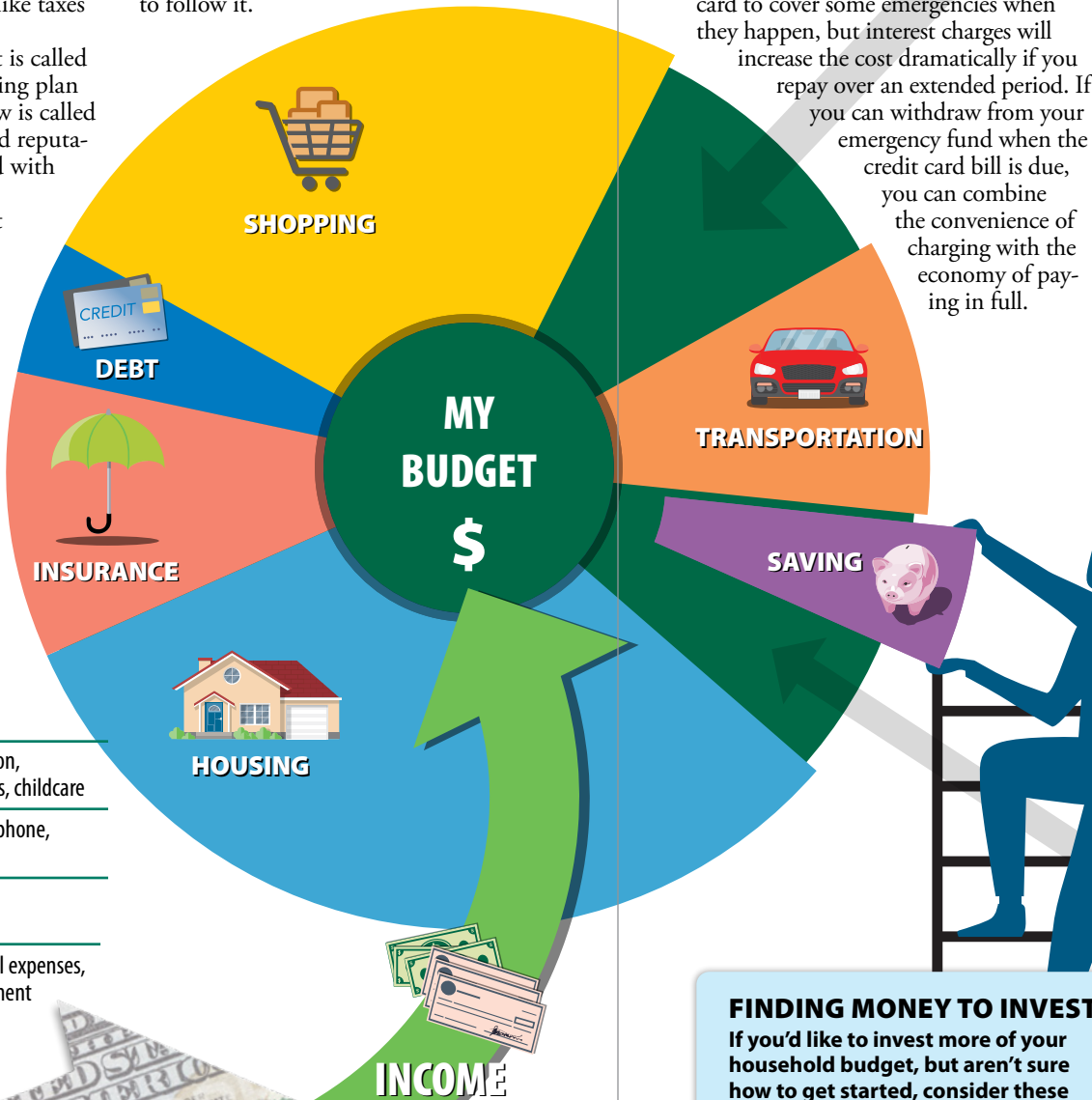
This in-and-out movement is called your **cash flow** and the spending plan you create to manage that flow is called a **budget**. Budgeting has a bad reputation because it's often equated with denying yourself things you want. But it's an essential part of financial planning and not as difficult or restricting as you might think.

HOUSEHOLD BUDGETS

Using last year's expenses as a base, you estimate how much you will spend this year for housing, food, transportation, and so forth—including the large bills like insurance that you pay quarterly or annually.

If your expenses are higher than your income or you want to invest more, you

can review what you're spending to see where you can cut back. The simpler and more realistic your budget, the more likely you are to follow it.



REGULAR EXPENSES

Weekly	Food, transportation, household supplies, childcare
Monthly	Housing, utilities, phone, loan repayments
Quarterly/annually	Insurance, taxes
Other	Medical and dental expenses, repairs, entertainment

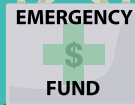
THE PART INCOME PLAYS

Your income determines the amount you can afford to spend on the necessities and pleasures of life. To keep your cash flow positive, which means having money left at the end of a pay period to spend as you wish, you may want to allocate income first to those essentials that have a fixed price, such as housing and loan repayments. You can then allocate to essentials with variable costs, such as food and clothing, where you can reduce your spending more easily if you are running short.

FUNDS IN RESERVE

Irregular income, unexpected repair bills, medical expenses, or loss of your job can pose special cash flow problems. It pays to have a safety net—customarily six months of living expenses—set aside in an **emergency fund**.

You can use your credit card to cover some emergencies when they happen, but interest charges will increase the cost dramatically if you repay over an extended period. If you can withdraw from your emergency fund when the credit card bill is due, you can combine the convenience of charging with the economy of paying in full.



IT DOESN'T TAKE MUCH

To create an emergency fund, multiply your monthly take-home pay times six to find the amount you want to save. Then decide how much you can reasonably afford to put aside each pay period to reach that amount as quickly as possible.

Whatever the reason you need money from your emergency fund, you should replenish it as quickly as you possibly can, even if it means sacrificing some immediate pleasures. It's the only way to be prepared for the next emergency.

TRACKING YOUR SPENDING

To budget effectively, you have to know where your money is going. It's relatively easy when you pay bills electronically or by check, since you have a record. Your credit card statement can be helpful as well, with each charge and amount listed. What's harder to track is the cash you take at the ATM—and it's often cash spending that gets you into budget trouble because it can be hard to track.

You might keep a daily spending record for several weeks, using either an app on your smartphone or a small notebook. You may be surprised at what you discover about where your money goes.

If you have children, encourage them to be part of the budgeting process, from allocating income to various family expenses to keeping track of spending. It's a great way to learn about money.

FINDING MONEY TO INVEST

If you'd like to invest more of your household budget, but aren't sure how to get started, consider these suggestions:

- 1 Have a percentage of your salary deducted from your paycheck and invested in an employer sponsored retirement plan.
- 2 Transfer a regular amount to an investment account when you pay your bills each month.
- 3 Invest any money you get from gifts, bonuses, or extra jobs.
- 4 Reinvest all the money you make on your existing investments, automatically if you can.
- 5 Pay off your credit card balances. Then put an amount equal to what you were paying in interest into an investment account.



Your Net Worth

Your net worth statement is a snapshot of where you stand financially at a given point in time.

AssetsWHAT YOU OWNs



Cash reserve assets include the money in your checking, savings, and money market accounts, CDs, Treasury bills, and the cash value of your life insurance policy.



Investment assets include stocks, bonds, mutual funds, retirement plans, annuities, and other investment products.



Personal assets are your possessions. Some—like antiques, stamp collections, and art—may **appreciate**, or increase in value. Others—like cars, boats, and electronic equipment—**depreciate**, or decrease in value over time.



Real estate includes your home and other land and buildings.

Assets

CURRENT ESTIMATED VALUE	for example
Cash in banks & money market accounts	\$20,000
Amounts owed to you	0
Stocks/bonds	\$44,000
Mutual funds	\$45,000
Certificate of deposit (CDs)	\$8,000
IRAs	\$70,000
Employer retirement accounts (vested interest)	\$245,000
Real estate:	
Home	\$200,000
Other	0
Business interests	0
Personal property*	\$30,000
TOTAL ASSETS	\$662,000

* Includes furnishings, jewelry, collections, cars, security deposit or rent, etc.

THE STARTING POINT

As part of deciding how to pursue your financial goals, you should take a look at where you stand right now. You do that by adding your **assets**—such as cash, investments, and retirement plans—in one column and your **liabilities**—or debts—in the other. Then subtract your liabilities from your assets to find your **net worth**.

Net worth doesn't measure cash flow, but there's a clear relationship between how you spend your money and what your financial picture looks like. If your assets outweigh your liabilities, you have a positive net worth. If your liabilities are larger, you have a negative net worth.

If your net worth is negative, turning it around by paying off short-term debt should be your financial planning priority. If it's positive, you'll want to look at how your assets are divided among cash, investments, and real estate and perhaps make some changes. Your age, goals, and amount of risk you're comfortable taking are important factors in determining the most appropriate focus. For example, if you're starting your career, it may be growth in your investment portfolio, or, if you're nearing retirement, a combination of growth and income.

FAIR MARKET VALUE

When you're calculating what your personal assets are worth, the number to use is their fair market value. That's the price a willing, rational, and knowledgeable buyer would pay for things you are willing to sell.

LiabilitiesWHAT YOU OWE CURRENTLY AND LONG TERM

Liabilities

AMOUNT	for example
Mortgages	\$160,000
Bank loans	0
Car loans	\$7,000
Lines of credit	\$3,000
Charge accounts	\$1,800
Margin loans	0
Alimony	0
Taxes owed:	
Income	\$21,000
Real estate	\$3,200
Other	0
Other liabilities:	
College loan	\$7,800
Insurance	\$3,500
Business loan	0
TOTAL LIABILITIES	\$206,500



Short-term debts are your current bills: credit card charges, personal loans, income and real estate taxes, and insurance. Your present credit card balances are generally included, even if you regularly pay your entire bill each month.



Long-term debts are mortgages and other loans that you repay in installments over several years.

OTHER PERSPECTIVES

When potential lenders assess your application—which includes a net worth statement—to decide whether you qualify for a loan, they look at what you already owe. But they may also calculate what you might owe if you charged as much as you could on all

NET WORTHASSETS MINUS LIABILITIES

USING NET WORTH STATEMENTS

Figuring your net worth is not only a critical first step in financial planning. It will also come in handy in many financial situations. For example:

- Mortgage lenders require a statement of your assets and liabilities as part of the application
- College financial aid is based on your net worth, so you'll have to report your assets and liabilities when your children apply—except not retirement accounts
- Loan and line-of-credit applications usually require net worth statements
- Certain high-risk investments may require that you have a minimum net worth—often \$1 million or more

your credit cards and drew on all your potential lines of credit. What most lenders like to see is a net worth statement that shows substantial savings and investments, and limited debt. Investments mean that you have resources to tap in an emergency, including assets that could be sold to pay your debts.

To Buy or Not to Buy?

That may be the question. The answer is both personal and financial.

If you're planning to buy a home, you probably have good reasons for your decision. It may be that you share the feeling that owning your own home is a key part of the American dream. But there are also financial issues involved in buying real estate that you need to consider as well.

From one perspective, a home is an investment, maybe the single largest one you'll ever make.

Like certain other investments, real estate has the potential to increase in value over the years, so that you can sell it for more than you paid.

But unlike investing in equities such as stock or mutual funds, which you buy as a way to achieve your financial goals, most people consider owning a home as an end in itself.

FOR SALE

REASONS TO BUY

There are strong emotional reasons for buying a home—and potentially stronger financial reasons.

Owning can help you feel grounded, and part of a community. It can provide a sense of accomplishment and a place to build family traditions. Often, you have more space than you would in a rental unit that costs the same amount of money. And owning can save you money.

That's because you can deduct mortgage interest you pay on your primary home and a second home when you file your federal income tax return. You can also deduct real estate taxes you pay to local governments. Those deductions, though they have dollar limits, have the potential to reduce your taxes significantly, especially in the first few years after you buy.

REASONS TO RENT

On the other hand, you might decide to rent rather than buy a home for practical and financial reasons.

If you're on your own, for example, getting together a down payment and managing the expense of a mortgage, taxes, insurance, and upkeep may put too great a strain on your budget. And having all your assets tied up in your home has serious drawbacks. Among other things, it limits your ability to invest enough to meet the other goals that are important to you.

Another reason to rent is a job that keeps you on the move or requires you to relocate

LACK OF LIQUIDITY IS ONE OF THE MAJOR PROBLEMS WITH INVESTING IN REAL ESTATE

periodically. It's not always easy to sell when you're transferred or change jobs. While your employer may help out with the cost of selling one home and buying another, you can't count on it. And the most expensive part of buying is the one-time, up-front costs.

FAMILY GIFTS

If your parents or grandparents are willing to help you buy a home, each of them can give you a tax-free gift of up to the annual limit set by Congress. It's a case where a timely gift may make a lot more sense than an inheritance at some unknown time in the future.

Be careful, though. Loans from family members earn **imputed interest** if the lender doesn't charge you any—or enough—interest. That means he or she has to pay income tax on the interest that normally would be paid but wasn't. One exception occurs when a parent's loan enables a child with no investment income to buy a home.

HOW BUYING WORKS

There are usually three distinct phases in buying a home: accumulating the down payment, finding a mortgage, and building your equity.

1 Generally you need a **down payment** of at least 10% and often as much as 20% of the purchase price available in cash in order to buy. You can also investigate some federal and state programs, like those run by the Federal Housing Administration (FHA), which require a smaller amount up front. Your attorney or real estate agent should be able to tell you about special programs.

2 When you have enough for a down payment, you can begin looking for a home and a mortgage. A **mortgage** loan is a long-term arrangement that provides the money you need to buy the home. You pay the loan back, usually in monthly installments over a 10- to 30-year period.

3 When you've arranged your mortgage and bought your home, you gradually build your **equity**, or ownership, by paying off the mortgage loan. In most cases your monthly payment will also include enough to cover the real estate taxes and insurance on the property.

INVESTING FOR A DOWN PAYMENT

If you're planning to buy your first home, you'll have to decide how to invest the money you're using for a down payment.

Timing is a major consideration. The sooner you plan to buy, the fewer risks you may want to take. You probably don't want to be in a position to have to sell investments if their price drops suddenly, or risk having to postpone your plans. On the other hand, the more price-stable an investment is, the less you'll earn on it.

One technique is to split up the money you are accumulating, putting part in income-producing stocks and mutual funds, and the balance in interest-bearing investments that will mature when you plan to buy.

You could also set goals for your equity investments, in either price gain or total return, and sell if an investment reaches that level. That's a different approach from buy-and-hold investing, but it could help you to build your down payment.

GENDER ISSUES

If you're single, it may be harder to get a mortgage than if you're married, and often harder for a woman than a man. While it's illegal to discriminate based on age, race, or gender, a lender can always turn you down.

Sometimes you can make out better applying to a bank or credit union you

already have a relationship with or using a mortgage broker who specializes in finding interested lenders. You might also consider a private arrangement with sellers who would be willing to finance the purchase—although you don't want to do that without the advice of a real estate lawyer you trust.

Paying for College

Once you fit all the pieces together, you'll have a clearer view of how funding your child's education works.

There's no doubt that the cost of higher education has increased dramatically in recent years. Yet, perhaps surprisingly, the number of students enrolling in all types of institutions has increased as well. One reason may be the recognition that a college education makes financial sense. Another may be the commitment—and sometimes sacrifice—that families are willing to make in order to pay for the opportunity that education provides. But a third, and possibly equally powerful factor, is that families can turn to a number of sources to help them cover the cost of college.

THE ROLE OF SAVING

Whether you're a brand new parent or you've had lots of

practice as a mom or dad, this probably isn't the first time you've thought about saving for college. It's hard to avoid the bottom line: Colleges and universities, as well as the federal government, consider it your responsibility to contribute to your children's higher education expenses. Without at least some savings, meeting that obligation may not be possible.

But it's equally true that while saving may not be easy, there are a number of programs designed not only to encourage you to put money away for college but to provide tax benefits if you do. In fact, you may already have a plan to accumulate the money you anticipate needing.

Among the most widely available choices are those that share the **529** label: college savings plans, state prepaid tuition plans, and the private college prepaid plan. Another alternative is the **Coverdell education savings account (ESA)**, which has lower contribution limits but more flexibility in choosing investments.

You may also realize tax savings in certain cases by paying college expenses with US savings bonds.

Better yet, you don't have to select just one method. You can create a savings plan that combines several of the options and takes advantage of their most attractive features.

IT'S A GRANT WORLD

It's the unusual person who doesn't enjoy receiving a gift. And the best gift a college student—and his or her parents—can receive is a grant or scholarship. Grants directly reduce the amount of your child's education expenses and, unlike loans, never have to be repaid. Grants make up about 59% of all financial aid that undergraduate students receive. About 28% of the grants in any year come from private institutions and individual colleges and universities, while others are provided by public institutions, including certain states and, in the case of **Pell grants**, the federal government.

One challenge may be determining the requirements a student must meet to qualify for a grant. Certain grants, such as Pells, are need based. Others are merit based, which means they're given in recognition of the student's achievement. Still others may take both the student's merit and need into account.

In most cases, students are offered grants after they've been accepted at a college or university, but sometimes a school or organization will offer a grant as an incentive to attract your child. You can check with the high school guidance office and organizations you belong to for a list of potential scholarships. You might also discover lists online—though few of these lists are really useful. Beware of sites that ask you to pay a fee to access their files: There's no reason to pay to find scholarships.

BUYING TIME

Unlike grants, higher education loans must be repaid. Like other loans, they accumulate interest, so that borrowers end up repaying more than the amount they actually spend on tuition, room, board, and other expenses. But the federal government offers both parents and students guaranteed loans that can reduce—though not eliminate—the costs of borrowing.

You and your child must complete a comprehensive federal loan application to qualify. But the good news is that federal loans have made it possible for many more students to afford a college education.

These federal loans—**Direct** for students and **PLUS** for parents—are available directly from the government.

You can find detailed information on what loans are available and how to apply at www.studentaid.gov, a US Department of Education website.

You can borrow money elsewhere as well, which you may opt to do if federal funding doesn't meet your needs. One of the issues you'll have to weigh in accumulating loans—even for a good cause—is the long-term responsibility they impose on you and on your child.

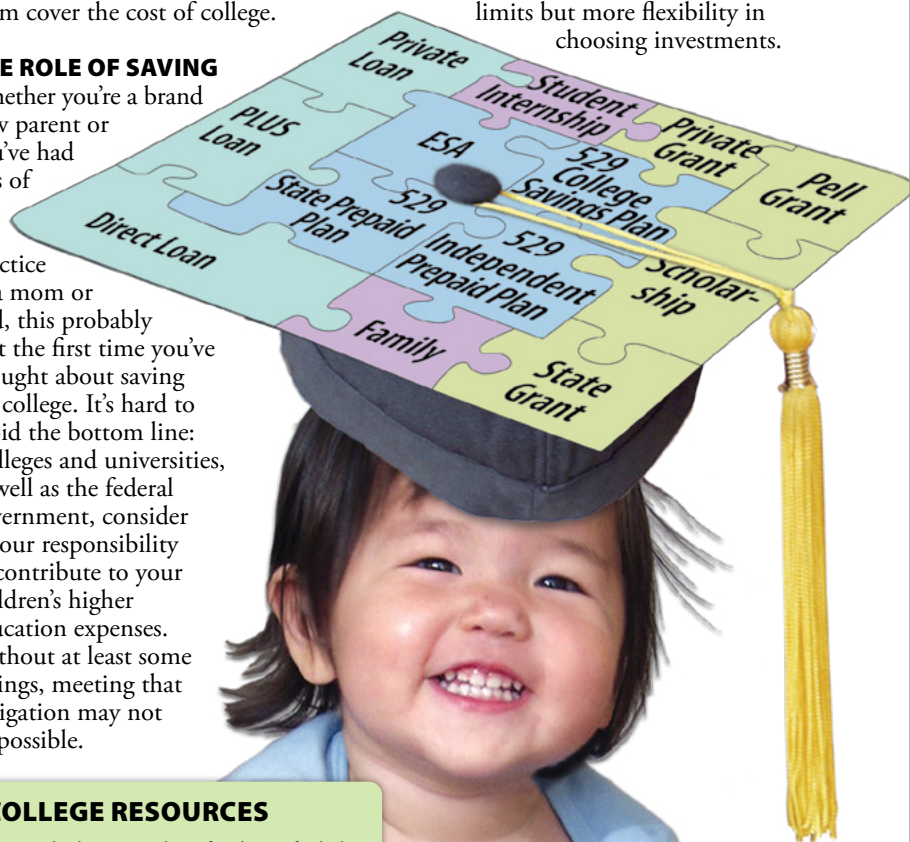
MAKING COMPROMISES

The other thing to remember about paying for college is that there are many routes to an undergraduate degree.

While some students finish their college education at one school within four years, many don't follow that pattern. For instance, students may begin at a local two-year public college and then transfer to another public institution or to a private college. They may attend school part-time throughout the year for five or six years rather than full-time during the fall and spring semesters for four years. Or they may select a school that expects students to combine time in class with paid internships.

Certain circumstances may also provide you with different ways to reduce the overall cost of your child's education. For instance, someone in your extended family might provide housing for your child to live off campus at a school he or she wants to attend, perhaps in return for doing certain chores. Or your child may accumulate advanced placement credits or take some required courses in the summer to reduce the length of time it takes to graduate.

Obviously, decisions such as these must be collaborative or the likelihood of their being successful is slim. But if you and your child can talk frankly about your shared goals and the financial realities, you can find a way to achieve what you both want.



COLLEGE RESOURCES

You can look to a number of websites for help in planning for your child's education.

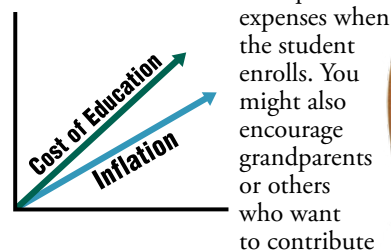
- www.collegeboard.org
Information on college costs, scholarships, and entrance exams.
- www.studentaid.gov
Guidance on the process of applying to and paying for college.
- www.collegesavings.org
Valuable information about 529 savings and prepaid plans.



Education Investments

The earlier you start planning for college, the easier it will be to pay those tuition bills.

The best time to start saving for college—for your children, nieces, nephews, or other family and friends—is as soon as they're born. But if you didn't get off to a quick start, don't despair. You can start now by choosing among a number of different investment plans that not only provide the opportunity for your savings to compound tax deferred but offer the possibility of tax-free withdrawals for qualified



to a child's education to open one or more of these accounts as well. Ideally there should be a coordinator who knows which accounts have been opened and the approximate value of the savings as they accumulate.

529 SAVINGS PLANS

The college savings plans known as 529 plans are among the most popular ways to invest for college.

These plans are sponsored by individual states and managed by financial institutions, such as brokerage firms, insurance companies, and mutual fund companies. When you set up the account, you designate a beneficiary for whom you'll use the money to pay qualified higher education expenses, including the cost of technical or trade school, college, or graduate school. You can also use up to \$10,000 a year in 529 assets to cover qualifying costs while the beneficiary is enrolled in grades K-12. The beneficiary can be anyone, including yourself.

Since every state offers access to a 529 plan, you have the flexibility to choose the one that best meets the criteria you set. In fact, you can open more than one 529 plan for the same beneficiary if you choose, since in most cases neither you nor the plan beneficiary have to live in the sponsoring state to participate in its plan.

Among the things you'll want to consider in choosing a 529 plan are:

- The investment options, investment objectives, and historical returns
- The fees, expenses, and state tax treatment of different plans
- Beneficiary rules
- Contribution limits

You may want to begin your search by investigating the plan sponsored by the state where you live, as many states offer extra incentives to residents enrolling in their plan. Your withdrawals may be free of state as well as federal income tax, for example. Or you may be entitled to deduct your contribution on your state tax return. But you may lose those advantages by choosing another state's plan. For more information, you can check www.collegesavings.org, a website sponsored by the College Savings Plan Network.

COLLEGE SAVINGS PLAN

529

Remember, though, that as with any uninsured investment, returns on 529 accounts are not guaranteed and you could lose money, especially in the short term.

PREPAID PLANS

You may also consider a prepaid tuition plan, another type of 529 plan. With a prepaid plan, you pay for future college costs by buying tuition credits at today's rates. Prepaid plans offered by an individual state must be used in that state, but credits you buy through the Private College 529 may be used at any participating school.

ON THE RIGHT TRACK

Most 529 college savings plans offer either age-based or fixed tracks, or both. An age-based track allocates your investment across different asset classes based on the beneficiary's age when you open the account, and then reallocates to create a more conservative portfolio as the child gets closer to college age.

With a fixed track, you choose whether to invest in equity, fixed income, balanced, or stable value funds. The portfolio's exposure to risk doesn't change over time, and the results are based on how the underlying investments perform.

COVERDELL EDUCATION SAVINGS ACCOUNTS

Like 529 plans, Coverdell education savings accounts (ESAs) offer tax-deferred growth and tax-free withdrawals when you use the money to pay for qualified education expenses at an eligible educational institution. With ESAs, that includes expenses

incurred in grades K through 12, as well as college and graduate school.

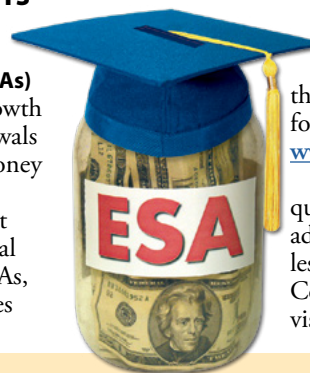
With an ESA, you choose the investments for your account, which gives you more control over how your money is allocated than you have with most 529 plans. There are limitations, though. Instead of investment ceilings that can be more than \$300,000 for some 529 plans, annual ESA contributions per beneficiary are capped at \$2,000. There are income limits governing who can contribute to an ESA. And the beneficiary must be younger than 18 when the account is opened, and must use the money before turning 30, although you can change beneficiaries to another member of the same family.

US SAVINGS BONDS

When you redeem certain US savings bonds to pay for qualified education expenses, you may qualify for a tax break. There are two types of bonds that are frequently used for education expenses, Series I and Series EE.

The interest rate on Series I bonds is linked to the inflation rate and changes twice a year. Series EE bonds issued since May 2005 pay a fixed interest rate and are guaranteed to at least double in value after 20 years. You can find information on how to buy these bonds and the rules that apply if you want to use them for educational expenses at www.savingsbonds.gov.

Remember, though, that to qualify for the tax break, your adjusted gross income must be less than the annual limit set by Congress. For the current limits, visit www.irs.gov.



- 1 Compare the investment alternatives of different college investment plans, and narrow the list to those that are best for you. You may decide to use a combination of plans.
- 2 Evaluate 529 college savings plans to find the ones with the most attractive investment alternatives at the lowest cost. You may want to start by investigating your home state's plan.
- 3 Combine making contributions to a 529 plan with putting money into some other college saving opportunities such as an ESA or savings bonds, to diversify your investments.
- 4 Don't plan on raiding your retirement plan to pay for college expenses—your beneficiary could receive grants or scholarships, but you alone are responsible for your retirement.

Investing for Retirement

Whether retirement is down the road or just around the corner, planning for it is a must.

Retiring may be the last thing you want to do. Or it may be the goal that keeps you going. Whether or not you're planning *on* it, you should be planning *for* it. The reason is simple: You're going to need the money.

Unlike mortgages and educational expenses, which eventually get paid off,

retirement means a permanent change—and usually a reduction—in the income you'll have to live on for the rest of your life. So when you cash your last paycheck, you'll need a substantial source of other income ready to fill the void.

That may come from Social Security, perhaps a pension, and investments you've made over the years.

How much of your current income will you need?

Since the income you'll need to live comfortably in retirement depends on your personal lifestyle, there's no fixed amount that applies to everyone. But most retirement advisors recommend that you plan to replace at least 80% of your preretirement income with pensions, Social Security, and investments.

To provide even more financial security, you may want to aim for replacing 100% of what you were earning in the last few years before you retire.

How will you get it?

SOCIAL SECURITY + RETIREMENT SAVINGS

When you take a job, remember to ask about the retirement plan. You'll want to know the kind of plan it is, when you can join, and whether there's an employer match.

ESPECIALLY FOR WOMEN

Lining up retirement income is especially critical for women, since two of the standard resources—pensions and Social Security—are linked to a lifetime of earned income. Since women earn, on average, about 82% of what men earn, and often work fewer years, they can expect to receive less from those sources when they retire. For example, women who collect Social Security benefits based on their own earnings typically get less than men of comparable age do.

What's more, since women as a group live longer than men, they need income over a longer period of time. For example, women make up a large proportion of the fastest growing segment of the population: people over 80. That means living for many years on retirement income.

It's worth noting, though, that a surviving spouse of either gender is entitled to a deceased spouse's Social Security benefit if it would provide more income than the survivor's own benefit.

A FIRM LEG TO STAND ON

Retirement income is generally described as a three-legged stool—balancing on pensions, Social Security, and investment income. So as fewer and fewer employers offer traditional pensions, and more debate surfaces about how Social Security will pay full benefits to the gradually growing number of beneficiaries, investments must carry more and more of the weight.

That's why it is so critical to focus on investment strategy as a key part of your retirement planning. You control how much you invest, and what you invest in. As an added incentive to build your investments, you can put money in tax-deferred retirement accounts that let you postpone taxes on your earnings until you start to take the money out—usually after you retire or by age 72. One advantage is that you can buy and sell the investments in those accounts, as well as reinvesting any interest and dividends without having to worry about paying income taxes or capital gains tax on any profits.

TARGETED INVESTMENTS

There are three primary ways to invest for retirement. Each has distinctive advantages and some potential limitations.

TAX-DEFERRED RETIREMENT PLANS

Employer sponsored retirement plans are tax deferred, whether the employer makes the contribution, you contribute, or both you and your employer do. Neither the amounts that are added nor any earnings are taxed until you withdraw. In addition, when you contribute, your salary may be reduced by the amount you put in, so you owe less current income tax too.

You can also invest in a personal tax-deferred plan, such as an individual retirement account (IRA) or a deferred

annuity to supplement or substitute for an employer's plan.

As an added bonus, when you start withdrawing after you retire, you may find you're paying tax at a lower rate than you would have paid when you put the money in. (You can't count on that, though, since there's no way to predict tax rates or your income even a few years ahead.)

Tax-deferred retirement plans do have some limitations, though:

- There's a cap on the amount you can invest in most plans each year.
- You usually can't use the money before you reach age 59½ without having to pay a 10% penalty on amounts you withdraw.
- You often must begin withdrawing after you turn 72.

+ INVESTMENTS

Investments produce the same results whether they're owned by men or women.

TAX-FREE RETIREMENT PLANS

There are two ways to invest for retirement that will allow you to take tax-free withdrawals of retirement income. One is the Roth IRA and the other is the Roth option that may be available as a way to make contributions to an employer sponsored retirement savings plan.

In both cases, you contribute after-tax rather than pretax money. And, in both cases, no tax is due on withdrawals provided you are at least 59½ and your account has been open at least five years.

These tax-free alternatives give you useful flexibility as you plan for and manage your retirement income.

TAXABLE INVESTMENTS

The most flexible way to build retirement savings is in a regular investment account. There's no limit on the amount you can put into the account each year, and no restrictions on when you can withdraw—or when you must start.

Another advantage of regular over tax-deferred investing is that the profit on any investment that has increased in value when you sell it is taxed at the lower long-term capital gains rate, provided you have owned the investment more than a year. The rate you

pay, always lower than the rate on your ordinary income, depends on your adjusted gross income.

In contrast, earnings you withdraw from a tax-deferred plan are taxed as ordinary income even if the money you're withdrawing represents the profit on an investment you've owned 20 years or more.

The downside of regular investments is that you've already paid tax on the money you invest, and you pay taxes every year on most investment earnings.

Retirement Savings Plans

It's never too early to take retirement seriously.

You can start saving for retirement as soon as you begin earning income. It's a smart move even if your retirement is many years in the future. You can take advantage of savings plans that allow you to defer taxes on your earnings, and sometimes on your contributions, or to avoid taxes entirely if you follow the rules.

There are two categories of tax-saving retirement plans: those offered by employers and **individual retirement accounts (IRAs)** that you open on your own. Even if you're part of an employer plan, you can contribute to an IRA, taking advantage of both ways to accumulate retirement assets.

In addition, you may want to invest in taxable accounts to make your retirement even more financially secure. You have more flexibility at every stage, from adding money to taking it out. And while you'll owe taxes on your investment income, the rate you pay on much—though not all—of it will be lower than the rate you pay on ordinary income.

EMPLOYER PLANS

Employers may sponsor a retirement plan for their employees if they wish. There are two basic plan types, and most employers offer one type or the other, though some employers offer both.

A **defined benefit plan**, better known as a pension plan, promises a certain level of income when you retire. The way your pension is calculated is described in the plan and is usually based on what you're earning at the end of your career, the number of years you work for the employer, or frequently

both. Your employer contributes to and manages the pension fund to produce the return it needs to make the pension payments owed to you and other plan members.

In a **defined contribution plan**, you, your employer, or both contribute money to a retirement account in your name. The retirement income you'll receive is not guaranteed. Rather, it depends on the amount that's contributed, the way the contributions are invested, and the return the investments provide over time.

One advantage of a defined contribution plan is that it's often **portable**, which means you can take your account balance with you if you change jobs. That's not the case with defined benefit plans.

BEING PART OF THE PLAN

If your employer offers a pension plan, you're generally included in the plan automatically, though you may have to be on the job a minimum length of time, be a full-time employee, or both, to be eligible.

Participation in a defined contribution plan is generally voluntary, so you may have to sign up. Increasingly, however, employers are automatically enrolling everyone who is eligible and offering the alternative of opting out.

In most, but not all, defined contribution plans, you defer a percentage of your pay, which is deducted from your paycheck. These contributions are invested in the investments you select from among those available through the plan—typically mutual funds, managed accounts, target date funds, company

THE PLANS AT A GLANCE

There are several varieties of defined contribution plans, including the ones mentioned here. With all except SIMPLEs, contribution limits are the same and balances can be moved between plan types if you change jobs. The type of plan you're eligible for depends on where you work.

401(k)

- Employees of businesses that sponsor plans
- Matching contributions optional

403(b)

- Employees of nonprofit, tax-exempt organizations
- Matching contributions optional

Section 457

- State and municipal workers
- No matching contributions

Thrift Savings (TSP)

- Federal employees and employees of companies offering plans
- Matching contributions for federal employees, others optional

SIMPLE

- Employees of companies with fewer than 100 workers
- Matching contribution required

stock, and fixed income investments, although other choices may be available.

If you're enrolled automatically, the percentage you contribute is set initially by the plan, as is the way your contributions are invested. But you always have the right to contribute more if you wish, up to the annual limit that applies, and to choose any of the other investments available through the plan.

ON YOUR OWN WITH AN IRA

IRAs are voluntary, so you must take the initiative to open your account with a bank, brokerage firm, mutual fund company, or insurance company, and contribute as much as you wish up to the annual limit. The financial institution where you open your IRA is its **custodian**, which involves holding the account assets, acting on your instructions to buy or sell investments, and providing regular statements of your IRA's value. But a custodian has no responsibility for the choices you make.

As with defined contribution plans, what your IRA is worth when you're ready to retire depends on the amount you have contributed, the investments you've chosen, and the way those investments have performed. Timing is also

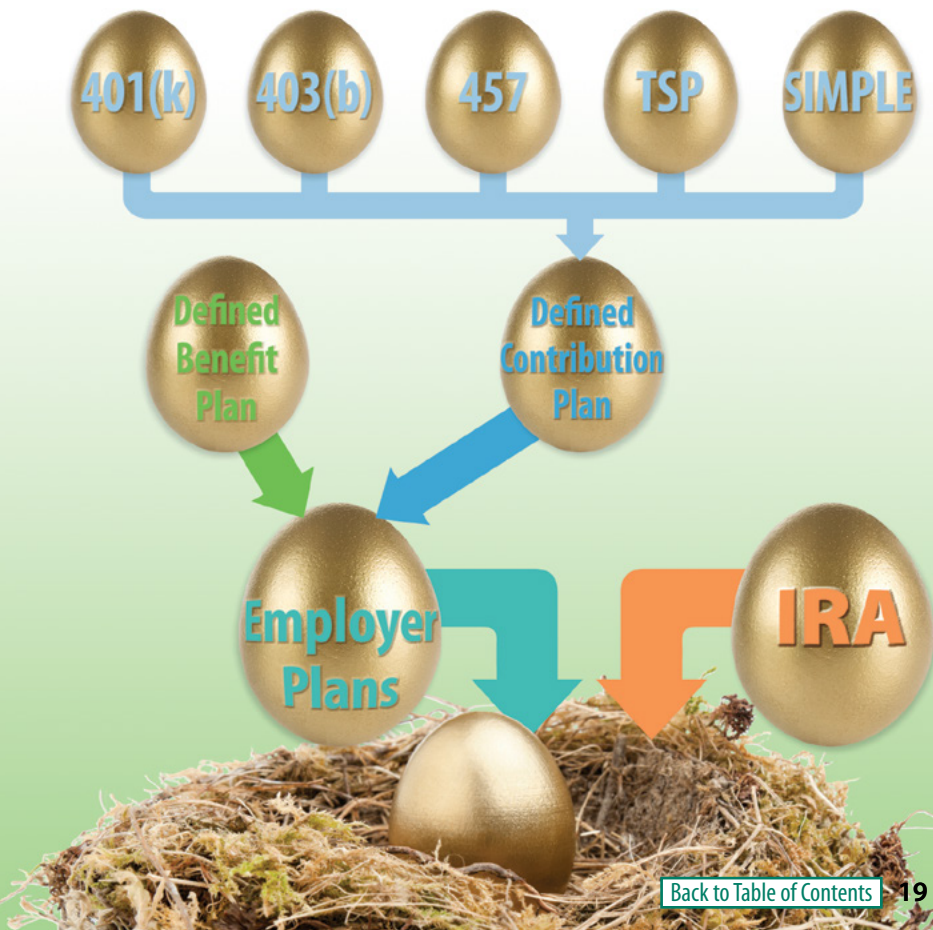
a factor, since the longer contributions compound, the larger they have the potential to grow.

KNOW YOUR LIMITS

Congress sets an annual maximum on contributions to employer plans and IRAs, though what you contribute to an employer plan doesn't reduce the amount you can to put in an IRA, or vice versa. You don't have to contribute the full amount that's permitted, but, the more you can afford to put away, the larger your account has the potential to grow over time.

If you're 50 or older, you're entitled to make additional **catch-up contributions** even if you've contributed the maximum every year you were eligible. The added money can give your account value a boost.

Contribution limits, or caps, which are higher for employer plans than for IRAs, are indexed to inflation and may increase as frequently as every year. In some years, they're unchanged, but they have never been reduced. For example, in 2022, the cap for most defined contribution plans is \$20,500 plus \$6,500 catch-up, while IRA caps are \$6,000 and \$1,000 catch-up. Different limits apply to defined benefit plans and certain small-company defined contribution plans.



IRAs

An IRA may be your first line of defense in protecting your future.

No retirement plan? You're not alone. Only about 67% of US workers are covered by an employer plan, leaving the rest without access to that source of retirement income. But an **individual retirement account (IRA)** is available to anyone who earns income or is married to someone who does.

With an IRA you can invest up to the annual limit and defer income taxes on any earnings, which are reinvested. You have the potential for faster growth than if you were paying taxes on an account earning the same rate of return. And

depending on your income, you may qualify for the additional tax advantages of being able to lower your current taxes by deducting your contribution or of selecting a Roth IRA with its promise of eventual tax-free income.

JUST SAY IT'S SO

You can establish an IRA with a bank, brokerage firm, mutual fund company, or an insurance company. When you fill out the paperwork and deposit your money, the IRA exists. It's as simple as that.

Good Reasons to Open An IRA

- Have a personal savings plan
- Defer or eliminate tax on earnings
- Add to your retirement account
- Choose among a variety of investments

A TAX BREAK FOR TRADITIONAL IRAs

If you meet either one of the qualifying tests, you can deduct your traditional IRA contribution on your income tax return. However, remember that contributions to Roth IRAs are never deductible, whether or not you have a retirement plan or meet the income test.

TEST #1 RETIREMENT PLAN COVERAGE

If you're not eligible for a pension or retirement savings plan where you work, you can deduct your full IRA contribution, whatever your income. You're eligible whether you're single or married. Even if your spouse is participating in an employer plan, it doesn't affect your eligibility provided your combined MAGI is less than \$204,000. You can take a decreasing deduction until your MAGI reaches \$214,000 in 2022.

A
TAX
BREAK
TO BOOST

Your IRA contribution reduces your taxable income—and therefore your taxes—if you meet one of the two qualifying tests.

TEST #2 LEVEL OF INCOME

If you are eligible for a pension or retirement savings plan where you work, you can deduct your full IRA contribution only if your income is either less than \$68,000 if you're single or less than \$109,000 if you're married and file a joint return. For each additional \$1,000 you earn, you can deduct less, until the deduction is phased out entirely at \$78,000 (single) and \$129,000 (married), in 2022.

The institution acts as custodian and invests the money as you direct in stocks, bonds, mutual funds, ETFs—the same kinds of investments available outside an IRA except art, jewelry, real estate (except REITs), and collectibles. You can't use your IRA to buy life insurance.

You usually pay an annual fee—\$25 to \$50—for maintaining the account. Some custodians waive fees, though, if your account is large enough. That can be a persuasive argument for consolidating your IRA investments with a single custodian.

DON'T STOP NOW

To get tax-deferred growth, you agree that if you withdraw from your account before you reach age 59½, you'll owe a 10% penalty plus the tax that's due on the withdrawal amount, in most cases. But you can still put money into your IRA after you reach age 59½. And you can make extra annual catch-up contributions once you turn 50. In 2022, you can add an additional \$1,000, for a total of \$7,000.

After you turn 59½, you can tap it any-time you need the money without paying the early withdrawal penalty. You must begin taking money out of your traditional IRA in the year after you turn 72, and must withdraw at least the

required amount each year. The way you figure that amount is spelled out in IRS Publication 590. You can work with your financial or tax advisor to be sure you get it right.

HOW NOT TO DO IT

Sometimes it's easier to decide how to make an investment decision—in this case, where to put your IRA money—by being clear on what you should *not* do.

Here are a number of things you should probably avoid.

- ❌ Buying tax-free investments, like municipal bonds or municipal bond funds, for a traditional IRA because all earnings are ultimately taxable.
- ❌ Investing primarily in low-interest savings and money market accounts because you won't earn enough to offset inflation.
- ❌ Sticking with an investment that isn't living up to expectations. You can move IRA money easily from one investment to another without owing tax on earnings.
- ❌ Opening a different IRA account every year. You'll pay more in fees, and you'll have more records to keep track of.
- ❌ Misplacing your tax records of non-deductible IRA investments. If you can't prove the tax was paid, you may pay tax twice on the same money.

ROTH OR TRADITIONAL?

Because there are choices in IRAs, between the traditional tax-deferred IRA and the newer tax-free Roth IRA, you need to know how they compare in order to select between them.

The appeal of the Roth is that you get the added benefit of tax-free income on your tax-deferred earnings when you take money out, provided you're older than 59½ and your account has been open at least five years.

But to be eligible to contribute the full amount to a Roth, your income must be less than \$129,000 (with partial contributions phased out at \$144,000) if you're single, and your joint income less than \$204,000 (phased out at \$214,000) if you're married. The contributions are never deductible.

In contrast, everyone qualifies for a traditional IRA, and, as the tests opposite show, in some cases you may be eligible to deduct your contribution, reducing current income tax.

Many experts advise choosing a Roth if you qualify, and add that it may pay to transfer your existing IRA to a Roth.

Although you may owe current tax, you'll avoid future taxes. But they all agree that before you make a decision it's smart to talk to your own advisor or someone at the financial institution where you have your existing account or plan to open a new one.

EARLY WITHDRAWALS

Though IRAs are intended as long-term retirement investments, you may be able to withdraw your accumulated assets without the 10% federal tax penalty in some very specific situations.

For example, you can use IRA money to pay college tuition, spend up to \$10,000 of it to buy a first home for yourself or a family member, or use it for medical expenses. While you will usually owe the income tax that applies to the withdrawal amounts, you won't owe the extra 10%.

The best approach, if you need to withdraw your IRA money early, is to confirm that your plans meet the tax requirements before taking out the money.

Annuities

Tax-deferred annuities are another way to build your long-term retirement savings.

When you purchase an **annuity**, or long-term insurance company contract, no taxes are due on your earnings until you begin to receive income under the terms of your contract. There are no contribution limits on annuity investing as there are with IRAs

or employer-sponsored retirement plans. That means you can build a substantial nest egg for your long-term needs. However, putting money into an annuity doesn't reduce your salary or income tax the way tax-deferred employer plans do.

Building Up

You can choose a **single premium annuity** with a lump-sum purchase, or build your annuity account by adding money regularly over a period of time. During this **accumulation phase**, while the money is invested and you are not withdrawing, your earnings in the account are tax deferred.

DEFERRED ANNUITIES

With a deferred annuity, you get the benefit of tax-deferred compounding for an extended period, at either a fixed or variable rate. When you're ready to begin withdrawals, the way you'll collect is spelled out in the terms of your contract. Usually it's in regular monthly installments, but it may be in a fixed number of lump-sum payments. The part of your payout that comes from earnings is taxed at your regular tax rate.

OR

IMMEDIATE ANNUITIES

You buy an immediate annuity with a single payment and begin the payout period right away, or within the first year. The amount of each payment is set by the terms of your contract. In the sense that an annuity provides regular income, usually after you retire, these plans resemble employer sponsored pensions. You can also buy an immediate annuity to provide a lifetime stream of income for another person.

Annuity Agreement

Your annuity contract defines the terms and conditions:

- Amount of premium
- Earnings at fixed or variable rate
- Method of payout
- Fees and other investment costs

Paying Out

You start collecting on your annuity investment during the **payout period**, usually after you retire. If you're 59½ or older when payments begin, you owe income tax on your earnings. If you're younger than that, you'll usually have to pay an additional 10% of the withdrawal as a penalty.

MONTHLY PAYMENTS

You can get regular monthly payments for as long as you live or for a set period of time, such as ten or 20 years.

OR

LUMP-SUM PAYMENT

Or you can end your contract and take a cash distribution. You may lose money if your plan imposes a penalty for early withdrawal.

IMMEDIATE ANNUITY PAYOUTS

The most common payout options for both deferred and immediate annuities are:

- **Single life**, which pays a set sum per month as long as you live. When you die, the payments stop.
- **Life or period certain**, which covers your lifetime or a set number of years, whichever is longer. Your heirs get the balance if you die before the term is up.
- **Joint and several**, which makes payments for your lifetime and the lifetime of your joint annuitant.

WEIGHING THE ISSUES

Immediate annuities provide the security of a regular income for people who are uncomfortable managing their investments. But they have some potential drawbacks:

- If you choose a single life annuity and die within a few years, the company keeps the balance of your money and your heirs get nothing.
- Your annuity income may not keep pace with inflation.
- The seller, usually an insurance company, may not fulfill its part of the contract.

takes responsibility for paying as promised. But actual payment depends on the issuer's ability to meet its obligations.

With a variable annuity, you decide how your money will be allocated among a specific menu of **subaccounts**, or annuity funds, offered by the issuer. Subaccounts are pooled investments, similar to mutual funds, with varying objectives and strategies. Variable annuities give you the chance to potentially earn more than you could with a fixed rate. However, the contract makes

no payment promises, so you could also end up earning less if the markets are weak or you choose poorly performing funds.

CHECKLIST FOR ANNUITY INVESTORS

- ✓ Consider annuities only if you're investing for the long term. Withdrawals before age 59½ face a 10% penalty tax, plus income tax.
- ✓ Investigate the reputation of the company offering the annuity to be sure it's sound.
- ✓ Compare surrender periods. Most annuities have surrender charges in the first seven years. You can avoid annuities with lifetime surrender charges.
- ✓ Look beyond the initial rate if buying a fixed-rate annuity. Approach unusually high rates with caution.
- ✓ Look for maximum flexibility on getting your money out. You can avoid annuities that don't offer a lump sum or give you a lower interest rate if you take one.
- ✓ Research the fees and annuity charges and avoid paying more than 1.5% to 2% annually.
- ✓ Compare costs. Some annuities cost more than others offering a similar rate and income stream.

LOOKING AT THE BOTTOM LINE

Annuities are popular ways to save for retirement, but they also have critics who argue that other investments give you more for your money. It pays to look at both sides:

Pluses	Minuses
<ul style="list-style-type: none">• Tax-deferred compounding• Guaranteed income stream with fixed-rate contract based on claims paying ability of issuer• With variable annuities, there is opportunity for growth of principal that may keep up with or exceed the rate of inflation	<ul style="list-style-type: none">• Some variable annuity contracts have high fees and other expenses• Some annuities impose stiff surrender charges• Taxes are due at regular income-tax rates, not the capital gains rate• Income from fixed-rate contract may not keep up with inflation

Social Security

For more than 85 years, Social Security has been a source of monthly retirement income.

Social Security was introduced in 1935 in the aftermath of the Great Depression to provide a safety net of regular income to retired and disabled workers and their families. It's a mandatory plan, requiring most employees, their employers, and the self-employed to contribute a percentage of their salary to support the program. In return, they, their spouses, and sometimes their dependents are eligible for retirement, disability, and survivorship benefits.

The program has been updated and expanded over the years, to include more workers and provide added benefits. Medicare, the healthcare plan for people over 65, was added in 1966. In 1972, benefits were indexed to inflation, so that as the cost of living goes up, your Social Security payments increase too.

BUILDING A RECORD

When you enroll in Social Security, your account is open though it isn't activated until you begin working. Then, every year the amount you contribute is recorded. Because what you'll ultimately collect is based on what you pay in, it's important that the record is accurate.

The Social Security Administration (SSA) creates a Social Security earnings statement if you are 25 or older and haven't yet begun to collect payments.

You can access a copy of your current statement by creating a secure, password-protected account at www.ssa.gov/myaccount. The statement reports what you've contributed each year and estimates the monthly benefit amounts you'll qualify for at retirement or if you're disabled. If you don't open a mySocialSecurity

account, you'll be mailed a statement every year if you're 60 or older and haven't started taking benefits.

If you discover your record is wrong—and it sometimes is, especially if you work more than one job—you can ask that it be corrected. You'll have to supply some evidence for your claim, such as the W-2 income-reporting forms that you file with your income tax. With that information, you should have no trouble correcting the problem. In fact, the SSA encourages people to check their annual earnings records carefully, since recent errors are easier to fix than long-existing ones.

To be eligible for Social Security benefits, you must contribute to the system for a total of ten years or be the spouse or dependent of someone who does.

FINDING HELP

You can call the SSA helpline at 800-772-1213 for assistance. Or, you can make an appointment at your local Social Security office. Either way, you should have copies of your most recent statement and back-up evidence to support your claim. It's not a speedy process, but it's worth the time.

PUTTING MONEY IN

Every year you earn income, you and your employer are taxed equal percentages of your earnings, as required by the Federal Insurance Contribution Act (FICA): 6.2% up to an annual earnings cap for Social Security and 1.45% of your total earned income for Medicare. Employees whose wages are more than

Social Security estimates that slightly more than 25% of 20-year-olds will become disabled before they turn 67, double the percentage who will die within the same time span. For most, the only disability insurance for which they'll be eligible will come from Social Security.

We've Got Your Number

When you're registered with Social Security, your nine-digit number usually stays the same for life, even if you change your name.

The first three digits

indicate the state where you applied for a card. The number changes as more cards are issued in that state.

The second group of digits

doesn't have a particular meaning—though they are related to the order in which cards are issued in a region.

The last four digits

are assigned in numerical order, for example 7091, 7092, 7093, and so on. One exception: Twins, triplets, or other multiple siblings don't get numbers in order.

987-65-4320

\$200,000 pay an additional 0.09% or 2.35% in Medicare taxes on amounts over that figure, but the employer's rate does not increase. If you're self-employed, you pay both parts but can deduct half the total when you file your federal tax return for the year.

To be eligible for benefits, you need to accumulate a total of 40 credits over your working life. You acquire credits at the rate of up to four each year for earning at least the required per-credit minimum dollar amount, which is reset each year.

GETTING MONEY OUT

People born before 1938 could collect full Social Security benefits when they turned 65. But **full retirement age (FRA)** increased to 66 for anyone born between 1943 and 1954 and increased again gradually for anyone born between 1955 and 1959 until it reached 67 for those born in 1960 or later.

You can collect a percentage of your benefit if you retire at 62. But if you work beyond your full retirement age and keep on contributing, the amount of your benefit increases 8% each year until you reach 70.

When you die, your surviving spouse is entitled to your benefits unless he or she would collect more on his or her own work record. The exact amount your spouse will be eligible for depends on what you were collecting and how old he or she is.

CALCULATING BENEFITS

Unlike most pensions, which calculate your benefit based on what you're earning at the end of your career, Social Security

counts what you earn over most of your working life, specifically the 35 years in which you earned the most. As with other pensions, though, the more you've earned, the higher the amount you'll receive.

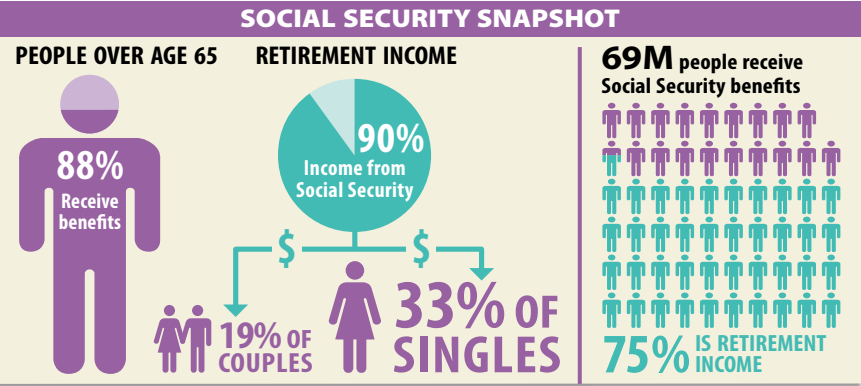
Although the dollar amount of your benefit is based on your average earnings, the percentage of earnings your benefit will replace is higher for people who earned less over their lifetimes, in keeping with the mission of providing at least a basic level of financial support.

You can use the Retirement Estimator at www.ssa.gov to calculate a sense of the benefit you can expect to receive based on your earnings record and the age at which you apply for benefits. However, this is just an estimate. Your actual benefit could vary, based on how long you continue to pay into the system, what your future earnings are, and any changes to the system itself.

TAXING BENEFITS

If your total income for the year, including half your Social Security and your tax-exempt earnings, is greater than the level set by Congress, you owe federal income tax on part of your Social Security benefits. The higher your total income, the greater percentage of your benefit is taxable, to a maximum of 85%.

About 20% of people getting Social Security benefits end up paying tax on part of what they receive. The Internal Revenue Service (IRS) provides a worksheet you can use to figure out exactly how much of your benefit you must include in your taxable income. If you pay estimated taxes, you'll have to be sure your installments cover what you'll owe.



Insuring the Future

Insurance is part of a complete financial plan.

When you invest, you put part of your income into a variety of assets to help you meet your financial goals. But what happens if you can no longer provide income to invest or even to pay everyday living expenses? Your illness, disability, or death could radically change your dependents' quality of life and expectations for the future.

As you create your financial plan, you should consider these risks. To make sure those who depend on you are taken care of, you can buy life and disability insurance to help replace your income, and long-term care insurance to pay for extended healthcare costs.

RISK AND COST

The cost of life insurance varies significantly, depending on the type you buy, the insurance company, and the risk you pose as shown on an actuarial table. These tables predict life expectancy based on your age, health, life style, and gender.

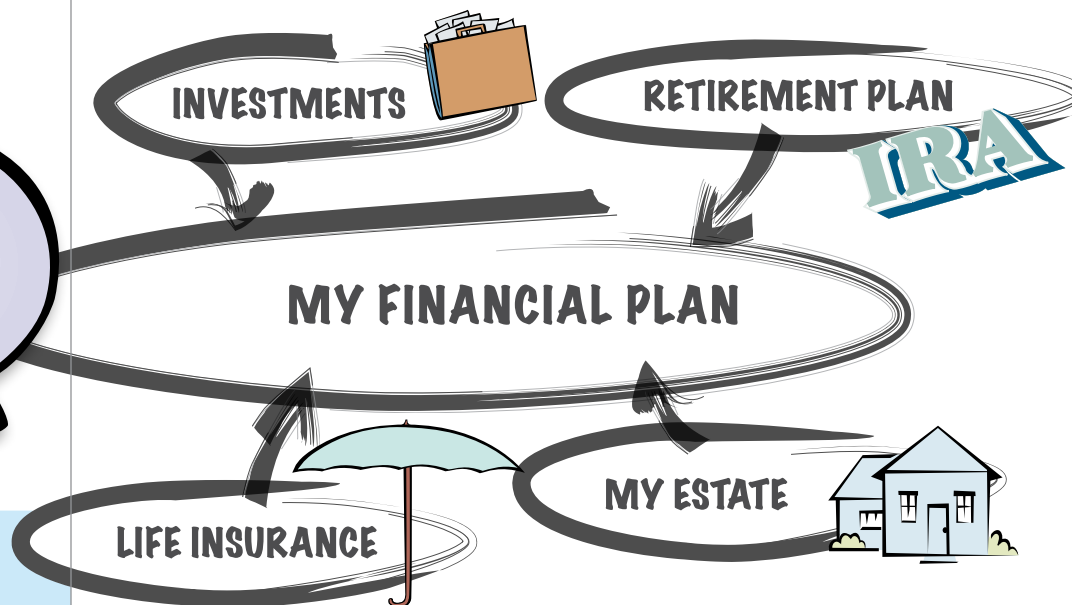
If you're considered high risk—for example, if you smoke, are overweight, or have a dangerous hobby like skydiving or scuba—the company is likely to charge a higher premium or refuse to insure you at all. But if you're a nonsmoker whose health and life style predict that you'll live longer, you are likely to pay less.

WORKING WITH AN AGENT

There are a number of advantages of working with a life insurance agent to choose a policy. Agents can help you assess your financial circumstances, define your coverage needs, and suggest whether a term or permanent policy might work best for you.

The more questions you have about how life insurance can help meet your financial needs, the more important the professional and personal attention you receive from an agent can be in selecting the right policy.

Life insurance companies originally did not insure women. When they began doing so in the late 1800s, they charged women higher premiums than men, due to the higher mortality rates associated with childbirth. Today, because women tend to live longer than men, they often pay lower life insurance premiums for the same amount of coverage.



LIFE INSURANCE

Life insurance serves multiple purposes. It can cover the costs associated with your death, sometimes known as final expenses. These could include funeral arrangements, any legal expenses involved in settling your estate, and your outstanding debts.

But life insurance can do much more. The beneficiaries you name on the policy you buy can use the **death benefit**, also known as the face value, as income replacement to pay for their living expenses, maintain their standard of living, and save for their goals.

Life insurance can also help you while you're alive. For example, some policies

have an **account value**, against which you may borrow. The death benefit will be reduced until you repay, but the loans are usually easy to arrange. Some policies also allow you to use a portion of the death benefit to cover the costs of a terminal illness.

The amount of insurance you need depends on your life situation and your financial situation. One rule of thumb suggests that your death benefit should be seven to ten times your annual income. But it's relatively simple to calculate your actual need using the online calculators available on insurance company websites.

plunder them to make ends meet. Even after you go back to work, you may have difficulty restoring your accounts to their previous levels, and you'll have lost any potential earnings you would have received by leaving the money invested.

What's more, your financial security could be at risk if you develop a medical

condition that leaves you unable to perform the basic, everyday activities of life on your own. Unfortunately, long-term care can be expensive and generally isn't covered by traditional health insurance. You may want to consider insurance contracts that will help pay for these costs.

PREPARE FOR SETBACKS

If a disability or serious illness strikes, it can have lasting effects on your finances. If you have dependents, the consequences may be even greater, since you'll still have to provide for their basic living expenses while you're laid up.

To prepare for this possibility, you'll want to buy disability insurance to replace a percentage of your income. Without disability insurance, a serious medical condition could make it difficult to pay the bills, and it could throw off your entire financial plan. Not only might you have to stop contributing to your retirement and college investments, but you may find it necessary to



STAY AT HOME?

If you're not the family breadwinner, you may still want to consider life insurance to replace the value of the services you provide at home. For instance, if you're a stay-at-home mom, how much would it cost your family to hire someone to do the work you do now?

Tax Planning

You can legitimately reduce the tax you owe by planning ahead.

The most effective way to pay the least tax that you are legally obligated to pay is to make financial decisions with an eye to their tax consequences. For example, one way to reduce your current income tax is to contribute to a **tax-deferred retirement account**, such as an employer-sponsored plan.

Of course, when you take money out of the account after you retire, you'll owe tax on the full amount of your withdrawal. But you may be paying at a lower tax rate when you take money out than you were when you put it in. In some sense it's a gamble, but thanks to the power of compounding, it's pos-

sible to come out significantly ahead, even if tax rates have increased.

If your employer's plan has a Roth option and you choose it, you contribute after-tax money but no tax is due on your withdrawals. That could be a real benefit.

Or, if you want to avoid mandatory withdrawals from your retirement savings, you might put your retirement money in a **tax-free Roth IRA**. While you'll contribute after-tax income, your withdrawals will be completely free of federal income tax provided your account has been open at least five years and you're at least 59½. Similar tax savings are available for college savings with a Coverdell education savings account (ESA) or a 529 college savings plan.

INVESTMENT PLANNING

Investment decisions have tax consequences, although minimizing taxes should be only part of your overall investment strategy. The investment risk you're willing to take, the return you can reasonably expect, and the impact of the transaction on your portfolio diversification are all at

least as important as the tax implications.

Here's what you need to know:

- A **capital gain** is money you realize for selling an investment for more than you paid to buy it. A **capital loss** occurs when you sell an investment for less than it cost you.
- If you've owned an investment for more than a year before you sell, you have a **long-term capital gain or loss**. If it's been less than a year, you have a **short-term capital gain or loss**.
- Long-term gains are taxed at a lower rate than your ordinary income, while short-term gains are taxed as ordinary income. The long-term rate is determined by your adjusted gross income (AGI), and may be 0%, 15%, or 20%. Surcharges may apply, again depending on your AGI.
- You can use long-term capital losses to offset long-term capital gains, or short-term losses to offset short-term gains, on a dollar-for-dollar basis. Unused losses can be carried over from one tax year to the next.

So, as you make investment decisions, you may want to postpone sales when feasible to qualify for the long-term gain rate and sell some assets with capital losses at the end of the tax year to offset some gains.

USING PRETAX DOLLARS

If your employer offers a **flexible spending account (FSA)** as an optional employee benefit, it's a tax-saving opportunity you probably don't want to pass up. An FSA lets you set aside pretax income to pay for uncovered healthcare expenses, including copays, deductibles, prescription drugs, and many over-the-counter medications that meet the IRS standards for treating or preventing disease or illness.

An FSA usually works on a calendar year. To participate you contribute, through payroll deductions, as much as you think you'll spend during the year, up to the maximum annual limit. If you and your spouse are both eligible to participate, each of you can contribute up to the annual limit.

There is one risk: If you don't use the money during the year for eligible expenses you may forfeit it. However, employers may offer either a two-and-a-half month grace period into the following year or allow you to carry over up to \$570 in 2022 of any unspent money, removing some of the pressure of using up your balance.

Using an FSA does involve substantial paperwork, but it can provide real tax savings. For example, suppose you contributed the full amount you could and spent it all on covered expenses. That would represent a tax savings of several hundred dollars, the exact amount depending on your marginal tax rate. If you want more information, check IRS Publication 502, "Medical and Dental Expenses."

Tax-deferred Retirement Account

DOING WELL BY DOING GOOD

You are entitled to deduct gifts you make to qualified charitable, religious, and educational organizations. The way you make the gift can have tax consequences. For example, you're likely to save on taxes by giving assets you own directly to the organization you want to benefit rather than selling the assets and making a cash gift.

The tax consequences of bequests you make to individuals, such as those to children and grandchildren, can be reduced as well by making those gifts in certain ways. Among the examples are creating trusts and avoiding the generation-skipping tax. Working with experienced legal and tax advisers as you make your plans is always wise and sometimes essential.

TRUST FUND

Tax-free ROTH IRA Retirement Account

FSA

CHARITABLE CONTRIBUTIONS

OFFSETTING CAPITAL GAINS

AVOID A WASH SALE

If you sell an investment that has lost value to offset your capital gains, but plan to buy it back because you think it has future promise, you need to be careful to avoid the **wash sale rule**. In brief, the rule says that a potential offset is disallowed if a substantially identical investment is sold and then repurchased, or purchased and then sold, within 30 days.

Estate Planning

Your estate contains the assets you have accumulated by the time of your death.

While much of the financial planning you do is designed to help you and your loved ones live the life you want, one aspect of it, called **estate planning**, deals with what happens to your assets after you die. There are many ways to ensure that they're transferred to the people or institutions you want to benefit, and that potential hassles are minimized or avoided.

The actual value of your estate isn't calculated until after your death, but, using your current net worth statement,

you can arrive at a fairly accurate estimate as you start the planning process.

Some assets, including those you own jointly, your retirement accounts, and the face value of your life insurance will go directly to your joint owner(s) or the beneficiaries you have selected. Other assets must be given away while you're living or transferred by will, trust, or other legal document.

The advice of an experienced lawyer who specializes in trusts and estates is always valuable and often essential to achieve your goals.



THE TAX ISSUE

While the most important aspect of estate planning is allocating your assets to your heirs, you can't ignore the potential for estate taxes. Under current law, federal taxes are due on net estates valued at more than \$10 million plus an annual inflation adjustment. In 2022, for example, the amount is \$12.6 million. A net estate is what's left after subtracting tax-exempt bequests—including those to your spouse and qualifying charitable institutions—as well as the cost of settling the estate from the estate's gross value.

Those assets that pass directly to beneficiaries—life insurance, retirement plans, and half the value of property you own jointly with your spouse—are included in your estate when it's valued. So are assets in any revocable trusts you have created, your share of a partnership or other business, and money you're owed.

While only a very small percentage of estates owe the federal tax, individual states may impose estate or inheritance taxes, or both, that are assessed against much more modest estates.



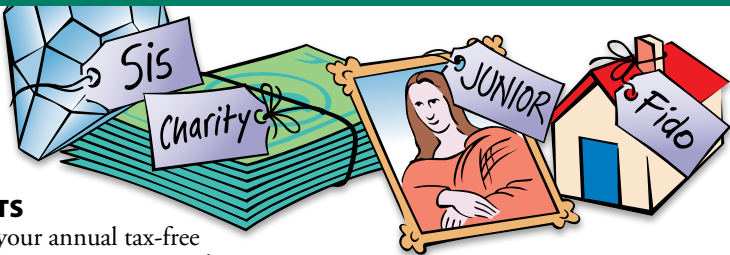
DEFENSIVE MEASURES

There are some strategies you can use to reduce the value of your estate and so the potential for estate taxes.

Tax-free gifts. You can give gifts of up to \$16,000 to as many people as you wish each year, totally tax free. If you're married, you and your spouse can give twice that, or \$32,000. Gifts to your spouse are always tax free, provided he or she is a US citizen. There's an annual cap if that's not the case. Gifts to qualifying charitable institutions are also tax free, though the annual amount you can give may be limited to a percentage of your adjusted gross income.

Paying education or medical bills. You can pay another person's tuition or medical bills not covered by insurance without incurring gift tax or reporting the payment to the IRS if you pay it directly to the educational or medical institution to which the money is owed.

Insurance. If someone other than you owns the life insurance policy on your life, the death benefit won't be included in your estate. If you are the current policyholder, you can assign ownership to another person, have



MAKING GIFTS

In addition to your annual tax-free gifts, you can give away assets worth up to \$10 million plus an annual inflation adjustment during your lifetime, though any part of the exempt amount you gift reduces the amount you can transfer free of federal tax at your death.

You have to report gifts over \$16,000 per recipient to the IRS using Form 709 when you file your tax returns for the year the gifts are made, but no tax is due until the total reaches the cap. And the government doesn't care how you share your assets—all as gifts, all as bequests, or a combination.

Gifts you make to a relative at least two generations younger than you

are, such as a grandchild or great-grandchild, may be subject to special generation-skipping, and somewhat complicated, tax rules.

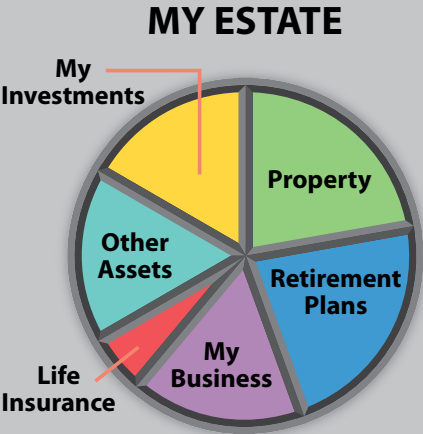
POWER OF ATTORNEY

You may want to consider granting a durable or springing power of attorney to someone who could handle your finances and other matters if you were too ill or disabled to make your own decisions. You should consult with your lawyer about the pros and cons as well as the process.

your spouse or child buy a new policy on your life, or, if you have a very large estate, use a life insurance trust.

Irrevocable trusts. If you move assets into a trust that you don't control and can't change, their value is no longer part of your estate. But you need professional help to create effective trusts, whether assets are transferred to them while you are alive or after your death.

Of course, any money you spend is no longer part of your estate either, though things you buy with the money will be if they have monetary value.



GIVE IT OR WILL IT?

If you're deciding whether to give someone a gift while you're alive or leave the property in your will, there are some things to consider, including the tax consequences.

	Outright gift	Inheritance
Value for income tax purposes	Value is what you paid for it originally.	The value is stepped up , or increased to what the property is worth at the time of inheritance.
What taxes are due	Potentially capital gains tax on increased value will be due when property is sold. No inheritance tax due. Potential estate tax can't reduce size of gift.	Capital gains tax if property is sold likely to be less than if received as gift. Inheritance tax may be due. Estate tax might reduce the size of the inheritance.

Financial Advice

Expert advice can be the key to making strong financial decisions.

If you'd like to have your investments working harder for you, ask yourself if you'd be making better decisions if you were getting professional advice. For many people, the answer is yes.

That's because the difference between getting advice and doing without it is often the difference between moving toward your goals and being stuck where you are.

Financial advice isn't something you save for emergencies. And it's not an admission of ignorance. Rather, advice works best when it's ongoing and goal-

oriented, helping you to increase your confidence and your investing skills as you develop a financial strategy and put it into action.

ALL IN THE FAMILY

Whether you share an advisor with your spouse or companion or choose your own is a matter of personal choice, just as your other financial decisions are. Some couples, for example, keep separate accounts and divide household bills. Others pool their money in a joint account. Both ways work.



FINDING THE RIGHT ADVICE

When you're ready to choose an advisor, you should look for one who'll help you move toward your goals. To make the search easier, it helps if you've thought about the kind of advice you're looking for and the things you want to accomplish. And remember, the choice is yours: Clients pick advisors, not the other way around.

Always ask potential advisors to explain specifically how investments and financial planning strategies they recommend may help you accomplish your goals. The more direct the answer, the better you'll feel about following the advice and developing a working relationship with that advisor.

Look for advisors and financial organizations that stress your

investment and financial planning concerns. Be alert to advisors who may promote investments or strategies that you don't understand and which they can't—or won't—explain clearly.

If you follow guidelines for choosing an advisor that put an emphasis on asking direct questions and checking references, you should be able to find a qualified advisor interested in building a long-lasting relationship that's centered on your goals. If you have specific planning needs—as a business owner, for example—seek an advisor with relevant experience. Professional associations, such as the National Association of Personal Financial Advisors (NAPFA), may be a good source of leads.

Sharing an advisor might make it easier for both of you to balance your portfolios and simplify tax planning. On the other hand, if you're used to making separate financial decisions, or if you feel that your partner's advisor is not interested in your concerns or your questions, finding your own advisor might be the right thing to do.

Your age, the length of your relationship, and other factors can also influence whether it's important to get separate advice. But remember that you're likely to be managing all the investments alone at some point. You won't want to face that responsibility without financial advice from an advisor you know and trust.

WHAT FINANCIAL GUIDANCE CAN DO

If you work with a financial advisor, what should you expect to gain?

- Help in defining your goals
- Help with understanding and managing risk
- Explanations of investment opportunities and common mistakes
- A structured, individualized strategy for investing
- Advice on specific investments
- Help with evaluating how well your investments are meeting your goals
- A system for recordkeeping

WHEN TO GET ADVICE

There's no right time for starting to work with a financial advisor—like your 35th birthday or the day you find the first gray hair. It's one of those situations when it's never too soon—or too late.

But there are occasions that might encourage you to talk to an advisor, either because things are going well or because they're not:

WHEN TIMES ARE GOOD	WHEN THEY'RE NOT SO GOOD
The balance in your savings accounts is more than six months' salary	You're afraid of losing your job, or don't expect a salary increase
You just received a big raise or a large bonus	You're facing the likelihood of divorce, and you're not sure where you stand financially
You inherited some stocks and bonds, but you don't know whether to hold onto them or sell them	You don't have a savings account or a money market fund
You have several large CDs that are about to mature, and the new interest rate is low	You know you'll need money for certain expenses—like education—but don't know how you can manage it
Your investments are doing well	Your investments have lost value, and you're concerned about future losses

529 Plan

529 college savings plans are designed to encourage families to invest for their children's educations by opening and contributing to an account in which earnings accumulate tax free. You can make federally tax-free withdrawals to pay for qualified educational expenses. Most states sponsor one or more federally authorized 529 college savings plans.

Assets

Assets are everything you own that has any monetary value, plus any money you are owed. Assets include money in bank accounts, stocks, bonds, mutual funds, equity in real estate, the value of your life insurance policy, and any personal property that people would pay to own.

Budget

A budget is a spending plan you use to allocate your income to cover your expenses and to track how closely your actual expenditures line up with what you had planned to spend. A budget covers a specific time period, typically a year. The goal is to end the year in the black, which means you have covered your expenses, increased your savings, and maintained a debt-to-income ratio of less than 40%.

Cash flow

Your cash flow includes the money coming into your accounts and the money you are spending over a specific time period. To determine if your cash flow is positive or negative, you subtract the money you receive from the money you spend on expenses. If there's money left over, your cash flow is positive. If not, it's negative.

Capital gain

A capital gain is the difference between the purchase price and the sale price of a capital asset when the sale price is higher than the purchase price. If you have owned the stock for more than a year before selling it, you have a long-term capital gain. If you hold the stock for less than a year, you have a short-term capital gain.

Capital loss

A capital loss is the difference between the purchase and sales prices of a capital asset when the sales price is less than the purchase price. You can use capital losses to offset capital gains in computing your income tax.

Defined benefit plan

A defined benefit plan—popularly known as a pension—provides a specific benefit for retired employees, either as a lump sum or as income for the rest of their lives. The pension amount usually depends on the employee's age at retirement, final salary, and the number of years on the job.

Defined contribution plan

Defined contribution retirement plans are employer-sponsored plans, including 401(k)s, 403(b)s, and TSP plans. The benefits you receive will depend on how much is contributed to the plan, how it is invested, and what the return on the investment is.

Education Savings Account (ESA)

An education savings account (ESA) is a tax-deferred account established in the name of a minor child to accumulate money that can be withdrawn tax free to pay his or her qualified education expenses. Money withdrawn from an ESA can be used at any level of education from kindergarten through graduate school.

Emergency fund

An emergency fund is designed to provide financial back-up for unexpected expenses or for a period when you aren't working and need income. To create an emergency fund, you generally accumulate three to six months' worth of living expenses in a secure, liquid account so that the money is available if you need it.

Equity

Equity is ownership. If you own stock, you have equity in the company that issued the stock even though your stake is very small. Equity also refers to the difference between an asset's current market value—the amount it could be sold for—and any debt or claim against it.

Financial plan

A financial plan is a document that describes your current financial status, identifies your financial goals and when you want to achieve them, and suggests strategies to meet those goals. Financial planners and other investment professionals can help you create a plan, identify appropriate investments and insurance, and monitor your portfolio.

IRA

Individual retirement provide tax advantages as you save for retirement. Everyone with earned income may contribute to a tax-deferred IRA. There are annual contribution limits, catch-up provisions if you're 50 or older, and restrictions on withdrawals before you turn 59½. Tax-deferred IRAs have required minimum distributions (RMDs) after you turn 72.

Liabilities

Liabilities are the amounts you owe to creditors, or the people and organizations that lend you money. Typical liabilities include your mortgage, car and education loans, and credit card debt.

Net worth

To figure your own net worth, you add the value of the assets you own, including but not limited to cash, securities, personal property, real estate, and retirement accounts, and subtract your liabilities, or what you owe in loans and other obligations.

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