

Saving Today for Retirement Tomorrow

Crystal Malik is a 58-year-old real estate agent earning \$60,000 per year. Crystal wants to retire in 12 years when she is 70. Crystal expects to live for 20 more years after she retires.

Crystal also expects her expenses to be about the same as they are now after she retires. She estimates that, along with her other sources of income and assets, by then, 100% of her current income will be necessary to support the lifestyle she desires. Crystal saves and invests but is pretty sure she should be saving more now to meet tomorrow's retirement goals.

Using this information and the information in the following tables, complete the worksheet to determine if Crystal's current plan will enable her to reach her goals. Assume a 2% return and growth rate (adjusted for inflation) on all savings and investments. Round your answers to the nearest dollar. Enter zero (0) in any rows for which there is no figure. Any Social Security retirement benefits or pension payments are annual amounts.

Savings & Investments – Current Balances

Amounts that Crystal already has available in today's dollars:

- Employer savings plans: \$0
- IRAs and Keoghs: \$10,000
- Other investments: \$17,000
- Home equity (net of possible replacement with new home after retiring): \$0

Savings & Investments – Current Contributions

- Crystal saves or invests \$900 per year.

Other Income

According to Crystal's most current Social Security statement, her estimated monthly Social Security retirement benefit in today's dollars is \$2,250. Crystal's employer offers a pension plan. According to the benefits advisor, Crystal's annual pension payment will be \$30,000.

**Crystal Malik's
Numbers**

1. Annual income needed at retirement in today's dollars.	<input type="text"/>
2. Estimated Social Security retirement benefit in today's dollars.	<input type="text"/>
3. Estimated employer pension benefit in today's dollars.	<input type="text"/>
4. Total estimated retirement income from Social Security and employer pension in today's dollars.	<input type="text"/>
5. Additional income needed at retirement in today's dollars.	<input type="text"/>
6. Amount Crystal must have at retirement in today's dollars to receive additional annual income in retirement.	<input type="text"/>
7. Amount already available as savings and investments in today's dollars.	
A. Employer savings plans (such as 401(k), SEP-IRA, profit-sharing)	<input type="text"/>
B. IRAs and Keoghs	<input type="text"/>
C. Other investments, such as mutual funds, stocks, bonds, real estate, and other assets available for retirement	<input type="text"/>
D. Portion of current home equity considered savings, net of cost to replace current home with another home after retirement (optional)	<input type="text"/>
E. Total: A through D	<input type="text"/>
8. Future value of current savings/investments at time of retirement.	<input type="text"/>
9. Additional retirement savings and investments needed at time of retirement.	<input type="text"/>
10. Annual savings needed (to reach amount in line 9) before retirement.	<input type="text"/>
11. Current annual contribution to savings and investment plans.	<input type="text"/>
12. Additional amount of annual savings that you need to set aside in today's dollars to achieve retirement goal (in line 1).	<input type="text"/>

2. The effects of compound interest

You've learned that the sooner you begin investing for your retirement, the more likely you are to achieve the financial goals you've set for yourself when you're finished working full time.

Consider the following two scenarios. Round your answers to the nearest dollar.

Fast approaching middle age, Scott, age 40, decided to start his investment plan this year by putting away \$1,500 every year until he retires at 65. He will invest this money in a bond mutual fund that yields an average rate of return of 6%.

According to Appendix A-3 (Future Value of a Series of Equal Amounts) in your text, the compounding factor is 54.8645.

Based on the information provided, how much will Scott have when he retires at 65?

Fast approaching middle age, Abejide, age 35, decided to start his investment plan this year by putting away \$1,500 every year until he retires at 65. He will invest this money in a bond mutual fund that yields an average rate of return of 6%.

According to Appendix A-3 (Future Value of a Series of Equal Amounts) in your text, the compounding factor is 79.0582.

Based on the information provided, how much will Abejide have when he retires at 65?

Since Abejide started his investment program five years earlier than Scott, and invested a total of \$ _____ during those extra years, at age 65, Abejide will have accumulated \$ _____ more than Scott.

What factors contributed to the difference between Abejide's and Scott's balances? Check all that apply.

- Their annual contributions
- Their retirement ages
- Compounding interest
- Their total contributions

Trusts are used to transfer assets from an estate. The contractual nature of a trust _____ probating its assets upon the death of the _____ and may _____ federal estate tax. An attorney who practices _____ law should be hired to draft the trust in order to ensure that all of the benefits of establishing a trust are realized.

Alex and Carl both created trusts but used different approaches:

Alex

Alex created a trust that goes into effect as soon as the papers are signed. Alex has the right to change the trustee, the beneficiary, and other terms.

What kind of trust did Alex most likely create?

- A testamentary trust
- An irrevocable charitable remainder trust
- A revocable living trust
- An irrevocable living trust

Carl

Carl created a trust with assets that will go to charity upon his death. Carl cannot change the terms of the trust but enjoys the income tax write-off for a charitable contribution.

What kind of trust did Carl most likely create?

- A testamentary trust
- A revocable living trust
- An irrevocable charitable remainder trust
- An irrevocable living trust

Jared and Hubert both created trusts but used different approaches:

Jared

Jared is a successful professional who has three competitive children. To avoid fueling sibling rivalry, Jared created separate trusts for each child with the same amount of money funding each trust, available on the child's 21st birthday whether Jared is dead or alive. Jared has no power to change the terms of the trusts regardless of how his children conduct their lives.

What kind of trust did Jared most likely create?

- An irrevocable charitable remainder trust
- A testamentary trust
- A revocable living trust
- An irrevocable living trust

Hubert

Hubert wants full use of his assets while he is alive. Hubert has no children. He created a trust to give eventually his assets to his nieces and nephews and provide income from those assets to his surviving wife.

What kind of trust did Hubert most likely create?

- An irrevocable living trust
- An irrevocable charitable remainder trust
- A testamentary trust
- A revocable living trust

Terminology: Wills

The probate court transfers property that was not distributed by contracts or trusts. The best way to ensure that this property goes to the people or institutions you wish is to make a well-structured will that is signed and witnessed.

Match the terms relating to the basic terminology and concepts associated with handling this portion of your estate on the left with the descriptions of the terms on the right. Read all descriptions first then make the **best** match between each description and term. Type the letter of the description in the Answer column next to the correct term. These are **not necessarily complete definitions**, but there is only **one** possible answer for each term.

Term	Answer	Description
Probate property	<input type="checkbox"/>	A. Property owned by the decedent that is not held in trust or a retirement account.
Will	<input type="checkbox"/>	B. A document describing the deceased's wishes. If it is in conflict with the will, the will prevails.
Executor	<input type="checkbox"/>	C. Used instead of revoking an existing will and rewriting a new one.
Codicil	<input type="checkbox"/>	D. A document that identifies a person's heirs and the assets that each heir will receive after the person's death.
Heir	<input type="checkbox"/>	E. When the resident state receives the deceased's assets.
Guardian	<input type="checkbox"/>	F. When the deceased did not have a will.
Letter of last instructions	<input type="checkbox"/>	G. The person named in a will to carry out all provisions of the will and conclude the deceased's financial business.
Intestate	<input type="checkbox"/>	H. A person who may be court appointed to raise surviving minor children.
Right of escheat	<input type="checkbox"/>	I. Legal position that married couples share their net worth.
Partnership theory of marriage rights	<input type="checkbox"/>	J. A person entitled by law to receive some or all of the deceased's assets.

Transferring Nonprobate Property By Contracts

Estate planning not only includes deciding who will inherit your assets but also how your heirs will receive them. One method is to transfer your property by contracts that you sign as part of your estate plan.

Amy recently died. It took almost two years before her heirs received any of their inheritance.

True or False: Amy's assets were most likely distributed by the probate court.

- True
- False

True or False: Maria has a stock brokerage account. She designated her best friend as her primary beneficiary and did not name a contingent beneficiary.

If Maria dies after her best friend dies, the stock brokerage account will go to her estate.

- False
- True

Eileen and Alison are best friends and have lived in the same house for many years. Eileen died suddenly. The following day Alison executed a contract to list the house for sale and within a couple days sold the house.

True or False: She was able to do this because she owned the house with Alison as joint tenants with right of survivorship.

- False
- True

Ginny is single and has three close friends. In the event of her death, she wants to leave them some money and doesn't want them to have to wait for probate on her estate to be completed.

True or False: One way to achieve her goal would be to open three savings accounts and sign payable-on-death designations naming each friend as the beneficiary.

- True
- False

Now It's Finally Time to Start Spending My Retirement Nest Egg

Not so fast! People work long and hard for years on their retirement plans. Paying smart attention to the plans doesn't stop when it's time to enjoy the fruits of the labor and sacrifice. When it comes time for **you** to begin using your funds, you'll need to make sure you follow some rules in order to avoid unnecessary expenses. Some questions follow that will help you remember wise ways to manage your money as well as avoid pitfalls that could cost you.

Keeping in mind that the primary purpose of tax-sheltered plans is to provide for your retirement, there are regulations in place to discourage early withdrawals, which presumably are intended for uses other than funding your retirement. That discouragement comes in the form of paying penalties and some taxes for which you would not otherwise be liable. However, there are some withdrawals allowed that wouldn't require you to pay penalties, as long as certain qualifications are satisfied. What are some of these penalty-free withdrawals? Check all that apply.

- Wedding
- College expenses
- Home renovation
- Pay down debt
- Early retirement
- Home purchase

It can be costly to spend your funds **before** the retirement rules allow if, **for any reason**, that spending doesn't fall into the narrow range of penalty-free early withdrawals. The farther away you are from retirement age, the cost that will **most** likely have the greatest negative impact is the _____.

The primary reason for the IRS 20% withholding rule is to:

- Make sure at least some of the income taxes on the withdrawal are paid
- Discourage early withdrawals
- Create more paperwork

Hubert is finally ready to retire with a nest egg of \$600,000. He wants his money to last 20 years and, taking inflation into consideration, expects the balance in his nest egg to earn 3% per year. Use the following interest table to compute how much Hubert could withdraw per year before his money ran out. Round your answer to the nearest dollar. _____

[Click here for table of interest factors](#) ▼

Hubert might want to have more money during his retirement years. What are some good options he should explore? Check all that apply.

- Buy an annuity
- Try to find a way to earn more interest on his nest egg balance
- Get a part-time job
- Withdraw less per year than the preceding calculation indicates

Personally Established Retirement Accounts

These days, almost anyone can open personal, tax-sheltered retirement accounts whether or not they're enrolled in a plan at work. Terms and provisions vary among plans, so it pays to do some homework before deciding which is best for your circumstances and goals. To help you focus on the aspects of different plans, answer the following questions.

Madeline earns less than \$100,000 per year. She opened a Roth IRA with a contribution of \$5,000. This contribution was made entirely with:

- Pretax dollars
- After-tax dollars

Eileen is a sole proprietor. She wants to create a retirement plan that requires the least amount of setup and maintenance effort. What type of plan is Eileen most likely going to open?

- Keogh
- SEP-IRA

Amy is 28 years old and opened a traditional IRA when she was 25. Amy earns less than \$100,000 per year. Her contribution for this year is \$5,000. This contribution is made entirely with:

- After-tax dollars
- Pretax dollars

Alison is a small-business owner who's decided to create a retirement plan that she believes will offer the most benefits to herself and her employees. Alison is willing to invest the time and money into setting up the plan and administering it. She knows that if maintaining the plan becomes too much to handle, she has the flexibility to convert it to a plan that's simpler to set up and maintain. What type of plan will Alison most likely decide to open?

- Keogh
- SEP-IRA

Terminology: Employer-Sponsored Retirement Plans

Many employers offer retirement plans as an employee benefit. An opportunity to participate in one should be seized, even if at its minimum participation requirements. In order to know what you're getting yourself into, you need to be familiar with the terms, provisions, and types of plans you may be offered.

Match the terms relating to the basic terminology and concepts associated with employer-sponsored retirement plans on the left with the descriptions of the terms on the right. Read all descriptions first then make the best match between each description and term. Type the letter of the description in the Answer column next to the correct term.

These are **not necessarily complete definitions**, but there is only **one** possible answer for each term.

Term	Answer	Description
ERISA	<input type="checkbox"/>	A. A plan that meets specified criteria established by the IRS.
Vested	<input type="checkbox"/>	B. A plan in which both employees and employers may make contributions.
Noncontributory plan	<input type="checkbox"/>	C. Type of plan that was the standard and most common employer-sponsored retirement benefit many years ago but no longer is today.
Contributory plan	<input type="checkbox"/>	D. Employers contribute company stock to employees as tax-deductible gifts and put the stock in trust for them.
Defined-contribution plan	<input type="checkbox"/>	E. A completely employer-funded plan that many large companies are changing to due to much lower administrative expenses.
Defined-benefit plan	<input type="checkbox"/>	F. A plan in which employees are not allowed to make contributions.
Qualified plan	<input type="checkbox"/>	G. A plan that specifies the contribution employees and, in some cases, employers make.
Profit-sharing plan	<input type="checkbox"/>	H. When employees take full possession of their employer's contributions to their plan accounts.
Cash-balance plan	<input type="checkbox"/>	I. When employees of a firm share some of the company's earnings.
ESOP	<input type="checkbox"/>	J. A law that regulates employer-sponsored plans. It establishes rules for proper reporting and disclosure to plan participants.

4. Calculating the effects of investing pretax or after-tax dollars in accounts that are or are not tax sheltered.

Amy just started learning about options for saving for her retirement. Her friend is a big fan of tax-sheltered accounts.

Why do you suppose that is? Check all that apply.

- Earnings are tax-deferred as long as they are reinvested within the account.
- Some withdrawals may be tax-free.
- Funds can be withdrawn at any time for any reason without penalty or tax payments.
- Contributions may be tax deductible in the year the contributions are made.



Before she commits any money to an account, Amy wants to see how much her savings would earn using different investment tactics. She asked you to help and provided the following information:

- She plans to invest \$2,000 every year for 30 years.
- She has found an investment account that earns 5% per year.
- She is in a 20% income tax bracket.

Interest Factor Table

Complete the following table to show Amy the effect of different options that are available to her. Round your answers to the nearest dollar.

Amy's Options			
	After-Tax, Not Sheltered	After-Tax, Sheltered	Pretax, Sheltered
Annual investment	\$2,000	\$2,000	\$2,000
Number of years to invest	30	30	30
Interest offered by account (as a %)	5	5	5
Effective interest for Amy (as a %)	<input type="text"/>	<input type="text"/>	<input type="text"/>
Interest factor from table	<input type="text"/>	<input type="text"/>	<input type="text"/>
Accumulated over 30 years	\$ <input type="text"/>	\$ <input type="text"/>	\$ <input type="text"/>
Invested over 30 years	\$ <input type="text"/>	\$ <input type="text"/>	\$ <input type="text"/>
Income tax bracket (as a %)	20	20	20
Income tax saved per year	\$ <input type="text"/>	\$ <input type="text"/>	\$ <input type="text"/>
Income tax saved over 30 years	\$ <input type="text"/>	\$ <input type="text"/>	\$ <input type="text"/>

Your findings _____ Amy's friend's fondness for tax-sheltered accounts, because, according to this analysis, they effectively earn _____ nonsheltered accounts.

Using **only** the factors taken into account in this analysis, Amy concludes that the _____ account is the best, in part, because it's the only one that would save her \$ _____ in income taxes every year.

Amy is tempted to use the money she would have sent to the IRS for fun but wants to know how much more she could earn if she put it toward her annual investment.

First, she computes that her new annual investment would be \$ _____ .

Next, Amy applies the interest factor from the table of _____ to reach an accumulated total of \$ _____ .