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Saving for Retirement and Social Security

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Choosing a Beneficiary for Your IRA or 401(k)

Selecting beneficiaries for retirement benefits is different from choosing beneficiaries for other assets such as life insurance. With retirement benefits, you need to know the impact of income tax and estate tax laws in order to select the right beneficiaries. Although taxes shouldn't be the sole determining factor in naming your beneficiaries, ignoring the impact of taxes could lead you to make an incorrect choice.

In addition, if you're married, beneficiary designations may affect the size of minimum required distributions to you from your IRAs and retirement plans while you're alive.

Paying income tax on most retirement distributions

Most inherited assets such as bank accounts, stocks, and real estate pass to your beneficiaries without income tax being due. However, that's not usually the case with 401(k) plans and IRAs.

Beneficiaries pay ordinary income tax on distributions from 401(k) plans and traditional IRAs. With Roth IRAs and Roth 401(k)s, however, your beneficiaries can receive the benefits free from income tax if all of the tax requirements are met. That means you need to consider the impact of income taxes when designating beneficiaries for your 401(k) and IRA assets.

For example, if one of your children inherits \$100,000 cash from you and another child receives your 401(k) account worth \$100,000, they aren't receiving the same amount. The reason is that all distributions from the 401(k) plan will be subject to income tax at ordinary income tax rates, while the cash isn't subject to income tax when it passes to your child upon your death.

Similarly, if one of your children inherits your taxable traditional IRA and another child receives your income-tax-free Roth IRA, the bottom line is different for each of them.

Naming or changing beneficiaries

When you open up an IRA or begin participating in a 401(k), you are given a form to complete in order to name your beneficiaries. Changes are made in the same way--you complete a new beneficiary designation form. A will or trust does not override your beneficiary designation form. However, spouses may have special rights under federal or state law.

It's a good idea to review your beneficiary designation form at least every two to three years. Also, be sure to update your form to reflect changes in financial circumstances. Beneficiary designations are important estate planning documents. Seek legal advice as needed.

Designating primary and secondary beneficiaries

When it comes to beneficiary designation forms, you want to avoid gaps. If you don't have a named beneficiary who survives you, your estate may end up as the beneficiary, which is not always the best result.

Your primary beneficiary is your first choice to receive retirement benefits. You can name more than one person or entity as your primary beneficiary. If your primary beneficiary doesn't survive you or decides to decline the benefits (the tax term for this is a disclaimer), then your secondary (or "contingent") beneficiaries receive the benefits.

Having multiple beneficiaries

You can name more than one beneficiary to share in the proceeds. You just need to specify the percentage each beneficiary will receive (the shares do not have to be equal). You should also state who will receive the proceeds should a beneficiary not survive you.

In some cases, you'll want to designate a different beneficiary for each account or have one account divided into



subaccounts (with a beneficiary for each subaccount). You'd do this to allow each beneficiary to use his or her own life expectancy in calculating required distributions after your death. This, in turn, can permit greater tax deferral (delay) and flexibility for your beneficiaries in paying income tax on distributions.

Avoiding gaps or naming your estate as a beneficiary

There are two ways your retirement benefits could end up in your probate estate. Probate is the court process by which assets are transferred from someone who has died to the heirs or beneficiaries entitled to those assets.

First, you might name your estate as the beneficiary. Second, if no named beneficiary survives you, your probate estate may end up as the beneficiary by default. If your probate estate is your beneficiary, several problems can arise.

If your estate receives your retirement benefits, the opportunity to maximize tax deferral by spreading out distributions may be lost. In addition, probate can mean paying attorney's and executor's fees and delaying the distribution of benefits.

Naming your spouse as a beneficiary

When it comes to taxes, your spouse is usually the best choice for a primary beneficiary.

A spousal beneficiary has the greatest flexibility for delaying distributions that are subject to income tax. In addition to rolling over your 401(k) or IRA to his or her IRA, a surviving spouse can generally decide to treat your IRA as his or her own IRA. This can provide more tax and planning options.

If your spouse is more than 10 years younger than you, then naming your spouse can also reduce the size of any required taxable distributions to you from retirement assets while you're alive. This can allow more assets to stay in the retirement account longer and delay the payment of income tax on distributions.

Although naming a surviving spouse can produce the best income tax result, that isn't necessarily the case with death taxes. One possible downside to naming your spouse as the primary beneficiary is that it will increase the size of your spouse's estate for death tax purposes. That's because at your death, your spouse can inherit an unlimited amount of assets and defer federal death tax until both of you are deceased (note: special tax rules and requirements apply for a surviving spouse who is not a U.S. citizen). However, this may result in death tax or increased death tax when your spouse dies.

If your spouse's taxable estate for federal tax purposes at his or her death exceeds the applicable exclusion amount (formerly known as the unified credit), then federal death tax may be due at his or her death. The applicable exclusion amount is \$5 million in 2011.

Naming other individuals as beneficiaries

You may have some limits on choosing beneficiaries other than your spouse. No matter where you live, federal law dictates that your surviving spouse be the primary beneficiary of your 401(k) plan benefit unless your spouse signs a timely, effective written waiver. And if you live in one of the community property states, your spouse may have rights related to your IRA regardless of whether he or she is named as the primary beneficiary.

Keep in mind that a nonspouse beneficiary cannot roll over your 401(k) or IRA to his or her own IRA. However, a nonspouse beneficiary can roll over all or part of your 401(k) benefits to an inherited IRA.

Naming a trust as a beneficiary

You must follow special tax rules when naming a trust as a beneficiary, and there may be income tax complications. Seek legal advice before designating a trust as a beneficiary.



Naming a charity as a beneficiary

In general, naming a charity as the primary beneficiary will not affect required distributions to you during your lifetime. However, after your death, having a charity named with other beneficiaries on the same asset could affect the tax-deferral possibilities of the noncharitable beneficiaries, depending on how soon after your death the charity receives its share of the benefits.



Planning for Retirement Checklist

General information	Yes	No	N/A
1. Has relevant personal information been gathered? <ul style="list-style-type: none"> • Age • Age of spouse or partner • Number of children (and other dependents) and their ages 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Has financial situation been assessed? <ul style="list-style-type: none"> • Annual income (pretax and after-tax) • Total annual expenses • Total assets and savings to date • Total retirement savings to date • Total liabilities to date • Total yearly contributions to 401(k)s and other employer-sponsored plans • Total yearly contributions to IRAs (Roth and traditional) • Total yearly contributions to other retirement savings vehicles • Health insurance coverage for each spouse • Long-term care insurance coverage for each spouse • Life insurance coverage for each spouse • Disability insurance coverage for each spouse • Wills, beneficiary designations, and other estate planning information 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Notes:			
Determining retirement income needs	Yes	No	N/A
1. Has retirement age been determined?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Has life expectancy been estimated in order to project how long retirement will last?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Have clear goals and objectives been established for retirement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Have those goals been prioritized with other major financial goals, such as paying for children's college?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Have annual retirement expenses been estimated, keeping in mind that those expenses may change from year to year? <ul style="list-style-type: none"> • Food, clothing, housing • Insurance • Health care • Travel and recreation • Other 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Have annual retirement income needs been estimated, based on the preceding goals and expenses?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



7. Has expected annual retirement income been estimated? <ul style="list-style-type: none"> • Social Security • Pensions • Savings and investments (including IRAs and retirement plans) • Job earnings • Other 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. If a retirement income shortfall is anticipated, has an estimate been made of how much must be saved each year to bridge the gap?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Have inflation, taxes, and conservative rates of return been factored into these estimates?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Notes:			
Saving for retirement	Yes	No	N/A
1. Is a 401(k) plan or other employer-sponsored retirement plan available?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. If so, does the employer match employee contributions up to a certain level?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Are contributions made up to the maximum allowed by law, or at least enough to capture the full employer match?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the 401(k) or other plan permit Roth contributions? If so, which type of contribution would be more appropriate, Roth or pre-tax?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Has an IRA account been established? <ul style="list-style-type: none"> • Roth IRAs • Traditional IRAs 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. If so, are contributions made up to the maximum allowed by law each year?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. If an IRA account has not been established, would it be appropriate to establish one, and which type?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. If current contributions to IRAs and employer-sponsored plans are not sufficient, are there budgetary steps that can be taken to increase those contributions? <ul style="list-style-type: none"> • Cut expenses • Decrease savings toward other goals (e.g., education) • Add a second job • Other 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Are other tools being used to save for retirement? <ul style="list-style-type: none"> • Annuities • Mutual funds • Stocks and bonds • Other 	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



10. Would these funds be more effective in an employer-sponsored plan?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. If not, would it be appropriate to add some of these tools to the retirement portfolio?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Is a substantial inheritance expected?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Notes:			
Investment planning	Yes	No	N/A
1. Have the appropriate investments for IRAs and employer-sponsored plans been selected?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Has someone been designated to monitor those investments for performance and make changes when appropriate?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Is there an investment portfolio that is designed to build wealth and achieve goals other than retirement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Has the impact of taxes been taken into account in assembling an investment portfolio?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Have expectations been established for how the retirement portfolio and other investments will perform over the long term?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Is some degree of investment risk acceptable?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Has an anticipated annual rate of withdrawal from the portfolio after retirement been established?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Notes:			
Insurance planning	Yes	No	N/A
1. Will adequate health insurance be available to meet potentially high health-care costs during retirement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Have long-term care insurance and other strategies been considered in case long-term care is needed during retirement?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Have other insurance needs during retirement been considered? • Life • Auto and homeowners • Liability • Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Notes:			



Estate planning	Yes	No	N/A
1. Have appropriate beneficiaries been chosen? • Employer-sponsored plans • IRAs • Annuities • Life insurance • Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Have valid wills been executed, including durable power of attorney and advanced medical directives?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Have other estate planning tools and strategies been considered? • Trusts • Gifting assets • Other	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Notes:			



Introduction to Retirement Planning

What is retirement planning?

Retirement planning involves an analysis of the various choices you can make today to help provide for your financial future. To make appropriate choices, you need to predict--as well as you can--your future economic circumstances. You'll also need to establish your post-retirement goals. When you've determined how much of an income stream you'll probably require in the future, you'll be in a position to make wise choices now about income, saving, investments, and employer-sponsored or other retirement plans.

Of course, you need to tailor your retirement planning to your own unique circumstances--planning methods may be different for employees and executives than for business owners. And no matter who you are, you'll probably want to gain some familiarity with the Social Security system, with post-retirement health care insurance coverage, including Medicare and long-term care (LTC) insurance. For some people, retirement may be an eagerly anticipated event, an opportunity to enjoy so many things that working may have precluded--travel, hobbies, and more family time. For other people, even the word "retirement" may conjure up feelings of fear or dread, particularly for those employees who work without the benefit of pension or other retirement plans. And newspaper stories predicting the collapse of the Social Security system can certainly compound anxiety. Whether you are financially comfortable or are of limited means, however, retirement planning is possible and can help you take control of your own future.

How can you determine your retirement income needs?

To determine your retirement income needs, you'll want to evaluate your present circumstances--your income, your expenses, your assets, and your debts. Next, you'll need to think about your future circumstances. There are four main sources for your retirement income: Social Security, pensions or other retirement vehicles, your investment portfolio, and savings. If you predict that your current income will not provide you with your desired retirement lifestyle, there are certain steps you can take now to help change your circumstances.

You'll want to think about your future sources of income, but also about where you'll live. Will you continue to live in your current home, for instance, or will you move to a condominium or retirement community? And if your employer typically provides early retirement packages to its employees, you'll need to know how to evaluate such packages from a number of perspectives. For information about the above, see [Determining Your Retirement Income Needs](#). See also [Personal Residence Issues in Retirement](#) and [Considering an Offer to Retire Early--Should You Take It?](#)

How do you save for retirement?

Learning how to save for retirement is imperative. There are a number of retirement vehicles available, including traditional and Roth IRAs, employer-sponsored retirement plans, nonqualified deferred compensation plans, stock plans, and commercial annuities. Proper retirement planning requires an understanding of the workings of these tools.

In addition, your personal investment planning can help you on the road toward your retirement goals. The sooner you start, the longer you'll have to accumulate funds for retirement.

You'll want to understand the taxation of your retirement and investment vehicles. This is especially important since the enactment of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (2003 Tax Act). The 2003 Tax Act reduced the capital gains tax rates and the tax rates of certain dividends, making the decision to allocate assets inside or outside a retirement plan more crucial.

Finally, you may want to learn strategies for handling the competing demands of educating your children and retiring. For information on all of the above, see [Saving for Your Retirement](#).



What should you know about distributions from IRAs and other retirement plans?

Effective retirement planning involves not only an awareness of the types of savings vehicles available, but also an understanding of taking distributions from these vehicles. In particular, you should be familiar with the income tax ramifications of distributions (including a possible 10 percent premature distribution penalty tax for distributions made prior to age 59 ½). You may be interested in knowing whether you can borrow money from your retirement plan, whether it is better to receive your retirement money in one lump sum or in monthly checks, and whether you can roll your retirement plan balance into an IRA.

In addition, you may be concerned about naming one or more beneficiaries for your IRA or employer-sponsored retirement plan. What are the tax implications? What about required minimum distributions from the plan after you reach age 70½? For information about these and many other related topics, see *IRA and Retirement Plan Distributions*.

What if you are an executive or business owner?

A number of additional retirement planning tools are often available for executives, such as nonqualified deferred compensation plans offered by employers to their key employees. If you're an executive, you should realize that nonqualified plans and stock plans can be valuable tools for retirement planning. You should understand the mechanics of the special benefits afforded by your employer, including the tax implications for you.

If you are a business owner, on the other hand, you have some special retirement planning concerns of your own. In particular, you may want to plan for the succession of your business to family members or to others. You may also want to know which retirement plans are best suited to your form of business. For information about these and related topics, see *Special Planning Considerations for Executives*, or *Planning for a Succession of a Business Interest*, or *Retirement Planning Options for Business Owners*.

How do Social Security and other government benefits programs impact retirement planning?

If you're planning for retirement, you should also consider the Social Security income (if any) you'll be receiving in the future. In fact, it is possible for you to estimate your Social Security benefits ahead of time. You may want to check your Social Security record periodically to ensure that you have met the eligibility requirements and that your information is accurate and complete.

You'll also want to become familiar with ways to optimize your Social Security benefits and minimize their taxation. The timing of your receipt of benefits can be important, as can the impact of post-retirement employment. For more information, see *Social Security*. Other governmental programs should also be considered when planning for retirement.

In particular, you should review the topics of Medicare and Medicaid. You should know what Medicare does and does not cover and what other health care options are available to you. How expensive are these governmental and supplemental health programs? What are the eligibility requirements? Medicaid planning can be particularly important for people of modest means. You should know the Medicaid eligibility requirements, the penalties for transferring assets inappropriately, and the various strategies available for protecting assets. In addition, you should become familiar with the specific methods of protecting your personal residence and the extent to which your state can impose liens on your property and pursue recovery remedies after your death. If you are planning for your post-retirement years, you should also gain some familiarity with long-term care insurance, nursing homes, retirement communities, assisted living, and other housing options for elders. For information on all of the above, see *Health Care in Retirement*.

Do government employees have special retirement concerns?



If you work for the federal government, a state government, a railroad, or if you are in the military, your retirement benefits may be subject to special rules. You should know how your retirement plan works, what distribution rules apply, how your survivors can benefit, how your plan may be integrated with Social Security, and what tax rules apply.

For more information, see Retirement Programs for Federal and State Employees, or Military Benefits, or Railroad Retirement System.



Saving for College and Retirement

What is it?

These days it's not uncommon for parents to postpone starting a family until both spouses are settled in their marriage and careers, often well into their 30s and 40s. Though this financial security can be an advantage, it can also present a dilemma--the need to save for college and retirement at the same time.

The prevailing wisdom has parents saving for both goals at the same time. The reason is that older parents can't afford to put off saving for retirement until the college years are over, because to do so means missing out on years of tax-deferred growth. Moreover, because generous corporate pensions (and lifetime job security) are now the exception rather than the rule, employees must take greater responsibility for funding their own retirements.

First, determine your monetary needs

The first step is to determine your projected monetary needs, both for retirement and college. This analysis will reveal whether you are on a savings course to meet both goals, or whether some modifications will be necessary.

For information on figuring your income needs in retirement, see [Determining Your Retirement Income Needs: Pre-Retirement](#).

For information on estimating college expenses, see [Estimating College Costs](#).

You've come up short: what are your options?

You've run the numbers on both your anticipated retirement and college expenses, and you've come up short. The numbers say you won't be able to afford to educate your children and retire with the lifestyle you expected based on your current earnings. Now what? It's time to sit down and make some tough decisions about your expectations and, ultimately, how to compromise.

The following options can help you in that effort. Some parents may need to combine more than one strategy to meet their goals.

Defer retirement

Staying in the workforce longer is one way of meeting your retirement and education goals. The longer you wait to dip into your retirement funds, the longer the money will last. For more information, see [Delayed Retirement Considerations](#).

Reduce standard of living now or in retirement

You may be able to adjust your spending habits now in order to have more money later. Consider making a written budget to track your monthly income and expenses (see [Budgeting](#) for more information). If your monetary needs have fallen far short of the mark, you will need to make a bigger spending adjustment than you would with a lesser shortfall. The following are some suggested changes:

- Move to a less-expensive home or apartment
- Sell your second car and carpool whenever possible
- Reduce your entertainment budget (e.g., bring your lunch to work, eat out once a month instead of every week, rent movies instead of going to the cinema)
- Get books and magazines from the library instead of the bookstore
- Cancel any club memberships (e.g., golf club, health club)



- Set a limit on birthday and holiday gifts for family members
- Forgo expensive vacations
- Shop for clothes in the off-season, when they're likely to be on sale
- Buy used furniture and used big-ticket items
- Limit your child's extracurricular activities, like music lessons or hockey camp

If you're unable or unwilling to lower your standard of living now, perhaps you can lower it in retirement. This may mean revising your expectations about a luxurious, vacation-filled retirement. The key is to recognize the difference between the things you want and the things you need. The following are a few suggestions to help reduce your standard of living in retirement:

- Reduce your housing expectations
- Cut back on travel plans
- Own a less-expensive automobile
- Lower household expenses

Note: There's a difference between reducing your standard of living in retirement and drastically reducing your standard of living in retirement. Most professionals discourage the use of retirement funds for your child's education if paying college bills will leave you high and dry in your retirement years.

Work part-time during retirement

About 25 percent of retirees work part-time. You may find that the extra income enables you to enjoy the kind of retirement you had anticipated.

Increase earnings (i.e., spouse returns to work)

Increasing earnings may be another way to meet both your education and retirement goals. The usual scenario is that a stay-at-home spouse returns to the workforce. This has the benefit of increasing the family's earnings so there's more money available to save for education and/or retirement. However, there are drawbacks. The additional income may push the family into a higher tax bracket (see Second-Income Analysis), and incidental expenses like day care and commuting costs may eat into your overall take-home pay. For more information on the pros and cons of a spouse returning to work, see Spouse Returns to or Increases Hours at Work.

In addition to a spouse returning to work, one spouse may decide to increase his or her hours at work, take another job with better compensation, or moonlight at a second job. Factors to consider here include the expectation of increased job pressure, less availability for child rearing and household management, the amount of extra income, the opportunity for advancement, and job security. Another way to create extra income is for a spouse to turn a hobby into a business.

Be more aggressive in investments

Your analysis has shown that your current savings (and the accompanying investment vehicles) will leave you short of your education and retirement goals. One option is to try to earn a greater rate of return on your savings. This may mean choosing more aggressive investments (e.g., growth stocks) over more conservative investments (e.g., bonds, certificates of deposit, savings accounts). This strategy works best the more years you have until retirement.

Caution: The more aggressive the investment, the greater the risk of loss of your principal. This strategy isn't for people who shudder at the slightest downturn in the stock market. If you'll have trouble sleeping at night, you probably shouldn't take on greater risk in your investment portfolio.



Reduce education goal

One of the realities parents may have to face is that they can't afford to fund 100 percent (or 75 percent, or 50 percent, as the case may be) of their child's college education. This is often an emotional issue. Parents naturally want the best for their children. For many parents, this translates into sending them to (and paying for) college (especially in cases where one or both parents didn't have such an opportunity).

You may have dreamed that your child would go to a prestigious Ivy League school. Well, with a year's cost at such a school hovering at the \$40,000 mark, maybe you need to lower your expectations. That small liberal arts college or the big state school may challenge your child just as much and at a far lower cost. Remember, there are loans available for college, but none for retirement.

Children pay more and/or assume more responsibility for loans

With college costs continuing to increase at a rate faster than most family incomes (see Estimating College Costs), and with perhaps more than one child in the family picture, chances are that more responsibility will fall on your child to help fund college costs. This money can come from part-time jobs or gifts, though the majority of your child's contribution is likely to come from student loans. For more information on student loans, see Financial Aid: Loans.

Though student loans can be a financial burden in the early years, when graduates are just starting out in their careers, many loan providers offer flexible repayment options in anticipation of this common situation (see Repaying Student Loans). In addition, if your child meets certain income limits, he or she can deduct the interest paid on qualified student loans (see Student Loan Interest Deduction for more information).

When children take out student loans, parents can always decide to help financially rather than mortgaging their house before college. Students who take out student loans to pay for college may have a more vested interest in their education than students who receive help from their parents.

Other ways to lower cost of college

In addition to reducing your education goal and having your child pay a portion of college costs, there are other ways to lower the cost of college. For example, your child can choose a college with an accelerated program that allows students to graduate in three years instead of four. Likewise, your child may choose to attend a community college for two years and then transfer to a four-year private institution. The diploma will reflect the four-year college, but your pocketbook won't. For more ideas on ways to lower the cost of college, see Implementing Other Creative Solutions to Cover Higher Education Costs.

How do you decide what strategy is best for you?

This decision must be made on a case-by-case basis. What works for one family may not work for another family. In some cases, more than one strategy will be necessary to deal with the demands of educating children and retiring successfully. Factors influencing your decision may include the following:

- The amount of your financial need
- Your current income and assets and any expectation of significant future income (e.g., a bonus at work, exercise of stock options, an inheritance)
- The number of years you have until retirement
- Your willingness to reduce your standard of living (now or in the future) for the sake of your children
- The number of children in your family who plan on attending college
- The academic, athletic, or other notable skills of your child that may raise the possibility of a college scholarship



Can retirement accounts be used to save for college?

Yes. But should you? Probably not. Many financial advisors recommend against dipping into your retirement account to pay college expenses as a preferred strategy. But if you must, there are some tax breaks available.

It's now possible to withdraw money from either a traditional IRA or Roth IRA before age 59½ to pay college expenses without incurring the 10 percent early withdrawal penalty that normally applies to such withdrawals. However, any distributions of earnings and deductible contributions from a traditional IRA and any nonqualified distributions of earnings from a Roth IRA may be included in your income for the year, which may push you into a higher tax bracket. For more information, see Traditional IRAs and Roth IRAs.

Tip: This college exception to the 10 percent early withdrawal penalty is a good reason to funnel your child's income from a part-time job into an IRA.

Unfortunately, there's no similar college exception for employer-sponsored retirement plans, such as a 401(k) plan. So, if you're under age 59½, you'll pay a 10 percent early withdrawal penalty on any withdrawals. As with an IRA, any withdrawals are added into your income for the year, which may push you into a higher tax bracket. Nevertheless, saving in a 401(k) plan can be an attractive option for some parents because the company may match employee contributions and because most employer plans allow you to borrow against your contributions (and possibly earnings) before age 59½ without penalty. For more information, see Employer-Sponsored Retirement Plans for Education Savings.

Tip: Some parents who have built a college fund within their 401(k) accounts, but who are not yet 59½ when the kids are in college, take out what's called a bridge loan (such as a home equity loan) to pay their child's college bills. A bridge loan is a source of funds that tides you over until it's more economical to tap your retirement account. Although you pay interest on a bridge loan, it may still cost less than what your 401(k) funds can earn. Then, when you turn 59½, you can start tapping your 401(k) plan to pay off the bridge loan with no early withdrawal penalty.

A benefit of using retirement accounts to save for college is that the federal government doesn't consider the value of your retirement accounts in awarding financial aid (the federal formula also excludes annuities, cash value life insurance, and home equity from consideration). However, most private colleges do consider the value of your retirement accounts in deciding which students are the most deserving of campus-based aid. See Applying for Financial Aid for more information.



Understanding Social Security

Over 57 million people today receive some form of Social Security benefits, including 87 percent of individuals over age 65. (Source: Fast Facts & Figures About Social Security, 2010) But Social Security is more than just a retirement program. Its scope has expanded to include other benefits as well, such as disability, family, and survivor's benefits.

How does Social Security work?

The Social Security system is based on a simple premise: Throughout your career, you pay a portion of your earnings into a trust fund by paying Social Security or self-employment taxes. Your employer, if any, contributes an equal amount. In return, you receive certain benefits that can provide income to you when you need it most--at retirement or when you become disabled, for instance. Your family members can receive benefits based on your earnings record, too. The amount of benefits that you and your family members receive depends on several factors, including your average lifetime earnings, your date of birth, and the type of benefit that you're applying for.

Your earnings and the taxes you pay are reported to the Social Security Administration (SSA) by your employer, or if you are self-employed, by the Internal Revenue Service. The SSA uses your Social Security number to track your earnings and your benefits.

You can estimate your retirement benefit online based on your actual earnings record using the Retirement Estimator calculator on the Social Security website, www.ssa.gov. Other benefit calculators are also available that can help you estimate disability and survivor's benefits.

Social Security eligibility

When you work and pay Social Security taxes, you earn credits that enable you to qualify for Social Security benefits. You can earn up to 4 credits per year, depending on the amount of income that you have. Most people must build up 40 credits (10 years of work) to be eligible for Social Security retirement benefits, but need fewer credits to be eligible for disability benefits or for their family members to be eligible for survivor's benefits.

Your retirement benefits

Your Social Security retirement benefit is based on your average earnings over your working career. Your age at the time you start receiving Social Security retirement benefits also affects your benefit amount. If you were born between 1943 and 1954, your full retirement age is 66. Full retirement age increases in two-month increments thereafter, until it reaches age 67 for anyone born in 1960 or later.

But you don't have to wait until full retirement age to begin receiving benefits. No matter what your full retirement age, you can begin receiving early retirement benefits at age 62. Doing so is sometimes advantageous: Although you'll receive a reduced benefit if you retire early, you'll receive benefits for a longer period than someone who retires at full retirement age.

You can also choose to delay receiving retirement benefits past full retirement age. If you delay retirement, the Social Security benefit that you eventually receive will be as much as 6 to 8 percent higher. That's because you'll receive a delayed retirement credit for each month that you delay receiving retirement benefits, up to age 70. The amount of this credit varies, depending on your year of birth.

Disability benefits

If you become disabled, you may be eligible for Social Security disability benefits. The SSA defines disability as a physical or mental condition severe enough to prevent a person from performing substantial work of any kind for at least a year. This is a strict definition of disability, so if you're only temporarily disabled, don't expect to receive Social Security disability benefits--benefits won't begin until the sixth full month after the onset of your disability. And because processing your claim may take some time, apply for disability benefits as soon as you realize that your



disability will be long term.

Family benefits

If you begin receiving retirement or disability benefits, your family members might also be eligible to receive benefits based on your earnings record. Eligible family members may include:

- Your spouse age 62 or older, if married at least 1 year
- Your former spouse age 62 or older, if you were married at least 10 years
- Your spouse or former spouse at any age, if caring for your child who is under age 16 or disabled
- Your children under age 18, if unmarried
- Your children under age 19, if full-time students (through grade 12) or disabled
- Your children older than 18, if severely disabled

Each family member may receive a benefit that is as much as 50 percent of your benefit. However, the amount that can be paid each month to a family is limited. The total benefit that your family can receive based on your earnings record is about 150 to 180 percent of your full retirement benefit amount. If the total family benefit exceeds this limit, each family member's benefit will be reduced proportionately. Your benefit won't be affected.

Survivor's benefits

When you die, your family members may qualify for survivor's benefits based on your earnings record. These family members include:

- Your widow(er) or ex-spouse age 60 or older (or age 50 or older if disabled)
- Your widow(er) or ex-spouse at any age, if caring for your child who is under 16 or disabled
- Your children under 18, if unmarried
- Your children under age 19, if full-time students (through grade 12) or disabled
- Your children older than 18, if severely disabled
- Your parents, if they depended on you for at least half of their support

Your widow(er) or children may also receive a one-time \$255 death benefit immediately after you die.

Applying for Social Security benefits

You can apply for Social Security benefits in person at your local Social Security office. You can also begin the process by calling (800) 772-1213 or by filling out an on-line application on the Social Security website. The SSA suggests that you contact its representative the year before the year you plan to retire, to determine when you should apply and begin receiving benefits. If you're applying for disability or survivor's benefits, apply as soon as you are eligible.

Depending on the type of Social Security benefits that you are applying for, you will be asked to furnish certain records, such as a birth certificate, W-2 forms, and verification of your Social Security number and citizenship. The documents must be original or certified copies. If any of your family members are applying for benefits, they will be expected to submit similar documentation. The SSA representative will let you know which documents you need and help you get any documents you don't already have.



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