



January 2006

## Baby Boomers Coming of Age

### A primer on retirement terms and accounts

2006 marks the first wave of 'Baby Boomers' (those born between 1946 and 1964) to reach age 60. Close attention has always been paid to this segment of our population since it accounts for over 80 million citizens or 28% of the US population.<sup>1</sup> Thus, changes in the needs and desires of this demographic group has a profound influence on consumer spending, social security, retirement saving. Of course these factors in turn will impact financial markets, which are always trying to interpret changes in the needs and desires of this group – the proverbial 'python digesting a goat' so to speak. So given the importance and interest, we'd like to dedicate a fair amount of 2006 *Fiscal Fitness* newsletters to relevant Baby Boomer financial issues. We'll start off the January edition with the basics of retirement plan accounts, terms and 2006 contribution limits. We'll try to keep this simple so as not to accelerate the Boomer graying process.

### Types of Retirement Accounts

- **Individual Retirement Accounts (IRA'S).** Contributions are tax deductible, depending your adjusted gross income (AGI) and whether you participate in a company plan. Earnings grow tax deferred until withdrawn, which must begin by age 70 ½. Increased 2006 contribution limits are \$4000/\$5000 (over age 50).
- **Roth IRA.** Similar to a regular IRA except contributions are not tax-deductible and there is a higher AGI limit (\$150,000-\$160,000). The tradeoff is earnings grow tax-free and qualified withdrawals are not taxed. 2006 contribution limits: \$4000/\$5000 if over age 50.
- **401k, 457, SARSEP, and 403b plans.** These are corporate sponsored plans funded by participants with pre-tax dollars plus usually involve a corporate match or contribution. Maximum 2006 employee elective deferrals: \$15,000/\$20,000 (over age 50).
- **Individual (Solo) 401k's.** Simplified version of the 401k above for those who are self-employed with no employees other than a spouse. 2006 employee deferral limits: \$15,000/\$20,000 and also allow a company match of 25% of employee income capped at \$27,000 for a maximum total annual contribution of \$44,000/\$49,000.

### By the Numbers

- **10%.** IRS penalty on premature withdrawals from retirement accounts prior to age 59 ½, with a few exceptions.
- **Age 55.** The earliest possible age to take retirement withdrawals without incurring a 10% penalty. Certain conditions must be met.
- **Age 59 ½.** The earliest age you can begin taking retirement distributions from your IRA without penalty (subject to certain exceptions such as death, disability, payment of medical expenses, purchase of first home).
- **Age 70 ½.** The latest age that retirement distributions must begin. If distributions do not begin by this age, penalties may apply. (Note: Roth IRA's are exempt from this provision).

### Beyond the Numbers

Now that you have the basics, know that there is a strategy to maximize the after-tax value of retirement accounts. Conventional wisdom suggests that tax deferral for as long as possible is your goal. However, remember that contributions and earnings to "qualified" retirement accounts (meaning sanctioned by the IRS and that provide special tax benefits) represent a tax *deferral*. Only the earnings on Roth IRAs *avoid* tax. When distributions are received from all other plans, they are taxed at ordinary income rates in that year. The objective, of course, is to deduct these contributions from your income when you're in a high tax bracket year and recognize the income in a later year when you are in a lower tax bracket.

You have some control over both decisions, subject to the distribution rules discussed above. For example, you may want to recognize IRA distributions in a poor earnings year so you would owe little or no tax thereon. This is possible, especially when you are living off social security and other investment income. Also, to minimize your tax on taking distributions, you may want to rearrange your portfolio to produce more tax-free or favorable income (dividends, capital gains). On a separate note, this reduction in investment income may have a positive effect on the taxation of any social security benefits.

As we approach spring, we'll continue to help you get into good "fiscal shape" by discussing related topics like IRA distribution rules, titling of accounts/naming beneficiaries, social security and more. While performance of the financial markets ebb and flow, making good decisions is always bullish.

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<sup>1</sup> Metlife: 2005