START FEEDING THE PIG

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According to the U.S. Department of Commerce, Americans spend $1.22 for every dollar they earn, and more than two million Americans file for bankruptcy each year. Our spending addiction has even prompted the American Institute of Certified Public Accountants and the Ad council to develop a campaign reminding us to feed our piggy banks if we ever expect to retire, called appropriately enough: "FEED THE PIG."

For 2007, I would like to ask that Arizonans take a serious look at their saving habits, and that they start to get real about what they can afford to spend today, and what they can put in the piggy bank for later.

BUT HOW?

First, ask yourself how much money you will need to save in order to retire. A general guideline to determine this figure is to first calculate how much you will need to withdraw from your retirement each year to maintain your lifestyle. Generally, it is safe to withdraw four to five percent of the value of the retirement account per year. This means you will have to save an estimated $240,000 to $300,000 for every $1,000 per month of income you will need to withdraw from your portfolio. For example, if a person determines he or she will need to withdraw $60,000 to supplement their pension and social security each year, that person will need to have saved at least $1,200,000 for retirement.

When it comes to saving for retirement, the primary method of saving is through your company's 401(k). However, now that more employers are allowing for Roth 401(k) contributions, you should seriously consider putting some money into the Roth option.

Many people have strong opinions about the benefit of a Roth account, but if you hold all of the assumptions about taxes, returns, and withdrawals constant, you get exactly the same answer regardless of whether you save using either method. The answer lies in the Associative Property of Mathematics. This property states that the addition or multiplication of a set of numbers is the same regardless of how the numbers are grouped. So whether you pay the tax up front or at the end, assuming the tax rates stay the same, you get the same result.

The benefit to a Roth is that is gives you tax diversification and provides flexibility. If taxes are higher in retirement than when the money was contributed, then a Roth would have a better result. Since no one can see the future, why not hedge your bets? Also, you do not have to begin taking money out of a Roth at age 70½, like you do in a traditional IRA. This extra deferral provides a valuable benefit. If you are lucky enough to have an estate large enough to pay estate tax at death ($2,000,000 per person), you will have to pay taxes twice on a traditional IRA but not on a Roth. The value of traditional IRA will be included in the estate and subject to estate tax. The beneficiaries will owe income tax on the proceeds when it is paid to them.

Another excellent way to save money is by using a 529 Plan. The Pension Protection Plan of 2006 made the 529 Plan laws permanent so the plans will continue to be an excellent way to save money on a tax deferred basis (tax-free if the money is used for qualified higher education expenses). You do not have to use the plan in the state you live in, but many times the state offers a tax incentive to do so.

Make 2007 the year you begin a program of personal financial literacy. The decision on where to save money is not as important as the decision to save money. Saving more money is as simple as spending less. The real important lesson in living within your means is to spend less than you make. That holds true if you are making $20,000 or $200,000.

Dale Walters is the CEO of Keats, Connelly & Associates, a fee-only wealth management firm in Arizona specializing in managing the complexities of accumulated wealth and U.S./Canadian cross-border planning. The firm will hold a one-day workshop focusing on Canadian cross-border living this January. For more information, please visit www.keatsconnelly.com.