

HOW...AND WHY...TO SAVE MORE MONEY

Want to save more money in your household, but you're not sure how? Or perhaps you're not even sure *why* you should save more. Here are a few tips from CERTIFIED FINANCIAL PLANNER™ practitioners about how and why to increase your savings.

Saving is a state of mind. If you don't see the purpose or benefits of saving, then you probably won't save. Saving occurs when you spend less than you earn and you keep the difference for future needs. This provides an immediate benefit—a sense of financial control. It also helps cushion you against life's inevitable financial cruelties, such as the loss of a job or a large out-of-pocket medical expense.

Saving earns money. You build money on money, and thus save even more without additional sacrifice. Savings reduces debt, which means less in finance charges, so you have more money to spend—or save. Savings also can reduce the risk of being forced to sell valuable assets, such as stocks or real estate, in order to meet basic or emergency expenses.

Last, but certainly not least, saving creates joy in your life by helping you achieve the things you desire, such as a dream vacation, the down payment on a home, a college education, or a financially secure retirement.

Save with a purpose. The standard advice is to save 10 to 15 percent of your income each month. There's nothing wrong with that advice, except it's vague. Knowing exactly *why* you are saving gives you more incentive to save. Watching savings grow toward a specific goal encourages you to continue to save—and save more.

One apparent exception to the idea of saving with a purpose might be the advice to have an emergency fund of three to six months cash reserves for bare-bones living expenses in the event of a financial crisis. Frankly, this is not money you get to have fun with, and which you hope you never have to dip into. But it does serve one purpose even if you never need it—peace of mind.

Save right off the top. You can develop a budget or spending plan or “pinch pennies” in order to come up with savings. There is certainly value in that, but it can be a lot of work, and like diets, often easy to quit. The easiest, most direct route to saving more is to take it right off the top and live on the rest.

Say you want to save 10 percent of your income. The first thing you do with each paycheck is set aside that 10 percent, whether it's going into your 401(k) plan, vacation fund, emergency fund, or a combination of accounts. You then live on the remaining 90 percent. As long as you meet basic expenses with the 90 percent, it's not critical how

you spend it—you've already saved. And your spending will likely self-adjust to the smaller amount.

Automate savings. The easiest way to follow the “pay yourself first” guideline above is to divert that savings amount automatically from your paycheck, before you ever see it. If possible, have a *percentage* taken out of your paycheck. That way, when you get raises or bonuses, you automatically save more. This method also counters the habit of people to automatically *spend* more whenever they make more.

Start small. Getting into the state of mind of saving is typically the challenge for people because we tend to live to our means, whether we make a little or a lot of money. A financial columnist recently fielded a question from a couple who complained that they were living paycheck to paycheck on \$110,000 a year.

For anyone having trouble getting started, whatever your income, try starting small. Instead of that more ideal 10 or 15 percent, try 3 or 5 percent (at least save enough to earn your employer's 401(k) match if one's available). Once you get into the habit, it's easier to increase that percentage over time.

Spend smart. There are many books, Internet sites, and other sources that provide tips on how to live less expensively. Many of the tips are useful, others silly and difficult to follow. But consistent winners include shopping for bargains, comparing prices for comparable products and services, and making shopping lists so you don't spend impulsively.

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WHAT YOU CAN DO IF YOUR PENSION PLAN IS SHAKY

Will your company's traditional pension plan be there when you retire, and what can you do now to prepare for the possibility that it might not be there?

The last few years have seen the implosion of several major corporate pension plans, particularly in the airline and steel industries. Hundreds of other companies have reported to the federal government that if their pension plan ended today, they wouldn't have enough money to pay their future obligations.

But there are steps you can take to assess the solvency of your company's pension plan and to put a contingency plan in place in the event the pension plan runs into trouble.

First, try to get as accurate a picture as possible of the true health of your employer's pension plan. Unfortunately, this isn't easy. Companies must disclose in their annual report the funding ratio for the "current liability" of their pension plan—how well they're able to meet current retiree payments. But they don't have to report how well they're funded in the event the plan is frozen or terminated.

For example, according to the Pension Benefit Guaranty Corporation, the federal agency that backs most defined-benefit pension plans, the pension plan for US Airways' pilots had reported shortly before the company filed for bankruptcy that its current liability was 94 percent funded. Yet after the bankruptcy filing, the pilots learned that the plan was only 33 percent funded on a termination basis.

To get the most recent information available, go directly to the plan administrator. Check to see if the PBGC covers the plan. Funding numbers typically change, so you'll need to monitor them. Current liability funding often moves with the markets. Compare the plan's net asset value at the start of the year with its value at the end of the year.

Assess the overall financial soundness of the company and the industry. Is the company's credit good or bad? A company's financial health can change quickly, of course—how many employees of United Airlines in the late 1990s would have thought their company would file for bankruptcy a few years later? But the long-term outlook for a company and industry at least provides some measure of the company's ability to fund the plan's obligations.

What happens to your pension payments if the worst happens—the plan is terminated? Pension plans pay insurance fees into the PBGC, which in turn takes over making pension payments should a particular plan fail. The problem for retirees is that the government agency is limited to how much it can pay out per worker.

For example, the maximum payment from PBGC for someone retiring in 2005 at age 65 is \$45,614 a year, or \$3,801 a month. At age 60, they'd receive a maximum of \$29,649 a year. Thus, higher-paid employees won't receive all of what they would have received from their plan. For example, some United Airlines pilots retiring at the mandatory age of 60 are qualified to receive \$100,000 a year in annual benefits, or \$8,333 a month. Yet the most they'll receive monthly from PBGC will be \$2,471.

Furthermore, PBGC bases payments on money earned up to the point the plan terminates. You can't earn additional benefits. If you're 55 and work another ten years at the company, your payments will be smaller than if the plan had remained solvent until you reached age 65.

What can workers do to minimize the impact of a potential pension plan insolvency? The most drastic, but sometimes necessary move, is to change employers or even industries. You might then take a lump-sum payout from the pension plan (if allowed) and roll it over into an IRA, though discuss this with your financial advisor before doing so.

Build your own pension plan. If you stick with your employer, contribute to that employer's defined-contribution plan, such as a 401(k), if available, or contribute to an IRA or consider annuities. You'll control these accounts.

Go easy on company stock. If the company's pension plan is in bad shape, the stock is likely to be in bad shape, too.

Decrease risk in other areas of your portfolio. Guaranteed pension plans are usually viewed as a lower-risk source of income, so if the plan is in doubt, you'll want to reduce portfolio risk in other areas.

TO CHOOSE OR NOT TO CHOOSE NEW SALES-TAX DEDUCTION TAKES PLANNING

The federal government is holding a sale on taxes. But should you take advantage of it?

Taxpayers who itemize—except for those subject to the alternative minimum tax—have long been able to deduct their state and local income taxes on their federal return. In the fall of 2004, Congress added a tax provision allowing itemizers the option of deducting their state and local *sales* taxes instead of their income taxes. The law, in effect only for 2004 and 2005 tax returns, was designed primarily for taxpayers who live in states with sales taxes but little or no income tax. But even taxpayers in high income-tax states may find the new option saves them taxes.

You have two ways to calculate how much you can deduct in sales taxes. First, you can go to the IRS tables in their new Publication 600. The tables are broken out by individual states that impose sales taxes, by the number of exemptions you claim on your federal tax return, and by your adjusted gross income (with certain modifications).

Modifications include adding certain nontaxable income to your AGI such as tax-exempt interest, veterans' benefits, and worker's compensation. A higher income translates into a higher sales-tax deduction on the federal tables because they presume you had more purchases subject to sales tax.

Say you live in Colorado, your AGI is between \$60,000 and \$70,000, and you take four exemptions. According to the table, you would be able to claim a sales-tax deduction of \$411. If you live in Florida, your exemption would be \$984. But the tables reflect only *state* sales taxes. Taxpayers who live in Denver, Colorado, for example, also pay city sales tax. The worksheet in Publication 600 has lines for adding local sales taxes.

Furthermore, you can add to the tax table amount any sales taxes paid during the year on the purchase of motor vehicles such as cars, trucks, motor homes, and recreational vehicles. Thus, you may want to bunch such major purchases into 2005 rather than waiting until 2006 when the sales-tax exemption will no longer be in effect under current law.

A second way to calculate your sales-tax deduction is to total up the actual sales taxes you paid during the year (Publication 600 describes some adjustments that may need to be made to this calculation). This option probably won't work for most taxpayers for 2004 because the law wasn't even passed until late 2004 and most taxpayers wouldn't have kept all their receipts. But you may want to start saving receipts during 2005, particularly if you expect high expenses during the year that will incur sales taxes.

Wealthier families also may want to keep receipts because the income levels on the IRS tax tables don't go above \$200,000.

Once you've calculated your sales-tax deduction, compare it with deductions you can take for any state and local income taxes. Clearly for people who live in a state with no state or local income taxes, such as Florida, the sales-tax deduction should be a no-brainer. The exception may be taxpayers who don't normally itemize—two-thirds did not in 2002, according to the IRS. Many of them may still be better off sticking with the standard deduction.

It gets more complicated for taxpayers whose state imposes both a sales and income tax, such as Colorado, which has 5 percent income-tax rate. Tax experts say that taxpayers whose state and local income tax rates are equal or less than the rate they pay in sales taxes may find the sales-tax deduction the better choice. Taxpayers in states where the deduction for the sales tax and the income tax are close also may be better off taking the sales-tax deduction if they have a state refund because they wouldn't have to claim the refund as income on their next year's return.

Even people in higher income-tax states, such as New York or California, should probably run the numbers, particularly if they have a significant amount of income not subject to state or local income tax, such as municipal bond income or a portion of their retirement income.

Another complication is that taxpayers subject to AMT cannot deduct state income taxes. This also may apply to the sales-tax deduction, so consult your tax professional.

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