the RETIREMENT issue

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Things that make you go hmmm....

LIVING LIKE A RICH BUM
How about never having to work again?

TAX WHAT?
Tax Qualified or Tax Deferred? PreTax or Post Tax?

RECESS & RETIREMENT...
401k or 403b

THE RETIREMENT ISSUE

Table of Contents

2 Introduction
3 Terms To Learn
4 Retirement Accounts
5 Traditional IRA
6 Roth IRA
8 SEP
8 SIMPLE
9 401(K)
9 403(B)
10 ROTH 401(K)/403(B)
11 Annuities
16 Conclusion

INTRODUCTION

This module covers the different types of tax-qualified plans and annuities available for the specific purpose of saving for retirement. It will be beneficial to review the Stocks and Investments Issue as well.

One of the most common goals among working Americans is to have the ability to retire comfortably. Retirement has many definitions but is usually perceived as the ability to maintain your standard of living without the necessity for daily employment. With the growing difficulties of government-sponsored programs, it is now more important than ever that individuals start their own saving plans for retirement and rely less on programs like Social Security, which was never designed to provide a full retirement. There are many different types of saving plans that offer tax advantages and are specifically designed for retirement savings.

TERMS TO LEARN

Annuitant
The individual designated in the contract to receive annuity payments.

Annuity
A retirement plan that combines an investment vehicle with an insurance contract.

Beneficiary
The person designated by the owner to receive the proceeds of an insurance policy, retirement account or other asset, following the death of the annuitant.

Custodian
An agent, bank, trust company, or other organization that holds and safeguards an individual's account assets for them.

Individual Retirement Account (IRA)
There are two types of IRAs for individuals: the Traditional IRA and the Roth IRA. IRAs are often referred to generically as tax-qualified accounts.

Maturity Date
The date on which a deferred annuity's accumulation period ends and annuity payments begin.

Tax-deferred Growth
Earnings that are not taxed until some future date, usually when the money is withdrawn from the account. Annuities feature tax-deferred growth, which is different from tax-qualified accounts.

Tax-qualified Plan
Retirement plans that receive special tax privileges such as tax-deferred growth, pretax payroll deductions, etc.

RETIREMENT ACCOUNT

Difference between a Savings Account and a Retirement Account

SAVINGS ACCOUNT

A savings account is ideal for maintaining cash for emergencies and for accumulating dollars for short-term necessities and larger planned purchases. Your money is readily available (liquid), and there is no penalty for withdrawal of the money.

RETIREMENT ACCOUNT

Retirement accounts offer tax advantages to encourage you to invest for retirement (long-term). Some are funded with pretax dollars, and all offer tax-deferred growth on investments. If you withdraw funds prior to age 59½, you will usually incur additional taxes and early withdrawal penalties.

- Traditional Individual Retirement Account (IRA)
- Roth IRA
- Simplified Employee Pension (SEP)
- Savings Incentive Match Plans for Employees (SIMPLE)
- 401(k)
- 403(b)
- Roth 401(k)/403(b)

TRADITIONAL IRA

A traditional IRA provides tax advantages for setting aside dollars for retirement. The IRA must be set up under a custodian, which can be a bank or credit union, savings and loan association, insurance company, mutual fund, or investment broker.

IRAs are offered in a variety of savings and investment vehicles, such as money market accounts, certificates of deposit (CDs), stocks, bonds, and mutual funds.

Tax Advantages & Considerations of a Traditional IRA

Depending on your gross income, you may be eligible to deduct all or part of your traditional IRA contributions for the year.

Tax-deferred growth: Taxes are paid only when you withdraw assets. Taxable assets include any earnings in the account and any contributions that were deducted from gross income.

Contribution Limits

The maximum contribution limits change from year to year. The scheduled contribution limits are based on the Tax Reconciliation Act of 2001, For 2010 those with earned income can contribute up to $5,000 per year.

This legislation allows participants age 50 and over to contribute an extra $1,000 per year. This applies if a person has reached age 50 by the end of the tax year (for most individuals, this is December 31).

Contributions to a traditional IRA may continue as long as there is taxable income for the year in which the contribution occurs; however, all contributions to a traditional IRA must stop once the participant reaches age 70½.

Your tax refund, which will be received in the following year, can be direct-deposited into an IRA for the previous year, as long as you are not at your contribution limit. It's important to know that this does not change the April 15 deadline for IRA contributions, so the tax return must be filed early.

Withdrawals

Withdrawals from traditional IRAs are reportable to the IRS and taxable. You can withdraw assets from a traditional IRA without penalty once you have reached age 59½. A withdrawal prior to age 59½ is called an early distribution.

Early distributions may be subject to a 10% additional tax. There are certain exceptions to this general rule.

Some exceptions are:

- First-time homebuyer (rules and restrictions for this type of distribution are explained under First Home in Chapter 1 of IRS Publication 590, Individual Retirement Arrangements).
- Disability.
- Death of the owner (the beneficiary can withdraw funds).
- Unreimbursed medical expenses over a certain percentage of income.
- Higher-education expenses equal to or greater than the withdrawal.
- Distributions, prior to age 59½, in the form of an annuity that continue for at least five years or until the participant reaches age 59½, whichever is later.

If you are the owner of a traditional IRA, you must start taking withdrawals from your IRA no later than April 1 of the year following the year in which you reached age 70½.

For example, if you turned 70½ in 2009, you must receive your first minimum required distribution no later than April 1, 2010. See Figuring the Owner's Required Minimum Distribution section in IRS Publication 590 to determine the correct amount.

ROTH IRA

A Roth IRA provides tax advantages for setting aside dollars for retirement. The Roth must be set up under a custodian, which can be a bank or credit union, savings and loan association, insurance company, mutual fund, or investment broker.

Roth IRAs are offered in a variety of savings and investment vehicles, such as money market accounts, certificates of deposit (CDs), stocks, bonds, and mutual funds.

Tax advantages and considerations of a Roth IRA

The growth on a Roth IRA is tax-free. Withdrawals from a Roth IRA are tax-free as long as certain criteria are met.

Contribution Limits

The maximum contribution limits change from year to year. In the chart below are the scheduled contribution limits based on the Tax Reconciliation Act of 2001. This legislation allows participants age 50 and over to contribute an extra $1,000 per year. This applies if a person has attained age 50 by the end of the tax year (for most individuals, this is December 31).

There are certain income limits associated with being eligible to contribute to a Roth IRA. If you are single, your adjusted gross income cannot exceed $120,000. If you are married filing jointly, the combined adjusted gross income cannot exceed $176,000.

See the following chart for Roth eligibility.

Filing Status	Adjusted Gross Income	Contribution Rules
Single OR **Married Filing Separately** (did not live w/spouse at any time)	< $105,000	Can contribute up to maximum allowed for given year
	$105,000 - $120,000	Allowable contribution amount gradually reduces
	> $120,000	Cannot contribute to a Roth IRA
Married Filing Separately (lived w/spouse at any time during the year)	$ 0	Can contribute up to maximum allowed for given year
	$0 - $10,000	Allowable contribution amount gradually reduces
	> $10,000	Cannot contribute to a Roth IRA
Married Filing Jointly	> $166,000	Can contribute up to maximum allowed for given year
	$166,000 - $176,000	Allowable contribution amount gradually reduces
	> $176,000	Cannot contribute to a Roth IRA

There are no age limitations. Unlike a traditional IRA, participants can continue to contribute to a Roth IRA past the age of 70½, as long as they have taxable income for the year in which they contributed. Your tax refund, which you will receive the following year, can be direct-deposited into an IRA for the previous year. It's important to know that this does not change the April 15 deadline for IRA contributions, so if you choose to do this, you must file your return early!

Withdrawals

Withdrawals from Roth IRAs are always reportable to the IRS, but they are not always taxable.

You can withdraw assets without additional taxes or penalty from a Roth IRA once you have reached age 59½ and have owned the account for at least 5 years.

Withdrawals that take place before one or both of these conditions are met may need to be included in gross income and may face an additional 10% tax.

Unlike traditional IRA accounts, there are no requirements to start liquidating the Roth IRA account at age 70½.

Note: If you intend to liquidate your IRA account, traditional or Roth, check IRS Publication 590, available on the IRS website, for additional information on taxes and penalties that may apply to your withdrawal.

SEP

Simplified Employee Pension Plan - SEP

A Simplified Employee Pension (SEP) Plan is an employer-sponsored retirement plan for small businesses and self-employed individuals. The employer makes voluntary contributions to the employee's account. Contributions can vary each year, and all eligible employees receive the same percentage of compensation.

Tax advantages and considerations of a SEP IRA

Tax-deferred growth

The employer making contributions to the SEP may be eligible to deduct the amount from his or her taxes. See IRS Publications 560, Retirement Plans for Small Business, and 590 for complete details.

Contribution Limits

The employer is able to contribute up to 25% of the employee's compensation or $49,000, whichever is less. If the employee makes more than $245,000, only the first $245,000 of compensation is usually considered.

Withdrawals

Withdrawals from SEP IRAs are reportable and taxable. You can withdraw assets from a SEP IRA without penalty once you have reached age 59½. A withdrawal prior to age 59½ is called an early distribution. Early distributions may be subject to a 10% additional tax.

SIMPLE

Savings Incentive Match Plan for Employees - SIMPLE

A SIMPLE, or Savings Incentive Match Plan for Employees, is an employer-sponsored retirement plan which allows employees to contribute a given amount of their annual income through an income deferral plan.

Employees may elect to participate or not. The employer is required to match each participating employee's contribution up to 3% of annual compensation.

Alternatively, the employer may elect to contribute 2% to all employee plans, regardless of the employees' levels of participation. These plans are known as SIMPLE IRAs. The rules governing them are based on the SIMPLE plan, rather than on the rules for traditional or Roth IRAs. See IRS Publications 560 and 590 for complete details.

Tax advantages and considerations of a SIMPLE

Tax-deferred growth

Taxes are paid when you withdraw your assets from the account.

Contribution Limits

SIMPLE IRAs allow up to $11,500 ($14,000 if over age 50, for 2010) of an employee's annual income to be contributed. The employer is required to match each contribution up to 3% of annual compensation. Alternatively, the employer may elect to contribute 2% to all employee plans, regardless of the employees' levels of participation.

Withdrawals

Withdrawals from SIMPLE IRAs are reportable and taxable. You can withdraw assets from a SIMPLE IRA without penalty once you have reached age 59½. A withdrawal prior to age 59½ is an early distribution. Early distributions may be subject to a 10% additional tax.

401(k)

A 401(k) is an employer-sponsored plan that many companies offer their employees. Employees can contribute pretax dollars through payroll deductions. The employer may match employee contributions up to specified limits and/or contribute money to the employee's fund. The employer may contribute to an employee's account, even if the employee doesn't. Usually, employees are provided a list of funds in which they may invest. From that list, the employee can select which fund(s) to contribute to and how much to contribute to each fund.

Tax advantages and considerations of a 401(k)

An employee contributes to a 401(k) in pretax dollars, which lowers taxable income. For example, if an employee is paid $1,000 gross pay but contributes $100 to a 401(k), only $900 will be considered for income taxes.

Contribution Limits

For 2010, employees can contribute up to $16,500 ($22,000 if over age 50).

Withdrawals

Like an IRA, the funds and growth are not taxed until the funds are withdrawn. Withdrawals are allowed in cases of termination, death, disability, or, if the company allows it, upon hardship.

A 20% additional tax usually applies to any 401(k) dollars taken directly in cash at the time of retirement or termination. To avoid this penalty, the dollars can be directly rolled over into another tax-qualified plan.

403(b)

A 403(b) is a defined contribution plan. Like the 401(k) plan, it was designed to enable workers to accumulate funds for retirement in long-term, income tax-deferred investment accounts.

The 403(b) is an investment plan for employees of non-profit organizations, hospitals, public schools, and universities. 403(b)s and 401(k)s are very similar in features and restrictions.

Tax advantages and considerations of a 403(b)

An employee contributes to a 403(b) in pretax dollars, which lowers taxable income. For example, if an employee is paid $1,000 gross pay but contributes $100 to a 403(b), only $900 will be considered for income taxes.

Contribution Limits

For 2010, employees can contribute up to $16,500 ($22,000 if over age 50).

Withdrawals

Like an IRA, the funds and growth are not taxed until the funds are withdrawn. Withdrawals are allowed in cases of termination, death, disability, or, if the company allows it, upon hardship.

A 20% additional tax usually applies to any 403(b) dollars taken directly in cash at the time of retirement or termination. To avoid this penalty, the dollars can be directly rolled over into another tax-qualified plan.

ROTH 401(k)/403(b)

Beginning January 1, 2006, sponsors of 401(k) and 403(b) plans have the option of offering a Roth feature for employee salary deferrals.

If the Roth is offered, participants have the option of making plan contributions in three different ways:

1. **On a pretax basis to a traditional account.**
2. **On a Roth basis (post-tax) to a Roth account.**
3. **Some combination of the two.**

Only employee-elective deferrals are available for Roth treatment; all employer contributions to qualified plans will remain pretax.

It is important to remember that contributions to a 401(k)/403(b) designated as Roth contributions will not lower your overall taxable income as a conventional 401(k)/403(b) contribution will do.

Tax advantages and considerations of Roth 401(k)/403(b)

The Roth 401(k)/403(b) has a higher annual contribution limit than conventional Roth IRAs and no income limits. The growth on Roth 401(k)/403(b) is tax-free, which means you won't have to pay income taxes upon withdrawal, as long as certain criteria are met.

Contribution Limits

Contribution limits are governed by the 401(k)/403(b) rules. For 2010, employees can contribute up to $16,500 ($22,000 if over age 50).

Contributions are irrevocable. Once they are in a Roth 401(k)/403(b), they cannot be shifted to a pretax account. Any employer contribution will continue to be made into the pretax 401(k)/403(b) account.

Withdrawals

Withdrawals are allowed in cases of termination, death, disability, or, if the company allows it, upon hardship. When you leave your company or retire, the Roth portion of your 401(k)/403(b) can be rolled over directly to a Roth IRA, where it can continue to grow tax-free.

For a withdrawal to remain tax-free, the account would have to be held for 5 years, and the account owner would have to have reached 59½ years of age.

You must start taking withdrawals from the Roth 401(k)/403(b) no later than April 1 of the year following the year in which you reached age 70½.

ANNUITIES

An annuity may become an important part of a retirement savings plan. Annuities combine an investment vehicle with an insurance contract.

The purpose of the insurance contract is to protect the designated beneficiary against loss of capital, but it also enables the investment to grow tax-deferred.

One drawback is that most of the assets cannot be accessed before age 59½ without a 10% additional tax. Also, capital gains are taxed as ordinary income when distributions begin.

The purpose of an annuity contract is to create an invested pool of money to provide a series of payments (an income stream) to the person named as the annuitant. Payments (usually monthly) may be for a designated time or for the life of the annuitant. There are several "persons" named in an annuity contract: the owner, the annuitant, and a designated beneficiary.

Often, the owner and the annuitant are the same. The beneficiary is the person designated to receive the proceeds of the contract, if there are any, following the death of the annuitant.

Types of Annuities

There are two major types of annuities:

- Deferred
- Immediate

A deferred annuity enables you to grow your money through tax-deferred interest accumulation over a period of time before you begin to receive payments.

There are two phases to a deferred annuity: the accumulation phase, in which the owner makes investments (payments) into the annuity, and the distribution (or annuitization) phase, in which the annuitant receives income.

An immediate annuity is purchased with a single, lump-sum payment and provides income immediately or within one year following purchase. In an immediate annuity, there is no accumulation phase. The distribution phase starts immediately.

Besides immediate and deferred, there are two other classifications of annuities:

- Fixed Annuity
- Variable Annuity

The money invested in a fixed annuity is guaranteed to earn a fixed rate of return throughout the accumulation phase of the annuity. Fixed annuities can be bought from insurnace companies or financial institutions with a lump sum or with periodic payments.

The money invested in the annuity is guaranteed to continue to earn a fixed rate of return during the annuitization phase.

A fixed annuity may be appropriate for a person who wants a guaranteed monthly income and has a low risk tolerance.

A variable annuity combines the characteristics of a fixed annuity with the benefits of owning mutual funds. It is only offered as a deferred annuity. This category of annuity does not have a fixed interest rate.

Advantages of Annuities

- No limit to contributions.
- Tax deferral on earnings until withdrawal.
- Potential for lifelong income. If you select the proper provisions upon annuity or payout phase, an annuity can provide a lifelong stream of income.
- Investment flexibility (for variable annuities).

Disadvantages of Annuities

No capital gains tax advantage. When withdrawals are made, the earnings are treated as ordinary income for tax purposes, without preferential treatment for capital gains. For those in a higher tax bracket, tax costs can be significant.

No residual estate. If the annuitant dies after the distribution phase has started, no residual payments will be made to his or her estate, regardless of the value of the account. Some annuity options provide continuing income to survivors.

Penalty for early withdrawal. If withdrawals are made before age 59½, the earnings portion of the withdrawal is subject to a 10% additional tax. (premature distribution penalty). The penalty may not be incurred in the case of death, disability, certain medical expenses, or periodic payments that continue at least 5 years or until age 59½.

Expenses. Annuities often come with a hefty price tag. A person considering an annuity for retirement should compare the cost and advantages against other options available such as IRAs, retirement benefits offered by employers, and ordinary mutual fund accounts.

When the beneficiary begins receiving distributions from the annuity, he or she will have to pay income taxes on any growth in the annuity that has occurred since it was purchased. This is also true for most tax-qualified plans. In most non-tax-qualified accounts, the cost basis is "stepped up" to the market value at the time of the owner's death. This means the beneficiary will only have to pay taxes on any appreciation that occurs after the owner's death.

Many of the features described above are discussed in the prospectus.

Cancellation

As long as the owner is alive, he or she has the option to cancel the annuity contract at any time before the annuity period. This is the beginning of the distribution phase.

The issuer may impose a termination penalty. Upon cancellation, the assets of the annuity, minus any penalties, will be returned to the owner.

Exchange

The owner also has the option to exchange the original annuity for another annuity at a different issuing company. This type of exchange is known as a 1035 exchange.

Withdrawals

Withdrawals can be made from an annuity during the accumulation period. Annuity contracts generally allow withdrawals of 10% to 20% of the assets yearly. Withdrawals may be subject to a withdrawal charge, depending on how long the assets have been in the annuity.

Since withdrawals are made on a last in/first out basis for income tax purposes, the first amounts withdrawn are usually earnings on which taxes and IRS penalties (for withdrawals before age 59½) are due. Withdrawals may be treated as a reduction of assets or as a loan requiring repayment and interest.

Details on the use of this option may vary from one annuity contract to another. See the annuity's prospectus for details on cancellations, distributions, and loans.

Selecting an Annuity

There are certain things that should be considered when selecting an annuity.

Cost

There can be a large variation in costs among annuities. Variable annuities generally have fees for both the insurance company (issuer) and the investment companies that manage the separate accounts.

Note: Average annual expense rates on annuities vary from year to year.

Investment Choices

The variety of investment choices and the quality of the investment options available in variable annuities should be examined.

Miscellaneous Features

An investor considering annuities should also look at the features that are offered. Are they suitable for the investor's needs? Are they offered by other annuities with comparable costs and investment choices? To find out about these factors for the annuity you are considering, check the prospectus or contact a financial advisor.

Minimum Amount

Most annuities have a minimum initial investment and a minimum amount for each subsequent investment. Check with the annuity company or the prospectus to confirm the required amount.

Appropriate or Inappropriate

There are many factors that should be considered in determining whether an annuity is appropriate for a given individual. Most of the financial world agrees that an annuity should not be considered as an option unless the person is already investing the maximum allowable amount in all other available tax-advantaged sources (for example, IRAs and retirement plans offered through employers). The costs of these programs are generally lower than the costs of annuities.

A good advisor may be the best person to help an investor make the decision about whether an annuity is actually appropriate.

PLAN. SMART.

Most people spend their working lives looking forward to retirement. But how many look forward and plan just what type of retirement will suit them best? Some things to consider when you look toward your retirement are the obvious: Will I have enough money to retire? Can I live on a budget? And the not so obvious: Can I really afford to retire? Secure retirement, if you want it; plan for it.

CONCLUSION

There are many factors that should be considered in determining which type of retirement account or annuity is appropriate for you.

Savings for retirement is an important goal, and there are many different options available to help you accomplish it. Time is the most important factor when saving for retirement.

A small monthly amount invested over a long period of time has a greater potential for growth than a large amount invested for a short period of time. Simply put, the time to start saving for your retirement is now.