The Sheridan Road Map

The Best Route to Financial Success

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Price Check

The Good News Is, Congress is Beginning to Look at 401(k) Fees.

Unfortunately, that also happens to be the bad news.

The Department of Labor has several initiatives currently under way, the Government Accountability Office (GAO) has called for more transparency, and a number of lawsuits have been filed alleging all sorts of fiduciary malfeasance on the subject (a complaint filed against Cigna last week seemed to suggest that having investment management fees netted against the returns in a mutual fund was some kind of conspiracy - see CIGNA Latest Target of 401(k) Fee Suit). In view of all that activity, last week's hearing before the House Education and Labor Committee was relatively sanguine (see Congressional Committee Hears 401(k) Fee Disclosure Testimony).

Not that there weren't points of contention and even a couple of moments of tension between those offering testimony. However, everyone agrees that we need to provide participants and plan sponsors with better information about the fees assessed against their retirement plan balances.

Comparison Points

Speaking on behalf of the American Benefits Council last week, Robert Chambers presented an intriguing analogy, noting that an automaker like Toyota no longer made cars—they assembled them, outsourcing the preparation of the various components. Consumers don't know—or particularly care—what Toyota paid the individual subcontractors. While it was a compelling image, the analogy falls apart in two key aspects. First, most of us buy our own vehicles, and not from a menu selected by our employer. Second, when I go to buy a car, I may not know how much the manufacturer paid its subcontractors—but I do know how much I am expected to pay for that car.

Participants, and some plan sponsors, have been lulled into a false sense of security about the fees they pay for these accounts. I don't know how many actually believe these accounts are free, but many would be amazed at how much they are paying each year (that doesn't mean those fees aren't necessarily unreasonable).

"Under" Currents

You can hear that same concern just below the surface of comments made by the defenders of the status quo—in between phrases about how "fragile" our current system is, and that participants might be so put-off by those revelations that they will eschew participation altogether. The implication is clear, even to those who aren't yet convinced there is a problem: If people actually knew how much they were being charged….

There are a couple concerns about how that information will be constructed and shared. First, the mandated structure will be prohibitively difficult or costly to produce. Second, the complexity of the information and/or mandate will render a meaningful disclosure impossible. Still a growing number are confident enough in the value provided to do the right thing, to place a visible price tag on those services. After all, if you don't know how much you're paying—it's hard to appreciate how much it's worth!

Nevin E. Adams, March 10, 2007

THE MILLION-DOLLAR KID

Where You Fall on the Kid-Spending Spectrum.

The government says families in the top-third income bracket will spend $279,450 to raise a child born in 2005 through age 17. The government clearly hasn't been to some kids' birthday parties lately.

In San Diego, Jacqueline Jones celebrated her fifth year with a $1,000 mermaid-theme party. Jacqueline's mom says it's worth it. "A lot of my friends said I'm crazy, but I mean, it's a memory she'll have forever."

With the debate about the country's wealth gap heating up again, pampered kids provide some of the most dramatic examples. But for many families, drawing the line between attentive parenting and extravagance is a tough call; even parents who are relatively strapped will go to great lengths for their children. And though millions can't afford the government's child-cost estimate, many others are spending far more.

To assess how relatively routine expenses, as well as more excessive ones, can contribute to the total cost of raising a child, The Wall Street Journal recalculated it using a different range of costs.

Escalating kid spending is more rampant among wealthier households, so we used the government's top-third income bracket as a starting point. We also added some costs that aren't included in that government calculation, such as college-savings plans.

We placed all these expenses on a spectrum. At the lowest end, our estimates came in at about $800,000 (in 2007 dollars) through the age of 17. Add in extras like private school, and a nanny and that figure can climbs to $1.6 million.

Some of the costs add up quickly. For parents whose kids are passionate athletes, for instance, baseball equipment costs about $3,000 from the age of 10 to 17 — take it one step further and add $12,500 annually for a travel league.

The biggest and most common driver is education. One in 10 children now goes to private or parochial school. Even a modest tuition at a parochial school of $6,000 a year would add $60,000 to the government's total figure of $36,000 for education and child care.

In many homes, a central issue is how to provide every advantage without overscheduling and spoiling. Irene Smith in San Jose, Calif., has mentally established parameters for her 7-year-old daughter, Amelia: only two classes a week. But Ms. Smith decided the most important thing for Amelia's future success is fluency in Spanish. She transferred Amelia to a $13,500-a-year private academy where Spanish is taught daily. She signed her up for a $900 weekly class with Berlitz, hired a private tutor, and has taken Amelia out of school to travel to Costa Rica and Mexico to perfect her foreign-language skills.

On days when she doesn't have Spanish, Amelia studies the piano, attends a computer class to learn the Web-design and podcasting, and has a weekly play date. (She also goes to Brownies once a month.) Ms. Smith acknowledges that she has broken her own guidelines but believes Amelia isn't as burned out as some of her friends.

Analysts who study consumer goods, such as Michael Silverstein of Boston Consulting Group, say DIOKs — double-income, one-kid families — are having their singlets at a later age when the parents can better afford to spend and spoil. It is often older parents who feel the most guilty about the world they are bequeathing their kids, from the war in Iraq and global warming to Britney Spears and Paris Hilton.

Parents with more than one kid then face the fiscal phenomenon of upgrading, where baby No. 1 starts with a standard stroller, the middle gets an upgrade to a $300 MacLaren and, No. 3 gets an $879 model by Bugaboo.

We found upgrades in other areas, too. The cost of a family vacation, for example. A one-week domestic trip totals about $1,830, according to AAA. But take your kids to Disney World, and that figure jumps to at least $5,000 — double that for a trip to Europe.

Behind some upgrades is parents' increasingly broad view of what constitutes an educational expense. School itself is just the beginning. It might mean paying $16,500 in annual property taxes in an area with top public schools, or springing for private-school tuition that can be twice that. Then there are costs that are directly in support of education, like SAT prep and tutoring. More parents now see everything from trips to volunteering in developing countries to art-appreciation classes as falling under the category of education.

Despite parents' willingness to spend with abandon to provide character-building experiences, educators and therapists say the practice can backfire. Principals in wealthy communities say children are in so many classes, they don't know how to work things out on their own. They also own so much stuff, the school lost-and-found is overflowing. "In the end, they'll be fine," says Gail Lynn Main, the principal of Lafayette Elementary, a public school in an affluent Washington, D.C., neighborhood. "But they're not as independent. They don't do chores at home.

Eileen Daspin and Ellen Gamerman - Wall Street Journal, March 3, 2007

A New Trick For Avoiding Estate Taxes

By Ron Lieber

Last summer, President Bush signed a bill that made earnings in certain college-savings accounts permanently free of federal taxes, as long as the money is used for tuition, room, board or other allowed expenses. This was great news for parents, since the tax break was scheduled to go away at the end of 2010.

Now, these "529" accounts look like an even better deal for grandparents and others looking to minimize inheritance taxes.

"A lot of what goes on in estate planning is trying to give clients as much control as possible without keeping something included in their estate," where it could be subject to taxes, says Stephen C. Hartnett of the American Academy of Estate Planning Attorneys.

The lure with so-called 529 accounts is that they accomplish this goal simply and cheaply: Account owners can move huge piles of money out of their estates without paying taxes, while still controlling the money.

How is this possible? Start with the 529 plans themselves. Those in play among estate planners are the state-run ones that allow you to invest money in an account where you choose among a handful of mutual funds.

Then, consider the rules on gifts. Normally, you can't give away more than $12,000 each year to any individual without creating a potential tax hit for yourself farther out. With 529s, however, you can give multiple individuals $60,000 each in a single year.

By doing that, however, you use up five years of $12,000 exemptions at once. That does leave you more vulnerable to taxes if you give another gift to that same person during that time period.

Now, take a grandma and grandpa with, say, four grandchildren and lots of money. They could each give $60,000 to every grandchild.

Once they do, that $480,000 is out of their estates and not subject to estate taxes. (Deathbed contributions may cause problems; if they die within five years of the big 529 dump, some money could get counted toward taxes).

Worried about wayward grandchildren? Disowning them turns out to be relatively easy. Account owners are free to change a 529 account's beneficiary, bequeathing the funds to a more favored relative (say one with designs on medical school).

You can also change the beneficiary's name to your own and use the money for classes at the local university. Or take it out to just pay for a nursing home or a boat, though you'll have to pay taxes on the gains plus a 10% penalty.

There's additional fancy footwork that one could also try here, in theory. For instance, you could change the beneficiary a few times, on purpose, to push money down through the generations in a way that avoids certain gift, estate or additional generation-skipping taxes. Don't try this at home without an experienced professional standing by.

The loophole-seeking that 529s have inspired in the estate-planning community has likely drawn the attention of Treasury Department officials seeking to close them, according to savingforcollege.com proprietor Joseph Hurley. If enough people pile money in, some of the rules could change.

Meantime, don't let fear of future changes keep you from taking basic steps to avoid the tax man — and retain the ability to take your money back from misbehaving heirs.

529 Accounts — An Even Better Deal for Grandparents

- 529s allow you to move large amounts of money out of your estate without paying taxes.
- You can give multiple individuals up to $60,000 each in a single year.
- Normally you can only give up to $12,000 as a tax-free gift to an individual.
- By putting the maximum amount in a 529 account in one year, you use up 5 years of $12,000 gifts.
- You still have control of the money and can change the beneficiary's name.
- If you decide to use the money for non-educational purposes, you have to pay tax on the gains plus a 10% penalty.

Wall Street Journal - February24, 2007

Borrowing From 401(k) Can Be Easy, But Costly

By Carolyn Bigda

Your 401(k) or 403(b) savings are meant for retirement but you could borrow from it for short-term needs. The main question is whether you should.

The Pros

- The loans are convenient.
- There's no credit check. To apply, you often just submit a form online, and the funds are distributed within a week.
- Although you can borrow up to only 50 percent of your account balance, or $50,000, within a 12-month period, there's typically no restriction on how you use the funds.

The Cons

- By depleting your 401(k) temporarily, you might miss out on a period when that money earns hefty returns.
- Your 401(k) is for your retirement. And, given pessimism about the future of Social Security and Medicare, it seems like one of the few resources that today's twentysomethings are going to have in old age.
- Though companies make it easy to borrow the cash, the repayment terms can be less accommodating. You generally have five years to repay the loan (or up to 15 years if the loan is used to purchase a home).
- Quit your job and, in most cases, you have only 60 days to pay off the remaining balance.
- If you can't cover the balance and you're younger than age 591/2, the loan is considered an early withdrawal. As a result, you will owe federal and state income taxes, plus a 10 percent penalty to Uncle Sam. All told, the final tax bill is often some 40 percent of the balance.

Chicago Tribune, March 18, 2007

$1,200,000

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The Best Route to Financial Success

March 1, 2007

McDermott Will & Emery is on our Roadmap!

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Our Firm has 70 years of experience serving a broad range of client interests. We understand the issues faced by corporate decision makers because many of our lawyers have held key government and in-house positions. We understand how economic, social and political issues affect operations because our lawyers have navigated the complex business and regulatory environment themselves.

Outstanding client service is a cornerstone of our practice that has withstood the test of time. We are proud of the recognition we have received from our clients, and we value their satisfaction as the best measure of our success.

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