INTEGRIS
WEALTH MANAGEMENT

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A Better Financial Legacy

June 2009

While this piece by Giff was published in the Monterey Herald 10 years ago, it is a timeless subject which we revisit frequently in client conversations.

When my daughter got her first job, she was just 15. It was a temporary job as a basketball referee for the local YMCA. I was very pleased with this first foray toward independence and proud of her dedication to doing her job well. Before she got her first paycheck, I made a deal with her that will in all probability, provide her with a million dollars, tax-free, when she reaches age 65 -- if she follows through. More on that in a moment.

I have always tried to get my children into the habit of investing some portion of their income. When their only source of income was an allowance, I encouraged them to trade off current consumption in favor of long-term savings. At one time we had the following arrangement regarding their allowance.

- Option 1 - They could pay a 15% “income tax”. After all, income taxes are part of the real world, and they might as well learn early. Since I was the provider of “governmental services” such as public safety, health, and education, the tax was paid to me. There was no withholding as I wanted them to physically hand over the money so that the tax would be more tangible to them.

- Option 2 – Instead of paying a 15% tax, they could invest twice as much as the tax, or 30% of their income, into their “401(k)”. If they did so, I would provide a 100% “employer match”, similar to the match employers make on their employees’ contributions to the company 401(k) plan.

My wife thought this was all a little over the top, but she went along.

Some of you are thinking, “keeping 85% of my income or keeping 70%, but getting 60% placed into savings, is hardly a difficult choice”. And you are right. But kids, as well as many adults, have a very hard time trading off immediate gratification for delayed gratification. I wanted to get my children into the habit of always saving some portion of their income, and so I provided them with an obvious decision.

As parents, we try to instill in our children the skills and character attributes that will allow them to make their way into society successfully. Helping your kids learn to defer gratification is one of them.

So when my daughter was told she had been hired, she was very excited about getting all this extra spending money. I wanted to intervene quickly before she got into the habit of spending every penny she makes. So I sat her down and explained she had a great new savings opportunity now that she had “earned income”. I explained that the government allows people who earn money by working to invest up to $2,000 per year in something called a Roth IRA (the law now allows $5,000 per year). I told her what was especially cool about a Roth is that the money grows tax-free.

As you can imagine, so far this discussion was not resonating with her. Her response was basically “Daddy, I am only 15! Why do I want to save for retirement?” I can also imagine that “tax-free” to someone who had never paid taxes is a near meaningless concept. So to get her focused, I explained if she saves just $2,000 a year, for just 5 years, that her $10,000 total investment could be worth over $1,000,000 when she retires! (Assuming a 10% average annual return)

Now I have a very focused kid on my hands! A million dollars to a 15 year old is a nearly infinite sum. She can hardly wait to get started. Now that I had her attention, I told my daughter I would help her. Since her job will barely pay her $2,000, I told her she should take one half of the earnings from her job, up to $1,000, and put that into a Roth IRA. The other half she can spend as she pleases. For every dollar she saves, I will match her, up to another $1,000. She gets to enjoy some of her earned income now, but she is also making a substantial deferral toward her future.

I was really hoping she would learn to always defer some of her income for the future - that she makes this a lifetime habit. Rather than leaving your children a pile of money when you die, a better financial legacy would be to give your children the encouragement and skills to create their own financial independence.

POSTSCRIPT – This same daughter has just graduated from law school. Every year since her first job she has had earned income and therefore qualified to make contributions to her Roth IRA, which she did. She did not just put money in for 5 years and then stop. She has put money in every year for 10 years. And she did this even though she was taking on student loans to pay for law school. I think my plan was successful.

Maybe you know of a young person - your child, your grandchild, a niece or nephew – who you could help to create a better financial legacy.

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