Secure Your Future: Educate Your Kids and Grandkids

"Dripping water can pierce a stone."

-- Chinese Proverb

By Justin Ford

I'd like to show you how, starting today, you can get your children to apply a little effort over time in a crucial area of life that is usually neglected when it comes to kids. I'm talking about money and your kids can become financially free shortly after they finish college.

"The secret to success," a former employer once told me, "is applied effort over time." I had heard different versions of that idea before, but this time it stuck. Perhaps it was because the man who said it had built a $100-million business from scratch, yet still seemed to enjoy his work almost like a kid at play.

By beginning a hands-on program today, not only can your kids or grandkids grow wealthier year after year, they can do it without giving up the dreams they most want to pursue. They'll have the luxury to choose careers that match their interests, values, energy and talents like kids at play, rather than simply working for a paycheck.

And it doesn't matter if your children are interested in becoming CEOs or not. Even if they have no interest in business… if they're aspiring firemen, nurses, doctors, schoolteachers, pilots or social workers… you can still see to it that they grow up to achieve significant wealth by the time they begin to raise families of their own.

What's more, they'll have done it themselves—but with your guidance. That's because I'm not talking about a trust-fund program or raising your children with silver spoons. I'm talking about a natural way to *train* your children in matters of money and actually getting them to begin *practicing* good money habits from a very early age.

About Justin Ford

Justin has been a very successful investment editor and writer, with a knack for finding great yields. He also developed *Seeds of Wealth*, an educational program for parents to teach their children about the value of saving.

He taught his own children the plan you'll learn in this chapter and it wasn't long before his children had more money than Justin had had well into his working years.

By beginning to consistently apply a little effort now in matters of money, their chances for success in this one, important, practical aspect of life will be dramatically increased.

At the very least, they should avoid the stress associated with out-of-control consumerism and crushing loads of debt. But it's likely the rewards will be far greater. By beginning to master and practice the right money habits from an early age, they should consistently grow wealthier as they grow older throughout their entire lives.

The way it *should* be.

Developing Concrete Habits

Talk to most adults about balance sheets, profit-and-loss statements, cash flow, leverage and return on equity, and their eyes will glaze over. Talk to most kids about these matters, and you'll lose them even sooner.

What's more, at its core, building wealth is *not* about understanding these financial concepts. It's about mastering a few fundamental habits that create wealth over time.

After all, there are MBAs and bank presidents who have gone broke. They knew better; they just didn't *do* better. There are accountants and stockbrokers who live from paycheck to paycheck. Their struggles probably aren't due to a lack of knowledge; it's more likely because they never mastered the right *personal habits* of consistently building wealth instead of debt.

There are many examples of the importance of habits over complicated knowledge in other pivotal areas of life as well. There are MDs who chain smoke, have high blood pressure and are overweight. Their abundant knowledge about health doesn't make them healthy. Only eating right, exercising regularly and keeping vices in check can help you do that.

There are counselors and ministers who will tell you they don't spend enough time with their families. Their degrees can't ensure they will build and maintain the relationships they want. Investing time in the people you care about is the necessary first step to achieve that.

So it is with money. It may not be the most important thing in life, but it is a necessary part of life. And you will be doing your children and grandchildren a great service by helping them acquire good money habits from an early age, and even begin to build wealth consistently, every month and every year from now on. And you'll do it with an emphasis on *doing* over simply "knowing how."

In this way, their knowledge about financial responsibility, money and investments can grow *naturally*—in lock step with their experience and their steadily compounding wealth. As a significant bonus, in the process of building that wealth, they will have to exercise virtues that are very useful in other areas of life as well: discipline, patience and foresight.

And the rewards will also be more than money. They'll have earned a significant sense of achievement. They'll understand what can be accomplished when consistently applying a little "effort over time," and they'll likely be more confident in all their financial dealings—whether buying their first home or car, negotiating a salary or fee, or not falling for the "quick-money" pitch of a fast-talking salesman.

So let's get to it and begin helping your children master these habits and plant the seeds of their future wealth right now. You can start by asking them a very simple question…

How Would You Like an Increase in Your Allowance… Say Between $4,000 and $18,000 a Month?

"Kids, how would you like an increase in your allowance? I'm thinking to maybe $4,000 or even $18,000 a month… How would that strike you?"

Try that at the dinner table. It's a guaranteed attention-getter.

The reactions will range from surprise to excitement to humor to skepticism. A general commotion may ensue. Simply repeat the offer because you're making it in all seriousness.

> "I'm going to show you how you can collect that $4,000 allowance every month. And that's just for starters. From there it could rise to tens of thousands of dollars every month."
>
> "In fact, I'm going to do more than show you, I'm going to actually help you get that allowance, starting today. You ready?"
>
> "First, I'm going to give each of you two dollars. It's my gift to you. And it's a small gift. But it's also the beginning of a great amount of wealth that you yourselves are going to create as you grow up. Sound good?"

By the time Warren Buffett graduated from high school, he had made enough money investing to buy a 40-acre farm!

> "Okay, here's how it works. One of the two dollars I'm giving to you now, you can spend however you please – on candy, Magic cards, combining it with some other money you have to buy something else… whatever you want."
>
> "The other dollar you're going to save – permanently. That means you're not going to spend it for any reason whatsoever for at least 30 years, maybe longer.

So far, so good?"

"Now every other dollar you receive from now on – whether it be for allowance, a birthday present, Christmas present, chore money, or money you find in the street – you're also going to save half permanently and spend half however you like."

"You keep doing this, and I'll help you, and in a few months you should have a hundred or maybe even a few hundred dollars in your permanent savings. At that point, we'll count it out together and I'll invest it for you."

"By 'invest' I mean, I'm going to buy a piece of a company, or companies, for you. You're going to own small pieces of businesses. What do you think of that?"

You'll find the exact words to best express these ideas to your children. But this dialogue should give you the general idea. They'll begin to understand exactly how you're going to help them create this wealth, once you introduce a very simple, yet very effective savings technique I call…

The RemarkableTwo-Box System™ For Installing Good Money Habits

The moment you first introduce the idea of saving and investing to your children, you're going to help make that idea a reality by doing two things. First, you'll give them two dollars so they can make their first allocation among spending money and savings. Second, you'll make sure they have two distinct boxes (or other receptacles) to put their money in.

These can be cardboard boxes, colored and designed by your child. They can be desk safes or piggy banks. One will be for their spending money (which is the same as "temporary savings"). The other will be for their permanent savings.

And that's really all they need to *begin* to build wealth and develop good money habits right away.

***"The child is father of the man."* – William Wordsworth**

You'll explain how these two types of savings are to be used with an example – to make sure they understand the importance of always saving and investing before spending. To do that, you might say something along the following lines:

"One of these boxes is labeled 'permanent savings' and the other is labeled 'temporary savings.' They're both going to go on your dressers. Every time you get a buck, two bucks, twenty bucks or a hundred bucks, half goes into the permanent and half goes into the temporary.

> "I've just given you two dollars, so what's going to happen with those two?
>
> "Right, one will go into the temporary savings and one will go into the permanent. From that permanent savings box you're going to grow a few dollars into a small fortune – or maybe even a big fortune – by the time you're around my age or a little older.
>
> "The temporary savings you can spend whenever you want on whatever you want."

Now, it's time for an example to make sure they truly understand what you mean by "permanent savings."

> "Let's say you get $20 from grandma, what do you do with it? Right, you put $10 in the permanent savings and $10 in the temporary savings.
>
> "Now, what happens if you want to buy a new skateboard? Can you ever use money from your permanent savings to buy it?
>
> "The answer is 'no.' You can buy the skateboard, but to do that, you'll have to get the money together from the temporary savings. The easiest way to do that is to set up a separate box for the skateboard. We'll call it the "Skateboard Fund" – and it's only to be funded from your temporary savings – *never* from the permanent.
>
> "The permanent savings are never to be <u>spent</u> for any reason – at least until you're about my age. They're only to be invested so they can grow into a lot more money as you grow up.
>
> "For instance, let's say the skateboard you want costs $80. You just got $20 from grandma so you put half, or $10, in the permanent savings. The other half, instead of spending it or putting it in the temporary savings box, you put in the new box for the skateboard – "the skateboard fund."
>
> "About a month later, you get $100 over the holidays. Of this $100, you've got to put $50 into permanent savings. The other $50 you can spend, put it in your temporary savings or in the skateboard fund.
>
> "You spend $10 on candy and comic books, and add $40 to your 'skateboard fund.' Since you had $10 in there previously, you now have $50 saved for the skateboard so far. You need just $30 more.
>
> "A few weeks pass by and you get $30 in birthday checks. That's the $30 you needed for the skateboard – but not so fast! Again, you have to put $15 of that in the permanent savings. Of the rest, you spend $10 on the movies and popcorn, and you add $5 to your skateboard fund. You've now got $55 put away towards the skateboard.

“Now you get another $60, this time from selling lemonade, washing cars, and doing chores around the house. $30 goes into permanent savings. You spend $5 on Magic cards… and add $25 to the skateboard fund. You now have $80 for the skateboard. That means you can buy it, *except…*

“You need $5 more for sales tax!

“You pick up $20 in allowance over the next couple of months, you put $10 in permanent savings, you spend $5 on candy and $5 goes in the skateboard fund. This gives you a total of $85 in the fund, and that’s enough to cover the skateboard and tax!

HOW TO BUY A SKATEBOARD AND GROW RICH AT THE SAME TIME							
Income	Source	Add to Perm. Savings	Spend from Temp. Savings	Add to Skate-board Fund		Balance in Skateboard Fund	Balance in Perm. Savings
$20	Grandma	$10	$0	$10	→	$10	$10
$100	Holiday	$50	$10	$40	→	$50	$60
$60	Chores	$30	$5	$25	→	$75	$90
$30	Birthday	$15	$10	$5	→	$80	$105
$20	Allowance	$10	$5	$5	→	$85	$115
*Temporary savings is for spending money. The skateboard fund is an example of a special savings box – funded strictly from temporary savings/spending – that does not interfere with permanent savings.							

“Now you can go ahead and buy the skateboard – it’s all yours! You deserve it because while you’ve put the money together for this purchase, you’ve also added $115 to your permanent savings (equal to the $85 you put in the skateboard fund plus the $30 you spent on candy, comics, movies, popcorn and Magic cards).

“Now, why go to all this trouble?

“Because, by doing this, you get your skateboard and you get to buy some other small fun things as well – the candy, etc. But the $115 you invest at the same time could multiply dozens of times by the time you finish college.

“The ‘permanent savings,’ in other words, is the part that’s going to pay you a big allowance every month when you grow up, long after you’ve retired the skateboard!”

Why Half Is Good

Now, in case you think you're asking a lot of your children by having them save half of every dollar they receive, let me ask you this: when was the last time you could spend 50% of every dollar *you* made on whatever you want?

For most people, the answer is "never."

By the time you're done paying the mortgage, food, clothing, income and property taxes, utilities, car payments, medical and dental bills, current education expenses for the kids, health insurance, homeowners' insurance, gas, auto repairs, and home maintenance—and fund your retirement plan and the kids' college funds—you're lucky if you have more than 10% of your income left to spend as you please.

And yet, children don't have any of these bills. In effect, they have 100% disposable income. They don't have to pay rent or alimony, the government doesn't tax their allowance or household chore money (up to the $11,000 gift tax exclusion), and they can even earn up to $4,700 a year from a "real job" tax-free (since the effective tax rate on the first $4,700 of earned income is zero).

And keep in mind that if you don't train your children to build wealth now, while they have 100% disposable income, they may learn the opposite lesson: to automatically spend all they earn or even more than they earn as adults.

Whistling While She Works

When I first started my *Seeds of Wealth Program* a few years ago, I received a flurry of orders one day and called the post office to come pick them up. The mailman was a mail-woman, in her early '40s. She had sun on her cheeks and a very upbeat energy about her.

As she began to toss the more the more than 100 packages into the back of the truck (yes, toss!), she asked me what was in them. I gave her the reply I give most people—where I try to epitomize the purpose and nature of *Seeds of Wealth.*

"It's a parent-directed savings, investment and financial education program for children," I said. "But it doesn't only teach them good money habits, it gets them to start practicing good money habits. That way, by the time they're young adults they'll have a half-million to a million dollars or working for them, no matter what they do for a living."

Without missing a beat, she said, "I have a half-million dollars. My dad did this kind of thing for me when I was young. Every dime I got a nickel, dime or a quarter—from the Tooth Fairy, you name it—he made me save some and we invested it. He was a real Buffett-type value investor."

"Today, I have investments worth over a quarter of a million dollars. And I own my house outright, and that's worth over a quarter of a million dollars. And to this day, I love him for it!"

This woman seemed to be doing exactly what she wanted to do for a living. She wasn't an office type, wasn't ambitious in the career sense. I imagine she'd suffocate in an office environment. It seemed she loved to be outdoors and liked people.

As far as pay goes, she didn't have the best job in the world. What does a postal worker make at her age—low '40s? And yet she had accumulated a significant amount of wealth just because her dad got her to start young.

That was nearly four years ago. I recently spoke to this woman again. Her dad has since passed and he left her a considerable amount of money—even though he never had a high-paying job in his life either. Her own investments have continued to do well.

Today, she drives a brand-new Lexus and now has a net worth in the seven figures. And she still works at the post office because she has a lot of good friends and just plain likes her job, whistling while she works.

Preventative Medicine for the “Gimmes”

From my own experience, I can tell you the Two Box System is not a great sacrifice for kids. On the contrary, the habits this simple technique helps instill should help your children enjoy what they do have all the more without becoming spoiled, or contracting what I call the dreaded “Gimme Disease.”

My youngest, for instance, just turned nine, but ever since he was five, he’s known exactly how much of each dollar he gets he must put into the “permanent savings” box on his dresser and how much goes into his “temporary savings” box.

He counts out the permanent savings with me twice a year and I invest it for him. The temporary savings he can spend all or part of on whatever he pleases whenever he wants. We’ve counted out hundreds of dollars from his permanent savings box in the last year alone. And that means he’s also had a few hundred dollars to spend. So it’s really no sacrifice at all.

After all, what could a nine-year old gain by spending a few hundred extra dollars? He’s truly a happy kid. I couldn’t imagine he’d be any happier if we simply decided to let him spend all of his money. In fact, he’s developing habits now where he wouldn’t *dream* of spending all of his money!

And the same goes with my 11-year-old. When he won $50 and a pen for first prize in an essay contest, he kept the pen and immediately divided the money among the two boxes—just as he’s been doing for years. He splits his allowance and household chore money the same way.

As for my oldest, he’s 14 so he no longer receives an allowance. Yet every two weeks he mows our lawn and his aunt’s lawn. He automatically puts half his yard-work earnings into his permanent savings and spends the other half as he pleases. He does the same with money he receives from birthday or Christmas presents and he’ll do the same with money he’ll earn when he takes his first part-time job.

These habits are now second-nature to all three of my boys. They have better money habits than I did just ten years ago…And that was the whole point! It’s as if the wealth they’re steadily accumulating is just a bonus—*But what a bonus!*

Six Super Savings Ratios

The 50% savings rate applies, of course, only to children five and older while they live at home and have no real living expenses. For other stages in their life, I recommend other savings rates.

Here are my six recommended savings rates for various stages of life. I call them the Seeds of Wealth Saving Ratios, and I believe they form a combination that can assure your children enjoy lifelong financial success:

100
50
10
15
15
10

Here's what these numbers mean:

Tycoon Tots: 100%. Until the time your kids are ready for kindergarten, you're likely to automatically save 100% of every dollar they receive, simply because they're too young to want or need to spend money.

Wonder Years: 50%. From the ages of 5 through 17, while they're living at home, I suggest you have them save half of every dollar they receive, for reasons already explained.

College Days: 10%. In college, I suggest you counsel your kids to save 10%. Money is extremely tight at this time, but by at least saving 10% of whatever they scrape together, they learn that there is never a reason to make an excuse not to save.

Single Working Adult: 15%. Once a child has graduated and is on his or her own in the working world, I advise they save 15% of current income. While this may seem high compared to most young adults who tend to consume all of what they earn, it shouldn't be a burden for your kids.

After savings 50% at home during childhood and seeing how saving and investing can create significant wealth over time, this 15% mark should now be a piece of cake. Also, in my opinion, when you're in your twenties you don't need to spend a lot of money to have a very rewarding life. It's when young adults begin to have children and mortgages and broader health and education expenses, that money becomes a more pressing concern.

Just Married: 15%. When your children first marry, it still shouldn't be a burden to save 15%. In fact, it may be even easier since they may find themselves with two incomes in the house—helping them to create more investment capital more quickly.

Married, with Children: 10%. When your kids begin to raise their own families, at that point they will be able to easily shift to what was for a long time the traditional savings rate of 10%. But also by that time your kids will have built up a significant amount of wealth that will compound for them along with their 10% savings year after year.

Making the Seeds Grow

OK. You've got your children to begin planting the seeds of their future wealth. Now, let's see what happens when you make those seeds grow…

In my 300+ page Seeds of Wealth program (available at www.seedsofwealth.com/van), I address investment techniques for children's portfolios in detail. The emphasis is on quality, value and risk control. In this book, *Safe Strategies for Financial Freedom*, you also have excellent advice on identifying quality and value. And you've been given detailed strategies for reducing risk while targeting high returns.

Let's see what happens when you combine the Seeds of Wealth saving ratios with investment returns ranging from 10% to 20%, over the long run:

Note that by the age of 30—when most young adults are only just beginning to build wealth—your children could own investments worth somewhere in the range of a quarter million dollars to a million dollars   And the income figures in the table are modest.[1]

Another way to look at it is to see that if your child averages just 10% returns (about the total returns of the broad market during the entire 20th century, including all bull and bear markets), he would accumulate approximately $500,000 by the age of 36.

At that point, 10% returns would generate $50,000 in gains a year… or about $4,167 a month.

There's the $4,000 monthly allowance you promised!

And if you use the strategies outlined in this book to realize higher returns, they can achieve that allowance even sooner. At 15% returns, you child could amass roughly $350,000 by the age of 28. From that point, the same 15% returns that would generate over $52,500 a year, or over $4,300 a month.

Finally, if you achieve high-watermark returns of 20% over the long term, your child accumulates assets worth over $274,000 by the age of 23. From that point, 20% returns then generate approximately $54,800 a year or more than $4,500 a month.

Quite a monthly allowance he'll be paying himself shortly after graduating from college!

And, of course, he could always give himself a bigger "allowance" if he allows his nest egg to grow a little longer before tapping it. For instance, let's say he's using the strategies in this book to achieve 15% returns and he decides to wait until the ripe old age of 30 to begin paying himself an allowance. In that case, he would start to pay himself 15% of roughly $487,000 (the amount accumulated at 30). That's equivalent to approximately $73,000 a year or more than $6,000 a month!

From Tots to Tycoons

				Compounded Annual Returns		
				10%	15%	20%
Age	Income	Savings in %	Savings in $	Wealth Accumulated	Wealth Accumulated	Wealth Accumulated
1	$730	100%	$730	$803	$840	$876
2	$730	100%	$730	$1,686	$1,805	$1,927
3	$730	100%	$730	$2,658	$2,915	$3,189
4	$730	100%	$730	$3,727	$4,192	$4,702
5	$730	50%	$365	$4,501	$5,240	$6,081
6	$730	50%	$365	$5,352	$6,446	$7,735
7	$730	50%	$365	$6,289	$7,833	$9,720
8	$730	50%	$365	$7,320	$9,428	$12,102
9	$730	50%	$365	$8,453	$11,262	$14,960
10	$730	50%	$365	$9,700	$13,371	$18,391
11	$730	50%	$365	$11,071	$15,796	$22,507
12	$730	50%	$365	$12,580	$18,585	$27,446
13	$1,300	50%	$650	$14,553	$22,120	$33,715
14	$1,300	50%	$650	$16,723	$26,186	$41,238
15	$5,200	50%	$2,600	$21,256	$33,104	$52,606
16	$5,200	50%	$2,600	$26,241	$41,059	$66,247
17	$5,200	50%	$2,600	$31,725	$50,208	$82,616
18	$7,800	10%	$780	$35,756	$58,636	$100,076
19	$7,800	10%	$780	$40,190	$68,329	$121,027
20	$7,800	10%	$780	$45,067	$79,475	$146,168
21	$7,800	10%	$780	$50,431	$92,294	$176,338
22	$50,838	15%	$7,626	$63,863	$114,907	$220,756
23	$50,838	15%	$7,626	$78,637	$140,913	$274,058
24	$50,838	15%	$7,626	$94,889	$170,819	$338,020
25	$59,510	15%	$8,926	$114,197	$206,707	$416,336
26	$59,510	15%	$8,926	$135,436	$247,979	$510,315
27	$59,510	15%	$8,926	$158,798	$295,441	$623,090
28	$59,510	15%	$8,926	$184,497	$350,023	$758,420
29	$59,510	15%	$8,926	$212,766	$412,792	$920,815
30	$71,620	15%	$10,743	$245,860	$487,065	$1,117,870
31	$71,620	10%	$7,162	$278,325	$568,361	$1,350,038
32	$71,620	10%	$7,162	$314,035	$661,852	$1,628,640
33	$71,620	10%	$7,162	$353,317	$769,366	$1,962,963
34	$71,620	10%	$7,162	$396,527	$893,007	$2,364,150
35	$87,480	10%	$8,748	$445,802	$1,037,018	$2,847,477
36	$87,480	10%	$8,748	$500,005	$1,202,631	$3,427,470
37	$87,480	10%	$8,748	$559,628	$1,393,085	$4,123,462
38	$87,480	10%	$8,748	$625,214	$1,612,108	$4,958,652
39	$87,480	10%	$8,748	$697,358	$1,863,985	$5,960,879
40	$89,900	10%	$8,990	$776,983	$2,153,921	$7,163,843

And if he's pulling down 20% returns? He can begin to pay himself 20% of approximately $1.1 million at age 30, equivalent to about $223,000 a year or over $18,000 a month!

Either way, if your children decide to take on a new life challenge in their twenties or thirties… perhaps start a family of their own… begin to build their own business… go back to school for their master's degree or doctorate… or dedicate some time to writing the Great America Novel… they would be in a very good position to do so.

Weeding Out the Bad Habits

OK, we've looked at ways you can help your children create "financial freedom" by the time they're young adults. Now let's see how you can teach them not to destroy their wealth.

In my program, *Seeds of Wealth*, I devote an entire chapter to "Nipping Bad Habits in the Bud." For now, let me give you the highlights.

The first thing children should understand is that just as smart investing creates wealth, borrowing to buy "stuff" tends to destroy wealth. Instead of receiving an allowance of thousands of dollars a month, they may end up working dusk till dawn to pay strangers thousands of dollars in interest every month!

To ensure this doesn't happen to your kids, begin by telling them there really are only two ways people can use their money. One is to invest it. The other is to buy "stuff" (consumer goods and services). And there's a very big difference between the two

A good investment tends to go up in value.
Even the best consumer goods tend to go down in value.

Now, we don't want to be wet blankets. It's perfectly fine to buy stuff. Everyone needs stuff (food, clothes, vacation, a car). They should buy stuff. Stuff is fun. But they should *never* buy more stuff than they have the money for. And that means they should never borrow for consumption.

Why? For three main reasons.

Borrowing increases the costs of stuff.

Stuff goes down in value (even though you're paying more for it when you borrow).

If you get in the habit of borrowing to buy stuff, that can eat into the savings you use to buy investments. And only investments create wealth over time.

Now to help them understand why they should avoid borrowing for consumption, explain the principle of compound interest. The best way to do that is to start with simple interest.

Let Compound Interest Work for You, Not Against You

You don't have to get very complicated to explain interest and compound interest to your kids. Just tell them that simple interest is when your money makes money. Invest a dollar at 10% and after one year, it's worth $1.10. You got your original dollar back plus ten cents in interest.

Compound interest is when your original dollar makes money, but then your interest starts to make money too. So your dollar turned into $1.10. Keep it invested at 10% for another year and now it grows, not by 10 cents, but by 11 cents! Why? Because you made another 10 cents on your original dollar plus 1 cent on your 10 cents interest (since 1 cent is 10% of 10 cents).

Leave the money invested for another year, and it grows, not by 11 cents, but by 12.1 cents. And so on. After 30 years, that original $1 would now be collecting $1.74 in interest a year! And your total $1 dollar investment would have grown to about $17.45.

With compound interest, your wealth "snowballs," and that's why your children will be able to start off averaging a little over a dollar a day in savings through the pre-teen years and grow their wealth to the point where they can pay themselves allowances of $4,000 to $18,000 a month as young adults.

But compound interest is a two-edged sword…

When it's working for you, it can make you rich. When it's working against you, it can make you poor and miserable. Here's a brief example to help your children see that…

Why Pay $12,958 for a $2,000 Computer?

Let's say you buy a brand-new computer on credit. It's got all the bells and whistles, CD burners, all the software, maximum power, giga this and mega that. The price tag is $2,000, but you decide to finance it over 36 months and at a 15% interest rate. This means the computer will not end up costing you $2,000 – but approximately $2,628.

Take that $628 difference and compound it over 30 years at a 10%. That's a reasonable rate of return you might have earned if you took that extra money and put the power of compound interest to work *for you*, instead of *against you*.

What happens? The purchase on credit ends up costing you much more than the additional $628– ***It ends up costing an additional $10,958 over the course of thirty years!***

Now add the long-term costs for other credit purchases year after year, and you can see how buying things on credit today can literally cost you your fortune in the future.

Is There Such a Thing as Good Debt?

Debt, of course, can be a very complicated subject. To keep it simple, teach them not to borrow for consumption. To give them some experience in the matter, if they insist on borrowing money, lend it to them, but with interest.

Charge them credit card interest rates to drive the point home. Say, 18% (after all, they don't have a job yet and no collateral!) Lend them $10 and charge them 15 cents every month. And explain that they still owe the full $10.

If the question arises as to whether it's ever OK to borrow money, the following is a good rule of thumb:

> Good debt fundamentally helps people build wealth with relatively little risk. That means you receive a higher interest rate on the money you borrow than the interest you pay on it. There are two outstanding examples of this: financing a college education and borrowing to buy your own home.

For all age groups, the average college grad made $50,623 in 2001. That's 89% greater than the high-school grads, who earned just $29,095. Multiply that extra $23,828 over a 45-year working career and the education results in a $1,072,260 earnings advantage!

As for homes, when bought right, you can turn a $10,000 or $20,000 down-payment into an extra half-million or million dollars by the time you retire. And not long after you buy it, your monthly payments should replace what you would have paid in rent anyway!

Investment debt can also make sense, but this is too involved to go into here. The merit of that debt depends on how much, how it's arranged, how well you and the lender understand the risks, and whether or not you have a plan in place to limit the risks. But unless you have an incorporated business, the only investment debt most people should consider is for real estate.

The deal on debt in brief is that borrowing to consume never made anyone rich—except the credit card companies. But it has kept many people poor or stuck in the middle class, struggling to pay the bills.

The one exception to this "don't borrow to buy 'stuff'" rule is a car loan. Buying a reliable car on credit can make sense, as long as the car price and loan are negotiated separately and as long as car payments don't exceed 3-5% of gross monthly income. A kid working as an assistant manager at McDonald's and making $2,500 a month shouldn't be driving a Mustang convertible with a $400 a month car payment. Not if he ever wants to leave McDonald's anyway…

Something for You

As the author of *Seeds of Wealth* (www.seedsofwealth.com/van), I teach parents and grandparents many specific techniques for helping kids develop lifelong wealth-building habits. Every once in a while a parent will write to me and ask, "But what happens when my children come of legal age?" They gain control over their investment accounts; what's to prevent them from squandering the wealth they've accumulated?"

The primary answer to this question is that the program outlined here is about helping your children to not only build wealth, but to develop responsible financial habits. They'll have created that wealth themselves through their own discipline. So they'll know wealth is not an easy-come proposition and are less likely to have an easy-go attitude about it.

However, there is a strategy I recommend to help maximize the growth of your children's investments. This same strategy can also help make sure a good portion of your children's wealth is socked away for the long term.

The strategy is to open a Roth IRA for your child the moment he or she has formal income. (By "formal income," I mean wages paid to your child by an employer who deducts these wages as a business expense.) Let me briefly explain the core differences between a traditional IRA and a Roth IRA to show you how this strategy can be a tremendous benefit for your children.

With a traditional IRA, you make tax-deductible contributions. For instance, if you put $3,000 in the IRA (the maximum allowable individual contribution in 2003), you take $3,000 off your taxable income for that year's taxes. The money then grows tax-deferred. It is only taxed as you withdraw it years later, in retirement.

With a Roth IRA, by contrast, your contributions come from after-tax dollars. It then grows tax-free and you withdraw it tax-free in retirement. As a rule of thumb, Roth IRAs are usually best when you're in a lower tax bracket now than you expect to be when you retire.

For kids, Roths fit like a glove. In fact, if your child earns only up to $4,700 in a given year, this can translate into 100% tax-free income, growth and withdrawals.

Why? Because the $4,700 is technically taxable, but at that level the effective tax rate is zero. It then grows tax-free and is withdrawn tax-free. One hundred percent free of taxes all the way along the line! In this way, the Roth provides for maximum compounding and helps ensure a good portion of their investments is tucked away for the long term.

Now let me show you how to take this technique and use it for your kids' benefit and your own benefit as well.

Let Your Children Work Part-time for You
And You Could Possibly Save Thousands in Taxes!

If you own a business, having your children work for you can provide a good source of income and work education for them. It can also provide substantial tax savings for you!

For example, let's say you pay one of your children a total of $4,700 during the year. That's right under the IRS minimum-income reporting requirement. At that level, your child won't have to pay taxes or even file a tax return. Yet you still get a deduction on that $4,700!

Even if you were at a low marginal tax rate of 15%, that would save you $705 a year in federal income taxes. At the maximum marginal tax rate of 38.6%, it would save you $1,814 a year in federal income taxes!

Depending on what state you live in, it could also save you money on state income taxes. In most states, this could easily cut a few hundred dollars more off your tax bill here. But for the sake of this illustration, let's say this saves you an even $100.

At the same time, because your child is under 18 years of age and working for a parent, you may not have to pay Social Security, Medicare or Federal Unemployment Taxes (FUTA) on the wages you pay him. This exemption applies if your business is a sole-proprietorship, including Limited Liability Corporations, and unincorporated family partnerships in which both partners are the child's parents.

In this case, that would save you an additional $651 in taxes on the wages you might otherwise pay to someone else (6.2% for SS, 6.2% for FUTA, and 1.45% for Medicare)!

At the very least, then, you'll get the benefit of legitimate "income shifting" at the federal level, and realize up to $1,814 a year in savings this way. If you qualify for all savings (state and employer, as well), in the extreme case you could cut your taxes by over $2,500 a year per child. And if three of your children end up working for you for a total of four years each, in this same way you could save over $30,000!

Now, spend half the savings as a reward to yourself for being so smart. Then sock the other half away and let it compound for, say, 20 years at 10% – ***and you've added $100,913 to your retirement nest egg to boot!***

Why This Hidden Technique Works So Well

With this technique, you deduct the wages you pay your child from your business income. The tax liability for those wages are, in effect, transferred to your child, whose effective income tax rate in this case is zero! In this way, you save thousands of dollars, and your child is exempt not only from paying federal income taxes, but even from having to file.

Simply have your child file a W-4 with you when he starts to work for you. Since he knows he'll make less than $4,701 during the year, he'll mark "exempt" on line seven and then submit it to you for your records. You won't have to withhold any federal income tax since you both know he won't owe any. And, again, if you're an unincorporated sole-proprietorship, limited liability company, or partnership where both partners are the child's parents, you won't have to pay Social Security, Medicare or Federal Unemployment taxes either.

Simply keep good records yourself to document that all work your child does for you is legitimate, and that the pay scale is legitimate.

Also, keep in mind that many accountants may not be familiar with this technique. But if you go to www.irs.gov and download Publication 15, Circular E and look under "Family Employees," you'll see it all in black and white.

But here's where this technique gets even better…

Making a Good Idea a Great One

Let's say you have a 15-year-old who receives $9,400 in the course of a year. Half of that ($4,700) comes from you and family and friends in various ways. It might come from a combination of allowance, chore money and gifts from various occasions (graduation from jr. high, confirmation, bar-mitzvah, birthday, holidays, etc.).

This $4,700 isn't taxable in any way because it falls under the $11,000 annual personal exclusion for gifts. In the case of the chore money, for instance, this is money on which you and your spouse have already paid taxes and you don't deduct this from your taxable income when you pay your kids to mow the lawn, wash windows, etc.

Now let's say the other $4,700 comes from working for you in a formal job. In other words, this is where he has a schedule and is working for your business and you, as his employer, deduct the wages you pay him as an expense. This income from the formal job, as we mentioned a moment ago, is technically taxable, but the effective tax rate on this amount is zero.

So what happens?

From your child's point of view he's received $9,400 during the course of the year and he knows he has to put half in his permanent savings, and from there invest it with your guidance. From the government's point of view, your child has made up to $4,700 and therefore he can contribute up to $4,700 to an IRA.

(For the sake of argument, we'll imagine this happens in 2008 since at that time the maximum allowable individual IRA contribution will rise to $5,000. If you're ready to use this technique in 2003, go ahead. Just keep in mind that the maximum IRA

contribution for people under 50 years of age for 2003 is $3,000. It will rise to $4,000 in 2005 and $5,000 in 2008, and from then on it will increase in line with inflation.)

The upshot is your child received a good deal of money during the year, a good portion of which he earned the old-fashioned way, working. Yet he owed zero taxes on all of it. He was able to save half and still spend half (a great deal, considering his rent, food, clothing and medical are paid by you). The investments in his Roth IRA will grow tax-free and will be withdrawn tax-free. But that's not the whole story…

The Roth has a few very interesting features that makes this great deal an unbelievably great deal.

Special Benefits from Special Features

The first special feature of a Roth (and traditional IRAs too, for that matter) is that the vast majority of college financial aid offices exclude IRAs from consideration when assessing an applicant's assets. The most commonly used form for financial aid is the Free Application for Federal Student Aid (FAFSA). This form asks for the current net worth of the applicants' investments but states that the home you live in and IRAs are not to be included in the investments you list for these purposes.

This means that, by using a Roth, you can help your children accumulate significant wealth by the time they're ready for college even while much of it (perhaps all of it) will not count against their financial aid eligibility. It will be shielded by the Roth.

The second special feature of a Roth is that it permits withdrawal of capital contributions beginning five years after his first contribution to the Roth. These capital contributions are tax-free. In addition, there are allowances for tax-free and penalty-free withdrawals in special situations. These include $10,000 each for higher education; buying, building or rebuilding a first home; and certain un-reimbursed medical expenses.

So let's suppose your child has averaged $5,000 annual contributions to a Roth from the age of 15 to 30. (Remember, the maximum contribution goes up to $4,000 in 2005, $5,000 in 2008 and then rises with inflation from there.) If his investments have compounded at 10%, the Roth account would be worth about $174,749 by the age of 30. And $75,000 of that will have been capital contributions.

Now let's say he wants to buy a house for himself and maybe a small investment property also—to begin to diversify away from investing strictly in financial assets. He can now take $10,000 out of the Roth for his first-time home purchase and $75,000 of his capital contributions out. The entire amount is tax-free and penalty-free.

He leaves $89,749 in the Roth to continue creating wealth for retirement. And he continues to make new contributions to an IRA out of current income in future years so his retirement nest egg grows even more.

At the same time, the Roth has not been his only investment account so he has even greater liquidity. Soon after he starts working after college, his savings will likely exceed the Roth limit so he'll also have funds invested in non-sheltered accounts which will remain easily accessible to him at any time.

Help Your Children Plant the Seeds of their Future Wealth And Put Thousands Extra in Your Pocket Too!

To sum up, the benefits of combining the Roth with the Seeds of Wealth strategy include:

- While at home, your children earn money tax-free that then grows tax-free and is withdrawn tax-free in later years.

- Much of the money in their Roth is accessible if they should need it as young adults.

- A good portion of their growing wealth is shielded from asset counting by college financial aid offices.

- If you are your children's employer while they're living at home, you can also save up to tens of thousands of dollars by having your kids work for you.

And don't forget the intangible benefits: your kids will never have to worry about not having enough money in their lives—no matter what careers they choose. They'll have more options professionally, in terms of travel and education. And from a very young age, they'll learn from experience the kinds of things they can achieve from applied effort over time.

And they'll have you to thank for it.

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Key Ideas for Chapter 19

- If you educate your kids early, they can be financially free shortly after they finish college or perhaps even earlier.
- Use the Two Box system and the key ratios to help them put away money for their future.
- Every six months or so take the money out of the permanent savings box and invest it for them using some of the strategies recommended in this book.
- Teach your kids about bad debt and what happens when you have it.
- Open a Roth IRA for your children as soon as he or she has formal income.
- Consider letting your kids work for you in your business part time.

Action Steps

- Start using the two box system today.
- If your children have formal income, open a Roth IRA for them by the end of the week.
- If you have your own business, consider employing your children part time.
- Once the two-box system has been going for about six months, teach your children about debt by allowing them to borrow and charging them one percent each month out of their spending box.

Notes for Chapter 19

[1] The income assumptions in the above table are modest. They assume average "income" in the form of gifts, allowance, household chore money, etc. of just $2 a day through the pre-teen years. Then they assume that, as young teenagers, they may begin neighborhood jobs such as mowing lawns or baby sitting and earn $25 a week for the ages 13 and 14. The assumptions are that during high school, your child may take an after-school or weekend job where they average just $100 a week. That part-time income assumption rises to $150 per week for the college years.

I believe these are all modest assumptions when you consider that most people I know in my age group made considerably more than these numbers when we were in high school and college 20 and 25 years ago. At the same time, we're talking about future earnings and so we might reasonably expect earnings to increase in coming years.

As for the earnings assumptions for adults, we took the average income for college graduates per age group, according to the latest US Census figures. According to those figures, the average incomes for college grads were as follows in 2001:

Age Group	Average Income
Ages 18-24:	$37,828
Ages 25-29:	$44,281
Ages 30-34:	$53.292
Ages 35-39:	$65,093
Ages 40-44:	$66,894

I then took these numbers and compounded them at 3% for 10 years. I did that to make this a more useful gauge of likely future incomes for kids today who will be college grads any where from a couple of years from now to 20 years from now.