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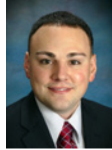

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Contributing to tax-advantaged retirement plans is one of the most effective financial planning strategies available to U.S. taxpayers: Saving money in a 401(k), IRA, or a Roth IRA account can trim your tax bill, while helping you prepare for the future. Even if you are already contributing to a retirement plan, you should review your retirement savings strategy regularly to ensure that you are making the most of the tax breaks you qualify for.

When you contribute money to a traditional individual retirement account (IRA) or an employer-sponsored defined contribution plan, such as a 401(k) or a 403(b), the adjusted gross income (AGI) figure that is used to calculate your income tax liability is lowered by the amount saved. Depending upon your income and the amount contributed, depositing funds in an IRA or 401(k) can substantially reduce your tax bill. While taxes must be paid on distributions from these accounts, most savers come out ahead because they are in a lower marginal tax bracket in retirement than they are while working. Investment growth within these retirement plans is also tax deferred. Even savers whose marginal tax bracket is not lower in retirement usually benefit by allowing money they would otherwise have paid in taxes to grow over time.

While the advantages of saving in tax advantaged retirement plans are clear, selecting the types of accounts that are best for your circumstances may be less straightforward. If your company offers a 401(k) plan with matching contributions, start by having your employer deduct from your paycheck at least the amount necessary to take advantage of the full match. If the plan allows,

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Retirement Savings: Do Yours Measure Up?

When envisioning retirement, you may picture living in tropical climates, traveling and sightseeing at leisure, or doing whatever suits you on any given day. Regardless of your age or circumstance, it might surprise you to learn that a "lifestyle plan" is an important part of retirement planning.

Knowing how you want to spend your retirement years, where you might like to live, and which activities you plan to pursue is necessary in determining the total amount of cash you'll need. A general rule of thumb suggests that you may need 60% to 80% of your current income per year in order to maintain your current standard of living in retirement. If you find this figure surprising, you are not alone.

Social Security

Although many people think that their Social Security benefit will provide a large portion of their retirement income, for the most part, it is a *supplement* to their retirement savings, rather than a main source of income. You can get an estimate of your future Social Security benefits by going to the Social Security website at www.ssa.gov and using the online estimate calculator. By obtaining your estimate of benefits online, you can plan for the amount of income you will need to supplement your desired lifestyle.

Since Social Security provides only a portion of needed income, many people rely on savings to make up the difference. And yet, according to The 2019 Retirement Confidence Survey (RCS), 40% of respondents who are currently working report having total savings and investments of less than $25,000.*

With the decline in traditional **pensions** and the uncertain future of Social Security, individuals are increasingly responsible for their own retirement funds, but according to these statistics, many have yet to take that important first step.

Taking the First Step

Starting a retirement savings plan can be a lot easier than you may think. In fact, the first step is to accept "free" money. This means taking full advantage of all of your employer's benefits. This may include a traditional pension, also known as a **defined benefit plan** that your employer contributes to on your behalf, which is then payable to you upon retirement.

Today, a more common benefit option is a **defined contribution plan**, such as a **401(k)**. Your employer may offer a company match in contributions up to a certain percentage. That's free money increasing your principal that did not come out of your paycheck, but you must make the contributions. Employer-sponsored 401(k) plan contributions may be deducted from your paycheck before taxes, and have the potential to grow tax deferred.

Because money is deducted from your gross pay, you may find that your contributions have a relatively small impact on net income, and can be of great benefit to your overall nest egg. For example, saving $5,000 today, over a period of 15 years, at a hypothetical 5% rate of return, could amount to over $10,569 in additional savings income.

Individual Retirement Accounts

Since retirement may require 75–90% of your current income, many people are contributing to **Individual Retirement Accounts (IRAs)** in addition to employer-sponsored retirement saving plans. **Traditional** and **Roth IRAs** allow for annual contributions of $6,000 in 2019 for those under age 50. For those age 50 and older, annual "catch up" contributions of an additional $1,000 are allowed in 2019. Funds in both accounts will be subject to a 10% Federal income tax penalty if distributions are taken before age 59½, however, certain exceptions apply.

Depending on your income and participation in an employer-sponsored plan, contributions to a traditional IRA may be tax deductible and earnings grow tax deferred until you retire. Contributions to a Roth IRA are made after taxes, but are tax exempt when you withdraw in retirement, provided you are age 59½ or older and have owned the account for at least five years. Taking the opportunity to save as much as you can afford each year could have a favorable and significant impact on your ability to reach your retirement goals.

You can achieve your retirement goals and live the lifestyle you desire, if you develop a game plan. Take time now to evaluate your resources, set retirement goals, and take the necessary steps to reach them. ■

* Source: Employee Benefit Research Institute (EBRI), *The 2019 Retirement Confidence Survey (RCS)*.

"Homing In" on Your Retirement Destination

As you think about your "golden years," where do you imagine yourself living? Would you choose an affordable house on a lake with room for visiting grandchildren or a condo near a golf course? Would you like to live closer to family and friends, or expand your horizons by moving to a new setting? What's important to you: a moderate climate, recreational opportunities, accessible medical facilities, a modest cost of living, or favorable local tax rates?

These, along with many other factors, can help you choose a retirement destination that will meet your personal and financial needs. Familiarize yourself with the advantages and disadvantages of potential retirement destinations. When it comes time to retire, you will be better prepared to make a well-informed decision. ■

trimming your taxes while saving for retirement

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consider contributing beyond the matching limit, up to the maximum of $19,000 or $25,000 ($19,000 + $6,000 "catch-up" contribution), for people age 50 and older in 2019. Depending upon your income, you may also have the option of contributing to an IRA in addition to your workplace retirement plan.

Employees without access to a retirement plan at work, either because they are self-employed or because their company does not offer one, have a number of options when choosing a tax-advantaged savings account.

If you have earned income, you and your spouse may be eligible to each make pre-tax contributions of up to $6,000 ($7,000 for those over age 50) to an IRA in 2019. There are also a number of tax-advantaged defined contribution plans designed specifically for the self-employed or small business owners, including simplified employee pension (SEP) plans, SIMPLE IRAs, and owner-only 401(k) plans. These plans are relatively easy to set up and administer, and they can help both owners and employees lower their taxes and build their retirement savings.

While Roth IRAs and Roth 401(k)s do not immediately reduce your taxable income, they can be useful tax planning tools over the long term. The contribution limits for Roth IRAs and Roth 401(k)s are the same as for traditional IRAs and 401(k)s, but the contributions to Roth accounts must be funded with after-tax dollars. Investment growth within Roth accounts is tax free, and no taxes are owed on qualifying withdrawals. However, it is important to note that Roth 401(k)s are subject to required minimum distributions (RMDs) starting at age 70½, whereas Roth IRAs are exempt from RMDs.

A Roth IRA can be an attractive option for people who earn too much to contribute to a traditional IRA, but whose AGIs are still below the Roth IRA eligibility phase-out ranges of $122,000–$137,000 for single filers and $193,000–$203,000 for married joint filers in 2019. For married couples who file separately in 2019, the Roth IRA eligibility phase-out remains $0 to $10,000. Roth IRAs also offer greater flexibility than traditional IRAs and 401(k)s. Unlike retirement plans funded with pre-tax dollars, Roth IRAs do not require savers to begin withdrawing funds after the age of 70½, making it easier to pass on a retirement nest egg to the next generation. A Roth IRA may also be a wise choice for people who do not expect to be in a lower marginal tax bracket in retirement, and wish to maximize their retirement income.

The ideal financial plan may involve contributing to a variety of tax-advantaged retirement accounts. Changes in your income or in tax law can affect your eligibility for some plans. Therefore, be sure periodically review your situation with qualified financial and tax professionals to modify your tax and retirement planning strategies, as needed. ■

U.S. Households Burdened By Debt Find It Hard To Save

As saving for retirement can be challenging, especially while on a tight budget, a study published in July 2019 by the Center for Retirement Research at Boston College (CRR), attempted to answer the question of why so many U.S. workers report that they have little money set aside to absorb financial shocks.

The issue brief, "Why Are So Many Households Unable to Cover a $400 Unexpected Expense?" was written by Anqi Chen, assistant director of savings research at the CRR. Citing data from two recent Federal Reserve surveys, Chen observed that despite the strength of the economic recovery in recent years, 41% of households surveyed in 2017 said they would find it difficult to cover an unexpected expense of just $400. In her study, Chen used these data to analyze the question of why so many households say they are unable to manage a relatively small unexpected expense.

The study cited survey results showing that, as expected, lower-income households were most likely to say they would be unable to pay for an emergency expense of $400, with 72% of respondents earning less than $25,000 a year reporting that they would have trouble covering such an expense. However, the findings also indicated that 34% of households with annual earnings of between $75,000 and $99,999 and 17% of households with annual earnings of $100,000 or more admitted that they would find it hard to pay for a $400 unexpected expense.

Chen pointed out that other survey data show that just 21% of households reported having less than $400 in their checking or savings accounts. She added, however, that another 17% of the households included in this survey said they would have trouble paying for an unexpected $400 expense once they paid their outstanding credit card debt, despite having at least $400 in their bank accounts.

The study looked at several possible explanations for why so many households—and especially middle- and high-income households—appear to be unable to cover a relatively small unexpected expense, including financial literacy, education, and other socioeconomic characteristics. Based on an analysis that included measures for both financial literacy and educational attainment, Chen found that financial literacy scores had little ability to predict whether a household would have trouble covering a $400 unexpected expense, while educational attainment had strong predictive power.

Moreover, the results of a latent class analysis that examined the characteristics of these vulnerable households showed that a subgroup were less advantaged; i.e., they either recently lost their job, had a low income, or had a high school degree or less. However, a second subgroup of households were identified who had relatively high incomes, net worth, and rates of participation in retirement plans, but who also had relatively high mortgage payments, credit card debt, or other loan payments.

"Many of these households may have enough liquid assets to cover a modest emergency expense but they also have mortgages, student loans, and/or other installment loans," Chen observed. "These loan payments, which constrain their household budgets, could explain why so many middle- and higher-income households do not have precautionary savings."

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