naea FALL 2006

Client Newsletter

Retirement Issues

Retirement is supposed to be the golden years of life. Whether it is or not depends on how well you plan for it. No matter what your age is, it's not too soon to begin planning.

The number one thing you should do to plan for retirement is to take care of your health. This has little to do with tax planning, but if you are not serious about health planning, there will be little need for tax planning for retirement. There is nothing sadder than to read in Monday's newspaper about the retirement of an acquaintance and then see the obituary in the following day's edition. We have all heard of that and certainly don't want to experience it first hand.

It's never too soon to think of retirement, even when you're looking at your newborn wrapped softly in the warm hospital blanket. Retirement can be used to pay for the rocking chair or the cottage by the lake, but it can also be used to finance Junior's college education.

You might also consider Junior's plan for retirement. It may sound strange, but Junior can start even earlier than you. If your child has income at an early age such as from modeling or even diaper testing, the earned income could be put into a traditional or Roth IRA. The traditional IRA would reduce income while the Roth IRA would grow tax free without reducing current income. As Junior gets older, the likelihood of being employed or even self-employed grows. What better way to use the tax code to plan for the future and limit taxes.

But what about you? Many people say, "I can't afford to save when my family is growing. I have house payments, car payments, education, and normal living expenses. There's nothing left." Perhaps the key is "nothing left." Having nothing left at retirement means living on Social Security. If nothing pushes you more, the fear of living on Social Security should.

As the children are growing, your company retirement is probably the easiest place to start. Companies have a variety of retirement plans available. The 401(k) is a popular plan both for you and the employer. The 401(k) allows you to defer the lesser of $15,000 or 100% of compensation. For every dollar you are able to defer, you reduce your taxable income by that amount. If you're in the 25% tax bracket, your tax savings on a $1,000 deferral is $250. Therefore, it really only took $750 out of your budget. Chances are, you can learn to live without this amount fairly easily. Many companies also match your deferral up to a certain level. That matching is "free money." If you're not taking advantage of it, you're losing out. For example, if a company is willing to match dollar-for-dollar up to 2% of your income, then it usually is an excellent idea to put at least 2% into the plan in order to take advantage of the opportunity.

Other plans such as the SIMPLE IRA may be offered by an employer. The SIMPLE IRA allows you to put up to $10,000 away as a deferral. The maximum is a little lower than the traditional 401(k) limit, but it has some benefits that may be more attractive to the employer. The employer will generally match dollar-for-dollar up to 3% of the compensation amount you agree to defer. Regardless of the kind of plan your employer offers, look into your options and make the best of it for your future.

One other opportunity exists for low income taxpayers. The government is willing to encourage you to save for retirement by giving a Retirement Savings Credit. The credit for married taxpayers who have an adjusted gross income of less than $50,000 could range from 10% to 50%. The lower the income is, the greater the potential credit. The credit is not limited to company pension plans. You can qualify for this credit by investing in a Roth or traditional IRA. If your joint AGI is below $50,000, with a traditional

IRA you would not only save tax by reducing your taxable income but also a minimum of $200 for the Retirement Savings Credit. The AGI level drops to $25,000 for taxpayers filing as single.

As you grow older, your financial situation may change. You may find that you have more money to put aside. The company pension plan is certainly the first place to start, but you should also consider the IRA. The deduction for the IRA may or may not be available to you. This year the income level for deductible IRAs has increased. A married couple can defer $4,000 per person (assuming earned income is equal to the deferred amount) and deduct the contribution if the AGI is less than $75,000. The deduction is phased out between $75,000 and $85,000 for taxpayers filing married filing jointly. That translates into a savings of 15% for federal taxes in many cases, not to mention possible state income tax savings.

The Roth IRA is another vehicle that has benefits worth looking into. The Roth IRA is limited to $4,000 for 2006. It requires earned income in the same manner as the traditional IRA. The difference tax wise is that you don't get a current deduction. The Roth investment will grow tax-free as opposed to tax-deferred as with the traditional IRA. The other useful feature of a Roth IRA is that it can serve as an emergency fund, a college savings plan, a home savings plan, or a retirement plan. The reason this plan offers those opportunities is because you can withdraw the money you have invested without tax consequences. The earnings on the money must stay in the plan until you have reached retirement age or have met the usual Roth IRA exceptions. In order to be eligible to participate in a Roth IRA your AGI for a joint return must be less than $150,000. This is generally not a plan available to the higher income individuals although there are some variations available through the new Roth 401(k) plans that may be available through your employer.

Speaking of the Roth 401(k) plans, this is the first year they are available. This is a way to invest in a Roth account regardless of income. It is a plan your employer has the option of making available. Not all 401(k) plans will have this. If your plan allows, you may decide to put any or all of your $15,000 401(k) deferral into a Roth 401(k) account rather than a traditional 401(k). This means you do not get the reduced tax benefit of the 401(k) currently. Rather, you can have the Roth benefit of no tax on the monies when they are distributed at retirement. You are trading off the tax benefit of a deferral now with a tax-free income stream later.

There are many more retirement options available. If you are a self-employed individual, you can't rely on your employer to provide for your retirement. You are responsible for your retirement. Do your homework, determine the retirement options that work best for you, and start saving. No time is too soon.

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