

Saving for Retirement



MIND YOUR MONEY

This course is intended to be an instructional guideline to saving for retirement. There are several options you have available that we will discuss. Each option may be taxed differently. Please consult with a Certified Public Accountant (CPA) for any specific tax questions.



Introduction

- Retirement has many definitions depending on who you ask but true retirement is when you no longer have to actively work to pay your bills. This means you either have enough income coming in or enough saved up to cover your expenses for the rest of your life.
- If you retire from a job but still *have* to go get a job to pay your bills, you are not really retired. However, some people do go back to work after they have retired but it is usually out of boredom and not necessity.



Introduction

- We are going to review all of the different options you have available to save for retirement and highlight each way you will be taxed on your money in retirement.
- The biggest expenses most people have in retirement are healthcare and taxes. By the time most people retire or are ready to retire, you have little control over your health or your taxes. While we encourage healthy living now for a healthy life later, we can only help you prepare for how taxes will affect you.



401(k)

- The most common account when it comes to retirement is a 401(k) account. This is not the suggested amount of money you should have saved in retirement (\$401,000) but actually refers to the section of the tax code that governs these type of accounts.
- We will later cover 403(b) accounts that behave similarly but are under a different section of the tax code.



401(k)

- A 401(k) account is a special type of investment account that allows you to grow your investments **tax-deferred**. You contribute money from your paycheck to this account, select a target mutual fund based on the year you think you will retire and someone else manages the fund to make sure your money grows.
- You can only access a 401(k) account through your employer and it is common for employers to match your contributions up to a percentage. For example, if you contribute 6% of your paycheck, your employer would also contribute 6% from their pockets.



401(k)

- Even though you can only access a 401(k) through an employer, the money you have contributed to your account is YOURS. If you decide to leave that job, you can **liquidate the account, roll the funds over to a new 401(k) or other retirement account, or just leave it alone.**
- You may not be able to take the funds that your employer has contributed if you have not been there long enough or met the vesting period. However, this is separate from the contributions you have made.
- We will discuss each option in more detail but you will not have access to ANY of these options if you do not begin saving in your 401(k).



401(k)

- Since 401(k) accounts are **tax-deferred**, this means that all the contributions going to the account are pre-tax contributions. You nor your employer have been taxed on the money that has gone into your account.
- This can be a helpful strategy to lower your taxable income as you are saving BUT be very clear - Uncle Sam WILL come for that money when you begin pulling it out in retirement.
- The IRS also has a contribution limit that is updated each year so you can only defer so much before Uncle Sam and the Alphabet Boys want their cut. Make sure to check www.irs.gov to get the current year limits.



401(k)

- For example, someone making \$50,000 saving 5% of their salary in their 401(k) will only be taxed on \$47,500 at the end of the year.
- The \$2,500 that was saved in the 401(k) can grow in the market without having to pay taxes on it until it is time to pull it out in retirement. Federal income tax rates range from 10% to 37%. Without taxes eating away at your savings, your investment can grow MUCH faster.



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401(k)

- Liquidating your 401(k) account could result in a 10% penalty if you are not 59 1/2 years old or older. It will definitely result in taxes of up to 25% being taken out since taxes have never been paid on any money in the account yet.
- Because of the taxes and penalties, this is never a recommended option unless absolutely necessary. However, if you need to use the money in the account for certain types of expenses, you can take out **hardship withdrawals** and will not incur a penalty even if you are younger than 59 1/2.



401(k)

- Hardship withdrawals can be taken if there is an immediate and heavy financial need. You are limited to withdrawing the amount necessary to satisfy the need. Some examples of qualified events for a hardship withdrawal are below:
 - Expenses associated with purchasing your primary residence
 - Expenses associated with preventing your home from being foreclosed or evicted
 - Certain medical expenses
 - Burial or funeral expenses



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401(k)

- Before looking to take any hardship withdrawals, you will want to review your plan documents or speak with Benefits in your HR department to see what rules apply to your specific retirement plan.
- Remember, hardship withdrawals are still taxed but they do not incur any additional penalties. This withdrawal will be considered as additional income for the tax year that it was taken out.



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401(k)

- If you don't qualify for a hardship withdrawal but still need to use some of the money in your account, you can take out a loan against your 401(k). This is not a true loan because it generally does not require a credit inquiry to review your credit history so it will not impact your credit score.
- You can access a portion of your account, which is generally 50% of the account or up to \$50,000, on a tax-free basis as long as the repayment rules are followed.



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401(k)

- You pay back the loan with automatic payments from your paycheck but this time it is with **after-tax** dollars.
- You also may not be allowed to contribute to your 401(k) until the loan has been repaid. Any interest that you are charged will be paid to the account as well.
- You typically have a 5-year repayment schedule but you can pay off the loan faster with no penalty.
- Loans can usually be requested from your 401(k) provider with a few clicks on their website and are disbursed within a few business days.



401(k)

- You can rollover your 401(k) which basically means you are closing the account, transferring the funds to another tax-deferred retirement account and are **NOT** paying any taxes or penalties by doing so.
- Most financial professionals will recommend rolling the account over to a new 401(k) or retirement account especially if you plan on continuing to save. If your new job does not offer a 401(k), you can still rollover your account to an individual retirement account or an IRA which is still tax-deferred. We will cover IRAs in detail later.



401(k)

- If you are planning on rolling over your 401(k) to a new account, you should always make sure the new account is set up first. When you complete the paperwork, you will want to include the new account number or there could be a delay in getting the funds to the new account.
- You can only win in the market if you actually have a position *in the market* so if your funds are sitting on the sideline, you are guaranteeing that you won't receive any potential gains until they are in the account.



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401(k)

- Leaving the account alone after you leave a job is not recommended but is better than incurring taxes and penalties from liquidating. Someone will always actively manage the fund you are invested in but you should not expect significant long-term growth since you are no longer contributing.
- There is no time limit on rolling an account over so if you are undecided, this may be the best option until you figure out what you want to do.



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403(b)

- A 403(b) account functions very similarly to a 401(k) account except 403(b) accounts are only available to people that work for non-profit organizations and the government while 401(k) accounts are only offered at for-profit organizations.
- 403(b) accounts also do not typically feature employer matches. If an employer is not helping to fund the retirement account, there are less regulations required for the employer so they generally avoid matching in 403(b) accounts unfortunately.



403(b)

- 403(b) accounts will have the same contribution limits and penalty for early withdrawal before 59 1/2 years old. Always review www.irs.gov for the most up-to-date contribution limits.
- You also have the ability to take hardship withdrawals and loans from 403(b) accounts as long as the retirement plan offers them.



403(b)

- Lastly, you will have the same options for your 403(b) as a 401(k) to take your money with you if you decide to leave. It is always recommended to rollover the funds into a new account.



IRA

- An individual retirement account or an IRA is a **tax-deferred** investment account intended for retirement. You can set up an IRA with your bank, brokerage or investment firm. You do not need to go through an employer to set up an IRA.
- An IRA has a couple similarities to a 401(k):
 - Funded with pre-tax dollars
 - Has contribution limits but typically much lower than a 401(k) (see www.irs.gov)



IRA

- While an IRA has lower contribution limits than a 401(k), you have more options when it comes to investing in an IRA. A 401(k) is typically limited to mutual funds that is managed by someone else. With an IRA, you can invest in mutual funds, stocks, bonds, certificate of deposits (CDs) and sometimes even real estate.
- You also have the freedom to invest how you see fit in an account that is deferring taxes until retirement age.



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IRA

- Since this is not through an employer, you do not have any option for employer match in an IRA. You also are not able to take any loans from your IRA but you are able to take hardship withdrawals.
- The good news is you can have both a 401(k) and an IRA as long as they are not exceeding the contribution limits for each account.



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Pension Funds

- The simplest way to describe a pension is an account from your employer that will pay you a fixed income from the time you retire until you die. The biggest difference in a pension is you did not have to save this money from your paycheck to receive this benefit.
- Unlike a self-funded retirement account that will eventually run out of money, a pension will never run out of money. You can even elect to have the pension pay until both you AND your spouse pass so it is the gold standard of retirement funds.



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Pension Funds

- Unfortunately, most employers no longer offer pension plans because they are so expensive. People are living longer which means the employers would have to pay longer which means the employers would have to save more of their own money to ensure they will be able to meet the commitment.
- Since pensions are not common and only accessible through employers, this will be the most we discuss the topic.



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Annuities

- If you are like most of us and do not have access to a pension but like the benefit of a pension, you may want to consider an annuity. Annuities function like pensions except they require your money. You get annuities from an insurance company using either a lump sum or periodic payments.
- An annuity is used in retirement but does not require you to be retired in order for you to turn on the payments. The annuity will pay you for the defined period of time you select when you purchase it.



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Annuities

- Because annuities are in the financial markets, you have the option for fixed or variable annuities:
 - A fixed annuity will pay a fixed income for the defined period and is guaranteed to be no less than the fixed income amount.
 - A variable annuity will pay an income that depends on the performance in the market which could be lower or higher than the previous month. Variable annuities may still have guaranteed minimum amounts.



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Annuities

- You can also fund annuities with pre-tax or post-tax dollars so you have additional flexibility when creating your retirement strategy.
- Since an annuity is funded with your money, you have options to try and get this money back but most are unfavorable because of the charges and penalties. You will want to discuss with both a financial advisor and a tax professional before deciding to purchase an annuity.



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Roth Accounts

- You may have heard about a Roth account and have an idea about what these type of accounts are but almost every account we have discussed includes a Roth option. There are Roth 401(k), 403(b) and IRA accounts.
- A Roth account is a retirement investment account that can provide **tax-free** distributions when you are ready to retire because it is **funded with after-tax dollars**. Not only can you take tax-free distributions in retirement *but the account will also grow tax-free*.



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Roth Accounts

- As you can imagine, the IRS has a contribution limit to all Roth accounts (see www.irs.gov) but also an income limit meaning *if you make too much money, you cannot actively save in a Roth account.*
- This is a perfect example of why you should not wait to begin saving for retirement because as you progress in your career, you could have less and less options to save.
- You can sign up for a Roth account in the respective ways you can sign up for the traditional accounts.



Social Security

- Social security income functions like a pension. If you have worked long enough and paid enough into your Social Security, you will receive this fixed income as long as you are living in retirement. However, social security income is intended to be supplemental to your other income sources in retirement.
- Social security income is **NOT** intended for you to be able to survive off of it alone.



Social Security

- In order to determine your social security amount, the government will use the 35 years where you earned the most. You must work and pay into Social Security for at least cumulative 10 years in order for you to receive the retirement benefit. If you had periods where you were not working, that will not matter as long as you have a total of 10 years (40 quarters) paying Social Security.



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Social Security

- You can decide to start your social security income as early as age 62 but it will be less than the amount you would receive at the designated “retirement age” of 65. If you wait until age 70, you will receive more than the amount you would receive at retirement age but there is no additional benefit to delaying past age 70.
- Social security income is also taxed when you begin receiving it.



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Even if it is a small amount of money, **regularly save and contribute to as many different retirement accounts as you can** to maximize your potential tax strategy in the future.



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Income in Retirement

- We've talked about all of the different ways you can save for retirement and also discussed how each of the options are taxed. Remember, the two biggest expenses in retirement are healthcare expenses and taxes. We can't control the healthcare expenses as much as we can the taxes as long as we prepare in advance.



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Income in Retirement

- Each individual's plan for retirement differs so you will want to discuss your plan with a financial advisor. Advisors will also be able to recommend and set up some of these accounts for you after discussing your plan with them.
- If you have enough income in retirement through your pension and social security income but you also have a traditional 401(k) and IRA, you will want to protect your 401(k) and IRA from required minimum distributions or RMDs.



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Income in Retirement

- A required minimum distribution is the IRS' way of requiring you to pay up on that money that you still have not paid taxes on. RMDs apply to any **tax-deferred** account that you funded with pre-tax dollars and generally begin at age 72.
- In the previous example, your lifestyle is already funded by two sources of income that will never run out so the RMDs would be extra money that may be unnecessary.
- **After age 72, the IRS will require you to take RMDs until the account is depleted.**



Summary

- There are many options to save in retirement but you want to make sure you are considering the tax advantages of each option.
- If your employer offers a 401(k) and a match, you want to participate because you can still take the account with you if you decide to leave. As long as you are vested, the match would be free money you left on the table by not participating.
- Do not plan to depend solely on social security income in retirement.
- Whether it is a 401(k), 403(b) or an IRA, make sure you have a Roth account.



Be sure to check out our other courses!



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