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21st century retirement

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Sharing characteristics of both 401(k)s and Roth IRAs, the Roth 401(k) retirement savings vehicle allows you to save after-tax dollars in a tax-deferred retirement account without the income restrictions and contribution limits that apply to Roth IRAs, and when you reach retirement, qualified distributions are tax free. (The Roth option may also be available to those with sponsoring 403(b) accounts.)

Compare and Contrast

Currently, only taxpayers whose adjusted gross income (AGI) falls below certain levels ($116,000 a year for single filers and $169,000 for joint filers) are eligible to contribute after-tax dollars to a Roth IRA. These income limits do not apply to Roth 401(k)s. Furthermore, you can save more money in a Roth 401(k) than in a Roth IRA.

The 2008 annual contribution limits for IRAs of all kinds are set at $5,000 for taxpayers under the age of 50 and $6,000 for older workers. The Roth 401(k) is subject to the more generous elective salary deferral limits that apply to conventional 401(k)s—$15,500 for taxpayers and $20,500 for those over the age of 50 in 2008.

The Roth 401(k) has other advantages over the Roth IRA. Contributions can be easily and conveniently made through payroll deductions. To participate, an employee currently contributing to a traditional 401(k) plan could, for example, simply opt to have his or her contributions diverted to a Roth version of the same plan.

Matching contributions made by employers must be invested in a traditional 401(k), not a Roth account. This means that, even if you make contributions exclusively to a Roth 401(k) account, you would still owe tax in retirement on withdrawals from funds contributed on a pre-tax basis by your employer.

The 401(k) annual deferral limits apply to all 401(k) contributions, regardless of whether they are made on a pre-tax or after-tax basis. If you contribute to a Roth 401(k), you may have to reduce or discontinue your contributions to your employer's conventional 401(k) plan to avoid exceeding these limits; however, you may contribute to both types of 401(k) plans.

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Focus on Women: Building Retirement Security

If, like many women, you are juggling competing demands, such as family, career, and a household, you may feel tempted to relegate retirement planning to the bottom of your "to do" list. But by putting off preparations for retirement, you run the risk of becoming one of the large number of women who spend their golden years struggling just to get by. You can avoid this with the right planning.

Saving enough money to pay for a comfortable retirement can be a challenge for most Americans, and it can be especially challenging for women who may, when compared with men, earn less, spend fewer years working, and live longer. These concerns are often more acute for women who are divorced, widowed, or otherwise single, as well as for those who have spent all or a significant portion of their adult years caring for children and other family members.

According to the most recent statistics from the U.S. Department of Labor (DOL, 2007), only half of all working women in the United States participate in a retirement plan (47% of 60 million as of March 2005). In addition, women typically spend nearly 12 years out of the work force while taking care of children or elderly parents, and the average woman in the U.S. in full-time employment earns less than her male counterparts (81 cents for every dollar a man made in 2005). Women are further disadvantaged when their jobs are part-time or with smaller firms that do not offer substantial retirement benefits.

Because of shorter careers and possible lower incomes, a substantial proportion of women currently do not receive enough in Social Security benefits to meet even their basic needs. According to the Social Security Administration (SSA, 2007), women's average monthly retirement benefit in 2004 was just $784. And married women often do not realize that the retirement benefits their husbands have accrued may fall away if they are widowed or divorced. These combined factors put many women at high risk for poverty as they age, especially if they don't do the needed planning now.

Clearly, most women will need to build up their own retirement savings if they wish to maintain a reasonable standard of living in their later years. Here are some strategies you can use to get started:

- If your current employer does not offer a good retirement plan, consider your options for securing better benefits. While companies with defined benefit plans that replace a percentage of income (based on your salary and years of service) are becoming increasingly rare, you should consider the long-term consequences of a job with a firm that does not at least match contributions to a 401(k) or other defined contribution plan. If you are lucky enough to be employed by a company with a traditional pension plan, find out what your benefit is likely to be and at what age you can collect the maximum benefit.
- Take advantage of the tax benefits of qualified retirement plans and traditional Individual Retirement Accounts (IRAs). Depending on your financial situation, you may find that making pre-tax contributions to a retirement account will not significantly reduce the amount of money you have available to spend. Contributions may decrease your current taxable income (and, consequently, your ultimate tax bill), and earnings are tax deferred. Taxes will be due when you begin taking distributions. If you withdraw money prior to age 59½, a 10% federal tax penalty will be due in addition to income taxes.
- Consider the role a Roth IRA or annuity may play in your long-term plan. Contributions to Roth IRAs must be made with after tax dollars, but earnings grow tax deferred. Qualified distributions made after age 59½ are tax free, provided the account has been owned for five years. Certain income limits apply. Annuities allow you to save money on a tax-deferred basis and offer you a variety of options for managing assets and receiving retirement income. All guarantees of income are dependent on the claims-paying ability of the issuer.
- Plan to work longer if necessary. Even a few extra years spent working will enable you to save more money toward your retirement. Your costs may also be substantially lower if you put off retiring until you qualify for full Social Security and Medicare benefits.
- Arrange to pay off your mortgage and other debt as quickly as possible. Owning a house outright in retirement not only

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ensures that you will have a place to live, but it can also serve as a valuable source of equity, should you need it. To give yourself an incentive to pay off your credit cards, you may want to resolve to turn your monthly credit card payments into retirement account contributions, when the debt is gone.

- If you are married, assess the capacity of your husband's retirement benefits to meet your future needs. Given the possibilities of divorce and widowhood, it is essential that you plan for a time when you will have to manage on your own. If you are staying at home while your spouse is working, set up an IRA in your own name. Find out, too, what rights you may have to your spouse's pension in the case of death or divorce, and research the effects of divorce and remarriage on your Social Security benefits.
- If your family budget is tight, carefully evaluate the benefits of putting extra funds into your own IRA or 401(k) versus putting money in a savings account for your children's college education. Your children may be able to get financial aid or low-interest loans to help pay for college, but there are no grants or scholarships for retirement. Also bear in mind that some funds may be withdrawn from a retirement account before the age of 59½ penalty free if used for qualified education expenses.
- If you own a business, you should consider implementing a retirement plan for you and your employees. Not only will a plan help you to live comfortably in your retirement years, but it may also be fully deductible, thereby reducing your business's current tax liability. If you already have a retirement plan for your business, you should review it with your advisor every few years to ensure it is still the best plan for your business and you are taking advantage of all tax benefits you may be entitled to take.
- If you are an executive and your company offers you the opportunity to participate in a nonqualified deferred compensation plan, consider the opportunity. Again, it will decrease your current income tax liability while providing you with an additional pool of money to draw upon in your retirement.

Saving for your own financial future should be a priority, even when there are bills to pay and the wants and needs of children and other family members feel pressing. While taking care of others is important, so is paying yourself for the many contributions you make to family life. ■

Workers Strongly Support Automatic 401(k) Enrollment

While concerns that some employees could resent automatic enrollment in 401(k) plans appears to have stopped some retirement plan sponsors from adopting automated features, most employees actually favor the programs, according to a study recently released by Retirement Made Simpler (RMS, 2007), a coalition formed by AARP and the Financial Industry Regulatory Authority (FINRA) to promote retirement saving.

Researchers surveyed a nationally representative sample of 10,130 U.S. adults. Of these respondents, 696 had been automatically enrolled in an employer-sponsored 401(k) plan, while 48 had opted out of a workplace plan after being automatically enrolled.

The survey found that 98% of respondents currently enrolled in an automatic 401(k) plan are generally pleased that their employers offer

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is a roth 401(k) right for you?

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With a Roth 401(k), you will be required to begin taking distributions after the age of 70½, and you will not be permitted to withdraw earnings tax free until you have held the account for at least five years and are at least 59½ years old. These provisions could make the Roth 401(k) less attractive to employees who are currently approaching retirement.

Which Choice Is Right for You?

In order to decide which option or combination of options works best in your retirement plan, it is important to weigh the advantages and disadvantages of both types of 401(k)s. With a traditional 401(k), you make contributions on a pre-tax basis, which lowers your current taxable income, and earnings are tax-deferred; however, your retirement distributions will be subject to ordinary income tax. With a Roth 401(k), your contributions are not tax deductible, but earnings and distributions are tax free, provided you meet the five-year ownership and age requirements. The right choice for you depends on your current tax situation and your long-term financial goals.

If a Roth 401(k) makes sense for you, ask your company's benefits administrator if the feature is available for your retirement plan. If it is not already in place, expressing interest in the Roth feature increases the likelihood your company will adopt the option.

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these plans, with 79% of this group saying they strongly favor automatic enrollment. In addition, 95% of the respondents who are participants in automatic 401(k) plans agreed that automatic enrollment has made saving for retirement easy, and 85% of this sample agreed that this feature has helped them start saving for retirement earlier than they had planned.

Commenting on the survey's findings, FINRA chief executive officer Mary Schapiro said, "Many employers have been concerned that employees would not like automatic 401(k)s—hence they reported being reluctant to adopt them. But these results overwhelmingly dispel that myth, making automatic 401(k) adoption a win-win for employers and employees."

The study also cited the example of the U.S. Chamber of Commerce, which recently added automatic enrollment to its 401(k) plan in an effort to boost participation. Explaining why the organization moved to an automatic plan, Shannon DiBari, senior vice president of human resources, U.S. Chamber of Commerce, said, "Our goal in implementing automatic 401(k) enrollment was to help our employees save more and save smarter. We recognize that, particularly with our younger employees, saving for retirement is not a high priority or focus. An automatic 401(k) helps them do the right thing and it is hassle-free. It also is an easy process for employers to set up."

Schapiro added that the RMS coalition hopes that these positive employee experiences with automatic 401(k)s will be the catalyst employers need to implement these plans in their own organizations. "We know that automatic 401(k)s are a simple and effective way to build retirement savings, and we now know employees like them and want them, too," Schapiro said.

The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any Federal tax penalties. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.

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