

It Is Never Too Early To Start Thinking About Retirement!

By

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Jim and Paula were expecting their first baby. Sitting in my office, their faces glowed with excitement. They had decided that Jim would be the primary caregiver for their new baby as Paula earned considerably more in her position with a telecommunications giant. They laughed about the ribbing that Jim was receiving from the guys on his softball team.

Jim admitted that he did have one concern, “I don’t want to stop contributing towards my retirement and I also don’t want to leave my 401K with my present employer. I have never been happy with the investment options that they offered. What do you suggest I should do?”

Jim, like many other caregivers who are not employed outside the home, was rightly concerned about continuing to contribute towards his retirement on a consistent basis. He was qualified to open a traditional Individual Retirement Account (IRA) as he and his wife were filing a joint tax return and she was receiving taxable earned compensation. The 2006 annual contribution allowable under tax law is \$4,000 (\$5,000 for individuals who reach age 50 by year-end). Jim wondered if his IRA contribution was tax-deductible. There were several factors to be considered. Since Paula was active in a qualified plan, only the amount of Jim’s contribution is fully tax-deductible as long as their combined modified adjusted gross income (AGI) is less than \$150,000. The tax-deductible amount of the contribution is phased out for incomes modified (AGI) between \$150,000 and \$160,000.

The good news is that his contributions and earnings would accumulate tax-deferred until withdrawals are made. At that stage, withdrawals are subject to ordinary income taxation in the year in which they are withdrawn. If Jim decided to take a distribution from his account prior to reaching age 59½, he would incur a tax penalty of 10% of the distribution in addition to ordinary income taxation. (No penalty is incurred in the following circumstances: death, disability or first-time home purchase up to \$10,000. Also there is no 10% penalty for substantially equal payments over a person’s lifetime, i.e. if equal amounts are withdrawn annually based upon life expectancy before age 59 ½. Income tax is incurred in each year the amounts are received.) Therefore, the illiquidity of such an account should be seriously considered. Government rules also require mandatory distributions take place once Jim reaches the age of 70½.

As Jim wished to move his retirement savings from his previous employer’s plan, one option is to roll his retirement savings directly into a Rollover IRA. There are several advantages, such as his savings would continue to grow tax-deferred while offering a wide-range of investment choices.

Instead of a traditional IRA, Jim may also wish to consider opening a ROTH IRA. As with a traditional IRA, Jim may only invest \$4,000 per year if their adjusted gross income stays under \$150,000. Over that limit, the amount he can contribute begins to decrease.

The ROTH could substantially benefit younger savers like Jim and Paula. The amount he contributes has already been taxed so the interest, dividends and any gains accumulate tax-free, in fact Jim never pays tax on it even when he starts to take distributions after age 59 ½ as long as the account has been open for at least 5 years. (If Jim makes withdrawals before age 59 ½, there is a 10% penalty on earnings.) Even Jim's beneficiaries would receive the proceeds income tax-free.

Unlike a traditional IRA, the government does not insist that the investor starts to take distributions at 70½ therefore offering even greater flexibility and a reduced tax bill in retirement. Generally, there is no penalty if Jim wished to withdraw the principle amount invested before he reaches age 59½. There is normally a 10% penalty on earnings withdrawn prior to reaching 59½, except in cases of death, disability, first time home purchase or qualified educations costs.

Surely, the message is clear that no-one can expect to live out their retirement on Social Security or expect Medicare to pay all their healthcare expenses. With proper planning, it is possible to live comfortably now and save for your retirement. Do you really want to live with your kids when you retire? Take the time to educate yourself about the many vehicles available for retirement saving and start today. Remember if you wish to contribute to an IRA for 2006, you must make your contribution before April 16, 2007

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