

The best is yet to come

Optimize your retirement by saving — and planning — right now

RETIREMENT IS ESSENTIALLY an opportunity: a chance to pursue dreams all your own and spend time with family without worrying about a busy work schedule. So why not optimize this period of your life by ensuring your own financial independence? Following are some ways to grow your savings right now as well as to keep taxes from diminishing your efforts.

Maximize contributions to employer-sponsored plans. You may be able to make pretax contributions to your 401(k), 403(b), 457 or Salary-Reduction Simplified Employee Pension (SARSEP) plan up to the legal limit — \$13,000 for 2004 (\$1,000 more than in 2003). Plus, your employer may match some of your contributions — also pretax. And plan assets grow tax-deferred. Similarly, under a Savings Incentive Match Plan for Employees (SIMPLE), you may elect to contribute up to \$9,000 of your salary pretax (also \$1,000 more than in 2003), and your employer is required to make contributions as well. Again, assets grow tax-deferred. Contribution limits

are scheduled to rise, and taxpayers age 50 and up can make additional “catch-up” contributions to these plans. (See Chart 4.)

Save more with a Keogh or single-employee SEP. If you’re a business owner or self-employed, you may be able to deduct contributions to a Keogh or single-employee SEP. This year, the annual contribution limit for defined contribution Keogh plans goes up \$1,000 to \$41,000, as does the limit on single-employee SEP contributions. The benefit limit for defined benefit Keogh plans increases \$5,000 to \$165,000. Limits for all three plans are annually indexed for inflation and their earnings accumulate tax-deferred.

Contribute to a traditional IRA. You may be able to take an above-the-line deduction for traditional IRA contributions up to \$3,000 or 100% of earned income, whichever is less. Taxpayers age 50 and up

TAX ACTION STRATEGY MAINTAIN A CONSTANT AWARENESS OF YOUR RETIREMENT PORTFOLIO

You may think you can set up a retirement portfolio, then return to work and forget about it. Think again: A healthy portfolio demands constant vigilance. First, you need to consider which investments you should hold inside and outside your retirement accounts. For instance, if you hold taxable bonds for the purpose of generating income and diversifying your overall portfolio, consider holding them in an IRA or qualified retirement plan where there won’t be a current tax cost. But try to own dividend-paying stocks that qualify for the 15% tax rate outside of retirement plans so you will benefit from the lower rate.

Second, you likely will need to reallocate your retirement plan assets periodically. For example, if you want 50% of the assets to be in large cap growth funds, but over the last year those funds have outperformed your income and money market funds, the growth funds may now make up 60% of your portfolio. Or, the allocation you set up for your 401(k) plan 10 years ago may be too aggressive now that you’re closer to retirement. In both situations, you may increase the likelihood of achieving your retirement savings goals by continuing to adjust your asset allocation.

Chart 4

Retirement plan contribution limits

Year	401(k)s, 403(b)s, 457s and SARSEPs	401(k), 403(b), 457 and SARSEP catch up ¹	SIMPLEs	SIMPLE catch up ¹	Traditional and Roth IRAs	Traditional and Roth IRA catch up ¹
2004	\$13,000	\$3,000	\$9,000	\$1,500	\$3,000	\$500
2005	\$14,000	\$4,000	\$10,000	\$2,000	\$4,000	\$500
2006	\$15,000	\$5,000	adjusted	\$2,500	\$4,000	\$1,000
2007	adjusted	adjusted	adjusted	adjusted	\$4,000	\$1,000
2008	adjusted	adjusted	adjusted	adjusted	\$5,000	\$1,000
2009	adjusted	adjusted	adjusted	adjusted	adjusted	adjusted

¹ For taxpayers 50 and over.

Source: U.S. Internal Revenue Code

can also make “catch-up contributions” of up to \$500. The contribution limits will increase in future years. (See Chart 4.) But if you participate in an employer-sponsored plan, your deduction may be limited based on your adjusted gross income (AGI).

Consider a Roth IRA. Like a traditional IRA, this may allow you to make annual contributions of the lesser of your compensation for the year, or \$3,000 (reduced by annual contributions to all your other IRAs), plus a catch-up contribution of \$500 if you are age 50 or over. But the contribution AGI phase-out range for Roth IRAs is higher. The contribution limits also will increase in future years. (See Chart 4.) You can’t deduct contributions, but you can take qualified distributions tax free.

Anticipate inflation’s effect. If your retirement is many years in the future, considering how inflation will affect your retirement living expenses is especially important. After all, as measured by fluctuations in the U.S. Consumer Price Index, inflation averaged 4% annually throughout much of the latter part of the 20th century even if it is a bit lower today. For best results, take into account two periods of inflation: the time you will be accumulating retirement funds and the estimated length of your retirement. Knowing exactly how much the cost of living will increase is impossible, but past inflation rates can help you generate a likely estimate. Equally important, life expectancies are increasing, and a longer retirement period means you’ll need more assets built up so that your money can survive as long as you do.

Avoid early withdrawal penalties with a lump-sum rollover. With a few exceptions, retirement plan distributions made before age 59½ are subject to a 10% penalty. But when you change jobs, you may receive a lump-sum distribution from your employer’s retirement plan. Consider rolling it over to the plan sponsored by your new employer within 60 days. Better yet, roll it over into a traditional IRA,



because you likely will have more investment choices. Either way, a rollover will avoid current income tax and early withdrawal penalties while allowing the assets to continue to grow tax-deferred. If possible, transfer by direct rollover to avoid any income tax withholding issues.

Plan for required minimum distributions. For employer-sponsored plans and traditional IRAs, once you reach 70½ (unless you’re still working), you must withdraw the minimum required amount or face a 50% penalty. Whether you should take distributions before 70½ or more than the minimum after that age depends on how much you will receive from other income sources, your life expectancy and other factors. Generally, maximizing tax-deferred growth provides more savings if you can afford to leave the funds in the plan — even if it means depleting other investment accounts. ▲