volume 14, number 5

21st century retirement

Andy Barkate
President
800-914-6837
661-631-4355 Bakersfield
760-371-2115 Ridgecrest
661-631-4350 Fax
abarkate@calretirement.com

in this issue:

It's Never Too Late to Save for Retirement

If you wonder how you'll ever save enough to fund your retirement, you're not alone. The finances of many Americans are stretched thin by mortgage payments, college tuition, or unemployment. The good news is that the Federal government has recognized that most people—especially those over the age of 50—could use some help in saving for retirement. Consequently, tax incentives for retirement saving were enhanced considerably under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and many of these provisions were made permanent by the Pension Protection Act of 2006 (PPA). In the years ahead, contribution limits for most retirement accounts will continue to rise according to inflation.

You may already know that there are various options for tax-efficient retirement saving, but you may not be aware of which account—or combination of accounts—is most appropriate for you, given your current income and your expected circumstances in retirement.

Employer-Sponsored Plans

Many employers offer a qualified retirement plan to help employees save for retirement. Begin by learning about your company's plan. Besides lowering your current taxable income, your contributions to an employer-sponsored retirement plan have the potential for tax-deferred growth. If your company offers matching contributions, it makes sense to contribute at least enough to get the full match.

If your plan and personal circumstances allow, you may wish to contribute up to the maximum to your account permitted by the Federal government. In 2012, the annual limit for 401(k), 403(b), and 457 contributions is $17,000, or $22,500 ($17,000 + $5,500) if you're age 50 and over. If your employer offers a SIMPLE plan, you can contribute $11,500 in 2012, and those age 50 and over may contribute an additional $2,500.

If you participate in a 401(k) or 403(b), consider a Roth option, if available. Offered in addition to a traditional plan, this option allows you to contribute after-tax dollars to a Roth account. Earnings grow tax deferred, and distributions are tax free, provided you have reached the age of 59½ and have owned the account for five years. Keep in mind that any matching contributions from your employer must be made to a traditional account, not a Roth.

continued on page four

Is the Roth 401(k) Right for You?

Since it first became available in 2006, many employers have added the Roth 401(k) to their benefit packages as a retirement savings option. A Roth option is available for Individual Retirement Accounts (IRAs) and 401(k) and 403(b) accounts. To see if a Roth 401(k) would be appropriate for your situation, let's take a closer look.

To Roth or Not to Roth

To start, let's consider 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 income subject to taxation, and earnings in the account have the potential to grow tax deferred. However, your distributions in retirement are subject to ordinary income tax. On the other hand, your contributions to a Roth 401(k) are made with after-tax dollars, but potential earnings and distributions are tax free, as long as you have held the account for at least five years and are at least 59½ years old. So, is it better to pay taxes on your retirement funds now or later? The most appropriate choice for you depends on your current tax situation and your long-term financial goals.

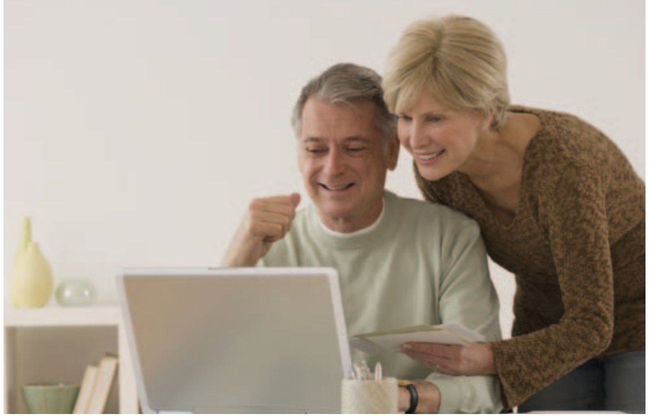
It is important to keep in mind that the 401(k) annual deferral limits—$17,000 for taxpayers under age 50 and $22,500 for those age 50 or older in 2012—apply to all 401(k) contributions, regardless of whether they are made on a pre-tax or after-tax basis. If you contribute to a Roth 401(k), you may have to reduce or discontinue contributions to your employer's traditional 401(k) plan to avoid exceeding these limits. However, you may contribute to both types of 401(k) plans.

Under the Small Business Jobs Act of 2010, participants in traditional 401(k), 403(b), and 457(b) plans are now permitted to roll over funds into Roth accounts within their plans, if applicable. Because contributions to traditional 401(k)s are made on a pre-tax basis, any funds transferred from traditional to Roth 401(k) accounts are taxed in the year of conversion.

Here's another point to consider. Matching contributions made by employers must be invested in a traditional 401(k), not a Roth account. So, even if you make contributions exclusively to a Roth 401(k) account, you may still owe tax on withdrawals from pre-tax funds contributed by your employer to the traditional 401(k) account.

What about the Roth IRA?

The Roth 401(k) is only available through an employer-sponsored plan, whereas the Roth IRA is available to all taxpayers (with income limitations). How do the two Roth options compare? First, you can save more money in a Roth 401(k) than in a Roth IRA. The 2012 annual contribution limits for IRAs are set at $5,000 for taxpayers under age 50 and $6,000 for those age 50 or older. On the other hand, the Roth 401(k) is subject to the more generous elective salary deferral limits that apply to conventional 401(k)s, such as $17,000 or $22,500 for those age 50 or older in 2012.



Further, the Roth IRA is subject to adjusted gross income (AGI) limits; only those with AGIs below $110,000 for single filers and $173,000 for married joint filers are eligible to contribute up to the maximum after-tax dollars to a Roth IRA in 2012. These income limits do not apply to Roth 401(k)s.

In addition, contributions to a Roth 401(k) can be made through payroll deductions, which can put retirement saving on autopilot. To participate, an employee who is currently contributing to a traditional 401(k) plan could, for example, opt to have his or her contributions diverted to a Roth version of the same plan. Unlike the Roth IRA, however, you must begin taking required minimum distributions from a Roth 401(k) after age 70½.

If you are interested in contributing to a Roth 401(k), ask your company's benefit administrator if this option is available for your retirement plan. If not, expressing interest in the Roth 401(k) may prompt your employer to adopt the option. ■

Retirement Plan Rollover Options for Non-Spouse Beneficiaries

If you participate in an employer-sponsored qualified retirement plan, such as a defined benefit plan, 401(k) plan, employee stock ownership plan (ESOP), 403(b) plan, or 457(b) plan, you may have chosen a beneficiary to receive your account balance in the event of your death. If you are married, the law requires that your spouse be named the primary beneficiary of your account, unless he or she waives that right in writing. However, if you are unmarried, or your spouse has waived his or her right, you may wish to name a parent, sibling, child, domestic partner, other relative, friend, or trust. As of 2010, non-spouse beneficiaries of inherited retirement plan accounts are permitted to roll over these assets into individual retirement accounts (IRAs) on a tax-free basis.

The provision allowing rollovers by non-spouse beneficiaries was included in the Pension Protection Act of 2006 (PPA) and initially went into effect on January 1, 2007. Prior to this time, only the spouse of the deceased account owner was permitted to defer taxation on the account by rolling over the funds to an inherited IRA, while any non-spouse beneficiary was required to take a lump sum distribution from the account. Non-spouse beneficiaries were thereby obligated to pay taxes on the full amount received and to declare the income on their personal tax return, potentially creating a challenging tax situation. Starting in 2007, non-spouse beneficiaries were allowed to make the same tax-free rollovers as spouses.

However, under the PPA, tax-qualified employer-sponsored retirement plans were not required to offer direct rollovers to non-spouse beneficiaries. Consequently, many non-spouse beneficiaries did not have access to these tax-free rollovers, unless the plan sponsors had voluntarily chosen to provide the option.

Congress closed this gap in the Worker, Retiree and Employer Recovery Act of 2008 (WRERA), through a provision mandating employer-sponsored retirement plans to offer the rollover option to non-spouse beneficiaries in plan years beginning after December 31, 2009. The WRERA provision also stipulates that beneficiaries who do not opt for a direct rollover, and instead choose to take distributions in the form of a cash lump sum, will be subject to mandatory 20% income tax withholding rules. As a result of IRS Notice 2008-30, non-spouse beneficiaries may also choose to roll over retirement account funds into an inherited Roth IRA.

Under the rules, non-spouse beneficiaries are permitted to directly roll over funds inherited from employer-sponsored retirement plans into inherited IRAs. According to the IRS, retirement plan distributions to a non-spouse beneficiary are subject to many of the same rules that apply to other eligible rollover distributions. Retirement plan sponsors must offer a non-spouse beneficiary the option of making a direct rollover, or a trustee-to-trustee transfer, of eligible rollover distributions to an inherited IRA. This means the transfer is made from the retirement plan to the IRA, and not to the beneficiary.

Other restrictions apply. The rollover must be made to a new IRA, not one already owned by the non-spouse beneficiary, and the new IRA must bear the name of the deceased, not the beneficiary. The rollover must be completed by December 31 of the year following the account holder's death. In addition, beneficiaries are not permitted to make additional contributions to the inherited IRA. The beneficiary must have the same basis in the inherited IRA as the deceased account owner, and the beneficiary may not combine the basis in the inherited IRA with the basis in his or her own IRAs.

After the rollover has occurred, the beneficiary must begin receiving distributions under the beneficiary distribution rules. The beneficiary will not owe taxes on the inherited IRA assets until he or she starts to receive distributions.

These rule changes, which provide important options to non-spouse beneficiaries of employer-sponsored qualified retirement plan accounts, apply to all retirement plans as of 2010. For more information about your employer-sponsored retirement plan, consult the benefit plan administration at your company.

How Longevity May Affect Your Retirement

One interesting factor changing the shape of retirement planning is the steady increase of life expectancies for Americans. Given this population trend, many people may spend one-third of their lives in retirement. Relying on retirement savings plans and Social Security may become increasingly difficult because these programs were not initially designed to provide *perpetual* income. Therefore, your retirement assets and personal savings will have to work longer and harder to help fulfill your financial objectives, whether or not you retire early.

Life Expectancy of All Americans*: 1940–2009

Year	Male	Female	Both Sexes
2009	75.7	80.6	78.2
2004	75.2	80.4	77.8
2000	74.1	79.5	76.9
1990	71.8	78.8	75.4
1980	70.0	77.4	73.7
1970	67.1	74.7	70.8
1960	66.6	73.1	69.7
1950	65.6	71.1	68.2
1940	60.8	65.2	62.9

*Life expectancy at birth for all races.
Source: National Center for Health Statistics, 2011.

it's never too late to save for retirement

continued from page one

The IRA Alternative

When it comes to retirement, personal savings are important, so you may want to incorporate Individual Retirement Accounts (IRAs) into your plan. Generally, the tax-advantaged contribution limit for all types of IRAs is $5,000 in 2012. Those age 50 and over can contribute an extra $1,000. Depending on your tax-filing status, your income, and your participation in a qualified employer-sponsored retirement plan, you may be able to take an income tax deduction for contributions to a traditional IRA. If you participate in an employer-sponsored plan, however, income limits may apply.

A Roth IRA may be an appropriate option if you participate in a qualified employer-sponsored retirement plan and exceed the income limits for a deductible IRA; however, you cannot exceed the income limits set for Roth IRAs. As with the Roth 401(k), contributions to Roth IRA accounts are made with after-tax dollars, but distributions are tax free after the age of 59½, provided the account is at least five years old. Tax-free withdrawals from a Roth IRA could come in handy if, for example, income from a job, combined with required minimum distributions (RMDs) from tax-deferred plans, were to push you into a higher tax bracket in retirement. There are no RMD rules associated with Roth IRAs, and penalty-free withdrawals are possible prior to retirement in certain situations.

If your high earnings render you ineligible for a traditional or a Roth IRA, you may consider contributing to a nondeductible IRA, which has no income restrictions. While it provides fewer tax advantages than other IRAs, your savings will still grow tax deferred.

Isn't it time to stop wondering about your retirement and start taking advantage of tax-efficient retirement savings options? Once you've exhausted your tax-advantaged options, you may want to consider other savings vehicles. Your advisors, including your qualified tax professional, can help you implement strategies that are most appropriate for your situation. ■

The information contained in this newsletter is not intended as tax, legal, or financial advice, and it may not be relied on for the purpose of avoiding any Federal tax penalties. You are encouraged to seek such advice from your professional advisors. The content is derived from sources believed to be accurate. Neither the information presented nor any opinion expressed constitutes a solicitation for any insurance or financial products.

21st Century Retirement is written and published by Liberty Publishing to help keep you up-to-date on the issues which may affect your financial well-being. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. For specific advice on how to apply this information to your particular circumstances, you should contact your insurance, legal, tax, or financial professional. Printed in September 2012.