Retirement questions your kids haven't asked but should

Become the expert they need

Retirement seems to be the reward for decades of success. But just like building a career, saving for retirement takes work and dedication. What lessons have you learned as you and your advisor planned how you'll fund 20 to 30 years of retirement? What do's and don'ts would you share with your kids – and their kids – if you could do it all again?

They may not be seeking answers yet, but it never hurts to start a conversation anyway. You'll need to cover the basics, of course, including the benefits and considerations of multiple investment vehicles, but you'll also want to share the importance of saving early and often. You should also probably tackle the nitty-gritty of tax efficiencies, and maybe even withdrawal strategies. It's a lot of ground to cover, but we think it'll be worth the effort. If you get stuck along the way, ask your advisor for some guidance, either for yourself or for the next generation of good financial stewards.

401 what?

401(k) plans are everywhere it seems. And while they're named after the IRS tax code that created them, what you really need to know is that they're employer-sponsored retirement plans that allow contributions to grow tax-deferred over time. A 401(k) is a good savings plan to help someone fund a big goal: retirement. You may invest the money among the available options within the plan, but perhaps even better is the fact that many employers agree to match some portion of your contribution. No reason to leave money on the table, right? Just be aware that there might be a vesting schedule, which means you may have to wait for a certain period of time before those employer contributions become yours.

Benefits: While 401(k) contributions are subject to Social Security and Medicare taxes, they are not subject to ordinary income tax, which reduces your taxable income. That means, for instance, if you earned $80,000, and you contributed $4,000, you'd only be taxed on $76,000.

Considerations: Earnings also grow without taxation. However, you will pay taxes when you withdraw the money. If you need the money before age 59 1/2, you'll most likely owe Uncle Sam a 10% penalty on top of ordinary income taxes. There are exceptions for qualifying distributions, so consult your financial advisors to ensure you know what to expect. And by age 70 1/2, the IRS will require you to start withdrawing the money as a required minimum distribution (RMD), based on life-expectancy tables.

Good for: Savers who need some discipline could benefit from the convenience of automatic payroll deductions and a possible employer match. Also, the contribution limits are higher than they are for IRAs.

More than 55 million participated in 401(k)s in 2018, accounting for roughly $5.3 trillion of the $27.2 trillion in retirement-plan assets in the U.S.

There's more than one kind of IRA?!

Often referred to as the granddaddy of retirement plans, individual retirement accounts (IRAs) have been around since 1975. Much like a 401(k), contributions are generally tax-deductible (see considerations below), which lowers your tax bill. You will pay taxes when you withdraw money in retirement, and RMDs must begin by age 70 1/2. Likewise, if you withdraw the money before age 59 1/2, you will be subject to ordinary income tax and may be subject to a 10% penalty.

The annual IRA contribution limit increased to $6,000 for 2019; $7,000 for individuals 50 years or older.

Benefits: An IRA is an easy, flexible way to save, and a great opportunity to reap the benefits of long-term tax-deferred growth. The range of investment choices generally exceeds that of a workplace retirement plan.

Considerations: An IRA may be a good choice if your employer doesn't offer a retirement plan or if you've maxed out your 401(k) contributions for the year. But if you also participate in an employer-sponsored retirement plan, such as a 401(k), the amount of your tax deduction may be limited – or you may not be eligible for a deduction at all. In this case, certain limitations apply based on your earnings, so be sure to consult your advisor.

Good for: People who want to make their own decisions about buying and selling the investments in their accounts or want to hire someone to do it.

Can I go wrong with a Roth?

When it comes to taxes, this retirement vehicle takes a different approach. Contributions are made after taxes, so you forgo the current tax deduction for a tax benefit down the road. In the meantime, the money grows tax-free. There is one caveat: Contribution limits are based on your modified adjusted gross income (MAGI), and those amounts begin to decrease for single taxpayers who earn more than $122,000 (2019) and joint filers who earn more than $193,000.

Benefits: You can withdraw your contributions before retirement age without taxation or penalty, as long as five years have passed since your first contribution. However, a withdrawal of earnings prior to age 59 1/2 would be subject to taxation and possible penalties. There are no required minimum distributions, regardless of age. The rules are slightly different for conversions, so please consult your tax and financial advisors for specifics.

Considerations: You can contribute to both an IRA and a Roth IRA, which may provide some tax diversification, but the total contributions cannot exceed the combined IRA contribution limit of $6,000 (2019) or $7,000 if you're 50 or older.

More than one-third of U.S. households owned individual retirement accounts in 2017.

60%

of U.S. households had retirement plans through work or IRAs.

80%

of IRA-owning households also had employer-sponsored retirement plan accumulations or had defined benefit plan coverage.

Good for: Individuals who anticipate the need for a tax break in retirement.

Are pensions a thing of the past?

Pensions, which are increasingly rare as a retirement option, are hard to beat. They offer a lifetime income stream, which can translate to increased confidence in your future financial security. If you're lucky enough to have one, your employer will contribute during your working years; some require you to contribute as well. What you get is a monthly check that mimics a regular paycheck for the rest of your life. The amount is determined by a complicated formula based on your age, salary and years of service, but because they're a defined benefit plan, you basically

Visit the Pension Benefit Guarantee Corporation (PBGC.gov) to determine if yours is covered under its guarantee and the amount of your specific benefit.

get a specified amount of money throughout retirement – regardless of the vagaries of the markets.

Benefits: Hands down, the biggest benefit is steady income for life. Contributions are pre-tax, and any investment income that accumulates is tax-deferred. Federal law also requires defined benefit plans to offer joint and survivor options for married participants, which allows for retirement income over two separate lives.

Considerations: Most pension money is taxable when you receive it. In instances where after-tax money was contributed, you may have some tax-free benefits, but these situations are rare. Your pension benefits are also subject to a vesting schedule, which indicates how long you have to work for the company to be eligible.

Good for: Pensions were popular during a time when employees typically worked for the same company throughout their career, but in today's mobile job market, pensions have largely been replaced by the 401(k). While roughly 38% of workers had a pension in 1980, only 18% of private-sector workers had access to one in 2017, and only 15% participated. Public-sector employees, such as teachers, police officers and government workers, are more likely to have a pension.

Who can have an HSA?

Then there's something called an HSA, or health savings account, which is intended to help you save for out-of-pocket healthcare costs. It's not traditionally considered a retirement savings vehicle, but it can be. Individuals with high-deductible health insurance plans who don't need the money for medical expenses can use the tax benefits to save for retirement.

Benefits: Contributions are made with pre-tax dollars via payroll deduction, so there's no upfront taxation. If your plan offers investment options at a certain threshold, those assets also grow tax-deferred, and qualified distributions are tax-free as well. If you don't spend the money, it rolls over year after year, which means you can tap into it for future medical expenses.

Considerations: If, before the age of 65, you withdraw money for something other than medical expenses, you will have to pay taxes and a 20% penalty. Be sure to save your medical receipts. There's no limit on reimbursements, so you can use the funds during retirement when healthcare expenses may be higher. Just note that you can no longer contribute to an HSA once you enroll in Medicare.

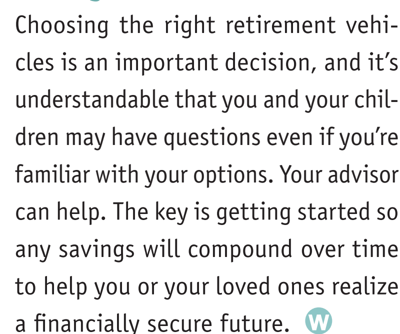
Good for: Individuals who don't anticipate big healthcare expenses. Otherwise, you might be better off with a healthcare plan that has a higher premium and covers a greater portion of the costs.

Is more really better?

According to the principle of asset allocation, it's important to diversify your financial plan among different asset categories. The same is true for retirement income. You might start with an employer-sponsored retirement vehicle, such as a 401(k), but that should not be your only choice. Down the road, for instance, you may want the flexibility that comes from having both taxable and non-taxable retirement savings.

If you have multiple accounts, it may be difficult to decide which assets should be sold first to generate retirement income. There are many things to consider, both from an income tax and estate tax perspective. That's why it's best to consult a tax expert and your financial advisor.

Getting answers



Choosing the right retirement vehicles is an important decision, and it's understandable that you and your children may have questions even if you're familiar with your options. Your advisor can help. The key is getting started so any savings will compound over time to help you or your loved ones realize a financially secure future.

What if I'm not working?

Even with no earned income, you can still save for retirement. If your spouse has taxable compensation and you file a joint tax return, you can contribute to a traditional or Roth IRA as a non-working spouse. Contribution limits for a spousal IRA are the same: $6,000 if you're under age 50 and $7,000 if you're 50 or older.

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Sources: investopedia.com; nerdwallet.com; moneytips.com; money.usnews.com; thebalance.com; forbes.com; ici.org; fool.com; finance.zacks.com