

Saving efficiently for retirement

How can you live comfortably in retirement? It's easy, in theory. You do it by saving and investing as much as you can right now. Yet, in practice, as we all know, it's not that easy.

If your income is substantial, as much as 35% can be lost to federal income tax, not to mention the additional hits of state, Social Security and Medicare taxes. It's extremely difficult to save efficiently for retirement when more than 40 cents of each dollar earned may disappear before you can save it. Add to that, depending on how you invest it, the income from what's left over may be taxed as well.

Fortunately, Uncle Sam offers a variety of investments and retirement vehicles that can reduce the potentially heavy tax burden on funds set aside for your retirement.

Solution one: the company retirement plan

Company 401(k) and other qualified retirement plans offer the best and simplest opportunity to build a substantial retirement nest egg. Your contributions are carved out of your salary free of income tax, and their income grows tax deferred as well. Many employers offer a match on your contributions. [Keoghs, SEPs and 403(b) plans offer similar benefits.]

The downside, of course, is in that word "deferred." You must pay tax to Uncle Sam eventually, and if you make a withdrawal prematurely, you may be subject to a 10% penalty on your withdrawal as well. What's more, you are limited in the amount that you can defer. For example, in 2007 the maximum 401(k) contribution is \$15,500—\$20,500 for those age 50 and over.

Solution two: tax exempts

Income from tax-exempt municipal bonds is exempt from federal tax. Usually, interest is also exempt from state income tax in the state where the bond was issued.

Thus, when evaluating investments for the bond portion of your portfolio, you should compare the after-tax return on an investment in taxable bonds with the lower return of munis, in order to determine which bonds offer you the greater opportunity for savings. With the lower tax rates set in place in 2003, munis are not as attractive to as many investors as they once were.

Solution three: IRA choices

Two other retirement vehicles, the traditional IRA and the Roth IRA, merit consideration as well. Eligibility for both depends upon your adjusted gross income (AGI).

Eligibility. In 2006, in order to make a fully deductible contribution to a traditional IRA, you must (1) not be an active participant in an employer's company plan, *or* (2) your AGI must not exceed \$75,000 (marrieds filing jointly) or \$50,000 (singles). You may contribute to a Roth IRA regardless of your participation in a company plan. Full (nondeductible) contributions to a Roth IRA are allowed as long as your AGI doesn't exceed \$150,000 (marrieds) or \$95,000 (singles).

Contributions. In 2006 both IRAs allow a maximum annual contribution of \$4,000 between them (\$5,000 for those age 50 and older). You may allocate your contributions between them in any way that you wish.

Withdrawals. For a traditional IRA the full amount of any withdrawals is taxed, except to the extent that they represent nondeductible contributions. There also are mandatory withdrawals after age 70 1/2. For a Roth IRA there is no tax on withdrawals and no mandatory withdrawals. However, for tax-free withdrawals of earnings, you must have owned the Roth IRA for at least five years and be at least 59 1/2 years old.

Withdrawals are also penalty free if you die, become disabled or, subject to certain conditions, use the withdrawals for qualified education expenses. A withdrawal of up to \$10,000 for first-time home-buying or home-building expenses also can be penalty free.

We would be glad to discuss your retirement investment options in more depth. Please feel free to call upon us at any time.

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Any developments occurring after January 15, 2007, are not reflected in this article.