KING
FINANCIAL GROUP LLC

Saving for the Retirement Years

Preparing for retirement requires a plan, and that plan should consist of two important phases: the saving years and the retirement years. To achieve the goal of a financially secure retirement, you will have to make wise decisions during the saving phase of your plan.

For starters, if you plan to use IRAs to help you save, you need to decide what type of IRA you're going to use. Traditional and Roth IRAs have different eligibility requirements, and each has its own advantages. More than likely, your unique financial needs will make one kind of IRA better-suited for you than the other, so it's a good idea to evaluate your options.

The main difference between traditional and Roth IRAs is the way their earnings are treated for tax purposes, so it's important you understand the concepts of tax-deferred and tax advantaged accumulation. With tax deferral, you only owe taxes when you withdraw money from the account. A traditional IRA lets you make contributions and pay taxes when you take withdrawals. Withdrawals prior to age 59-1/2 may be subject to a 10% IRS penalty.

On the other side of the coin, tax-free growth means you don't have to pay federal taxes on your earnings. A Roth IRA offers the potential for tax-free growth on the after-tax dollars you invest, as long as you meet a few specific requirements. To avoid paying taxes on your Roth IRA earnings, you must have held the IRA for five years and you must be age 59½ or older at the time of withdrawal. Nonqualified withdrawals may be subject to income taxes and a 10% IRS penalty.

In addition to the difference in how earnings are taxed, another important consideration is the tax deduction possibilities of a traditional IRA. As long as you meet certain conditions, you may be able to claim a deduction on your income taxes based on the amount of your IRA contributions.*

To help illustrate our objective, let's consider an example. Suppose Kim, age 30, is thinking about investing for her future retirement security. Even before considering her IRA options, her first smart move would be to invest in her employer's 401(k) plan. Assuming she's already done that, let's think about her IRA options. With a modified adjusted gross income (MAGI) of $30,000, she is eligible for either a tax-deductible contribution to a traditional IRA or a non-deductible contribution to a Roth IRA. To help her decide, she should think about her answers to a few key questions. For one thing, how would she handle the immediate tax benefit (i.e. tax deduction) of a traditional IRA contribution? If she chooses to invest the money she would otherwise pay in taxes, her savings could get an additional boost. But if she chooses to spend it elsewhere, the deduction a traditional IRA offers may not help in building her retirement assets.

Kim also needs to ask herself how soon she will need to access her retirement savings. Any traditional IRA withdrawals before age 59½ will be taxed as ordinary income and may also incur a 10% IRS penalty. So if she expects to need access to her retirement savings before age 59½, tax- and penalty-free access to Roth IRA contributions would probably prove valuable.

Additionally, Kim needs to think about whether her tax bracket during retirement will be higher or lower than what it is currently. This could provide valuable insight as to which account would be better suited for her, given the taxation of traditional IRA withdrawals versus the tax-free withdrawals from a Roth IRA.
Like our example, it's important for you to think about retirement savings well before you approach the time when you'll actually need the funds. Take steps now to get your savings started, and make the most of the years you have to add to that savings.

** Your ability to deduct traditional IRA contributions is determined by your participation in an employer-sponsored retirement plan, tax filing status, and MAGI.*

Our firm does not give tax or legal advice.

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