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Youth + Roth IRA/401(k) = Successful Retirement Planning

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What makes youth and a Roth IRA such a great combination? Starting to plan for retirement early creates many possibilities for success. As young adults start their first job with retirement benefits, one of the initial questions they need to address is how to invest in the 401(k) or other defined contribution plan offered by their employer. Deciding whether to pay taxes now or in retirement can affect the amount of money you need to save.

It is important to begin planning for retirement at a relatively early age, even if you've just started your career and the day you stop working seems like a long way off. To help you tackle the many decisions that go into this process, let's consider the following questions:

1. Do you understand the implications of pre-tax versus after-tax contributions?
2. Are you single or married?
3. Do you have children?
4. Do you have flexibility in your budget to contribute to the plan?
5. Do you get a tax refund or are you looking for tax breaks?

Taking the time to consider these questions, and ask some additional ones, can have a powerful impact on your retirement success. The first step, however, is making the decision to start saving.

1. Do you understand the implications of pre-tax versus after-tax contributions?

When 401(k) plans were first created, they provided an opportunity to save for retirement with pre-tax dollars. This means, for example, that you could deduct $50 from your check each pay period and contribute it to your 401(k). That money would be taken from your pay before taxes, so the benefit would be a reduction in taxable income. Essentially, it would make the actual deduction of $50 feel like a deduction of only about $45 from your paycheck. This would vary, of course, based on your personal tax rate, and you may consider discussing how this would affect you individually with your tax professional. That $50 would be invested and grow in your 401(k) until you retired. You would then pay taxes on it, and on any earnings, based on your tax rate in retirement, when you withdraw the funds. The idea is that your tax rate would hopefully be lower in retirement, which can extend the time your savings will last.

When after-tax (or Roth) options were added to 401(k)s, it gave employees who didn't need the tax deduction at the present time an opportunity to pay taxes on their contributions from each paycheck. If contributions are not distributed before age 59.5, all distributions (contributions and earnings) will be tax-free.

2. Are you single or married?

The IRS has set limits on the amount of income an individual or married couple can earn and still contribute to a Roth IRA. These earnings limits, however, are not applicable to Roth contributions inside a 401(k) plan. But other limits do still apply. In 2016, they are as follows:

Income limits for Roth IRAs:

Single	Phase-out starts at $117,000, ineligible at $132,000
Married	Phase-out starts at $184,000, ineligible at $194,000

Contribution limits:

Roth IRA	$5,500	Over age 50, $6,500
Roth 401k	$18,000	Over age 50, $24,000

Contributions inside a 401(k) can be split between after-tax (the Roth option) and pre-tax (the traditional 401(k) option). If your employer offers the Roth feature, the future benefits are worth the time to consider it.

3. Do you have children?

Having dependents gives you an additional deduction on your tax return. Child-care costs are also deductible while children are in daycare and after-school programs. These deductions may reduce your tax liability and generate opportunities to prolong the benefits of contributing after-tax dollars to your Roth 401(k).

4. Do you have flexibility in your budget to contribute?

When deciding what to contribute to your retirement plan, it is easy to overestimate how much you can afford. This is especially true when your employer contributes matching funds (a benefit you generally want to take full advantage of). Although most plans do allow for hardship withdrawals and loans, it is important to set your contribution level based on a realistic budget and a commitment to not take out contributions prior to retirement. Consider these funds "out of sight and out of mind."

Some plans offer the opportunity to set up your contribution as a percentage of your salary. Give this option some thought. The benefit could be instant additional savings. Each year (or however often you receive pay raises) when your salary increases, you will automatically increase the amount you are contributing to your retirement savings without thinking about it or changing your budget.

5. Do you get a tax refund or are you looking for tax breaks?

Whether it makes more sense to elect the after-tax or pre-tax option can change at different phases of your career. Your answers to each of these questions may also change at multiple stages and times during your retirement-accumulation period. Changes to those answers will affect how you answer the question about tax refunds versus tax breaks. As your career continues and your salary increases, other deductions may also change. A periodic review of your contribution strategy is important to be sure you are taking advantage of all the options available to you.

Creating a retirement savings plan at the same time your start your career can be confusing. But the importance of educating yourself on your savings opportunities can have a huge impact on your personal success. Consult an advisor as you make your plan. Advisors may include the retirement plan advisor, tax accountants or other investment advisors. The more knowledge you have, the greater your chances for a fulfilling and worry-free retirement.

About Judi Pflaumer, Wealth Strategies, Wealth Management Group, LLC, Dover, DE

Judi develops and maintains a strong working relationship with clients by understanding that investment planning is more than just selecting investments. She creates a relationship by getting to know what is important to you and helping to create a plan that puts your focus on the things that are most vital in your life.

Judi enjoys working with businesses to create a retirement plan that supports employers in providing opportunities and education to assist employees in planning for their retirement. Judi Pflaumer has been with the firm since 2001. Along with Wealth Strategies, she also serves as Chief Compliance Officer.

Judi received her Bachelor's Degree in Organizational Management in 2012 along with her Master's Degree in Management. In 2016 Judi completed the Certified Pension Fiduciary Advisor (CPFA) designation. She is an active volunteer in Kent County serving as a board member and volunteer for several organizations.