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Last Opportunity for 2016 Retirement Contributions

"Invest Now to Improve Your Retirement"

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Each and every year the Internal Revenue Service allows anyone with earned income another chance to contribute to a retirement account. One of the best things you can do for yourself is to make that contribution. Those of you who believe retirement is too far into the future to worry about it today, are missing an opportunity to have your money work as hard, if not harder than you. For most, the contribution deadline for a 2016 contribution is April 17, 2017 since the 15th is on a Saturday this year.

After many years of tax regulation simplification by Congress, it only takes a small matrix to determine the best plan for you. The matrix can determine whether you should make a pre-tax or an after-tax contribution, the deductibility of the contribution, if your non-working spouse is eligible to make a contribution, whether or not the amount of earnings is below the limits for contributions, and lastly the annual contribution limit or if you are eligible for a bonus contribution. We should be thankful to Congress for making this so easy.

For individuals, there is the option of a traditional Individual Retirement Account (IRA), a Roth account, or a combination of both. Those under the age of 50 at the end of 2016 can contribute up to the plan limits set at $5,500 and those 50 and over can add an extra $1,000, a total combination of $6,500. To be eligible, the contributor must have earned income (W-2 wages) or profits from a sole proprietorship at least equal to the contribution. For married couples, one spouse can make an ineligible spouse eligible by having earnings in excess of their own contribution and sufficient to cover the contribution for both spouses. As a reminder, IRS codes stipulates distributions from IRA plans are taxable when taken while distributions from Roth accounts are tax free. There are many rules governing these plans including a penalty for taking distributions too soon, or failing to take one once the holder reaches 70 ½ in age which Roth accounts are not subject to the mandatory distribution rules at age 70 ½.

Unfortunately, the IRS has placed income limits on whether someone is eligible to contribute to a Roth plan or whether a contribution is deductible when it is an IRA plan. Those whose income is too high to contribute to a Roth, may still be able to add to a Roth account through the conversion of an IRA account. There could be tax consequences on the conversion but this depends upon each taxpayer's individual circumstances. For traditional IRA plans, the contributions are deductible unless the taxpayer's income is too high and they participate in an employer's plan. Based upon the tax rules it is best to avoid non-deductible IRA contributions as you can see by the following. When a nondeductible contribution is made to an IRA, the taxpayer is now required to keep track of the tax basis of those

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contributions by filing an additional tax form every year until the plan is depleted of funds. Additionally, when distributions are taken during retirement and part of the IRA value contains non-deductible contributions, a portion of each distribution must be allocated part of the tax basis to avoid paying tax on contributions that were taxed in the year of the contribution; this is based upon the ratio of the basis to the total IRA value.

For businesses, only the SEP-IRA plan can be established once the year has ended and still funded for 2016. All other business plans are required to be established prior to the end of the year. The contribution limit for this type of plan is twenty-five percent of the wages paid or profits and could be required to include employees of the business. This plan can be opened and funded up until the due date of the return including extensions.

Since most taxpayers look for tax deductions, the traditional IRA is used more often because contributions can be deducted where Roth contributions are not. In coaching my clients, I believe it is beneficial to have substantial funds not only in an IRA, but also Roth and taxable accounts at retirement. Doing so better allows the taxpayer to manage their income tax bill during retirement by withdrawing a portion of their needs from each type of account since each is taxed differently. It is crucial to remember, it is not always the amount that is earned, but what is kept after taxes.

	Years to Retirement					
Return	40	35	30	25	20	10
5%	$35199.94	$27580.08	$21609.71	$16931.77	$13266.49	$8144.47
7%	$74872.29	$53382.91	$38061.28	$27137.16	$19348.42	$9835.76
9%	$157047.10	$102069.84	$66338.39	$43115.40	$28022.05	$11836.82

The above is a hypothetical example provided for illustrative purposes.

Investing $5,000 now as shown in the table, may provide more confidence during retirement. And the more years you have until retirement as shown in the table, the more significant a single contribution can make. Those under the age of 40 often fail to realize the impact a small retirement contribution can make. Or the benefit a small balance from an old 401(k) plan can make by letting it grow, in lieu of closing the account and paying the taxes and penalty just because the amount is small. Parents and grandparents have the opportunity to significantly impact a child's future life by assisting them to make a retirement contribution. While the child needs to have earned income, the funds for the contribution can be a gift from parents or grandparents.

A small account with $2,000 in it for a 30 year old, could grow to $40,827.94 by age 65 without additions. Or, if withdrawn and after taxes of 25% (including the 10% penalty) is only worth $1,500. The question becomes $1,500 of fun now, or potentially $40,000 of fun later?

Retirement is the longest vacation you will take. Will it be one you enjoy? Or, the longest struggle of your life?