

Winning Wealth by Dawn J. Bennett

Discover rest of the nest, go beyond 401(k) plans

Most of us accept the fact that traditional pension funds are disappearing and being replaced by tax-deferred retirement plans, such as 401(k) plans. Indeed, many of us have embraced the trend, even though we are essentially giving up a guaranteed pension in exchange for a chance to do better by managing our own savings plans.

With a 401(k) plan you put a portion of your pay into a personal account, rather than into a group account such as a traditional pension plan. You then direct your savings into investments, typically mutual funds. Neither your contributions nor the investment earnings they generate are taxed until you withdraw them in retirement. That way they can compound year after year and, ideally, grow into a tidy sum.

However, pinning your retirement hopes on a 401(k) plan is not without risk. If you don't put enough of your wages into the plan or if you invest unwisely, you could have to postpone your retirement or live more frugally than you had hoped. This serious problem will become more acute during the next decade as the bulk of the baby boom generation hits retirement age.

Most workers don't take retirement seriously until it appears on the horizon — sometime in their 30s, but more often when they are in their 40s and 50s. At that point it is too late, even if they have invested wisely. The maximum allowed 401(k) annual contribution for this year, \$15,500 or \$20,500 for people 50 or older, simply will not be enough for many workers who have not saved regularly throughout their careers.

If you find yourself in this situation, you need to broaden your investing horizon beyond the 401(k) plan to strengthen your reserves. Unlike the traditional pension plan, the 401(k) is not necessarily an all-in-one

solution. Other tax-deferred investing plans are available, and you should take advantage of as many as you can while building up your 401(k) savings. Let's take a look at some of the options.

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IRAs: Individual retirement accounts (IRAs) come in two varieties, traditional and Roth.

The Roth IRA is the most advantageous. Although you get no immediate tax break for putting money into a Roth, your investment gains will never be taxed.

Unfortunately, the Roth IRA comes with income restrictions, making it impractical for many workers. You can contribute up to \$4,000 annually (\$5,000 if you're 50 or older), as can your working spouse, even if you have a 401(k) plan at work. However, your eligibility to contribute begins to phase out as your adjusted gross income rises above \$95,000 for individuals or \$150,000 for married couples.

With traditional IRAs, gains on your investments within the plan are not taxed until you withdraw them in retirement. That gives them valuable time to grow and compound, making them a better savings vehicle than a plain-vanilla, taxable savings account.

Annuities: An annuity is an insurance contract that promises to pay you a guaranteed stream of income until you die. Because annuities are sold by insurance companies, many consumers mistakenly view them as life insurance products. But an annuity is really just another investment vehicle, one that can supplement your retirement income.

There is no immediate tax benefit for making contributions, but your investments grow tax free until they are withdrawn in

retirement. Happily, there are no income limits or contribution limits for annuities. The guaranteed income stream, however, is a form of insurance and carries a cost that is not present in IRAs. It pays to shop around. Look for an insurance company with strong capitalization and consistently high safety ratings.

Annuities come in two varieties: fixed and variable. Fixed annuities offer a guaranteed rate of return, comparable to bank certificates of deposit. Given today's low interest rates, they really don't make sense except for the most conservative investors. Contributions to variable annuities can be invested in a variety of vehicles, typically mutual funds. In that manner, they are much like 401(k)s. Look for an annuity that offers a wide range of investment options.

Health savings accounts: These accounts, approved by Congress in 2003, allow you to save money on a tax-free basis to pay health care expenses. An HSA plan must be paired with a high-deductible health insurance plan. Many employers are beginning to offer them.

As with other savings plans, you can invest your HSA contributions (up to \$2,800 annually for individuals, \$5,650 for families) and watch them grow. Though you can spend your HSA savings to pay current bills, you're better off allowing them to compound over time. A dedicated, tax-free pool of money for medical expenses will take on increasing importance as you grow older.

Long-term care. Unlike the other options discussed here, long-term care is not a tax-deferred savings plan. It is a form of insurance that can pay a portion, typically \$50 to \$250 a day, of the cost for nursing homes, in-home care, a nurse's aide, physical therapy and other health-related outlays.

Given the continually rising cost of medical care, long-term care is essential. Think of it as a retirement savings plan that will keep you from cleaning out your coffers to cover medical costs.

When shopping for a long-term care plan, look for a guarantee the policy won't be canceled or non-renewed as you age or

become ill. Also be sure it covers unskilled as well as skilled help and consider a plan with an inflation protection option.

Granted, managing your 401(k) plan along with so many other saving plans requires time and attention. But you can hardly complain that you are without options. Congress has provided a pretty good

menu of tax-deferred savings options. It is your job to take advantage of them.

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