

## Tax Tips You Can Use



Financing Retirement: 401Ks  
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Many people worry about financing retirement, but don't know what options are available to help them save for retirement. The next three articles in this series will talk about the options that wage earners and self-employed individuals have to save for retirement. This month, the subject is 401K plans and other retirement savings plans offered to wages earners. Retirement plans can be called 401K, 403B or other names. Typically, these names refer to the code section or law that defines the rules for the plan. Section 401, Paragraph K of the Internal Revenue Code defines the 401K retirement savings plan. Although company plans may be governed by different laws, the basic rules for wage earners are very similar.

People who work for wages have taxes, insurance and other items withheld from their periodic paychecks. If the wage earner has signed up for a 401K or other retirement savings, the money withheld for this account is taken after the social security taxes (FICA and Medicare) are calculated, but before the income tax is figured. These dollars are pre-(income)tax dollars. Most of the time this is a good deal for the taxpayer but there are rare exceptions.

It is a good deal when there are matching funds from the employer. Even if the employer matches only \$1 to \$10 of contribution, the wage earner has made 10% "interest" on his money right away. This early increase will compound with investment growth and add substantially to the final amount of retirement funds. If your employer offers any matching funds for retirement savings, a wage earner is foolish not to save in this way.

Putting money into a 401K is a good deal because it is a forced and continuous savings for retirement. It is taken out of the paycheck before you see it and once you get used the amount of net pay that you will receive each payday, you don't miss the money that you are saving. Even a few dollars per payday can add up to a large retirement nest egg because the savings will grow over time.

Saving for retirement with a 401K is a good deal because it will lower the income tax that you pay in the year you save. If your family taxable

income is over about \$20,000.00, you are in the 15% bracket for federal income tax and 9% bracket for Oregon income tax. Every dollar that you save will reduce your tax bills by 24 cents. If you put \$5000.00 into a 401K, you will save over \$1000.00 on your tax bill.

There is a set of circumstances where saving in a 401K is not a good deal. If your employer does not match your contributions and if you are in circumstances that cause you to have no tax liability, saving for retirement with a 401K is not a good idea. The wage earner is taking money that, if taxed today, would have zero tax due and pushing it out into the future to be taxed later when, because of salary increases, fewer deductions or tax rate increases, tax could be due.

In this unusual event, saving retirement dollars in a Roth IRA is a better deal...if the taxpayer has the discipline to set the money aside for the Roth contributions. Anyone who needs a forced savings plan is still better off with payroll deductions because in this day-and-age saving for retirement is not optional, it is a must do.

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