Larson Gross

Retirement Savings: 401(k) vs. IRA

There are many different types of retirement plans, and it can be difficult to choose the right one for your situation. While pensions have long been touted as the best retirement plans, most companies no longer offer this alternative. Still, you have many other options to consider. Should you opt to fund a retirement plan yourself, independently from your employer, or should you elect to utilize your company's 401(k) plan? Should you choose to draw Social Security and hope for the best, or possibly even work a part-time job throughout your golden years? This guide will walk you through the most popular retirement options and help you choose the best one for your situation.

Why Should you Choose a Retirement Plan?

First, it's important to understand that retirement savings should always be your first choice. You should never rely on Social Security alone to cover your living expenses throughout retirement. Why? Mostly because the program was never designed to fully replace your income. It's meant to supplement your retirement savings. In fact, the average Social Security benefit is roughly $1,400 per month. That's hardly enough to cover basic living expenses, and you will need much more if you want to travel or enjoy the finer things in life.

In addition to the more obvious reasons, however, there are other financial concerns to consider. For one, retirement accounts offer many tax advantages and other incentives. You may also be eligible for a tax credit if certain criteria are met.

But which retirement plan should you choose? Let's review some of the most popular retirement options.

401(k)

A 401(k) is a type of defined contribution plan offered by many companies for their employees. With most 401(k) plans, the employee contributes a certain percentage of their gross paycheck to the plan, and oftentimes the employer elects to match a portion of this amount with their own funds. The portion is generally 100% or 50%, though it varies from one employer to the next. For example, if you contribute 5% of your pay, your employer may elect to match that amount, essentially doubling your investment.

Unfortunately, some employers don't offer a match at all. Still, there are other benefits to a 401(k) if you're in this situation. If your employer's plan is a traditional 401(k), your contributions won't be taxed. Instead, you will pay taxes on the withdrawals you make during retirement.

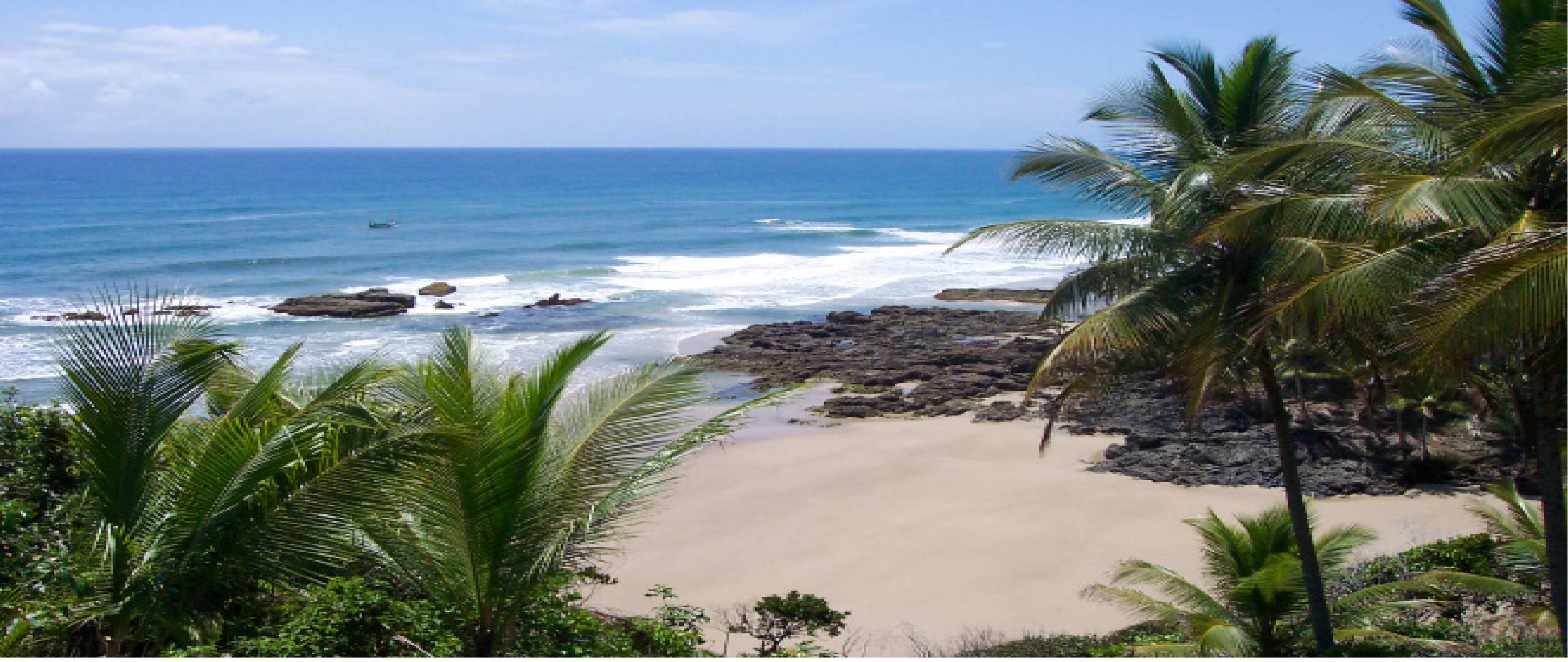
If it's a Roth 401(k) plan, the opposite is true: You will pay taxes on your contributions now, but your withdrawals will be tax-free once you reach retirement age.

In addition, a 401(k) is often the easiest retirement plan to utilize. Because your employer handles all of the setup and maintenance, all you have to do is fill out a few forms, then the money is automatically deducted from your paycheck. However, most companies charge administrative and/or management fees for their services.

401(k)s also have higher contribution limits than most other retirement plans, which is a huge benefit if you want to max out your retirement savings. Most Roth 401(k) plans have no income restrictions either, unlike Roth IRAs. Also, you can take your 401(k) savings with you if you ever change jobs, thanks to rollover options.

However, there are a few drawbacks to 401(k) plans, as well. Many people dislike the limited choices when it comes to investing their retirement funds, and your company may require a vesting period, which means all of the money in your account isn't technically yours until you have worked with the company for a certain number of years.

Still, even with these drawbacks, a 401(k) is arguably the most popular option for retirement savings for most people because of the many benefits they offer.



IRA and Roth IRA

An Individual Retirement Account (IRA) is another solid investment strategy. There are a few different types of IRA accounts available, with traditional and Roth IRAs being the most common options.

With an IRA account, you will make your own decisions about your investments. In addition, there is usually a much wider range of investment options available than you'll have with a 401(k).

However, the yearly contribution cap is generally much lower than a 401(k) cap. There may also be a phase-out schedule for certain income levels, and you may or may not be able to deduct all of your traditional IRA contributions.

But there are additional benefits to a Roth IRA. The most important thing to note is that Roth IRA withdrawals aren't taxed during retirement (though the contributions will be taxed when you make them). In addition, there is no mandatory withdrawal age, so your funds can continue to grow until you need them.

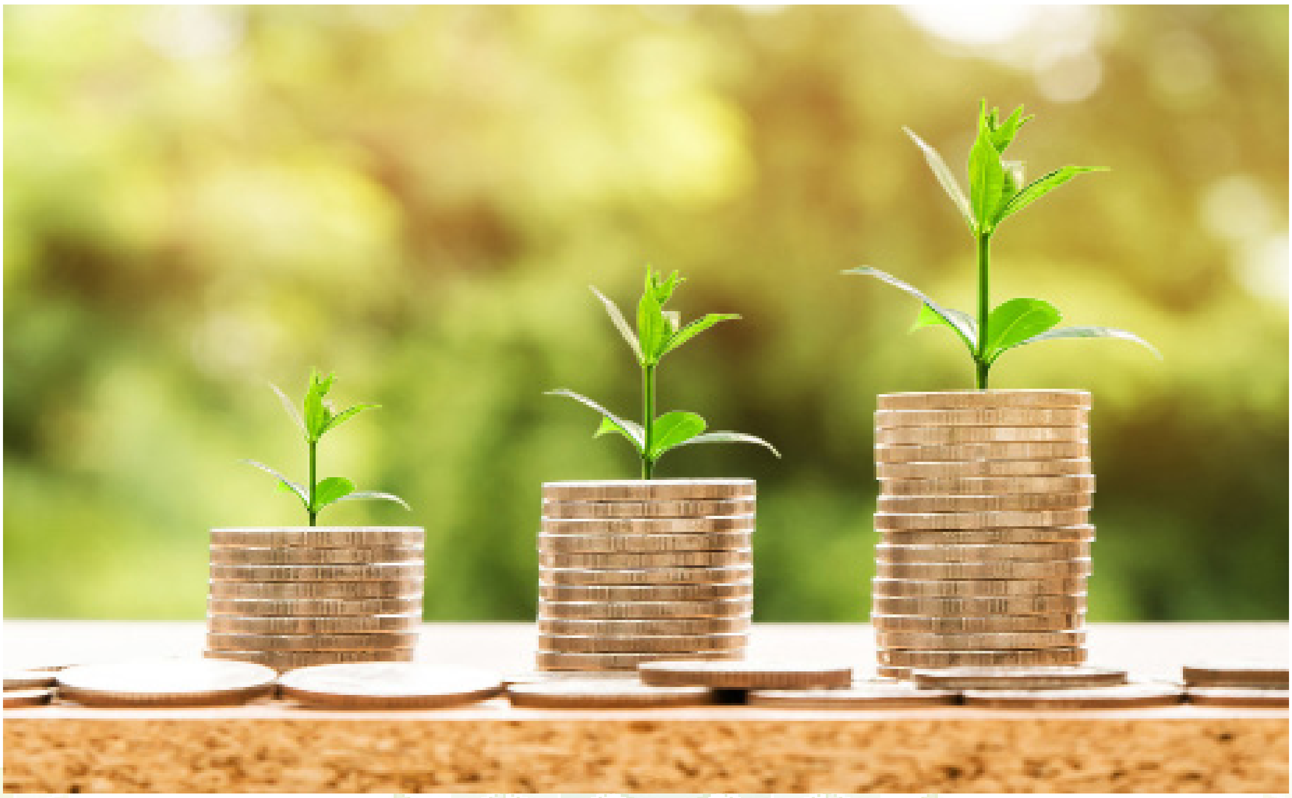
Many people qualify for both a traditional and Roth IRA account within the same year. This helps you diversify your tax savings, too.

Current Contribution Limits

For each type of retirement account, there are contribution limits. These may change from year to year or whenever Congress enacts new tax laws.

IRAs:
In 2018, the contribution limit for both traditional and Roth IRAs was $5,500 for ages 49 and younger. The limit is $6,500 for 50 and older.
However, if your taxable income is $189,000 or greater (married, filing jointly), there are further limitations on Roth IRA contributions.

401(k)s:
The limits for 401(k)s work a bit differently. The limit for the employee's portion of the contributions is $18,500 for 2018. However, your employer may contribute an additional amount for a total limit of $55,000 (or 100% of your salary – whichever amount is lower).



Which option should you choose?

So, now that you see the pros and cons of each, which option should you choose? The answer varies a bit, but here is some general advice that applies for most people:

1. Max out your options.
If you have both a 401(k) plan and an IRA plan available, it's best to maximize your contributions. That means contributing as much as you are legally allowed each year to each plan. Obviously, this method gives you the best tax benefits as well as the most savings and earnings to utilize during retirement. Of course, your income may not allow you to max out both accounts, making this a nonviable option.

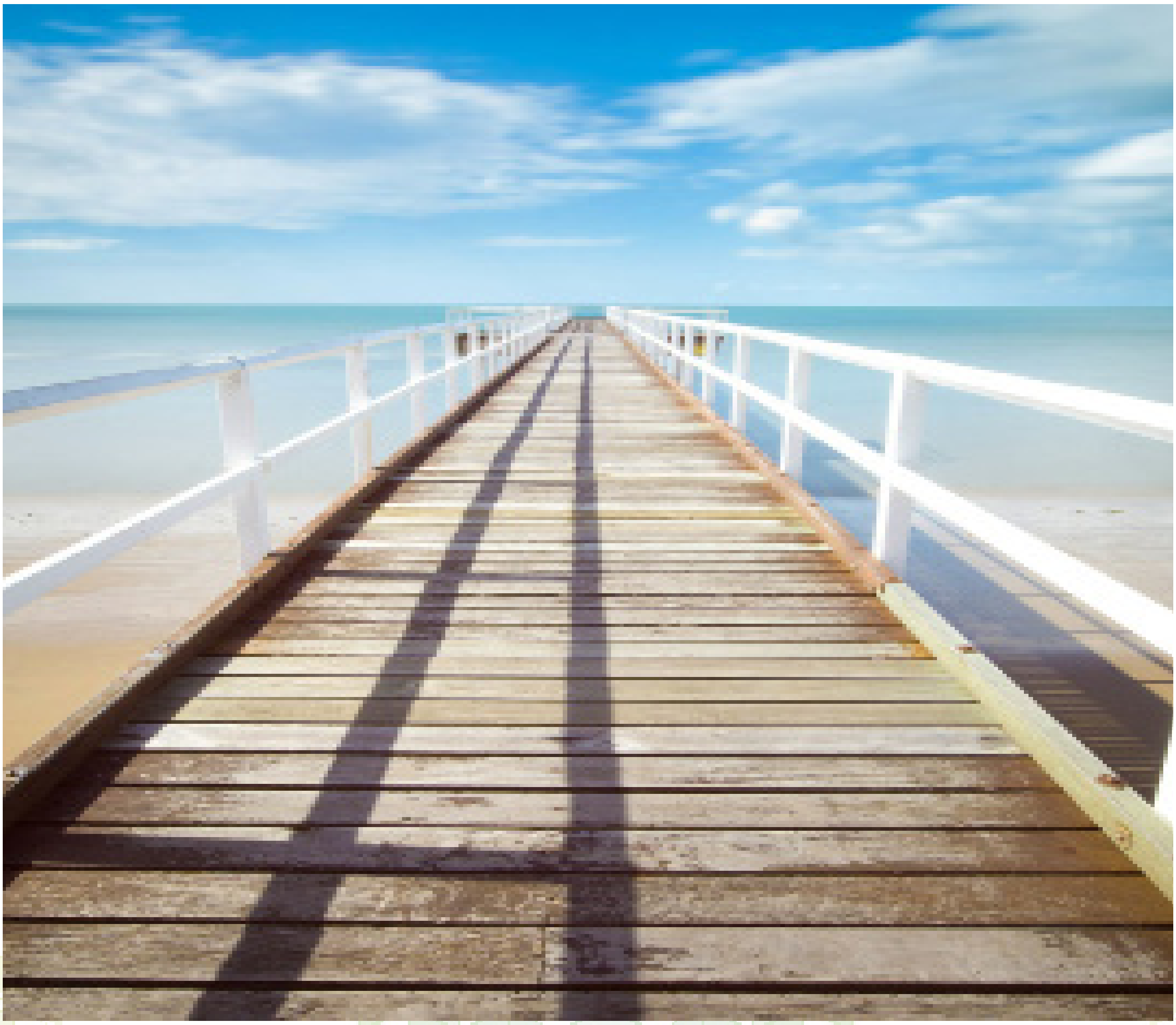
2. Utilize your employer's match.
If you can't max out both accounts, you should attempt to utilize your employer's matching policy. That means you should at least contribute enough to get the full employer contribution. If, for example, your employer matches 100% of your contribution up to a maximum of 5% of your paycheck, you should contribute 5% of your paycheck so you get the full match.

3. Contribute to an IRA.
If your employer doesn't offer a 401(k) or doesn't match any of your funds, skip the 401(k) for now and set up an IRA instead. If you are eligible for either a Roth IRA or a traditional IRA, use this rule of thumb to decide which one to use:
Use a Roth IRA if you think your tax bracket will be higher during retirement than it is now.
Use a traditional IRA if you think your tax bracket will be lower during retirement than it is now.

4. Put the rest of your contributions in a 401(k).
Once you reach the maximum contribution limit on your IRA account, use the rest of your funds to contribute to your 401(k).

Conclusion

Ideally, you would take advantage of all the retirement savings accounts available. Unfortunately, sometimes that just isn't an option. Still, when it comes to retirement, any amount of savings is better than none at all. If you are wondering where to start or have any additional questions about retirement planning, please contact our office for assistance. We are always happy to help with all of your financial planning needs.



About Larson Gross

Ted Larson and Dennis Gross founded our firm in 1949. They built the business based on excellence, passion, integrity, trust and pro-action — values still important to us more than seven decades later.

Even well into their retirement years, Ted Larson and Dennis Gross continued to have the best interest of the firm at heart. Mr. Larson would come into the office on a regular basis to meet every new face and make a personal connection with each of our team members. He remembered the name of every employee, as well as the names of their spouses and children, and would greet clients by name as he passed by the reception desk. Sometimes, you'd even find a newspaper clipping on your desk that Mr. Larson dropped off, highlighting that your son made the honor roll. This is the example of a genuine relationship we strive to embody with our people and clients.

Today, we're led by ten partners who are growing our firm with respect for where we've come from and a new vision for future success. Our 120-plus team members and three offices located in Bellingham, Lynden and Burlington make us the 10th largest public accounting firm in the Puget Sound region. While we're determined to expand our impact and help strengthen as many businesses and individuals as we can, we're also committed to remaining a locally-owned organization. We're incredibly proud of where we've come from and look forward to a future of possibility

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