Start Saving for Tomorrow, Today:

What to Know about Retirement

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The twenties and thirties are an ideal time for establishing future financial success. However, various and competing financial goals and responsibilities such as student loans, home purchases, raising children, and saving for retirement can be overwhelming. Diversified Trust has compiled a series to help guide young people toward a brighter financial future.

Retirement considerations are a key component of any deliberate financial planning exercise. But, as a young adult kickstarting your career, retirement may feel like light-years away. Though you may not be retiring soon, saving for retirement cannot begin soon enough.

Over the next twenty years, older Americans are projected to hand down approximately $70 trillion to their Millennial and Gen X heirs in the Great Wealth Transfer. Gen X (born 1965-1980) will inherit 57% of these assets, while Millennials (born 1981-1996) will inherit 43%.

▸ TIME = MONEY

Let's start with a question: "Why now?" When it comes to retirement savings, understanding the time value of money is the most important principle. $100 earned today is worth exponentially more than $100 earned five years from now, thanks to the potential earning capacity of today's money.

Any amount of money is worth more the sooner it is invested. And thanks to the power of compounding, your initial investment can grow at a faster rate. Let's say you put $10,000 into your retirement account with a 5% rate of return. Your closing balance at the end of the year would be $10,500.

In year two, the 5% rate of return is not calculated on your initial $10,000, but rather the $10,500 balance. Therefore, your retirement account will gain $525 in year two, making your closing balance $11,025.

The same will happen in year three, with a 5% return on $11,025, closing year three at $11,576. That's $1,576 in growth in just three years. Imagine what that number is in 30 years! (There's a formula for that, if you're curious.) And, if you are contributing to that initial $10,000 on a regular basis, the amount of compound earnings is even greater.

▸ BUILDING THE NEST EGG

Once you have decided to save for retirement today, the next logical question is, "How much should I save?" The answer: "As much as you can." While that may not be a satisfying response, it is truly the most accurate one.

Everyday expenses and short-term savings are likely a priority for you right now. You are just beginning to build a life for yourself, so there's no need to go into credit card debt just to save for retirement. However, any excess funds you have should be contributed to retirement savings, no matter how small. As your earnings increase over time and you have more discretionary income, you can and should increase your retirement contributions. If you can afford to, consider maxing out your annual contributions to tax-deferred accounts so you can reap the full benefits of those accounts.

While cash flow planning and potential withdrawal schedules can wait until further down the line, building as much of a retirement nest egg as possible early in one's career should be the priority.

▶ DECODING THE 401(K) AND IRA

Allocating savings to tax-deferred accounts in the early days of your career can make an incredible difference later in life. While a number of these accounts exist, priority at this phase of your planning should be placed on the 401(k) and the Individual Retirement Account (IRA).

401(k) accounts are employer-sponsored retirement plans where funds are deferred into the retirement account directly from your compensation. In 2022, the maximum that a single individual can contribute into a 401(k) is $20,500. Most employers will offer to match contributions up to a certain amount. **Translation: free money**. For this reason, funding a 401(k) account should take priority over funding of an IRA.

A Roth 401(k) is a type of 401(k) that allows you to make after-tax contributions, then make tax-free withdrawals when you retire. Most employers that offer a Roth 401(k) and traditional 401(k) will allow you to split your contributions or switch between accounts.

401(k) accounts are only active while you work for the sponsoring employer. Following termination of employment, funds from the 401(k) can be rolled into an IRA account. Every 401(k) is different and may have specific rules and regulations associated with the program, so it is important to review plan information available from the sponsor.

Unlike a 401(k), an **Individual Retirement Account (IRA)** has no affiliation with an employer. There are two types of IRAs – a Roth IRA and a Traditional IRA.

A **Roth IRA** has income-eligibility restrictions, making it ideal for the early days of your career. To contribute to a Roth IRA in 2022, you must be making less than $144,000 (modified adjusted gross income), or less than $214,000 for married couples filing jointly. You can contribute up to $6,000 per year if you are under 50 and $7,000 per year If you are over 50.

There is no tax break on money contributed to your Roth IRA, but earnings and withdrawals are generally tax-free. If you are in a lower tax bracket now than you plan to be when accessing the funds, investing after-tax dollars and receiving tax -free withdrawals works to your advantage. Roth IRAs do not require withdrawals during your lifetime, so you can even pass the account on to your children. If you withdraw funds prior to age 59 ½, you may have to pay a 10% early withdrawal penalty. You can, however, withdraw up to $10,000 of Roth earnings penalty-free to pay for qualified first-time home buyer expenses, provided it has been at least five years since your first contribution. Roth IRAs can be invested in wide variety of investment options, Including index funds, lifecycle funds, individual stocks, and exchange-traded funds (to name a few).

Anyone with earned income can contribute to a **Traditional IR**A, but tax deductibility is based on income limits and participation in an employer plan. In 2022, the contribution limit for a Traditional IRA is $6,000 if you are under 50, and $7,000 for those age 50 and above. Anyone with earned income who is younger than 70 ½ can contribute to a Traditional IRA.

Once you reach age 72 (70 ½ if born before July 1, 1949), you must take required minimum distributions from your retirement plans Most retirement plans (excluding Roth 401(k)s and IRAs) also have a 10% early withdrawal penalty, which can be waived if you are under 59 ½ for first-time home buyer expenses, qualified higher education expenses, and some disability or medical expenses (up to $10,000).

TRADITIONAL IRA	ROTH IRA
WHO CAN USE IT?	
Anyone who earns or whose filing-jointly spouse earns "taxable compensation," until **age 70 1/2.**	Anyone who earns or whose spouse earns "taxable compensation," **no matter how old they are.**
MAXIMUM YEARLY CONTRIBUTION (2022)	
$6,000 — **$7,000** if age 50 or older.	**$6,000** — **$7,000** if age 50 or older.
Does not apply to rollover contributions	
CAN YOU EARN TOO MUCH TO CONTRIBUTE?	
No.	**Yes.** You must earn **less than $144,000** filing single, **$214,000** married filing jointly in 2022.
CAN YOU CONTRIBUTE TO THE IRA AT THE SAME TIME AS A 401(K)?	
Yes. However, **you may not be able to deduct the entire amount** from your taxes, depending on income and how much you contribute.	**Yes.**
ARE YOUR CONTRIBUTIONS TAX DEDUCTIBLE?	
Maybe.	**No.**
DO YOU HAVE TO TAKE OUT MONEY?	
Yes. You must start withdrawing money ("required minimum distributions") at 72.	**No, if you opened the account.** If you inherited it, you must take distributions, although the process differs between surviving spouses and non-spouse beneficiaries.
HOW DO YOU GET YOUR MONEY OUT?	
Withdrawals **after age 59 1/2 are taxed** as regular income. Any withdrawal made before then is subject to taxes plus a 10% penalty fee.	Withdrawals **after age 59 1/2 are not taxed,** as long as you've had the account for at least five years. You can withdraw contributions tax-free any time, but if under age 59 1/2 you must pay taxes and 10% penalty fee on earnings.

▸ PASSING IT ON

You put money into a retirement account to ensure your financial security and to maintain your standard of living beyond your working years. But all retirement accounts have a beneficiary in the event that you do not utilize those funds.

Determining a beneficiary for your retirement accounts is a very personal decision. It is also one that may be updated when there is a substantive change in your life. Early in your career, a parent, sibling, or even philanthropic cause may be your preferred beneficiary. Following marriage, most individuals choose to update the beneficiary designation to include a spouse. Children may then be listed as contingent beneficiaries if something were to happen to the spouse. It is important to inform your estate planning attorney if you will be naming minor children as contingent beneficiaries of your retirement accounts, as this may require additional considerations.

You can always have more than one primary beneficiary on your accounts, but you must allocate proceeds on a percentage basis. You should also always consider including both primary and contingent beneficiaries.

Take some time to think about these beneficiary elections, and don't be afraid to adjust over time.

People are living longer than ever, which means you may be relying on your retirement funds for many years. If you start saving today, those funds should help you comfortably kick up your feet long after you stop punching the clock.

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