

21st century retirement



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Contributing to tax-advantaged retirement plans is one of the most effective financial planning strategies available to U.S. taxpayers: Saving money in a 401(k), IRA, or a Roth IRA account can trim your tax bill, while helping you prepare for the future. Even if you are already contributing to a retirement plan, you should review your retirement savings strategy regularly to ensure that you are making the most of the tax breaks you qualify for.

When you contribute money to a traditional **individual retirement account (IRA)** or an employer-sponsored defined contribution plan, such as a **401(k)** or a **403(b)**, the **adjusted gross income (AGI)** figure that is used to calculate your income tax liability is lowered by the amount saved. Depending upon your income and the amount contributed, depositing funds in an IRA or 401(k) can substantially reduce your tax bill. While taxes must be paid on distributions from these accounts, most savers come out ahead because they are in a lower marginal tax bracket in retirement than they are while working. Investment growth within these retirement plans is also tax deferred. Even savers whose marginal tax bracket is not lower in retirement usually benefit by allowing money they would otherwise have paid in taxes to grow over time.

While the advantages of saving in tax-advantaged retirement plans are clear, selecting the types of accounts that are best for your circumstances may be less straightforward. If your company offers a 401(k) plan with matching contributions, start by having your employer deduct from your paycheck at least the amount necessary to take advantage of the full match. If the plan allows, consider contributing beyond the matching limit, up to the maximum of \$17,500 or \$23,000 (\$17,500 + \$5,500 “catch-up” contribution for people age 50 and older) in 2013. Depending upon your income, you may also have the option of contributing to an IRA in addition to your workplace retirement plan.

Employees without access to a retirement plan at work, either because they are self-employed or because their company does not offer one, have a number of options when choosing a tax-advantaged savings account. If you have earned income, you and your spouse may be eligible to each make pre-tax contributions of up to \$5,500 (\$6,500 for those 50 and over) to an IRA

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Retirement Planning: Let the Journey Begin

The sage advice that a journey of a thousand miles begins with a single step, also applies to saving for your retirement. It's up to you to take that first step. If you wait until you have "enough" money to begin saving, you may never start at all. Instead, focus on the first step. Then, you can begin transforming that thousand-mile journey to retirement into smaller, more manageable goals.

In order to start saving, you must spend less than you earn. If you feel that this is easier said than done, you're not alone. But, it's time to manage your personal finances and begin saving for your future. The concepts are simple: Monitor where your money actually goes and plan ways to spend it carefully. In other words—prepare a budget.

If the mere thought of a budget makes you feel deprived, think of it as a personal spending plan instead. Rather than focusing on what you should not spend, a personal spending plan can help you redirect the money you do spend.

The first rule of saving is to pay yourself first. Even if you start small, with patience and persistence, you can find ways to reallocate your money over time and watch your savings grow.

Not sure how to get started? Consider the following steps:

1. Track your expenses for one month. Record your daily expenses for at least one month. Categorize them as fixed, variable, or discretionary. *Fixed* expenses include those for which the cost remains the same every month, such as your mortgage or rent, car payment, and insurance premiums. *Variable* expenses are those you pay on a regular basis, but for which the amounts vary, such

as food, utilities, childcare, travel expenses, and credit card debt.

Discretionary expenses are those you could forgo if necessary, such as dining out, vacations, and entertainment. After tracking your expenses for one month, you can begin to see exactly where your cash is going.

2. Calculate each expense as a percentage of your income. This exercise helps identify how each expense relates to your total income. For instance, if you lease a new vehicle for \$320 per month and your monthly income is \$3,200, you are spending 10% of your income on your vehicle. Aim to trim these percentages wherever possible. You may be able to make large gains in savings by reducing many expenses by small percentages.

3. Prioritize your expenses. Rank each expense as "important," "moderately important," or "unimportant." Carefully scrutinize each item, starting with the unimportant ones. Eliminate those items you can do without. You may have the most leeway when it comes to discretionary expenses. The savings you generate in this area alone may be enough to begin a modest savings program. Then, look for opportunities to trim

expenses that fall into the moderately important and important categories. For instance, you may be able to find a less expensive Internet provider if you shop around. Or, perhaps you could find a less expensive or more fuel-efficient vehicle when your auto lease is up.

4. Pay yourself first. Here's the key to success—once you've explored all potential savings, write yourself a check for the amount you saved and "pay yourself first." How you manage your money depends on how much you have and your future goals. As you plan for retirement, consider contributing on a regular basis to an **Individual Retirement Account (IRA)** or employer-sponsored **401(k) plan**. If you're also saving to send a child to college, you might develop an education funding plan.

By paying yourself first, along with your other expenses, you'll be a lot more successful at saving money for your future. As you see your funds accumulate, you'll be glad you took that first step. So, what are you waiting for? Your retirement will be here before you know it, so let the journey begin. ■



Traditional IRAs vs. Roth IRAs

Currently, there are two popular **Individual Retirement Accounts (IRAs)** vying for your attention: the **traditional IRA** and the **Roth IRA**. While both are long-term savings vehicles with tax benefits, each has different rules concerning contributions, age, and income that may change from one year to the next.

Contributions

Perhaps the biggest difference between traditional IRAs and Roth IRAs is the taxation of the contributions. Contributions to traditional IRAs may be pre-tax (deductible on the taxpayer's income tax return). Although contributions and earnings accumulate on a tax-deferred basis, income taxes are due when IRA distributions are taken. On the other hand, contributions to Roth IRAs are made with after-tax dollars, and contributions and earnings accumulate tax free. No income tax is due when distributions are taken from a Roth IRA. For tax year 2013, the maximum contribution to either a traditional IRA or Roth IRA is \$5,500 (\$6,500 for individuals age 50 or older).

Age Restrictions

Contributions to traditional IRAs may be made in the years in which an individual receives compensation prior to attaining age 70½. **Required minimum distributions (RMDs)** must begin by April 1st of the year after reaching age 70½ (or a considerable tax penalty may apply). In contrast, Roth IRAs have neither an age limit for contributions nor minimum distribution requirements. However, both traditional and Roth IRAs have a minimum age for distributions: 59½. Distributions taken

prior to age 59½ may be subject to a 10% Federal income tax penalty. Certain situations qualify as exemptions, such as distributions to pay first-time homebuyer expenses or qualified education expenses. Furthermore, before tax-free distributions can be received from a Roth IRA, the account must be five years old.



Income Eligibility Limits

Depending on your tax-filing status, your income, and whether or not you participate in a qualified employer-sponsored retirement plan, you may be eligible to take an income tax deduction for contributions to a traditional IRA. If you are a single taxpayer, do *not* participate in a qualified employer-sponsored plan, and earn a minimum of \$5,500, contributions are deductible regardless of your **adjusted gross income (AGI)**. However, if you do participate in an employer-sponsored retirement plan, income limits apply. Deductions in 2013 phase out for single filers with **modified AGIs (MAGIs)** between \$59,000 and \$69,000, and for married couple joint filers with MAGIs between \$95,000 and \$115,000.

The income eligibility requirements are different for Roth IRAs. If you participate in a qualified employer-sponsored retirement

plan, you may contribute to a Roth IRA; however, if you are also contributing to a traditional IRA, your contributions may not exceed the annual contribution limits. You are eligible to make a full contribution to a Roth IRA if your MAGI does not exceed \$127,000 for single filers or \$188,000 for married joint filers (contributions phase out for single filers with MAGIs between \$112,000 and \$127,000, and for married joint filers with MAGIs between \$178,000 and \$188,000) in 2013. For a married individual filing separately who participates in a workplace retirement plan, the phase-out range is \$1 to \$10,000.

A Roth IRA is often a favored choice for those who participate in a qualified employer-sponsored retirement plan and exceed the income limits for a deductible IRA, but who meet the income eligibility requirements for a Roth IRA.

Analyze This

As you investigate which IRA, or combination of IRAs, offers you the best bottom line, you may want to consider the following questions:

- 1) What tax benefits, current and long-term, are available to you?
- 2) Would you like to make contributions beyond age 70½?
- 3) When do you anticipate needing your IRA proceeds?

An analysis of your personal financial situation and retirement objectives with a qualified financial professional can help you develop a financial strategy to meet your specific needs. Scrutinizing the details *now* may save you time and money in the future. ■

Let Your Employer “Work” for You

many companies offer their employees a tax-advantaged retirement savings option, such as a 401(k) plan, as part of their benefits package. A 401(k) plan provides you with the opportunity to defer part of your salary, with restrictions, into a retirement fund. Your contributions are pre-tax and any earnings are tax deferred; payment of taxes will not commence until you begin taking withdrawals. In addition, your employer may



choose to match your contributions, up to a predetermined percentage and subject to a maximum. For example, if your employer matches your contributions by 50% for every dollar you put into the fund, your employer will add \$.50. The sooner you take advantage of tax-deferred savings and matching contributions by your employer, the longer your 401(k) has to work for you and the more your savings have the opportunity to grow. ■

trimming your taxes while saving for retirement

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in 2013. There are also a number of tax-advantaged defined contribution plans designed specifically for the self-employed or small business owners, including **simplified employee pension (SEP)** plans, **SIMPLE IRAs**, and owner-only 401(k) plans. These plans are relatively easy to set up and administer, and they can help both owners and employees lower their taxes and build their retirement savings.

While Roth IRAs and Roth 401(k)s do not immediately reduce your taxable income, they can be useful tax planning tools over the long term. The contribution limits for Roth IRAs are the same as for traditional IRAs and 401(k)s, but

the contributions to Roth accounts must be funded with after-tax dollars. Investment growth within Roth accounts is tax free, and no taxes are owed on qualifying withdrawals. A Roth IRA can be an attractive option for people who earn too much to contribute to a traditional IRA, but whose AGIs are still below the Roth IRA eligibility phase-out ranges of \$112,000–\$127,000 for single filers and \$178,000–\$188,000 for married joint filers in 2013.

Roth IRAs also offer greater flexibility than traditional IRAs and 401(k)s. Unlike retirement plans funded with pre-tax dollars, Roth accounts do not require savers to begin withdrawing funds after the

age of 70½, making it easier to pass on a retirement nest egg to the next generation. A Roth savings plan may also be a wise choice for people who do not expect to be in a lower marginal tax bracket in retirement, and wish to maximize their retirement income.

The ideal financial plan may involve contributing to a variety of tax-advantaged retirement accounts. Changes in your income or in tax law can affect your eligibility for some plans. Therefore, be sure periodically to review your situation with qualified financial and tax professionals to modify your tax and retirement planning strategies, as needed. ■

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