Heartland Institute of FINANCIAL EDUCATION

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NEWS REVIEW

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Will Uncle Sam match your 401k?

Emily Brandon, U. S. News & World Report, February 2014

Here's how low-and middle-income earners can take advantage of the retirement saver's tax credit.

Low-and moderate-income workers who save for retirement in 401k's and individual retirement accounts may be eligible for a valuable tax credit that could be worth as much as $1,000 for individuals and $2,000 for couples. Here's how to claim the saver's credit on your 2013 or 2014 tax return:

Contribute to a retirement account
The saver's credit can be claimed on up to $2,000 ($4,000 for couples) that is contributed to IRAs, 401k plans or similar types of workplace retirement accounts. Workers have until April 15, 2014, to make an IRA contribution that can count toward tax-year 2013.

“Don't give up on your deductions and credits for 2013. You have up until your tax filing deadline to make this move,” says Lisa Greene-Lewis, a certified public accountant with TurboTax and a contributor to the U.S. News My Money blog. “It's a winning situation because you are saving for your retirement, and that money is going to grow and you are also saving on your taxes.”

However, contributions to workplace retirement plans generally need to be made by the end of the calendar year to qualify for the credit. “Employees who are unable to set aside money for (2013) may want to schedule their 2014 contributions soon so their employer can begin withholding them in January,” according to a statement from the Internal Revenue Service.

Adhere to the income limits
The saver's credit can be claimed by individuals with incomes up to $29,500 in 2013 or $30,000 in 2014. For heads of household, the income limits are $44,250 in 2013 or $45,000 in 2014. Married couples can earn as much as $59,000 in 2013 or $60,000 in 2014 and still claim the saver's credit. These income limits are adjusted annually to keep pace with inflation.

Calculate your credit

The amount of the credit will be 50 percent, 20 percent or 10 percent of your 401k or IRA contributions up to $2,000 ($4,000 for couples), with the biggest credit going to savers with the lowest adjusted gross incomes. To get the 50 percent credit, savers need to have an income below $18,000 for individuals, $27,000 for heads of household and $36,000 for couples in 2014. The 20 percent credit rate applies to individuals earning between $18,001 and $19,500 ($36,001 and $39,000 for couples). And individuals with an adjusted gross income between $19,501 and $30,000 ($39,001 and $60,000 for couples) in 2014 are eligible for a 10 percent credit on their retirement savings.

Twice the tax breaks

The saver's credit can be claimed in addition to the tax deduction you get for contributing to a traditional 401k or IRA. The saver's credit can also be claimed on Roth IRA contributions, but in this case, you would only get the credit and not a tax deduction.

For example, consider a married couple in which one spouse works and earns $30,000. If they contribute $1,000 to an IRA, their adjusted gross income will be reduced to $29,000 on their tax return. The couple may also claim a 50 percent credit, which is worth $500, for their $1,000 IRA contribution.

“Most are well aware of the tax-deferred nature of saving in a 401k or similar plan or the opportunity to save in a Roth IRA, and the fact that there could be a full-on tax credit in the form of the saver's credit above and beyond that saving advantage is almost too good to be true,” says Catherine Collinson, president of the Transamerica Center for Retirement Studies. “Whether someone contributes $20 or $50 or $200, it's important to take advantage of that benefit.”

You might not get $1,000.

Saver's credits worth just over $1.1 billion were claimed on nearly 6.4 million individual income tax returns in 2011. But most retirement savers received small credits, averaging $128 for individuals, $166 for heads of household and $215 for couples.

The saver's credit is nonrefundable, so you won't be able to claim it if other credits have already eliminated your tax liability. “You would need to contribute $2,000 as an individual, and the couple would each need to contribute $2,000, so $4,000 in total, to get $1,000 or $2,000 as a credit,” says Jackie Perlman, a principal tax research analyst for The Tax Institute at H&R Block.

And you would need to be below the income cutoffs to get the full 50 percent match. For most people, ‘You might get a few hundred dollars back on your tax return,” Perlman says.

Find out if you're ineligible
You won't be able to claim the saver's credit if you are under 18 years old or were claimed as a dependent on someone else's tax return. Individuals who were enrolled as full-time students during any part of five calendar months during the year are also unable to get the credit. Rollover contributions aren't eligible for the saver's credit, and eligible contributions could be reduced if you have recently taken distributions from a retirement account.

Get the right forms
You'll need IRS Form 8880 to claim this credit, and to attach it to your 1040, 1040A or 1040N when you file your tax return. “Don't use the 1040EZ Form,” Collinson cautions. “If you use tax-preparation software, be on the lookout for it so you can be sure to claim it.”

Only 23 percent of people with household incomes of less than $50,000 per year, the group most likely to qualify, say they are aware of the saver's credit, according to a 2013 Transamerica Center for Retirement Studies survey. If you're close to the income cutoffs, consider calculating whether or not you could get a tax deduction and credit by putting even a small amount of cash in a retirement account.

“Do some modeling with tax-preparation software and see what your tax would look like if you fund the IRA and took the credit or if you did not,” Collinson says. “For those that meet the income eligibility requirement, it's really important to take advantage of that.”

Retirement Strategies for the Self-Employed

Geoff Williams, US News & World Report February 18, 2014

Christopher Nelson is 44, and like many of his self-employed brethren, he has nothing saved for retirement.

He still has time. He also has plenty of reasons to think the future is bright. He is the chief financial officer of Glass Handbag, a company that sells high-end handbags outfitted with integrated light systems.

He runs it with Tamara Leuty, Glass Handbag's inventor and founder.

"I am hoping Glass Handbag takes off and creates the retirement I desire," Nelson says.
Of course, Nelson has ample reason to worry that he won't have the retirement he desires. According to the Small Business Administration, 50 percent of new businesses won't celebrate their five-year anniversary. Two-thirds won't reach the 10-year milestone. Glass Handbag started four years ago.

Retirement Strategies for the Self-Employed, continued..

Nelson has another job as a real estate appraiser, making a little over $100,000 annually, but he says he hasn't managed to save anything for retirement. He put away $150,000, but that went to Glass Handbag. It doesn't help that he is shuttling between two cities with a high cost of living: Las Vegas and New York, where he and his fiancée are moving.

"I haven't had any retirement [savings] for about five years, and it makes me very worried. Sometimes, I don't sleep well at night," Nelson says. "The thought of knowing you can't survive without working, even for a short time, is very nerve-wracking.“

Unfortunately, there are a lot of people like Nelson lying awake at night. Financial services provider TIAA-CREF recently surveyed more than 1,000 adults and found that 21 percent of those who hadn't retired had nothing saved for retirement. Forty-four percent had saved 10 percent or less of their current annual income. And yet 37 percent surveyed said they planned to retire *before* age 65.

How much should you be putting away?

Most experts say at least 15 to 20 percent of your annual salary should be going toward retirement.

That can be a challenge for anyone, of course, but when you're self-employed, cash flow can be sporadic. Income from clients may not show up when expected or not at all if business is bad. Even if you can pay your bills, extra money may go right back into the business.

"Many small business owners pay themselves last while they are building their business," says Thomas Goodson, founder and CEO of AmeriFlex Financial, a financial planning and wealth management firm in Santa Barbara, Calif.
Kelly Costello, who lives in Pittsburgh and owns puppycake.com, which manufactures and sells specialty dog treats, is emblematic of many entrepreneurs.

"I cashed in my 401(k) from my first corporate job shortly after the recession to keep my business afloat, and I have yet to put a dime toward retirement," says Costello, 28. "Right now, my priorities are pay myself a small salary, get out of debt ...build a six-month emergency fund. Then I will work on building savings and putting it toward retirement.“

What sort of retirement plan do I need?

Financial advisors often suggest strategies that work well for self-employed people raking in money but not so well for those who aren't yet. And many self-employed people don't have anyone to advise them on their personal finances.

"If you are a small business owner with enough money for a financial advisor, you are one of the few lucky ones," Nelson says.

But if you can regularly put away money for retirement, consider starting a simplified employee pension individual retirement account, says Joe Jennings, investment director for PNC Wealth Management.

He says SEP IRAs are popular retirement savings vehicles for business owners and self-employed individuals.

"There are contribution limits for self-employed individuals," Jennings says. "From an investment standpoint, the vehicle is the same as any other IRA account and provides a great deal of flexibility regarding investment options.“

The maximum amount a self-employed individual can put into a SEP IRA in 2014 is $52,000.

If you're spitting out your coffee and rolling your eyes, a Roth IRA is probably more your speed. The maximum contribution for a Roth IRA in 2014 is $5,500; if you're 50 or older, it's $6,500. To contribute, you can't make more than $127,000 a year if you're an individual filer or $188,000 if you file jointly.

Just don't put it off

There's a reasonable argument for delaying retirement saving if you're young and your business needs all of your cash, and it seems poised to grow. But if your company is more about making a good living for you and your family, not saving enough for retirement is a risk you shouldn't take.

David Cohen, 52, is an instructive example. He lives in Philadelphia, and about 20 years ago, after finding himself miserable as a pastry chef, he started an events planning business revolving around his love for classical music. An accomplished musician, he plays the classical and flamenco guitar, Chinese pipa and bagpipes.

For about two decades, Cohen and his wife, Tatyana, a dental hygienist, made an honest living, raised a son and put him through college. Thanks to guitarpoint.net, he was frequently booked solid in Pennsylvania and neighboring states.

Then in 2008, the Great Recession took hold, and corporations and individuals didn't have the extra money to hire classical musicians. Cohen's self-employment imploded, virtually overnight.

Cohen, now in his mid-40s, decided to attend Temple University. His family never had the money to send him to college, and he felt a diploma would help him become employable. He majored in tourism and hospitality management. But he had to suspend his studies a few times. Tatyana was diagnosed with cancer.

"On Valentine's Day, three years ago, she went into the hospital for chemo, and she never came home," Cohen says.

He now has a diploma -- Tatyana urged him to finish school -- but at age 52, Cohen is a combination of unemployed and under-self-employed, still performing but not enough. He's trying to carve out a career making hospitals more hospitable, an idea he formed while spending far too much time in hospitals. He consults at hospitals on a volunteer basis but hasn't landed a paying, permanent position yet.

The Cohens did put some money away for retirement, most of it through Tatyana's pension. That is gone now. Cohen fully agrees that his story is a good argument for not putting off saving for retirement, and for saving as much as possible.

One moment Cohen sounds full of hope and promise about the idea of someday having plenty of income to live on during his golden years. "I'm not giving up because that's not part of my makeup," he says.

But almost in the same breath, he talks of being in his early 50s and having next to nothing saved for retirement: "It's definitely scary, and I will have to work the rest of my life."
Cohen says he sometimes goes to Sam's Club and watches the greeters. "I check out their technique and see what works the best," he says.

He envisions someday being a senior citizen and when dining out, "getting the higher premium cat food," he says.
He is kidding -- sort of.