

Investment and Retiring:

Individual Retirement Accounts (IRAs)

Roth IRA: A Roth IRA is a retirement account designed to let the earnings of the account accumulate tax deferred and possibly withdrawn tax free after the age of 59 ½. An investor can open a Roth IRA at most financial institutions and purchase an array of financial products inside the IRA account, typically mutual funds. There are limits to the amount of money that can be set aside each year into the account and as well as income limitations for those who qualify. Because you pay taxes on the money you invest now in order to take it out tax free later, a Roth IRA benefits someone young who is in a lower tax bracket than they will more likely be when they are older.

Traditional IRA: A traditional IRA functions similar to a Roth IRA however with one key difference. The money is invested before taxes annually but will be taxed upon withdrawal, typically after age 59 ½. Contributing into a traditional IRA reduces an investor's taxable income in the year of the contribution and is beneficial to someone who is in a higher taxable bracket now than they anticipate being in the future. A traditional IRA has no income limitations as does the Roth IRA but does have required mandatory distributions that begin at age 70 ½.

Employer Sponsored Accounts

401k: A 401k is an employer sponsored benefit program that functions similar to a traditional IRA as far as taxes are concerned. In a 401k, funds are typically deducted from an employee's paycheck before taxes and put into their 401k account. The funds may grow tax deferred while in the plan and are taxed as income when they are later withdrawn. Often as an added benefit to the employee, the employer will match a portion of the contribution into the account. For those employees who take advantage of this, it is like getting a bonus that they will see in the future.

403b: A 403b is very similar to a 401k but is used for nonprofit and educational organizations whereas a 401k is typically used for corporations. Like a 401k, contributions into the 403b are made before taxes when they are payroll deducted and are taxable as income at the time of withdrawal.

Pension Plans: A pension is a benefit that is paid to a person as an income stream for the rest of their life upon retirement. The payments are generally in the form of a guaranteed annuity and may have insurance aspects that pay spouses or other beneficiaries upon the death of the former employee. Pensions are typically offered by very large employers because 401ks and IRA plans have grown in popularity due to employees changing career paths more frequently.

Cafeteria Plans: Employees or employers with cafeteria plans may select benefits such as health insurance, life insurance and flexible spending accounts through the plan, similar to choosing at a cafeteria. Most cafeteria plans operate by salary reduction agreements which are a payroll deduction that is pre-tax because the funds are not actually received and paid by the employee.

Incentive Plans: Many employers offer their employees a variety of incentive plans in addition to their regular benefits. These incentives may be various awards, bonuses or exotic trips based on sales performance, meeting quality standards, or other criteria set by the organization.

Other Retirement Considerations:

Annuities: An annuity is a contract with an insurance company to pay a stream of payments in exchange for a sum of money. An annuity has two time periods, the time in which the money is being contributed and the time of disbursement, or annuitization. The money may be contributed into the annuity as a lump sum or over many years and grows tax deferred until withdrawn. At the time of annuitization, the person's life the annuity is based upon trades the money accumulated for a promise by the insurance company to pay an equal payment to them for the rest of their life, no matter how long that may be. If the person should die prematurely there are generally various payout options for the annuitants beneficiaries. In this way, annuities are useful for insuring that a person does not outlive their income.

The money growing inside the annuity must be invested somehow. Because an annuity has the benefit of tax deferral and penalties associated with premature withdrawal, younger people often choose to place the funds in mutual funds held by the annuity. This is an example of a **variable annuity** because the growth will vary depending on the market. Other investors closer to retirement choose to purchase **fixed annuities** rather than certificates of deposits (CDs) at financial institutions because the tax deferred treatment of the annuity decreases their tax liability. Fixed annuities have a set rate for a set time period similar to CDs and do not change reflecting the market. Many people choose to never annuitize and may roll the annuity over into a different product or simply withdraw it after reaching 59 ½.

Long Term Care Insurance: Long term care insurance is designed to pay for services with a chronic illness or disability that cannot care for themselves for a long period of time. Long term care has generally been thought of as nursing home insurance however the product has been developed to cover much more in today's increasingly complex health care system for elderly people. Today long term care pays for services to keep people from having to go to nursing homes such as in home care and related medical equipment, adult day care, and training for family members to learn to care for their aging family members. One of retirees' greatest concern for their retirement nest eggs are medical costs which could easily consume years of savings. By obtaining long term care coverage early, usually in one's forties or fifties, a person can both protect their assets against future medical costs and ensure that their late retirement plan is a comfortable lifestyle.

Programs in agriculture and natural resources, 4-H youth development, family and consumer sciences, and resource development.
University of Tennessee Institute of Agriculture, U.S. Department of Agriculture and county governments cooperating.
UT Extension provides equal opportunities in programs and employment.