

FINANCIAL FEATURE



Retirement Planning Made Easier

[By Shaileja Mammen]

The Pension Protection Act (PPA) of 2006 has been amended to require that new workers be enrolled in 401(k) retirement savings plans beginning in 2007. Congress accepted the findings of the Employee Benefit Research Institute (EBRI) and made this amendment to the Pension Protection Act. The objective of the amendment is to help individuals plan effectively for retirement.

The report based on research conducted by the behavioral economists at EBRI was published in the January 2007 EBRI Issue Brief. The findings of the research reveal that many workers do not participate in employer-sponsored retirement plans.

The PPA of 2006 provisions aim at reducing disinterest among workers regarding their retirement planning. These include automatic enrollment of new workers, default contributions, and automatic deferral increases. While in the past workers would passively not participate in 401(k) retirement savings plans, the new provisions require workers to actively opt out. This may produce better results, with more workers participating in retirement plans and contributing more toward them.

What do these changes to 401(k) retirement savings plans mean for workers?

A 401(k) retirement fund is an employer-sponsored program offered by a qualifying company. The program allows an employee to make a tax-deferred contribution every time he or she receives a paycheck. Prior to the 2006 amendment, such plans required workers to take the initiative to enroll; now, all new workers will be automatically enrolled in 401(k) plans.

Participation in a 401(k) retirement plan is open to individuals who are older than 21 years of age and are employed by a business

or company that currently offers such a plan. 401(k) enrollment is offered to employees who have been with their company for a minimum period of time (decided by the employer) that is less than one year.

The advantages of 401(k) enrollment include reduction of income (to the extent of one's contributions to his or her fund), matching contributions from the employer, and tax deferral on interest.

In the event that the participant moves from one employer to another, invested funds can move from one employer-sponsored retirement plan to another. This is known as rolling the fund over into another account. Rolling over to another IRA or 401(k) is advantageous when you move to a new job. The rollover continues to add value to your money, too. You will want to ensure that the check is made out to the trustee of the new fund when rolling over funds from a previous employer.

It is important to note that there is a limit on the amount of funds that can be invested in a 401(k) every year. Withdrawing from a 401(k) before retirement requires the participant to pay income tax on the withdrawn amount, in addition to a penalty fee. Withdrawal of funds from a 401(k) should start at age 70, at the latest.

The employer who provides a matching contribution to a retirement plan decides if

the employee moving to another job will be allowed to take away the entire matching contribution. This decision depends upon how long the employee has worked for the employer.

While there is a wide range of investment opportunities when it comes to 401(k) plans, your choices are limited to those offered by your employer. When you enroll in a 401(k) plan, different proportions of funds can be invested in equities and bonds. The range of choices available is decided by your employer, but these choices can be expanded by lobbying your employer.

So far, we have focused only on employer-sponsored retirement plans, which may not be offered by all employers. The question that arises now is "What can I do if my employer does not offer a retirement plan?"

Those who work for such employers need not be disheartened.

You can plan your retirement at any time by participating in one of the individual retirement savings plans available. It is never too soon to plan for retirement.

Retirement saving can be managed through an "individual retirement account," an "individual retirement annuity," or both. There are several types of IRAs: the traditional IRA, the educational IRA, the Roth IRA, the simple IRA, and the simplified employee pension (SEP) IRA.

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Traditional IRAs, educational IRAs, and Roth IRAs are individual retirement accounts. SEP IRAs and simple IRAs are retirement plans established by employers. An IRA can be set up with a bank or other financial institution, life insurance company, mutual fund, or stockbroker. Contributions to this account can be made in the form of cash, check, or money order as soon as the IRA is set up.

Traditional IRAs can be set up by an individual, who can contribute a maximum of \$2,000 in one year. This amount may be tax-deductible depending on the individual's gross income and participation in an employer-sponsored IRA.

An educational IRA is an IRA in which an individual can invest as much as \$500 per year. Growth is tax free, but the distributions

of an educational IRA receive preferential tax treatment, and they can be used only for authorized education expenses of the beneficiary.

Only singles with gross incomes under \$95,000 and couples with gross incomes under \$150,000 are eligible to participate in Roth IRAs. Their contributions are not tax-deductible, but the earnings accumulated and the distributions are tax-free. However, if the funds are withdrawn within five years, the beneficiary (or beneficiaries) must pay a penalty.

An individual can have multiple IRAs (individual as well as employer-sponsored), but his or her IRA choice(s) will depend on taxable income, age, and family status.

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