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April 2003 - How Much Retirement Savings is Enough? (And How the New Savers Credit Can Help You.)

Many people have been hit hard by the stock market decline of the past three years. People who thought they had enough money saved to retire are now rethinking those plans as a result.

So, how much retirement savings is enough? Or put another way, what can a person do so that regardless of how their investments do, they can have the financial freedom to live the way they want at the age they choose to do.

As in many of my articles, I am going to try to take a very complicated subject and develop some simple action steps that will help the reader reach his or her individual goals. These action steps include:

- Identifying sources of monthly residual income.
- Determining how much you can add to this monthly residual income by establishing a regular monthly savings habit now.
- How to keep inflation and poor investment results from eroding retirement savings.
- Taking advantage of incentives in the tax law to help you reach your retirement savings goals, including the new savers credit.

Identifying Sources of Monthly Residual Income

You may have more places to draw on a recurring monthly income at retirement age than you realize. Let's start with Social Security. You have probably already received a report from Social Security telling you how much you can expect to receive at retirement, including "early retirement" (age 62), "regular retirement" (traditionally age 65, but this is gradually increasing to age 67 depending on your birth year), and the highest Social Security payments that can be received by waiting until age 70 to begin collecting. If you or your spouse will have worked at least 27 years at retirement in jobs or self employment under the Social Security system, you can probably count on at least $900 per month "regular retirement" if you are single or at least $1,350 per month for you and your spouse together if you are married. If you haven't already received your report, or would like an update, call the Social Security Administration toll free at (800) 772-1213 to order this report.

The next step is to review what retirement income is available to you from the places you have worked in your lifetime. This could come either through a monthly guaranteed check, or from a lump sum that you can rollover into an individual retirement account (IRA). Divide the lump sum by 400 to estimate the monthly residual income it will generate that can grow with inflation each year for as long as you live in retirement without depleting the lump sum.

There are other ways you can accumulate a lump sum at retirement. One is to sell your home and move to something smaller or in a less expensive area at retirement, and put the equity into your lump sum savings. Another way is to develop equity through a business you own or income properties, even if these are part-time ventures while working a full-time job. Often you can supplement current income while building equity that can be sold in the future or otherwise used to add to retirement income.

Adding to Your Monthly Residual Income by Establishing a Regular Savings Habit

The longer you have until retirement, the more compound interest can work in your favor. If you have waited a long time, start anyway. Whatever you save now will be a welcome supplement when you need it! Here is an estimate of what you can expect to accumulate, based on the number of years you have left until retirement:

Years to Retirement	Multiplier
5	0.1641
10	0.3542
15	0.5747
20	0.8303
25	1.1266
30	1.4701
40	2.3299
50	3.4854

Take the multiplier in the chart above and multiply by the amount you plan to save each month to determine the amount of monthly income you can expect for the rest of your life that will keep up with inflation and which can continue for the rest of your life without depleting your savings.

For example, if you save $100 each month for 5 years, you can expect to have $16.41 (100 times 0.1641) per month that you could use for the rest of your life, and you could expect to increase this monthly amount each year to keep up with inflation without depleting or outliving your savings. By contrast, if you save $100 each month for 30 years, you could expect to generate $147.01 in monthly lifetime income, again inflation protected.

How to Keep Inflation and Poor Investment Results from Eroding Your Savings

In the decade of the 1990s, the stock market grew at an unusually rapid rate, which gave many people unrealistic expectations that their savings could always grow that quickly, and worse that they had little risk of a decline. Obviously, that bubble has now been burst.

Historically, carefully chosen investments have provided an average return 3% better than inflation. That is the rate used to calculate the multiplier and monthly income figures listed above. Admittedly, this is a conservative rate of return. It provides that if the stated rate of return is say 5% and inflation is 2%, that you could withdraw the 3% as your retirement income for the year and retain the other 2% so that next year's retirement income check could be adjusted up for inflation, thus keeping you even.

Some years you may do much better than this. Treat this as a very nice surprise, and guard the growth carefully, so that your overall results will exceed your expectations rather than fall short.

Tax Incentives to Help You Reach Your Retirement Income Goals

Taxes also can play havoc on your long-term savings plans. If you are not careful, you will pay taxes each year on any gains you realize, making it much harder to reach your goals. This is the biggest advantage of the various IRA, 401(k), and 403(b) retirement plans available. If your employer is even partially matching your savings in one of these plans, it is like bonus earnings on your savings – be sure to take advantage of it to the full extent you can.

If you can save more than your employer will match, strongly consider a Roth IRA for the rest. You will be passing on the current tax deduction, but if you keep it in the plan at least 5 years and past age 59 ½, all the earnings you receive over your lifetime become tax free, giving you a much larger "deduction" then.

The New Savers Tax Credit

If you earn less than $50,000 per year, and feel you just can't afford to save anything for retirement at all, the new Savers Credit is for you. If there is a 401(k) or 403(b) plan available to you at work with employer matching, not only do you avoid income tax on the amount you save, but now there is a credit that can contribute hundreds of dollars towards the amount you are saving. In effect, it is like a government match in addition to the employer match to your retirement savings. The credit varies with income, but in some cases it is nice enough to almost pay your monthly retirement savings for you.

The Savers Credit is also available for those using the Roth IRA. This is especially nice, because not only do you get the tax-free withdrawal benefits, but also get a large tax savings right now.

Am I Too Late For Retirement Tax Savings for 2002?

You can add to an IRA account up to the due date of your tax return (April 15) and designate the addition to the 2002 income year, including claiming the Savers Credit. If you contributed to a 401(k) or 403(b) plan and have already filed your 2002 income tax return without claiming the Savers Credit, and later determine you were eligible, you can amend your return within 3 years to claim this credit. Be sure to check with a professional to see if you can claim this on your return, and also to review how the other ideas presented in this article specifically apply to you personally!

Important Note!

The information in this article is intended to inform you of some of the financial opportunities provided in the tax laws or elsewhere. It is not intended to give you specific advice for your personal situation. If you need such advice, please contact a qualified professional! Please call or e-mail me (doug@accuteksolutions.com) for a free initial 30-minute consultation to discuss your personal situation and how the tax laws might benefit you. Questions you'd like to have answered in a future article are welcome!