401, IRA, SEP, ROTH – What Do I Need?

Today there are a myriad of choices that make knowing what retirement account to get is as easy as solving a rubik's cube blindfolded. To start, let's look at what a 401(k) account is and how it differs from an IRA (individual retirement account). A 401(K) is a tax deferred account that has been created by an employer and offered to their employees. The employees can contribute money into their accounts and often the employer will match a percentage of that contribution. The employer has some options of what type of 401(K) plan to create and to offer to the employees. IRA accounts are created by the individual for their needs and depending on the type can be also be used for small businesses.

Below is a quick overview of the most popular IRAs.

Traditional IRA: The most popular of the individual retirement savings features include contributions that may be tax deductible (depending on your current income and tax filing status and the availability of a workplace retirement plan to you and/or your spouse), mandatory withdrawals at retirement age that are taxed at your tax rate at that time.

Roth IRA: Contributions are not deductible but withdrawals during retirement are tax-free. Eligibility to contribute to a RothIRA is based on your income the same as they are for the traditional IRA and withdrawal rules are more lenient.

SEP (Self Employed Pension): A traditional IRA, set up and funded for employees by an employer. Contribution limits are much higher and while employer contribution size may vary year to year based on the business's cash flow, it must always be equal for all eligible workers (including the owner/employee #1). Employees are not allowed to contribute to the plan via salary deferral. Sole proprietors can open a SEP IRA for themselves.

Spousal: While the IRS rules mandate that a person must have earned income to be eligible to contribute to an IRA, the spousal IRA solves the problem if one spouse isn't working (or brings in minimal income). Limited to couples who file taxes jointly.

Non-Deductible: Similar to the Traditional IRA except the plan is funded with after-tax dollars and provides no immediate tax benefit.

Self- Directed IRA: Self-directed IRAs (can be both traditional or Roth) have greater flexibility in investment options. The IRAs covered above limit investments to common vehicles like stocks, bonds and mutual funds. In a self-directed IRA, assets can include real estate, hard assets like gold and privately held companies. The IRA requires a trustee or custodian who specializes in the type investments in the account and does not allow holding things like collectibles and life insurance. It also prohibits any "self-dealing" transactions that the IRS may see as equivalent to taking a distribution.

SIMPLE IRA (Savings Incentive Match Plan for Employees): Similar in many ways to a 401(k) the and a traditional IRA, the SIMPLE IRA is set up by employers for small companies and self-employed. Employees are allowed to contribute to the account via salary deferral and may allow an employee to select the financial institution they want to use to hold their account. Employers are generally required to add up to a 3% matching contribution or a fixed contribution of 2% of each eligible employee's compensation.

This is just the tip of the iceberg as each type of retirement account has differing contribution limits, withdrawal rules, other benefits and regulations. Keep in mind that there is no such thing as a one size fits all plan and what may work perfectly for one person may leave another in trouble. If you would like more information and to see what is the best retirement account for you please set up an appointment with one of our financial advisors.

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