This publication provides an initial review of investing for retirement. To find out more about investing, see Before You Invest (NebGuide G1925), Investment Alternatives (Extension Circular EC481), and Investing for Education (NebGuide G2098).

Topics covered include:

- Retirement Income Sources
- Employer-Provided and Self-Employment Retirement Plans
- Personal Savings and Investing, including IRAs
- Employment During Retirement
- Estimating Retirement Income Needs

Retirement Income Sources

Retirement is one of the most important reasons to invest. Financial experts used to describe retirement income sources as a three-legged stool: Social Security, retirement plans provided through an employer or self-employment, and personal savings or investing including IRAs. With growing concern over the future of Social Security, a reduction in defined-benefit retirement plans offered by employers, and a low personal savings rate, the three legs of the traditional retirement income “stool” have become shaky. A fourth leg is needed — paid work after retirement.

Employer-Provided Retirement Plans

Retirement plans provided through employment in the past were defined benefit plans fully funded by employers and that provided employees with retirement income for the rest of life. Most employment-related retirement plans today are defined contribution or cash-balance plans. Employee stock-option plans and profit-sharing plans are also offered, usually only to higher-income employees.

Defined Contribution Plans. Generally funded with contributions from both employers and employees, most defined contribution plans defer income taxes on employee contributions until retirement. All earnings then are taxed when money is withdrawn from the retirement fund. The employee decides where to invest retirement money by choosing among the options provided by the employer.

While regulated by the government, there is no guaranteed benefit income amount.

Types of employer-sponsored retirement plans include:

- 401(k) for employees of private companies.
- 403(b) for employees of state and local governments and some non-profit entities such as religious organizations.
- Section 457 for state and local government employees and non-religious controlled tax-exempt organizations.

Contribution limits to all of the above plans are adjusted for inflation, so change annually. If the funds are withdrawn prior to retirement, they are taxed as ordinary income plus a 10 percent tax penalty.

Cash-Balance Plans. A combination of the traditional defined-benefit and more recent defined-contribution plan, the cash-balance plan provides each employee an interest-earning account credited with a percentage of monthly pay by the employer. Fully funded by the employer, this account moves with the employee when changing jobs.

Self-Employed or Small Business Retirement Plans

Retirement plans for those who are self-employed or employees of small businesses include:

- Keogh Plans allow self-employed persons to contribute to their own tax-deferred plan based upon a set annual amount limit periodically adjusted for inflation with all withdrawals taxed. Keogh plans can be set up through a bank, mutual fund, or other financial institution. These plans can be complicated and costly to set up and administer because a professional actuary is required to oversee them. Generally, Keogh plans are used as a catch-up strategy by older business owners who have put off setting up a retirement plan.

- SEP or SEP-IRA (Simplified Employee Pensions) allow business owners to make contributions to their own individual retirement accounts (IRA) and to the IRAs of their employees. Dollar limits and percentages of pay are limited by law. Contributions do not have to be made every year. Employers must contribute the same percentage to the employees’ SEP as they do their own. Such plans require much less paperwork to set
up and do not have the same reporting requirements as a Keogh. Generally, contributions are made by the employer and are tax-deductible to the employer.

- SIMPLE Plans (Savings Incentive Match Plan for Employees) provide employers with less than 100 employees a way to set up a tax-deferred retirement savings plans. The employee contribution limit is adjusted periodically for inflation. The employer can match up to 3 percent of the employee’s compensation. Employees must earn at least $5,000 a year in order to be covered. The employee’s contribution reduces taxable income and the employer’s contribution reduces the business’s taxable income. A SIMPLE-IRA is owned by each employee even if employment is terminated.

**Personal Savings and Investing for Retirement**

**Personal savings and investing** will provide a major portion of retirement income for most people, especially in the future. Savings and investments identified for retirement may be any of the alternatives described in *Investment Alternatives*, EC481. Most of these alternatives may also be included in Individual Retirement Accounts (IRAs).

An **Individual Retirement Account (IRA)** is a tax-deferred personal retirement savings plan allowing you to direct how funds in your account are invested. Arrangements to open an IRA are made with financial institutions, brokerage firms, or mutual fund companies. The maximum amount you may contribute is adjusted annually by law. There are two types of IRAs:

- **Traditional IRA.** Depending on how much money you earn, you may be eligible to deduct an IRA contribution from gross income for tax purposes. But there are usually penalties for taking money out of an IRA before turning 59½. All withdrawals from a Traditional IRA are taxable and treated as ordinary income. Withdrawals must begin no later than April 1 of the year after you turn 70½.

- **Roth IRA.** While eligibility for a Roth IRA is determined by annual income, annual contributions to a Roth IRA are not deductible from taxable income and all growth in a Roth IRA is tax-free. Qualified withdrawals are tax-exempt if made more than five years after the Roth IRA was established, or the taxpayer has reached age 59½, becomes disabled, or dies. Investors do not have to make withdrawals after they reach a certain age like they must with Traditional IRAs.

**Employment During Retirement**

Employment during at least the early part of retirement will depend upon whether you are employable and able to work. Take care of your health before retirement and keep skills and knowledge updated to better ensure the ability to find post-retirement employment, whether for financial or non-financial reasons. Financial benefits of employment in retirement include reducing or delaying withdrawals from other retirement income sources. Non-financial reasons include being with people, remaining active, gaining access to employer-provided health care benefits, and feeling useful as a contributing member of society.

**Estimating Retirement Income Needs**

Just how much money needs to be set aside while working for retirement depends on:

- Current and anticipated retirement lifestyle
- How long you anticipate living
- How long health holds up
- Returns earned by investments
- Inflation
- The general economy
- Planning for unexpected life events.

Run the numbers at least annually to see if you are investing enough money so you can live your life in retirement the way you would like. Check the American Savings Education Council’s website at [www.aesc.org](http://www.aesc.org) and click on “Ballpark Estimate” to access a two-page worksheet that will help you quickly identify approximately how much you need to save to fund a comfortable retirement.

**Tips for Retirement Income Planning**

- Start early and save often, preferably through payroll deduction.
- Take enough risk to increase the likelihood there will be enough money when you need it.
- Keep hands off retirement money. Don’t withdraw or borrow it for other purposes prior to retirement, including rolling over retirement when changing jobs.
- Work with a retirement planning professional to help tailor a retirement income plan.
- Fund retirement before funding education for children if a choice must be made.

**Resource**

[extension.personal_finance](http://www.extension.org/personal_finance).

**This publication has been peer reviewed.**

**UNL Extension publications are available online at** [http://extension.unl.edu/publications](http://extension.unl.edu/publications).

**Index: Financial Management**

**Money Management**

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