August 26, 2015

When an Employer Doesn't Have a 401(k)

Q. My son just got his first job, but the company doesn't offer a 401(k) plan.

A. Congratulations on your son's new job!
Although his employer may not offer a 401(k) to help with his retirement savings, he does have the option of opening an individual retirement account, which is more commonly known as an IRA, said **Claudia Mott, a certified financial planner with Epona Financial Solutions in Banking Ridge**. IRAs were created in 1974 to provide a tax-deferred savings option for employees who worked for companies that did not offer a pension, Mott said. They also provided a place to roll over retirement assets when an employee left a firm.

"The combination of tax deferred savings and the potential tax deduction make the IRA the closest option to a 401(k) for your son," she said. For 2015, the maximum IRA contribution is $5,500 for individuals under the age of 49 whose taxable income exceeds the contribution limit. "If your son is single, he will be able to fully deduct the contribution on his income tax return, because his employer does not offer a retirement plan," Mott said. "However, the deductibility rules would change if he is married and his spouse has a retirement plan." Mott said payroll deduction is one of the conveniences that an employer-sponsored 401(k) provides because it helps ensure that retirement dollars are set aside each pay period.

"Your son should consider setting up his own version of this by creating an automatic transfer from each of his paychecks into his new IRA," she said. "The custodian will likely have a form that can be used to set up the automatic purchase of shares in the mutual fund(s) he chooses." Mott said even those with the best of intentions can have difficulty setting aside the money needed to make the annual contribution if it is sitting in an account used to pay regular bills.

As part of this, your son will need to understand his cash flow needs before he sets up the automatic withdrawal. "Whether it's with paper and pencil, a spreadsheet or a financial planning tool, he needs to know the bills he is responsible for each month and how that compares to his income," Mott said. "He may not be able to reach $5,500 in his first few years of employment, but if he is able to target 10 percent — a very popular savings rate hurdle — and still have extra cash to put into an emergency savings fund, he'll be off to a good start."

His last decision is going to be how to invest his IRA.

Mott said because he's just getting started, a target-date retirement fund will give him diversification and an asset allocation appropriate for his age. Many custodians provide these mutual funds because they allow individuals to own a variety of different types of investments such as stocks and bonds both in the United States and internationally with just one purchase, Mott said. "The proportion of each different asset is based on the age of the participant and becomes more conservative as retirement approaches," she said. "They are a good option to consider for someone just getting started."

It's never too soon to start saving for retirement, Mott said, and your son needs to understand the importance of creating his own savings plan in the absence of one provided by an employer.

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