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The Retiring DC

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Until the last few years, a favorite vehicle of the DC to shelter income was the use of an individual retirement account (IRA). The DC was allowed to put money away for retirement and pay no income tax on the money reserved for retirement. Under tax "reform," the rules have changed.

Now many IRAs have become non-deductible.

The present scenario (and who knows if it will change next year) is that a DC and spouse who file a joint return are entitled to claim a full deduction on their income tax return of $2,000 per person, but that is only allowed if the "adjusted gross income" is below $40,000. If their collective income is between $40,000 and $50,000, the deduction is reduced. An unmarried DC can take a full deduction of $2,000, but only if the DC earns less than $25,000. He can take a partial reduction if his income is $25,000 to $35,000.

There is a complicated form that is utilized to ascertain how much would be allowed under a partial deduction. The DC is advised to see his accountant in this respect.

For reasons unknown, the IRS has decided to make it even more difficult for married couples filing jointly to claim the joint deduction. For example, the contribution of the spouse of the DC could not, for example, be greater that 50 percent of the maximum deductible contribution allowed.

Hypothetically, if the total deductible contribution would only be $2,000 for a couple, then each spouse would be allowed to contribute only $1,000. If one spouse contributes less than $1,000, the other spouse is not entitled to contribute more to make up the difference.

Turn to An Annuity?

If the DC suddenly finds himself with a non-deductible IRA due to his income level and is seeking other methods to create a retirement fund, there are pension and profit sharing plans, stock bonus plans, simplified employee pension plans, and numerous other vehicles to consider.

A financial planner should be consulted in this respect.

One possibility is the use of an annuity. The DC must be careful, however, because there are many insurance companies which suggest their annuity program as the best available, and yet nothing could be farther from the truth. Conceptually, however, an annuity could theoretically allow the growth of the amount deposited on a tax-free basis until the funds are withdrawn.

However, the DC should not be confused into thinking that the initial deposit is tax free.

Once the money is deposited, it would be invested through the insurance company's investment portfolio, which typically includes property, mortgages, stock, bonds, etc. The insurance company should provide a guaranteed rate of return, and each year thereafter a new interest rate should be declared.

While there is no limit to how much can be contributed to an annuity, the DC must again realize that the initial contribution is typically not tax deductible.

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