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Underappreciated Options for Building Retirement Savings

More people ought to know about them.

There are a number of well-known retirement savings vehicles, used by millions. Are there other, relatively obscure retirement savings accounts worthy of attention? Are there prospective benefits for retirement savers that remain under the radar?

The answer to both questions is yes. Consider these potential routes toward greater retirement savings.

Health Savings Accounts (HSAs). People enrolled in high-deductible health plans (HDHPs) commonly open HSAs for their stated purpose: to create a pool of money that can be applied to health care expenses. One big perk: HSA contributions are tax deductible. Another, underappreciated perk deserves more publicity: the federal government permits the funds within HSAs to grow tax free. Just ahead, you will see why that is important to remember.[1,2]

While 96% of HSA owners hold their HSA funds in cash, others are investing a percentage of their HSA money. Tax-free growth is nothing to sneeze at: an HSA owner who directs 100% of the maximum $3,450 yearly account contribution into investments returning just 4% annually could have an HSA holding more than $200,000 in 30 years. Prior to age 65, withdrawals from HSAs are tax free if they are used for qualified medical expenses. After that, withdrawals from HSAs may be used for any purpose (i.e., for retirement income), although they do become fully taxable.[1,2]

In 2018, an individual can direct $3,450 into an HSA; a family, $6,900. Additional catch-up contributions are allowed for HSA owners aged 55 and older.[1,2]

"Backdoor" Roth IRAs. Some people make too much money to open a Roth IRA. That does not mean they are barred from having one. Anyone can convert all or part of a traditional IRA to a Roth, and pre-retirees with high incomes and low retirement savings occasionally do. Why? A Roth IRA offers the potential for future tax-free withdrawals. Roth IRA owners also never have to take Required Minimum Distributions (RMDs). A Roth conversion is typically a taxable event, and it cannot be undone. The IRA owner may enter a higher tax bracket in the year of the conversion, so anyone considering this should speak with a tax professional beforehand.[3]

Cash value life insurance. Permanent life insurance policies often have the capability to build cash value over time, and high-income households sometimes purchase them with the goal of achieving more tax efficiency and using that cash value to supplement their retirement incomes. Cash value accounts within these policies are designed to earn interest and grow, tax deferred. Withdrawals lower the cash value of the policy but are untaxed up to the total amount of premiums you have paid. Tax-free, low-

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interest loans may also be taken from these policies; unrepaid loans, though, lower a policy's death benefit. The big risk here? If you have an outstanding policy loan, you could potentially face huge income taxes if you run into a situation where you must surrender the policy or are unable to pay the premiums.[4]

Cash balance pension plans. Many small business owners need to accelerate the pace of their retirement saving. A cash balance plan, when wedded to a standard workplace retirement plan that features profit sharing, may enable a business owner to save much more for retirement annually than the low contribution limits of an IRA would ever allow. If contributions are very large, the yearly tax savings linked to the plan could even reach six figures.[1]

The Saver's Credit. Lastly, the federal government provides a significant tax credit to encourage low-income and middle-income households to save for retirement. The Saver's Credit can be as large as $2,000 each year. Joint filers with adjusted gross income (AGI) of $63,000 or less, heads of household with AGI of $47,250 or less, and other filers with AGI of $31,500 or less may be eligible for the credit, which equals either 50%, 20%, or 10% of their annual workplace retirement plan or IRA contribution, depending on their respective AGI level. Taxpayers contributing to ABLE accounts are also eligible to take the Saver's Credit, so long as they are the designated beneficiary for that account.[5]

Citations.

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