

AWM Financial Planning

What is a Roth 401(k)?



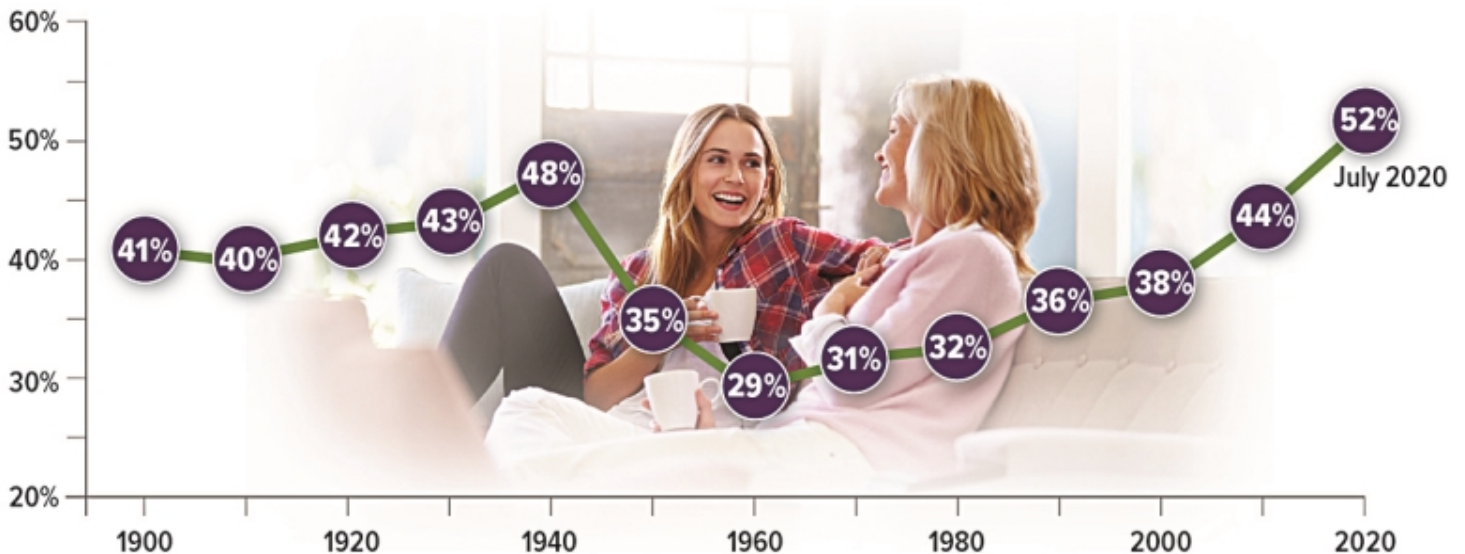
Steve Giacobbe, CFA, CFP®
Accredited Wealth Management
6010 Brownsboro Park Blvd. • Louisville • KY • 40207
502-290-1905
sgiacobbe@accreditedwm.com • www.accreditedwm.com



A Roth 401(k) is similar to a traditional 401(k) in that it is an employer-sponsored investment savings account. The main difference is when you pay taxes. With a traditional 401(k), contributions are with pre-tax dollars, giving you a tax break up front. Your money grows tax-deferred until you withdraw it. Withdrawals are considered ordinary income and you pay taxes at your current tax rate. With a Roth 401(k), it's the reverse. You make contributions with after-tax dollars, so there is no upfront tax deduction. However, withdrawals are tax-free after age 59½, as long as you've held the account for five years. A Roth 401(k) is well suited for people who think they will be in a higher tax bracket in retirement, are in a low tax bracket today (e.g. your children), or who want to diversify the tax characteristics of their assets. Seven in ten employers now offer a Roth 401(k) so check with your HR department. We can help recommend the savings account best suited for your situation.

Majority of Young Adults Living at Home

In 2020, a record number of 18- to 29-year-olds lived at home with their parents. In July, 52% of young adults were living at home, surpassing the previous high of 48% recorded in 1940 at the end of the Great Depression. This record return to the family home has been driven by the coronavirus pandemic and exacerbated by the overall economic downturn, record-low housing inventory along with a shortage of affordable entry-level homes, and high levels of student debt. The number of young adults living with their parents grew across the board for all demographic groups and regions of the country.



Source: Pew Research Center, 2020

Key Retirement and Tax Numbers for 2021

Every year, the Internal Revenue Service announces cost-of-living adjustments that affect contribution limits for retirement plans and various tax deduction, exclusion, exemption, and threshold amounts. Here are a few of the key adjustments for 2021.

Estate, Gift, and Generation-Skipping Transfer Tax

- The annual gift tax exclusion (and annual generation-skipping transfer tax exclusion) for 2021 is \$15,000, the same as in 2020.
- The gift and estate tax basic exclusion amount (and generation-skipping transfer tax exemption) for 2021 is \$11,700,000, up from \$11,580,000 in 2020.

Standard Deduction

A taxpayer can generally choose to itemize certain deductions or claim a standard deduction on the federal income tax return. In 2021, the standard deduction is:

- \$12,550 (up from \$12,400 in 2020) for single filers or married individuals filing separate returns
- \$25,100 (up from \$24,800 in 2020) for married individuals filing joint returns
- \$18,800 (up from \$18,650 in 2020) for heads of households

The additional standard deduction amount for the blind or aged (age 65 or older) in 2021 is:

- \$1,700 (up from \$1,650 in 2020) for single filers and heads of households
- \$1,350 (up from \$1,300 in 2020) for all other filing statuses

Special rules apply if you can be claimed as a dependent by another taxpayer.

IRAs

The combined annual limit on contributions to traditional and Roth IRAs is \$6,000 in 2021 (the same as in 2020), with individuals age 50 and older able to contribute an additional \$1,000. The limit on contributions to a Roth IRA phases out for certain modified adjusted gross income (MAGI) ranges. For individuals who are covered by a workplace retirement plan, the deduction for contributions to a traditional IRA also phases out for certain MAGI ranges. (The limit on nondeductible contributions to a traditional IRA is not subject to phase-out based on MAGI.)

MAGI Ranges: Contributions to a Roth IRA

	2020	2021
Single/Head of household	\$124,000–\$139,000	\$125,000–\$140,000
Married filing jointly	\$196,000–\$206,000	\$198,000–\$208,000
Married filing separately	\$0–\$10,000	\$0–\$10,000

MAGI Ranges: Contributions to a Traditional IRA

	2020	2021
Single/Head of household	\$65,000–\$75,000	\$66,000–\$76,000
Married filing jointly	\$104,000–\$124,000	\$105,000–\$125,000

The 2021 phaseout range is \$198,000–\$208,000 (up from \$196,000–\$206,000 in 2020) when the individual making the IRA contribution is not covered by a workplace retirement plan but is filing jointly with a spouse who is covered. The phaseout range is \$0–\$10,000 when the individual is married filing separately and either spouse is covered by a plan.

Employer Retirement Plans

- Employees who participate in 401(k), 403(b), and most 457 plans can defer up to \$19,500 in compensation in 2021 (the same as in 2020); employees age 50 and older can defer up to an additional \$6,500 in 2021 (the same as in 2020).
- Employees participating in a SIMPLE retirement plan can defer up to \$13,500 in 2021 (the same as in 2020), and employees age 50 and older can defer up to an additional \$3,000 in 2021 (the same as in 2020).

Kiddie Tax: Child's Unearned Income

Under the kiddie tax, a child's unearned income above \$2,200 in 2021 (the same as in 2020) is taxed using the parents' tax rates.

COVID-19 and the Importance of Disability Income Insurance

The prospect of being unable to work due to an illness or injury may seem remote to many of us, particularly during our younger working years. However, the COVID-19 pandemic has increased the chances of getting sick and not being able to work for an extended period, making disability income insurance (DI) more important than ever, regardless of your age.

Health insurance may pay for some of the medical expenses related to your illness, but it won't cover your lost wages if you can't work. And while many employers offer some form of sick leave, it may not last long enough to cover the length of time you can't work. Disability income insurance pays a portion of your salary if you are unable to work due to an injury or illness. But will DI cover you if you can't work due to COVID-19?

Will Disability Insurance Pay for COVID-19-Related Disabilities?

Generally, disability income insurance provides income benefits if you are unable to work for a medical reason. Before paying a claim for benefits, most DI policies require that you are unable to work because of a diagnosed medical condition, such as COVID-19, that has been verified by a doctor or other qualified medical professional.

If you are ill, or test positive for the virus, and are unable to work due to your illness or a medical quarantine (i.e., you can't work remotely), you should qualify for DI benefits. On the other hand, even if you tested positive and have a mild illness or are under a medical quarantine, but you have the ability to work, (i.e., you can work remotely), then you probably won't qualify for DI benefits. It is important to note that social quarantine (e.g., a government-mandated stay-at-home order) is not a medical quarantine and will not qualify for DI benefits. Likewise, if your employer shuts down temporarily or permanently due to the virus, you will not qualify for DI benefits.

Short-Term Disability Insurance vs. Long-Term Disability Insurance

There are two types of disability income insurance, short term and long term. While the provisions may vary by insurer, short-term DI policies usually have short elimination, or waiting periods (3-14 days) following the onset of your disability before the insurance pays. Although some policies offer benefits for up to two years, many contracts pay benefits for six months to one year.

Long-term DI policies have a longer elimination period (typically 90 days), but may pay benefits up to age 65, although, in certain instances long-term DI may pay lifetime benefits. Disability policies typically pay benefits that equal 50% to 70% of your gross monthly base salary. A monthly maximum benefit may apply.

For disability protection related to COVID-19, short-term DI should be enough if you miss work due to a medical quarantine. However, if you're unable to work for a longer time due to complications from the virus, long-term DI would be needed.

A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the policy. It should be noted that carriers have the discretion to raise their rates and remove their products from the marketplace. Guarantees are subject to the financial strength and claims-paying ability of the issuer.

Where Can You Get Disability Insurance?

In general, access to disability benefits can come from private insurance (individual or group DI policies purchased from an insurance company) or government insurance (social insurance provided through federal or state governments).

Private disability insurance refers to disability insurance that you purchase through an insurance company. Many types of private disability insurance exist, including individual DI policies, group policies, group association policies, and riders attached to life insurance policies.

Private disability policies usually offer more comprehensive benefits to insured individuals than social insurance. Individually owned disability income policies may offer the most coverage (at a greater cost), followed by group policies offered by an employer or association. Check with your employer or professional association to see if you are eligible to participate in a group plan. Even if your employer offers disability insurance, it's probably short-term DI and may not provide benefits if a disability due to COVID-19 lasts for more than three months. For disabilities that last longer or are permanent, you'll need a long-term DI policy to provide benefits while you can't work.

Umbrella Insurance Offers Extra Liability Coverage

Accidents can happen, no matter how careful you are. Even if you make every effort to help ensure that your house and the surrounding area are safe for visitors, rain, snow, or ice can cause slippery stairs and walkways. You might face an increased risk of having a liability claim filed against you if you have a dog, a swimming pool, a trampoline, employ workers in your home, or own a rental property. Or you could be held responsible for a serious auto accident — a special concern if you have a teenage driver.

American society is litigious, and some legal judgments seem excessive. Standard homeowners and auto insurance policies generally cover personal liability, but you may not have enough coverage to protect your income and assets in the event of a high-dollar judgment. That's when umbrella insurance could be a big help, providing additional coverage, up to policy limits.

On top of the liability coverage amount, an umbrella policy may help pay legal expenses and compensation for time off from work to defend yourself in court. It might also cover situations not included in standard homeowners policies, such as libel, slander, invasion of privacy, and defamation of character.

Umbrella insurance is not just for wealthy households; it is also appropriate for middle-income families with substantial home equity, retirement savings, and current and future income that could be used to satisfy

a large jury award. (Home equity might be protected, at least in part, by state law. Qualified retirement plan assets may have some protection from creditors under federal and/or state law, depending on the plan and jurisdiction, but you would still be liable for any judgments.)



Protecting yourself with an umbrella policy could help avoid expensive consequences down the road.

Although coverage and costs vary by insurer, you can typically obtain \$1 million in coverage for \$300 or less per year; higher coverage amounts can be even more cost-effective. Before adding umbrella insurance, however, you generally must purchase a certain amount of liability coverage on your homeowners and auto policies (typically \$300,000 and \$250,000, respectively), which serve as a deductible for the umbrella policy.¹

Your insurer can help you determine how much current liability protection you have, and how much more you can purchase. It might be helpful to consider your assets, potential exposure, and what you consider to be an acceptable risk.

1) Insurance Information Institute, 2020

IMPORTANT DISCLOSURES

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