Investing for a secure retirement is a goal shared by most individuals. “If you consider that your retirement could last to age 95 or longer, it makes good investment sense to thoroughly evaluate your options when formulating your overall retirement savings plan,” says Stuart Ritter, CFP®, a financial planner with T. Rowe Price. “Retirement accounts can offer substantial tax advantages and provide you with opportunities to benefit from the powerful effects of compounding.”
While you may be inclined to put all your retirement contributions into your 401(k) plan first, you may want to revisit your approach—individual retirement accounts (IRAs) can play a more significant role in your investment strategy than you might think.

**ESTABLISH YOUR CONTRIBUTION AMOUNT**
As you examine your overall savings strategy, it’s important to begin by establishing how much to contribute to your retirement accounts on an annual basis. T. Rowe Price recommends that you contribute at least 15% of your annual gross income—including any company match from your 401(k), if applicable—in order for your investments to replace 50% or more of your current salary over the course of a retirement that could last to age 95 or longer, adjusted for inflation. It’s likely you will be receiving about 25% of additional income from other sources—such as Social Security, employer pension plans, or part-time work—which could bring you closer to the 75% of preretirement income that is usually recommended to maintain a comfortable lifestyle during retirement.

In 2008, you can contribute $15,500 to an employer-sponsored 401(k) plan, if offered. (This includes both pretax and Roth contributions.*) And if you are age 50 or older, you can make additional contributions of up to $5,000, for a total of $20,500. IRAs allow investors with earned income to contribute up to $5,000 in 2008, with an additional $1,000 permitted for those age 50 or older.

**DETERMINE YOUR RETIREMENT ACCOUNT CONTRIBUTION ORDER**
After you’ve established how much you will invest each year, you’ll need to determine an efficient contribution strategy that increases your potential to maximize the tax benefits of the different types of retirement accounts available to you. When deciding how to prioritize your contributions, there are three important questions to ask yourself. Answers to these questions will help you determine your best course of action. The Determining Your Contribution Order chart on page 18 provides a summary of the information that follows.

1. **Do Roth contributions make sense for your situation?**
   In general, Roth contributions to a retirement account may be your best option. These contributions are made with after-tax income, and although they’re not tax-deductible, any growth of your investments is tax-deferred. Also, you do not pay federal taxes on withdrawals once you reach age 59½ and the account has been open for five years or more (other exceptions may apply). Distributions that meet these requirements are often referred to as “qualified distributions.” There are no required minimum distributions (RMDs) from a Roth IRA, which means you can accumulate and compound any earnings tax-deferred for as long as you leave your money invested in the Roth IRA. (RMDs are required to be taken from a Roth account within your employer-sponsored retirement plan.)

   For investors under age 50 or those over age 50 who don’t expect their tax brackets to drop significantly in retirement, making Roth contributions to a 401(k) or an IRA potentially may provide more income in retirement. “An increasing number of individuals in good health and with a need or desire to earn extra income are choosing to work beyond age 65,” notes Ritter. “Others are choosing to simply scale back their careers in their 60s and 70s rather than retiring outright. As a result, their incomes and marginal tax rates may not decline dramatically, especially if they begin collecting Social Security payments and taxable distributions from retirement accounts.”

---

*Some employer-sponsored retirement plans may allow after-tax elective contributions that are not subject to the annual IRS deferral contribution limit.
If Roth contributions do not make the most sense for you, the order in which you contribute to your retirement accounts is fairly straightforward. You will want to contribute the maximum amount permitted to your pretax account within your employer-sponsored retirement plan, and then contribute any amount remaining to a Traditional IRA.

2. Does your employer offer a Roth contribution option within your 401(k) plan?
If Roth contributions are the most sensible option for you, you will want to take every opportunity to benefit from them. Therefore, if your 401(k) offers a Roth contribution option, it can be in your best interest to contribute the maximum allowed to it. Note that unlike Roth IRAs, there are no income limitations to making Roth contributions within your 401(k) plan.

“Many employer-sponsored retirement plans do not yet offer the option of contributing to a Roth account,” states Ritter. “If your 401(k) plan is among those that don’t offer such an option, it’s still important to contribute enough to your pretax account within your 401(k) to earn your company match, if offered.” (See your plan administrator for details.) “These company contributions are free money. The best option for investing any additional available retirement amounts will depend upon your eligibility to contribute to a Roth IRA,” he adds.

3. Are you eligible to contribute to a Roth IRA?
In tax year 2008, to fully fund a Roth IRA, you must have a modified adjusted gross income (MAGI) below $101,000 as a single taxpayer or below $159,000 as a married couple filing jointly. Partial contributions to a Roth IRA are permitted for single taxpayers with MAGI below $116,000 and MAGI below $169,000 for married taxpayers filing jointly.

---

Determining Your Contribution Order

When deciding how to prioritize contributions to your retirement accounts—your 401(k) and/or your IRA—there are three important questions to ask yourself. Answers to these questions will help you determine your best course of action.

1. Do Roth contributions make sense for your situation?

2. Does your employer offer a Roth contribution option within your 401(k)?

3. Are you eligible to contribute to a Roth IRA?

CONTRIBUTE Maximum to your Roth account within your 401(k). Then contribute the maximum to a Roth IRA.

CONTRIBUTE Maximum to your Roth account within your 401(k). Then contribute the maximum to a Traditional IRA.

CONTRIBUTE Maximum to your pretax account within your 401(k) to earn your company match. Then contribute the maximum to a Roth IRA. If you still have money left to invest, contribute it to your pretax account within your 401(k).

CONTRIBUTE Maximum to your pretax account within your 401(k). Then contribute the maximum to a Traditional IRA.

---

1 Roth options may make sense if you are age 50 or younger or you are over age 50 and don’t expect your tax bracket to decrease significantly in retirement.

2 In tax year 2008, to make the full Roth IRA contribution, you must have a modified adjusted gross income (MAGI) below $101,000 as a single taxpayer or below $159,000 as a married taxpayer filing jointly. Partial contributions to a Roth IRA are permitted for single taxpayers with MAGI below $116,000 and MAGI below $169,000 for married taxpayers filing jointly.

3 All individuals are eligible to make designated Roth contributions within a 401(k) if offered by their employers—there are no income limitations.

4 If make nondeductible contributions to a Traditional IRA, there are no income limits. However, for deductible contributions, if either spouse participates in an employer-sponsored retirement plan, the amount of the deduction will depend on the couple’s MAGI.
If you are eligible to contribute to a Roth IRA and you have a Roth contribution option within your 401(k), you may first want to maximize the Roth account within your employer-sponsored retirement plan and then contribute as much as you can to a Roth IRA. If you can contribute to a Roth IRA and your employer’s plan does not offer the Roth option, your best course of action may be to contribute enough to your pretax account within your 401(k) to earn your company match (if one is available) and then contribute any additional savings to a Roth IRA. If you still have money left to invest, contribute it to the pretax account within your 401(k). Remember that your goal is to contribute at least 15% of your annual gross income (including any available company match).

Both Roth and Traditional IRAs offer substantial tax benefits as well as a wide range of investment options. With a Traditional IRA, all or part of your contributions may be tax-deductible, depending on your income level and whether you or your spouse participates in an employer’s retirement plan. (For more detailed information, visit www.irs.gov.) As long as your money remains in the Traditional IRA, you pay no taxes on any earnings. However, you will be responsible for paying taxes on any earnings (and contributions if they were tax-deductible) when you make your withdrawals. And you must begin taking RMDs from your Traditional IRA by April 1 of the year after you turn age 70½.

FUND YOUR ACCOUNT
As with your employer-sponsored retirement account, the best way to fund your IRA is to make contributions on a regular basis—for example, monthly or each pay period. Direct payroll deductions are an easy and practical way to channel money into IRAs, ensuring that part of your paycheck is automatically earmarked for a retirement account and not your daily expenses. “Often, investors who try to accumulate a lump sum for their IRAs—expecting to make one large contribution at year-end—fall far short of their goal because it is so easy to find other uses for the money,” Ritter says. “Making your contributions throughout the year can ensure that this money won’t be diverted from your retirement savings.”

TAKE ACTION
By making regular contributions and choosing the optimal retirement accounts, you can make the most of your tax-advantaged investment opportunities. “Regardless of how far you are from retiring, the decisions you make today can better help you to be financially prepared for the future,” concludes Ritter.

Consider Converting Your Traditional IRA to a Roth IRA

If you have a Traditional IRA, you may want to consider converting it to a Roth IRA if it makes sense for your future income considerations or if you’d like to limit your tax liability in retirement. After a conversion, you may be able to take distributions tax-free if you meet certain requirements.* To make the conversion, you must pay income taxes on any earnings and deductible contributions in the year you convert the Traditional IRA. Since you want to maximize the amount of assets that can accumulate tax-free in a Roth IRA, converting is often beneficial only if you do not have to use any of your tax-deferred assets to pay the tax bill incurred by the conversion.

The IRA Calculator, available at ira.troweprice.com, can help you determine whether converting your Traditional IRA to a Roth IRA is right for you.

*Roth IRA assets previously converted from a Traditional IRA may be distributed from the Roth IRA tax-free at any time (however, early distribution penalties may still apply). Any earnings that accumulate on the converted assets in your Roth IRA may be distributed tax-free if taken at least five years after January 1 of the year of the Roth IRA conversion, and you’ve reached age 59½, become permanently disabled, or have passed away. If your distribution of earnings from the Roth IRA does not meet these requirements, it may be subject to taxes and penalties.