

RETIREMENT NEWS

NEBRASKA PUBLIC EMPLOYEES RETIREMENT SYSTEMS STCO • JANUARY 2018

IRA – TRADITIONAL OR ROTH?

If you elect to contribute to an IRA, you must decide if you want utilize a Traditional or Roth IRA. Both are good options to save additional funds for retirement, and both offer tax saving advantages – but is one a better choice than the other? The contribution limits are the same. In 2017, you can contribute a maximum of \$5,500 (\$6,500 if over age 50) of earned income to one, or the other. In order to determine which is the better choice, you need to consider differences in taxation and ask yourself... which option will provide you with the most after tax income during retirement?

A Traditional IRA provides tax savings in the form of “pre-tax” contributions. Money you contribute can be taken as a deduction, which lowers your Adjusted Gross Income and reduces your taxes for that year. The account grows tax-free and when you take distributions, all withdrawals, including contributions and earnings, are subject to state and federal income taxes.

Contributions to a Roth account are made on a “post-tax” basis. You pay taxes up-front and contributions cannot be deducted from your yearly income, but when you reach retirement age both the earnings and contributions can be withdrawn tax-free.

THE GOAL OF “MORE MONEY” – IT’S COMPLICATED...

One of the common assumptions often made is a Roth will provide more money at retirement. This may or may not be true. Let’s compare a Roth vs. a Traditional IRA using a 25% tax rate and 5% rate of return for each account. When the tax rates and the rates of return are identical, would one option put more dollars in your pocket during retirement?

For this example, both of our savers have reviewed their budgets and determined they can afford a reduction in pay of about \$75 each month.

The Roth saver will pay taxes first, and then make the monthly post-tax contribution to the IRA. At a 25% tax rate, in order to contribute \$75 they must earn \$100. \$25 will be paid in taxes and the remaining \$75 contributed to the Roth IRA. At retirement, the distributions will be tax-free.

The Traditional IRA saver will pay taxes when they take distributions, but because they are not paying taxes up front, the \$25 dollars that would have gone to taxes will instead go into the IRA. Their \$100 monthly contribution will create the same \$75 reduction in take home pay as the Roth IRA saver.

Now let’s apply the 5% rate of return over a 20-year time-frame* and then deduct the 25% in taxes the Traditional IRA saver would pay on distributions during retirement.

TRADITIONAL
Pre-Tax Monthly Contribution = \$100
After 20 years & 5% return = \$41,103.37
After 25% tax = \$30,827.53

ROTH
Post-Tax Monthly Contribution = \$75
After 20 years & 5% return = \$30,827.53
Account is tax free = \$30,827.53

In both examples our savers have earned \$100 in income but the Roth saver gives up 25% of this to taxes which reduces the amount they can contribute each month. Our Traditional IRA saver must pay taxes when they take distributions, but if they are taxed at the same 25% rate, they end up with the same \$30,827.53. The argument can be made that the Roth saver essentially paid less overall in taxes but what tangible financial benefit did they gain? If both savers contribute an equal amount, say \$100, then the Roth does provide more funds at retirement – but failure to increase the contribution rate when participating in a Traditional IRA diminishes the tax benefit it provides.

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New Ameritas Security Verification

In an effort to enhance online security, Ameritas has implemented a new 2-step verification process for online account access. Each time you initially log into your account using a “new” device (computer, laptop, smartphone, etc.), you will be initially asked to complete the one-time setup process for that device. Ameritas will send a passcode to the email or phone number associated with your account. Entering your username, password, and the passcode will allow access to your account on that device. You will need to repeat this verification process each time you log in the account using a new, unrecognized device.

In a world where data breaches are happening on an alarming basis, this new security feature will help provide an additional layer of protection for your Ameritas Online access. Even if someone steals your username and password, this process may help prevent the thief from accessing your account on an unknown device.

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TAXES – A BIG PART OF THE EQUATION.

So all things being equal, which option is going to provide you the most income for retirement? It all revolves around what percentage you end up paying in taxes. As your Adjusted Gross Income (AGI) increases, so do your taxes:

FILING STATUS SINGLE	
2017 AGI BRACKETS	TAX RATE
\$0 – 9,325	Taxed at 10%
9,326 – 37,950	Taxed at 15%
37,951 – 91,900	Taxed at 25%
91,901 – 191,650	Taxed at 28%
191,651 – 416,700	Taxed at 33%
416,701 – 418,400	Taxed at 35%
418,401 – above	Taxed at 39.6%

MARRIED FILING JOINTLY	
2017 AGI BRACKETS	TAX RATE
\$0 – 18,650	Taxed at 10%
18,651 – 75,900	Taxed at 15%
75,901 – 153,100	Taxed at 25%
153,101 – 233,350	Taxed at 28%
233,351 – 416,700	Taxed at 33%
416,701 – 470,700	Taxed at 35%
470,701 – above	Taxed at 39.6%

Can you manage your income to pay taxes at a lower rate? If you assume your taxable income during retirement will be lower, it may make sense to take the tax break now by contributing to a Traditional IRA, then pay taxes on the distributions during retirement – at the lower rate. If you believe your taxable income/rate will be higher during retirement, then the tax-free distributions of the Roth may be a better option.

Unfortunately, trying to determine what your income and tax rate will be during retirement is at best, a guess. These brackets represent the current tax code. Your sources/amount of income, deductions, expenses, and future changes to the tax codes will all work for or against you.

SO MANY THINGS TO CONSIDER...

How much of your retirement income will come from taxable sources? Will distributions from these accounts push you into a higher tax bracket? During retirement there will be times when you may take a larger than usual distribution to replace an aging automobile or go on that dream vacation. Having funds in a Roth account allows you to cover all or part of those major expenses with tax-free distributions, thereby keeping your taxes in a lower bracket/rate.

You may have fewer items to deduct during retirement. For example,

getting the house paid off is a wonderful thing, but how will losing that deduction impact your taxes? On the flipside, not having monthly mortgage payments may enable you to maintain the same standard of living with less income – potentially maintaining the same (or even a lower) tax rate. Review your current deductions and expenses and consider how they will impact your tax rates and income needs during retirement.

Will Social Security affect your income and tax rates? Under current law, Social Security benefits are subject to income tax at certain income thresholds determined by adding your AGI, plus any nontaxable interest, plus ½ of your annual Social Security benefit. Once you exceed these income limits, either 50% or 85% of your Social Security benefit can be taxed. The tax rate is determined by the applicable tax bracket IE: 10%, 15%, 25% etc. If taxable distributions and earnings are not reduced, adding Social Security benefits to the mix could result in increased taxable income and push you into a higher tax bracket. For many retirees however, their Social Security benefits may reduce the need for taxable distributions or earnings, and result in lower taxes.

Will required minimum distributions push you into a higher tax bracket during retirement? At age 70 ½ you must begin taking distributions from pre-tax retirement plans including a Traditional IRA. The highest distribution amount begins at age 70 ½, at which point a retiree with a Traditional IRA would be required to withdraw approximately 3.65% to fulfill the required minimum distribution. For lower or middle income retirees, these withdrawals may not be large enough to push a portion of their income into a higher tax bracket.

Under the current Nebraska tax code, earned income and distributions from a Traditional IRA are subject to state income tax. What if you plan on moving to a state with no state income tax during retirement? If the answer is yes, distributions from a Traditional IRA would be subject to federal but not state income taxes. If that is the case, would you be better off contributing to a Traditional IRA now?

What is your current tax rate? Are you just starting out your career and anticipate earning more as you advance beyond entry level positions? If you fall into the lowest tax bracket now but expect to earn more in the future, then contributing to a Roth may make more sense at this stage of your life. If your income increases to the point where you fall into a higher tax bracket, then switching contributions to a Traditional IRA may become the better option.

Do you want to pass an inheritance to your spouse or children? One of the benefits of a Roth IRA is the ability to bequeath those dollars on a tax-free basis. If your heirs' income tax rates fall into the lower brackets, they may be better off inheriting a Traditional IRA rather than a Roth. Remember the example above – the larger account balance in the Traditional IRA has the potential to provide a greater overall benefit if taxed at a lower rate. Be aware the tax implications of inheriting any IRA can be complicated. Beneficiaries may need professional assistance to limit their tax liability.

SO WHAT IS THE ANSWER? TRY A BLEND OF BOTH?

Each individual situation is different and this article only covers a few of the circumstances you may encounter. The best choice might be to employ both a Traditional and Roth IRA. Even if you think your tax rates during retirement will be lower, having a portion of your nest egg in a Roth IRA provides additional flexibility to manage your taxable income during retirement. In the end, there really is no wrong choice! Both Traditional and Roth IRAs are excellent options to save for your future.

**Calculations made using the U.S. Dept of the Treasury "Savings Planner" calculator.*

Saver's Tax Credit



Low and moderate income employees may be able to significantly reduce their taxes by qualifying for the Federal Saver's Tax Credit.

Contributions made to an employer sponsored retirement plan such as the voluntary Deferred Compensation Plan (DCP) or an individual retirement arrangement (IRA), may qualify for a tax credit of up to \$1,000 per individual (\$2,000 if filing jointly).

This credit only applies for contributions made to voluntary retirement accounts. Eligibility and the amount of the credit are determined by filing status and adjusted gross income (AGI).

FILING STATUS/ADJUSTED GROSS INCOME LIMITS FOR 2018

CREDIT RATE	JOINT	HEAD OF HOUSEHOLD	SINGLE
50%	\$0 to \$38,000	\$0 to \$28,500	\$0 to \$19,000
20%	\$38,001 to \$41,000	\$28,501 to \$30,750	\$19,001 to \$20,500
10%	\$41,001 to \$63,000	\$30,751 to \$47,250	\$20,501 to \$31,500

For example, a couple filing a joint return with an AGI of \$38,000 or less is eligible for the 50% rate. If both contributed \$2,000 (or more) to a qualified plan, both would receive the maximum \$1,000 Saver's Credit. If their AGI was a bit higher at \$39,000, they move to the 20% bracket and both would receive a \$400 credit.

Don't confuse tax "credits" with "deductions." A deduction reduces the amount of your taxable income and you pay taxes on the remaining income at a percentage based on the IRS tax brackets. A credit reduces the final amount of taxes you owe dollar for dollar and provides significantly better savings. In addition, contributions made to DCP reduce your AGI and may help you qualify for a higher Saver's Tax Credit.

2018 DCP CONTRIBUTION LIMITS

The 2018 maximum contribution limits for the voluntary Deferred Compensation Plan (DCP) has been announced by the IRS. Certain limits for 2018 have increased and some remain the same limits previously set for 2017.

The standard yearly maximum contribution for 2018 has increased to \$18,500 for members under age 50. The additional contribution amount for members age 50 or older is unchanged from the \$6,000 amount provided in 2017. The 2018 total contribution limit for members age 50 and older will be \$24,500.

DCP is a tax-sheltered retirement plan somewhat similar to a Traditional IRA. It is a long-term investment plan and not intended as a short-term savings account. All state employees are eligible to participate, as are some county employees whose employer does not offer a section 457 plan. Please refer to the NPERS website for more information and DCP enrollment forms.

DEFINED CONTRIBUTION ANNUITY RATE CHANGE

Effective January 1st, the annuity rate for Defined Contribution members has been updated from the 2017 rate of 2.62% to the 2018 rate of 3.14%. Per Nebraska statutes, this rate is determined using the January Pension Benefit Guaranty Corporate rate (2.39%) plus 0.75%.

At this time, the annuity rate for Cash Balance members participating in the plan prior to 1/1/2018 remains unchanged at 7.75%. The annuity rate for Cash Balance members joining the plan on or after 1/1/2018 will be 7.5%.

Please refer to your plan handbook for more information on the annuities offered to State and County members at retirement or termination.



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QUARTERLY CASH BALANCE RATE

For the quarter beginning January 1st, 2018, the rate of return for Cash Balance participants is 5%.

The current and historical Cash Balance rates of return are available via the "Cash Balance Rates of Return & Dividends" link on our website.