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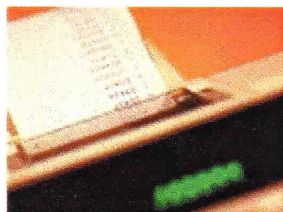
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RETIREMENT > 401(k)s & IRAs

Pre-tax money and 401(k)s



October 23, 2000: 12:52 p.m. ET

How to make decisions with your contributions to a company plan

NEW YORK (CNNfn) - Pre-tax dollars, after-tax dollars. When you're making contributions to your 401(k), it can make a big difference.

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Debra Morrison, a certified financial planner from Fairfield, N.J., said you may want to consider whether after-tax contributions should go in your 401(k) or another investment account.

"The after-tax option of saving into a 401(k) is valuable," Morrison said. "Should the investment choices be limited or not so great in your 401(k) plan, you may wish to save in other vehicles."

Morrison appeared recently on CNNfn's *Your Money* and also answered some questions via e-mail for CNNfn.com.

VIDEO

Debra Morrison answers questions on Your Money's Viewer Mail segment recently.



Ryan writes: I am 24 years old and currently make about \$70,000 a year. I am investing 20 percent of my salary into my company's 401(k) plan. However, there is a legal limit to the amount of 'pre-tax' dollars that are invested into a 401(k). The extra dollars

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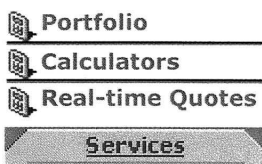
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are invested "after tax." Will this extra money grow without being taxed? Should I continue this route or should I invest the maximum pre-tax dollars, and put the extra into a separate IRA?

Yes, the limit for 401(k) contributions is \$10,500 this year if you are not considered a "highly compensated employee" relative to all the participants in your company's plan according to Employee Retirement Income Security Act of 1974 (ERISA). If so, your limit could well be lower.

I applaud you for saving into the 401(k) plan, and maximizing your pre-tax portion.

Most companies allow you to save pre-tax and after-tax dollars in your 401(k). The after-tax portion would grow tax-deferred in the 401(k) plan until you would withdraw it. Then you would pay taxes on the earnings. However, should the investment choices be limited or not so great in your 401(k) plan, you may wish to save in other vehicles.

Presuming that you are a single taxpayer, your adjusted gross would have to be less than \$32,000 for you to be eligible to deduct contributions to an IRA, so that is not an option.

You would be taxed on the gains and/or interest and dividends during accumulation. So you would choose a tax-efficient mutual fund or a growth stock. Eventually, when the money is a substantial amount, you would choose real estate, where the main objective is capital growth, not the generation of taxable income.

Finally, the after-tax option of saving into a 401(k) is valuable if you aren't disciplined enough to systematically save, since the 401(k) deduction comes right out of your check *before* you have a chance to think twice about saving or spending it.

You can arrange with most any mutual fund company however, to automatically deduct an amount from your checking account each month,

which is the next best alternative to payroll deduction, in my opinion.

Bob writes: My wife is 58-1/2 years old, retired and has a 403(b) tax sheltered annuity (TSA), which is growing at a very low rate of interest. While she was working, the employer, a school district, matched her contributions. She has not begun to draw any money from this annuity. She would like to transfer this 403(b) to an IRA and establish an account with an online broker so that she can try to build this money in a self directed IRA because she believes she can do better than the low interest it is now earning with the TSA. Are there any penalties for doing this? As long as she has the money transferred directly from one institution to another are there any tax consequences to her?

Answer: Your wife can transfer her 403(b) via a "trustee-to-trustee transfer" to another 403(b) account. This can be an online account, or with most any custodian like an insurance company or discount brokerage. She can either manage the money herself, or have an adviser assist her. There would be no current income tax ramification to her via a trustee-to-trustee exchange.

I would keep the 403(b) status, since 403(b) plans CAN accommodate loans -- depending on the plan agreement -- whereas a Rollover IRA could not offer any loan provision.

Additionally, depending on how long she has contributed to the 403(b) plan, she MAY be eligible to defer a part of her minimum distribution past age 70-1/2.

As for penalties, she should inquire with the present provider if she is 'out of surrender'. Many plans have a deferred sales charge that typically declines every year, for transfers within the first five years, or so. If she is still 'in surrender', she should ask for the particulars about the percentage she would be charged on a transfer

out, and then further, on what date would that surrender charge decrease, or be eliminated.

Kisan writes: If a family has a revocable family trust (living trust) which is designated as a beneficiary of life insurance, 401(k), IRAs, pension plan etc., how are the estate taxes calculated? The deed of the principal residence is in the name of the family trust. Two adult children are designated as the beneficiaries of the living trust after the death of parents.

Answer: Estate taxes are calculated based upon the decedent's estate value -- the total of all assets owned -- on the date of death, or six months afterwards.

Assets owned by a revocable trust are not excludable from the decedent's estate. Only assets owned by an irrevocable trust are exempt from estate tax.

Presuming the decedent was a U.S. citizen, you would add up the value of all the decedent's assets, remembering to net out any deductions; i.e. charitable donations, etc., and then accessing the estate tax tables, calculate the appropriate tax.

Then you would subtract the exemption equivalent amount from that net tax, and pay the same within nine months of the date of death.

The exemption is \$675,000 for 2000 and 2001, increasing to \$700,000 for 2002 and 2003, \$850,000 for 2004, \$950,000 for 2005, and \$1,000,000 in 2006.

I would definitely advise utilizing an attorney who specializes in estate taxes to assist you through this process! ■

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