Retirement Savings Without a Retirement Account

What Should You Do If You've Maxed Out Your 401K and IRA?

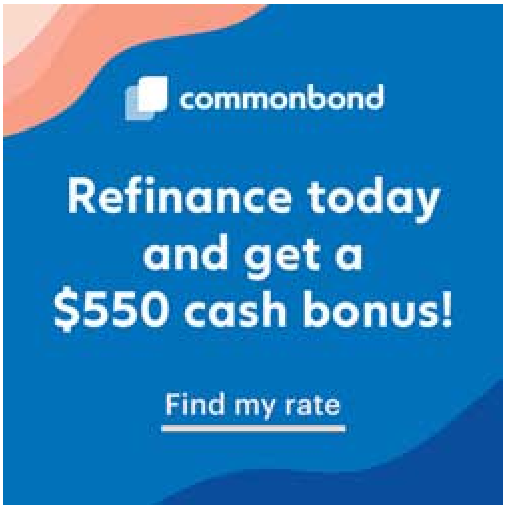
Q.

I'm an employee and have already maxed out a 401K ($17.5K), a back-door Roth IRA ($5.5K), and an HSA ($3250). I'd like to save more for retirement. What are my other options?

A.

The amount of "space" in available retirement accounts rarely lines up exactly with what an investor would like to save for retirement. Some people have far more of that space available than money to invest, while others have plenty of money without enough space! There are so many different options, there's no reason one has to stop saving for retirement if they wish to save more in any given year. Let's consider each of them one by one.

Spousal Retirement Accounts



If you're married, you can save money in your spouse's retirement accounts. Remember that money is fungible and a dollar doesn't care if it was made by you or your husband. There's no reason you can't take all your savings from your income and have most or all of your spouse's paycheck go into his 401K. If you have a stay-at-home spouse, or one with very little earnings, you can do a backdoor Roth IRA for your spouse with your own income, creating another $5500 in retirement "space" each year. Being married also allows you to put $6450 into a Stealth IRA (i.e. HSA) instead of just $3250.

Paying Down Debt

Many of us, especially in our thirties, carry around a large amount of debt, some of which may be at a relatively high-interest rate. If you have maxed out your retirement accounts and have debt at 6-7% or even more, it's a no-brainer to use your additional income to pay that down. It's the equivalent of purchasing an investment with a guaranteed 6-7% return. Even paying down a 3-4% mortgage may be an attractive option for additional savings for some people.

Lobby Employer for Additional Retirement Accounts

Self-employed physicians can use a Solo 401K or SEP-IRA with a

$51K limit. Many partnerships have 401K/Profit-sharing plans in place with the same limit. These physicians may also have a defined benefit plan allowing them to save another $10-50K. While an employed doctor can't just walk out and open these types of accounts on her own, she can lobby her employer to add them to the mix. You may find your employer is more than willing to change the retirement options available, but just doesn't happen to understand his options and how important this is to his employees.

Catch-Up Contributions

Once you hit age 50, you can actually contribute more to your retirement accounts. The 401K employee contribution limit goes up from $17.5K to $23K. Profit-sharing plans go from $51K to $56.5K. Your personal and spousal Backdoor Roth IRA contribution limits also go up from $5.5K to $6.5K and even the Stealth IRA limit goes up by $1000 to $4250 (single) or $7450 (married). If you have a 403B and a 457 as many academic docs do, the limit for each of them goes up from $17.5K to $23K, providing another $11K in retirement savings space.

Annuities

While I'm generally not a big fan of annuities due to their additional costs and the fact that they turn income that would be taxed at a lower capital gains tax rate into income taxed at your higher regular rate, there are situations when they can make sense, especially if costs are very low, the asset classes invested in are particularly tax-inefficient like bonds, REITS, or high-turnover stock funds, and if you hold it for a very long time. They may also provide some additional, state-specific, asset protection benefits. However, in exchange for some tax benefits and possibly some asset protection benefits, you give up many of the unique benefits and flexibility of investing in a taxable account.

Cash-Value Life Insurance

I'm also not a big fan of cash-value life insurance, whether it be whole life, universal life, or variable universal life. It is often marketed to high-income people as an additional retirement account and has been discussed in the blog ad nauseum. Returns tend to be low and you must hold the policy for the rest of your life to get any kind of reasonable return. Withdrawals must be taken as "loans" from the policy, on which you must pay interest until your death (or pay back the loan.) You must also be insurable at a reasonable rate, so it really isn't an option for those with relatively poor health or dangerous hobbies. A life insurance policy may provide you some estate planning and asset protection benefits depending on your individual situation and state of residence. Some people may also highly value the permanent death benefit a cash-value life insurance policy is designed for. There are a few steps you can take to make a life insurance policy work out a little better as an investment, but as a general rule, the lack of flexibility and low returns make these an inferior option. You certainly shouldn't be buying one if you haven't maxed out all of more traditional retirement accounts.

Real Estate Investing

Investing in real estate allows you to take advantage of relatively safe leverage (when compared to buying stocks on margin) and many significant tax advantages such as depreciation, the ability to write off travel to the location of the property, 1031 exchanges, and the step-up in basis at death. Downsides include huge transaction costs and the fact that, in many ways, real estate investing is a second job, something most physicians don't need. Certainly, many physicians and other investors have had great success with real estate investing.

Accounts For Your Kids

Some doctors prefer putting extra money toward 529 accounts for their children or into their children's UGMA accounts. While this does have the benefit of lowering your tax bill, it really isn't a great place for your retirement savings due to restrictions on these accounts. Money taken out of a 529 and not spent on education is taxed at your regular marginal rate with an additional 20% penalty. Money put into a UGMA account can only be spent for the child's benefit. Besides, when the child turns 18-21, he can blow the money on dope and strippers and there's nothing you can do about it.

Taxable Investing Account

The much-maligned taxable investing account isn't nearly as bad as most physicians, and certainly most annuity and life insurance salesmen, think they are. Sure, it is exposed to your creditors, but the truth is that few of us will ever have to deal with a judgment that isn't covered by our malpractice or umbrella policies. Retirement accounts, annuities, and life insurance aren't really protected from the judgment most commonly faced by doctors, a divorce settlement, anyway. It is also taxed as it grows, unlike many of the other accounts listed above. However, it has many advantages that the other accounts do not. First, it is immensely flexible. You can invest in pretty much anything and you don’t have to deal with age 59 1/2 related restrictions. Second, you can get a step-up in basis at death, passing money to your heirs’ income tax-free. Third, you can get significant tax benefits during your life by donating shares to charity or tax-loss-harvesting. Fourth, you can minimize taxable income by choosing tax-efficient investments such as total market stock index funds and municipal bonds. If not completely tax-free or at least deferred, income will generally only be taxed at the lower capital gains and dividend rates rather than your regular marginal tax rate.

As you can see, there are lots of options for retirement investing even after you’ve maxed out your retirement accounts. As with most things in life, knowledge and creativity are rewarded financially.

What do you think? Which types of accounts do you use for your retirement savings?