Saving for retirement

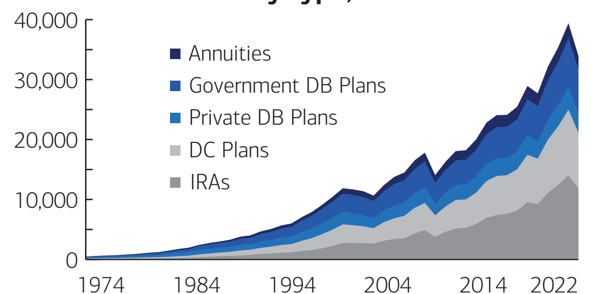
Make the most of your tax-advantaged assets

Retirement planning can be a complex undertaking. The decisions you make about when, where and how to invest your retirement savings will have a significant impact on your future financial security.

Given the transition over the years from solely employer-funded retirement plans (i.e., defined benefit or traditional pension plans) to primarily employee-funded retirement plans (i.e., defined contribution plans, annuities and individual retirement accounts (IRAs)), doing your homework on the features, benefits and considerations associated with various retirement account types has taken on even greater importance.

You can no longer depend on pension and Social Security benefits to meet the majority of your income needs throughout retirement. Forty-five years ago, pensions accounted for the majority of all retirement assets, with the balance made up of defined contribution plans, annuities and IRAs. Today, however, that ratio has nearly reversed.

Retirement assets by type, 1974–2022



Source: Investment Company Institute.[1]

Government DB Plans include state and local government DB plans and Federal DB plans.

Tax-advantaged ways to save

Given the wide range of tax-advantaged retirement savings opportunities available, an important question to consider is: How should you allocate the assets you have across these vehicles to make the most of your retirement savings? In this fact sheet, we'll explore two tax-advantaged savings vehicles — **defined contribution plans**, including 401(k) and 403(b) plans, and **Individual Retirement Accounts (IRAs)**, including traditional and Roth IRAs. We'll also provide you with information about additional things to consider, such as Health Savings Accounts and IRA catch-up contributions.

Employer-Sponsored Retirement Plans

- With employer-sponsored retirement choices such as 401(k) and 403(b) plans, you can contribute pre-tax earnings and your gains may accumulate tax-deferred until they are withdrawn. Essentially, these plans allow you to pay yourself first, by allocating a percentage of your paycheck into the plan before most other deductions (including income taxes) are taken.
- Most plans offer an array of investment choices (e.g., stock, bond and money market funds), and in order to encourage participation, some employers will offer to match your contributions up to a certain percentage, making it even more potentially beneficial to participate.
- Company matches are, in effect, a bonus that your employer is willing to give you just for investing, subject to other applicable plan terms (such as vesting requirements, if any).

Continued on page 2.

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Individual Retirement Accounts (IRAs)	• There are two common types of IRAs: traditional and Roth. Because the investment choices they offer (e.g., stocks, bonds, CDs, mutual funds and managed portfolios) may be broader than those available through most employer-sponsored plans, IRAs afford you choices to align your investments to your risk tolerance and asset allocation preferences. • A traditional IRA allows you to contribute pre-tax dollars (if you meet certain parameters) to the account and accumulate potential earnings tax-deferred until you begin taking distributions. In exchange for this tax-deferred growth, you'll be required to pay income tax on the entire distribution.[2] Should you move into a lower income tax bracket in retirement, however, you may realize additional benefits from tax deferral. • With a Roth IRA, your contributions are made with after-tax rather than pre-tax dollars. Therefore, you are not required to pay federal (and possibly state) income tax on any earnings distributions as long as at least five years have passed since the first day of the year in which you made your first Roth IRA or Roth conversion, if earlier, and you have reached age 59½, become disabled or deceased.[2] And since Roth IRAs are not subject to Required Minimum Distribution (RMD) rules beginning at age 72,[3] if you do not need to access those assets for retirement income, they can be earmarked as a legacy for your beneficiaries.[4]

Comparing employer-sponsored plans and IRAs

	401(k) and 403(b) plans	Traditional IRAs	Roth IRAs
Tax-deferred account growth	✓	✓	✓
Allows pre-tax contributions	✓	✓	
Allows after-tax contributions	✓*	✓	✓
Matching employer contribution	✓*		
Loan provisions	✓*		
Broadest choice of investments		✓	✓
Provides tax-free retirement distributions	✓**		✓
2023 contribution limits	$22,500 if under age 50; $30,000 if age 50+	$6,500 combined IRA limit; $7,500 if age 50+	

* Typically available in 401(k) and 403(b) plans but you should confirm whether these choices are available in your plan.
** Designated Roth contributions and any associated earnings are tax-free in retirement if taken in a qualified distribution.

Preparing for healthcare costs

Health care plays an important role as you plan for the future — since medical costs are one of the biggest expenses in retirement. Consider setting up a Health Savings Account (HSA) as a long-term, tax-advantaged way to cover both existing and future medical costs. If you have a high-deductible health plan (HDHP), you may be eligible to set up an HSA. Along with supplementing your savings, an HSA offers potential tax benefits[5]:

- Federal tax-free contributions;
- Tax-free growth on interest or investment earnings; and
- Tax-free withdrawals for qualified health care expenses.

Note: To be eligible to contribute to an HSA, you must be covered by an HDHP on the first day of the month in which you are contributing, have no other health coverage, not be enrolled in Medicare and not claimed as a dependent on someone else's tax return.

Additional considerations as you plan your retirement savings strategy

Take advantage of catch-up contributions. If you are age 50 or older during the calendar year, tax law allows you to make additional "catch-up" contributions to an employer-sponsored retirement plan (if the plan terms permit) and/or an IRA. These provisions provide workers who are closer to retirement an opportunity to enhance their retirement savings. Using a 5% annual rate of return, an extra $1,000 contribution to your employer-sponsored plan or to your IRA every year between age 50 and 65, along with the contributions you were already making, could add an extra $22,657 in pre-tax retirement savings by age 65.

Early withdrawals can have significant tax implications. Since 401(k) accounts, 403(b) accounts and IRAs are all meant to be used in retirement, in addition to ordinary income taxes, a 10% early withdrawal additional tax is imposed on withdrawals taken before you reach age 59½ (some exceptions apply).[2,6]

Some employer plans may also include a loan feature, but since assets withdrawn as a loan cannot be invested, loans can negatively impact the ability of your account balance to grow.

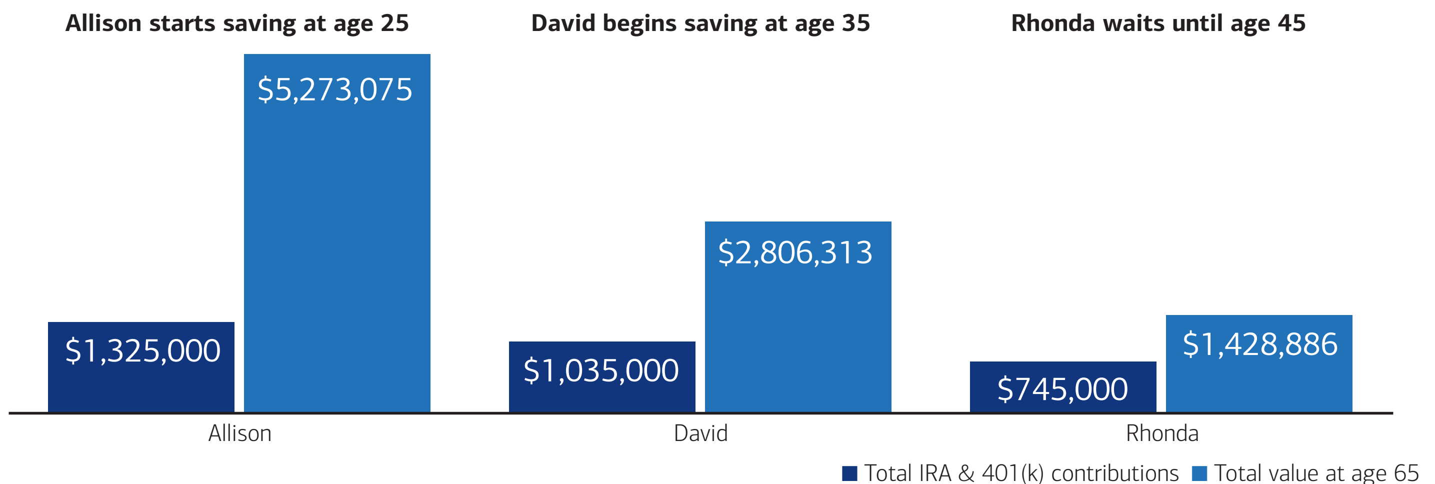
Maximize your contributions. Start by focusing on your 401(k) or 403(b) plan if you have access to one. Make sure you're taking advantage of any matching funds offered by your employer. If you're fortunate enough to be able to save the maximum amount in your company plan, then turn your attention to making additional contributions into your IRA.

Keep track of accounts with previous employers. According to the Bureau of Labor Statistics, by the time the average American worker reaches age 52, he or she will have held more than 12 different jobs.[7] For those who choose to keep their retirement plan assets with past employers, effectively managing multiple accounts can be challenging — from gauging your overall investment risk to ensuring proper asset allocation.

Power of tax-deferred compounding

Tax-deferred compounding is a powerful way to grow your retirement investments. Tax-deferred compounding is the process of the earnings from your accounts being added to the principal and reinvested year after year. The longer the process is allowed to continue, the more potential your retirement savings has to grow. *See hypothetical example below.*

Hypothetical example showing the power of tax-deferred compounding: Consider three co-workers, Allison, David and Rhonda, who all contribute to an IRA with $6,500 a year until age 49 and then $6,500 plus the additional $1,000 catch-up contribution from ages 50 to 65. If each individual also contributed the maximum amount to their 401(k) plans ($22,500 a year until age 49 and then $30,000 annually with catch-up contributions from ages 50 to 65), the power of tax-deferred compounding would be even more impactful.



This hypothetical illustration assumes a 6% rate of return compounded annually for all three investors. Allocations are for illustration only and do not constitute investment advice. They are being shown only to illustrate how a portfolio may change over time. You should consider the number of years until you retire, your goals and risk tolerance. The stock and bond fund allocations will vary for each portfolio depending on the number of years both before and after the planned retirement. Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns.

Get started

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[1] Investment Company Institute, *The US Retirement Market, Second Quarter, 2022*. September 15, 2022.

[2] Any distribution (up to $100,000) taken from an IRA or retirement plan account on or after January 1, 2020 and before December 31, 2020 by a "qualified individual" may be deemed a coronavirus-related distribution (CRD) and may be rolled back into the IRA or plan account, if the plan allows, within 3 years of the day after the date of distribution. A CRD is included in income ratably over 3 years and not subject to the additional 10% tax on early withdrawals. The one-rollover-per-year rule does not apply to the recontribution of a CRD. A CRD may be taken from a beneficiary account and receive the favorable income tax treatment, but a CRD may not be recontributed to a beneficiary account. Consult your tax advisor for more information on your personal circumstances.

[3] The required beginning date for RMDs is age 72. You may defer your first RMD until April 1st in the year after you turn age 72, but then you'd be required to take two distributions in that year. Failure to take all or part of an RMD results in a 50% additional tax applicable to the amount of the RMD not withdrawn. Consult your tax advisor for more information on your personal circumstances.

[4] Generally, for a distribution from a Roth IRA to be federal (and possibly state) income tax-free, it must be qualified. A qualified distribution from your Roth IRA may be made after a five-year waiting period has been satisfied (this period begins January 1 of the tax year of the first contribution or the year of conversion to any Roth IRA) and you (i) are age 59½ or older, (ii) are disabled, (iii) qualify for a special purpose distribution such as the purchase of a first home (lifetime limit of $10,000), or (iv) are deceased. If you receive a non-qualified distribution from your Roth IRA, the earnings portion of such distribution generally will be subject to ordinary income tax, plus a 10% early withdrawal additional tax if received before age 59½ unless an exception applies. A 10% early withdrawal additional tax may also be owed on converted Roth IRA principal withdrawn before the end of the five-year period. Although RMDs are not required for the original account owner, RMDs would apply to the inherited IRA account.

[5] About triple tax advantages: You can receive tax free distributions from your HSA to pay or be reimbursed for qualified medical expenses you incur after you establish the HSA. If you receive distributions for other reasons, the amount you withdraw will be subject to income tax and may be subject to an additional 20% tax. Any interest or earnings on the assets in the account are tax free. You may be able to claim a tax deduction for contributions you, or someone other than your employer, make to your HSA. Bank of America recommends you contact qualified tax or legal counsel before establishing a HSA.

[6] Taking distributions from traditional IRAs before you reach age 59½ generally will result in not only ordinary income tax, but also a 10% early withdrawal additional tax on the taxable portion. Exceptions to this additional tax include, but are not limited to, withdrawing assets to buy your first home or to pay for qualified higher education expenses. The 10% early withdrawal additional tax may apply to the taxable portion of early withdrawals from a Roth IRA. You should check with a tax advisor before taking such a distribution.

[7] U.S. Department of Labor, Bureau of Labor Statistics, Number of Jobs, Labor Market Experience, and Earnings Growth: Results from a National Longitudinal Survey, August 2019.

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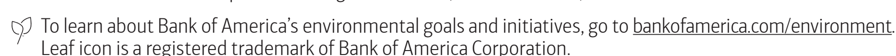

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