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Turn Job-Loss Lemons into Retirement Lemonade

by Chris Kissell / Published October 10, 2012 / Bankrate.com

A bout of long-term unemployment can trigger trauma and uncertainty. Some have equated the emotional fallout with that of a divorce or the death of a loved one.

But Alan Moore, founder of Serenity Financial Consulting in Milwaukee sees potential opportunities for smart retirement planning moves.

"If properly managed, I believe this time can be one of the most beneficial periods in my clients' career(s)," he says.

Following are three ways to turn the sour lemons of job loss into the sweet lemonade of financial security in retirement.

Convert Traditional IRA to Roth IRA
Certified Financial Planner professional Clark Kendall, founder of Kendall Capital, has watched many clients struggle with employment income issues over the last decade.

"First it was the IT people who went through an economic fallout, then real estate people, then bankers," says Kendall, whose firm is

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based in Rockville, Md. "It's been kind of like a rolling recession."

However, people usually overcome hard times and thrive again in the future, he says. His message to hardworking, out-of-work taxpayers is upbeat: "Your income's falling off, your tax rates are falling off -- let's take advantage of that," he says.

Converting a traditional individual retirement account to a Roth IRA is one of the best ways to plant financial seeds that will bloom in later years, Kendall says.

Small-business owners sometimes use this strategy if they anticipate little or no taxable income in the venture's first several years, Kendall says. Each year, the entrepreneur converts tax-deferred retirement savings earned earlier in his or her career to a Roth IRA.

The entrepreneur pays "a little bit of taxes, maybe at 5%" on the converted retirement savings once deductions and write-offs are figured in, Kendall says.

The money then compounds over several decades, giving the business owner $2 million or $3 million in tax-free savings at retirement.

"Like many things in life, you make small changes and, given a little bit of time, it makes a huge difference," he says.

That same principle can apply to anyone who is out of work and has made little or no income over the tax year, Kendall says.

"If you're not going to have taxable income and you have a $20,000 IRA, let's convert 100% of it," he says.

Take the Federal Retirement Savings Credit
A stretch of long-term unemployment that drops your income substantially may qualify you for goodies intended for low-income workers, such as the federal retirement savings contributions credit, also called the savers credit.

If your adjusted gross income falls under certain levels and you put money into any qualified retirement account -- such as a 401(k), 403(b), IRA or Roth IRA -- you can take the credit and reduce your tax bill by up to $1,000 for an individual, or $2,000 for a married couple.

Even better, this credit is available in addition to -- rather than instead of -- the original tax break you may earn from contributing to the retirement account.

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"If you qualify and can afford it, it's a no-brainer to take advantage of the credit," says Certified Financial Planner professional Michael Rubin, founder of Total Candor, a financial planning education firm based in Portsmouth, N.H. "The government doesn't often give you as big an incentive to save as it does with this credit."

To be eligible for the credit in 2012, your adjusted gross income must fall below $57,500 for a married couple filing jointly, $43,125 for a head of household and $28,750 for a single filer.

Set up a Solo 401(k) Plan

Unemployment can push workers into "an incredibly difficult transition period," particularly if they are older, Moore says. However, it also presents an opportunity to re-examine career goals.

"When a client experiences a job loss, the first question I ask is, 'Do you really want your old job back?'" he says. "Many Americans are unhappy in their job."

Perhaps you decide instead to start a small business. Or, maybe in the scramble to find a quick source of income, you end up doing part-time or full-time freelance or contract work that eventually becomes your new career direction.

If you end up self-employed for several months or longer, you can create a major tax break by setting up a solo 401(k) plan. And this is one of the best vehicles available for retirement planning.

This type of plan -- also called an individual 401(k), or I-401(k) -- allows freelancers, contractors and other self-employed people to earmark huge amounts of money to their retirement savings.

For 2012, the total contribution limit -- which includes both elective salary deferrals and employer contributions -- is $50,000, or $55,500 for those ages 50 and older.

Several mutual fund firms offer these plans, including T. Rowe Price, Fidelity, Vanguard, Charles Schwab, OppenheimerFunds and TD Ameritrade.

Joe Dellutri, a retirement specialist with T. Rowe Price, says the large contribution limits associated with solo 401(k) plans make them a great fit for "individuals who are looking to max out retirement savings."

The plans are designed for self-employed individuals and married couples who do not plan to expand their business and add employees later. Freelance writers and physicians or other professionals who become consultants are examples of good candidates for a solo 401(k), Dellutri says.

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"In essence, if they *are* the business, the I-401(k) serves them well," he says.

Solo 401(k) plans require paperwork and ongoing administration, so Dellutri recommends speaking with a tax professional before going this route. He also urges participants to avoid tapping such accounts prematurely to pay business expenses or other bills.

"The I-401(k) is not a piggy bank. It's not an emergency fund," he says. "It's a retirement plan."

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