Delaying IRA Contributions Can Be Costly

Make your 2014 investment now, not next April, to boost your nest egg and trim taxes

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Updated Jan. 16, 2014 10:40 a.m. ET

It's a new year. And that means it's time for investors to do what they could have done last year—but didn't.

Namely: make contributions to their 2013 individual retirement accounts. Indeed, an analysis of traditional and Roth IRA contributions made by Vanguard Group customers for the 2007 through 2012 tax years showed that, on average, 41% of the dollars contributed to IRAs for any given tax year are invested between January and April of the *following* year. Half of those dollars are contributed in the first half of April—the final weeks when contributions for the previous year can be made.

The study found only 10% of dollars are contributed in January of the corresponding tax year, the earliest month contributions can be made. "We are trying to encourage people to change their way of thinking and think about it sooner," says Maria Bruno, a senior investment analyst with Vanguard Investment Strategy Group.

Valid Excuse?

There are legitimate reasons that big dollars flow into IRAs near the tax-filing deadline. At that point, taxpayers typically know whether their income for the prior year was low enough to qualify for deductible contributions, and can see by exactly how much a contribution would lower their tax bill.

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But some advisers say the habit is one of the ultimate examples of investor laziness, nearly on par with not maxing out the company match for 401(k) contributions or not seeking retirement advice until after retirement.

"As humans we naturally procrastinate," says Mackey McNeill, an accountant and financial adviser in Bellevue, Ky.

Procrastination can be costly. The problem, advisers and retirement consultants say, is that investors who make IRA contributions at the last moment miss out on 16 months of potential gains (from January of one year until April of the following year), as well as the chance for those gains to compound over many years. Even if two investors contribute the same amount of money over the years, the person who starts earlier could end up with significantly more savings down the line.

Compare a saver who makes the maximum annual IRA contribution of $5,500 for those under age 50 in January of each year with another saver who contributes the same amount each April 15 of the following year. Over 31 years, assuming the money is invested in a moderate portfolio earning a hypothetical 7% annual return, the saver who makes full contributions in January could end up with $55,000 in additional savings, even though both investors contributed equal amounts—about $170,500—overall, according to an analysis by Ms. McNeill.

Tax Burden

Another downside to putting off contributions: It could add to your tax bills. Money in a taxable account over that 16-month period may incur gains that would have been deferred in an IRA, says Ed Slott, an accountant and founder of IRAHelp.com, a website for retirement savers.

Some pros say investors' excuses for not contributing as early as possible are looking thin. Most people don't see their income swing wildly from one year to the next, Ms. Bruno says. They can likely use last year's tax return to decide whether to make a contribution for the current tax year each January.

Procrastinators still have time to change their ways. Some can catch up if they now make their 2013 and 2014 contributions—a total of $11,000 for those under 50 contributing the maximum for each year, Ms. McNeill says. Those investors can then get in the habit of making their IRA contributions at the start of each year. (Investors 50 or older can contribute as much as $6,500 to their IRAs each year.)

While a doubled-up contribution is a lot to set aside at once, she says: "You've only got to make this change for one year."

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Corrections & Amplifications
Contributing $5,500 to an individual retirement account each January, rather than in April of the following year, over 31 years (with an average annual 7% return) could boost the IRA balance by $55,000, according to a corrected hypothetical example from accountant Mackey McNeill. An earlier version of this article gave the figure as $83,000.