Everything You Need to Know Now about Tax Advantaged Investment Accounts

Article Published by Suzanne Heron, Financial Advisor at Lovett Advisors, LLC
Published on January 21, 2019

Everyone tells you to start planning for your retirement early. If you're like most Americans you might be asking yourself "How do I get started?" A great way to start saving for retirement is by opening up a tax advantaged investment account.

Types of Tax Advantaged Accounts

1. **401k and 403b accounts-** If you are employed at a mid to large size corporation or non-profit, chances are you have heard of these accounts. When you contribute your money to one of these plans you're able to basically shield your income from taxes until it's withdrawn from the plan in retirement. Once you hit 59 ½ you can take withdrawals without a penalty. If you take money out before then (with a few small exceptions for disability & medical expenses etc.) you are penalized by 10%. Once you reach the age 70 ½ the IRS mandates that you begin taking required minimum distributions each year starting on April 1st the year after you turn 70 ½ which are taxed at your ordinary income rate. RMDs are based on the account value and your age. If you forget to take your RMD you are assessed a penalty of 50% of the amount you didn't withdraw. There are also solo 401k plans designed for employers with no full time employees. *As of 2019 you are permitted to save up to $19,000 in your 401k with a catch-up contribution available for those over 50 of $6000.*
2. **Traditional IRAs-** Contributions to this account are tax deductible in the year made, depending on your income level (Tax deductions are phased out based on income level. The phase out is from $64,000 to $74,000 , for MFJ that phase out is from $103,000-

$123,000. Contact your accountant for more information) Once you hit 59 ½ you can take withdrawals without a penalty (exceptions are made for disability, medical expenses, first time home purchases etc.- see your accountant for more details.) You are taxed on the withdrawals at your ordinary income rate. Once you reach the age 70 ½ the IRS mandates that you begin taking required minimum distributions each year starting on April 1st the year after you turn 70 ½ which are taxed at your ordinary income rate. RMDs are based on the account value and your age. If you forget to take your RMD you are assessed a penalty of 50% of the amount you didn't withdraw.
As of 2019 you are permitted to save up to $6000 in your IRA with a catch-up contribution available for those over 50 of $1,000.

3. **ROTH IRAs-** Contributions to ROTH IRA's are made with after tax dollars, but because this money has been taxed already they grow tax free and are distributed to you in retirement tax free as well. You can make early withdrawals out of ROTH IRA's prior to 59 ½ up to what was deposited, but you have to wait until you are 59 ½ to avoid having to pay taxes on the gains. Roth earnings taxation does also have exceptions for death, disability, first time home purchases, etc.
As of 2019 you are permitted to save up to $6000 in your ROTH IRA with a catch-up contribution available for those over 50 of $1,000.
4. **Health Savings Accounts-** HSAs have three tax advantages. You are able to deduct contributions and withdraw funds tax free when used for a qualified medical expense. In addition once you reach a certain balance investment gains are also not taxed when withdrawn for qualified medical expenses. If you reach the age of 65 or older you are able to withdraw funds for non-qualified medical expenses without being penalized (you are hit with a 20% fee if you withdraw for non-qualified medical expenses before 65.)
As of 2019 you can contribute $3500 for individuals and $7000 for families with maximum catch-up contributions for people over the age of 55 of $1,000.
5. **529 College Savings Plans-** Contributions are not deductible for federal tax (many states do allow deductions) but earnings are not subject to federal tax (and typically depending on the state and the plan- not state tax either) when used for qualified education expenses for the designated beneficiary. Qualified education expenses can now include a certain amount of tuition for kindergarten through 12th grade. Expenses include things like books, room & board, fees and tuition. Contributions are limited to the anticipated cost of qualified educational expenses- which can be quite high, but annually the contribution amount is not limited. If the beneficiary doesn't go to college or use the funds for educational expenses you can change the beneficiary to another eligible family member, or incur taxes and a 10% penalty on the earnings portion of the withdrawals.
6. **SEP IRA-** These are popular with self-employed individuals because they offer a much higher contribution limit than traditional or roth IRAs. In this type of account you are able to contribute 25% of your salary up to an annual maximum of $56,000 as of 2019.

For self-employed individuals the 25% must be calculated off of net self-employed income (which accounts for the reduction in income from the SEP contribution and other taxes.) In this type of plan contributions are made only by the employer. If you have eligible employees you must contribute the same percentage to their account as you do to your own, which is why this type of account is generally used most by self-employed people.

7. **Simple IRA-** this is a convenient employer retirement plan for businesses with less than 100 employees that allows contributions from both the company and the employee. They have lower start up and administrative costs than 401k plans. Contributions are made to the plan pre-tax and accumulate tax deferred until you take them out after the age of 59 ½. If you take anything out before you will get hit with a 10% penalty fee. *As of 2019 contribution limits for this plan are $13,000 with a catch up contribution if you are over the age of 50 of $3,000.*
8. **Beneficiary or Inherited IRA-** If you inherit a traditional, roth, rollover, SEP or SIMPLE IRA and don't take the inheritance as a distribution (and incur taxes on it depending on the type of IRA account you inherit) you must start taking required minimum distributions no matter what age you are. These are calculated based off of IRS tables and account year end values. If you inherit an IRA from your spouse different rules apply- because you can transfer it into your own IRA. It is generally best to work with a financial professional and accountant when it comes to inheriting an IRA because each situation is different.

The contribution limits for all of these accounts, catch-up contributions, age restrictions and RMD requirements can change annually based on current tax legislation so be sure to talk to your accountant for the latest information. A savvy financial advisor is also a great person to talk to if you're not sure where to start.

At Lovett Advisors we help you to plan for the retirement you want. Would you open a business without a business plan? Probably not. So why retire without a comprehensive retirement plan? We can help you come up with a financial plan that fits your goals. Not sure what your goals should be? We can help with that too. Give me a call today to discuss next steps and to get started. There is no time like the present!

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