



Building Wealth Through Tax-Deferred Accounts

Deferring taxes on our invested capital is an extremely attractive component of building wealth. In tax-deferred accounts, the income you earn on your principal is allowed to compound tax-deferred until that money is withdrawn. Only at the time of withdrawal do you become liable for taxes.

Tax-deferral is encouraged by the government to stimulate long-term retirement planning. Individual Retirement Accounts (IRA's), 401k's, Keough's, SEP IRA's, and other Qualified Retirement Plans (QRP's) all benefit from tax-deferral. In addition, certain annuities and life insurance contracts include the benefit of tax-deferral.

The benefit of deferring taxes as long as possible is that the compounding effect can be dramatic over an extended period of time, allowing us to accumulate more capital at a faster rate of speed.

A strategy of making contributions to deferred accounts at the *beginning* of each year rather than the end of the year, assuming an 8% return, can amount to an additional \$40,000 of capital growth over 30 years.

There are a variety of retirement planning options that can meet your needs. Your employer funds some, and you fund some. In most cases, withdrawals made before age 59-1/2 are subject to a 10% penalty. Withdrawals usually must begin by April 1 of the year after you turn age 70-1/2. Withdrawals are subject to income taxes.

The following list describes some common retirement account options:

A **Defined Benefit Pension** normally provides a specific monthly benefit from the time you retire until you die. This monthly benefit is usually a percentage of your final salary multiplied by the number of years you've been with the company. Defined Benefit Pensions are usually funded completely by your employer.

A **Money Purchase Pension Plan** provides either a lump-sum payment or a series of monthly payments. The size of this benefit depends on the size of the contributions to the plan. Your employer will normally fund a Money Purchase Pension Plan, although some plans will allow employee contributions.

A **Profit-Sharing Plan** is funded by your employer with employee contributions usually optional. Upon retirement, you will normally receive your benefits as a lump sum. The company's contributions, and therefore your retirement benefit, may depend on the company's profits. If a Profit-Sharing Plan is set up as a 401(k) Plan, employee contributions may be tax-deductible.

A **Savings Plan** provides a lump-sum payment upon your retirement. The employee funds Savings Plans, although employers may also contribute. Employees may be permitted to borrow a portion of vested benefits. If a Savings Plan is set up as a 401(k) Plan, employee contributions may be tax-deductible.

Under an **Employee Stock Ownership Plan** (ESOP), an employer periodically contributes company stock toward an employee's retirement

plan. Upon retirement, Employee Stock Ownership Plans may provide a single payment of stock shares. Upon reaching the age of 55, with 10 or more years of plan participation, you must be given the option of diversifying your ESOP account up to 25% of the value. This option continues until age 60, at which time you have a one-time option to diversify up to 50% of the account.

Tax-Sheltered Annuities or **403 (b) Plans** are offered by tax-exempt and educational organizations for the benefit of their employees. Upon retirement, employees have a choice of a lump-sum or a series of monthly payments. These plans are funded by employee contributions and the contributions are tax-deductible.

Individual Retirement Accounts (IRA's) are available to all people with earned income. They are funded solely by individual contributions. There are two types of IRA's, Traditional and Roth. Contributions to Traditional IRA's may be tax deductible and are taxed upon withdrawal, whereas contributions to Roth IRA's are not tax deductible and qualified withdrawals are tax-free. IRA's are usually held in banks, brokerage firms, insurance companies, mutual fund companies, credit unions, or savings associations. Funds in IRA's may be used to buy stocks, bonds, mutual funds, limited partnerships, government securities, annuities, and a few other investments.

Keogh Plans were specifically designed for self-employed people. They are funded completely by earned income contributions and provide for either lump sum or periodic withdrawals upon retirement. Keogh Plans have the same investment opportunities as IRA's. Contributions to Keogh Plans are tax deductible within limitations.

Simplified Employee Pensions, or **SEPS**, were designed for small businesses and the self-employed. Like IRA's, they can provide either a lump-sum or periodic withdrawals upon retirement. Unlike an IRA, the employer primarily funds SEPS, although some SEPS do allow employee contributions. SEPS are usually held in the same types of accounts that hold IRA's.

Becoming familiar with retirement plan options is a must, so that you are able to select the best plan or combination of plans for your own personal situation. No matter which *specific* plan is the best for you to make your contributions, it is most important to consistently do your best to:

1. Maximize your retirement plan contributions each year.
2. Make each contribution as early in the year as possible.
3. Invest wisely with a focus on long-term consistency and compounding year after year.

If you can do these things, you will find that you are most likely able to grow your assets faster than you ever thought possible. Good luck!

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