Module 5

TYPES OF INVESTMENT ACCOUNTS

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Introduction

- Understanding the different investment accounts available to you, is an important part of financial planning

- The key difference in these different accounts, is how they are treated for tax purposes

- For all intents and purposes, an investment account is nothing more than a holding place for your investments and the determining factor for how your investments are taxed

Module Outline

- Section 5.1: Pre-Tax Accounts
- Section 5.2: Tax-Free Accounts
- Section 5.3: Taxable Accounts
- Section 5.4: Contribution and Participation Limits

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Let's get started!

Section 5.1

Pre-Tax Accounts

- Broad term for situations in which contributions are made to the account before taxes or tax deferred
- Also referred to as, "Qualified Accounts"
- Common examples include 401(k), IRA, SIMPLE IRA, and SEP IRA

Section 5.1

Pre-Tax Accounts

- All withdrawals from the account are subject to ordinary income tax
- Making changes in your account does not have any tax implications until withdrawal
- Early withdrawals, before age 59 1/2, are subject to an additional 10% penalty

Section 5.1

Pre-Tax Accounts

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Example: 401(k)

1. Contribution withheld from paycheck
2. Contribution deposited into 401(k) along with company match
3. Account grows with taxes deferred
4. Client retires and pays taxes on their withdrawals

Section 5.1

Pre-Tax Accounts

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Pro's	Con's
Taxed deferred growth	Penalties for early withdrawal
Opportunity for investment growth	Entire investment is taxable
Potential of being in a lower tax bracket in retirement	Tax burden in retirement
	Required Minimum Distributions

Section 5.2

Tax-Free Accounts

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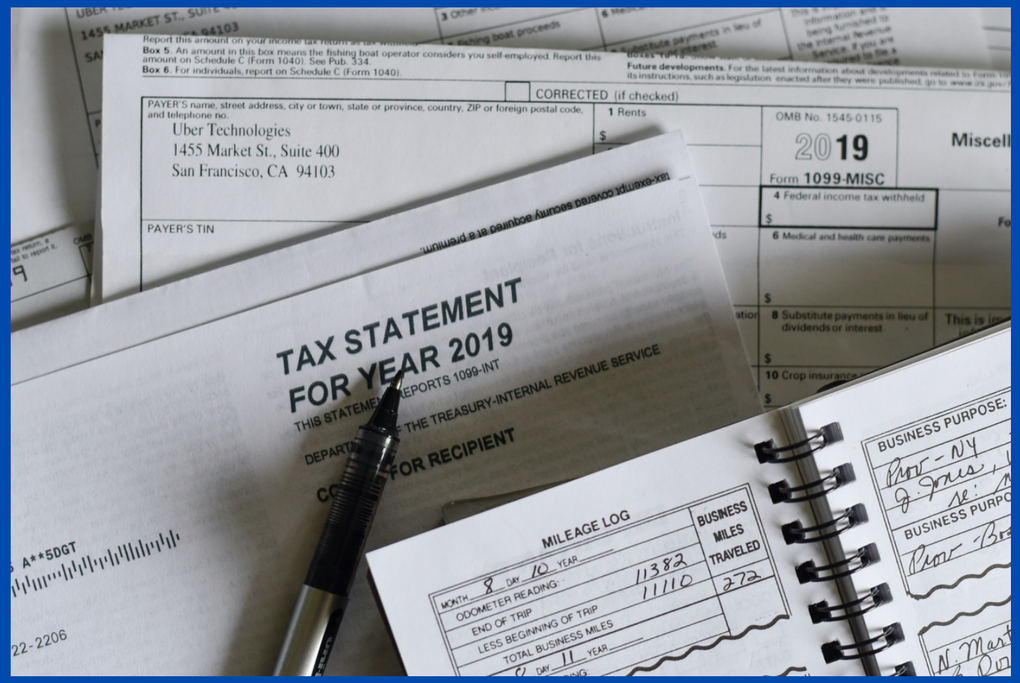
- Broad term for accounts funded with after tax contributions
- Also fall under the broader umbrella of "Qualified Accounts"
- Common examples include Roth IRA and Roth 401(k)

Section 5.2

Tax-Free Accounts



- All contributions are invested after taxes, typically directly from a bank account
- Similar to a pre-tax accounts, you are free to make invesment changes without tax consequences
- Unlike pre-tax accounts, all withdrawals are tax free after age 59 1/2
- Also, only your investment gains are subject to early withdrawal penalities may be excused in certain circumstances

Section 5.2

Tax-Free Accounts

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Example: Roth IRA

1. Receive paycheck
2. Contribution by check, ACH, or wire transfer
3. Account grows tax free
4. Client retires and all withdrawals are tax fee

Section 5.2

Tax-Free Accounts

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Pro's	Con's
Tax free growth	Penalties for early withdrawal (on investment gains)
Contributions withdrawn at any time	Contribution limits
Gains are tax free in retirement	Eligibility limited by income

Section 5.3

Taxable Accounts

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- An investment account that does not carry with it any tax benefits
- Also referred to as, "Non-Qualified Accounts"
- Common examples include individual accounts, joint brokerage accounts, trust accounts

Section 5.3

Taxable Accounts

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- No restrictions on contributions or withdrawals
- Ordinary income tax on interest and dividends ; Capital gains tax on investments sold at a gain

- Could be exempt from capital gains tax depending on your annual income

Section 5.3

Taxable Accounts

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Example: Individual Account

1. Receive paycheck
2. Make contribution by check, ACH, or Wire
3. Taxes paid on interest, dividends, and realized gains
4. No restrictions on withdrawals

Section 5.3

Taxable Accounts

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Pro's	Con's
No restrictions on contributions or withdrawals	No preferential tax treatment
Same investment opportunities as other account types	Potential for high taxable gains
	Gains could bump you into a higher tax bracket

Section 5.3

Summary

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	Pre-Tax	Tax-Free	Taxable
Q/NQ	Qualified	Qualified	Non-Qualified
Types	IRA, 401(K), SIMPLE IRA, SEP IRA	Roth IRA, Roth 401(K)	Individual, Joint, Trust
Taxes	Contributions and gains taxed on withdrwal	Contributions and gains tax free on withdrwal	Taxes paid on dividends, interest, and realized gains
Penalties	All withdrawals prior to retirement age subject to 10% penalty	Withdrawals of gains subject to 10% penalty prior to retirement age	N/A
Retirement	59 1/2	59 1/2	N/A
RMD's	72	N/A	N/A

Section 5.4

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Contribution and Participation Limits

- Retirement accounts have annual contribution limits
- As of 2021:
  - IRA/Roth IRA: $6,000/$1,000 catch up
  - 401(k)/403(b): $19,500
  - SEP IRA: The lesser of 25% compensation or $58,000
  - SIMPLE IRA: $13,500/$3,000 catch up

Section 5.4

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Contribution and Participation Limits

- Participation in a retirement account is limited by your income
- As of 2021:
  - Roth IRA: Phase out between $198,000-$208,000 in annual income if you are married and filing jointly
  - IRA: Contributions can be made but ability to defer taxes is phased out between $105,000-$125,000 when covered by a company retirement plan
  - Complete list can be found on the IRS website

Section 5.4

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Contribution and Participation Limits

- Participation and contribution limits are evaluated every year
- Some work arounds to these limitations
- Penalties for over contributing
- Consult with your tax professional or financial advisor

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Conclusion

- You should now have a general understanding of the different types of investment accounts and the impact that they could have to your finances

- Now we will move on to our next module, “The Place of Insurance in your Financial Plan”

Congratulations on Completing Module 5!

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Fixed and Variable annuities are suitable for long-term investing, such as retirement investing. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal. Guarantees are based on the claims paying ability of the issuing company. Withdrawals made prior to age 59 ½ are subject to a 10% IRS penalty tax and surrender charges may apply. Variable annuities are subject to market risk and may lose value