the effect of taxes on your retirement account
Taxes play an important role in your financial life. This is especially true when it comes to your retirement plan. There is often confusion when it comes to types of retirement accounts and how and when the accounts are taxed. Let’s clear up the confusion. There are two main retirement plan paths: participating in your employer-sponsored plan and investing in an Individual Retirement Account (IRA) on your own. Whether you contribute through your employer’s plan or you open an account on your own, it’s important to understand the most common types of accounts and the taxation of each.
If a company employs you and they offer an employer-sponsored retirement plan, it behooves you to take full advantage of this benefit. Some companies offering a retirement plan may also offer a plan match, which means they will contribute into your retirement account as well. Usually there is a caveat for this to happen, and it’s that you have to contribute up to a certain percentage in order to receive the funds from them, though each company has different parameters. The match is a beautiful thing. Take advantage of it!

Some employers do not offer a retirement plan option, so it is up to you to prepare for your own retirement. IRAs are a way to do this. You can also open an IRA in addition to your employer-sponsored retirement plan.
There are two main types of retirement accounts offered by employers, each with its own taxation stipulations.

**TRADITIONAL 401(K), 403(B), AND OTHER SIMILAR RETIREMENT PLANS**

A 401(k) or a 403(b) is a plan in which contributions are made via payroll deduction. The contributions are tax-deferred, meaning you do not initially pay taxes on the money or funds that are put into the retirement plan. The funds in your 401(k) or 403(b) grow tax-deferred.

The tax-deferred structure of a 401(k) or 403(b) does a couple of things for your financial life. First of all, the income you allocate to these plans lowers your taxable income. This lowers your tax burden in the present. Sometimes a joint filing or a raise will put you into the next highest tax bracket, bringing with it a spike in income tax. A 401(k) or 403(b) can be a way for you to legally shelter your income from being taxed, for the time being.

Since a 401(k) or 403(b) is tax qualified, the account grows tax-deferred. However, this also means that since you aren’t paying taxes on your contributions, or as you earn gains, you will have to settle up when you withdraw. You can withdraw from a 401(k) or 403(b) without a penalty at 59½ years old. The benefit of having a 401(k) or 403(b), and paying taxes after the age of 59½, is you may be in a lower income tax bracket at that time.

**ROTH**

While a traditional 401(k) or 403(b) is a common option for employers to offer, sometimes employers will offer a Roth option. This type of retirement account differs from a traditional 401(k) or 403(b) in that money is contributed into this account after taxes are withheld. Since money contributed into a Roth account has already been subjected to taxation, any gains grow tax free, and withdrawals are tax free after the age of 59½.
There are two main types of IRAs to consider: a **Traditional IRA** and **Roth IRA**.

**Traditional IRA**

Traditional IRA contributions are taxed exactly like 401(k) or 403(b) contributions. Funds contributed to an IRA are tax-deferred, or pre-tax. The gains also grow tax-deferred. When you reach the age of 59½ and withdraw funds from your IRA, you pay taxes on the funds. They will be subject to whatever income tax bracket you are in at that time.

**Roth IRA**

Contributions to a Roth IRA, like a Roth employer-sponsored retirement plan, are taxable; however, gains can grow tax-free. Since the funds are subject to income tax at contribution, any gains and withdrawals made after the age of 59½ aren’t taxed.

And just like with a 401(k) or 403(b), there are no right or wrong answers when it comes to choosing between a traditional or a Roth IRA. It’s best to discuss this sort of decision with your tax professional.
The most important part of retirement planning is **contributing**. The type of account you choose to make contributions in is secondary to planning for your retirement.
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