EXPERT CONTRIBUTOR

TAX-PREFERENCED $AVINGS VEHICLES

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Our Social Security system was never intended to fully fund an individual's retirement, and pension plans seem to be a rarity these days. Therefore, the federal government has provided financial incentives to encourage individuals to save toward their own retirement nest egg. Investment returns can take a hit with taxes and fees. Crafting a portfolio that incorporates tax-advantaged strategies may help keep more of those earnings in your pocket. Other important factors to consider include the expected rate of return, the potential risk of an investment, and any penalties that may apply if the funds are not used for the designated purpose.

TAX-DEFERRED VERSUS TAX-FREE

A tax-deferred investment vehicle means that income taxes will not become due on current earnings until sometime in the future. One common example is the traditional 401(k) retirement account. Money is deposited into your 401(k) account during your working years, invested and grows until you retire, years down the road. Funds will be taxed as you withdraw it later, presumably while in a lower tax bracket.

On the other hand, qualified withdrawals from a tax-free investment vehicle will not incur federal or state income taxes, or both in some cases. The Roth 401(k) retirement account is one such account that will not incur federal income taxes when funds are withdrawn, and depending on your state of residency, the funds may escape state taxes as well.

SAVING FOR RETIREMENT

- **Employer-Sponsored Retirement Plans -** These accounts include 401(k)s, 403(b)s, and 457 plans (depending on the type of employer). Contributions to these plans reduce your current taxable income and grow tax deferred until you take a distribution. At that time income taxes will be due on the distributed amount. For 2025, employees can contribute up to $23,500 to one of these plans. Catch-up contributions for individuals age 50 and older allow an additional $7,500. The catch-up contribution increases to $11,250 for those individuals age 60 to 63. Plans can generally permit after-tax Roth contributions as well, allowing qualifying distributions later to be tax free.
- **Traditional IRAs -** Anyone who has earned income, or whose spouse has earned income, can contribute to an IRA. Contributions to a traditional IRA are allowed regardless of your income level. A tax deduction for your contribution to a traditional IRA may be limited or eliminated if you are a higher earner or if you're covered by an employer's retirement plan. Contributions will grow tax deferred. Income taxes will not be due until you take a withdrawal in the future. For 2025 you may contribute up to $7,000 to a traditional IRA (up to $8,000 for those age 50 and older).
- **Roth IRAs -** Roth IRAs on the other hand are only available to individuals with earned income below certain limits. Contributions to Roth IRA accounts are made with after-tax dollars. Similar to traditional IRAs, these contributions grow tax deferred. However, qualified distributions from Roth IRA accounts will be tax free. The same annual contributions limits apply as with traditional IRAs. Total contributions to Roth and traditional IRAs combined cannot exceed $7,000 ($8,000 for those age 50 and older) for 2025.
- **SIMPLE IRAs and SIMPLE 401(k)s -** These retirement plans are generally established by individuals with small businesses. Contributions reduce taxable income for the year the contribution is made and grows tax deferred. Income taxes will not become due until you take a withdrawal. With higher contribution limits, you can fund these plans with up to $16,500 for 2025, plus an extra $3,500 for individuals age 50 and older, or an extra $5,250 for those age 60 to 63. SIMPLE 401(k) plans may also permit Roth contributions, which would allow for qualifying distributions taken later to be tax free.
- **Annuities -** This type of investment vehicle is purchased from the annuity issuer, often an insurance company. The issuer promises to pay a fixed income stream representing a portion of the principal you invested initially plus earnings, to you or your beneficiary, for life. There's no limitation on the amount you can invest, and contributions grow tax deferred. Income taxes will be due on the earnings component of your distributions when received. Be sure to understand and take into consideration the associated fees and expenses, including surrender charges if you terminate the annuity early.

SAVING FOR EDUCATION

- **529 Plans -** College savings plans and prepaid tuition plans allow you to save funds for college that will grow tax deferred. Distributions used to pay for qualified education expenses will be free from federal taxation, and usually state taxes as well. Income limitations do not apply to contributions to these plans and contributions may be at least partially eligible for a state tax credit.
- **Coverdell Education Savings Accounts -** These accounts are available to individuals with income below certain limits. Contributions are allowed for up to $2,000 per year, per beneficiary. Earnings on contributions will grow tax deferred. As with 529 plans, withdrawals will be free from federal taxes, and possibly state taxes as well, if the funds are used to pay for qualified education expenses.

OTHER TAX-ADVANTAGED SAVINGS VEHICLES

- **Series EE and I Treasury Savings Bonds –** Interest earned on these savings bonds grows tax deferred. Once redeemed, the interest income will be exempt from state income taxes. As a bonus, if you meet certain requirements when you redeem Series EE or I savings bonds issued after 1989 for qualified education expenses, the interest will escape federal income tax also.
- **Health Savings Accounts (HSAs) -** Health savings accounts offer a triple tax benefit! Contributions to HSAs are deductible for the tax year contributed, up to $4,300 for an individual account or $8,550 for family accounts for 2025. The earnings will grow tax deferred, and distributions taken to cover qualified medical expenses will avoid taxation.

We are here to answer any tax-related questions you may have. Give us a call at (309) 276-0977 or visit us online and check out the free resources available at www.SaveMooreTax.com.