

Taxation of Retirement Accounts

A lot of investors get confused about the difference between an investment account and the investments held inside the account. I find a helpful analogy is that of packing for a trip. There are a lot of different bags you can use to carry your clothes in. For some trips, a backpack is appropriate, but there are times you might want a large suitcase or a small carry-on. Different bags are suitable for different trips. But you can put any combination of clothes (stocks, bonds, mutual funds) inside any type of bag (investment account.) This chart lists the various types of investment accounts and their advantages in avoiding the taxman.

Taxation of Various Tax-Advantaged Accounts

| Type of Account | Contribution | Pre-Withdrawal Growth | Pre-retirement Withdrawal | Post-Retirement Withdrawal |
|-----------------------------------------------------------------------------------------|--------------------------|---------------------------------|-----------------------------------------------|----------------------------|
| Taxable | Ordinary Income Tax Rate | Capital gains/Dividend Tax Rate | Capital Gains Tax Rate | Capital Gains Tax Rate |
| Traditional IRA, 401K, 403B, 457, SEP-IRA, SIMPLE IRA, Keogh, Profit-sharing Plans etc. | None | None | Ordinary Income Tax Rate + 10% | Ordinary Income Tax Rate |
| Roth IRA, Roth 401K, Roth 403B | Ordinary Income Tax Rate | None | 10% (No penalty on withdrawing contributions) | None |
| HSA Spent On Health Care | None | None | None | None |

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|---------------------------------|--------------------------|-------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|
| HSA Not Spent On Health Care | None | None | Ordinary Income Tax Rate + 20% | Ordinary Income Tax Rate , (after 65, not 59 1/2) |
| ESA, 529 Spent On Education | Ordinary Income Tax Rate | None | None | None |
| ESA, 529 Not Spent On Education | Ordinary income Tax Rate | None | Ordinary Income Tax Rate On Earnings Only, + 10% | Ordinary Income Tax Rates On Earnings Only, + 10% |
| Variable Annuity | Ordinary Income Tax Rate | None | Ordinary Income Tax Rate + 10% +/- Surrender Fees | Ordinary Income Tax Rate |
| Cash Value Life Insurance | Ordinary Income Tax Rate | None | None from basis, Ordinary Income Tax Rate on earnings +/- Surrender Fees, loans tax-free (but reduce amount paid at death) | None from basis, Ordinary Income Tax Rate on earnings +/- Surrender Fees, loans tax-free (but reduce amount paid at death) |
| UGMA, UTMA | Ordinary Income Tax Rate | None on first \$950/year, 5%-10% on second \$950, then Parent's Capital Gains/Dividend Tax Rate | None on first \$950/year, 5% on second \$950, then taxed at Parent's Capital Gains Tax Rate | Not Applicable As Account Terminates Prior to Child's Retirement Age |

Note: High earners cannot contribute directly to a Roth IRA (they must use a [backdoor Roth IRA](#)) nor can they deduct traditional IRA contributions if they have another employer-provided plan.