Benefits of Tax-Advantaged Savings Vehicles

By Greg Patterson

Some of you may not want to think about taxes after dealing with them in April, but taxes can take a big bite out of your total investment returns. It is helpful to look for tax-advantaged strategies when building a portfolio. Keep in mind, however, that investment decisions should not be driven solely by tax considerations; other factors to consider include the potential risk, the expected rate of return and the quality of the investment.

Tax-deferred and tax-free investments. Tax deferral is the process of delaying (but not necessarily eliminating) until a future year the payment of income taxes on income you earn in the current year. For example, the money you put into your traditional 401(k) retirement account isn't taxed until you withdraw it, which could be many years down the road.

Tax deferral can be beneficial because:

- The money you would have spent on taxes remains invested,
- You may be in a lower tax bracket when you make withdrawals from your accounts (for example, when you're retired)
- You can accumulate more dollars in your accounts due to compounding.

Compounding means that your earnings become part of your underlying investment, and they, in turn, earn interest. In the early years of an investment, the benefit of compounding may not be that significant, but as the years go by, the long-term boost to your total return can be dramatic.

Taxes make a big difference. Let's assume two people have $5,000 to invest every year for a period of 30 years. One person invests in a tax-free account like a Roth 401(k) that earns 6% per year, and the other person invests in a taxable account that also earns 6% each year. Assuming a tax rate of 28%, in 30 years the tax-free account will be worth $395,291, while the taxable account will be worth $295,896—a difference of $99,395.

Tax-advantaged savings vehicles for retirement. One of the best ways to accumulate funds for retirement or any other investment objective is to use tax-advantaged (i.e., tax-deferred or tax-free) savings vehicles when appropriate.

- Traditional IRAs— Anyone under age 70½ who earns income or is married to someone with earned income can contribute to an IRA. Depending upon your income and whether you are covered by an employer-sponsored retirement plan, you may or may not be able to deduct your contributions to a traditional IRA, but your contributions always grow tax deferred. You will not owe income taxes until you make a withdrawal. You can contribute up to $5,500 (for 2016) to an IRA, and individuals age 50 and older can contribute an additional $1,000 (for 2016).
- Roth IRAs—Roth IRAs are open only to individuals with incomes below certain limits. Your contributions are made with after-tax dollars but will grow tax deferred, and qualified distributions will be tax free when you withdraw them. The amount you can contribute is the same as for traditional IRAs. Total combined contributions to Roth and traditional IRAs can't exceed $5,500 (for 2016) for individuals under age 50.
- SIMPLE IRAs and SIMPLE 401(k)s—These plans are generally associated with small businesses. As with traditional IRAs, your contributions grow tax deferred, but you will owe income taxes when you make a withdrawal. You can contribute up to $12,500 (for 2016) to one of these plans; individuals age 50 and older can contribute an additional $3,000 (for 2016). (SIMPLE 401(k) plans can also allow Roth contributions.)
- Employer-sponsored plans (401(k)s, 403(b)s, 457 plans)—Contributions to these types of plans grow tax deferred, but you will owe income taxes when you make a withdrawal. You can contribute up to $18,000 (for 2016) to one of these plans; individuals age 50 and older can contribute an additional $6,000 (for 2016). Employers can generally allow employees to make after-tax Roth contributions, in which case qualifying distributions will be tax free.
- Annuities—You pay money to an annuity issuer (an insurance company), and the issuer promises to pay principal and earnings back to you or your named beneficiary in the future (you will be subject to fees and expenses that you will need to understand and consider). Annuities generally allow you to elect to receive an income stream for life (subject to the claims-paying ability of the issuer). There is no limit to how much you can invest, and your contributions grow tax deferred. However, you will owe income taxes on the earnings when you start receiving distributions.

Tax-advantaged savings vehicles for college. For college, tax-advantaged savings vehicles include:

- 529 plan—College savings plans and prepaid tuition plans let you set aside money for college that will grow tax deferred and be tax free at withdrawal at the federal level if the funds are used for qualified education expenses. These plans are open to anyone regardless of income level. Contribution limits are high—typically over $300,000—but vary by plan.
- Coverdell education savings accounts—Coverdell accounts are open only to individuals with incomes below certain limits, but if you qualify, you can contribute up to $2,000 per year, per beneficiary. Your contributions will grow tax deferred and be tax free at withdrawal at the federal level if the funds are used for qualified education expenses.
- Series EE bonds—The interest earned on Series EE savings bonds grows tax deferred. But if you meet income limits (and a few other requirements) at the time you redeem the bonds for college, the interest will be free from federal income tax as well (it is always exempt from state tax).

Bottom line. Though tax considerations shouldn't be your only investing concern, by putting your money in tax-advantaged savings vehicles and investments when appropriate, you will keep more money in your own pocket and put less in Uncle Sam's.

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Pine Knoll Shores Women's Club

By Michelle Powers

Many Pine Knoll Shores residents enjoy traveling, but few have visited the more remote areas that have attracted Pine Knoll Shores Women's Club member Susan Toms and her husband. Susan recently spoke to club members about living, working, volunteering and trekking in places such as Korea, Bangladesh, Nepal, Vietnam, Laos, Thailand and locations throughout Europe. The couple taught for many years in Germany and Korea, and their love of travel brought them to many places around the world that are not the typical tourist destinations.

In Laos and Vietnam they did homestays, living with the locals in areas with no electricity and no toilets—where the residents have little but are willing to share. She told of a small village where 25 children happily shared one toy.

One of the most intriguing stories of her travels was achieving her goal of going to Mount Everest Base Camp. She relayed her admiration for the Sherpas, who travel for one month with 100 pounds of equipment on their backs over land that is all cliffs and mountains in one of the most dangerous places in the world. The Sherpas have "stolen" her heart, she said. Though the Sherpas spoke no English, they enjoyed playing card games and managed to communicate and connect with the group during the climb to Base Camp. Ms. Toms says that despite the hazardous work, the Sherpas are always smiling and eager to make friends.

While the people she met on her travels were from different cultures and spoke different languages, she has learned that basically we all are the same. "No matter where you are, people want to connect one on one," she said. She urged club members to venture off the beaten path when they travel, assuring them that it is a most rewarding experience.

During the short business meeting that followed Ms. Toms' talk, various club members briefed the group on upcoming Women's Club activities for the next several months. Once again, the club will participate in the Mile of Hope weekend on May 6-8 for children undergoing cancer treatment. The children and their families will visit the area, and the Women's Club will provide a picnic lunch for them at the Atlantis Lodge in Pine Knoll Shores, the official headquarters for the event. Club members have participated in this event for the last several years and are anxious to do so again this year.

The installation luncheon and last meeting of the season will be held on June 3 at the Coral Bay Club. More information will be provided to club members on this event via email and at the May 20 general meeting.

Pine Knoll Shores Women's Club meetings are held at the Pine Knoll Shores town hall, beginning at 9:30 a.m. with light refreshments, followed by a guest speaker. On May 20 the speaker will be Pine Knoll Shores Building Inspector Jim Taylor, who will provide guidance on home safety. With recent concerns about the safety of local decks and walkways, this will be a most informative session.

Guests are always welcome to attend Women's Club meetings, and new residents are encouraged to join the club to meet your neighbors and make new friends.