Retirement Accounts Can be More Than Just a Way to Save for Retirement

When most people think about retirement accounts, they think about putting money away for the future. They're also powerful tax planning tools that can help you keep more of you earn.

The first thing to understand is that nearly every retirement account falls into one of two tax categories:

1. Traditional: Traditional accounts generally allow you to defer taxes until retirement.
2. Roth: Funded with after-tax dollars and can provide tax-free growth and qualified tax-free withdrawals.

An **IRA** is an Individual Retirement Account that you open yourself, while a **401(k)** is a retirement plan established through a business. Both can have either Traditional or Roth tax treatment, so the primary difference is who sponsors the account.

Some retirement plans do more than hold investments. Certain plans allow participants to borrow against their account balance. Those funds may be used to invest in opportunities such as real estate, start or expand a business, purchase equipment, or meet other financial needs. Unlike a traditional bank loan, the interest you pay is paid back into your own retirement account (awesome!). There are limits and restrictions so you should consult a tax professional before proceeding with this type of loan.

Contribution limits and income limits are another area of confusion. Every retirement account has annual contribution limits established by the IRS, and some accounts also have income restrictions. However, reaching those limits doesn't necessarily mean you're out of options. There are legal tax planning strategies, like a back door Roth, that may allow higher income taxpayers to continue building tax-free retirement savings even if they don't qualify to contribute directly.

Finally, many investors have never heard of self-directed retirement accounts. While most banks and brokerage firms limit investments to stocks, bonds, mutual funds, and ETFs, the IRS permits certain retirement accounts to invest in a much broader range of assets, including real estate, private lending, private businesses, and other alternative investments. These accounts come with additional rules and restrictions, but they can provide opportunities that many investors never realize exist. I'll be doing a separate post regarding self-directed accounts and discount conversions.

The bottom line is this: retirement accounts aren't just about saving for retirement. Whether you're just starting your career, building a business, or planning for retirement, understanding how these accounts work can help you build wealth while minimizing taxes.

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