

CUTTING THROUGH THE JARGON:

Tax-Free vs. Tax-Deferred

Understanding Tax-Free and Tax-Deferred Accumulation

Tax-deferred and *tax-free* are two different concepts. Something that is tax-deferred is something that must eventually have taxes paid on it. Something that is tax-free will not need any tax payments made.

One of the biggest differences between IRA accounts is in their tax set up. Roth IRAs offer tax-free asset accumulation because contributions are made with after-tax dollars and the gains made by those contributions, once they are in the account, is tax-free as long as they are not withdrawn before age 59 ½ and the account has been open at least five years.

Traditional IRAs, on the other hand, offer tax-deferred growth after the tax deductible contribution is made. So in addition to getting a tax deduction on an IRA contribution, the deposited funds are allowed to grow within the IRA without taxes due until they are withdrawn. When withdrawn at retirement, the funds will generally be subject to a lower tax rate than they would have been if payable before retirement because a post-retirement income is likely to be much lower than a pre-retirement income and subsequent tax rate.