



RETIREMENT PLANNING

Qualified Plans vs. Nonqualified Arrangements

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Page 1 of 4

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QUALIFIED PLANS VS. NONQUALIFIED ARRANGEMENTS

SUMMARY

WHAT ARE QUALIFIED PLANS AND NONQUALIFIED ARRANGEMENTS?

Qualified plans and nonqualified arrangements are both methods of saving and investing for retirement, with the primary objective to produce retirement income. A major difference is in how they are taxed.

Qualified plans must be set up in accordance with IRS requirements to receive special tax treatment on both contributions and earnings during the accumulation period.

Most nonqualified arrangements receive no special tax treatment. One exception is deferred annuities, which enjoy a tax-deferred accumulation of earnings until they are paid out as income.

WHAT ARE SOME TYPES OF QUALIFIED ARRANGEMENTS?

Typical qualified arrangements include certain employer-sponsored retirement plans established for the benefit of employees—401(k) and 403(b) plans, for example. Individual retirement accounts or annuities (IRAs) established by individuals also qualify for tax benefits.

WHAT ARE THE BENEFITS OF QUALIFIED CONTRIBUTIONS?

Employers may make contributions on behalf of their employees and, subject to certain limits, deduct the contributions from their taxes.

Employees enjoy even greater benefits. Contributions made with pre-tax dollars are not included in the employee's gross income and, consequently, are not currently taxed. In arrangements such as 401(k)s, SIMPLE IRAs and 403(b)s, where employees defer a portion of salary on a pre-tax basis, employers may make matching contributions up to some limit. Accumulations from both sources grow on a tax-deferred basis, so no taxes are imposed until they are withdrawn as income, typically at the employee's retirement.



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Individually funded IRAs are subject to limits on deductibility and contribution maximums. With traditional IRAs, an individual's contributions may be tax deductible and grow tax deferred until they're withdrawn. With Roth IRAs, contributions are subject to current tax, while distributions can be received tax free when strict requirements are met.

WHAT ABOUT NONQUALIFIED CONTRIBUTIONS?

Nonqualified contributions are made with after-tax dollars, meaning taxes are paid on funds before money can be set aside rather than when funds are withdrawn. Earnings may or may not be tax deferred, depending on the particular type of investment vehicle. If they are tax deferred, the earnings are taxed as income when they are paid out.

DO LIFE INSURANCE AND ANNUITIES MEET QUALIFICATION REQUIREMENTS?

Except for annuities used to fund IRAs and qualified employer retirement plans, the IRS does not consider accumulations in these contracts to be qualified. As a result, contributions are made with after-tax dollars. However, the earnings generated in both life insurance policies and annuities grow on a tax-deferred basis.

WHAT'S IMPORTANT IN CHOOSING A RETIREMENT INCOME INVESTMENT?

Taxes are a major consideration in selecting individual savings and investment vehicles. Are contributions made with pre-tax or after-tax dollars? Are earnings taxed currently or are they tax deferred? When accumulations are withdrawn, are they taxed fully, partially or not at all? The answers can have a significant impact on the amounts intended to provide a future retirement income.

