The Ultimate Guide to Investment Accounts

IRAs, 401(k)s, HSAs, and taxable accounts. What they are, which ones you need, and where to open them!

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Welcome to
The Ultimate Guide to Investment Accounts!

In order to start investing, it's extremely important to set yourself up with the RIGHT investment accounts. Otherwise, you'll end up paying way more in taxes than you need to, and nobody wants to do that!

All of the plans described in this guide offer tax advantages, either now or in the future (except for the last one, the Taxable Account). I've done my best to summarize all the dispersed information you've seen on the Internet into one simple, actionable guide.

We'll go over the 6 types of investment accounts you need to know, including:

- Traditional IRAs and Roth IRAs
- 401(k)s and Roth 401(k)s
- SEP IRAs
- HSAs
- Taxable Accounts

This guide is organized into three sections:

1. In the first section, I explain what each account is and how it works
2. Then, I explain which accounts YOU need to set yourself up for financial success.
3. And finally, I give you my top recommendations on where to open each account.

Let's dive in!

What Are The Accounts?

TRADITIONAL IRA

IRA stands for Individual Retirement Account. Back in the day, the Traditional IRA was the only type of IRA – hence the name Traditional. Nowadays, there's other types of IRAs, such as Roth IRAs and SEP IRAs, which I'll explain later in this guide.

Traditional IRAs are investment accounts that give you special tax benefits in order to help you put money away for retirement.

- Contributions: When you contribute to a Traditional IRA, it immediately reduces your taxable income. The maximum you're allowed to contribute to a Traditional IRA is $6,000 per year. If you contribute $6k to your Traditional IRA, then you reduce your taxable income by $6k. That's huge! If you're in a 40% tax bracket, that's $2,400 in taxes that you DON'T have to pay. You know how you get a tax break when you donate to charity? It's just like that, except that the money is going to yourself, rather than to charity! And if you put away $6k into a Traditional IRA every year, the tax savings are really gonna add up.

- Capital Gains and Dividend Income: Typically, whenever you sell stocks at a profit or you earn dividends, you have to pay taxes. Capital gains tax on stock profits, and income tax on dividend income. But not if you hold your stocks in a Traditional IRA! The IRA shelters all your capital gains and dividend income from taxes, so that you can keep more of the money you make for yourself, vs giving it to Uncle Sam. Keeping more of what you make means your nest egg can grow and compound faster.

- Withdrawals in Retirement: Alas, all good things must come to an end. Once you turn 59.5, you can start withdrawing money from your Traditional IRA without incurring penalties, but this is where the tax benefits of the Traditional IRA come to an end. Since Uncle Sam will eventually want his share of the money, any withdrawals you make from your Traditional IRA incurs full income taxes. So the tax benefits of the Traditional IRA are frontloaded: tax-free contributions and tax-free growth, but full taxes on withdrawals later on.

ROTH IRA

Now let's talk about Roth IRAs. The Roth IRA is a newer type of IRA that was introduced in 1997, thanks to Senator William Roth. Hence the name Roth IRA. I guess there's some sense behind all these acronyms and financial mumbo-jumbo, after all!

A Roth IRA is almost identical to the Traditional IRA, but the only difference is in the timing of the tax benefits. Whereas the tax benefits of the Traditional IRA are frontloaded, the tax benefits of the Roth IRA are backloaded: full taxes on your contributions, but tax-free growth and tax-free withdrawals.

- Contributions: The maximum you're allowed to contribute to a Roth IRA is also $6,000 per year, same as the Traditional. But unlike the Traditional IRA, contributions to a Roth IRA do not reduce your taxable income. So if you contribute $6,000 to your Roth IRA every year, you're making those contributions with after-tax money, or money that has already been taxed.

- Withdrawals in Retirement: This is where you realize the beauty of the Roth IRA. Remember how with Traditional IRAs, you have to pay full income taxes on all withdrawals? Well, not with a Roth IRA. Once you turn 59.5, withdrawals from your Roth IRA are 100% tax free, forever and forever. In other words, tax-free retirement income for the rest of your life… heck yes!

So to recap:

Traditional IRAs give you a tax break upfront and no tax break in retirement. Roth IRAs DON'T give you a tax break upfront but you do get a permanent tax break in retirement. Either way, you get a tax break now OR in the future… but not both. An easy way to think about it is that Traditional IRAs give you immediate gratification in the form of tax savings today, while contributions to a Roth is delayed gratification, because you have to wait until retirement to enjoy the tax savings.

401(K) AND ROTH 401(K)

401(k)s are employer-sponsored plans that help you put money away for retirement. It's named after the section of the U.S. tax code that created them: section 401(k). So even though the name sounds like something fancy, it's really not.

401(k)s and IRAs are very similar, but the 401(k) is an employer-sponsored plan, whereas IRAs are self-directed plans. When you get a 401(k) with your employer, you typically get to choose between a 401(k) or Roth 401(k) plan.

401(k)

The 401(k), also known as the Traditional 401(k), is identical to the Traditional IRA in terms of tax treatment. Just like with the Traditional IRA, with the Traditional 401(k) you get tax-free contributions and tax-free earnings, but you incur full income taxes on withdrawals in retirement.

Roth 401(k)

And the Roth 401(k), is - you guessed it - identical to the Roth IRA in terms of tax treatment! Just like with the Roth IRA, you make after-tax contributions, but you get tax-free earnings and tax-free withdrawals in retirement.

Employer matching

The best part about both types of 401(k)s is the employer match. Many companies offer to match 401(k) contributions as part of your employee benefits package. The employer match is usually dollar-for-dollar, but it could also be more or less.

At my first job, the employer match was 3-for-1, so $3 for every $1 that I contributed. It was pretty amazing! Employer match is literally the main reason why I have a good-sized investment portfolio for someone my age.

Employer 401k match is FREE money, so if your job offers it, you should ALWAYS always max that out. Period. Never say no to free money.

For the 2020 tax year, the contribution limit is $19,500 per year, and if combined with employer match, the contribution limit is $57k per year. This means that with 401(k)s, you can put a LOT of tax-sheltered money away for retirement!

What about if you're self-employed and you don't have a 401(k)?

Don't worry, I've got you covered! You've got PLENTY of other options to help you put money away for retirement.

One option is the Solo 401(k). Essentially, a Solo 401(k) is a 401(k) that you set up and manage yourself. It's just like an employer sponsored 401(k) plan, and you can even set up a Solo Roth 401(k) plan as well.

As long as you're self-employed and you have no other full-time employees other than a spouse, you should qualify for a Solo 401(k). There's a bit of paperwork involved when setting up a Solo 401(k), but it's well worth the effort and I'll show you exactly how to open one later in the "Where To Open Them" section of this guide.

SEP IRA

Another great option for entrepreneurs and self-employed individuals is the SEP IRA. The SEP IRA is almost identical to the 401(k). Just like the 401(k), all contributions are made pre-tax. And when you turn 59.5, you will have to pay full income taxes on all your withdrawals.

As for annual contribution limits for the SEP IRA, they are as follows: 25% of your net income, up to a maximum of $57,000 per year. So if you net

$100k of self-employed or business income in one year, then you can contribute $25k into your SEP IRA. If your net income is $1M, then the maximum you can contribute to your SEP IRA is $57,000.

Everything you contribute to your SEP IRA is an immediate tax write-off, so it's a great way to reduce your taxable business income as well as saving for retirement. Contributing to my SEP IRA has saved me thousands of dollars in taxes every year.

SEP IRA vs Solo 401(k)

Between the SEP IRA and the Solo 401(k), I like the Solo 401(k) better. Why? Because of the Solo Roth 401(k) option. There's no such thing as Roth SEP IRAs. Whenever possible, I always choose Roth-style accounts over Traditional accounts, because I would much rather pay the taxes today and enjoy a tax-free retirement vs the other way around.

HSA

The HSA, which stands for Health Savings Account, is my FAVORITE type of account! HSAs are supercharged tax-sheltered investment accounts that help you put money away for health-related expenses. The annual contribution limit to an HSA is $3.5k for the 2020 tax year.

What I LOVE about HSAs is that they combine all the tax benefits of Traditional IRAs and Roth IRAs in one! That's right... pre-tax contributions, tax-free earnings, and tax-free withdrawals.

The only caveat is that the withdrawals need to be for health-related expenses. But then again, everyone has health-related expenses. Doctor visits, acupuncture, therapy, contact lenses, dental work, x-rays, you name it - these are all qualified HSA expenses that can be withdrawn tax-free.

When you open an HSA, you'll get a debit card that you can swipe whenever you need to pay for a medical expense. Unlike IRAs and 401(k)s, there's no age restriction on when you can start spending your HSA; as long as it's for a qualified expense, you don't have to wait until you turn 59.5.

HSAs are full-blown investment accounts

You can buy stocks, bonds, and mutual funds in your HSA just like you would in any other investment account. That way, you can put your HSA money to work until you need it.

What if you're a bionic superhuman and you never have health-related expenses? Don't worry - after age 65, you can withdraw your HSA money for any reason - health-related or not. You will, however, incur full income taxes on those withdrawals.

How to qualify for the HSA

To qualify for an HSA, you must be on a health insurance plan that allows you to have an HSA. Check with your insurance provider to see if your plan qualifies you for an HSA. If your plan doesn't allow HSAs, then consider switching to one that does, because HSAs are simply awesome.

TAXABLE ACCOUNT

Last but not least, the taxable account! Any brokerage account that isn't specified explicitly as an IRA, HSA, 401(k), or otherwise tax-advantaged account, then it's a fully taxable brokerage account.

In other words, there are no tax benefits of any kind when you make investments in this type of account. You will incur capital gains tax every time you sell and make a profit, you incur income tax on any dividend and interest income, and of course, any contributions you make to these accounts are with after-tax money.

There's not much else to say here! The taxable account has zero restrictions on when you can withdraw from it and offers zero tax benefits of any kind. Since taxes eat up a large portion of investment earnings and profits, you always want to maximize tax-advantaged accounts like IRAs, 401(k)s and HSA before putting money into taxable accounts.

Which Ones Do YOU Need?

Now that you're an expert on all these different types of investment accounts, it's time to talk about which ones YOU should have!

In general, I think everyone should have a Roth IRA, end of story. And if you qualify, you should also have an HSA. The HSA is a turbocharged wealth-building vehicle. Besides, healthcare isn't getting any cheaper!

SO HERE'S MY RECOMMENDED SETUP IF YOU HAVE AN EMPLOYER:

401(k) + Roth IRA + HSA

- Max out 401(k) up to the employer match. Do Roth 401(k) if possible.
- Then max out Roth IRA
- Then max out HSA. If you don't qualify for HSA, skip this step.

Example:

> *Your employer will match you up to $5k max, so contribute $5k to your 401(k). If you have money left over, then max out your Roth IRA to the $6k annual contribution limit. Then, if you still have money left over AND you have an HSA, max out your HSA up to the $3.5k annual contribution limit.*

HERE'S MY RECOMMENDED SETUP IF YOU'RE SELF-EMPLOYED:

OPTION #1:
Roth IRA + HSA + Solo 401(k)

- Max out Roth IRA
- Then max out HSA. If you don't qualify for HSA, skip this step.
- Then max out Solo 401(k). Do Roth 401(k) if possible.

Example:

You own your own business and you have no full-time employees (other than your spouse). You made a ton of money this year, so you put $6k in your Roth IRA, $3.5k in your HSA, and all the rest into a Solo Roth 401(k). Winning!

OPTION #2:
Roth IRA + HSA + SEP IRA

- Max out Roth IRA
- Then max out HSA. If you don't qualify for HSA, skip this step.
- Then max out SEP IRA

Example:

You own your own business and you have full-time employees so you don't qualify for a Solo 401(k). You put $6k in your Roth IRA, $3.5k in your HSA, and all the rest into a SEP IRA. Winning!

Where To Open Them

Here's my top 3 recommendations for each type of investment account.

TRADITIONAL IRA, ROTH IRA, SEP IRA, AND TAXABLE ACCOUNTS

1. Fidelity
    - Pros: No account service fees, no investment minimums, $0 trading commissions, lowest fund fees in the industry, virtually unlimited investment selection.
    - Cons: The platform can be tricky to navigate for beginners.

2. Vanguard
    - Pros: Unique ownership model, where Vanguard is owned by all investors of Vanguard funds. This aligns the company's interests with its clients' interests. Also offers $0 trading commissions.
    - Cons: Annual account service fee of $20 if you have less than $50,000. Although if you sign up for e-statements, this fee can be waived. The platform can be tricky to navigate for beginners.

3. Betterment
    - Pros: As a roboadvisor (vs a self-directed platform like Fidelity and Vanguard), Betterment creates a custom-tailored investment portfolio for you when you open an account with them. In other words, everything is done for you, which can be nice if you don't know how to pick your own investments!
    - Cons: Betterment does not allow you to select your own investments (stocks, bonds, mutual funds, ETFs).

HSA

1. Fidelity
   - Pros: All of the above, plus ability to open many other account types at Fidelity so you can keep all your finances in one place.
   - Cons: The platform can be tricky to navigate for beginners.

2. Lively (in partnership with TD Ameritrade)
   - Pros: Modern, mobile-friendly website that is easy to navigate.
   - Cons: N/A

3. HSA Bank (in partnership with TD Ameritrade)
   - Pros: One of the longest-standing HSA providers in the country.
   - Cons: Monthly account service fee of $2.50 if your HSA balance is below $5,000.

SOLO 401(K)

1. E*Trade
   - Pros: No account service fees, no investment minimums, $0 trading commissions, virtually unlimited investment selection.
   - Cons: Lots of paperwork to submit. Definitely get on the phone with an E*Trade customer service rep and have them walk you through the application.

**I have yet to discover any other viable Solo 401(k) options!*

TAXABLE ACCOUNTS

1. Fidelity
   - Pros: All the pros listed above.
   - Cons: The platform can be tricky to navigate for beginners.

2. Betterment
   - Pros: All the pros listed above.
   - Cons: As a roboadvisor, Betterment does not allow you to select your own investments (stocks, bonds, mutual funds, ETFs).

3. Robinhood
   - Pros: Sleek, millennial-friendly user interface. Easy to navigate compared to platforms like Fidelity and Vanguard. Also offers $0 trading commissions.
   - Cons: Does not offer any mutual funds, only stocks, options, and ETFs.

THE ULTIMATE GUIDE TO INVESTMENT ACCOUNTS

Awesome job! You’ve made it to the end of The Ultimate Guide to Investment Accounts. I hope that it’s helped you immensely.

Keep in mind that choosing and opening the right type of investment account is just the beginning. Once you open and fund your account, don't forget to invest the money in your account! Unless you've opened an account with a roboadvisor, the money will sit there uninvested - like money in a bank account. There's tons of info on my YouTube channel (Investing With Rose) about how to pick investments for your new account.

Be sure to also connect with me on Instagram @investingwithrose, where you'll find even more actionable investing tips and mini-trainings!

Happy investing! 🌈

To your wealth,

Rose