Investing 103

Investment Account Types

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What are the main types of investment accounts?

- We touched on a brokerage account in earlier courses but there are other types of accounts that can be used to buy stocks and other investments in the market.
- Stocks can be purchased using brokerage accounts, retirement accounts or education savings plans.

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Brokerage Account

- A brokerage account is a fancy way of saying an account that can buy stocks. There are cash accounts and margin accounts. Margin basically means part of your buying power is credit from whoever you have your account through.
- You must be over 18 to have a brokerage account.
- Also, there is no limit to how much you can put in a brokerage account because the account is taxed each year.

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Margin Account

- In order to start a margin account, you need to deposit at least $2,000. You also have to maintain 50% liquidity in your account at all times even as your investment portfolio increases or decreases.
- If you don’t maintain the required percentage in your account, you can be margin called and your investments can be forced sold, even if it is for a loss.

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Margin Account

- If you want to sell a stock short, you have to have a margin account. We will touch on short selling in a future course but a margin account is not recommend for beginner investors.

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Cash Account

- A cash account does not have the same liquidity requirements and you don't have to take any immediate action if your investment price significantly decreases suddenly.
- Most brokerage account applications default to cash accounts and has less potential risk than a margin account.
- Even if you feel you have enough money to meet the margin requirements on a regular basis, you should still start with cash account until you are a more experienced investor.

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Custodial Brokerage Account

- You can also set up a custodial brokerage account for children until they turn 18 (or 21 depending on state law) as either Uniform Gift to Minors Act (UGMAs) or Uniform Transfers to Minors Act (UTMAs).
- UTMAs: Can hold real estate, cash, stocks, bonds, mutual funds and index funds
- UGMAs: Can only hold cash, stocks, bonds, mutual funds and index funds

Custodial Brokerage Account

- Both accounts can be used for any purpose, not just college tuition. However, if the child applies for financial aid, the account is considered the student's and can possibly impact any eligibility and the amount of aid they receive.
- Contributions are not tax-deductible and are irrevocable but you can give up to $15,000 per year without incurring a "federal gift tax" as of 2021 ($30,000 for a married filing jointly couple).

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Individual Retirement Account

- An individual retirement account (IRA) is a retirement account that you set up outside of your employer. You can set one up through your bank or through any financial institution as long as you are 18 or older.
- Traditional IRAs are beneficial because they allow you to contribute pre-tax dollars. This means if you make $50,000 a year and you contribute $5,000 to your IRA, your taxable income is now $45,000.
- Although you do not pay taxes now, you will have to pay taxes when you begin to withdraw the money.

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Individual Retirement Account

- Because you are taking advantage of tax deferral, the IRS will not allow you to withdraw that money without penalty until you are 59 1/2. The penalty for early withdrawals is 10% so it is wise to exhaust all your other savings in an emergency before using your retirement funds.
- There are several exceptions that will allow you to withdraw the funds without penalty but you will always be subject to paying taxes at whatever tax bracket you're in when you withdraw the money.

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Individual Retirement Account

- You are also able to contribute up to $6,000 a year to your traditional IRA if you are under age 50 and up to $7,000 if you are 50 or older as of 2021.
- The IRS allows individuals closer to the average retirement age are allowed a $1,000 annual catch-up contribution since they do not have as much time left in the market before they plan to use their funds.

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Employer Sponsored Retirement Accounts

- You may have a 401(k) or a 403(b) at your job. The letters or numbers aren't important. You just need to know that these are employer sponsored retirement accounts.
- You are allowed to have IRAs as well as 401(k)s or 403(b)s. However, your annual contribution limit is $19,500 as of 2021 with an additional $6,500 catch-up contribution allowed for people age 50 or older.
- These are also pre-tax contributions.

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Employer Sponsored Retirement Accounts

- Aside from the much higher contribution limit available, employer sponsored retirement accounts also allow employer match contributions. Depending on your company policy, your employer may match your contributions dollar-for-dollar up to a certain percentage.
- The most common employer match is 3% dollar-for-dollar. This means that for each 3% that you contribute, your employer contributes 3%.
- For example, if you make $50,000 a year and contribute 3%, you would have contributed $1,500 and your employer would have contributed $1,500.

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Employer Sponsored Retirement Accounts

- As of 2021, the total employee and employer contribution amount can't exceed $58,000 or 100% of your compensation, whichever is lower. This doesn't include the additional $6,500 catch-up contribution that workers age 50 and over can add.
- Someone could potentially *save up to $64,500 in their 401(k)*.

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Vesting Periods

- With employer sponsored retirement accounts, you are able to take 100% of the money you put in with you when you leave but you may have to wait for a **vesting period** before you can take the employer match.
- For example, if your company policy says that you have to be with the company for one year before you are 50% vested and two years before you are fully vested, you would only be eligible for $750 of the $1,500 match if you left before two years but would be eligible for your full $1,500 contribution.
- Your account balance would show $3,000 before you left but only $2,250 would be rolled over to your new 401(k) or 403(b).

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Roth Retirement Accounts

- Whether it's an individual or employer account, you can set up a Roth retirement account which simply means you are using ***after-tax dollars.***
- Almost all of the rules for each type of pre-tax retirement account applies to Roth retirement accounts. You still will get penalized if you take money before you are 59 1/2 years old.
- However, since you already paid taxes on the money you put in, you could withdraw money from this account in retirement - including your investment earnings - **tax free!**

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Roth Retirement Accounts

- You can set up a traditional IRA and a Roth IRA. However, you are still only able to contribute up to $6,000 a year to both your traditional ***and*** Roth IRA if you are under age 50 and up to $7,000 if you are 50 or older as of 2021.
- The same situation applies with your traditional 401(k) and your Roth 401(k): $19,500 limit if you are under age 50 with up to a $6,500 catch-up contribution if you are 50 or older. And this is assuming your company offers the option to invest in both.

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Roth Eligibility

- Because Roth IRAs and 401(k)s are such tax friendly accounts, the IRS also limits the amount of income you can make to be able to contribute to one. As of 2021, you can't make more than $140,000 or $208,000 a year depending on how you file your taxes.
- We touch on retirement planning in more detail in a future course.

529 Savings Plans

- A 529 plan is a flexible, tax-advantage savings account designed specifically for education expenses for your child or a child you know.
- This is not a pre-tax account so all the contributions could be withdrawn tax-free (since you've already paid taxes on it) and using the money for qualified education expenses means there would be no federal or state income taxes on the earnings.

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529 Savings Plans

- You don’t even have to be the one to contribute. These accounts can be funded by grandmas, cousins, uncles or even friends.
- However, you know the IRS has a contribution limit on this as well. You can only contribute up to $75,000 (or $150,000 per married couple) without being subject to additional taxes.

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529 Savings Plans

- The money can be used at any time for any reason but if it is not used for qualified education expenses, you may have to pay taxes on the earnings and a 10% federal penalty tax and other state or local taxes can be added.
- Taxes are everywhere you turn and can really put a damper on your funds. Which is why we discuss them in much more detail in future courses.

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Next Steps

1) Review your current bank's investment options.
2) Compare your bank options vs. competitors including WeBull, Robinhood and other fintech brokers.
3) Review your current employer's benefit package and see if they offer a 401(k) or 403(b).
4) Create an investment account that fits your financial goals.

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Be sure to check out our other courses!

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