Four Reasons to Save for Retirement in a Taxable General Investing Account

In some situations, it may make sense for individuals to save for retirement in taxable accounts in addition to tax-advantaged retirement accounts.

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KEY INSIGHTS

- Saving for retirement in a taxable account helps those who can't save in employer accounts or want to save beyond IRS contribution limits.
- Taxable accounts provide more penalty-free accessibility to assets than retirement accounts.
- When saving in taxable accounts, be mindful of the fees and how interest, dividends, and capital gains are taxed.

For most people, saving for retirement is best done through accounts specifically designated for retirement, such as 401(k)s or Traditional or Roth individual retirement accounts (IRAs). By design, these accounts offer preferential tax treatment—you either get a tax break now or later in retirement.

For example, most contributions in Traditional IRAs and 401(k) accounts reduce taxable income today, but the money is taxed later when it is taken out of the account. Conversely, Roth IRA and designated Roth contributions in a 401(k) plan do not provide a tax break today but do potentially provide tax-free withdrawals in retirement.

A good rule of thumb is to save 15% or more (including any employer contributions) of your household gross income every year for retirement. There are several situations where you may want to supplement your retirement savings with a taxable general investing account. Here are four:

1. You don't have access to a 401(k) plan at work.

Your workplace may not offer a retirement plan at all. Some employers have a waiting period (e.g., 90 days or one year) before someone is eligible to participate. Or the plan might only be available to full-time workers.

If this is your situation and the only retirement account option is an IRA, contributions are limited to $7,000 per year in 2024 ($8,000 if age 50 or older). For many workers, an IRA by itself will not get you to that 15% savings rate. Making additional contributions to a taxable account can help you meet this savings target.

2. You want accessibility to your long-term investments.

Some households may want to start investing beyond what they've saved as their emergency reserve. Other households may not want to tie up all their long-term investment savings in retirement accounts. A taxable account provides the flexibility to add money and take money out with few limits, penalties, or restrictions. There are also no required distributions. You can save more toward retirement or any other future goal.

3. You have maxed out your 401(k) or IRA and want to save more.

For 2024, the 401(k) plan contribution limit is $23,000 ($30,500 if age 50 or older). Some households, especially dual-income households, may be able to save aggressively for retirement. Consider someone under age 50 earning $170,000 a year. Using the 15% retirement savings target, they should aim to save $25,500 or more each year, well above the contribution limit. The next option, an IRA, could be problematic as Roth IRAs have income limitations and a Traditional IRA may be nondeductible. Additional savings can be invested in a taxable account.

4. Your only IRA option is nondeductible.

Continuing from the previous scenario, a nondeductible IRA means that you do not qualify for a tax deduction when contributing to a Traditional IRA; therefore, you lose that tax benefit. This happens when you or your spouse have access to a workplace plan, which makes deductibility subject to income limitations. While any earnings will still be tax-deferred in a nondeductible IRA, they will be taxed as ordinary income when the money is used. With a taxable account, you may benefit from a lower long-term capital gains tax rate.

For example, the same single person under age 50 making $170,000 in 2024 cannot contribute to a Roth IRA, and, assuming they are participating in their company plan, they cannot deduct their contributions to a Traditional IRA. They would benefit from a 0% and 15% long-term capital gains rate versus a marginal income tax bracket of 24%.

Opening a Taxable General Investing Account

You can typically invest after-tax dollars in a variety of stocks, bonds, mutual funds, and exchange-traded funds in brokerage accounts, bank accounts,

2024 Federal Individual Tax Brackets for a Single Filer

Long-Term Capital Gains Tax Rates		Ordinary Income Tax Rates	
Rate	**Taxable Income**	**Rate**	**Taxable Income**
0%	Up to $47,025	10%	Up to $11,600
		12%	$11,601 to $47,150
15%	$47,026 to $518,900	22%	$47,151 to $100,525
		24%	$100,526 to $191,950

Source: taxfoundation.org

and other financial institutions. When saving in taxable accounts, be mindful of the fees and how income earned through interest and dividends is taxed as well as capital gains when realized.

The Benefit of Tax Diversification

Tax diversification is the allocation of investment dollars to more than one account type. If you're not sure what tax bracket you'll be in during retirement, it can be a good idea to have assets spread across multiple account types that can help you develop a sustainable withdrawal strategy with taxes in mind.

Given that retirement could last several decades, it's important to not let taxes diminish too much of your savings to allow your assets to last as long as possible. Using a combination of pretax, Roth, and taxable general investing accounts to save for retirement can provide you with added flexibility when you need to spend that money. Just as you diversify your investments to help tackle the uncertainty of the markets, diversifying the tax treatment of your accounts can help you weather the uncertainty of the tax landscape and manage your income in retirement.

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