SAVE THOUSANDS OF DOLLARS WITH AN IRA

If you use an individual broker account to buy and sell stocks, chances are you are losing thousands of dollars over your lifetime. Though you might not be aware of it, the tax man could be taking from you twice.

You can't be building wealth if someone is always taking from you. The tax man is always taking from you, especially when you are making more money.

In the investing world, we know of these taxes as capital gains. There are two types of capital gains taxes: short term capital gains and long term capital gains.

Short term capital gains are applied to any stock investment that is sold after being held for less than a year. The goal of this tax is to limit day trading, but the smart traders and investors know how to work around this tax. The implications of this tax are substantial; the gains have historically been taxed at your income tax rate.

Long term capital gains are for any stocks that are held for a year or greater. But even this tax can do a lot to hinder the growth of your capital. Long term capital gains are taxed depending on your income tax bracket, historically ranging anywhere from 0% - 20%. Where you fall within that range depends on your income. Yet even this tax can be intelligently avoided.

A typical investment portfolio can easily contain 6 to 7 figures throughout the lifetime of the investor.

With these kinds of amounts, a tax can easily take away thousands to tens of thousands of dollars.

Learning to avoid these taxes can make a big difference to your net worth. There's a simple way to avoid the capital gains taxes if you trade with an individual broker account. Here's how.

Tax Advantaged Accounts

One of the best ways to avoid double taxation with investing is with a 401k or IRA.

An IRA has two types: traditional and Roth. Both accounts will save you a layer of tax. Instead of being taxed twice, you will only be taxed once.

A traditional IRA is tax deferred. That means the money you put into it is not taxed; it avoids federal income tax. Instead, the money is taxed when you withdraw. Any capital gains taxes that were accrued during this time don’t have to be paid until the time of withdrawal.

The Roth IRA works differently. The money deposited into a Roth IRA is taxed for federal income, but then avoids any tax thereafter. As in the case with the traditional IRA, capital gains taxes are avoided.

The Roth IRA helps you compound your money tax-free. This is a huge advantage for investors.

Over a lifetime, this can add to savings of thousands of dollars. The 401k accounts work the same as IRAs, with the "traditional" or "Roth" option.

However, most 401ks don’t come with the flexibility of an IRA. With an IRA, you can buy individual stocks and bonds. With most 401ks, you have to choose between a predetermined selection of mutual or index funds. Depending on the skill of the investor, this could be a disadvantage.

While I’m not a tax professional and can’t legally give you personalized advice, I do think you should take advantage of the 401k as much as you can. What I used to do when I worked for an employer was maximize my 401k match, and then put the rest into a Roth IRA. If there’s any left over after that, then I’d increase my 401k contributions.

What this did was allow me to capitalize on the free money from an employer, and also obtain the flexibility and chance for higher returns in the Roth IRA. This money will also compound faster being in a Roth account.

If employers give you the option of a Roth 401k, think about taking advantage of it.

Example: Tax Differences

Consider this example of two investors with similar income and age. They both make $50,000 and are 25 years old.

One investor, Bob, invests in a Roth IRA. The other investor, Jerry, just invests in a regular broker account.

Assuming they both make annual returns of 10%, how much would each have at age 65?

According to 2014 capital gains law, Jerry’s long term capital gains would be taxed at 15%. Jerry would make $2,434,221.75 from his investments minus at least $365,133.26 to taxes (assuming 1 sell order).

Bob would make $2,434,221.75 and be able to keep it all.

Top Brokers for Opening an IRA

What's great about today's environment is that you can open an account and pay zero dollars in fees and zero dollars in commissions.

There's a wide range of reputable brokers to open an account with, and there's nothing to say you can't open more than one account. Just make sure you don't contribute more than the IRA annual limit when you look across all of your accounts.

Personally, I have brokerage accounts with Ally, Fidelity, Schwab, and Merrill Edge. They have all worked well enough for me.

As of 2021, both Fidelity and Schwab allow you to buy partial shares of companies, and also DRIP those shares.

With that, you can buy any stock with as little as $5.

I've started using Fidelity's fractional shares for the Roth IRA of the Real Money Portfolio for The Sather Research eLetter, while also keeping my original Ally Roth IRA intact too. It's so easy to get these accounts funded these days, so there are no excuses left at this point.