Delaware Life® | Retirement Education

The power of tax deferral

How tax deferral can help your retirement account value grow

Tax deferral allows you to delay paying taxes on earnings—such as interest, dividends, or capital gains—so they can accumulate tax-free until you withdraw them after you retire. The most common types of tax-deferred retirement accounts are IRAs, 401(k)s, and tax-deferred annuities. Delaying taxes on the earnings in these accounts can help in two ways:

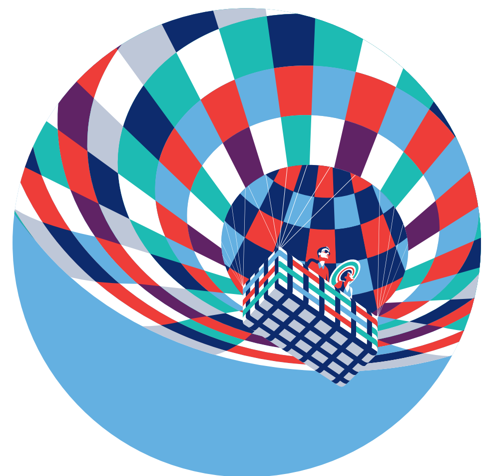
1 More growth potential when you're saving

Instead of paying taxes on your earnings every year, in a tax-deferred retirement account the taxes are delayed until you make withdrawals in retirement. That means you may have more money in your account to potentially grow, through compounding. With compounding, your interest earns interest every year, which can increase your account balance over time.

2 Earnings potentially taxed at a lower rate

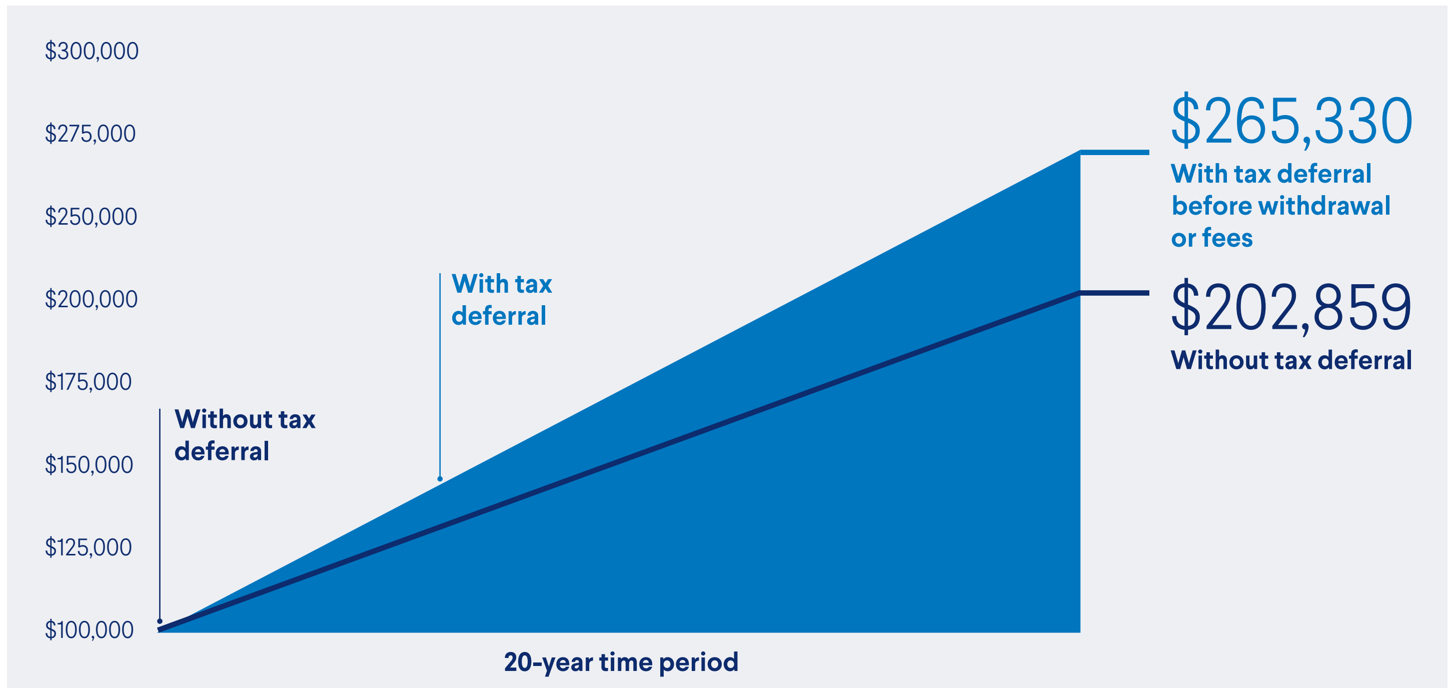
The prime saving years for retirement are typically your peak working years when you likely pay higher income taxes. But once you retire and your income is lower, you could be taxed at a much lower rate. Any tax-deferred earnings you withdraw in retirement would be taxed at that lower rate too.

Remember: Your earnings in a tax-deferred account continue to grow tax-free, until you start taking withdrawals or income payments in retirement. When you do, your withdrawals of taxable amounts are subject to ordinary income tax, and if taken before age 59½, you may have to pay a 10% federal tax penalty.



The longer you defer paying taxes, the better

Consider this example. A $100,000 contribution that earned a 5% average annual return and paid taxes each year in the 28% tax bracket could have grown to $202,859 over 20 years. By contrast, a $100,000 contribution that earned 5% in a tax-deferred account over the same time period would have grown to $265,330—a $62,471 advantage.



This hypothetical chart illustrates how tax deferral would affect a $100,000 initial premium, before any withdrawals or fees, during a 20-year period. The chart assumes an average annual return of 5% and a federal income tax rate of 28%. Actual tax rates may vary for different taxpayers and for different assets than those illustrated. For example, capital gains and qualified dividend income are taxed differently. Actual performance of your investment also will vary. Lower maximum tax rates on capital gains and dividends would make the investment return for the taxable investment more favorable, thereby reducing the difference in performance between the examples shown. Consider your investment time horizon and income-tax brackets, both current and anticipated, when making an investment decision. This example illustrates tax deferral and does not represent the past or future performance of any product. Actual results will vary.

Take advantage of tax deferral

Talk to your financial professional to learn more about how to use it for your retirement savings.

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