## Sample article for organizations to use to reach customers

*Customize and post the following article on your websites and/or use in other communication vehicles, to assist your customers in satisfying their tax filing liabilities.*

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**Tax-Free Compounding Increases Retirement Savings**

Retirement plans and individual retirement accounts (IRAs) provide tax-free compounding that can translate into more money for you when you retire.

Simply put, compounding means earnings on previous earnings.

*Here is an example.* Your account earns at a 12% annual percentage rate (APR) and provides monthly compounding at a rate of 1% per month (12% ÷ 12). At this rate, on an account with $100, you'll have earned $1 ($100 x 1%) by the end of the first month and your new account balance would be $101. With monthly compounding, you'll have earned $1.01 ($101 x 1%) at the end of the second month and your account balance would be $102.01. At the end of 12 months, your account balance will be $112.68.

With a regular savings account, you will likely have to pay tax on your earnings in that account at the end of the year. If you pay the tax with money from that account, then less will be available for future earnings. Even if you don't pay the tax with money from that account, you'll have to come up with the money from somewhere else.

*So* assume that the account in the above example is your regular savings account. Your balance is $112.68 by the end of the first year because you have earned $12.68 ($112.68 - $100). If your tax rate is 25%, you may have to pay $3.17 on the earnings of $12.68 ($12.68 X 25%). If you withdraw this amount at the end of the year to pay the tax, you'll have $109.51 ($112.68 - $3.17) in the account for future earnings.

Retirement plans and IRAs provide compounding but offer the added advantage of tax-free compounding. This is because retirement plans and IRAs are tax-deferred accounts, and you generally don't pay taxes on any earnings in these accounts until they are withdrawn.

*If you have* an IRA or retirement plan account with a $112.68 in the account at the end of the first year, you are not taxed on the earnings of $12.68 until you withdraw them. So if you keep the earnings in the account, you will have $112.68 left in the account for future earnings.

It's a mathematical fact that you earn more on a larger sum of money. That's why a larger account balance at the end of the year means increased earnings during the following year. Over time, tax-free compounding means a significantly larger account balance.

So, why not use the tax-free compounding power of retirement plans and IRAs to boost your retirement savings?

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**NOTE TO EDITOR:** *Below are helpful resources on retirement topics on IRS.gov:*

- Life Events That Can Affect Retirement Savings – Retirement savings information and tips for every stage of your life.
- 2011 IRA Contribution and Deduction Limits – Information and charts to determine your maximum IRA contribution and deduction limits.
- Retirement Plans FAQs – Answers to frequently asked questions about IRAs and retirement plans.
- Publication 590, *Individual Retirement Arrangements (IRAs)* – Information on traditional and Roth IRAs.
- Types of Plans – Information on various types of retirement plans.