What does the term "qualified plan" mean?
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Answer:

A qualified plan is an employer-sponsored retirement plan that qualifies for special tax treatment under Section 401(a) of the Internal Revenue Code.

There are many different types of qualified plans, but they all fall into two categories. A defined benefit plan (e.g., a traditional pension plan) is generally funded solely by employer contributions and provides you with a specified level of retirement benefits. A defined contribution plan (e.g., a profit-sharing or 401(k) plan) is funded by employer and/or employee contributions. The benefits you receive from the plan depend on investment performance.

The annual contribution limits and other rules vary among specific types of plans. However, most qualified plans share certain key features, including:

• Pretax contributions: Employer contributions to a qualified plan are generally able to be made on a pretax basis. That is, you don't pay income tax on amounts contributed by your employer until you withdraw money from the plan. Your contributions to a 401(k) plan may also be made on a pretax basis.

• Tax-deferred growth: Investment earnings (e.g., dividends and interest) on all contributions are tax deferred. Again, you don't pay income tax on those earnings until you withdraw money from the plan.

• Vesting: If the plan provides for employer contributions, those amounts (and related investment earnings) must vest before you're entitled to them. Check with your employer to find out when this happens.

• Creditor protection: In most cases, your creditors cannot reach your qualified retirement plan funds to satisfy your debts.

• Roth contributions: Your employer may also allow you to make after-tax Roth contributions to the 401(k) plan. While there's no up-front tax benefit, qualified distributions are totally free from federal income taxes.

If you have access to a qualified retirement plan, strongly consider taking advantage of it. Over time, these plans can provide you with substantial retirement savings.
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