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Who's Retirement Are You Planning – Yours or Uncle Sam's?



GUEST COLUMN

By Bruce Weide

Most Qualified Retirement Plans, being tax-deductible upon contribution, will be taxed at one's existing federal income tax rate when funds are distributed upon retirement. This should greatly alarm most people who are saving in Qualified plans. But the pacifying theory, chanted to sooth the masses is "When you retire, you will be in a lower tax bracket." Therefore, it is supposedly better to deduct a 28% percent tax on a small contribution to your plan today, than to pay a 23% percent tax on the much larger distribution you will take out one day.

It is not necessarily true that the Baby Boomers and Generation X'ers will land in a lower tax bracket upon retirement. It does take some courage to face up to why this is so.

Income tax is at historically low levels today. The highest federal tax bracket is 35%. Compare that to pre-Reagan levels of 1972 when a \$76,000 taxable income landed you in a *58% tax bracket!* (Plus add about 6-7% for California at that time.)

Income tax levels were lowered in the 1980's by cutting taxes (1986 top tax bracket lowered from 50% to 28%) and increasing borrowing on the national debt until the economy was to recover. Toward the end of President Reagan's term, on Sept. 30, 1988, the national debt was \$2,602,337,712,041.16

- **As of 11/10/2005, the national debt is \$8,050,739,770,455.58!** Don't fool yourself that this debt need not be repaid. Defaulting on such a debt would be the stuff that collapses entire economies, such as occurred in Argentina over recent years. Average Argentinean middle-class wage earners became street people overnight.
- **The interest alone for Fiscal 2005 was \$352,350,252,507.90.** Compare that to the massive \$80billion Pres. Bush wanted for the first Iraq War allocation.
- **The Social Security Retirement Income Trust is very likely to go bankrupt as more and more Baby Boomers retire and demand benefits.** The Social Security Trustees report predicts complete bankruptcy by the year 2030, and a whole lot of trouble and reductions before then. And President Bush has suggested increasing the National Debt by \$2trillion more to transition to his

proposed individualized private accounts for future Social Security recipients.

The Medicare system will be in even worse trouble. In August of 2004, Alan Greenspan told Congress, *“The shortfalls in the Medicare program, however, will almost surely be much larger and much more difficult to eliminate (as compared to Social Security).”*

Now, if you have an entire generation —*the demographically largest generation*— in a position to begin taking income from their investments *at the point when their investments would potentially be at their greatest value*, and all of it coming out from IRAs or company sponsored Qualified plans being 100% taxable at current income tax rates, explain to a sensible person how these funds would not become an *irresistible target* to raise taxes upon, in a climate where Social Security and Medicare are broke and the national debt, in the tens of trillions of dollars, must be confronted.

Some Hard Numbers

Consider a worker who is putting \$12,000 a year into an company 401K. (401Ks are a great deal only if your boss is *matching* you, because that’s an immediate 100% return on your money. Outside of that, the following sad scenario applies.) Because 401K contributions are tax deductible, if our fortunate friend is in a 33.3% marginal tax bracket, that means that he/she will save \$4,000 a year in taxes that would have otherwise been due on the income. Now do that for 30 years, with funds earning 8% per annum, you will have accrued to approx. \$1,359,400 by the end of the run. And over that 30 years your total tax savings was \$120,000 (\$4,000 X 30 years.) If the account were to continue to earn 8% during retirement, and our goal was to just cream the interest off the top and leave the principal intact, we could withdraw \$108,752 per year. But we don’t get to keep that because the IRS has waited a very long time with bated breath for their returns on the taxes you invested for them. With the mortgage paid off, child tax credits gone, no more business write-offs, and every single dime of income exposed to taxation, our friend will have to remit \$36,250.67 in taxes. ***In 3.3 years our subject has paid back every single dime of tax that was saved over the 30 year period! And what do you think will happen if tax rates climb 10-15% next decade or two, considering our country’s fiscal predicament delineated above?***

Hint - Don’t use government-stamped retirement plans. Custom-build your own private retirement plan by using deductible funding through trusts and/or deductible mortgage interest, in combination with accrual vehicles that can deliver tax-free returns that aren’t affected by changes in future tax laws.

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