- The hidden threat successful professionals face from 401k, SEP, IRA and Defined Benefit Plans.
- How advice meant for the masses can cost the high income household a small fortune.

The 401k Tax Trap

by Denver Nowicz

Denver Nowicz is an independent financial services professional. He is the founder of Equity4Profit and Wealth For Life Financial Solutions.

Over the last 14 years, Denver has successfully developed and implemented comprehensive wealth building retirement plans for individuals and businesses of all sizes.

Through dedication and personal attention, he has helped his clients to have greater certainty and peace of mind by eliminating risk, reducing taxes, and achieving more predictable results. For over seven years he has hosted the “Get Wealthy Arizona” radio show featured throughout Arizona.

Learn more about Denver by clicking this link: http://www.linkedin.com/in/denvernowicz

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Problem #1: Taxes don't go away in retirement.

You've probably been told max out your "Qualified Plan" to save you money on taxes. (Qualified Plans such as a 401k, IRA, SEP or defined benefit plan.)

This is not a "tax savings." This is a "tax deferral." You still have to pay the taxes – just not right now.

You get a tax deduction now.

Your money grows.

You pay taxes later.

When you retire and withdraw money from your "Qualified Plan" your withdrawal is taxable as ordinary income.

Since you will have to pay those taxes later a few questions may come to mind:

- What tax bracket will you be in when you retire?
- Will taxes be higher or lower?
- Will you end up paying more in taxes by waiting to pay them later?

Pay taxes now on this?

$25,000

Or wait until your money grows and pay taxes on this?

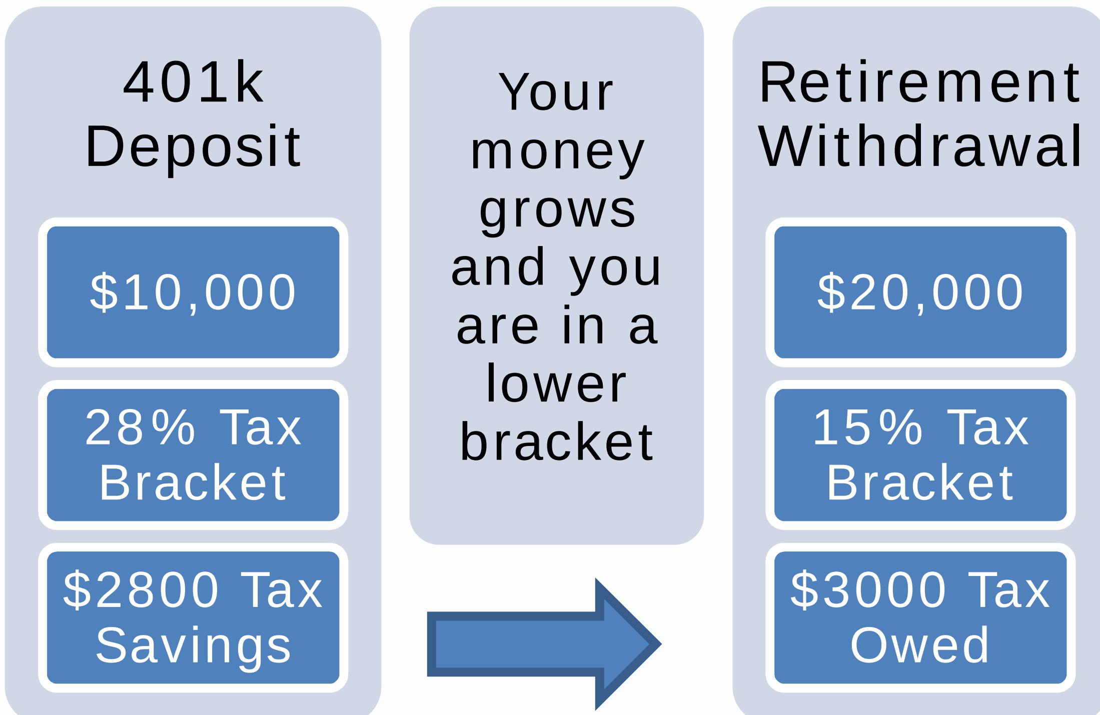
$50,000

Wont you be in a lower bracket when you retire?

“The old thinking was that you should defer tax bills until you are in a lower bracket at retirement. Higher bracket is more like it. ...plan on big federal deficits and higher income taxes when you retire...”

The Tax-Deferral Trap
Forbes Magazine - September 07, 2009

Even if you end up in a lower bracket you could still pay more…



…because you are simply paying taxes on a larger amount of money.

Problem #2: The Double Taxation Trap.

If you don't have a qualified retirement plan or if you have maxed out your contribution, you fall into the double taxation trap:

"Nearly one out of every three dollars spent by high income retirees goes to taxes."
Lincoln Financial Group/Spectrum research study October 9th, 2009.

Unfortunately, most Americans have their wealth allocated to tax deferred (taxed later) or double taxed positions.

80% Taxed Later

20% Double Taxed

0% Tax Free

The solution is to move toward a Tax Diversification Strategy which would look something like this:.

50% Taxed Later

0% Double Taxed

50% Tax Free

How does Tax Diversification impact taxes in retirement?

First, it depends on your spending in retirement.

Studies show that people spend a lot more in retirement than was originally thought.

For middle class, spending tends to be within 15% of pre-retirement levels.

Upper income Americans tend to spend about the same as pre-retirement levels.

So let's take a look at the impact of taxes on three different retirement incomes:

$75,000 → $120,000 → $250,000

Retirement Income Example #1: $75,000

Hypothetical case studies based on 2012 tax rates. Estimates from http://1040.com. Consult your tax advisor for more info.

BEFORE tax diversification

- $30,000 social security
- $45,000 401k withdrawal
- No Tax free withdrawal

• $6,000 federal tax married filing jointly
• $11,000 federal tax – single

AFTER tax diversification

- $30,000 social security
- $22,500 401k withdrawal
- $22,500 Tax free withdrawal

93 %
Savings Married

77 %
Savings Single

• $400 federal tax – married filing jointly
• $2,500 federal tax – single

Retirement Income Example #2: $120,000

Hypothetical case studies based on 2012 tax rates. Estimates from http://1040.com. Consult your tax advisor for more info.

BEFORE tax diversification

- $30,000 social security
- $90,000 401k withdrawal
- No Tax free withdrawal

• $16,000 federal tax married filing jointly
• $23,000 federal tax – single

AFTER tax diversification

- $30,000 social security
- $45,000 401k withdrawal
- $45,000 Tax free withdrawal

63% Savings Married

52% Savings Single

• $6,000 federal tax – married filing jointly
• $11,000 federal tax – single

Retirement Income
Example #3: $250,000

Hypothetical case studies based on 2012 tax rates. Estimates from http://1040.com. Consult your tax advisor for more info.

BEFORE tax diversification

- $30,000 social security
- $220,000 401k withdrawal
- No Tax free withdrawal

• $52,460 federal tax married filing jointly
• $63,533 federal tax – single

AFTER tax diversification

- $30,000 social security
- $110,000 401k withdrawal
- $110,000 Tax free withdrawal

60%
Savings Married

54%
Savings Single

• $21,212 federal tax – married filing jointly
• $29,055 federal tax – single

For all three incomes the potential yearly tax savings is significant:

$75,000 Income	93% yearly savings	$108,000 over 20yr retirement
$120,000 Income	63% yearly savings	$200,000 over 20yr retirement
$250,000 Income	60% Yearly Savings	$624,000 over 20yr retirement

So where do you grow money for tax free distribution?

- Tax Free Municipal Bonds
- ROTH IRA/ROTH 401k
- Whole Life Insurance
- IUL - Indexed Universal Life Insurance

Of these, Indexed Universal Life offers the most advantages. Let's look at some of the reasons why...

The advantages of Indexed Universal Life:

- ✓ No income or contribution limits like ROTH IRA/ROTH 401k plans.
- ✓ The principal is guaranteed against market losses.
- ✓ Double-digit growth potential from popular market indexes with no downside risk. Much higher yield potential than muni-bonds or whole life.
- ✓ Costs are much lower than whole life and traditional fee based investments. As much as 60%-70% less long term.
- ✓ If you pass away prior to retirement your plan is fully funded for your family thanks to the death benefit.
- ✓ Designed to provide tax free income streams.

Why is life insurance tax free?

IRS Code Section 72(e) and 7702

The most unique feature of permanent life insurance is that under Section 72(e) and 7702 of the Internal Revenue Code the accumulation of cash inside the insurance contract is tax advantaged. Not only can the cash value accumulate tax free, but the cash can also be accessed tax free.

> "The tax exemption for life insurance is the single biggest benefit in the tax code."

PBS

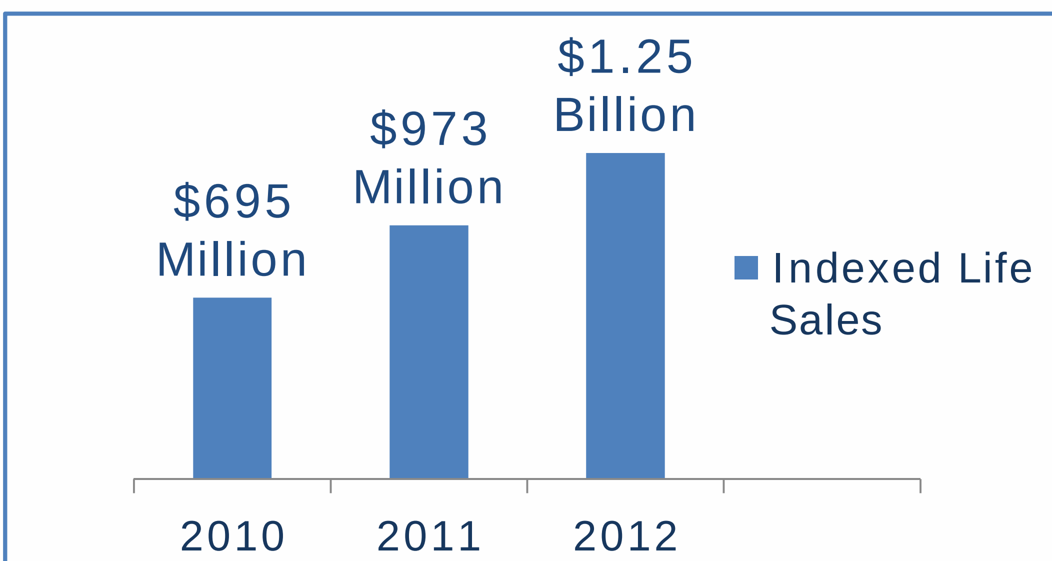
Ed Slott – one of America's top nationally recognized CPA's in his 2012 PBS Special "Retirement Rescue"

The strategy is already established and proven:

THE WALL STREET JOURNAL.

"The richest Americans own over half of the tax free investment gains built up in life insurance." October 3rd, 2010

Indexed Universal Life is one of the fastest growing segments in the insurance industry:

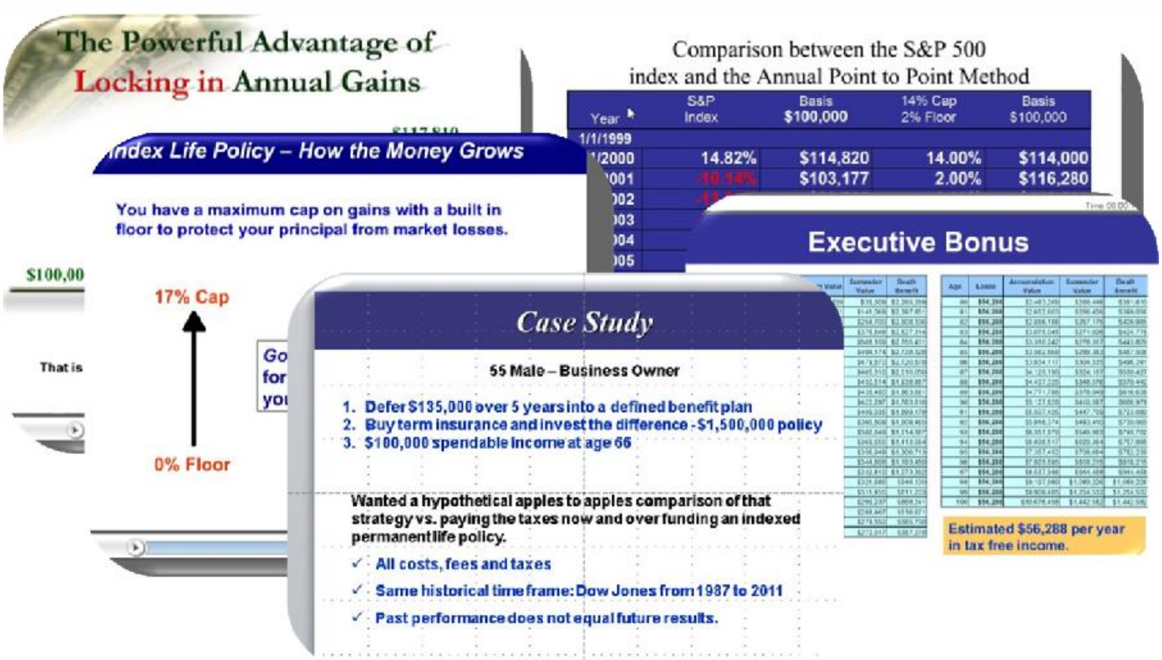


Learn more about creating tax free income on our weekly webinars.

Visit WealthForLife.net to learn more.

Our weekly webinars cover:

- ✓ Creating tax free income with life insurance policies.
- ✓ Life insurance costs: What are the downsides?
- ✓ Insurance vs. Market returns: Who wins?
- ✓ Client Case Studies Q& A's and more.



Important takeaways from this e-book:

- 401k, IRA, SEP, 403b and Defined Benefit Plans are not tax savings plans. They are tax deferral plans. They simply delay paying the taxes you owe until the future.

- When you withdraw money at retirement from qualified plans it is taxed as ordinary income – just like your income is now.

Important Questions to Ask:

- ➢ Will you pay more in taxes by waiting until retirement to pay them?

- ➢ What tax bracket will you be in during retirement?

- ➢ Will taxes be higher or lower in future?

- ➢ Would you rather pay your taxes now and have them out of the way or wait until retirement?

The reality is taxes get paid either now or later. It is just a matter of how much and when.

"Nothing is certain except death and taxes."

Benjamin Franklin
November 13, 1789

- ✓ By waiting to pay all the taxes you owe until retirement, you could end up paying two or three times as much as you should.
- ✓ A balanced approach between taxable and tax free income sources could save you 50%-90% per year in retirement taxes.
- ✓ This could give you a lot more money to spend during retirement.

What to do next:

1. Take inventory of how much you have in taxable vs. tax free accounts and see if you are on track with a balanced approach. If everything is taxable or taxed later, you will want to make changes.
2. At least 50% of your ongoing savings should be going into a tax free position.
3. See if we can help. Call our office to schedule a meeting at 480-970-5663 or click here to schedule online
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Wealth For Life
Financial Solutions

Rollover Solutions	• 401k, IRA, ROTH, SEP and 403b • Create guaranteed income for life
Tax Free Solutions	• Reduce taxes in retirement • Avoid double taxation
Mortgage Solutions	• Pay off mortgages in 6-10 yrs. • No change in spending or refi.
Individual Solutions	• College funding, legacy planning • Trust and estate coordination
Business Solutions	• Executive compensation • Company retirement plans • Premium financing strategies

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