# Principles vs. popularity

## Tax deferrals: What is it and how will the current rate affect your business in the future

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Consider this principle: for tax delay or deferral to work, your tax exposure in the future must be lower than it is today. In other words, your tax bracket in the future needs to be lower than it is today to make tax deferral or delay an effective and efficient income strategy in retirement.

In general, do you think tax rates will be going down in the future or do you think that tax rates will most likely go up? Let me give you a hint: the National Debt is at an all-time high and the Trump Tax Plan recently reduced US tax rates for most individuals and businesses to the third lowest point in the history of taxation. Do you think that we will see further reductions? The current income tax rates are set to expire on January 1, 2026 and return to the higher rates of 2017. So, the answer is undoubtedly up, and we know the exact date!

When considering the facts above, does making contributions into a Tax-Deferred 401k or IRA today, only to take the money out at a potentially higher tax rate in the future, still seem like a good idea? Will the savings result in a higher or

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lower income stream when it's time to take distributions?

What is popular is not always right, and what is right is not always popular...

Taxes will continue to be an issue. Understanding where you put your savings for the future will in fact determine the ultimate effectiveness of those savings. We need to be strategic about where and how our savings are allocated in order to create the largest income streams in retirement.

The goal of successful retirement planning should be to maximize your potential future income. It's not always the size of the pile of cash you accumulate; it's where that pile of cash is sitting when you take distributions from it that matters most. Critical thinking is required to look beyond popular opinions. Without utilizing a validation process, it is just that: an opinion.

If you were to describe a perfect scenario for retirement planning, it could sound something like this.

"I would like to substantially increase my wealth, reduce my overall financial risk and maximize my income with no change to my current lifestyle or out-of-pocket expenses". Sounds great: now how in the heck do you accomplish that?

Retirement isn't what it used to be. When social security was established in 1935, the average life expectancy was 62. Social Security was available beginning at age 65. 42 workers were contributing for every 1 worker drawing money out. If you did make it to 65, you only drew off Social Security for a few years.

Today, the ratio has fallen to 3 to 1, and within 10 years it's anticipated to fall to 2 to 1. In addition, Americans begin taking payments as early as age 62 and draw until age 85 on average! The math behind Social Security is very problematic.

We must look beyond simply increasing retirement assets. Investment diversification during the accumulation phase, the common solution touted by financial advisors, combined with tax diversification during the distribution phase (often overlooked by financial advisors) provide greater protection from market risk and tax risk.

In simple terms, investment diversification refers to creating a portfolio made up of various types of investments, from stocks, bonds and mutual funds. Tax diversification refers to keeping assets in a variety of accounts that are taxed differently upon distribution. You must hedge against the federal tax system to have more control over potential tax liability (income loss).

Understanding how your money is taxed upon contribution, while growing within the account and at distribution is critical to understanding if the plan will provide the maximum amount of income possible. A 'tax-preferred' retirement plan is one where contributions are tax-deductible, accumulation is tax-deferred and distributions are tax-free.

Let's examine three different types of accounts: taxable, tax-deferred and tax-free. Income generated in a taxable account is taxed each year to the account owner. Examples include bank interest, rental income and gains from the sale of investment assets, among others.

Income generated within a tax-deferred account is not taxed until distributions are taken. Examples include 401(k) plans, IRAs, 403(b) plans and profit sharing plans, among others. These plans are often funded by tax-deductible dollars.

Income within a tax-free account, assuming certain qualifications are met, is not taxed upon distribution. Examples include Roth IRAs, Roth 401(k) plans and Cash Value Life Insurance.

Given the instability of Social Security, disappearing pension plans, uncertainty of tax rates and increasing longevity, establishing a plan based on economic principle, and not by popular vote, is crucial to a successful retirement.