SHOULD YOU BE GETTING READY TO DUMP MONEY INTO YOUR RETIREMENT PLAN FOR A BIG TAX DEDUCTION?

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As we speed toward the end of the calendar and financial year thoughts turn to how much we may, or may not, owe in taxes in the first quarter of 2014. Nobody likes to pay taxes so it is at this time of year you are searching for ways to reduce that burden.

One of several ways people have used to lower their taxes is to fund their 401k, IRA, or any other type of qualified plan with as much money as they can scrape together. The reasoning behind this is usually twofold:

1. We need to save for our later years and retirement
2. We think we are beating the tax man by qualifying for a last minute income tax deduction (this is in the case of traditional retirement accounts and not Roth accounts)

John Jamieson

The first reason is good reason to put money away for retirement but the second reason is not really valid when you look at the entire picture. To begin with a “tax deduction” taken for contributions made to a retirement account is really not a tax deduction but rather a “tax deferral”. This means you are agreeing not to pay the tax now but will pay later when you take the money out of the account.

A true tax deduction is money that is written off of your taxes without having to pay it back at a later date. So why does everyone get so excited about the tax benefits of contributing to a retirement account? We are a people who only look very close into the future and see the immediate result and are unaware of the long term consequences of the action.

The reasoning for the deduction is the theory that because we did not pay tax on the money we have more of it available to put into the account and the more money you will have when you get older. This could be true depending on what you invested the money in when it was put into the account. The vast majority invest the funds in mutual funds which get invested into the stock market. So we are told that if you “average” 8% over the next 20 years you will have more money in the account than if you had to pay tax on the money today. The assumption is that 8% is compound growth when in fact the stock market goes up and down and does not truly compound. It is a matter of timing and trading in the market and very little to do with actual investing any longer.

With that in mind the extra money you put into the market is available to grow more or to LOSE more depending on what the market does after you put it in the fund or the individual stock. Also when you do go to take the money out you will owe tax on the entire account balance both contributions and any gains from growth. We are told that the income rates will be lower for us later in life because we will be making less money. This is not a fact but a huge assumption. Do you think tax rates are going higher or lower in the next 10 or 20 years? If you answered higher as most do then ask yourself this question: “why am I agreeing to defer tax from today until tomorrow on a larger amount of money and at unknown probably higher tax rate”?

The fact is investing or saving just for alleged tax advantages is never a good bet. You should place money only where you think it will be an asset to you by either growing or stopping one of your 4 massive wealth drains of Income taxes, interest and fees paid to banks, market losses, and depreciation of large assets such as cars, boats, and equipment. If there are tax advantages then all the better but the main reason you do something should never just be about taxes.

Many people elect to reduce their taxes by aggressive legal tax structures and whatever tax they do have to pay, they pay today and put it away in a tax free vehicle where the government has very little say in how it is used in the future. This means not putting it in qualified plans of any kind.

By John Jamieson

John Jamieson is the owner of Perpetual Wealth Systems a total wealth strategy company showing investors how to stop their 4 wealth drains while funding their 5 circles of wealth. He is a sought after national speaker and the author of the #1 bestseller “The Perpetual Wealth System” available at www.theperpetualwealthsystem.com.

Perpetual Wealth Systems is a vanguard wealth strategy company that specializes in showing people and businesses non-traditional ways to grow and protect wealth. They are based out of Clinton Township, Michigan but have clients in dozens of states and Canada.

Perpetual Wealth Systems services a unique sector of the investment and insurance worlds. Their best clients are people not happy with the traditional financial vehicles and want to explore the possibility of reallocation of assets into guaranteed vehicles as well as non guaranteed programs. They help people invest in real estate, private loans, private notes, tax deeds as well as help people and businesses set up their own private banks and private pension systems. The company believes in team approach to wealth creation and wealth preservation. They bring in experts from many different financial and business arenas to help service their clients many different needs.

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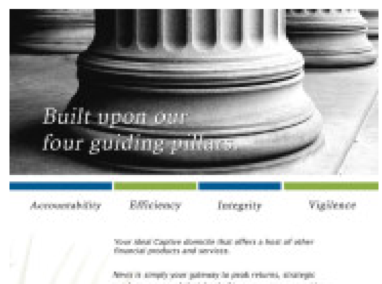

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