Wealth & Wisdom

INSTITUTE

ELIMINATING LOSING FINANCIAL STRATEGIES

Qualified Plans

Financing Your Future or the Government's

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IF I COULD TELL YOU THE EXACT DAY THAT YOUR RETIREMENT ACCOUNT WOULD SUFFER ITS GREATEST LOSSES, WOULD YOU WANT TO KNOW THAT DAY?

THEN IN KNOWING THAT DAY, IF YOU COULD DO SOMETHING NOW TO PREVENT THOSE LOSSES. . .WOULD YOU DO IT?

Major Transfers Of Your Wealth

In your everyday existence, you are confronted with transfers of your wealth. You continuously, unknowingly and unnecessarily, give or transfer money away. Not only do you give this money away but you also lose the ability to earn money on that money once it is transferred. This compounds your loss. To eliminate or reduce these transfers, you must first learn to recognize them and then understand how directly or indirectly they cost you money. You may have to confront conventional financial wisdom. Remember, the ones giving you these financial programs tend to profit from them. Always ask, who would profit from these transfers? Here is a list of the transfers of your wealth we will be discussing:

- Taxes
- Qualified Retirement Plans
- Financial Planning
- Disability
- Credit Cards
- Tax Refunds
- Owning A Home
- Life Insurance
- Purchasing Cars
- Investments

These ten transfers can create financial losses for you. You should study each one and determine how they will affect you. On the surface, the transfers seem pretty basic. It is not until you think a layer deeper that you find that these transfers may cause unintended consequences in the future. The future demographics of the country will affect everyone's financial future.

WHOSE FUTURE ARE YOU FINANCING . . .

YOURS, OR THE GOVERNMENT'S?

Qualified Retirement Plans
Thinking A Layer Deeper

I, for one, don't believe qualified retirement plans are all that they profess to be. They are surrounded by ever-changing, complicated rules that can turn out to be very costly. I do believe qualified plans serve a purpose. At best, I believe they force people to save, which is something that people could do on their own with a little discipline. I don't believe all the rhetoric about tax savings. Someone is going to be taxed on this money. If not you, then your heirs. The question is, at what rate will it be taxed?

Tax Savings: Real Or Apparent?

I want to share with you an example of a 45 year-old person who was told they should have an IRA so they could generate tax savings. I gave this example to a group of accountants. I told them I would give $100.00 to each accountant who came up with the right answer. The question was this: If a 45 year-old person, in a 28% tax bracket that qualified for an IRA put $2,000 into an IRA, what would the tax savings be for that person? [I know the amount that can be deposited into IRAs has changed, just bear with me for the sake of the example]. I told them to write the answer on the back of their business cards and pass them forward. Every one of them passed their card forward positive that they would be $100.00 richer. I reviewed all the cards. They all said the same thing, $560.00. Which they figured by taking 28% of $2,000.00. I hesitated and then asked, "Is this tax savings real or apparent?"

I went to the chalk board, and wrote these numbers:

Age	IRA plan growing at 10%
45	$ 2,000
52	$ 4,000
59	$ 8,000
66	$16,000

By simply using the Rule of 72, at 10% rate of return the money would double about every seven years. All the CPAs agreed with this calculation. I then told them every card they sent forward on it had the answer as $560.00. None of them seemed surprised. I then asked them, if this person could invest the $560.00 tax savings, what would that look like assuming I could get a 10% rate of return on that money?

Age	Tax savings growth at 10%
45	$ 560
52	$1,120
59	$2,240
66	$4,480

Saving $16,000.00 in an IRA, investing the tax savings and having those savings grow to $4,480.00 looked great. I then combined the two charts:

Age	IRA savings at 10%	Tax savings at 10%
45	$ 2,000	$ 560
52	$ 4,000	$1,120
59	$ 8,000	$2,240
66	$16,000	$4,480

Now this person turns 66 years old and wishes to withdraw $16,000.00, along with other savings. Miraculously, they are still in a 28% tax bracket at the time of withdrawal. His accountant reminds him that he has to pay taxes on it at withdrawal.

Interestingly, the tax due on that $16,000.00 withdrawn is $4,480.00. Exactly what was saved in the tax savings account? Over the 21 years of saving in my example, $784.00 had to be paid in capital gains taxes. This lowers the tax savings account to $3,696.00. Now this person had a tax due of $4,480.00 and had $3, 696.00 to help pay the tax.

We're Not Done Yet

If you understand the demographics of the country, you will come to the conclusion that you will very likely retire to a higher tax bracket.

Age	IRA savings at 10%	Tax savings at 10%
45	$ 2,000	$ 560
52	$ 4,000	$1,120
59	$ 8,000	$2,240
66	$16,000	$4,480
	Capital Gains Tax	-$ 784
	Savings after tax	$3,696

Tax due at withdrawal:
28% tax bracket= $4,480
35% tax bracket= $5,600
40% tax bracket= $6,400

No one argued my calculation. No one argued the results or even the demographics. Most agreed it will be a problem in the future.

After my example, I spoke to some of the accountants and I asked if they would still recommend IRAs to some of their clients. Some said yes. It is possible that the decisions of these accountants could cause larger transfers of their clients' wealth in the future, unknowingly and unnecessarily.

Tax A Derby

If I can tell you the exact day that your qualified retirement account will suffer its greatest loss, would you want to know that day? And in knowing that day, if we could do something now to prevent these losses, would you do it?

Taxes are the largest transfers of your wealth. The day you activate your qualified retirement account is the day that it will suffer its greatest loss, due to <u>taxation</u>, not because of losses in the stock market. 100% of your qualified retirement income becomes taxable. Congratulations, you've become the perfect taxpayer.

What We Have Here Is A Failure To Communicate

You may consider other complications that surround qualified plans. Many people suffer from a lack of liquidity, use, and control of their money. Qualified plans limit the amount of access you have to your money. If this is the only source of your savings you may consider diversifying into more non-qualified accounts also. Limiting your access to your money may also limit your options and opportunities in the future.

If you ask what would happen if you were to take money out of your IRA before the age of 59½, what would the typical response be? You will be taxed on the amount you took out and penalized 10% of that amount for early withdrawal. Tax professionals consider this a major no-no. They will tell you if you wanted to withdraw $1,000.00 and you were in a 28% tax bracket that you would lose $280.00 in taxes and be penalized $100.00 to boot.

Let's get one thing straight. You were going to get taxed on this money either now or later. The thought that you will lose money for early withdrawal by being taxed for it is misleading, since it will be taxed no matter what. Perhaps if you study the demographics of the country, once again you may come to the conclusion that there is a possibility you will be taxed on that money at a higher rate. The 10% penalty on the early withdrawal is a reality, unless . . .

Have You Heard This One

Accessing IRA funds before the age of 59½ without incurring the 10% penalty is permissible under the IRS notice 89-25-IRB 1989-12.68 section 72t by using one of the three following distribution methods: 1)Life expectancy; 2)Amortization; and 3)Annuitization. The life expectancy method simply calculates the amount which can be withdrawn annually, by dividing your account balance by your life expectancy based on tables furnished by the IRS. The second method is amortization, which allows you to amortize your account balance based on a projection of what your account might earn over your lifetime. The IRS requires that the interest rate assumed in this calculation be "reasonable." For the annuitization method, the IRS also allows withdrawal based on a life insurance mortality table (UP-1984) and a "reasonable" interest rate assumption. This method normally generates the largest withdrawal.

If something you thought to be true wasn't true, when would you want to know about it? It <u>is</u> possible to avoid the 10% penalty for early withdrawals from an IRA.

In the event you have a 401(k) and lose your job or retire early, transferring your 401(k) to an IRA will allow 72t distributions. 72t does not apply to 401(k)s directly. Remember, in using qualified programs the real concern along with market results, is the future taxation of these plans. If you are depositing money while in the current tax bracket, but may have to pay a higher tax in the future, is this a good strategy?

IF SOMETHING YOU THOUGHT TO BE TRUE <u>WASN'T</u> TRUE,

WHEN WOULD YOU WANT TO KNOW ABOUT IT?

On Trial: Financial Beliefs

What is on trial here is a belief system: The fast paced, get-rich-while-you-can mentality, where the solution is based upon products, not knowledge. There is nothing wrong with most investment products, but products are not the only answer to securing your financial future. We have become so mesmerized by rates of return, we fail to use common sense, which costs us a lot of money. Have we become so busy that we just look the other way when giving away our money? I believe we have been systematically trained to do just that. From our education system, to banks, brokers, investment companies, the government to tax preparers, we are told very little about how to manage our personal finances. But we are blindly guided down this narrow path and eventually left hanging out to dry, for one reason and one reason only: So that others can profit.

Relying On Stupidity

I can't blame these institutions and companies for wanting profits. If the public is willing to freely give away their money, then more power to them. No one is being forced to do anything. The concept of making money out of nothing is ingenious. Motivated by the emotions of fear and greed, love and hate, people will freely throw money away. If anyone dare throw common sense into this mix, they would probably be labeled as cold and calculating. As long as people are willing to give their money away, someone will take it. One thing I am positive of: this will never change. PT Barnum said it best, "There's a sucker born every minute." People have been duped so long, they are afraid of change in the fear of being duped again. The only thing that will stop this madness is knowledge. Until that happens, billions of dollars will be made from us, the public, by simply relying on our stupidity.

Financial Puppets

Because of this lack of knowledge, you will, willingly or unwillingly, stay financially tied to these institutions for the rest of your life. The money you will transfer away is enormous. Reducing these transfers will help create personal wealth for you. Achieving some financial freedom in your life should be a personal goal. If financial institutions had their way, you would remain captive to them forever. For that reason, they don't want to educate you too much. Rather, they want to create a dependency on them.

POVERTY PLANNING:
IT TAKES NO TIME
IT TAKES NO EFFORT
RESULTS* ARE GUARANTEED
*Results may vary depending on luck

All too often I see people doing the very basics, financially. Their heads buried in the sand, they take the ostrich approach to planning. The "wait-and-see" retirement strategy suits them well. Then, with this limited or non-existent knowledge, they attempt to survive in a world created for them by the government. They have been told that their pension and retirement savings will be enough to live on in their golden years. Let us not forget social security. But the ever-increasing cost of living, increased taxation and increased cost of insurance, drains the basics of their planning away. They all too often end up looking for part-time jobs after retirement. Pride, fear, and laziness fuel the ignorance of poverty planning. They received financial advice from their friends and neighbors, but remain skeptical of anyone with professional knowledge. They work and work and never get ahead. Unfortunately, these are the same financial lessons they pass on to their children.

Tax Cuts And The Rich

Another common misconception is that tax cuts are for the rich. This is nothing more than political "get-me-re-elected" talk. It is obvious that the rich make up such a small portion of the tax paying population, the politicians view this as a small group of voters. There are more poor, middle class, and upper middle class voters then there are rich voters. So don't be surprised when a politician favors the area where there are more voters. The tactic is as old as dirt. Divide and conquer, blame someone else for your problems, so you will vote for them. These are not poor or middle class people running for office. Remember, these people will spend millions to get elected to get a position that pays a couple of hundred thousand dollars a year. Makes sense, right?

I would like to compare our system of paying taxes to ten people going out to dinner. The common belief is the rich get more back than us ordinary tax payers and that is not fair. The reality is, the rich pay more so they <u>should</u> get more back.

If ten people went out to dinner, and when the bill came we used the rules of the tax code to pay this bill, it would look something like this: The bill for dinner for ten came to $100.00; Persons #1 through #4 would pay nothing; Person#5 would pay $1.00; Person #6 would pay $3.00; Person #7 would pay $7.00; Person #8 would pay $12.00; Person #9 would pay $18.00, and; Person #10 (the richest person) would pay $59.00.

If the restaurant owner decided to give the group a 20% discount, the dinner for 10 is only $80.00. How should they divide up the $20.00 savings? Remember, the first 4 paid nothing to begin with, so the savings should be divided between the remaining six. Twenty dollars divided by six equals $3.33 each. If you subtracted that amount from those six people's share, then persons #5 and #6 would be paid to eat their meals. This doesn't seem fair, so the equitable answer is to reduce each person's bill by the same percentage. The results look like this: Persons #1 through #5 would pay nothing; Person #6 would pay $2.00; Person #7 would pay $5.00; Person #8 would pay $9.00; Person #9 would pay $12.00; Person #10 (the richest person) would pay $52.00 instead of $59.00.

Now everyone starts comparing and complaining. Person #6 complains because he only got $1.00 back and Person #10 got $7.00 back. "Why should he get $7.00 back when I only got $2.00?" shouted person #7. "Why should the wealthy get all the breaks?" Person #1 through #4 yelled "We didn't get anything back. This system exploits the poor!" Then the nine people surrounded Person #10 and beat him up. That seemed to satisfy them. The next time they went out to dinner, Person #10 did not show up, so they sat down and ate without him. When they were finished the bill came and they discovered they were $52.00 short.

The people who pay the highest taxes get the most benefit from a tax deduction. It's common sense math. If you tax them too much and attack them for being wealthy, they may decide not to show up at the table anymore. For everyone involved that would create an unintended consequence. <u>Everyone</u> would have to pay more.