J. Rob Jones

How To Plan For A Totally Income Tax Free Retirement

It's been said the only two certainties in life are death and taxes. So, what's the best strategy for preserving retirement savings and avoiding taxes on its' future growth? Obviously, I can't help you avoid physical death; I can help you avoid paying taxes on retirement savings. Many people made the decision to accumulate for their retirement years by depositing into pre-tax programs such as IRAs, 401K's, SEP's, TSA's, 403b's etc.

Though these programs provide excellent tax protection during accumulation phase of retirement savings but unfortunately; tax protection under these programs provides only temporary deferment; not permanent avoidance. The future awaits you with a tax bill on both principle investment and return on investment; most likely higher than what you are prepared for.

Some of the reasons higher taxes are an almost certainty for our future include our tax history which show an average tax rate of 60% since taxes were first introduced as a temporary tax in 1913. It also includes our massive debt load, the interest on our debt, our unfunded liabilities for entitlement programs, pension guarantees and the like, the amount of money we spent on stimulus plans, bailouts, and the countless numbers of wars we've financed on a credit card.

To get a sense for how bad tax rates could be in the future, the Congressional Budget Office projects that if "Social Security, Medicare and Medicaid go unchanged, the rate for the lowest tax bracket would increase from 10% to 25%; the tax rate on incomes in the current 25% bracket would have to be increased to 63%; and the tax rate for the "former" highest bracket of 35% would have to be raised to 88%."

So if you agree with me that taxes will be higher in the future, the next question is how do your beliefs line up with your actions? In other words, are you accumulating money in the right kinds of investments to prevent you from suffering from significantly higher taxes in the future? Over the years after meeting with clients planning for retirement, I've met few people who are actually accumulating money in the right investments to avoid this ticking tax time bomb. From a tax perspective, there are only **3 types of investments or "tax buckets** that you can accumulate money in.

(1.) Taxable Bucket: This would include any investment that generates a 1099 each year requiring you to pay tax on the growth of that investment. CD's, Stocks, Bonds and Mutual Funds certainly fit the bill. Since these generate a tax bill for you annually, the question is why have them in the first place? The answer lies in the fact that they are generally very liquid and as such make for good emergency reserve funds. Having too much money in these accounts, can cause you to experience unnecessary wealth transfers in the amount of taxes you pay. So the goal is to only maintain an ideal balance in these accounts. For an emergency reserve fund, many financial experts agree you need about 6 months of living expenses. So, that would be the ideal balance we want to see in this bucket from a tax perspective.

(2.) Tax Deferred Bucket: This includes any investment where the growth isn't taxed currently, but rather deferred until some later point in time, like at retirement, where the distributions are taxed as ordinary income. Qualified Plans like IRAs, 401K's, SEP's, TSA's, 403b's are good examples.

There are two primary goals in arriving at an ideal balance in this bucket. The first goal is to manage the growth of money in these accounts such that when you are forced to take distributions from the account at age 70.5, those distributions are only equal to what your projected tax deductions (probably just your standard deduction and personal exemption) will be at retirement.

A 55 year old married couple in 2014 can take a standard deduction and personal exemptions that total $20,000. At 3% inflation, by age 70.5, the projected tax deductions from both of those items would be about $32,000, which would be the maximum amount we would want them to take as distributions so as to end up with ZERO in taxable income for the year.

The second goal would be to limit contributions to these types of qualified plans to just enough to get the full company matching contribution. Why? Because it's the matching contribution that helps you pay future taxes which would probably be at higher rates than your funding years.

(3.) Tax-Free Bucket: These are investments with 2 characteristics. First, they are free from any federal, state or capital gains tax. Second, they don't cause your social security income to be taxed at retirement. Hence, the ideal balance in this bucket is really unlimited. Good candidates include ROTH 401K's, ROTH IRA's, ROTH Conversions, Non-Deductible IRA's that are converted to ROTH IRA's, and Life Insurance Retirement Plans (LIRP's).

The beauty of planning for a total income tax-free retirement, is when you accumulate and plan properly for a tax-free retirement, you could have diverse streams of income at retirement from:

- A Roth 401K which would be non-taxable
- A ROTH IRA which would be non-taxable
- A ROTH Conversion which would be non-taxable
- A Traditional IRA or 401K with distributions equal to your tax deductions at retirement which would also be non-taxable
- A Non-Deductible IRA converted to a ROTH IRA which would be non-taxable
- A Non Modified Endowment Contract which would be non-taxable (immediately).

• Social Security which would be non-taxable by virtue of your other sources of income being non-taxable or under the provisional income limitations

While owning any number of these tax-free bucket candidates requires that you pay the tax today to do so, I think you would agree that income taxes, like mortgage rates, are at an all time low. Paying taxes today to avoid paying twice or three times that amount in the future is certainly a financially prudent thing to do. Apply these principles to help you win the money game and enjoy a totally income tax-free retirement!

For more information on financial products and services, Contact:

2015 Spirit Financial/Contact Us

http://www.spiritfinancial.biz