A Tax-Effective Retirement Plan

The Dangers of Tax Deductions

Written by Ali Nasser and Geordie Hrdlicka *March 16, 2012*

As tax day approaches there is usually one thing on everyone's mind: "How can I get the most deductions and pay as little as possible." However, when it comes to your retirement and investment planning, you'll want to consider more than just immediate tax benefits before pulling the trigger. In some cases, tax deductions can create negative consequences in the future.

Historically speaking, tax-deductible retirement plans have been very effective strategies. These plans, such as 401(k), were first introduced in the early 1980s to help participants save money for retirement while also saving on taxes. The concept was ideal: Take a tax deduction now and drop your tax bracket; invest and grow your account tax-free; then, when you retire, you can withdraw the money while in a lower tax bracket. This worked wonders in 1980 as the tax bracket for couples earning over $215,400 was 70%. A participant could take a tax deduction at 70%, then, assuming they retired today, they could withdraw income at a top tax rate of only 35%, generating a 35% tax savings. Great Deal!

Times have changed but the habit of taking a tax deduction has not. Today, with tax brackets being at historically low levels, there are several key factors to consider:

1. With all of the fiscal issues surrounding government programs what might happen to tax rates? Could they potentially go up?
2. How much retirement income will I need, and where will it come from?
3. What is your tax diversification plan to protect your money if tax rates increase to historical levels?
4. How can you develop tax savvy planning strategies while still protecting yourself against the risk of increased tax rates?
5. What are your retirement accounts really worth if tax rates go to 45%, 55%, or 65%?

In many cases tax deductible retirement plans may be a very good choice. It all depends on your personal circumstances, retirement income, asset values, business interests, existing plans, and other objectives. However, it's very important to evaluate your investment and retirement tax plan in advance. The sooner the strategies are implemented the better chance of success.

** Any tax advice contained herein is of a general nature. Further, you should seek specific tax advice from your tax professional before pursuing any idea contemplated herein. This advice is being provided solely as an incidental service to our business as (insurance professionals, financial planner, investment advisor, securities broker)*