RICHON INSURANCE & INVESTMENT

# WHY YOU ARE NOT MAKING THE MOST OF YOUR 401(K)

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**This report will reveal the secrets of…**

**Why you're not actually saving for retirement,**

**Why you're definitely not saving on taxes and**

**Why your 401(k) puts your Social Security in jeopardy.**

**And will also provide you with solutions that make retirement more secure, by minimizing taxes, making retirement income easier to produce and understand (and letting you keep more of your money) and helping to answer the question, "Do I have enough?"**

So, you're doing everything you've been told to do to prepare for retirement. You're paying yourself first. You're automatically contributing to your company sponsored retirement plan. You're capturing your company match. You've even gotten some life insurance to take care of your family, just in case you don't make it there. Hopefully you will but, is your 401(k) really the best thing you could be doing to get you there?

## WHAT WE'VE BEEN TOLD

Here's what we've been taught: You should put the first 10% of what you earn into saving for your future. Of that savings, you should be sure to put at least enough in to capture any "free money" match to contributions offered your company. By contributing to the company plan, you are "saving" for retirement. You are also "saving" on taxes. During the last several years of your working career, dump as much as you can in and "catch up" on any missed contributions, or if you feel you are behind. When you finally retire, growth on the contributions (and any company match) will provide you with the means supplement Social Security and support a comfortable retirement, where you will be paying lower taxes than you did while you were working.

## REALITY CHECK

Here is the reality of each one of those accepted axioms of retirement planning and why we should potentially reconsider what we think we know.

- **Saving 10%**

Let's break this down with some simple math. If we work and save for a 30 year career, saving 10% of what we make each year, by the end of that time we have a whopping 3 years worth of income saved. By the way, you probably made significantly less in the first several years than you did in the latest years of your career, but let's ignore that. Let's say you earned $100,000.00/yr. over all 30 years and saved 10%, or $10,000.00/year. After 30 years, you have contributed $300,000.00, the equivalent of 3 years worth of the income you are accustomed to making. If we had reasonable returns, along with some company match, and managed to double our money two times, we would have a sizable $1,200,000.00. But, is this

enough to sustain a 20, 30, 40 year retirement for someone who is used to making $100,000.00? The broken "4% Rule" (search Google for "4% Rule" to see many reports on why it is broken) would suggest that from a nest egg of that size, one should be able to generate an income of $48,000.00/year. Less than half of your working career income, at a time that you are hoping to relax and enjoy life and treat every day like a vacation. Perhaps we should consider trying to save more aggressively, or at least more effectively.

- **Capture the "Free Match"**

Ever heard the saying, "Nothing in life is free" or "There is no such thing as a free lunch?" Well, while it is accepted and promoted by the financial industry that these age old wisdoms are somehow not true in this particular case, they are. There is certainly no such thing as "free Money." That money is yours. You earned it. You worked for it and it is part of your overall compensation. This particular piece of your compensation is offered as an incentive and may only be received contingent on you also contributing a portion of your base pay to a company sponsored retirement savings plan. Furthermore, this money still is not "free." The company may match but, they do so pre-tax. They are not paying your taxes for you out of the goodness of their hearts. Effectively, they are transferring their tax liability onto their workers for the dollars the company contributes and deducts from their profits. So, over time, as your balance grows, so does the eventual cost of this "free money." The larger your balance of tax-deferred dollars at retirement (whether contributed by you or matched by the company), typically the more you will ultimately pay to Uncle Sam in taxes over your retirement. And you have to account for this tax liability out of your retirement account balance, rather than out of your paycheck as you did when you were working.

- **You are "Saving" for retirement**

This one may be splitting hairs and really is just a matter of truly understanding the difference between and definition of specific words. Saving does not involve the possible risk of loss of principal. When you "save" the money is safe. 401(k)'s notoriously have limited and overwhelmingly poor options for keeping your dollars safe and protected.

The reason being is that the companies sponsoring and administrating these plans are Wall St. based and make their respective fees only by keeping assets at risk in the market. What the vast majority of those "Saving" for retirement are actually doing therefore is "Investing" for retirement. The assets in your 401(k) are typically at the risk of whims and fluctuations of the market. At certain points this is appropriate, because we are hoping for higher returns than what safer options may offer and typically have a longer time horizon but, it is still important to understand the definition and the difference between saving and investing and what the potential results of each may be.

- **You are "Saving" on taxes**

Short term pleasure, long term pain. That's what most people experience when they "save" on taxes with contributions to a tax deferred savings plan. In fact, let's just correct that word. You do not save on taxes. The IRS is not forgetting that you didn't pay your tax on those dollars you earned and tucked away. Unfortunately however, many people forget that they didn't. So, let's call it what it is; you "postponed" paying taxes. What's more, you postponed it from a time when you were earning a paycheck with which to pay it and at a known tax rate, to a time that you will likely be forced to pay those taxes not out of a paycheck, but from your retirement account balance itself and, the tax rate your will be paying is yet to be determined and could change at any time. Let's get real. This country is $20,000,000,000.00 in debt. Twenty trillion! There is a decreasing workforce earning stagnant wages that has to account for an increasing population of retirees collecting benefits. The debt has been serviceable only because of our prolonged period of historically low interest rates. What happens to taxes when those collecting benefits becomes equal to or greater than those contributing? What happens if interest rates rise, making the amount of interest that debt costs us a larger percentage of the total tax revenue? Do you think that the $27 Trillion dollars currently invested in tax-deferred retirement savings accounts might become a target?

Several years ago, the small country of Cypress shuttered bank doors for a week. When citizens were finally able to again access their accounts, there was less money in them. The government had confiscated bank held

assets in order to help pay for government operations and obligations. People here were worried. Could the same thing happen in the US? Well, it doesn't really have to. To accomplish the same goal of harvesting more money, all our government has to do is incrementally raise tax rates on money that has already been earned and they will accomplish the same thing.

IRA stands for Individual Retirement Arrangement. Do you know who controls all terms of that arrangement? It's not you! It's your non-blood relative, Uncle Sam. And he can vote himself a larger share of your retirement any time he wants. That is the arrangement of the deal you agree to when you postpone paying taxes.

Let's put this another way. If you have ever "owned" a home, you probably had a mortgage and took a deduction for the interest you paid on that mortgage each year. By taking that deduction, neither the bank nor the government had ownership stake of your home. Once it is paid off, you own it. …But, what if you didn't? What if every time you took that deduction, the government owned a little bit more, and a little bit more of your home? And finally, when it was all paid off, and you did truly own the home, the government came and said, "Not so fast. Since you took that deduction, we now own a portion of your home." Would you take that deal? Probably not. Especially since we don't know what portion they would ultimately own. Well, that is the exact same arrangement you make when you take a deduction and defer paying taxes on your retirement savings. In fact, for many people, the amount they owe in taxes from their retirement account may be more than their paid off home is worth by the time they retire.

There is an assumption that taxes will be lower in retirement or that we will pay less in taxes in retirement. There is nothing in the tax code, or that I have seen in real life that dictates lower taxes in retirement unless we have significantly less income in retirement. So, is your goal to have significantly less income in retirement? Maybe we need to rethink that.

As stated early, the simple mathematics of our economy, with our debt and deficits, with our entitlement programs and benefits, may ultimately dictate the direction of our tax environment into the future.

But, let’s assume I am wrong…

Let’s assume that what we have heard is true. Let’s assume that we will in fact, pay lower taxes in retirement. Does that mean that we have “saved” taxes?

Table 1

| Contributions | Pre-retirement traditional 401(k) | | | Pre-retirement Roth 401(k) |
|---|---|---|---|---|
| 25% Tax Bracket | Contribution to 401(k) | $10,000.00 | | $10,000.00 |
| | Amount Paid in tax | $0.00 | | $3,333.00 |
| | Amount in account | $10,000.00 | | $10,000.00 |
| | x10 Years Total Contributions | $100,000.00 | | $100,000.00 |
| | Total Taxes Paid while working | $0.00 | | $33,333.33 |
| | Good returns (11.4%) | $200,000.00 | | $200,000.00 |
| **Withdrawals** | **Post-retirement traditional 401(k)** | | | **Post-retirement Roth 401(k)** |
| 20% Tax Bracket | Income Need | $40,000.00 | | $40,000.00 |
| | Withdrawal | $50,000.00 | | $40,000.00 |
| | x4 Years Withdrawal | $200,000.00 | | $160,000.00 |
| | Amount paid in tax from retirement nested | $40,000.00 | | $0.00 |
| | 5th Year Income | $0.00 | | $40,000.00 |
| **Effects on Social Security** | | | | |
| | Individual | 85% Taxable | | 0% |
| | $2,000/mo benefit | $1,700.00 Taxable | | $0.00 Taxable |
| | Net Benefit | $1,660.00 | | $2,000.00/mo |
| | Annual tax on Social Security | $4,080.00 | | $0.00 |
| | Married | 50% Taxable | | 0% |
| | $3,000/mo combine benefit | $1,500.00 Taxable | | 0% |
| | Net Benefit | $2,700.00 | | $3,000.00/mo |
| | Annual tax on Social Security | $3,600.00 | | $0.00 |

Hypothetical illustration for presentation purposes only. Actual investment experience will vary with stock selection and changing market conditions.

Take a look at the chart above. It indicates that an investor in the 25% tax bracket is putting $10,000.00 dollars away, each year over 10 years into a taxed deferred 401(k) each year. It compares this to paying the tax and putting the same amount into a Roth 401(k).

Once in retirement, the tax bracket drops and they are now only paying 20% effective tax on their income. How much do they “save” while working and what does that cost them once they retire?

Given these assumptions, the $33,333.00 “savings” while working, ended up costing this individual $40,000.00 and an additional year’s worth of income in retirement. Also note the additional impact on the amount of Social Security this individual was able to keep (which of course would mean we have to pull even more income from our own funds to meet budgetary expenses).

So, just remember that as you contribute to a tax-deferred plan, and as those contributions are matched and hopefully grow over time, you are not necessarily “saving” on taxes, as we have been taught. The more that account grows while we have a paycheck, the more you will ultimately be liable for to pay in taxes when you don’t.

The number one fear of retirees is running out of money. We believe that fear is legitimate for most. If the current methods of retirement planning were effective, then why would we have this concern? The 401(k) does not reduce or address this concern. Due to the myths and misconceptions we have been taught, the results of the way we are planning may actually increase these concerns.

If you would like to evaluate your current retirement planning, or review strategies and options available that will help you keep more of your hard earned dollars and potentially produce more income you get to keep in retirement, we welcome you to call Richon Insurance & Investments today for a complimentary review and evaluation of your plan.

We provide the ability to receive professional oversight and guidance with the money in your current company retirement plan while you are still working. We can also assist with strategies to simplify planning and take control if you have left accounts at previous employers or have reached age 59½. Call today for a complimentary discussion of your financial goals and opportunities to be better prepared for retirement.

## About the author:

Peter Richon is president and CEO of Richon Insurance & Investments. He has been providing retirees and pre-retirees financial guidance to secure their lifestyle and manage their planning for over a decade. Peter has an understanding of the potential obstacles in the way of a secure financial future and has developed practical strategies for dealing with the difficulties his clients face. Peter has been heard on local and national financial talk radio programs providing insight for over 15 years, even prior to becoming a licensed advisor himself. It was through this experience that he realized he wanted to help educate people on how to build true financial security. He is an Financial Advisor with a fiduciary responsibility to his clients and their interests. He has been featured in books, articles and interviews on television news for his financial insight and opinion. He assists advisors across the country with improving the financial education of the people in their communities and spends his spare time coaching his son's sports teams, volunteering at his church and enjoying life with his family.

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