# A Backwards Look at Retirement Planning

**Here's what the distribution phase can teach us about the accumulation phase.**

BY BRYAN M. KUDERNA



Approximately 10,000 Baby Boomers are turning age 65 every day. If you are one of my usual followers or readers of Millennial Millionaire, you are probably expecting a gloomy, yet realistic, diatribe on the downward pressures this generation will impress upon social security, pensions, healthcare, etc. I am excited to throw you a curveball. As the Greatest Generation gives way to the most expensive generation, let's learn from this unfolding case study.

The defined benefit pension made famous by our Baby Boomer parents is nearly extinct (less than 4% of private employers now offer a pension).[1] The Employee Retirement Income Security Act prepared America for this day by creating the Traditional IRA in 1974, followed by The Revenue Act of 1978 which gave birth to the 401(k). These two acts of legislation quietly asked America to pave their own way towards retirement.

Thanks to mainstream media and a fortune spent on marketing by employers and financial institutions, the 401(k) and IRA have now become synonymous with retirement planning. Congress ramped up the message via The Pension Protection Act of 2006, which incentivizes employers to auto-enroll their employees into their company 401(k). To quickly recap—the 401(k) currently allows an employee to defer income up to $18,500 (this will increase to $19,000 in 2019) and allows employees over age 50 to add an extra catch-up contribution of $6,000. The traditional IRA offers up to a $5,500 pre-tax contribution (going to $6,000 in 2019), plus an extra $1,000 for those over age 50.

**The defined benefit pension made famous by our Baby Boomer parents is nearly extinct.**

So why does everyone do it? The most popular reason is that contributions are pre-tax, meaning they will lower your taxable income for the year; accountants by and large love this trait as it can generate a larger tax refund. Employer-sponsored plans like the 401(k) may provide a company match which can be a very valuable perk. Lastly, retirement plans through work are accessible and user-friendly—contributions never even touch your pocket as they are payroll deductions.

### Tax Saving is Really Tax Postponement

However, what is often explained as a "tax savings" is not a savings, but rather a compounding tax postponement to an undefined tax rate possibly 40 years away. In addition, funds within these accounts generally cannot be accessed without penalty before age 59.5, aside from select hardship provisions or loans. Furthermore, distributions from such plans can create a "tax torpedo", not only elevating a retiree's tax bracket, but

*Continued on page 54*

© Stephanie Kloos Donoghue

*A Backwards Look* *(from page 53)*

also subjecting social security income to be taxed at a higher rate, Medicare premiums to be increased, opportunities for children's college financial aid (FAFSA) to be denied, and possible exposure to a 3.8% Medicare surtax for high net worth individuals.

The guiding factor for many of these extra taxes is your MAGI (Modified Adjusted Gross Income). There are a few select income sources that are considered exempt from MAGI calculations. They are Roth IRA and Roth account distributions, HSA (Health Savings Account) distributions towards qualified medical expenses, withdrawals or loans from cash values in non-MEC life insurance policies, tax-free withdrawals from non-qualified annuities, or a reverse mortgage.

Recognizing the unexpected pains many retirees experience drawing down their pre-tax retirement plans and their greater appreciation for post-tax assets should clue in the current workforce to take a second look at how they're saving. The advantages of the aforementioned vehicles... potential tax-free distributions, greater liquidity, and MAGI exemptions should be considered. Not only should investors diversify their allocation, but also diversify their accounts to provide greater flexibility for when it may be needed most. **PM**

**Not only should investors diversify their allocation, but also diversify their accounts to provide greater flexibility for when it may be needed most.**

**Reference**

[1] https://money.cnn.com/retirement/guide/pensions_basics.moneymag/index7.htm

**Relevant Websites**

www.thewhitebook.net
www.kudernafinancial.com
www.amazon.com/author/bryankuderna

**Bryan M. Kuderna** is a Certified Financial Planner™, Life Underwriter Training Council Fellow, and Investment Adviser Representative with Kuderna Financial Team. He is a perennial qualifier for the industry's prestigious Million Dollar Round Table®, Leaders Club, and Inner Circle. He is the author of the best-selling book, A Guide to Become a Millionaire by 30.