

Roth IRA, 401(k) offer a better tax timetable

Tax-free contributions now postpone a future tax burden, but taxable Roth IRAs and 401(k)s are tax-free at retirement

Thomas J. O'Connell, Correspondent | May 31, 2016



I know I sound like your parents, harping on you to save for a rainy day, but it's for a good reason. A study published on May 16 by Bankrate.com found that the overwhelming No. 1 financial regret that older Americans have is "Not saving for retirement early enough." The No. 2 financial regret was "Not saving enough for emergency expenses." This should show you that even your parents wished they had someone like me harping on them.

Let me ask you a few questions. Which do you think is better to have, taxable money or tax free money? Do you think you'll be making more money in the future or less? Do you think taxes could be higher in the future? A lot higher? Do you think you should pay taxes on a little bit of money (the seed) or on whole pile of money (the harvest)? Do you think there will be inflation in the future?

Here's why I ask all my clients these questions, because the traditional way you're being told to invest money is wrong! Everyone, from the brokerage houses to the government, tells you to sock away as much in your 401ks and IRAs as possible because you'll save on taxes and get tax breaks. It's not true. When you invest money in a 401k or IRA you only postpone a tax obligation into the future so you really don't get any breaks. So back to my questions; if you think you're going to

make more money in the future that means you'll be in a higher tax bracket paying higher taxes. If you think taxes could be higher in the future that means taxes are on sale today. And, if you think there will be inflation in the future, your dollar will have less and less value in the future.

Why would anyone want to postpone paying taxes today, in a low tax environment (you're earning less), on a small contribution (your seed) while your dollar is worth a dollar so that they can pay higher taxes in the future (you're making more and taxes are higher) on a whole pile of money (your harvest) when inflation has caused your dollar to only be worth say 50 cents? It's illogical.

You have two alternatives, the Roth IRA and Roth 401k. If you're working for a company that has a 401k, 403b, 457 plan most of them now have the option for your contribution to go into the Roth 401k, Roth 403b or Roth 457. That means you'll pay tax today on your contribution (the seed) and get your pile of money tax free in the future (the harvest)! Trust me, tax free is ALWAYS better. Don't worry, you won't miss out on any matches, the company will still match but their piece has to go into the tax postponed part of the plan. If you don't work for a company that has a plan, and you are within the income requirements you have the option of having your own Roth IRA instead of a traditional IRA. Again, you'll pay tax on the small amount you put in (the seed) but your pile of money will also be tax free (the harvest). Trust me, tax free is ALWAYS better.

I don't like to say think out of the box because for some people that has a negative image. I want to educate people so they have a bigger box with more options to choose from. So here's your choice, do you want tax free money in the future or do you want to owe the government an unknown amount in the future? Now you have the knowledge to make the right choice for you.

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