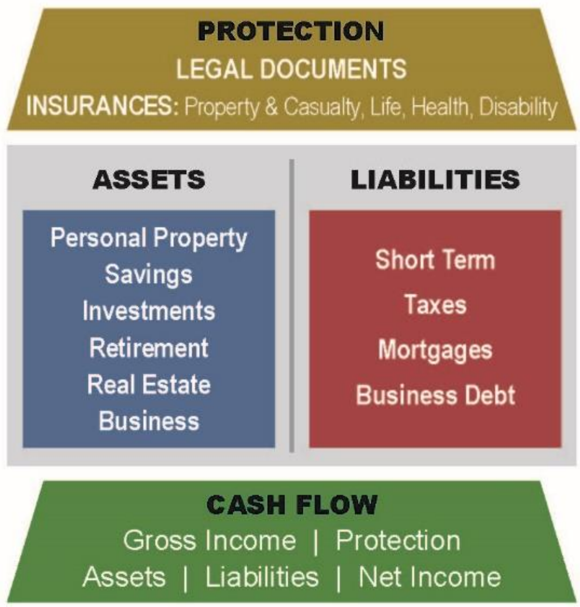
How much of your 401(k) account belongs to you? The answer might surprise you.



If you've been following my articles about my hypothetical clients Bob and Lisa, you'll know that we've been focusing our initial work on the four financial domains that encompass every factor of their financial life – Protection, Assets, Liabilities, and Cash Flow. Each domain has a specific philosophy of care, or set of guidelines, that drives my work with Bob and Lisa. At our most recent meeting, we spent time talking about their **Liabilities Domain**, where we want to **1) eliminate debt, 2) minimize or avoid taxes, and 3) exploit the time value of money.** In this article, I'll focus on taxes.

When I asked Bob and Lisa how much of their 401(k) balances belonged to them, they looked at me as if I had two heads and said, "Well, all of it. It's ours." "What about the tax you'll owe when you start taking that money out of your accounts?", I replied. "Oh, yeah, taxes," said Bob, "I forgot about that. Bummer." Bummer is right.

One of the biggest liabilities Bob and Lisa could face is the potential tax burden on their investments. When I work with folks like them, who are saving and investing money for long-term goals, such as funding retirement income, I try to minimize taxes now and in the future. The conventional wisdom is often to "defer, defer, defer" the tax burden as far as one can into the future. There is nothing wrong with that strategy, and a pre-tax IRA or a 401(k) plan is, for many of us, the cornerstone of a sound retirement plan. However, as I explained to Bob and Lisa, money that is distributed from a pre-tax investment is taxed the same as ordinary income. Who wants to pay a bunch of taxes in retirement after 30 years of saving? Plus, many of us think we'll be in a lower bracket during retirement, and that our tax burden will be less. How can we know that? What if we aren't? What if tax rates need to go up so the national debt can be paid off? So, when Bob and Lisa finally retire and start spending their money for income, I want some of it to be as tax-free as possible. A simple strategy might be to, first, pay the tax now, while marginal rates are some of the lowest in U.S. history, rather than defer them to the future, when they could possibly revert to heights we saw in the 60s, 70s, and 80s. They can do this by putting money into an after-tax investment account. Or, they might consider funding Roth IRAs, using after-tax money now and then taking the funds out tax free during their retirement years. Or, they might choose a cash value life insurance policy, which can serve as a source of tax-free cash during retirement, and provide a death benefit.

Any way they do it, tax minimization, to me, is a big part of financial success. If you would like to learn more about how taxes and other liabilities might affect your financial future, call me for a complementary meeting.

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This is a hypothetical example and is not representative of any specific situation. Your results will vary. A Roth IRA offers tax deferral on any earnings in the account. Qualified withdrawals of earnings prior to age 59½, or prior to the account being open for five years, whichever is later, could result in a 10% IRA penalty. Limitations and restrictions may apply.

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