

Oops, I Goofed!

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Boy, did I make a big boo-boo! I want to apologize to all of you who read my article "More Taxes? Yuk!" in the April 20, 1998 issue of *Dynamic Chiropractic*. These errors were made by me, and all I can say is that I goofed big-time. It was an honest mistake, but a stupid one. I received a letter from a financial advisor who read my article and accused me of "blatant manipulation." I am not aware of that "technique," nor is it taught at the colleges where I teach! Please accept my apology and let me set the record straight.

The planner's first problem was that anyone making a \$30,000 contribution would be making a lot of money and thus would be in a higher tax bracket. He felt, and rightly so, that would enhance the value of a qualified plan. He failed to realize that while it does increase the value of a qualified plan, it also increases the taxes that you would have to pay when you take the money out of a qualified plan. In my original illustration, the qualified plan paid out \$118,615 per year gross, which after a 30% tax rate of \$35,584 left a net of \$83,031. If we raise the taxes to 40% at the suggestion of the planner, the tax bite is now \$47,446, which now leaves only a net of \$71,169, a difference of \$11,862 per year.

If we increase the tax rate, we must also increase the rate on the deposit to the insurance plan. At the 30% tax rate, the \$30,000 deposit took a gross of \$42,857. At the 40% rate, to net the \$30,000 deposit it takes \$50,000, so the tax goes up to \$20,000 per year for 20 years for a total of \$400,000. That's an increase in the taxes on the insurance plan of \$142,860.

Now we get to the point where I made the big error. I ran the investments for 20 years and then compared it to the insurance plan that I let accumulate for 30 years. I even stated that in the article, but I did not catch it myself. For that I apologize again.

Here is an apples to apples comparison after 20 years for both. The qualified plan accumulating at 8% would have a total of \$1,482,687. The insurance plan at 6% would have \$1,029,165. Yes, the insurance plan is at just 6% because that is what they are now paying. Can that go up? Yes. Can the investments in the qualified plan go up? Yes. The difference is \$453,522. I stand corrected. At the 40% tax rate, the qualified plan would have a "net" payout per year of \$71,165 ($\$118,608 - \$47,443 = \$71,165$), while the insurance plan would pay \$50,000 per year. The difference per year is \$21,165.

Now let's do one other step that the planner forgot to ask for. Let's compare the taxes that both plans will now have to pay at the new, higher 40% bracket. The insurance plan, as we have seen, will pay \$20,000 per year for 20 years for a total of \$400,000. The qualified plan will pay no taxes on the front end, but will pay \$47,446 per year on the withdrawals. If that person lives to be 100, that is a total of \$2,135,070! Maybe it's not so good to live a long life! In fact, the person will pay back all the tax savings at the beginning in just 8.435 years. That is based on the insurance plan tax of \$400,000. The longer you live, the more Uncle Sam loves you!

I made another error that the planner did not pick up on. I started withdrawing money from the

qualified plan in 20 years; in this case, age 55. Big mistake. Now, in addition to the \$47,446 income tax per year, there is also a 10% penalty for early withdrawal from a qualified plan. That is \$11,861.50 for 4 1/2 years. That's a total penalty of \$53,376.75. Is there a tax on the money taken out of the insurance plan? No. Any penalties? Again, no. Big difference? You tell me!

I will now attempt to put a summary together because I am sure if you did not see the first article, you are totally lost! Total pay-in to both plans: \$600,000. Taxes on pay-in for the qualified plan: \$0. Taxes on pay-in of insurance plan: \$400,000. Difference: \$400,000 to the good for the qualified plan.

Taxes paid on withdrawals from plans to age 100: qualified plan -- \$2,135,070; insurance plan -- \$0, a \$2,135,070 difference. The total tax difference is $\$2,135,070 - \$400,000 = \$1,735,070$. I know that somewhere there is a person screaming that no one will live to age 100 and that I am being unfair with my comparison, so let's only use a person living to 80. Tax on qualified plan payout -- \$1,186,150; tax on insurance payout -- \$0; difference -- \$1,186,150. The total tax difference is $\$1,186,150 - \$400,000 = \$786,150$. We must also remember the difference in the payout each year of \$21,165, which to age 80 is \$529,125. If we subtract that from \$786,150 we are still left with \$257,025. The insurance plan still comes out on top. Should we just forget the tax penalty on the early withdrawal from the qualified plan of \$53,376.65? Yes, I think I can make my point without it!

Let's not forget the other differences, too: no employees to include; no forms to file; no annual fees to keep your plan current and valid; no dealings with the IRS; no concern about future tax law changes that affect qualified plans. You can get to your money at any time without worry about tax penalties. Best of all, there's a savings somewhere between \$700,000 and \$1,700,000 in taxes! Now you tell me, which plan do you like?

The investment professional that caught my mistake said that he has a hard time dealing with the media's periodic inaccuracies and one-size-fits-all approach. It seems like he made some errors, too. He failed to read the last paragraph of my article in which I state: "It isn't new and I have told my clients for years that the best type of retirement planning would probably be a combination of both a qualified and a life insurance policy used as a nonqualified retirement plan." That does not sound like a "one-size-fits-all" approach to me.

One other small oversight is what would happen if the individual died after only one year of contributions to either plan. What would the family get? Qualified plan: \$32,400. That is the \$30,000 plus 8% interest that it has earned. Life insurance plan: \$2,500,000. Difference: \$2,467,600. Not a minor difference.

There you have it. All the apologies and corrections are now in place. I have been doing this column since April 1988 (where have you been all these years?), and I can say that this is the first big mistake I have made. Not too bad for 10 years! I will try not to have another one for the next 10 years. As before, if you have any questions or would like to see the numbers for your specific situation, just follow the instructions at the bottom of the page as so many of your colleagues have, and I do mean many! In other words, keep in touch!

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