

How to Pay Zero Taxes Legally in Retirement

And when you pay zero taxes, you shouldn't be doing it the way most people do it – which is by being broke.

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Are you gambling your retirement savings on the idea that your taxes will be lower when you retire? If so, I've got some bad news. If you have your retirement savings in a tax-deferred retirement account such as a 401(k), IRA or 403(b), you're sitting on a tax time bomb.

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For decades, purveyors of conventional financial wisdom have told Americans to max out their contributions to tax-deferred plans such as 401(k)s and IRAs. "Your money compounds without being reduced by taxes, and you'll end up with more money during retirement" is their common refrain.

But, like much conventional wisdom about personal finance, that refrain doesn't hold up to scrutiny – or even basic mathematics!

According to the Society of Actuaries: "It doesn't make any difference whether [the taxes] are taken away from you at the beginning (tax-exempt) or at the end (tax-deferred). It's the same fraction of your money that is left to you."

And, to make matters worse, the above statement assumes tax

rates will stay the same, but why would anyone assume that?

Taxes are already one of the three largest expenses for retirees, and they are likely to increase in coming years. Pressure from the ballooning national debt, which recently passed \$21 trillion for the first time, and growing government expenditures as more people retire, practically guarantees it.

In short: If tax rates do go up, and you're successful in growing your nest egg, you'll end up paying higher taxes on a bigger number.

Nevertheless, most people look at their retirement savings and think it's all theirs. They forget that they will owe Uncle Sam all the taxes they were able to defer all those years – which means taxes on every penny they've contributed and on every penny of growth.

To fully grasp what that means, consider what tax rates might be during a retirement that could last 30-plus years.

Americans have been told that when they retire, they will probably be in a lower tax bracket. But many folks who have already retired have discovered otherwise. They complain that they're actually in a *higher* tax bracket now than when they were working! This is happening for two reasons:

1. Required minimum distributions (RMDs). RMDs mandate that retirees start drawing money from tax-deferred accounts around age 70½ – whether they want to or not. This often pushes them into a higher tax bracket.

2. The “Social Security tax torpedo.” RMDs and income from various sources can trigger a ‘tax torpedo’ that taxes up to 85 percent of your Social Security benefits. Financial planners and CPAs are seeing some retirees’ tax rates double or more because of this.

But there is a legal way to lower your taxes without going broke ...

As more people become aware of these pitfalls, they are looking for ways to minimize the tax hit they can expect in retirement. One increasingly popular way to do this utilizes a specialized form of dividend-paying whole life insurance to save for retirement, a method discussed by attorney, author and my fellow *Entrepreneur* contributor Mark J. Kohler in a column titled "Why Life Insurance Has to Be Part of Your Wealth-Building Plan." Specifically, he points to the strategy I call "Bank On Yourself."

"The essence of this strategy is to take advantage of the tax-deferred growth on the earnings within life insurance policies by using tax-free loans to access the cash when needed," Kohler wrote. "So you borrow the money from yourself instead of the bank, then pay yourself the interest and repay the loan you took from your policy."

These policies provide a way to save for retirement without your having to worry how much of your hard-earned savings the taxman will take.

How is this possible? These policies are funded with after-tax money, which grows tax-deferred and may be accessed tax-free under current tax law.

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In addition, money from such plans is not subject to the RMDs that can push you into a higher tax bracket.

Income from the policy is also not included when the IRS determines how much tax you'll pay on Social Security income. Nor will that income increase your Medicare premiums, unlike IRA distributions and tax-exempt bond income.

Guaranteed, predictable growth

Unlike 401(k), IRA and other conventional, government-sponsored retirement plans, growth of these plans is guaranteed. Principal and gains are locked in and won't vanish when markets crash. They also offer a return that's significantly greater than what savings, money market accounts or CDs have historically offered. Over time, the return can be equivalent to a 5 percent to 7 percent annual return in a tax-deferred account, but without the risk of stocks, bonds and other volatile investments.

For so long, Americans have been told the nonsense that we have to accept high levels of risk in order to grow a sizeable nest egg. (Can you say oxymoron?) The foolishness of this notion is made all the more clear when you consider the impact of delaying paying taxes on savings.

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Ben Franklin famously said that, "In this world, nothing can be said to be certain, except death and taxes." If, like most folks, you believe tax rates will go higher in the long term, you can eliminate unpleasant surprises by paying taxes upfront. Then, the money in your retirement savings can be truly yours to keep, without its being counted against you.

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