

A Story about Bill

I'd like to tell you a story about Bill. Bill is a fictitious thirty-six year old in upper management with a major corporation. However, it wouldn't matter if Bill was a physician, a small business owner, a lawyer, a farmer, a teacher, or an employee of any company large or small. Though figures would differ, the story would be the same.

Bill's current annual salary is \$150,000. This is the only company he's worked for since he graduated from college (with honors I might add) and in the fourteen years he has been with this company, he has worked his way up from the front lines due to his faithful and diligent effort. He arrives early and is often the last to leave. He's a company man that everyone respects, and he's sought out for advice from both those who report to him as well as his superiors.

Bill has been married to Marcy for 9 years. Together they have three young children – Lori 6, Billy 4, and Scott 1. He loves his kids and though he doesn't get as much time with them as he would like, he wants what's best for them and is willing to help them in any way, including financially. He hopes that each of them will study hard, go to college (a cost he is planning on paying, just as his father had for him), and find a solid job with a great company, just as he was fortunate to find. Secretly, Bill hopes that one or all of his kids will follow in his footsteps and become future employees of his current company.

Bill's company has a wonderful 401(k) program that he has contributed to faithfully since the beginning of his employment. When he first started with the company he heard a presentation by a financial professional who told him the best place to invest his money was in his company's sponsored 401 (k) for three reasons.

First, the presenter said that the company would match up to \$1500 per year. This was free money. All he had to do was contribute. That sounded good to Bill. He'd take all the free money he could get.

The second reason he was told this was the best place to save money for his future was that all the income he contributed was tax deferred. At 22, Bill didn't know what that really meant, but the individual went on to explain that all the money he contributed would avoid tax in the year it was put into the plan. So if he made an annual income of \$30,000 and contributed \$1,500 to the 401 (k) he would only be taxed on \$28,500. And no tax was owed on the money until he took it out at retirement. The more he contributed the more tax he saved.

The third reason the presenter gave him as to why this was such a great investment method was that when he began withdrawing the money in retirement

he would be in a lower tax bracket. Since he would be in a lower tax bracket, he would pay less tax. Again, another exciting prospect in Bill's mind.

Bill has always been good at seeking advice from other professionals so he went to see his CPA as well as one of the top executives of his company.

His CPA told him that investing in his company's 401 (k) was a wonderful idea and that it would indeed lower his tax bill each year. The CPA encouraged him to save as much as he could in his 401 (k), even while his income was small.

The executive Bill visited (who had been a long time family friend) gave him similar advice. He told Bill that the 401 (k) had been the single best investment choice he had ever made. As a matter of fact, it had been the only investment that had really made him money. The executive laughed out loud as he recalled some other investments he had made on "tips" from others – across the board all had been losers.

Bill was really excited to begin his investing career. He had done his homework, he had sought advice, he could avoid taxes now and he didn't have to pay a penny in tax until he began to withdraw money from his account at a lower tax rate. What could be better than that?

After these two visits, Bill made a commitment to contribute as much as he could afford to his 401(k), even if it meant he would have to stretch in other areas. During his fourteen years with the company, Bill had been a diligent saver and had accumulated \$145,000 in his account. Since his income was meager in the early years, and the demands of his young family were growing. Bill was not able to contribute as much as he had wanted, but he is now proud of his growing nest egg. Now that his current income is much more significant, Bill is able to contribute the full maximum to his retirement account will allow. At this rate, and with this continued funding, his benefit statement shows a projected value of \$2,669,414 at the age of 62, which is the year Bill hopes to retire. Since he is contributing so much to his 401(k), he is not able to save any additional money, including money toward his children's college education. This concerns Bill, but he figures that with his current income he and Marcy can cut back on some of their extra living expenses when the kid's college and just pay for each year as the tuition comes due. Bill is 36 and he feels good about his financial future...a financial future that will come to greet him all too quickly.

Let's take a peek at his future, at least in some possible ways it might play out for this shrewd, hard-working individual.

Time has passed quickly. Bill is now 50 and his oldest daughter Lori is a junior in college. It has been a great two years seeing his daughter flourish in a small private university. He has contributed the maximum allowed to his 401 (k) every year for the last eleven years. Bill is proud of his wise savings because his 401(k) now sits at \$848,819 ... he is almost a millionaire.

However, the finances have been far tighter than Bill had expected. Though his income has blossomed to a whopping \$259,751, at 4% increase per year, school costs have escalated far more quickly – a rate near 7%. That means that what was once a \$30,000 price tag for a year of private tuition now demands a whopping \$77,356. He never imagined that one child's college tuition could demand almost 30% of his gross income and almost 40% of his net income. Bill and March have been scrambling for the last two years to try and pay for Lori's tuition out of pocket, but it just wasn't happening. Bill and March have managed to live right up to their increasing income. They have been able to make some cuts, but not enough to pay the entire bill, or even half of it for that matter. Bill doesn't want to tell Lori that she can't attend the college of her dreams, so he knows he'll figure out a way to make it happen.

They have tried looking into financial aid, but with Bill's healthy income they don't qualify. *How can anyone afford to send their kids to college?* Bill wonders.

After they had been rejected by the financial aid office, Bill decided to call the benefits department at his company to inquire about taking money out of his 401(k). Bill was told that he could not make an early withdrawal (before 59 ½) without paying tax on the money as ordinary income. Currently Bill's federal rate has risen to 40%, his state income tax rate has risen to 10% and on top of that he has a 10% tax penalty for early withdrawal. That means he would have to take out \$193,390 from his 401(k) just to be able to pay a \$77,356 tuition bill. Ludicrous! That was 22.8% of his *entire* 401(k) for just one year of Lori's tuition. Bill and March have spent the last two years significantly cutting back on all the luxuries they have come to enjoy. But they believe their mission is worth the cost. Besides, it is only for a short season. They have stopped going out to fancy dinners; they canceled plans for nice family vacations for the next few years; they were advised to take out a second mortgage on their home at a rate of 11%; and Bill even came to the conclusion that he would no longer be able to fund his 401(k), at least until the kids were done with college and all their debts were paid off, a decision he really dislikes.

Bill wonders to himself how he could almost be a millionaire on paper but feel flat broke. He has no access to his money without severe penalties. He feels like his own money is being held hostage by the tax system. But he has not worked so hard to sock money away for his retirement only to find 60% of it gobbled up in taxes. A little thought passes through Bill's mind and he wonders for the first time if his 401(k) really had been the best place to save money.

But Bill's financial concerns don't end here. This is also the year that Billy is going to be a freshman in college as well. If one child has been a struggle, how

in the world is he going to afford two kids in college? And still a third is not far behind. Bill sees only three options:

1. Tell the kids they need to get a job to help pay for their own tuition. 2. Tell the kids they need to go to less expensive schools. 3. Borrow more money. After talking with March, Bill and Marcy choose number three.

At age 50, Bill is no longer feeling so good about his financial future.

Bill is now 65. The financial storm of his kids' tuition is now a distant memory of years gone by. He and Marcy have survived and are glad they gave their kids the gift of a good education. Yes, he did have to delay his retirement to age 65, but that, too, was a small price to pay. Each of their three children has graduated from college and all three have good jobs. Lori owns her own business and is able to juggle all the demands of a working mother of three. Billy has become an attorney at a local practice in town. And Scott is a high school math teacher in a neighboring community. Bill and Marcy had borrowed what they needed to make it work, and have spent most of the years since then paying off the debt they had accumulated. They were also committed to having their house paid off by the time Bill retired, so they could save that expense in retirement. It is a goal they have achieved just in time. They are now debt free and ready to take on the new adventure of retirement, grandkids, and leisure.

Though Bill had not been able to continue to save money in his 401(k) after Lori's junior year, his original contributions have grown to quite a large sum. His account now stands at a whopping \$3,091,808. Bill sits back in his chair and lets out an audible sigh. *Wow, even with those tough years I have still accumulated over three million dollars.* Bill is glad he had chosen to invest in his 401(k). *Good thing I invested as much as I could in those early years. I guess I did receive good advice.*

BUT ... that was before Bill began taking money *out* of his account.

Two months before Bill's retirement a new president of the United States had been elected. Along with a new president, the country also elected a new Congress and Senate. All three had the same agenda – begin to pay down the horrific debt. The country was serious about attacking the problem and had elected a government it believed would save it from the devastating nightmare of insurmountable debt. The future of America was at stake.

What Americans didn't realize, and what was never spoken during the months of campaigning, was *how* this administration was going to accomplish this task. Those running for office had talked about cutting programs and eliminating governmental waste; the country bought it hook, line, and sinker. No true American wanted to see his or her country go under and many believed it was now or never to salvage the mess. However, along with those original campaign

promises lurked the real method of accomplishing the task, which was to raise taxes.

Though taxes had continued to go up over the last 15 years, this was the granddaddy of them all. Bill's federal tax rate has now risen to 55% overnight. He is stunned. To make matters worse, he no longer has any deductions to offset his retirement income. His kids are grown and his house is paid off. All the deductions that he used when he was younger have now evaporated. Every dollar he takes out of his 401(k) is going to be taxed – and taxed hard.

Wait a minute! Bill thinks. *What happened to lower tax rates in retirement because my income is lower? What happened to the idea of saving the tax during the contribution phase because it is better in the long run?*

Bill quickly realizes that the few thousand dollars he had postponed in tax when he was young will now likely cost him well over a million dollars. For the first time it dawns on him that he had never really *avoided* taxes to begin with; he had simply *delayed* them. And by delaying them Bill has only compounded them, making them far worse than he could have ever imagined. Worse than anyone could have imagined.

At age 65, Bill is feeling a little sick to his stomach. Uncle Sam is going to ruin his golden years.

It is now five years since Bill's death. He passed away at the age of 80 and Marcy survived her husband by four additional years. It has been nearly a year since she went to rest beside her husband. All three kids appreciated the financial sacrifices of their parents. For over a year they have worked hard at settling all the estate issues. It has been extremely complicated and far more time consuming than any of the three had ever imagined.

But, the biggest shock came when they got the final distribution from their parents 401(k).

In Bill's later years he had confided to his kids about how much money he had saved. He had preserved his original savings of \$3,091,808 because he didn't know how long Marcy or he might live and he didn't want to run out of money while one of them was still living. He knew that if he began to spend down his account he might end up with nothing left to sustain Marcy in her later years if he predeceased her, which was a likely event. He didn't want to take that risk. To do this, they lived frugally. With the new tax rates, Bill and Marcy could only live a shadow of the life they were used to. *This* part of his retirement he never shared with his kids.

Once Bill and Marcy's estate was settled and the 401(k) funds were distributed, the kids thought there must certainly be some mistake. Of the nearly three million in their father's account, only \$476,368, or 15% was passed onto them. Instead of each child receiving close to \$1,000,000, after taxes the three

children ended up with just over \$150,000 each. Though Scott is nearly retired from teaching math, he knows his skills aren't that rusty. Something has to be in error. He calls a local accountant to show him the situation and after careful review, the CPA tells him that, indeed, the numbers are correct. With the nearly instated federal, state, and estate tax rates imposed by congress, taxes have taken a full 85% of his father's qualified retirement account.

The kids are shocked. Why hadn't someone warned their father about this situation? Why hadn't someone warned *them* about this situation? Why hadn't someone showed their father a better way to save for his future?

As they asked around to other financial professionals in the community they quickly realized the answer ... no one they talked to knew of a better way.

Though Bill has long since passed, had he realized what Uncle Sam was going to take from his savings once he and Marcy were gone, he would have said to himself, "I definitely don't feel good about my financial past."

For some of you, this story may have many similarities to your life. For others, this may look nothing like our current reality; that is always the danger of using examples. You may be older or younger, female not male, make more money or less money. You may be a business owner and have never worked for a corporation a day in your life. Or you might have worked for multiple companies in your career (and probably have.) You might not have a matching provision for your 401(k) – but that's okay! You will face the same potentially devastating tax disasters unless you choose a better way!

In this book, I will show you there *is* a better way to save money for your future. A simple way. A way that you don't feel like your money is being held captive until retirement age. A way that you can get at your money *any time* and in *any amount* without paying any taxes ... that's right ... *zero!* A way that does not hold you hostage to the changing tax rates of the future. And a way to live a fully-funded retirement, enjoying all the things you want to do and still leaving behind a potentially huge legacy that will pass to the next generation free from federal and state income tax.

Excerpt: Chapter 12 A Story about Bill from his book
Tax-Free Retirement by Patrick Kelly