AN EXCERPT FROM

MONEY RULE$

CHAPTER 11

PRE-TAX VS. POST TAX

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Introduction

Money Rules is not your typical book about money. It is an overarching mindset written for people who want to maintain massive wealth. When you know the rules of how money really works and the ideas and strategies within Money Rules, you will be able to build and protect your money, not just have momentary fortune.

The philosophies and approaches in this chapter are presented to you by Harry J. Abrahamsen, and while you may be able to implement many of them right away, they are not to be mistaken for direct advice. Money Rules empowers you to be the master of your own wealth—your advisors are just one piece. At this point, you have been introduced to one aspect of the macro mindset. Make sure to read the rest of Money Rules to move into mastery.

Written for Influential Individuals, Entrepreneurs, Business Owners, and Families with Money. Though I dare anyone to pick it up and read it now.

There are many books written for individuals who are seeking to build wealth, but when you reach the point of impressive success and multiple commas to your name, you may be reliant on your inner circle with your decisions about money. You feel you have control, but you are just a few mistakes away from sacrificing everything.

This book is written for you, and in it you will find out the things you are missing, no matter how diversified your portfolio is or what you think you know about money. When you know the rules of how your wealth really works and the ideas and strategies within, you will be able to build and protect it, not just have success for a moment.

This book is not about what's right or what's wrong, it's about doing things the right way.

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Pay now or pay later.

CHAPTER 11

Pre-Tax vs. Post Tax

Pay me now or pay me later?

—The U.S. Government - Internal Revenue Service

Imagine you hear a knock on the door and open it to find a mysterious stranger. This stranger hands you a bag of seeds and presents you with a decision. In one scenario, you would return 20% of the seeds to them, and the stranger would disappear forever. You would be able to do anything with the seeds—eat them, sell them, plant them, whatever you desired, and you would keep all the gains that you made from them. The alternative would be to keep all the seeds, but in this situation you must plant them; everything must go into the ground. Then some day in the future, without warning, the stranger would hunt you down and demand to see the crop you'd been working so hard to produce, and they would determine the amount they deemed they deserved from the harvest. They may take 60%, 80%, whatever they desire. They may even take it all if they happened to be in a bad mood. What would you decide?

There is no question about this. You have amassed an empire, and no one will be seizing what you have built. You would never surrender the right to decide what to do with your money, to give away what you have built. Entering such a blind, lopsided agreement as the second

scenario—giving away some unknown amount of money on some unknown date, boxed in by such restrictions—would be absurd.

But what you don't realize is that you probably have done this with the IRS. You have probably chosen the second option (pre-tax savings) and scoffed at the first (post-tax savings). With your 401(k)s and your IRA's, the mysterious stranger—the government—is giving you the decision between a known percentage today and an unknown seizure in the future, and you may be taking the bait without even realizing it.

The Infamous 401(k)

Surprise, surprise, this will be the story of something that becomes more unfavorable for individuals and more favorable for institutions, including the government, with time. It begins in the late seventies with Johnson and Johnson, pension consultant Ted Benna, and HR Executive Herbert Whitehouse. Benna and Whitehouse helped bring forth a tax code that would permit employees to shovel their bonuses away into a savings plan. By siphoning off some of their income, these employees would fall into a lower income tax bracket and would be able to supplement their pension plans. This was not, however, a hit with the moderate-to-low income employees. They did not have the luxury of deferring income that they badly needed to pay their bills, and since they already had a pension plan and didn't require the tax benefit, they rejected it as a "salary reduction plan."

Because institutions care about one thing and only one thing—their bottom line—firms wizened to the fact that they could significantly reduce their risk and their spending by phasing out defined benefit pension plans entirely and just offering the 401(k). They offered "generous" matches and marketed the plans as "benefits" and "rewards" with incentives for employees to stay, while shoveling responsibility onto the backs of the employees themselves. Defined benefit pension plans all but disappeared in most firms, and no one seemed to blink an eye.

While people reminisce about the days of pensions and take jabs at Social Security, they laud their company's benefits. They get excited when they're eligible to participate in their 401(k) plan. *Wow, I qualify!* Yes, they qualify...to walk into a risky, rule-based relationship with the IRS. The match they're so excited for is a slap in the face and is nothing compared to the institutional cost, and individual benefit, of a real defined benefit pension plan. And it strips employees of something the firm should be offering without question in repayment for their time—financial security. The government is fully on board with this; they don't care about what tax bracket you're in today if there's a huge pile of money waiting for them tomorrow.

The brutal truth about pre-savings became evident with time, though, and many initial backers of the 401(k) plan eventually retracted their support. Benna himself said, "If I were starting from scratch today building the 401(k), I'd frankly blow up the existing structures." Whitehouse admitted, "We weren't social visionaries." What a concept. Economist Teresa Ghilarducci said in 2017 that people "would have enough to retire if they set aside just 3% of their paychecks in a 401(k)" and predicted that "assumed investments would rise by 7% a year." But just a few years later, she admitted that the math she'd used in the 1980's and 1990's to justify her projections no longer presented an equivalent or better solution to defined benefit pension plans. Why? Because the world doesn't stand still, and because money is not math. Her proposed solution? A savings program administered by the Social Security Administration. Ah, because the broken, underfunded Social Security Administration is doing so exceptionally well. Firms shoved off their responsibility for their employees' incomes for the benefit of their bottom lines and their shareholders, making the situation so dire with pre-tax savings that the failing Social Security system was nominated to be the savior. Since when does one broken thing fix another broken thing?

401(k)s, and IRA's (which sit within the same tax code), are red herrings when it comes to savings—they seem like the wiser choice, but they're really just distracting from the wide open field of taxable cash. Be cautious if your 401(k) is your main savings strategy, but more importantly, know that it is a siren and that its song was written by people who regret what they composed. Just because it's there, just because you qualify, just because it's called a "benefit" doesn't mean it won't wreck your ship.

The relationship between taxpayers and the IRS is strained and temperamental, swinging back and forth in the most mercurial way. It is subject to the impulses of political sentiment, the party system, and the short terms of the presidents, not to mention black swans. With pre-tax savings you have no say in who is getting the money or how and where it will be spent. You are at the mercy of the government, and if you're not ready to withdraw yet, it will be a government that you don't recognize. What if your money ends up in the hands of a despot? Is that truly impossible to imagine? Sure, maybe you want to be contributing to infrastructure, community, the public good. You will be doing that if you pay tax upfront, and you will still have all your remaining money and future growth to spend on whatever programs you determine at another time.

Pre-tax savings like 401(k)s and IRA's (traditional IRA, SEP-IRA, and SIMPLE IRA) are about unknown sacrifices—the amount you must give up isn't known to you, the tax rates will be different when you want to access the money, and the state of your wealth in the future is filled with question marks. Because of these unknowns, people who rely on 401(k) or IRA savings without any macro strategies are basically throwing their financial board out of the window. Any attempt at a strategy is shrouded in darkness—there is no way to know if you will be paying 20% more or 2% less on the day you start to withdraw. If you were to be sure that your taxes would be 50% lower in the future, I am sure you would save differently today. If you were to know tax rates would be 65% higher, you'd have different tactics to hedge against

that increase. Flying blind with your power three savings is flying blind with your entire financial estate. (If you are already relying on this money, you are probably starting to understand what it is like to be tossed around by the tides and thrashing in the water.)

This is worsened by the fact that the IRS has unbelievable reach. The U.S. federal government has the right to take up to 100% of your income. I will say that again: it is completely within the U.S. government's right to tax you at any rate they determine. Just as the stranger may take whatever amount they want based on their mood, the government may alter tax rates, brackets, create new laws, and provisions by massive amounts whenever the wind blows, without warning. If you don't think they are willing to do it, think about this: in 1916, the U.S. government raised the income tax for the top bracket from 15% to 67%, and then again in 1918 to 70% to pay for World War I. Then in 1944, to pay for World War II, the government raised the tax to 94% for income over $200,000, the equivalent of $2.5 million in 2021. (Post World War II, for three more decades the rates did not drop below 70%.) Imagine if ninety-four cents out of each dollar you have disappeared. There is no reason that taxes couldn't skyrocket again overnight—you are essentially strapped to the hull of a ship crossing the Atlantic, hoping to survive.

THE GOVERNMENT'S PROBLEM WITH POST-TAX

If you really want to know how murky the situation is with pre-tax savings, you should think about the government's position with post-tax savings, specifically Roth IRA's. Many economists paint a stormy picture for the government detailing exploding revenue losses associated with Roth IRA's. In a study for The Tax Policy Center, the economist Leonard Burman calculated that the government would lose a total of $14 billion between 2014 and 2046 due to Roth IRA-related provisions, saying that the government is "bringing in more now, but giving up much more in the future." Remember, macro strategies rarely benefit institutions more than they do individuals: resistance from the institution is a sign of a benefit to the individual.

> If post-tax savings would result in exploding revenue losses for the government, then pre-tax savings would result in tax explosions. If pre-tax savings are preferred by the government, post-tax savings are preferable for individuals. The best strategy for the individual meets resistance from the institution.

The other issue with pre-tax savings plans is the extent of rules and restrictions imposed upon you. Your pre-tax plan sits somewhere, out of reach, the entire time you are working. Then when you stop working and start to withdraw, you have to follow the required minimum distribution stipulations (RMD), meaning you are stuck withdrawing (and paying tax on) a specific percentage that the government has decided for you. If you were thinking of withdrawing when taxes were favorable and not withdrawing when they were terrible, think again.

Additionally, some people assume they will be in a lower tax bracket when they stop working. But this means you are planning to have less in terms of your preferred way of life. What about your wants? This is a mindset of scarcity—it is planning based on the idea of needs, rather than your true wants. You shouldn't cap your standards, now or in the future.

Planning on being in a lower bracket when you stop working is not a winning strategy.

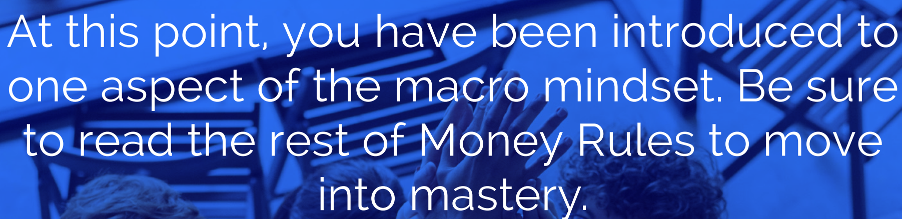
There's no information on the shelves to tell you differently about pre-tax, including from those who supposedly work to benefit your wealth. Financial authors like Suze Orman and Dave Ramsey write books promoting pre-tax investments without any mention of the results of unknown tax rates, ignoring the fact that a sudden increase in taxes during a time of war or disease might evaporate your hard-saved wealth like water hitting hot pavement. Dave Ramsey is famous for eschewing debt. Yet apparently he doesn't mind shepherding people into the IRS's

slaughterhouse, guiding them into untold seizures of their harvests though their 401(k)s. People hate owing money to such a degree that they'll sacrifice their way of life to pay off their mortgage, all the while pouring tons into pre-tax savings and owing an insane unknown amount to a government that is just waiting to pounce. Think about it. 401(k)s and IRA's are the biggest pool of available untaxed money. While you watch your account balance increase, the government waits for their tax harvest. Just because you're not indebted to the bank doesn't mean your money safely belongs to you. An unknown tax burden may be more woeful than a known debt.

Think back to the matchmaking scenario. Would you match your friend with someone who had $3 million, a bad high-rolling poker habit, and an unpredictable temperament or someone stable with shared interests and a $1.5 million estate? The pile of money in your pre-tax savings is just a mirage, a fantasy that requires a lot of denial. It's a bad marriage that gets worse with time. And I will tell you, divorcing yourself from your 401(k) or IRA is ugly, but staying with it is worse.

The IRS is a bear in hibernation—when you withdraw, that hungry bear comes for its meal, and you don't know what its temperament will be. The risk associated with tax changes makes strategizing for pre-tax savings moot, particularly within a political environment that swings back and forth like the pendulum on a grandfather clock. No matter your feelings about the government or the way that taxes are implemented within society, your knowledge of changing tides should guide you to what is known and secure. Being macro with this is not about relying entirely on post-tax savings. It is simply about understanding the potential for the devastation that comes from a lack of predictability—specifically with something that has the potential to diminish your assets by any amount, overnight. If you think this paints a gloomy picture, it does.

Pre-tax versus post-tax might seem similar to Sophie's choice. But the grandmaster doesn't feel bad; they buckle down. They don't get indecisive; they get intelligent. As I said before, this is the moment in which you must be planning many moves ahead on the board, the most important moment to block and protect. Because, trust me, you don't want the government to say checkmate.



At this point, you have been introduced to one aspect of the macro mindset. Be sure to read the rest of Money Rules to move into mastery.

You may also wish to receive a complimentary personal coaching session on one or more of the Money Rules.

Schedule My Session

WRITTEN FOR INFLUENTIAL INDIVIDUALS, ENTREPRENEURS, BUSINESS OWNERS, AND FAMILIES WITH MONEY

9 RULES TO MASSIVE WEALTH

MONEY RULE$

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HARRY ABRAHAMSEN