How To Avoid A Tax Problem

by John A. Addison, Jr.

(NAPS)—If you have a job, you may have a tax problem. The harder you work to get ahead, the more taxes you may have to pay. Fortunately, there are ways to minimize taxes so you can have enough cash at retirement.

Many people think that tax deferrals are only for the wealthy. That may be one reason that thousands of wage earners fail to take advantage of such tax deferral opportunities.

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The fundamental rule of tax savings is: Get every deduction or deferral you can get. IRAs can save you money. Here are a few things you should know about your options:

Traditional IRA, deductible. The IRA saves you money by giving you and your spouse the potential to contribute $5,000 each (if you meet certain requirements) off the top of your gross income, which reduces your taxable income. At a 25 percent tax bracket, you could save $1,250 in taxes in one year, just by putting $5,000 in an IRA.

Traditional IRA, nondeductible. This means you can postpone payment of current taxes until funds are withdrawn at a date in the future, commonly at retirement. This means that more of your money is allowed to grow and compound than if taxes were taken out of your account each year.

Roth IRA. This option offers tax deferral on earnings and tax-free withdrawals. Earnings on your Roth IRA can be withdrawn tax-free as long as the account has been open for at least five years and you are age 59½ when you begin withdrawing the proceeds. State income tax may apply.

Other tax-deferred plans include:

The 401(k) plan. Many employers now sponsor tax-deferred retirement plans. The most common is the 401(k) plan, which allows employees to contribute a certain percent of their salary up to a specified maximum. Contributions are excluded from your gross income and earnings are tax-deferred until withdrawn. If you're lucky, your employer may provide matching contributions.

Simplified employee pension plans. Also known as SEP Plans, they have the advantages of an IRA but are designed for the self-employed, owners of small businesses and their employees. The SEP Plan has been called the Super IRA. It allows people to contribute up to 25 percent of their income or $49,000, whichever is less, and to contribute the same percentage of their employees' gross income.

Rethink your refund. Paying too much tax so that you get a refund is really giving Uncle Sam an interest-free loan. You may want to readjust your withholding to free up extra money for your own financial program. If you reinvest the amount you get back, it can add up. For example, investing a $2,000 refund over 70 years at a hypothetical 10 percent rate of return, compounded monthly, could earn you $638,000. Please remember that actual investments will fluctuate in value.

It makes sense to discuss such options with a financial professional. Primerica representatives are not tax advisers. Therefore, related questions should always be directed to an appropriately licensed professional.

For More Information

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