



EFFICIENCY OF TAX DEFERRAL

PUTTING YOUR MONEY TO WORK

RENEWED FOCUS ON TAX EFFICIENCY

A common figure of speech used in financial planning is the concept of “putting your money to work for you”. The principle behind this expression is the positive effect of compounding interest over long periods of time or “earning interest on interest.”

An extreme example is to ask the question:

Would you rather have \$5,000,000 today or have a single penny that doubles every day for the next month?

As a result, most individuals would opt for the doubling penny. However, a savvy investor might ask an additional important question:

What effect can taxes have on my growth?

Let us assume that at the end of every day, when our penny doubles we owe 15% in taxes on the growth. At the end of our 30 days, our \$10,000,000 potential would have only grown to a little over \$1,000,000. As a result our ending account balance is reduced nearly 90%, due to owing taxes on our gains.

Once an individual has established adequate liquidity, investing inside of a tax favored or tax deferred investment vehicle can help one’s money “work” more efficiently. This is accomplished by deferring taxation of gains and allowing earned interest to compound over time. This table shows a comparison of all three scenarios discussed above: “The Offer” of \$5,000,000, a single penny doubling over 30 days with the 15% reduction denoted as “Taxable”, and a “Tax Deferred” example allowing the true doubling to occur.

“Compound interest is the eighth wonder of the world. He, who understands it, earns it...he who doesn't...pays it.”

—Albert Einstein

DAY	THE OFFER	TAXABLE	TAX DEFERRED
0	\$5,000,000	\$0.01	\$0.01
1	\$5,000,000	\$0.02	\$0.02
2	\$5,000,000	\$0.03	\$0.04
3	\$5,000,000	\$0.06	\$0.08
5	\$5,000,000	\$0.22	\$0.32
10	\$5,000,000	\$4.70	\$10.24
15	\$5,000,000	\$101.76	\$327.68
20	\$5,000,000	\$2,205.13	\$10,485.76
25	\$5,000,000	\$47,785.18	\$335,544.32
27	\$5,000,000	\$163,544.77	\$1,342,177.28
28	\$5,000,000	\$302,557.83	\$2,684,354.56
29	\$5,000,000	\$559,731.98	\$5,368,709.12
30	\$5,000,000	\$1,035,504.17	\$10,737,418.24

This is a hypothetical study in nature and does not provide legal, tax, or accounting advice.