



PROSPERA PERSPECTIVES

The Tax Bill Already Inside Your Retirement Plan

Why business owners need tax diversification before the decisions
are made for them

Every pre-tax dollar you saved came with a silent partner.
The question is how much say that partner gets in retirement.

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For decades, the advice to business owners has been simple: defer taxes now, pay them later. Max out the 401(k), add a profit-sharing contribution, take the deduction. It works well during the building years. The trouble is that “later” eventually arrives, and many owners reach it with nearly all of their retirement wealth sitting in a single tax bucket.

Deferral Is a Loan From the IRS, Not a Gift

A dollar in a traditional 401(k), SEP, or IRA is not entirely yours. Part of it belongs to federal and state tax authorities, and the size of that share is set by the tax rates in effect when you take the money out, not when you put it in. Nobody knows what those rates will be in 2035 or 2045.

The One Big Beautiful Bill Act, signed in July 2025, made the current individual brackets permanent, which removed the scheduled 2026 increase that many planners had been preparing for. “Permanent” in tax law simply means there is no built-in expiration date. Future Congresses can still change rates, and federal deficits make that a reasonable possibility to plan around.

The core question: If most of your retirement income will be taxable as ordinary income, how much control will you actually have over your tax bracket in any given year?

Where the Pressure Points Show Up

Concentration in tax-deferred accounts tends to create problems at predictable moments:

- **Required minimum distributions.** Under SECURE 2.0, withdrawals generally must begin at age 73, rising to 75 for those born in 1960 or later. Large balances can force taxable income you do not need.
- **Medicare premium surcharges.** Higher reported income can trigger IRMAA surcharges on Medicare Part B and Part D premiums, set from income two years earlier.
- **Social Security taxation.** Additional ordinary income can cause more of your Social Security benefit to be taxed.
- **The surviving spouse.** After a death, the survivor typically moves to single-filer brackets while much of the household income continues, often a meaningful tax increase.
- **The business sale year.** A liquidity event can stack on top of plan withdrawals and push income into the highest brackets.

Owners also face a newer wrinkle. Beginning in 2026, SECURE 2.0 requires catch-up contributions from higher earners to be made on a Roth (after-tax) basis, a reminder that the rules around tax-deferred saving keep moving.

Three Buckets, Not One

Tax diversification means holding retirement assets across accounts that are taxed differently, so that each year you can choose where income comes from. A simple framework:

Bucket	Examples	Tax character of income
Taxable	Brokerage and bank accounts	Interest, dividends, and capital gains taxed as earned or realized
Tax-deferred	Traditional 401(k), SEP, IRA	Withdrawals generally taxed as ordinary income; subject to RMDs
Tax-advantaged	Roth accounts; properly structured cash value life insurance	Qualifying distributions or policy access may be received without income tax, subject to the rules for each

Roth accounts are the familiar version of the third bucket, though contribution limits and income rules restrict how much a high earner can place there. For many business owners, that bucket is underfilled relative to everything else.

Where Life Insurance Fits

Permanent life insurance is first and foremost a death benefit. Under Section 7702 of the tax code, a properly structured policy can also accumulate cash value on a tax-deferred basis, and policy owners may access that value through withdrawals up to their basis and through policy loans, which are generally not taxed as income while the policy remains in force. The death benefit is generally received by beneficiaries without federal income tax.

That combination is why cash value life insurance is often discussed as part of a tax diversification strategy. It is not a retirement account or a qualified plan, it is not a substitute for one, and it only works when it is designed, funded, and monitored with care.

Not an off-the-shelf result. Tax-advantaged access to cash value depends on a policy that is specifically designed and consistently funded for that purpose. Funding above IRS limits turns a policy into a modified endowment contract (MEC), which changes the tax treatment of loans and withdrawals and can add a 10% penalty before age 59½. Cash value in the early years is typically less than premiums paid. Policy loans accrue interest and reduce the death benefit and cash value, and a lapse with a loan outstanding can create a taxable event. Any non-guaranteed elements, such as dividends or crediting rates, can be changed by the insurer. Review a full illustration with guaranteed and non-guaranteed values.

A Year-End Checklist for Owners

- **Map your buckets.** List retirement assets by tax character, not by account name.
- **Project the RMD years.** Estimate required distributions and the brackets they imply, including for a surviving spouse.
- **Plan around the sale.** If an exit is on the horizon, model how that income interacts with plan withdrawals.
- **Revisit your Roth options** with your CPA, including conversions in lower-income years.
- **Review existing life insurance.** Older policies may be underfunded, over-insured, or candidates for redesign.
- **Coordinate the team.** Tax, legal, and insurance decisions should be made together, not in separate meetings.

Tax diversification is less about predicting tax rates than about keeping your options open when they change. Bringing those decisions together with your CPA and attorney is what we mean by **the entrepreneur's family office**: one coordinated plan instead of a collection of accounts.

How Much of Your Retirement Is Already Spoken For?

At Prospera, we work alongside your CPA and attorney to evaluate how your retirement income will be taxed and whether life insurance has a place in your retirement income plan.

Schedule a complimentary retirement income review.

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The Entrepreneur's Family Office

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