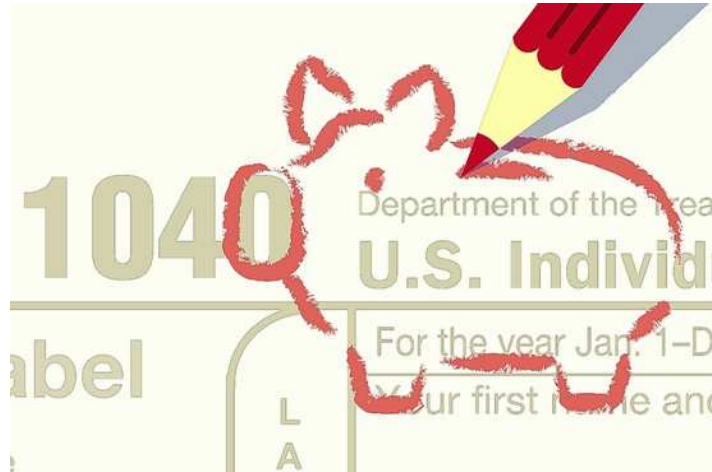


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A New Diversification Tactic Places the Focus on Taxes



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As recently as 1980, the top federal marginal income tax rate (TFMITR) was 70%. While you may believe your income tax rate will be lower in retirement that may prove to be a very conservative assumption. In all likelihood the government will be forced to battle the federal deficit by raising the TFMITR from its current 35% level.

If you maximize your traditional IRAs and/or employer-sponsored retirement plans (401(k), 403(b), 457(b), SEPs, SIMPLE IRAs, etc.) you will likely retire with a large nest egg. Unfortunately, in most circumstances you must withdrawal at least a minimum amount annually after your turn 70 ½. The amount you must withdrawal is called the Required Minimum Distribution (RMD) and is based on Life Expectancy tables published by the IRS. RMDs from pre-tax employer plans and traditional IRAs are generally subject to income tax.

If you retire with a \$2.5 million 401(k), your RMD may equal 5% or \$125,000. That extra \$125,000 of income could force you into a higher tax bracket. Of course, this assumes you keep all of your tax deductions and exemptions upon retirement; otherwise your effective federal income rate could increase even further.

If the government raised the TFMITR upon your retirement, you would actually realize an even higher effective federal income tax rate. Add additional sources of income, such as social security or pensions and you could be ‘working for the government’ instead of enjoying your retirement.

Fortunately, many employer plans provide for after-tax contributions and growth in the form of Roth contributions. Roth contributions and the growth on those contributions combined with Roth IRAs can provide a tax free source of retirement assets, as Roth withdrawals are income tax free. The lack of income can reduce or eliminate income taxes on your Social Security benefits and enhance your ability to shelter resources away from Medicaid (with or without a Long Term Care Insurance Partnership Program certified policy).

Importantly, there are estate and financial planning strategies to avoid RMDs entirely. Avoiding RMDs can save \$875,000 of taxes on a \$2.5 million pre-tax 401(k) account, based on the current 35% top federal marginal income tax rate. The tax savings would be significantly greater if the assets experienced any appreciation, income or dividends. The tax savings would be even greater if the TFMITR increased slightly. They tax savings would double if the 35% top federal marginal income tax rate reverted to the 70% rate of 1980.

Implementing estate and financial planning strategies that allow you to avoid RMDs can mean the difference between ‘working for the government’ and enjoying your retirement.

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