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Taking Your Pension Private



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The same way you wouldn't place all your savings in one stock or one bond, you wouldn't subject your savings to one tax strategy. Using diversification to reduce risk is important for investing and for tax planning. We discuss the benefits of tax diversification in our October 15, 2011, Money Matters article entitled: "[Skloff Financial Group Addresses Advantages of Tax Diversification](#)".

Taxes on contributions to a defined benefit retirement plan (pension) are deferred until you begin making withdrawals. **All of the withdrawals (including the principal) are taxed at your income tax rate at that time.** Those who rollover their pension to an IRA are generally required to withdrawal at least a minimum amount annually after turning 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.

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

Tax Diversification with a Roth 401(k)

If you are self-employed, you are considered the employer and the employee and can establish a Roth 401(k) retirement plan. Generally, you can contribute up to \$17,000 per year if you are less than 50 years old or up to \$22,500 if you are 50 years old or older to a Roth 401(k).

Although contributions to a Roth 401(k) are made after taxes (foregoing an immediate tax benefit) all withdrawals associated with those contributions (including the principal, interest and dividends) are tax free.

Additionally, as the employer you can match contributions and/or provide profit sharing contributions. The maximum contribution amount you and your employer (combined) can make per year is \$50,000, based on \$250,000 maximum considered compensation.

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