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"The Retirement Experts"

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Even with the best intents, you may be placing your wealth AT RISK

Even though the federal estate tax laws were recently changed (to the benefit of many individual taxpayers), estate taxes could still pose a major threat to your overall wealth. With highest estate tax rates still close to 50%, protecting your estate from the ravages of estate taxation (not only for now but for the future), remains a priority for higher net wealth individuals.

Unfortunately, some families place their wealth at risk, even with the best intentions in mind. Married couples sometimes do it by owning assets jointly or by naming spouses as the sole beneficiary of their IRAs and other retirement plan accounts (without naming contingent beneficiaries).

Don't Rely on Average Life Expectancy. Longevity or the risk of outliving your savings is a significant concern for many who are facing retirement today. It goes without saying that improper assumptions about life expectancy can sometimes lead to inappropriate financial planning in retirement.

So how long should your retirement savings last? Unfortunately, different statistical sources can sometimes lead to conflicting assumptions. For example, IRS publication 590 for 2004 suggests that a 70-year-old is expected to live 17 years, on

than the asset's cost). If you sell an asset after only a year or less, you will have a short-term capital gain, which is taxed at ordinary income tax rates (i.e., your marginal income tax rate). If you own an asset for more than a year before you sell it, you will have a long-term capital gain.

Long-term capital gains tax rates are generally more favorable than ordinary income tax rates. Currently, the highest ordinary income tax rate is 35 percent whereas the highest long-term capital gains tax rate (for most assets) is 15 percent...a difference of 20 percent. Holding an asset for long-term growth is a tax-saving strategy.

Tip: You may also elect to include net capital gains as ordinary (investment) income. Such income will be taxed at ordinary income tax rates, not capital gains tax rates however; this may be advantageous if you don't have capital losses but do have investment interest expenses. Investment interest expense may only be deducted to the extent of investment income (though it can also be carried forward to future years).

Qualified dividends

Qualified dividends are dividends received by an individual shareholder from a domestic corporation or a qualified foreign corporation. Under the 2003 Tax Act, effective for tax years 2003 through 2008, such dividends are taxable at the same rates that apply to long-term capital gains. Absent further legislative action, dividend tax rates revert to pre-2003 Tax Act levels (i.e., they will be taxed at ordinary income tax rates) beginning in 2009.

Eligible dividends also include qualified dividends passed through to investors by stock mutual funds, other regulated investment companies, partnerships, or real estate investment trusts (REITs). Thus, it may be advantageous to invest in vehicles that pay qualified dividends, especially if you need current income.

Distributions from tax-deferred vehicles, such as IRAs, retirement plans and annuities do not qualify even if the funds represent dividends from stock. Thus, holding investments that pay qualified dividends within a tax-deferred plan may no longer be desirable.

Tip: As with capital gains, you can elect to include these dividends in investment income. Such income will then be taxed at ordinary income tax rates, not capital gains tax rates. This may be advantageous if you have investment interest expenses in excess of investment income. Investment interest expense may only be deducted to the extent of investment income (though it can also be carried forward to future years). This election must be specifically made for IRS tax purposes.

Ordinary (investment) income

Ordinary investment income consists of any investment income that is not capital gain income, qualified dividends, or tax-exempt income, and is taxed at ordinary income tax rates.

Investment expenses

If you borrow money to buy investment property, you probably pay investment interest. Investment interest may be used to offset investment income only. Excess investment interest may be carried forward to future years. Other investment expenses (e.g., investment advisory fees, commissions, and other fees associated with investments) are deductible as an itemized deduction on Schedule A and are subject to the 2 percent rule.

Passive income and losses

A passive activity is an investment in a business in which you are not an active participant. Rental real estate and limited partnerships are two common examples. Income generated by a passive activity and gain from the sale or exchange of a passive activity is included in passive income and taxed at ordinary income tax rates. Generally, losses from passive activities may offset income from passive activities only--they cannot be used to offset ordinary income or capital gain income. Excess losses in a given year can be carried forward into future tax years.

Tax-exempt income

One of the more common tax-exempt investment vehicles is the municipal bond. Usually, interest paid on municipal bonds is not subject to federal or state tax (at least not in the state of issue). When deciding whether to invest in taxable bonds or tax-exempt bonds, it is important to compare the after-tax rate of return on municipals with that on taxable bonds with similar risk.

Caution: While the interest on municipal bonds is tax exempt, capital gains tax may be imposed when you sell the bonds.

Tax-deferred income

Tax-deferred investments produce earnings that are not taxed until withdrawn. These earnings are reinvested and continue to fuel investment growth. This is one of the most powerful investment tools available. First, there is a time-value of money advantage. The longer you can keep the money in your own pocket and out of the hands of the IRS, the greater the potential benefit will be to you. Second, since our income tax rates are progressive, you may find yourself in a lower tax bracket in the year the earnings are finally taxed. If so, the actual amount of tax paid on those investment earnings will be less. **END**