Avoid Hidden Tax Triggers When Planning for Retirement

Jill Perlin
Prudential Annuities

Tax season is upon us — but before you break out that box of old receipts in search of every last deduction, think about whether you're taking advantage of all the tax benefits associated with saving for retirement.

> Are you needlessly paying taxes now on income that you may not actually use until sometime in the future?

Your nest egg can generally be divided into three categories, at least from a tax perspective: assets that are taxed now, those that carry special tax advantages, and those that will be taxed later.

Assets that are taxed now include mutual funds, stocks, and certificates of deposit. They're purchased with after-tax income, and investors pay short- or long-term capital gains taxes on their profits after they sell or cash in the assets.

These types of assets carry two hidden tax risks, too.

The first, turnover, afflicts investments like mutual funds. Over the course of a year, managers buy and sell securities to ensure that the fund adheres to its stated objective and to lock in gains on securities within the fund. So if a fund advertises a turnover ratio of 25 percent, then the managers executed trades that represented one-quarter of the fund's total assets.

Turnover can trigger capital gains — which investors must pay taxes on.

The other hidden tax risk is rebalancing. Many people sell assets that have grown in value and then buy securities whose value has decreased in order to bring their overall asset allocation back into balance.

For instance, if mutual fund A jumps in value while mutual fund B plunges, then fund A will comprise a greater percentage — and fund B a lesser share — of an investor's portfolio. Selling A and buying B can allow an investor to position his portfolio in line with its original strategy. Unfortunately, the gains on the sale are taxable.

With these risks in mind, it's worth asking yourself whether you're needlessly paying taxes now on income that you may not actually use until sometime in the future.

In short, are you capitalizing on tax-advantaged and tax-deferred savings vehicles? That is arguably the single-best way to take control of your tax risks. It also has the salutary effect of maximizing your retirement income.

Tax-advantaged assets include such vehicles as Roth Individual Retirement Accounts (IRAs). Investors contribute to a Roth IRA with after-tax income but can typically withdraw their money — including any gains — tax-free as long as they comply with certain requirements.

Taxed Now	Mutual funds Stocks CDs	Limited control over when taxation will occur ***Tax Treatment:*** Short-term/long-term capital gains or ordinary income
Taxed later	IRAs Qualified retirement plans Annuities Cash Value Life Insurance withdrawals and surrenders	IRA, qualified retirement plans and annuities have required distribution and taxation at certain ages ***Tax Treatment:*** Ordinary Income
Tax-Advantaged	Roth Accounts Municipal Bonds/funds	Limitations on contributions, investment returns ***Tax Treatment:*** Typically not taxable

On the downside, the assets within a retirement account are subject to the vagaries of the market. Savers are also subject to income and contribution limits when using Roth IRAs.

Traditional IRAs, qualified retirement plans like 401(k)s, cash-value life insurance, and annuities represent types of assets that are taxed later. Some of these savings vehicles require a saver to withdraw a portion of the funds once he reaches a certain age. When withdrawn, the proceeds are generally taxed as regular income.

Of this third category, annuities provide savers with the greatest flexibility. Holders of annuities can control their tax burden, as they don't pay taxes on any earnings until they withdraw funds. They also have access to professionally managed investment options and can avoid the tax risks associated with rebalancing their portfolios.

Further, annuities are the only vehicle that can provide savers guaranteed retirement income that's insulated from potential market downturns, while leaving the possibility of a death benefit for an investor's heirs.

Of course, the tax treatment of an asset is just one criterion for evaluating an investment, and assets of all kinds merit inclusion in a saver's portfolio. But as you prepare your taxes this year, consider how you might be able to benefit from tax-advantaged and tax-deferred savings vehicles.

Jill Perlin is vice president of client effectiveness and education at Prudential Annuities.

Prisoners

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decades. The total cost of incarcerating state inmates swelled from $12 billion in 1988 to more than $50 billion by 2008.

Washington faces a $5 billion budget deficit, and that has politicians looking for savings in the cell blocks.

State Sen. Adam Kline, D-Seattle, has proposed early release of some inmates who have not committed sex offenses, murder, or certain drug offenses. An inmate with low risk to reoffend could see 120 days shaved off a sentence under the proposal, while a high risk, but nonviolent, inmate would get 60 days off.

Some of the saved money would be used for treatment and education programs that lower recidivism rates, Kline said.

"A person with a high likelihood of committing a violent offense isn't going to be allowed to be released under this program," Kline said.

Proponents say the state could save $6.6 million in the next two years, a tiny percentage of the deficit. Prosecutors oppose the measure.

Kline said his bill would reduce the daily prison population by about 3.5 percent. It costs about $37,000 to keep a prison inmate in Washington. A study conducted by the Washington State Institute for Public Policy found that the bill would result in 3,700 fewer crimes over the next 20 years, saving taxpayers $35 million, assuming rehabilitation works.

In Washington, discussions about reducing the prison budget come amid the horrific backdrop of the murder of a female corrections officer on Jan. 29. Jayme Biendl was strangled by an inmate while working alone in the chapel at the Monroe Correctional Complex.

While prison officials have said Biendl's murder was not related to state budget cuts, which had yet to impact Monroe much, the case has become something of a political football.

The union representing corrections officers is demanding a series of reforms, some of them expensive, to make the job safer.

A report by the National Institute of Corrections provided 15 recommendations, and a bill to implement some of those has been introduced in the state House.

The bill would reform offender classification at each facility; authorize a study of the use of personal body alarms and proximity cards for guards; hire a consultant to study the use of more video monitoring cameras in prisons; and authorize a pilot program on the expanded use of pepper spray. The cost of the various studies is about $2.7 million. But full implementation of items like monitoring cameras and body alarms would cost millions of dollars, the House Public Safety committee was told Wednesday.

"We have been urging the state for years to make these changes, but our input has fallen on deaf ears," said Lynn Kunkle, a nurse at Monroe and member of Teamsters Local 117, which represents prison workers. "It's disturbing that it takes the murder of one of our co-workers before the state promises to take action."

Union officials contend state budget woes are making their jobs more dangerous, said Tracey Thompson, chief executive officer of the union. For instance, the union contends that too many prisoners are being reclassified by administrators from violent to nonviolent, allowing them to be placed in the general population.

This year, the union is pushing hard for legislation that