

## BUSINESS

# Planning for taxes in retirement can be a balancing act

Personal Finance. By [Katherine Voigt](#). AMNews staff. May 8, 2006.

From owning a bicycle shop to starting a bed and breakfast, John C. Johnson, MD, an emergency physician in Valparaiso, Ind., hasn't been shy about putting his money into different types of investment vehicles.

When it came time for Dr. Johnson to start thinking about how he would draw income in retirement, he decided to follow the same philosophy --put his money into different investment vehicles. And in doing so, he found a way to spread out his potential tax liability during those years.

Dr. Johnson's philosophy is echoed by financial advisers. They say that just as you need a balanced diet for a healthy life, you also need a balanced mix of income streams during retirement to avoid the heartburn of higher-than-expected taxes in your golden years.

The tax shock could come in a number of ways, even for those who have presumably done everything else right in preparing for retirement. Pretax contributions to plans such as 401(k)s become taxed distributions when you start withdrawing from them. You might not have mortgage and dependent deductions that helped lower your taxable income. And if you've sold your practice or your share of it, you now have a new source of income to be taxed.

There are different ways to achieve this balance, and each individual situation could warrant a different approach. But it is commonly done in part by making sure the person has a mix of money in traditional retirement plans, which provide a tax break at the time they are funded but whose distributions are taxed later, as well as some assets that have been funded with after-tax money and will not face income taxes upon withdrawal.

Rod Coleman, a certified financial planner with SYM Financial Advisors in Warsaw, Ind., recommends having a mix of qualified assets, which aren't taxed until their withdrawal upon retirement, and nonqualified assets, which are. "If I hit age 60 with the two pots, I can substantially choose my tax rate for the

ensuing years," he said. "It gives you that opportunity down the road to spread out your tax burden."

Instead of concentrating solely on a qualified retirement plan, Coleman said devoting some assets to equities in a stock portfolio could provide a nice tax break in retirement. The equities are paid for with money that has already been taxed, so no additional income tax will be owed on it. As long as the funds are held for at least a year, the tax owed upon distribution likely will amount only to long-term capital gains tax, currently a mere 15% and much more palatable than some of the higher income tax rates.

Curt Anderson, a certified financial planner with Physician Advisory Resources in Champaign, Ill., advises retired clients to dip into their nonqualified plans first, so the money in the qualified plans can

limits to the Roth 401(k), though to get one your employer has to offer it, or you as the employer have to offer it to all qualified employees.

Anderson said the Roth 401(k) is "in its infancy," so it hasn't become a major force in retirement planning. Also, the tax provision allowing for it is currently set to expire in 2010, so many analysts recommend that vehicle more for late-career physicians.

There is speculation that other tax laws will change in coming years as well, perhaps raising capital gains tax rates or income tax rates, which are currently low when compared with historic rates. But Coleman said this shouldn't necessarily affect your tax planning for retirement. After all, he said, even if the capital gains rate increases, it likely still will be less than the income tax rate, and trying to



Al Woodward, a certified financial planner in Greenwood Village, Colorado, encourages some clients to take some of their distributions from qualified plans, pay taxes on them and then migrate them into a trust that holds life insurance, turning the money into a tax-free vehicle. The goal is to do this as part of balanced overall plan.

continue to grow as much as possible and benefit from its tax-deferred treatment.

There could be other appropriate strategies for reducing your taxes in retirement, depending on your specific situation and your adviser's tactics.

Michael Johnson, a certified public accountant and principal with St. Louis-based Moneta Group LLC, said physicians also could consider a Roth IRA, which uses after-tax money so the distributions in retirement are tax-free. But they are subject to income limits, and as of last year, a married couple earning more than \$150,000 could not enjoy the full benefit of these accounts, he said,

A related vehicle, called the Roth 401(k), entered the market this year. It basically works like a traditional 401(k), except in reverse when it comes to taxes. Contributions to the Roth 401(k) are made with after-tax dollars, and distributions can be withdrawn after retirement tax-free. There are no income

predict income tax rates only leads to unreliable "guesswork."

Still, some work can be done. To get the flexibility that he wanted, Dr. Johnson and his adviser found a mix that seemed right for his situation. He built up some funds in a traditional retirement account, and he'll pay taxes on those distributions when they come out. He put some other after-tax dollars into accounts that will allow him to draw tax-free income during retirement. He can use a mix of the two to adjust his tax rate up or down. He also has a stake in some liquid assets that could be used for income or held on to as a safety net.

Dr. Johnson, 58, former president of the American College of Emergency Physicians, no longer sees patients, though he maintains an administrative role in his practice. He is closing in on retirement, and when he gets there, he is confident that he won't find himself in a tax pinch thanks to the planning he has done.