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Tax strategies for retirees can pay off in the long run

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Now that you are either retired or close to retiring, preserving your principal while taking a steady income from your investments could be more important than ever. But if you are in a high-income tax bracket, the federal government could be waiting to take up to 35 percent of the income you receive from your investments (2005 federal income tax rates).

With respect to your IRA money, you could also be at the age (older than 70) where you are required to take minimum distributions (RMD). But each year, do you find yourself sticking the money into a checking account or CD? Although there is something to be said about safety and the FDIC insurance afforded to these investments, it is important to also consider the effects of income taxes and cost of living. In years where inflation is on the rise, you could find that your "after-tax" return is not keeping up with the cost of living. (Society of Certified Senior Advisors, Working With Seniors, p. 351, December 2003).

As a practical matter, municipal bonds could offer an alternative and some tax relief, since the interest is generally received free of federal, state and local income taxes. This could provide more income to help meet retirement needs. Of course, there are exceptions to the favorable income tax treatment for taxpayers that are subject to the Alternative Minimum Tax or who have invested in bonds outside of their state of residence. You should remember that these bonds are backed by the credit of the issuing local government, and the principal and yield on these bonds can fluctuate with market conditions.

On another note, if your beneficiaries receive your IRA money, they will have to pay income taxes on their distributions. Assuming that your IRA grows, this means that the potential income tax liability to your love ones will also increase. On the other hand, beneficiaries who receive assets that are owned "outside" the IRA will receive them at the fair market value on your date of death. In other words, your beneficiaries receive a "stepped-up" cost basis on the inherited asset. To illustrate this principal, you could have mutual fund shares in your IRA that are worth \$100,000. When the funds are held inside an IRA or other qualified retirement plan, your beneficiaries will eventually pay income tax on the entire value of the shares at their respective tax rate. However, if you own the shares outside an IRA, your heirs could receive and sell the shares without owing any federal income taxes (although federal estate taxes could apply if the decedent's estate exceeded \$1.5 million). This is something to consider if you are concerned about the end-result of your estate plan.

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