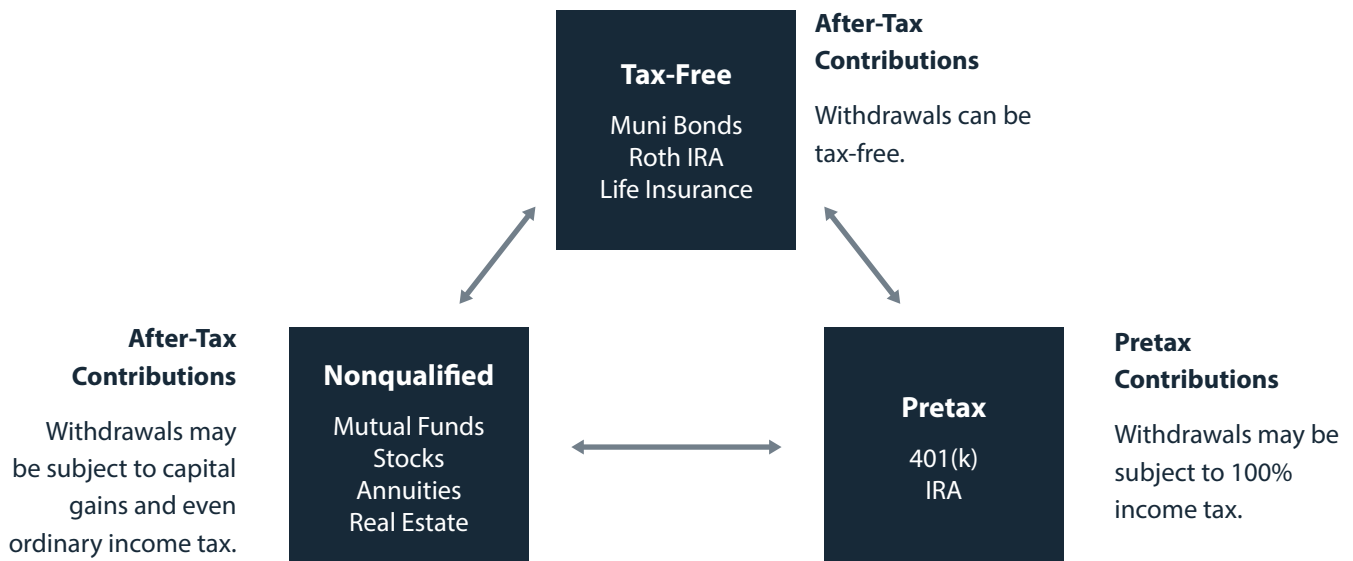# Tax Diversification in Retirement Planning

Diversification is one of the most popular planning techniques in the financial services industry. The old adage of "Don't put all your eggs in one basket" comes to mind when talking to producers and clients. A concern for many of your clients is how you can reduce their income tax liability through proper financial planning.
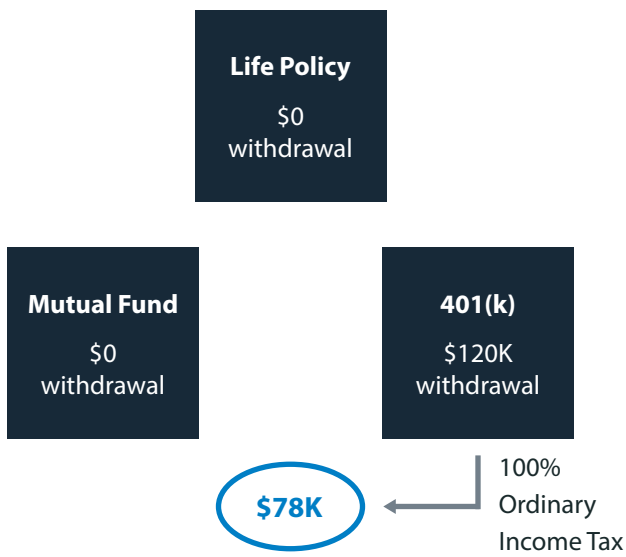
THE TAX TRIANGLE BELOW SHOWS HOW VARIOUS VEHICLES MAY BE TAXED:

Tax-Free

Muni Bonds
Roth IRA
Life Insurance

After-Tax Contributions

Withdrawals can be tax-free.

After-Tax Contributions

Withdrawals may be subject to capital gains and even ordinary income tax.

Nonqualified

Mutual Funds
Stocks
Annuities
Real Estate

Pretax

401(k)
IRA

Pretax Contributions

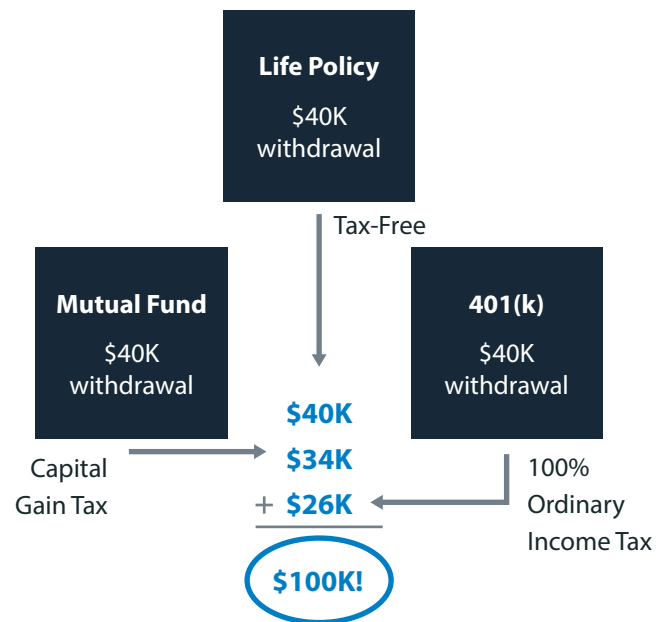Withdrawals may be subject to 100% income tax.

WHY IS TAX DIVERSIFICATION IMPORTANT, AND HOW DOES IT WORK?

Clients need to decide where to invest their additional retirement savings. Diversifying the income tax treatment of investments can reduce income taxes in retirement. Let's assume husband and wife withdraw $120,000 from their 401(k). They would be left with $78,000 (assuming a 35 percent tax rate). Instead, if they took $40,000 from each of the three alternatives – $40,000 from their 401(k), $40,000 from a mutual fund and $40,000 from a permanent life insurance policy – they could potentially receive net income of $100,000 (assuming a 35 percent income tax bracket and 15 percent in capital gains taxes). As you can see, diversifying taxes is an important part of retirement planning. Life insurance can provide supplemental income in a tax-favored way (without the same limitations that are placed on retirement plans), and provides a death benefit for the heirs.

NON-DIVERSIFIED WITHDRAWALS

Life Policy
$0
withdrawal

Mutual Fund
$0
withdrawal

401(k)
$120K
withdrawal

$78K ← 100% Ordinary Income Tax

DIVERSIFIED WITHDRAWALS

Life Policy
$40K
withdrawal

Tax-Free

Mutual Fund
$40K
withdrawal

401(k)
$40K
withdrawal

Capital Gain Tax

$40K
$34K
+ $26K ← 100% Ordinary Income Tax

$100K!

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