

# The Wave of the Future in Retirement

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In light of the impending tax hikes, it is becoming increasingly prudent to convert taxable retirement income into tax-free retirement income.

Our experience shows us that retirees and pre-retirees are not only concerned with having enough money for the rest of their lives, but also concerned with the implications of taxes on that income. It is pretty clear to anyone who gives it thought that given the opportunity, taking tax-free income could potentially leave a retiree with more money to live on for a much longer period of time.

Unfortunately, the mainstream financial press historically has not been very conducive in discussing various structural planning techniques that allow a retiree to have tax-free income. It is certainly possible retirees might not be aware such techniques are available.

While there are variations on this theme, one popular planning technique is called IRA Rescue. The concept here is to use a high-grade Indexed Universal Life (IUL) policy that is structured to maximize the availability of tax-free income or a lump sum. This technique can be used in a number of ways.

One example of when a client would need an IRA Rescue is when a client has excess IRA assets that are not likely to be needed for income. The IRA Rescue technique works best when the IRA is distributed over a short period of time, say, five years, and fed into an investment-grade IUL policy. The idea with this type of plan is to minimize the cash build up and maximize the death benefit, so as to provide a tax-free lump sum at death to a client's heirs or beneficiaries.

In one illustration, we took a distribution from one IRA over a 5-year period. Each year we deducted the tax first and paid the balance into the investment grade IUL. The result in this type of plan is that the owner turned a taxable \$500,000 IRA into a \$1.4 million dollar tax-free death benefit to the heirs, free of any government regulation! With proper legal advice about using trusts, a lump sum can be removed from any potential of estate tax.

The other variation of the IRA Rescue is used when a client wants to maximize their tax-free retirement income. This technique works very much the same way in that the IRA is distributed over a short period of time, say 3 years, and fed into the investment grade IUL policy. The difference between this plan and the one previously mentioned is that we minimize the death benefit and maximize the cash build up. We are utilizing the tax benefits of a life insurance policy for maximum tax-free income.

For example, a male, age 55, has an IRA valued at \$500k. His number one concern is to keep his money safe from market loss. In addition, he wants the cash value to earn a reasonable rate of return and to "lock in the gains" when credited, all on a tax-advantaged basis. In this type of plan, as the taxes are due on each distribution, the amount needed to pay the taxes is subsequently borrowed from the policy so as not to disturb the earning power of the original principal fed in. (Properly structured, the money borrowed is from a side fund of the insurance company, not the client's working principal.) The net result of this illustration, at age 70, provides a tax-free income in the amount of just over \$108,000 per year. That is equal to a taxable equivalent yield of over \$155,000 per year! The net result allows the client to have an income of \$2,160,000, tax free, and to still have a death benefit of at least \$400,000.

Most economists and financial advisors agree that the trend for tax rates is going to be increasing. Given that fact, tax-free income and IRA conversion techniques are the wave of the future in retirement planning.

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