Laddering, *continued from page 9*

money mature in a low-interest-rate environment.

The advantage to the clients is that they no longer need to worry about the direction of interest rate movements, especially if the ladder has notes coming due every couple of years or so. If rates do rise soon after one year's bonds are purchased, comfort can be taken in the fact that soon additional monies will come available to take advantage of the change. Similarly, if rates fall after a purchase, higher rates have been locked in for that portion of the portfolio. The bottom line is you don't get stuck one way or the other.

Ladders can be made with any type of bond (Treasury, corporate, municipal) as well as certificates of deposit, although Treasuries are commonly used because they have relatively little risk and are widely available.

In addition to being available through brokerage firms, Treasuries are also available directly from the government through a program called Treasury Direct (www.treasurydirect.gov). However, while Treasury Direct allows purchase as low as $1,000 at no transaction costs, it only offers new issues. New Treasuries are only offered in maturities of three months, six months, two years, three years, five years and ten years. Consequently, constructing a well-designed laddering structure to meet specific client needs is pretty much impossible using Treasury Direct alone.

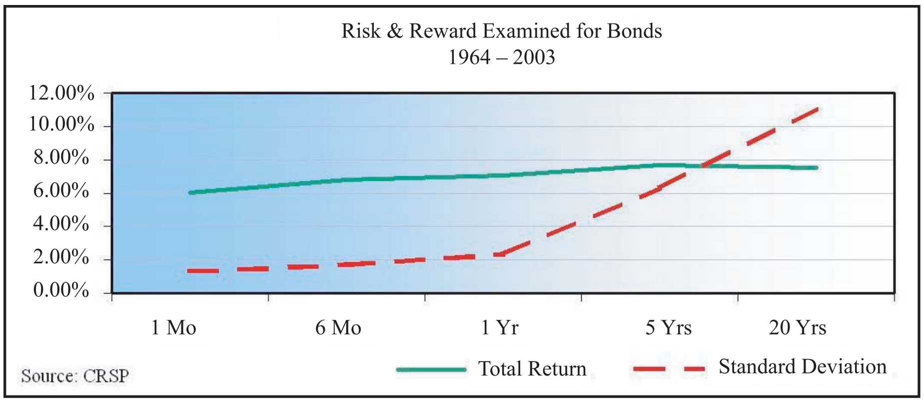
Similar to dollar-cost averaging in stocks, laddering a fixed income portfolio may not provide the highest return available over a given period of time. The "averaging" of interest rates means there is a potential for lower returns. For example, if interest rates remain unchanged, or decline when it is time to reinvest, a laddered portfolio would yield less than if the investor had locked in a longer-term rate. Historically, however, averaging has produced better long-term results than trying to pick the top or bottom of the interest rate cycles.

Given the dynamic nature of interest rates, it is difficult to predict the timing or direction of the market's next move. While there is no way to completely eliminate an investor's exposure to interest rate fluctuations, it is possible to minimize the impact by using a bond ladder.

Bond-laddering can be a tricky arrangement. Consult an investment professional before committing to an investment. §

1 For example, see Edward L. Martin, "Intermediate-Term Bonds" AAII Journal, January 1991, pp. 13-16.

2 Treasury instruments 1964-2002: CRSP. Standard deviation annualized from quarterly data.



About the author

Gary E. Pia is President of G. E. Pia & Company, a registered investment-advisory firm. The firm's practice includes retirement solutions for individuals, advising employers in the creation and fiduciary oversight of qualified retirement plans, and the implementation of the strict fiduciary duties owed by trustees, executors and administrators to their heirs and beneficiaries.

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Full pre-retirement income is not necessary in retirement years

TAX: Paying less tax on income means clients can maintain a similar lifestyle before and after retirement.

By Richard Malamud, CPA
Special to the ECP

How many times have you heard your client tell you, "I can't retire because my pension and other income is not equal to my current salary and I need the same income I make now just to pay my bills?" Even if 100% of current cash flow is necessary to retire, your client doesn't need 100% of current income. In fact, tax savings can greatly reduce that income requirement and if your client moves to a no-tax state, the requirement can be reduced even further.

Taxpayers do not need 100% of income to achieve 100% of cash flow because their salary is subject to the Medicare and Social Security taxes, which take 7.65% of their gross salary. Retirement income is not subject to these taxes, so the same cash flow can be achieved after retirement simply by receiving 92.35% of salary (100% - 7.65%). However the math is far more complicated because income tax is paid on the gross salary, so in effect wage earners are paying tax on their Social Security tax. Thus, assuming a 30% federal and state marginal tax rate, tax on the 7.65% creates an additional FICA tax of almost 2.3% for a total of 9.95%.

NOTE: Even if all of the retirement income is taxable, a retiree only needs about 90% of pre-retirement income because of savings in Social Security taxes alone.

The following chart illustrates how dramatically income needs can drop after retirement because of tax considerations alone. It calculates the after-tax cash flow for a 62-year-old single individual at various

See **Income**, *page 11*

Income, *continued from page 10*

Income Comparison

Pre-retirement income					
Salary/AGI	**40,000**	**50,000**	**60,000**	**70,000**	**80,000**
Less:					
Soc. Sec.	(3,060)	(3,825)	(4,590)	(5,355)	(6,120)
Federal tax	(4,756)	(7,256)	(9,756)	(12,256)	(14,808)
State tax	(1,462)	(2,363)	(3,293)	(4,223)	(5,153)
Net cash	30,722	36,556	42,361	48,166	53,919
Retirement Income					
Pension or other income	**22,760**	**30,800**	**39,370**	**48,140**	**56,925**
Add: Soc. Sec.	12,000	12,000	12,000	12,000	12,000
Less:					
Soc. Sec.	-	-	-	-	-
Federal tax	(3,666)	(5,456)	(7,594)	(9,781)	(11,981)
State tax	(364)	(792)	(1,414)	(2,196)	(3,014)
Net cash	30,730	36,552	42,362	48,163	53,930
Pension/salary percentage	**57%**	**62%**	**66%**	**69%**	**71%**

salary levels and compares that to the amount of pension income required by the same individual to achieve the same after-tax cash flow after retirement with Social Security income of $12,000.

This illustration is simplistic and does not consider other issues such as state employment taxes and lifestyle changes at retirement. Many taxpayers will have itemized deductions and other tax and non-tax issues that will affect both their taxes and their cash flows. However, all other things being equal, this taxpayer will require only 57% - 71% of his or her former salary to reach the same cash flow while retired.

In addition, more than $3,000 less retirement income is needed to obtain the same after-tax cash flow if an $80,000-a-year taxpayer moves to a state that does not have an income tax. Even lower-income taxpayers may benefit by more than $350 just by moving to the right state. But then how could they visit their grandchildren? §

About the author

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Social Security death index Web site is a useful practice tool

INFORMATION: Date of death is important for different types of filing, and can be found easily through a Social Security Web site.

By Wayne Otchis, CPA
Special to the ECP

As your practice matures and your clientele ages, do you find yourself checking the obituary column in the local newspaper more and more often? Many newsletter subscribers and seminar attendees have reported that this has become a daily ritual as their practice has grown and has lost any morbid connotations that once may have been associated with it.

Along the same lines, there is a Web site that may prove beneficial in your practice. This site is offered by the Social Security Administration (SSA) and contains the names of over 72 million individuals registered under Social Security who have passed away. By entering the Social Security Number or name (if SSN is unknown) the user will, within seconds, get a report showing the date of death and city where the person passed away. If it's a common name and you don't have the SSN, you may have to sort through pages of listings to find the person you are looking for. A very unusual name often only produces one entry.

Why would a tax preparer use such a Web site? Here are just a few uses of the site:

- Confirm the date of death for a trust or estate return.
- Allocate income on a combined 1099 when you don't have the death certificate handy.
- Obtain investment valuation as of date of death for basis step-up purposes.
- Satisfy your curiosity as to why an elderly client did not come in this year to have their return prepared.

The SSA updates the site quarterly,

See **Site**, *page 12*