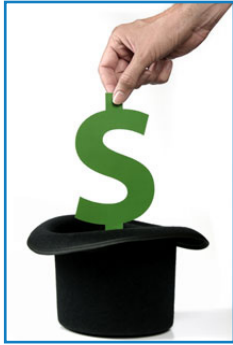


SECOND OPINION



There is No Rule of Thumb for Taxes

Q: I am 67 and retired. My wife will soon retire. We have several healthy IRAs to supplement Social Security income. One concern is guessing how much we can withdraw from our IRAs each year without jumping too many tax brackets.

Is there a SIMPLE way to estimate how much we can withdraw each year without jumping tax brackets? I asked the IRS, but they got stumped at the word "simple." Is there estimating software that we could use for our purpose without having to buy official tax software each year? - J.T., Houston

A: Calculating the amount of Social Security benefits to be taxed is one of the most vexing tax problems we face. It's difficult to come up with rules of thumb. Also, because adding \$1 of regular retirement income can cause you to add as much as 85 cents of Social Security benefits to your taxable income, it's very easy to "overrun" a tax bracket and see a major increase in your tax bill.

The best do-it-yourself tool is the one you don't want to use: tax software. Buy it, and you can play with different options for minimizing your tax bill. The best alternative is to ask your tax preparer to do some tax planning for you. If your income situation is stable, you'll have some simple steps to follow each year.

One thing you can do is to draw your spending money from regular assets rather than qualified accounts. This will reduce your taxable income because you'll be spending

principal. Another thing is to defer taking Social Security benefits and draw down your qualified plan assets until you are 70 1/2 and need to take Required Minimum Distributions.

Q: How should a couch potato investor be reacting to the large downturn in the housing market? My portfolio consists of 15% REITs. Should I sit tight and allow the asset allocation to pull me through, rebalance the portfolio now rather than at the end of the year, or get out of the REITs for the time being? - F.M., by e-mail

A: The goal of asset allocation is to combine asset classes in ways that work to reduce the volatility of the overall portfolio. When you hold many assets, it is a certainty that some will be doing better than others. Some may be doing poorly. The moment you start to cherry pick by eliminating the asset class that's doing poorly is the moment you'll lose the benefits of asset allocation.

Worse, there's a very high probability of being wrong - of selling the asset that should be bought and buying the asset that should be sold. My advice: Trust diversification. Rebalance at the end of the year. You may need to add some to your REIT position.

Q: Could you tell me how the change in Medicare premiums occurred after all these years of always being the same for everyone but is now indexed to income? I happened to make a transfer to a Roth IRA in 2005 and now have an additional monthly charge for Medicare coverage for this year. Had I known of the change in Medicare charges, I would have considered the added Medicare charge in my tax planning. - D.M., Houston

A: Many have been surprised by the premium increase, but it's here and it's real. While the monthly premium for most people (singles with income under \$80,000 and couples with income under \$160,000) is \$93.50 for this year, it will go as high as \$162.10 for singles with income above \$200,000 and couples with income above \$400,000.

Somehow, I don't see a mass protest movement based on this since the increase is modest relative to income and most retirees will pay the base amount.

This is the third step our government has made to take back some of the benefits politicians of both parties have promised while seeking election. The first was the initial taxation of Social Security benefits during the Reagan administration. The

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second was the increase in taxation of Social Security benefits during the Clinton administration. I think we can expect more weaseling on promises from politicians of both ilks as more boomers retire.

Many people retiring will get snagged for higher premiums because the premiums are based on 2005 reported income, not your income in 2007. Fortunately, it is possible to dispute your increase. You can find all the basic information online at www.ssa.gov/pubs/10162.html

(Questions about personal finance and investments may be sent by e-mail to scott@scottburns.com or by fax to 505-424-0938. Check the Web site:

www.scottburns.com. Questions of general interest will be answered in future columns.)

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On The Net

Medicare information on new premiums, including how to dispute your premium increase:
www.ssa.gov/pubs/10162.html

Centers for Medicare and Medicaid Services press release on 2007 Part B Premiums:
www.cms.hhs.gov/apps/media/press/release.asp?Counter=1958

Senior Citizens League estimates of future premiums:
www.cms.hhs.gov/apps/media/press/release.asp?Counter=1958

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