SMART INSIGHTS FROM PROFESSIONAL ADVISERS

Why Guaranteed Income for Life Doesn't Always Offer the Best Retirement Options

Focusing on accumulating assets may give you opportunities to benefit from government tax incentives and programs, and to transfer wealth to loved ones.

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Today's retirees are probably the last generation that will benefit from reasonable lifelong pensions. With pension income, plus Social Security, octogenarians are aging knowing they can cover their needs (food, clothing, utilities and some modest amenities) for the rest of their lives. For people who want to ensure their own casual comfort and financial independence, a guaranteed retirement paycheck is a good deal.

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However, due to the structure of government programs and taxation, people with assured lifetime incomes may find it difficult to transfer their wealth to their children. Also, America's tax system favors people who have assets more than people who earn guaranteed income. While large incomes usually limit your ability to receive government assistance, owning substantial assets often doesn't stop you from using these programs.

So yes, while stable incomes may be good for retirees, you may also want to consider maintaining your available assets. Here's why:

1. Income Tax Rates Are Higher Than Capital Gains and Estate Taxes

Capital gains tax rates on "passive investments" are significantly lower than "sweat labor" income tax rates. In other words, people who own assets that appreciate in value pay a lower percentage in taxes than people who earn it by working.

And even though gift and estate taxes have some of the highest rates of all taxes, there are many exemptions, exceptions and planning mechanisms to minimize these transfer taxes. Consider the fact that less than 0.1% of couples pay a federal estate tax when they die. That should shed some light into how much our tax system prefers successful families transferring wealth over struggling families creating a decent living wage. Advantage: Asset owners.

2. Government Programs Have Income Limits

People with high levels of income don't qualify for these types of assistance programs. Medicaid planning for aging family members is the best example: People with large incomes, such as former employees who receive pensions, face a very hard time shielding their pension income from paying medical expenses. Income must be paid over to pooled trusts or directly to the government to qualify for Medicaid. But Medicaid prospects with assets can transfer them to family members with proper planning.

Another example: One of my clients is living in a midtown Manhattan apartment under a New York rent control program for disabled individuals because he receives less than $1,200 a month of disability income. The fact that he has $240,000 in the bank is irrelevant to the city's calculation.

Even the Affordable Care Act works better for asset holders than income earners. That's because mandated health insurance premiums are based on income, not assets. For instance, an adult whose apartment was purchased by his parents or whose checking account was fortified by gifts from his grandparents could still receive relatively low premiums despite being rich in assets.

3. Assets Are More Private than Income

While your assets are private information, the government (and often the media through public records) has the ability to obtain substantial information of your reported income. For example, you can probably find out how much money your favorite movie star, athlete and corporate CEO earned last year. But if you try finding out how wealthy these people are, all you will usually see is a wide-ranging estimate of their net worth.

4. Income Is Inflexible and Difficult to Transfer; Assets Are More Fungible

Your income is usually set in stone. When you retire, what you get from pensions, Social Security and interest or retirement plan requirement minimum distributions remains somewhat static. That leaves you few options to adjust your budget for changes. And typically, you can transfer some of this income to only one person: a spouse. Families who have large incomes tend to lose that money when the earner dies.

People with assets, however, can change how their assets are invested within a few days, or transfer their investments to other people quite easily by just writing a check or drafting a legal document like a deed or business agreement. Therefore, people who already have assets can transfer their wealth to other family members.

The moral of the story: In order to take full advantage of government programs while also creating opportunities to transfer wealth to family, focus on building your asset base. You may want to consult with professionals regarding lump-sum retirement plan options. Also, be cautious when using commercial annuities, and avoid locking up your assets in long term income-generating investments when you can, especially in low-interest rate environments.

Income for life looks good, but it is usually only good for *your* life and only if you are opposed to receiving government assistance.

SEE ALSO:
State-By-State Guide to Taxes on Retirees

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