THE WHITE PAPER

Strategies for Managing Your Assets

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How Taxes and Inflation May Affect Your Retirement Portfolio

Benjamin Franklin famously stated that the only two certainties in life are death and taxes. But there's at least one more that could probably be added to the list: inflation.

Inflation is the sustained, ongoing increase in the general level of prices for goods and services. As prices rise over time, the purchasing power of every dollar goes down. Due to inflation, one dollar in ten years will likely purchase less than the same dollar would today.

How Inflation Is Measured

The rate of inflation in the United States is measured by the Consumer Price Index (CPI), which calculates monthly changes in the prices paid for a representative basket of goods and services. Over the past three decades, inflation in the United States has risen at an annualized rate of 2.69%.[1] This has shrunk the purchasing power of $1 in 1985 to just $0.45 today.[2]

It is critical to understand the effects of inflation on a retirement portfolio, because a retirement account in the future probably won't have the same purchasing power that it has today. For example, a $1 million portfolio today would need to grow to $1.7 million in 20 years to have the same purchasing power.[2]

But inflation is not the only potential hazard to the long-term purchasing power of your retirement nest egg.

The Tax Man Cometh

Let's go back to Mr. Franklin, because taxes may also impact how much money you actually get to put in your pocket when you begin taking distributions from your retirement account in the future.

Many retirement plans allow participants to save money on a tax-deferred basis, but this isn't the same thing as saving on a tax-free basis. When you contribute money to a traditional IRA or 401(k), for example, your contributions are excluded from your current taxable income. In other words, you don't have to pay tax on the money today, but instead are deferring this tax until you begin taking distributions from the account typically during retirement.

In comparison, contributions to a Roth IRA or 401(k) are included in your current taxable income. And since you are paying taxes on the money now, you don't have to pay taxes again when you withdraw the funds during retirement.[3]

Pay Me Now, or Pay Me Later

One of the decisions you must make as part of your retirement strategy is whether to invest on a tax-deferred basis, and pay taxes when you withdraw the money, or invest tax free and pay the taxes now?

No one has a crystal ball to predict whether tax rates will be higher or lower in the future. That is why it is important to work with a financial planning expert who, using sophisticated retirement planning tools and software -- and taking your individual circumstances, risk tolerance, and goals into consideration -- can help you work through various inflation and tax scenarios to determine the most appropriate strategies for you.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

[1] *United States Department of Labor -- Bureau of Labor Statistics. For the 30-year period ended June 30, 2015.*

[2] *Wealth Management Systems Inc. based on price inflation for the 30-year period ended June 30, 2015.*

[3] *Withdrawals from qualified plans taken before age 59½ are generally subject to a 10% additional federal tax -- on top of any regular income taxes owed -- although there are a few exceptions to this rule.*

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