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TAX CUT MAY HIT RETIREMENT SAVINGS, MUNI BONDS

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President George W. Bush's plan to eliminate taxes on dividends will be a big boon for stock market investors - but it may discourage long-term retirement savings.

While the dividend tax cut will make dividends tax-free in the year they are distributed, while withdrawals from 401(k) accounts where dividends have been reinvested will be taxed as ordinary income in retirement.

"The incentive for people to put money away for retirement is disappearing," said Jacob Friedman, chairman of the tax department at Proskauer Rose LLP, a top law firm. Other financial advisers expressed concern as well, saying they had already held meetings with clients to re-evaluate which stocks to hold in retirement plans and which to hold outside of tax-deferred plans.

"A lot of my clients have asked about this as details of the Bush plan leaked out," said Ralph Anderson, a senior vice president at Neuberger Berman. "But this is just a proposal now, and will be worked over on its way to becoming law, and it's highly possible that this inequity will be dealt with in Congress."

While stock investors greeted the Bush plan with cheers, there were catcalls from real estate investment trusts and states and cities that issue municipal bonds.

That's because stocks will become a much more attractive option, while REITs and munis will be less attractive since they no longer have a tax advantage over stocks.

"The total elimination of taxes on dividends puts municipal bonds at a disadvantage, since dividends become an alternative source of tax-free income, precisely at a time when state and local governments need all the help they can get," said Sam Stovall, chief investment strategist at Standard & Poor's.

Within the stock market, large-cap stocks are the most likely beneficiaries, since most of them already issue dividends.

"If investors were to buy stocks based on dividend yield alone, it could be safe to conclude that the large-cap S&P 500 would be the most attractive of the three major [S&P] benchmarks, since 70 percent of the companies in this index currently offer dividends," said Stovall.