David McKnight

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SUMMARY KEYWORDS

tax, question, money, pay, bucket, social security, ira, year, tax rates, provisional income, tax bracket, david walker, taxes, retirement, people, long term care, irs, coyote, roth iras, taxable

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Well, thank you for joining us today for the Career Speaker Series. This series brings to you the nation's top career authors who provide tips, tools and best practices you can use to create a successful career strategy. Hello, my name is Don Philbin, and I'll be your host, I'm really excited to share with you our guest today, David McKnight. He's a financial services professional and he is author of the power of zero. So in the next hour, you're going to learn how to deal with some amazing ideas that he will share with you as you prepare for your retirement years. Now, before we get started, have your pen, paper or electronic device ready to take notes? Check the download option to gain access to resources that will help you integrate David's ideas and ask questions, you can submit your questions by clicking on the main menu in front of you share your questions when you think of them, type them in. So I can share with them with David during the q&a session at the end. This is really about you. And those questions are important. So don't be shy. Get those information out. You will get advice from David today. So you're also invited to help influence our program. So offer your thoughts on how we can continue to be a support to your career. And to do that, click on the menu option that says give us your feedback. And then keep in mind you can fill in the frame on your computer with a presentation today by clicking on the crust arrows in the bottom right of the slide that essentially fills the frame. And then when you need to ask a question to simply hit escape. So let's learn a little bit about our speaker today. David McKnight graduated from Brigham Young University with Honors in 1997. And his popular workshop, the power of zero has been seen by 1000s of people from coast to coast. This workshop was recently showcased on the main platform at form 400. It's an annual gathering of the top 1% of financial advisors in the nation. It's the kind of information most people pay big bucks to participate in. And you're very lucky to be able to hear some of those ideas today. Also in in 2014, David was the focus speaker at the worldwide conference $4 million roundtable in Toronto, Canada, Canada. And he's also a top of the table qualifier as the author of power of zero, which was one of the actually to Amazon best selling books the power of zero. And look before you Li Rp. He contributes regularly to a number of national magazines on the subject of tax free retirement, David has trained 1000s of financial advisors on his tax free paradigm and currently serves as mentor to an exclusive group of financial advisors from across the country. So today, David is going to be your private consultant. And he's going to share with you his philosophies and his ideas from the book The power of zero. And we welcome you to ask questions at any time, David, thanks for joining us today.

03:20

Thank you, Dan, for having me. Thanks, everybody for being on the call. We're actually as it says here on the screen, we're gonna have a start with a final exam. And really, it's more of a quiz. So normally, I would do this presentation in front of an audience where I can interact. So I'll ask a lot of questions. Consider those questions rhetorical. So if I asked a question, you can just I'll pause for two seconds and let you try to answer it in your mind. By the way, there's also quite a bit of animation in my slide show that did not show up, you'll figure out which slides those are pretty quickly. The module here doesn't allow us to show the animation. So let's just jump right in. So the first question on the quiz is simply this. What is the highest marginal tax bracket and as your country what's the worst it's ever been? Well, the last two years of World War Two, the highest marginal tax bracket was 94%. And that was for any dollar that you made above and beyond $200,000. Now $200,000 back then was a pretty big deal was about $3.2 million in today's dollars. Well, can you even think of anybody back then that made that type of money? Well, there were you know, your Rockefellers and your Carnegie's and your JP Morgan's, but there was also an actor who later became a politician. Can you think of who that was? Let's try it was Ronald Reagan. If you study Ronald Reagan's biography, he talked about how he never made more than two movies in the year Reason being he made about $100,000 per movie, and any dollar he made above and beyond $200,000 he only kept six cents on the dollar. Now truth be told he didn't even get to keep the six cents. Who do you think got the success some people might Say the MC or his agent actually went to the state of California to pay for state tax. So it literally did not pay for ronald reagan to work past the month of June. So if you read his biography, facts, the houses the rest of your off, he rode horses, went to his ranch started making movies again, January 1 the following year. So that was a long time ago. Let's see if we can fast forward to the 70s was the highest marginal tax bracket during the entire decade of the 70s. So you can see it there. It's it's 70%. Once again, for any dollar you made above and beyond $200,000. That's fast forward to 2012 2012. What was the highest marginal tax bracket? What was the tax rate at which Bill Gates paid taxes on most of his income? So it is earned income anyway? Well, as you can see, here, it's 35%. So I usually like to ask people is 35% of good deal compared to what we experienced in the past? And this is not a trick question. And the answer, of course, is this. It's a great deal. Okay. tax rates hadn't been this low, really in 80 years. That's interesting, because I do this workshop all across the country. And I routinely ask a roomful of people how bad taxes were in 2012. And what do you think they say, oh, as bad as they've ever been. The truth is, in 2012, they were just about as good as we've seen in our lifetime. But something happens to that tax bracket in 2013. Do they go up or down? They went up? Why did it go up to? As you can see, here, it went up to 39.6. Now 39.6, is not enough to keep me awake at night. Okay. And the reason is, is because 39.6 is what tax rates were throughout the entire decade of the 90s. Can you guys remember how well the stock market was doing in the 90s? Yeah, it was it was doing phenomenally. In fact, if you put $100,000 in the s&p 500, in 1990, took a nap for nine years woke up in 1999. Over that 100,000 be worth the worst around $600,000. And that's under these types of tax rates. So again, not enough to keep me awake at night, the real question I have for you, is what is likely to happen to tax rates in the future as we move forward in time to 2017 2020 and beyond. And as you know, there really are only three things that can happen to tax rates as we move forward in time, they can either go up, they can stay the same or they can go down. So I want you to think OSHA, ask yourself, are tax rates in the future likely to be higher or lower than they are today? And if you think that they're going to be higher, I want you to ask yourself, why? What could we be spending money on as a government that could literally forced tax rates to go up? Well, I get a lot of different a lot of different really good guesses. So you've got some really some common ones. You've got Social Security, Medicare, Medicaid, interest on the debt, I like to talk about the debt. We have $20 trillion of, of national debt, we owe some of that for ourselves. We bought some from ourselves, or we loaned it, some of it to ourselves. We borrowed some of it from Social Security. But who else do we owe a lot of that money to? When we owe a lot of that money to China? And if he has recently realized that the US Treasury just came out with a new $100 bill.

08:18

I think that's just China's got all the old ones. That's as good as they get folks. It doesn't get any more comedic than that. So how are we going to liquidate all that debt? Okay. So if we were to look at all of the different things that we will likely the spending money on, we've got the fence, we've got infrastructure gets inches, I'll tell you, I met with a lady the other day, I said, what happens to your pension. If your company goes bankrupt, she says I don't worry about my pension. My company goes broke the federal government guarantees that I will always receive two thirds my pension every year till I die, folks. That's what we call an unfunded obligation. What's an unfunded obligation? It's a promise that the government's made that they can't afford to keep, okay. There's, you know, they've made over $120 trillion of promises that they can't afford to keep, I mean, the list goes on and on, and we get health care, you get welfare stimulus, so on so forth. But let's see if we can wrap our brain around why we have we have so many problems with debt. Let's open up a brief parentheses on Social Security. So the first question to ask you is in what year Social Security first established? When did they roll out social security? Well, it was the linchpin of the New Deal, right? It was the hallmark of the Roosevelt administration. So they rolled that out in 1935. And here's the question for you 1935. How many workers were continue? were contributing to social security for every one person that took money out? That ratio was 42 to one you had 42 workers putting money in to the program for every one person that took money out and back then, how well did you have to be to draw on social security? Well, it was 65. Anybody want to take a stab at what the average Life expectancy was back then, was 62. They didn't even anticipate that the average person would live long enough to ever drawn Social Security. And if you're lucky enough to make the 65 How long did you draw on Social Security before you took over dead? Well, it's about two years. So the question becomes, was Social Security pretty solid? when it first started out? And the answer is, yes, it was set up to last forever. And then something happened. soldiers came up for World War Two, and they started to do well, I'll get back up a little before you can understand what happened, we have to understand that there's basically five generations over the course of the last century, we started at the turn of the century of what we call the Henry Ford generation. These are what we call the Tom Brokaw calls the baby or sorry, the, the greatest generation, and then you have the silent generation, they were still sort of reeling from the Great Depression, you can see that the the population went down a little bit. And then we moved to what we call the baby boomers. Now remember, when the first baby boomer was born, my mom was actually one of the very first baby but were she was born January 17th 1946. And the last baby boomers Born in 1964. So if you find yourself somewhere in that timeframe, you are a baby boomer. Now, we have currently 78 million baby boomers is 25% of our country. Now baby boomers did have a few children of their own, but a few is the operative word there. They had what we call Generation X. Generation X, they had 32 million fewer children. Okay, and then a generation Y. I've got seven kids, that's exactly what I asked myself in the middle of the night. So when you look at this generation, that they are this chart that baby boomers have nearly as many kids as their parents do. The answer's no, they have 32 million fewer kids, which leads us to our our next problem. If I were to ask you today, how many workers are contributing to social security for every one person that takes money out? What does that ratio look like today? Well, today, it's three to one and another 10 years, it's going to be two to one. And what's the earliest age at which you can draw on social security? Well, you can draw as early as 62. And if you start drawing at 62, how long will you continue to draw? Before you tip over dead? Well, all the way? Well, first of all, a lot of times when we think about life expectancy, the number 7778 pops up. That is life expectancy in our country, but that includes infant mortality, and all the bad things that can happen to you up until age 62. The truth is that if you make it to

62, and start drawing on Social Security, you will continue to drop social security on average, until age 85. Okay, so 23 years. So the question becomes, is Social Security just a little bit different today than when it first started out? Absolutely. I mean, it started out as insurance against living too long. And it slowly morphed into a pension program that covers us for nearly a quarter of our lives. Now ask this question. How do you guys have ever heard of a guy named David Walker?

13:10

Well, David Walker is what we call a Comptroller General of the federal government means basically, he was the CPA of the federal government. He did that for 10 years, under Bush and Clinton. So he's very non partisan. He's actually in the CPA Hall of Fame. He really knows what he's talking about. And David Walker, the reason I brought him up is because he probably knows more about these numbers, more behind them, you know about the math behind the scenes than anyone else on the planet. And you want to know what he said. He said, that Social Security and Medicare and Medicaid are like a fiscal cancer. That's enough from within, he says, You think social security is bad, he says Medicare is five times more expensive and Social Security says in order to be able to deliver on these two promises, he said this in 2018. So we would have to double taxes immediately. He says you don't have to double taxes immediately. But for every year that you postpone doubling taxes, the national debt will grow by $3 trillion per year, every single year until we get this magical moment when we have $53 trillion of debt in our country. So the question is this, what's wrong with a country that has $53 trillion dollars of debt? Because that's the path wrong? And the answer is, did you know that if we had $53 trillion of debt, that all of the revenue all of the tax revenue coming in at that point, would only be enough to pay the interest and all that now the debt level on any principle, let alone India Social Security, Medicare, Medicaid, any of the other programs we listed on the board there? David Walker was so concerned about this, that in 2008, he resigned and started to crisscross the country, raising the warning prior to whoever would listen in 2010. He wrote a book called comeback America. And in that book, he sort of diagnose the problem and he told he appeared on NPR in 2010 to talk about this book, and he told the radio show host he said, hey, it's actually set to double and we're gonna go pro. He says we're gonna slide and insolvency. She did believe him. So he says, Look, I can give you one four letter words, to explain why tax rates have to double. So she couldn't guess what it was. So they open up the phone lines, and people started a call, and nobody could figure out what the one four letter word was to explain why tax rates have to double. And so nobody could figure out what the word was. So I'm gonna open up to you guys and just sort of answer your brain. What is the four letter word that explains why tax rates have to double? I've heard a lot of interesting guesses over the years. Some people say life Some people say death. Some people say kids, but here's the answer. The answer is math. Math is the four letter word that explains why your Texas has to double. And what does he mean by that? Well, basically, it's like your own personal household. If you're bringing in $2,000 a month, or and your expenses are $4,000 per month, you have that you either have to double what's coming in cut in half what's going out or some combination of the two. I remember I was giving this same presentation, in a little cynical Fond du Lac, Wisconsin. This is two days before midterm elections in 2009. And I remember afterwards, everyone came up to me and I said, Dave, Dave, Dave, Who should we vote for? Who should we vote for? And I never felt so powerful. And I said, You know what, it doesn't matter who you vote for, because whoever gets elected, is going to inherit a math problem. The solution to which involves either doubling taxes, reducing spending by half, or some combination of the two. All right, I know we've got a lot of baby boomers in the room. So I know that you guys have all seen the roadmap. The question is who's always trying to kill the Roadrunner? The answer, of course wily coyote, were a couple of years ago, I was with my kids. You're watching The Road Runner. In this particular episode, the coyote was trying to kill the Roadrunner. And he was building a bomb with which to do so can you remember who makes his bombs? That's right, accurate. So he's building his bomb made by Acme inside a shed that was also made by Acme. And he was so focused and intent on finishing this bomb, that he didn't realize that the Road Runner had pushed his shot onto a train track. Now, very important question, most important question. And he also didn't realize until the very last moment that there's a huge freight train bearing down on a very important question. Most important question I'm gonna ask today, if you found yourselves on a train track, with a huge freight train bearing down on you. What would you do? Well, if you said get off the track run for safety, that would be the correct answer. And before I tell you what the coyote does, I'm going to read you a little snippet from a little blurb I found in the USA Today back in 2009, says a man from far west, Utah managed to bail out of his car that was stuck on a railroad track before the vehicle struck by a commuter train at 55 miles per hour. And he also is 62. So he took a wrong turn, and got his 98 Nissan Sentra, stuck between the rails when the easiest, important part I want you to pay attention when he saw the train lights approaching in his rearview mirror, ready for this, he decided to get out of the car.

17:57

Well, let's go back to the coyote instead of jumping out of the way, what does the coyote do? He simply pulls down the window shape, thinking that the act of doing so would make the problem go away? Does the problem go away? Well, of course not. You know, the shed blew up. And unfortunately, the coyote never really, really dies. It's a little frustrated. But as you as the camera came back to him, you could see him sort of limping off the screen very much worse for wear. Well, why do did we gather here tonight to talk about the coyote and the and the rover and well as Americans who do most of our saving for retirement, and what we call tax deferred vehicles like 401, KS and IRAs, we have a very real freight train that's bearing down on us and is bearing down on us in the form of what what's bearing down on us in the form of higher taxes. And we got a couple of choices of what we can do, we can pretend like the problem doesn't really exist, we can pretend like the math was David Walker refers doesn't really add up. But isn't that a little bit like pulling down the window shape, or we can implement some strategies that we'll be talking about tonight, they can help get you off the train tracks, thereby insulating and buffering you from the impact of higher text. So before we go any further, we have to evaluate the three different types of investments and there's millions of different types of investments out there. But all of those investments basically fit into three types of accounts. And you can see this is the slide that has a lot of animation. So we're going to try to work through this. But you can see there's three basic types of investments. The first one is what you call a taxable bucket, meaning every year as your money grows, you get to pay a tax. What are some common taxable investments we can see right there in the bucket, you get your savings account CD, money, market, stocks, bonds, mutual funds, 1099, so on and so forth. The question is, why do we have these types of accounts and every year that they grow we have to pay tax? Well, we have these types of accounts because they're very liquid. What is liquid means means you can get your hands on You can convert into cash without penalties or taxes, which means that they make for great emergency funds. What do financial experts tell us about how much we should have an emergency fund? Well, about six months worth of basic living expenses? So the question becomes, can you have too much money in your taxable bucket? And the answer is, of course, again, in fact, we see it all the time, we see couples that that lived through the depression, they shuffle into my office, and they said, Hey, we got nine CDs for 100,000 each and nine different banks, we think we may be changed, you mentioned tax, are they paying too much in tax? Yes, because you can have too much money in the taxable bucket. So the moral of the story here is that you can have too much money in your taxable bucket from a tax efficiency perspective. But you can have not enough from an emergency fund perspective. So what we're looking for in the taxable bucket is just the right amount. And just the right amount is six months worth of basic living expenses. All right, second type of bucket is tax deferred, meaning you don't pay taxes as your money grows, when you pay the tax, at the very end when you take the money out. So what are some typical examples of of tax deferred investment, so you've got your 401, K's, IRAs, 403, B's, some types of an annuity, so on and so forth. And typically, these investments, there's lots of different rules that apply to them. But generally speaking, they all have two things in common. The first thing that they have in common is when you put money in, you get a tax deduction. So for example, if you make 100,000 per year, and you put $10,000, in your 401k, what's your new taxable income? Well, it's $90,000 per year. The second thing they have in common is the manner in which they're taxed upon distributions. Now, the IRS has a special word that they use to characterize this income when you take it out. What do they call us income, they call it ordinary income, ordinary income. So what does that mean? That means that when you put money into your 401k, all you really did was defer the receipt of that income until some point much further down the road. And when you take the money out, at what rate Are you taxed? Whenever the tax rate happens to be in the year you take that money out? So folks, that's a little bit like going into a business partnership with the IRS. And every year the IRS gets a vote on what percentage of your profits, they get to keep Does that sound like a good business partnership? Anyone? So you can have a million dollars in your IRA, but unless you can accurately predict what tax rates are going to be in the year you take that money out? How much money do you know, do you have any idea how much money you really have? The answer, of course, is No. You don't have any idea how much money you really have. And it's pretty hard to plan for retirement, if you don't know how much money you have. Now.

22:35

I will tell you, some people, some experts, you may have even heard them on TV will say hey, don't worry, because you're going to be in a much lower income tax bracket in retirement than you were during your working years. I'm going to ask you ask yourself, have you ever heard that statement? And do you buy into Do you think it's going to it's going to be true? Well, this much we know. And this is a fact all of the deductions that you experienced during your working years literally vanish into thin air? Right when you need them the very most, which is when at retirement? So I've got them listed up here. What are the number, the top four examples of top four deductions people experienced during their working years? Well, the first one is your home. Is your home typically paid off by the time you reach retirement? And the answer is yes, a lot of times it is. But if you're 25 years into a 30 year mortgage, it was very interesting to look at that point. Not a whole lot. Second one is your kids. And this is a double whammy because your kids count as a as a credit and an exemption. Okay, a credit is $1 for dollar reduction in your tax bills. And an exemption is $1 for dollar reduction in your taxable income. I've got seven kids, once I figured that out. I never looked back. So here's the question. Are your kids still living with you in retirement? The answers? Hopefully not. But even if they are you just can't deduct them anymore. And those that are 401k. Are you still contributing to your 401k? in retirement answer, of course is no. The whole reason you did so you take money out by putting money in for purposes actions. And the last one we'll talk about is charity. And what we found is that if you were charitable during your working years, you're likely to continue to be charitable in retirement, only retirement, but it tends to be less money go around. So instead of donating money, what do people donate? they donate time. So instead of writing that, check out to the soup kitchen, they may actually walk down to the soup kitchen and ladle the soup themselves, which is incredibly noble and worthwhile. But what does the IRS Think about your time? Well, they don't think about your time at all. It's not a deductible activity doesn't even show up on their radar. So guess what all of these deductions during your working years may have added up to 5016 in some cases $70,000 of deductions. Absent any of these deductions in retirement, what do you have left? We have what's called a standard deduction. You throw in a personal exemption for yourself, person exemption for your spouse. You can see there it adds up to you see there in the middle adds up to about 21,000 dollars. Okay, so 40 5060 in some cases $70,000 in deductions during your working years 21,000 retirement. Okay. So I remember a couple years ago, oh, by the way, if you need $100,000 to live in retirement, you have $21,000 of actions. What's your taxable income? Well subtract 21 from 100,000, that gives you $79,000 of taxable income. That's, that puts you in a 25% marginal tax bracket thrown in another 6% or so for saying that you're looking at a marginal tax bracket of 31%. That's a lot higher than most people think I remember I listened to a radio show a couple years ago, Lady calls and she says, I don't understand. I'm making less money in retirement, but I pay more in taxes. How's that possible? And the radio show host says, oh, tell me about your deductions. She goes, deductions. I ran out of those A long time ago. He says, Oh, I think I understand your problem. So will we necessarily be in a lower tax bracket in retirement? Not necessarily. Now, how many guys have heard of the book called catch 22? Okay. Catch 22 by Joseph Heller, catch 22 main character of catch. 22 is a guy named yo sareum. Your Sarah was on a bombing squad, and World War Two, all his buddies were also involved in squads. And he noticed a very disturbing trend, all of his buddies would fly in the battle. One by one, they get shot down and they wouldn't come back. So he realized that if he kept on going on these bombing missions, sooner or later, he was getting one of those guys that flew into battle didn't come back. So we had to try to figure out a way to get out of this. So he starts to read the airforce rules and regulations when it comes across rule number 22. And rule number 22 says that if you complete insanity, you can be honorably discharged from the Air Force. So this is what he decides to do. He goes up to the superior officer says, You know what, I can't do this job anymore, because I'm going crazy. What does he say? He says, There's no way you could be going crazy, because this is the perfect job for crazy people. Okay.

26:52

He says the fact that you're trying to get out of it is actually proof that you're perfectly saying. So keep on going almost on emissions. And that's exactly what he had to do. Well, why do I tell you the story? Do we still use the phrase catch 22 today, of course we do. stuck between a rock and a hard place darned if you do darned if you don't. But you got to remember anything in this tax free bucket is the perfect modern day example of what we call a catch 22. Here's what you got to remember, if you look at look at the box in the upper right hand screen, that's our rock. Okay, that's our rock. Our rock is what happens when we take when we don't take enough money out. Okay? If we don't take enough money out, remember, the IRS forces you to take money out at age 70 and a half. It's called required minimum distributions. And if you choose not to or forget to take money out of that account, whether there's 401k. Ira, what have you, then they give you what's called a 50% excise tax. So if you're supposed to take out 10,000 chose not to forget, so you get a $5,000 bill in the mail. Does that include state and federal tax? No, throw another 31% on the margin, and you just lost 81% of what you're supposed to take out but did not. So that's a pretty big deal. I mean, the IRS is pretty serious about getting their money. So that sort of the rock, if that's the rock, what's the hard place? Well, the hard place happens when you take too much money out. Now. I gotta tell you, the IRS keeps track of something called provisional income, what is provisional income. provisional income is the income they track to determine if they're going to tax your Social Security. So what counts as provisional income? Well, any 1099 is from your taxable bucket counts, provisional income, any distributions at all from your tax deferred bucket count is provisional income, plus one half of your Social Security Council's provisional income. So the IRS adds all of this provisional income up. And as a single person, it adds up to more than 34,000 worth as a married couple that's up to more than 44,000, then up to 85% of your Social Security becomes taxable to you. So let's put that into perspective there look under the neath the middle bucket, there was a tax deferred, you can sort of see where it says Social Security 25,000 bucks, let's say you're you're planning on getting $25,000 of social security. And let's also say that you because of your distributions out of your tax deferred bucket, you're in the 25% tax bracket, okay, so you can sort of see that shaded in on the right side there. Let's also say that your provisional income exceeded $44,000. Well, the IRS is gonna say, hey, before we let you keep all of that $25,000 Social Security, we've got to do one additional calculation, because you exceeded the 44,000, then I'm gonna take 85% of that 25,000, which is about 21,000. And they're gonna drop it into your little tax cylinder over there. And that's going to land right on top of all your other income, at which point you get to pay taxes as 25% on the $21,000, which is about 5250 bucks. So because you took too much money out of your tax deferred bucket, you now have a $5,250 hole in your Social Security. Well, how do you think most people go about plugging that hole? Well, they take more money out of their IRAs and 401k. So here's a question for you. If tax rates went up to 50% like David Walker's predicting how much would you have to take out of your 401k or IRA to be able to pay the tax to the IRS and be left over with 5250? with which you could then plug the hole in your social security? Well, the answer, of course, is double 50 to 50 10,000 10,500 bucks. So why do I even bring this stuff up? I bring it up, because I've done the math 100 times in 100 different ways, and 100 different clients. And I have concluded that when your Social Security gets taxed, you run out of money, five to seven years faster than people who do not have their Social Security tax. Why? Because the act of compensating for Social Security taxation forces you to spend down all your other assets that much faster. All right, everybody, pretty much in a good mood right now. All right, let's do a little case study here. So a case study that we're going to do, oh, by the way, should go back and say, by the way, there is a tax free account, some people call it tax advantage, some call a tax preferred, some call it tax exempt, I like to call it tax free. Now, there's a couple of different things, we're looking for it with tax free, we don't want to have any states state tax, we don't want to have any federal tax, we don't wanna have any capital gains tax, we don't want distributions to count as provisional income. A lot of us may have heard of municipal bonds, or municipal bonds, for example, are not truly tax free, you can in some circumstances be taxed at a state level. And interest off of municipal bonds does count as provisional income, so it's not truly tax free. Okay, so now that we know that these three buckets exists, now, I'm going to give you a little case studies, we're going to talk about Mr. Mrs. Jones here, they're both 50. They have a household income of 100,000. And they plan on retiring at 65. Now, let's say that these folks, so we've got our buckets up here, we've got a taxable bunch of the tax free bucket, the tax free bucket. Now let's say that these folks have

31:54

$500,000. In their IRAs, they've got $100,000. In their mutual funds, that's their emergency fund. It's in the taxable bucket. They're putting 10% into their 401k. And they're getting no match no free money. They're paying $2,000 per year for some term life insurance. And they're paying $4,000 per year for some long term care insurance. Now, the question is, if this couple were to walk into a traditional tax deferred paradigm financial advisors office, how the conversation go? Well, I've been training tax deferral paradigm financial advisors for the last 15 years in the process of doing so, I've sat in their offices, and I've listened to them as they spoken to people like this for the first time. And this is how the conversation goes. As far as an IRA goes, is the first thing we'll say is Congratulations, you did a great job saving money in that IRA. When you switch, then they'll also say, problem is last year, you only got 7%, we think we can get you 8%. So roll that money over to us. As far as your mutual funds go, that's a great emergency fund problem is last year, you only got 3%, we think we'll get your five so managed service, or let us manage that for you as well. As far as your 401k. With no match goes keep on doing that. When you switch jobs, give us a call, we'll roll your 401k into your IRA and everything under one roof. Maybe we'll save you some breakpoints at some things. As far as your term life insurance, Long Term Care Insurance goes, gosh, you know, they might say it's not really what we do. But who are we this agency doing? Now, when someone like this walks into my office for the very first time I see red flags all over the place? For example, what's wrong with that IRA? I'm not so much concerned with what's in that IRA today. What keeps me awake at night is what that IRA is going to be worth 15 years from now, if it grows at a percent per year. What's that IRA going to be worth 15 years from now if it grows at 8% per year, but you can't really see it here, but the answer is $1.6 million. Now, I know it sounds great to have 1.6 million in your 401k or IRA. But what's the problem with that? The problem with that is that required minimum distributions alone on 1.6 million will put you in one of the higher marginal tax brackets, and also literally guarantee that your Social Security will be taxed in perpetuity. So what we want to do is we want to prevent that IRA from ever getting to 1.6 millions, how do you prevent an IRA from growing? And don't anyone say put it on the stock market? Well, one of the things that we can do is we can do what's called a Roth conversion. The Roth conversion basically says that if you have money in your tax deferred bucket in the form of an IRA, you can shift it to tax free, so long as you do what, so long as you pay taxes at current tax rates along the way. So let's say that this couple were to do a Roth conversion on the full $500,000 IRA, and they had a 40% marginal tax rate. What amount of tax would they pay? Well, they would pay $200,000. Well, what's wrong with that scenario? Well, they're what's wrong with it is is Mr. Mrs. Jones don't have $200,000 just lying around. They don't have it. You can't pay the tax out of the IRA itself. Because if you pay the tax out of the IRA itself, you're going to get a 10% penalty wise, for premature distribution. So here's the key. Even if you take money out of that IRA, and give it right back to the IRS in the form of a tax, if you're younger than 59 and a half, you will pay a penalty. So here's a thought for you. There's a little gnomes section of the IRS tax code, section 72, subsection t in our industry, we simply call it 72. t 72. t says that you can take money out of your IRA, pre 59 and a half without penalty, so long as you do it in separate equal yearly distributions, that lasts for at least five years, or Intel 59 and a half, whichever is longer. So these days, so when doing a 72, t could take out about 5%, three year. Okay. So let's go back to these guys. Okay, so if we were to do the IRA, we could take out 5% of that $500,000. It's just about $25,000. And we could shift it to tax free, okay, not a problem. Let's take a look at the mutual funds, if that's their view, if that's our emergency fund, would you say that they have too much, or too little in their emergency fund? Well, if they make $100,000 per year, they should really only have six months worth of living expenses, and that taxable bucket in that mutual fund. So not only do they have too much, they really should have about $50,000. So not only do they have too much, but they're growing in mutual funds every year, which means your problems growing and compounding each and every year. So what we want to do is we want to take

36:30

the growth on that mutual fund plus some of the principles shifted from taxable to tax free each and every year such that by the time they reach 65, they've got the perfect amount, which is about $60,000. I've done the math here, it's going to take a shift, if you look over in the far right column, it's going to take a shift of about $6,000 per year into the tax free bucket even each and every year for the next 15 years to get that down to the right amount. All right, here's where I'm going to challenge your paradigm. What do we think about 401 K's that don't have matches? Should we do them? Now, and I tell you this is the one thing that Suze Orman, Clark Howard a Dave Ramsey actually agree upon. The rule of thumb when it comes to 401k is as you do up to the match, but not a penny above and beyond you do whatever is required to get the free money. And then you move on to the next best thing. Well, if these folks are not getting any free money, okay, then we would want to recapture all 10% What's 10% of their salary and make 100,000 per year 10% of 100,000 10,000. So we want to recapture that and shift that to tax free. How do you feel that term life insurance or long term care insurance, we feel like it's incredibly important to mitigate these two risks either one of which could really, really upset your financial applecart. In the years leading up to retirement, however, we feel like sometimes not always, sometimes there can be a better way to pull that off. So we recapture that 2000, that 4000, respectively, as well. So how much total money that we free up on an annual basis to be able to reposition a tax free? Well, if you add up that far right column, it all adds up to $47,000. Well, usually at this point, it's almost a day and not so fast. You don't really have $47,000. And I'll say why? And they'll say because some of those recommendations that you made, are actually taxable events. And that's true, which ones are the taxable events? Well, the 72 teams coming out of the IRA, that $25,000, that's a taxable event. And then when you put less money into your 401k, that actually increases your taxable income on the margin. So that's actually an additional $10,000 of taxable income there so. So we have $35,000 of additional taxes, taxable, until if we want to try to take advantage of the strategy, if we say, taxes are 30%, that means you've got $10,500 of taxes each and every year that we would have to pay in order to do this strategy. Well, if you Mr. Mrs. Jones, here have $10,500 lying around that they would love to earmark for the sexual answer's no. And if we say quit going out to eat, quit, go on vacation, pull back the veil a couple of notches, just so you can pay that tax bill, will they return my phone calls? And the answer is, of course they won't. So we've got to find a way to help them pay the tax bill such that they we are not encroaching on their lifestyle. So what I might recommend is that if you remember, remember that 47,000 that we freed up there at the bottom? Well, I'm going to recommend that we pay the tax that 10,500 right out of the 47,000 we just freed up which means we really have $36,500 per year that we can reposition a tax free. So the question becomes Where can we put $36,500 per year, so that grows in a truly tax free way? Well, this point, I'm going to talk about my various favorite tax free investments. That's what we call a Roth IRA. Now, why do I like Roth IRAs so much? I like them because as long as you have earned income, you can put money into your Roth IRAs and the limit these days for Roth IRAs is 60 $500. per person, and for a total of 13,000 per couple. Okay, I love Roth IRAs, because so long as you're 59 and a half, all distributions are 100%, tax free. And I also like it because when you take money out of your Roth IRAs, it does not count as provisional income does not cause your social security to be taxed. So we put 13,000 of that 36, five into Roth IRAs that leaves us with sort of hard to see here, it leaves us with 23. Five, where can we put $23,500 per year such that it grows in a truly tax free way? Now, at this point, I may bring up a bucket of money that gets treated differently for tax purposes than anything else we've talked about so far.

And what does that what does that what does this bucket look like? Well, the IRS basically says, with this bucket, you can touch this money. If you're looking at the upper left hand, part of the screen here, you can touch this money pre 59 and a half without any penalty. Well, can you do that with your IRA or 401k? And the answer, of course, is no. The next thing is they say is that if you take the money out, when you take the money out the right way, it does not show up on your tax returns reportable income, what does that mean? That means the distributions are tax free. It also says if you look down below that says no income limitations. Now the questions arises. Can Bill Gates do a Roth IRA? Okay, remember what the the

41:29

there are income limitations for the Roth IRA. So once you start making north of $194,000, of modified adjusted gross income, you can no longer do a Roth IRA. Okay. Can my children do Roth IRAs? And the answer is, in order to do a Roth IRA, you have to have earned income, okay? You have to be working somewhere earning a paycheck, my kids work, I just don't pay. So none of those rules apply. None of those income limitation rules apply to this particular bucket. Next, there are no contribution limits. So I've got clients that do 50 bucks a month, and I've got clients that do $200,000 per year into this bucket. By the way, if you follow college football, you'll you may have noticed that the coach of Michigan, I think it's john Harbaugh, I can't remember it's either john or Jim, I think it's john. He just got one of these buckets. The college just gave him one of these buckets, it made him the highest paid football coach in college football because of this bucket, and then all goes tax free to him when he retires. And finally the one on the lower right. There are no legislative risks. What does that mean? I'll give an example. I've got a client in Cedarburg, Wisconsin, in 1963, he signed up for the Wisconsin State teacher pension plan. And one of the stipulations that they said at the time, was that if you take this money out in retirement, we're going to give it to you state tax free. We said that sounds great fun. Yep, I'm in. So he signs up. Well, guess what the very next year 1964. They changed the rule. They said, Now we are going to tax these things. At the state level, we'll Fast Forward 30 years, he gets his first Wisconsin State teacher pension check, do they take out state taxes? And the answer is they do not? What do they call that kind of clause, or we call it a grandfather clause? Well, the same thing has applies applies to this bucket, they changed the rules and this bucket three times in 80 to 84 to 88. And every time they change the rules, they simply said Whoever has this bucket before the rules change gets to keep it and continue to put money into them the old rules for the rest of their lives. And they usually at this point, someone will say Dave, this this is like the perfect This is like the perfect investment. It's just like a super Roth is like a Roth IRA on steroids. Why not just put all my money into this bucket? Of course I answer that by saying is it ever a good idea to put all your eggs in any one basket? And the answer, of course is No. Not only that, but the IRS says if we're going to give you the benefits of an unlimited bucket of tax free dollars, we require that there be a spigot attached to the side of the bucket. So you can see the spigot there through which flows on a monthly basis of expenses. And what are those expenses go towards? They actually go towards the cost of term life insurance. Here's the problem. If your house is paid off, your kids have moved out you're rapidly approaching retirement is Term Life Insurance really all that high on your wish list? And the answer is no. This is usually right about the time people start dumping the term life insurance. Companies that sponsor these programs recognize that so they've done something to sweeten the pot. They simply say that in the event that somewhere down the road, you should need long term care. You can sort of see the long term care if you're in the upper right hand corner, should you need long term care, they will give you your death benefit while you're alive for the purposes of paying the long term care. So let me give you an example. Let's say you have a death benefit of 400,000. You wake up one day you can no longer feed yourself at ease of transfer yourself What have you need to have six activities of daily living. You can find one doctor to write one letter to that effect, they will start sending you 2% of that death benefit or about $8,000 per month, every month for four years for the purpose of paying for long term care. They will discount that slightly based on how young you are when you say benefit, but the point is this there, there are companies out there, they're willing to give you your death benefit while you're alive for the purpose of paying for long term care. Now, I don't know how many of you guys have looked into traditional long term care. But traditional Long Term Care tends to give people heartburn. Why? Because number ones, you're paying for something that you hope you never have to use, because nobody wants to pay for something that you know where they're crossing their fingers, and I hope I never have to use this. Number two is that cheat can cost you anywhere from four to $1,000 per year for a couple number. The third thing is they can raise those expenses whenever they want, and they frequently do. And the last thing is, it can be hard to qualify for long term care, you might live to 120. But if you have a bad knee, about hip, that elbow, what have you maybe you don't even qualify, this is a little bit different. Because in the event that you should die peacefully in your sleep 30 years from now never have a year long term care, someone's still getting a death benefit. So there isn't that sensation of having paid for something you hope you never have to use. By the way, what do we call this bucket? We call this an L i Rp. What does that stand for life insurance retirement plan, why life insurance because the IRS says in order for this bucket to work, you got to be willing to pay those drops coming out of the spigot for that term life insurance. Why retirement plan because one of the ways that these what companies have done in engineering these programs, is they've designed them so that you build money up so that somewhere down the road, you can take money out and spend it on your lifestyle. And if you're in your life, when you're likely to

46:32

see tax rates are much higher than they are today. So before we go any further, you can sort of see I have my final question here. The final question is, is what is the perfect tax bracket? If you could be in any tax bracket or any tax bracket of your choosing in retirement, which tax bracket would you choose? And the answer? My favorite tax bracket is zero. Okay. Why? Because if you're in the 0% tax bracket, then tax rates double what's two times zero? And the answer, of course is zero. So question is, can we get these folks to a 0%? tax bracket? Well, we know that they've got the Roth IRA, that's going to be no tax. We know they've got the Li RP that's going to be no tax. Now, let's see here. So we've lost a little bit of our animation here. The question is, is there any way to get money out of their IRA? tax free, and it's got to be legal, if they have $500,000. If that is by doing the 72 t we kept their IRA from growing by the time they reach 65, they're still gonna have $500,000 in that IRA. The question is, is there any way to get money out of that IRA without paying taxes? The answer is yes. Okay. Then you can actually spend on your lifestyle. And remember, we said if you retire today, you're going to get a standard deduction of 12,600% exemption for your self first exemption for your spouse, it all adds up to about 20,700. Okay, does the IRS index that number, these numbers to keep up with inflation they do at about 3% per year. So over the course of the next 15 years before these guys retire, by the time they reach 65, they will have standard deductions and personal exemptions of 32,250. So the question becomes, if in retirement, do you have $32,250 of deductions? How much can you take out of your IRA without paying any tax at all? And the answer is 32,250. So if we were to go back to that IRA and say, how much do we want us to take out of that IRA in any given year, you want to take up 32,250? Because that's what your deductions are, in any given year. And as those deductions grow, you can take a little bit more out. Okay. So if we have a Roth IRA, that's tax free, and Li RP that's tax free in an IRA, that's actually what happens to social security? Well, if we can keep you below those provisional income thresholds, then your Social Security can be tax free. And if you have tax free tax, free tax free tax free, what tax bracket is that put you in? It puts you in the 0% tax bracket. Why do we make such a big deal by being in the 0% tax bracket? Like I said, if we can't get you the 0% tax bracket, what's the next best tax bracket? Well, isn't one, two or five, it goes all the way up to 10 thrown another 5% per state? You're talking 60%? If what David Walker says comes through tax rates have to double two times 15 is now 30. So all sudden second place, is it looking all that great? Now, I love it when things make sense, conceptually, but I love it even more when they make sense mathematically. So what I did was I actually did what I call a before and after comparison, I basically said if the couple the scenario we just went through if that couple had never met me, they never came into my office. We never helped them out and we didn't get some sort of 0% tax bracket, how much money would they will be able to spend in retirement, will they be able to spend a little over $4 million after tax. If however, we were able to get them and they run out of money by the way at age 85. If however, we were able to get them to the 0% tax bracket use their social security tax free, they can now spend just a little bit shy of 8 million, they have 1.4 million leftover at age 100. So mathematically, these can be very, very compelling if you can get to the 0% tax bracket. So there's three questions I typically get, and then we can get into some of your questions. Am I too old to do this? The answer is, you're not too old to do this. And David Walker, a number of other economists have basically said, hey, look, we can Congress can continue to kick the can down the road or raising taxes, however, there will come a point in time beyond which they can no longer procrastinate raising taxes, and that's about 10 years. So the real question should be is, is if 2017 rolls around, Willy and tax rates double, what do you look back on the year 2016 2017? And say, Gosh, why did I not take advantage of tax rates while they were historically low? Why did I not pay my taxes while they were on sale? Because all tax rates have to do in the futures go by 1%? For the math here to to success? Second question I get is can you be in the 0% tax bracket and still be a good citizen? I actually get that a lot.

51:03

And the answer is, you know, a lot of people say, hey, look, if we're almost 0% tax bracket, who's gonna pay for the roads? Who's gonna pay for the schools? Who's gonna pay for the social workers? Well, the answers, of course, we're not always going to be in a 0% tax bracket. But the other question is, did these folks pay tax? In order to get to the 0% tax bracket? The answer is they did, they did pay tax. In order to get to the 0% tax bracket, we're simply saying, you know, the the overall theme here is, when given the choice between paid taxes, and today's historically low tax rates, or postponing the name of those taxes till some point much further down the road, you're probably better off paying them today. Also, I'd like to read this quote by one of most famous judges to never become a Supreme Court justice. This is what he had to say, says anyone may arrange his affair so those taxes shall be as low as possible. He's not bound to choose that pattern, which best pays the Treasury, there's not even a patriotic duty to increase one's taxes. Over and over again, the courts have said that there's nothing sinister and so arranging affairs as to keep taxes as low as possible. Everyone does admission for life. And all the right for nobody owes any public duty to pay more than the law demands. So there's a third question, How come I've never heard this before? We're not going to get into that because we've we're sort of running out of time here. So why don't I just say, I know that I went through this very