

YOUR FINANCIAL ROAD MAP

*Planning For Life, Retirement,
and Financial Freedom*



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CHAPTER 1

INTRODUCTION

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According to Dahl's Wedding Company, the average time spent on planning for a wedding can reach 120 to 200 hours. That's 200 hours spent planning for 1 day. How much time do you spend planning for the rest of your life? As important as a wedding is, that day will come and go. Retirement, however, could last you 20 years or more.

Our belief is that if you ask ten different people how to describe financial planning, you'll get ten different answers. And unfortunately, if you ask ten financial advisors the same question, you'll probably get an entirely different set of answers. We wrote this book to help demystify the concept of what financial planning is and to bring clarity to why everyone should consider investing the time to create their own personal financial roadmap.

We believe that proper financial planning needs to include conversations around your feelings about money just as much as it needs to include the hard facts about money. Discussions around “peace of mind”, providing for your loved ones, protecting your income and preserving your legacy are all critical elements that need to be woven into the planning conversation. To help illustrate what the various components of the financial planning process can help accomplish, we have included real-life examples of stated client goals and the solutions that were set into motion to achieve them.

Case studies are denoted as this (**) throughout the text. While we realize that these examples may not apply to your specific situation, we hope you will begin to see how the most complex objectives can be solved by engaging in the planning process. If you wish to dig a little deeper regarding your personal situation, we invite you to contact us at the Wealth Planning Group.

Let's begin...

CHAPTER 2

WHAT IS FINANCIAL PLANNING?

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Have you ever taken a long road trip from say, Los Angeles to Duluth, Minnesota? You wouldn't think to leave your house without an idea of the route you would take, would you? You would probably ask yourself how much time should be allotted for the trip and which highways you should travel to reach your destination in the most efficient way.

Why would you embark on your financial journey without a similar roadmap, which would give you the best chance of reaching your financial destination? Your personal financial plan is the roadmap that guides you towards achieving your financial objectives. In today's complex world, it is easy to feel confused or overwhelmed about planning for the future unless you find a way to understand the big picture. A written financial "roadmap" can help bring clarity to your finances and help you develop a

strategy. This makes it easier to make financial decisions, set short and long term goals and stay on track.

Financial planning is the process of creating your roadmap for success. From budgeting to planning for retirement, saving for education, managing your taxes, insurance protection, and passing your wealth on to future generations. “Finances” doesn’t mean just one thing for most Americans, and “financial planning” means much more than investing. Bringing all the pieces of your financial life together is a challenging task. In general, the financial planning process can help you take a thorough look at all aspects of your financial life and organize them in the most efficient fashion for your situation.

Financial planning is a fundamental pillar of success for every American. There are hundreds of books, conferences, and seminars that help people plan for their retirement, debt repayment, tax management, investing, and much more. It can be a daunting task to piece financial health together, but we are here to guide you along the journey and help you plan for your future.

Financial planning is the roadmap to achieving financial success. As with any roadmap, it is a good idea to prepare for your journey ahead of time

and know which steps you will be taking along the way. Having a financial plan will help you fulfill an important pillar of survival, so it is important to be proactive and consider working with a financial advisor to develop your custom roadmap.

A well-crafted, comprehensive wealth plan needs to be dynamic and flexible. A qualified financial planner can help you create a plan that adapts to the unexpected curveballs and milestones in life. Keep in mind that a financial plan is just a starting point and should be used as a guideline only. It is important, however, to have ongoing reviews of the plan to ensure it is meeting your needs as time goes by. Working closely with an advisor will enable the financial plan to stay up to date with any changes in your life. Also, it ensures that your financial advisor is setting you up for your maximum level of success.

CHAPTER 3

WHY DO I NEED A FINANCIAL PLAN?

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The average person faces an uncertain economy and is offered more options for saving and investing than ever before. It is easy to feel overwhelmed or confused. Creating a financial plan is a way to quantify your goals and measure your progress towards achieving them. As the great motivational speaker Zig Ziglar once said: “You can’t hit a target you cannot see, and you cannot see a target you do not have.”

It is important to have a target, so you can aim all your energy and effort into hitting it. Quantifying your goals will help you properly allocate your money into savings, investments, and retirement. Having a written plan takes the guesswork out of managing your finances and helps you understand the implications of each financial decision you make. Taking the time to create your financial roadmap will make you feel more confident

with your money. Also, a roadmap will help you be in control of your finances, which provides a sense of discipline and comfort.

CHAPTER 4

WORKING WITH A FINANCIAL PLANNER

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You may be asking if you could manage your own financial planning. While most people can handle basic budgeting, you may want to seek help from a professional if you want to better manage your finances but don't know where to start or simply don't have the time to do your own planning. It is wise to consider working with an advisor when it comes to complex projections and goal attainment. The top reason to have a financial planner is simply that most people don't possess the expertise to do it on their own.

Financial planning is a unique skillset and advisors have extensive knowledge about investments, insurance, taxes, estate planning and more. To have a successful financial plan, your advisor will need to take a comprehensive look at the whole picture because all components of the roadmap are interconnected. Having an advisor can also serve as a soundboard that will let you talk through your future plans, help you to clarify your life's vision and then turn those ideas and dreams into an actual

workable plan. It's important to realize that financial planning is not a one-time event, but rather an ongoing process. Advisors are trained to give unbiased advice and working with them on an ongoing basis can keep you motivated, accountable and on track to achieve your goals. You and your advisor should review your financial plan at least once a year to ensure you are on the best plan as you move along your financial journey.

HOW DO I FIND THE RIGHT FINANCIAL PLANNER?

So, you have decided that working with a professional planner is the way to go. Now what? What should you look for in a financial planner? What questions should you ask? How will you know if the person you are considering is qualified? Look at it this way, if you needed open-heart surgery, you would certainly make sure that your MD was at the very least a Cardiothoracic Surgeon that was certified by the governing medical board. If you were doing high-level tax planning, an enrolled agent might suffice but you would be more comfortable using an accountant that carried the CPA designation.

In short, you would want to know you were working with the most qualified person to complete the task at hand. In the complex world of finance, financial planners offer different services depending on several factors,

including credentials, licenses, and areas of expertise. They also have different approaches. Most people think all financial planners are “certified”, but this isn’t true. Many professionals may call themselves “financial planners” but today, more than ever, Certified Financial Planners (CFP) is an essential resource.

CFP professionals have completed extensive training and experience requirements and are held to rigorous ethical standards. They understand all the complexities of the changing financial climate and they know how to make recommendations in your best interest.

Unlike many financial advisors, CFP professionals must develop their theoretical and practical knowledge by completing a comprehensive course of study offering a financial planning curriculum approved by the CFP Board.

They must pass the comprehensive CFP certification exam which tests their abilities to apply financial planning knowledge to real-life situations. This exam ensures that a CFP is highly qualified to develop a plan for your finances.

CFP professionals must also complete several years of hands-on experience related to delivering financial planning services prior to earning the right to use the CFP certifications trademarks.

Most importantly, when it comes to ethics, CFP professionals are held to the highest standards. They are always required to put your interests ahead of their own and to provide financial services as a “fiduciary” – acting in the best interests of their clients.

The partners at the Wealth Planning Group are Certified Financial Planners (CFP’s) with over 30 years’ experience in creating, implementing and reviewing financial plans for our clients. Regardless of who you choose to work with, your financial advisor should be a trusted partner whom you feel comfortable with and who understands your needs. Be sure to interview the planners you’re considering and find the best fit.

HELPFUL QUESTIONS

Even when a financial planner is highly recommended, it’s wise to take the time to interview them to make sure you will be working with someone who is right for you. These questions might help. We acknowledge the CFP Board for their input.

What experience do you have?

Find out how long the planner has been in practice and with what types of companies he/she has been associated.

What are your qualifications?

Inquire about the licenses and other financial service credentials the planner holds and how they stay abreast with changes and developments in the planning field. CFP professionals stay up-to-date through mandatory continuing education courses. If the planner holds a financial planning certification, you can check the background with the relevant professional organization. For CFP professionals, visit cfp.net.

What services do you offer?

Designations, licenses, credentials, and areas of expertise are all factors that determine the services that can be offered by a financial planner. Planners cannot sell securities products (stocks, bonds or mutual funds) or insurance without proper licenses. Planners also need to be registered with federal or state agencies to give investment advice.

Are you a fiduciary?

A fiduciary is someone who puts the needs of their clients above their own. They are bound ethically to act in the other's best interest. Not all

financial advisors are fiduciaries. Only CFP professionals are held to those fiduciary standards.

What is your approach to financial planning?

Make sure the planner's philosophy isn't too aggressive or overly cautious for your needs. Understand how they carry out recommendations or refer tasks to others.

What types of clients do you typically work with?

You will want to understand what areas of expertise the planner has. Do they prefer to work in certain professions? Does the planner have minimum net worth requirements? You will want to find a planner that you are comfortable with and who will be a good fit for your individual situation.

Could anyone besides me benefit from your recommendations?

Ask the prospective planner if there might be a conflict of interest when making certain recommendations. Often, planners will have a business relationship with the companies that provide financial products such as insurance, securities or mutual funds. Once again, keep in mind that CFP® professionals agree to abide by a strict code of professional conduct and have an ethical obligation to put your needs first when providing financial planning advice.

How are you compensated?

Although your particular needs will determine what you will pay, the planner should be able to provide an estimate of possible costs based on the work performed. Planners can be compensated in several ways: through fees, commissions or a combination of both. Your financial planner should make it clear how they will be paid for the services provided.

CHAPTER 5

STEPS TO CREATING A FINANCIAL PLAN

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By now you have most likely decided that having a personalized financial plan makes a lot of sense and you may have decided that working with a Certified Financial Planner is the path you wish to take. Now what? What does the process look like?

The Financial Planning Board has developed a six-step process to create a comprehensive financial plan that we here at the Wealth Planning Group use as our template as well.

The first step is to establish the relationship between the client and the planner. At the very beginning, the financial planner will explain his or her financial planning services and identify which services are to be provided. The financial planner will define the scope and subject area of what the plan will look like, as well as the responsibilities for both. During this phase, the planner will disclose and define the compensation arrangements so there is full transparency and the client knows exactly what to

expect. Also, it would be wise to establish the duration of the engagement and how decisions will be made.

The next step requires the advisor to gather client data and develop financial goals. Since the quality of the final plan is only as good as the information that is provided, this step can be time-intensive and require a focused commitment on the client's part to be organized and accurate. There is qualitative data, which includes goals, objectives, interests, hobbies, risk tolerances, employment expectations, and changes in lifestyle. Then, there is the quantitative data, which are the assets, liabilities, cash flows, inflows, and outflows. There are factors such as insurances, investments, taxes, trusts, retirement benefits information, and so forth that should also be discussed. At the Wealth Planning Group, an itinerary will be provided as to what information to bring to this meeting. We tell our clients to be prepared to spend at least 2 hours to complete this process.

The third step of the process is where the planner will analyze and evaluate all the data that was gathered in step two. During this process the planner considers all aspects of your situation to determine what will be needed for you to meet your financial goals. Many assumptions, such as rates of return, inflation expectations, future employment, etc. will go into finalizing your plan. Depending on what services were agreed to, your

planner may analyze your assets, liabilities and cash flow, current insurance coverage, investments, tax or estate planning strategies and any specific concerns you have discussed, such as college funding.

The fourth step is the delivery of your personal, comprehensive plan and recommendations. Your planner will go over his or her recommendations and explain the rationale, so you can make informed decisions. At this stage, you should be prepared to share any concerns you may have with your planner. This allows any previous recommendations to be revised, if necessary.

Step five is prioritizing and implementing the recommendations from the financial planner. This happens after your concerns and questions have been addressed and answered to your complete satisfaction. A plan with no action serves very little purpose. Your planner may carry out the recommendations or serve as your coach, coordinating the process with you and other professionals, such as attorneys, accountants or stockbrokers.

That last piece of the six-step plan is to monitor the plan. You should benchmark your progress against the financial goals you have established. Life is dynamic and constantly changing, so it is wise to periodically check in with your advisor and review the plan. There are many life events that are unexpected and often unplanned for, so taking the time to reevaluate your plan will ensure you remain on target to hit your goals. Ideally,

you can work regularly with a financial planner who has been a part of your journey from the beginning and is aware of your goals. They will be able to guide you along your course to ensure you have the best chance of achieving all of them. Taking the time to do check-ins will set you apart from the dreamers and turn your goals into quantified successes. Companies, such as the Wealth Planning Group, will compile real-time updates from your investment accounts and bank accounts, and they will have a snapshot of your financial health at any time. With the real-time updates, it becomes possible for planners to review the plan and see changes from a daily, monthly, or even yearly timespan. This data provides analytical feedback that can help you review your progress and make necessary adjustments to the roadmap. Because so much planning for the future is based on projections and historical data, taking the time to review and monitor your personal plan will help you stay the course.

CHAPTER 6

THE COMPREHENSIVE WEALTH PLAN

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There are a few ways to get started on your financial planning journey. The clear majority of the clients we see here at the Wealth Planning Group are interested in discussing and creating a plan that will encompass all aspects of their financial life. They are interested in creating what we refer to as a *comprehensive wealth plan*. Some of the components that go into a comprehensive plan include:

Retirement planning: Planning for retirement is a life long endeavor. Ensuring there are adequate resources to continue your chosen lifestyle in later years requires careful analysis and proper allocations of current and future income.

Risk management or insurance planning: Your ability to continue to meet your long- term goals despite an unexpected loss is the essence of risk management. Some risk exposures that you may face include premature

death, disability, illness, property loss, liability or unemployment. The best means for most in protecting against these risks is with insurance.

Investment management: Your investment portfolio serves as a means to achieving your long-term goals and should be designed to be consistent with your time horizon, your tolerance for risk, and diversification appropriate to the current economic conditions.

Tax planning: Paying more taxes than legally required will negatively affect your ability to achieve your long-term goals. The judicious use of available deductions, exemptions and appropriate investments can help to minimize tax liability.

Estate Planning: Estate planning is all about maintaining control - control over how, when, and to whom all property will be distributed. This can also include control over minimizing the number of settlement costs and taxes to be paid and adequately providing for the care of dependents, both financially and physically. Proper estate planning also ensures that your philanthropic wishes can be met.

Planning and saving for a specific event (college funding, wedding, large purchase, etc.)

At times the comprehensive approach is simply too overwhelming to tackle all at once, so occasionally a client will want to create a *topic-specific* plan or take a modular approach in planning. Perhaps you want to begin a college savings plan for your newborn child. Maybe you just turned 50 and are wondering, “Am I saving enough for retirement?”. Or your priority may simply be to consolidate your debt.

Keep in mind that all aspects of your financial picture are interconnected, and financial planning generally involves both “opportunity costs” and choices with your assets and income. For example, if you choose to fund your child’s college education, then you’ve lost the opportunity to fund your retirement or a large purchase. Or if you choose to pay off your mortgage or other debt early, you’ve lost the opportunity to fund your retirement. Once again, working with a financial planner, can provide a comprehensive analysis and help you prioritize your goals, minimize your risks and make informed financial decisions.

Before we break down these components in a little more detail, let’s touch on two very different approaches to the planning process: *Means-based* planning or *Needs-based* planning. Means-based planning says, “this is what I have today.” What will it get me in the future? If there is a shortfall, what will I have to give up in the future? Whereas, needs-based planning looks at, “What do I want in the future?”. What is my vision and what will

I need to accomplish that vision? If there is a shortfall, what do I need to start saving to realize my vision of the future?

CHAPTER 7

NET WORTH AND CASH FLOW

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If you took a snapshot of your financial situation today, would you know your net worth? Do you know how much you spend every month and what you spend it on? Even though gathering the information required to answer these questions can seem overwhelming, taking the time to do so is the first step in bringing clarity to where you are in life. This is where the rubber meets the road. This is where you begin to take the guesswork out of where you are. You will finally know that you are serious about creating your personal financial plan when you commit to gathering this information and putting pen to paper. Now, you are taking control of your financial life.

WHAT IS NET WORTH?

Net worth is the amount by which your assets exceed your liabilities. In other words, it is the value of everything you own, minus all your debts.

An *asset* is anything of value that can be converted into cash. Some examples are:

- Cash and cash equivalents, bank checking and savings accounts, CD's.
- Your residence and additional real estate you own.
- Personal property such as automobiles, boats, artwork and collectibles, jewelry and household furnishings.
- Investments including retirement accounts, stocks and bonds, pensions, annuities and the cash value of life insurance policies.

Liabilities, on the other hand, are any debts or payments you owe, such as:

- Mortgages and/or home equity loans
- Automobile loans
- Student loans
- Credit card debt

Calculating your net worth is simply $Assets - Liabilities = Net\ Worth$. If you find you have a negative net worth, it's time to take dramatic steps to get out of debt. If you find you have a positive net worth, consider investing more. As with any component of your financial plan, it is wise to review and recalculate your net worth periodically.

This brings us to the *budget sheet*. This is where you will be tracking your actual spending. There are many budget worksheets available to use as a template and all good ones are customizable to your specific needs. The household budget worksheet will allow you to input the following data:

- Income: All family paycheck take-home pay
- Savings/Investments: Savings account, Emergency fund, Retirement accounts, College savings
- Loans/Debt: Mortgage or Rent, Credit card, Automobile, Student, Home Equity or Personal loans
- Utilities: Electricity, Gas, Telephone and Cable, Water, Trash
- Insurance Premiums: Life, Auto, Health, Home, Long Term Care
- Taxes: Income, State, Local
- Miscellaneous: Groceries, Entertainment (dining out, movies, etc.), Vacation, Clothing, Child Care, Charitable Contributions, Gas (auto), Medical expenses

This is simply an example of a budget worksheet and your personal one will be tailored to your needs. This is also where working with a qualified financial planner can help you by assisting you in constructing and maintaining your worksheet. Once it is completed you will have a much better understanding of what you own, what you owe and what you spend. You can now gain insight into what adjustments you will want to make to your

saving and spending habits. Now, you are on the road to achieving your financial goals. Congratulations!

CHAPTER 8

RETIREMENT PLANNING

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Although there are many components to a well-designed comprehensive wealth plan, we have found that the biggest concern is, “Where do I stand regarding my retirement?”. Most people get serious about financial planning as they enter their fifties mainly because this is when they start to worry if they have enough saved to retire comfortably. Even if you have a retirement plan in place, you may about not having enough. Let us look at the various stages of retirement planning:

WHEN SHOULD I START PLANNING FOR RETIREMENT?

The short answer is as early as you can. When you are young, you are just embarking on your work career or starting a family. You are faced with purchasing your first home and are thinking about the cost of raising children, funding their college education or even paying your own college loans. Your retirement is so far off into the future that planning for it

doesn't even register on the radar. But let us illustrate the virtue of beginning a retirement savings program as early as possible. Beyond getting into the habit of seeing yourself as a "saver" first and a "spender" second, which is a discipline that will greatly help you as you build your nest egg.

There is a concept known as compound interest. For those of us that have carried credit card debt at some point in our lifetimes, we have seen clearly how negative compounding can work against you. But that same compounding of interest can be your best friend if you can develop a savings habit. Look at the following eye-opening example:

Let's use age 60 as the projected retirement age. Two people, Mary and Bill decide to start saving \$250 every month toward their retirement and their investment portfolio generates an 8% annual return. The only difference is that Bill doesn't start saving until he is 50 years old. Mary, on the other hand, began saving at age 20. At 60 years old, Bill will have accumulated \$46,041 in his account but Mary's account will have grown to \$878,570!! At a 10% annual return, Bill's account would have \$51,638 but Mary would have a whopping \$1,594,195 In her account. Clearly, the earlier that you can begin to put money away and be disciplined and consistent, the better chance you have of securing a comfortable retirement nest egg.

WHAT TYPE OF ACCOUNT SHOULD I USE FOR MY RETIREMENT?

There are two types of savings accounts that can be established: Qualified or non-qualified. Non-qualified accounts are checking and savings accounts at financial institutions where you can deposit and withdraw money at any time.

To save for retirement, you will want to consider a qualified account. What distinguishes qualified accounts from non-qualified accounts are the tax advantages. Depositing money in a qualified account will allow you to deduct the contribution from your gross income in the year the deposits are made. Additionally, your investments within the accounts will grow tax-deferred until they are withdrawn. Here are a few examples of qualified accounts:

Individual Retirement Account (IRA and Roth IRA): These are individual retirement accounts that you open and fund yourself (not through an employer). These accounts are best for people who want to lower their taxable income for the year and do not have access to a retirement account through work.

401(k) Plans: Retirement account offered to the employees of a company through salary contributions. Since many companies offer a matching

contribution, it would be very prudent to contribute up to the company match.

403(b) Plans: Retirement account for employees of a tax-exempt organization (nurses, teachers, etc.)

Simple IRA Plans: Retirement plan set up by an employer that allows employees and employers to contribute to traditional IRAs set up on behalf of employees.

SEP Plans: Retirement account established by a small business owner or self-employed person for themselves (and any employees).

There are many plans available, but these are the most common. For a more in-depth look at retirement planning for business owners or executives, feel free to contact us at the Wealth Planning Group.

HOW DO I KNOW IF I HAVE BEEN SAVING ENOUGH?

This is the essence of financial planning and where working with a financial planner can be valuable. The first step is gaining clarity on what retirement means to you. Are you planning on retiring at a certain age? Are you working on achieving financial freedom? Remember, the earlier you

wish to retire, the longer you will need to provide for your income needs. Having a clear vision of what your retirement is going to look like will help you understand if there is a shortfall that has to be met.

Other factors that your financial planner can help bring clarity to are:

- A better understanding of how your expenses will change after retirement verses in your earning years.
- Identify and prepare for the various sources of income that you will have such as retirement savings, pensions, social security, etc.
- Factoring in the effects of inflation (the loss of purchasing power over time).
- When you should begin taking social security benefits.

At the Wealth Planning Group, we use a retirement calculator to monitor progress and bring more clarity to whether you are able to achieve your retirement vision. We employ what are known as *Monte Carlo Projections* to determine the likelihood of your having enough funds to last a lifetime of retirement. These projections incorporate a wide range of *what if* scenarios, estimates, and variables that include investment return risk and inflation. Our program links directly to your investment and bank accounts to get real-time financial data to make sure you are on track to meet your goals. As with all goals, monitoring your progress on a regular basis

is essential to giving yourself the best chance of attaining your retirement vision.

A note on withdrawing funds from a qualified retirement account: As mentioned earlier, all monies deposited into a retirement account are considered pre-tax dollars and, as such, reduce your gross income in the calendar year they were deposited. Also, all investments within the retirement account will grow tax-deferred. Because of these tax benefits, when funds are finally withdrawn from the qualified account, they will be considered earned income and taxed at the individual's current tax rate. An individual can withdraw any amount of funds from his or her retirement account after they have attained the age of 59 ½. Any monies withdrawn from a qualified retirement account before the age of 59 ½ will be subjected to a 10% penalty in addition to the required income tax. (there are certain exceptions to the 10% penalty, but that discussion is beyond the scope of this book).

REQUIRED MINIMUM DISTRIBUTIONS (RMD)

Even though there are many tax advantages for establishing and maintaining a qualified account, you cannot keep retirement funds in your account indefinitely. The IRS will want what's theirs at some point. You generally have to start taking withdrawals from your IRA, SIMPLE IRA,

SEP IRA or retirement plan account when you reach age 70 ½. (Roth IRA's do not require withdrawals until after the death of the owner). The RMD is the minimum you must withdraw from your account each year. The actual RMD is calculated using the IRS's "Uniform Lifetime Table" and is based on the individual's age and the account balance at the end of the preceding calendar year. You can always withdraw more than the minimum required amount and, like all withdrawals, the entire amount will be included in your taxable income.

CHAPTER 9

INVESTMENT MANAGEMENT

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Your investments are a critical component of your financial plan. A properly designed and managed investment portfolio will greatly improve your chances of achieving your financial goals and living the lifestyle that you envision. Your investments do not exist for their own benefit but serve as a means to an end. That end may be a short-term goal, such as funding your child's college education, purchasing a home or buying a new car. Or maybe, it's a long-term goal such as funding or supplementing your retirement. As such, you will most likely have multiple investment accounts with each one having a different objective and time horizon that may be built and managed very differently.

THE INVESTMENT PYRAMID

Where do you begin? How does one approach separating these various objectives? We have found that the investment pyramid serves as a very

good visual for making sense in building your investment portfolio. There are 4 levels to the investment pyramid.

The largest level, or the base of the pyramid, contains the least risky and most liquid of your investments. These would include your bank checking and savings accounts as well as your emergency funds. These are the funds that are available to you at a moment's notice. A question we are frequently asked is, "How much should I have in my emergency fund?". The simple answer is whatever you feel comfortable with, although we find that between 3 and 6 months of living expenses is the most common.

The next level would contain investments that might be tied up for between 1 and 5 years. The funds might be earmarked for short-term goals such as a new car purchase or funding higher education costs for your 8th grader. These accounts would be managed in a more conservative manner.

The next level up the pyramid is where you will fund your growth and wealth accumulation goals, such as your retirement. These investments will, most likely, be made up of a diversified portfolio of stocks and bonds and would have a time horizon of more than 5 years. Because of volatility and the cyclical nature of the stock market, a good rule of thumb is to invest in the stock market only when your funds will not be needed for at least 5 years.

The top (smallest) section of the investment pyramid will contain investments that are more speculative in nature, such as options, commodities, limited partnerships, etc. These investments have the potential for the greatest return, but at increased levels of risk. The skill level required in selecting investments for this level of the pyramid is beyond the scope of this book. In conclusion, as you travel up the pyramid you will have potentially higher returns, more risk, and less liquidity. Conversely, as you travel down the pyramid, you will find potentially lower returns, less risk, and more liquidity.

PORTFOLIO RISK

This is a good time to discuss risk as it pertains to your portfolio. We believe that one of the most important factors in determining your success as an investor is to have a clear understanding of the concept of risk and an honest assessment of your personal comfort level.

So, what is risk? Risk is defined as a probability or threat of loss that may be avoided through preemptive action. In finance, the probability that an actual return on an investment will usually be lower than the expected return. But here is where it gets cloudy and why it is important to understand your personal feeling about what risk means. When it comes to investing, some people see risk as a potential loss of their money by being

in the stock market, while others view risk as an opportunity lost by not being in the market. Which type of person are you? History tells us that prudent investing over time in the stock market is one of the best ways to accumulate wealth, but one must accept the fact that there will be times of market fluctuation and periods of negative return.

There are two main types of portfolio risk. *Systematic risk* is the risk inherent to the entire market. This type of risk is both unpredictable and impossible to avoid.

Some examples of Systematic risk are:

- Market Risk: The risk of loss because of a drop in the market price of shares.
- Interest Rate Risk: The risk of losing money because of a change in the interest rate.
- Currency Risk: The risk of losing money because of a movement on the exchange rate.

Unsystematic risk is the type of uncertainty that comes with a specific company or industry and generally can be reduced through diversification. Examples of unsystematic risk are:

- Business Risk: The risk that a company will have lower than anticipated profits or experience a loss.

- **Liquidity Risk:** The risk of being unable to sell your investment when you want to.
- **Credit Risk:** The risk that a company or government entity won't be able to pay the interest or principal at maturity.
- **Inflation Risk:** The risk of a loss in your purchasing power because the value of your investments does not keep up with inflation.
- **Political Risk:** The risk of loss when investing in foreign countries.

One of the best ways to lessen unsystematic risk in your portfolio is through diversification. The idea behind diversification is to include asset classes that are not correlated to one another so when one asset falls, another may not be affected or even rise.

For example, since a fall in the U.S. domestic market may not affect the market in Japan, adding an international stock fund to your portfolio will help diversify it. Whether you are looking to grow your wealth aggressively or to conservatively preserve your principal, a portfolio built with a well thought out diversification of bonds, stocks, cash equivalents, and real estate will help you achieve your goals with the least amount of risk.

OTHER CONSIDERATIONS

Some people prefer to build and manage their own investment portfolio, but we find that most would rather work with a financial advisor to oversee their investments. If you fall into the second category, here are some points for you to consider and questions to ask your financial advisor:

Where are my assets held? To protect yourself from fraud, you will want to make sure that your accounts are held at a reputable third-party custodian (such as Charles Schwab or TD Ameritrade), titled in your name, and not co-mingled with other client assets. You should receive all account statements directly from the custodian and be able to move them whenever you want. Remember, you are just authorizing your advisor to manage your investments, but you always want to maintain complete control over the account.

Are you a fiduciary? Does your company have proprietary products? Do you receive payments from a mutual fund or investment company that you recommend? How do I know I am receiving unbiased advice? Many advisors are employed by insurance companies and are required to sell insurance products as investments. Others are employed at banks or a brokerage house often with proprietary products that pay a higher commission. It is next to impossible to be a fiduciary and offer unbiased advice

or recommendations under either circumstance. Make sure the advisor you select is truly independent.

How are you compensated? Are you fee-based or are you paid commissions on investment products that you recommend? If you are looking to establish a long-term relationship, to “sit on the same side of the table” with your advisor, understand how they are being compensated. There is very little incentive for an advisor to nurture the relationship after the commission has been paid. On the other hand, a fee-based advisor, who’s compensation is based on a percentage of assets that are managed must earn his pay every day and as such, has every reason to work with you to achieve your stated goals since the advisor will only get “a raise” as your account grows.

What certifications, licenses and/or credentials do you have? It goes without saying that your advisor should be qualified to manage your investments. There are several websites and regulatory agencies (such as the SEC, FINRA and the regulatory board for the state you reside in) to do your due diligence. You want to make sure that licenses are current and that there has been no regulatory issue with the advisor.

Can you describe your investment approach? What strategies do you have in place for managing risk? Investment advisors come in all sizes and

shapes from passive, buy and hold managers to active, tactical managers. You will want to understand their approach so that you are comfortable with the advisor that you choose.

How frequently do you communicate with your clients? How often can I expect to meet with you? At the Wealth Planning Group, both partners are Certified Financial Planners (CFP) and oversee all investment portfolios as a team. We are a small company that allows us to connect on a personal level with our client's family. Because we are truly independent and have no proprietary products, we are free to construct portfolios with the best investments we can find and eliminate any conflict of interest from compensation. All client assets are held with a third-party custodian (TD Ameritrade Institutional as of this writing) and we are compensated as fee-based advisors.

CHAPTER 10

INSURANCE PLANNING

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One of the most important components of a comprehensive wealth plan is to protect what you have worked hard to build. We protect ourselves and our loved ones with the use of insurance and as such, insurance is an important element of any sound financial plan. Insurance decisions should be based on your age, family and economic situation. There are different types of insurance to help protect against the costs of accidents, illness, disability and death. Not only is it necessary that we have coverage to protect us in the event of life's unpredictable moments, but the right amount of coverage is important, and a good planner will work with you to help determine those amounts.

LIFE INSURANCE

What is it and do I need it? A life insurance policy is a contract between a person or an entity and a life insurance company. The person (or entity) must have a financial interest in the life of someone else. In a nutshell, if

anyone relies on you financially, you will want to consider life insurance. The life insurance death benefit, payable when the insured dies, can provide a surviving spouse, children, and other dependents the funds necessary to help maintain their standard of living. It helps cover the costs of final expenses, outstanding debts, educational expenses and lost income. Life insurance can also provide peace of mind for the policyholder. You will have to qualify for coverage by filling out an application and completing a medical exam.

Underwriting is the process through which the insurance company classifies how much of a risk you are based on your current and past health, as well as your family health history. There are many ways to purchase life insurance and a discussion with your financial planner will help you determine which is the best for you. The two broad categories of life insurance that you should become aware of are *term* and *permanent*.

Term Insurance: Term insurance is the least expensive and simplest form of life insurance. It is the best choice when you want protection at a set price for a set amount of time. The term is for a selected amount of time, typically 10, 20 or 30 years and the premiums are guaranteed for the length of the term after which the policy generally becomes cost-prohibitive to maintain. The amount of the premium is determined by your age, the length of the term and your health. Even though life insurance can

serve many purposes, we have found that in most cases, replacing the bread winner's income is the main reason to own life insurance and term policies are the simplest and most affordable.

You may be asking yourself at this point, "What if I am still living at the end of the term?". The policy will lapse at the end of the term and you will have paid, possibly decades of, premiums for "peace of mind." If that prospect is not acceptable and you are willing to pay more for protection, you will want to explore a more *permanent* type of policy. There are a few different types of permanent insurance and we will touch on each of them.

Permanent Insurance: Permanent insurance differs from term insurance in that it offers lifelong protection, has the ability to build cash value, and can have the flexibility to adjust your policy and/or premiums if your needs change. With each payment that is made to a permanent policy, part of the premium goes toward insuring your life and part goes toward building cash value. The most common types of permanent insurance are:

Whole life: Whole life combines permanent protection with a cash value or savings component. These policies have fixed premiums, part of which pays for the protection and the remainder builds the cash value portion. As the policy gains value, you may be able to borrow your policy's cash

value tax-free. Policy loans will reduce the death benefit and cash value and may trigger a taxable event if the policy lapses.

Universal Life: Universal Life is similar to Whole Life, but the main enticement is that it allows flexibility with both your premiums and the death benefit, which can give you options as your life changes. These policies also have a cash value component that you can access. Drawbacks to this type of insurance include interest-rate sensitivity and higher fees.

Variable Life: Variable Life offers policyholders the opportunity to put the cash value in an investment account of stocks & bonds managed by the insurance company. Cash values and death benefits can rise and fall based on the performance of the investments. Earnings can be used toward premiums or add to the death benefit. On the plus side, capital gains and dividend earnings can accrue as tax-deferred. Conversely, the downside is that if the investments do poorly, you won't have the funds to put toward premiums and your death benefit may decline.

So far, we have been using life insurance as an income replacement tool but there are many other considerations and alternative uses for life insurance in the planning process. Life insurance can be used for:

- Paying final expenses, including funeral or cremation costs

- Business uses: fund a Buy-Sell agreement, Key man protection, deferred compensation
- Supplementing retirement income
- Personal or small business loans
- Reducing estate taxes: funding an irrevocable Life Insurance Trust (ILIT)
- Funding college tuition or paying off debts
- Funding your favorite charity

For example (**) Dolores, age 59, a successful self-employed businessperson with a steady income came to see us with the objective of supplementing her income after retirement. No more funds could be added to her traditional SEP IRA as she had maxed out her annual contributions. After doing retirement projections, her goal was to add approximately \$2,000 per month to her retirement income. A max-funded cash value life insurance policy was the solution.

By rapidly building a cash value component that would grow on a tax-deferred basis, it offered her the opportunity for a stream of potentially tax-free income. Also, because it was a life insurance policy, it provided a death benefit of \$375,000 for her two children. As an added feature, this policy also provided accelerated living benefits to assist her in the event of a qualifying terminal or chronic illness.

How it works:

For this strategy to work to its fullest, it is important that the insured is in good health and in this case, she was underwritten as a preferred, non-smoker. Because of her income, she was able to max-fund this policy by contributing a total of \$150,000 over the first 7 years (\$24,000 each year for the first 6 years and \$6,000 in year 7). Funding stops after year 7 as the cash value component would be able to continue paying the premiums. After year 11 and based on projected earnings of 7% annually, she would be able to withdraw approximately \$2,000 per month potentially tax-free from the policy. Yes, there was a death benefit provided, but due to the tax-deferred and loan provision features of the cash value account, she was able to use a life insurance policy to achieve her objective of supplementing her retirement income.

In the end, no one enjoys talking about death, so it is hard for most people to discuss life insurance. But the peace of mind in protecting your family and loved ones makes having an open and honest discussion about life insurance an important part of a comprehensive financial plan.

HEALTH INSURANCE

Health insurance is insurance that everyone needs to have and, with the passing of the Affordable Care Act (ACA or Obamacare), it has now become mandated. Generally speaking, there are two ways to acquire medical insurance. One, you may be one of the many who enjoy health insurance as an employee benefit, often with the employer paying all or part of the premiums. If you are in this category, then the Affordable Care Act does not apply to you.

On the other hand, the ACA is mainly for people or small groups who pay for their own insurance. Because of the changes in health insurance for individuals brought on by the ACA, including subsidies that are available to those in lower income brackets and the various tiers of coverages and deductibles for those that aren't, it is highly recommended that you work with a health insurance specialist to obtain the coverage that is best suited to you. You will have a choice between HMOs (health maintenance organizations), which are usually cheaper but with more constraints, and PPOs (privately purchased health insurance), which are generally more expensive depending on deductibles and coverage choices.

Health care planning in retirement: For those that are nearing or even in retirement here are a few things to consider. We are living longer, which

means more time in retirement and higher healthcare costs. Understanding and having proper insurance coverage will be crucial to not seeing your financial plans derailed. It is important to understand how Medicare works and when and how to enroll. You will want to understand the different Medicare supplemental insurance coverage and what it will cost. Estimating your out of pocket medical expenses in retirement is a huge part of the planning process.

Health Savings Account (HSA): A health savings account (HSA) is a tax-advantaged savings account that works along with a high-deductible health insurance policy. The HSA provides both health care coverage and acts as an investment account.

It gives the owner the option to build a retirement savings account using pre-tax dollars that can be used to pay medical expenses without taxes or penalties. The funds you deposit into your HSA are yours to withdraw at any time to pay medical costs that aren't covered by your individual health insurance policy. If you never use the funds for medical expenses, it is an interest-bearing account that grows until you retire.

Unused HSA funds can be rolled over from year-to-year and can be used tax-free to pay for future medical expenses in retirement. This can reduce future income taxes and possibly reduce future Medicare premiums.

Many businesses offer these policies to their employees, but they can be purchased on your own from a health insurance carrier or on the exchange in your state.

DISABILITY INSURANCE

If you wanted to determine your most valuable asset, you might consider your investment or retirement accounts or maybe your personal residence. Perhaps your most valuable asset is your ability to earn a living. *What would happen to you if you were injured and couldn't work? How far could you go without your paycheck?* Fortunately, there is some protection for that scenario and its called disability insurance.

Disability insurance will pay out a portion of your income in the event you become too ill or disabled to work and anyone who collects a paycheck should have this coverage. The simplest way to purchase disability insurance is to sign up for employer-sponsored coverage at work (if available). Most companies that offer disability insurance will pay some or all of the cost of premiums. It is easy to qualify for your employer-paid disability insurance, but the insurance payouts are taxable.

What if you don't have enough coverage at work or you are self-employed? You can always shop for and purchase your own individual coverage. Purchasing your own policy will let you:

- Shop around and choose the insurance company with the best coverage
- Keep your coverage even if you change jobs as employer-paid coverage ends when you leave the company.
- Collect benefits tax-free if you become disabled.

Short-term disability insurance replaces a portion of your paycheck for a short period of time, usually for a minimum of three months and up to a maximum of one year. Most people get short-term coverage through their employers. These policies typically offer a payout at 60% to 70% of your base salary and have a short waiting (or elimination) period, such as two weeks after you become disabled before benefits are paid out. Since the average disability time is around three years, short-term isn't an effective alternative to long-term coverage. Also, since it's about the same cost as long-term coverage (1% to 3% of gross income), it is not a very cost-effective choice.

Long-term disability insurance, on the other hand, is the most cost-effective and comprehensive type of disability insurance. The benefit period can last 2 to 10 years, or even until retirement, although the waiting period is typically 90 days. Keep in mind that many factors affect the cost of

premiums, such as your age and health, if you smoke, your occupation, your income, the definition of disability, and length of benefits.

Lastly, there are two major categories of policies that act very different when paying out claims and they are based on how broadly “disability” is defined.

Any occupation: These policies are often relatively inexpensive. If you become disabled and cannot work in your chosen profession, but are able to work any job, even a low paid one, you won’t qualify for benefits under the terms of the policy.

Own occupation: This type of policy allows you to claim disability insurance benefits even if you can earn an income doing something other than your chosen profession. Own-occupation disability insurance is the most lenient type of policy and the one that best protects your income, although you will pay more for this type of coverage. Highly skilled people who have invested a lot in training (an orthopedic surgeon, for example) will want this type of policy as it will pay out if they can’t work in their specialty.

A note about Workers’ compensation: Because this type of insurance is required by employers in every state, many people believe that workers’

comp is a substitute for disability insurance. Workers' comp does pay out a monthly benefit in the event an employee cannot work, however only if the injury occurred at work.

As you can see, disability insurance can become quite complicated and working with a qualified planner can help guide you in selecting the coverage that is right for you.

LONG-TERM CARE INSURANCE

Of all the components that make up a well-designed financial plan, we have found that the least understood and the least planned for is long-term care. This subject is an unsolved problem for many people. Since the topic of long-term care insurance has so many moving parts and can get quite involved, we will endeavor to provide the basics to long-term care planning in the hopes of de-mystifying the subject. Because of its complexity, if you find that you would like to pursue long-term insurance, we would highly recommend that you consult an independent insurance broker that specializes in the genre.

First, let's look at some of the facts: According to the Department of Health and Human Services, someone turning age 65 today has almost a 70% chance of needing some type of long-term care services and 20%

percent will need it for longer than 5 years. In addition, one in four people currently age 65 will face over \$50,000 in lifetime out of pocket long-term care expenses.

What exactly is Long-Term Care? Long-term care is a range of services needed to meet your personal care needs. It is not medical care, but rather assistance with the basic tasks of everyday life referred often as Activities of Daily Living (ADLs).

These ADLs include:

- Bathing – washing oneself in the bathtub or shower or by sponge bath.
- Dressing – putting on or removing all items of clothing and any necessary braces, fasteners, or artificial limbs.
- Transferring – Moving into and out of a bed, chair, or wheelchair.
- Using the toilet
- Caring for incontinence – inability to maintain control of bladder or bowel functions, as well as the inability to perform personal hygiene.
- Eating – Feeding oneself

Where and how does one receive long-term care? Most long-term care is provided at home, either by an unpaid caregiver such as a family member or friend, or by a nurse or home care aide. Outside of the home, a variety

of facility-based programs offer more options. Facility-based choices include nursing homes, assisted living, board and care homes, and continuing care retirement communities.

Does Medicare cover long-term care services? Medicare is the federal health insurance program for people over 65 and others with disabilities. Although Medicare will pay for a short visit to a skilled nursing facility after a hospital stay, it is limited to a benefit period of 100 days. Medicare will also pay for hospice care if you have a terminal illness, are no longer seeking a cure, and are not expected to live more than six months. But as it pertains to our discussion on long-term care, Medicare *does not pay* for custodial care, which makes up more than 90% of all long-term care services. These are the Activities of Daily Living described above.

How is long-term care paid for? The cost of long-term care depends on the type and duration of care you need, the provider you use, and where you live. There are various ways to cover the cost of long-term care. On the one hand, wealthier people with an asset of perhaps \$2 million or more may find it reasonable to self-insure and cover care costs themselves.

On the other side of the spectrum, Medicaid may be able to cover the long-term care costs of those who are impoverished. Most people, however, fall somewhere in the middle and will seek out some form of long-term

care insurance to cover these expenses. As mentioned earlier, long-term care insurance can be quite complex and there is no one size fits all solution. Long-Term Care (LTC) insurance rates will depend on your age and health history at the time of purchase. The cost of LTC insurance also depends on the following benefits that you choose:

- Benefit Period – the total amount of time or the total amount of dollars up to which benefits will be paid (typically two, three, four, and five years).
- Elimination period – the waiting period before benefits begin, which start the day you become ill or injured. The typical elimination period is 90 days.
- Daily Benefit – The maximum amount the insurance will pay in any single day.
- Inflation Protection – a rider that increases benefits each year adjusted for inflation

Due to the increased costs of traditional long-term care policies, some alternative solutions have begun to find their way into the marketplace. For example:

- Short-Term Care insurance is similar to LTC, but benefits are usually tapped at one year. These policies may be available to older seniors or those who aren't otherwise eligible for LTC.

- Hybrid policies. Whole Life insurance that you can draw from for long-term care. These policies are typically two to three times more expensive than traditional LTC but will return money to your beneficiaries if you don't end up needing long-term care, unlike traditional LTC. Also, because premiums are locked in upfront, you don't run the risk of a rate hike.
- Partnership program. A federally-supported, state-operated initiative that allows individuals who purchase a qualified long-term care insurance policy to protect a portion of their assets that they would typically need to spend down prior to qualifying for Medicaid coverage. Not all states participate.

As with all insurance, you want to make certain that the premiums are in your budget and that they can be covered indefinitely.

UMBRELLA INSURANCE

Umbrella insurance is extra liability insurance. This type of insurance is designed to protect you from major claims and lawsuits above the limits of your homeowners and auto insurance policies and helps protect your assets and your future.

Protecting what you have worked hard for requires a regular and thorough review of all of your insurance.

CHAPTER 11

TAX PLANNING

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Taxes, left unchecked, can cause the largest erosion of your estate and net worth. Because of that, tax planning is an essential part of a comprehensive financial plan. The purpose of tax planning is to ensure tax efficiency. Maximizing the ability to contribute to retirement plans and the reduction of tax liability is crucial for your success. We are not talking about tax evasion, but we are talking about tax avoidance and tax deferral. Before we get into the various taxes that Americans pay, it is interesting to look at the history of income taxation.

A BRIEF HISTORY OF TAXATION IN AMERICA

In colonial times, the issue that led to the American Revolution was whether parliament had the right to impose taxes on Americans without representation in parliament. In order to help pay for its war effort in the Civil War, Congress imposed its first personal income tax in 1861. Until then, tariffs were the largest source of federal revenue from the 1790s until

it was surpassed by income taxes during World War I. In 1913, Congress ratified the 16th Amendment which gave them the power to collect taxes on incomes from whatever source derived and enacted an income tax of 1% on personal incomes above \$3,000 as part of the Revenue Act of 1913.

By 1918, the top income tax rate was increased to 77% to finance World War I. The top marginal tax rate steadily increased, reaching 94% during World War II, when Congress also introduced payroll withholding and quarterly tax payments. The top marginal tax rate has been steadily reduced since then and as of this writing currently stands at 37% for taxable income over \$500,000. Income taxes remain the largest source of revenue for the federal government, accounting for over 40% of yearly tax revenue.

THE VARIOUS TAXES LEVIED IN AMERICA

The tax system is very complex and understanding the different types of taxes you may face can be a valuable tool in financial planning. Not all taxes are paid at the same time. Some taxes, such as federal income tax, payroll tax and state income tax are deducted from your paycheck. Other taxes are levied at the cash register. State and local governments collect sales taxes on individual goods and services and the federal government

charges an excise tax on certain items, such as gasoline, cigarettes and alcohol.

Income Tax: Income taxes are charged at the federal, state and local levels. At the federal level, the amount paid depends on a number of factors, including income bracket and marital status. State income taxes vary considerably as some states do not levy an income tax at all, while a few states use a single income rate and others apply different tax rates depending on income.

Payroll Tax: There are two payroll taxes that employers and employees both have to pay. For the Social Security tax, employees pay 6.2% of their wages and employers match that for a total contribution of 12.4%. As of 2019, the maximum amount of earnings subject to the Social Security tax was \$132,900. Similarly, there is a tax for Medicare. Employees and employers, both, are required to contribute 1.45% of wages for a total of 2.9% to fund the program with no maximum taxable wage.

Sales Tax: Sales taxes are taxes on goods and services purchased and are usually calculated as a percentage of the price paid. Sales tax varies by state. Some states charge as much as 10% when combining state and local taxes whereas in some states there are no sales taxes at either the state or local level.

Excise Tax: Excise taxes are similar to sales taxes, collected by states and the federal government on certain purchases, including gasoline, cigarettes, beer and liquor. These taxes are often combined with sales taxes on a single purchase.

Property Tax: Property taxes are levied on real estate and are based on the property's appraised value. These taxes are imposed to fund local services and can vary considerably from one state to another.

Estate Tax: Estate tax is defined as a tax on your right to transfer property at death by the IRS. Real estate, cash, bank and investment accounts, insurance and business interests are among the items considered part of an estate. As of 2019, an estate would need to be valued above \$11.18 million for the estate tax to be relevant. As such, very few estates would be subject to the tax.

Gift Tax: The gift tax is similar to the estate tax, in that it is a tax on wealth transfer. As of 2019, anyone is permitted to transfer up to \$15,000 to an unlimited number of living persons annually without being subject to the gift tax. Like the estate tax, there is a lifetime exclusion of \$11.18 million. Any gift over \$15,000 in one year given to a single person decreases both your lifetime gift tax exclusion and your federal tax exemption you will receive when you die.

FUNDAMENTALS OF TAX PLANNING

Tax planning is the analysis and arranging of your financial affairs in order to reduce the cost of taxes. However, it is important to understand the basics of how income is taxed and the methods of limiting your tax liability to maximize your annual net income.

HOW INCOME IS TAXED

Establishing a tax plan begins with an understanding of how your income is taxed. Income is generally divided into 3 major categories:

- Ordinary income is comprised of all income received from salary or wages, self-employment income and dividends
- Passive income is comprised of the income received from real estate investments, limited partnerships and other business activities.
- Capital income is comprised of the income received from the sale of property and investments.

These categories of income taken together make up your Gross Income.

Income reduction: If your gross income is high, so are your taxes. To reduce your taxes, you need to reduce your gross income. This can be accomplished by contributing money to a qualified retirement plan (401k,

traditional IRA, etc.), a 529 plan, Education Savings Account, Health Savings Account, etc. After these reductions are calculated, you are left with the Adjusted Gross Income or AGI.

Tax Deductions: To further lower the amount of tax liability you can now apply a list of financial items that serve as tax deductions, such as Health Care costs, real estate expenses, mortgage interest, charitable contributions, business travel expenses, business insurance, work expenses, etc. Having proper documentation of such deductions is a necessity.

Tax Credits: A tax credit is an amount of money that can be offset dollar for dollar against a tax liability. The most popular is the Child Tax Credit but other credits are available. For example, if you plan on taking additional college classes, you may qualify for a college expense tax credit.

Now that we looked at an overview of tax planning, let's dig a little deeper. As mentioned earlier, there are two strategies for reducing tax liability; Tax avoidance and Tax deferral.

TAX AVOIDANCE

In addition to the aforementioned standard and itemized deductions, there are other strategies for avoiding taxes in the current year.

Section 199A: also called the Qualified Business Deduction (QBI) or pass-through deduction. Thanks to the Tax Cuts and Jobs Act of 2017, section 199A allows taxpayers to deduct up to 20% of qualified business income from a domestic business operated as a sole proprietorship or through a partnership, S Corporation, trust or estate.

Home Sale Exclusion: An individual can avoid paying capital gains taxes on the first \$250,000 (\$500,000 for a married couple) of capital gains from the sale of the primary residence. To qualify you must own and occupy the home as your principal residence for at least two years before you sell it. If you meet all of the requirements for the exclusion, you can take the \$250,000/\$500,000 exclusion any number of times (you cannot use it more than once every two years).

Stepped-Up Basis: Used in conjunction with estate planning, a step-up in basis is the readjustment of the value of an appreciated asset for tax purposes upon inheritance. It can be used to eliminate capital gains in highly appreciated assets, such as securities or real estate, as the cost basis adjusts to the market value of the asset upon the date of death of the owner. For example, an investor purchases shares of ABC stock at \$10 and leaves them to an heir when the shares are \$100. The shares receive a step-up in basis, making the cost basis for the shares the current market price of

\$100. Any capital gains tax paid in the future will be based on the \$100 cost basis, not on the original purchase price of \$10.

Tax-Loss Harvesting: Tax-loss harvesting is the selling of securities at a loss to offset capital gains tax liability. An investment that has an unrealized loss is sold allowing a credit against any realized gains which occur in your portfolio. The asset sold is replaced with a similar asset to maintain the portfolio's asset allocation.

A cautionary word about gifting: We have seen many times a parent adding a child to the title of the primary residence. Understand by doing that, you are in effect, gifting one half of the home to the child, which will cause gift tax to be due in the current year or reduce the lifetime gift tax exclusion by the appropriate amount. Consult your tax accountant, estate attorney or financial planner before following through on that strategy.

TAX DEFERRAL

Qualified accounts: The most common strategy to defer current tax liability is to contribute to a qualified retirement account (401k, Traditional IRA) or business retirement accounts for business owners. For 2019, the current maximum contribution to a 401k is \$19,000 with a \$6,000 catch-up contribution for those over 50. For a traditional IRA the maximum

contribution is \$6,000 with a catch-up contribution of \$1,000 for those over 50. Not only will maximizing your contribution into your retirement account help you build your retirement nest egg, but you can reduce your tax liability for the current year of the contribution. For business owners, there are many options for establishing retirement accounts to maximize tax and retirement benefits that are beyond the scope of this discussion.

Health Savings Account: Contributing to a qualified Health Savings Account (HSA) is a way to pay for qualifying medical expenses. Like retirement accounts, contributions to an HSA are considered an “above the line” deduction and will serve to lower your adjusted gross income.

Deferred Compensation: Highly compensated individuals might want to consider a deferred compensation package if offered. Deferred compensation refers to money received in one year for work performed in a previous year, typically after retiring or leaving employment. Generally speaking, the tax treatment of deferred compensation is easy to understand. Employees pay taxes on the money when received, not necessarily when earned.

1031 Exchange: A properly structured 1031 exchange allows an investor to sell a highly appreciated property to invest the proceeds in a new like kind property and defer all capital gains taxes.

For Example (**) Joan, the sole owner of a 4-unit apartment building, came to see us to discuss her options regarding selling the property. The property had been in the family for many years and, as such, had a low-cost basis. She was still looking for the income but no longer wished to be a landlord.

Objective:

- Sell existing 4-unit apartment building
- Defer capital gains on the sale of property
- Replace the income lost on the sale of the property

Solution:

- A 1031 exchange to a qualifying property

How it works:

Working with a qualified intermediary, we were able to identify a like kind property: a new off-campus student housing facility on a growing university in Nevada. She would be one of many investors in this property that was set up as a DST (Delaware Statutory Trust). She sold her apartment building for \$900,000 and purchased the same amount in the student housing facility. Since her apartment building had a cost-basis of \$300,000, she was able to defer \$600,000 in capital gains (saving approximately \$90,000 in taxes at a 15% capital gains rate). In addition, the new

property was paying a 5% dividend (resulting in a monthly income of \$3,750), which enabled her to replace the income lost on the sale of her building without the responsibility of being a landlord. This solution enabled Joan to accomplish all of her objectives.

You have probably surmised by now the United States Tax Code is quite complicated and ever-changing. As a matter of fact, those filing their personal income taxes in 2014, would have had to comply with the terms of a tax code that takes over 73,000 pages to explain.

As if that wasn't enough, consider the changes that were made to the tax code by the "Tax Cuts and Jobs Act" just in 2018:

- **Changes in Income Brackets and Marginal Tax Rates.** Marginal tax rates are the percentages of your income you pay in taxes depending on how much you make, and income brackets are simply income ranges. In 2018, all seven income brackets were redefined, and all tax brackets were slightly lowered.
- **Changes to the Standard Deduction.** In 2018, the standard deduction, an automatic reduction in what you owe in taxes, almost doubled. That would be good news except for the 2018 tax reform bill also eliminated the personal exemption, the amount a taxpayer used to be able to deduct from their taxable income for themselves and any dependents. This

change made the decision to itemize your deductions or take the standard deduction a real challenge.

- Child Tax Credit: The 2018 tax reform bill increased the child tax credit from \$1,000 per qualified child to \$2,000.
- Home Mortgage deductions: The 2018 tax reform bill saw changes in the way the mortgage for your personal residence was calculated and also eliminated the interest deduction on home equity debt.
- State and Local Taxes: In the past, there was no limit on the deduction of state and local taxes, but the 2018 tax reform bill limits the total deductible amount on the deduction allowed.
- The above points were just a partial look into the changes to the tax code in 2018. The tax reform bill also made changes to the Estate Tax Exemption, Medical Expense deductions, Health Care, Charitable Donations and deductions for tax preparation expenses, alimony payments, moving expenses, unreimbursed employee expenses and other business expenses.

As you can see, the tax code is always changing. It's hard enough for tax preparers working full time in the profession to stay on top of it, let alone an individual taxpayer or business owner. That is why we strongly recommend working with a seasoned tax accountant or CPA when it comes to tax planning and preparation. Also, working together with your financial planner, investment advisor, and tax preparer ensure that investment and

tax planning strategies are aligned to save you the maximum in personal and business taxes.

Remember: It's not what you earn, it's what you get to keep.

CHAPTER 12

ESTATE PLANNING

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Another building block of a comprehensive Wealth Plan is Estate Planning which provides instructions on how to distribute your property in the most tax-efficient manner after death, and to ensure your health care wishes are honored while you're alive. Proper estate planning will provide instructions declaring who will receive your estate assets, exactly what they will receive and when they are able to receive it.

An estate plan isn't something that is dependent on age, but rather on the size of the estate. The larger the estate, the greater the need for estate planning. Typically as you start getting older you will have a larger estate and more complexities in the estate, such as children, blended families, and other dependents or beneficiaries. The more complex your estate plan is, the more of a need there is for rules so that the probate courts can be avoided. The more control you want over your estate, then the more planning you will need to do.

There is a lot that can go wrong at any point in our lives, so it is important to proactively prepare your assets for life events that are out of your control. For example, you can put documentation into place if both you and your spouse pass away, which will determine who will gain guardianship of your children, which prevents the state from taking them into protective custody.

What is an Estate? An estate is all the property owned by you at the time of your death. Your estate includes real estate, bank accounts, investments, personal property (artwork, autos, jewelry, etc.) and life insurance policies.

What will Estate Planning accomplish? In addition to the above-stated objective of passing on your “estate” to your designated heirs in the most tax-efficient manner, a good estate plan will prevent your wealth from going to unintended beneficiaries. It will also avoid probate.

Probate is the legal process through which a deceased person’s estate is distributed to designated beneficiaries and heirs and any debt to creditors is paid. If you fail to have a plan, your state has one for you and you, most likely, won’t like it. Without an estate plan, your estate will be distributed according to the probate laws in your state upon your death.

If you are married, your spouse and children will receive a share according to the state laws. The state will designate a guardian for your minor children if necessary and if no prior documentation has been put into place. These are all matters that should be handled privately by your family and not by the courts.

Also, keep in mind that even though a will provides your instructions, it does not avoid probate. Assets titled in your name must go through the probate process before they can be distributed to your heirs. The probate process can be very expensive with legal fees and court costs and can take anywhere from nine months to three years. A simple will can also be contested by anyone who wants to lay claim to your estate. Anyone has an opportunity to come forward. Probate and the courts can generally be avoided through the creation of a living trust.

Proper estate planning can also dictate the type of life-prolonging medical care you wish to receive if you become disabled. Once again, without proper documents, the courts (and not your family) will control how your assets are used to care for you. Your estate plan can also provide for special needs family members or even children who might be irresponsible with money or who may need protection from creditors. Your estate plan can also name a guardian for minor children. Lastly, your estate plan can

set forth the type of funeral arrangements you would like and how related expenses are to be paid.

What is a Trust? A key component of constructing your estate plan will be the use of one or more ‘trusts’. A trust is a legal document that allows a third party or trustee to hold assets on behalf of beneficiaries. Because trusts generally avoid probate, your heirs can gain access to these assets more quickly and less expensively than if they were transferred using a will. And since probate is a matter of public record, a trust will allow assets and family matters to remain private.

A trust will allow you to control your wealth since you are able to specify the terms regarding what, when and to whom distributions will be made even in complex situations that result in beneficiaries from more than one marriage. Even though there are many types of trusts, the major distinction between them is whether they are revocable or irrevocable. A *revocable* or *living* trust can help pass assets outside of probate. It allows you to retain control of the assets during your lifetime and can be dissolved at any time. As the creator, or grantor, you can name yourself trustee or co-trustee and retain ownership and control over the trust during your lifetime and name a successor trustee to manage it in the event of your incapacitation or death.

A trust is its own entity with its own individual lifespan. You may transfer assets into the trust, and you can manage and utilize those assets. Even though a revocable trust can avoid probate, it will not avoid estate taxes. If the primary aim is to reduce estate taxes, an *irrevocable* trust is preferable over a living trust since the assets in the trust would be effectively removed from your estate. Once an irrevocable trust has been established, it can not be altered by the grantor since you will lose control over the assets and cannot change any terms or even decide to dissolve the trust. The assets of the trust may also be protected in the event of a legal judgment against you.

TYPES OF TRUSTS

Even though there are many types of trusts available, these are the most common:

- *Marital Trust*: This is also known as an “A” trust; designed to provide benefits to a surviving spouse. It is generally included in the taxable estate of the surviving spouse.
- *Credit Shelter Trust*: This is also known as a “B” trust; established to bypass the surviving spouse’s estate to make full use of any federal estate tax exemptions available for each spouse.

- *Generation-Skipping Trust*: This trust is used to permit trust assets to be distributed to grandchildren without incurring estate taxes on the subsequent death of your children.
- *Charitable Lead Trust*: This trust allows certain benefits to go to a charity and the remainder to your beneficiaries.
- *Charitable Remainder Trust*: This trust allows you to receive an income stream for a certain period and the remainder of the trust assets go to a charity.
- *Irrevocable Life Insurance Trust*: This trust is also known as an ILIT and it is used to exclude life insurance benefits from the deceased's taxable estate. It provides liquidity to the estate or the trust's beneficiaries.

Another important document involved in the estate planning process is the durable powers of attorney. This document will allow someone to step in and manage assets and make health care decisions for you if you are incapable. A durable power of attorney will cover assets that are not held within a trust. Also, you should have a HIPPA document in place. The Health Insurance Portability and Protection Act (HIPPA) ensures that medical professionals are prohibited by law from sharing your private information with anyone without your expressed permission and consent. The HIPPA paperwork will allow you to release information to a specific person who can speak and make decisions on your behalf. In addition, you

can include what you would like to happen for funeral arrangements, such as cremation, burial, memorial, etc. By having this information in your will, your family can honor your wishes.

To understand what documents and trusts you will need, it is important to work with your financial planner and engage in the services of a knowledgeable estate planning attorney, since the trust is a legal document. Your attorney will conduct a thorough interview with you to understand what you are looking to accomplish with your personal estate plan and then draft the appropriate documents.

After your trust is written, it is very important to fund the trust with your assets. This is accomplished by re-titling your assets, such as your home, automobile and any bank and investment accounts you own, into the name of the trust. Doing this important step is crucial for probate avoidance since it will remove assets from your personal ownership and have them owned by the trust.

Again, your estate attorney should handle this part of the process or provide guidance for you to accomplish it. A word of note here: assets with a named beneficiary or beneficiaries, such as retirement accounts (401k,

IRA, Roth IRA, etc.), annuities and life insurance policies will be excluded from the trust since they will avoid probate and their assets will pass directly to the beneficiaries.

*For example, (**) Dave, a 70-year-old, successful retired executive who has been receiving \$150,000 annually from his retirement pension, came to see us regarding the upcoming required minimum distribution from his individual IRA account. (see RMD in the retirement planning section). After a discussion with Dave, we discovered that there were other concerns that he had that expanded the problem from simply a retirement planning question and into the realm of wealth transfer and estate planning.*

Concerns:

- Without the need for any more income, he was required to begin taking distributions from his \$1,200,000 individual IRA.
- He was concerned about any estate taxes that might be due upon his death and wanted to look into transferring a portion of his estate to his 2 adult children.

Objective:

- Begin wealth transfer to his 2 children

- Turn his taxable required minimum distribution dollars into a tax-free benefit

Solution:

- Carve out a portion of his IRA into a Single Premium Immediate Annuity (SPIA)
- Use his Required Minimum Distribution to fund an Irrevocable Life Insurance Trust (ILIT)

How it works:

The first step was to carve out \$250,000 to purchase a Single Premium Immediate Annuity (SPIA) that would be held inside his IRA. The SPIA would produce enough income to cover the yearly required minimum distribution.

The second part of the plan was, with the assistance of his estate planning attorney, create an Irrevocable Life Insurance Trust (ILIT) that would hold a life insurance policy. In this case, the policy would have a \$740,000 death benefit and his 2 children would be the named beneficiaries of the ILIT. As long as Dave lives, the SPIA will remain in force and will continue to fund the ILIT.

When Dave passes away, the SPIA will go away instantly, thus removing \$250,000 from his estate. Also, his children will be the beneficiaries of a \$740,000 tax-free death benefit.

By putting this solution in motion, Dave was able to take his RMD, remove \$250,000 from his estate and transfer 3 times that amount, tax-free to his 2 children. For this plan to work, it was important that Dave was in good health to qualify for life insurance.

There are many moving parts to this case and it is more complicated than most, requiring the service of a financial planner, estate planning attorney and an insurance professional, but it will give you an idea of what can be accomplished by engaging in the financial planning process.

CHAPTER 13

CONCLUSION

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We have come to the end of our brief overview of financial planning and the process of creating your personal financial roadmap. It is our hope that we have demystified the planning process and shed some light on what is involved in creating a comprehensive wealth plan. We also trust that we have brought clarity to the importance of understanding what matters to you in life, how to create and prioritize your financial goals, and how to systematically develop a plan for achieving those goals. Most importantly, we hope that we have given you enough incentive to invest time in yourself to begin the process. Sure, life can be complicated and overwhelming at times. There always seems to be some reason or excuse to put planning off. But, as the old question asks, “How do you eat an elephant?”, the answer is one bite at a time.

A journey of a thousand miles does indeed begin with the first step. While you can take this journey yourself, we believe that working with a qualified and trusted advisor can help you get started, stay on track and keep you motivated. We know from experience that you will benefit from the time you spend creating your personal financial roadmap. You will find it much easier to reach your destination when you have established a clear path on how to get there. Contact us at the Wealth Planning Group if you have further questions about the financial planning process or to discuss specific issues that pertain to your unique situation. There is never an obligation to talk to us. Once again, thank you for taking the time to read this book. Perhaps it is now time to begin your own personal journey.