

# You Deserve

An Amazing Retirement

Volume 2 - Issue 2

## NAVIGATING THE TIDES OF RETIREMENT: TAXES

HOW TO STEER THROUGH VOLATILITY, INFLATION AND RISING TAXES WITHOUT CAPSIZING YOUR RETIREMENT INCOME

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## LONG TERM CARE PLANNING

KNOWING YOUR OPTIONS EARLY WILL ENSURE THE RIGHT STRATEGY IS IN PLACE TO MEET YOUR FUTURE NEEDS.

## RETIREMENT DREAM TRIP TO MOROCCO



## Deserve

**EDITOR-IN-CHIEF** BRETT T. SASO, SR.

**MANAGING EDITOR** PATCHARLES IOVANELLA  
**DIRECTOR OF EDITORIAL OPERATIONS** CAROLINE MURPHY  
**DISTRIBUTION MANAGER** RANDY REESE  
**ADVERTISING AGENCY** MBI, INC.

**ART DIRECTOR** ANTHONY IORLANO  
**CONTRIBUTING EDITORS** KAYLA MOYER,  
TAMARA STAFFORD-IOVANELLA

**CONTRIBUTING AUTHORS** PATCHARLES IOVANELLA, RANDY REESE, ADRIAN T. CHENG, MATTHEW GIANFORTE

## Contributors



### Ed Guanill

Ed is a financial and retirement planning professional with over 18 years of experience in the insurance industry and has been an independent advisor representative since 2012. Ed is a member of the Registered Financial Planners Institute, RFP®, He has offices in both Sacramento and San Diego.



### Jack Leger

Jack is a senior at Wesleyan University majoring in economics and government with a focus on American politics. Jack's love for finance led him to a summer internship position as a private equity analyst at Atlas Holdings in Greenwich, CT. His interests include backpacking, soccer, golf, and anything political.



### Jesse Andrews

Jesse is President & Founder of WisePath Financial Group. He has worked in the financial services industry for over a decade in multiple roles. This background gives him an appreciation and understanding of what matters for his clients. He works closely with his clients to understand their needs, fears, and aspirations.



### Sara Cahn

Sara holds an M.S. in Natural Science Education from the University of Wyoming and is deeply involved in ecological patterning; the relationships between all species and with their environments. She is a fine artist, author, and teacher based out of both New Mexico and New Hampshire. She is an avid fly fisherman and biker.



### Judi Snyder

Judi is a Financial Services Professional and a Retirement and Financial Transition Coach, with a focus on helping those navigate retirement or other financial transitions. Judi joined her husband Jeff in his practice in 2006. Prior to joining, Judi enjoyed a successful 25-year professional career in Medical Imaging Sales & Marketing and Business Development.



### Meaghan McElroy

Meaghan is a writer, researcher, and recent graduate of Ithaca College, where she studied journalism and environmental studies. Her work has been featured in The Ithacan, The New Paltz Times, Oxfam India, and through WRFI Community Radio. In her free time, she likes to cook, hike, and read.



### Bryan Nicolaysen

Bryan is a Senior VP at Retirement Architecture. Bryan also runs a full service Financial Planning firm. Bryan's background is in advanced tax planning, retirement income planning, as well as asset preservation and transfer strategies.



### Quinn Tucker

Quinn is a recent 2020 graduate from Wesleyan University with a double major in Film Studies and Political Science. Quinn is a passionate filmmaker and photographer with an obsession for everything wine. Tucker's background is in documentary filmmaking, wine service, and culture writing.

# Navigating the Tides of Retirement:

# TAXES

By Ed Guanill

How to Steer Through Volatility, Inflation and Rising  
Taxes Without Capsizing Your Income.





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**T**axes play a starring role in the theater of retirement planning. Everyone is familiar with taxes but not everyone is familiar with how to make tax planning a part of their retirement strategy. When you retire, you move from the earning and accumulation phase of your life into the asset distribution phase of your life. For most people that means relying on Social Security, a 401(k), an IRA or a pension. Wherever you have put your money for retirement, you are going to start relying on it to provide you with the income that once came as a paycheck.

Most of these distributions will be considered income by the IRS and will be taxed as such.

There are exceptions to that (not all of your Social Security income is taxed, and income from Roth IRAs is not taxed), but for the most part, your distributions will be subject to income taxes. Learning how to be strategic about how you pull out or distribute this money can save you hundreds, if not thousands of dollars that can be put to use elsewhere.

Consider the following story about the widow who had inadvertently given away over \$30,000 of her legacy money to Uncle Sam:

Maggie's husband died about 10 years into their retirement and he was the one who handled all of the finances. When she took them over, Maggie wasn't sure what she had and how things were positioned. One of her main concerns was reducing her taxes, because although she felt she had enough assets for income production, she was paying a large tax bill every spring.

Maggie made an appointment with a financial professional who also worked with a CPA and in addition to doing her retirement income planning, she had her taxes reviewed. The CPA discovered that for the past five years, she was paying taxes on interest income that she wasn't spending. Her financial professional noticed that Maggie had more than one account that was generating interest she wasn't spending on her own needs, so she asked her, "What is the purpose of these accounts?"

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Maggie replied. "I want that money to be left to my children and grandkids."

This money represented a legacy that Maggie wanted to leave, and so she didn't want to spend it. She also didn't want to let it languish in a low-earning account, either. She wanted it to grow so that she could leave the largest legacy possible to her children and grandchildren.

Her financial professional suggested that she move that money out of the taxable accounts they were currently in, to tax-deferred accounts. He explained the type of investment vehicles that she could use to accomplish her goal without paying taxes on the money, and Maggie was delighted.

Now, Maggie can grow the money she wants to leave for her children and grandkids, AND her tax bill has been reduced by \$6,300 every year!

The benefits of using a tax-deferred investment vehicle give you a growth using triple compounding. What this means is you get more interest growth three different ways. With triple compounding, you get:

- Interest growth on your principle.
- Interest growth on top of the interest earned.
- Interest growth on the money that would have otherwise been paid out in taxes.

Furthermore, by using a tax-deferred vehicle, you don't have to pay the taxes on all of this growth. You pay less, and your beneficiaries get more. This is just one example of the many ways that tax planning can go to work for you during retirement.

### **Planning For vs Paying Your Taxes**

Taxes are taxes, right? You'll pay them before retirement and you'll pay them during retirement. What's the difference? The truth is that a planful approach to taxes can help you save money, protect your assets, and ensure that your legacy remains intact.

How can a tax form do all of that? The answer lies in planning. Tax planning and tax reporting are two different things. Most people only report their taxes. March rolls around, people pull out

their 1040s or use TurboTax to enter their income and taxable assets and ship it off to Uncle Sam at the IRS. If you use a CPA to report your taxes, you are essentially paying them to record history. You have the option of being proactive with your taxes to plan for your future by making smart, informed decisions about how taxes affect your overall financial plan. Working with a financial professional who, along with a CPA, makes recommendations about your finances to you, will keep you looking forward instead of in the rear-view mirror as you enter retirement.

Regarding assets that you have in an individual retirement account (IRA) or a 401(k) plan that uses an IRA, when you reach 70½ years of age, (age 72 if born after June 30, 1949) you will be required to draw a certain amount of money from your IRA as income each year. The amount depends on your age and the balance in your IRA. The amount that you are required to withdraw as income is called a Required Minimum Distribution (RMD). Why are you required to withdraw money from your own account? Chances are the money in that account has grown over time, and the government wants to collect taxes on that growth. If you have a large balance in an IRA, there is a chance your RMD could increase your income significantly enough to put you into a higher tax bracket, subjecting you to a higher tax rate.

Here's where tax planning can really begin to work strongly in your favor. In the distribution phase of your life, you have a predictable income based on your RMDs, your Social Security benefit and any other income-generating assets you may have. What really impacts you at this stage is how much of that money you keep in your pocket after taxes. Essentially, you will make more money saving on taxes than you will by making more money. If you can reduce your tax burden by 30, 20 or even 10%, you earn yourself that much more money by not paying it in taxes.

How do you save money on taxes? By having a plan. In this instance, a financial professional can work with the CPAs at their firm to create a

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distribution plan that minimizes your taxes and maximizes your annual net income.

### **Building a Tax Diversified Portfolio**

So far so good: avoid taxes, maximize your net annual income and have a plan for doing it. When people decide to leverage the experience and resources of a financial professional, they may not be thinking of how distribution planning and tax planning will benefit their portfolios. Often more exciting prospects like planning income annuities, investing in the market and structuring investments for growth rule the day. Taxes, however, play a crucial role in retirement planning. Achieving those tax goals requires knowledge of options, foresight and professional guidance.

Finding the path to a good tax plan isn't always a simple task. Every tax return you file is different from the one before it because things constantly change. Your expenses change. Planned or unplanned purchases occur. Healthcare costs, medical bills, an inheritance, property purchases, reaching an age where your RMD kicks in or travel, any number of things can affect how much income you report and how many deductions you take each year.

Preparing for the ever-changing landscape of your financial life requires a tax-diversified portfolio that can be leveraged to balance the incomes, expenditures and deductions that affect you each year. A financial professional will work with you to answer questions like these:

- What does your tax landscape look like?
- Do you have a tax-diversified portfolio robust enough to adapt to your needs?
- Do you have a diversity of taxable and non-taxable income planned for your retirement?
- Will you be able to maximize your distributions to take advantage of your deductions when you retire?
- Is your portfolio strong enough and tax-diversified enough to adapt to an ever-changing (and usually increasing) tax code?

When Beverly returns home after a week in the hospital recovering from a knee replacement, the 77-year-old calls her daughter, sister and brother to let them know she is home and feeling well. She also should have called her CPA. Beverly's medical expenses for the procedure, her hospital stay, her medications and the ongoing physical therapy she attended amount to more than \$50,000.

Americans can deduct medical expenses that are more than 7.5% of their Adjusted Gross Income (AGI). Beverly's AGI is \$60,000 the year of her knee replacement, meaning she is able to deduct \$45,500 of her medical bills from her taxes that year. Her AGI dictated that she could deduct more than 80% of her medical expenses that year.

Had she been working with a financial professional who regularly asked her about any changes in her life, her spending or her expenses (expected or unexpected), Beverly could have saved thousands of dollars. Beverly can also file an amendment to her tax return to recoup the overpayment.

This relatively simple example of how tax planning can save you money is just the tip of the iceberg. No one can be expected to know the entire U.S. tax code. But a professional who is working with a team of CPAs and financial professionals have an advantage over the average taxpayer who must start from square one on their own every year. Have you been taking advantage of all the deductions that are available to you?

### **Proactive Tax Planning**

The implications of proactive tax planning are far reaching and are larger than many people realize. Remember, doing your taxes in January, February, March or April means you are writing a history book. Planning your taxes in October, November or December means that you are writing the story as it happens. You can look at all the factors that are at play and make decisions that will impact your tax return before you file it.

Realizing that tax planning is an aspect of financial planning is an important leap to make.



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When you incorporate tax planning into your financial planning strategy, it becomes part of the way you maximize your financial potential. Paying less in taxes means you keep more of your money. Simply put, the more money you keep, the more of it you can leverage as an asset. This kind of planning can affect you at any stage of your life. If you are 40 years old, are you contributing the maximum amount to your 401(k) plan? Are you contributing to a Roth individual retirement account? Are you finding ways to structure the savings you are dedicating to your children's education? Do you have life insurance?

Taxes and tax planning affects all of these investment tools. Having a relationship with a professional who works with a CPA can help you build a truly comprehensive financial plan that not only works with your investments, but also shapes your assets to find the most efficient ways to prepare for tax time. There may be years that you could benefit from higher distributions because of the tax bracket that you are in, or there could be years you would benefit from taking less. There may be years when you have a lot of deductions and years you have relatively few. Adapting your distribution to work in concert with your available deductions is at the heart of smart tax planning. Professional guidance can bring you to the next level of income distribution, allowing you to remain flexible enough to maximize your tax efficiency. And remember, saving money on taxes makes you more money than making money does.

What you have on paper is important: your assets, savings, investments, which are financial expression of your work and time. It's just as important to know how to get it off the paper in a way that keeps most of it in your pocket. Almost anything that involves financial planning also involves taxes. Annuities, investments, IRAs, 401(k)s, 403(b), and many other investment options will have tax implications. Life also has a way of throwing curveballs. Illness, expensive car repair or replacement, or any event that has a financial impact on your life will likely have a



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corresponding tax implication around which you should adapt your financial plan. Tax planning does just that.

One dollar can end up being less than 25 cents to your heirs.

When Michael's father died, he discovered that he was the beneficiary of his father's \$500,000 IRA. Michael has a wife and a family of four children, and he knew that his father had intended for a large portion of the IRA to go toward funding their college educations.

After Michael's father's estate is distributed, Michael, who is 50 years old and whose two oldest sons are entering college, liquidates the IRA. By doing so, his taxable income for that year puts him in a 39.6% tax bracket, immediately reducing the value of the asset to \$302,000. An additional 3.8% surtax on net investment income further diminishes the funds to \$283,000. Liquidating the IRA in effect subjects much of Michael's regular income to the surtax, as well. At this point, Michael will be taxed at 43.4%.

Michael's state taxes are an additional 9%. Moreover, estate taxes on Michael's father's assets claim another 22%. By the time the IRS is through, Michael's income from the IRA will be taxed at 75%, leaving him with \$125,000 of the original \$500,000. While it would help contribute to the education of his children, it wouldn't come anywhere near completely paying for it, something the \$500,000 could have easily done.

As the above example makes clear, leaving an asset to your beneficiaries can be more complicated than it may seem. In the case of a traditional IRA, after federal, estate and state taxes, the asset could literally diminish to as little as 25% of its value.

How does working with a professional help you make smarter tax decisions with your own finances? Any financial professional worth their salt will be working with a firm that has a team of trained tax professionals, including CPAs, who have an intimate knowledge of the tax code and how to adapt a financial plan to it.

Here's another example of how taxes have

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major implications on asset management:

Barry and Karen, a 62-year-old couple, begin working with a financial professional in October. After structuring their assets to reflect their risk tolerance and creating assets that would provide them income during retirement, they feel good about their situation. They make decisions that allow them to maximize their Social Security benefits, they have plenty of options for filling their income gap and have begun a safe yet ambitious Managed Money strategy with their professional. When their professional asks them about their tax plan, they tell him their CPA handled their taxes every year and did a great job.

Their professional says, "I don't mean who does your taxes, I mean who does your tax planning?" Barry and Karen aren't sure how to respond.

Their professional brings Barry and Karen's financial plan to the firm's CPA and has her run a tax projection for them. A week later their professional calls them with a tax plan for the year that will save them more than \$3,000 on their tax return. The couple are shocked. A simple piece of advice from the CPA based on the numbers revealed that if they paid their estimated taxes before the end of the year, they would be able to itemize it as a deduction, allowing them to save thousands of dollars.

This solution won't work for everyone, and it may not work for Barry and Karen every year. That's not the point. By being proactive with their approach to taxes and using the resources made available by their financial professional, they were able to create a tax plan that saved them money.

### **Managed Money and Taxes**

There are also tax implications for the money that you have managed professionally. People with portions of their portfolio that are actively traded can particularly benefit from having a proactive tax strategy. Without going into too much detail, for tax purposes there are two kinds of investment money: qualified and non-qualified. Different investment strategies can have different effects

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on how you are taxed on your investments and the growth of your investments. Some are more beneficial for one kind of investment strategy over another. Determining how to plan for the taxation of non-qualified and qualified investments is fodder for holiday party discussions at accounting firms. While it may not be a stimulating topic for the average investor, you don't have to understand exactly how it works in order to benefit from it.

While there are many differences between qualified and non-qualified investments, the main difference is this: qualified plans are designed to give investors tax benefits by deferring taxation of their growth until they are withdrawn. Non-qualified investments are not eligible for these deferral benefits. As such, non-qualified investments are taxed whenever income is realized from them in the form of growth.

Actively and non-actively traded investments provide a simple example of how to position your investments for the best tax advantage. In an actively traded and managed portfolio, there is a high amount of buying and selling of stocks, bonds, funds, ETFs, etc. If that active portfolio of non-qualified investments does well and makes a 20% return one year and you are in the 39.6% tax bracket, your net gain from that portfolio is only about 12% (39.6% tax of the 20% gain is roughly 8%.) In a passive trading strategy, you can use a qualified investment tool, such as an IRA, to achieve 13, 14 or 15% growth (much lower than the actively traded portfolio), but still realize a higher net return because the growth of the qualified investment is not taxed until it is withdrawn.

Does this mean that you have to always rely on a buy and hold strategy in qualified investment tools? Not necessarily. The question is, if you have qualified and non-qualified investments, where do you want to position your actively traded and managed assets? Incorporating a planful approach to positioning your investments for more beneficial taxation can be done many ways, but let's consider one example. Keeping your actively managed investment strategies inside an IRA or some other

qualified plan could allow you to realize the higher gains of those investments without paying tax on their growth every year.

Your more passively managed funds could then be kept in taxable, non-qualified vehicles and methods, and because you aren't realizing income from them on an annual basis by frequently trading them, they grow sheltered from taxation.

### Estate Taxes

The government doesn't just tax your income from investments while you're alive. They will also dip into your legacy.

While estate taxes aren't as hot of a topic as they were a few years ago, they are still an issue of concern for many people with assets. While taxes may not apply on estates that are less than \$11 million, certain states have estate taxes with much lower exclusion ratios. Some are as low as \$1 million. Many people may have to pay a state estate tax. One strategy for avoiding those types of taxes is to move assets outside of your estate. That can include gifting them to family or friends or putting them into an irrevocable trust. Life insurance is another option for protecting your legacy.

### Let's Recap

When you report your taxes, you are paying to record history. When you plan your taxes with a financial professional, you are proactively finding the best options for your tax return.

It's important to understand the tax repercussions when tapping into assets from a 401(k) or a traditional IRA for the use an income source.

At the age of 70½ (age 72 if born after June 30, 1949) the federal government requires all IRA participants take their RMD or Required Minimum Distribution. Failure to take your RMD can cost you thousands of dollars in taxes and penalty fees.

Taxes play an important role during your retirement. It's important that you understand your obligations, and the differences between tax-deferred and tax-advantaged.

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