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Tax-Exempt Is King!

And Tax-Deferred Is The Peasant

If you believe the IRS tries really hard to take the fun out of being successful, like I do, and you understand they do this by creating obstacles for those who are successful…then you're in the right spot. Because of these obstacles, I believe successful people like you deserve the opportunity to learn how the tax code…that's key – the tax code…permits you to get your assets positioned in such a way that when it's time to finally use your wealth later for retirement or whenever it's time to distribute the wealth, that you are completely exempt from both federal and state income taxes…regardless of your income level and regardless of the state you reside in. If you're in California with the 13.3% state income tax…it can make living there quite a bit sweeter! Could you imagine? Wouldn't that be awesome, if it were possible?

Now, how I do this is by understanding and demonstrating the tax code to you. What I do is make this possible for people. So I'm going to walk you through a simple conversation of three different phases:

1. How much do you want to share with the IRS?
2. How much will you share with the IRS?
3. How do you get to tax-exempt?

Let's first determine where you stand: pretend I draw a pie (a simple circle). This pie represents 100% of all of your wealth, both current and future wealth. If I took a knife and made the first cut then handed you the knife and asked that you make the second cut which would represent how much of this wealth you want to share with the IRS, how big, if it were up to you, how big would you make that slice? I'm very confident I know how you answered: something like "I wouldn't give 'em _____".

If that’s how you answered then you’re in line with what I make possible. How I do it is by demonstrating the tax code. Why I do it is because I believe you deserve the opportunity to get what you want; after all, if it were up to you, you would want ALL of your money exempt from the IRS. Me too. This begs a very simple question: ***If the current tax code allows you to do this, would you do it?*** I’m serious and it really is that easy, it’s available, it’s allowed and it comes down to whether or not you want it. You definitely don’t need it.

If you do in fact want it but would not do it, then please stop reading. There’s no reason to waste your time. I’m sincere when I say that to you.

Okay, so over the years I’ve come up with an analogy that I feel is the best analogy to help somebody get the big picture of their entire financial life, it’s really simple…that analogy is climbing a mountain. And it fits so perfectly.

When you climb a mountain you essentially have three stages: you have the ascent. You have the summit. And then you have the descent, coming back down. Your financial life has these exact stages. The ascent is the accumulation phase. The accumulation phase is best defined as when you work, you have income and then you save part of that income and invest it to create a nest-egg. Sounds simple enough right?

Imagine I put an "R" in the flag at the top of the mountain which stands for "Retirement." Not everybody has the same opinions and views on retirement but there is a common theme which is this: you're either going to stop working or work less, and you're probably going to either stop saving or save less. At that point in time begins the "descent" which in your financial life is the *distribution phase.* The distribution phase is where you replace either all or some of your income with income from your assets.

Now, unfortunately the financial services industry both starts and stops everything they do at accumulation (the ascent phase). People get to the top and they have no distribution plan, no exit strategy nor have they been prepared for the complexities they will face coming down. And the analogy holds true just as more people die coming down a mountain than going up, more people have financial ruin on this side of the mountain than when they're trying to accumulate. Can you relate to this? Do you know anybody that's experienced challenges during retirement?

So, one of the things that makes me unique is that I do very little on the accumulation side because most of my clients are great at creating money for themselves or they have advisors that are doing it. My expertise looks at the end game first because just like climbing a mountain, you MUST take the tools with you on the way up that are required to get down. ***The IRS loves it when you're standing on the summit without those tools***...this is where my knowledge and expertise comes to life. Let me show you.

It’s important to understand that there is a rate of return on each side of the mountain. Most people understand and have been taught what an accumulation rate of return is but most people have not been taught about the importance of the distribution rate of return.

The RoR on the accumulation side, the easiest way to remember this one is it’s a RoR *ON* your money. So I’ll give you a simple example. If somebody has $100,000 and they have a 5% accumulation RoR, it’s 5% on the 100 which means they now have $105,000. Sadly, this is what financial planning has turned into: An advisor will say,

“How much money do you have? Where is it? Oh, I can do better because I have better products with higher rates of return.”

The problem is there’s so much more going on. Remember that Fidelity commercial years ago, I think it was Fidelity, where people were walking around Central Park with these big placards? And they’ve got their number…”What’s your number?” the commercial asked. Supposedly that’s their asset total at retirement. The problem is, the dude holding his $2,000,000 sign might very well have more income than the dude holding the $4,000,000… because one doesn’t have to deal with the IRS and the other does.

Let’s talk about a distribution RoR. This one is no longer on your money, the best way to remember it is that it’s *OF* your money. I’ll give you an example: let’s say that someone has accumulated $1,000,000, I’ll just say for arguments sake that it’s in a 401k.

If they want to turn that million dollars that's in the 401k into income for the rest of their life, they now need to be focused on the distribution rate…the accumulation rate is now really irrelevant. If you want to retire at normal retirement age which is somewhere between 62 and 66, your industry standard distribution rate is 3%. They call this calculation the Monte Carlo… basically, it's the percentage of your money you're able to take out every year as income and ensure you don't run out of money before your life expectancy.

It's often referred to as the "4% Rule" and it started back in the late 80s…4% is now considered too aggressive (Google it, you'll find this to be true) so the financial service world is quoting about 3%. Now it doesn't mean it's growing at 3%, what that means is you can take 3% of the million, which is $30,000, each year as income and that will last – *this is important* – for **two lives**, both yours and the surviving spouse. You see, if you pass away in the middle of the descent, this money has to continue to last for your spouse. Make sense?

Distribution is more complicated than accumulation but that's why I spend more time on it. There's actually more roadblocks here that a lot of people don't think about: you have taxes, you have Social Security, you have Medicare, you have distribution rates, you have legacy (what you want to leave to your family and/or charity) and the importance of not outliving your money.

This is why I do what I do. Now you might think I'm making this up, but in 14 years in this line of work, I've never met one person that had an exit strategy…and I don't blame them, I blame traditional financial planning.

By the end of this, you'll understand the exit strategy.

Okay, let's get back to the pie (the circle that I had you imagine I drew)...there's three types of money that make up this pie. The first is Accumulated Money. That's defined as money that you've saved and are currently saving.

Second, we have Lifestyle Money. This is the exact opposite of Accumulated. Accumulated is saving money for tomorrow and Lifestyle is spending money today to enjoy whatever lifestyle you want. Now the goal is to eventually have enough in your accumulated pile that can fund your lifestyle, right? The third type is what I call Transferred Money and this is defined as money that you're losing unknowingly and unnecessarily. A great example is what you told me earlier: you said that if you could, you'd want all of your assets exempt from taxes. If that were possible for you but you didn't know it and therefore incurred unnecessary taxes, then that would be a transfer of wealth that did not have to happen. True?

A second very common transfer is Social Security. Important question: Do you believe you'll get your Social Security benefits when it's time? Did you by chance say anything like: "I doubt it" or "Probably not" or "Who knows, I'm not counting on it"? Think about those answers for a moment: you are admitting to a 100% tax...***we threw tea in the Boston Harbor over 200 years ago for taxation without representation and now we just shrug off 100% taxation WITH representation.*** Isn't that ridiculous? Remember how I believe they create obstacles to get in our way? This one is huge.

So would you agree that most likely only those *who don't have income, or those with very low income* (this is important to remember), will be the ones to get their Social Security? And that those with "good" income, won't? I can't stress the importance of not only understanding this paragraph but also answering those questions…please don't just fly past this.

I'll admit, this one bugs me. You can't shrug off and opt out of the collection of Social Security taxes. It's funded with after-tax dollars and you're told you'll get it all back. So, regardless of how successful you are, if you COULD get all of your Social Security during retirement, would you take it? If that were possible for you but you weren't aware of how to do it, then this would be another big example of an unnecessary transfer of your wealth…***I mean this one is huge*** and I'll show you the impact in a moment.

So here's my big picture philosophy: I focus on the Transferred Money to relieve some pressure from the Accumulation Money in order to make sure the Lifestyle happens. At a high level, if this were possible, do you see how it could benefit you? Me too…I love this stuff.

Now, let me give you another example of a wealth transfer and how this relates to the descent phase of planning, this one is easy to demonstrate. How do you feel about Debt? There certainly is good debt and bad debt. Now I am going to give you a hypothetical example of a bad debt. And I want you tell me what you think of it, okay? You're in an emergency and you need a $50,000 loan. You have nothing in your pie here that can help you and the bank has already declined you as well.

As a last resort you come to me and you say:

“Kelly, I am in an emergency, I have exhausted all possible avenues and I need to borrow $50,000. Will you lend it to me?”

And I quietly say “Yes” then proceed to write you a check. I add the word “Loan” to the memo line and I slide it over the desk to you.

Now before you cash my check what two things do you want to know? I’m confident you said the Terms and the Interest Rate. Here are the terms, I say:

“Look man, you’re struggling financially the last thing I want to do is burden you right now with a monthly payment. Just take the money, there are no terms, for now.”

Sounds good so far, right? Maybe. But then I say:

“Here’s the interest rate: one day down the road at some point in the future, when you’re back on your feet, I am going to want my money back. And based upon my needs at that future time, I get to determine THEN whatever interest rate I want to charge you, and make it retroactive to today.”

How do you feel about that loan now? Horrible right? What I just described was the worst possible debt imaginable: debt that’s payable at an unknown interest rate with unknown terms…all of which are controlled by me, the lender.

Now believe it or not, I just described to a T a financial vehicle most Americans own and my guess is you do as well. Any guesses?

What I just perfectly described was a 401k and an IRA.

Let that run past your brain real slow.

I'll explain what I mean. Let's pretend you have a 401k with a $1,000,000 balance and you bring the statement to me. My first question is always, "How much of this is yours?" What's the only answer you can give me? ***The only answer is "I don't know."*** It's SO important to understand this truth. Neither you nor I nor any financial planner or tax expert on the planet knows how much of this $1,000,000 is yours because the government *hasn't decided how much they want to take yet*. You have a partner in this thing and they've been riding along with you the whole time. You getting this?

At some point, you're going to want to take money out of this account. So you ask your planner, "How much you should take out this year?" You might add:

"Should I take out more this year because taxes are going up next year or should I take out less this year in case taxes go down next year and I can take out more then?"

What's now the ***ONLY ANSWER*** your planner can give you? The same answer you gave earlier…"I don't know." THIS right here is why traditional planning both starts and stops at accumulation… there is NO distribution strategy, not because they suck but because it is IMPOSSIBLE to effectively create one since no one can predict the future. This happens every year…heck, not one single planner even knows what next year's taxes are going to be let alone every single year of your entire life expectancy.

Without any doubt, the government ensures they collect more in taxes than what you saved in taxes along the way. The only evidence you need is the fact that if you take this money out prior to age 59 ½ they get to charge you an additional 10% tax, a **penalty.** So if you're deferring at the 25% tax bracket and take it out early, they get it at 35%. Do you really believe they have your best interest at heart above their own? Me neither. What's sad is the entire financial industry all of a sudden becomes no different than a waiter at a restaurant when they have clients in retirement with these types of accounts because all they can do is take your order…*"Well, Mr. Client, I don't know, so how much income do you want to take out of it to fund your lifestyle? Okay, I'll initiate the order."*

Here's something to consider: I'm confident, if given a choice, you desire to have control of the knife and have your entire pie exempt from taxes…but yet this account, this unknown tax debt held against the 401k and/or IRA actually hands the knife to the IRS. The worst part, they get to use the highest tax rates in the entire code, Ordinary Income Tax, to carve their slice which creates a major problem.

At the very least, it represents something you have that you've admitted earlier you did not want and I'd have to agree with you. How do you feel about that? Are you seeing it in a different light? And if you said, "Well that's why I'm doing a Roth", then I'm not sure you're a good fit for me...if you're reading this, you should already be income phased out of the Roth IRA.

So, you have three options with these types of accounts (Before Tax, Tax Deferred):

1. You can continue to funnel your money into them, which I call the ***Ever Increasing Tax Plan****.*
2. You can flatten the tax using a certain provision in the tax code called a 72t, which allows you to withdraw money out prior to age 59½ without incurring the 10% penalty...there's some particular components to this strategy but it is possible.
3. You can ***Get Out*** and get out as fast as you can once you hit 59 ½ and have access to these funds because this is NOT where you want to be distributing money from over your retirement.

Even though you're not retiring tomorrow, you have to begin with the end in mind and so creating a distribution plan in conjunction with an accumulation plan is essential and you'll see that here in a second. I promised I'd dig into taxes, social security, medicare and distribution rates so let's do it. You ready?

Let's start with taxation. Now this is where you can make your first mistake because ***you don't want retirement income!*** *You want* ***cashflow*** *and it makes all the difference in the world.*

When you're coming down the mountain, you're going to be faced with four different types of taxation (imagine I draw four different buckets). The first bucket is titled "Bucket #1 - Ordinary Income." The best example would be if you had income from a business, income from real estate, income from a 401k or an IRA…all of which is taxed as Ordinary Income.

Let's say you had $80,000 of income from this Bucket #1 in your first year of retirement, the first thing you need to know is that the entire 80,000 is taxed, the second thing is it's taxed at the highest rates in the code, which is Ordinary Income Rates, and third you're going to have to pay two entities: both the federal government and the state. California has a 13.3% state income tax on top of your Federal Income Tax…crazy. According to tax rates today, if they don't go up which they will, the most the government can tax the 80,000 is 35,000 which leaves you with 45,000 to spend. Now this is where it takes an interesting turn and this is eye opening for people. The government has decided that if you have $80,000 of gross income in retirement coming from Bucket #1 then you are rich beyond your wildest dreams and therefore ***you don't deserve your Social Security.***

Today with $80,000 of income, the government will tax 85% of your Social Security. Meaning, they'll take 85% of the Social Security benefit and *add it back* to the top of your gross income distribution. Did you know that? When do people discover this fact? It's been my experience that the discover this when they're finally at the top of the mountain. So, this is a form of means testing.

The government says that you have other forms of income and you don’t need your Social Security, so they take it from you. I’ve already explained why this literally boils my blood…this is double taxation, each at the highest tax rate allowed. We should be in revolt over this. Pissing you off yet? I’m sure it’s making even more sense why I say I believe the IRS tries really hard to take the fun out of being successful…here’s one shining example.

Now, again, I’m confident you won’t need your Social Security, but if you could get 100% of it back, would you take it? Damn straight. Well, let’s see if Bucket #2 makes that happen for us.

Bucket #2, is called Capital Gains Tax. This would come from selling a business, selling real estate, or selling your investments… your stocks, your bonds, your mutual funds that are not in a Qualified Plan. Now, let’s say you have $80,000 of income from Bucket #2. The first difference between this and Bucket #1 is they don’t tax the entire 80. They just tax your gain hence Capital Gains. So, to figure out how much gain you have on a distribution your CPA is going to ask you for a fancy term called Cost Basis. All that means is the difference between what you paid for the asset originally and it's ending balance.

So let’s assume you doubled your investment in value over time (so for example, you contributed $500,000 and over the years it grew to $1,000,000), when you finally distribute the $80,000 of income from this asset, the IRS is going to subtract 50% of your distribution, 40k, which you get to keep tax free as your Cost Basis. The remaining $40,000 is considered the growth and this is what you have to pay tax on.

But, the Capital Gains rate is lower than the Ordinary Income rate. It's about half which is why some people refer to Capital Gains tax as the most advantageous tax.

Now, when I got in the business the Cap Gains rate was 12%, then went to 15%, then to 20%, then Obamacare added a 3.8% Net Income Surcharge, during his 2nd State of the Union he vowed to raise it to 28% before he left office...fortunately that didn't happen. The point isn't to bash Obama but to prove that Capital Gains is just another funnel of taxes that they can turn up or turn down as they wish...again, they control the terms and they control the rates.

For the most part, people use a Capital Gains tax rate of 20%...so you would pay $8,000 in tax on the 40,000 of gain which leaves you with $32,000 of your gains that you can spend and live on. Since you got to keep your $40,000 of Cost Basis, you actually have $72,000 to spend. So, your gross income was the same from Buckets 1 & 2, $80,000, but your spendable income after the government was done was 60% higher in Bucket #2. So it is more tax advantageous to be in Bucket #2 than Bucket #1 but where do you think most people have their money? Bingo, in Bucket #1...it's typically about 100% of their money in Bucket #1. The government has done a great job of pushing people into these tax-deferred products. As a matter of fact, most advisors recommend people max out their Bucket #1 before they even begin building Bucket #2. I honestly believe part of the reason is the fact that money in those accounts are trapped for years. You can't touch them without penalty until you're 591/2. Certainly helps fascilitate a long relationship with clients.

There's another hidden benefit here which is fascinating: your 40,000 of Cost Basis actually stays back on your tax return in Schedule D and it doesn't make it all the way to your 1040 which is Page 1…only the 32,000 does and on the 1040 is where ***they do the Social Security calculation***. So since there's only $32,000 not $72,000 the government doesn't tax 85% of the benefit anymore, they are oh so kind to tax 50% of the benefit with $32,000 of income. So even though your income was higher you actually got to keep more of your Social Security…interesting right? But still crap. Showing $32k of income STILL doesn't deserve all their Social Security? Are you kidding me? Does that annoy you? Drives me nuts. ***But please don't let this slip past you: in these two examples, with the same gross income distribution, the one with the HIGHER spendable income actually got to keep MORE of his Social Security. Interesting right? So, is it possible to have an even higher spendable income and keep ALL of the Social Security…keep reading.***

Now there is no right or wrong answer to this question. Do you believe taxes today feel high or feel low? They feel high to me. They feel so high I went and studied the history of the income tax. I was curious…this is brutal…I am getting killed right? Here is what I found, the income tax started in 1913 and it started as a temporary tax. So the good news is it will go away one day (yeah right!). What I was shocked to find out is I struggled to find a year where taxes were lower than they are today. I averaged the top tax bracket in every year since 1913. The average was 58.3%. I was shocked to find out taxes are historically low. There's only two time periods in history where taxes were lower than they are today 1988-1991 and in the 1920's…that's it.

So here's the reality, do I know how high taxes are going to be in the future? Of course not, I have no clue. But I do know one thing: they are going to go up. They have to because the problem is so big. During her campaign for President in 2016, Hillary Clinton proposed 55%, Bernie proposed 70% (he's called for it to be even higher now)...these two weren't run out of town either.

Let's now look at the third bucket, Bucket #3 - Tax Free. There's only one example of this and its Municipal Bonds (often referred to as Muni Bonds). If you have $80,000 of interest from a double or triple tax free muni bond, your tax bill is zero and you actually are left with $80,000 to spend which means we have another increase in income by moving over from Bucket #2. And that's the sales pitch for these. Here's what's interesting, even though this is tax free the 80,000 still goes on your return. Why? So that the government can use it against you. Isn't that awesome?

So because you have $80,000 on the tax return, just like the $80k from Bucket #1, the government is going to tax 85% of the Social Security! And, if you're married, you're going to pay $800 per month for your Medicare because you have other income. Interesting, right? So this still didn't accomplish what you claimed you wanted earlier.

Alright, Bucket #4, this is the Tax Exempt bucket. Let me first explain what I mean by tax exempt. First, any distribution is tax free just like Bucket #3. So if you used $80,000 for income you get to spend all 80. What makes this different is the distribution is ***NOT means tested for Social Security***, or any other benefits for that manner. Why?

Because it doesn't hit your 1040. So, this means, regardless of your income level and regardless of the state you reside in, if you show nothing on your 1040 then there's nothing to means test and you'd be able to have 0% of your Social Security taxed… meaning you get all of it. Please make sure this sinks in because this is KEY! Remember at the very beginning when you agreed that those who make very little to no money are the ones who get to keep their Social Security? [Potential "light bulb" moment]

Plus, you'd pay about $100/mo for Medicare instead of $800. And you'd qualify for any government cheese that exists. I have a client right now, who is receiving over $420,000 per year in tax exempt income and he gets 100% of his SS, he pays $100 for Medicare, he even qualifies for his State's EBT Food Stamp program…he doesn't do that though he believes that's inappropriate…but he could get it. That's awesome right? Wouldn't that be incredible? Would you like those results? I'll show you exactly how we did it for him.

This is where I start having A LOT of fun typing.

Here we go: there are only two products in all of the tax code that fit into this bucket. First, the Roth IRA. Now what's interesting is the fact that a distribution from a Roth generates a 1099R. I've asked many CPAs why this is and really none of them know…now it's not because they're ill informed, it's because there is no answer. I believe it's an IRS earmark so at some point they can apply Roth distributions to the Capital Gains Bucket in order to use it as a means test for your Social Security.

That'd be real easy for them to do. For now, it's Tax Exempt because it's a tax free distribution and it doesn't means test against your Social Security. But, the government disqualifies successful people from this opportunity. If you make over $120k'ish per year then you begin to be phased out of being permitted to contribute money to this account. Interesting right? That's fascinating to me. If you do qualify, you can only put in just over $5,000 per year...that's not very much which means these accounts will never really grow enough to be able create many years of distribution.

So, the government disqualifies you from the Roth because you're successful in order to push you into these other buckets. Please remember one key point, our politicians must follow tax code as well. They do not have their own tax code. With that said, the only other financial product, the only one remaining according to all of the tax code, according to the 46,000 pages, the 26 feet of bookshelf space, is Over Funded Life Insurance Contracts. Biggest benefit in the code. Have you heard of it? The reason most people haven't heard a lot about or haven't researched it yet is because only 4% of all life insurance is actually Over Funded but who makes up that 4% is incredibly intriguing.

First and foremost its banks. Banks have more of this than any other entity on the planet. As a matter of fact, they make up almost all of the 4%. Today BOA just BOA has about 25 billion dollars in cash in their life insurance reserves (public record by the way, its Line 41 on their Assets and Liabilities report provided through the FDIC.gov site).

Theses values are referred to as their Tier One Capital. It's their Tier One Capital because of how they use it...I'll show that in a moment.

Next, we have the government. Not the government itself but the politicians. As an example, I have a colleague that helped a current sitting senator set up an OFLI contract where he contributes $500,000 per year. There's not a contract that costs $500,000 a year for him, he is overfunding it to the tune of $500,000 per year...***shoving cash in***. My biggest client in this arena, over funds a policy by $2,000,000 per year and he falls into the last group, the wealthiest Americans. History is riddled with successful/wealthy people who had and used life insurance.

What do banks, politicians, and the wealthiest Americans know how to do better than most people? Plan for taxes, and keep others off their money.

So, again, all of these products mentioned up to this point are great for accumulation (businesses, real estate, investments, 401ks, IRAs) but we can't stop at accumulation; when it comes time for the distribution, we move money as far to the right (if Bucket #1 was on the left and Bucket #4 was on the right) as possible because of the benefits coming down the mountain. Make sense? So we literally will do that...we will create Bucket #4 in such a way that it will allow for the transfer of funds from the other three when it's time to begin distribution.

With my clients, I first take a look at the money they're currently forwarding to the various Buckets and see if it makes sense to redirect any contributions and/or balances. But, just like climbing the mountain, it's not effective to figure this out when we finally get to the top. To do this right, we have to get this piece implemented early in order to have the ability to dump money into it later. An example would be a business owner who plans to sell their business. They need to ***create Bucket #4 years before*** they sell the business not right when the sale is done. The IRS loves that mistake. Look, this is a 105 year old tax code that nobody reads.

So let's do a quick lesson on over-funded insurance contracts to tie this together and then I'll show you exactly how that client of mine is completely tax exempt with $420,000 of cashflow. Let me be clear on something, it's my intention at the end of this conversation to ask you to spend some time on the phone with me because it's highly likely that what I'm about to show you within the tax code is something no one has ever shown you before and since quality is never available at a discount, you need the right people helping you with this.

So, I'm going to use an example of an actual client from earlier this week. Pretend I draw a large box and it represents his life insurance contract that he's wanting to buy. This life insurance contract has a death benefit of $2,800,836. There's a minimum dollar amount it would cost him to buy this contract. Who determines that minimum? Other than himself, because if it were up to him he'd want if for free. So who determines this? The insurance company.

They look at his age, his sex, his habits, his hobbies, his blood, his urine and they decide how much they are going to charge per month or annually in order to offer him this $2,800,836 life insurance policy. In this case, they determined that for $2,946.12 a year he could have this protection. This is term insurance.

Have you ever wondered how this works? Economically it can't. He'd give them $2900 for the first year and then accidentally walk in front of a bus and his spouse would get 2.8 million? You can find studies that show that less than 2% of all term policies ever pay the death benefit...meaning the people don't die during the term. So 98 cents of every dollar collected for a term policy is pure profit to the insurance company. But, we need protection so there's definitely value in this for us; however, these policies are cash machines for insurances companies.

Now if there is a minimum premium that's advantageous to the life insurance company there's also a maximum premium. Did you know that? ***Did you know there was actually a maximum amount this client could pay*** for this same $2,800,836 policy? Here's what's interesting: who determines the maximum? It's not the insurance company. It's not him. ***It's our government.*** Like I said before, let that run past your brain real slow!

The U.S. Government sets the maximum. Now that causes me to pause and think about that fact for a moment since we know they try to take the fun out of our success. Why would the government give this guy, give you and me, a limitation on what we can do with our money? Pretty easy, because they want to control our funds as much as possible...*and the corresponding taxes of those funds.*

This maximum wasn't always present. Prior to 1988, you could put as much as you wanted, all at once, in an insurance contract. Interesting. In 1988 with the Technical and Misc. Revenue Act (TAMRA), the government established a maximum dollar amount for each policy by making one big change to insurance contracts: they discontinued the ability to dump all your money in at once and receive favorable tax treatment. So there's no more putting a million dollars in one time and still maintaining a tax-exempt status; therefore, in order to receive the tax exempt benefit they said you must put money in (premiums) more than once, meaning more than one premium payment; however, they didn't specify how many payments. Interesting isn't it?

Why would they make this rule? There's many reasons but here's one thing that often happened back then: prior to 1988, if grandpa died and left a $200,000 tax free life insurance death benefit to his son, his son could take that $200,000 and dump all of it into a new insurance contract on himself. Resulting in all of this $200,000 being completely accessible and also completely tax exempt. When the son died he left an even bigger tax free life insurance policy that's maybe worth $500,000 and his son would do the same thing…these monies were therefore never taxed, ever. This is how the Kennedys amassed so much wealth.

There's countless ways that someone could end up with a large sum of money and want to protect it. So in 1988 the government said, "You can't do that anymore. You have to spread this $200,000 out over time…if not, if you dump all of it at once then we'll tax your life insurance monies just like an IRA."

Remember how I said that I believe the IRS tries really hard to take the fun out of being successful, here's yet another example. Please note, ***they didn't get rid of the tax benefits***, not one bit… all they did was change HOW you can get the money into the contract.

If the grandson in the previous example, received a $500,000 tax free death benefit upon the death of his father, today if he wanted to put all of that into a new policy he'd have to bleed it in over time…he can't do it all at once like his father and grandfather could and still keep the IRS off of it.

Here's how this works now: the insurance company will provide you a health rating and they will then run the math to see exactly how much money you can shove into the contract based upon the IRS' limitation. So, as an example using my recent client again, the insurance company approved him for the $2,800,836. He could buy it the form of a term policy for only $2,946.12 per year or he could over-fund it to the tune of $120,000 per year. ***You see the strategy here is to buy the smallest amount of life insurance allowable by the IRS in order to get the most amount of your cash into the contract…we want to squeeze this corridor.*** Make sense? So that's what we did with this guy. He wanted to direct $120,000 of his annual cashflow into an overfunded insurance contract instead of the other Buckets, so we took an application, he was underwritten, they approved him, and based upon his health rating and the government's limitations, his $120,000 could buy $2,800,836 of life insurance as the minimum death benefit allowed in order to get all of his premium working inside the contract…in order to make it over-funded with cash.

Oh it's so beautiful...at least for money geeks like me!

Could you imagine the look on an insurance guy's face if he walked in and said, "I make a lot of money and I want to spend $120,000 per year on my life insurance premiums?" The agent's eyes would get huge and he'd try to sell him a gigantic life insurance policy, but that'd be a waste of the client's money since all of it would be going to the cost of the insurance and very little to any accumulation.

What you would think prior to reading this eBook, if a friend of yours who you knew to be successful told you that he paid $120,000 per year for his life insurance? How big of a death benefit would you think he had? Huge right? Millions of dollars in life insurance. What's fascinating to so many people when they finally see these types of illustrations is just *how little it buys when you make it about the cash* and maximize the government's limitations. This $120,000 only bought $2.8 million of life insurance making it CASH heavy, not insurance heavy!

So this begs the question: if this client of mine could buy the $2,800,836 worth of life insurance as a term policy and only pay $2,946.12 per year, why in the world would he direct $120,000 per year for the same death benefit? Well, because he wanted a lot of money in his Bucket #4 for the distribution phase later in his life but also because of all the benefits he'd receive on his cash while he "climbed the mountain"...so let's explore those:

1. Tax free Accumulation. On the way up the mountain (Accumulation Phase) you don't pay taxes on the growth.

2. On the way down the mountain (Distribution Phase) you have tax free distribution while you're living. You don't have to die to get this money .

3. Tax free transfer to your spouse.

4. No penalty to access your contributions prior to age 59 1/2. Now do these first four seem familiar? Where have you seen these before? These four benefits are the same as a Roth IRA. Here's the history: Senator William Roth from Delaware wanted to come up with a Roth IRA and he simply copied the tax code for Life Insurance verbatim. Congress scratched 2/3 of the benefits off the list and only gave him these four (plus the "not means-tested-against-Social-Security but they did add the 1099R to track these distributions for potential changes in future). But they went a step further and said we're going to limit people to $5,500 per year and if they make too much money they can't put money in at all and that's what we know today as the ROTH IRA.

Something to consider: Why does the government allow me as self- employed individual to contribute $53,000 a year into to a Sep IRA but zero into a Roth because of my income? Follow the math. They know they're going to need to get taxes from wealthy people, the people that actually save and put money away; therefore, they don't allow wealthy people to contribute to a Roth but they encourage us to put 53 grand a year into a Sep IRA. Crazy.

5. Now what other benefits do these policies have that you don’t get with a Roth? Well, there is no penalty **to access your gains** before the age 59 1/2. This one is big.

6. You have a tax free death benefit, Roth’s don’t have a death benefit.

7. There’s no 1099. There is no communication between the IRS and the insurance companies whether money’s going in or out of the account. So a proper distribution doesn’t hit your 1040 which means it’s not only tax-free but tax-exempt.

8. Which means there is no Social Security means testing.

9. Money in Bucket #4 is also not subject to creditors. Interestingly enough OJ Simpson had a lot of his money in life insurance contracts and was able to avoid paying the Nicole Brown family after he lost the civil case. So there is creditor protection which is FAR more important that one may think and another reason why wealthy people, the banks and our politicians shove capital into these contracts. Just note, the amount of credit protections is based upon the state of residency. 33 states have 100% protection.

10. Money inside this contract is not subject to AMT. If that tax has ever been assessed to your tax return, you’ll know that is the most egregious tax there is; and very, very painful. This is not subject to the alternative minimum tax.

11. Competitive rate of return when you consider the strength of the distribution. Typically, a standard investment account has to perform over 10% annual returns every year after fees just to compete.

12. The policy has guarantees. A typical investment cannot guarantee anything. If they were required to illustrate any guaranteed performance they'd show zeroes. Not insurance. You cannot lose their money.

13. You also have a provision called Waiver Of Premium. If you should become disabled the insurance company will waive up to $20K a month of your contribution (i.e. your premiums), which depending upon your age or your health may or may not be available to you. This makes it a self-completing asset if you're unable to work. Could you imagine the press an IRA would get if somehow your annual contributions would continue to be made so that you continued to grow the asset if you were disabled? Everybody would sign up for it…but this happens every day with properly designed insurance policies. You do NOT lose the ability to continue to grow your asset!

14. Chronic & Terminal Illness Provisions. If it's determined that you are terminally ill, you can access a large percentage of your death benefit prior to your death to be used for anything you want. Take a final trip, splurge on your family, use it for a surgery that's not covered by insurance…whatever.

15. Next you have no market risk, this is significant. Money inside a OFLI contract is not subject to any type of market risk. No stock market risk (during the Coronavirus outbreak I've yet to have one client call me…my clients do NOT lose money, ever!) People that have been over funding their life insurance contracts with these companies have received growth every year without missing one year for the last hundred years.

16. Guaranteed loan provisions. No questions asked this is a completely private transaction. Why would you take a loan against your values? I'll get into that in a moment.

17. You have unlimited contributions. So what would I do if this guy ends up having the ability to put $200,000 into a policy after he started the original policy using $120,000 per year? Well, we would direct the additional $80k into a second policy. This could be on his life or one on his wife.

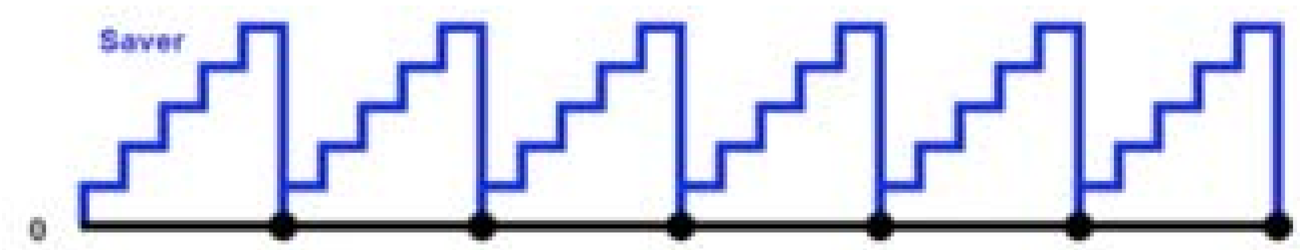
18. These policies and their values fall under contract law NOT tax law. This is why I only use mutual insurance companies because the policy holder is an owner of the company; therefore, creating contract law provisions. These things are as strong as ever and not susceptible to political pendulum swings like the other Buckets.

19. Lastly you can use money inside your over funded life insurance contract as collateral.

This last one is key! It's the critical component to how you use these monies later…it's a concept I call Collateral Capacity and it's why banks hold billions and billions of dollars in these contracts. Let me show you what I mean.

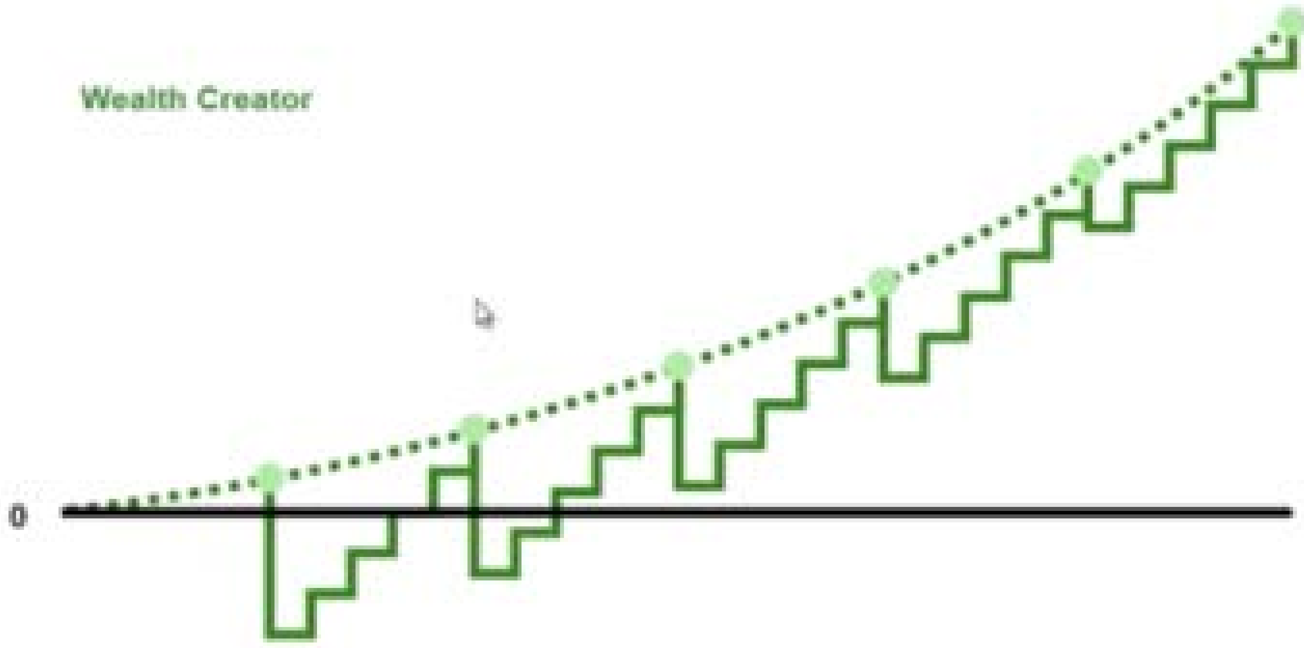
This is the financial zero line:

You must remember that we finance every single thing we buy. This is who I call the "debtor":



She then saves, pays cash then saves and pays cash. Notice, they both get to the same place…they both get to financial zero. The debtor paid interest. The saver lost interest because she depleted her account. Mathematically these two are identical.

Now, within this model is the third type, one who has collateral capacity, what I call the "wealth creator". Here's why: their money never stops compounding…even if they use it.



You see if this individual wants to buy what these two bought then they simply put a loan against their assets, use it as collateral, and then pay off the loan...just like the saver built her account back up and the debtor paid off his debt. It's the exact same thing, with the exact same outflow only the wealth creator never lost the ability to earn interest on their money. This is exactly what banks do. If you and I were partners on a huge construction project, let's say we were building a $100m golf course in Florida and we went to the bank: would they loan us the money using the funds from their depositors? No way...they leverage their billions of dollars in their insurance contracts. So they'd borrow the $100m from the insurance company and the insurance company would charge them something like 4.5%. Then they'd charge us around 7-8% and you and I would pay off this loan...but what happened to the banks money? It never got off the compound interest curve...it never stopped earning...it was just simply used as collateral.

Real estate is no different. If your home was free and clear right now, no mortgage, and you decided to go put a mortgage against it, would the value change on the house? Of course not. The loan against the house has no bearing on the value of the house itself.

So here's how this works once we decide to use of the cashflow during retirement...this is the part I love about what I do...again, I believe you deserve the opportunity to get what you want and have your assets positioned in such a way that when it's time to finally use those assets, you are completely exempt from both federal and state income taxes, regardless of the income level and regardless of the state you reside in...***here's how you do it.***

We climbed the mountain properly and ensured we had the proper tools. In this case, we ensured we had a large amount of capital in our over-funded insurance bucket. The year we decide to use it for income, we take a loan against it. ***Loans are not a taxable event...they don't hit your 1040.*** Could you imagine if loans became taxable income? Holy crap that'd be a huge disaster...if you took a mortgage loan and it counted as income to you? Loans are not taxable. ***This is a loan therefore it's completely tax free and doesn't have a place to go on the tax return (making it tax-exempt) which means you have zero means testing for your social security and/or other benefits. ZERO!***

This small loan collateralized by the balance of the entire bucket, does have a small interest expense but our full value is still earning so this loan would never catch up.

The next year we do the same thing…and so on and so on all the while the entire balance is earning. ***We collateralized our retirement spend-down***. There's an additional benefit to this that I didn't cover before…because this is a collateral strategy the amount we can get out each year is higher than if we were just depleting an investment account. Insurance contracts can yield about a 6% safe withdrawal rate…so if this had a balance of 1,000,000 dollars, we could receive about $60,000 of tax exempt income each year. To compare that to a traditional investment account we'd have to have a much larger balance. Look, let's pretend we didn't do the over-funded insurance contract and decided to direct our money to some other investment account. If this account also grew to $1,000,000 and we decided to begin using it for income, the withdrawal rate is 3%…not 6%. So you could generate about $30,000 of TAXABLE income. Why? For a few reasons, this is at risk so it could lose, it has to last for both the lives of you and your spouse…if you die half way down the mountain this money has to last on for your spouse as well. But it also is a depleting strategy instead of a collateral strategy. You see, if you withdrew money for your income, then the account balance shrinks…which effects the interest you can earn…just like the cash buyer. Then the next year when you do it again, the accounts shrinks again. In the financial industry, the "safe withdrawal rate" as it's called, is considered to be 3% because it's a safe number to ensure the money lasts for both lives and that you don't run out of money either.

What happens over here in Bucket #4 if you die half way down the mountain? What does your spouse get? That's right, the tax free death benefit.

This bucket has to only last for one life...not two. Over-funded insurance contracts create the most cash flow due to these variables: collateral distribution and tax exempt.

So it begs the question: how much money would the other investment account have to grow in order to create the same $60,000 spendable income as well as adjust for the hit to our social security? Well, let's just solve for the $60k?

We'd take 60,000 and divide it by 3% which equals $2,000,000... after fees. Our investment account has to outperform the insurance contract by more than double...crazy. But what if taxes go up? This this thing needs to do even better. I run this number every time for everyone and when you consider all the variables and the complexities of the spend-down, normally the investment account has to get about 9.5 to 12% every single year without ever incurring a loss after fees! Truly, it's just math. And this is why traditional planning both starts and stops at accumulation and why in 14 years I've never had one person sit across from me who had a detailed exit strategy in place prior to sitting down with me.

So here's what we look to do to solve this and tie everything together.

I first want to have an understanding of your buckets. I refer to this as "old money" and "new money." Old money is how much you already have in each of these four? What are your balances? New money is that which you are adding to these either monthly or annually and that you plan to do so going forward...as well as any future amounts like inheritances or the divestment from real estate or businesses.

Then, we want to keep our focus on the pie from the beginning and how much of it you wanted to have exempt from the IRS. Can we get you what you want or can we better balance it out…like a teeter totter. At the very least we want this balanced where our three buckets ***and*** our insurance bucket can actually put us in a position to navigate down the mountain strategically.

You see, we only want Buckets #1-3 to be the primary source of income during retirement if tax laws and rates are extremely favorable. If they are then maybe we'll take a bit more out in distribution and let the insurance bucket cook a little longer…or vice versa. But we always have the ability to ensure we're pulling out an income level from these buckets that won't trigger a tax or a means test on our benefits. Also, we want the assets in the other Buckets to kick butt…go get a big return, kill it. Build your business, invest in your business. Find a great investment planner to create solid returns; however, we just want to make sure you have a place to put those rewards when it's time to use them for income later.

So how we do this is simple. We may have to use some of the funds available in these accounts, the old money, and some of your new money for a few years in order to establish this fourth bucket. Then we stop and wait until it's time in order to take the proceeds from these and move them strategically over.

I've mentioned my client that has a $420,000 tax exempt cash flow. This is exactly how we did it for him about eight years ago in preparation for today.

He was a surgeon. He wisely bought the three story medical building where he officed and he rented out the other office spaces. He had a junior partner who was planning to buy the practice as well as the building…this was our client's primary retirement funding. So what did we do? Did we wait until he sold the practice and THEN began his decent down the mountain? Of course not…the IRS would love that strategy for him. Eight years ago we directed some of his new money and some of his old money to start a $1,000,000 per year premium into his over-funded insurance. After three years we stopped. This meant that from year 4 to year 7, he didn't contribute another dollar into the insurance. By doing this he created a void to the tune of $1,000,000 per year, approximately $4,000,000 total (year 4 – 7) that he could "fill up" with the future proceeds from the sale of his practice and the sale of his building. When he sold those two, he incurred a capital gains tax, which he paid once, and then had a place holder to fill this insurance policy up with about $4,000,000 of his profits from the sale.

This left him in a far more balanced position (imagine a balanced teeter totter - you can't have all your assets on one side, you need to provide some tax-exempt pressure to balance it out.) He has more left over in Buckets #1, some old 401ks and small IRAs, he has some in his capital gains bucket (Bucket #2) from the sale of his business and the real estate AND he has about $7,000,000 in his insurance contract. This policy will generate a $420,000 tax exempt income for him without even touching these other accounts.

If he does use those other buckets, he can use them at a level that keeps him in the lowest tax bracket or below and makes sure that he doesn't take too much out of those to trigger a Social Security means testing. He even qualifies for food stamps! He doesn't do that because he believes that's abuse but he gladly accepts 100% of his Social Security…his is the one who funded after all!

That is the concept and I want to emphasize ***it is the tax code, NOT the product,*** that affords us all of these benefits and gives us the privilege of building wealth in such a way where our retirement distribution is completely exempt for both federal and state income taxes…regardless of the income level and regardless of the state. The product is just the funding mechanism for maximizing the efficiency of the code. Who cares what the product is called?

The last reason you may not be a fit for me is because you care more about what the product is called than what I can do for you. I'm not your guy if that's the case. Again, who gives a crap what's it's called if it accomplishes what it is you claimed you wanted… which was being in the control of the knife!

So, that's what I'd like to uncover with you and in order to really discover those things we have to kind of run two parallel tracks because not everybody can have this…this is life insurance, you can't need it when you buy it. In other words, you can't be sick. So we've gotta make sure you're healthy and that comes with the signing of an application for life insurance. It doesn't commit you to anything.

Also, we have to schedule a para-med nurse come to your house, stick you with a needle, get a blood sample and a urine specimen to make sure you're healthy and while the insurance company is evaluating you, we want to look at your finances to see how big of a life insurance bucket we need to build for you according to what you want to do. It's all according to what you want to do.

You tell us how much is in each bucket, how much you want in the Bucket #4 and we'll design it for you. I'm sure you have questions so that's why I make my personal calendar available to you. You can speak with me directly by simply clicking the button below and finding a time that works for you (this button gets you direct access to my calendar.)

If you made it this far please know that I am very grateful and I'd be honored to talk with you.

All the blessings,
Kelly O'Connor

the green button