

CHAPTER TWO



How to Stop the Bleeding on Your Taxes

“First and foremost, take as much of your income used for non-deductible expenses as you can and find a way to make them deductible.”

The actions of the government, in the form of taxes, will have a bigger impact on your money than almost anything else. And the truth is, income taxes and estate taxes are only two of the dozens of taxes that may affect your future. Just in your day to day life, you face social security taxes, property taxes, school taxes, energy taxes, telephone taxes, capital gains taxes—the list goes on and on. Basically, the

only things that aren't taxed are those that are illegal.

The sheer amount you pay in taxes every year is staggering. Fortunately, there are ways to avoid paying unnecessary taxes, and to avoid more taxes than you need to—ways that go far beyond merely using a qualified plan.

Early in my career, I ran across a letter from United States Supreme Court Justice Louis Brandeis that made a huge impact on my life. The letter read:

“I live in Alexandria, Virginia. Near the Supreme Court chambers is a toll bridge across the Potomac. When in a rush, I pay the dollar toll and get home early. However, I usually drive outside the downtown section of the city and across the Potomac on a free bridge.

If I went over the toll bridge and through the barrier without paying the toll, I would be committing tax evasion.

If, however, I drive the extra mile and drive outside the city of Washington to the free bridge, I am using a legitimate, logical, and suitable method of tax avoidance, and I am performing a useful social service by doing so. For my tax evasion, I should be punished. For my tax avoidance, I should be commended. The tragedy of life today is that so few people know the free bridge even exists.”

Finding the free bridge is more important today than ever. As I remember it, back in the late 1970s and early

1980s, when Jimmy Carter was in office, tax rates were ridiculously high. If you had an income of roughly \$400,000, you would pay a 70% tax on anything over that \$400,000. Then, on top of that 70% tax, you would have estate taxes. You could literally walk away with zero dollars. Your kids could literally walk away with zero dollars. Some people were paying up to 90–95% taxes. In my eyes, that's bordering on communism. On top of all this, interest rates were in the double digits.

In my opinion, this was one of the ugliest times in American history. Home values were in decline, and it was not until Carter left office that things started to look up. When Ronald Reagan came into office, he began to focus on spurring business growth. He started to bring tax rates down, and people were once again able to afford to be in business.

Since the Carter administration, tax rates have plummeted to an all-time low. We are now in the lowest marginal tax rate we are likely to experience anytime in the foreseeable future. Unfortunately, the federal government's only source of revenue is taxes, and the problem is that the government spends more than it collects. The Obama administration has quadrupled the American deficit, and the only way we can pay it down is higher tax rates.

The federal debt is growing exponentially, and the labor force in this country is declining, and will continue to do so. Meanwhile, the number of retirees who subsist on government programs such as Social Security and Medicare is on the rise, and those retirees are living longer and longer. There will soon be fewer taxpaying workers than ever. If the government raises interest rates substantially, they will destroy the real estate market, and with it the American Dream. In my opinion, the only answer is increasing the tax rates.

While the current administration has said that they are only going to go after the income levels above \$250,000, they have raised the estate (death tax) exemption to \$12,060,000 per person (\$24,120,000 per marriage). This means that fewer estates are in the estate-tax-paying bracket and as a result, the larger financial needs now lie in income tax planning. And while the burden is now on the income tax planning, I believe that it is only a matter of time before they go right back and attack the estate. It is all very confusing.

For me, this rising tax environment is a key area of concern. I think that the government knows how money works, and they hide the truth from the general public. If you listen to your parents, you will expect to be in a lower

tax bracket when you retire. That is outdated thinking from the 1940s and 1950s, when every company built a retirement plan for its employees. The average employee lived to be sixty-two years old, and the company could use your money to retire your neighbors. This worked well for companies until the entire country started living longer. Now the fastest growing segment of America is the centenarians, the people who live to be 100. All the post-war era money is gone.

If you achieve your financial goals for retirement, you will have at least as much income as when you were working, if not more, regardless of whether you take it or reinvest it. If we have increasing tax rates, you could be biting your nose off to spite your face.

Why? Well, let's assume that you are paying an average tax rate now, say 24 percent (which could be as high as 37%). If you succeed in your financial goals, you should have just as much money when you retire as you do today. This means that when you retire, you will be in the same income range as you are today. Now imagine that the tax rates rise, as is almost inevitable, and the marginal tax rate hits a hypothetical 45% maximum bracket, and you fall into that. Say you were incredibly fortunate and you earned enough to double the money in your retirement

plan. You now have twice as much money as when you started. You put your money away in a 24% bracket, so you have saved 24% in taxes on half of it. But when you pull it out in retirement, the value is much higher as your money grows, you will be paying 45% on the whole thing. Why would you want to save money from taxes in the lowest tax bracket you have ever seen, just to grow that money tax deferred and take it out in a higher bracket?

I once heard a wise man say, “Rich people think like rich people, and poor people think like poor people.” It is my belief that the biggest difference between the two is that rich people know how money works and can figure out how to make the adjustments to save taxes, leaving the heaviest tax burden to the masses.

Mandy and Gabe came to me just in advance of Gabe’s retirement date. Their concern was the effects of an increasing tax environment in retirement. Gabe had worked forty years as a successful engineer in the aerospace industry. He did not want to see all of his hard-earned income and assets go to the government with a new administration on a spending spree. They had about \$1,000,000 in retirement funds and about \$7,000,000 in assets, including a substantial real estate portfolio. Gabe’s goal was to use the declining real estate market to leverage his retirement income,

even though his employer took care of most of his income needs, at least in the beginning of the retirement phase.

At the conclusion of our analysis and after our work with tax and legal counsel, \$200,000 was re-characterized from taxable income to tax-free profits in the combined Roth IRAs for Mandy and Gabe. Another \$30,000 was converted to a tax-deductible format using the other options within the plan, including a fully funded program to put their four grandchildren through college in the years to come. This is just an example of the results that can be achieved with a successful plan. Your results may vary, simply because every situation is unique.

That was then, and this is now. The tools that we have for accredited investors are night and day from those of the recent past. I just finished working with another couple that owned an automotive business. Their prior counsel advised them to set up a massive administration system, just so they could fund a huge qualified plan, legally segregate their money, and have little impact on giving it to their employees. After the lawsuit settled with the tax advisor they came to me to fix this.

We used an oil and gas based program that allowed them to deposit almost \$1,500,000 of retirement money and wait for the initial valuation a year later. That valuation

will come in at about \$600,000, and at that point we will convert the qualified plan into a totally tax free Roth form. Net savings to the client is 2/3 of the expected tax bill.

In another case, we ran into a mess of a different kind, one in which Sam asked us to manage his pension plan. We came in as a replacement advisor some years back. He gave us over \$2,000,000 to manage but was also still making contributions to the plan. The problem that we didn't realize was that the tax counsel he was using had a too highly leveraged platform to make the contributions he was making. It all came to light when it was time to close down the contribution phase and work on the income phase. In the process of developing an investment strategy we got lucky and experienced a good market.

The problem arose that his salary base did not support the income requirements, and as such, the returns generated a significant overfunding, that caused what we expected to be 50% combined tax rate, plus a 50% excise tax on the overfunding. Had we not caught that, we would have continued to build on the problem with any additional returns on the investment.

The solution came with a collaboration of talents using myself, the tax attorney, the new accounting firm, the Third-Party Administrator, and his actuarial team. By

using some of the capital to buy his life insurance needs, we were able to slow the bleeding and place a need in a more efficient place for him. The next step was to amend his income tax returns to show more self-employment income in the years he needed, so he could qualify for the higher income payout level. It did cause a small amount of additional tax from self-employment taxes, but that was minimal in respect to the cost of the excise tax penalty he would have suffered. We also had the ability to move the assets effectively to a defined contribution (401k) plan and get some substantial breaks in the process.

There are solutions to the problem of rising tax rates. I think that we are all brainwashed into thinking we need to use government savings plans in order to survive. These plans are marketed by everyone from banks to brokers. But more often than not, if you look closely, the tax savings and deferral programs sponsored by the government end up helping the government and the companies far more than they help the taxpayer. So, if putting money into a retirement account isn't the solution, what are the other options for saving money on taxes? There are myriad possible ways to use your retirement plan to pay for things with pre-tax dollars that you would normally pay for with after-tax dollars.

Remember, qualified plans were designed by the government for the benefit of garnering additional tax revenue. If you save \$1 of taxes, and that saved money grows to \$10, the government just added a lot of money to their revenue stream. Qualified plans were designed with the worker in mind. That relates to the 95% of the American public and does great things. If you are in the 5% (affluent market) you have little need for the qualified plan and can do much more efficient things with your money than build a nest egg for the government.

For those of you who are selling highly appreciated assets as a capital gain, and want to leverage those into a lifetime of tax favored or tax free assets/income, the Trump administration produced what is called the “Opportunity Zone.” This is fabulous for those who already own property in an Opportunity Zone, but how does that apply to most of us that aren’t that fortunate ?

First, let’s define what this is:

Opportunity Zones (OZs) are defined as **“economically-distressed communities where new investments, under certain conditions, may be eligible for preferential tax treatment.”** First conceived in April of 2018, OZ plans are now in place for communities in all 50 states.

If you want to take advantage of an Opportunity Zone,

seek out a current investment company that is active in that process. If you decide to invest in them (similar to investing in a mutual fund or private placement), you receive that tax benefit pass through. Additionally, all funds invested get a dollar-for-dollar offset of federal capital gains tax in the year of investment. Make sure you get all the data because it works slightly differently with each vendor, and the program runs out for new investors at the end of 2026.

First and foremost, take as much of your income used for non-deductible expenses as you can and find a way to make them deductible. The self-employed world has been doing this for years. You may be able to make all of your out-of-pocket medical, dental, vision care, and child care expenses pre-tax; be able to pay your life insurance premiums from a tax-deductible source.; and even move your credit card debt to a source that can be deductible. The list goes on.

As I mentioned previously, all of this leads to the what I call the “Ticking Time Bombs of Tax Planning,” which refers to all of the things that traditional wisdom encourages you towards in tax planning. If you listen to the government, you will pay into social security and pay into your 401(k) all of your working life. If you listen to the financial institutions of the world, you will do the same thing.

Why? Because both the government and financial institutions know when the time bomb is set to go off. Do you?

If you're an institution, you primarily care about keeping investors happy enough to retain their money there. If you are a fee based financial advisor, you only get paid if the money stays put; they know when the bomb goes off and the fees get paid. If your assets are being managed by an advisor, what happens when you lose money? They lose fees, and you lose assets and the value of those fees.

If you are the government, when does the bomb go off? When you pay tax! Except most people only spend the Required Minimum Distributions yearly because they don't need all the money presently. That simply passes the burden on to their children or other heirs.

If you know when your bomb is set to go off, you can plan to minimize or eliminate the pain altogether. You just need to find a way to get the government to participate in your plan(s).

Most people simply want a hard cost reduction. The affluent, however, know how to make traditionally non-deductible costs deductible. When you learn how money works for financial institutions and government, you will see how you can make them your allies and possibly take those savings and put them into your future. Use retirement

plan rules to your advantage and maximize Roth programs for maximum tax-free growth. If you are investing in real estate, and the program is strong enough, you can even take a Roth IRA with little money in it and convert it to a self-directed program that could leverage your tax-free savings into a retirement opportunity.

There are actually two places you can go to find your opportunities or your pitfalls. If you are looking at your business, a legitimate valuation will direct you to the opportunities. Business valuations are not cheap, but they are worth their weight in gold. By using a qualified business valuation firm, you can find issues with your books, your employees, your management style, and it can actually bring a much higher value to your business by understanding all of the facets that go into valuations.

Your real choice here is whether you want more cash in your pocket today by maintaining your cash flow business (at ordinary income tax rates mind you), or if you want to increase the multiples of your business by reorienting into a “Value” based model.

Cash flow businesses are run as though the owner of the business is set up to simply replace his income from when he worked for another company. So many business owners fall into the trap of thinking that if they take more

income the business will be worth more money. It is simply not true. If I am a business owner and I make \$250,000 per year, and I increase the business enough to adjust that figure to \$350,000, the value of that is \$100,000 less the cost of taxes on that income. It is more challenging to show that on a balance sheet to get top dollar for the business when they sell.

A value-oriented business knows how to mitigate expenses and increase profit so they show on the balance sheet. If you increase your balance sheet by \$100,000 in that given year, and decide to sell the business, you get a multiple of your gross, net, or profitability when you sell. In this case, if the multiple was 5X, that \$100,000 would be worth \$500,000 extra in the sale.

To top that off, the \$500,000 would apply to taxes as a capital gain, whereas the income to cash flow shows as ordinary income. There is a huge difference between the two. If the business owner needs more income, there are better ways to take it.

To see what opportunities you have from a tax planning standpoint, you can spend hours and hours with your CPA (at a fairly high cost) or you can obtain a summary report in advance by employing an advisor that can strip out all of the opportunities with a holistic report. This type of report

is not available at many offices, only the ones that subscribe to an advanced analytics model that use technology to characterize what options you have clearly taken advantage of, and which you have missed upon. Once this report is generated, you can sit with any collaborative of advisors that you want. In today's virtual world, it is cheaper and easier to get all of your trusted advisors on a zoom call to get right to the heart of matters.

Does the government pay you a substantial tax refund every year? You may want to consider that an interest-free loan to the government every year. In fact, the only reason you get a refund is because you overpaid during the year. Then you ask for your money back when you file the tax return. Does the government pay you interest on that money you loan them? No. They don't even thank you for using your money while they had it.

Why do we have to work so hard to get our tax refunds at the end of the year, when in reality that money should have been ours all along? Think about the size of your tax refund. For an average income, that refund is probably a couple of thousand dollars at least. Now imagine how useful that money would have been if you could have used it over the course of the year! Many people could use that money to pay the high interest rates on their credit cards,

instead of allowing it to accumulate while the government uses your money.

What we want to do is maximize what you do during the year in order to minimize the amount you are overpaying the government. That way you get to use that money during the year, instead of the government using it free of charge. Take control of your money and your future, or they will. Learn the ins and outs of how money works, and you will make government and institutions your allies.

Banks will loan directly to your retirement plan on a non-recourse basis. Let the risk lie with the government, not your personal assets. As a matter of fact, one of the key things we teach while building great wealth is to protect the wealth you have now, as well as the wealth you are targeting for your portfolio. It is a well-known fact that government makes the rules that you are told to follow. I believe that when you learn how money really works, you can learn how to use government rules and government money for your retirement, instead of contributing to excessive government spending, as many people are doing right now.

It has been said that saving money won't make you rich but leveraging the money you save will. Take the risk off of your back and stop bleeding cash on your taxes!

Visualize the Possibilities!



Chapter in Review

1. Taxes Are on the Rise

Regardless of what tax bracket you are in, our national deficit needs to be reduced. When Jimmy Carter was in office, we had a 90% maximum tax rate. If that sounds outrageous, what is even crazier is that we had little debt. Including the double-digit interest rates, we had little debt, and nobody could afford what they already owned. Now we have low single digit interest rates, and a maximum tax rate of 37%, but the deficit is many trillions of dollars. Does it really make sense to save retirement dollars in a low bracket knowing that rates will be higher when we retire?

2. The Best of Both Worlds

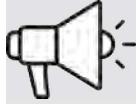
Let's explore how we can use retirement funds in today's low tax bracket and leverage it to get them out using tax favored or even income tax free solutions.

3. The Opportunity Zone Benefit

Take advantage of an Opportunity Zone by seeking current participation with an investment company. It's like a mutual fund or private placement, but you receive a pass-through tax benefit. Plus, all funds invested get a dollar-for-dollar offset of federal capital gains tax in the year of investment. This program runs out for new investors at the end of 2026.

4. Whose Money Is It Anyway?

Investment companies are constantly telling us to put money into government programs like IRAs, 401(k)'s, and pension plans. For what good reason? Is it for us, or the institutional world? Mutual fund companies want control of the money for the privilege of a potential rate of return. The government wants the money inside the IRA and qualified plans. It's because it is good for them, so they make you feel like it should be good for you. Whose money is it anyway?



Call to Action Solution

The first step in making your money work for you, is to understand how money works. The best way to do that, is to get with your tax strategist and develop a plan. If your tax planner is just a historical planner that just plugs the numbers in the right slots, then have your planner connect with a financial planner and create an integrated solution that makes a difference. As the old adage goes, if you fail to plan, you plan to fail. Call my office for any advice or referral you may need.