CHAPTER 14

TAX-FREE RETIREMENT BEYOND THE ROTH IRA

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Many of us have heard all of the secrets and lessons "Mamas" have taught us for many years. For example, "always look both ways before crossing the street" or "don't touch the stove because it's hot!" Well, Mamas always have known best and I can surely appreciate some of the lessons I've learned from my "mama." One of the things I remember about my "mama" is her reading all of those childhood stories like *Bambi, The Cat in the Hat*, and this one in particular, *Cinderella*.

We all can remember the story where Cinderella was mistreated by her stepmother and stepsisters and made to do all of the menial chores, while her stepsisters were allowed to prepare for the ball in hopes of meeting the handsome prince. If you can recall, Cinderella's fairy godmother granted her the wish which eventually allowed her to attend the ball, but she had to leave before midnight after which everything would return to normal. Eventually, as we learn, Cinderella loses her slipper which led to the Prince searching for the owner of the glass slipper. That led to a mass proclamation to find who would fit this slipper that was worn by Cinderella.

Obviously, as the story unfolded, the glass slipper was fitted by Cinderella and she lived happily ever after with her prince charming. Now, why is Steve talking about Cinderella and a glass slipper? The answer is because too many famous financial experts have made blanket statements suggesting that everyone should never do this or do that. You've heard it many times I'm sure – "Buy Term, invest the difference." and "You shouldn't buy annuities because their fees are too high." but they never tell you that there are no-fee annuities and that all annuities are not the same, or that life insurance has more to offer than just a death benefit.

Essentially, what they are trying to do is make everyone wear the same proverbial glass slipper. You are "Cinderella" and your retirement planning is unique to you, so separating fact from fiction is extremely vital – which is what the goal is here. Now that we know you are "Cinderella," let's take a deeper look into various challenges that retirement will bring and why your retirement plans should include not only tax-deferred planning, but also tax-preferred planning – including Tax-Free options.

Most of us have heard by now about Roth IRAs and how they grow tax-free, but we need to understand how the Roth actually works and what its limitations are. The Roth is absolutely a beautiful, phenomenal vehicle. However, there are four limitations that you need to make sure you are aware of, and I wouldn't even go so far as to call them limitations as they are just guidelines. These are things that you need to know about the Roth – the four limitations or guidelines of the Roth:

(1) Income limit (You make too much money; the government does not allow you to put anything in).
(2) Contribution limit (This depends on how old you are – the most you can put in is either $6000 or $7000 if you are over the age of 50).
(3) 59½ rule. Are you familiar with the fact that if you try to take your money out, particularly your gains, you pay a 10% IRS penalty for accessing the money prior to reaching age 59½?

(4) Market Risk: What do you think your money is tied to as its investment options? Typically, it is tied to Mutual funds, which come with volatility. So, if it is tied to Mutual Funds, this means your principal is at risk. This doesn't make it a bad vehicle, but you just need to know the risks you are taking.

Also, keep in mind the 5-year rule regarding a Roth's tax-free status which states: Five years must have elapsed since the tax year of your first Roth contribution before the earnings can be withdrawn tax-free. That applies across the board to retirees, even if the account owner is 99 years old or a first-time homebuyer. Eligible Roth IRA contributors don't need to do anything special to ensure that only your contributions are withdrawn. The Roth goes by the rule, "first-in, first-out." That means that the money that went in first is the first to be distributed. You only need to worry about the 5-year rule if your withdrawal is in excess of the amount contributed and the IRS decrees that Roth IRA distributions are taken in this order:

1. Contributions.
2. Conversions or rollover contributions.
3. Earnings on investments.

What is the Five-Year Rule for Roth IRA Withdrawals?

Furthermore, an investor can withdraw his or her contributions to a Roth IRA at any time without tax or penalty. But that does not apply to any earnings or interest that you have earned on your Roth IRA investment according to IRS.gov. In order to withdraw your earnings from a Roth IRA tax and penalty-free, not only must you be over 59½ years-old, but your initial contributions must also have been made to your Roth IRA five years before the date when you start withdrawing funds. If you did not start contributing into your Roth IRA five years before your withdrawal, your earnings will not be considered a qualified distribution from your Roth IRA because the withdrawal violates the five-year rule.

This is also true for Inherited Roth IRAs that they can have a 5-year waiting period as well, but it starts with the original account owner. If the account owner dies before five years have elapsed, the clock keeps going when the inheritor gets it.

So, now that we've digested the Roth IRA, what are the other two tax-free vehicles that I can invest in? Well, one is Municipal Bonds. According to Investor.gov: Municipal bonds (or "munis" for short) are debt securities issued by states, cities, counties and other governmental entities to fund day-to-day obligations and to finance capital projects such as building schools, highways or sewer systems. By purchasing municipal bonds, you are in effect lending money to the bond issuer in exchange for a promise of regular interest payments, usually semi-annually, and the return of the original investment, or "principal."

A municipal bond's maturity date (the date when the issuer of the bond repays the principal) may be years in the future. Short-term bonds mature in one to three years, while long-term bonds won't mature for more than a decade.

Generally, the interest on municipal bonds is exempt from federal income tax. The interest may also be exempt from state and local taxes if you reside in the state where the bond is issued. Given the tax benefits, the interest rate for municipal bonds is usually lower than on taxable fixed-income securities such as corporate bonds.

The two most common types of municipal bonds are the following:

- General obligation bonds. These are issued by states, cities or counties and not secured by any assets. Instead, general obligation bonds are backed by the "full faith and credit" of the issuer, which has the power to tax residents to pay bondholders.
- Revenue bonds. Revenue Bonds are not backed by a government's taxing power but by revenues from a specific project or source, such as highway tolls or lease fees. Some

revenue bonds are "non-recourse", meaning that if the revenue stream dries up, the bondholders do not have a claim on the underlying revenue source.
(Information is courtesy of Investor.gov)

The challenges with Municipal Bonds are call, credit, interest, inflation, longevity and liquidity risks. In addition, and this is my opinion and shared by many advisors I know, that they are: low diversification, low yield, and unless you are a multi-millionaire looking for a small stream of income, there are better tax-free retirement options which leads me to the other tax-free retirement planning option: Cash Value Life Insurance. Yes, Life Insurance can be tax-free and does not have the 59½ rule of the Roth IRA nor does it have market risks associated with the Roth and Municipal Bonds.

Cash Value Life Insurance (CVLI) has been around a long time even going back to the time of JC Penny – who used his CVLI policy to fund his business during the depression and which allowed him to pay staff and succeed when the market was hemorrhaging. Not only JC Penny, but Ray Kroc (the one who started McDonald's), after convincing Maurice and Richard McDonald to sell him their hamburger stand and all of its trade secrets, took out a loan on two of his cash value policies to get McDonald's off the ground and well, you know the rest.

The fact that men like Ray Kroc and JC Penny knew the importance of not having all their eggs in one proverbial wealth "glass slipper," i.e., stocks and bonds offered via Wall Street, this is a lesson we all can learn from. In fact, most of my clients prefer CVLI for this very reason:

All those guidelines that applied to the Roth (market corrections, income limitations etc.) don't apply to CVLI. There is no income limit and no contribution limit for CVLI!

(Side note: Roth IRA is phased out but will go up by $2,000 for singles from $120,000 in 2018 to $122,000 in 2019. It will go up by $4,000 for married filing jointly from $189,000 in 2018 to $193,000 in 2019. You can't contribute anything directly to a Roth IRA when your income goes above $135,000 in 2018 and $137,000 in 2019 for singles, and $199,000 in 2018 and $203,000 in 2019 for married filing jointly, up by $2,000 and $4,000 respectively in 2019.)

So, putting those two together, the CVLI and the Roth IRA, as you start making more money, you can put more money in CVLI which is the reverse in a Roth. Because, as you make more money in a Roth, they phase you out! Also, there is no 59½ rule in life insurance because it is not an Erisa plan. Therefore, it is not subject to Erisa rules. You don't have a 10% penalty because of your age. And last but not least, you are 100% protected from market risk but can participate in a product called the Indexed Universal Life (IUL) which allows you to use an index like the S&P, but your money is never directly invested into the market. (At www.FigWealthAdvisors.com, we have uncapped strategies with participation above 100%, and in some cases, 200%.) Basically, you get all the gains with no risk to principal ever, and any gains cannot be lost due to future market volatility, they are locked in!

When the stock market corrects itself again (and it's never a question of *if*, only when), you won't lose a dime. Plus, you shift the responsibility from yourself to the insurance companies. Hey, isn't that the reason why we buy insurance, in case something happens. You have insurance on your car, home and even our cell phones, so let's insure your retirement.

The other reason why life insurance, in particular cash value life insurance, is important, is that America has $19 trillion in debt, and ironically, we have roughly the same in our 401(k)s and our traditional IRA accounts. So, logically, where do you think they are going to tax in order to make it up? Remember, those accounts are tax-deferred (have not been taxed yet), so the importance of tax-free planning beyond the Roth IRA with no limitations on income or contributions is akin to not trying to fit your retirement planning all into the glass slipper that many advisors have recommended.

The Success Formula for investing is understanding that a balanced portfolio consists of tax-deferred and tax-preferred retirement income planning.

About Steven

Steven L. Crawford, MBA, Certified Financial Fiduciary®, RFC®, National Social Security Advisor®, also known as The Retirement Wealth Coach®, is CEO and Managing Partner of FIG Wealth Advisors and Ford Insurance Group. He has 19 years' experience in the insurance and financial services industry, winning several awards working as a "Foundation Capital and Retirement Specialist." In addition, Mr. Crawford is a member of the National Association of Experts, Writers & Speakers®, National Ethics Association, National Black MBA Association and a Hall of Famer with a youth sports organization (Pembroke Pines Optimist) in Pembroke Pines, Florida.

Furthermore, Steve is a member of an exclusive group of only 3% of the nation's advisors who has specialized retirement products with two of the leading money management firms in the world just for his clients. He has extensive retirement income planning expertise with a focus on safe money and alternative non-correlated asset planning that secures retirement from stock market-related volatility that can erode life savings.

Mr. Crawford has been seen on CBS television show *Morning Break, CBS Local News at 5PM*, Fox Sports and NBC 6 South Florida. He is currently featured on the leading website in the world for "Safe Money"-related searches. In addition, Steve is a financial instructor for a non-profit where he teaches retirement and safe money strategies for affluent attendees. Also, he is a sought-after advisor requested to teach estate preservation, retirement income for affluent attendees, and business continuation strategies for business owners at various businesses throughout the country.

Lastly, he is a former host to two ESPN Charlotte radio shows, *Preps 2 Pros with Steve Crawford* and *Coffee & Cash Flow* which aired for 3 years. Now, both shows have evolved into highly regarded Podcasts.

Steve's motto is: *To provide refined <u>Foundation Capital and Retirement Plan Solutions</u> primarily for a select group of individuals who, among other things, are looking to elevate the performance of their retirement assets, alleviate the concerns many have of "outliving your money," and aspire to a work-optional lifestyle.*

Mr. Crawford does this through a process he's developed and refined called TCE: TOTAL CLIENT ENGAGEMENT. This is a process of educating clients about what's really happening with your money in spite of the media or uncertainties of Washington and Wall Street.