Consider This Program

Episode Date:

February 22, 2020 Episode

On This Show:

Big Joe Clark, CFP®: Managing Partner and Lead Advisor of Financial Enhancement Group

Angi Kinser: Event Coordinator at Financial Enhancement Group

Show Notes:

Topics Include:

- The Dreaded Phantom Capital Gains
- Fiduciary Versus Suitability
- QCDs Versus Secure Act
- Distribution And Taking Money Out

Phantom Capital Gains

We talk about this twice a year, every year. One: as you're preparing for taxes, because a lot of people don't understand that form 1099-r. That's the form that says you have taxable income. Then we talk about them around Halloween because how can you not talk about anything called phantom around Halloween.

What is phantom income? Phantom income is exactly what it says it is. It's income that you pay taxes on that is phantom. It's not in your purse. It's not in my billfold. It's not in your checking account. It's income that you never really get and it comes in the form of a capital gain. It can come in the form of any income that you didn't receive, but it is very much capital gain driven. What is the difference between long term and short term capital gain? When you're talking about capital gains, you're not talking about an IRA or a 401(k). Capital gains are in accounts that you have opened with money that has already been taxed. You've taken that money and you've made an investment. You bought a stock, a bond, or a mutual fund.

It is considered a short term capital gain because you held it for less than one year and is taxed at your full marginal rate. If you hold things for one year and one day, that's a long term capital gain and your tax rate is preferential, meaning that it's much lower than your marginal rate.

You're not going to experience them here at the Financial Enhancement Group for one good reason: we don't use mutual funds. When you look at where phantom capital gains come from, it's very understandable how they arrive.

Why would you want to put yourself in a losing position starting out? Why would I ever want to allow myself to be taxed on money that I didn't get? A mutual fund is set up as a trust and it functions under a "pass-through entity", which means what happens inside of that trust happens on side of your tax return. We use individual equities and exchange traded funds, never open-ended, actively traded in mutual funds because of taxes. We believe in reduced fees and expenses. Whenever you can put yourself in a better tax structure, that's what an ETF is going to help you do.

Financial Advisors

There are different types of financial advisors.

There is no such thing as a license for a financial advisor. I went through three years of education and learning financial planning, then took a board exam to be a Certified Financial Planner. You can't say you're a Certified Financial Planner without that, but you can say you're a financial advisor. You can say you're a wealth manager. It's deceptive.

The term "fiduciary" is basically just a standard of care, correct?

There's no license in our industry that makes you a fiduciary. It's how you behave and when you agree to do it, how you're regulated. We are considered a hybrid registered investment advisor. We have all the securities licenses that you can use to sell things. We just choose not to. We have them because when people transfer an annuity contract to us that they bought, for us to be able to help, we have to have the licenses to be able to put our name on it. We do not sell any new ones or any new products. We just use it to manage.

What are the other kinds that sell products and make commissions?

Everybody has a fiduciary, but the probability is that it's you that is acting as your own fiduciary. You have to make what you believe is the best decision for your money or you can hire people like the Financial Enhancement Group who are registered investment advisors. We are required to be

fiduciaries. We have to treat your money as if it were our money and we were in the same situation. When the SEC comes in, they don't ask if we did something under what is called “suitability.” As a registered investment advisor, acting as a fiduciary, I treat your account as I would my account if we were in the same situation. Nationwide, 90% of people have somebody that is under suit. Their accounts are under suitability.

In Indiana, it's 92%. There's only 8% of us that function under the fiduciary concept in Indiana. If you want to know what your responsibilities are as a fiduciary, there's two checklists we can give you. One is your fiduciary duties. Then the second one is fiduciary responsibilities. The second one is if I was hiring an advisor.

QCDs

Before the Secure Act, a QCD was the absolute biggest no brainer for those of you that were charitably inclined, over 70 and a half that wanted to make gifts out of your IRA and not have to pay the taxes on it, especially with the change between the standard deduction and itemized deductions. Things have changed.

You had to be at the required minimum distribution age to be able to take a QCD. You had to be 70 and a half. Now the IRS has said, “No, you don't have to take your RMDs until you're 72.” What happens for that year and a half? What happens if you're at 70 and a half? Can you still do a qualified charitable distribution? The answer is yes. Can you do a QCD at 70 and a half if you're charitable inclined and have an IRA? Yes.

You can give more if you want to, but many people do it up to their required minimum distribution so they don't have to take that extra money and throw it on their tax return. Can using a QCD lower your taxes or your AGI? Absolutely.

There are rules behind QCD and the custodians are going to send out a 1099-r that shows that you took a distribution out of your IRA, even though you had that money go directly. It has to go directly to a charitable entity. You have to know how to fix it. Fill out your tax return correctly. Every year we find somebody who's been doing it wrong.

What about nondeductible or inherited IRAs? You'd never want to do a nondeductible IRA because of the way the basis worked. An inherited IRA is very confusing because most will say you cannot use an inherited IRA for a qualified charitable distribution. That is not the case. You actually can, you just have to be over 70 and a half, as the beneficiary.

Can spouses combine RMD amounts? You don't combine them. It's an *individual* retirement *arrangement*, not an account. You can combine them together in your name but not your spouse's name.

Which account should I withdraw from first?

Is there a general rule of thumb to which accounts we withdraw from first? When we're saying which accounts, we're talking about the different types of accounts like: after tax, your brokerage accounts or savings accounts, tax deferred, your IRA, your 401k. Your two objectives are going to be: the average tax rate you pay on each dollar you withdraw, and the volatility of your account.

Here's scenario #1) "My wife and I are recently retired, ages 65 and 66. We've decided to delay Social Security until age 70. We have a substantial amount of savings in IRAs, but neither of us have a pension. We also have Roth IRAs and around $22,000 in savings. We are trying to decide which accounts to take our income stream from."

They're going to delay Social Security, they have no pension, so they start off with a clean tax.

Rule #1) Mailbox checks - that's what Social Security or a pension is. They have no belt mailbox checks.
Rule #2) How much money do they need to maintain their standard of living?

As I look at this situation, we're going to find out how much they need to maintain their standard of living. We're going to walk them through the retirement budget so they can understand the difference between fixed and social expenses. We do that in our process called Next Steps.