



Tax Traps That Could Be Costing You Thousands Every Year [Ep. 27]

Transcript

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At the highest levels of wealth, it's not always about what you make, it's about what you keep. Sure, what you save. Tax planning isn't a luxury, it's a necessity. (...) And for many high-net-worth individuals, it's like playing a game of chess, not checkers. You always have to remember; the IRS isn't going to do you any favors.

Awesome, Well, today we're gonna talk about tax strategies for the high-net-worth, right?

And pitfalls, I know there's probably 20, 30 episodes we could do of 10 hours each on this. And we're just gonna do it from, I would say somewhat of a high level of things that are common that we see with clients.

Whether they have 10, 20, 50, 100 million bucks, a couple things to be thinking about. Yeah, I got my cheat sheets ready, cuz there's a lot of information, especially as tax laws cuz they continuously change. So, you need to make sure that you're accurate on everything. Yep, So, what are some of the pitfalls? Why don't we start just from the top, what are the pitfalls? I'd say one of the biggest ones is thinking that capital gains is free money. People always think that capital gains is that free money, we don't have to worry about it until Uncle Sam shows up. And then knowing, especially for high-net-worth individuals, knowing what tax bracket they fall in. Because many people think that if they know that they have taxes, that is just 15%. Well, it can be 15% taxes on their capital gains, or up to a certain level, it can be an extra 3.8% net income investment tax or net investment income tax. And plus it could be 20. And then that was my next

comment. And then you can go to 20, So, if you're over that level and you're at 20, Well, now you're really at 23.8%.

So, you need to know what your tax rate's gonna be, and then you need to understand as far as state laws, there are a few states that can charge you state taxes on it. The next thing I would say is thinking that passive income is really passive, right? There's things that, when you think of passive income, let's think about rental properties, rental income. A lot of people, even some of our clients, have rental income. Well, it's not just free money, there's certain tax implications that you need to think about, especially if you're working at a part-time job. So, there's self-employment tax, you may have depreciation tax and cost, kind of what you're trying to depreciate of that asset. So, passive income isn't always passive, in the sense of how it's taxed. It can be taxed at different tax rates and not just capital gains. And how should high-net-worth individuals look at taxes from a budgeting standpoint? (...) Treat taxes like rent. I mean it's due whether you want it to be or not, and it's not just April. Don't just have a plan for when April comes around in its tax season. Have something built into your plan on a monthly basis, and then separate it out. Think about what's earned income, what's capital gains, what's passive income, and then have buckets separated in your plan that calculates for each of those things, in each of those different streams. And we've even done, right, if we know we need a chunk of money a certain period of time, we've done a CD to match up the date of maturity on that CD to when taxes are due or put a portion of the account into a money market or a fixed income product in order to maximize the return. So, yeah, makes sense. What are some tax saving tools that a lot of people are not paying attention to? I think there are many things that people can do, but let's focus today on people. We have a lot of clients that are charity inclined. (...) So, let's talk

about two specific topics that if you love to give to charities or your charity inclined that you could do. There's good ways to save, put away assets. So, the first one I would say is a charitable remainder trust, right? This is where you can take a chunk of assets that you have, whether it's from appreciated stock, real estate, even a liquidity event, something you're going to pay taxes on. You can put it in a charitable remainder trust, right? And you can even set it up to where the good thing about this is, is it can provide you income. Whoever you deem, it could be a loved one. It can provide income, whether it's for a specific period of time. Let's just for this example, let's say 10 years, right? Or you can do it through your lifetime. The only catch is that at the end of the plan, whether it's 10 years or a lifetime, the excess money that is growing, right? It's growing with the market goes to the charity. Now you will pay taxes on your distributions, but how your distributions are taxed does depend on where the assets are coming from and how they were set up in the first place, whether or not you've already paid taxes on any of those, whether they were capital gains,

initial investments of appreciated cash. So, that can get a little murky, but how you set it up really does matter. The next one is a donor advised fund. We've done a podcast on donor advised funds. This is where if you're charity inclined, you can set aside a chunk of money, let's say 500,000 or a hundred thousand. It doesn't really matter. Or appreciated stock. Or appreciated stock. You set it aside and a donor advised fund, again, it grows. You're not taking an income on it though. You're just taking, you've had a liquidity event and you're taking a chunk

of money that you don't want to pay taxes on right now that in any other situation. So, you have the tax deduction now. Right.

And both the charitable remainder trust and the DAF, you get the immediate tax deduction in that year for what you're putting into it. So, you will get in the donor advised fund, you will get the tax deduction that year.

And if you give, let's say to a church on an annual basis or even a school on an annual basis, instead of doing it out of your paycheck every year, you take from the donor advised fund. Now it's growing with the market. So, if you want to say a hundred thousand, let's say you know you're going to give to a church for the next 10, 20 years and you know kind of what you give, right? Let's say it's that 10%. (...) Well, calculate what that would be over a 10, 20 year timeframe. And maybe you do a little bit less than that. Why? Because you know the money is going to grow. So, if you have a big income year, take a chunk of that money, put it to the side, get the immediate tax deduction and then all of your contributions to your charity, you just take directly from that donor advised fund and fund it. So, it gives you a tax break and it's still growing, and you don't have to pay taxes on the gains.

So, tax loss harvesting is a big deal, right? So, how do market dips affect that? How do people take advantage if the market drops a little bit to do a tax loss harvesting? You know sometimes we'll talk about it, it's like turning lemons into lemonade. What do we mean by that? Well, lemons by themselves don't taste good. Fruit into juice? Fruit into juice. Yeah, but I mean if you, nobody wants to suck on a lemon by itself but if you add some sugar to it and some water it starts tasting good. So, what does that really mean in our environment? Or if it's tequila maybe it's tequila, I guess. Well, tequila, vodka, whichever one. (...) So, what does that mean? Let's pick a stock just for simplicity purposes and let's say Walmart. (...) You buy Walmart and let's just say we buy it at \$100 a share because I want to make sure this example is easy to follow. So, you buy a couple thousand shares of Walmart, \$100 a share. Walmart has a bad year or a bad quarter, whatever the case may be and it falls, let's say it falls 30%.

Do you sell Walmart? Maybe but do you sell it right then? Maybe not. (...) Walmart's a good stock. Why is it falling? First do your research, understand why the stock is falling in the first place. Why is Walmart down to \$70? Why is it down 30%?

Because here's what you could do. (...) You decide why and if you still like the stock and then you buy it again. Maybe you buy. If it's a quality stock, you buy even though it dip. So, maybe you have \$10,000 in it but that \$10,000 has dropped to \$7,000 and now you just do a true up. You buy another \$10,000. So, you're kind of in essence doubling down. Well, if you wait 31 days after the purchase of that stock you can sell the lost stock. You can sell the first tranche that you bought and what do you get? The tax deduction on that and maybe even in that 31 day period the stock actually rebound a little bit. You'll still get the losses but not as big as you thought. But what did you ultimately do in that scenario too? You lowered your call spaces. You captured that dip in the market. Inequality stock. Which if you keep until you die that would even be stepped up. Stepped up call spaces. And So, because what you did is you bought another

\$10,000 worth at the \$70 a share and it bounced back up and then 31 days later you sold the losses. Now I love this conversation because So, many people, there are So, many especially do it yourselves and we've done an entire podcast on do it yourselves where they had this philosophy of if a stock drops 5% or 10% or 15% I'm just going to sell it regardless. That's my threshold. I'm going to sell it. How many times in your career and my career have you seen a quality stock have a bad quarter, have a bad year and you go you don't sell it. You look I mean that is quality on sale. Take advantage. You've just been given a golden opportunity to take advantage of. Don't sell something and just count those losses. Take that opportunity, lower your call spaces and get the gains on the way back up. So, sorry I get I feel like we get really passionate about this part because some people will throw the rules out of the window because they're making up their own rules. So, I would still steer clear of that. It's very enlightening Robert. Thank you. I'm proud. What about a lot of times high-net-worth people they get their assets from a business liquidation. So, if they have whatever 30 million bucks a small fraction of it is in a retirement benefit. Talk to us about how people could be taking better benefit or more advantage of retirement accounts. So, I appreciate you talking about high-net-worth individuals with liquidity events but also, having retirement accounts or qualified accounts. Many high-net-worth individuals believe that there's they don't they don't they don't need it. It's pointless.

There are other basic, but I'd say basic but brilliant. Also, in the same conversation because what makes high-net-worth individuals are smart high-net-worth individuals smart when it comes to investing is taking advantage of all tax strategies. Well, walk us through how IRAs or qualified accounts would count as a tax strategy. Well, take an IRA and let's let's specifically talk about Roth conversions. Let's say you do have a business owner that's 50 55 years old. They're not going to retire for 10 years and they want to convert money right. They want to pay taxes now. Now maybe they don't want to pay taxes now but if they want to do a Roth conversion. So, a business owner about 50 years old have a liquidity event. They want to see if it makes sense to convert money from a traditional to a Roth IRA. Correct and So, how would this benefit them. They're concentrating on their business. They just had a huge liquidity event. But why would this even maybe it's a smaller portion of their assets. Why would this make sense. Well, every tax dollar that they can save for the future makes sense. So, let's take that traditional IRA. Let's look at it. Let's look at their tax bracket. They've got 10 15 years to retirement or 10 to 50 or 50 10 or 15 years before they even need to worry about Medicare which is a huge thing especially given their income bracket. So, now we might be looking at how many tax dollars can we not only save them in Roth but how much can we save a Medicare premiums over their lifetime. And if that's possible So, you've got to do the math. So, let's take that chunk of IRA and let's do the math and convert it to a Roth. Now I know in the past we've done a Roth conversion episode right. But let's recap that when you convert a traditional IRA with it regardless of the dollar amount from a traditional IRA to a Roth you will pay taxes in that year that you convert for whatever dollar amount you can convert at whatever your ordinary income tax rate is which unfortunately is the highest tax rate you will pay. I mean it's higher than capital gains and other things. No right. So, you convert it you pay taxes in that year. But now what does it do. It grows tax-exipped for the rest of your life or until you need it which if we don't need it for 15 years it should let's just say it doubles. I mean the rule of 72 is you're in 15 years your assets should double twice at that point. Now you've got all of those gains. Assuming you're making 10

percent. Now you've got all of those gains completely tax-exempt. (...) What calculation what algorithm could some advisor show you to where that doesn't make sense. High-net-worth individuals are usually smart when it comes to making money and saving money. It's not just about making it. It is about saving it. Every tax dollar saved is money in your pocket. That's the same as making money. So, understanding how to convert assets from traditional IRAs to Roth IRAs is a huge part of many high-net-worth individual strategies. Should high-net-worth people look at this tax planning as a one time event or is this a constant thing they got to be on top of. That's a great question. And I would tell you that if you think of anything in a one time scenario one time planning one time savings ongoing planning ongoing savings. Your wealth is going to evolve. Most people's will. So, you need to have an ongoing plan and ongoing strategy that looks at your income looks at tax strategies. What else is going to change. Tax laws are going to change. So, it's not just your wealth for high-net-worth individuals. You're going to have a great plan today but two years from now something changes and the laws that change your plan. That's such an important thing too because people build a plan. How many seminars do we do where you ask who in here is that a financial plan built for them a sophisticated financial plan built for them. And of course as we know more than 70 percent of advisors don't even build financial plans for their clients. So, very few people raise their hand. But then we're like when is the last time you revisit it. You're playing. And for many people it's years. They haven't looked at it. Right. So, how do they even know if it's on track. And what's changed over the past few years. Looks like an MRI. We talked about that. If you had an MRI.

Oh I had it done great when 10 years ago. A lot of things could have had change. That's why you do new MRIs new CAT scans. You could have to answer 10 years later. So, that's the point is you need to look at your financial plan a minimum as you know and as far as GDS is concerned we've put our clients in front of their financial plan a minimum of twice per year because life's changing. Taxes are changing. Laws are changing. As this happens we need the plan to evolve. It's kind of our belief that if we stay on top of what our clients have told them is important to them and that's our measure of success then we should not get 5, 10, 15 years down the road and go oops I'm sorry Mr. and Mr. Client we missed something. Why did we miss it. Because there wasn't a plan. So, if you're constantly judging your success off of a plan then you shouldn't have that issue. Yeah makes sense.

So, take us home on this Robert.

Land a plane for us. We're going to take one thing away from this episode. You shared a lot of good nuggets but what's one thing that you would want somebody to take away hopefully from this. Well, first you don't want me flying your plane. (...) That's going to be the first day. Is that because of the eyesight going blind? Is the eyesight or just the fact that I don't have the ability of flying a plane I never finished my courses So, let's start there. But I would tell you Glen at the highest levels of wealth it's not always about what you make it's about what you keep. Sure what you save. Risk planning isn't a luxury it's a necessity. (...) And for many high-net-worth individuals it's like playing a game of chess not checkers. You always have to remember the IRS isn't going to do you any favors. So, have a plan in place. Work with an advisor that has the

the ability the technology at their fingertips to stay on task or stay abrupt with everything that's coming to light and that has your goals your situation planned out for you.

I'd say that's the biggest takeaway is you have to have a sophisticated plan. The higher net worth people don't just wing it. They work with professionals that know what they're doing and give them advice to find those potholes along the way to protect them. Makes sense. Yeah Well, said. Thank you. Well, we have the mail bag.

You ready for this? Bag me. Mail bag question. (...) This is from Kale. (...) Kale? No offense to Kale. That sounds like. I mean that's what I eat. That must be from California where I'm from. (...) Please don't hold anybody don't hold Glen against that.

How do I balance saving for retirement and other goals?

Well, you know a lot of people will tell you we're affiliated with people like Dave Ramsey. Not that we get all of our clients from Dave Ramsey, but many people will say focus on your retirement first. Right. Why? I love my kids. Right.

I never had. (...) I grew up as you know very poor and my parents couldn't pay for college So, I had to pay for it myself. But a lot of our clients they tend to be hiring at worth, and they want to pay things for their college. They want all of these other goals, but I would say take care of retirement first. Why? Because if you give everything to your kids and your kids get out into the workforce and you didn't plan right for retirement Well, they don't want you living with them. (...) Right. If your retirement is not planned for first, you could be putting a huge burden on other people on your loved ones. So, plan for retirement first then with the leftover funds start planning for those extra luxuries or those extra goals that you may have. Yeah. The analogy I've heard too it's like if you're on a plane and oxygen masks come down, they always say put it on yourself first and then the others. Great analogy. I think t's the same thing. If you're worried about helping your kids do this or other goals and your retirement is not taken care of that's a problem. You know because to your point where are you going to be living how are you going to live, survive, support yourself. Yeah I love that you use the mask analogy. Because we had a plan earlier too. Right. So, it falls right in place with it. Why do they say that? Why do they say put the oxygen mask on yourself first? What happens if you don't? So, you don't pass out. So, if you pass out because you're trying to help somebody else now you're both done. You're both done for.

So, and that's hard to think about especially when it's your kids. If we're going down or we're in danger the first thing I want to do is react and help my kids. But if I don't protect myself first I can't protect them. And So, if you don't take care of your retirement first you could be putting a huge burden on other people. Makes sense. Thanks Robert. My pleasure. Thanks everybody for listening today. (...) By the way these episodes we committed to do a certain amount of them. If you're enjoying this and want us to continue we would love any likes comments on YouTube follow subscribe. That will let us know that this is getting out there and you're enjoying

it and we'll continue to make additional episodes if it if there's enough of you out there that would like us to. Thank you So, much.

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