Retirement Distribution Planning – Part 1
Tax Diversification

July 21st

In January of this year, we wrote a **ONE*Idea*** titled ***Life Insurance: The Solution to a Looming and Massive Transfer Tax Problem***. The article discusses a September 2016 26 - 0 Senate vote to kill the ability for taxpayers to "stretch" their IRA's which could potentially tax qualified plan balances and IRA's to the tune of $5 trillion over the next generation.

Later in the year, in June 2017, Gonzalo M. Garcia, CLU published an article in ***Advisor Magazine*** titled ***Life & Leverage: Three Challenges for Tapping Into a $10 Trillion Opportunity*** where he addressed using life insurance as a practice diversification tool for financial advisors working with clients on accumulation, distribution and generational wealth transfer planning.

There are many reasons why life insurance as an accumulation, distribution and generational wealth transfer planning tool makes sense for the right clients. However, many of these clients do not understand the incredible tax benefit of life insurance as a financial asset.

We have all heard of "asset allocation" and Harry Markowitz's Modern Portfolio Theory (MPT) - one of the most important and influential economic theories in the finance and investment communities. MPT quantifies the benefits of diversifying investments among different asset classes to reduce the overall risk of a portfolio while not necessarily giving up the potential for attractive returns. All investment advisors and financial planners employ asset allocation strategies in investment portfolio construction.

As a financial advisor who understands life insurance, you are very conscious of the impact that taxes have during the accumulation and distribution phases on your client's portfolio and ultimately the generational transfer of these assets to the next generation. This is largely ignored by MPT and other investment portfolio theory.

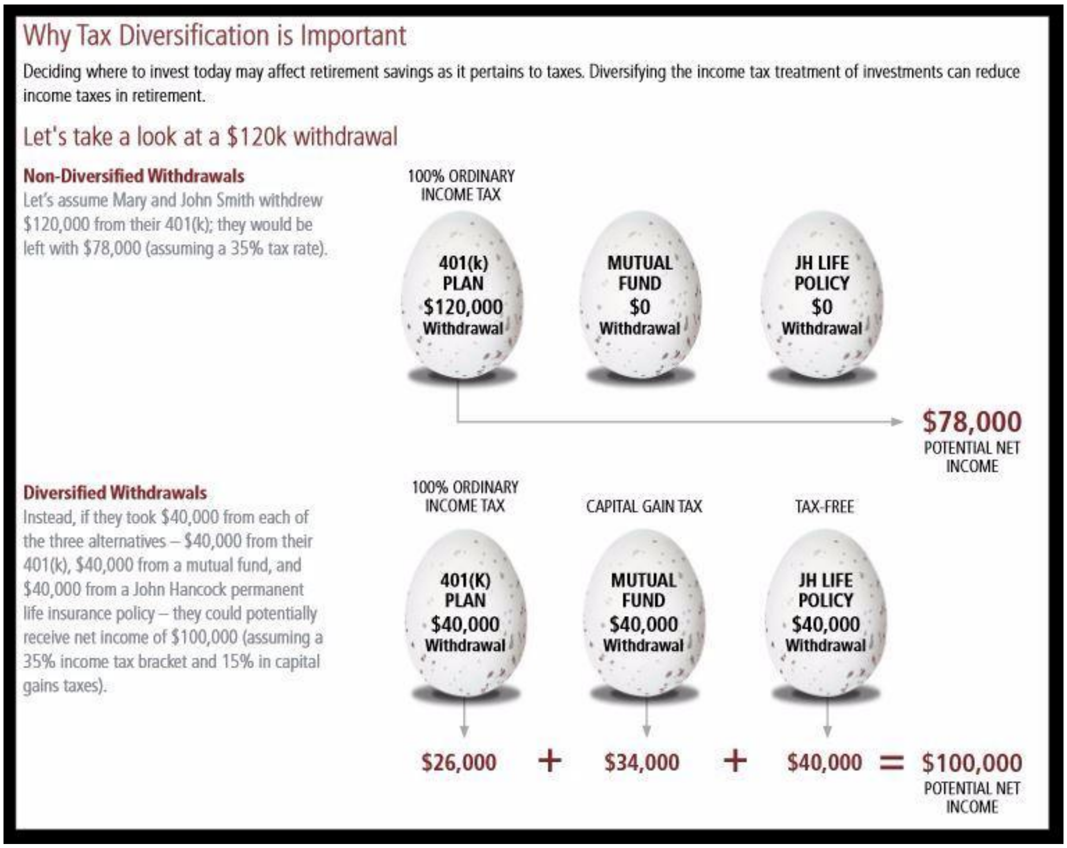
One of my favorite quotes by life insurance industry legend, Simon Singer, and he has many of them, is that a client's biggest expense is not his or her mortgage payment, healthcare or car payment, but rather what they pay in taxes. Most people don't think of taxes as an expense that can be managed but rather as an inevitable fact of life!

Let's have a look at the three basic choices your clients have for making contributions to their financial portfolios during the accumulation phase as shown in the box below:

- **Nest Egg #1** - Pre-tax contributions to 401(k) plans and IRA accounts
- **Nest Egg #2** - After-tax contributions to Mutual Funds, Stocks, Annuities and Real Estate
- **Nest Egg #3** - After-tax contributions to Municipal Bonds, Roth IRA accounts and Cash Value Life Insurance

During the accumulation phase, most client advisors and unadvised clients focus on maximizing contributions to nest egg number 1 (left). Getting an income tax deduction and deferring taxes on capital gains and dividends during the years leading up to retirement is deemed a wise decision - ask any CPA.

However, everything changes during the distribution phase. John Hancock has an excellent client guide called **"The Case for Tax Diversification in Retirement Planning"**. The illustration below from John Hancock summarizes the plan:



As you can see, a diversified tax strategy provides a much more tax-efficient income stream for the client.

To accomplish this plan, the client must have understood the difference between these two scenarios during the accumulation phase, because regrettably, upon retirement, making a "tax reallocation" is not as easy as making an investment portfolio reallocation.

Life insurance can be a very effective and powerful tool in the tax diversification conversation. The advantages of life insurance include:

- Income tax-free death benefits for generation wealth transfer
- Tax-deferred growth
- No retirement contribution limits
- Tax-free distributions if the policy is not a modified endowment contract
- No penalties for early access to cash
- Access to death benefit for long term care or chronic illness costs when a rider is added

Finally, your client's retirement income from policy withdrawals and loans does not affect his or her:

- Income tax bracket
- Medicare premiums
- Capital gains
- AGI (Adjusted Gross Income) or MAGI (Modified Adjusted Gross Income)
- Social Security

Make sure to speak to your clients about the value of life insurance as an accumulation, distribution AND generational wealth transfer planning tool. In our next Advanced Markets **ONE*Idea***, ***Retirement Distribution Planning - Part 2*** we will discuss how this concept can further protect clients during retirement using a comprehensive distribution strategy based on sequencing of market returns

Please contact AgencyONE's Marketing Department at 301.803.7500 for more information or to discuss a case!