

Hourly Advice for Do-It-Yourself Investors

Dear Clark & Natalie,

Thank you for using our financial planning services. We discussed several topics on our recent call.

You are 61 and 58, married, with no dependents. Clark worked his last day at the office yesterday. In her own business as a mushroom farmer, Natalie earns \$36,000. You estimate your living expenses at \$91,000 per year – excluding taxes.

You have \$5MM+ in cash and investment accounts. \$1.8MM+ of this is in tax-deferred accounts. You own your home (\$675,000), mortgage-free.

Natalie is planning to retire at the end of 2023. You are looking for help with withdrawing from your portfolio in retirement. Here are your financial planning *To-Dos* in light of your goals from our call:

- ❑ **RAINY DAY FUND:** You have \$1.6MM+ in cash savings. During our call, we discussed investing *at least* \$600,000 of this into your long-term investment portfolio – outlined in the *Investments* section. Investing more would also be appropriate.

Continue maintaining at least six months of living expenses in cash as your rainy day fund. [Learn more here](#). To be conservative, holding up to one year in cash is also appropriate.

Tax-Advantaged Investment Accounts

One of your biggest challenges is managing the tax impacts of investments in your taxable account. Therefore, you want to take advantage of tax-sheltered investment accounts where possible.

- ❑ **TAX PROFESSIONAL:** Confer with your tax professional before moving forward on the below.
- ❑ **HIGH-DEDUCTIBLE HEALTH PLAN HEALTH SAVINGS ACCOUNT (HSA):** As long as you are enrolled in an HDHP, contribute the maximum to your HSA annually: \$9,200 for 2021. This includes your family contribution of \$7,200, plus two \$1,000 catch-up contributions for each of you.

Invest in the low-cost stock funds outlined in the *Investments* section. Pay for medical expenses with cash, letting HSA investments grow tax-deferred. Save all receipts for qualified medical expenses forever. [Learn more here](#).

- ❑ **NATALIE'S SOLO/INDIVIDUAL 401(k):** Open and fund a solo/individual 401(k) for Natalie to decrease your 2021 tax bill. Assuming \$30,000 of income, you can [save \\$22,305 more in a solo/individual 401\(k\) than the SEP IRA](#) you are currently using. You can open a solo/individual 401(k) at Vanguard.
- ❑ Make the maximum contribution to Natalie's new solo/individual 401(k) each year *she* has earned income. Each year, your tax professional can provide you with the amount of the maximum eligible contribution given Natalie's business's profitability.

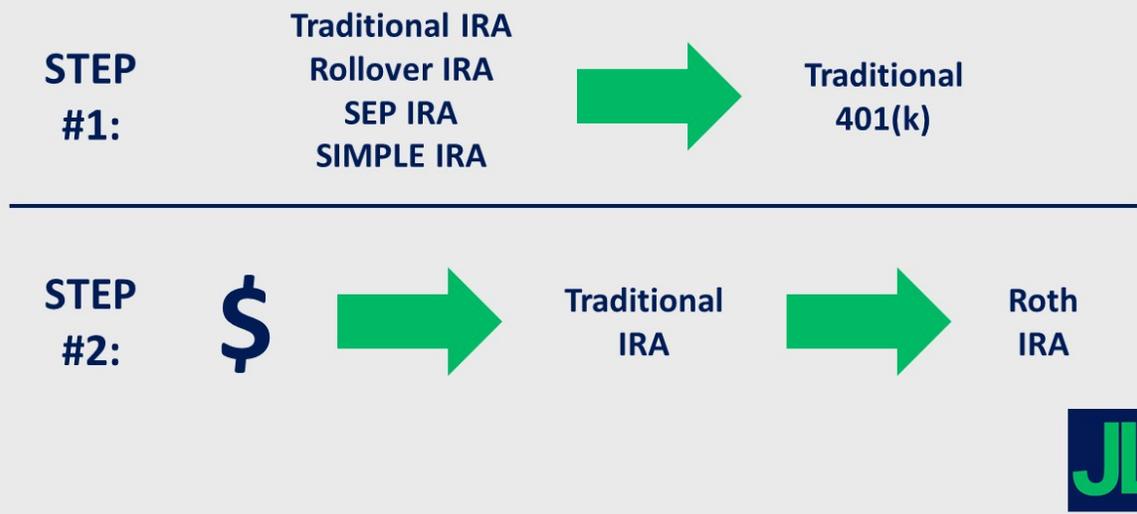
- **IRA-TO-401(K) TRANSFER AND SUCCESSIVE BACK-DOOR ROTH IRA CONTRIBUTIONS:** Using a back-door Roth IRA allows you to save more money in tax-advantaged accounts.

To make back-door Roth IRA contributions tax-efficiently, transfer Natalie's SEP IRA to her new solo/individual 401(k). Then, make back-door Roth IRA contributions.

Natalie will need to open a new traditional IRA to make back-door Roth IRA contributions. Contribute the maximum ([\\$7,000 for 2021](#)) to this new traditional IRA. Then, convert that \$7,000 to your Roth IRA. Invest the \$7,000 conversion for long-term growth using the low-cost stock funds listed in the *Investments* section. Do not claim a deduction for this contribution on your tax return.

In your first year doing this, leave \$1 in the traditional IRA – so that the investment custodian does not close what would otherwise be an account with a \$0 balance.

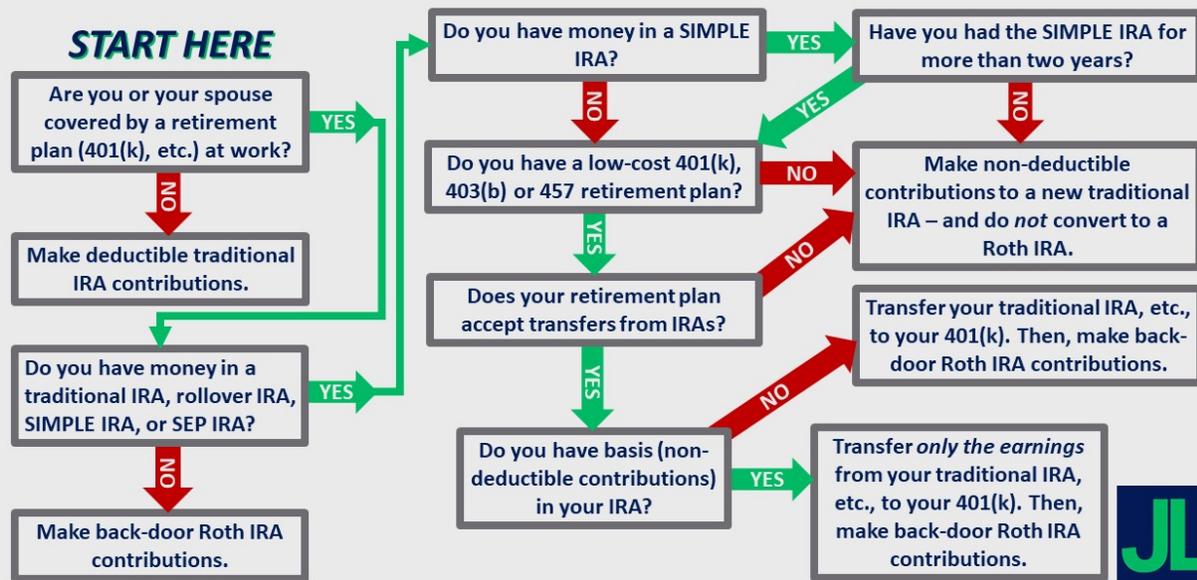
TAX-DEFERRED IRA TO 401(K) TRANSFER AND SUCCEIVE BACK-DOOR ROTH IRA CONTRIBUTION



- **CLARK'S 2021 NON-DEDUCTIBLE IRA CONTRIBUTIONS:** Contribute the maximum (\$7,000 for 2021) to a *new* traditional IRA to take advantage of tax-deferred growth provided by these accounts. Do not claim a deduction for the contribution. Report non-deductible contributions on Form 8606 annually.

Open a new traditional IRA to receive these non-deductible contributions. Opening a new traditional IRA exclusively for non-deductible contributions can make keeping track of basis easier. This is helpful for future tax planning.

IRA CONTRIBUTIONS FOR HIGH EARNERS



- **2022 IRA CONTRIBUTIONS:** During our call, we discussed that you may have earned income in 2022. Once you have an estimate for household income in 2022, you can better determine which IRA contribution strategies would be most appropriate: Roth IRA, traditional IRA, etc.

Tax Planning

- **FUTURE TAX PLANNING:** As mentioned on our call, planning for next year's account distributions this year does not make much sense. Between now and then, tax laws can change, as can your income and living expenses. However, the below strategy *could* be appropriate. Re-evaluate your tax strategy annually.
- **PARTIAL ROTH CONVERSION:** When Clark is subject to a second-year required minimum distribution (RMD) from his IRA at age 73, you will likely find yourself in the 22% tax bracket. At that time, you will have income from not just the RMD, but also both of your Social Security retirement benefits. Once the Tax Cuts and Jobs Act tax holiday expires in 2026, the 22% bracket will revert to the historical 25% bracket.

Therefore, beginning as early as next year, make partial Roth conversions. Convert enough annually to get you to the top of the 12% tax bracket - \$81,050 for 2021 for married-filing-jointly. Paying taxes at the 12% brackets today can offer tax savings relative to paying taxes at the 25% tax bracket in the future. Pay the taxes on the distributions with your cash savings.

[Learn more here.](#)

- **PRIORITIZE SOME TAX GAIN HARVESTING OVER ROTH CONVERSIONS IN 2022:** As discussed on our call, dividend investing is challenging for several reasons, including the oft-neglected risk of capital loss, tax inefficiency, and more. [Learn more here.](#)



For your situation, holding dividend funds creates an extra and unnecessary tax bill. Given your large cash holding, you don't need these tax-inefficient distributions.

Selling the dividend funds in your taxable account results in a more tax-efficient portfolio. Next year, use some of your lower tax brackets to realize long-term taxable gains (LTCG) at the 0% bracket – at the expense of doing a smaller partial Roth conversion in 2022.

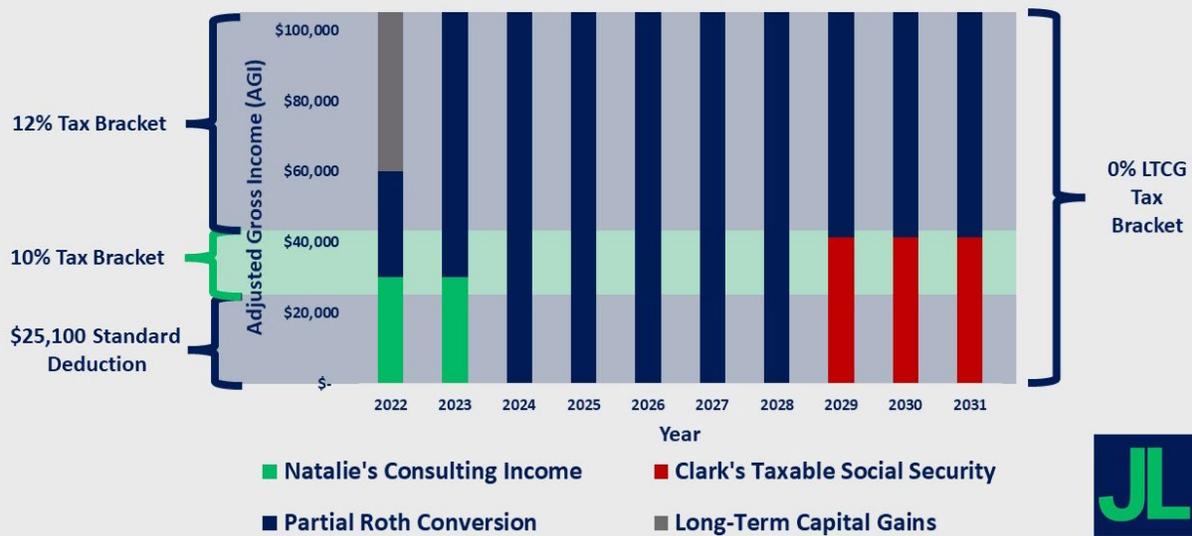
This strategy makes sense since a one-time sale of the dividend funds (at the 0% LTCG rate) allows you to rid your portfolio of these tax-inefficient funds tax-free. In 2023, with the dividend funds liquidated, you'll have more room at lower tax brackets to make partial Roth conversions.

See the following graph, which illustrates how you can utilize the lower tax brackets year by year – between next year and the last year before your RMDs begin:

- Next year in 2022, you'll make a small partial Roth conversion. You'll use up your lower tax brackets to make room for Natalie's part-time income and the sale of your dividend funds.
- With no sales from your taxable account in 2023, you'll be able to make a larger partial Roth conversion.
- From 2024 through 2028, you can use all of your lower tax brackets to make partial Roth conversions.
- From 2029 through 2031, you'll once again make smaller partial Roth conversions – as Clark's Social Security income will use much of your lower tax brackets. With RMDs for Clark starting in 2032, you will not make partial Roth conversions after 2031.

In calculating the amount of partial Roth conversions to make each year, remember to make room for your investment portfolio and cash savings account income: capital gains distributions, dividend income, and cash and bond interest income.

TAX-GAIN HARVESTING & ROTH CONVERSIONS BY YEAR



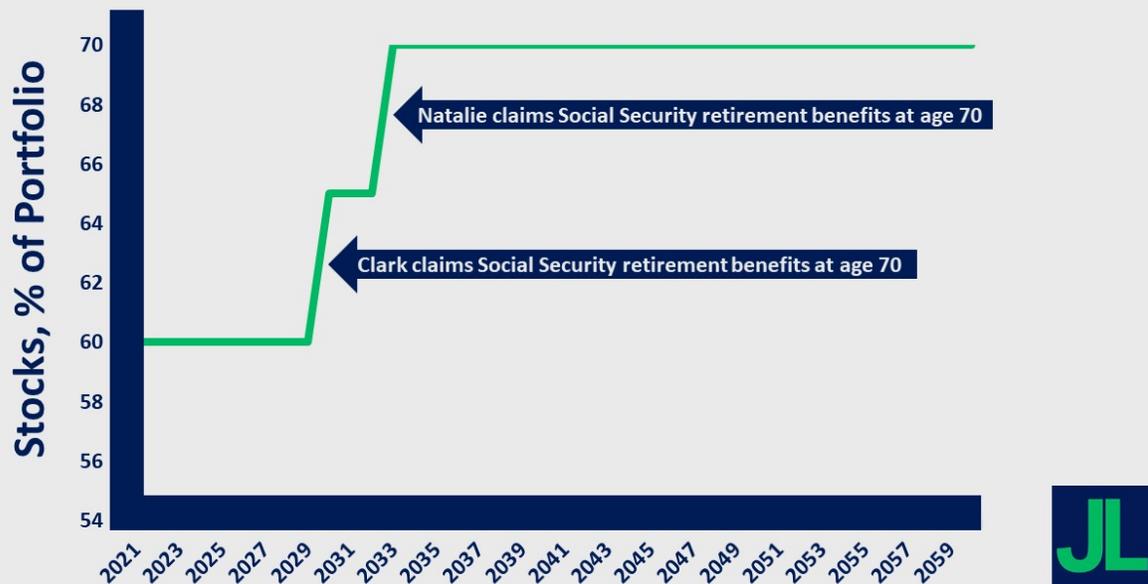
Investments

- **ALLOCATION:** We discussed a 60% stock and 40% fixed income portfolio. This portfolio is appropriate given your ample savings and relatively smaller portfolio distributions. Once you claim Social Security retirement benefits, with Social Security income providing for a portion of your living expenses, you should re-visit – and possibly increase – your portfolio equity allocation.

For a 60/40 stock/bond model portfolio, see the below:

- The U.S. stock default is a total stock market index fund – 30%
 - Vanguard Total Stock Market Index Fund ETF (VTI/VTSEX)
- The international stock default is a total international stock index fund – 30%
 - Vanguard Total International Stock Index Fund ETF (VXUS/VTIAX)
- The bond default is an intermediate-term Treasury fund – 40%
 - Vanguard Intermediate-Term Treasury ETF (VGIT/VSIGX)

STOCKS BY YEAR



- **ASSET LOCATION:** Already mentioned: to get the most out of the tax-free growth of your Roth and HSA accounts, hold only stock funds in these accounts. Do not hold bonds or cash in your HSA or Roth accounts, such as with the \$13,000+ cash in your HSA, and the \$8,000 in your Roth IRA at Vanguard.

Similarly, do not leave uninvested cash in *any* tax-advantaged investment account, such as with the Vanguard Cash Reserves Federal Money Market Fund Admiral Shares (VMRXX) \$384,201 in your rollover IRA at Vanguard.

- **LIQUIDATING HOLDINGS IN YOUR TAXABLE ACCOUNT:** You have multiple, over-lapping funds in your taxable account. As they are broadly diversified and low-cost funds, it is appropriate to maintain certain funds in your taxable accounts to defer capital gains. As mentioned, next year, sell the dividend funds at the 0% LTCG rate to increase the tax efficiency of your portfolio.

Having sold the dividend funds, consider selling other funds to simplify your portfolio. Sell positions with the highest basis first. Do this while staying within [the 0% long-term capital gains \(LTCG\) bracket](#). [Learn more here](#).

While selling your dividend funds in 2022 (at the expense of doing fewer dollars in a partial Roth conversion) is an easy decision, selling other funds for the sole purpose of simplifying your portfolio is more challenging. Selling other funds for the sole purpose of simplifying your portfolio may be appropriate once you have done several years of partial Roth conversions. With less money in your IRA in future years, it could be possible that projected RMDs do *not* bump you into a higher tax bracket. At that point, using lower tax brackets for tax-gain

harvesting (over partial Roth conversions) to simplify your portfolio could make sense. Compare the value of tax-gain harvesting versus partial Roth conversions annually.

- ❑ **DISTRIBUTIONS & REBALANCING:** In retirement, your portfolio will fund your living expenses. Therefore, distribute dividends and bond interest payments from your taxable account – not re-investing them back into your funds – to fund living expenses. Not re-investing dividends and capital gains can also simplify tax lots. [Learn more here](#).
- ❑ **INVESTMENT POLICY STATEMENT (IPS):** Create an IPS to help hold you accountable for your investment strategy. [Learn more about Investment Policy Statements – and download a free template – here](#).

Tax-Loss Harvesting

TLH can offset income from traditional IRA and 401(K) distributions during retirement, including income from partial Roth conversions.

You can also offset up to \$3,000 per year in ordinary income. If your net capital loss exceeds this limit, you can carry the loss forward to later years.

Considering your other financial planning To-Do's, consider tax-loss harvesting a lower-priority project.

- ❑ **TRACKING TAX LOTS:** Opt for "Specific Identification", instead of "First in, First out" (FIFO), "Last in, First out" (LIFO), etc., with your investment custodian.
- ❑ **DO NOT RE-INVEST DIVIDENDS:** Allow interest and dividends to flow into the money market fund. Use that cash plus any extra cash to buy more ETF shares of one fund where it's needed. This will make the number of tax lots you have manageable.
- ❑ **SELL LOTS AT A LOSS:** When the stock market falls, sell tax lots at a loss and harvest the tax losses.
 - Immediately buy a similar "swap" fund, so you're not out of the market. It is not a "tax wash" because they are different funds from different investment companies.
 - Swap Vanguard Total Stock Market into the iShares Core S&P Total U.S. Stock Market ETF (ITOT – 0.03% fee).
 - Swap Vanguard Total International Stock into the iShares Core MSCI Total International Stock ETF (IXUS – 0.10% fee).
 - If the markets continue down, you can swap back after 30 days.

BE CAREFUL not to buy any fund you sold for a loss within 30 days of the sale, including your retirement accounts. If so, you will cancel the tax loss. [Learn more here](#).

Retirement Planning

- ❑ **RETIREMENT DISTRIBUTIONS:** While previous [research suggested sustainable distribution rates of 3% over 40 years](#), more recent research suggests even lower rates over shorter periods: [2.4% over 30 years](#). You may be able to [achieve a higher distribution rate by being flexible with your spending](#) – reducing distributions in the event of market corrections. [Learn more here](#). Lastly, these historic and suggested distribution rates can serve as a guideline, and *not* as a guarantee.

With an initial portfolio distribution rate of just 1.8%, you are on a great track. Assuming you both claim Social Security benefits at age 70, your distribution rate could drop to as low as 0.4%. It is highly unlikely you will need to decrease your spending in retirement.

Social Security

- ❑ **BOTH DELAY FILING TO MAXIMIZE BENEFITS:** You should each wait to claim benefits until age 70.

As discussed on our call, this approach is appropriate for several reasons. Assuming above-average life expectancy, this strategy generates the greatest lifetime wealth. [Learn more here](#). Secondly, in a worst-case scenario one of you does not live into your early 80's (the breakeven point for delaying benefits), your finances would still be okay. Lastly, delaying benefits is also helpful for tax planning (to perform partial Roth conversions and tax-gain harvesting in lower tax brackets). [Learn more here](#).

Estate Planning

Having recently reviewed your estate planning documents (Will, Trust, Power of Attorney, Advanced Health Care Directive, and Side Letter of Instruction) and reviewed your beneficiary designations, you have just one Estate Planning *To-Do*.

- ❑ **SIDE LETTER:** Complete a Side Letter of Instruction listing professionals and account login information. Share this information securely with the appropriate parties (trustees, executor, attorneys-in-fact) via a password manager, such as LastPass or 1Password. Alternatively, store a hard copy of this information along with your estate planning documents. You can [use this template](#). [Learn more here](#).

Insurance Planning

- ❑ **HIGH-Deductible Health Plan (HDHP):** Continue to take advantage of a Health Savings Account (HSA) eligible HDHP – so long as it meets your health insurance goals. The lower premiums of an HDHP can save you money. [Learn more here](#).
- ❑ **SELF-INSURING FOR LONG-TERM CARE INSURANCE:** You have more than enough assets to self-insure for the cost of long-term care. You do not need to purchase long-term care insurance.
- ❑ **UMBRELLA INSURANCE INCREASE:** Great job getting a \$1MM umbrella insurance policy! Umbrella insurance increases the liability coverage of your auto and homeowner's insurance. Increase your umbrella policy coverage to \$4MM to better protect your net worth. Remember to maintain your underlying liability coverages at \$300,000 – or the amount required by your umbrella policy – on your various underlying policies (auto insurance, etc.). Make sure this increased coverage amount is per *occurrence*, and *not* just an annual aggregate limit.
- ❑ **HOMEOWNER'S INSURANCE:** To save money, consider increasing the deductible on your homeowner's insurance policy. [Learn about optimizing your homeowner's insurance here](#).

- ❑ **FLOOD INSURANCE AND WINDSTORM INSURANCE:** A homeowners policy alone won't cover all potential hurricane damage to your home. Flood insurance and windstorm insurance can help protect the value of your home. Purchase flood insurance and windstorm insurance.
- ❑ **AUTO INSURANCE:** To save money, consider declining Comprehensive & Collision coverage on your automobile policy. You have sufficient assets to self-insure. At the very least, consider raising your deductible to the maximum allowable. [Learn more here.](#)
 - Underinsured/Uninsured: Opt for the highest Underinsured/Uninsured coverage.
 - "Additional Coverages:" Consider stripping additional coverages to save money via self-insurance, such as rental car reimbursement, or windshield glass replacement.
- ❑ **ROADSIDE ASSISTANCE:** To keep your auto insurance cost lower, only purchase roadside assistance through a provider that is not your automobile insurance company, such as AAA. [Using roadside assistance provided by your insurance company may count as an at-fault claim.](#)
- ❑ **RE-SHOP YOUR POLICIES:** Re-shop property and casualty (auto, homeowners, umbrella) insurance policies at least every three years to ensure you are paying a competitive rate.

Cyber Security

- ❑ **PASSWORD MANAGER:** Store account logins and other sensitive information in a password manager. Consider LastPass, Dashlane, or 1Password. [Learn more here.](#) Do not store your passwords unsecurely, such as with an unencrypted spreadsheet, unencrypted Word document, or written down or printed on paper held outside of a physical safe.
- ❑ **FREEZE YOUR CREDIT:** To protect against identity theft, freeze your credit with all three credit agencies. [Learn more here.](#)
- ❑ **TWO-FACTOR AUTHENTICATION (2FA):** If available, enable 2FA with the various financial institutions you use: your bank, your investment custodian, for example. [Learn more here.](#)
- ❑ **VIRTUAL PRIVATE NETWORK (VPN):** Install a VPN on all your devices (computer, cell phone, tablet, etc.), especially those you use to access financial accounts. It almost always makes sense to leave your VPN on all the time. [Learn more here.](#)



This covers most of our discussion and a little more. You're on a great track. Your urgent projects are:

- your partially uninsured net worth (solved by increasing umbrella insurance coverage), and
- creating a side letter of instruction.

Please send me an email at hello@jonluskin.com if you have any questions. Good luck!

Best regards,

Jon Luskin, CFP®