MONOTELO ADVISORS

*THE PURPOSE OF OUR WHITE PAPERS is to give our prospective clients the opportunity to hear the solutions we have recommended to address complex problems and to help people understand the issues to consider when making complex financial decisions. While the situations are real, the names have been changed to protect the innocent!*

# WHITE PAPER

## INTRODUCTION COULD-A-WOULD-A-SHOULD-A!!!

This case was more of a "could have, would have, should have" than it was an opportunity to go back and correct the mistakes of the past. We are choosing to share this case because we think it demonstrates why it's so important to pursue wise counsel when making big financial decisions.

The case involved a high-earning couple. He was a highly paid executive and she was a high-producing realtor. They were planning to make some improvements to their home while also investing in a few income properties.

## THE CHALLENGE

Having a high percentage of their nest egg wrapped up in their retirement accounts, they decided to pull $200,000 out of one of their IRA's to fund their purchases.

When this couple decided to pull the money out of their IRA, they were fully aware of the 10%, $20,000 penalty they would have to pay on the early withdrawal. Given the size of their retirement accounts, it seemed harmless at the time. They, however, had no idea how this decision would come back to haunt them.

In creating another $200,000 of taxable income for that year, they not only incurred the $20,000 early withdrawal penalty, they also

- Moved themselves into the highest tax bracket (39.6%)
- Lost all their exemptions (which cost them over $5,000)
- Lost a significant portion of their itemized deductions (which cost them $2,000)

When all was said and done, they paid about $95,000 in federal income tax and penalties on their early withdrawal, and netted about $105,000 of the $200,000 they withdrew.

At Monotelo, our focus is more than tax preparation; it is to make a difference with actionable and meaningful financial solutions that positively impact our clients' lives.

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## THE SOLUTION

If this family had sought our advice at the time, we would have recommended that they avoid the $95,000 tax bill by simply choosing to take out a small home equity line of credit. In doing so, they would have retained the full $200,000 in their retirement account and paid no additional taxes.

Had this family not been able to borrow against their home we would have encouraged them to do two things:

1. Split the IRA distribution over two years:
2. Not make the $40,000 contributions that they were making to their 401K and IRAs, and use the additional cash flow to reduce the amount needed from the retirement account.

This course of action would have enabled them to use their itemized deductions and more of their personal exemptions. They would have put themselves into a lower tax bracket, reduced their tax liability by around $20,000 over the two-years, and had another $10,000 in their retirement accounts when all was said and done.

Not all decisions lead to this kind of negative outcome, but in this case, the lack of wise counsel caused this family to go down a road that was less than optimal. Having the right advisory team in place would have saved them over $30,000. Could-a-would-a-should-a!

*Failing to order your affairs to minimize your tax burden could cost you significant money – so don't wait to take action. If you have additional questions or need some planning help, please reach out to us.*

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