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New Year's Resolution: Review Your Estate Plan

Before you ring in another New Year, you may want to take time out of your busy schedule to observe another annual ritual: a review of your estate plan. If you're like most people, you probably stuck your will and other documents in a drawer or a safe deposit box as soon as you had them drawn up—and have rarely thought about them since. But changes in your personal circumstances or other events could mean it's time for an update.

It normally makes sense to review an estate plan at least once a year, just to make sure it's still meeting your main objectives.

Events That Could Spur Changes

What sort of changes might necessitate a change in your plan? Here are events that require alterations in your will or other estate documents.

- The birth or adoption of a child, grandchild, or great-grandchild;
- The death of a spouse or another family member;
- Marriage, divorce, or re-marriage;
- Illness or disability affecting you or another family member;
- A child or grandchild reaching the age of majority;
- A child or grandchild in need of education funding;
- The death of a guardian, executor, or trustee;
- Taking on or paying off a sizeable debt;
- Significant changes in the value of your assets;
- The sale of your residence or a second home;
- A significant promotion at work or a change in jobs;
- Retirement of you or your spouse;
- A large gift or inheritance;
- Sale of a business interest;
- Revisions in federal or state income tax or estate tax laws.

What You May Need To Do

If one or more of these events happens to you, there are several legal documents you may need to revisit.

Your will: As the centerpiece of your estate plan, your will dictates who gets which assets, and it also specifies a guardian for any minor children. Changes in your life since you had the will drafted could require significant alterations. (Note: If a will is kept in a bank safe, it may be sealed upon death. It's better to keep it in another safe.)

Often that will include revisions in the bequests for some of your heirs. For instance, you might expand the list of beneficiaries to include a newborn in the family or reduce it if you've had a falling-out with a relative. A divorce could necessitate a complete overhaul. Also, you might decide to switch

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A Reminder: Always Expect Unexpected Events

What's going to happen next on the investment scene? No one knows for certain. In fact, if there's one sure thing, it's that you can expect the unexpected.

For instance, events unfolding in the far corners of the world could affect your portfolio. Political unrest. Natural disasters. Deepening recession. Runaway inflation. Corporate scandals. They've all occurred before and will happen again.

So how do you protect your assets against a potential calamity? If you don't have an investment policy statement (IPS) in place, it's a good time to develop a game plan to address your needs. If we have already helped you create an IPS, rely on it to ride out the hailstorms.

The IPS outlines general investment goals and objectives, and, typically, it describes an asset allocation designed to meet those goals. It may also emphasize strategies tied to your risk tolerance, liquidity requirements, and retirement needs. Finally, the IPS may delve into other financial areas, including your estate plan.

The principal reason for developing a long-term investment policy, in writing, is to protect your portfolio from ad-hoc revisions during times of market turmoil and assure that your investments stay true to your long-term goals. Of course, an IPS isn't a panacea for all possible ills. But it will help you be better prepared when the unexpected happens...and it will.

This Tax-Free Rollover Goes Right To Charity

The tax law provides a unique planning opportunity for retirees who have to take required minimum distributions (RMDs). You're allowed to transfer funds directly from your traditional IRA to a qualified charitable organization without paying any federal income tax on the distribution. Although the contribution isn't tax deductible, it does count toward your RMD for the year.

This tax break—sometimes called a "charitable rollover"—had expired and been reinstated several times. Thanks to the Protecting Americans from Tax Hikes (PATH) Act of 2015, however, the tax provision is now permanent.

Under the PATH Act, someone who's at least age 70½—the age at which RMDs must begin—can instruct an IRA custodian to move up to $100,000 of funds from that person's IRA to a favorite charity. A married couple can transfer up to $200,000, assuming they're both old enough to begin taking RMDs.

Can't you accomplish the same result by taking a taxable IRA distribution and then donating that amount to charity? Not exactly. There are several other factors to consider, including annual limits on deductions for donations to charity, plus potential tax return complications. What's more, the direct rollover is valuable to non-itemizers who aren't eligible to deduct charitable contributions. And this method is simpler.

There are, however, a few more details to attend to with this approach. To qualify for the tax exclusion, the distribution must be made directly from the IRA trustee to a qualified charitable organization. You're not allowed to use the funds temporarily before transferring them to the charity's coffers.

In addition, the contribution must otherwise qualify as a charitable donation. If the deductible amount decreases because of a benefit received in return — for example, the value of a dinner at a fundraiser — or the deduction would not be allowed due to inadequate substantiation, you can't take the exclusion.

A bonus is that you're required to start taking RMDs in the year after the year in which you turn age 70½. If you take a charitable rollover, you can meet this obligation without paying the usual tax on an IRA distribution.

This tax law provision also applies to Roth IRAs, though it may not be advisable to take this approach with a Roth. Roth IRA distributions to account holders over age 59½ are usually tax-free, and it doesn't make sense to use money that isn't taxed to make a donation that isn't deductible. But a portion of a distribution may be taxable if your Roth hasn't been in existence for at least five years. In that case, it might be reasonable to transfer the taxable amount directly to a charity. ●

Tax Rewards For Charitable Trusts

Are you thinking of giving a large gift to charity? A charitable trust can help you satisfy your philanthropic goals, preserve wealth for your heirs, and collect tax breaks, all at the same time. One of the most popular of these is the charitable remainder trust, or CRT.

A CRT requires you to give up control over the assets that you transfer into the trust and it's irrevocable. There's no going back, so make sure this charitable vehicle suits your needs before you commit to it.

Typically, you will set up a CRT with a particular charity you want to support. The charity must be approved by the IRS as a tax-exempt entity. During its term, you (or another income beneficiary or beneficiaries that you specify) receive regular payouts. The CRT may last for terms of years or for your lifetime. Finally, when the trust ends, whatever is left—the remainder—goes to the charity.

There are three main tax advantages to this setup:

1. Regular income tax: You're entitled to a current tax deduction for the projected value of the remainder that will go to the charity at the end of the trust's term. Your tax adviser and charity officials can help determine the amount of your deduction.

2. Capital gains tax: If you transfer appreciated assets into the trust you won't owe any tax on the appreciation. And if the charity sells property from the trust and turns it into cash, you don't have to worry about capital gains tax then, either. But you pay income tax on the annual payments you receive.

3. Estate tax: When the remainder eventually goes to the charity at the end of the trust, those assets are removed from your taxable estate. So there aren't any estate tax concerns with a CRT.

Let's not forget that you'll be receiving annual income from the CRT.

Avoid These 6 Mistakes In Stretch IRA Planning

As talk of the possibility of tax reform continues in Washington, there's an increased focus on the rules for "stretch IRAs." This retirement planning technique, which enables you to preserve assets in an inherited IRA for an extended period, could be targeted in a larger tax reform package. For the time being, however, stretch IRA planning remains a viable option for many people.

But to use a stretch IRA successfully, you'll need to follow a number of important rules and avoid common mistakes made by those who inherit IRA assets.

If you own an IRA, you must take required minimum distributions (RMDs) annually beginning in the year after you reach age 70½. Otherwise, you'll be hit with a stiff IRS penalty. Those distributions are taxed at your rate for ordinary income—which could be as high as 39.6%—and are based on a calculation that considers the account balance at the end of the previous year and your life expectancy (or your joint life expectancies with your spouse).

However, beneficiaries who inherit your IRA can arrange for RMDs based on their own life expectancies, unless they choose to empty the account more quickly. Stretching out the IRA over the longer time can help preserve wealth for younger generations.

With those basics in mind, consider these six common mistakes in stretch IRA planning:

Mistake #1: Your account is titled improperly. When someone dies and IRA assets are inherited, it's crucial to ensure that the account name is titled correctly. For example, if someone other than your spouse inherits your IRA, your name should remain on the inherited IRA account title and it must be indicated that it is an inherited IRA by using the words "beneficiary" or "beneficiary IRA" or "inherited IRA."

Mistake #2: You fail to take RMDs. If the IRA account holder already was taking RMDs at the time of death, inheritors will need to make sure that the RMD is withdrawn for the year in which the account holder died. Failing to meet this requirement triggers a penalty equal to 50% of the amount that should have been withdrawn.

Mistake #3: You, as the primary beneficiary, fail to utilize a disclaimer when appropriate. A qualified disclaimer is a legal document that effectively says you choose not to receive the IRA assets, which then will pass to the contingent beneficiaries listed on the IRA paperwork. This strategy may be preferable if you don't need the money and you intend to pass along the inherited assets to younger beneficiaries eventually. Doing it now means RMDs will be based on the new owners' longer life expectancies.

Mistake #4: You fail to analyze contingent beneficiaries when using a disclaimer. It's important to consider all relevant financial and tax factors before agreeing to pass up inherited IRA assets through a disclaimer. This is not a casual decision. Consider whether the contingent beneficiaries in fact will be able to stretch out the IRA longer under their life expectancies and look at their tax consequences. Younger contingent beneficiaries may be in a lower tax bracket than you are, and if they pay the taxes that could reduce the overall tax bite.

Mistake #5: You take a lump-sum distribution. Some people think they're required to take a lump-sum distribution from an inherited IRA to empty the account immediately. That's simply not true. If you need the money, go ahead and take it. But if you don't have a pressing need, going the stretch IRA route could enable you to preserve wealth longer and generally will reduce tax liability.

A large lump-sum distribution could rocket you into a higher tax bracket and force you to lose more of the inheritance in taxes.

Mistake #6: You fail to analyze spousal rollovers. Current tax law offers greater flexibility to spouses who inherit an IRA. They can roll over inherited assets into their own IRA accounts and set up payouts calculated on their own life expectancies. However, a rollover isn't always the optimal approach for spouses. For instance, if a surviving spouse is under age 59½, payouts from the IRA will trigger the 10% penalty tax for early withdrawals, on top of the regular income tax owed. ●

It can be structured in one of two ways, which must be determined when you set up the trust. You can't change your mind later. Here are the two ways:

- **Fixed annuity method:** The CRT pays out a fixed dollar amount each year. So even if trust earnings fall, you'll still receive the same amount of money.
- **Percentage of assets method:** Another version, which is more common, is to base the annual payment on a percentage of assets. For instance, you might arrange to receive 6% of the value of the trust assets each year. Accordingly, your annual 6% payments generally will provide larger payouts over time, assuming the assets go up in value, but the amounts are based on market conditions.

In any event, the IRS requires you to receive at least 5% of the value of the trust each year and the charity's remainder value must be at least 10% to preserve the tax breaks.

This is just a brief overview of CRTs. For more information about this rewarding tax planning technique, reach out to your advisers. ●

SS Benefits: Tax Danger Ahead!

If you thought you left your tax troubles behind at retirement, think again. There are still plenty of tax minefields for retirees to avoid. For instance, you run the risk that the Social Security benefits you receive will be subject to federal income tax. And the higher your income for the year is, the greater the tax.

The IRS offers a safe haven for retirees who have "provisional income" (PI) below a specified level. If you stay below the threshold, you don't have to pay any tax on your benefits. But watch out if you cross into the "50% zone" for income above the threshold and further into the "85% zone" above a second threshold. The taxes that you may owe are computed on line 20b of your Form 1040.

There's no tax if your PI is under \$25,000 for single filers and \$32,000 for joint filers. For this purpose, PI is the total of (1) your adjusted gross income (AGI); (2) your tax-exempt interest income (usually from municipal bonds); and (3) one-half of the Social Security benefits you received during the year. Suppose you're a joint filer with an AGI of \$25,000, \$1,000 in municipal bond income, and you got \$10,000 in Social Security benefits—your total PI of \$31,000 (\$25,000 + \$1,000 + \$5,000) is under the threshold.

However, if your PI exceeds this first threshold, you're taxed either on one-half of your benefits or 50% of the amount of your PI that exceeds the threshold, whichever is less. So if a single filer has a PI of \$30,000, including \$10,000 in Social Security benefits, his or her tax would be based on 50% of the PI above the threshold—half of \$5,000, or \$2,500—rather than the \$5,000 representing half of the Social Security benefits.

But there's a second threshold that can result in more of your benefits being taxed. If your PI is greater than \$34,000 for single filers or \$44,000 for joint filers, you're swept into the 85% zone and may be taxed on 85% of your benefits. But that's it. No more than 85% of your benefits will ever be taxed.

When it makes sense, take steps to reduce your PI to reduce or completely avoid the tax on Social Security benefits. A few possibilities are:

- Realize capital losses that offset capital gains and other income.
- Invest in long-term growth stocks that don't produce current income.
- Consider annuities that offer growth for retirement without current taxable income.
- Life insurance, too, offers possibilities for future income without tax consequences.
- If you're eligible, contribute to an IRA or an employer-sponsored retirement plan. ●

Review Your Estate Plan

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executors. Finally, your will may need to be updated to reflect changes in state or federal laws.

Revocable living trusts: Similar to a will, a revocable living trust provides for the distribution of assets transferred to the trust. Unlike a will, however, these assets don't have to pass through probate upon your death. This can save both time and money, and you might decide to use a living trust to supplement your will.

Because the trust is "revocable," you retain the right to change beneficiaries and reallocate assets designated for certain beneficiaries. The same sort of additions and subtractions used for a will might apply to the trust. In addition, depending on your situation, you could amend other terms, such as changing the guardian of minor children, a trustee, or successor trustees.

Durable power of attorney: A power of attorney is a legal document authorizing someone (the "attorney-in-fact") to act on your behalf in financial affairs. A "durable" power of attorney stays in force if you become incapacitated. This can be a vital component of your estate plan.

Are you planning to buy or sell assets or undergo life-threatening surgery? A durable power of attorney may be especially beneficial in these situations. Include this document in your estate plan if you haven't already done so.

Living will: Finally, a living will can provide guidance to your loved ones should they face difficult end-of-life scenarios. This can be combined with a health care power of attorney to ensure that your physicians and the hospital comply with your wishes.

Living wills are often associated with elderly people, but issues can arise at any stage of life. In your review of your estate plan, look again at this document to see whether it still accurately reflects how you feel. And if you don't have these documents yet, consider adding them to your plan.

Once you've completed the year-end review of your estate plan, circle back to your professional advisors for assistance in implementing any changes that are needed. When you're done, you can look forward to a happy New Year! ●

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