INSIGHT ON ESTATE PLANNING

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ESTATE PLANNING PITFALL
Your charitable gifts are unrestricted

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How does the SECURE Act affect estate planning?

The Setting Every Community Up for Retirement Enhancement (SECURE) Act is the biggest retirement planning law in decades. However, when all is said and done, the new law may have just as significant an impact on estate planning, especially if younger individuals are in line to inherit IRAs or qualified retirement plan accounts.

Key SECURE Act provisions

The SECURE Act includes noteworthy provisions for both individuals and businesses. Let's focus here on a summary of the key tax law changes for individual retirement-savers.

Delayed RMDs. Generally, you must begin taking distributions from qualified retirement plans and IRAs after a certain age. Before the SECURE Act, these "required minimum distributions" (RMDs), which are based on your account balance and life expectancy, had to start at age 70½, although technically the first distribution has to be made no later than the April 1st after you reached age 70½. For those who reach 70½ prior to 2020 (that is, anyone born before July 1, 1949) the rules don't change. If you were born July 1, 1949 or later, however, the SECURE Act extends the age requirement to age 72, giving you even more time to build up your tax-deferred nest egg. Thus, you may defer the first distribution to as late as April 1 after you reach age 72.

Previously, you couldn't contribute to an IRA after age 70½, but the SECURE Act removes this age restriction.

As a result of the coronavirus (COVID-19) pandemic, Congress passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) shortly after the SECURE Act became law. (See "The CARES Act waives RMD rules through year end" on page 3 for additional details about delayed RMDs.)

IRA contributions. Previously, you couldn't contribute to an IRA after age 70½, but the SECURE Act removes this age restriction. This enables you to supplement existing retirement plan accounts with IRA contributions if you continue working or otherwise qualify. For 2020, the annual contribution limit is the lesser of earned income or $6,000 ($7,000 if you're age 50 or older).

Annuity options. To encourage the use of annuities in retirement planning, the new law requires 401(k) plan administrators to provide annual "lifetime income disclosure" statements reflecting annuity options. In addition, it provides more flexibility to participants

The CARES Act waives RMD rules through year end

To help mitigate the financial crises related to the coronavirus (COVID-19), the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) waives the required minimum distribution (RMD) rules for certain defined contribution plans and IRAs for calendar year 2020. This will help individuals avoid a financially imprudent sale of retirement assets during the stock market downturn.

The waiver covers both 2019 RMDs required to be taken by April 1, 2020, and RMDs required for 2020. It applies for calendar years beginning after December 31, 2019.

who acquire annuities, including portability between plans (such as when an employee leaves a job and begins participating in a new employer's 401(k) plan).

Stretch IRAs. The SECURE Act cracks down on stretch IRAs that allowed nonspouse beneficiaries to spread out RMDs over their life expectancies. If set up properly, a stretch IRA could span multiple generations. Furthermore, this technique could also be used with qualified retirement plans as well as IRAs.

Under the SECURE Act, funds from inherited accounts must generally be distributed to nonspouse beneficiaries within 10 years of the account owner's death. This provides a finite end to stretch IRAs and reduces their effectiveness as an estate planning tool.

Be aware, however, that the qualified beneficiaries who inherited accounts before 2020 can still benefit from a stretch IRA. Also, the new law includes exceptions that will allow certain nonspouse beneficiaries to take distributions over their life expectancy.

Strategies after the SECURE Act

Because of the SECURE Act's impact on estate planning, review your estate plan and corresponding documents, such as beneficiary designation forms. In light of the changes, you may be inclined to make certain revisions, especially in regards to stretch IRAs.

It may make sense to convert a traditional IRA into a Roth IRA. Generally, RMDs from inherited Roth IRAs will be 100% tax-free. This provides a distinct advantage over traditional IRAs. Balance the current tax liability for a conversion against the benefit of future tax-free payouts.

Alternatively, you might establish a charitable remainder trust (CRT). With this approach, the charity designated as the beneficiary receives the trust remainder on your death, while designated income beneficiaries, such as your children, receive annual distributions from the CRT.

Similarly, you might arrange qualified charitable distributions (QCDs) to go directly from an IRA to a charity. If you're age 70½ or older, the first $100,000 of such distributions is tax-free, although they won't count as deductible charitable contributions. (Be aware that any QCD amount also counts as an RMD.) Further, the $100,000 limit is per IRA owner, so if both you and your spouse have IRAs, and you're so inclined, you could both transfer $100,000 per year.

Now is the time for an estate plan review

Provisions of the SECURE Act will likely affect your retirement and estate plans. Your estate planning advisor can help you review your plans to ensure that they continue to meet your objectives. •

Take the proper steps to insulate your estate from creditors

For years, you may have viewed estate taxes as the main threat to your family fortune, especially if you own a successful business or valuable real estate. But with the federal gift and tax exemption set at $11.58 million for 2020, estate taxes are perhaps no longer a concern.

Today you may be more focused on protecting your estate from creditors and lawsuits. There are several ways to accomplish this objective in accordance with prevailing state laws.

Personal assets

The way you handle the personal assets comprising your estate can make a big difference. For instance, you and your spouse may own your home or other real estate as joint tenants with rights of survivorship (JTWROS), for convenience's sake. But this exposes the property to the reach of creditors.

One way to protect your assets from creditors is to secure adequate insurance coverage.

Alternatively, a couple might arrange to own the property as a tenancy by entirety, when permissible under state law. As with JTWROS, the property automatically passes to the surviving spouse on the death of the other. However, in this case, the property can't be used to satisfy a judgment against the other spouse.

Also, note that you can use the annual gift tax exclusion to reduce the size of your taxable estate without tapping your gift and estate tax exemption. For 2020, the gift tax exclusion is $15,000 per recipient ($30,000 for joint gifts by a married couple).

Insurance policies

One way to protect your assets from creditors is to secure adequate insurance coverage. This includes several types of insurance policies.

Start off with liability insurance for your business. This is especially important for physicians, attorneys and other professionals who are frequent lawsuit targets and must rely on malpractice insurance.

Similarly, by acquiring adequate automobile and homeowner's insurance, you can guard against a financial catastrophe. Make sure you understand the key elements, including what is covered, the policy limits and which exclusions apply.

You can buy life insurance naming your spouse and children as beneficiaries. If certain requirements are met, the proceeds won't be included in your taxable estate. This is often accomplished through an irrevocable life insurance trust (ILIT).

Business ownership

If you have business interests or real estate holdings at risk, the form of business ownership is critical. Essentially, an entity may be used to distinguish business assets from personal ones and thereby limit a creditor's ability to seek recovery.

For example, if you're a sole proprietor or a partner in a partnership, you usually face unlimited personal liability for business debt. One protection method is to form a corporation, limited liability company (LLC) or family limited partnership (FLP) for the business. Generally, this reduces your exposure. However, make sure you understand all the tax and legal implications.

Retirement accounts

Not only does stockpiling funds in a tax-deferred retirement plan such as a 401(k) plan make good financial sense, it also offers protection from creditors. Generally, employer-sponsored plans are covered by the Employee Retirement Income Security Act (ERISA). Qualified plans governed by ERISA benefit from unlimited protection from creditors (except for the IRS and child support liability). Therefore, the more you can contribute to your retirement accounts, the better.

Even retirement plans not covered by ERISA may provide some creditor protection. For instance, IRAs typically have an inflation-indexed protection cap of $1 million (currently $1,362,800) from bankruptcy proceedings.

Trusts

Entire books have been written about the use of trusts to protect personal assets. While trusts have many variations and uses, one of their main attractions is their general ability to shelter assets from creditors.

Notably, to protect your assets from judgments, the trust must be irrevocable. This means you can't revoke it or maintain control over the assets.

For example, when permitted under state law, you might establish a "spendthrift trust" designed to protect funds accessible to beneficiaries like young children or grandchildren. The designated trustee controls the disposition of assets until the beneficiaries reach a specified age. As mentioned above, an ILIT may be used to provide life insurance proceeds without including them in your taxable estate.

A trust may also incorporate charitable giving through a charitable remainder trust or charitable lead trust.

Refocus your estate plan

With estate tax liability no longer an issue for many families, asset protection becomes a primary focus of estate planning. Contact your advisor to discuss which asset protection methods are best for your personal needs. •

HSAs

Understanding the health savings and estate planning benefits

In addition to serving as a viable option to reduce health care costs, a Health Savings Account (HSA) can positively affect your estate plan because its funds grow on a tax-deferred basis. An HSA is similar to a traditional IRA or 401(k) plan in that it's a tax-advantaged savings account funded with pretax dollars. Funds can be withdrawn tax-free to pay for a wide range of qualified medical expenses.

ABCs of an HSA

To provide these benefits, an HSA must be coupled with a high-deductible health plan (HDHP).

For 2020, an HDHP is a plan with a minimum deductible of $1,400 ($2,800 for family coverage) and maximum out-of-pocket expenses of $6,900 ($13,800 for family coverage). A recent benefit of HDHPs is that they can cover the costs of coronavirus (COVID-19) testing and treatment *before deductibles are met* without risking the plan's status as an HDHP. In addition, plan participants who have HSAs may continue contributing to their existing accounts.

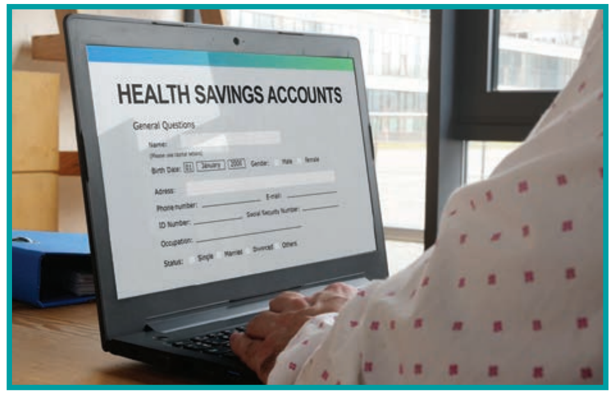
Another requirement for HSA contributions it that you not be enrolled in Medicare or covered by any non-HDHP insurance (a spouse's plan, for example). Once you enroll in Medicare, you're no longer eligible for an HSA, although you may still make contributions for the time you were eligible before going on Medicare. You may, however, continue to withdraw funds to pay for qualified expenses, and the list of qualified expenses expands when you turn age 65.

HSAs can lower health care costs by reducing insurance expenses and allowing you to pay qualified expenses with pretax dollars.

Currently, the annual contribution limit for HSAs is $3,550 for individuals with self-only coverage and $7,100 for individuals with family coverage. If you're 55 or older, you can add another $1,000. Contributions may be made by you or your employer, although the limit is a combined limit, not a payer limit. Thus, if your limit is $7,100 and your employer contributes $5,000, you may add only $2,100.

Cost savings benefits

HSAs can lower health care costs in two ways: by reducing your insurance expense



(HDHP premiums are substantially lower than those of other plans) and allowing you to pay qualified expenses with pretax dollars.

In addition, any funds remaining in an HSA may be carried over from year to year, continuing to grow on a tax-deferred basis indefinitely. When you turn 65, you can withdraw funds penalty-free for *any* purpose (although funds that aren't used for qualified medical expenses are taxable).

To the extent that HSA funds aren't used to pay for qualified medical expenses, they behave much like an IRA or a 401(k) plan.

Estate planning benefits

Except for funds used to pay qualified medical expenses, an HSA's account balance continues to grow on a tax-deferred basis indefinitely, providing additional assets for your heirs. The tax implications of inheriting an HSA differ substantially depending on who receives it, so it's important to consider your beneficiary designation.

If you name your spouse as beneficiary, the inherited HSA will be treated as his or her own HSA. That means your spouse can allow the account to continue growing and withdraw funds tax-free for his or her own qualified medical expenses. If you name your child or someone else other than your spouse as beneficiary, the HSA terminates, and your beneficiary is taxed on the account's fair market value. Note, however, that any of your qualified medical expenses paid with

HSA funds within one year after death aren't taxable to the HSA beneficiary.

What if your estate is the beneficiary of the HSA? The full amount of the HSA is taxed to you in the year of death. Depending on your situation (for instance, if you're in a low tax bracket and the beneficiary is in a high tax bracket) it may be a good tax planning strategy, or (if you're in a high tax bracket and your beneficiary is in a low tax bracket) it could be a bad idea tax-wise. As with most tax planning issues, be sure to consider the various factors when making a decision.

The next steps

Opening and contributing to an HSA offers a tax-advantaged options that can help reduce health care costs and provide estate planning benefits. Contact your estate planning advisor for additional details. •

ESTATE PLANNING PITFALL

Your charitable gifts are unrestricted

If you're making sizeable donations to charity as part of your estate plan, your good intentions are clear. But how do you know the funds will be used to further the charity's mission? There are no absolute guarantees.

For instance, a financially sound charitable organization could begin experiencing economic difficulties and eventually file for bankruptcy or even halt operations. In that case, your donations may be used by the charity to pay off creditors or be allocated to some other purpose you hadn't envisioned — and no one is going to ask your permission.

Fortunately, however, you can take steps to preserve your charitable legacy. Begin by placing restrictions on your gift at the time of the donation. Typically, you might limit use of the funds to a specific cause or function of the charity, like stating that the money must be spent on medical research or shelter for the homeless. Have this documented in your will, a trust or an endowment fund agreement.

The exact rules will vary based on applicable federal and state laws but restricting gifts can generally prevent charities from using the donated funds to satisfy creditors in bankruptcy proceedings. The charity is obligated (both legally and morally) to adhere to these restrictions.

Best approach: Do your homework before making substantial gifts to a charity. Consider using the IRS Tax Exempt Organization Search (TEOS) tool. TEOS provides access to information about charitable organizations, including their latest tax returns, IRS determination letters and eligibility to receive tax-deductible contributions.

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Utilizing Grantor Retained Annuity Trusts in a Low-Interest-Rate World

Even before people around the world began dealing with the reality of COVID-19, interest rates were at a recent low. For May 2020, the long-term annual AFR rates are as follows: long-term 1.15%, mid-term .58%, and short-term .25%. One common estate planning strategy is the use of Grantor Retained Annuity Trusts ("GRATs"). This strategy is even more effective when interest rates are low.

A GRAT is an estate planning vehicle in which the Grantor (the creator of the trust) places assets in an irrevocable trust in return for the right to receive annuity payments over the term of the GRAT. At the end of the trust's term, typically the Grantor's life, trust assets pass to the Grantor's beneficiaries. The benefit is that any appreciation in the assets transferred out of the Grantor's estate and into the GRAT will pass to the GRAT's beneficiaries estate tax free. For this reason, highly appreciable assets should be transferred into the GRAT. The annuity must pay interest out to the Grantor at least at the AFR rate at the time of the GRAT's creation. When interest rates are low, this strategy is particularly effective. The key is that, over the GRAT's term, the appreciation in trust assets needs to "beat" the annuity payments out to the Grantor. This technique allows the Grantor to "freeze" the value of an appreciable asset and use their lifetime estate tax exemption based on the asset's current value, rather than its appreciated value. This can be a very useful tool for those clients who expect to pay estate tax.

If a client is already the Grantor of a GRAT, the current economic climate may provide an opportunity to maximize the benefit of the GRAT. In order to create a GRAT, the Grantor must retain one of a certain handful of powers. These powers include the power to revoke the trust, the power to borrow trust assets without adequate security, and, commonly, the power to substitute trust assets out for assets of equal value. If you currently have a GRAT which contains such a "substitution power," this may be a good time to consider exercising that power. If a Grantor possesses assets which currently have artificially depreciated values, it may be a good time to substitute them into the GRAT in exchange for assets that have not experienced significant depreciation. When the depreciated assets recover in value, that appreciation will escape estate tax upon the Grantor's death.

If you are interested in setting up a Grantor Retained Annuity Trust or are interested in reviewing a currently existing Grantor Retained Annuity Trust, we at Stokes Lawrence would be happy to assist. Please contact a member of the Stokes Lawrence Estate Planning Group at (509) 853-3000 in Yakima or (206) 626-6000 in Seattle.