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TRUST & INVESTMENT
UPDATE
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Inheritance protection plans

Thoughtful planning may create a lasting legacy.

There are three primary methods for distributing an inheritance:

• *Outright.* The simplest approach is to give the heir full control of the inheritance, without restrictions. For heirs with sufficient financial maturity and investment savvy, this may be appropriate.

• *General needs trust.* Trust planning comes immediately to mind when planning for a surviving spouse or an heir who is a minor. With a trust, one gets professional investment management guided by fiduciary principles. For young beneficiaries, a trust can provide for education funding, and for getting a good financial start in life.

But what about when the children are fully grown, established in their careers and financially mature, in their 30s or even 40s? Even then, trust-based planning will be an excellent idea for many affluent families. With a thoughtfully planned trust, wealth may be conserved and deployed on a long-term basis for the benefit of heirs.

• *Special needs or supplemental needs trust.* This type of trust may be considered for an heir who has disabilities resulting in qualification for government benefits. The trust must be carefully crafted to meet legal requirements so as to not impair or replace that government support.

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Trusts in action

Among the key benefits that can be built into a trust-based wealth management plan:

Professional investment management. A significant securities portfolio is a wonderful thing to have, but it requires serious care and attention, especially when economic growth is uncertain; inflation is at a 40-year high; interest rates are rising; and taxes are uncertain. How can adequate income be provided to beneficiaries without putting capital at risk? What is the best balance between stocks and bonds? How can portfolio management be made more tax efficient? These types of questions will be addressed by corporate fiduciaries, such as us.

Creditor protection. One of the most frequent questions that we hear is, "How can I keep my money and property out of the hands of my son-in-law (or, sometimes, my daughter-in-law)?" The inquiry is understandable, given the high divorce rates in this country. Our answer: Use a trust to own and manage the property, and give your heir the beneficial interest in the trust instead of the property. A carefully designed trust plan can protect assets in divorce proceedings, as well as protect assets from improvident financial decisions by inexperienced beneficiaries.

Future flexibility. Parents typically have a fuzzy definition for treating their children "equally." As each child is unique, his or her needs may require financial support that is out of proportion to that of siblings. By utilizing a trust for wealth management, one may give a trustee a similar level of discretion, permitting "equal treatment" on something other than gross dollar terms. The trust document may identify the goals of the trust and provide standards for measuring how well the goals are being met for each of the beneficiaries.

Capital foundation. Federal estate taxes are slated to zoom in 2026 and later years, with the amount exempt from federal estate and gift tax cut roughly in half. A trust may provide a capital foundation that avoids successive imposition of transfer taxes, and thus keeps more hard-earned wealth in the family.

Surviving spouses, blended families

When the heir will be a surviving spouse, there are additional considerations. An outright distribution would be the simplest, if the spouse is comfortable with handling the asset management. If a trust will be created, there are four choices:

- *The Traditional Marital Deduction Trust* provides the spouse with all of its income paid at least annually, and the spouse must have the power to direct the assets at his or her death. The federal estate tax deduction for this trust is unlimited, but the full value of the trust will be exposed to estate tax at the spouse's death.
- *The Qualified Terminable Interest Property Trust*, sometimes referred to as a QTIP Trust, also provides all its income to the surviving spouse, but with this trust the rights to the remainder of the trust assets are fixed when the trust is created. This approach is typically used when there are children from an earlier marriage who will inherit the remainder. The marital deduction is allowed on an elective basis for the QTIP Trust.
- *The Credit Shelter Trust* may be sufficient for estates smaller than the federal estate tax exemption equivalent ($12.06 million in 2022). This trust will avoid federal estate tax at the first death, and will not be included in the taxable estate of the surviving spouse. Because the marital deduction will not be claimed, the trustee may be given broader discretion on the distribution of income and principal.
- *A Qualified Domestic Trust* is required to secure the marital deduction for a spouse who is not a U.S. citizen. The terms are parallel to the QTIP trust, but there must be a U.S. trustee.

Your estate planning advisor can fill in more details.

Choices for marital trusts

Trust type	Estate tax exposure at spouse's death	All income to spouse?	Spouse can direct remainder?	Comment
Traditional marital deduction trust	Yes	Yes	Yes	Best for larger estates, paired with a credit shelter trust
Qualified Terminable Interest Property (QTIP) Trust	Elective	Yes	No	Best for multiple-marriage situations
Credit shelter trust	No	Elective	No	Appropriate by itself for smaller estates, but may be paired with traditional or QTIP trust
Qualified Domestic Trust (QDOT)	Yes	Yes	Elective	For a spouse who is not a U.S. citizen

Source: M.A. Co.

Our invitation to you

We specialize in trusteeship and estate settlement. We are advocates for trust-based wealth management planning. If you would like a "second opinion" about your estate planning, if you have questions about how trusts work and whether a trust might be right for you, we're the ones you should turn to. We'll be happy to tell you more. ☐

Planning year-end gifts

Year-end tax planning often concerns deferring income, accelerating deductions, and harvesting capital losses to offset realized capital gains. From a wealth management perspective, one should also look at asset transfers every year. Here are two ideas to consider.

Annual family gifts

Major gifts of property are subject to a federal gift tax, much as estate transfers are. However, the annual gift tax exclusion shields modest gifts from tax and filing requirements. For 2022 the annual exclusion is $16,000, and for 2023 it goes to $17,000. The amount of the exclusion is adjusted for inflation in $1,000 increments.

Generally speaking, every taxpayer is allowed to give an annual exclusion amount to each of as many individuals as he or she desires. What's more, a married taxpayer, with the help of his or her spouse, can double the tax exclusion. (This "gift-splitting" must be reported by filing a gift tax return.)

Now $16,000 or $17,000 may not sound like much in a multi-million dollar estate. But consider the possibilities for married grandparents with three children and four grandchildren. As much as $224,000 can be gifted to the seven in 2022, and another $238,000 in 2023 and subsequent years.

In five years, the total would reach $1,176,000 (assuming no future inflation adjustments to the exclusion). What's more, each of the recipients (or the trustee for each grandchild) presumably will invest the amounts transferred each year. Assuming they achieve an after-tax annual return of 4%, investment earnings would add another $147,615 to that $1,176,000.

All in all, then, this five-year-program of tax-excluded gifts would shift over $1.323 million out of the potentially taxable estate of the donor—and the donor's spouse—and keep it in the family.

For comparison, suppose that the entire total of $1.3 million remained subject to a federal estate tax of 40%. After the IRS took its bite, roughly $780,000 would remain in the family!

Direct charitable gifts from an IRA

A "charitable IRA rollover" is available to those who have reached age 70½. Up to $100,000 may be transferred directly by the IRA custodian to the charity. When handled properly, there are two favorable tax consequences: The gift is not included in the donor's taxable income, but it does count toward his or her required minimum distribution (RMD) for the year. (RMDs begin in the year the taxpayer turns 72), In past years, many retirees simply have directed their RMDs to charity.

The income tax exclusion for a transfer to charity from an IRA might not seem like such a big deal. After all, one always has been allowed to follow an IRA withdrawal by a charitable contribution and claim an income tax deduction. But it is a big deal, because the full benefit of that deduction is not available to all taxpayers.

- *Nonitemizers.* According to the IRS, only an estimated 11% of all taxpayers still itemize their deductions. Just 25% of households with income in the $100,000 to $200,000 range still do so. Retirees typically have lower incomes.
- *Big donors.* Percentage limits on the charitable deduction mean that some donors can't take a full charitable deduction in the year that they make a gift. They can carry the deduction forward to future years, but the charitable IRA rollover is much better. There are no percentage limits (just the $100,000 cap), and the excluded amount is not aggregated with other charitable gifts for the year in determining whether the percentage cap has been breached.
- *Social Security recipients.* An increase in taxable income may cause an increase in the tax on Social Security benefits for some taxpayers. The direct gift from an IRA avoids this problem.

A few caveats to keep in mind:

- The donor may not receive anything of value in exchange for the gift from the IRA. If something of value—even as little as $25—is received, the entire exclusion from income is lost.
- The exclusion is not available for transfers from 401(k) plans, Keoghs, or other tax-qualified retirement plans. However, it may be possible to arrange a tax-free rollover from such plans to a traditional IRA, and from there make the charitable gift.
- Married couples may exclude up to $200,000 for direct gifts, but only if each spouse has an IRA as the source of the donation.

Be sure to consult with your tax advisors before making any decisions that you might not be able to reverse. ☐

Record adjustments

As the nation is enduring the worst inflation in 40 years, it should come as no surprise that the increase in Social Security benefits for 2023 is the largest since 1981. The 8.7% benefit increase for about 70 million Americans will boost their average monthly benefit by roughly $140, according to the Social Security Administration.

Interestingly, inflation notwithstanding, the premiums and deductible for Medicare Part B are going down, not up, in 2023. Standard monthly premiums drop by $5.20, from $170.10 to $164.90, and the annual deductible falls from $233 to $226. How is that possible? The 2022 premium included a contingency margin that created larger than anticipated reserves in the Part B trust fund in 2022, and that will be shared with retirees in the form of the lower premium.

Bottom line, retirees should have noticeably more spendable income from Social Security beginning with the January checks.

The 8.7% benefit increase, the largest in 42 years, does not set a record—it comes in fourth. The record inflation adjustment happened during the final year of the Carter Presidency, 1980, which saw a 14.3% hike. The year 1981 comes in second, at 11.2%, followed by 1979 at 9.9%. By 1984, following a short, sharp recession, the inflation adjustment had fallen to 3.5%. From that year until 2022, the adjustment topped 5% only twice, in 1991 and 2009.

To pay for the increased benefits, the maximum amount of earnings subject to Social Security tax will increase to $160,200. These benefits are meant to fund retirement. To that end, the benefits are curtailed if one keeps working after claiming them. For early retirees, the earnings limit will increase to $21,240. One dollar of benefit is lost for every $2 of earned income above that threshold. In the year one reaches "full" retirement age, the earnings limit goes to $56,520, and the penalty is reduced to losing a dollar of benefits for every three dollars of excess earnings. After that year, there is no benefit reduction for earning income.

Those who were born in 1956, and so turned 66 in 2022, have a full retirement age of 66 years and four months. Those born in 1957 have a full retirement age of 66 years and six months.

Qualified retirement plans. Inflation adjustments will also be made to a variety of limits affecting qualified retirement plans. The limit on the amount that may be contributed to an IRA or a Roth IRA will be boosted from $6,000 to $6,500. The "catch-up" contribution limit of $1,000 for taxpayers who are 50 and older is never inflation adjusted. Upward adjustments will be made to the phaseouts for deductible IRAs and for contributions to Roth IRAs.

Maximum employee contributions to 401(k), 403(b) and most 457 plans will jump from $20,500 in 2022 to $22,500 in 2023. □