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Trust & Investment

UPDATE

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New retirement realities

In 2019, Congress passed the Setting Every Community Up for Retirement Enhancement Act, generally known by its initials as the "SECURE Act." A wide range of changes were covered in that legislation, including postponing Required Minimum Distributions until the taxpayer reaches age 72 (the old rule had been 70½) and the elimination of the "stretch" treatment for an inherited IRA. That legislation enjoyed bipartisan support, and has been considered a success.

In 2022, Congress developed four new bills addressing various aspects of qualified retirement plans. Ideas from all four proposals were consolidated into the SECURE Act 2.0, which then became Division T of the "Consolidated Appropriations Act, 2023" (the omnibus budget bill enacted just before Christmas). The new law has received generally good reviews from the retirement planning community. Most of its provisions are directed at employers—for example, automatic enrollment will be required for 401(k) plans (employees will be able to opt out) and coverage of part-time employees. Employers will be able to add new emergency savings account features to 401(k) plans, which will allow for easier participant access to funds to some extent. New tax credits will reduce the costs for an employer adopting a retirement plan.

> **"Getting old is NOT for sissies."**
>
> *—Anonymous retiree*

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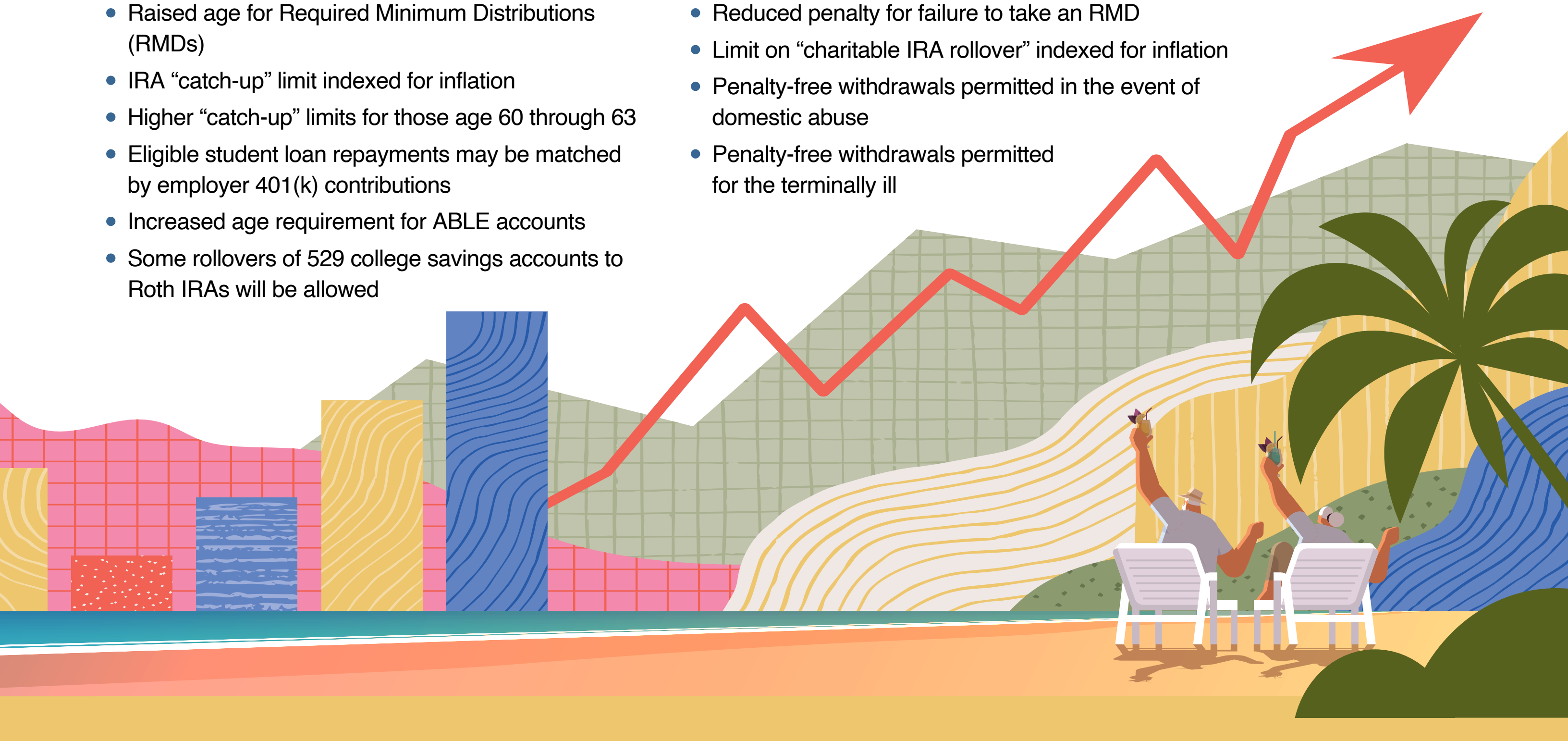
At a glance, SECURE Act 2.0

Employers are the primary target for the SECURE Act 2.0 changes, but changes for individuals were also included. Here are some of the provisions that could affect your financial planning.

- Raised age for Required Minimum Distributions (RMDs)
- IRA "catch-up" limit indexed for inflation
- Higher "catch-up" limits for those age 60 through 63
- Eligible student loan repayments may be matched by employer 401(k) contributions
- Increased age requirement for ABLE accounts
- Some rollovers of 529 college savings accounts to Roth IRAs will be allowed
- Reduced penalty for failure to take an RMD
- Limit on "charitable IRA rollover" indexed for inflation
- Penalty-free withdrawals permitted in the event of domestic abuse
- Penalty-free withdrawals permitted for the terminally ill



New rules for individuals to ponder

Some elements of SECURE Act 2.0 may affect the financial plans of individuals, especially with respect to retirement.

Another RMD postponement. Beginning in 2023, the age for starting Required Minimum Distributions is lifted to 73. On January 1, 2033, the age goes to 75. On the one hand, those who can delay their retirement plan distributions will have more years of tax-deferred growth. On the other hand, the eventual RMDs will be larger each year, which could mean higher income taxes on them. ***Note***: This change does not affect the "charitable IRA rollover," under which those who are 70½ may arrange for a direct transfer of up to $100,000 from an IRA to a qualified charity. Also, that $100,000 limit is now indexed for inflation.

Larger "catch-up" contributions. Those who are 50 and older are permitted an extra $1,000 on their IRA contribution limit. Although the basic IRA contribution limit is indexed for inflation, the extra "catch-up" contribution has not been. Beginning in 2024, it will be. What's more, beginning in 2025 the "catch-up" contribution limit will be boosted to $10,000 for those who are 60, 61, 62, and 63. On the one hand, for many these are the high earning years, when education and housing expenses have been completed, so the added tax shelter may be most welcome. On the other hand, that doesn't allow for many years of tax-deferred account growth.

Matching student loan payments. Recent college grads who are still paying off their student loans at the start of their careers may find it difficult to defer any of their earnings into an employer's retirement plan. Failure to contribute would be a shame, because then they miss out on the employer match for retirement deferrals, which is effectively free money. Under the new law, employers may condition the 401(k) matching contribution on an employee's student loan payments.

529 plan rollovers. What happens when there is money left in a 529 education savings account when the beneficiary graduates? Tax penalties apply if the funds are not used for qualified education expenses. Beginning in 2024, 529 plan beneficiaries may roll up to $35,000 of their leftover funds into a Roth IRA under certain conditions. The account needs to have been in existence for at least 15 years.

Reduced penalty for failure to take an RMD. What happens if someone fails to receive a Required Minimum Distribution? A 50% excise tax is applied to the amount that should have been distributed. Beginning in 2023, that tax is reduced to 25%, and if the taxpayer makes a timely correction, the tax is reduced to 10%.

Penalty-free distributions in some circumstances. Beginning immediately, premature distributions to terminally ill persons will no longer be subject to the 10% penalty tax. Beginning in 2024, survivors of domestic abuse will be permitted to withdraw the lesser of $10,000 or 50% of their retirement plan account without the 10% tax penalty. Income taxes will apply, but can be refunded if the amounts withdrawn are repaid within three years.

The turbulent economy

Most retirees are living on a fixed income. The Social Security benefit has inflation protection built in, but most other sources of retirement income lack that advantage. That's what makes inflation such an important consideration in planning and managing retirement income. The country enjoyed a long stretch of relatively benign inflation, which may have made some people complacent. That period is over. The Federal Reserve continues to ramp up interest rates to combat inflation, and there are some signs of success, but the fight appears far from over.

At the same time, at exactly the moment retirees were facing these higher expenses the stock and bond markets both declined, reducing the resources to meet the need. Market volatility is expected to continue through 2023. In fact, there is always the possibility that the Fed's actions to combat inflation will trigger a recession, which could also drive stock prices still lower.

Given these realities, this might be the right moment to seek professional help in investment management.

Put us on your team

You may want to consider professional help in preparing and implementing your retirement plans. We specialize in two areas of personal financial management:

• Helping clients to achieve financial independence, using tax-sensitive techniques as appropriate.

• Helping clients to maintain financial independence by providing unbiased investment advice and trusteeship.

For specifics on how we might help you, see our asset-management specialists. ☐

Retiree financial services

At your request, we'd be happy to tell you more about—

- **IRA rollovers.** Preserve the tax benefits of your 401(k) money.
- **Personal investment accounts.** We will design, implement, and monitor a personalized investment program for you.
- **Living trusts.** The same personalized investment guidance is available to clients who wish to set up their investment programs as revocable living trusts. A trust-based financial plan doesn't impair the client's control of his or her investments, but it does offer such added benefits as probate avoidance, integration with the estate plan, and financial management in the event of prolonged illness or incapacity.

Ask a Trust Officer

DEAR TRUST OFFICER:
My investments are worth about $3 million after taking a pretty big hit in 2022. My 401(k) is worth about $1.5 million, and my home is assessed at $500,000. Do I need to worry about death taxes at my wealth level?
—COMFORTABLE RETIREE

DEAR COMFORTABLE: Don't relax just yet. You don't mention your age, but unless you expect to die before 2026, there is probably a death tax in your future.

For those who die in 2023, the amount exempt from federal estate and gift tax is $12.92 million, which would give you plenty of coverage. However, under current law, that figure will be adjusted for inflation in 2024 and 2025, then fall roughly in half in 2026, likely in the range of $6.5 million to $7.0 million. You've estimated your estate to be $5 million, though my guess is that your home is worth much more than its assessed value. Should your portfolio do well in the next two years, your net worth could easily climb into taxable territory.

What's more, don't overlook state death taxes (inheritance tax, estate tax, or both). The states that still impose such taxes generally have much lower exemption levels. If you live in or own property in such a state, your estate will be vulnerable.

Mention these concerns to the estate planning professionals during your next will review.

DEAR TRUST OFFICER:
Can a trust be changed after it has been funded?
—SEEKING PERMANENCE

DEAR SEEKING: Yes and no. What kind of trust are you talking about? A revocable living trust may be changed by its creator at any time and in any way, even canceled completely—that is what "revocable" means, after all.

Irrevocable trusts, on the other hand, may not be altered so lightly. The beneficiaries of an irrevocable trust have vested interests that may be enforceable by law. These may be rights to present trust income or future principal.

From your signature, I take it you hope to "tie up" your assets so as to exert control of them from beyond the grave. This can be done if that is truly your wish. However, estate planners generally recommend building some flexibility into estate plans, because you can't foresee the future circumstances, you can only provide guidance for the objectives of your trust. You may, for example give the trustee some discretion in the distribution of trust income or principal, taking into account the successes or failures of the beneficiaries. In a marital trust for a surviving spouse, it is common to provide the spouse with a general power of appointment, which may be used to redirect assets at the trust's termination.

Sometimes the terms of an irrevocable trust may be altered through a process called decanting, in which assets are poured into a successor trust. Finally, you might want to include a trust protector for your trust, someone with the power to amend the trust consistent with the vision that you have for it.

DEAR TRUST OFFICER:
I understand that you are a "corporate fiduciary." What is that exactly? Aren't you just a different flavor of stockbroker or financial planner?
—SHOPPING FOR ADVICE

DEAR SHOPPING: "Fiduciary" is a legal term that describes the duties that one party owes to another in a business relationship. A fiduciary duty is the highest duty of care in the law and has been a standard element of trust practice for decades. There are many elements to fiduciary duties, but perhaps the most important is the duty of loyalty, to put the interests of the client ahead of one's own interests.

A "corporate fiduciary" is a business entity, such as ours, that has been granted permission by the state to act in a fiduciary capacity. We can serve as trustee, and we can settle estates. In this capacity, we are subject to a wide range of audit controls and government regulatory supervision.

More and more financial advisors have voluntarily moved to abide by this standard.

We are compensated for our services with a fee that varies with the size of the account under management. We do not earn more based upon the transactions that we generate or the type of service that we recommend. Our interests are, therefore, always aligned with the interests of our clients. We prosper when they do.

When we act as trustee, our investment decisions must be responsive to the needs of both current and future beneficiaries. This is not an ordinary perspective to have for portfolio management. Our approach cannot be risk free, but it does tend to be risk averse.

We would be pleased to have an in-person meeting to tell you more.

DEAR TRUST OFFICER:
Do I still need a marital deduction trust in my will for my wife?
—CONCERNED HUSBAND

DEAR CONCERNED: Most likely, yes. If your current will includes a trust for a surviving spouse, you probably will want to keep it.

A trust for a surviving spouse provides asset management benefits that can be vitally important to a person who is entering widowhood. For most affluent families, a marital trust is the way to go.

Blended families are a special case for which provision may be made for a spouse and children from an earlier marriage. The tool is called the Qualified Terminable Interest Property Trust, or QTIP trust. Even if the marital deduction allowed for the QTIP trust is not needed, securing the inheritance for all beneficiaries may be an important enough consideration to employ the trust in wealth management. ☐

The role of donor-advised funds

Taxpayers generally welcomed the rough doubling of the standard deduction in the 2017 tax reform legislation. One group that was worried about unintended side effects of the change was the nonprofit sector. The larger standard deduction, coupled with the cap on the deduction for state and local taxes, meant that most taxpayers would no longer get any tax benefit for their charitable gifts.

The worries turned out to be unfounded, as total charitable giving has not declined. Most people give to charity for philanthropic reasons, not to get tax benefits. However, there was a related side effect, and that has been a boom in donor-advised funds.

The idea behind a donor-advised fund is that money is permanently set aside for charity in the fund, but the charity may not yet be specified. A full tax deduction may be allowed in the year of the contribution to the fund, while the disbursements to charity take place over the subsequent years. Note that the advice that the donor makes to the fund about the charitable beneficiary in subsequent years is not binding, but the fund will typically follow the wishes of the donor.

The tax strategy that this suggests is to bunch charitable deductions. One year, the taxpayer doubles up on charitable gifts and itemizes deductions, while the next year, no such gifts are made and the standard deduction is taken instead. When the large gift is made to a donor-advised fund, the receipt of the money by the charity is deferred.

A recent report from the National Philanthropic Trust documents the success of donor-advised funds [https://www.nptrust.org/reports/daf-report/]. Key metrics:

- The number of accounts in donor-advised funds rose from 1,007,745 in 2020 to 1,285,801 in 2021, an increase of 27.6%.
- Assets held in these funds grew 39.5% from 2020 to 2021, from $167 billion to $234 billion.
- Total transfers to charities by the funds in 2021 were $45.74 billion, a 27.3% payout rate. This was a 12.7% increase over the 2020 payout rate.
- Private foundations hold some $1.3 trillion in assets, about five times larger than the donor-advised funds. Yet the total grants by private foundations came to only $96.27 billion, about double the total grants from the donor-advised funds. (Private foundations are only required to distribute 5% of their assets annually to charity.)

The report concluded with a prediction of slower growth for donor-advised funds in the coming year, in part as a response to financial market volatility in 2022. ☐