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Trust & Investment

UPDATE

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Protect your retirement money with an IRA rollover

According to the Investment Company Institute's *2023 Fact Book*, IRAs are the largest pot of retirement money, with $11.5 trillion at the close of 2022. They have had that status for more than a decade. Defined contribution plans, such as 401(k) plans, rank second, at $9.4 trillion. Private sector pension plans now hold only $3.1 trillion, while government pension plans have $7.6 trillion in assets. The amounts owned by pension plans are not sufficient to cover their promised benefits—see "Retirement accumulations" on page 2 for more detail.

How did the accumulation of funds in IRAs grow so large? It wasn't from annual contributions or investment earnings; it was through IRA rollovers from employers' qualified retirement plans.

If you expect to retire soon and will be receiving a lump sum distribution of your retirement benefits, you need to buckle down. A lump sum distribution can be rolled over into an IRA, to preserve beneficial tax treatment for your retirement money. However, you will have many important decisions to make during this process. The consequences of your choices will last for the rest of your life, so make them carefully.

How do I arrange for an IRA rollover?

Most people will opt to roll their lump sums into an IRA to avoid current income taxation. There is a wrong way and a right way to handle this.

The wrong way is to accept a check for the amount of the lump sum. If you take this approach, your employer will be required to withhold 20% in income taxes on the distribution. You'll either have to be satisfied with an 80% rollover, or you'll have to come up with the difference from other savings sources.

The right way is to arrange a direct transfer from the qualified plan trustee to the trustee of your IRA rollover—there is no withholding requirement with this approach.

How should IRA assets be invested?

During the accumulation years, most people saving for retirement have a significant amount invested in the stock market. That exposure typically falls as one approaches retirement, and it falls still further in retirement. Retirees often need the steady stream of income that bonds can provide.

One also needs to keep in mind the probability of eroding purchasing power due to inflation, especially over the course of a long retirement. Some amount of

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stock investing is often needed to hedge against inflation. According to the *2023 Fact Book*, IRA owners in their 20s have 84.3% of their plan assets in equities, and those in their 60s have 56.2% in equities.

If you have significant savings in taxable accounts, you don't want to evaluate your investment strategy for your IRA rollover in isolation. You'll need to decide whether your stock investments belong in the IRA rollover or on the taxable side of the ledger. All the distributions from the IRA will be taxed as ordinary income, whether they are of interest, dividends, capital appreciation or return of principal. For the sake of tax efficiency, many advisors suggest focusing the IRA on providing steady income and doing the growth investing outside of the IRA.

Who should be the surviving beneficiary?

You'll want to designate a surviving beneficiary for your IRA rollover. Usually, a surviving spouse is named, but another beneficiary may be appropriate, depending upon the composition of family wealth and other family circumstances. The decision can be changed at any time.

Will death taxes apply to my IRA?

The federal estate tax will apply in full to the assets remaining in your IRA rollover at your death. State inheritance or estate taxes may apply as well. Although the federal estate tax is targeted to the wealthiest families ($12.92 million and up for deaths in 2023), estate planning for your IRA rollover remains important. The exemption is scheduled to drop in half in 2026, and there is some political support for accelerating that date. What's more, unlike most inheritances, heirs must pay income taxes on distributions from the inherited traditional IRAs.

If your spouse will inherit the IRA rollover, the estate tax may be deferred with the marital deduction. With careful drafting, it is possible to coordinate an IRA rollover with a Qualified Terminable Interest Property Trust (affectionately known as the "QTIP trust") for the surviving spouse. The QTIP trust is often a core element of marital estate plans, especially when one or both spouses have been married more than once.

Where can I get more information for planning my IRA rollover?

Are you expecting a lump sum payout from a retirement plan in the next year or so? Or do you have questions about your retirement readiness? It's not too soon to start rehearsing your tax strategy and reviewing your investment options. We're available to offer you our assistance with these important financial planning issues.

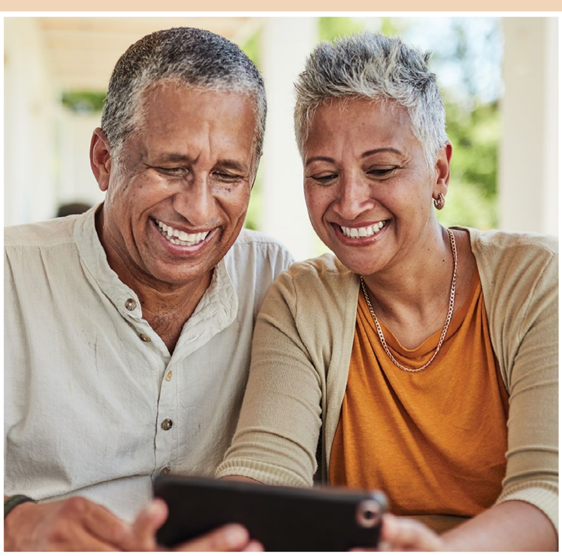
We look forward to meeting with you to discuss your needs. ☐

Retirement accumulations
(trillions of dollars, year-end 2022)

Type of plan	Total assets	Unfunded benefits
IRA	$11.5	0
401(k)	$6.6	0
Other defined contribution	$2.8	0
Private sector pension	$3.1	17%
State and local pensions	$5.2	46%
Federal pensions	$2.4	37%
Annuities	$2.2	0

Source: Investment Company Institute's *2023 Fact Book*

Our services for retirees



You don't have to be retired to benefit from these financial services, but if you have started your retirement (or plan to soon), you should give them some careful consideration. At your request, we'd be happy to tell you more.

- **IRA rollovers.** When you receive a plan payout, you may preserve tax advantages for your retirement capital by arranging for an IRA rollover. Do you already have such an account with another firm, but feel lost in the shuffle? We'd be happy to help you move your IRA so that you can begin to benefit from our personalized investment management.
- **Personal investment accounts.** After careful study of your goals and circumstances, resources and risk tolerances, we recommend, implement, and monitor a personalized investment program for you. Because we charge annual fees linked to market value, our best interests and the best interests of our clients are linked clearly.
- **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.

Build a wall around your wealth

How thoughtful planning can create a legacy that lasts.

Those who have built significant wealth are rightfully concerned about how best to use that wealth for family financial protection. As often has been noted, the wealthy want their heirs to have enough to be able to do anything, but not so much that they don't have to do something.

Trust planning comes immediately to mind when planning for a child who is a minor. The trust can provide for education funding, for getting a good financial start in life. Incentives can be built into the trust for achieving certain milestones, such as reaching a certain age or beginning a professional practice.

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.

Basic tools

A great variety of financial protection strategies may be implemented with careful trust planning. Among the choices to evaluate:

- ***Gifts-to-minors trust.*** For young children, contributions of up to $17,000 per year to this sort of trust will avoid gift taxes. A married couple can together set aside $34,000 each year for each child or grandchild, so in a few years a significant source of capital may be built up. Assets may be used for any purpose, including education funding, and will be counted as the child's assets for financial aid purposes. The assets of a gifts-to-minors trust must be made fully available to the child when he or she reaches age 21. However, the child may be given the option of leaving the assets in a trust.
- ***Support trust.*** For an adult child who needs a permanent source of financial support, with the trust principal protected from the claims of creditors, a support trust may provide a solution. The beneficiary's interest is limited to so much of the income as is needed for his or her support, education, and maintenance.
- ***Discretionary trust.*** The trustee has sole discretion over what to do with the income and principal, just as the grantor does before the trust is created. The beneficiary has no interest in the trust that can be pledged or transferred. When there are multiple beneficiaries, the trustee may weigh the needs of each in deciding how much trust income to distribute or reinvest, when to make principal distributions, and who should receive them. The trust document will often include guidelines on such matters.
- ***Spendthrift trust.*** The beneficiary is forbidden to transfer any financial interest that he or she has in the trust, and may not compel distributions.

Here are examples of how such trusts may work.

A trust in action

Alice tried to treat each of her four children fairly throughout their lives. That didn't mean she treated them equally. Three of the children went to college; and two to graduate school. The fourth child developed substance abuse problems. The rehabilitation costs almost looked like college tuition expenses at times.

Alice isn't keeping score as she provides her children with financial help. Some families have unusual financial needs. Alice wants to apply her financial resources where she believes that they will do the most good. That may mean that the most financially successful of her children will get only a nominal inheritance, while others will get more. Yet she also knows that fortunes can shift over time, that the person who is successful today might suffer a reversal tomorrow. Thus, ongoing monitoring is an essential component of her long-term planning.

A discretionary trust plan for managing the inheritance of Alice's children can have this same flexibility built into it. The trustee can evaluate the status of the children and their families and adjust the trust distributions in accordance with the guidelines set down in the trust.

Our invitation to you

We specialize in estate settlement and trusteeship. We are advocates for trust-based financial 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. ☐

Start your year-end gift planning

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 like estate transfers are. However, the annual gift tax exclusion shields modest gifts from tax and filing requirements. For 2023, the annual exclusion is $17,000. The amount of the exclusion is adjusted for inflation in $1,000 increments, and it is likely to be higher in 2024.

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, $17,000 may not sound like much in a multimillion-dollar estate. But consider the possibilities for married grandparents with four children and six grandchildren. As much as $170,000 can be gifted to the ten heirs in 2023 and more in subsequent years.

In five years, the total would reach $850,000 (assuming no future inflation adjustments to the exclusion).

All in all, then, this five-year program of tax-excluded gifts would shift over $850,000 plus investment earnings out of the potentially taxable estate of the donor. For comparison, suppose that the entire $850,000 remained subject to a federal estate tax of 40%. After the IRS took its bite, only $510,000 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 73 in most cases.)

In addition to the satisfaction of helping a favored charity, there are these tax benefits:

- ***Nonitemizers.*** With the doubling of the standard deduction, far fewer taxpayers are itemizing.
- ***Big donors.*** Percentage limits on the charitable deduction don't apply to gifts from IRAs.
- ***Social Security recipients.*** The direct gift from an IRA does not increase income taxes on Social Security benefits.

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