IN THIS ISSUE

TRUST & INVESTMENT

UPDATE

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December 2023

Year-end charitable gift planning

The SECURE Act 2.0 created new considerations

The Pension Protection Act of 2006 temporarily created the opportunity for making charitable gifts from an IRA. Specifically, taxpayers who were 70½ or older could arrange for the direct transfer of up to $100,000 from their IRAs to a qualified charity. The temporary provision was consistently renewed until it was finally made permanent. Informally, this strategy is known as a charitable IRA rollover; more formally, it is a qualified charitable distribution, or QCD.

The QCD is not included in the retiree's taxable income, but it does count for purposes of calculating the required minimum distributions (RMDs) from an IRA. Note that RMDs are not required until age 73, while the QCD opportunity comes earlier.

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.*** With the doubled standard deduction, far fewer taxpayers are itemizing their deductions these days. What's more, retirees typically have lower incomes, and are even more likely to rely on the standard deduction.
- ***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

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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.

New opportunity

The SECURE Act 2.0 allows up to $50,000 of a Qualified Charitable Distribution to be paid to a charitable remainder trust or a charitable gift annuity. A spouse who also has an IRA could double that, to $100,000. The QCD gift may not be made to an existing charitable remainder trust, and no other additions are permitted for the trust receiving the QCD. Only the donor and spouse may be income beneficiaries of the trust funded with a QCD. Distributions from the trust will be taxed as ordinary income.

Although the planning opportunity is welcome, in most cases, charitable remainder trusts are substantially larger than $50,000. A conventional trust offers the chance for deferral of taxes on appreciated assets, greater flexibility in choosing beneficiaries, as well as a tax deduction to shield other income from taxation.

Watch out!

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.

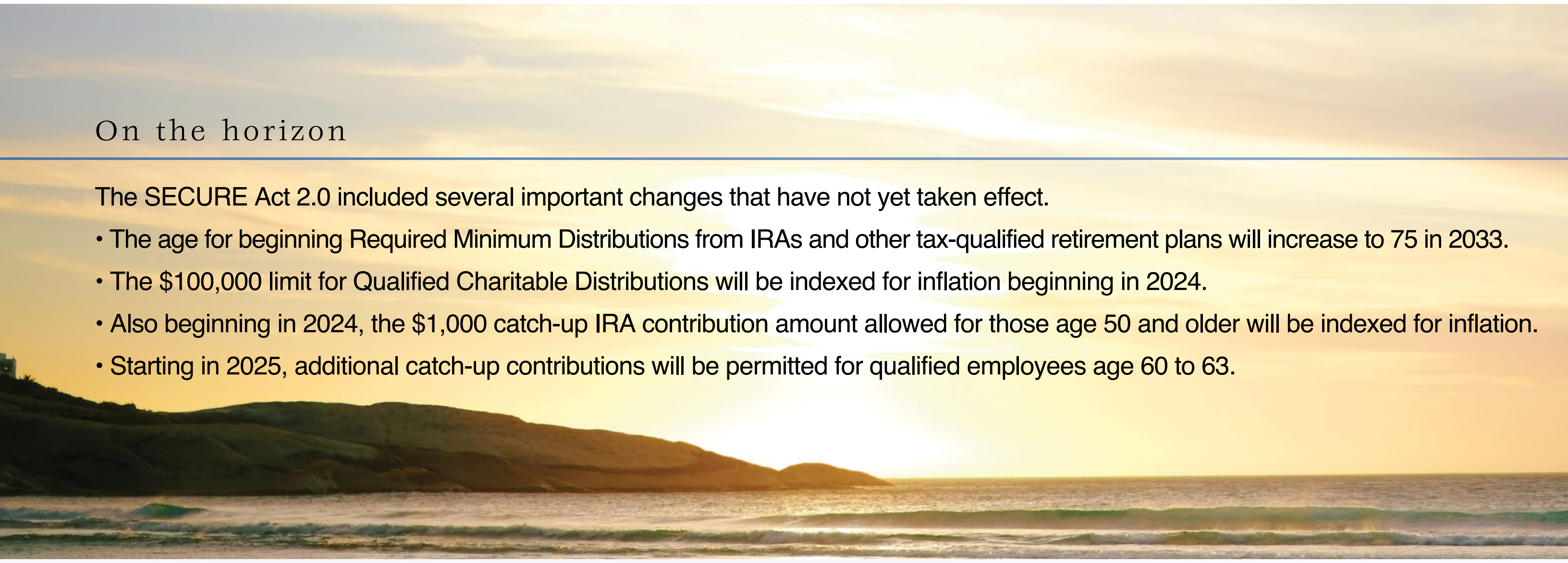
• The gift must be made *after* the donor has reached age 70½, and not merely be made *during* the year the donor reaches that age.

• The exclusion is only available for direct charitable gifts from traditional and Roth IRAs, not 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.

• Inherited IRAs will have RMDs for younger taxpayers. They don't get the benefit of this charitable transfer rule. A charitable rollover may be made from an inherited IRA, but only if the beneficiary has reached age 70½.

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



On the horizon

The SECURE Act 2.0 included several important changes that have not yet taken effect.

- The age for beginning Required Minimum Distributions from IRAs and other tax-qualified retirement plans will increase to 75 in 2033.
- The $100,000 limit for Qualified Charitable Distributions will be indexed for inflation beginning in 2024.
- Also beginning in 2024, the $1,000 catch-up IRA contribution amount allowed for those age 50 and older will be indexed for inflation.
- Starting in 2025, additional catch-up contributions will be permitted for qualified employees age 60 to 63.

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.

Another *bump* in the federal estate tax exemption

In the history of the U.S. estate tax, the amount exempt from the tax has never been reduced. Rather, the threshold of taxation has been increased from time to time, so as to keep targeting the federal estate tax on only the largest estates. This year, the amount exempt is $12,920,00 per taxpayer; in 2024 it goes to $13,610,000. Married couples can double that exemption with ordinary estate planning.

However, that exemption is slated to fall roughly in half in 2026 under current law. That has led some estate planners to recommend making large taxable gifts before 2026, so as to “lock in” the larger exemption amount. The exemption will fall to $5 million plus inflation adjustments, and is projected to be about $7 million in 2026 if Congress does not act.

The IRS has issued Final Regulations that show how the “lock-in” strategy will work [IR-2019-189, T.D. 9884].

Basic example. Elizabeth made a $5 million taxable gift in 2020, and so used up that much of her basic exempt amount. If she dies in 2024, her estate tax exemption will be reduced by that $5 million, so it will be $8.61 million. If she dies in 2026, assuming that the exemption has then fallen to $7.0 million, her basic exclusion amount will be $2.0 million.

Larger gift. Now assume Elizabeth made $10 million worth of taxable gifts in 2020 and survives to 2026, when the exemption has fallen to $7.0 million. The estate tax is determined by bringing taxable gifts back into the calculation and allowing whatever credits were granted for those lifetime gifts. That means Elizabeth’s basic exclusion amount in 2026 will be $10 million, even though under the statute it will have fallen much lower for anyone who made no taxable gifts at all. She will have locked in a portion of the larger exclusion amount.

Married couple. When Fred died in 2019 his executor elected to have Ethel inherit his unused exemption amount, then $11.4 million. If Ethel dies in 2024, she will have her own exempt amount of $13.61 million, plus the exemption she inherited from Fred, for a total basic exempt amount of $25.01 million.

What happens if Ethel survives until 2026? The exempt amount inherited from Fred does not change, but her own exemption will fall. Assuming that it’s then $7.0 million, her basic exempt amount would be $18.4 million.

Ordering rules

Under the Regulations, one cannot use the “bonus” exempt amount first, to save the basic exempt amount for the future. In the basic example above, Elizabeth cannot try to shield a $5 million gift with the enhanced portion of her basic exempt amount. She must exhaust the basic amount before the bonus is tapped, under the ordering rules.

In short, the IRS has made it explicit that, as it stands today, the extra protection from the federal transfer tax provided by the 2017 tax reform is a “use it or lose it” proposition.

Planning

Is locking in the larger exemption with a taxable gift a good idea? At the current 40% tax rate on estate and gift transfers, the tax savings comes to roughly $2.5 million, which is real money. There are strategies available to leverage that number higher, and there is the chance that the estate tax rate goes higher in the future, which also magnifies the potential savings.

On the other hand, estate planners were in much the same position in 2012, when an exemption of $3.5 million was scheduled to fall to $1 million. Many recommended lock-in strategies then, only to be confounded when Congress instead raised the amount exempt to $5 million!

Death and taxes may be certain, but the details are subject to change. ☐

A bump in the annual gift tax exclusion

The annual exclusion from the federal gift tax rises from $17,000 in 2023 to $18,000 in 2024. When total gifts to any one person do not exceed those amounts, no federal gift tax return is required. There is no limit on the number of annual exclusion gifts one may make, but the exclusion expires every year. Unused exclusions are lost forever.

Married couples may double their annual exclusion gifts, to $34,000 in 2023, and $36,000 in 2024. A gift tax return generally will be required to achieve this result.

Example. Grandfather and Grandmother have three adult children and seven grandchildren, for a total of ten possible annual exclusion gifts within the immediate family. They could make gifts of $340,000 this year and $360,000 next year, removing $800,000 from future federal estate taxation. Future asset appreciation will be removed from the taxable estate as well.

Reporting delayed again

Until 2021, Form 1099-K was required to be filed by taxpayers who received over $20,000 from 200 or more third-party payments from online platforms such as Venmo or eBay. The tax law changed with the passage of the American Rescue Plan Act of 2021. Evidently lawmakers felt that someone was dodging taxes under the prior standard. The newly enacted rule lowered the reporting threshold to $600, for even a single transaction.

There were practical barriers to the implementation of the new rule, so in December 2022, the IRS delayed the new reporting requirement for a year. One major issue is that not all such payments are taxable income, and there is no way to differentiate payments for goods or services from nontaxable gifts.

Now the IRS has suspended such reporting for 2023 as well. According to the Government Accountability Office, the rule, if applied as written, would triple the number of Forms 1099-K to over 44 million, but the "IRS does not have a plan to analyze these data." The rule is slated to go into effect in 2024, but with a $5,000 threshold.

According to a news release from IRS Commissioner Danny Werfel, "We spent many months gathering feedback from third-party groups and others, and it became increasingly clear we need additional time to effectively implement the new reporting requirements. Taking this phased-in approach is the right thing to do for the purposes of tax administration, and it prevents unnecessary confusion as we continue to look at changes to the Form 1040. It's clear that an additional delay for tax year 2023 will avoid problems for taxpayers, tax professionals, and others in this area."

The dollar threshold could go lower in future years, or Congress could reevaluate the wisdom of the entire idea. ☐