Year-End Estate Planning & IRA Strategies Post SECURE Act: What's Next

Presenters

Leon C. LaBrecque, JD, CPA, CFP®, CFA
Executive Vice President, Chief Growth Officer
Sequoia Financial

Scott J. Swain, CPA, CFA, CFP®, MT
Partner, Tax
Cohen & Company

Gift & Estate Tax:
Quick Refresher on Current Status

- 2021 Annual Exclusion - $15,000 for 2021 (likely going to $16,000 for 2022)
- Estate & Gift Exemption - $11,700,000 for 2021 (Approx. $12,060,000 for 2022)
- Current Exemption sunsets at 12/31/25, likely dropping to about $6,000,000 for 2026
- Gift splitting is available for spouses
- For individuals under the exemption amounts, focus on income tax basis planning
- Have a dialogue with estate planners if it has been a while since documents updated

Comparison of Biden and Ways & Means

Biden	Build Back Better (New 11/02) Framework	Comment
Raise corp. rate to 28%	15% minimum tax on Book Income, 1% surtax on corp. buybacks	**Changes earnings on ~1,000 companies, changes buyback**
Raise top indiv. rate to 39.6%	Appears to retain current rules	**Status quo**
State and Local Tax (SALT)	Raise deduction cap to $80,000 until 2030	**Goodbye to the tax return "postcard"**
Tax Cap Gains as ordinary income 39.6% (+ NIIT). Carryover basis	Appears to be replaced by surtax No Carryover basis	**CG rate and step-up retained**
No high income surtax	5% on AGI over $10M, 3% over $25M	**New wealth tax**
Raise Global Intangible Low Income Tax Rate (GILTI)	15% GILTI enforces BEAT SHIELD	**Affects about 120 of the S&P 500**
Phase out Pass-through >$400K	Add 3.8% NIIT/limit Excess Loss Limitation	**Affects pass-thorough income & trusts**
No estate or gift tax changes	Appears to leave estate tax alone	**Status quo for now**

Estate Tax:

- **WHAT IT IS:** Retains status quo
  - Note exclusion expires (reverts to $5M, inflation-adjusted) on 12/31/25 under the TCJA.
- **WHAT IT MEANS:**

  Continue Planning for 2025 expiration

- **WHAT TO DO ABOUT IT:**

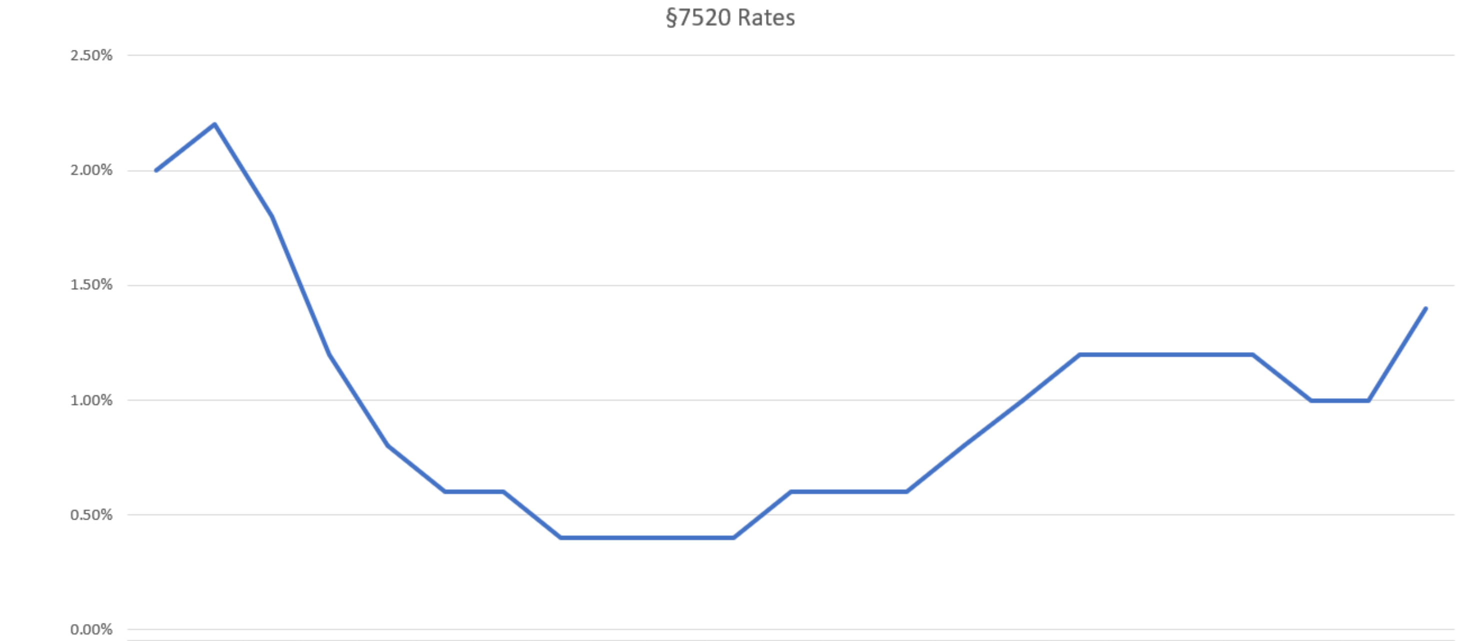
  NOW:
  - Utilize estate planning strategies
  - Watch effective date
  - Lifetime gifts now
  - SLATs, GRATs, CLATs, IDGTs, ILITs
  - USE THE EXCLUSION!

  LATER:
  - Be vigilant on asset purchases using multiple entities or family shifting techniques

Polling Question #1

Interest Rate Opportunity

- IRS interest rates are still near historical lows for Nov 2021
  - §7520 rate: 1.4%
  - Applicable Federal Rates (AFRs)
    - Short-term (<3 years): 0.22%
    - Mid-term (3-9 years): 1.08%
    - Long-term (10+ years): 1.85%
- §7520 rate comparison
  - January 2019: 3.4%
  - March 2000: 8.2%



	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21
§7520 rate	2.00%	2.20%	1.80%	1.20%	0.80%	0.60%	0.60%	0.40%	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.80%	1.00%	1.20%	1.20%	1.20%	1.20%	1.00%	1.00%	1.40%

Chart populated with data taken from IRS.gov

Intra-Family Loans

- Intra-family loans vs. traditional lenders
  - Lower rate
  - No underwriting
- Help family without giving away money
- Refinancing considerations

Intra-Family Loans - Example

- Granddaughter buying a house
- $500,000 mortgage for 15 years
- Bank offering
  - 2.6%
  - Monthly payment $3,358
- Intra-family loan from grandma
  - 1.85%
  - Monthly payment $3,183
- Savings to granddaughter of over $31,500, and above market ROR for grandma

Give It Away

- Business and real estate values are still depressed in some cases due to the pandemic
- Gifting ownership is a simple approach
  - Outright
  - Irrevocable trust
    - Spousal Lifetime Access Trusts (SLATs)
    - Intentionally Defective grantor trusts (IDGTs)
- Valuation & gift tax return filing required
- Carryover basis

Spousal Lifetime Access Trusts (SLATs)

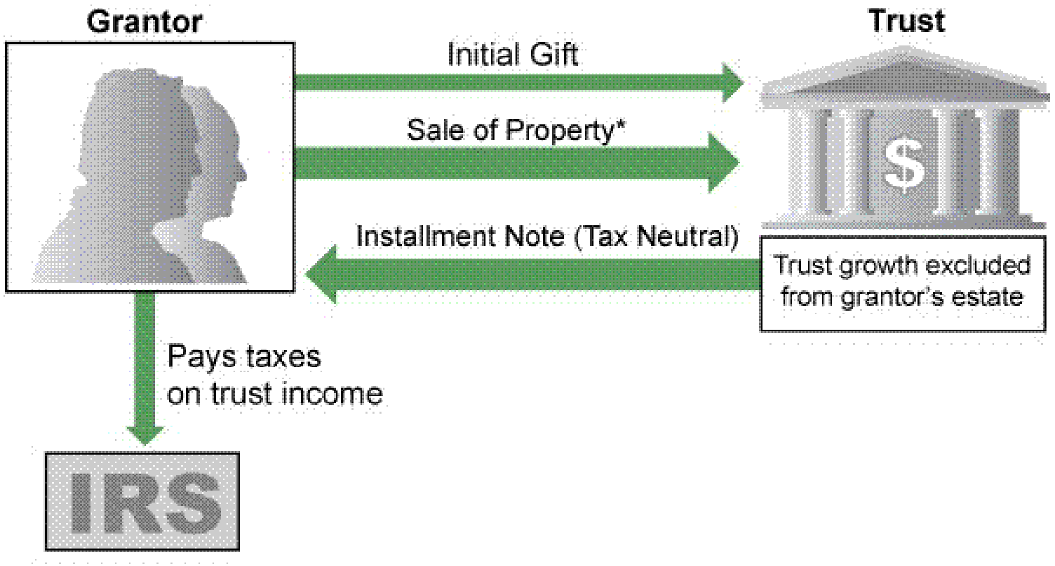
- A type of irrevocable gifting trust used by married couples
- One spouse (grantor) gifts assets to a trust for the benefit of:
  - Children
  - Future descendants – “Dynasty Trust”
  - Spouse while still living
- Typically no mandatory distributions of income to anyone during spouse’s lifetime
- Also typically set up as a “defective grantor trust” taxable to the grantor
- Spouse is often the trustee
- Advantages:
  - Can gift away the full $11,700,000 and spouse retains access to it if assets are ever needed
  - Assets grow tax free outside of taxable estate
  - Good option to use “Generation Skipping Tax” Exemption so assets are free of estate tax forever

Installment Sales

- Full purchase price financed by seller at the low AFR
- Buyers use business cash flow to fund note payments
- Income stream to seller from note repayment
- Buyers have basis equal to purchase price
- Taxable gain to seller
  - Minimized with discounted valuations
  - Spread out over the term of the sale

Installment Sales & Intentionally Defective Grantor Trust (IDGTs)

- Seed gift uses basic exclusion amount
  - Lower valuation reduces this impact
- Remaining interest financed by seller with note at the AFR
- Eliminates taxable gain to seller
- Carryover basis for buyers
- Efficient GSTT planning vehicle



*The sale of property may be subject to a discount

IDGT Example

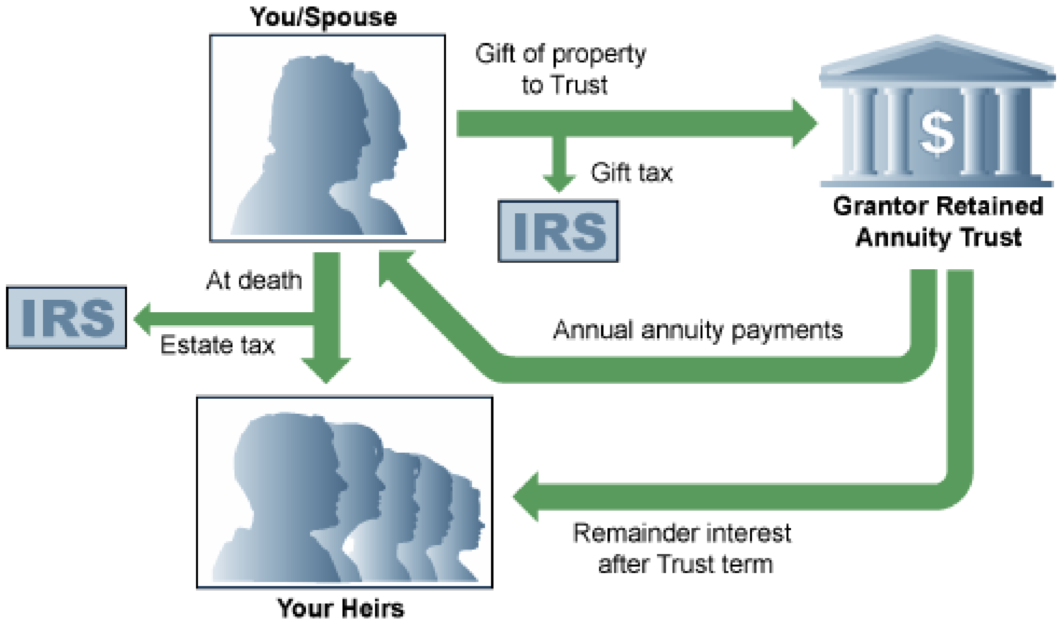
- $10M FMV
- 20% valuation discount (15-35% range)
- $8M discounted value
- Assume annual cash flow = $1,430,000 (7 X multiple)

- $800,000 seed gift to trust
- $7.2M sale to trust via 9-year note
- Mid-term AFR 1.08% (Nov 2021)
- $834,000 annual P&I payments
- Total interest $356,333
- Could instead use interest-only with a balloon payment
- Net effect is transfer of $10M of stock while using only $800,000 of exemption
- Trust assets at payoff = $15,364,000

Polling Question #2

Grantor Retained Annuity Trusts (GRATs)

- Transfer assets in exchange for an annuity
- Annuity calculated at the §7520 rate
- Excess appreciation goes to beneficiaries
- Minimum term of two years
- “Zeroed-out” design can eliminate exemption usage
- Carryover basis
- GSTT exemption not allocable until end of trust term



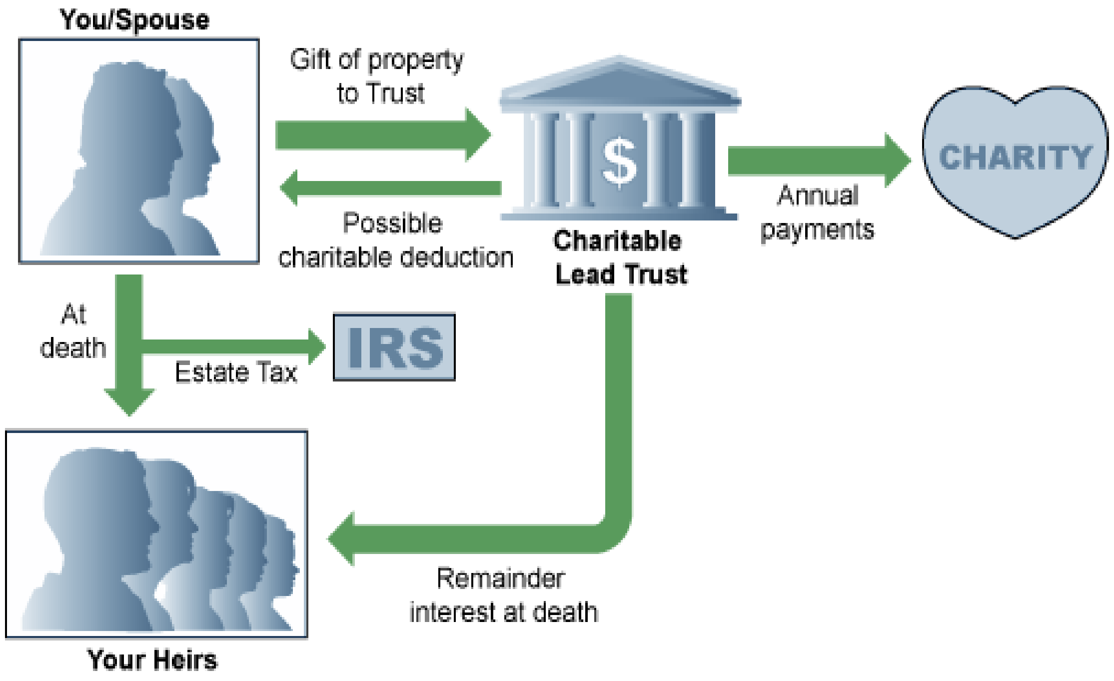
GRAT Example

- Married couple
- $25M net worth
- Real estate, investment assets, & family business
- Business has 5% growth & 5% distributed income each year
- Transfers $10M of the business to a GRAT
- 20% discount ($8M discounted value)

- 1.4% §7520 rate
  - $862,887 (~10.78%) annual annuity for 10 years
  - $1 PV remainder interest gift
  - $8,940,000 to heirs at the end of 10 years at undiscounted value
- Compare at 3% §7520 rate…
  - $643,556 PV remainder interest gift

Charitable Lead Annuity Trusts (CLATs)

- Split interest charitable trust with gift tax deduction provided
- Annual payments to charity with annuity based on the §7520 rate
- Excess appreciation to heirs at the end of the trust term
- Charitable beneficiary options
  - Restrictions on family foundations
- Non-Grantor vs. Grantor (Reversionary vs. Non-Reversionary)



CLAT Example

- Transfer $1M to 20-year CLAT
- 5.7673% ($57,673) payout to charities for 20 years
- 1.4% §7520 rate
- $1,000,000 PV of charitable benefit
- $0 PV remainder interest gift
- Compared to $142,000 taxable gift at 3% 7520 rate w/ same annuity
- If 6% total after-tax return, $1,085,595 transferred tax free in year 20

- More aggressive variable annuity payments
- If $10 annuity in year 1, increasing at 75% each year until $415,000 in year 20, $0 taxable gift, and $1,796,018 transferred tax free in year 20 with assumed 6% after tax return

Comparison of Transfer Strategies

	Outright Gift	IDGT	GRAT	CLAT
Gift	Yes, for full value of transfer	Yes, for seed funds	Yes, of PV, except 'zeroed-out' GRATs	Yes, for non-reversionary CLATs that are not 'zeroed-out'
Tax Treatment	Future income/sale proceeds taxed to beneficiary	Grantor trust	Grantor trust	Grantor or Non-grantor trust
'Freeze' Asset Value	Yes	Yes, when note is paid	Yes, once principal is paid and grantor survives	Yes
Mortality Risk	No	Yes, until note is repaid	Yes	Yes, for grantor CLATs
GST Exemption	Yes	Yes	No	Yes, subject to the adjusted GST exemption amount
Carryover Basis	Yes	Yes	Yes	Yes
Gift Tax Issues	Yes, file 709 if value exceeds annual exclusion or gift is asset other than cash/publicly traded securities	Yes, file 709 for seed funds	Yes, file 709; recommended even if 'zeroed-out'	Yes, file 709 for non-reversionary remainder interest
Valuation Rate	Fair market value	AFR (May 2020: mid-term 0.58%; long-term 1.15%)	§7520 rate (May 2020: 0.8%)	§7520 rate (May 2020: 0.8%)

Danger Ahead:

- Proposed legislation to eliminate basis step-up at death
- Would drastically increase taxation to heirs (on top of the impact of the SECURE Act)
- Tracking challenges across generations
- Could be in conjunction with decreased estate exemption
- Changes to "defective grantor trust" regime also possible

Polling Question #3

Recap of SECURE Act Provisions

Prior Law

- Required minimum distributions (RMD) required starting at 70 1/2
- Spousal rollover
- All non-spouse beneficiaries could stretch distributions over life expectancy
- Trust beneficiaries could also stretch over beneficiary life expectancies if certain rules met
- Unnamed beneficiaries or estates had to distribute within 5 years

New Law

- RMDs start at age 72 (2020)
- Spousal rollover
- Eligible beneficiaries can stretch:
  - Minor children (until age of majority)
  - Disabled or chronically ill
  - Within 10 years of age of IRA owner
- All other designated beneficiaries must take 100% out within 10 years
- All non-designated beneficiaries still distribute under prior law

Recap of SECURE Act Provisions (cont.)

- Note the new rule affects not only all IRAs, but all qualified defined contribution plans: (§401(k), 401(a), 403(b), 457(b), ESOPs, Cash Balance and Defined Benefit with lump-sum options)
- It applies to Taxable and Roth IRAs
- Note: TCJA income tax brackets expire 12/31/25
- Note: Possible Biden tax rate increases
- Now post-mortem tax brackets could be much higher to heirs

Retirement Plan Accumulation: RMD 70½ vs 72

- RMD would be at 72 versus 70½
- Still permitted to take earlier distributions
- Can contribute now to a traditional IRA (and Roth) after 70½:
  - Must have earned income
  - Both spouses can contribute
  - Only one spouse needs income

RMDs on IRA With a Balance of $500,000 at 70½*

Beginning at Age 70½

AGE	RMD AMOUNT	YEAR-END BALANCE
70½	$18,248	$510,657
75	$23,929	$555,477
80	$30,765	$577,215
85	$38,433	$562,196

Beginning at Age 72

AGE	RMD AMOUNT	YEAR-END BALANCE
72	$21,945	$572,246
75	$25,809	$599,126
80	$33,183	$622,572
85	$41,453	$606,373

*January 1 of the year you turn 70½. Assumes a 6% return. SOURCE: IRAHelp.com

There's More: SECURE 2.0 & Cardin-Portman

- Mandatory 401(k) (403(b) and SIMPLE) enrollment (plans established after 2021). Default 3%, increase 1% a year to 10%. Does not apply to existing plans.
- Gradually increases RMD age from 72 to 75. Age 73 in 2022, 74 in 2029 and 75 in 2032.
- Current catch-up contributions of $6,500. Increases to $10,000 for ages 62-64, starting in 2023. Effective 2022, all catch-up contributions must be Roth. In addition, an employer can amend plans to allow participants to elect Roth on all or a portion of matching contributions. (Match would be included in their taxable income).
- Part time: 500 hours in 3 years is now changed to 500 hours in 2 years for employees to able to participate.
- Matching contributions for student loan repayment.
- After-tax Roth to SEP and SIMPLE

Likely Impact: Non-spousal Beneficiaries

- This affects beneficiaries based on the balance at the death of the second spouse
  - <$100K, not significant problem
  - >$100K <$400K, manageable
  - >$400K, planning advised
- Choices:
  - For smaller balances: not much planning needed
  - For larger balances: Manage it (bracket topping, Roth IRA's, charitable planning, trusts)

Income Tax Planning

- Taxable IRAs: Bracket Topping
- Roth IRAs: Delay Distributions
- Ancillary effects on deductions, credits, state taxes, & Medicare premiums

Bracket-Topping

- Applies to spousal IRAs as well as other beneficiaries
- Taxable income is focus for planning, not AGI
- Take IRA distributions up to the edge of a target bracket
- Convert to Roth
- Spend or reinvest outside of IRA
- Spousal planning in year of death – deeper MFJ brackets

2021 Income Tax Bracket Thresholds				
	Single	Married Filing Jointly	Married Filing Separate	Head of Household
10%	$0	$0	$0	$0
12%	$9,950	$19,900	$9,950	$14,200
22%	$40,525	$81,050	$40,525	$54,200
24%	$86,375	$172,750	$86,375	$86,350
32%	$164,925	$329,850	$164,925	$164,900
35%	$209,425	$418,850	$209,425	$209,400
37%	$523,600	$628,300	$314,150	$523,600

Bracket Topping: RMD to Fund Roth Conversion

- Spouse, over 72, at top of 22% bracket
- Doesn’t like or need RMD
- Usually takes RMD and saves it
- Use RMD to pay taxes on Roth conversion
- Roth Conversion to the edge of the next bracket
- Example: RMD is $25,000
  - Withhold 100% for fed tax
  - In 24% bracket, withholding pays for RMD tax and $79,000 of Roth conversion
  - Used up full 24% bracket

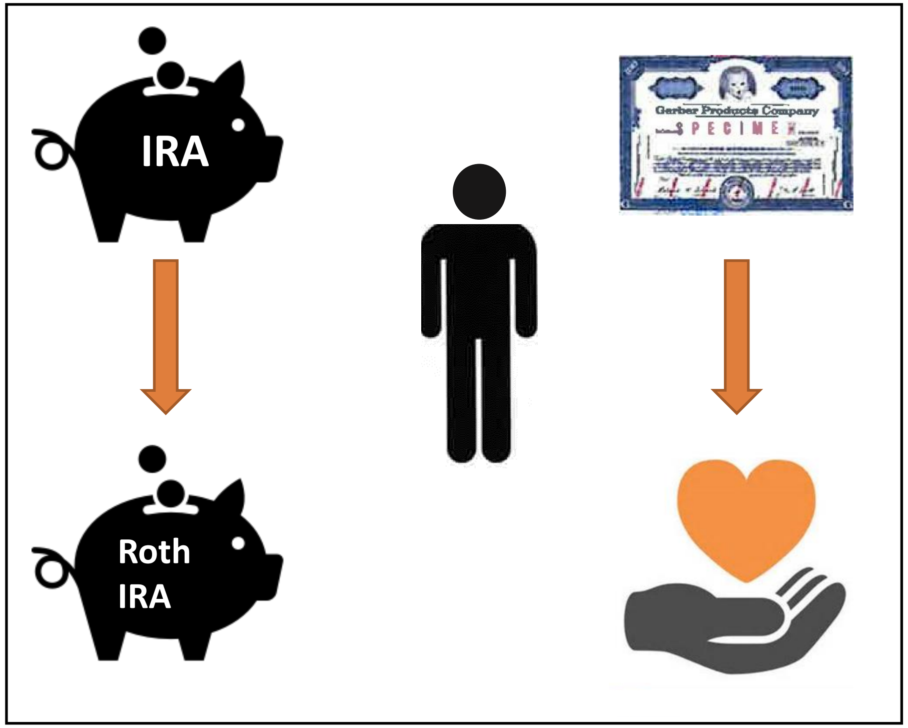
Polling Question #4

New Life for Roth IRAs

- Roth allows tax-free accumulation and tax-free distribution (after 10 years) to beneficiary
- RMD math shifts distribution higher and bracket creep on the horizon
- RMD for couple usually leaves one spouse single in higher bracket

Roth Charity Offset

- Concept: Use a charitable contribution to offset a Roth conversion.
- Convert $100K Traditional to Roth, creating $100K of income, then fund charitable contributions
- 2021 limit on cash gifts is 100% of AGI, or 30% on LTCG positions
- Will need other income to get the full deduction if use LTCG property



Roth Strategies: Mom Roth

- Older parent in lower tax bracket
- Taxable IRA
- RMD not needed
- Someone has funds to pay for conversion
- Bracket-top to the edge of next tax bracket

Roth Strategies: Kid Roth

- 16-year-old earns over $6,000 a year.
- Until age 25, mom or dad (or maybe grandma or grandpa) deposit $6,000 in a Roth, putting it in an index fund as a gift.
- Deposit at the beginning of the year, 6% annual return.
- Age 25, the Roth would contain about $79,000.
- Don't disturb until age, 65, the Roth would be worth over $813,000, tax-free, all from ten $6,000 contributions.
- Kids (or donor) continues to make contributions; the kid would have $1,637,000 at 65.
- Withdraw 4%, $65,510 a year tax-free during his/her retirement years.

Roth Funding

Type	Limit Per Spouse	Requirements	Stipulation
Contributory	$6,000 ($7,000 if 50+ or older)	Income <198-208K (MFJ) <125-140 (Single). At least one spouse must have earned income	Can do in addition to §401(k)
Back-Door Roth	$6,000 ($7,000 if 50+ or older)	No income limit. At least one spouse must have earned income	Be careful of other taxable IRA balances
§401(k), 403(b), 457 (b) Roth	$19,500 ($26,000 if 50+ or older)	After-tax Roth contribution	Roll to Roth IRA on retirement
Mega-Roth After-Tax in Plan	Up to $38,500	§401(k) must allow for it Plan testing	Must do salary deferral first
Roth Conversions	Unlimited	Must pay taxes	Taxes should be paid from non-deferral sources

What To Do: Roth Strategies

- **Age 72+:** Use QCD, possibly use RMD Roth strategy
- **Age 70 ½ - 72:** Delay RMD, bracket top to convert to Roth
- **Ages 60-70:** Optimum bracket topping Roth conversion period
- **Ages 50-60:** Roth IRA / 401(k), Back Door Roth, In plan-Mega Roth
- **Ages 40-50:** Roth IRA / 401(k), back-door Roth
- **Ages 30-40:** Roth IRA / 401(k)
- **Ages 20-30:** Roth IRA / 401(k)

Income Tax Planning: Ancillary Effects

- Most analysis done at Federal level, but don't forget to consider feedback effects on:
- Federal Tax Rates
  - Income threshold for Net Investment Income Tax of 3.8%
  - Taxability of Social Security
- Deductions & Credits
  - Impact on QBD for income from specified service businesses
  - Phaseout of itemized deductions or certain tax credits with income thresholds
  - May free up charitable carryovers as well
- State Income Taxes
  - Minor in most cases, but should be considered, particularly NY and CA residents
  - Move to nontaxing state during draw down of inherited IRA. (Puerto Rico?)
- Medicare Premiums – also affected by income levels, up to triple the base rate
- Best bet is to use a robust tax projection software like BNA Income Tax Planner

Polling Question #5

Estate Tax Planning

- Living Trust as IRA Beneficiary
  - Conduit trust
  - Accumulation trust
  - "See-through" trust rules
- Charitable Considerations
  - Qualified Charitable Distributions
  - Donor Advised Funds or Private Foundations
  - Charitable Lead Trusts
  - Charitable Remainder Trusts

Planning With Trusts

Conduit Trusts

- Standard living trust design in the past to allow for “stretch” over beneficiary lifetimes
- Written so that trustee takes RMD each year and distributes to each beneficiary
- If all requirement were met, allowed for stretch over beneficiary life expectancy (now 10 years)
- Results of this language may not be desirable under the new SECURE regime
  - Is trustee required under trust terms to take the RMD each year and pay it out to beneficiaries?

Accumulation Trusts

- Didn’t work as well in the past since an RMD was required each year, so not often utilized
- Now trustee has flexibility on when to take and retain IRA distributions within the trust / pay tax in the trust
  - Could allow trustee to maximize the benefit of tax brackets by making “bracket-topping” IRA distributions out to beneficiaries during the 10-year period
  - Or retain Roth IRA balance in trust growing tax deferred for 10 years, then distribute
  - Best practice would be to spell out in the trust any special powers related to the IRA assets
    - *Example: Trustee has the power to make distributions in accordance with beneficiaries’ personal tax situation*
- Gives trustee more control over spend thrift beneficiaries and retains creditor protection

Charitable Considerations

- Qualified Charitable Distribution (QCD)
- Direct transfer of IRA assets to a qualified public charity satisfy RMD requirements
- Maximum distribution is $100,000 per year per person, so a couple can fund up to $200,000
- Must be over age 70 ½ to make a QCD (did not change to 72)
- Beauty of this strategy is that it is not included in AGI or as an itemized deduction
  - Not included in Medicare premium calculation or taxable Social Security phase in
  - Charitable deduction can’t be phased out
  - Avoids state income taxes in states like Ohio

Charitable Considerations (cont.)

- **General Strategy for Taxable Retirement Accounts**
  - Goal is to maximize the use of the 10-year stretch
  - Execute bracket topping in years 1 through 9
  - In year 10, distribute the remaining IRA balance
  - Execute charitable gift in year 10 with a goal of minimizing income taxed in the highest brackets
  - Could be done with public charities, but there are several vehicles that can be used to enhance the basic strategy

Charitable Considerations (cont.)

- **Options for Taxable Retirement Accounts**
  - Donor Advised Fund
    - Simplest approach, maximum deductibility at 60% of AGI
    - Allows you to fund many years of future charitable contributions with tax efficiency
    - One twist would be to fund the DAF with appreciated stocks in year 10 and reinvest the cash IRA distribution with 100% tax basis
  - Private Foundation
    - Much more complex to set up and administer, but nice option if it already exists
    - Tax deductibility limited to 30% of AGI

Polling Question #6

Questions?

- **Leon LaBrecque**, Chief Growth Officer, ***Sequoia Financial Group***
  - 248.918.5905 | llabrecque@sequoia-financial.com

- **Scott Swain**, Partner, ***Cohen & Company***
  - 216.774.1262 | sswain@cohencpa.com

Check out: *"The GUIDE to Stretch IRA Rules Under the SECURE Act: What has changed and what to do"*

https://www.sequoia-financial.com/sites/default/files/docs/stretch-ira-guide.pdf

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