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PLAN FOR A LIFE WELL LIVED

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Prepare Clients Who Fear Their Heirs are Spendthrifts

By Howard Hook, CFP®, CPA, CAP®

Some investors don't want to immediately leave a large inheritance to their children or grandchildren because they fear the money will be spent quickly (and perhaps unwisely). So they've often had to decide what to do with their retirement plans, which comprise the largest assets held by many people.

Good estate planning for those in this situation often meant putting their retirement plan in trust rather than giving it outright to their children or grandchildren. The trustee would withdraw the required distribution from the IRA each year, temporarily deposit the funds into the trust account and then pass it on to their beneficiaries. This satisfied the tax rules, while also limiting the amount of money children or grandchildren could get their hands on at one time. The nice thing about this strategy was it could be done annually and stretched over the beneficiaries' life expectancy.

This was commonly referred to as a "conduit" trust because the trust acted as a conduit to pass through the required distribution from the inherited retirement plan to the child or grandchild.

For all retirement plans, other than Roth IRAs or Roth 401(k)s, income tax would be paid annually by the child (or grandchild) in this situation. What was not distributed annually could be left in the retirement plan to grow tax-deferred. This last part, however, bothered many in Congress, which led to tax changes.

Unintended Consequences

On December 20, 2019, Congress passed The SECURE Act, which changed the way certain beneficiaries were required to take distributions from retirement plans they inherited. Annual distributions are no longer required. Instead, for many beneficiaries, the entire account has to be fully withdrawn by the end of the tenth year following the year in which the original retirement plan owner died.

So how has this affected the so-called conduit trust? On one hand, no annual required distributions mean more money can stay in the retirement plan and out of the hands of the child or grandchild (or their creditors). Another benefit is investments in retirement plans can continue to grow tax-deferred. There is one major downside, however. Due to the way the conduit trust language was drafted, trustees are not permitted to make any annual distributions that were not considered "required distributions" under the tax code.

Since the only required distribution under the new law is in the tenth year following the year of death, trustees would be required to distribute the entire amount to the child or grandchild at that time. This could result in very high income taxes and also put significant assets at one time in the hands of the beneficiary – not exactly what was intended.

Lower Taxes, Less Protection

One solution to the problem has been to revise the terms of the trust so the trustee has discretion to make distributions from the IRA to the trust. This provides two benefits: It allows the trustee to make distributions throughout the 10 years to minimize taxes in the last year, and it allows the trustee to take a distribution from the IRA – leaving it in the trust rather than passing it on to the beneficiary. This provision protects the IRA from the child or grandchild.

However, there is a downside to leaving the distribution in the trust: Namely, higher income taxes. Distributions from the IRA to the trust that remain in the trust are taxed at trust tax rates. Trust tax rates are the same as individual tax rates, but trust income is taxed at these higher rates at much lower taxable income levels.

For example, someone filing an individual income tax return in 2021 pays tax at the highest tax rate of 37% only once their taxable income exceeds $523,600. Trusts pay income tax at 37% once the trust taxable income exceeds $12,950. This puts trustees in a bit of a quandary. If the goal is to minimize the amount of money distributed to

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Rules for Investing in the Stock Market

By Leo Chubinishvili, CFP®

Warren Buffet has two rules for investing in the stock market:
Rule Number 1: Never lose money.
Rule Number 2: Never forget Rule Number 1.

One of the world's most successful investor's philosophies seems like an excellent introduction to discuss the differences between *investing* in the stock market and *speculating*.

Simply put, investing involves acquiring an asset with the goal of appreciation and income. Speculating is about assuming substantial risk with the expectation of significant gain.

One involves an in-depth fundamental analysis of the investment. The other is more of a hunch, a roll of the dice, a gambler's "put everything on black" mentality with the hope of getting lucky.

One is science. The other is art.

Speculating vs. Investing

Speculating among younger, less experienced investors is on the rise. The COVID-19 pandemic certainly helped to fuel this. Many millennials - lacking diversions such as sports, bars, and other recreation - turned to day-trading without any experience or skill. Many used their stimulus checks to fund their day-trading experiment, and a lot of these amateur investors even made money. However, it's virtually impossible to do this consistently. Here's why.

Speculating is a bet. Inexperienced investors tend to invest in things and companies that make them feel good. They purchase stocks in anticipation of making a quick killing.

Emotional buying is one of the worst strategies an investor can employ. Equally dangerous is not having a game plan. For example, you may love technology, but investing everything you have only in technology stocks can be catastrophic when the sector suffers.

Investors must strategically think when buying and selling investments to be successful over the long term. Investing is purposeful and should be done with an investor's short and long-term goals in mind. Some of the most basic rules of investing for the best chance of success include:

- Focus on the long term
- Diversify your portfolio
- Don't buy (or sell) because everyone else is
- Never try to time the market
- Follow a disciplined investment approach
- Don't let emotions cloud your decisions

Benjamin Graham, the Father of Value Investing and Buffet's mentor, writes in his book, *The Intelligent Investor*, "If I observe the 65 miles per hour speed limit, I can drive the distance in two hours. But if I drive 130 miles per hour, I can get there in one hour. If I try this and survive, am I right? Should you be tempted to try it too because you hear me bragging that it worked? Flashy gimmicks for beating the market are much the same. In short streaks, so long as your luck holds out, speculating works. Over time, it will get you (financially) killed."

A good example of this is what happened to the stock market in 2020 and continues in 2021. During the height of the pandemic, the market dropped approximately 35 percent. Then, everything recovered. It was like catching trout in a fish-laden stream; you could not miss. People made money, but it also gave many a false sense of invulnerability. After all, how many times have you heard someone thrust out their chest and proudly exclaim, "I made a lot of money this year in the market." Unfortunately, we have heard this before – think back to the dot.com craze in the 1990s that eventually gave way to the dot.com bust.

Why Experience, Training, and Patience Makes a Difference

Registered Investment Advisors (RIAs), such as Access Wealth, approach investing differently. For starters, the approach is scientific and strategic. Investment advisors conduct an in-depth fundamental analysis of every investment they recommend, which could include mutual funds, ETFs, bonds, and stocks. Rather than investing based on a hunch, an RIA analyzes data and purchases investments in anticipation of long-term, steady growth.

On the other hand, amateur day-traders typically employ technical analysis when evaluating stocks, ETFs, commodities, etc. Technical analysis is the forecasting of future financial price movements based on an examination of past price movements. It can work, but technical analysis alone is not enough to earn profits over the long term.

Investment advisors understand that patience is a virtue. They are trained to make decisions based on in-depth analysis and not react to short-term market swings. They build portfolios that align with an individual's goals, giving them the best chance to succeed over the long term.

Unlike many investors who try to do it themselves, RIAs typically have access to a team of knowledgeable professionals with years of experience. At Access Wealth, we have an Investment Committee that regularly meets to discuss and analyze investments currently used by the firm as well as constantly evaluate alternatives. We choose investments that fit the Committee's mission to help clients meet their financial goals by providing them with investment strategies focused on the long-term perspective of the markets while delivering appropriate risk-adjusted returns as measured against industry-standard benchmarks.

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How to Cut Costs in Retirement

By Howard S. Milove, CPA, PFS

Once retired or planning to retire, you'll need to determine how you will pay your expenses when you no longer receive a regular paycheck. You may also want to consider how to cut costs in retirement.

Many retirees find themselves spending more money on vacations and entertainment after they retire. After all, you finally have time to do what you want, and you should enjoy your retirement years.

So, what are some of the ways you can cut costs in retirement? You might choose to downsize your home or move to a less expensive area, thereby reducing your mortgage payment and possibly freeing up capital that you can invest. If possible, it's always a good idea to pay off interest-bearing debt, such as credit card debt, to increase the amount of money you have available to you monthly. There's also the option of selling one of your cars if you don't think you'll need it.

An often-overlooked way to cut costs in retirement is to examine your insurance costs. What are you paying for, and do you need it at this time in your life?

Do You Need Life Insurance Once Retired?

Years ago, when your family was young, life insurance was critical to maintaining your family's lifestyle should you no longer be around. You needed it to provide cash flow to a dependent spouse and children, pay off liabilities like a home mortgage or college tuition, and, if desired, guarantee an inheritance to your beneficiaries. Not having sufficient life insurance was dangerous, living life with blinders on and simply praying for the best.

But now, if you have accumulated enough assets, your children are on their own, and your liabilities are paid, life insurance may no longer be necessary.

Is Disability Insurance Necessary Once Retired?

During their working careers, many people (particularly business owners) invested in private disability insurance. Disability insurance provides individuals with a revenue stream that replaces the loss of income should they become sick or injured and unable to work. Note that this is different than government disability programs.

Considering your disability insurance may be a moot point, as most disability insurance policies end at 65 years of age and may require you to be working to qualify. Often, those policies that do pay for older policyholders charge expensive premiums. Therefore, if you plan on retiring soon, it may make sense to terminate a private disability insurance policy.

So, now that we've established you can possibly cut costs in retirement by eliminating life insurance and disability insurance, let's discuss the insurance policies that you need to keep in your retirement years.

Health Insurance. Health insurance is expensive, but it's probably the most important insurance policy to pay for as you age. While you become eligible for Medicare at age 65, you may also need to pay for Medigap insurance to cover the gaps in costs that Medicare does not pay for.

Car Insurance. If you plan to continue to drive, you'll need to maintain your auto insurance policy.

Home Insurance. Whether you own or rent, you'll want to keep paying for homeowners' or renters' insurance to protect your personal property.

Umbrella Liability Insurance. Umbrella liability insurance pays for losses when your auto and homeowners' policy limits are exhausted. We recommend keeping this insurance, and if you don't have it, speak with your financial planner to discuss if it's right for you.

Long-Term Care Insurance. Long-term care insurance is a policy that many Americans don't carry but should as they get older. It is estimated that 52 percent of people turning age 65 will need some long-term care services in their lifetimes. Yet, only about 11 percent of this population carry long-term care insurance.

Health insurance does not cover custodial care (whether it is for home care or care provided in a nursing home or assisted living facility). Annual premiums run high but not as high as custodial costs, which can range from $3,000 to $12,000 a month depending on the level of care and where you live. These costs, which can last for years, can wipe out a family's savings. Owning long-term care insurance pushes the risk onto the insurance company, allowing your savings to be used by your spouse or passed on to heirs.

Retirement should be a time of enjoyment. However you choose to spend your days, you'll need to determine how to pay for retirement, and cut costs in retirement. Analyzing your insurance portfolio is a great place to start, as your insurance requirements may be very different than they were in the past.

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children or grandchildren, then more money may wind up staying in the trust and more taxes incurred. If tax minimization is the goal, then more money will need to be distributed to the children or grandchildren. Although this results in lower taxes, the inherited assets are less protected.

A Client's Dilemma

We had this potential situation with a client last year. Fortunately, the client is still alive so we had time to evaluate the different strategies. We worked with their estate planning attorney, who was able to draft a plan that makes sense under the current law.

Our client is widowed, with an estate worth approximately $9 million. Approximately $3 million is in a retirement plan; the balance of the estate consists of real estate and brokerage assets. The current estate plan left the retirement plan to a conduit trust created under the client's will, so the beneficiary would not inherit the retirement plan outright.

We ran some calculations using life expectancy assumptions for our client, as well as the projected growth in the retirement plan once the child inherited it. Our calculations showed a projected balance of close to $6 million at the end of the tenth year following the year we projected our client were to die. Under The SECURE Act, that amount would have then needed to be fully distributed with significant income tax paid on the distribution.

The estate planning attorney who worked with the client replaced the conduit trust language in the will to allow for discretionary distributions to be made by the trustee each year. This would allow the trustee to determine if it made sense to take distributions before the end of the tenth year and also to determine whether to keep the amount distributed in the trust (and pay income taxes at the trust rates) or pass it out to the child.

Our client wanted to provide for their three grandchildren so three additional discretionary trusts were created in his will, one for each grandchild. This gave the trustee the ability to pass out distributions to four trusts. Since each trust pays its own income taxes, this would allow more of the distribution to be taxed at a lower trust rate.

By the Numbers

Here is how that works: Passing out $48,000 to one trust would result in the amount in excess of $12,950 ($35,050) being taxed at 37%. But passing out $48,000 to four trusts ($12,000 to each) would keep each distribution amount to less than $12,950 and thus less tax would be paid.

The final thing we did was carve out some of the client's retirement plan and name two charities as beneficiaries of a designated amount. These two charities had been included in the original Will to receive direct bequests totaling $200,000. By removing them from the Will and instead carving out $200,000 of the retirement plan funds for them, it reduced the amount that would be required to be distributed in 10 years from the retirement plan.

We allowed the $200,000 of direct bequests instead to go to the child and grandchildren. This resulted in a better tax outcome for their child and grandchildren because those direct bequests would receive a stepped-up basis, eliminating much and maybe all of any taxable gain under current law.

The last part of the new plan was a bit tricky. As you probably can see by now, the use of a discretionary trust makes decisions more complicated for the trustees. Unlike a conduit trust where the trustee only had to make the required distribution each year, the decisions they need to make with a discretionary trust include whether to make a distribution in a given year *and* whether to distribute any of that amount to the beneficiary, or keep it in trust. The trustee presumably would need to have knowledge of the tax code — or at least have access to someone who does — to help make those decisions. And who would let the trustee know that these decisions even had to be made?

Reach Out to Clients

That was resolved by letting those individuals who were being named as trustees know who they could reach out to if they had any questions about their duties. Fortunately, in this case, we knew the trustees and the estate attorney well, so we facilitated the conversation.

I fear there are many people in similar circumstances, who under the new law could end up with adverse tax consequences or, even worse, assets going to heirs who may mismanage them. In the next few months, we will likely see other changes to the estate laws that may have additional adverse effects on estates. Now is the time to reach out to your wealth advisor. Together, we can ensure you efficiently pass your assets down to your heirs.

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Rules for Investing...

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There is a significant difference between how investment advisors build portfolios and how a day-trader builds a portfolio. One of the best ways to invest for the long-term is to invest in a diversified portfolio where not all the investments go up together and not all the investments go down simultaneously. This method helps to protect your portfolio from large market swings. Your asset allocation should be directly tied to your personal and financial goals.

Speculators, by definition, never make investments hoping those investments do not all go up at the same time. On the contrary, that is precisely what they hope for. This also means everything can go down together. The latter is never contemplated by the speculator who thinks that successful investing is where everything always goes up. But as Benjamin Graham said, "You must never delude yourself into thinking that you're investing when you're speculating."

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