WEALTH MANAGEMENT **ADVISOR**

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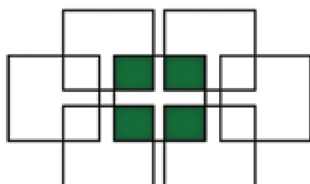
RMDs ARE BACK

Here's how to soften the tax blow



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RMDs are back

Here's how to soften the tax blow

To provide some relief during the COVID-19 pandemic, the CARES Act suspended required minimum distributions (RMDs) from traditional IRAs and employer-sponsored retirement plans for 2020. No such relief is available in 2021. Therefore, many retirees will need to take taxable RMDs by the end of this year. Fortunately, a couple strategies are available to help you soften the tax blow.

Reviewing the rules

If you have savings in a traditional IRA or employer-sponsored retirement plan, such as a 401(k) plan, you must take RMDs every year beginning at age 72 (70½ if you reached that age by December 31, 2019). If you were subject to RMD requirements before 2021, you'll need to take an RMD by December 31, 2021. If you're turning 72 in 2021, you have until April 1, 2022, to take your first RMD. After that, you must take RMDs by the end of each year, beginning with December 31, 2022.

RMDs must be taken on time. The penalty for missing one is 50% of the amount you should have withdrawn. That amount is calculated by taking your retirement account balance as of December 31 of the previous year and dividing it by your IRS-prescribed life expectancy as of December 31 of the current year. For example, if your account balance was $700,000 on December 31, 2020, and your life expectancy as of December 31, 2021, is 21.5 years, then this year's RMD is $32,558.14 ($700,000/21.5). If assessed, the penalty for not taking this RMD could be $16,279!

SO YOU'RE NEARING RETIREMENT …

If you're only a few years away from retirement, now's an ideal time to consider several strategies for managing required minimum distributions (RMDs) down the road. One option is to start withdrawing retirement funds early (so long as you're older than 59½ and won't be penalized for doing so). Although this will accelerate some of your tax liability, it allows you to spread distributions over a longer period, potentially minimizing undesirable tax consequences. It also reduces your account balance, lowering your RMDs once you reach age 72. But look at current tax rates and compare them with what you expect in later years.

Another possibility is to convert a portion of your traditional IRA assets into a Roth IRA. Roth IRAs aren't subject to RMDs and you're allowed to make tax-free withdrawals from them. If you transfer to a Roth, you'll have to pay tax on the converted amounts up front. But you might be able to minimize taxes by converting the account gradually over several years.

Strategies to consider

Unless you need the money for living expenses, try to minimize or defer RMDs as much as possible. Doing so reduces the impact on your tax bill and allows your savings to grow and compound on a tax-deferred basis as long as

possible. You might be able to take advantage of one or more of the following strategies:

Take your first RMD early. If you're turning 72 this year, you have until April 1, 2022, to take your first RMD. But that means you'll have two RMDs next year (April and December), which could push you into a higher tax bracket. It may be preferable, therefore, to take your first RMD in 2021, even though it'll increase this year's taxable income.

Name your spouse as sole beneficiary. If your spouse is more than 10 years younger than you and is your sole beneficiary, you can use your joint life expectancies to calculate your RMD. This will increase the life expectancy factor and reduce the annual RMD amount.

Make a qualified charitable distribution (QCD). If charitable donations are already part of your plan, consider donating a QCD from a traditional IRA rather than other assets. This technique allows you to transfer up to $100,000 per year tax-free directly to a qualified charity and apply that amount toward your RMD. Because the funds bypass your taxable income, it's the equivalent of a charitable deduction. But using a QCD is a more effective strategy if an ordinary charitable gift wouldn't be fully deductible (for example, because you don't itemize) or if an RMD would trigger undesirable tax consequences.

Note: QCDs aren't available for employer-sponsored plans, but it still may be possible to take advantage of this technique by rolling the funds into an IRA.

Invest in a qualified longevity annuity contract (QLAC). You can fund a QLAC with the *lesser* of 25% of your retirement account balance or $135,000 (in 2021). RMDs on those funds are deferred until the annuity payments begin (at age 85), reducing your RMDs at ages 72 through 85.

Continue working. If you keep working (and you don't own 5% or more of the company you work for), your employer-sponsored plan may permit you to defer RMDs until April 1 of the year following the year you retire. This option is available only for your current employer's plan, not for previous employers' plans or IRAs. However, some plans may allow you to roll over funds from those accounts and defer RMDs.

Have a plan

There's one piece of good news: Starting in 2022, the IRS will use new tables with longer life expectancy factors, which can have the effect of reducing RMDs. Even so, it's important to have a plan to ensure that you avoid tax penalties, minimize your tax costs and maximize the value of your retirement accounts. Discuss these issues with your financial or tax advisor. ■

Choosing your retirement destination based on taxes

If you're contemplating retiring to another state, there are several factors to consider — for example, climate, proximity to family and friends, cultural attractions, housing costs, health care quality, and transportation access. Taxes may be another factor. But assessing a state's tax-friendliness is less straightforward than you might initially think.

Look beyond income

Many people deem a state "tax-friendly" if it has a low (or no) income tax. But to understand the potential impact of a state's tax laws you'll need to look at the big tax picture and consider property, sales, estate, investment and other taxes.

It's also important to consider your financial goals. For example, if your primary goal is to maintain or improve your standard of living, income and investment taxes may be most relevant. On the other hand, if you're most concerned about leaving as much wealth as possible to your heirs, you may prefer a state with no estate or inheritance taxes. Of course, a few states offer the best of both worlds: No income tax and no estate or inheritance tax.

Sources of income may also factor into your decision. Will you continue to work or will you live off your retirement savings right away? Some states impose no income tax on wages but do tax interest and dividends. And a few states without an income tax have "intangibles" taxes based on the value of certain investments or other property. Even if a state has an income tax, it's important to read the fine print. Certain types of income may be tax-exempt, such as Social Security, pensions or retirement account distributions.

Don't overlook local taxes, such as property, sales, and even income taxes. These can vary dramatically depending on where you live in a state. And many budget-strapped cities and towns have raised these taxes in recent years to increase revenue.

Watch out for multistate taxation

Don't assume that moving to a new state means that your old state's tax laws immediately cease to apply to you. If you maintain a residence in the old state and continue to spend a significant amount of time there, it's possible both states will impose their taxes on you. Most states provide tax credits to avoid double taxation, but those credits aren't always available. Even if they are, they may not fully offset your increased tax.

To avoid or minimize the potential for multistate taxation, take steps to establish domicile and residence in the new state. A full discussion of these steps is beyond this article's scope, but they include:

- Buying a home,
- Obtaining a driver's license,
- Registering your vehicles,
- Registering to vote, and
- Opening a bank account in the new state.

Even if you successfully change your domicile and residence, remember that many states apply their income, estate or inheritance taxes to property located in the state, regardless of the owner's location. So, for example, if you move from State A, which has a substantial estate tax, to State B, which has no estate tax, you may remain subject to State A's estate tax on real estate you own there. Potential options for avoiding State A's estate tax may include selling the property and reinvesting the proceeds in State B or, depending on applicable law, transferring title to the property to a trust or LLC established in State B.

Don't assume that moving to a new state means that your old state's tax laws immediately cease to apply to you.

Do the math

Taxes usually aren't the most important factor in deciding where to retire. But if they're a concern, your tax advisor can help you compare various states' tax-friendliness and show you how those taxes are likely to affect your retirement and financial planning goals. ■

Is your revocable trust fully funded?

If your estate plan documents make use of a revocable trust (also known as a "living trust"), you need to ensure that the trust is fully "funded." When properly structured, revocable trusts can provide significant benefits, including the ability to avoid probate of the assets they hold and facilitate management of your assets in the event you become incapacitated. However, these benefits aren't automatic. You must fund the trust, which means transferring title of assets to it or designating it as the beneficiary of retirement accounts or insurance policies.

Avoid probate and more

For larger estates, a revocable trust generally is the most effective tool for avoiding probate. It involves some setup costs but allows you to manage the disposition of all of your wealth in one document while retaining control and reserving the right to modify your plan. As the "grantor," you can instruct the trustee how and when to distribute the trust's assets and you usually can revoke the trust at any time.

To avoid probate, it's critical to transfer title to virtually all of your assets — now and in the future — to the trust. Assets outside the trust

at your death will be subject to probate unless you've otherwise titled them in such a way as to avoid it (or, in the case of life insurance, annuities and retirement plans, you've properly designated beneficiaries).

Undesirable outcomes

What happens if a revocable trust isn't funded? Say, for example, you acquire new assets but fail to transfer title to the trust or name it as beneficiary. Not only will those assets be subject to probate, but they'll be beyond the trust's control in the event you become ill or disabled and unable to manage your own financial affairs. To avoid this result, it's a good idea to take inventory of your assets periodically and ensure that your trust is fully funded.

Another important reason to fund your trust is the ability to maximize FDIC insurance coverage. Generally, individuals enjoy FDIC insurance protection on bank deposits up to $250,000. But with a properly structured revocable trust account, it's possible to increase that protection to as much as $250,000 per beneficiary, up to five beneficiaries, regardless of the dollar amount or percentage allotted to each unique beneficiary.

For instance, if your revocable trust names five beneficiaries, a bank account in the trust's name is eligible for FDIC insurance coverage up to $250,000 per beneficiary, or $1.25 million ($2.5 million for jointly owned accounts). For informal revocable trust accounts, the bank's records, though not the account name, must include all beneficiaries who are to be covered. FDIC insurance is provided on a per-institution basis, so coverage can be multiplied by opening similarly structured accounts at several different banks.

Keep in mind that FDIC rules regarding revocable trust accounts are complex, especially when a trust has more than five beneficiaries. So be sure to consult your financial advisor to maximize insurance coverage of your bank deposits.

Achieve several goals

Avoiding probate is just one part of estate planning. Each financial situation is unique, so consult with your legal, tax or financial advisor. Your advisor can help you develop a strategy that uses a revocable trust and other tools to minimize probate, reduce taxes and achieve other goals. ■

ESG investing

Why you don't have to sacrifice returns

Environmental, social and governance (ESG) investing has been around for decades. But only in recent years has it taken off with investors. And the growth in the number of ESG options is expected to build under the Biden administration. Let's take a look.

Laggards no more?

At one time, ESG (also referred to as socially responsible, sustainable, and impact investing) was viewed as requiring a tradeoff. Many investors thought that buying stock of companies whose values align with their personal values meant sacrificing performance. But potentially achieving increased investment returns (doing well) and investing responsibly (doing good) no longer have to be mutually exclusive.

One explanation for this change is that ESG funds are more widely available today. According to a recent report by the U.S. Forum for Sustainable and Responsible Investment, from 2018 to 2020, the value of U.S. assets under management that use socially responsible strategies increased from $12 trillion to $17 trillion. This represents one-third of all U.S. assets under professional management.

Also, portfolios that buy stocks that, in addition to meeting certain financial characteristics, meet selected ESG criteria, outperformed during the COVID-19 pandemic. Investment research company S&P Global, analyzed 26 exchange-traded funds (ETFs) with more than $250 million in assets and that screened stocks based on sustainability, disclosure practices, fossil fuel exposure, workplace diversity and other ESG factors. It found that between March 2020 and March 2021, the ETFs rose between 27.3% and 55%, compared with 27.1% for the S&P 500 index.

It should be noted that this is a relatively small time period. Results may be different over longer periods, and past performance doesn't guarantee future results.

Accelerating trend

The popularity of ESGs may accelerate during the next four years. Many of President Biden's appointees are committed to environmentally and socially responsible issues. For example, Brian Deese, director of the National Economic Council, previously served as the global head of sustainable investing at BlackRock, the world's largest asset manager.

It's important to note that ESG investments aren't only for Democrats or social progressives. Some ESG portfolios invest according to the teachings of specific religious denominations. Others avoid alcohol and tobacco stocks.

Explore your options

If you're interested in investments that better reflect your personal values, contact your financial advisor to discuss options. There are no guarantees that returns on these investments will meet or beat those of major indexes. And, as with any investments, there's a risk that you can lose part or all of the money you've invested. ■

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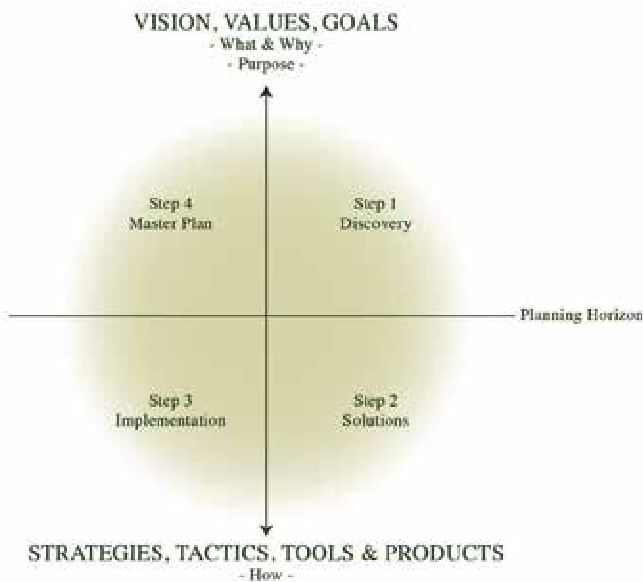

The Integrated Planning Process™

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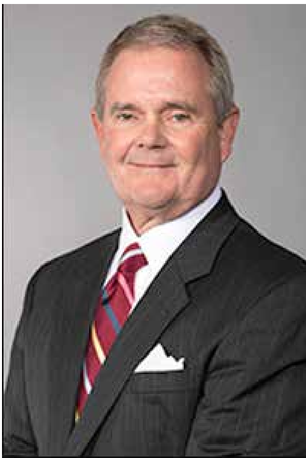
Through this experience, we have developed a process that provides a strategic approach to addressing the important financial concerns that our clients encounter. This unique four-step process, The Integrated Planning Process™, assists our clients in gaining clarity and insights as to their Vision and Goals for themselves, their family, their business and their community.

We believe that success breeds success. While we acknowledge there are many qualified advisors to choose from, very few can match the combination of our experience, resources, perspective and success.

Meet Michael



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