INSIGHT ON ESTATE PLANNING

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ESTATE PLANNING PITFALL
You haven't updated your estate plan after a move

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The return of RMDs

COVID-19-related suspension of RMDs is a thing of the past

The temporary reprieve is over. Due to the COVID-19 pandemic, Congress suspended the rules for required minimum distributions (RMDs) in 2020, including inherited accounts. But the rules have been restored for the 2021 tax year. Essentially, participants in qualified plans and IRAs who've reached their required beginning date must take 2021 distributions or potentially pay a hefty penalty.

The deadline for RMDs is December 31, 2021 (later for those that reach the required age in 2021), but you should get your ducks in a row before then.

Starting point

Be aware that the RMD rules apply to employer-based retirement plans — including pension and profit-sharing plans, 401(k) plans, 403(b) plans for nonprofits and 457(b) plans for government entities — as well as traditional IRAs. Roth IRAs — other than those that are inherited — are exempt from distributions.

Previously, the required beginning date for participants in these plans was April 1 of the year following the year in which you turned age 70½. However, the Setting Every Community Up for Retirement Enhancement (SECURE) Act pushed the required beginning date to age 72, as of 2020. Therefore, if you turn 72 this year, you must begin taking distributions from qualified plans and IRAs by April 1, 2022.

But remember that RMD rules continue to apply for each succeeding tax year with a deadline of December 31. Thus, for the 2022 tax year, the usual deadline for RMDs is December 31, 2022. So, if you're turning age 72 in 2021, you may end up taking two year's worth of RMDs in the same tax year.

To avoid this scenario, you might arrange to receive your initial RMD in 2021. Calculate your tax liability both ways before the clock strikes twelve on December 31.

When one RMD is enough

Generally, IRA participants take a required minimum distribution (RMD) annually from *each* account to meet their obligations and avoid penalties. But it doesn't have to be that way.

If it suits your purposes, you can arrange to receive the total amount required from just one IRA (or perhaps two or three). It doesn't matter where you take the money from as long as at least the minimum amount of total dollars is paid out. This could be preferable based on investment performance in various accounts.

This option generally isn't available for qualified plans like 401(k) plans. RMDs must be taken separately from each of these plan accounts.

Ins and outs of withdrawals

How much is your annual RMD? It depends on the value of the account on December 31 of the prior year. In other words, your RMD for 2021 is based on the account balance as of December 31, 2020. The IRS has created tables for calculating your RMD, but you may also use an online calculator or have your financial advisor perform the calculations for you.

Depending on your situation, you may be able to "pick your poison" when it comes to taking distributions if you own multiple accounts. (See "When one RMD is enough" on page 2.)

Of course, there's nothing stopping you from taking more than the required amount based on the IRS tables. Just be aware that this reduces your nest egg for the future and should be accounted into your estate plan.

If you fail to meet your RMD obligations, the IRS can impose a steep penalty equal to 50% of the amount that should've been withdrawn (reduced by any actual withdrawals). For example, if the required withdrawal is $20,000 and you took out only $5,000, the penalty is $7,500 (50% of $15,000) — that's in addition to the regular income tax you owe on the distributions.

Other factors to consider

You don't have to take RMDs from a qualified plan of an employer if you still work full-time for the employer and you don't own more than 5% of the company. But this "still working exception" applies only to qualified plans such as 401(k) plans — not IRAs.

Alternatively, you might transfer up to $100,000 directly from an IRA to a charity without paying any federal income tax on the distribution ($200,000 for a married couple if both spouses separately qualify). But these "qualified charitable distributions" (QCDs) aren't tax deductible, even if you itemize.

Extra tax incentive: QCDs count as RMDs that can satisfy your obligations for the year.

For inherited accounts where the original owner died after 2019, a nonspouse beneficiary is generally required to complete withdrawals by December 31 of the tenth year after the original owner's death. RMD rules for accounts inherited prior to 2020 are calculated differently.

Note, though, that if the account owner dies after the required beginning date, and hasn't taken an RMD for the year of death, then the beneficiaries of the account must take the account owner's RMD as a distribution for that year.

Spousal beneficiaries have greater flexibility than nonspousal beneficiaries, including being able to treat the account as his or her own, regardless of when the original owner died.

Year end is approaching

The temporary, one-year reprieve for taking RMDs has passed. Make arrangements now for your RMD in advance of the December 31 deadline. Also, confirm the required amount with your advisor to ensure you're not overpaying yourself. •

Protecting business wealth from creditors

If you're a business owner, you've likely worked long and hard to achieve your goals. It would be a shame if creditors were able to reach your assets before you've transferred wealth to the younger generation. Fortunately, there are several options to consider that may provide asset protection.

The need for an asset protection plan

Before digging deeper, you should start with an understanding that an asset protection plan is needed to insulate your estate from the claims of creditors and lawsuits. The first lesson to be learned is easy: Don't think this can't happen to you. In fact, no one is immune.

When you create an asset protection plan proactively, you add a layer of protection before any claim or lawsuit arises. This can deter creditors and possibly thwart the seizure of assets. The sooner you act, the better.

There are, of course, various strategies you might employ based on your circumstances. Some popular ideas revolve around the form of business ownership and the use of trusts.

3 forms of business ownership

Depending on the structure of your business, you may have adequate protection from creditors, minimal protection or none at all. Thus, you might consider changing the ownership structure to create a corporate shield. Let's briefly review the three primary forms of ownership:

C corporation. Generally, a C corporation provides limited liability exposure to the personal assets of its principals. There's no personal liability for corporate debts, contract breaches or personal injuries to third parties caused by the corporation or its employees. So a creditor can't seize your personal assets if the corporation can't pay its bills. This is a distinct advantage over traditional partnerships.

But be aware of an exception for certain personal services. For example, a physician might be held personally liable for damages incurred while performing services on behalf of a medical practice. In other situations, personal liability may be attached if the corporation has no significant assets and doesn't really act as a separate entity.

S corporation. With an S corporation, income and losses are passed through to shareholders on a personal level, thereby avoiding "double taxation" faced by C corporations. Like a C corporation, however, shareholders benefit from some corporate liability protection, albeit with additional limits as to the number and type of shareholders, allocation of profits and losses among shareholders, and the type of stock that may be issued to investors. For many business owners, an S corporation is the preferred choice.

Limited liability company (LLC). An LLC operates much like an S corporation without some of the extra formalities. Significantly, LLC principals are afforded the same liability protection as those in a C corporation, along with the favorable "pass-through" tax benefits available to an S corporation.

Note that filing requirements and creditor protections for LLCs may vary from state to state. Nevertheless, state laws generally protect personal assets of LLC owners from claims based on LLC activities.

Trusts and FLPs

One of the tried-and-true methods for protecting assets from creditors is to establish a trust and then transfer assets to it. The trust is managed by your designated trustee for the benefit of the trust's beneficiaries.

Trusts come in a wide range of shapes and sizes. An "inter vivos" trust is created during your lifetime while a testamentary trust comes into being upon your death through a provision in your will.

The types of trusts are too long to describe here, but they may be divided between revocable and irrevocable trusts. As the name implies, revocable trusts generally permit you to change beneficiaries and make other modifications.

With an irrevocable trust, you concede full control. From an estate planning perspective, an irrevocable trust is advantageous because creditors can't touch assets you don't control.

Similarly, a family limited partnership (FLP) may be a viable approach for providing protection against creditors as well as tax benefits. With an FLP, a business owner transfers assets to other family members (the limited partners) without relinquishing full control of the operation. Any subsequent earnings are taxed to the family members, so if they're in a lower bracket there may be an additional tax-savings benefit.

Furthermore, FLP shares may be discounted in value because there's no public market for the shares. This enables the owner to shift even more business assets to the younger generation.

Assess your options

An asset protection plan is essential for business owners who are seeking to preserve and ultimately transfer wealth. Keep in mind that, for these strategies to work, you must implement them at a time when there are no pending or threatened claims against you. Otherwise, you may run afoul of fraudulent conveyance laws. Discuss your asset protection options with your estate planning advisor. •

Behold the 21st century will: the e-will!

A will is commonly drafted in a lawyer's office in the presence of witnesses and a notary public. However, this scene is slowly changing with the rising popularity of electronic wills (e-wills). Before you choose to use an e-will, it's important to learn their advantages and disadvantages.

States that allow e-wills

As of this writing, there are four states that permit e-wills by statute (Nevada, Florida, Indiana and Arizona). In addition, the Uniform Law Commission (ULC) has issued the Uniform Electronic Wills Act (E-Wills Act).

The ULC isn't a legislative body. It's a non-profit organization that "provides states with nonpartisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law." A uniform law doesn't apply in a given state unless the state adopts it, and lawmakers are free to modify the law's language as they see fit.

Understanding the E-Wills Act

The E-Wills Act is designed to allow participants in the estate planning process (lawyers, clients, witnesses, notaries) to create, transfer, sign, and record wills and other documents in electronic form, while preserving traditional protections against undue influence and fraud.

Although the rules will vary from state to state, the E-Wills Act contemplates that any requirement that witnesses be in the physical presence of the client will be supplemented by an "electronic presence" option. The act defines electronic presence as "the relationship of two or more individuals in different locations communicating in real time to the same extent as if the individuals were physically present in the same location."

What are the pluses and minuses?

E-wills offer several significant advantages, including:

Convenience. People who are elderly or have health problems that make it difficult to travel can review and execute wills and other estate planning documents from the comfort of their homes, without the need to send paper documents back and forth. Similarly, people who live in rural areas, or otherwise lack easy physical access to lawyers, notaries and witnesses, can execute these documents in a matter of minutes rather than hours or days.

Encouragement of estate planning. Millennials and other young people are accustomed to the speed and convenience of online transactions, so the availability of e-wills may encourage them to plan their estates earlier than they would otherwise.

Security. E-will laws that incorporate fingerprint scanning (or other identity verification procedures), archived video recordings and other security features provide some protection against fraud and abuse.

Potential disadvantages include:

Uncertainty. Will states without e-will laws recognize e-wills that were executed in other states?

Cybersecurity issues. As with any type of online transaction, hacking and identity theft are a concern, so it'll be critical for vendors that provide e-will services to incorporate robust security features into their offerings.

Susceptibility to fraud and undue influence. Some have expressed concern that e-wills will be more susceptible to challenges based on fraud or undue influence. But others believe that these concerns generally revolve around the possibility that people will execute e-wills without involving an attorney.

The first disadvantage — uncertainty over whether e-wills will be recognized by other states — is particularly relevant if you execute an e-will in a state that allows it, but later move to another state that does not. Although the E-Wills Act contemplates that the second state would give effect to the e-will under the laws of the first state, some states may not be so inclined.

Seek professional advice

It's sometimes hard to break tradition and embrace new technology, but using an e-will can offer great convenience. Before taking any action, though, discuss with your attorney whether an e-will makes sense for your situation. •

ESTATE PLANNING PITFALL

You haven't updated your estate plan after a move

Are you planning to move to a different state? It may be due to a change in jobs, a desire for a better climate, an opportunity to downsize or to be closer to your kids. In any event, you'll have to cope with some hassles, including securing motor vehicle registrations, finding new physicians and updating financial records.

Here's some practical advice: Don't forget to amend your will and other estate planning documents. It doesn't have to be the first thing you do, but it shouldn't be the last, either.

Remember that the laws governing wills, as well as most other estate planning documents, vary from state-to-state. Although your will is still generally valid, you may need to take extra steps to ensure complete enforcement. For example, depending on your situation, you might consider appointing a different executor. And, in extreme cases, some estate planning documents may be called into question.

Furthermore, state laws for estate planning are constantly changing. This could adversely affect the implementation of your will, trusts, powers of attorney and medical directives. You may no longer be able to achieve the intended results or you might have to forfeit certain tax benefits. In a worst-case scenario, your documents could be rendered obsolete. Also, consider the state tax impact on pensions and other retirement plan accounts.

The optimal approach is to review your estate plan with your estate planning advisor *before* relocating to determine if any changes will be needed.

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What is Going on with the Federal Estate Tax Exemption Amount?

When a change in presidential administration occurs, like clockwork there is discussion of what will happen to the federal estate tax exemption amount. The federal estate tax exemption amount being the amount that a person can pass free of estate tax to their heirs and beneficiaries. In some instances the speculation is on point, such as when the Obama administration raised the exemption amount to $5 million with the 2010 Tax Relief Act, or the Trump administration doubled the exemption amount to $10 million (currently $11.7 million indexed for inflation) with the Tax Cuts and Jobs Act of 2017. At other times, policy makers seem to forget about estate and gift taxation and focus their policy changes elsewhere, such as on income tax.

This time around there have already been murmurs and, indeed, proposals for change. Senator Bernie Sanders released a proposed bill in March that, among other things, would reduce the estate tax exemption amount to $3.5 million and the gift tax exemption amount to $1 million. The proposal also increases the estate tax rate (currently at 40%) to a base rate of 45%, to be increased to 50% for amounts exceeding $10 million, and 65% for amounts over $1 billion. To be clear, this proposal would not affect the Washington State estate tax exemption amount, currently at $2.193 million.

The Sanders proposed bill, as written, would go into effect January 1, 2022. The significant drop in the exemption amount would leave many clients facing new estate tax dilemmas and the imminent effective date leaves little time for planning. To make matters more complicated, it is quite possible the bill never gets passed. If the Sanders bill doesn't become law, the $11.7 million dollar exemption is set to be cut in half on January 1, 2026, but even that isn't a guarantee since new legislation is always possible.

The takeaway from all of this is that we just don't know what is going to happen with the exemption amount. So, what is the savvy estate planner to do. The most important thing anyone can do is to review their estate plan with their attorney to see if these potential changes will have an impact on them. If so, it might be possible to do some planning now in order to be ready if changes occur. While there is usually some advance warning before a change in the tax code takes place, the warning can be minimal. In case it is, it is best to be ready. As an example, many effective tax planning strategies to deal with a decreasing exemption amount utilize gifts to irrevocable trusts. If an irrevocable trust is set up in advance and funded with a small amount of seed money, it makes transferring significant amounts of money to the trust on short notice much more possible.

If you have questions about potential changes to the estate tax exemption amount or think the potential changes may affect you, we at Stokes Lawrence would be happy to assist. Please contact a member of the Stokes Lawrence Estate Planning Group at (509) 853-3000 in Yakima or (206) 626-6000 in Seattle.