INSIGHT ON ESTATE PLANNING

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When is the right time to begin receiving payments?

Are you nearing the time when you can begin receiving Social Security retirement benefits? You deserve it after paying into the system all these years. But the monthly amount you're entitled to collect, as well as how long you receive benefits, depends on when you officially apply for benefits.

This isn't an easy decision, and it can affect retirement and estate planning techniques for both yourself and the rest of your family. Let's review the main options at your disposal.

Timing is everything

The Social Security Administration (SSA) says you're entitled to receive 100% of the benefits based on your earnings history at full retirement age (FRA). The FRA, which is based on the year of your birth, ranges from age 65 for those born in 1937 or earlier to age 67 for individuals born in 1960 or later. For Baby Boomers born between 1943 through 1954, the FRA is age 66.

But you don't have to wait until your FRA to receive benefits. In fact, you can elect to begin taking benefits as early as age 62, although monthly benefits will be reduced. The monthly reduction can be as much as 25% of the FRA amount. The closer you apply to your FRA, however, the lesser the reduction.

Conversely, if you choose to delay benefits, you'll receive a higher monthly amount than the FRA amount. Essentially, your benefits are increased by 8% for each year you delay taking benefits until age 70. Thus, the maximum increase for Baby Boomers with an FRA of 66 is 32%. Once you reach age 70, the benefits are maxed out.

Two Social Security loopholes closed

As you plan your estate and factor in your Social Security benefits, bear in mind that two popular strategies are no longer available:

1. File-and-suspend strategy. Previously, a higher-earning spouse could first apply for benefits at full retirement age (FRA) and then suspend them, thereby earning Social Security credits until age 70. In the meantime, the lower-earning spouse would claim benefits based on the higher-earning spouse's earnings history.

2. Restricted application strategy. A spouse who was approaching FRA could file a restricted application for spousal benefits only. Then the spouse would wait until age 70 to apply for benefits based on his or her own history. This enabled the spouse's Social Security credits to continue to grow.

Even though both strategies are no longer available, the laws still provide plenty of flexibility.

Factors to consider

Should you opt to begin receiving benefits before your FRA or hold off? One thing to consider is the fact that you may live longer than you initially thought because of medical advances. If this occurs, it'll further stretch the resources needed to sustain a comfortable retirement. On the other hand, you might decide to retire early and rely on benefits while you're still enjoying good health. Applying for benefits at your FRA may be a reasonable compromise.

Every situation is different, but let's take a look at several key factors that may affect your decision:

Accumulated assets. Do you have enough funds to live on if you choose to apply for benefits early? You may have heard horror stories about people outliving their savings late in life. However, consider if you'll be spending less in retirement, so your needs won't be as great. Furthermore, if you're investing at least part of the benefits, you're putting more money to work for you.

Breakeven point. At some point, you'll come out ahead dollar-wise if you delay benefits (and you live long enough). This "breakeven point" depends on the amount of your benefits and assumptions used to account for taxes and investment opportunities. The SSA provides an online calculator to help calculate your personal breakeven point.

Spousal benefits. Don't forget to factor your spouse into the equation. The amount of survivor benefits for a spouse who's earned little during his or her working years may reflect the record of a deceased spouse's benefit.

Earnings test. If you receive Social Security benefits before your FRA, they will be reduced if you continue to work. Under this "earnings test," you must forfeit $1 in benefits for every $2 earned above an annual limit ($16,920 for 2017) divided by 12. Thus, if you earn more than $1,410 per month your benefits

will be phased out. In the year in which you reach your FRA, the reduction is $1 in benefits for every $3 over another limit ($44,880 for 2017), although it applies only for earnings prior to reaching your FRA. After you reach your FRA, there's no reduction in benefits. Thus, in that year, if you earn $44,880 prior to your FRA and another $44,880 after your FRA, there's no reduction. Also keep in mind that the reduction isn't permanent. The lost benefits will be used in the determination of your monthly benefit upon reaching your FRA.

Estate planning considerations

Don't discount the impact that Social Security choices can have on estate planning. Notably, a surviving spouse may be entitled to benefits based on a deceased spouse's history. In some cases children are able to claim benefits based on a deceased parent.

The choice is yours

Besides the hard numbers, your personal preferences can affect the timing of benefits. For instance, if you're simply ready to call it quits as soon as possible, you may choose to begin receiving benefits at age 62. Others might enjoy working into their 70s or beyond and don't want to forfeit benefits under the earnings test. What's more, you must coordinate this with other aspects of your estate plan. Discuss your options with your estate planning advisor. •

Planning ahead after a divorce

If you've recently divorced, your time likely has been consumed with meetings with attorneys and in negotiations, even if everything was amicable. Probably the last thing you want to do is review your estate plan. But you owe it to yourself and your children to make the necessary updates to reflect your current situation.

Keep assets in your control

The good news is that a divorce generally extinguishes your spouse's rights under your will or any trusts. So there's little danger that your ex-spouse will inherit your property outright, even if those documents haven't been revised yet. If you have minor children, however, your ex-spouse might have more control over your wealth than you'd like.

Generally, property inherited by minors is held by a custodian until they reach the age of majority in the state where they reside (usually, age 18, but in some states it's age 21). In some cases, a surviving parent — perhaps your ex-spouse — may act as custodian. In such a case, your ex-spouse will have considerable discretion in determining how your assets are invested and spent while the children are minors.

One way to avoid this result is to create one or more trusts for the benefit of your children. With a trust, you can appoint the person who'll be responsible for managing assets and making distributions to your children. It's the trustee of your choosing — not your ex-spouse's.

This also allows you to determine when and under what circumstances your children will receive your property. For example, you may want to delay distributions until they're past the age of majority or have reached certain milestones, such as attaining a college degree or finding a job.

Furthermore, a trust can be beneficial when adult children inherit assets. In the event that your child gets divorced, the trust can be designed to shield the assets from your child's ex-spouse. However, if the child has too much control over the trust, a court may view the trust assets as marital property subject to division in divorce. For greater protection, give the trustee full discretionary authority over distributions.

Types of trusts

As part of the postdivorce planning process, you might include a variety of trusts, including, but not limited to, a:

Living trust. With a revocable living trust, you can arrange for the transfer of selected assets to designated beneficiaries. This trust type typically is exempt from the probate process and is often used to complement a will.

Credit shelter trust. This trust type typically is used to maximize estate tax benefits when you have children from a prior marriage and you also want to provide financial security for a new spouse. Essentially, the trust maximizes the benefits of the estate tax exemption.

Irrevocable life insurance trust (ILIT). If you transfer ownership of life insurance policies to an ILIT, the proceeds generally are removed from your taxable estate. Furthermore, your family may use part of the proceeds to pay estate costs.

Qualified terminable interest property (QTIP) trusts. A QTIP trust is often used after divorces and remarriages. The surviving spouse receives income from the trust while the beneficiaries — typically, children from a first marriage — are entitled to the remainder when the surviving spouse dies.

Considerations for the future

Finally, consider the possibility that you might remarry, requiring revisions to your will and trusts. Otherwise, a substantial portion of your estate may go to your children (under your ex-spouse's control, if they're minors). This may not be the optimal result, particularly if your new spouse and any children of the second marriage need more financial support than children from the previous marriage.

In any event, whether remarriage is in the cards or not, your estate plan should account for taxes. Under current law, a couple can maximize federal estate tax benefits through a combination of the unlimited marital deduction and estate tax exemption. Again, you can use trusts to further this purpose and they should be coordinated under your postdivorce plan.

A divorce generally extinguishes your spouse's rights under your will or any trusts.

If you're currently in the middle of a divorce, it's critical to contact your estate planning advisor to make the necessary revisions to your estate plan, as well as to discuss changing the titling or the beneficiary designations on retirement accounts, life insurance policies, and joint tenancy accounts. •

ABLE accounts benefit disabled family members

For families with disabled loved ones who are potentially eligible for means-tested government benefits such as Medicaid or Supplemental Security Income (SSI), estate planning can be a challenge. One potential tool is to open a Section 529A account — also known as an ABLE account, because it was created by the Achieving a Better Life Experience (ABLE) Act of 2014.

ABCs of an ABLE account

The ABLE Act allows family members and others to make nondeductible cash contributions to a qualified beneficiary's ABLE account, with total annual contributions limited to the federal gift tax annual exclusion amount (currently, $14,000). To qualify, a beneficiary must have become blind or disabled before age 26.

The account grows tax-free, and earnings may be withdrawn tax-free provided they're used to pay "qualified disability expenses." These include health care, education, housing, transportation, employment training, assistive technology, personal support services, financial management and legal expenses.

An ABLE account generally won't affect the beneficiary's eligibility for Medicaid and SSI — which limits a recipient's "countable assets" to $2,000 — with a couple of exceptions. First, distributions from an ABLE account used to pay housing expenses are countable assets. Second, if an ABLE account's balance grows beyond $100,000, the beneficiary's eligibility for SSI is suspended until the balance is brought below that threshold.

ABLE accounts vs. SNTs

For many years, the most effective tool to provide for loved ones with disabilities was to set up a special needs trust (SNT), which provides resources for the care of a disabled child while preserving his or her eligibility for government benefits. SNTs also offer some asset protection against creditors' claims.

Here's a quick review of the relative advantages and disadvantages of ABLE accounts and SNTs:

Availability. Anyone can establish an SNT, but ABLE accounts are available only if your home state offers them, or contracts with another state to make them available. Also, as previously noted, ABLE account beneficiaries must become blind or disabled before age 26. There's no age limit for SNTs.

Qualified expenses. ABLE accounts may be used to pay only specified types of expenses. SNTs may be used for any expenses the government doesn't pay for, including "quality-of-life" expenses, such as travel, recreation, hobbies and entertainment.

Tax treatment. An ABLE account's earnings and qualified distributions are tax-free. An SNT's earnings are taxable.

Contribution limits. Annual contributions to ABLE accounts currently are limited to $14,000, and total contributions are effectively limited to $100,000 to avoid suspension of SSI benefits. There are no limits on contributions to SNTs, although contributions in excess of $14,000 per year may be subject to gift tax.

Medicaid reimbursement. If an ABLE account beneficiary dies before the account assets have been depleted, the balance must be used to reimburse the government for any

Medicaid benefits the beneficiary received after the account was established. There's also a reimbursement requirement for SNTs. With either an ABLE account or an SNT, any remaining assets are distributed according to the terms of the account or the SNT.

Discuss your options

If you have a disabled family member you'd like to provide for, an ABLE account may be a viable option. Discuss with your family and your estate planning advisor whether it or an SNT is best for your situation. •

ESTATE PLANNING PITFALL

You chose your executor too hastily

Haste makes waste. Or, in the case of estate planning, it can lead to other problems and, possibly, financial loss. Notably, if you don't take enough time to choose the executor for your estate, the "wrong call" can cost your family.

You may think that there's not much to the job, but an executor's responsibilities are extensive. As your personal representative, he or she will be entrusted with several significant duties, including collecting, protecting and taking inventory of the estate's assets; filing the estate's tax returns and paying its taxes; handling creditors' claims and the estate's claims against others; making investment decisions; distributing property to beneficiaries; and liquidating assets, if necessary.

Whom should you choose as executor? Usually, it comes down to a decision between a family member or close friend or a professional. You may first opt for a family member or a trusted friend. But this may be a mistake for one of these reasons:

- The person may be too grief-stricken to function effectively,
- If the executor stands to gain from the will, there may be a conflict of interest — real or perceived — which can lead to will contests or other disputes by disgruntled family members, or
- The executor may lack the financial acumen needed for the position.

The executor may hire any necessary professionals. You might instead consider choosing an independent professional as executor, particularly if the professional is familiar with your financial affairs.

Finally, it's common to appoint co-executors — one person who knows the family and understands its dynamics and an independent executor with the requisite expertise. Whether you decide to use co-executors or only one, be sure to designate at least one backup to serve in the event that your first choice is unable to do so.

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Certain Medical and Tuition Expenses Paid as Gifts May Qualify for Tax Exclusion

Individuals who pay certain educational and medical expenses as gifts may do so without incurring any gift tax liability or reducing their $5.49 million lifetime gift and estate tax exemption if the payments are made directly to qualifying institutions. Similar to the $14,000 annual gift tax exclusion, there are unlimited gift tax exclusions for the payment of certain qualifying tuition and medical expenses, which provide another means for donors to leverage the amount of gifts they can make tax-free to their family and friends.

Qualifying medical expenses include those for certain medical care (e.g., amounts paid for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body); transportation and lodging primarily for, and essential to, the foregoing medical care; certain long-term care services; and health insurance premiums. In order to qualify for the gift tax exclusion, the donor must pay the medical facility, health care provider or insurance company directly.

The qualifying tuition expense exclusion covers only tuition paid to a qualified educational organization. Payments for costs of supplies, books, dormitory fees or board do not qualify for the exclusion. Again, the donor must pay the qualified educational organization directly in order to qualify for the gift tax exclusion.

The donor does not need to file a gift tax return for qualifying medical or tuition expenses paid on behalf of the donee. Additionally, the exclusion is permitted regardless of the relationship between the donor and the donee.

Additional rules and limitations apply to gifts for qualifying medical and tuition expenses (particularly those relating to transportation, lodging, and long-term care services) so before making such gifts, the donor should consult with his or her advisors to ensure the gift will qualify for the gift tax exclusion. For more information about gifts for qualifying medical and tuition expenses, please contact any member of the Stokes Lawrence Estate Planning Group at (206) 626-6000 in Seattle or (509) 853-3000 in Yakima.