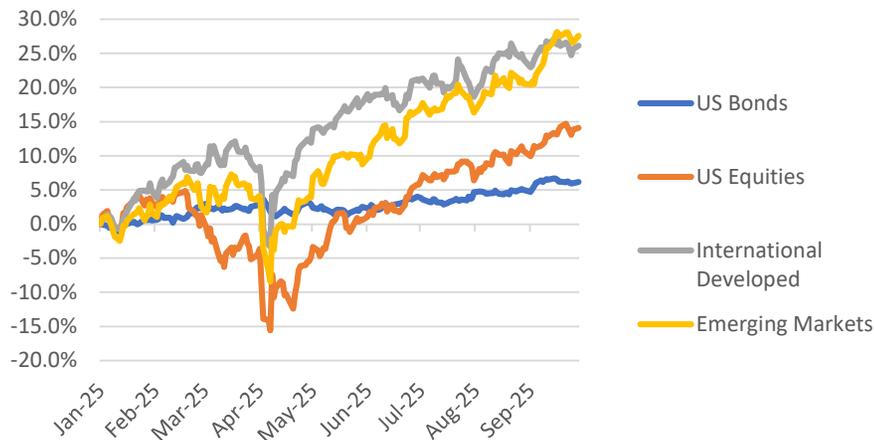


Simple Estate Planning Opportunities

As we head into the final quarter of the year we continue to see strong performance despite the heightened volatility. While most areas of the market are positive on the year, the strongest growth has come from non-US stocks. The combination of low prices, strong earnings, and a falling US Dollar have all collaborated to provide some of the best performance for non-US stocks in the last decade. Here is the performance of the biggest global financial markets so far this year.

Year-to-Date Performance



Source: Yahoo Finance

As the chart demonstrates, it has been a positive year across global markets, but it has been an exceptionally strong year for International and Emerging Markets stocks. Our overweight position in these two asset classes has led to very strong performance in our portfolios so far this year. While we cannot predict short-term market movements, our long-term projections remain optimistic.

Many of our clients have heard us use the phrase “maximizing spendable wealth”. We like the phrase because it encompasses the variety of strategies that we can use to achieve our primary goal: maximizing our client’s spendable wealth during their lifetime. This obviously starts with a good investment strategy, but also encompasses the bucket strategy, cash flow modelling, and tax planning – all of which are tools aimed at maximizing spendable wealth.

One biproduct of being successful in this strategy is that most clients expect to have significant assets left at the end of their life, which will be passed on, typically to either family or charity. Today we will look at a few strategies that are focused not on maximizing spendable wealth during retirement, but specifically at maximizing the wealth that will be transferred after death.

The first strategy to maximize inheritance is simply to avoid having the majority of assets go through probate proceedings. Probate is the legal processing of a person’s estate after their death, according to their will if they have one. While nothing we are saying here is meant as legal advice and you should always consult an attorney regarding legal matters – it is generally true that probate is an expensive and time-consuming process, and it is often unnecessary. Here are some of the biggest costs of probate:

	Cost	Description
Executor Commission	2%-5% of total estate	Commission schedule is set by the state
Attorney Fees	\$250 - \$450/hour, or 2%-5% of total estate	Flat fees are more common for estates under \$500,000, hourly or % more common for larger estates
Court Filing Fee	\$1,250	For estates over \$500,000

Source: Alatsas Law Firm; New York City Bar

Because many of the fees are tied to the value of the assets being probated, the cost of having assets like investment accounts or real estate pass through probate can be extremely high. While it may not be possible to avoid probate entirely, there are relatively simple tools such as “Designated Beneficiary Plans” and “Living Trusts” that can allow for many assets to avoid probate altogether.

The next strategy that we come across fairly often relates to the taxation of qualified retirement accounts like IRAs, 401Ks, and 403b’s. Many people are reluctant to spend down these accounts during their lifetime because withdrawals are taxable as income. However, that simply means that the withdrawals will be subject to taxation by the beneficiaries, often at higher tax rates. This is even more true after recent legislation created more stringent rules for how quickly inherited IRAs need to be distributed (and therefore, taxed).

If the named beneficiaries of these accounts are in a higher tax bracket than the account owner, this can become a very expensive form of inheritance. Fortunately, there is a simple tool that allows for an easy fix – Roth Conversions. This feature in the tax code allows anyone to convert pre-tax dollars into Roth dollars by paying the income taxes in the year of the conversion. If your beneficiaries are in a higher tax bracket than you are, this allows you to essentially pre-pay the income taxes on their inheritance at your current lower tax rate, so your beneficiaries receive their inheritance tax-free. Here is a generic example of how the tax math works.

	Taxable to Client	Taxable to Beneficiary
Social Security Income	\$50,000	\$0
IRA RMDs	\$20,000	\$0
W2 Income	\$0	\$200,000
Total Taxable Income	\$70,000	\$200,000
Hypothetical IRA Distribution/Conversion	\$50,000	\$50,000
Taxes Owed	\$6,000	\$11,000
After-Tax Funds Remaining for Beneficiary	\$44,000	\$39,000

In this case the Roth Conversion saved \$5,000 in federal taxes, increasing the beneficiary’s net spendable wealth by 13%.

The final planning strategy is also tax-related, but specifically regarding charitable contributions. Since the 2016 tax law eliminated the deductibility of charitable contributions for most taxpayers (there are several workarounds

depending on age and amount of annual giving), there has been increased attention to leaving money to charities after death. How this is done, and which specific assets are being left to charities, has significant tax consequences and therefore on the net inheritance for other beneficiaries.

Specifically, because of a tax perk called “stepped-up-basis-upon-death”, there is little-to-no tax benefit to leaving most types of assets to charities. The exception is qualified retirement accounts, which are otherwise taxable to normal beneficiaries, but not taxable when left to charities. Let’s look at the difference in net inheritance by leaving behind money to charity from retirement accounts vs from other assets:

	Charitable Gift from Other Assets	Charitable Gift from Retirement Account
Retirement Account Value	\$1,000,000	\$1,000,000
Other Assets	\$1,000,000	\$1,000,000
Total Estate	\$2,000,000	\$2,000,000
\$ Amount to Charity	\$500,000	\$500,000
\$ Amount to Children	\$1,500,000	\$1,500,000
Children's tax bracket	28%	28%
Taxes Paid on Inheritance	\$280,000	\$140,000
Children's Net Inheritance	\$1,220,000	\$1,360,000

In this case the simple decision on which account to use to fund charitable giving increases the children’s net inheritance by 11%.

As always, this is neither tax nor legal advice, and you should always consult your accountant and your lawyer. But these are fairly common scenarios we come across where a little proactive planning can have a large impact on long-term net spendable wealth.

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