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Trusted Insights

WEALTH MANAGEMENT

Fine tuning

The much-anticipated Proposed Regulations on 2019's SECURE Act arrived in February, and were generally welcomed by the estate planning community. There were two surprises, which we explore in our first item in this issue of *Trusted Insights.*

A recent survey reveals that taxes are *not* the top estate planning concern of those with more than $1 million in assets. As our second entry reveals, the potential negative consequences of sudden wealth on the next generation ranks much higher, and needs to be addressed in thoughtfully crafted wealth management strategies.

What concerns are you hearing from your clients, as the pandemic wanes? Are interactions back to normal yet? Please share your thoughts for future issues of *Trusted Insights*.

Eileen T. Cahill, CFP®
Director of Financial Planning
203.328.8104
ecahill@websterbank.com

Rogean B. Makowski
Director of Fiduciary Services
401.228.2044
rbmakowski@websterbank.com

Timothy H. Throckmorton, JD, LL.M, CExP™
Senior Vice President
860.692.1708
tthrockmorton@websterbank.com

SECURE Act proposed regulations

THE IMPACT OF THE SECURE ACT OF 2019, CONTINUES TO REVERBERATE FOR ESTATE PLANNERS. The IRS released some 300 pages of Proposed Regulations on the SECURE Act in February. With one exception, the proposals were generally well received by estate planners.

Before SECURE the beneficiaries of inherited IRAs were permitted to stretch the distributions and tax benefits from such accounts over their lifetimes (the "stretch IRA"). That option has been restricted to surviving spouses and other eligible designated beneficiaries. The general rule now is that the IRA money must be paid out over the 10 years following the owner's death.

Estate planners generally had assumed that the new 10-year rule would operate as the old 5-year rule did, that is, no distributions would be required until the end of the 10-year period (though beneficiaries would be free to take earlier distributions if desired). The Proposed Regs. included an additional element. The approach of leaving all distributions to the tenth year is only available if the account owner dies before Required Minimum Distributions (RMDs) have begun at age 72. If the account owner has begun a program of RMDs, then the beneficiary of the inherited account must take annual distributions every year, and then empty the account by the end of the tenth year.

“This new wrinkle suggests that Roth IRAs have an additional tax advantage, **as the owner of the Roth IRA never has RMDs from it.**”

This new wrinkle suggests that Roth IRAs have an additional tax advantage, as the owner of the Roth IRA never has RMDs from it. The surviving beneficiary of a Roth IRA will not need to make withdrawals before the tenth year after the owner's death.

What about RMDs for 2021?

Estates of 2020 decedents were the first to be affected by the SECURE Act changes. Under the Proposed Regs., some beneficiaries of 2020 estates were required to take an RMD in 2021 (if the decedent had been taking RMDs). What happens if such a beneficiary relied upon his/her professional advisors and the general consensus in 2021, that all distributions were optional, and took no distributions at all?

The Proposed Regs. do not resolve the question. A "reasonable, good faith interpretation" of the law will be acceptable for tax year 2021, but what that phrase encompasses remains ambiguous. It does not appear to extend a tax amnesty for tax year 2021 returns.

Writing for Leimberg Services, Natalie Choate points out that the Proposed Regs. are inconsistent with IRS Publication 590-B, both the 2020 and 2021 editions [LISI Employee Benefits & Retirement Planning Newsletter #782 (April 4, 2022) at http://www.leimbergservices.com]. In fact, it says the opposite, in that distributions during the 10-year period are permitted but not required. Further clarification from the IRS is needed.

> "For purposes of inherited IRA distributions, the age of majority will be 21, **and there are no exceptions for students.**"

A bright line for age of majority

An ambiguous SECURE exception concerned an heir who is a minor child. The law states that the ten-year rule for minors only kicks in when they reach the "age of majority." But states have different laws as to when the age of majority occurs. What's more, in some states the status of "minor" may be extended until age 26 for full-time college students.

The Proposed Regs. put the ambiguity to rest. For purposes of inherited IRA distributions, the age of majority will be 21, and there are no exceptions for students. For example, if the five-year-old child of the IRA owner inherits the account, there will be small RMDs for 16 years, and then the account will have to be distributed over the next ten years. The IRA must be terminated when the child reaches age 31.

Note that this option is restricted to the children of the IRA owner, not the grandchildren or other relatives. Those beneficiaries must abide by the 10-year rule.

A major concern of 67% of millionaires

THE MOTLEY FOOL CONDUCTED A SURVEY OF 2,000 HIGH-NET-WORTH INDIVIDUALS (NET WORTH GREATER THAN $1 MILLION) ABOUT THEIR ATTITUDES TOWARD INHERITANCE. Perhaps unsurprisingly, some two-thirds were concerned about leaving "too much" money to their heirs [https://www.fool.com/research/high-net-worth-inheritance/].

What are the problems associated with too large an inheritance? The following issues were identified:

Money/assets would be used irresponsibly.	58.74%
Beneficiaries are not prepared to manage a large inheritance.	56.54%
Believe assets would have better use elsewhere (e.g., charity).	56.03%
Doing so would cause beneficiaries to be lazy.	55.77%
Concerned about the attention it would attract.	54.84%

Source: The Motley Fool

Concern about the impact that sudden wealth may have upon heirs is well founded. Roughly one-third of lottery winners fail to manage their new fortunes wisely and end up in bankruptcy. A study by the NFL in 2015 revealed that some 78% of players were in financial trouble within two years of leaving the game, and 15.7% actually had to file for bankruptcy within 12 years, despite earning millions during their active years.

One solution, according to the survey, is to put conditions on the inheritance instead of leaving it outright to the heirs. Typically, that involves leaving an inheritance in trust. Some 68% of respondents reported that they plan to impose conditions on the inheritance. Interestingly, this view was most common among persons who themselves had been required to meet conditions before accessing their own inheritance. A trust arrangement can put the asset management responsibility in professional hands, and in most cases affords financial privacy to the heirs.

Some 64% of respondents were considering using a generation-skipping trust in their estate plan, benefiting grandchildren instead of children. Only 59% of respondents felt that tax considerations in structuring an inheritance were "very" important, though another 26% said taxes are somewhat important. Some 15% are ignoring the tax consequences of their estate planning.

"About 82% of millennials believe that **passing on an inheritance is an important financial goal.**"

About 82% of millennials believe that passing on an inheritance is an important financial goal. Only 57% of baby boomers agree. These are not the millennials who are anxiously awaiting their inheritance, as all the survey respondents were already millionaires. Nevertheless, the generational split is curious.

The report included data from the Federal Reserve for context. Only 2% of inheritances in 2018 were $1 million or more, but they accounted for 40% of all the dollars distributed by inheritance. The average inheritance was $46,200. For the top 1% of beneficiaries, the average was $719,000. The 2% to 10% wealth percentile received an average of $174,200. In the bottom 50%, the average inheritance came to $9,700.

Short takes

Extension granted for portability election

According to a recent Private Letter Ruling, when Decedent died his lifetime taxable gifts coupled with his estate at death were small enough that no federal estate tax return was required to be filed. In that case there would be a Deceased Spouse's Unused Exemption amount (DSUE amount). To claim the DSUE for the surviving spouse an estate tax return must be filed (even though not required and no taxes will be due) in order to make the election for portability of the DSUE. No such return was filed for Decedent's estate "for various reasons."

Some time later—the dates are not provided in the ruling—the oversight was discovered, and Decedent's estate requested an extension of time to file his estate tax return. Because the estate was below the taxable threshold, the IRS granted the extension.

The Ruling notes that no opinion is being expressed about the amount of the DSUE passing to the surviving spouse. What's more, if at a later time it is found that Decedent's estate and lifetime taxable gifts was so large as to require the filing of an estate tax return, the ruling will be null and void [Private Letter Ruling 202216010].

What do the rich own?

The IRS has released a report of the 2020 federal estate tax filings. There were 3,441 estate tax returns filed that year, reporting some $122 billion in assets. However, only 1,275 of those estates were taxable, thanks largely to the unlimited marital and charitable deductions! Of the 2,166 nontaxable estates, 1,523 were less than $20 million. Many of these were likely filed to secure the Deceased Spouse's Unused Exemption amount, an election that may only be made on a timely file estate tax return. Net estate tax collections came to $9.3 billion.

"**Perhaps surprisingly, the taxable estates reported $3 billion worth of art,** a figure larger than the combined value of Treasury bonds, corporate bonds, bond funds, and net life insurance!"

As one might expect, publicly traded stocks were the largest asset category of the taxable estates, at $13.7 billion. In second position was closely held stock, $10 billion. Personal residences came in at $1.69 billion. Perhaps surprisingly, the taxable estates reported $3 billion worth of art, a figure larger than the combined value of Treasury bonds, corporate bonds, bond funds, and net life insurance! State and local bonds (generally free of income taxes) came in $4.3 billion.

Estate planners have long recommended making lifetime gifts to reduce the eventual sting of estate taxes. Up to $16,000 may be given to donees in 2022 without the need for even a gift tax return filing, under the annual gift tax exclusion. Larger gifts, such as transfers to irrevocable trusts, will reduce the amount of transfer tax credit at death, but they save overall taxes in two ways. First, they "freeze" the value of the gifted assets, and second, they are taxed on a tax-exclusive basis. With the federal estate tax, the tax applies to the tax itself as well as to what beneficiaries receive.

The advice to make substantial lifetime gifts has been heeded by those with sufficient assets to worry about federal estate taxes, according to the report. The taxable estates, with assets of $63.5 billion, reported total lifetime transfers of $24.3 billion. [https://www.irs.gov/statistics/soi-tax-stats-estate-tax-statistics-filing-year-table-1].