COLORADO FINANCIAL MANAGEMENT®

All Things Financial Planning

Written by Jason Foster
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SUMMARY:

- Introduction
- Purposes and Objectives in Trust Planning
- Reverse Mortgages
- MAGI for Medicare Premiums

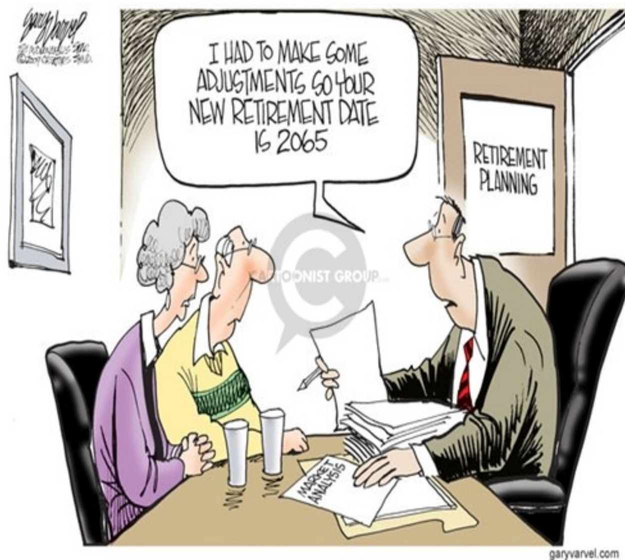
Greetings from the CFM Planning Team,

I hope all of you are staying safe and secure in what has become an unprecedented period of time in our lives. We have been handling planning requests and projects remotely, conducting our meetings and presentations with clients through phone conferences and Zoom meetings. It has been a challenging but successful transition, and we'll continue to conduct business this way for the foreseeable future. If you had a financial plan completed prior to the pandemic and would like to revisit the results in lieu of the market turmoil or because of changed circumstances, let us know. We are happy to reexamine these plans to see if adjustments might be warranted, or new strategies need to be deployed.

For those of you who have not yet filed your tax returns for 2019, the deadline for filing both Federal and the State of Colorado returns is July 15th. The government passed the CARES Act to combat the impact of the coronavirus in late March. From cash payouts to waiving required minimum distribution payments for 2020, the federal government has stayed active throughout this crisis. I wrote a separate piece on the Act in April summarizing the provisions having the greatest impact on our client's financial affairs. If you have any questions about this legislation or the SECURES Act, which went into effect on January 1, 2020, please let us know.

We plan to resume our program of providing financial planning topical presentations once it is deemed safe to have group gatherings again. Our next topic will be on Medicare. Medicare expert and licensed agent Hilarie Kavanagh has let us know she can be available when the situation allows for it. It is possible that we will decide to have these seminars via Zoom until we can meet again in person. Once we make a decision on how we will be proceeding, we'll let you know.

As for this quarter's newsletter, we have written articles on utilizing trusts in estate planning, and some basics about reverse mortgages. We also explore how your modified adjusted gross income effects Medicare premiums. I hope you find these articles worthwhile reading. Let your planning team or financial advisors know if you have any questions.



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Estate Planning and Trust Options
by Jason Foster, Director of Financial Planning, JD

In handling the estate planning reviews at CFM, I see a wide range of plans set out to accomplish various objectives. Many of these plans involve a trust in some capacity, sometimes more than one. Other plans do not utilize a trust arrangement simply because it is not needed, nor is it deemed desirable. But in most of my conversations with clients, we explore the topic of trusts and whether a trust could be an effective technique to enhance their estate plan.

So when might a trust make sense? Purposes for using trusts can vary, but the rationales for trust creation can be summarized in three main objectives: 1) control and management, 2) asset protection, and 3) tax planning. All trusts attempt to satisfy at least one of these goals, and many times, more than one. As I discuss different types of trusts within this article, you can trace the rationale for the trust back to at least one of these three objectives.

Basics. A trust is a legal entity created to hold property on behalf of a beneficiary or beneficiaries. The language of the trust agreement controls the property in the trust, and a trustee manages the property based on these detailed instructions. Some trusts are revocable and can be changed. Others are irrevocable and generally cannot be modified. Most trusts avoid probate and allow beneficiaries to gain access to trust property faster and more efficiently than if assets were transferred using a will.

You can place almost any kind of asset into a trust, but the assets you transfer into the trust will depend largely on your goals. If you would like income generated by the trust, an income producing asset makes the most sense. If you want to take advantage of an asset appreciating in value outside of your estate, transferring high growth assets into the trust will be necessary. If your estate will require liquidity to pay expenses and taxes, transferring life insurance into a trust would be a prudent choice.

Regardless of the reasons for creation, a trust is a major commitment in an estate plan. It requires more complex drafting, resulting in both increased preparatory costs and administration costs associated with managing the trust after formation. These administration costs can consist of trustee and accounting fees, and the expenses that arise with the preparing and filing of tax returns. Utilizing irrevocable trusts can also result in removing assets from your ownership and control, which for certain clients, could be a non-starter.

Created for the right reasons, trusts can be powerful tools that can better accomplish estate planning objectives. I have outlined some of the most popular types of trusts and have provided a brief description of each below. Whether or not any of these trusts would be appropriate for your plan will always depend on your specific situation and your goals.

Revocable Living Trusts. In a previous newsletter, I discussed the differences between a will and a revocable living trust, and choosing one as the foundation for your estate planning. Revocable living trusts can help create privacy for the client and their heirs, and can provide an efficient, cost-effective and probate-free administration of the estate. While they do not provide direct asset protection, they do allow assets to be transferred in and out of the trust, and do not necessitate tax returns or other administrative costs that irrevocable trusts typically require. If you have property located in more than one state, these are very effective tools to avoid probate in multiple jurisdictions.

A-B Trusts. Frequently utilized in a blended family situation or to reduce estate tax liability, this arrangement creates two trusts after the first

spouse passes away, allowing the deceased spouse to maintain some control over their assets after death. The Family Trust ("B" Trust), or Bypass Trust, typically receives the remaining portion of the deceased spouse's unused estate tax exemption, while providing income and flexibility to the surviving spouse as the primary beneficiary. The contingent beneficiaries are named by the deceased spouse and cannot be changed by surviving spouse. Assets can grow outside of surviving spouse's estate and still benefit the spouse during their lifetime.

The **Marital Trust ("A" Trust)** provides management for the balance of the assets of the deceased spouse and avoids any transfer taxes at the death of the first spouse because of the unlimited marital deduction allotted to the surviving spouse. This deduction allows for an unlimited amount of property to pass from one spouse to another without tax complications during life or at death. Although the surviving spouse is the primary beneficiary and typically receives all income from the trust, the deceased spouse still controls who inherits the principal of the trust after the surviving spouse dies.

A Marital Trust does not have to accompany the Family Trust. One could utilize a Family Trust for a portion of their estate and pass the other portion directly to the surviving spouse, outside of trust. Use of the Marital Trust will depend on how much control the deceased spouse wishes to exercise over his or her estate.

An ancillary benefit in utilizing one or both of these types of trusts is asset protection. The assets situated in a Family or Marital Trust will enjoy protection from creditor claims and lawsuits for the duration of surviving spouse's life. A basic A-B trust arrangement is illustrated to the right.

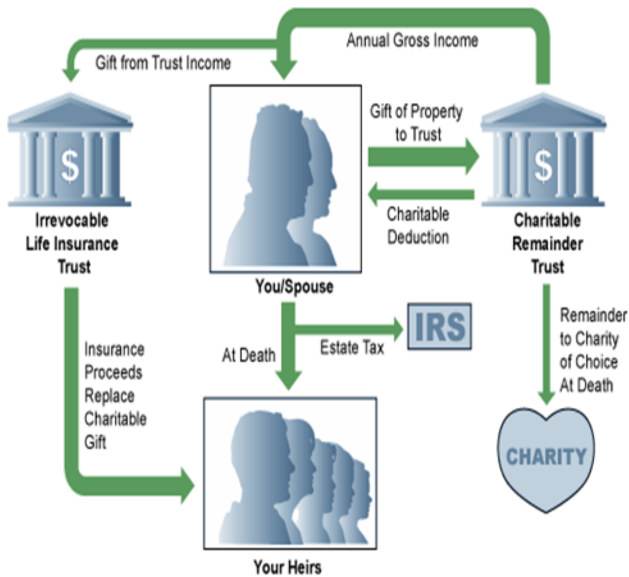
Special Needs Trusts (SNTs). Leaving money or property to a loved one with a disability must be done prudently otherwise benefits such as supplemental security income (SSI) and Medicaid benefits can be jeopardized. Fortunately, a special needs or supplemental needs trust can be used to both leave assets for the benefit of an individual with a disability and preserve these vital government benefits. Individuals with disabilities in Colorado cannot own more than $2000 of assets, nor make more than $2349/month in income and still qualify for Medicaid. The SSI program also has income and asset limitations.

By utilizing a SNT, the assets are never owned or controlled by the beneficiary, and as long as the trustee has absolute discretion in providing income and principal distributions, the benefits will be protected and the beneficiary interest will not disqualify the individual from government assistance programs. The trustee can carefully supplement these benefits where they deem appropriate with trust distributions, such as paying for personal care attendants, vacations, home furnishings, out-of-pocket medical and dental expenses, education, recreation and physical rehabilitation costs.

Charitable Remainder Trusts (CRTs). A charitable remainder trust can provide a number of benefits, including the satisfaction of fulfilling your philanthropic goals. You can annuitize an asset once transferred into the CRT and receive a fixed dollar amount for the duration of your life, or you can create a unitrust arrangement, where the payments received are based on the value of the trust assets reassessed annually. If the value of the trust assets increase, so will the annual payout. You can also name multiple beneficiaries, such as a spouse and children, to receive these payments,

with the charity receiving the principal left in trust after the last of these beneficiaries dies.

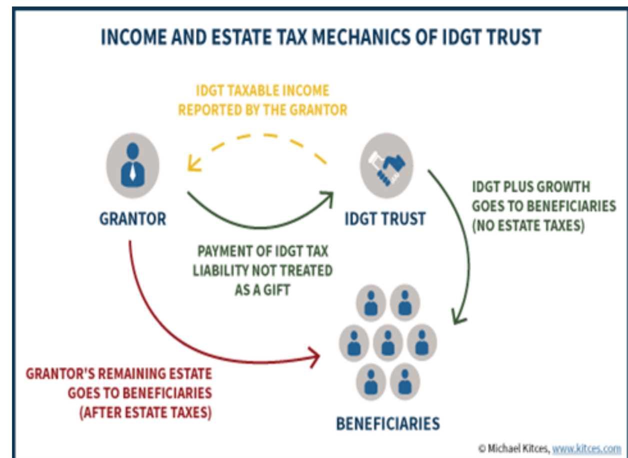
There are multiple tax benefits attributable to CRTs. The donor receives an income tax charitable deduction based on the net value of the gift, and the asset is removed from the estate without utilizing any of the individual owner's estate tax exemption, all while creating the aforementioned stream of income for multiple beneficiaries. The basic framework of a CRT is detailed below. This particular CRT flowchart includes an Irrevocable Life Insurance Trust, funded by CRT income, to augment the size of the inheritance to the heirs.



Irrevocable Life Insurance Trusts (ILITs). Specifically designed to hold life insurance policies, ILITs have historically been used to pay estate administration expenses and taxes by leveraging the paying of premiums on life insurance policies owned and managed by the trust, outside of the insured's estate. In doing so, it creates liquidity for the estate, which can be especially important if a high percentage of estate assets are illiquid, such as a business interest or real estate. Without liquidity to pay taxes and other estate expenses, heirs may be forced to sell business interests and real estate in order to satisfy these expenses, which might not be part of the overall plan.

Spousal Lifetime Access Trusts (SLATs). A SLAT is created to reduce a surviving spouse's exposure to estate taxes by utilizing a portion of the unified exemption during the grantor's life. This type of trust functions like a Family Trust in the A-B Trust arrangement described above, taking advantage of property growing outside of both the grantor and his or her surviving spouse's estate. Trust assets are still available to the family unit (typically to the spouse), and the grantor can indirectly enjoy the assets that are no longer part of his or her taxable estate. Spouses can create reciprocating SLATs and benefit as beneficiaries of these trusts, but very careful drafting of both trusts must take place in order to avoid IRS scrutiny and the possibility the entities will be disregarded for tax purposes.

Grantor Retained Annuity Trusts (GRATs) and Intentionally Defective Grantor Trusts (IDGTs). These types of trusts are more complex estate tax planning techniques designed to remove appreciating property from the estate, while allowing the creator to maintain control of the assets transferred to or sold into the trust. An annuity or promissory note accompanies the arrangement establishing a flow of income and equity back to the grantor tax free. The grantor still pays any income tax generated by the trust (just not on the annuity or promissory note payments), which can magnify the overall amount removed from the grantor's estate over a longer period of time. These trusts work very well when interest rates are low. The mechanics of how a basic IDGT Trust functions is shown below.



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The above trusts are a few of the more popular tools utilized by estate planning attorneys to accomplish the objectives set forth in the introduction. Whether the goal is to maintain control of your estate assets for asset protection

reasons, save on estate taxes, or create an efficient and private estate that avoids probate, trusts can serve a vital role in the right estate planning context. I am happy to review any current trusts in your estate plan to discuss functionality and applicability. Or if you believe the creation of a trust may further objectives you wish to accomplish, I can help assess the wisdom of adding such tools to your estate plan.

Reverse Mortgages
by Viktoria Falus, Senior Financial Planner, CFP®

Although often misunderstood, reverse mortgages can be a viable option for individuals or couples seeking a stream of income in retirement. This instrument is not limited to house-rich seniors with few other nominal assets. It can be used in a variety of financial planning circumstances and can provide flexibility as income demands change over time.

Structure. Reverse mortgages (RMs) are FHA mortgages, secured by real property that enables the borrower to access their equity (unencumbered value) and defer payments on the loan. Unlike traditional mortgages in which borrowers build equity by repaying the loan, an RM loan is repaid when the borrower sells the home, permanently vacates the property, or dies. Borrowers are still responsible for property taxes and homeowner's insurance, but there are no monthly payments due on the RM. Interest accumulates on the loan balance monthly. Generally, the older the homeowner, the more he/she is allowed to borrow and the lower the interest rate. Although the loan balance grows and can eventually exceed the value of the home (especially in times of declining home values), the loan is treated as a non-recourse loan, meaning the borrower or their heirs are generally not required to repay any additional loan balance in excess of the value of the home.

Eligibility. A primary homeowner over age 62 can apply to borrow roughly half of the home's value, up to approximately $765K as of January 2020. Any existing mortgage encumbering the property must be paid off using the proceeds of the RM. To qualify, the homeowner must either own the home outright or be close to satisfying any existing mortgage. Rather than taking the loan as a lump sum, homeowners may establish the RM as a line of credit or as a fixed monthly payment stream at a variable interest rate.

Planning Considerations. An RM enables homeowners to make their home equity a liquid asset that is readily accessible. This liquidity can then be used for a variety of big-ticket expense items such as long-term care costs, life- or long-term care-insurance premiums and to cover general living expenses. RMs can also be utilized as an alternative to an income annuity, and a tool to reduce the tax impact of 401k and IRA heavy portfolios. In addition to risk mitigation and tax flexibility, RMs can be vehicles that provide cash flow for seniors who are temporarily residing in assisted living facilities, if they maintain the intention of returning to their primary residence.

As a general rule, retirees can withdraw 3-4% of their portfolio each year without running out of money. According to some recent research, for retirees whose home equity value is much higher than their retirement portfolio, the safe withdrawal rates can increase to as high as 6% or 7% each year. Some studies suggest that the careful utilization of a reverse mortgage in a financial plan can increase one's nest egg and net worth over their lifetime.

Covering Long Term Care Expenses.
Consider a situation where a spouse is diagnosed with Alzheimer's and the cost of a care facility is $10,000 per month. Instead of utilizing retirement savings, which would cost the couple significantly more in ordinary income taxes, the couple could access the equity of their $1.5M home by taking out a reverse mortgage. They could apply and qualify for a $750K RM and receive a lump sum or a line of credit, and help

supplement the costs of the long term care with a tax free stream of income, as long as one of the spouses is still occupying the home. If their primary residence appreciates, this added value can more than offset the amount being added in interest each year.

Alternative to Annuities. During periods of low interest rates (such as in today's environment), annuities are likely to have lower payout rates. An income stream created from an RM is actually higher during periods of low interest rates, and is tax free. An RM provides a better liquidity option as well due to the steep surrender charges annuities demand if you need to unwind the investment. A line of credit from a reverse mortgage could strategically be used as a better longevity insurance substitute instead of utilizing an immediate or deferred income annuity.

Risk Management. RMs can also be considered a "buffer asset," similar to a HELOC or margin loan. When faced with an extended equities market decline, instead of liquidating assets where retirees may be exposed to material "sequence of return" risk, an RM can provide an alternative approach. Sequence of return risk is one of the biggest risks retirees face today. Establishing a reliable line of credit such as an RM for liquidity creation may better manage this risk, allowing the homeowner to more easily handle unanticipated needs for cash.

Impact on Medicaid Eligibility. If you qualify for Medicaid, there are a few key factors to consider that could have an effect on the decision to use an RM, or on how to utilize RM proceeds appropriately to maintain eligibility. In general, RM payments do not count towards Medicaid resource limits as long as distributions are spent each month and are NOT received as a lump-sum distribution. RM proceeds are considered loan distributions and not income, and thus will not count toward your Medicaid income eligibility limits either. RMs can successfully supplement taxable income to help individuals stay qualified for Medicaid.

Other Considerations. Reverse mortgages are generally **not ideal** for retirees who are planning to sell the primary home in the near future. High up-front costs associated with loan creation make an RM impractical if the intention is to relocate in the near term. If you are single or widowed and are considering a move to an assisted living facility with the hope of paying for it with a reverse mortgage, RM regulations consider such a move lasting more than 12 consecutive months permanent, and you would be forced to satisfy the loan in full. Also be careful from an estate planning perspective – if the objective is for the home to be passed down to heirs, an RM could force a sale of the property upon the death of the borrower under certain circumstances.

The Bottom Line: Reverse mortgages are increasingly being deployed by retirees to provide income and resource flexibility. While there are upfront expenses and interest attached to the reverse mortgage loan, it may still be a good opportunity under certain circumstances. Given the looming dynamic economic climate foreshadowed by the recent impact of the pandemic, we recommend keeping all viable devices for financial planning on the table. RMs should be part of this conversation. For more information on whether an RM fits within your goals, please contact your advisor to further explore whether this potentially valuable tool may be appropriate for you.

"You're a member of half a dozen class action lawsuits and that's your retirement plan?"

Medicare Premiums and Income
by Tim Dutton, Associate Financial Planner

Medicare Programs. There are several Medicare programs with varying costs to consider. The main programs include Medicare Part A (inpatient/hospital coverage), Medicare Part B (outpatient/medical coverage), and Medicare Part D (prescription drug coverage). Under the basic Medicare payment formula, the federal

government pays 100% of Part A and 75% of Part B. The remaining 25% of Part B coverage is paid directly by the Medicare enrollee. Under the Medicare Modernization Act (2006), Medicare enrollees are also responsible for a portion of Part D premiums.

Costs for the Medicare Programs. Premiums for this government mandated benefit are primarily paid through withholdings from another entitlement program: Social Security. But for those age 65 or older who have not yet begun receiving Social Security benefits, these premium payments must be paid directly.

The Income Related Monthly Adjustment Amount (IRMMA). Higher Medicare premiums for Medicare Part B and Medicare Part D will be charged to individuals with higher incomes. This is called the Income Related Monthly Adjustment Amount (IRMMA) and can result in a surtax requiring enrollees to pay greater than the 25% portion of their Medicare Part B premiums that are mandatory as a base requirement. The percentage of the total could be 35%, 50%, 65% or 80% higher, based on where you fall on the IRMMA scale. Likewise, the surcharge on Part D premiums is an additional amount you must pay, starting at $12.20/month for 2020, and rising as high as $76.40/month, depending on the income threshold.

The IRMAA determination is based on your Modified Adjusted Gross Income (MAGI) and the income levels are considered "cliff" thresholds. Any amount of MAGI above the threshold and the entire surcharge will apply. The Medicare premiums for 2021 will be established by October 2020, even though the tax year will not have concluded. The households "prior-prior" year income is used instead to determine MAGI for IRMMA surcharges rather than the "prior" year's income. Thus, for the 2021 calendar year, the IRMAA for Part B and Part D premiums is based on the 2019 tax year using the tax return filed in 2020. Confusing, but important to remember how it works if a potential appeal is warranted, and for planning purposes.

Appealing or Requesting a Reconsideration of IRMMA Surcharges. There are instances where a household's income declines due to "events beyond the taxpayer's control". In these cases, using the taxpayer's prior-prior year income is not an accurate reflection of the household's current income. For those who have experienced a "life changing" event, which impacts the applicability of IRMMA surcharges, Form SSA-44 entitled "Medicare Income-Related Monthly Adjustment Amount Life-Changing Event" can be submitted to request a reduction in your IRMAA surcharges. Below is a list of specific "life changing" events listed on the form that can assist in reducing potential surcharges to your Medicare premiums:

- Marriage
- Divorce/Annulment
- Widowing/death of a spouse
- Work stoppage (i.e., retired or laid off)
- Word reduction (i.e., material reduction in work hours)
- Loss on income-producing property due to a disaster or similar circumstance
- Loss of pension income (e.g., due to a pension default)
- Income for the year was due to a settlement with an employer for the employer's bankruptcy or reorganization.

For new retirees over age 65 who begin Medicare immediately upon retirement, submitting Form SSA-44 to report their "Work Stoppage" can prevent their pre-retirement wages from being treated as part of MAGI for determining IRMAA surcharge amounts. This can save a household thousands of dollars in the first year or two of retirement.

There also might be other life changing events not specifically listed above that can still be considered to reduce the Medicare surtax. You can submit a request for reconsideration on Form SSA-561-U2 to appeal Medicare surcharge rulings. This same form is used to appeal Social Security and Disability decisions.

Strategies to Minimize Medicare Premium Surcharges. Lowering MAGI to minimize the effect of IRMMA is a regular planning conversation we have with clients. Consider the below opportunities to lower your MAGI to both manage income tax brackets and IRMMA tiers:

Fund an HSA. If you participate in a high deductible health plan, fully funding your HSA will always be a prudent tax and surcharge savings strategy. Contributions to an HSA are tax-deductible, grow tax-deferred and withdrawals are tax free if used for qualified medical expenses. Since qualified distributions from your HSA are tax free, there is no impact on MAGI, and thus no

corresponding effect to Medicare rates.

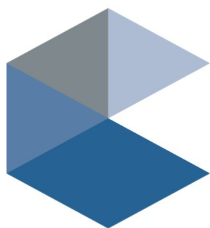
Sell Taxable Investments for a Loss. End of year tax-loss harvesting can be a savvy tax planning tactic to help reduce MAGI below certain thresholds, resulting in a potential correlating drop in IRMMA. Harvested losses in your taxable accounts will first offset capital gains. After capital gains are zeroed out, you can apply an additional $3,000 of losses to ordinary income for a particular tax year, and any remaining losses can be carried forward and utilized in future years.

Qualified Charitable Distributions (QCDs). Another highly tax efficient approach involves the use of Qualified Charitable Distributions. Utilizing QCDs for making charitable donations directly from an IRA to the charity reduces your taxable income dollar for dollar. Amounts distributed as a QCD can be counted toward satisfying your required minimum distribution (RMD) for the year, up to $100,000. QCDs are not deductible – they are simply excludable as income to you. This distinction is important. If you take the IRA distribution as income, it can push you into a higher tax bracket and may also reduce your eligibility for certain tax credits and other deductions. If you are charitably inclined, the better plan is to make use of QCDs. You can begin deploying them when you turn 70 ½.

Paying Attention to Income Levels. It is important to be cognizant of your MAGI and the IRMAA tiers previously discussed. If you have room within a tier in a particular year, you could accelerate income for that year, if it means your taxable income would drop the following year. Or in the alternative, if your MAGI puts you near an IRMMA cliff or slightly over into the next tier, you might consider ways to defer income or take capital gains losses to avoid going over the cliff so you can save on Medicare surcharges.

But always consider the bigger picture when tax planning. Although managing MAGI for Medicare premium planning can be an important consideration for those close to threshold limits, there are many circumstances where optimizing your MAGI for IRMAA reduction purposes may be less than optimal, given the greater context of the overall financial plan. Let us know if you have financial and tax planning questions associated with Medicare premiums. We would love to have this conversation with you.

The Financial Planning Department
And Your Entire Colorado Financial Mgmt. Team



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