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All Things Financial Planning

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SUMMARY:

- Introduction and Tax Planning
- The SECURE Act
- Everything You Need to Know About HSAs

It has been an incredibly difficult first quarter with the coronavirus disrupting all aspects of our daily lives. We understand your concerns and frustrations. On the financial planning team, we have made adjustments on how we conduct business. For the foreseeable future, instead of in person meetings, we have gone exclusively to phone conferences and Zoom meetings, depending on your comfort level with technology. The important thing is that we are still working hard on your financial plans and estate plan reviews and are available to have a conversation with you at any time.

Some of you have already contacted us to review your plan in light of the coronavirus market shocks. For perspective, our financial plans are conservative and flexible, taking into account all types of scenarios and market fluctuations. We are happy to visit with you to discuss the current market and the effect on your plan, and even model in various market outlooks and projections to assist you. We are here for you.

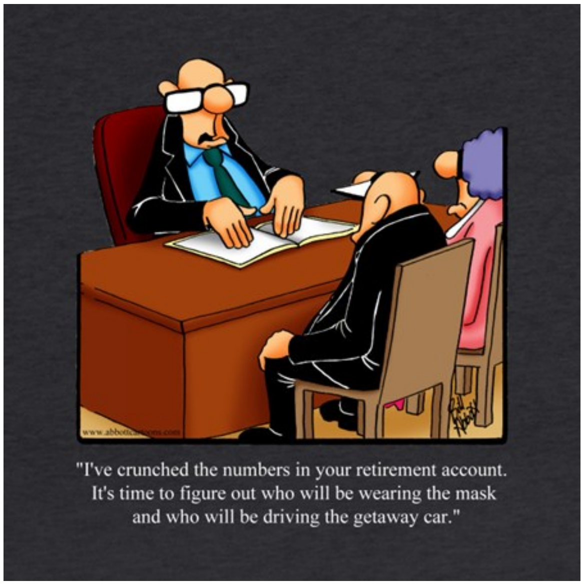
The federal government has pushed this year's tax deadline to July 15, 2020. Colorado has followed suit. Thus, you now have until July 15th to contribute to an IRA for 2019. If you're not enrolled in a workplace retirement plan, you can deduct an IRA contribution of up to $6000, or $7000 if you were 50 or older in 2019. If you have a workplace retirement plan, receiving a tax deduction for contributing to an IRA is income dependent.

You also now have until July 15th to set up and fund a health savings account (HSA) for 2019. If you qualify, you can contribute up to $3500 to an HSA if you had single coverage, or $7000 if you had family coverage. You can contribute an additional $1000 if you were 55 or older in 2019, or another $2000 if you were married and both spouses were at least 55. We have more information on the benefits and the inner workings of HSAs in a separate article within this newsletter.

We have pushed back our first quarter financial planning topical presentations to the second quarter of 2020. We hope to have Medicare expert and licensed agent Hilarie Kavanagh presenting at our 3 locations in late May or June, assuming we are all clear to do so. Of course, your safety and well-being is our top priority, so we will only move forward with these presentations if we are 100% certain you will be safe. When we are able to proceed with these sessions, there will be coffee, bagels, pastries, and lots of valuable Medicare information to share.

This quarter's newsletter will focus on The SECURE Act and how this new law will affect your IRAs. As previously mentioned, we also have a separate article on everything you need to know about HSAs – what they are, the advantages of having them, and how to utilize them. I hope you find these subjects informative and helpful.

If you missed either of the financial planning newsletters published in the 3rd and 4th quarters of 2019, or would like to access them, you can find both on our website at colofinancial.com, or email me directly at jason@colofinancial.com, and I will send copies to you.



The SECURE Act and Your IRAs – What to Know and Consider
by Jason Foster, Director of Financial Planning, Attorney

Amid all of the political drama on Capital Hill late last year, both houses of Congress were able to agree upon and pass legislation that resulted in considerable changes in rules associated with your IRAs. The President signed the legislation into law in mid-December and the Act become effective as of January 1, 2020.

In January, I presented on these changes at our annual All Client Investment Committee Meetings in Denver, Boulder and Johnstown, but I wanted to make sure we addressed these important changes in our financial planning newsletter as well.

Although there were a number of important changes associated with the new legislation (officially called **S**etting **E**very **C**ommunity **U**p for **R**etirement **E**nhancement), such as expanding the use of 529s to satisfy up to $10,000 of student loan debt per beneficiary, and offering tax credits and incentives to small business owners who set up retirement accounts for employees, this new law has left financial and estate planners scrambling to assess it's far reaching ramifications related to IRAs. I will start by outlining some potentially less impactful changes, and then spend the majority of this article on the most substantial change – the elimination of the "stretch" IRA for most non-spousal beneficiaries.

Delay Taking RMDs until 72.
For those who didn't turn 70 ½ by the end of 2019, an IRA owner can now delay taking required minimum distributions (RMDs) from their IRAs until 72. The same rules apply – you must take your first RMD by April 1st of the year in which you turn 73, and a second RMD by December 31st of the same year to avoid penalties by the IRS.

For those that are not taking distributions from their IRAs yet, and do not need to take the full amount necessary to manage their financial affairs, this is welcome news. Every distribution from your IRA is taxed as ordinary income, and to delay withdrawing money from these tax deferred growth vehicles as long as possible can be part of a good overall financial planning strategy. Pushing the RMD age back also gives IRA owners more time to convert IRA money to a Roth, depending on the owner's objectives and whether or not the opportunity makes sense. Pre-RMD Roth conversion opportunities are planning strategies we discuss and review with clients at CFM on a regular basis.

No Age Limit on IRA Contributions.
The SECURE Act now eliminates age restrictions on contributing to IRAs, as long as you have income from an employer or small business to contribute. Prior to the law change, you could contribute to IRAs only until the year you turned 70 ½. These contributions generally provide tax deductions when added to a traditional IRA, assuming your income level does not phase you out. Still, it may be a better strategy to contribute to a Roth instead given the opportunity. If you are in a position to do either, it is worth having a conversation with us so we can assess the benefits of both approaches to your overall plan.

QCD Age Still 70 ½ - not 72.
One item that did not change with the Act is the age in which you can take qualified charitable

distributions (QCDs) from IRAs. Although RMDs moved to age 72, QCDs still can be made in the year you turn 70 ½. QCDs offer a method to avoid IRA distributions becoming taxable income to you by having distributions go directly from the IRA to a selected charity. Having these distributions go directly to charity is a more tax effective strategy than receiving the distributions as ordinary income, and then making a tax-deductible charitable contribution, especially considering the current size of the standard deduction ($12,400 for individuals and $24,800 for married couples filing jointly in 2020). You can make QCDs of up to $100K per year.

Elimination of the Stretch IRA.
In what is considered the most far-reaching change, the SECURE Act has eliminated the availability of the "stretch" IRA for all but a few exceptions, likely resulting in a significant increase in future tax revenue for the government.

Prior to the SECURE Act, anyone who inherited an IRA could receive RMD payments based on their current age and life expectancy, "stretching" out the payments for the duration of their lifetime. The recipient of these IRAs always had the option of taking as much as they wanted, but whatever they received was considered taxable income to them, so allowing the owners of inherited IRAs to limit the amount of income flowing out to them was very advantageous, especially if they were high income earners. The remaining portion of the inherited IRA continued to grow tax-deferred and passed down to future heirs who could have also "stretched" the RMDs for their lifetimes.

Congress has replaced the stretch IRA with a 10-year payout for all designated beneficiaries except: 1) a surviving spouse, 2) minor children until the age of the majority (then the 10-year payout kicks in), 3) designated beneficiaries less than 10 years younger than the IRA owner, and 4) any beneficiary who is disabled or chronically ill. Inherited Roths are also subject to a 10-year payout, but Roth distributions are still tax free. Current inherited IRAs (involving an original IRA owner passing away prior to 2020) still get to stretch their inherited IRAs for their lifetimes. But these beneficiaries of the owner of the inherited IRAs will be on a 10-year payout unless they qualify for one of the above listed exceptions.

Large IRAs pose the biggest tax problem for beneficiaries. For example, the likelihood of our planning team suggesting changes for clients who have a $500,000 IRA with their 5 children designated as beneficiaries would be low. But if a client has a $2 million IRA going to one child at the owner's death, we will want to explore planning options that are available to the client, especially if the adult child beneficiary is already in a higher tax bracket, and will be there for some time.

There are a number of planning techniques to consider in lessening the tax impact for your heirs who do not qualify as an exception beneficiary. For owners of inherited IRAs now subject to the 10-year rule, because no distributions are required on inherited IRAs until the 10th year, taking larger distributions during lower income years (if any) can be a good strategy to pay less in taxes than if you waited the full 10 years and took the lump sum distribution at the end.

If it is an inherited Roth IRA, we may suggest the opposite approach: wait the entire 10 years so you can continue to enjoy tax free growth. The distributions are tax free whenever you take them, so waiting the full 10-year period gives you the opportunity to maximize the benefit of having a Roth.

For those who are single or widowed with large IRAs, Roth conversions are worth considering. With Congress pushing back your first RMD to age 72, you can focus on converting IRA money to Roth money from age 59 ½ until RMDs kick in. You can also delay taking social security until age 70. This strategy will increase the value of future benefits by 8% per year and reduce your taxable income during the years that you are delaying the receipt of these payments, which could allow the possibility of larger conversion opportunities at lower tax rates. A Roth conversion strategy is not the right financial choice for everyone and is very fact and circumstance specific. Contact your advisor or planner at CFM and we'll assess your situation and do a properly tailored analysis.

The elimination of the "stretch" IRA also compels us to take another look at charitable planning opportunities. If you plan to give to charities, it is more tax efficient to name charities as beneficiaries of your IRAs versus naming them in your Wills or Living Trusts to receive outright bequests. Charitable recipients do not pay income taxes on the inherited IRAs. You also have increased the amount your heirs will receive in your Wills or Living Trusts – which likely includes highly appreciated low basis assets. Unlike retirement accounts, these assets "step up" in basis at the owner's death, resulting in heirs receiving these assets with a basis as of your date of death. If your heirs then sold these assets shortly after receiving them, they would pay little or no capital gains taxes. This would result in a win-win for clients with charitable intentions associated with their estate plan.

For those clients with a larger charitable intent, a Charitable Remainder Trust (CRT) could be an option to consider with the implementation of this new 10-year payout for the majority of non-spousal beneficiaries. Traditionally used to reduce income and estate taxes while satisfying a charitable objective, the functionality of these trusts can be expanded to also help clients circumvent the 10-year payout rule. In practice, a CRT can be designated as the beneficiary of your IRA, pay no income tax upon liquidation, can payout to multiple beneficiaries for their collective lifetimes, and end up with a charity or multiple charities of your choice after the last beneficiary dies. You are essentially annuitizing the asset, and although these payments will be considered taxable income to your heirs, you have "stretched" out the payments for one or multiple lifetimes and have avoided the 10-year payout. The remaining portion of the trust must go to charity, so a charitable intent should be present with such a plan.

Utilizing IRA distributions to purchase life insurance is also a creative possibility for individuals under the right circumstances. Whereas income taxes await heirs on distributions from an inherited IRA, life insurance death benefits are income tax free. To implement, the IRA owner utilizes the taxable distributions to pay the premiums of a permanent life insurance policy. If the IRA owner's estate will be subject to estate tax, the benefit of this approach has the potential to be magnified by utilizing an Irrevocable Life Insurance Trust (ILIT) to both own and be the beneficiary of the policy. This makes sure the life insurance benefit is removed from the estate to avoid it from being a taxable asset for estate tax purposes.

Outside of implementing any of these more complex solutions, there are more basic planning techniques you can always deploy. Simply taking IRA distributions, paying the taxes and gifting money into a 529 account, or to an heir for them to contribute to a Roth, is a subtle way to set your heirs up with a form of tax-free growth. If you have both IRAs and taxable accounts, and you find yourself in a lower tax bracket in any particular year, consider increasing IRA distribution amounts to balance the personal budget versus utilizing highly appreciated brokerage account funds. Unlike the IRA account, the brokerage account will receive a step up in basis when you pass away, which as I have previously discussed, can be a great benefit for your heirs. We look forward to having a conversation with you about how the SECURE Act effects your financial planning and what solutions are worth exploring to alleviate the impact. Please contact us to discuss.

Everything You Need to Know About HSAs
by Shannon Knight, Senior Client Service Manager

"I've Maxed My Retirement Accounts. Now what?" This is a conversation we love to have with clients because there are always several options available, depending on the client's objectives and current financial plan. One possible solution is a Health Savings Account (HSA).

Fidelity's 2019 "Retiree Health Care Cost Estimate" study estimates a married couple can expect to spend $285,000 in health care costs throughout retirement.[1] With that number expected to continue to grow, HSAs can be an effective solution to cover inflating health care expenses, while providing both the flexibility of an investment account and additional tax benefits and savings for an individual or couple during retirement.

[1] https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/press-release/healthcare-price-check-040219.pdf

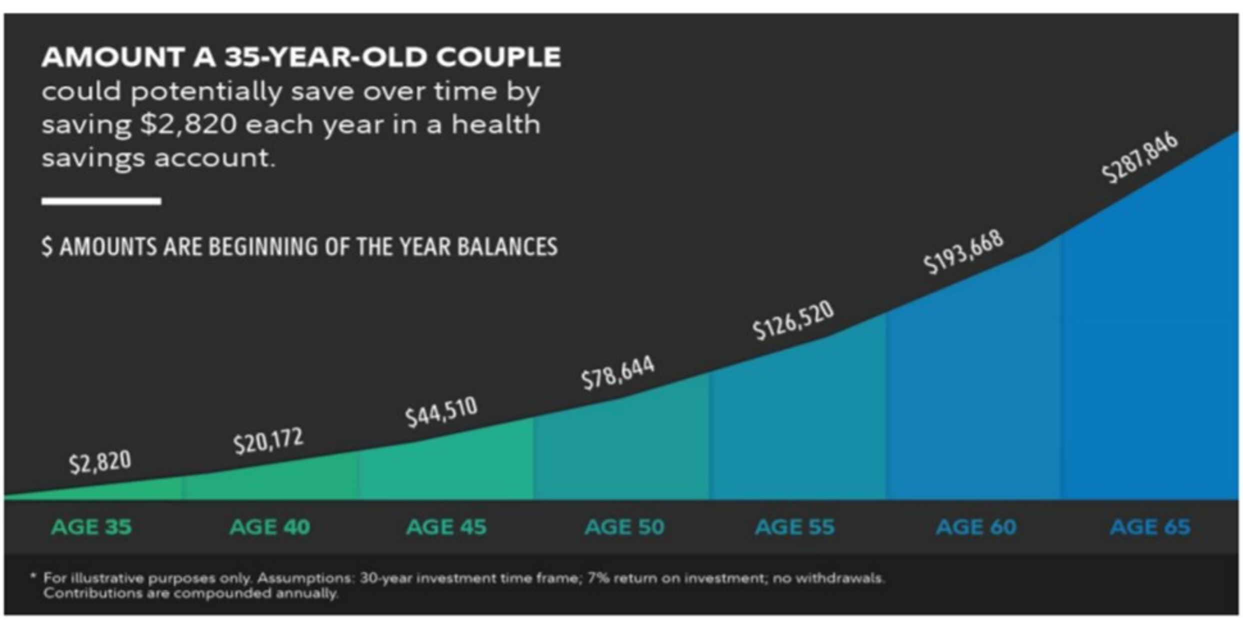
Available for Individuals with High Deductible Insurance Plans. HSAs are only available for those that have high-deductible health insurance plans. The policy must have had a deductible of at least $1350 for individual coverage, or $2700 for family coverage in any given year. An individual also cannot be claimed as a dependent on another person's tax return.

Tax Benefits. There are several tax advantages to utilizing an HSA. Contributions into HSAs through an employer are made utilizing pre-tax dollars. If you open an HSA and fund an account on your own, these contributions are tax deductible, even if you do not plan to itemize your deductions. The account will grow tax deferred, and as long as the withdrawals from the account are used for qualified medical expenses, the withdrawals are tax-free. It's like a Roth designated for health care costs.

Reimbursement for Out-of-Pocket Expenses. You also have the option of paying out of pocket for qualified medical expenses and getting reimbursed from the HSA at a later date. There is no time limit associated with implementing this strategy. This offers some possible planning opportunities. As long as the account is established before the qualified medical expense occurs, one can pay out-of-pocket for the medical expense, keep the receipt, and reimburse oneself from the HSA at a later date with no applicable taxable consequences.

Contribution Limits. Unlike a Flexible Spending Account (FSA), unused HSA funds carry over every year. The ability to accumulate a balance in the account is absolute and is not dependent on maintaining a high deductible health plan, staying employed, or changing jobs. HSAs are yours forever.

A family can have multiple HSAs, as long as annual contribution limits are not exceeded. For 2020, HSAs have contribution limits of $3,550 for individuals and $7,100 for families (plus an additional $1,000 "catch-up" contribution for those age 55 or older by the end of the tax year). The contribution deadline is April 15th (except this year, where the deadline has been extended to July 15th). Because the accounts grow tax-free if used for qualified expenses, it's important to invest the funds, especially if you are not planning on utilizing the funds right away for qualified medical expenses. Currently, only 5% of Americans place their HSA contributions into investments to take advantage of this tax-free growth. The chart below details the amount a 35-year old couple can accumulate by contributing $2820 a year to an HSA for 30 years, earning a 7% return per year on the contributions. By age 65, they have amassed over $287,000 in tax fee funds available to cover their health care costs in retirement.



Functionality. HSAs can also function like a retirement account. Prior to age 65, non-qualified distributions made from an HSA are subject to a 20% penalty in addition to applicable income taxes. After age 65, funds can be withdrawn with no penalty for non-qualified medical expenses. So, you still can enjoy tax deferred growth – the non-qualified distributions would be akin to withdrawing from an IRA after 59 ½. Once you've reached the age of 65 and are enrolled in Medicare, you are unable to continue to contribute to an HSA. Outside of regular medical costs and expenses, Medicare premiums (except Medigap Premiums), some long-term care premiums, and dental and vision-care expenses are also considered qualified expenses. [2] https://www.irs.gov/pub/irs-pdf/p969.pdf

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If you're able to pay out-of-pocket for medical expenses and let your HSA continue to grow, it can be an incredibly helpful planning tool to use during retirement when health care costs are likely to be much higher. Our financial planning team builds in a 7% annual increase in health care costs when we build out our financial plans for clients. It's critically important to think about these rising costs while budgeting for retirement. If you feel that opening an HSA is a good option for you, please reach out to your Financial Advisor or the planning team here at CFM and we would be more than happy to assist you.

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

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