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All Things Financial Planning

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SUMMARY:

- Introduction: Tax Law Change Update; SECURE ACT; 529 Changes in CO Law
- Financing Options for Long Term Care
- Charitable Planning Techniques and Strategies

Dear Clients,

With vaccination rates up and new COVID cases on the decline, we are welcoming back clients to our offices in person, if they feel comfortable meeting this way. Our office policies are evolving and our capacity is slowly increasing. We will continue to wear masks during meetings and as we move around the common areas in our office space. We will also continue to be vigilant in wiping down surfaces and maintaining cleanliness. But overall, seeing both co-workers and clients has been an enjoyable transition from the isolation we all experienced over the past 12 months or so. Welcome back!

Tax Legislation Update. For all the proposals and plans put forth by Congressional members and the President to effectually raise revenue through taxation to pay for new initiatives, not much has gained traction.

Senator Bernie Sanders proposed to increase the corporate tax rate to 35% and reduce the estate tax exemption to $3.5M per person, with a progressive tax on estates starting at 45% and increasing to 50% or more for estate values over $10M. The Sanders plan would also tax capital gains at the same rate as ordinary income for taxpayers with income of $250K and above.

President Biden also put forth a plan for Congress to consider, increasing the top marginal income tax rate for individuals and married couples to 39.6%, up from the current 37%. This rate increase would apply to individuals making more than $452,700 and married couples filing jointly with income over $509,300. His plan would raise the corporate tax rate to 28% and would eliminate the step up in basis on assets at death (with a small potential exemption baked in). It also would raise capital gains rates to 39.4% (43.4% when you include the net investment income tax) for those making more than $1M annually.

But Republicans and many centralist Democrats have viewed these proposals and plans with disinterest and as non-starters when it comes to raising taxes. So for now, the proverbial tax can is being kicked down the road. It is possible we could have some legislation gain momentum in the fall, but any tax changes passing both Houses would likely be severely watered-down and not the significant overhaul the President and Democrats had initially envisioned in November.

The SECURE ACT 2.0 legislation I discussed in the first quarter newsletter, however, is gaining traction. The House Ways and Means Committee voted unanimously to send this legislation to the full House for consideration. This bill would require employers to auto enroll new employees in defined contribution plans, allow employees ages 62 through 64 to make extra catch-up contributions to a 401k or similar plan up to $10,000, and would require all catch up contributions to be designated as Roth contributions. It also would allow plan sponsors the option of permitting employees to elect that some or all of their matching contributions be treated as Roth contributions for 401k plans.

And in a move that would affect the financial planning we provide for soon-to-be retirees, the new legislation proposes the age in which you must take your required minimum distributions (RMDs) be pushed back to 73 starting in 2022, increasing to age 74 starting in 2029 and 75 starting in 2032. Although there is bipartisan support for these changes and others, the final version of these proposals will likely be modified as the bill makes its journey through Congress.

SECURE Act and the 10-Year Payout. Anticipate clarification on the original SECURE Act and the 10-year payout for most non-spousal beneficiaries who inherit retirement accounts. The rule requires that all inherited retirement accounts must be emptied by the tenth year following the year of death of the original account holder. The initial interpretation was that no distributions were due until the 10th and final year, which means Roths could grow tax free for 10 years, and financial and tax planning could be deployed to a certain extent during the full 10-year period to manage the tax impact of distributions from tax deferred accounts, with no distributions mandated during the first 9 years.

But the IRS recently issued guidance on the new rule, indicating minimum distributions were required in each of the 10 years, and that any remaining balance in the account would need to be withdrawn by the end of the tenth year. This surprising publication was mere guidance and not official, so look for something more definitive to come out from Congress or the IRS on the subject later this year.

Potential Changes to Colorado 529 Contributions. Locally, a major tax reform bill proposes to cap how much Coloradoans can deduct on contributions made to 529 college savings plans. The bill would place a $20,000 yearly cap for individuals ($30,000 for a joint return) on tax-free contributions and would limit itemized deductions for those that make over $400K a year. Legislators who support the bill say the cap would close a loophole and make the system fairer, while reining in tax breaks for wealthier families and place Colorado's college savings accounts in line with other states. It would also generate a significant amount of state tax revenue. This would affect the tax breaks certain clients would receive, especially those who consider front-loading 529 plans with 5 years of the annual exclusion amount of $15K each ($75K total for individuals and $150K for married couples). The entire amount is currently deductible on your CO State Tax Return for the year of contribution. If the current proposal is passed into law, a full state tax deduction for this front-loading strategy would no longer be allowed, although such a planning approach still might be preferable to take advantage of tax-free growth in the accounts over a longer period of time. More on this state law change in the coming months.

Financing Options for Long Term Care
by Shannon Knight Howell
Associate Financial Planner

Every day through 2030, 10,000 Baby Boomers will turn 65. According to the Department of Health and Human Services (HHS) in 2019, almost 70% of the US population will require long term care services during their lifetime, for an average of 3 years. Considering the average life expectancy for 2021 is 79 years and this number continues to trend upward, it equates to a growing segment of the population that will need care or assistance in some form in their later years.

The cost to provide this type of care continues to inflate upwards. Nationally, the 5-year average cost of long-term care (LTC) has grown between 3% and 3.8%. In the Front Range, the cost has grown at a greater clip, between 4% and 5.2%, depending on the type of care provided. When we put financial plans together here at CFM, we budget an average of $100,000 per year at 4.5% inflation for long-term care events.

"Use your savings to build a time machine. You can afford to retire in 1950."

The Role of Government Programs in LTC. Unfortunately, government assistance to supplement this growing need is currently limited. Medicare only provides resources for short stays at skilled nursing facilities for rehabilitation, therapy services after a hospital stay, and hospice care. It does not directly cover ongoing personal care at home, assisted living or other forms of long-term care. Some states, including Colorado, have a Medicare service called PACE (Program of All-Inclusive Care for the Elderly). The program provides in home care and services to people electing to live at home who would otherwise need care in a nursing home. But the program requires a considerable monthly payment (unless you qualify for Medicaid) to supplement its sustainability.

Medicaid will cover the cost of long-term care at home or in skilled nursing facilities but has limited income and asset requirements to qualify for such a resource, which means for many of our clients, assets must be mostly or completely exhausted before they can gain access to the program. So unless the government decides to expand these resources to cover more comprehensive care for longer, those in need of LTC will have to utilize their personal balance sheet or look to an array of LTC products to assist in funding the care required.

Self-Insuring the Cost of LTC. Funding LTC costs from your personal resources is an exercise in financial planning. Utilizing different types of assets on a balance sheet to pay for LTC can have varying consequences, from resulting in significant income taxes upon the liquidation of an asset, to upsetting estate planning objectives. But based on current trends, there likely will be a need to pay for 1 to 3 years of LTC, with greater than 15% paying more than $250K total, according to a 2016 report from the National Association of Insurance Commissioners (NAIC). Individuals with dementia will average lifetime costs that exceed $350K per a recent Morningstar Report. For those with various types of assets, we often will model out in anticipation of such an event which assets are the best to use for LTC needs from a financial planning perspective.

Reverse Mortgages. For those without sufficient liquidity in their net worth to pay for LTC, but who have adequate equity in their homes, a reverse mortgage can offer some flexibility for cash flow needs. But these are complex financial products requiring some due diligence prior to implementation, as we highlight throughout the rest of this section.

Assuming the homeowner meets eligibility requirements detailed below, they can **use the equity in their home to acquire a lump sum amount, line of credit or automatic payment stream (like an annuity)**, utilizing their house as collateral. The difference between this type of loan and a conventional mortgage is that a reverse mortgage does not have to be paid back until the last borrower (i.e. the surviving spouse) passes away or moves. The home must be the primary residence of the applicant, they need to be at least 62 years of age, and the home must be a qualifying home-type (single family, townhome, condo, duplex, or manufactured home). There also cannot be a mortgage or any debt against the home – the reverse mortgage must secure the first lien position.

If you are considering a reverse mortgage, careful planning should take place to not disqualify an individual or family from the use of Medicaid, as home equity (up to a certain amount) is a protected resource and not considered for Medicaid eligibility. For example, if a homeowner opts for a lump sum payment, the equity would likely be deposited into a bank account, which can then be considered a disqualifying asset. Annuity-like payments stemming from a reverse mortgage can also effectively disrupt eligibility for Medicaid.

The timing of taking out a reverse mortgage can also be critical. If the homeowner moves into a nursing home or assisted living facility for more than 12 consecutive months, this would be considered a permanent move under reverse mortgage regulations and the loan would need to be paid in full. This might result in the selling of the property, which could create liquidity that is not protected as a resource under Medicaid rules. A reverse mortgage can be a great planning tool in the right situation – but make sure you complete a comprehensive financial plan prior to making such a commitment.

Long Term Care Insurance. If there are not assets on the personal balance sheet that can support LTC costs and with government programs limited in scope, insurance is an option worth considering should LTC needs arise in the future. There are a variety of types of products available with various strengths and weaknesses. The differences in the sophistication of such products are predicated on cost of premiums, benefit payout, and optionality of the product.

Traditional Long Term Care Insurance often provides the highest leverage. These benefits can be tailored depending on budget and needs of the client. Some traditional LTC products offer inflationary rider options for an increased cost. Traditional LTC policies do not offer guaranteed premiums leaving open the possibility of increasing premium costs (which can be problematic both from a budgeting standpoint and with insurance companies scrambling to pay the benefits contracted for), nor do they offer death benefits. Spouse or partners of the policy may be able to share benefits, depending on the plan. These policies traditionally demand an individual be in good health, requiring extensive questionnaires and background checks regarding the personal and family health of the participant.

A long-term care policy can also offer to pay **life insurance benefits and can accelerate these benefits.** This type of policy is known as a "living benefit" plan. The death benefit is used to pay for long term care while the policy holder is living. Any remaining benefits are then paid to the beneficiaries after the death of the insured. It is possible to guarantee premiums and benefits for an additional cost, and because it is a traditional life insurance policy, cash surrender policies are available. The cash value of existing policies can also be exchanged for a new policy with accelerated benefits via a 1035 exchange, if exchanging the policy results in a superior product that better fits into your financial plan.

The downside to this type of policy can be the lack of inflation protection. Collecting accelerated benefits may also affect the ability to utilize Medicaid, as the use of the death benefit could be considered income, thus potentially disqualifying the insured from accessing much needed government resources.

There are also linked benefit LTC products known as "hybrid" and "asset-based" policies. These products combine LTC insurance and life insurance with accelerated benefits. It can feature guaranteed premiums with a portion of the principal returned, if surrendered, and can insure two individuals with lifetime benefits available. Premiums can be paid with a single lump sum, or can be paid utilizing various payment schedules, including a 10-pay, 15-pay, 20-pay, or lifetime premium plan. The cost for these linked benefit policies is much higher than traditional LTC insurance as an individual is buying a life insurance death benefit, accumulating cash value, and receiving guaranteed premiums payments.

A **Hybrid LTC Annuity policy** combines LTC insurance and a deferred annuity, with the unused portion of the annuity paid out as a death benefit. These policies can have guaranteed premiums. The underwriting of these policies can also be easier than traditional LTC policies and are available to older individuals, although health requirements can vary depending on the company. It can insure two individuals and benefits can come in the form of a reimbursement.

This option works for an individual having an existing deferred annuity with no plans to annuitize the product for income. As with all annuities, it may require a large, up-front premium payment. Withdrawals of any gains from annuities are also taxed as income. Hybrid policies may not offer the best coverage by bundling. The products are also limited in the ability to customize to support an individual's specific needs.

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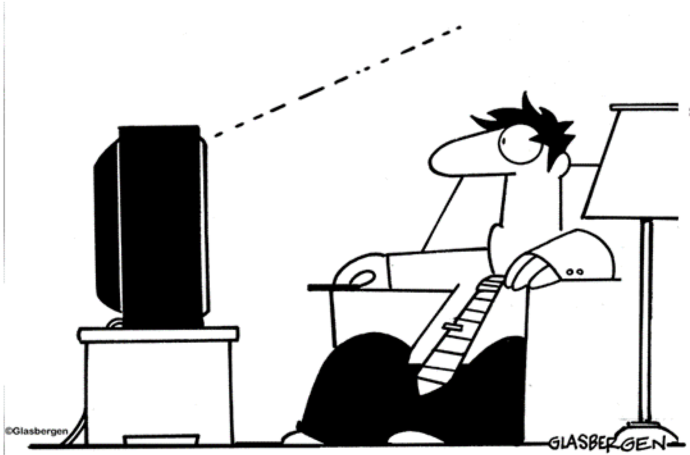
There is much to contemplate when planning for the possibility of long-term care in your future. Considering government resources are currently limited, an examination of your family health history, and whether or not a long-term care event would be adequately covered by your own resources, would be the first steps to take before determining whether long-term care insurance might be worth exploring. We provide this type of comprehensive analysis for many of our clients, and would be happy to review your financial plan and provide you with our recommendations. Please reach out to your financial advisor or financial planner if you'd like to discuss LTC options, or would like a LTC or life insurance policy analyzed to see if the product still makes sense in the overall context of your financial plan.



"The stock market bounced back today until analysts determined that bouncing looks silly and undignified."

Charitable Giving in 2021
by Viktoria Falus, CFP, EA
Senior Financial Planner

Charitable giving is an important element in many of our client's financial plans. In addition to satisfying personal objectives, charitable giving can also be an effective tax-planning tool. The purpose of this article is to explore charitable giving strategies available, the tax savings associated with deploying these strategies, and how recent changes in the tax laws have impacted these philanthropic techniques.

One important consideration when it comes to charitable giving from a tax planning standpoint is whether you can **itemize your deductions**, or whether the **standard deduction** is applicable. The Tax Cuts and Jobs Act (2017) allows you to take a standard deduction in 2021 of $12,550 for individuals and $25,100 for couples. If your total allowable deductions exceed these levels, you can still itemize them and receive a larger tax deduction benefit. So for strictly tax planning purposes it only matters if your charitable giving will result in your itemized deductions exceeding these standard thresholds. Otherwise, you are using the standard deduction the IRS provides everyone, and although you may be fulfilling a personal charitable intent, there will be no additional tax savings (there is a small additional benefit discussed within the article when you make a qualified charitable cash donation in 2021 while still using the standard deduction). Keep this in mind as you read through these techniques as the charitable planning tax savings tactics assume an itemization of your deductions, unless otherwise stated. Considering the tax benefits increase as you deduct more than what the standard deduction allows for, this could influence the amount you give in a particular year, or could have an effect on a multi-year gifting strategy, as we will discuss toward the end of this article.

A Direct Gift to Charity. This is the simplest form of giving. You give a direct gift to your favorite qualified charity and you can deduct the fair market value of the gift from your income tax in any given year, assuming as we discussed above, you can itemize it. The most common types of donations are cash and marketable securities. Some qualified organizations accept less traditional assets such as real estate or other complex assets including private stock, restricted stock, business interests, and/or art and collectibles, but the donor should follow up with the charity to insure less traditional asset classes will not be rejected.

With a cash donation, prior to the CARES Act (passed into law in March 2020), a donor could deduct the value of a cash donation up to 60% of the donor's adjusted gross income (AGI) as an itemized deduction. But in 2021, the CARES Act allows donors to deduct up to **100% of their AGI for a cash donation**. Another less monumental change for 2021 introduced with the CARES Act was the ability of an individual to deduct up to **$300 as an "above the line" deduction**. Married couples filing jointly can deduct up to $600. This change allows people who do not itemize their deductions and are taking the standard deduction to still deduct a cash contribution up to this amount. Prior to the CARES Act, only those who itemized were able to deduct charitable contributions.

A donation of long-term appreciated assets (stocks, bonds, and mutual funds) rather than cash to charity has an additional potential tax benefit. By not selling the appreciated holding, and instead gifting it to the charity, the donor avoids capital gains tax, while also receiving the benefit of a tax deduction up to 30% of the donor's AGI. Consider the following hypothetical:

Donor has $200,000 worth of appreciated assets she would like to donate to a qualified charity. Assuming the original cost of the securities was $50,000, and a federal long term capital gain rate of 20%, then the donor would incur a $30,000 capital gains tax if she sold the securities prior to gifting. The charity would receive $170,000 and the donor's tax deduction would be based on that value. But if she instead donated the securities with a value of $200,000 directly to the charity, she would avoid any capital gains tax, and would increase both the charitable gift amount and the tax deduction amount.

Gift via a Donor Advised Fund. One type of account that has made charitable giving more efficient and flexible in recent years is a **Donor Advised Fund (DAF)**. A DAF is a holding account that receives donations for current and future giving. The donor makes a gift to the DAF and retains control over the distribution timing and charitable organization(s) who ultimately receive the gifts. A gift into a DAF is irrevocable and the donor *cannot* access the funds in the DAF for personal use after the transfer is made. The funds in the DAF can be invested and managed for growth by the donor or an advisor, such as CFM or a community foundation.

A DAF optimizes and simplifies donating appreciated assets through technology and account linking. When a donor contributes to a DAF, they are generally eligible to take an immediate tax deduction in the tax year the donation is made. It is the same as giving directly to the charity, but involves the utilization of a simpler, more time efficient online platform. Although this might change in the future, one consideration in utilizing a DAF is that the aforementioned 100% of AGI rule via the CARES Act that temporarily applies to direct-to-charity cash donations does not apply to cash donations to a DAF. Instead, a donor can still deduct up to 60 percent of AGI in cash and up to 30 percent of AGI in appreciated assets contributed to a DAF.

Gifts to Charitable Trusts. The two most common types of charitable trusts include a **Charitable Lead Trust (CLT)** and a **Charitable Remainder Trust (CRT)**. Typically, these types of charitable vehicles are best used when making larger contributions, so whether there will be enough to itemize the deduction is not of consequence. A donor can establish a CLT or CRT with the help of an attorney and then transfer designated assets into the trust. The assets in a CLT generate a stream of income that is transferred to a charitable organization each year. Money left in the trust at the end of the established giving 'term' can be distributed to other beneficiaries. With a CRT, the donor (and possibly other beneficiaries) will receive the stream of income first, and then the charity receives the remainder at the end of the term, or at the death of the last beneficiary.

With a CRT, if it is funded with cash, the donor can take a partial income tax deduction of up to 60% of AGI. If appreciated assets fund the trust, then up to 30% of AGI may be partially deducted in the current year. Since the transfer to a CRT and CLT is irrevocable, by placing highly appreciated assets into a CRT you can avoid capital gains tax by having the CRT or CLT sell the assets after receipt. Assets transferred to a CRT or CLT can also reduce the donor's taxable estate by removing assets from the estate and revaluing the interest the donor or future beneficiaries have in the assets after transfer, based on the terms of the trust.

Qualified Charitable Distributions from an IRA. If you are age 72 or older, IRS rules demand that you take a required minimum distribution (RMD) each year from your tax-deferred retirement accounts. A **qualified charitable distribution (QCD)** is a transfer of funds from your IRA, payable directly to a qualified charity. Amounts distributed as a QCD can be counted toward satisfying your RMD for any given year, up to $100,000. You can begin utilizing QCDs at age 70.

The beauty of a QCD is it is *excluded* from your taxable income. If you take a withdrawal from your IRA and later choose to donate to charity, the distributions will be included in your taxable income *even if offset by a deduction*. This is an important distinction because the additional taxable income may push you into a higher tax bracket and change your AGI, which is the number used to calculate several deductions and credits. Furthermore, making QCDs has the added benefit of reducing your AGI by the QCD amount and allowing the donor to utilize the standard deduction.

Naming a Charity as Your IRA Beneficiary. Charitable giving can also be a part of your estate plan by **designating a charity or a DAF as a beneficiary of an IRA or other deferred retirement account**. Assets transferred to charity upon the account owner's passing will not be included in his/her estate.

Another benefit to designating charities as beneficiaries of a tax deferred retirement account is the income tax savings your heirs will enjoy. Most non-spousal heirs who are named beneficiaries of an IRA will have to start taking minimum distributions (per a recent IRS publication) immediately and deplete the account within 10 years, paying ordinary income tax at their own marginal rate on those distributions. Charities do not pay income tax on IRA distributions. If a taxpayer has a large estate with various types of assets and charitable intentions, leaving an IRA or portion of an IRA (instead of a taxable account) to a charitable organization might be a more optimal solution. (Note: This strategy may be less effective if new tax laws are passed that eliminate the step-up in basis on taxable assets of a decedent upon their death. Stay tuned!)

Bunching Charitable Donations Together to Take Advantage of the Large Standard Deduction. Many donors who historically itemized deductions on their tax returns can continue to do so while also taking advantage of the larger standard deduction by employing a **'bunching' technique**. A donor can concentrate and itemize their charitable contributions in higher income years and then benefit from the increased standard deduction in other years.

For example: A married couple has $24,000 of itemized expenses, including a $12,000 donation to a qualified charity or DAF. Because the $24,000 in total deductions is below the $25,100, the couple would claim the $25,100 standard deduction for that particular year. If these same numbers played out in consecutive years, they would claim a total of $50,200 in standard deductions and would not itemize.

But the couple could take a more tax-advantaged approach by doing the following: Instead of donating $12,000 to charity in both 2021 and 2022, the couple could concentrate, or "bunch," together their charitable donations all in a single year. The concentrated donation creates a total of $36,000 in itemized deductions for the year in which they "bunch" together the charitable donations. In the "non-bunching" year, they still take the $25,100 standard deduction. Thus, over this 2-year period, the couple can utilize an additional $10,100 of deductions on their joint tax returns.

The above strategy can be very beneficial in years when a donor expects a large taxable event, such as a business sale, property sale, the vesting of a significant amount of stock options, or during a year in which a Roth conversion strategy is being used. These types of events can typically create an unusually high taxable income amount for a taxpayer in the given year. Coordinating charitable giving in high income years is part of any well-managed, deliberate financial planning strategy. If you would like to discuss any of these techniques in further detail for applicability to your specific situation, we would welcome the conversation and opportunity to assist.

As always, please consult with your CPA or tax attorney before the implementation of these charitable giving strategies to make sure any intended actions coincide with the desired tax savings outcome. Happy giving!

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

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