COLORADO FINANCIAL MANAGEMENT®

All Things Financial Planning

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SUMMARY:

- Introduction:
- Tax Contribution Deadlines, Deductions and Credits
- Planning for Incapacity: Finding the Right Approach in Assisting You with Your Financial Affairs

Dear Clients,

Just as Covid-19 seems to have subsided and we all are starting to experience what the other side of a pandemic feels like, Russia decided to invade Ukraine. Couple this with the higher cost of food, energy and other goods and services due to inflationary forces at work, and celebrating any victory over the pandemic feels short-changed and somewhat empty.

In response to inflation running hot, we have decided to adjust our general inflationary assumptions for financial planning modeling purposes to 2.75%, up from 2.25%. This percentage is the yearly upward adjustment we make to your living expenses to account for an increase of expenditures over time. While inflation across the board is running much hotter currently, we do expect the increase in the cost of goods and services to come down over time, but we may be in a higher inflationary environment for a while, so we certainly want to account for it. We'll continue to monitor a number of different inflationary measures, including the **Consumer Price Index (CPI)**, and how it might affect living expenses both in the short term and long term, and whether we need to make further adjustments in our financial planning modeling.

At one time, the **Build Back Better (BBB) legislation** was likely to pass, and the question was to what extent changes in the tax code would have an effect on our clients. Now the bill has stalled in Congress and has all but been left for dead. Other than the potential for additional legislation designed to assist the Ukrainians in some capacity, there is not much on the horizon for new legislation that might have an impact on your finances. Curbing inflation is likely in the hands of the federal reserve and father time. The federal reserve just raised interest rates by a quarter percentage point and will likely continue to raise rates in the months ahead. Hiking interest rates increases the cost of credit throughout the economy and tends to lower inflation and moderate economic activity. Assuming supply chain issues moderate, and there is some type of resolution to the conflict in Ukraine, this should help quell inflationary increases in the cost of goods and services. But we will need to be patient as we see how everything plays out.

Regarding the remaining contents of this newsletter, considering we are in the thick of tax season, I thought I would provide some contribution deadline reminders and the corresponding amounts available to contribute, if pertinent to your specific situation. I also have outlined some of the more common tax

deductions and tax credits utilized on tax returns to assist you in your discussions with your CPA regarding applicability. Additionally, this newsletter contains a detailed article on incapacity planning and some common strategies available as you plan for the possibility that one day you may need assistance in managing your financial affairs. I hope you find the material informative and useful.

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"Here. You figure out this mess!"

Tax Filing and Contribution Deadlines. The **tax filing deadline is April 18, 2022** for your 2021 Tax Return, unless you were a victim of the recent **Marshall wildfires**, in which you can claim an extension until May 16, 2022 to file tax returns and make tax payments. There also is the possibility to claim a disaster loss deduction, if any reimbursement from insurance does not cover the full total of the loss. Please consult your accountant for the full details and to assist with this process if this horrific tragedy directly impacted you.

For **contributions to IRAs and Roths**, up to $6000 can be contributed if you are under 50. For those of you 50 and over, you can add $7000 to your IRAs. If you have a high-deductible health insurance plan that makes you eligible for a **health savings account**, you can make tax-deductible contributions for 2021 until April 18th. The max contribution to a health savings account for 2021 is $3600 for self-only coverage and up to $7200 for family coverage, although those over age 55 can contribute an additional $1000 as a "catch up" amount.

For self-employed individuals, if you have opened an account prior to December 31, you can still contribute to your solo 401k or SEP IRA up to $58,000 (plus a $6500 catch-up contribution for those 50 or older) up to the tax filing deadline.

Other Tax Deductions and Tax Credits. Although most taxpayers now take the standard deduction of $12,550 for single filers, $25,100 for married taxpayers, and $18,800 for heads of household, it is worth reviewing your total deductions to see if it is still beneficial to itemize. I detailed many of these common deductions last year during this time, and I will do so again this year, in case you missed the publication:

- **Student loan interest deduction** – up to $2500 from your taxable income if you paid interest on your student loans
- **Mortgage interest deduction** – the mortgage interest paid on the first $1 million of mortgage debt (if purchased prior to 12/15/2017, otherwise $750K is the limit)
- **State and local tax deduction** – up to $10,000 for a combination of property taxes and state and local income taxes or sales tax
- **Charitable donations deduction** – a dollar for dollar deduction for gifts made to charity (you also can deduct $300 on your tax return for gifts to charity if you are utilizing the standard deduction, and $600 if married filing jointly)
- **Medical expense deduction** – for qualified, unreimbursed medical expenses of more than 7.5% of your adjusted gross income for the tax year
- **Home office deduction –** if you utilized your home regularly and exclusively for business-related activity, it is possible the IRS will let you deduct associated rent, utilities, real estate taxes, repairs, maintenance and other related expenses. Although this possible deduction continues to be popular, you will want to consult your CPA about its applicability in your situation.

You can apply tax credits regardless of whether you itemize or take the standard deduction. Here are some popular tax credits included again this year for your review:

- **Child Tax Credit** – expanded through the American Rescue Plan (signed into law on March 11, 2021), receive up to $3600 per child under the age of 6, and $3000 for each child ages 6 to 16, as a credit on your return. This tax credit is reduced to $2000 per child if your modified AGI in 2021 exceeds certain limits. Also note that many parents may have received an advance on these child related tax credits in the second half of 2021, so the credit available may be reduced on their actual return
- **Child and Dependent Care Tax Credit** – up to $8000 of expenses for 1 child or $16,000 for 2 or more dependents. Additionally, you may be able to write off as much as 50% (up from 35%) of those expenses, depending on your AGI
- **Earned Income Tax Credit** – worth between $1502 to $6728 depending on how many children you have, your marital status and your income level
- **American Opportunity Credit** – covering each of the first 4 years of college, a credit of $2500 per qualifying student is available for tuition and fees (qualification based on income level)
- **Lifetime Learning Credit** – covering any years of post-secondary education (not just the first 4 years), a maximum credit of $2000 is available per return (qualification based on income level)

Although we are not CPAs, we are happy to have a conversation with you about whether a specific deduction or tax credit may apply and assist you with tax planning. We can also connect you with a local accountant who can provide advice and help you with the filing of your return. Either way, please let us know how we can help.

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Planning for Incapacity: Finding the Right Approach to Assist You with Your Financial Affairs

By Jason Foster, Director of Financial Planning, JD

With an estimated 6.2 million Americans 65 and older living with Alzheimer's in 2021, and 72% being age 75 or older, it is worth having a conversation about making sure there are proper protections in place to not only preserve your net

"At this point, bulls and bears might be more useful in your freezer than in your retirement portfolio.

worth, but also to make sure your finances are managed appropriately and efficiently if you are no longer able to manage them on your own. There are a few common approaches that can be utilized to manage incapacity. The following information is designed to detail these common strategies and the pros and cons of each arrangement, so you can make an informed decision to help protect you and your assets in the future.

Trusted Contacts on your Accounts. At the brokerage account level, both Schwab and Fidelity have forms account holders can utilize to name an individual that we can contact if we observe activity that seems inconsistent with what we have become accustomed to seeing in the past. The idea behind having this trusted contact on your accounts is to address potential financial exploitation, confirm contact information, and to confirm health status or the identity of a legal guardian, executor, trustee or agent under a power of attorney. The trusted contact would have no access to the account, could not view account balances, information or details, nor could they execute transactions, or even inquire about any activity that is taking place on the account. But it allows your financial advisor here at CFM to contact someone that might be able to look further into our inquiry, as we uncover activity that seems abnormal or is a clear departure from the normal course of business. If you do not have a trusted contact on the account, we encourage you to have one so this basic protective action is in place. Please

contact your financial advisor here at CFM and we will assist you with the form and process.

Joint Account Owner Approach. While adding a trusted contact to your accounts will serve a limited purpose, there are other methods necessary to assist with the actual management of accounts in case help is needed or eventually required. Over the years, both in private practice and at CFM, I have had clients suggest the use of "convenience accounts" to accomplish this goal. These are really just joint accounts, set up for administrative purposes that allows both the individual account holder or a trusted individual added to the account to manage the account. Clients can set these joint accounts up as a new account and transfer assets into the account, or simply add the trusted individual to an already existing account. It avoids the professional legal work needed to set up a power of attorney, and it's easy (hence the name "convenience account"). The trusted joint owner can do everything that the account holder can do on the account – deposit money, write checks, pay bills online, withdrawal money, get statements, make investment decisions, etc. But unless it is a very special situation, **we rarely would recommend this arrangement because of a myriad of potential issues** that can result from such an approach.

One potential problem with the joint account owner approach is that it creates a 100% ownership of the account by both people. This results in the new owner having full access over 100% of the account. This creates a situation where either owner can access the account and take distributions without protections in place to thwart any improper activity. It's also possible that adding an additional account holder could be deemed a gift for gift tax return purposes, which means the possibility of filing a return as if you intended to gift a portion of the account to the trusted joint owner. You might be able to prove the joint account was established purely for convenience and the creation of the arrangement was not intended to be a way of transferring assets, but there is some exposure here to an unintended consequence.

Another issue resulting from the perceived notion of ownership here is the potential exposure of this "convenience account" to the joint owner's creditors, lawsuits, bankruptcy filings, divorce proceedings, or other unwanted adverse actions the joint owner may be dealing with now or in the future. Again, it's possible arguments could be made to keep these accounts from being considered owned by the joint account holder, but depending on the fact pattern and state laws in play, the risk in establishing these types of accounts is not worth the simplicity of set up and use.

If the account is owned with a joint tenants with rights of survivorship designation, it means that the account will automatically transfer to the joint account holder upon the death of either of the account owners. But what if this is not the intention? If the true owner's estate plan contemplates a different result, dividing all assets, including this joint account, between several heirs, then owning the account with just one trusted heir creates a conflict. And legally speaking, the joint ownership designation on the account would trump any contradictory intentions spelled out in a Will. Thus, the overall estate distribution would not be equal, and other heirs might be relying on the goodwill of the surviving joint account holder to add this back into the estate.

Regardless of the above concerns, there are also limitations to the approach of adding someone to your accounts to assist in the management of these accounts. You are unable to add someone to a retirement account the way you are a bank or brokerage account because an IRA or Roth cannot be jointly owned. So if the plan is to

"You're confused. That means I explained it properly."

employ this joint account ownership strategy across several different types of accounts so the joint account holder can manage assets for convenience in the face of incapacity, this tactic has limitations, assuming one has retirement accounts on their balance sheet.

Powers of Attorney. Establishing an agent under a power of attorney gives a trusted individual access to assets to help manage these assets and facilitate transactions. The agent chosen has a **fiduciary duty to the principal**, which is a legal requirement to act in the principal's best interest. No ownership of assets are transferred when a power of attorney document is executed. So none of the issues discussed in the previous section regarding the creation of "convenience accounts" exists with an agency arrangement created under a power of attorney.

Although it is a much better overall approach to managing your net worth if you are unable to do so, powers of attorney can provide some inconveniences and frustrations along the way, especially when dealing with institutions. Often times banks, lenders, brokerage houses, and other financial institutions struggle to know when a power of attorney is in full force. These institutions may have their own back office approved power of attorney form, and although you had a power of attorney drafted and executed by a reputable lawyer following state statute, the institution may subject the document to a lengthy analysis regarding its validity. One solution to this problem might be to submit the power of attorney document to the institutions holding your various accounts well in advance of the need to use the agency relationship. In this regard, the institution's legal team can complete the "approval" process early on so the agent does not have to wait before being able to actively manage the accounts.

The **powers given to the agent by the principal can be general or limited**, and if the powers are limited, the agent can only act on behalf of the principal for certain things. One example of a limited power of attorney involves your relationship with CFM. In opening up a brokerage account with us and having us manage the account for investment purposes, you name CFM the agent under a limited power of attorney regarding these accounts. We have a fiduciary duty to you to manage the account in your best interests, and we can only manage the account per the limited scope of the arrangement. We have no power to manage outside accounts or other assets. **A general power of attorney, by comparison, gives the named agent broad powers to manage** most or all of the financial affairs of the principal, and you'll want the agent to have these broad powers if you become incapacitated.

Powers of attorney can be non-durable, springing, or durable. These various types of powers of attorney define when the arrangement will go into effect:

- Non-durable: in effect immediately and ends when the individual becomes incapacitated
- Springing: in effect once a triggering event occurs, such as an individual's incapacity
- Durable: in effect immediately and continues to be in effect when the individual becomes incapacitated

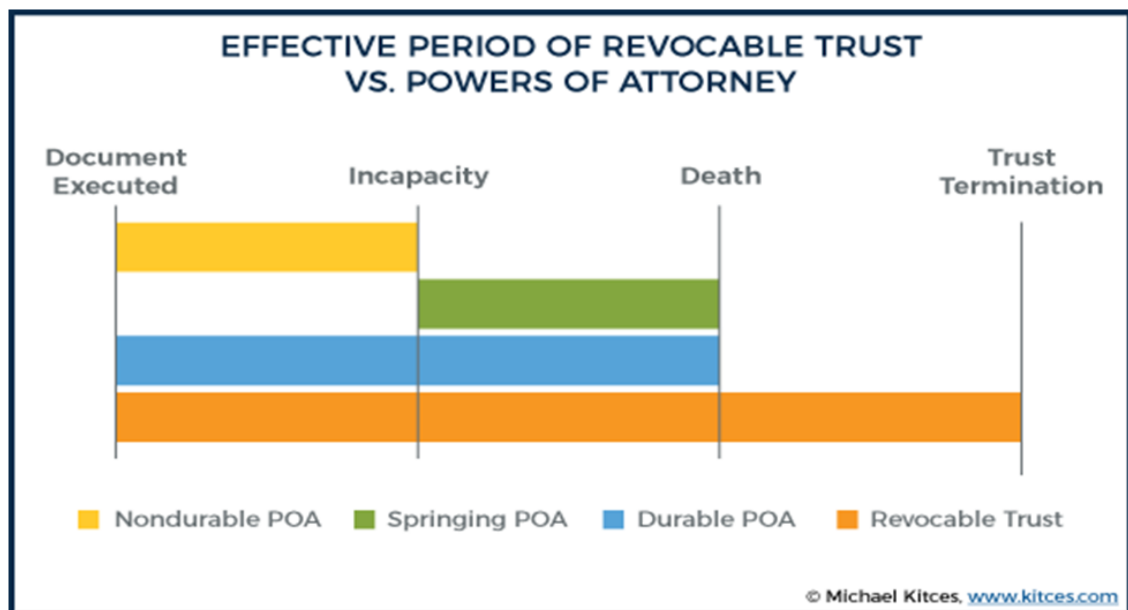
Most often, attorneys will create a springing or durable power of attorney because most clients are creating these agency arrangements for incapacity reasons. But which is better? The **durable power of attorney is likely preferable** because there is no triggering event, such as incapacity, that needs to be determined in order for the agency relationship to be in full force. This allows the agent to act quickly and immediately.

I'll provide a brief example to illustrate the advantage of utilizing a durable versus springing power of attorney: Imagine discovering a parent or sibling has been neglecting payments on bills due to perceived incapacity issues. You would like to assist them in making these payments, and managing other financial matters that you have found to have been neglected as well. You find you have been named as the agent under a financial power of attorney they drafted several years prior. If it is a springing power of attorney, the determination of incapacity must take place before you can take action to manage their financial affairs. But the problem is you are not qualified to make that incapacity determination. Depending on the document, you may have to get two physicians to declare in relatively short order that the parent or sibling has capacity

issues or is incapacitated. Not only will this take some time, but what if one or both of the physicians decides your loved one still has all or some of their capacity? What if the family member you are trying to help is upset that you are trying to prove they are incapacitated? The power of attorney document is meaningless to financial institutions, and they will deny you access to the accounts unless you have these incapacity declarations. The power of attorney does not officially "spring" into effect until this happens.

This is why the durable power of attorney is the preferred approach. You can **act in the principal's interest immediately upon execution**, so no incapacity determination is needed for the agent to manage assets. Some might feel uncomfortable giving these powers to an agent right away, but remember, this is a hand-picked, trusted person who has a legal duty to act in your best interests, and you are giving these powers to this agent while you can still manage your financial affairs. It seems logical then that you can trust them now while you have complete capacity (to monitor their actions) because you are also trusting them to manage your affairs if you become incapacitated (and can no longer monitor them)!

Trustee Arrangements. Living Trusts are created for a variety of reasons, most notably for probate avoidance and privacy. I have detailed the pros and cons of utilizing living trusts versus wills as your basic estate plan in a previous newsletter, but one additional benefit to discuss as it relates to this article, is the ability to name a successor that can manage your assets owned by the trust during life if you become incapacitated, and at death, when the assets in the trust need to be distributed according to your wishes.



The **successor trustee has the same fiduciary duty as an agent under a power of attorney** – a legal obligation to act in your best interests. But this doesn't mean the successor trustee is managing all of your assets. They can only manage assets that have been transferred into the trust prior to incapacity or death, which means for assets outside of the living trust, these must be managed by an agent under a power of attorney. The agent under a power of attorney would also need to manage retirement account assets because they are not transferable to a living trust. Thus ideally, the successor trustee and agent would be the same person.

One appealing characteristic of a successor trustee arrangement is that **the management powers do not end at the death of the living trust creator, unlike a power of attorney**. The living trust, which is revocable in nature, becomes irrevocable upon the death of the creator, which results in the successor trustee continuing to manage the assets post-death. Instead of managing them for the benefit of the one who created the trust, the successor trustee is now handling the disposition of the living trust assets. A comparison between the effective periods of the various types of powers of attorney and a trustee arrangement under a revocable living trust is illustrated below.

Co-Trustees vs. Successor Trustees. In creating a living trust, you typically will name yourself as the trustee. You retain control of the assets, can revoke the trust, add or remove assets, and generally speaking, can manage the trust for your benefit. Some clients will add their spouse as a co-trustee, or simply make them the successor trustee, so if you become incapacitated or pass away, the continued management of assets is streamlined.

But what is better: a co-trustee or successor trustee arrangement? A successor trustee may have to deal with the same problems an agent under a springing power of attorney encounters. In the previous section, I discussed the possible difficulties an agent under a springing power of attorney may confront when attempting to acquire an incapacity determination prior to being able to act on their powers for the benefit of the principal. Whereas a successor trustee has this same issue, a co-trustee can continue to manage trust assets as long as there is language in the trust allowing each co-trustee to act independently. Like an agency arrangement created with a durable power of attorney, a co-trustee will have the power to legally administer and manage assets from day one, which likely guarantees no delays if you become incapacitated. Also remember that a co-trustee is not a co-owner, so by adding a trusted co-trustee to manage the living trust, this does not transfer ownership to them. The trustee is obligated to manage the assets for the benefit of the beneficiary or beneficiaries named in the trust.

If there are concerns that the co-trustee will use their powers irresponsibly, a removal power can be added to the trust language so that the creator of the trust (or an independent third party) has the power to replace a co-trustee in the future. But a trustee, like an agent under a power of attorney, has a fiduciary duty to act in the best interests of the beneficiary, and assuming the individual creating the living trust is choosing a trusted individual to be their co-trustee, the probability of an abuse of trustee powers is likely limited here.

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Understanding the available strategies to employ to protect and manage your net worth is a critical part of any financial and estate plan. Adding trusted contacts to your accounts we manage and making sure the right fiduciary documents have been executed and are in place are important steps in this process. If you have questions about what types of documents you have to address the management of assets if you become incapacitated, or what documents are necessary to accomplish this objective, feel free to reach out and CFM would be happy to provide this review and have this discussion with you so you can rest assured knowing that if capacity ever becomes an issue, you have the right arrangements in place to protect you and your assets.

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