INSIGHT ON ESTATE PLANNING

YEAR END 2020

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Shh!
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ESTATE PLANNING PITFALL
You've named the wrong executor

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Does a qualified charitable distribution make sense this year?

A unique provision in the tax code allows certain transfers, made directly from a traditional IRA to a qualified charitable organization, to avoid taxation. Although this benefit of a qualified charitable distribution (QCD) has been negated for 2020, there are still several viable reasons for making a QCD this year.

At the same time, charities that are in dire need of funding during the COVID-19 pandemic will greatly appreciate your generosity.

The back story

Normally, distributions from traditional IRAs are taxable at ordinary-income tax rates, currently reaching as high as 37%. If you take money from an IRA and donate it to a qualified charity, it's deductible on your annual tax return if you itemize deductions. Thus, these actions may cancel each other out. Nonitemizers who claim the standard deduction receive no tax benefit. (For 2020, a limited charitable deduction of up to $300 is available to nonitemizers.)

With a QCD, you avoid the middleman. So long as certain requirements are met, the transfer isn't treated as a taxable distribution. Thus, you won't be taxed on the amount, but you can't deduct the contribution, either.

To qualify for this special tax treatment, you must be at least 70½ years old at the time of the transfer. In addition, the maximum annual QCD allowed is $100,000 per taxpayer. A married couple, thus, can

double this amount to $200,000 if both make a QCD.

Be aware that certain charities — including donor-advised funds, private foundations and supporting organizations — aren't eligible to receive QCDs. Also, Roth IRAs may be used for QCDs, but there's no advantage to it.

But that's not the end of the story.

Revised rules for RMDs

Significantly, a QCD also counts as a required minimum distribution (RMD) from an IRA. This is often cited as the main reason for arranging QCDs.

Participants in traditional IRAs must begin taking RMDs by April 1 of the year following the year in which they turn age 72. They must continue RMDs in each succeeding year. The RMDs are based on life expectancy tables and the value of the account on December 31 of the prior year.

Previously, the required beginning date (RBD) was based on age 70½, but the Setting Every Community Up for Retirement Enhancement (SECURE) Act pushed back the RBD, beginning in 2020. Thus, under the

SECURE Act, you would normally have until April 1, 2021, to take your first RMD if you turned age 72 in 2020.

The RMD rules also apply to beneficiaries who've inherited traditional IRAs. But mandatory lifetime distributions aren't required for participants in Roth IRAs. (Roth IRA beneficiaries must empty out their account under special rules.)

The Coronavirus Aid, Relief and Economic Security (CARES) Act, with additional IRS guidance, suspends the RMD rules for 2020. Furthermore, this waiver extends to all beneficiaries of IRAs. So you don't have to take any RMDs for 2020 if you don't want to receive the money and don't need it.

This change dilutes the benefits of using QCDs. In fact, some might even say there's no reason to do it at all this year.

But there's still more to the story.

Benefits of QCDs in 2020

Granted, a QCD won't count as an RMD in 2020, because there's no requirement to take distributions this year. While the tax benefits of the QCD are effectively neutralized for this year, there are other factors to consider.

For starters, as mentioned before, charities still need support — perhaps this year especially. Thinking ahead to 2021 and subsequent years, by reducing the value of your IRA you'll reduce the RMD for future years, which may help to reduce future tax.

Keep in mind that by reducing your AGI in subsequent years you create a positive domino effect on the rest of your return, which could impact deductions and credits you may claim, your alternative minimum tax (AMT) liability and imposition of the net investment income tax, among other things. Depending on other factors, reducing your AGI could reduce the taxability of your Social Security income, creating a cascading benefit of further reducing your AGI — and related tax.

Taxpayers who've itemized in the past may currently be claiming the standard deduction instead, due to numerous changes in the Tax Cuts and Jobs Act (TCJA) for 2018 through 2025. The TCJA reduced or eliminated several deductions. Using a QCD effectively "adds on" to the standard deduction.

By taking funds out of your account at zero income tax cost, you may also be saving your family potential estate tax liability. While you'd receive the same estate tax benefit if the assets were donated at your death, the ability to make QCDs may allow you to provide more support to charitable organizations during your lifetime.

Icing on the cake

Finally, remember that QCDs benefit your favorite charities without a significant tax drain on your finances. The goodwill comes at a time when many organizations need the money more than ever before. Consider all the implications before you bypass a QCD this year. •

ABCs of QCDs

How do qualified charitable distributions (QCDs) work? The funds must be transferred directly from your IRA custodian to the qualified charity. Arrange to have your IRA custodian issue a check from your IRA that's payable to the charity. You can then request that the check be mailed to the charity, or you can do it yourself.

Conversely, if a distribution is payable to you, it doesn't qualify as a QCD and will be treated as taxable income.

Consider all the angles of joint ownership

Estate planners generally tout the virtues of owning property jointly — and with good reason. Joint ownership offers several advantages for surviving family members. But this shouldn't be viewed as a panacea for every estate planning concern. You must also be aware of all the implications.

2 types of joint ownership

As the name implies, joint ownership requires interests in property by more than one party. The type of joint ownership depends on the wording of the title to the property.

From a legal standpoint, there are two main options for married couples:

1. Joint tenants with rights of survivorship (JTWROS). This is the most common form and often is used for a personal residence or other real estate. With JTWROS, either spouse can sell their share of the property without the other's consent. The property is subject to the reach of creditors of all owners.

2. Tenancy by the entirety (TBE). In this case, one owner can't sell their share of the property without the other joining in. But TBE offers more protection from creditors in noncommunity property states if only one spouse is liable for the debt. Currently, a TBE is available in slightly more than half the states.

Property may also be owned as a "tenancy in common." With this form of ownership, each party has a separate transferable right to the property. Generally this would apply to co-owners who aren't married to each other, though in certain situations married couples may opt to be tenants in common.

Key benefits

The main estate planning attraction of joint ownership is that the property avoids probate. Probate is the process, based on prevailing state law, whereby a deceased's assets are legally transferred to the beneficiaries. Depending on the state, it may be time-consuming or costly — or both — as well as being intrusive. Jointly owned property, however, simply passes to the surviving owner.

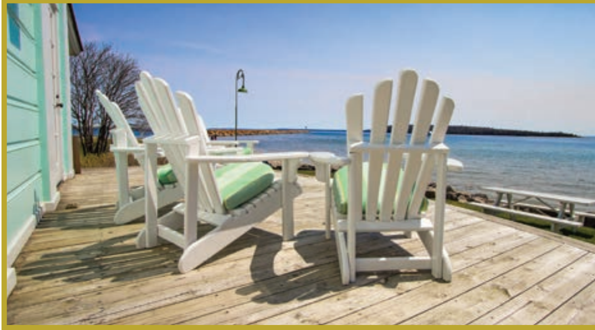
Disadvantages

Joint ownership is a convenient and inexpensive way to establish ownership rights. But the long-standing legal concept has its drawbacks, too. Some disadvantages of joint ownership relate to potential liability for federal gift and estate tax. Comparable rules may also apply on the state level.

For starters, if parties other than a married couple create joint ownership, it generally triggers a taxable gift, unless each one contributed his or her own property to obtain a share of the title. However, for a property interest in securities or a financial account, there's no taxable gift until the other person actually makes a withdrawal.

For smaller gifts, the gift tax liability may be covered by the annual gift tax exclusion ($15,000 per recipient in 2020). If the gift exceeds the exclusion amount, it can be sheltered from gift tax by the gift and estate tax exemption ($11.58 million in 2020). However, doing so will erode the remaining estate tax shelter.

Note that property that avoids probate may still be included in your taxable estate. To



avoid both probate and estate tax, you must relinquish all interests in the property — including ownership and control over assets and benefits. Joint ownership doesn't meet these requirements.

Also, be aware of possible income tax repercussions. For estate tax purposes, if spouses own property as JTWROS and one spouse passes away, the value of the deceased's half of the property is "stepped up" to the fair market value on the date of death. There is no step up on the other half at that time. Contrast that to the result if the property had been owned 100% by the deceased spouse, in which case it could be eligible for a step up to the full fair market value at that time.

When property is owned jointly with someone other than a spouse, the entire property is included in the estate of the first to die, unless the other owner can show that he or she contributed enough to acquire a share of the property. This can have adverse estate tax consequences.

Finally, consider that a survivor of jointly owned property maintains complete ownership rights. Therefore, property could end up outside the family due to a second marriage. For example, the children of a second spouse might subsequently inherit the property. Such a scenario may defeat the intentions of the original owners.

Lessons to be learned

Joint ownership is a valuable estate planning tool, especially because it avoids probate, but it's not the solution for all problems. Nor should this technique be considered a replacement for a will. Consult your estate planning advisor to coordinate joint ownership with other aspects of your estate plan. •

Shh!

This is a silent trust — let's keep it quiet

Generally, estate planning advisors recommend that you be upfront with family members about how you plan to divide your assets. For example, you might hold a family meeting or write a letter to accompany your will. However, if you're using a "silent trust," sometimes referred to as a "quiet trust," you'll have to keep it to yourself.

A silent trust limits the amount of information shared with beneficiaries or, in some cases, keeps the existence of the trust secret. This trust type offers many benefits, but also a few drawbacks. Let's take a closer look.

Understanding your options

The duties of a trustee are governed by state law, which varies from state to state. Most states require trustees to keep beneficiaries (at least those who've reached the age of majority) reasonably informed about the existence of a trust as well as its terms and administration. Typically, at a minimum, trustees must provide beneficiaries with a copy of the trust agreement and an annual accounting of the trust's assets and financial activities.

Most states allow you to place limits on the information provided to beneficiaries, but they accomplish this in different ways. Some states, for example, allow the trust agreement to waive the trustee's duty to inform the beneficiaries. Others allow the trust's settlor (the person establishing the trust) to limit the trustee's duty by executing a separate waiver document.

Eventually, beneficiaries must be given information about a trust. Some states require disclosure after a specified time or upon the occurrence of a specified event (such as the beneficiary reaching a certain age). Others allow the settlor to determine when beneficiaries will be informed.

Silent trust benefits

The ability to keep a trust's terms or existence a secret offers several important benefits, including:

- Maintaining confidentiality over the settlor's financial affairs and estate planning arrangements,
- Avoiding beneficiary scrutiny of the trustee's investment and management of trust assets,
- Preventing the disclosure of information about the trustee's management of family business interests, and
- Potentially reducing disincentives for beneficiaries to behave in a financially responsible manner, pursue higher education and gainful employment, and lead a productive life.

A secret trust may also help protect beneficiaries from becoming targets of fraud, identity theft or other nefarious schemes.

Silent trust drawbacks

The most significant drawback of a secret trust is that it defeats one of the key purposes of keeping beneficiaries informed: to enable them to monitor the trustee's activities and ensure that he or she is acting in their best interests. Without anyone "policing" the trust, there's an increased risk of litigation years or even decades down the road, when beneficiaries learn of decisions by the trustee that they believe breached the trustee's fiduciary duty. This may be less of a concern, however, in states that allow a third-party surrogate to monitor the trust.

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Another drawback is that secret trusts may not be effective in discouraging irresponsible or destructive behavior. It's nearly impossible to keep your wealth a secret from your children, so they'll likely expect to share that wealth one day, regardless of whether they know about a trust. But failure to explain the details of your estate plan to your children could lead to hurt feelings and disputes when they learn about them years later.

Assess your situation

With a quiet trust, you keep your beneficiaries' inheritance a secret and hope that, without the negative influence of future wealth, they'll behave responsibly. Talk with your estate planning advisor to help determine if a silent trust is right for your particular situation. •

ESTATE PLANNING PITFALL

You've named the wrong executor

Maybe you thought that a member of your immediate family — perhaps your spouse or oldest child — would serve as the executor of your estate. Or you may have planned for a close friend to handle these duties. But the person you assumed would be the obvious choice turned out not to be the best one for the job.

Notably, choosing the "wrong" executor could cause a multitude of problems. For example, missteps by this person could lead to financial or logistical troubles. He or she may make mistakes that hinder the probate process or jeopardize estate planning benefits. And the executor might make decisions that defeat your intentions.

Even worse, an executor's actions could create friction within your family and result in legal squabbles. It might even split the family apart for good.

So how do you pick the "right" person for the role of executor? First, be sure that your top choice is willing to provide the services required. While your spouse may be the best choice, it's also important that he or she know that tasks may be delegated. The executor is ultimately responsible for ensuring that your wishes are

carried out appropriately, and such responsibility would include relying on experts as needed.

To the extent that you wish to choose someone other than your spouse, you'll reduce the potential for confusion if you choose someone with financial acumen. The person doesn't have to be a professional executor, but it helps if he or she has the smarts needed to perform these duties. Finally, pick someone who's familiar with your affairs or can easily be brought up to speed.

While you still may choose a relative, consider using a professional, especially if he or she is a trusted member of your estate planning team. At the very least, consider naming a professional as the successor or contingent executor.

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Do You Need a Revocable Living Trust?

A revocable living trust ("RLT") is one of the most common estate planning devices nationwide, touted most often as a way to avoid probate. For Washington residents, however, avoiding the probate process should not be the primary purpose for utilizing an estate plan with an RLT because the probate process here is more streamlined than in most other states . This article provides background on RLTs and the Washington probate process and also highlights some important considerations involved in Washington-resident estate planning.

What is a revocable living trust?

An RLT is a type of trust that is created and managed during your life and after your death. It typically only serves its purpose if, after creating the RLT, all of your assets are transferred or re-titled to the RLT. The management of the RLT is governed by the trust document and is carried out by the named Trustee. Typically, while you are living, you are the Trustee and have control over all of your assets owned by the RLT. While you are living and competent, you may revoke or amend the RLT at any time. These powers would also apply if you and your spouse created a joint RLT. Upon your death, the assets owned by the RLT pass as provided in the trust document without the need to start a formal probate matter with the court.

What is probate?

Probate is the legal process of naming a fiduciary who has the authority and duty to pay all of your creditors and taxes and then pass your remaining assets in the manner provided in your Will. In Washington, a personal representative (or executor) acting with "nonintervention powers" may accomplish this process without the need for court approval for every transaction. This is in contrast to states like Oregon, California, New York or Florida, which require court hearings and approval for sales of property, payment of certain fees and the distribution of assets to heirs. Nonintervention powers will be granted to a personal representative in most situations, so long as the estate is solvent and the decedent's Last Will does not preclude the granting of nonintervention powers.

Why you might not need an RLT…

The use of an RLT to avoid an already efficient probate process in Washington may create more burden than it relieves. This is primarily because effectively using an RLT requires the extra step of transferring your assets to the trust. If property is not conveyed to the trust while you are alive, then some of your estate must pass through probate and only some will pass without probate. The process of locating and transferring all of your assets to the RLT can be time consuming and costly, which is why the asset transfers are often not completed.

Assets transferred to the RLT may avoid the probate process at death, but they are still considered owned by you for creditor and estate tax purposes. Using an RLT will not provide for any creditor protection, and any estate tax benefits that are included in the RLT can also be included in a Will.

Why you might want an RLT…

RLTs can still be useful for Washington residents in certain circumstances. For instance, RLTs can provide for a smooth transition for the management of assets in the event of incapacity. Control of accounts already titled in the name of the RLT can be turned over without opening new accounts. In addition, for individuals who would like a financial institution or trust company to manage their assets and pay bills as they age, the institutions will likely require that they do so as Trustee of your RLT. RLTs can also provide people with a certain amount of privacy because an RLT owning all of your assets will not be filed with the court at death. This may avoid unwanted scrutiny of your estate plan. Finally, if you own real property outside of Washington, creating an RLT to own your out-of-state asset (even if you do not put Washington-owned assets in it), can help avoid going through probate in the state where the property is located.

If you have any questions about revocable living trusts, please contact a member of the Stokes Lawrence Estate Planning Group at (206) 626-6000 in Seattle or (509) 853-3000 in Yakima.