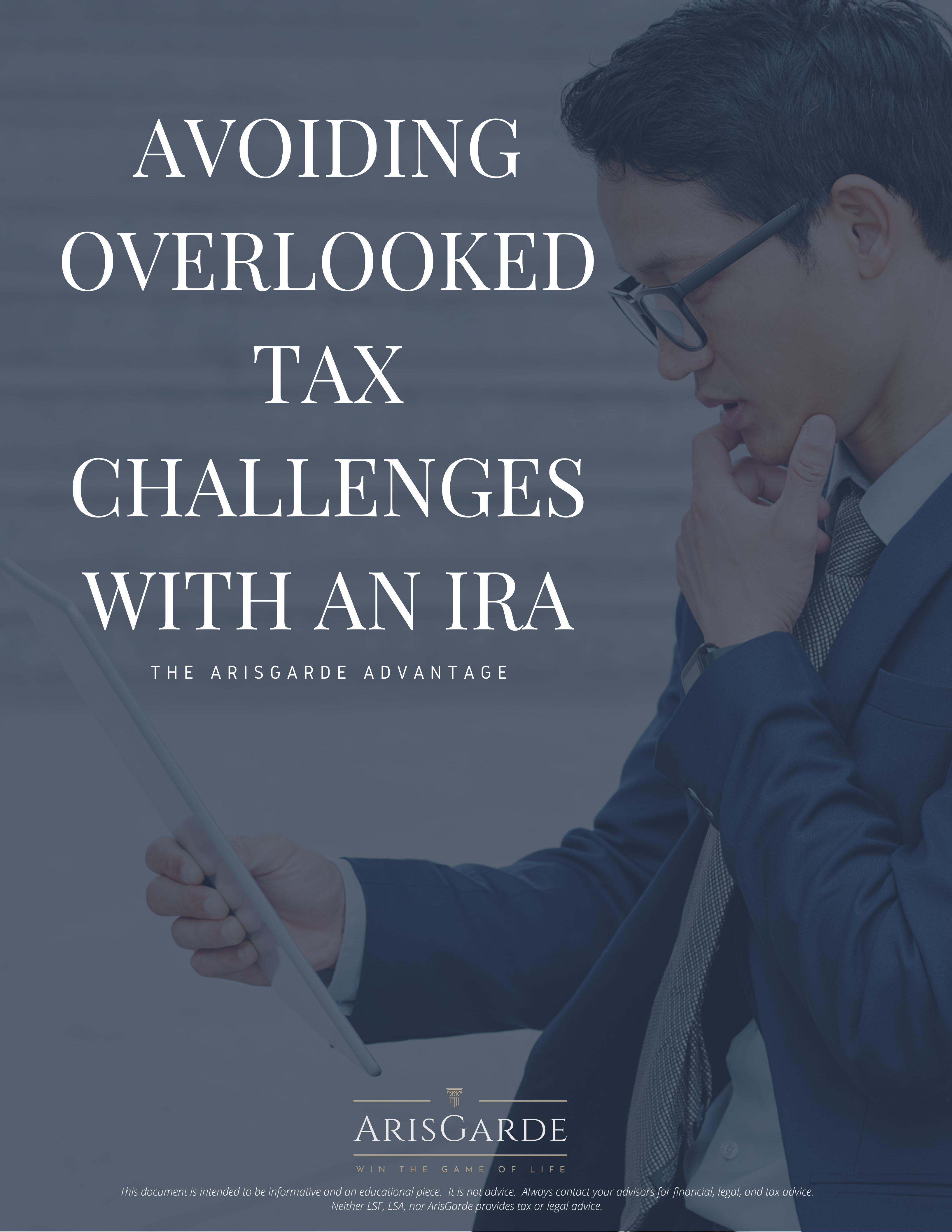

AVOIDING OVERLOOKED TAX CHALLENGES WITH AN IRA

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AVOIDING OVERLOOKED TAX CHALLENGES WITH AN IRA

BY: JOSH FRIEDLANDER

AFFLUENT FAMILIES AND INVESTORS ARE NOW FACING WHAT COULD BE THE ULTIMATE CATCH-22.

With the passing of the SECURE Act in December of 2019 and proposed unilateral tax rate increases looming, savvy investors are now looking to grow wealth in more efficient ways. This growth comes down to a new formula, addition by subtraction. It's not about what you make, but rather, what you keep. Investing money inside qualified retirement plans on a pre-tax basis was a tremendous strategy to defer income recognition, not eliminate it for tax purposes. Most high-net-worth investors and business owners fail to recognize that they have made a "Mr. Wonderful" deal. What's a "Mr. Wonderful" deal? Let me explain.

For myself, in spare moments, watching Shark Tank on MSNBC is the ultimate "Why didn't I think of that!" moment. It's great to see entrepreneurialism at its finest, and seeing the likes of Daymond John and Mark Cuban go toe-to-toe with Kevin O'Leary (aka Mr. Wonderful) is fantastic.

"IT'S NOT ABOUT WHAT YOU MAKE, BUT RATHER, WHAT YOU KEEP."

On Shark Tank, Kevin often will propose the classic debt-to-equity arrangement. Kevin will loan money to the business in exchange for an equity stake or royalty in the business. What does this have to do with retirement plans, you may ask? Everything!

Kevin O'Leary borrowed this idea from none other than Uncle Sam himself. When a participant in a retirement plan makes an income deferral decision within a retirement plan, the IRS effectively gives the participant a zero-interest loan by not paying income taxes today.

What's the catch?

Here it comes—the debt-to-equity deal. None of us know what stake in our retirement assets Uncle Sam will have until we, or our beneficiaries, start making distributions from the plan. Understanding this consideration leads to asking essential questions.

What will my income tax bracket be when making distributions from the plan? Will it be higher or lower than it is today?

Conventional wisdom tells investors to plow as much money as they can (or can afford) into pre-tax retirement accounts because "at retirement," you will be in a "lower tax bracket." Is this true? Maybe.

What if rates are higher?

Higher rates could lead to a less than desirable outcome, and it may have been better to pay the tax bite up-front on the income rather than deferral. Many have seen the proposed income-tax changes circulating, and the consensus amongst economic and tax advisors point to the need to increase taxes across the board.

What will my HEIRS income tax bracket be when they are making distributions from the plan?

According to Kitces.com, life expectancy for a married couple at 65 years of age is 89. Assuming child-bearing years for our now retired couple is when they were in their mid-30's, by the time their children inherit the retirement plan assets, they very well may be in their peak income-earning years during their career. According to Indeed, income earning potential is at its highest between 45 and 54 years of age.
The passage of the SECURE Act has virtually eliminated the ability for non-spousal beneficiaries to enjoy the benefits of a stretch IRA. All assets inherited inside an IRA for a decedent whose date of death is after December 31, 2019, must be distributed within ten years.

The result of the SECURE Act for heirs?

All distributions very well could be at the highest income tax bracket. For New York and California residents, this could easily eclipse half the value of the assets inside or the IRA.
What will the true net internal rate of return be on the assets? Net of both income AND estate taxes?
Let's add insult to injury, shall we? For non-spousal beneficiaries facing a higher than 50% income tax consequence, estate taxes are also due on all inherited assets. The estate tax, commonly referred to as the death tax, is due in cash and nine months after the date of death. Unless changed, until 2026, families can pass up to $11,700,000 (adjusted for inflation) in 2021, and married couples that are both US citizens can double this coupon.

Do you have assets above this amount?

Depending on the decedent's state of residence, the estate tax can also approach as high as 50% in some instances. So, why is it called a death tax? You may be starting to see why— "it kills assets if unplanned for."

What can I do about this?

We have seen investors and business owners switch gears, especially in 2020 and leading into the first eight months of 2021. If the goal is to mitigate double tax on retirement accounts at death, Roth conversions during life could help address this issue.
Assuming we do see income tax rates increase beginning in 2022, paying income taxes on the retirement plan (or a portion) at the lower rate today through a Roth Conversion could be an option to explore.
Recognizing this income now, and paying income taxes with other assets, could help maximize the amount of monies growing tax-deferred and distributed income tax-free during your lifetime and your heirs up to the ten-year stretch limit.

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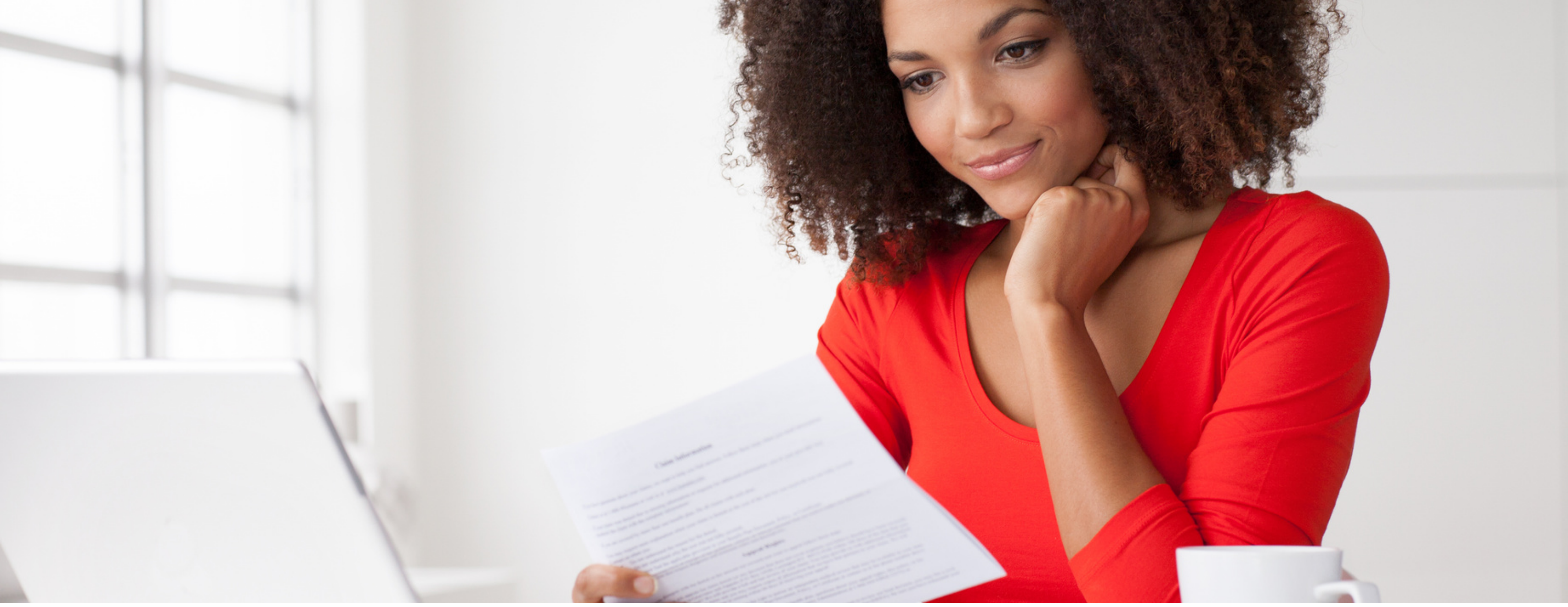

U.S. Treasury Department released its "Green Book"

On May 28, 2021, the U.S. Treasury Department released its "Green Book," formally known as the General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals.

This 2022 Green Book Proposal includes significant tax law changes affecting affluent and business owners and taxpayers.

These taxpayers are urged to consult with their financial, tax, and legal professionals immediately to plan accordingly. There may be planning opportunities to prepare for while there is still time to do so.

"CERTAIN TRUSTS, SUCH AS A GRANTOR TRUST, COULD HELP PROVIDE LIQUIDITY TO PAY INCOME AND ESTATE TAXES ON RETIREMENT PLAN ASSETS."

Life insurance can also be an appropriate tax hedge. How?

Certain trusts, such as a Grantor Trust, could help provide liquidity to pay income and estate taxes on retirement plan assets. Rather than the proceeds from a life insurance policy being paid to a beneficiary directly, the insurance company pays the face amount of a life insurance policy to a trust at the time of death.

A Grantor Trust owning a life insurance policy can help ensure the death benefit on a life insurance policy is not subject to estate taxes if structured properly. Plus, since the death benefit of a life insurance policy is generally income-tax-free, the policy can provide liquidity in a highly efficient manner. This is especially true in a tax environment becoming increasingly burdensome and can serve as a promising hedge.

Although qualified plans can offer the benefits of tax-deferral and broad creditor protection, don't let the tax tail wag the dog.

How Can We Help?

ArisGarde provides wealth management and insurance structuring services. By identifying coordination gaps and planning opportunities for clients, goals become more than just good ideas by integrating and combining legal, tax and financial perspectives. As an industry expert, ArisGarde offers a customized approach to implementing solutions.

If you're ready to take your goal planning to the next level, contact us today for more information.

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WHY ARISGARDE?

OUR EXPERIENCE means that we are able to recognize their unique planning opportunities to help them reach their goals. We take the time to educate them and block out the noise and misinformation.

OUR FIRM seeks to take the guesswork out of how legal, financial, and accounting systems work together for your benefit.

OUR TEAM develops a customized plan to make up for lost time in ways that are focused, effective, and based in experience.

With these considerations, clients realize that working with a thought-leader helps impact their chances to win the game of life.

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