ClientLine®

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# TRUSTS AND TAXES

Every wonder why people put some or all of their assets into trusts? Some affluent financial consumers use trusts for their estate tax advantages, but anyone can benefit from the privacy and control a trust can offer. Here's what you need to know.

## TWO BASIC TYPES

There are dozens of different types of trusts, but they fall into one of two categories: revocable or irrevocable. As their names imply, you can revoke the conditions of a revocable trust, but usually can't change the terms of an irrevocable trust.

This difference matters greatly if you're looking to reduce estate taxes, because only an irrevocable trust can shield your estate from them. While recent changes have greatly increased the federal estate tax exemption, many states still have much smaller exemptions. Note that for either type of trust to shield your assets from taxes or the public glare of probate, you will need to give ownership of the assets to the trust.

Within these two categories, there are separate trusts meant specifically to shield your home, life insurance benefits and future charitable contributions. Other trusts can preserve a deceased spouse's estate tax exemption, fund the expenses of a special-needs child and pass tax-advantaged assets to grandchildren.

## CONSIDERATIONS

Those who prefer a revocable trust typically do so for the flexibility to change its terms. However, in addition to not shielding assets from estate taxes, this type of trust doesn't protect against creditors' claims. An irrevocable trust will accomplish these two things, but changing its terms can be next to impossible. Still, an irrevocable trust may be the appropriate choice for a family with significant assets.

If you believe a trust may work for you, first understand the costs and consequences of creating a trust and putting assets into one. An estate planning attorney can help you draw up a trust for anywhere from a few hundred to a few thousand dollars, depending on its complexity.

## Continuing the Family Business

If you have an asset-rich, cash-poor family business that you hope will eventually pass to loved ones, putting the entity into the right type of trust may spare your heirs from needing to conduct a fire sale to distribute the assets.

### Flexible Vehicle

A properly written trust should allow the business owner to transfer assets to and from the trust in order to meet business needs. After the trust grantor, who is usually the business owner, dies, the trust terms will dictate which family members receive the business assets. Without the right type of trust, a cash-poor business may have to liquidate its assets so heirs can pay potential taxes.

### Tax Consequences

Business assets in some types of trusts may also be subject to income taxes. Work with your tax and estate planning professionals to learn more.

# WHEN SAFE IS BEST

When investment markets are volatile or declining, investors and savers flock to more predictable, less volatile instruments like money market mutual funds, bank money market accounts and bank Certificates of Deposit (CDs). But these savings and investing vehicles are not the same.

## CERTIFICATES OF DEPOSIT

CDs are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000 per person, may pay the highest interest rates of the three and are less liquid than money market alternatives. The longer the term, the higher the rate you'll get in return. A CD can be a good spot to earn a few dollars for a short period of time, but beware of early withdrawal penalties.

## MONEY MARKET ACCOUNT

Backed by the FDIC as CDs are, a bank money market account may offer different levels of interest rates depending on the balance you maintain. This account may restrict how many checks you can write per month, and it usually pays a lower rate than savings accounts in exchange for more flexibility. This can be a good parking spot for emergency funds that need quick access.

## MONEY MARKET FUND

A money market mutual fund pays interest, but could have higher fees than its alternatives. No mutual fund has the benefit of the FDIC's $250,000 guarantee per depositor, per insured bank, for each account ownership category. While mutual fund companies try to maintain money market share prices at $1 a share, they can lose principal. They may, however, allow lower minimum balances and fewer check-writing restrictions than bank money market accounts.

## YOUR CHOICE

A savings account may be best for immediate access to all of your money, but if you want to earn a little more, you might consider the two money market alternatives.

# Client PROFILE....

**William's business is tourist-dependent and earns most of its money during the warmer months. He has always filed his tax return based on the calendar year, but would like to change it to a fiscal year ending in October. What does he need to do?**

First, William should make sure he is eligible. The IRS says if you file your first return using the calendar tax year and later become a sole proprietor, a partner in a partnership or a shareholder in an S corporation, you must continue to use the calendar year unless you get IRS approval to change it or meet one of the exceptions listed in its Form 1128 instructions.

You must adopt the calendar year if, among other reasons, you don't keep books or records, have no annual accounting period or your present tax year does not qualify as a fiscal year.

William may even qualify for automatic IRS approval to change his tax year. A tax professional can help determine that as well as whether changing the tax year is the right course of action.

*Client Profile is based on a hypothetical situation. The solutions we discuss may or may not be appropriate for you.*

# HOW TO TAKE TAX-FRIENDLY RMDs

Before you retire, consider planning for your required minimum distributions (RMDs). This can be more complicated than you imagine if you have significant retirement assets in qualified plans, such as 401(k) accounts and IRAs, but you can achieve a tax-friendly result with a little planning.

### KNOW THE RULES

Generally, you must begin taking RMDs by April 1 of the year after you reach age 70 ½ and by December 31 of each subsequent year. Your tax professional can help you determine your RMDs, which typically are calculated by dividing the balance subject to RMDs by your life expectancy.

Different rules apply if your spouse is the sole beneficiary and at least 10 years younger than you. Stiff tax penalties apply on RMD amounts not taken.

### EASING THE BITE

Use the years before age 70 ½ to help ease the potential size and subsequent tax bite on eventual RMDs. For example, consider converting some traditional IRA assets to a tax-free Roth IRA during lower-income years, to limit the future income tax bite (you'll pay ordinary income tax upon conversion).

Or invest some IRA money in a Qualified Longevity Annuity Contract (QLAC), which can delay required payments for several more years. Deducting up to 60% of your adjusted gross income annually for charitable contributions can also help reduce the tax bite.

# KEEP THEM OR DUMP THEM?

How long should you keep your business income tax records?

### RULE OF THUMB

In most cases, three years should be sufficient, according to the IRS. However, this statute of limitations goes out the window if you don't report more than 25% of your gross income on a return, file a false return or don't file at all. You must keep your records indefinitely in the latter two cases.

### ODDS AND ENDS

Keep tax records for three years from the date you filed your original return or two years from the date you paid the tax, whichever is later. If your business owns property, keep your records until the period of limitations expires for the year in which you disposed of the property.

Other terms apply for non-income taxes, such as employment taxes. Work with your tax professional to make sure you follow the rules and keep the records you may need in case Uncle Sam wants more information from you.

# .... Q&A

**Q** **I just inherited a large amount of money. Will I have to pay income and estate taxes on the funds?**

**A** One of your first steps should involve talking to a tax professional to learn more about your personal situation. You typically won't pay estate taxes; the estate will, if tax is due. But your state may impose an inheritance tax on a portion of what you receive. As important, seek qualified financial advice and consider working with an attorney. Go slow, and consider paying off debts first. After that, look at financial vehicles such as qualified retirement plans and college savings plans to take care of long- term financial goals in your life.

**Q** **I am considering adopting a 401(k) plan for my business, but I heard something about discrimination testing. What is that?**

**A** Discrimination testing ensures non-highly compensated and highly compensated employees in traditional 401(k) plans are treated equitably. In other words, contributions made for rank-and-file employees should be proportional to contributions made for owners and managers, and testing must be done annually. To avoid discrimination testing, you might consider adopting a safe harbor 401(k) plan, for which you would have to contribute 3% of compensation for each employee, match 3% of employees' contributions and half of their next 2%, or match 4% of employees' compensation.

## ClientLine® SHORT BITS....

**> PRODUCER PRICES UP**
The Producer Price Index for final demand increased 1.7% for the year ended July 2019. While liquefied petroleum gas and egg prices declined 58.2% and 53.5%, respectively, producers' cost of fresh and dry vegetables rose 43.3% year over year. Producer prices can indicate potential future inflation if producers pass their cost increases to consumers.

**> EDUCATION PAYS**
Americans are paying increasing tuition, room and board costs for a college education and, if they're lucky, the degree will pay them back. The Bureau of Labor Statistics (BLS) projected annual salaries by educational degrees through 2026 and found that workers in management, computer and math, legal, and architecture and engineering fields will earn more than twice the median of $37,690 for all occupations. Most of these professions needed a bachelor's degree or higher.

**> MILLENNIALS RULE**
Speaking of college attainment, the oldest Millennials have outdone the youngest Boomers when it comes to attending college, according to the Bureau of Labor Statistics. Almost three out of every four Millennials born between 1980 and 1984 attended some college, while 44% of the Boomers born from 1960 to 1964 did the same.

**> OWNERS POSITIVE**
The National Federation of Independent Business' July Small Business Optimism Index increased 1.4 points from the previous survey to 104.7. The organization's Uncertainty Index fell 10 points, after surging in June to its highest level since March of 2017. Capital outlays were reported by 57% of owners, according to the survey, with about four in 10 of those purchasing new equipment, 25% acquiring vehicles and 16% improving or expanding facilities.

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