The
FINANCIAL UPDATE
DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING

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Managing Your Wealth

Financial services giants make financial planning and wealth management sound very simple in slick TV ads, but it's not. Managing wealth requires knowing a lot about technical highly topics, like math, taxes and finance as well as history, psychology and how to communicate with loved ones about sensitive issues. This article highlights many of the topics of knowledge needed to manage wealth and why it's so daunting without the help of an independent personal financial advisor.

Estate tax is in flux. The $12 million personal exemption from estate tax is set to revert to $5 million on January 1, 2026. However, this could change, depending on Congress and financial, economic and political events.

Income tax brackets are also uncertain, and income tax planning includes watching Washington and acting strategically after the November 2022 election results are decided.

Charitable strategies are always important just because giving back is the right thing to do. Supporting a cause can build on your legacy and inspire the next generations in your family to keep your causes top of mind.

IRAs are more important than ever in creating a strategic financial plan because that is where Americans save for retirement. After retiring, assets in 401(k) accounts can be managed by you in IRAs. IRAs, for income tax purposes, are treated the same as 401(k), 403(b) and other federally qualified retirement accounts. They grow tax-free only until you withdraw money and withdrawals are taxed at your ordinary income tax rate. However, Roth IRAs are totally tax-free. Even withdrawals are tax-free.

Converting a 401(k) to an IRA, converting a traditional IRA to a Roth IRA and planning how your IRA accounts will be distributed to loved ones or charity upon your demise requires understanding the federal laws on qualified retirement accounts and knowledge of financial economics.

Psychology's pivotal role in financial decisions has come to be recognized only in the last two decades. The burgeoning field of behavioral finance is now part of the investment knowledge needed to avoid making mental mistakes, reacting emotionally to bad news, and recency bias.

Modern families have spawned new legal and accounting strategies to protect family members from horror stories in estate planning. People are living longer than ever and are wealthier than ever. With half of all marriages ending in divorce, families are split asunder by injustice and argument over assets.

After a 50-year marriage and raising two children, Edith, a 75-year-old succumbed after a long battle with cancer. Ed, her 75-year-old spouse, could not stand to live alone and remarried a server he met at the casino. A year after marrying Rita, a 50-year-old with two children, Ed dies. Rita, and her children, inherit Ed's $3 million portfolio and two homes. His children get nothing because he never created a Will.

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Getting A Good Estate Planning Result Is Hard

Paul Hood, Jr., one of the nation's leading estate planning educators of lawyers, accountants, and financial advisors, identifies all the things that can go wrong with an estate plan. It's a lot! For individuals facing estate plan questions, here are some important considerations.

The players involved in creating an estate plan include you, the client, of course. But you will probably need to work with two or three advisors, and they must be coordinated with each other. And then there are your beneficiaries – and those who believe themselves to be beneficiaries but are not, loved ones and charitable causes you want to support after your death. The interaction of the players creates opportunity for confusion, misunderstanding, personality conflict and the array of things that can go wrong in human interaction.

Fear, emotion, and self-interest further complicate the ability to get a good estate planning result according to Hood. Clients often fear or don't completely trust their advisors, fear losing control of their estate plan, or worry about the cost of getting advice.

Meanwhile, legal, tax, and financial advisors can also get in the way of a good estate plan result because of their need for business, fear of being sued for malpractice, need to compete with other advisors on your team to be the lead advisors and their technical knowledge of tax law and the psychological factors involved in estate planning.

Loved ones who you want to benefit from your estate plan could have difficulty getting over the fact you are no longer there to talk to. Or some of your heirs could be jealous of what another beneficiary inherited. And then there is a chance that you or your advisors failed to communicate the whole story about the decisions you made in your estate plan, according to Hood.

Getting a good estate planning result is hard, but at least you now know about the things that could go wrong and can try to be mindful of these factors.

Sincerely,
Day & Ennis, LLC

IRA Strategies For 60- To 72-Years-Olds

Investments in IRAs are the main source of funding retirement income for a vast majority of Americans. Your IRA is probably crucially important to your retirement success and may also play a role in your estate plan. Trouble is, the rules on IRAs have changed and so has the investment environment, and, as a result, taking a strategic approach is not so easy. Here is a very simplified explanation of strategic planning opportunities triggered under current estate and income tax rules.

The Rules

At age 72, the law requires you start taking money out of an IRA account annually. The required minimum distribution (RMD) is based on an actuarial table of life expectancy, which sounds complicated but don't get hung up on it. All you need to know is that your RMDs are based on your age.

RMDs get taxed. When you withdraw the RMD annually, you will need to pay income tax on the amount withdrawn. A key aspect of IRA strategic tax planning is minimizing withdrawals on IRA accounts to keep as much of your IRA as possible growing without being subject to income tax.

How The Rules Affect You

If you die at age 72 before beginning RMDs from a regular IRA, your family will not be required to take anything out of that regular IRA for 10 years. To be clear, assuming your heirs don't need all or any of the IRA assets you left them, they can escape any taxation of the growth on the IRA for 10 years. That's great! The trouble is, you're dead. This is not a strategy you want to plan on happening. You want to plan to live many years past age 72.

If you have a regular IRA and you die after the required beginning date for taking RMDs, then you will be required to take RMDs annually for 10 years to deplete the IRA. That's not a good result because the IRA gets reduced by your required distribution annually and less principal is left to grow at a compound rate.

Roth Conversion Strategy

The key strategy for maximizing IRA assets in 2022 is converting traditional IRA assets to a Roth IRA. A Roth IRA is like dying before starting your required minimum distributions at age 72. It's almost like you died and went to tax heaven! There are no required minimum distributions on a Roth IRA; asset growth compounds tax free all your life. It's a great way of preserving your assets for your 80s and 90s and it offers a powerful estate tax planning benefit.

If you die, your heirs inherit a Roth IRA that must be depleted all at once in 10 years. To be clear, your heirs – assuming they do not need the assets you left for them – can let the account grow tax-free for 10 years and withdrawals by your heirs from the inherited Roth IRA is tax-free income.

Roth IRA conversion is not a strategy you want to begin to start thinking about in your 80s. If you are in your 60s and own an IRA asset that might outlive you and benefit your spouse and children after you're gone, converting to a Roth should probably be evaluated. Conversion requires paying income tax on assets withdrawn from your regular IRA and that is a calculation you must make with a qualified professional. We are here to help as always. ●

New Research Warns Consumers On Long-Term Care Insurance Policies

A new survey of long-term care insurer rate increases offers a rare glimpse into an insurance sector with a history of problems for consumers.

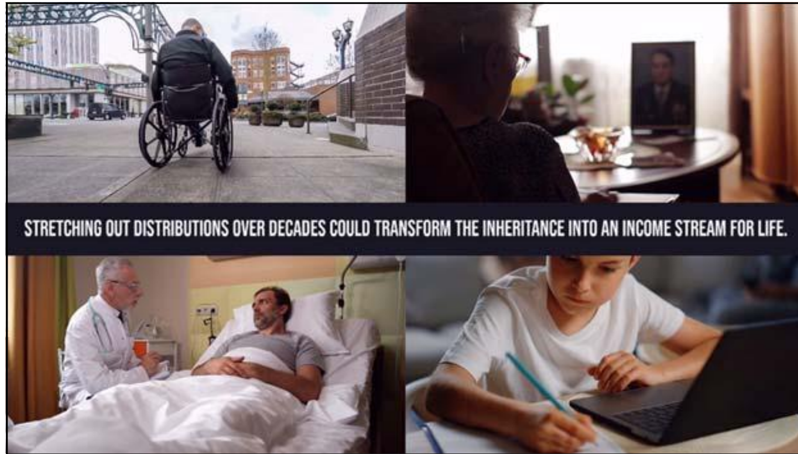
Long-term care insurance (LTCI) is a relatively new type of insurance. For most of its 50-year history, insurers made overly optimistic assumptions about key factors in the price of their policies, including:

- how much to charge for policies
- how many policyholders would keep their policies in force
- how long policyholders would live
- how many policyholders would need long-term care during their lives and for how long
- the yield insurers would earn on their investments

Because the insurers' assumptions turned out to be wrong so often, they have gone to state insurance regulators to request approval for price increases, as allowed by the policy contracts. Milliman, a national actuarial firm, recently released the results from a voluntary survey of 20 insurance companies that have asked for a rate increase. A few highlights:

Making A Life-Changing Difference To Loved Ones

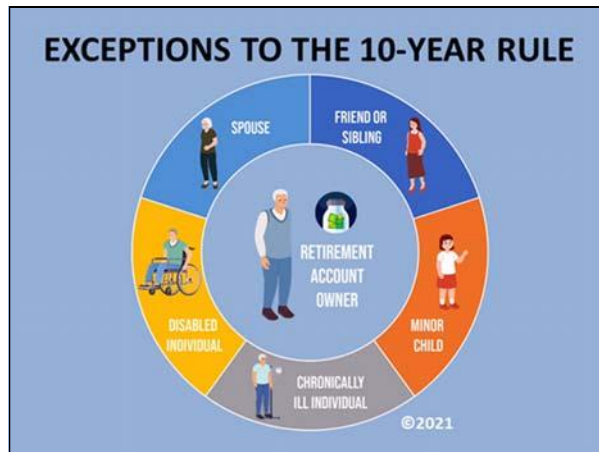
Tax law and estate planning might bore you to death, but this brief tip could make a life-changing financial difference to your surviving spouse, and other loved ones, including disabled and chronically ill family or friends, as well any minor children in your life.



These individuals are among the five exceptions to the usual distribution rules on the inheritance of assets in IRA, 401(k), or other federally qualified retirement plans.

New rules, that went into effect on January 1st, 2020, with the enactment of The Secure Act, require the beneficiary of inherited IRA or 401(k) accounts to deplete the money in those accounts within 10 years. It was a technical change that many individuals overlooked in the rush of tax law changes that occurred in 2020 during the pandemic, particularly since required minimum distributions were not required in 2020 due to the pandemic. But it can make a significant difference in tax planning, and it is worth wading through the technical details to ensure the new rules are understood.

To be clear, until 2020, beneficiaries of an inherited IRA or 401(k) were not required to liquidate an inherited account within 10 years. That had left open a major tax break to heirs of retirement accounts. They had the option to stretch out distributions over their actuarial life expectancy, thus, leaving the assets to compound tax-free for a much longer period.



The 10-year mandatory distribution rules in the Secure Act carved out some key exceptions for certain individuals that now require consideration of those who intend to pass on assets in their retirement plan, IRA or other qualified plan assets to a spouse, chronically ill or disabled individual or minor child.

For a disabled individual, who inherits federally qualified retirement assets, for instance, stretching out distributions over decades could transform the inheritance into an income stream for life. The same is true for a widower, chronically ill individual, or minor child that inherits your retirement account.

In addition, a fifth exception to the usual distribution rules applies to a beneficiary who is less than 11 years younger than the retirement account owner. A sibling or friend who is 10 years or less your junior, who inherits qualified retirement account assets, also may use their life expectancy -- instead of taking required distributions over 10 years.

If you own a sizable IRA, 401(k) or other qualified account, and your beneficiary is your spouse, a friend or sibling 10 years or less younger, an individual with a disability, chronic illness, or a minor child, the five exceptions to the 10-year rule pose complicated tax planning as well as legal and investment issues requiring personal advice from a professional that is beyond the scope of this article. ●

- Most rate hike requests received full or partial approval.
- The average approved increase was 29%, with a range from 5% to more than 60%.
- Companies that request a rate increase also provide reduced benefit options, including reduced daily benefits, reduced benefit periods, increased elimination periods, and reduced inflation protection. Only about 11% of policyholders elected a reduced benefit option.
- Many companies also offer a reduced paid-up benefit, with no further premiums due, but fewer than 5% of policyholders elected this option.
- Cash buyouts are under discussion but are not yet common.
- The review process and the results vary by state. A National Association of Insurance Commissioners task force is developing a multi-state process to encourage uniformity and efficiency.

The March 2022 survey of long-term care insurer rate increases confirms that LTCI is fraught with risks to policyholders. Whether you have a received a policy rate increase notice or are considering buying a new policy, we recommend consulting with a professional who understands the risks. ●

"Simplification" Of College Financial Aid Requires Attention Now

The Consolidated Appropriations Act (CAA) of 2021, signed into law December 27, 2020, by President Donald J. Trump, was a massive $2.3 trillion spending bill. At 5,593 pages, Wikipedia says, it was also "the longest bill ever passed by Congress."

Buried in CAA is a section on college-student aid dubbed "FAFSA Simplification." It reduces the number of questions on the Free Application for Federal Student Aid (FAFSA) form from 108 to 36. It affects your college funding financial plan starting in 2022.

A FAFSA form must be completed by current and prospective undergraduate and graduate college students to determine their eligibility for student financial aid for a given academic year. The form must also be submitted to determine eligibility for many scholarships and merit-based college funding programs, in addition to need-based college financial aid.

"The simplification of the FAFSA form effectively redefines how eligibility for aid will be determined," says Kalman Chany, author of "Paying for College, 2022: Everything You Need to Maximize Financial Aid and Afford College." "There will be winners and losers."

In changing the eligibility criteria, "simplification" is expected to set off financial and administrative difficulties for many students. Many families eligible for needs-based federal aid under the current criteria will no longer be eligible under FAFSA Simplification.

Since 1986, Mr. Chany has authored and annually updated a book on college funding and financial aid. He says the new FAFSA formula will no longer boost aid for families with more than one child in college. This single adjustment may slash the amount of aid families receive by thousands per student.

Another important change is that the FAFSA form will no longer consider pre-tax contributions to 401(k), 403(b) and other qualified retirement account assets. However, the FAFSA formula will continue to count contributions to traditional IRA, KEOGH, SIMPLE IRA, and SEP accounts in your adjusted gross income as untaxed income.

The changes in the FAFSA formula were supposed to go into effect beginning with the 2023-2024 academic year. However, because of technology and other issues, the U.S. Department of Education has asked Congress to delay implementation of the law until the 2024-25 academic year.

"The 2024-25 school year may seem far off, but aid eligibility that academic year will be based in part on your 2022 income, due to a two-year look-back for income," says Mr. Chany of Campus Consultants in New York City.

Aid calculations are based on individual student and family circumstances, and the new FAFSA formula that is scheduled to go into effect in 2024-25 could yet be delayed. However, it is prudent for parents and students to know about the major changes in the FAFSA formula coming in the months ahead and to begin planning now, even if you are not sure you will qualify for aid. ●

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Another example is the couple who, upon the marriage of their child, give the newlyweds a $1 million down payment on a home. Ten years later, when the child is divorced, the value of the home must be split evenly with their child's spouse.

Trusts, prenuptial agreements, insurance, and qualified retirement accounts must be structured to protect your children, spouse, and other loved ones from losing control of assets you give them when you die. That's part of the new landscape of financial planning for modern families.

Business owners contend with a unique set of circumstances involving:

- corporate form of business or entities, (LLC, S-Corp, or Corporation, etc.)
- partnerships
- equity ownership
- business and personal liability for debts and other risks
- income earned annually
- buy/sell agreements
- family impact
- taxation of the business

Real estate investors and **doctors** have all of the same variables to consider but they have some added twists. For instance, owners of apartment buildings with swimming pools may face a large liability if someone drowns. Protecting yourself from slip-and-fall lawsuits and other risks inherent in developing and owning real estate is just one aspect of knowledge needed to invest wisely in real estate. Successful business owners often find it advantageous to purchase a building to house their business by setting up a real estate entity that owns the building and leasing it to the existing operating business. This is a common real estate strategy for doctors as well as business owners.

Investing is thought by many individuals to be the only knowledge or by far the main knowledge topic required to manage wealth and make a sound financial plan, but it is only one aspect of the job. Investing is important but the other aspects listed above are often just as important.

Retirement is a mashup of all of the topics previously discussed. To create a smart retirement plan requires knowledge of investing, tax, and the full range of topics mentioned here which may be required or come in handy. ●

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