Planning for retirement benefits

A critical question in many estate plans is what to do about retirement benefits. For many the answer has been to rely on a stretch IRA to maximize tax advantages. Unfortunately, that approach seems to have lost favor in Congress, as detailed in our lead article.

Next we review how demographic changes over the past decades have challenged some of the conventional assumptions about family structures and estate planning goals.

When your clients are in need of fiduciary services, we hope that you will keep Webster Private Bank in mind. If you have ideas for our future coverage in Trusted Insights, we welcome them. Our next issue will review new CT UTC provisions, which are effective in January 2020.

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Preview of the SECURE Act

Scary headline in The Wall Street Journal: “Congress Is Coming for Your IRA” [July 9, 2019, column by Philip DeMuth]. The author was warning about one provision in the Secure Act [H.R. 1994, “Setting Every Community Up for Retirement Enhancement Act”] that sailed through the House of Representatives in May on a 417 to 3 vote. The headline may overstate the problem, but estate planners do need to take this legislation seriously.

Elements of the proposal

The reason for the bipartisan support for the SECURE Act is that it is largely pro-taxpayer. Among other things, the bill would:

- raise the age for required minimum distributions from 70½ to 72;
- eliminate the age restriction on traditional IRA contributions;
- allow more part-timers to participate in 401(k) plans;
- facilitate automatic enrollment;
- make annuitizing benefits easier; and
- allow for penalty-free withdrawals in case of the birth of a child or adoption.

As welcome as these changes may be, there is a temporary revenue cost for them—temporary because all retirement savings eventually do face full taxation. To offset the revenue cost, the Act takes aim at a popular estate planning strategy, the stretch IRA. Under current law, distributions from an inherited IRA may be spread over the beneficiary’s lifetime. With a young beneficiary, the financial protection offered by years of tax deferral with a stretch IRA can be very impressive.

The proposal provides that inherited IRAs will have to be distributed within 10 years. There is an exception

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SECURE Act . . . continued

for a surviving spouse and for beneficiaries who are disabled. If the beneficiary is a minor, the 10-year period begins to run upon reaching the age of majority.

The Joint Committee on Taxation has scored this change to the taxation of inherited IRAs as raising $15.75 billion over ten years [JCX-23-19]. That estimate has been challenged as overly optimistic by some. For example, Ed Slott has predicted an expansion of the use of life insurance and trusts to achieve the same sort of beneficiary protection offered by stretch IRAs [Tax Notes, August 1, 2019].

Outlook

The SECURE Act appeared headed for quick, bipartisan approval. However, shortly before the House vote, a provision allowing for use of some 529 education savings money to be used for home schooling was pulled from the legislation. As a result, when unanimous consent for the bill was requested in the Senate, Senator Ted Cruz objected. Reportedly, other Senators also have objected to a special provision in the Act for the retirement plans of community newspapers. No progress was made during the summer.

There is a similar bill in the Senate, the Retirement Security and Savings Act of 2019 [S. 1431] that may be taken up. It would also:

• expand the saver’s credit;
• increase the catch-up contribution limit for those 60 and older; and
• eliminate RMDs for accounts smaller than $100,000.

Costs

In his article Philip DeMuth noted that the accelerated taxation of IRAs demanded by the SECURE Act would boost taxation to perhaps one-third of the account’s value, even half in states with high income taxes. This is so because the beneficiaries are likely to be in higher tax brackets themselves as they may still be working, and they will be required to take the IRA distributions in large bites. DeMuth was not optimistic that Senator Cruz will be able to prevent this development.

Estate planning for new family structures

Family structures are in a period of transformation, which has important implications for estate planners. Among the key demographic changes:

• Married couples, which were 80% of households in the 1950s, now represent less than 50%.
• Only 18% of adults age 18 to 29 are married, compared to 59% for this age group in 1960.
• The most common family in the 1950s was a married couple with three children. That ranks seventh today, as the most common household now is a single person. Married and childless is second, married with one child third, and married with two children fourth.
• As divorce has increased, one-sixth of American children are growing up in blended families, and 40% of Americans have at least one step-relative.

Here’s one example. An individual in a second marriage has children from each of the two marriages. He is roughly 15 years older than his wife, who is roughly 15 years older than the children from the first marriage. They were roughly 15 years older than the children from the second marriage. An estate plan for this family will need to take four distinct generations into account.

The stepmother in that situation is unhappy with the traditional approach, that the children from the first marriage would have to wait for her death to receive their inheritance. The solution in such a case could involve a family conference and a plan to advance the inheritance to those children during life, with the clear understanding that there would be nothing further in the future.

Family wealth means values, as well as assets. In an era of dramatically increased transfer tax exemptions, the estate planning focus may be less centered on transfer taxes and more oriented to family goals (accomplished in a tax-efficient manner). The planning process is becoming less paternalistic and colloquial, and evolving into one that is more engaging and adaptable to family composition,
from one that is less narrow culturally to one that is more cognizant of cultural perspectives; and finally to one that adds to its perspective on the balance sheet, an enlarged understanding of each family’s total wealth.

**Trusts for today’s families**

Trusts will continue to play a vitally important role in family wealth management. The happy news is that in many cases, they will no longer be constrained by tax considerations.

Perhaps trusts should include an explicit statement of intent, so as to bridge the divide between the grantor’s hopes for the trust and the beneficiaries’ expectations. A statement of intent tells the trustee what the purpose of the trust is, and it will provide guidance in the exercise of discretionary powers. This may prove especially valuable in situations where there is more than one fiduciary responsible for trust management.

The more important audience for a statement of intent is the trust beneficiaries. Why is a trust being used for family wealth management? Why is the trust superior to other alternatives for wealth management? What goals will be pursued by the trust?

With the advent of nearly perpetual private trusts, following the modification of the rules against perpetuities in many states, a statement of intent could become essential in a generation or so. Perpetual trusts will “speak” to multiple generations of beneficiaries, many of whom will never have met the grantor. Guidance for the trustee of a long-lived trust will need to be drawn carefully, especially regarding discretionary distributions.

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**WHEN S CORPORATION STOCK IS VALUED, THE ECONOMIC ENVIRONMENT MUST BE TAKEN INTO ACCOUNT.**

Green Bay Packaging Inc. was founded in 1933 by George Kress. The firm manufactures corrugated packaging, folding cartons, coated labels, and related products. It remains privately held, though it employs about 3,400 people in 14 states. The Kress family owns 90% of the stock, and the remaining shares are owned by employees and directors of the company.

In order to keep the family business in the family, members of the Kress family have engaged in systematic intrafamily gifts of stock. In 2007, 2008, and 2009 James and Julie Kress made substantial taxable gifts to their children and grandchildren, and they paid federal gift taxes of over $1.2 million each.

The IRS audited those gift tax returns and concluded that the shares were undervalued. For example, where the couple had reported a value of $28.00 per share in 2007, the IRS believed that $45.97 was closer to the true value. The couple paid the deficiency and sued for refund.

At trial the IRS did not provide a rationale for the $45.97 figure. Their expert concluded that $38.04 was the appropriate per share price. The Wisconsin Federal District Court picked apart the analysis and rejected it. The appraiser had failed to take into account the worsening economy in the years that the gifts were made, and at least one of his “comparables” was not truly comparable at all.

However, the taxpayer’s expert was not accepted in full either. The expert had applied a marketability discount of 30% to reflect the lack of liquidity in the holdings and the restrictions in place to keep the family holdings in the family. The Court believed that the appraiser failed to demonstrate the impact of the specific family transfer restrictions on value, and reduced the discount to 27%. The bottom line was that the share value in each of the three years went up by about $1 [James F. Kress et ux. v. United States; No. 1:16-cv-00795].
**Briefly noted**

An extension is granted to elect special use valuation.

The date of D’s death is not given in this ruling, but he owned farmland when he died. His wife was named the executor of his estate, but her attorney did not tell her about the election under IRC §2032A to value the farm property for its agricultural use rather than its fair market value. When the wife timely filed Form 706, the election was not made. Wife later was removed as executor by the probate court, and an Administrator Ad Litem was appointed. He hired an accounting firm to review the tax filings, and that firm also overlooked the §2032A election. A supplemental Form 706 was filed to make corrections to the first filing, and still the election was not made.

The ruling does not make clear what event caused the realization that this overlooked election could have saved the estate considerable tax dollars, but now an extension has been requested to make the election. The IRS concludes that everyone acted reasonably and in good faith relied upon tax professionals, so an additional 120 days is granted to file another Form 706 making the special use valuation election. [Private Letter Ruling 201908018].

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