Ascension Capital

The Importance of Estate Planning in 2021

The past year was characterized by relentless uncertainty, a major economic recession, and in the most unfortunate cases, lost loved ones. Reflecting on last year's challenges fills the Ascension team with empathy and humility, but it also gives us fresh resolve and commitment to our clients. We believe the best way to counter uncertainties in life—and to ensure long-term financial well-being and security—is by having a solid financial and estate plan.

With regards to estate planning specifically, there may be some urgency to review your plans this year. Currently, individuals have a unified $11.7 million estate and gift exemption, with wealth transfers exceeding that amount subject to a top tax rate of 40%[i]. These terms are set to expire at the end of 2025, but we think high-net-worth individuals need to start thinking now about possibility of higher taxes.

Government spending has been rising on an unprecedented scale, with the latest installment having a price tag of $1.9 trillion. In all, fiscal stimulus in the last twelve months has amounted to approximately $4.8 trillion[ii], and the Biden administration has been fairly vocal about potentially raising taxes to pay for some of it.

According the Tax Policy Center, President Biden's campaign plan would increase taxes by more than $2 trillion over a decade, by raising $3 trillion from corporations and high earners while cutting $1 trillion for everyone else[iii]. One of the potential targets for increased taxes: estates.

With Democrats currently controlling the legislative and executive branches, there is concern that the estate exemption level could drop to $5 million or even $3.5 million from the current $11.7 million. There is also the possibility the administration could lower the lifetime exemption for gifts to $1 million and raise the tax rate on transfers over those amounts to 45%. Also in question is the possible elimination of the step-up provision in capital gains.

Needless to say, there is much to consider. While we do not see major estate tax changes taking effect this year, we do think now is a good time to revisit estate plans and to consider plans for the future. Below, we detail six actions people can take now.

6 Estate Planning Considerations for 2021

We'll jump right in.

1. UPDATE WILLS AND POWERS OF ATTORNEY – we recommend clients review their wills and powers of attorney at least once a year, to ensure the documents still align with your goals and wishes. For example, do you need to assign or change the executor(s) of your estate?

People should also consider a healthcare power of attorney, which designates a trusted person to make healthcare decisions on your behalf in the event you are no longer able. You may also consider assigning a durable power of attorney, which would give a trusted family member or advisor the ability to make financial and property decisions on your behalf.

2. REVIEW BENEFICIARIES – beneficiary designations on your retirement accounts and other investment accounts generally overrule your written will, so be sure your beneficiaries are up-to-date.

The accounts to consider are IRAs, 401(k)s, life insurance, annuities, and other tax deferred accounts.

Taxable investment accounts do not have explicit beneficiary designations like retirement accounts do. The distribution of taxable investment money at death depends on the account 'registration,' which can take on a few different forms[iv].

For example, there is a JTWROS registration, which stands for Joint Tenants with Rights of Survivorship. In the event of one spouse's passing, the assets would go to the surviving spouse. There is also a "TOD" registration, which stands for Transfer on Death and would specify who should receive the assets. One issue that can potentially arise is that taxable account registrations will supersede what is written in a will. If your will says the money should go to your kids but the account is registered as JTWROS, the assets will go to your spouse[v].

By default, Ascension opens accounts as Joint Tenants in Common, which would allow the estate plan to ultimately determine where the assets are passed. In community property jurisdictions such as Texas, such a description is referenced in will-drafting circles as “Community Property.” These two types of accounts essentially accomplish the same, key objective: ensuring your written will is the arbiter of where assets should flow. If your goal is to optimize multi-generational wealth transfer planning, then it is important to consider Tenants in Common/Community Property versus JTWROS.

3. GIFTING AND TRUST PLANNING – One aspect of estate planning to consider now (or soon) is gifting. The federal lifetime estate and gift tax exemption is currently $11,700,000, but it is scheduled fall back to $5,000,000 in 2025. In other words, if you’re planning several years ahead, you could be subject to federal estate tax if your estate is greater than $5 million, not the current $11.7 million.

In some cases, we recommend high-net worth families make lifetime gifts, which is particularly relevant while the current exemption is in force. Here are some strategies to think about:

- Gifts to Trusts: Some trusts can be structured so that a living spouse of the grantor may have access to assets in the trust in the event they are needed. Funding trusts is also a way to earmark money for future generations.
- Grantor Retained Annuity Trust (GRAT): Contribute assets to a trust that pays its grantor an annuity for a set period of time. The initial amount contributed to the trust, plus interest, is returned to the grantor, leaving the remaining appreciation outside of his or her estate. This is a great strategy for assets expected to appreciate rapidly in the near future. Structured properly, these trusts do not use any of the lifetime gifting exemption described earlier.
- Charitable Lead Annuity Trust (CLAT): Contribute assets to a trust that pays to charity for a number of years and remainder is left for heirs. Grantor gets an immediate charitable tax deduction and makes a smaller gift for estate tax purposes to heirs.
- Qualified Personal Residence Trust (QPRT): Gift a residence to a trust while retaining the right to use the property for a set term of time. At the end of the term years, the value of the gift will be less than the current value of the property and use less of the lifetime exclusion.
- Outright Gifts: Each person can gift up to $15,000 per year to as many individuals as he or she wants, without any gift or estate tax consequences. It may make sense to gift a highly-appreciated asset to an individual who can sell it in a lower capital gains tax bracket. Outright gifts do not come with the restrictions (good and bad) that come with more complex strategies.

4. CONSIDER THE POTENTIAL VALUE OF ROTH CONVERSIONS – in cases where a person expects their tax bracket to rise over time (which seems like a distinct possibility in the current environment), it could make sense to explore a Roth conversion.

The basic premise of a Roth conversion is to take assets in a traditional IRA, pay the taxes on the assets, and move them to a Roth IRA where the assets grow tax-free and can also be withdrawn tax-free. An all-out conversion to a Roth IRA can be challenging, considering the size of the potential tax bill. But it is also possible to convert IRA assets to a Roth IRA incrementally, over time.

Ascension Capital can review your current situation and suggest potential strategies, if applicable.

5. CONDUCT A THOROUGH REVIEW OF YOUR INSURANCE COVERAGE – often times people obtain insurance coverage and forget to review it every year. But it is important to remember that insurance can be a crucial part of an estate plan, from ensuring your family receives tax-free benefits to also using insurance strategically, as a potential means to pay taxes.

One example of a resourceful estate planning tool is an Irrevocable Life Insurance Trust, or ILIT. These trusts are easy to establish and can be wedded to the other trusts embedded within each spouse's will, providing identical or similar terms of testamentary passage to future generations. These trusts own only a single asset, which is a cash value life insurance product. The premiums needed to fund the policy may be contributed to the trustee by the settlor annually, assuming the trust contains a "Crummey provision" clause. With this structure, the family can take advantage of part or all of the annual exclusion gift to cover premium costs.

We think it is important to review insurance coverage each year within the framework of your overall estate plan.

6. REVIEW OR CREATE A FINANCIAL PLAN – building an estate plan without having a financial plan is like 'putting the cart before the horse.' In order to think-through and consider what your estate will look like at the time of your passing—and in order to gain a clear understanding of how you want your assets distributed—you must first have a comprehensive financial plan, in our view.

Perhaps you have never created a financial plan, or you have not reviewed your plan in some time. We think now is a perfect time to do both, and we can help guide you every step of the way.

[2] To note, the '2000s' decade above refers to 2000 – 2010.

7. DISCUSS YOUR ESTATE PLAN WITH FAMILY – in some cases, discussing an estate plan with family can be challenging. It is often an uncomfortable subject and can even lead to disagreements. But in our experience, the clearer the estate plan is to the family, the easier it will be to execute the plan over time and without any issues.

Having a financial advisor or another trusted family advisor present during these discussions can be helpful, to serve as a neutral party who can also answer questions.

Conclusion

In our view, it doesn't matter if your net worth is $1,000,000 or $500,000,000+. We think it is critically important to make sure the wealth you accumulated is passed to family or charity according to your wishes.

Estate planning is a complex task, so many investors tend to put it off. But if 2020 taught us anything, it's that it is important to take action and make preparations for any and every outcome. Now might be just the right time to start your estate plan or to fine tune it and make sure it is up-to-date. Ascension Capital is here to help.

Sources:

[i] Source: Internal Revenue Service
[ii] Source: U.S. Treasury Department
[iii] Source: Tax Policy Center
[iv] Source: FINRA
[v] Source: FINRA

Disclaimer:

Ascension does not provide tax or legal advice, and we recommend consulting your accountant and attorney for guidance as to your particular situation.