ROSEMONT FINANCIAL GROUP

*Quarterly*Newsletter
Gain Through Confidence

Dynasty Trusts: The Gift That Just Keeps On Giving

Would you like your assets to last forever? Of course, there are no guarantees, but a "dynasty trust" could help you preserve wealth for your heirs indefinitely. As the name implies, this type of trust is designed to span several generations, barring drastic changes in applicable laws or your family's financial circumstances.

Under a common law principle known as the "rule against perpetuities," trusts normally are required to have a beginning, middle, and an end. This rule was adopted in many states, establishing an expiration date for trusts of 21 years after the death of a potential beneficiary who was alive at the time of the trust's creation. California and other states have adopted a variation of that rule with a limit of about 90 years. Delaware is among the few states that have repealed the rule completely and actively encourage people to set up dynasty trusts in those states.

With a dynasty trust, you transfer selected assets—perhaps stocks, bonds, real estate, or a combination of those—to a trust managed by an independent trustee. The trust can be created as an "inter vivos" transfer during your lifetime or a testamentary transfer through your will. Once established, the trust is irrevocable —you give up control over the assets and the right to change beneficiaries.

The trustee invests the trust assets. Depending on the terms of the trust, income may continue to accumulate within the trust or it could be paid out to beneficiaries, usually your descendants. You might name your adult children as the initial beneficiaries, to be followed by your grandchildren and great-grandchildren. The trustee also may have discretion to invade the trust principal for the health, education, support, and maintenance of beneficiaries or for other reasons.

By letting you designate the ultimate beneficiaries of the trust at the outset, this arrangement gives you some control over where the assets end up. In addition, a dynasty trust could help you protect some kinds of assets from creditors.

But a dynasty trust also may help reduce potential estate taxes. Under current rules, everyone is entitled to a generous estate and gift tax exemption of $5.49 million in 2017, which is indexed for inflation, and likely will rise in future years. This exemption is "portable" between spouses, which enables you to use any leftover amount not used when your spouse died.

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Recent Events Create Optimistic View Of Future

Hello and thanks for taking the time to look over our winter newsletter. We hope that 2017 is off to a prosperous start for you and your family. There have been many events since our last newsletter that have begun to shape the landscape of both our country and our markets.

Like many of you, seeing the Dow Jones Industrial Average break 20,000 was extremely exciting and has given us a very optimistic view of the year ahead. Considering the many recent changes, we have tailored our articles around some of the hot topics of the year.

Using required minimum distributions from retirement accounts for a variety of purposes is a common topic often discussed with clients. Although many times RMDs are needed for income; if they are not, life insurance could be an excellent tool to maximize the legacy you leave. Life insurance could enable you to maximize the inheritance to a higher level than just account value while leaving the death benefit to family, a friend, or a favorite charity.

Another article focuses on seven key aspects for the current U.S. tax plan. This, along with an overview of 2017 IRS savings plan contribution limits, should get you ready for meeting with your tax professional as well as possibly drumming up some questions for your tax strategy moving forward.

As always, thanks for your continued loyalty and do not hesitate to call or email us with any questions that come up. Thanks!

Using RMDs To Buy Life Insurance

It's a fact of tax-deferred investing for retirement. Eventually—within a year of reaching the age of 70½—the Internal Revenue Service expects you to begin pulling your savings out of retirement accounts and paying income tax on your withdrawals. These "required minimum distributions" (RMDs) are mandated for 401(k)s and other employer-sponsored plans, as well as for traditional IRAs (but not Roth IRAs).

Yet while there's no way around taking these mandatory distributions, if you use the money to buy life insurance you may be able to provide substantial tax-free benefits to your family.

Although the money you contribute to tax-deferred retirement accounts can grow without current tax erosion, RMDs must begin by April 1 of the year after the year in which you turn 70½. Then you have to take an RMD by December 31 every year thereafter. These RMDs generally are taxed at ordinary income tax rates as high as 39.6%.

If you're still working full-time and don't own the company, you may be able to postpone withdrawals from a plan sponsored by that employer until retirement. But this exception doesn't apply to IRAs.

The amount of the RMD is based on life expectancy tables and the value of your accounts on the last day of the previous year. For example, if you're age 75, the value of all your accounts is $500,000, and your spouse, who is the sole beneficiary, isn't more than 10 years younger than you are, the RMD under the tables is $21,834.

The penalty for *not* taking RMDs is equal to 50% of the amount you should have withdrawn (or the difference between the required amount and any lesser amount you did withdraw). For instance, if you failed to take any distribution in the example above, the penalty is $10,917, plus regular income tax. In addition, taking an RMD can trigger other tax complications. You might be subject to the 3.8% "net investment income" (NII) tax.

But what if you were to use the money to buy life insurance? Suppose that, in our example, you use the RMD amount, after paying tax on the withdrawal, to acquire a life insurance policy with a death benefit of $500,000. Further suppose that you pay a total of $200,000 in premiums before you die. Your family still comes out ahead by $300,000, and none of the $500,000 in proceeds from the life insurance is subject to income tax.

Choose the policy carefully to reduce the risk that your family will have less money with life insurance than if you invested the premiums somewhere else.

You could sweeten the deal by transferring ownership of the policy to an irrevocable life insurance trust, thus removing the value of the life insurance proceeds from your taxable estate. That could save your family from federal estate tax as well. ●

5 'Other' Retirement Saving Ideas

Usually, experts will tell you that the best way to save for retirement is by putting money into a 401(k) plan, an IRA, or another well-known retirement saving vehicle. And they're usually right. But you may not have access to a 401(k), and the contribution limits for IRAs are relatively low. Or those options may not appeal to you for other reasons.

That doesn't mean you can't save for retirement. Here are five other possibilities you might consider:

1. Brokerage accounts: Unlike when you sell a holding from inside a tax-deferred retirement plan, the sale of stocks, bonds, or mutual funds in a brokerage account may result in current taxes. But the maximum tax bite for assets held longer than one year is only 15% or 20% for investors in the top ordinary income tax bracket. That's much better than the taxes you'll rack up when you eventually withdraw money from your retirement plans. Those distributions will be taxed at rates as high as 39.6%.

2. Annuities: An annuity is a contract with a financial institution that provides you with income for a term of years or for your lifetime. There are many kinds of annuities, and the amount you receive may be fixed or variable, perhaps depending on the performance of investments. You'll be taxed only when payments are made, but annuity income is taxed at ordinary income rates.

3. Real estate: There are no guarantees, but real estate investments may appreciate in value and provide steady income. If you own investment real estate (for example, a commercial building or an apartment complex), you can rent it to tenants and receive regular income. You also may be able to deduct certain expenses, including depreciation, to offset the tax due on that rental income. When you finally sell the property, any appreciation will be taxed at the rates for capital gains.

Seven Key Parts Of Trump's Tax Reform Plan

On November 8, 2016, Donald Trump was elected the 45th president of the United States, culminating a two-year campaign. It is expected that it will take considerably less time for the former business mogul to push tax proposals through a Republican-led Congress. Although these provisions likely will be tweaked during congressional debate and negotiations, here are seven key items on Trump's tax agenda:

1. Individual tax rates. One cornerstone of Trump's tax plan is a restructuring of individual income tax brackets. The seven-bracket system now features a bottom tax rate of 10% and a high of 39.6%. Trump would replace the system with one having just three tax brackets: 12%, 25%, and 33%. Most taxpayers could pay less with this structure, but the largest benefits will be for those in the higher tax brackets.

2. Corporate tax rates. Another consistent theme in Trump's campaign was a pledge to reduce corporate income tax rates. Corporations currently pay tax at rates as low as 15% and as high as 35% (with a 38% bubble on some income). Under Trump's plan, all businesses would be taxed at a 15% rate, providing a tax cut to the majority of corporations. At the same time, Trump hopes to eliminate "double taxation" for C corporations, while preserving benefits such as liability protection.

3. Itemized deductions. Although Trump is offering tax relief to individuals with one hand, he would take it away with the other by eliminating some itemized deductions or limiting the total amount of itemized deductions. However, exceptions could be carved out for certain deductions, such as those for charitable donations and mortgage interest. The loss of the state income tax deduction could have an adverse effect on upper-income residents of states with high tax rates, such as California and New York.

4. Business write-offs. Under Section 179 of the tax code, a business currently may deduct up to $500,000 of the cost of assets placed in service during the year, subject to a phase-out threshold of $2 million. Plus, a business may be entitled to a bonus depreciation of 50% on qualified property. As part of his plan to boost business growth, Trump would double the Section 179 deduction to $1 million and provide an immediate deduction for business investments. This could be accompanied by a repeal or modification of the depreciation rules.

5. Estate taxes. Trump has proposed to repeal the federal estate tax. In addition, he has called for eliminating the tax rule allowing heirs to adjust the taxable basis of inherited property to its value at the death of the person making the bequest. This so-called step-up in basis may reduce capital gains taxes on inherited assets. The proposed changes could cause income tax complications for some taxpayers.

6. Repatriation tax. Tax revenue has shrunk in recent years due to so-called "tax inversions," through which multinational companies relocate their headquarters in a foreign country to avoid paying higher U.S. taxes. Trump has advocated a one-time tax repatriation holiday rate for corporations that would let them pay a tax rate of 10% on income brought back to the U.S.

7. Child care. The current tax law attempts to help beleaguered parents through a child tax credit (CTC) and a dependent-care credit for certain child-care costs. Low-income families may benefit from the earned income tax credit (EITC). Trump would overhaul the rules and institute a new deduction for child-care expenses, increase the EITC, and create tax-favored dependent care savings accounts, among other changes.

Many more changes could be in the works. For instance, Trump has advocated repealing the alternative minimum tax (AMT), the benefits for "stretch IRAs" that let inheritors spread out distributions over their life expectancies, and the 3.8% surtax on "net investment income" authorized by Obamacare. ●

4. Small businesses: You might start a business and run the company yourself, or you could invest in someone else's enterprise. The tax law provides a special exclusion for investments in "qualified small business stock" (QSBS) if you meet certain requirements. Such investments bring the chance of a big payoff, but they also can be risky. Many small businesses fail within their first years of operation.

5. Life insurance: Although life insurance technically isn't an investment for retirement, it could provide benefits that help fund your retirement. Typically, a policy offers protection for your spouse in retirement if you should die, and you can borrow against the cash value of some kinds of insurance. An added benefit is that life insurance proceeds are completely exempt from income tax. You may also be able to take withdrawals or arrange a tax-free exchange to an annuity or a long-term care insurance policy.

These are a few ways to think outside the box in deciding how to fund your retirement. Talk with your advisor about the ideas that will work best for you. ●

IRS Adjusts Retirement Plan Limits

Every year, the Internal Revenue Service (IRS) adjusts the amounts you can contribute to employer retirement plans and IRAs, based on inflation indexing. For 2017, the limits are slightly higher in some cases, while others stay the same. Here's a rundown on the key limits for participants:

Limits that will change for 2017

Defined contribution plans – The limit on total annual additions to 401(k), profit-sharing plans, and other such vehicles is increased to $54,000 for 2017 (up from $53,000).

Defined benefit plans – The maximum size of the annual benefit for traditional pensions and related retirement plans increases to $215,000 for 2017 (up from $210,000).

Annual compensation – The maximum amount of compensation that can be taken into account for most employer retirement plan calculations increases to $270,000 (up from $265,000).

Deductible IRA contributions – Phase-outs in 2017 for deductible IRA contributions will reflect the following changes:

- For single filers participating in an employer plan, the phase-out range increases to between $62,000 and $72,000 for 2017 (up from $61,000 and $71,000).
- For an IRA contributor filing jointly who participates in an employer plan, the phase-out range increases to between $99,000 and $119,000 (up from $98,000 through $118,000).
- For an IRA contributor filing jointly whose spouse participates in an employer plan, the phase-out range increases to between $186,000 and $196,000 for 2017 (up from a range of $184,000 to $194,000).

Roth IRA contributions – For single filers, phase-outs for the ability to make contributions increase to a range of from $118,000 to $133,000 for 2017 (up from $117,000 to $132,000). For joint filers, the phase-out range increases to between $186,000 and $196,000 for 2017 (up from $184,000 to $194,000 for 2016).

Limits that won't change in 2017

Elective deferrals – The deferral limit for those who participate in a 401(k), 403(b), most 457 plans, and the government's thrift savings plan remains at $18,000 for 2017. The limit for catch-up contributions to these plans for participants age 50 or over remains at $6,000.

SIMPLE plan deferrals – The limit on earnings deferrals to a SIMPLE plan remains at $12,500 for 2017. The limit for catch-up contributions for participants age 50 or over holds steady at $3,000.

Highly compensated employees – The dollar limit used to define highly compensated employees (HCEs) for employer plans stays at $120,000 for 2017.

IRA and Roth contributions – The maximum amount you can contribute to traditional and Roth IRAs stays at $5,500 for 2017. The $1,000 limit on catch-up contributions for participants 50 or over isn't subject to inflation indexing. ●

Dynasty Trusts

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Similarly, while there is a generation-skipping transfer tax (GSTT) that applies to most transfers that skip a generation, including those made to a trust, that same exemption amount applies to the GSTT.

When you transfer assets to a dynasty trust, the transfer is potentially subject to federal gift tax—if its value exceeds $5.49 million. But future appreciation of those assets won't be taxed, and that growth could benefit multiple generations of your heirs.

For example, suppose you and your spouse transfer $10 million to a dynasty trust. That gift isn't taxed because it is less than the total $10.98 million combined exemption that you and your spouse are allowed. But by the time both of you have died, suppose the assets have grown to be worth $5 million more than your combined exemption would have covered. Without a dynasty trust, your family would have to pay a 40% estate tax, or $2 million. The estate tax bill for the dynasty trust is zero.

Of course, there are other considerations, including income taxes, which the trust must pay each year on investment earnings. For this reason, dynasty trusts often are funded mainly with assets that don't produce current income—growth stock that doesn't pay dividends, for example, or tax-free municipal bonds. Life insurance policies also could be transferred to a dynasty trust.

Just keep in mind that these trusts are complex arrangements, and you'll need the help of an experienced estate planning specialist to create one that can benefit your family for generations to come. ●