# THE ESTATE PLANNER

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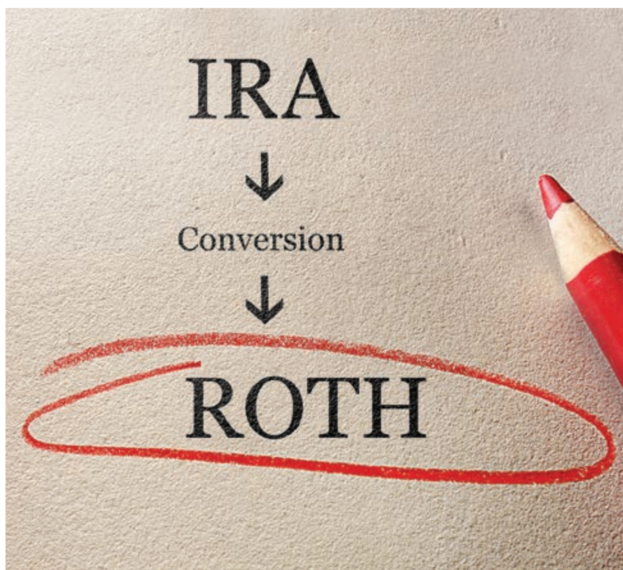
# Thinking about a Roth IRA conversion?

*Now may be the ideal time*

Roth IRAs offer significant financial and estate planning benefits. If you have a substantial balance in a traditional IRA and are considering converting it to a Roth IRA, there may be no better time than now. The Tax Cuts and Jobs Act (TCJA), enacted late last year, reduces individual income tax rates from 2018 through 2025. By making the conversion now, the TCJA both enhances the benefits of a Roth IRA and reduces the cost of converting.

## Roth IRA estate planning benefits

The main difference between traditional and Roth IRAs is the timing of income taxes. With a traditional IRA, your eligible contributions are deductible but distributions of both contributions and earnings are taxable. With a Roth IRA, on the other hand, your contributions are nondeductible — that is, they're made with after-tax dollars — but qualified distributions of both contributions and earnings are tax-free. As a general rule, from a tax perspective, you're better off with a Roth IRA if you expect your tax rate to be higher when it comes time to withdraw the funds. That's because you pay the tax up-front, when your tax rate is lower.




*One reason to convert now is that lower current income tax rates reduce the cost of conversion.*

From an estate planning perspective, Roth IRAs have two distinct advantages. First, unlike a traditional IRA, a Roth IRA doesn't mandate required minimum distributions (RMDs) beginning at age 70½. If your other assets are sufficient to meet your living expenses, you can allow the funds in a Roth IRA to continue growing tax-free for the rest of your life, multiplying the amount available for your loved ones. Second, your children or other beneficiaries can withdraw funds from a Roth IRA tax-free. In contrast, an inherited traditional IRA comes with a sizable income tax bill.

## Why now?

The TCJA's tax changes may make it an ideal time for a Roth IRA conversion. As previously discussed, Roth IRAs offer tax advantages if you expect your tax rate to be higher in the future. By temporarily lowering individual income tax rates, the TCJA ensures that your tax rate will increase in 2026 (unless a future Congress lowers tax rates). Future tax rates are irrelevant, of course, if you plan to hold the funds for life and leave them to your loved ones. In that case, you're generally better off with

## There's still time to undo a 2017 conversion

Prior to the Tax Cuts and Jobs Act (TCJA), taxpayers were given a limited window after a Roth IRA conversion to "undo" the conversion. Generally, you could "recharacterize" a Roth IRA as a traditional IRA up until the extended due date of your federal income tax return for the year in which the conversion was made. The TCJA eliminated this option, effective January 1, 2018, but the IRS has clarified that you still have until October 15, 2018, to recharacterize a conversion made in 2017.

Why would you want to undo a Roth IRA conversion? Potential reasons include the following:

- The value of the IRA's assets has declined substantially after the conversion, so that you now owe taxes on gains that have disappeared.
- You now expect your tax rate to be lower in the future, erasing the tax advantages of a Roth IRA.
- Your tax rate has dropped, and you wish to take advantage of the lower conversion cost.
- You don't have the funds you need to pay taxes on the conversion.
- The conversion pushed you into a higher tax bracket.

If you undo a 2017 conversion, it's possible to wait until January 1, 2019, and then reconvert, when conditions are more favorable.

a Roth IRA, which avoids RMDs and allows the full balance to continue growing tax-free.

Another reason to convert now is that lower current income tax rates reduce the cost of conversion. When you convert a traditional IRA to a Roth IRA, you pay taxes (but not penalties) on the amounts you convert, to the extent they're attributable to deductible contributions and earnings on those contributions. Converting now, when individual income tax rates are lower, will likely cost less than converting after 2025, when tax rates are scheduled to return to their previous levels.

One good strategy for softening the tax blow is to do the conversion gradually between now and 2026. This allows you to spread the cost over eight years. Also, by reducing the amount converted in a given year, you minimize the chances that the income generated by the conversion itself will push you into a higher tax bracket.

### Proceed with caution

If you're contemplating a Roth IRA conversion, be sure to discuss the costs, benefits and potential risks with your advisor. It's important to be cautious because, once you convert a traditional IRA to a Roth IRA, you're stuck with it. The TCJA repealed a provision that previously made it possible to "undo" a Roth IRA conversion that turned out to be a mistake, although there's still time to undo a conversion made in 2017. (See "There's still time to undo a 2017 conversion" above.)

# Estate planning solutions for members of the "sandwich generation"

Are you familiar with the term "sandwich generation"? If you're currently caring for your children and your elderly parents, all the while trying to save for retirement, consider yourself a member. As a member of the sandwich generation, it's critical that you be sure your estate plan reflects your current situation.

## A balancing act

First, let's start with the "bottom" part of the sandwich, your children. Assuming they're still in their formative years, make them your top priority. At this stage, you'll still have most of the control over the decisions affecting their lives. These involve personal choices that are different for every family.

The "upper" half of the sandwich can be more problematic. Depending on their health status and other factors, including finances, your parents may resist your efforts to assist them. They may be oblivious to changes or dismissive of your concerns. And their attitude might range from being cooperative to highly resistant.

## Talk frankly

The first thing to do, and perhaps the most important, is to initiate a family meeting. Invite all the key players — your parents, siblings and, as appropriate, their spouses, at the least — to the gathering. This could be difficult to arrange, especially if certain relatives reside in far-flung places, but it helps if you can meet face-to-face.

*Typically, the power of attorney, which expires on death, is coordinated with a living will and other health care directives.*

What should you discuss? Cover the entire estate planning gamut. This isn't the time to be evasive — the dialogue should be frank and honest. Many issues can be sensitive and emotions can run high, so be prepared for some hand-wringing or pushback.

You probably won't be able to accomplish all your objectives in a single session. Consider meeting again with as many of

the other parties as possible. In fact, you might broaden the circle to include your professional estate planner. Take as much time as you need to work things out.

## Estate planning tools

Of course, once you develop a concerted approach, you'll need to implement the main concepts. Typically, this requires the drafting of certain estate planning documents that meet legal requirements. The complete list will vary family-to-family, but here are some basic components:

**Will.** If a legally valid will has been executed, your parents' assets will be distributed in the manner described within. In addition, an existing will may have to be modified or replaced due to extenuating circumstances. For instance, your parents might want to add a grandchild to the list of beneficiaries or change direction due to a divorce in the family. Review the last updated version of the will periodically.

**Durable power of attorney.** This document authorizes someone to handle your parents' affairs and health care decisions in the event of disability or incompetence. This might be you or a sibling. Typically, the power of attorney, which expires on death, is coordinated with a living will and other health care directives.

**Letter of instructions.** Although it isn't legally binding, the letter can be as important as a will. It generally provides an inventory and location of assets; account numbers for securities, retirement plans and IRAs and insurance policies; and a list of professional contacts. It may also be used to state personal preferences, such as funeral arrangements.

**Living will.** A living will spells out your parents' desires relating to life-sustaining measures in the event of a terminal illness. It specifies what means should be used, and not used, but doesn't provide legal authority for anyone to act on their behalf. For this reason, it may be coupled with a health care power of attorney.

**Revocable living trust.** By transferring assets to a revocable living trust, your parents can continue to manage those assets while they are still alive. A revocable living trust avoids probate, keeps personal information private and allocates the trust assets to one's heirs.

## Keep calm and learn your options

It's easy to become overwhelmed when confronting the financial (and emotional) responsibilities of funding your retirement, raising your children and supporting your aging parents. Talk to your estate planning advisor about your estate planning options. ∎

# New pass-through deduction creates estate planning opportunities

The Tax Cuts and Jobs Act (TCJA), enacted late last year, is best known for slashing income tax rates paid by C corporations and temporarily reducing individual rates. It also created a new 20% deduction for certain entities, effective through 2025, to help them compete with lower-taxed corporations. The deduction — which is available to qualifying S corporations, partnerships, limited liability companies (LLCs) and sole proprietorships — creates opportunities to transfer business interests to your children or other loved ones in a tax-efficient manner.

## Section 199A basics

The "pass-through deduction" can be found in new Internal Revenue Code Sec. 199A. It allows eligible owners to deduct 20% of their allocable share of the entity's qualifying business income (QBI). QBI generally refers to net business income earned in the United States, excluding investment income, such as capital gains, dividends and non-business-related interest. Also excluded is reasonable compensation received by S corporation shareholders and guaranteed payments received by partners.

Generally, an owner's deduction is equal to 20% of QBI or 20% of the owner's taxable income

(less net capital gains) — *whichever is less*. The deduction is taken against adjusted gross income (AGI) in computing taxable income, but it's not an itemized deduction.

The deduction may be reduced or even eliminated if an owner's taxable income exceeds $157,500 ($315,000 for joint filers). Once this threshold is reached, two limitations are triggered:

1. For "specified service businesses," the deduction is gradually reduced and then eliminated after an owner's taxable income reaches $207,500 ($415,000 for joint filers). Covered businesses include health care providers, accounting and law firms, consulting firms, investment-related firms and certain other service providers (but not architecture or engineering firms).

2. For all businesses, the deduction is limited to the *greater* of 1) 50% of the owner's allocable share of the entity's W-2 wages, or 2) 25% of W-2 wages plus 2.5% of the original cost basis of qualified depreciable property. This limitation is phased in beginning at the threshold amount and applied at full force when taxable income reaches $207,500 ($415,000 for joint filers).

In other words, for high-income owners to benefit from the deduction, their businesses must be other than specified service businesses *and* they must either pay significant W-2 wages or have a significant investment in real estate or other depreciable property.

## Estate planning opportunities

If you own a business structured as a partnership, S corporation or LLC, Sec. 199A may offer some attractive estate planning opportunities. For example, if your taxable income is above the threshold and your deduction is reduced or eliminated by one or both of the previously discussed provisions,

you may be able to obtain the full benefit of the deduction. Do so by transferring interests in the business to family members at lower income levels or to properly structured trusts for their benefit. (Trusts are subject to the same $157,500 income threshold as individuals.)

Be aware that W-2 wages and the basis of depreciable property are apportioned between the trust and its beneficiaries in proportion to the amount of income retained by the trust and the amount passed through to the beneficiaries.

## A complex provision

Bear in mind that this is a highly simplified summary of Sec. 199A. In fact, it's one of the most complex provisions of the TCJA. Consult your tax advisor to determine whether the pass-through deduction will benefit your business or your estate plan.

ESTATE PLANNING RED FLAG

## You're getting divorced

If you're divorcing, it's important to review your estate plan as early as possible, for two reasons: First, you may wish to revise your plan immediately to prevent your spouse from inheriting or gaining control over your assets if you die or become incapacitated before the divorce is final. Second, although a divorce judgment or settlement automatically extinguishes certain of your former spouse's rights, some documents must be modified to ensure that he or she doesn't receive unintended benefits.

Consider revising your will and any revocable trusts to exclude your spouse. Note that in many states your spouse will retain elective share or community property rights to a portion of your estate until the marriage ends. But revising your will or trust will limit your spouse to the legal minimum if you die before the divorce is final. If you have irrevocable trusts, determine whether they provide for your spouse's interest to terminate automatically upon divorce.

Other actions to consider include:

- Changing beneficiary designations in IRAs, life insurance policies, annuities or retirement plans (note that federal law prevents you from removing your spouse as beneficiary of a retirement plan, without his or her consent, until the divorce is final),
- Changing payable on death (POD) or transfer on death (TOD) designations in bank or brokerage accounts,
- Revoking powers of attorney or health care directives naming your spouse as agent, and
- Establishing trusts for your minor children. (If they inherit assets from you outright, a court will likely appoint your former spouse as conservator.)

Finally, under the Tax Cuts and Jobs Act, alimony paid pursuant to divorces finalized after 2018 will no longer be deductible by the payor or taxable to the payee. Keep this change in mind in determining the timing of your divorce and the amount of alimony.

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