REFLECTIONS

Client Newsletter

To Your Future Prosperity

WINDGATE
WEALTH MANAGEMENT
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HOW TO MAXIMIZE YOUR ESTATE FOR FUTURE GENERATIONS

Money is not everything, but if you can pass wealth to the next generation, it can transform your family's future.

It takes a level of planning beyond wealth building strategies to effectively pass it on to the next generation. When planning for your financial legacy, keep the following considerations in mind.

Estate Planning Goals

Having an estate plan in place can help you feel more confident that your loved ones will be taken care of. The first step is to consider your goals. Comprehensive planning can help solve several needs, including providing financial support for your spouse and heirs, ensuring your assets will be distributed according to your wishes, and minimizing taxes and expenses. Initial questions to ask yourself include:

•Is there concern regarding your heirs' ability to manage and protect their wealth?
•Do any heirs have special needs you would like to meet?

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•Are you looking to protect assets from a beneficiary's divorced spouse or future creditors?
•Are you concerned about a tax burden imposed on assets before they reach your heirs?

Protecting Your Legacy

When most people think about threats to the financial legacy they want to leave to future generations, one of the first things that comes to mind is taxes. There is a hefty estate tax upwards of 40% (plus potential state taxes) for any assets you own at passing above the "exemption amount" of $11.7 million per individual ($23.4 million per couple). Starting January 1, 2026, the exemption will be reduced to $5.49 million adjusted for inflation, likely somewhere around $6 million ($12 million per couple).

One of the most effective ways of protecting your estate from this future tax is annual gifting. You can give $15,000 ($30,000 per couple) in assets annually with no gift tax needing to be filed. Gifting appreciated stocks can be doubly effective as it allows you to pass on any capital gains to your heirs at (potentially) a lower tax rate if they do not earn as much income as you do.

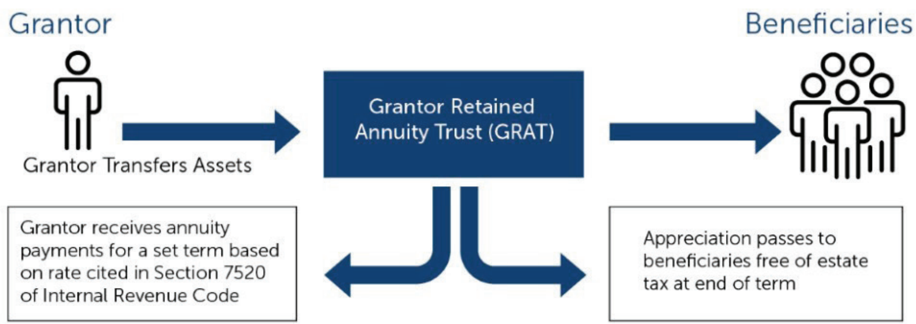
Gifting assets into a trust is often an effective strategy. Investments can be gifted to the trust, and as the founder of the trust, you get to set the rules and determine how the assets should be distributed. You can also set up rules for how the assets are managed and invested within the trust. Distributions can be determined for your beneficiaries at certain ages, properties can be dictated to be used for certain purposes, and other conditions may be established as you see fit. Additionally, a trust is not subject to probate and the associated costs. If assets are in an irrevocable or permanent trust, they will also be sheltered from lawsuit liability since the assets technically no longer belong to you.

Trusts Built for Growing

How you plan your estate will have a significant impact on how much your family must pay in taxes, especially if you own assets like company stock that you expect to appreciate substantially.

Strategic estate planning can allow you to minimize estate tax and preserve family history. One example of this strategy is the creation of a Grantor Retained Annuity Trust, or GRAT. A GRAT can freeze the taxable value of a business or investment in its early stage, allowing you to limit future taxes. You then receive an annuity payment in return. You can retain control and continue to receive cash flows upon exit.

Assets with a low current valuation compared to their expected future value (such as stock in a privately held firm) are particularly well suited to putting into a GRAT. This is because assets with the potential for greater appreciation also have the potential for triggering large estate tax liabilities, and a GRAT allows you to bypass these future taxes.



Source: Kitces.com

Family LLC Planning

One of the more sophisticated – yet effective – estate planning strategies is the Family LLC. Ideal for families projecting to be well above the federal estate tax limit, a Family LLC can help reduce estate taxes while ensuring permanence of the family's wealth in a businesslike structure.

Here, assets are transferred into an LLC entity in exchange for ownership "shares." Parents are then owners of the LLC shares rather than the underlying assets. Beneficiaries can receive their own interest in the LLC throughout life or at passing, as opposed to assets or cash. Profit distributions can be made depending on the family's wishes.

The unique advantage to this set up is the Valuation Discount. The estate tax is determined by the value of the assets reported on the tax return at death. The lower the value of the assets, the lower the estate tax. The value of assets in an LLC can often be discounted on a tax return because of its lack of marketability and lack of control.

Remember that heirs are only receiving shares in the family LLC, not outright assets. Shares that have no voting or management rights are clearly less valuable than the underlying asset. So, while the ultimate discount will be based on facts specific to any situation, a typical discount range is 20-40%. This means that a $10 million asset would be reduced by $4 million, saving $1.6 million in estate taxes. This discount can also be applied to any gifting of shares during life.

Proper Preparation

The last thing you want is for your estate, built from years of hard work and planning, to whittle away. There are numerous ways to help ensure your estate does not decline amidst the transfer to the next generation, and our team of [Windgate Wealth Management] professionals is equipped with the skills necessary to help you navigate this exchange.

One of the most effective ways of protecting your estate from this future tax is annual gifting.

MID-YEAR MARKET COMMENTARY

This is an extraordinarily unusual time, and we really don't have a template or, you know, any experience of a situation like this.
—Federal Reserve chair Jerome Powell, June 16, 2021

In case you missed it, here is our recent market commentary included in your last quarter's statements. Inflation continues to be a key question in today's market environment, and we remain prepared for any outcome.

The year 2020 helped remind investors of an important truth: we cannot predict the future. Even if you had known in advance that we would experience a global pandemic and economic shutdown, you likely still would have gotten the market reaction wrong. Under the circumstances, few would have predicted that equities around the globe would surge above pre-pandemic levels, a trend which has continued through the first half of 2021.

A strong global economic recovery seems possible over the next 12 months, driven by the re-opening and accommodative monetary and fiscal policy. While many asset class valuations are expensive, these macro conditions remain supportive of corporate earnings and global equities. However, as the Federal Reserve Chairman, Jerome Powell says, there is significant uncertainty as the economy recovers from the unprecedented pandemic-induced dislocations. Absent a severe resurgence in the pandemic or other external shock, one key market risk is inflation.

It is still too early to say if the past two months' inflation reports are harbingers of a sustained period of meaningfully higher inflation. Or, as the Fed believes (and hopes), most of the recent sharp price increases will prove transitory, as current supply shortages catch up to demand and increasing productive capacity comes online as the pandemic recedes.

Given the uncertainties, we believe investors should balance the upside returns in a reflationary scenario with downside risks from an inflation surprise in either direction. We incorporate inflation and deflation risks into our thinking about your portfolios. Historically, stocks have been excellent at generating returns above inflation. While a sustained period of high inflation would be bad initially for most equities, over time many areas would likely do well, including emerging-market stocks, value stocks, and smaller company stocks. Also, in the event of a macro shock and deflationary pressure, more defensive positions, such as bonds, gold, and cash would help offset declines elsewhere. Put

Of course, 10%-plus stock market corrections can always occur. Along these lines, valuations for U.S. stocks are historically very high and embed a lot of good news/high expectations for continued strong U.S. corporate earnings growth. This raises the potential for a typical "mid-cycle" market correction (a 10%-plus decline) should actual earnings growth fail to meet such lofty expectations. As the U.S. stock market progresses further into a mid-to-late cycle phase, it is typical for high-quality stocks (for example, those with high and stable profit margins and return on equity) to outperform low-quality, more-speculative names. As always, equity investors should be prepared for a bumpy ride.

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HOW MUCH DOES LONG-TERM CARE REALLY COST IN ILLINOIS?

When a person goes hiking, they are cautious and keep an eye out for bears. When merging into traffic, a careful driver looks in their blind spot for possible collision hazards. When looking to retire, however, there is a dangerous situation that some retirees do not think to look for, and it can cause real damage to financial stability during retirement.

That hidden hazard is the extreme expense of long-term care. If caught unprepared, a retiree may see their financial situation decline rapidly, and may even find themselves in a crisis. Here we will discuss the high costs of long-term care, and what you can do to be prepared.

The Danger

Judy had been super careful with her savings over the years, and in retirement, she had a comfortable income of about $80,000 a year. Then a bad car accident left her needing to be in assisted living care for six months and requiring in-home care for several years after that.

The toll on Judy's finances was extreme. After $28,000 for assisted living and $120,000 for in-home care and rehabilitation, her nest egg had taken a big hit. She was forced to reduce her annual withdrawals down to $65,000 to keep her account retirement. She would still have a roof over her head, but a lot of the extracurricular activities she had planned were no longer going to be a reality.

This kind of story is not unfamiliar and demonstrates the very real danger that not having a plan for long-term care presents. In 2020 the annual cost of a home health aide in Illinois was about $58,344. To get a private room at a nursing home facility would increase that cost to $84,315 a year.

Retirees cannot afford to leave long-term care out of the plan.

The Antidote

There are primarily two methods available to prepare for long-term care. The first is to purchase long-term care insurance. Basically, you pay an insurance company a premium to carry the risk, and if there is an unexpected health emergency, they foot most of the bill. While this is a comprehensive way to protect yourself, it does have a major drawback.

The cost of long-term care insurance is very high. If you choose to go this route, you will need to plan to pay costly premiums throughout your retirement. The amount you pay will depend on how young you are when you get the insurance. If you are in your 50's when you acquire your insurance, you will pay much less than you would at age 70. However, you'll be paying for coverage that you are a lot less likely to need in your younger years.

Increasingly, retirees are exploring another strategy to cover these kinds of medical expenses in retirement through self-insurance. To self-insure is to establish enough savings to be able to effectively fund any crisis, without putting your retirement savings at risk.

This can be accomplished in a variety of ways. You could increase your 401(k) funding, estimating a target of possible expenses and planning to raise those funds by your retirement date.

You might also be eligible for an HSA (health savings account), which is a tax-sheltered savings plan for medical expenses. A married couple can save up to $7,200 a year in a qualified HSA, and once the minimum threshold has been met, the money can be invested, just like money in a 401(k).

The great thing about this method is that the money you put in is pre-tax, and if it is used for qualified medical expenses, it will never be taxed at all. If you find that you need access to it during retirement, after age 65, there is no penalty to withdraw the funds for any reason. You will simply pay standard income tax on your withdrawals.

Though the cost of long-term care is a threat to retirement stability, you can retire with confidence if you have a solid plan in place.

HOW PHYSICIANS CAN REDUCE LIABILITY WITH RETIREMENT PLANS

As a physician in today's world, you are under more pressure than ever to protect yourself from liability. You work longer hours as bureaucratic paperwork becomes ever more demanding, but you have less face-to-face time with your patients, possibly resulting in less trusting relationships between patient and physician.

These combined factors could increase your risk of a lawsuit. You could be held liable for mistakes in patient records, misinforming patients of test results, or even for the actions of other physicians employed by your practice. Some of these risks are out of your control and may occur no matter how careful you have been, so it is important to reduce liability where you can.

Many physicians may not realize it, but costly insurance is not the only way to protect yourself from liability. A strategy to increase retirement contributions above and beyond the typical $57K annual limit allows you to protect more assets and take advantage of significant tax benefits as well.

Reduce Liability with Retirement Contributions

Most employer-sponsored retirement plan assets, such as a 401(k), are protected from creditors and civil lawsuits. Money you contribute to these types of accounts cannot be seized or used to pay personal debts. And as you probably already know, there are considerable tax benefits to contributing higher amounts of your gross income.

For these reasons, we believe that physicians miss out on opportunities to decrease their liability when they do not contribute the maximum amount to a 401(k) plan each year. Current contribution limits stand at $19,500 annually. For high-income earners (especially older earners), this limit may be too low to fund the retirement lifestyle you want and protect your assets from a lawsuit.

Save More with A Cash Balance Plan

A better solution is to open a cash balance plan, which is a [defined benefit plan](). In addition to contributing the maximum amount to a 401(k), a cash balance plan is a good option for physicians who can contribute more than $57,000 per year to their retirement. A cash balance plan allows you to:

- Contribute more to retirement
- Further reduce liability
- Benefit from greater tax advantages

A cash balance plan allows some earners to contribute well over $200,000 annually depending on age. Contributing this much to your retirement not only better ensures your security during your golden years, but also better protects your assets from liability. Taxwise, contributions to a cash balance plan bring down your taxable income, dollar for dollar. What is not to love?

Work with A Professional to Understand Your Options

Although the tax benefits and other advantages of a cash balance plan are significant, they are also incredibly complex. Working with an experienced wealth management professional can help you understand and determine your ideal contribution level each year. Determining this level is unlike determining how much to contribute to a 401(k) plan, as it is based on how much you can take out of the plan each year when you retire.

If you are considering adding a cash balance plan to your retirement portfolio, you will need to commit time and effort to working with licensed professionals, including a tax advisor, an actuary, and a wealth manager, such as Windgate Wealth Management.

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