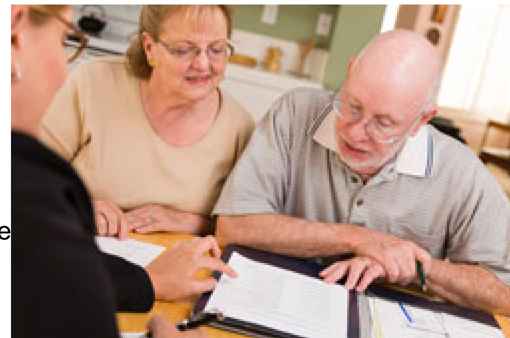
Fourth Quarter 2019

Withdrawal Strategies and Your Estate



If you anticipate leaving assets to your heirs when you die, which assets will make the best inheritance? Should you spend down your retirement accounts or non-tax-deferred investments first? While the correct answer will depend on your unique financial situation, one consideration is the impact of taxes.

As of 2018, thanks to the Tax Cuts & Jobs Act, federal estate taxes won't apply until an estate exceeds $11.2 million. For couples, $22.4 million can currently pass tax-free to heirs. The higher exemption is inflation adjusted, but like most of the individual provisions in the new law, it is scheduled to sunset by 2026. If a future Congress doesn't change the rules again, in 2026 the tax-free amounts will revert back to 2017 levels.

Before you decide your estate will be too small to be affected by federal taxes, remember that your home state may have a different estate tax limits, and your heirs could end up with a sizeable tax bill at the state level. Plus, federal estate tax laws could change yet again. The withdrawal strategies you use today have the potential to impact your heirs in the future.

Investments and assets such as stocks and bonds, real estate, personal property and collectibles are *"marked to market"* when inherited. This allows their current market value to be used when calculating whether or not estate taxes apply. Because the accounts or assets pass to your heirs at their market value, no long- or short-term capital gains taxes are owed on accumulated gains during the period you held the assets. This can be particularly beneficial on assets with substantial appreciation. For example, stock you purchased for $125,000 that is valued in excess of $800,000 today would incur substantial capital gains taxes if sold before your death. Your heirs, however, would inherit the shares at a $800,000 basis. Capital gains taxes would be owed only on appreciation after your death.

There is no mark to market on retirement accounts. These accounts can be rolled over by your heirs into an inherited IRA or cashed out immediately or over a five-year period without incurring a 10% early withdrawal penalty if the heir is under age 59½. Regardless, when withdrawals are made from inherited retirement accounts, they are taxable at the heirs' personal tax rate. In addition, retirement account balances are included in the calculation of the estate's total value for the purpose of determining estate tax liability. Life insurance and annuities add another layer of complexity depending upon how contracts are structured.

This article is not intended as tax advice but rather a highlight of some of the issues to consider when designing retirement income strategies. If you are concerned about minimizing taxes on your estate and optimizing the value your heirs receive, review your retirement income strategy with a qualified financial advisor or tax consultant. It could make a significant difference to your heirs.

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