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Wealth Planning Strategies in 2022

A Roadmap for Success

It likely will be some time before we understand the true impact of the pandemic on investor attitudes toward market volatility and risk. One thing seems certain: more investors than ever are turning to financial advisors and wealth planners to feel more confident in their financial future.

There are other forces at play shaping the near-term future of retirement and wealth planning. For HNW individuals, increases in individual tax rates by the Biden administration – along with the proposal to increase capital gains and eliminate step-up in basis at death – should result in more of the traditional charitable giving strategies as part of a client's estate planning.

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How Soon Is Now? The Unraveling of Deathbed Estate Planning

A discussion of the details, interpretation and application of deathbed transfers.

In “How Soon Is Now: Estate of Moore & the Unraveling of Deathbed Estate Planning,” Professor Beckett G. Cantley and Geoffrey C. Dietrich discuss in detail the interpretation and application of Internal Revenue Code Section 2036 by the Tax Court to so-called deathbed transfers, relevant cases, including Moore, and the policy behind the Tax Court’s interpretation of the rules.

Background

Cantley and Dietrich start off with a brief summary of the federal gift and estate tax laws as they apply today to individuals who make gifts or have a taxable estate in excess of $11.7 million. They then go on to explain the common end-of-life transactions that may attract the attention of the Internal Revenue Service and caution against such last-minute planning due to the uncertainty over whether such deathbed planning will in fact accomplish the decedent’s tax objectives.

Two transactions frequently scrutinized by the IRS involve: (i) family limited partnerships (FLPs) and (ii) the use of valuation discounts to leverage the lifetime gift tax exemption. In the context of an FLP, family members serve as general or limited partners of a family business or other pooled assets. Rather than making a capital contribution to the FLP, limited partners are gifted their ownership interest by a senior member of the family and have little control over the management of the FLP. These limited partnership interests generally will have a lower value than the underlying assets of the FLP, due to lack of marketability of the interest and lack of control by the limited partner over the FLP, both resulting in a lower valuation of the partnership interest for estate or gift tax purposes.

The article opines that the opportunity to make discounted transfers of FLP interests doesn’t end at the initial transfer of ownership interest to a limited partner, but can continue into other estate and tax planning transactions. Transfer of an FLP interest to a grantor retained annuity trust (GRAT) or charitable lead annuity trust (CLAT) enables the grantor to take an additional valuation discount for the retained right to the FLP’s income stream for a term of years, which

would have a lower value than transferring the FLP interest as an outright gift. Sales to children, other family members or trusts also provide a means to transfer FLP interests presumably at a value lower than outright sale of the underlying assets. While the sale will result in the frozen value of the FLP interest remaining in the transferor’s estate, all appreciation will be moved out of the estate and to the purchaser, while using little or no gift tax exemption.

While the article provides a simplified explanation of the mechanics of GRATs and CLATs, Cantley and Dietrich could clarify how these specific trust structures differ from other types of trusts to allow for further discounting, specifically by including a brief discussion of IRC Sections 2702 and 7520.

IRC Section 2036(a)

IRC Section 2036(a) includes in the value of a decedent's gross estate any property over which the decedent retained possession or enjoyment, had the right to possess or enjoy, or had the right to designate who shall possess or enjoy such property. The article provides insight into congressional intent behind the purpose of this Section, and then goes on to discuss the interpretation and application of IRC Section 2036 by the IRS and Tax Court in the fundamental cases Estate of Bongard, Estate of Strangi, Estate of Powell and Estate of Moore.

In each of these cases, the Tax Court applied the following test to determine whether IRC Section 2036 may apply to the transfer of

property, namely FLP interests: (1) the decedent made a lifetime transfer of property; (2) the transfer was not a bona fide sale for adequate and full consideration, which requires that there be a legitimate nontax reason for the FLP; and (3) the decedent retained an interest or right enumerated in Section 2036(a)(1) or (2) or (b) in the transferred property that the decedent did not relinquish before death.

Cantley and Dietrich then discuss their view on the policy behind application of Section 2036 and focus primarily on its effect on deathbed transfers. Although the pertinent case law reflects a pattern of transfers being made for tax planning purposes very near the transferor's death, the article's focus on the relationship between the application of Section 2036 and deathbed planning may be too pronounced. While it's accurate to use these cases and Section 2036, together with IRC Section 2035, to caution against tax planning at the end of one's life, it's important to note that the timing of a transfer isn't part of the Section 2036 multipronged test applied by the Tax Court. Deathbed transfers clearly strengthen the argument that a legitimate nontax reason didn't exist for creating the FLP, but that argument could be made in any situation in which an FLP was established as part of a comprehensive estate and tax planning structure. Cantley and Dietrich allude to this risk that Section 2036 should be considered for any FLP transfers (not just deathbed transfers) in their discussion regarding steps to take in order to avoid application of Section 2036 but could be more clear in their explanation.

Written by: Mary Ann Mancini and Ashley B. Sawyer, WealthManagement.com

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How to Help Philanthropically Minded Clients Develop a Charitable Giving Road Map

The sheer number of nonprofits shouldn't force clients into a self-imposed game of 'eeny, meeny, miny, moe.'

The charitable giving universe can be overwhelming and confusing to navigate as clients embark on a journey with impact as their end goal. Many of us frequently receive donation requests in the mail—or maybe even phone calls—from various charitable organizations.

For the charitably inclined individual or family who wants to give back to their community or endorse specific social causes they care about, selecting and prioritizing which charities to devote their time and financial support to can be daunting. For context, the National Center for Charitable Statistics reports that there are over 1.5 million nonprofits in the United States!

However, the sheer number of nonprofits shouldn't force clients into a self-imposed game of "eeny, meeny, miny, moe." Financial advisors can—and should—play a meaningful role in helping clients craft a charitable giving road map that guides them over the long term while also aligning their philanthropic goals with their holistic financial plan.

Below are some best practices and tips for advisors to draw on when working with clients to develop charitable giving road maps:

Start With A Mission Statement

Clients are often on the receiving end of donation requests from many nonprofits, but no one can give to every deserving organization. There is a broad spectrum of philanthropic causes, from education to animal rights as well as many specific philanthropic focuses ranging from scholarships to combating animal cruelty (to name just a few examples).

At the beginning of a new client relationship, advisors should ask what philanthropic causes and focuses the client is passionate about or which organizations they have donated to in the past, discussing which are most important to them or have made them feel the happiest to support.

An advisor can then help draft a mission statement that narrows philanthropic giving to a maximum of two or three causes, explaining why they are important to the client and how they intend to remedy the identified issue. Geographic scope, which can be local, national or international, should also be defined. (Nonprofits with programs benefiting people and communities in other countries frequently have U.S. affiliates—often with "American friends" in their names—enabling American donors to direct tax-deductible gifts overseas.) An example of an effective mission statement is as follows:

"We will give to local after-school programs that promote college readiness in lower-income school districts. Our charitable giving will seek to bridge the gap in education funding which disadvantages these children in order to increase

lower-income college attendance."

Defining these parameters of "who, what, where, why and how" for charitable giving makes it much easier for clients to methodically evaluate individual donation requests. Ultimately, a client's mission statement should guide their personalized charitable giving strategy, helping them effectively filter out donation requests by plucking up the confidence to say "no thank you" when a charity doesn't align with their philanthropic vision.

Conduct Thorough Due Diligence on Charities

Clients often have at least one favorite charity in mind when building out their charitable giving road map. However, depending upon a client's desired impact and the charity's financial profile, the 501(c)3 organization that they have frequently donated to in the past may not be the best one to give to going forward.

Advisors can research nonprofits to help clients understand if their gifts are making a meaningful impact. Charity Navigator and GuideStar offer reliable data on nonprofit organizations based on 990 tax forms and other materials educating donors on how charities spend their money. Important questions to answer are: What portion of a charity's budget actually goes toward its programs and services versus how much goes toward administrative costs and fundraising? Are there any financial red flags (e.g., extensive liabilities)? Obviously, a charity that consistently directs the bulk of its budget to programs and services over the years is an ideal candidate for a client's donations.

Advisors can also reach out to individual charities to ask for more information about their specific initiatives and inquire if there are any funding gaps that could maximize the impact of their client's donation. Most nonprofits employ donor relations personnel who can answer questions about their current budget, how long they would be able to operate if they didn't receive another cent from donors and how much in additional fundraising they would need to be able to achieve their

stated goals. Donor relations professionals are often eager to engage with donors and their financial advisors to discuss projects where donations would accomplish the most good.

It might also be worthwhile for an advisor to work with a client to create a concise "grant application" that lays out all relevant questions they want the charity to answer. This will allow the advisor and client to better compare individual charities side by side and also serves as a handy due diligence record for future reference.

Utilize investment vehicles and options that can maximize impact: From a very early age—when we were old enough to drop coins into donation cans—many of us think of cash as the default method for donating to charity. But when we are old enough to invest (and file our own tax returns), writing a check isn't always the most efficient way to make a donation.

Today, investors can open up what is called a donor-advised fund (DAF)—akin to a charitable investment account that can be funded with

irrevocable contributions of cash, stock, crypto, etc.—at many of the large brokerage firms or at community foundations. One powerful technique is for clients to donate highly appreciated stock to their DAF, thereby avoiding capital gains taxes when the shares are sold and increasing the size of the client's gift compared with liquidating the stock in their taxable account and donating the post-tax proceeds.

Simultaneously, the donor receives a tax deduction (if they itemize) while allowing them to diversify away from a concentrated stock position. Furthermore, investments in a DAF grow tax-free for future giving. Advisors can sometimes even manage a DAF account's investment allocation. When the client is ready to donate to a specific 501(c)3 nonprofit, they can then make grant recommendations from their account.

Additionally, advisors can help amplify the positive change of their clients' donations via socially responsible investment strategies in DAFs. Environmental, social and governance (ESG) criteria, such as negative screens, can reduce or eliminate investments in companies whose practices or policies are at odds with the client's personal values. For example, some ESG strategies can screen out fossil fuels, tobacco and weapons. Advisors can also work with high-net-worth clients to customize the socially responsible investment approach of their DAFs to better align with their values (for example, promoting LGBTQ+ rights or divesting from animal testing).

Revisit the Mission Statement On an Annual Basis

A lot can change in a year, and this includes clients' charitable giving priorities. This is why advisors should check in with clients to review the mission statements driving their charitable giving every year.

Maybe a client would like to incorporate an additional cause into their giving plan. Or maybe they have focused on impact in their local community and would now like to broaden their scope by supporting national programs.

Charitable giving mission statements are designed to provide guidance and guardrails but should also be flexible enough to accommodate clients' ever evolving philanthropic interests and goals.

Revisiting mission statements also provides the opportunity to critically assess the tangible impact of a client's donations over time. Together, advisors and clients can review each nonprofit's annual report and discuss the numbers behind their work in order to determine whether the client's mission statement justifies continued support of certain charities.

Well-off clients often want to give back and make a positive difference in the world with their wealth. Advisors are well positioned to help these clients understand how to do the most good with their money.

Written by: Ryan Klippel, WealthManagement.com

Too Much of a Good Thing: Unwinding a Concentrated Stock Position

Single-stock concentration can increase a portfolio’s risk while squashing the benefits of diversification.

Amassing a large exposure to a single stock may not elicit much concern from an investor. After all, many investors find themselves holding large, concentrated stock positions resulting from good fortune such as equity-linked compensation, an inheritance, or the sale of a business.

As the saying goes, however, you can have too much of a good thing. A heavy concentration of a single stock can increase a portfolio's risk while reducing diversification benefits.

Unwinding a concentrated single-stock position can be challenging. For taxable investors, liquidating shares means confronting capital gains taxes. Selling stock involves a trade-off between the known up-front tax and transaction costs and the uncertain future benefits of risk reduction. For many investors, capital gains taxes as high as 37% may seem too high a price to pay for diversification. However, it is possible to reduce a portfolio's single-stock concentration risk over time using a separately managed account (SMA) to alleviate an investor's risk and tax exposure.

The Downside of a Concentrated Single-Stock Position

It's common for investors to find themselves holding a concentrated single-stock exposure. Sometimes, the stock position is that of a current or former employer; other times, it's the result of a merger or acquisition. As we've witnessed with technology shares, the stock may have achieved its dominant position merely by outperforming other holdings.

Investors with concentrated stock positions face the risk that a change in the fortunes of a single company could jeopardize their financial well-being. (Simply ask former employees of Theranos or Enron.)

Because a concentrated stock portfolio can generate massive underperformance, most advisors typically recommend that clients restrict single-stock positions to no more than 10% of portfolio value.

Reducing Concentration Risk is Best Approached in Stages

Whittling down a hefty stock position is easier when tackled over time. Our Concentrated Stock Position Calculator demonstrates why: Immediately liquidating a concentrated stock portfolio typically results in a high tax bill and lower long-term portfolio returns.

Instead, the process can start with a staged diversification strategy. This methodical approach establishes rules that dictate when portions of concentrated shares can be sold, based on gains or losses in the stock's price. A staged diversification strategy enables investors to reduce concentrated stock holdings over multiple years while paring portfolio risk.

At the same time, an investor can establish an SMA and invest stock sale proceeds into the account, which allows them to spread realized gains across multiple years.

The SMA can also be customized to provide broad-cap exposure while building the portfolio around the concentrated stock position. For instance, for an investor with an overly large tech exposure, the SMA can exclude the technology sector. An investor's target exposure can then be adjusted over time as the tech position is reduced. Realized losses in the SMA can be used to help offset taxes resulting from the sale of the concentrated technology stock.

Transforming a Concentrated Stock Portfolio

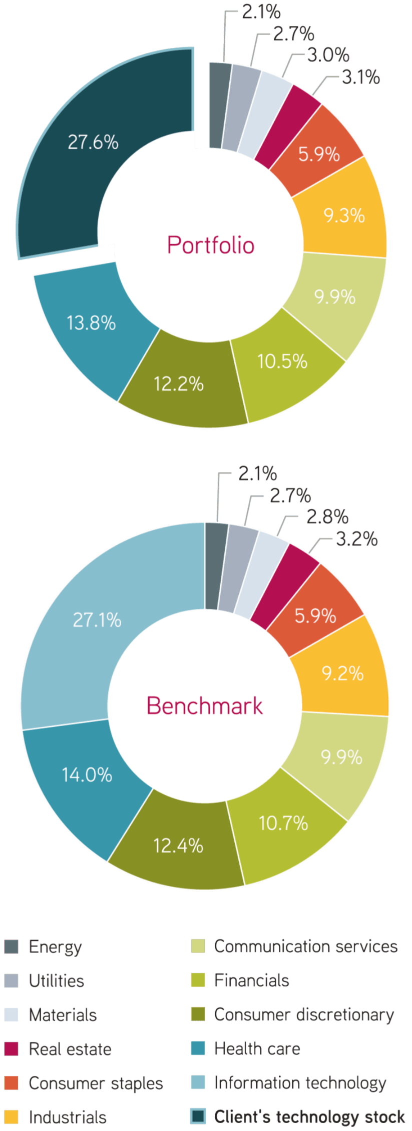
The illustration below shows how a staged diversification approach, combined with an SMA, can transform a concentrated stock portfolio. Building a broad-cap SMA account around an investor's tech stock helps to diversify the portfolio without incurring the taxes of fully liquidating the position. Over time, the move from the concentrated technology stock to a diversified broad-cap exposure reduces the portfolio's stock-specific risk. Harvested losses in the SMA can be used to offset gains from the sale of the concentrated position, helping an investor to diversify tax efficiently over time.

The Bottom Line

Liquidating a concentrated stock position may appear daunting. Many investors feel loyal to a stock that has performed well, believing that past performance is indicative of future returns. The prospect of facing capital gains taxes can act as an additional deterrent.

But holding onto a concentrated stock position is risky and may put your long-term financial goals in jeopardy. Investors can work with their advisors to reduce risk by establishing a tax-deferred diversification plan that may increase a portfolio's value over time and reduce single-stock concentration.

Written by: Thomas Lee, Parametric



Tips From the Pros: Unique Trends and Approaches to Charitable Giving

Al W. King III discusses both traditional and non-traditional strategies for charitable giving as part of a client’s estate planning.

Population and wealth trends will continue to have an impact on charitable giving. In 2020, charitable giving reached a record $471.44 billion in the United States. It's anticipated to rise 4.1% in 2021 and 5.7% in 2022. Ninety percent of high-net-worth (HNW) families donate to charity in the United States. Only 17% of these wealthy donors indicate that their primary motivation for charitable giving are the tax benefits. They operate under the premise that charitable giving doesn't need to be hazardous to their wealth. For this group, increases in individual tax rates by the Biden administration will likely result in increased giving due to the increased value of the charitable deduction.

Additionally, the Biden proposal to increase capital gains as well as eliminate step-up in basis at death should also result in more of the traditional charitable giving strategies as part of a client's estate planning (that is, charitable trusts, donor-advised funds (DAFs) and private foundations (PFs)). Additionally, non-charitable trusts (for example, dynasty trusts and spousal lifetime access nongrantor

trusts) will continue to gain popularity to take advantage of Internal Revenue Code Section 642(c).

IRC Section 642(c)

Section 642(c) permits an unlimited charitable income tax deduction for distributions made from a non-charitable trust to charity if such a distribution is specifically allowed by the trust. In addition to the unlimited charitable income tax deduction, the 3.8% net investment income tax obligation is shifted to charity. It's important to note that it's very difficult, if not impossible, to reform/modify a trust to add this provision. Consequently, include charitable distribution provisions in newly drafted non-charitable trusts to prevent losing such a valuable unlimited trust deduction in the future. This is particularly the case with modern dynasty trusts. Discretionary trust distribution provisions to charity are very different than a limited power of appointment from trusts to charities.

Family Values and Legacy

Many families that use these non-charitable trusts for charitable giving realize that family goals aren't the same as philanthropic goals but that successful philanthropy can reinforce family values and, thereby, strengthen a family legacy. Typically, many families accomplish the promotion of social responsibility and successful philanthropy by using PFs, DAFs, community foundations, pooled income funds, charitable remainder trusts and charitable lead trusts. Non-charitable trusts are now another popular way for them to promote social responsibility and successful philanthropy. The development of charitable giving with non-charitable trusts results from the evolution and popularity of the modern directed trust, which, when combined with active family involvement, has provided a powerful charitable giving alternative.

Modern Directed Trust

The modern directed trust is usually structured so that the directed administrative trustee in a modern directed trust jurisdiction takes direction from a distribution committee that's usually comprised of family as well as trusted family advisors. Most of these trusts are drafted as discretionary trusts. The distribution committee members and their advisors act as mentors for the younger family members on the committee as well as for the beneficiaries. It's recognized that the key time for beneficiary development is generally between ages 20 and 40 (that is, the Millennial's age bracket). In addition to making direct distributions to charities, some families also prefer to actively participate in charities. Millennial distribution committee members and beneficiaries generally prefer that distributions be made to their favorite charities, many of which they often volunteer for and exhibit other forms of activism to support. Many trusts have

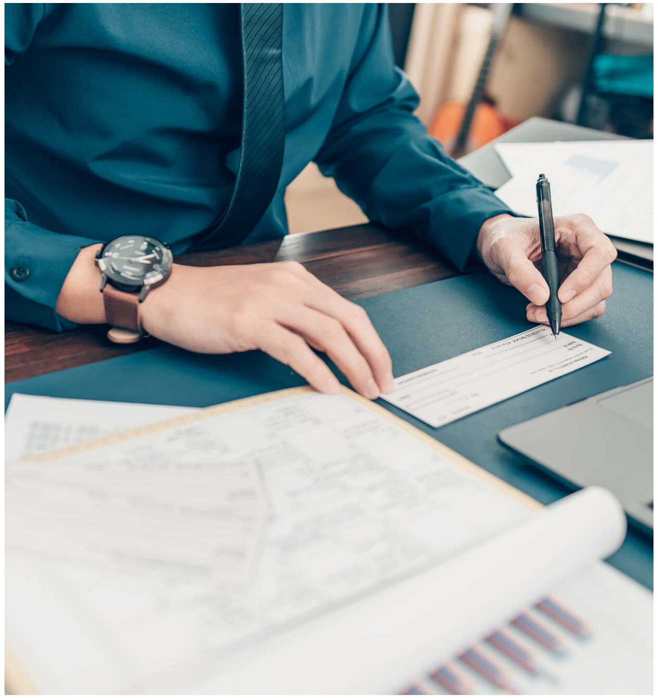
provisions to supplement a beneficiary's income if they decide to be employed by a charity at the expense of taking a higher paying private sector job. Some non-charitable trusts have provisions that state that once a trust reaches a certain value, or the beneficiary's net worth attains a certain level, the trust must distribute the excess to a charity either directly or indirectly. This approach ensures that the family gets together to focus on charitable giving and their social responsibilities. Some trusts will also match a beneficiary's charitable contribution. This assumes the beneficiary would make a donation after receiving a trust distribution versus the trust making the distribution.

Purpose trusts also provide another new and unique approach to charitable giving. These are trusts that exist for a purpose and don't have any beneficiaries. Once the purpose is accomplished, the trust protector frequently reforms these trusts to add family and/or charitable beneficiaries. Many times, a charitable gift may take place on the completion of the purpose. The most common version of the purpose trust is a pet trust involving both the care of a pet and an ultimate gift over to a pet charity. Purpose trusts have greatly expanded beyond pet trusts and can generally be used for any legal purpose. A popular purpose is to provide for a philanthropic cause that doesn't qualify for a charitable income tax deduction. Examples of non-deductible charitable contributions include contributions earmarked for certain individuals for economic, medical or educational needs, the value of time for services volunteered for charity, gifts to nonprofits that aren't charities, political donations and various social causes.

Purpose trusts are becoming a very useful tool for Millennials who are leading the way in charitable giving and volunteering. They typically want to ensure that their donations are impactful and effecting real change. More than 75% of Millennials make donations to charity, which is more than any other age group. Seventy percent of Millennials believe their parents aren't as committed to charitable giving as they are. Thirty-two percent of Millennials versus 14% of Baby Boomers and the Silent Generation combined believe that they give back through impact and social investing. Both intergenerational family trusts (that is, dynasty trusts) as well as purpose trusts can be structured to allow for impact and social investing to accommodate the charitable giving desires of these Millennial beneficiaries.

Charitable LLCs

Charitable limited liability companies (LLCs) have also been gaining popularity in the last several years. The charitable LLC is generally preferred to the PF because it's not subject to the PF restrictions and limitations (for example, 5% fair market value (FMV) distributions, excess business holdings, jeopardy investments, self-dealing and taxable expenditures). Additionally, many families believe that the charitable LLC provides greater flexibility and allows them to better accomplish their philanthropic goals. This is particularly important when the proposed activities and expenditures aren't permitted by a PF. Another important advantage of charitable LLCs is that they're more private than PFs because there's no requirement to file a Form 990-PF, which is public for all to view. If desired, the charitable LLC can be dissolved and liquidated with assets being distributed back to the members. Additionally, the charitable LLC has no attorney general oversight as is the case with many PFs because the attorney general typically has the authority and oversight regarding the administration of assets dedicated for charitable purposes.



Charitable LLCs aren't generally set up for tax reasons. They're tax neutral. Contributions to the charitable LLC aren't tax deductible like they are with a PF, which is limited to 20% or 30% (long-term capital gains) of the donor's adjusted gross income with a 5-year carryover. However, contributions of appreciated stock made to charity from a charitable LLC will produce an income tax deduction based on FMV, thus avoiding capital gains on the contribution. Additionally, income realized from the charitable LLC isn't exempt from income tax. It's a pass-through entity for tax purposes. Consequently, the tax consequences flow through to the members. If there's no dividend or income, then there's no flow through to the members. The charitable LLC can generally avoid estate taxes at death by planning so the charitable LLC assets/shares pass to charity via a PF or some other charitable vehicle or combination of charitable vehicles.

Beneficiary Quiet Provisions

Beneficiary quiet provisions provide another popular alternative for keeping charitable intentions private until the family is ready to make them public. Clients will typically elect to use beneficiary quiet provisions for both their charitable and non-charitable trusts. Beneficiary quiet trusts allow a client to elect to withhold trust information from a beneficiary until some point in the future. Not all states have beneficiary quiet statutes. Most of the top no income tax boutique dynasty trust states have these statutes. Consequently, if the trust is sitused and properly administered in one of these states, the beneficiary quiet provision can be elected and trust information be kept private from beneficiaries until some point in the future. This may also apply to charitable beneficiaries with trusts sitused in certain states. It's important to note that 28% of wealthy donors stopped giving to charitable organizations as a result of their receiving too frequent solicitations from the non-profit organizations. Consequently, privacy regarding a family's charitable intentions has become very important to many families.

An Evolving Issue

Charitable giving remains and continues to evolve among HNW families. Charitable donations are made for both deductible and non-deductible causes. Charitable trusts, DAFs and PFs all remain popular charitable giving vehicles. However, non-charitable trusts now also provide another powerful source for charitable giving. Privacy regarding charitable giving is also a growing and popular trend for many families. Ultimately, charities benefit, regardless of the motives and planning of each family. The glass is definitely half full for charitable causes.

Written by: Al W. King III, WealthManagement.com

Advisors Who Offer Philanthropic Planning Reap the Benefits

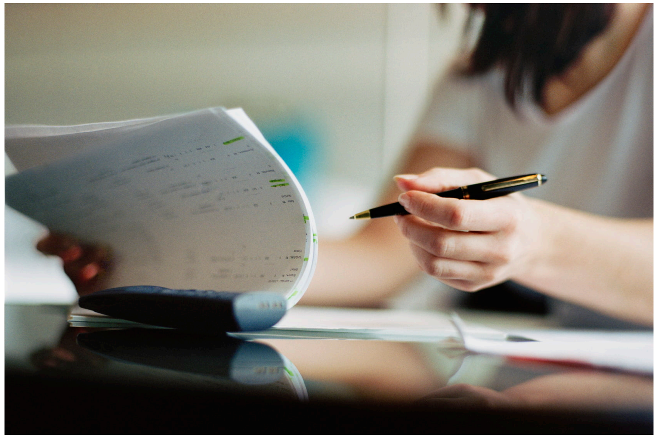
A recent study by Fidelity Charitable highlights just how much of an advantage these planners have.

Traditionally, during challenging times, Americans have opened their checkbooks, and philanthropy experiences a dramatic uptick.

The pandemic era has been no different. In 2020, charitable giving hit a record level of $471 billion. With no true end to COVID-19 in sight, 2021 looks to be another big year for giving, and that's a major opportunity for advisors.

Contrary to popular belief, the vast majority of charity in this country stems from smaller individual donors and bequests, not larger entities, like corporations and foundations. With such a broad swath of client profiles potentially interested in giving, advisors who are comfortable operating in that space and facilitating client philanthropy will be at a dramatic advantage.

According to a recently released study by Fidelity Charitable, advisors offering charitable planning tended to have significantly greater assets, organic growth and new money. An analysis of over 1,200 RIAs and family offices found that those who offer charitable planning



had 6x the median assets, 3x the median organic growth and 1.3x the median new money per investor as compared to advisors who don't.

And the benefits extend beyond traditionally measurable assets. According to another Fidelity study in 2020 that surveyed 1,181 investors, half of whom were millionaires, clients who receive charitable planning are more loyal and likely to recommend their advisor compared with those who don't. Such advisors outperformed their colleagues among respondents answering questions, including: "I trust my primary financial advisor to make decisions that are in my best interest" (7% greater); "My advisor demonstrates that he/she is considering my unique needs/ goals/ preferences" (13% greater); and "My advisors is a multigenerational resource to my family" (27% greater).

Further, advisors who offer charitable planning tend to have a larger wallet share (81% vs. 76%) and a significantly higher proportion of clients with more than $1 million in managed assets (33% vs. 18%) than their colleagues who don't perform similar services.

And there's little end to this trend in sight, as the uptick in philanthropy is not simply pandemic related. Overall philanthropy levels have steadily climbed in the past 50 years, effectively tripling since 1980. Ultimately, the data all points to the same conclusion: It's increasingly critical for advisors to realize that strategic charitable planning should now be a part of all of their client conversations, regardless of client wealth.

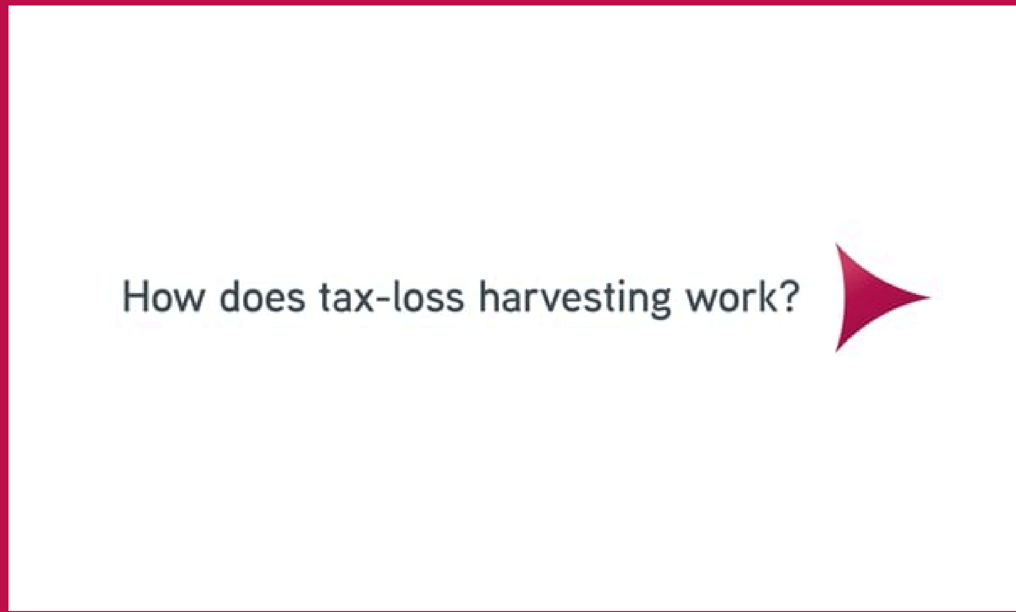
Written by: David H. Lenok, WealthManagement.com

How Does Tax-Loss Harvesting Work?

No one invests with the express purpose of taking a loss. But for well-diversified investors—such as those with passive allocations to a chosen benchmark—losses are inevitable. Even in periods when the broad market indexes show a gain, many individual stocks experience a drop.No one invests with the express purpose of taking a loss. But for well-diversified investors—such as those with passive allocations to a chosen benchmark—losses are inevitable. Even in periods when the broad market indexes show a gain, many individual stocks experience a drop.

What separates many passive investors from the pack is their ability to harvest those losses to their advantage using a tactic called tax-loss harvesting. This is a key benefit of direct indexing, and this short video explains how it works.

Video contributed by Parametric



Cut Your Clients' Taxes Now, and in the Future

What must be done before December 31

Nobody likes paying taxes, and clients will be especially grateful for your proactive advice on how they can avoid shelling out any more than what's legally required.

Here are three steps you can take before the end of 2021 to reduce the tax bill your clients will get on April 15 and two more you may be able to use to reduce their taxes in future years.

Sell the Losers

Go through each client's taxable accounts to identify any positions that currently hold an unrealized loss. Selling those positions with losses will reduce the client's taxes in the following manner: First, the client can use any realized losses to offset the taxation of any realized gains in the same tax year. Then, up to $3,000 of additional realized losses can be used to offset ordinary taxable income in the same tax year. And the realized losses can be carried forward into the future until the realized loss amounts are exhausted.

A couple notes of caution on selling

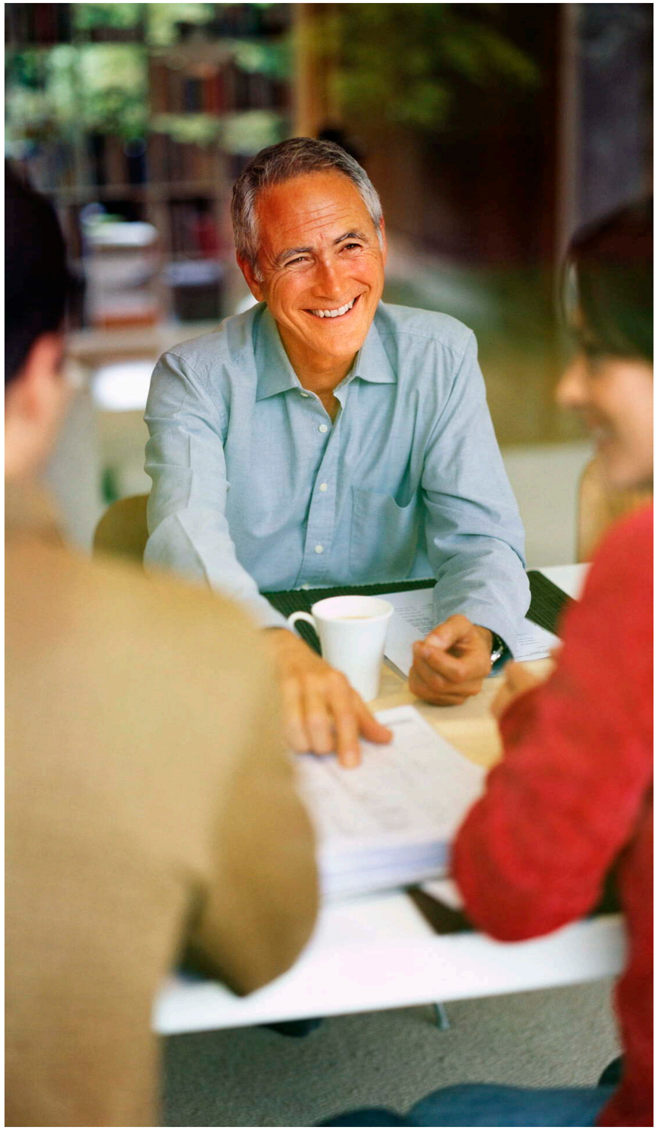
investments to realize losses, though. Make sure that you haven't bought any of the same security for the client within 30 days before or after the loss-incurring sale, which would then trigger the "wash sale" rules and disallow the loss for tax purposes. This is an especially treacherous situation when a client has a mutual fund in a taxable account with automatic reinvestment of capital gains and dividend distributions, so you may want to disable that practice in the client's account until the wash sale period has expired.

Second, make sure the client is aware that the security in question may rise in value after the sale but before the wash sale period expires and the security can be repurchased. The prospective increase may offset any tax advantages of selling.

Avoid the Winners' Distributions

Many mutual funds make distributions of dividends and net realized capital gains in the fourth quarter of the calendar year. If you purchase shares of a fund in a taxable account for a client, and the fund then distributes these amounts, your client could be liable for taxes on the distribution, even if they weren't along for the ride up in share value.

There are a couple of ways you can mitigate the damage from this situation or avoid the distributions altogether. First, until the fourth quarter has passed, consider making any new fund investments only in tax-sheltered accounts, like IRAs and Roth IRAs.



If you must invest in funds within a taxable account, first check with the intended fund to see if any gains will be distributed, when that might happen and how much the gains may be. Then discuss with the client why they may want to delay making the investment.

Finally, there may be a "mulligan" if your client receives a larger taxable distribution shortly after making a purchase. When a fund makes a distribution of dividends or capital gains, the funds' net asset value drops by a commensurate amount. So, if the client receives the distribution, they can (in theory) sell the fund at the new lower price to help offset the distribution of the gain. The client still needs to avoid making a sale of the same security within 30 days before or after the purchase because of the aforementioned wash sale rule.

More to the 401(k)

You will be surprised by how many working clients have the money and the room to make larger pretax contributions to their at-work retirement plans—like 401(k)s and 403(b)s—but haven't taken the action to do so.

For 2021 the maximum annual contribution to these plans is $19,500, with an additional $6,500 added to the limit for workers who are 50 or older in 2021. Certain state and government employees who also have access to a 457(b) plan have an extra opportunity, as they can then contribute to both their 403(b) and the 457(b), thereby doubling the potential amount that can be deferred. Some employers might limit how much workers can withhold on a per-paycheck basis, so to get the greatest effect for 2021, it's better for clients to raise their contributions sooner rather than later.

Two for the Future

For clients who are already otherwise in a low or no taxable income situation in 2021, there are some moves to be made before the end of the year to take advantage of their favorable status—especially if the clients expect to be in a higher-income tax bracket in future years.

Start by realizing any long-term capital gains, on which the federal tax rate could be as low as

0% depending on the amount of the gain and the client's other income. Then you can immediately repurchase the same security, thereby establishing a new higher cost basis on the position.

Those clients with low income and IRAs should also strongly consider converting a portion of their IRAs to Roth IRAs before the end of the year. Ideally, the client will not withhold any portion of the converted amount for prospective taxes and will instead pay any corresponding tax liability from current personal savings.

> Nobody likes paying taxes, and clients will be **especially grateful** for your **proactive advice** on how they can avoid shelling out any more than what's legally required.

Making Calculations

There are a few online calculators you and your clients can use to estimate the potential tax cost and savings of these strategies, such as the tax calculator at efile.com and the capital gains tax calculator at smartasset.com.

If you want the numbers run by an expert, ask your clients for permission to contact their tax preparer for some estimates as to the benefit of these moves. Not only will it be less work and liability for you, but it also makes it more likely that the figures will be correct.

Written by: Kevin McKinley, WealthManagement.com

Decluttering Tax Management

Investors may be missing opportunities through the wrong tax management strategy. While one size does not fit all, an organized, systematic approach that continuously monitors and adjusts can ensure investors make the most of all opportunities.

In a recent blog post, Unpacking Tax Management, we examined some tax management tactics employed in the investment industry, from the tax-aware to the

tax-focused investment manager. What should be clear is that there are some basic methods that can be used. Some managers may claim tax management as central to their investment thesis when in fact it may be an afterthought, secondary to other active decisions and considerations.

Sparking Joy with Tax Management

As we stare in dismay at the figurative heap of tax tactics we've piled on the floor, let's channel our inner Marie Kondo to declutter and tidy them up into a coherent and smart, simple, tax-managed strategy. It quickly becomes clear that not all tax management is the same. What essential aspects add value to the investment process?

- Ensure tax management tactics are embedded in the investment process systematically. They indicate the degree to which taxes matter to the manager. They further reveal the relative importance of more certain after-tax outcomes in an industry often driven by less certain pretax performance expectations.
- Ensure the manager continuously looks for opportunities to harvest tax losses. The manager who explores tax-loss harvesting only as a last-minute exercise in December each year will always leave harvestable losses on the table. Take 2020, for example: The manager who looked for losses to harvest at year-end largely missed out on numerous opportunities from the pandemic downturn in the first half of the year, as markets had recovered handsomely by December. Constant monitoring of the portfolio and the market environment serves the taxable investor better than calendar-based rebalancing.
- Ensure the manager monitors risk factors common to all equity investments. Investment science has shown returns can be explained by characteristics—or factors—common to all publicly traded stocks, such as value, growth, momentum, and beta, to name a few. The use of a fundamental factor model is critical in terms of monitoring risks—just as critical to relative returns as sector inclusion and the individual constituents themselves. In particular, a tax-

managed strategy can display biases among common factors as segments of the market perform differently over time. Portfolios that explicitly manage and monitor these relative risks can better tune tracking error.

- Consider a broad, less concentrated exposure. Although portfolios with limited holdings will have opportunities for tax-loss harvesting like any other portfolio, the most consistent results come from broad investment across many underlying constituents in the index. Portfolios of ETFs, for example, have their merits, but advisors are typically best served by investments in individual companies, if possible.
- Consider the turnover of the manager or index. High-turnover managers and indexes will be inherently less tax efficient. If you're compelled by the pretax investment thesis but the turnover is high, you're more likely looking at a tax-efficient implementation that realizes fewer gains than a strategy that generates excess losses for use against gains elsewhere outside the portfolio.

There is no one-size-fits-all solution to most investors' circumstances. What we do know is that taxes matter to the taxable investor—and that they matter a lot. Equity markets don't leave us happy in all market environments all the time. Butorganizing into a structure leaves all investors well positioned for an outcome that will spark after-tax investment joy.

The Bottom Line

Look for a manager who gets fundamental tactics right by using sophisticated software on a flexible platform to continuously harvest tax losses and manage relative risks, including fundamental factors, sectors, and securities. Reconcile the manager or index to ensure the investor's pretax and after-tax expectations are in sync.

Written by: Andrew Subkoviak, Parametric

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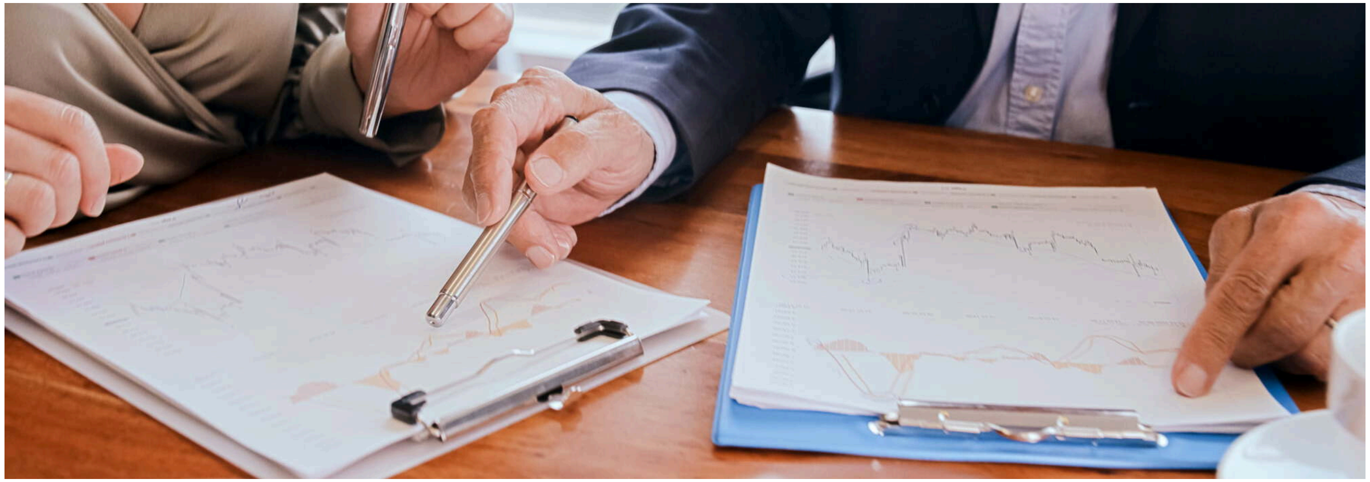
Till Death (And Qualified Trusts) Do Us Part

There are many reasons to shift the beneficial interest of a QTIP trust and its underlying assets during a surviving spouse's lifetime.

The overarching policy of the estate tax regime in the United States can largely be summed up as follows: Assets should be taxed once at each generation. In developing the sections of the Internal Revenue Code that govern the estate tax, Congress has also made clear that spouses are considered to be in the same generation, regardless of age. This is grounded in another tenet of U.S. tax policy that treats spouses as one economic unit.



Since 1981, the Internal Revenue Code has permitted unlimited, tax-free transfers between spouses. That same year, Congress also enacted an exception to the terminable interest rule, permitting a decedent to leave assets in trust for the surviving spouse, without requiring the decedent to give the surviving spouse a right to dispose of the property during the survivor's life or at the survivor's death. This type of trust, a qualified terminable interest property (QTIP) trust, permits the surviving spouse to receive all income from the QTIP trust for the survivor's life and delays the payment of tax until the death of the surviving spouse. By using a QTIP trust, the donor-spouse may choose to whom the assets pass after the death of the survivor spouse. Further, the donor-spouse's estate may receive a deduction for the assets transferred to a QTIP trust if the appropriate election is made.

But, inevitably, things happen between the death of one spouse and that of the survivor. The needs of the surviving spouse may wane, and those of the descendants or other beneficiaries may grow. It may also become necessary to react to changes in the IRC or to the growth (or depletion) of trust assets. While the terms of the QTIP might be black and white, it doesn't follow that trustees and beneficiaries are bound to their eventual, potentially unintended, results without recourse.

Division and Modification of a QTIP Trust

Private Letter Ruling 202116001 (released April 23, 2021) involved a QTIP trust established by a decedent spouse. As required by the IRC, all income was to be paid to the surviving spouse for the survivor's lifetime. The residual beneficiaries were the decedent's two daughters, who would only become income beneficiaries after the death of the surviving spouse.

It was represented that the terms of the QTIP trust didn't restrict the trustee from dividing the trust. The applicable state statutes authorized a trustee to divide a trust into two or more trusts, provided that such division didn't impair the rights of any beneficiary or adversely affect the accomplishment of the purposes of the trust. Additionally, such statutes authorize courts within the state to order the termination or modification of a trust, in whole or in part, if the continuance of the trust unchanged would defeat or substantially impair the purposes of the trust.

During the life of the surviving spouse, the trustee of the QTIP trust divided the trust into two separate trusts, named "Qualified Trust-A" and "Continuing Qualified Trust." Both new trusts contained the exact same terms as the original QTIP trust. Following the division, the trustee and beneficiaries petitioned a court to enter an order modifying the terms of Qualified Trust-A.

The order issued by the court modified the Qualified Trust-A by permitting termination of

all or any portion of the trust in favor of the principal beneficiaries, including—critically—before the death of the surviving spouse. Additionally, the surviving spouse was removed as an income beneficiary of Qualified Trust-A, and the two daughters became income beneficiaries in proportion to their interests in the principal. The modification explicitly treated the surviving spouse as having died on the date the order was entered. The order also was effective on "Date 3," but was expressly conditioned on a subsequent receipt of a favorable ruling by the Internal Revenue Service prior to "Date 4."

Where's The Tax?

In evaluating the facts, the IRS first confirmed that the division of the QTIP into two separate trusts didn't subject the transaction to the gift tax regime. The simple division of the QTIP trust into two separate trusts with terms mirroring the original trust didn't change the beneficial interests of the surviving spouse or the daughters.

Unlike the simple division of the QTIP trust, however, the IRS determined that the modification of Qualified Trust-A by court order did change the beneficial interests of the surviving spouse and the two daughters, thereby triggering gift tax consequences.

The Gift Needn't Be Directly Made

IRC Section 2511 provides that the provisions imposing a gift tax apply "whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. . . ."

Additionally, IRC Section 2519(a) provides that "any disposition of all or part of a qualifying income interest for life in any property . . . shall be treated as a transfer of all interests in such property other than the qualifying income interest." According to Section 2519(b), this includes, specifically, QTIP property for which the donor's estate received a deduction.

The surviving spouse also needn't directly grant the gift to be subject to gift tax. Treasury Regulations Section 25.2511-1(c)(1) provides that the gift tax applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred on another, regardless of the means or device employed, constitutes a gift subject to tax. Therefore, the court's modification order disposing of the income interest is sufficient to subject the transaction to gift tax.

Valuing the Resulting Gift

Treasury Regs Section 25.2519-1(c)(1) provides that for gift tax purposes, the amount treated as transferred under Section 2519 on a disposition of all or part of a qualifying income interest for life in QTIP property is equal to the fair market value of the entire property subject to the qualifying income interest, determined on the date of disposition (including any accumulated income and not reduced by any amount excluded from total gifts under IRC Section 2503(b) with respect to the transfer creating the interest), less the value of the qualifying income interest in the property on the date of the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under Treasury Regs Section 25.2511-2.

Accordingly, the IRS ruled:

1. The surviving spouse is deemed to have made a transfer of all the property in Qualified Trust-A under Section 2519, other than the value of her qualifying income interest; and
2. The surviving spouse is deemed to have made a transfer of her qualifying income interest in Qualified Trust-A under Section 2511.

Both taxable gifts were deemed to have been made as "Date 3," or the date the court entered its order approving the modifications to Qualified Trust-A.

Practical Implications

While the reason for the division of the QTIP trust and modification of the terms of Qualified Trust-A isn't expressed in the present case, one could imagine how a transaction such as this might be useful to families in their estate planning:

- **Use available exemption before it's lost.** A lot of recent talk in the estate tax world has surrounded the eventual, perhaps inevitable, lowering of the estate tax exemption. The Tax Cuts and Jobs Act of 2017 doubled the available exemption, but such doubling is set to sunset at the end of 2025. We may even see a lowering sooner than expected, with the White House and both houses of Congress currently controlled by Democrats. If a surviving spouse is determined to use exemption before it disappears, such spouse may opt to gift all or a portion of assets held in a QTIP trust to quickly use up exemption.
- **Tax-exclusive vs. tax-inclusive asset transfers.** Gift tax is thought of as the lesser of two evils because it allows a donor to transfer wealth and further reduce the taxable estate by the current payment of gift tax (that is, tax-exclusive). By contrast, the estate tax is the greater evil because tax is levied not only on assets passing to beneficiaries, but also on assets used to pay the estate tax (that is, tax-inclusive). A surviving spouse who subscribes to this idea may choose to gift assets before death and may look to QTIP property to make that gift.
- **QTIP trust no longer needed.** Perhaps it's become a hassle to administer, or the exemption available to the surviving spouse is so great that no tax results from terminating the trust now. Either way, a surviving spouse may choose to terminate the QTIP trust early by adjusting the beneficial interests of the trust.
- **Spin-off assets that have greatest appreciation potential.** Are there assets currently held by the QTIP trust that are expected to appreciate dramatically? If so, there may be tax advantages to dividing the QTIP trust into two trusts: one holding the assets due to appreciate; and the second holding the balance of the QTIP property. From there, the trustee, either directly or with a court order, could modify the provisions of the trust holding the assets due to appreciate by changing the beneficial interests of the trust. By this division, only the assets due to appreciate are subject to the gift tax regime at their current, lower value.
- **Change in family dynamics.** Finally, one could put aside the tax consequences and decide that the ultimate beneficiaries need access to assets now. Instead of waiting for a surviving spouse to die, beneficiaries may receive access to some or all of the assets immediately.

There are many reasons to shift the beneficial interest of a QTIP trust and its underlying assets during a surviving spouse's lifetime. Motives will vary from one family to another. Regardless, the PLR discussed above provides practitioners with a road map to navigate the tax consequences of the QTIP trust modification.

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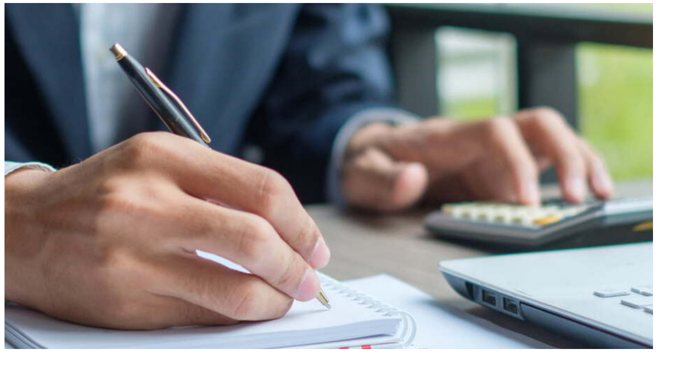

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Tax-Management Strategies for Appreciated Portfolios

Going back to the end of the global financial crisis, equity markets have generally been favorable to investors—so much so that many today now hold appreciated positions that dramatically raise the risk level in their portfolios. Diversification via a vehicle such as an exchange-traded fund may make sense, but ETF shares must be paid for in cash. This means selling out of some or all of the investor's appreciated positions to get the right level of diversification. Which in turn means realizing potentially large capital gains. Which, of course, means a sizable tax bill.

There's another way. As this short video shows, investors can look to a different three-word vehicle, a separately managed account, or SMA, to help them gain tax advantages, add flexibility, and take control of their passive allocations.

Video contributed by Parametric

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Investment strategies that seek to enhance after-tax performance may be unable to fully realize strategic gains or harvest losses due to various factors. Market conditions may limit the ability to generate tax losses. Tax-loss harvesting involves the risks that the new investment could perform worse than the original investment and that transaction costs could offset the tax benefit. Also, a tax-managed strategy may cause a client portfolio to hold a security to achieve more favorable tax treatment or sell a security to create tax losses. Prospective investors should consult with a tax or legal advisor before making any investment decision.

For more information regarding Parametric and its investment strategies, or to request a copy of the firm’s Form ADV or a list of composites, contact us at 206.694.5500 or visit www.parametricportfolio.com.

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Wealth Planning Strategies in 2022: A Roadmap for Success