Wealth planning opportunities in volatile times

Market volatility and economic uncertainty can be unsettling even for the most sophisticated of investors. But with disruption often comes opportunity for those who have the foresight and framework to identify and act on it. While much happening in the economy and our communities right now is beyond our control, there are proactive planning steps you can take that might allow you to better manage important facets of your personal wealth. Highlighted below are several planning strategies to consider in light of the current economic environment and recent relief actions adopted by Congress and the IRS.

Please note that the planning considerations and information provided below are not intended to be legal or tax advice and you should not rely on it as legal or tax advice. Each person’s tax situation is unique and the planning considerations and legislation discussed will impact each person differently. Therefore, you should discuss with your tax advisor how these planning considerations and new legislation might impact your situation and which planning strategies might be right for you.

**Tax loss harvest and strategically rebalancing your portfolio.**

Distressed markets and a decline in portfolio values create the potential to take future advantage of current losses with tax loss harvesting. Selling and reinvesting these proceeds provides opportunity for portfolio rebalancing to maintain desired asset allocations, restructuring to put in place a more tax efficient portfolio and tactically realizing current losses to offset future gains. Note: work with your tax advisor in determining tax implications and in being mindful of the 30-day wash sale rules.

Convert a traditional IRA to a Roth IRA.

Lower current market values mean a lower income tax payment owed upon converting a traditional IRA to a Roth IRA. Keep in mind that a Roth IRA conversion is generally beneficial when future tax rates are expected to be equal to or greater than the current income tax rates and where the tax owed on conversion can be paid from non-IRA assets. A Roth IRA conversion is likely not beneficial where the IRA assets are needed to fund retirement expenses and/or your applicable tax rates are expected to be lower in the future.

With the recent passing of the new SECURE Act provisions (see our recent alert titled, *The new SECURE Act makes changes to retirement saving*), most inherited IRA beneficiaries other than surviving spouses must now take their required minimum distributions (RMDs) within 10 years (or by the 10th year). Under these new rules, there is an increased efficacy of a Roth IRA conversion for wealth transfer planning purposes. Because the income tax is paid upon conversion and the IRA owner is not required to take RMDs during their lifetime, the funds are allowed to appreciate tax-free until the beneficiary inherits the Roth IRA. Furthermore, the beneficiary receives their RMDs income tax free. A beneficiary who receives a Roth IRA is thus given the gift of a tax-free asset. It is only any funds the beneficiary saves from their RMDs that would then become income taxable funds.

“With disruption often comes opportunity for those who have the foresight...”
The below chart illustrates the potential benefit of a Roth conversion. The example assumes $1 million traditional IRA is converted today, 100% of the IRA is taxable and the converted Roth IRA is then held for 20 years before it is inherited by an adult child. Tax rates in the future are the same as today and the assets have an expected growth rate of 5%. The beneficiary takes the full RMD in the 10th year following inheritance.

<table>
<thead>
<tr>
<th>Portfolio Value</th>
<th>Value in 2040</th>
<th>Value in 2107 – *Beneficiary life expectancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>No conversion</td>
<td>$2,443,153</td>
<td>$22,243,420</td>
</tr>
<tr>
<td>Conversion</td>
<td>$2,785,963</td>
<td>$26,583,644</td>
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</tbody>
</table>

*For illustrative purposes only, future investment performance cannot be guaranteed.*

Conclusion: the Roth IRA conversion versus no conversion offers an additional $342,810 to the beneficiary in year 2040 and an additional $4.3 million over their lifetime.

Consider how the new “tax day” and Coronavirus Aid, Relief and Economic Securities Act “CARES Act” impact you.

**Federal income tax filing and payment extension considerations**

The April 15 filing and tax payment due date for all 2019 federal individual income tax returns has been automatically extended by the Treasury Department to July 15, 2020 with no dollar limit on the amount of tax owed that can be deferred until the extended due date (this also includes trust and gift tax returns). The extension also applies the extended July 15 due date to 2020 first quarter estimated tax payments. The IRS recently issued FAQs regarding the extension provisions that specifically note that 2nd quarter estimated taxes must still be paid by their original due date of June 15.

Keep in mind that states have their own filing and payment rules and may not offer the same extension to file and/or pay. Many states including Arizona, Illinois, Minnesota and Wisconsin have also extended their tax filing and payment due dates to July 15.

The tax return filing and payment requirements for your state(s) should be reviewed with your tax advisor. Additionally, planning for your extension, 1st and 2nd quarter estimated tax payment(s) should be carefully calculated and planned with your tax advisor as well.

With more time to pay taxes and depressed market values, consider the implications of the payment extension on your liquidity and investment portfolio planning decisions. Consider whether a line of credit might be a short term solution for tax liabilities in order to allow your portfolio to stay invested and potentially recoup market value.

**CARES Act considerations**

*Extension for IRA contributions:* The deadline for making a 2019 contribution to an IRA has also been extended until July 15. Because IRAs are a tax deferred savings vehicle, contributing to an IRA can be advantageous in reducing overall income taxes by allowing the IRA investments to appreciate without the burden of tax until RMDs must begin. If you have not yet filed your 2019 tax return, consider whether you could benefit from making an IRA contribution. There are limitations to making these contributions based on earned income and adjusted gross income (“AGI”) that must be discussed with your tax advisor in making this decision.

*Expanded cash charitable contribution:* The CARES Act increases for 2020 the deductibility limit for cash contributions to charities from 60% of AGI to 100% (no AGI limit). This increase applies only for this year. Consider whether you can benefit from making additional cash contributions to charity in 2020 in light of your overall philanthropic planning strategy.

*Temporary waiver of RMD:* The CARES Act waives RMDs from all retirement accounts for 2020. If you have already taken your 2020 RMD you may be able to return that payment by utilizing the 60-day rollover rule, but should consult with your tax preparer to ensure this is done correctly. RMDs from inherited retirement accounts cannot be reversed. Consider whether you can take advantage of this waiver and not take your RMD this year as you consider your current cash flow and liquidity needs.

*No penalty for early withdrawals from retirement accounts:* The CARES Act allows those affected by the coronavirus to withdraw up to $100,000 from a qualified retirement account before the end of the year without being subject to the 10% early withdrawal penalty. Additionally, a participant loan from certain retirement plans for coronavirus-related relief is allowed up to the lesser of $100,000 or 100% of the account balance. As you consider your cash flow and liquidity needs, this may be a consideration where no other readily efficient and available cash exists.
Net operating loss ("NOLs") opportunities: The CARES Act restores NOLs to pre 2018 rules for 2018, 2019 and 2020 whereby NOLs can now offset 100% of taxable income and can be carried back five years. If you own a pass-through business (S corporation, LLC, or sole proprietorship) the CARES Act expands the ability to use trade or business losses to offset your other taxable income beginning with the 2018 tax return. You should consult with your tax preparer about the expanded opportunities provided by the CARES Act to utilize NOLs to reduce your taxable income. For example, there may be an opportunity to file an amended return(s) and receive tax refunds. If you anticipate having a pass through NOL for 2020, you may want to consider offsetting it by accelerating income into this year where possible. This could be accomplished through a ROTH IRA conversion, as discussed above, or selling an appreciated asset. Both strategies would generate income that could be offset by the NOL.

Please see our alert titled, Coronavirus relief: CARES Act and tax filing extension, for an outline of the select tax aspects of the legislation for individuals.

Review estate plans and irrevocable trusts

Now is a good time to make sure your estate plan is complete, takes into consideration applicable law changes and reflects your current intentions. This includes reviewing the following: wills, powers of attorney for property and healthcare, living wills, revocable trust(s) and beneficiary designations. Also review and confirm that the fiduciary appointments made in your documents still make sense and that the proper succession plan is in place for those named to act.

If you have previously made gifts to a trust that now has depressed market values, there may be an opportunity for you to exchange assets you own that have strong growth potential for underperforming assets in the trust to shift future appreciation out of your taxable estate. The trustee(s) and counsel should first confirm that the trust allows for the substitution of assets with no adverse tax consequences. This is also an opportune time to consider whether other modifications to the trust could be considered, such as changing the situs of the trust for state income tax purposes. This may also present an opportunity to discuss and reaffirm with the trust parties their understanding of roles, responsibilities and beneficial interests to promote strong working partnerships.

Make lifetime gifts

With depressed asset values and historically low interest rates, now might be a good time to make gifts and move additional appreciation out of your estate, assuming first and foremost you feel comfortable with your own long-term financial security. This can be accomplished with annual exclusion giving whereby you can give $15,000 per donee ($30,000 with a spouse). There are also very generous lifetime gift exemption amounts available whereby you can give $11.58 million individually ($23.16 million for a married couple) during your lifetime without incurring gift tax. These gifts and the appreciation only gifts discussed below can be leveraged further if made with assets that can be valued with a discount for lack of marketability or lack of control, such as a closely held business interest.

Another consideration is gifts where you only give away the appreciation. A Grantor Retained Annuity Trust ("GRAT"), Intra-family loans (outright or to a trust) and Charitable Lead Trusts (CLT) can all help accomplish this. With each of these strategies, you make a gift or loan (in the case of an intra-family loan) and in return receive back the principal and a stated amount of interest over the specified term. In the case of the GRAT, the principal and interest is returned in the form of an annuity over the stated term. The amount passing to the beneficiaries is the appreciation over the stated interest rate. Below is an illustration outlining how the appreciation over the stated interest rate ("hurdle rate") paid to the donor is the amount the beneficiary retains. Current prevailing interest rates are at historic lows, as indicated, making the necessary growth to pass appreciation over the “hurdle rate” relatively low.

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<table>
<thead>
<tr>
<th>AFR Rates</th>
<th>Short-term AFR 0.91%</th>
<th>Mid-term AFR 0.99%</th>
<th>7520 Rate 1.20%</th>
<th>Long-term AFR 1.44%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market conditions and trends will vary. Future rates cannot be guaranteed.</td>
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"Now is a good time to make sure your estate plan is complete."
Review cash flow needs

In this time of market disruption, continue to monitor your cash flow needs and make adjustments as reasonably prudent. This might include deferring major purchases or immediate retirement plans, revising budgets, adjusting savings goals, reviewing the asset allocation for your investment portfolio and considering whether strategic borrowing might be beneficial. The keys are avoiding panic decision making as we await some stabilization and working with advisors who can provide guidance on market, tax and other important assumptions to be considered.

Consider strategic leverage

Consider establishing a line of credit as a ready and relatively inexpensive source of liquidity. This funding tool may be used to optimize cash needs and take advantage of historically low interest rates. A line of credit can also help you: supplement cash flow; fund purchases, fund investment opportunities, fund tax payments or capital calls; avoid the sale of assets at an inopportune time; maintain your current investment strategy and overall asset allocation including the diversification of your investment portfolio. This may also be a good time to revisit existing debt structures for refinancing.

Keep in mind, that the interest expense may be tax deductible depending on how the loan proceeds are used. You should work with your tax advisor in making the determination on tax deductibility of interest.

These challenging times and the resulting relief efforts like the CARES Act provide an opportunity to reflect and take stock of your current wealth planning. As the battle against the coronavirus continues, we can expect a clearer picture to emerge on the health and economic forces that will lead to stabilization, as well as additional relief and stimulus legislation that may impact your personal planning. Please reach out to your BMO advisory team and coordinate with your tax advisors to consider the planning opportunities and strategies we have outlined for you here.

Your BMO team is here to help.