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# NFI, LLC Financial Insights

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## Weigh Five 401(k) Options When You Leave A Job

If you have participated in a 401(k) plan where you work, you may have accumulated a tidy nest egg for retirement. But what happens to those funds if you switch jobs or retire? Typically, you will have at least five options:

**1. Take a lump-sum distribution.** If you have a pressing need for the money, you can arrange to have your investments sold and the proceeds paid to you in a single sum. However, beyond depleting your savings, this also may have negative tax consequences. Most or all of the money may be taxed at ordinary income rates, which can reach as high as 39.6%, and a large payout may result in other tax complications, including a 3.8% surtax on net investment income (NII).

And if you're younger than age 59½, you also may owe a 10% early withdrawal tax, unless an exception applies. You might not have to pay this penalty if you need the money for a divorce settlement or medical expenses, for example.

**2. Arrange a series of payments.** If your plan allows it, you might set up a system of periodic payments you receive on a monthly, quarterly, or annual basis. You also can simply withdraw money when you need it.

By taking distributions gradually, you spread out your tax payments and may pay less. For example, suppose that a lump-sum distribution would push you into the top 39.6% bracket—whereas with a series of payments, you may be taxed at a 35% rate or lower. This also could reduce your exposure to the NII surtax.

**3. Roll over to an IRA.** Another option is to transfer funds from a 401(k) to a traditional IRA in your name. As long as the rollover is completed within 60 days, you won't owe tax on the distribution, and you also won't be subject to the 10% penalty tax. In effect, you can take an interest-free loan from your savings for two months, although 20% of any money you withdraw will be withheld for potential taxes. If you repay the funds on time you can recoup that money when you file your tax return. If you miss the 60-day deadline, however, you'll owe income tax on the full amount.

A safer approach may be to use a trustee-to-trustee transfer, in which your funds go directly from the 401(k) to the IRA—your hands never touch the money—and there are no taxes.

If you roll over funds from your 401(k) to a Roth IRA instead of a traditional IRA, you'll owe tax on the amount of the conversion, just as if you'd transferred money from a traditional IRA to a Roth.

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## *What Are The Main Items On Trump's Tax Reform Agenda?*

President Donald Trump is making tax reform one of the top priorities in the early days of his administration. Although there are no guarantees, some or all of his proposals may be approved by a Republican-led Congress, possibly with modifications. These are among the key items on the agenda:

- Replacing the seven-tier income tax rate structure for individuals with three brackets of 12%, 25%, and 33%.
- Eliminating some itemized deductions or limiting the dollar value of deductions claimed on personal returns.
- Reducing the top corporate income tax rate from 35% to 15%.
- Repealing the estate tax and replacing the step-up in basis for inherited assets with a carryover basis rule or income tax consequence at death.
- Repealing the 3.8% surtax on net investment income.
- Repealing the alternative minimum tax.
- Curbing the benefits of stretch IRAs.
- Providing immediate deductions for investments in businesses.
- Doubling the maximum Section 179 allowance from $500,000 to $1 million and revamping depreciation deduction rules.
- Revising tax benefits for child-care expenses, including a new deduction and tax-favored savings accounts.
- Implementing a one-time 10% repatriation tax for multinational corporations.

We will provide more details if and when any of these provisions are enacted into law.

# This Type Of Trust Is A Failure

Trusts come in many shapes and sizes, but you could divide them into two broad groups—grantor trusts and non-grantor trusts. There's also a third type, however—the "intentionally defective grantor trust," or IDGT, that is designed to break tax rules for estate planning purposes.

With a grantor trust, the grantor—the person who creates it—retains considerable power over how it's administered, including the rights to amend, revoke, or terminate the trust. The grantor also maintains control over the trust assets. Typically, the grantor is a beneficiary of the trust income and principal. For instance, the grantor could be the primary beneficiary, with other family members entitled to the remainder. The grantor also can act as the trustee responsible for administering the trust.

With non-grantor trusts, however, grantors give up all of those rights. They aren't entitled to the income or the principal and, usually, payouts from the trust go to other family members. Also, the grantor cannot be the trustee of a non-grantor trust.

Now consider the tax implications. Because grantors retain control over grantor trusts, they're taxed for the income the trusts produce. For grantors in higher tax brackets—including the top bracket, with its 39.6% tax rate—the income tax consequences can be significant. In contrast, income earned by a non-grantor trust is taxed to the trust itself, not to the grantor.

But that can be a problem because trusts pay comparatively high tax rates. For instance, that top 39.6% rate kicks in when trust income exceeds $12,500 in 2017. Compare that to the $470,700 threshold for the top rate for a married grantor who files a joint return, or $418,400 for a single filer. That can translate into very high taxes for a non-grantor trust.

But that's where an IDGT may come to the rescue. As long as the grantor retains certain powers, the grantor, rather than the trust, will be taxed on trust income—even if none of that income goes to that person. An IDGT trust is set up so that it will purposely fail to qualify as a non-grantor trust, thus avoiding the higher taxes that come with the non-grantor designation.

What about estate and gift taxes? Money you transfer to an IDGT is treated as a taxable gift, but there's a current individual exemption of $5.49 million in 2017 that could reduce or eliminate your tax liability for the gift. (There also are other ways to structure this transfer so that it's not considered a gift at all.) In addition, the assets you transfer into the trust are no longer in your taxable estate, whose value will be reduced further by the annual taxes you pay on trust assets.

But IDGTs are complex arrangements, and you'll need the help of an experienced estate planning professional to create a trust that fits your needs. Seek expert assistance. ●

# Tune Into The Tax Break For NUA

NUA isn't the latest channel available on your cable TV system. It stands for "net unrealized appreciation"—a little-known gem of a tax break for those who take payouts in the form of company stock from a 401(k) or other employer-sponsored retirement plan.

This tax law provision lets you benefit twice: once when you pay the tax on the plan distribution and once when you sell the stock.

If you receive a retirement plan distribution in company stock, you'll be taxed only on what you initially paid for it. You won't have to pay tax on any subsequent gains in value—known as net unrealized appreciation, or NUA. In contrast, cash distributions from your 401(k) normally are taxed as income, at rates up to 39.6%.

And what happens when you sell the shares you received from your retirement plan? Then you will be taxed on the difference between what you paid for the stock and its sale price. But that profit will be taxed at capital gains rates, and if it qualifies as a long-term gain—because you've owned the stock longer than one year—the maximum tax rate is only 15% (or 20% if you're in the top 39.6% ordinary income tax bracket).

But the tax breaks for NUA aren't automatic. The distribution must be:

- Made from a "qualified" retirement plan sponsored by your employer. (IRAs don't count.)
- Due to a triggering event—death, disability, attaining the age of age 59½, or separation of service from the company sponsoring the plan.
- Taken in a single tax year.

Assuming you qualify, though, the tax savings for NUA can be substantial. Suppose that during the past 20 years, hypothetical investor Jane Doe has acquired 20,000 shares of company stock in her 401(k). The stock originally was bought for $5 a share,

# Take 7 Financial Steps In A Second Marriage

Marrying again after divorce or the death of a spouse may offer great personal benefits. But it also can lead to financial complications, especially if you have children from your first time around.

However, the blessed event doesn't have to be ruined by family squabbles. Discussing matters openly and deploying a range of estate planning strategies can help you develop a plan that meets your needs. Here are seven steps to help move you along:

**1. Open the lines of communication.** Before you tie the knot, be up-front about your concerns and preferences. Talk to each other about your intentions and how you expect to pass along assets to other family members, including any children and grandchildren. You might find it helpful to include an impartial person, such as your financial advisor, to "broker" the talks.

Consider this checklist of points to discuss:

- Existing financial obligations (for example, a promise to pay for a grandchild's education);
- Plans for future support and funding for retirement;
- Guardianship of any minor children; and
- A prenuptial agreement protecting your personal interests.

**2. Conduct an inventory.** Now is a good time to compile a list of your assets. This may include: stocks, bonds, mutual funds, and other investments; amounts that you've transferred to trusts; retirement plan and IRA funds; and proceeds that will be available from life insurance policies. Also, review any agreements made during the course of your first marriage. For instance, if you were required to name your then-spouse as the beneficiary of your retirement plan accounts, you may have less flexibility than you thought.

**3. Consider the variables.** Not everything is cut and dried. It's up to you to decide which assets, if any, you will comingle with your new spouse's. Keep in mind, though, that the laws of your state also may come into play. For instance, in community property states, the law presumes that assets will be owned jointly. But most states mandate "equitable distribution," calling for property to be distributed fairly, but not necessarily equally. Also, you'll want to factor in your age and health status, as well as those of your spouse.

**4. Pay attention to titles.** The way that property is titled, both prior to marriage and after, can have a profound effect. For example, setting up accounts as joint tenants with rights of survivorship (JTWROS) will make it clear that assets will go directly to the other named person, such as your spouse, when you die. But if a title names you as the sole legal owner of assets, they'll pass to your estate and not directly to your spouse.

**5. Name your beneficiaries.** If you're entering a new marriage you'll likely need to amend your existing will or replace it entirely. In particular, it's important to review the beneficiaries you've named for various assets in the will. Also, take a look at the beneficiary designations in documents for all of your retirement plans, IRAs, and life insurance policies. Those beneficiary designations take precedence over whatever may be in your will.

**6. Show some trust.** Your estate plan may include one or more trusts, which can be useful in transferring wealth to children of an earlier marriage while imposing some constraints on the recipients. Here are a few possibilities:

*Bypass trust*: This vehicle could be designed to provide income to a surviving spouse, with the remainder of trust assets going to other designated family members.

*Q-tip trust*: With a qualified terminable interest property (Q-tip) trust, a surviving spouse may receive income, but not principal, when the owner dies, with children receiving the remainder from the surviving spouse's estate.

*Spendthrift trust*: As the name implies, this trust can be helpful in restricting beneficiaries' access to assets until they reach a specified age or meet other requirements.

**7. Don't forget about taxes.** Last, but not least, it makes sense for both of you to consider how to minimize estate tax on the federal and state levels. That likely means use of the generous estate tax exemption ($5.49 million in 2017) as well as the "portability" provision allowing a surviving spouse's estate to benefit from the unused portion of a deceased spouse's exemption. Such provisions could be included in trust documents or other estate planning devices.

The second time around, it's more important than ever to seek expert assistance from your estate planning advisors. Don't hesitate to contact us. ●

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but now it's worth $50 a share, or a total of $1 million.

If Jane sells the stock within the 401(k) and then takes a cash distribution of the proceeds, the entire $1 million will be taxed as ordinary income. If Jane is in the 39.6% tax bracket, she'll be hit with a federal income tax bill of $396,000 (39.6% of $1 million). But if she instead takes the distribution as stock, not cash, she'll be taxed only on her original cost of $100,000, and she will pay only $39,600.

Now suppose that Jane sells the stock immediately for $1 million. Her $900,000 gain ($1 million - $100,000) is taxed as long-term capital gain at the maximum 20% rate, giving her a tax bill of $180,000. Add that to the $39,600 she paid on the distribution, and her total taxes are $219,600—or $176,400 less than she would have paid if she'd sold the stock inside her retirement plan. ●

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## Weigh Five 401(k) Options

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**4. Roll over to a new 401(k).** If you're changing jobs and your new employer provides a 401(k), you may be allowed to transfer your savings into a 401(k) account sponsored by the new employer. Your new company also might offer the option of converting to a Roth 401(k)—here, too, you would owe income tax on the amount you convert to a Roth account.

This kind of rollover also must be completed within 60 days to avoid tax liability. A trustee-to-trustee transfer may be your simplest choice.

In deciding where or whether to move your savings, you may want to compare the investment offerings of the various possibilities. For instance, you might opt to use an IRA if it provides more investment flexibility or better selections than you'd get in the new employer's plan.

**5. Keep the funds where they are.** Finally, your existing 401(k) might let you leave your money where it is. This option has been discouraged in the past, because you no longer work for the employer and might have concerns about access to your account, but recently it has become more common.


Once again, your preference may depend on the investment choices available through your plan. If you've had good success with the investments in your old employer's plan, you might decide to stay the course. At the very least, you can retain the status quo until you decide on your next step.

Of course, everyone's situation is different. Your financial advisor can help you analyze the particulars of each option so that you can make an informed decision. ●