INSIGHTS

A QUARTERLY WEALTH MANAGEMENT PUBLICATION *of* FERGUSON WELLMAN, OCTAVIA GROUP *and* WEST BEARING

WEALTH MANAGEMENT
FOURTH QUARTER 2022

IN THIS PUBLICATION

Strategic Tax and Philanthropic Planning........ I

Strategic Roth IRA Conversions.......... II

Charitable Giving Tax Limitations.......... IV

Founded in 1975, Ferguson Wellman is a privately owned registered investment adviser, established in the Pacific Northwest. As of January 1, 2022, the firm manages $8.2 billion for 913 clients that include individuals and families; Taft-Hartley and corporate retirement plans; and foundations and endowments with portfolios of $4 million or more.

West Bearing Investments, a division of Ferguson Wellman, serves clients with assets starting at $1 million.

Octavia Group, Ferguson Wellman's private family office, provides fee-based services for clients with $10 million managed by firm.

INVESTMENT EXCELLENCE
LIFELONG RELATIONSHIPS

STRATEGIC TAX AND PHILANTHROPIC PLANNING

MARY LAGO, CFP®, CTFA
Principal
Wealth Management Chair

As fall leaves begin to turn, we may start to anticipate the holidays and realize year-end is quickly approaching. This last quarter of the year is the perfect time to fine-tune tax planning and ensure philanthropic giving is structured for maximum impact and optimized tax deductions.

Strategic tax planning generally involves taking a multiyear view of expected marginal tax brackets, focusing on deductions in high tax-rate years and shifting income to years when we expect to be in lower brackets. This shifting is achievable through strategies such as accelerating or limiting the realization of capital gains, Roth IRA conversions or increased pre-tax retirement savings. Tax preparers may offer additional choices based on specific circumstances.

Since the 2017 Tax Cuts and Jobs Act eliminated many income tax deductions and limited state and local tax (SALT) deductions to $10,000 per year, it has become more difficult to manage personal income tax brackets by grouping deductions into select years. However, for those inclined, charitable giving allows for a positive impact to others and remains ripe for strategic tax planning. Philanthropic strategies range from simple to complex. A comprehensive review of how your wealth is expected to evolve over time, combined with a thoughtful plan for your desired philanthropic impact, can help narrow the plethora of charitable giving options.

Two very simple and common tools for maximizing the tax benefits of charitable giving include qualified charitable distributions (QCDs) from individual retirement accounts (IRAs) and donor-advised funds (DAFs). A QCD is the direct contribution of IRA funds to charity and is most appropriate for those who are subject to required minimum distributions, not itemizing their deductions and have the financial capacity to part with the income. QCDs apply towards satisfying required minimum distributions while avoiding the realization of income on the amount contributed. Note that QCDs are only available to those over age 70 ½ and cannot exceed $100,000 per year, per IRA account owner.

Donor-advised funds provide many administrative conveniences in addition to potential tax benefits. To begin, donor advised funds can be funded with appreciated securities, allowing the donor to deduct the full market value, while avoiding triggering any capital gains. Another powerful attribute of DAFs is the ability to claim a charitable deduction each year the DAF is funded, while deferring the distribution of the funds to future years. This ability to separate the tax deduction from the ultimate distribution allows donors to group several years of planned charitable giving into a single year, potentially increasing the portion of the gift that exceeds the standard deduction and thus improving the overall tax impact of each dollar contributed.

Our Ferguson Wellman logo is based on a bronze coin of Marcus Aurelius Antoninus, emperor of Rome from A.D. 161 to 180. According to historian Edward Gibbon, he was the only person in history in which, "the happiness of a great people was the sole object of government." Marcus Aurelius was the author of a series of personal writings and meditations that revealed a mind of great humanity, natural humility and wisdom.

STRATEGIC ROTH IRA CONVERSIONS

SAMANTHA PAHLOW, CTFA, AWMA®
Senior Vice President
Portfolio and Wealth Management

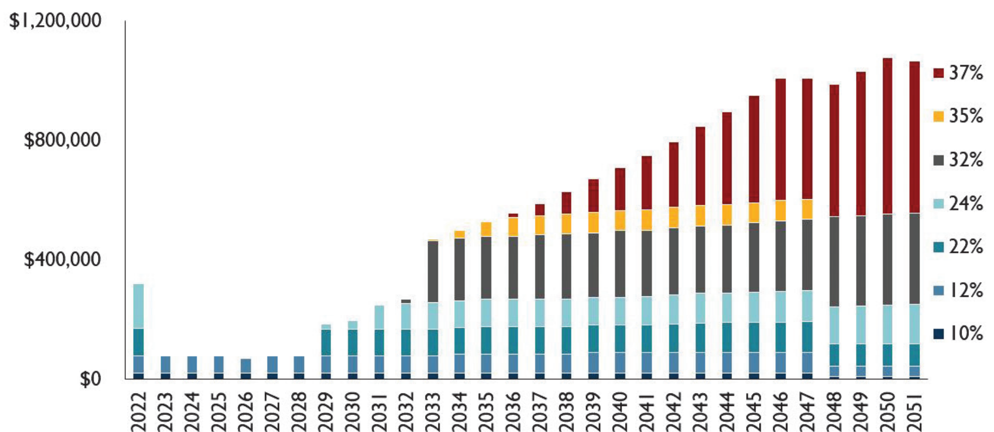
TAX DEFERRAL IS USUALLY A GOOD thing. By deferring taxation, you can let your assets grow without taxes taking a bite - until later. However, there can be too much of a good thing, particularly if your future tax rates will be higher than they are now. Many savers find themselves in retirement holding very large tax-deferred accounts and annual required minimum distributions (RMDs) taxed at high marginal rates. Individuals should be aware of this potential issue and evaluate the opportunities to convert portions of their tax-deferred accounts to a Roth IRA in years when they have lower income-tax rates.

Further, with the current low marginal tax brackets instituted by the 2017 Tax Cuts and Jobs Act, individuals may be in *temporarily* lower brackets than they will be after the rates are scheduled to sunset in 2026. For example, an individual with $150,000 of taxable income today is in the 24% bracket; but, when the legislation sunsets in 2026, that same individual may find themselves in the 28% bracket simply by virtue of the rates reverting.

For those unfamiliar with the Roth IRA, it is a powerful tax-advantaged savings vehicle. A Roth IRA is funded with after-tax dollars, grows tax-free, does not have required distribution during the owner's life and distributions are generally tax-free. Contrast this to a traditional IRA, which is funded with pre-tax dollars and grows tax-deferred, but requires mandatory distributions at age 72, which are taxed as ordinary income.

A Roth IRA conversion can be an excellent strategy for shifting income into lower tax-rate years, pre-paying taxes at lower rates and building a base of tax-free assets. Conversions reduce the size of your traditional tax-deferred assets, thus reducing the amount of ordinary income that might later be taxed at higher rates. The result can be a smaller lifetime tax bill and greater after-tax wealth.

Many professionals find the years immediately following retirement as the ideal time to consider Roth IRA conversions. Many retirees are not yet claiming Social Security and may be living off accumulated savings and investments, with low levels of taxable income. This may be an ideal time to convert portions of an IRA to a Roth, possibly over a number of years, filling up lower tax brackets before required distributions start at age 72.



Source: MoneyGuide Pro

The laurel is part of our Octavia Group branding. Octavia the Younger was one of the most prominent women in Roman history. She was respected for her nobility and humility. Octavia was hailed as a "marvel of womanhood" and was a political advisor between her brother and husband. She was immune from the "tutela," which placed in her the unique position of managing her own finances.

As an example, let's assume a single retiree was earning $150,000 per year and immediately after retirement they have only $30,000 of taxable investment income per year before they begin claiming Social Security. This puts them in the 12% marginal tax bracket. They could convert $11,775 to fill-up the 12% bracket, or $59,075 to also fill up the 22% bracket. This strategy would be advantageous if they expect to have income taxed at rates over 22% later in retirement.

"If you prepare yourself at every point as well as you can ... you will be able to grasp opportunity for broader experience when it appears."

– Eleanor Roosevelt

There are of course situations when it may not be ideal to convert.

- If you expect to be in a lower tax bracket in your retirement years. Paying tax now, at higher rates, likely doesn't make sense.
- It is generally best to pay taxes on a Roth conversion from non-retirement assets. If you do not have adequate cash to pay the taxes, a Roth conversion may not be optimal.
- Do not convert funds you will need to live on over the next five years. Roth IRA conversions have a special five-year rule that can trigger taxes and penalties on distributions. The five-year rule requires you to leave the converted funds in the Roth IRA for five tax-years before withdrawing the converted amount and earnings, and a new five-year clock starts with **each** conversion. If you take the funds out before the end of the five-year window, you will have to pay taxes on the earnings and may have a 10% penalty on the withdrawal if you are under age 59 1/2.
- If you are planning to leave your IRA to charity, then paying taxes on conversion usually won't be appropriate. A better option may be to direct up to $100,000 per year of your annual required minimum distribution to charity using a qualified charitable distribution (QCD) and name the charity as a beneficiary of your IRA. This arrangement avoids most of the taxes that would be paid on the IRA distributions.

It is important to understand that Roth IRA conversions will create taxable income in the year converted, potentially increasing your tax bracket, taxation of Social Security income and Medicare premiums. Before completing a Roth conversion, work closely with your tax advisor and portfolio manager to evaluate the impact of a conversion on your entire tax picture and ensure you have adequate non-retirement assets to pay the tax bill associated with the conversion.

Roth	Traditional IRA
After-tax contributions	Pre-tax contributions
Growth is tax-free	Growth is tax-deferred
Distributions are tax-free	Distributions are taxed as ordinary income
No required distributions during life	Required distributions begin at age 72

It is impossible to predict with certainty what your future tax rates will be, as it depends on many variables that are not yet known, such as your spending, investment performance, changes in future tax rates and more. However, thoughtful Roth conversions can be an excellent hedge against higher future tax rates and provide valuable tax diversification in retirement years.

"For all your days be prepared, and meet them ever alike."

– Edwin Markham

Our West Bearing logo is inspired by the American bison, an iconic creature symbolizing resilience, grace and the western path to growth and opportunity. Most animals attempt to outrun inclement weather, prolonging their exposure to the elements and, in doing so, weaken their conditions. Only bison instinctively turn to face the storm, often bearing west, to find the quickest path to clear skies.

CHARITABLE GIVING TAX LIMITATIONS

CHRIS BIXBY, CFP®, EA®
Senior Vice President
Portfolio and Wealth Management

"Gazillionaire gives away fortune!" Sound familiar? The media often touts large gifts to charity, giving publicity to the donor. But that raises a sensible question: What tax benefits are they receiving as a result of a large gift? This does not imply that they give only to receive a tax benefit; rather, most people give because they are motivated to help others. And the financial benefits are limited as the IRS Code limits the deduction that an individual may take.

In our opening article, Mary Lago, CFP®, CTFA, discussed the concept of "bunching" charitable contributions to achieve a better overall deduction. This strategy creates significantly higher contributions in individual years. But, like they say, too much of a good thing … Well, that can mean lost deductions.

The IRS limits all charitable contributions to no more than 60% of adjusted gross income (AGI). Any contributions above this amount will be carried forward up to five years to be deducted on future tax returns if there is any available limit in those years. While most of us will never give away 60% of our income during our working years, these limitations may come into play in the early years of retirement. In these years your taxable income may be low, while you continue to support your favorite charities. This scenario ties into the article on pages two and three regarding strategic Roth IRA conversions and proves that timing charitable contributions to years with Roth conversions will increase the benefit of your deduction.

In addition to the 60% limit, there are several other limitations that apply. Stock and in-kind gifts (e.g., cars, art, jewelry, property) given to charity are limited to 30% of AGI. Any amount donated over that threshold will be carried forward, but it will still be subject to the 30% of AGI limit in future years. This limitation to non-cash donations means that any deductible gifts over 30% of AGI must be made in cash.

For example, a taxpayer donates a $500,000 property to charity in retirement. Their AGI is $100,000/year. The deduction is limited to $30,000/year for five years, for a total of $150,000. The remaining deduction value would be lost, though they could make an additional $30,000/year in cash contributions.

"Someone's sitting in the shade today because someone planted a tree a long time ago."

—Warren Buffet

There are several other unique limitations and rules that one should be aware of. The first is that the above rules apply generally to public charities. Donations to most private foundations are limited to 30% of AGI for cash and 20% of AGI for non-cash donations. Also, any in-kind gifts must be legally transferred to charity to be deductible (donating the use of a vacation home is typically not deductible). If the charity uses the item for their mission, you will receive a fair market value (FMV) deduction based on a comparable sale value. If the charity sells the item to raise cash, then the deduction is the lower of the sale price or the FMV. Note, any item worth more than $5,000 must have an independent qualified appraisal to receive a deduction.

Giving to charity is a matter of the heart, but maximizing the benefit of your gift gives you more resources to direct to your financial and charitable goals. By working with your financial and tax professionals, you can help you maximize your resources.

Disclosures: *Ferguson Wellman and West Bearing do not provide tax, legal, insurance or medical advice. This material has been prepared for general educational purposes only and not as a substitute for qualified counsel who can determine how this information applies to you.*