REFLECTIONS

Client Newsletter

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To Your Future Prosperity

WHY WAIT? THINGS YOU NEED TO KNOW ABOUT GIVING AN INHERITANCE WHILE LIVING

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While many people are dedicated to leaving an inheritance after they die, a new trend has emerged over the last few years: Accelerated Inheritance. This might be the right option for you, but you need to fully understand it before you decide to utilize it.

What is An Accelerated Inheritance?

An accelerated inheritance refers to an inheritance given during your lifetime, rather than at death. It is a way for parents to provide financial support to their children while they are still around to enjoy it, rather than leaving assets and money after they pass away.

Accelerated Inheritance Strategies

An accelerated inheritance does not have to look the same as a traditional inheritance. There are many ways to share your wealth with your children during your lifetime, including:

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Our firm is built on client trust and referrals. If you know any of your friends or family who might benefit from our services, please give us a call at 844.377.4963 or email Sean@windgate.com.

LIFETIME GIFTING

You do not need to wait until you have passed away to give money and assets to your kids. In 2023, the annual gift exclusion is $17,000 per year per person. If you are splitting the gift with a spouse, you can give up to $34,000. So that means a married couple with two kids can give $34,000 to each child (or to any friend or relative) for a total of $68,000 without filing a gift tax return.

Lifetime gifting can help you strike a balance between taking care of your kids and depleting your own retirement assets, and it can also help reduce the taxable portion of your estate.

It is worth noting that once you gift more than the annual exclusion, the excess amount spills into the "lifetime exclusion bucket." You must use this entire amount before the IRS requires you to pay gift tax. For 2023, the current lifetime exclusion is $12.92 million for individuals and $25.84 million for married couples.

Unless something changes, the lifetime exclusion amount is set to decrease starting in 2026. It will be reduced to $5 million per person and will only increase to account for inflation in subsequent years. If you think your estate is going to be subject to estate taxes once the exclusion amount resets, you may want to consider taking advantage of the current exclusion to make gifts.

GIFTING APPRECIATED SECURITIES

Many parents wish to give large gifts to their adult children, usually in the form of a wedding gift or down payment for a house. There is a common belief that cash is the best way to give these gifts. But gifting appreciated securities can be the best strategy. Gifting securities can reduce your tax liability on capital gains, as well as reducing the value of your taxable estate.

For those who are not eligible for the 0% capital gains tax rate due to income thresholds, consider gifting highly appreciated assets to an adult child instead of selling them yourself. Chances are your kids are in a lower tax bracket, which will result in a reduced or eliminated tax liability if they sell the investment themselves.

FUND A FAMILY VACATION

Increasingly, successful parents are thinking less about leaving money to their children and instead looking to enjoy the fruits of their life-long labor through quality time with their family. Experiences shared as a family will often mean more than cold, hard cash. Rather than safeguarding your wealth from being left after you are gone, consider buying a vacation home where everyone can gather. Or take your whole family on that trip you have always dreamed about. These experiences will produce lifelong memories that are likely more impactful than leaving a larger inheritance.

CONSIDER A 529 PLAN

Another great way to transfer wealth to your children and grandchildren is with a 529 college savings plan. There is a special provision that allows donors to contribute 5 years' worth of gifts as a lump sum. This means an individual can gift up to $85,000 ($17,000 x 5) and a married couple can gift up to $170,000 without incurring gift taxes! The beneficiary can then withdraw the funds and investment growth tax-free to pay for qualified education expenses. If the child chooses not to go to college, the funds can be transferred to another beneficiary or withdrawn at the marginal tax rate and charged a 10% penalty. New rules also now allow unused 529 funds to be rolled over into a Roth IRA.

CREATE AN IRREVOCABLE TRUST

If you have concerns about how gifted or inherited funds will be used by your kids, or you want to leave specific instructions on how the money should be spent, consider creating an irrevocable trust. Utilizing an irrevocable trust can be an effective tool to reduce your estate tax and provide guidance for your heirs on your desires for the inheritance. It is permanently binding, and you cannot change the terms or beneficiaries. Depending on how the trust is structured, your beneficiaries can receive payments before you pass away, making this an effective vehicle for Accelerated Inheritance.

Making The Right Choice

While it can be a valuable way to support your children and share your wealth, an accelerated inheritance is not a decision to make lightly. It is important to consider several factors, like:

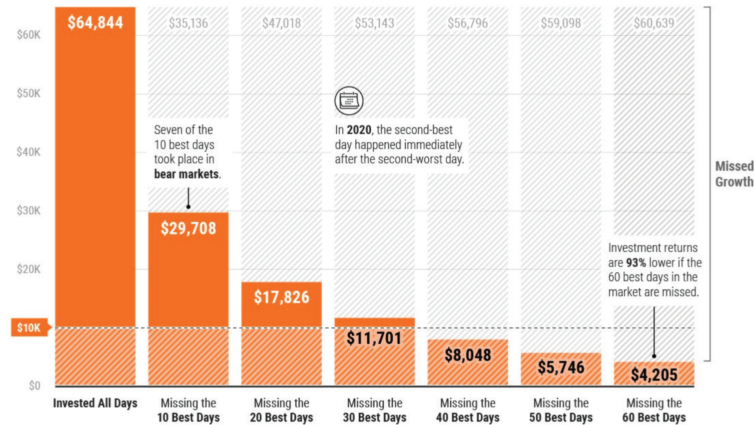
- Retirement security: Before giving an accelerated inheritance, it is essential to assess your own financial situation and make sure you have enough savings to support your retirement goals. Remember, a well-planned and thoughtful accelerated inheritance can be a valuable way to support your children, but it should never come at the expense of your own financial stability. (continued on page 8)

THE COST OF Timing the Market

Bad timing can take a bite out of returns.

Below, we show the risk of trying to time the market. By simply missing out on the 10 best days, an investor could lose the majority of their overall return.

Value of $10,000 Invested in the S&P 500 Jan 2003–Dec 2022



When Were the 10 Best Days in the Market? % Return

Source: Visual Capitalist - https://www.visualcapitalist.com/use-our-visualizations/

TAKE ADVANTAGE OF A BACKDOOR ROTH IRA: TIPS ON GROWING YOUR RETIREMENT SAVINGS TAX-FREE

There is a reason Americans love Roth IRAs—they come with major tax benefits. Unlike traditional IRAs which provide tax-deferred growth (you pay the tax eventually), Roth IRA assets grow tax-free. In addition, when you start taking Roth IRA withdrawals in retirement, none of that money counts as taxable income. This can provide flexibility in retirement years, where the future state of tax rates is very uncertain. The Roth IRA protects you from paying future income taxes, and this protection also continues for your heirs. It is an extremely attractive option for those who can qualify.

But that is the problem—most high-income earners do not qualify for a Roth IRA. As of 2023, you are not eligible to contribute to a Roth IRA if you make at least $153,000 as an individual or $228,000 as a married couple. The solution is the Backdoor Roth IRA, a strategy that allows high-income earners to reap the benefits of a Roth without violating the income limits.

How Does A Backdoor Roth IRA Work?

While contributing to a Roth IRA is prohibited for high-income earners, anyone can make non-deductible contributions to a traditional IRA. In addition, anyone who has funds in an IRA can "convert" the assets into a Roth IRA. Put together, high-income earners can sidestep the Roth income limitations by contributing to an IRA and then converting it to a Roth.

So as a first step, you will need to open a traditional IRA and fund it with non-deductible contributions (maximum of $6,500 in 2023; $7,500 if you are over the age of 50). Then, you will immediately convert your non-deductible IRA to a Roth IRA. Repeat this process each year to take advantage of tax-free growth.

The $6,500 contribution limit may seem small, but over time you can amass sizable retirement savings, especially when combined with other tax-advantaged retirement vehicles. If you are looking for even more, business owners who can design their own retirement plan or those fortunate to have a flexible 401(k) at work might be eligible to implement the Roth Supercharge Strategy or maximize the benefit of a Roth conversion.

Even just an annual back-door Roth contribution can likely save you thousands of dollars in taxes over time. Plus, unlike traditional retirement accounts, backdoor Roth IRAs are not subject to required minimum distributions (RMDs). This means you will not be forced to start taking withdrawals—and paying taxes on those withdrawals—when you reach age 73. This is an added estate planning benefit because with no RMDs, you are free to let your account balance grow and build for as long as you live. Then, you can pass it on to your heirs if you wish to do so, and they can receive tax-free withdrawals for up to ten years.

Considerations of a Backdoor Roth IRA

There are some things to be aware of when considering a backdoor Roth.

PRO RATA RULE

The main obstacle preventing backdoor Roth IRAs is whether you already own existing Traditional IRA accounts. If you do have Traditional IRAs, a backdoor Roth strategy is likely unworkable. The reason is the pro-rata rule. This rule forces all IRAs to be counted as one account, so a $6,500 Roth conversion will be considered as a partial conversion of all existing IRA assets, not as a standalone transaction. For example, if you already own $65,000 in IRA assets, a $6,500 Roth conversion will be considered as 10% of your assets, and therefore just 10% of the conversion will be tax free (the remainder will be considered a taxable distribution – not the desired outcome).

Note: the rule only aggregates IRA accounts, so 401(k)s, spouse's accounts, or other Roth accounts are not counted (SIMPLE and SEP IRA assets are included).

IRREVERSIBLE

Roth conversions are irreversible. That means if you converted too much at once and got pushed into a higher marginal tax bracket, or later decide against the strategy, you cannot take it back. But this can usually be avoided by keeping your conversion amounts to the annual contribution limits.

5-YEAR RULE

Backdoor Roth IRAs also have two five-year rules to keep in mind. The first rule says that you must wait at least five years from your first

contribution before you can make a penalty-free withdrawal from your Roth IRA—even if you are over age 59½.

The second five-year rule states that each of your backdoor Roth conversions has its own five-year period. For example, if you do a conversion in 2023 and another in 2024, you will have to wait until at least 2028 to access the first conversion and 2029 to access the second.

As with anything tax-related, consult a wealth advisor to position your money in a way that minimizes tax liability and maximizes growth.

Is A Backdoor Roth IRA Right For You?

If you exceed the income limit for a Roth IRA, a backdoor Roth IRA can be an effective strategy to reduce your tax burden during retirement while taking advantage of future growth opportunities. At Windgate Wealth Management, we are committed to helping you optimize your financial plan.

> "It's the best motivation to save for retirement that we've seen in America. Everybody should be in the Roth game if they can."
>
> -IRA expert and financial-industry speaker, Ed Slott

(continued from page 4)

- Level of financial security: It is important to assess your child's level of financial responsibility before giving them an accelerated inheritance. Giving money to children who are not mature enough to handle it can lead to poor financial decisions, such as overspending, debt accumulation, or even becoming victims of scams.
- Taxes: When gifting money or assets to your children, there may be tax implications to consider, especially if the gifts are above the annual exclusion amount. Therefore, it is crucial to understand how an accelerated inheritance will impact your tax liability before making any decisions.

HOW TO HANDLE TAX PAYMENTS WHEN YOU HAVE A VARIABLE MONTHLY INCOME

For most individuals, taxes are a once-a-year consideration since they are estimated and deducted from their paychecks. This leaves them with only the task of filing their taxes in April. However, for self-employed individuals and entrepreneurs with uncapped income, tax management is more complex.

To optimize your less-predictable income, proactive tax planning is crucial to avoid fees and penalties. Read the following 5 tips from our team that you can take as a self-employed individual or small business owner to manage and reduce your tax burden.

1. Understand When Estimated Tax Payments Are Due

Self-employed individuals and entrepreneurs are responsible for paying taxes directly to the IRS in the form of quarterly estimated payments. Being your own boss means you must calculate and remit payment for what you owe; it is not automatically deducted from your paycheck like it is for W-2 employees.

This is great in that you do not have to pay taxes right away, but it can quickly become an administrative and financial burden if you do not stay abreast. Failure to pay your estimated taxes or past due payment may result in penalties and fees charged by the IRS, so it is critical to stay on top of these dates.

To better manage your tax payments, you must first understand when they are due. This table highlights the typical due dates for quarterly estimated tax payments:

Taxes are due on…	…for money earned…
April 15	January 1 – March 31
June 15	April 1 – May 31
September 15	June 1 – August 31
January 15 of the following year	September 1 – December 31

2. Understand How Much You Should Pay

Understanding how much you should pay in taxes can be especially difficult if your income fluctuates each year. If you overpay, you run the risk of giving the IRS an interest-free loan, and if you underpay, you run the risk of being penalized. In this case, the safest thing to do is to avoid the underpayment penalty by paying the lesser of:

1. 90% of your current year tax liability or

2. 100% of your prior year tax liability (if your adjusted gross income for the prior year was more than $150,000, then you must pay 110% of your prior tax liability)

Keep in mind that the IRS also provides a stipulation if you receive uneven income throughout the year. You may be able to reduce or avoid penalties by annualizing your income and making unequal payments throughout the year.

3. Create A Tax Plan

After you determine how much tax you should pay, the next step is to create a tax plan to ensure you save the appropriate amount. The general rule of thumb is for self-employed individuals to set aside 25-30% of their income for taxes, but the exact amount you need to set aside depends on your business structure, tax bracket, state of residency, and more.

For individuals with irregular income, it is important to adjust your savings as your income fluctuates. If you have a particularly successful month, consider putting a large amount away to make up for months where your income is lower. Given the attractive rates available on cash savings, make sure to have a plan for any excess cash you are holding. Working with a wealth manager or utilizing a bookkeeping system are great ways to stay on top of your tax payments so you do not find yourself facing a penalty come tax season and maximizing your returns in the meantime.

4. Keep Track Of Deductions

It is easy to forget about all the expenses you paid for when you are focused on managing your irregular income. But it is important to document as much as you can to take advantage of every deduction. This may help you reduce your tax liability, ultimately reducing your estimated tax payments and putting less strain on your uneven cash flow.

There are dozens of expenses you can deduct as an individual or self-employed business owner. Here are some of the most common deductions:

- Startup costs
- Advertising
- Online services and subscriptions
- Travel expenses
- Continuing education
- Software, hardware, and other equipment
- Health insurance premiums and medical care expenses
- Home office and supplies
- Retirement contributions

5. Partner With A Trusted Advisor

Tax payment management can often seem like a daunting task, but with the right team of professionals on your side, it does not have to be. At Windgate Wealth Management, we are dedicated to assisting individuals and business owners in managing the fluctuating income that comes with their professions.

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