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Wealth Management

Welcome to the November 2022 issue of the Peapack Private Planning Quarterly. Planning issues arise at every stage of life. Here, we're addressing a variety of tax-flavored issues, from taking IRA distributions to planning for next year's rate changes. Please reach out to our authors—or to any of our investment and planning professionals—with your questions and feedback. You may inspire a future article. We hope our guidance can help you achieve your financial goals.

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How to Take Your Required Minimum Distribution

By Claire E. Toth, JD, MLT, CFP™

Year end is fast approaching. If you are at least 72, do you know where your Required Minimum Distribution (RMD) is? Taking money out of a retirement account should be straightforward, but we're in the tax twilight zone, with many traps for the unwary. Real opportunities exist as well, so it pays to be well-informed.

First, a limitation: this article discusses only the RMD from your own retirement accounts (including IRAs). "Your" accounts include any accounts inherited from your spouse if you were the outright beneficiary on those accounts. They do not include accounts inherited from a non-spouse or those left to you in trust. This definition is a preview—every rule about RMDs has an exception and words in the tax twilight zone don't necessarily mean what you think they do.

Understanding the RMD

Most retirement accounts are tax-deferred but not tax exempt. You pay taxes only as you withdraw money from them, and the government wants to ensure you withdraw that money, whether you need to do so or not. The RMD is the minimum amount you must withdraw each year, beginning (usually) the year you turn 72.

The RMD is also a rough approximation of how much to withdraw each year so that relatively little remains in the account at your death. Your RMD for any given year is calculated by dividing your December 31 account balance for the prior year by the life expectancy opposite your age on December 31 of the current year, as set forth in an IRS document called the Uniform Distribution Table. For reasons too tedious to recount, the life expectancies in that table are the joint life expectancy of you and a hypothetical person ten years your junior. Again, there is an exception—if your beneficiary is your spouse and your spouse is more than ten years younger than you, you use a different life expectancy table, with your real ages.

Using the standard table, if your December 31 IRA closing balance was $1 million, your first RMD would be that dollar amount divided by 27.3, or $36,630. The joint life expectancy of a 72 year old and a 62 year old is 27.3—hence the divisor. Each year, the life expectancy decreases by slightly less than a year, and the percentage you must withdraw increases.

Taking the RMD

Different rules apply to IRAs (including SEP-IRAs) and to employer-sponsored plans, such as 401ks. If you have multiple non-Roth IRAs (no RMD for those), your RMD is based on their December 31 total. You can pick and choose from which IRA or IRAs to take the money. Just be aware that if you have multiple custodians, they won't see you taking money from other accounts, and each will continue urging you to withdraw your RMD.

Employer-sponsored plans are treated differently. There, you must calculate your RMD account by account and take each account's RMD only from that account. Of course, there is one exception for those aged 72 and older: if you are employed throughout the year, own no more than five percent of the company employing you, and the plan so allows, you are not required to take an RMD from that specific plan. You must still take RMDs on any plan with a former employer.

If you have after-tax (non-deductible) money in an IRA or a 401k, then a pro rata part of every distribution is tax free. The after-tax dollars in the account are expressed as a percentage of the prior year's December 31 balance. If you made after-tax IRA contributions, all of this is tracked on form 8606, attached to your tax return. If you made after-tax 401k contributions (typically before the Roth 401k came along), your plan administrator has your total contributions. Once you roll the 401k out to an IRA, you and your tax preparer should track this. Better yet, you can roll out after-tax 401k contributions directly to a Roth IRA, bypassing this problem entirely.

If all of this convinces you to roll out old retirement plans and consolidate IRAs, you should. Your former employers don't want to track you down in retirement to ensure you are taking your RMDs. If you forget about an old 401k plan and DON'T take your RMD, you could be subject to significant tax penalties.

One decision to make when you take your RMD is how much, if any, income tax to withhold. The federal default is ten percent. States vary, and many (including New Jersey) have no requirement at all, even if the state imposes an income tax.

For your first RMD only, you have the option to delay taking your RMD until as late as April 1 (not April 15—why should this be easy?) of the following year. Before jumping at the chance to delay your tax bill, consider what taking two RMDs in the same year could do to your tax bracket and perhaps to your future Medicare premiums. Further, if you do delay your first RMD, remember to reduce your December 31 account balance by the delayed first RMD when doing the math to calculate your second RMD. Most retirees decide that the one-time delay is not worth the candle.

Planning with Your RMD

- Once you turn 70-1/2, you have the option to have as much as $100,000 annually go directly from your IRA to a charity. This technique is called the Qualified Charitable Distribution, or QCD. The QCD can be a great choice for using your RMD—the money never appears on your tax return. No income and no deduction is never worse and often better than income plus deduction—it can help reduce future Medicare premiums, avoid the ACA surcharge on non-retirement income, and effectively allow you to take the standard deduction plus get the benefit of a charitable contribution.

  The gift must be to an operating charity (no gift fund or private foundation) and exclusively for charitable purposes (you can't buy tickets to the annual gala). The RMD does not have to be all or nothing—you can divide it between yourself and the charity. Even better, if you have after-tax IRA contributions, the charitable gift comes first from the pre-tax contributions; the after-tax dollars come out to you, tax free.

- Most retirees pay estimated taxes each quarter. Regardless of when in the year you withdraw your RMD, any taxes you have withheld are deemed to be paid ratably, throughout the year. Thus, if you do not need your RMD for living expenses, you can take it at the end of the year, have all or most of it withheld as taxes, and reduce (or perhaps eliminate) your estimated tax payments by the same amount. This keeps more of your money working for you longer.

Looking Ahead

As this goes to press, Congress is poised to pass the SECURE Act 2.0, which would make additional changes to retirement plans. Among those, the new law would increase the age at which taxpayers must take RMDs. The age would increase from 72 to 73 effective in 2023 (applying to those born in 1951 and later). It would increase age to 74 in 2030 (applying to those born in 1956 and later) and to 75 in 2033 (applying to those born in 1958 and later).

Other changes would reduce the penalty for failing to take an RMD on time, would create a national "lost and found" for former employer retirement plans, and would index QCD limits for inflation.

Contact Claire at ctoth@pgbank.com or (908) 598-1717 with any questions.

The IRS Gives Taxpayers an Inflation Break

By Cynthia Aiken, MBA, CFP™

Well, the Internal Revenue Service may not ***actually*** be giving us a break, but the 2023 tax year adjustments for all things IRS related have had significant changes due to the sharp increase in inflation Americans experienced in 2022. Because inflation is higher than at any time since the 1980s, tax code adjustments are higher than usual too. Tax code adjustments occur annually under formulas set by Congress and typically match analysists' projections. The changes will take effect for tax year 2023 and are designed to prevent inflation from causing tax rate increases. Americans will see lower tax withholding from paychecks in January 2023 and therefore generally larger take home pay in 2023.

Here are a few of the key 2023 tax law changes:

Income Tax Rates and Brackets

As expected, the marginal income tax brackets remain the same with the top bracket at 37% for individuals with incomes greater than $578,125 and $693,750 for married couples filing jointly. However, all the income bracket limits have been adjusted upward by approximately 7%.

Tax Rate	Single	Married Filing Jointly
10%	$0 - $11,000	$0 - $22,000
12%	$11,001 - $44,725	$22,001 - $89,450
22%	$44,726 - $95,375	$89,451 - $190,750
24%	$95,376 - $182,100	$190,751 - $364,200
32%	$182,101 - $231,250	$364,201 - $462,500
35%	$231,251 - $578, 125	$462,501 - $693,750
37%	$578,126 and above	$693,751 and above

Likewise, the Standard Deduction was increased approximately 7% for all taxpayers. For married couples filing jointly the standard deduction rises to $27,700, an increase of $1,800 from the 2022 level. Single taxpayers and married individuals filing separately will also see a standard deduction increase of $900 to $13,850, while the standard deduction for heads of households increases by $1,400 to $20,800. For married taxpayers 65 or older, the 2023 standard deduction is increased by $1,500 per person for married couples filing jointly; for singles or surviving spouses, there is a $1,850 increase.

Capital Gains and Qualified Dividends Tax Rate Thresholds

The tax rates for capital gains and qualified dividends are unchanged for 2023, but the income thresholds have been inflation-adjusted upwards.

Capital Gains Tax Rate	Single	Married Filing Jointly
0%	Up to $44,625	Up to $89,250
15%	$44,626 - $492,300	$89,251 - $553,850
20%	Over $492,301	Over $553,851

Social Security and Medicare

The headline increase in 2023 Social Security benefits is a landmark 8.7% rise over the 2022 benefit. This cost-of-living adjustment (COLA) is based on the increase in the Consumer Price Index (CPA-W) from the third quarter of 2021 through the third quarter of 2022.

For those still contributing to Social Security through their earned income, the maximum earned income subject to Social Security tax increased to $160,200 in 2023 from $147,000 this year.

Surprisingly, Medicare Part B Premiums are decreasing in 2023 from 2022 levels due to lower than projected spending and thus, larger than anticipated reserves in 2022. The 2023 monthly premiums are based on your Modified Adjusted Gross Income (MAGI = Adjusted Gross Income + certain deduction) and are updated as follows:

2023 Monthly Premium Part B	2023 Monthly Premium Part D	MFJ 2021 MAGI	Single 2021 MAGI
$164.90	$0	Up to $194,000	Up to $97,000
$230.80	$12.20	$194,001-$246,000	$97,001-$123,000
$329.70	$31.50	$246,001-$306,000	$123,001-$153,000
$428.60	$50.70	$306,001-$366,000	$153,001-$183,000
$527.50	$70.00	$366,001-$750,000	$183,001-$500,000
$560.50	$76.40	$750,000	$500,000

Retirement

The IRS provided the largest increase ever to the contribution limit for 401(k) and similar workplace plans for tax year 2023, allowing Americans to save thousands more in their retirement accounts. The employee contribution limit for workplace plans will increase $2,000 to $22,500 for 2023. The 401(k) catch-up contribution for those 50 or older will rise $1,000 to $7,500 for 2023, thus allowing those over 50 to contribute a maximum of $30,000 to their tax-advantaged retirement accounts.

In 2023, the maximum contribution to a personal IRA is $6,500, an increase of $500 from the 2022 max of $6,000. For taxpayers over 50, the catch-up contribution limit remains at $1,000 for 2023. Note, single filers covered by a workplace retirement plan and making contributions to a traditional IRA will see a phase out of their tax deduction for gross incomes between $73,000 and $83,000. For married couples filing jointly, in which the spouse making IRA contributions is covered by a workplace retirement plan, the deduction is phased out for taxpayers with incomes between $116,000 to $136,000 in 2023.

Roth IRAs are an attractive retirement savings account because although contributions must be made with after-tax dollars, the growth in the account and withdrawals from the account are completely tax-free. However, eligibility to contribute to Roth IRAs is based on income levels. In 2023 the Roth IRA eligible income range for individuals phases out between $138,000 to $153,000 compared to $129,000 to $144,000 in 2022 and for married couples filing jointly the eligible income range phases out between $218,000 and $228,000 compared to $204,000 and $214,000 in 2022.

Estate Taxes

The IRS has bumped up the amount you can give tax-free to your family and friends annually and to your heirs at your passing.

Estates of decedents who die during 2023 have an increased lifetime exclusion to $12,920,000 from the 2022 lifetime exclusion amount of $12,060,000. A married couple can pass nearly $26 million to their heirs tax-free.

The annual gift exclusion for calendar year 2023 increases by $1,000, to $17,000. This means that anyone can give tax-free gifts of up to $17,000 to an unlimited number of people and these gifts do not count against the larger lifetime estate-tax exclusion.

Awareness of these tax law changes may allow you to consider some smart tax-planning moves before December 31st. If you expect to be in a lower tax bracket next year, you may want to delay some income to 2023 if possible. On the flip side, if you expect to be in a higher tax bracket in 2023, you may want to push some tax deductions to next year.

Please note that we are not tax accountants and have no knowledge of your personal tax situation. We strongly encourage you to consult your tax professional regarding the impact of these IRS code changes on your personal tax situation.

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Planning Issues for Non-Traditional Couples

By Betty S. Thomas, CHFC™, CFP™

In 2015, the Supreme Court decision in *Obergefell v. Hodges* legalized same-sex marriage legal in all 50 states and expanded marriage's legal benefits to same-sex couples across the country. More recently, when the Supreme Court decided *Dobbs v. Jackson,* Justice Clarence Thomas wrote that the court "should reconsider" Obergefell. He stated, "it was one of the court's demonstrably erroneous decisions." What if the ruling was overturned? How would that change planning for same-sex couples and the LGBTQ+ community?

"Unmarried individuals, whether in a relationship or not, may not have their wishes for financial or medical management of their affairs while alive, or their wishes for handling matters on their death honored, without some estate planning documents in place."

The legal recognition of same-sex marriages opened a multitude of previously unattainable tools and tax-savings that come along with a legally recognized marriage. Still, same-sex couples and the LGBTQ+ community encounter situations that require extra or special planning, such as adoption by non-biological parents or navigating complicated dynamics with family members who may not accept them even while married.

Some states and local jurisdictions offer domestic partnerships, civil unions, or similar methods of legal recognition for same-sex couples and the LGBTQ+ community. These forms of relationships are offered in addition to marriage. In New Jersey, couples can register for Domestic Partnership, Civil Union, or marriage. These non-marriage alternatives offer some benefits but will not result in recognition of the relationship by the federal government.

As it stands now, estate planning for married same-sex and LGBTQ+ couples is no different than estate planning for any other married couple. Everyone should establish an estate plan, married or not. Couples who can potentially see their marriages legally disappear should build in needed flexibility.

Further, many heterosexual couples have not entered formal marriages and do not have the legal protections they provide. For them, estate planning is critical to providing for their partners. Unmarried individuals, whether in a relationship or not, may not have their wishes for financial or medical management of their affairs while alive, or their wishes for handling matters on their death honored, without some estate planning documents in place. Without the legal protection of marriage, non-traditional couples must create many of those legal structures themselves.

Some key estate planning basics for same-sex, LGTBQ+, and other non-traditional couples are:

- **Will** – The will dictates how you want your estate to be settled after your death. If you are not married and want to pass your estate to your partner, the will is essential. Some same-sex couples and LGBTQ+ adults may be rejected by family members and friends. This could lead to the will being contested by family members that may not recognize the validity of the relationship. When drafting the will be sure to speak with a qualified estate planning attorney, who is familiar with the legal and personal needs of the LGBTQ+ community and discuss adding language consistent with current laws to protect your family and to help ensure your wishes are carried out. Also, in NJ, if you are not registered as a domestic partnership, civil union, or married, your partner may be subject to inheritance taxes as high as 16% on assets received from the estate.

- **Revocable Living Trust** - This is a legal document created while you are alive, and it is an effective way to avoid probate. It accomplishes many of the same objectives as a will while also providing greater protection, control, and privacy of your assets. Another benefit is that those relatives that may have issues with your relationship are less likely to successfully challenge a revocable living trust compared to a will.

- **Review Beneficiary Designations –** Beneficiary designations on life insurance, retirement accounts, and accounts designated as "Transfer on Death," or "Pay upon Death" supersede whatever is written in the will. It is important to keep these documents up to date. If you previously named an ex-partner or spouse as beneficiary on an account and forgot to change it, that person will receive those assets regardless of what you have in your will. Also, note that as of 2020, non-spouse beneficiaries of retirement accounts must withdraw the entire value of an inherited IRA within 10 years of the of the original owner's death. There are some exceptions to the 10-year rule for minor children, disabled or chronically ill individuals, and those within 10 years of age of the deceased. In that last instance, the annual required minimum distributions (RMD) would be based on the beneficiary's life expectancy. This is less beneficial than the rules for a spouse as beneficiary but often better than a ten-year payout.

- **Durable Power of Attorney –** This document gives someone you choose the ability to act on your behalf if you are not able to manage your own affairs. Naming your partner here is critical if you are no (or are no longer) married to each other.

- **Medical Directive (sometimes called Medical Power of Attorney or Living Will) –** This document identifies who can make medical decisions on your behalf if you are not able to do so. It is an essential part of the estate planning package if there are family members that may not recognize your relationship. Whomever you name as on the Medical Power of Attorney, give that person a HIPAA Release. The HIPAA Release allows them full access to your health information which would keep them informed on your need for care. The document also expresses your wishes regarding life support. For example, would you want to be kept alive by artificial means if you were unconscious or if you had a terminal condition with no reasonable chance of recovery? It can be easier for us to say what our wishes are in a medical directive than to burden our loved ones with making those decisions.

- **Power of Attorney to Dispose of Remains –** You may name someone in a separate document or instructions can be put into the will. This appoints someone to carry out your wishes for burial, cremation, donation of body parts, etc. and can be useful if family members do not recognize your relationship. Alternatively, you can arrange (and pay) for this in advance; then it is set in place.

- **Planning for Children –** If same-sex or LGBTQ+ couples have children sometimes only one of the parents is biologically related to the child. If this is the case, the non-biological parent or stepparent should consider adoption. Typically, when parents die, they want their assets to pass to their children. To ensure this result, same-sex, or LGBTQ+ parents may need to make adoption part of the estate planning process.

- **Guardianship –** Dying and leaving behind minor children is something no one wants to consider. Creating a guardianship for children after death will give peace of mind in the event of a tragic accident or illness knowing that your children will be with someone you chose.

The dynamics of the Supreme Court may bring about challenges for married same-sex and LGBTQ+ communities in the future. Prepare for change. This could mean reviewing your will, or any other important documents you have in place to ensure your wishes remain clear, up to date and protected.

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Beware the Inheritance Tax

By Patricia Daquila, MBA, CPA, CFP™

Estate plans require period reviews and updates—life changes, laws change, the environment changes. Your estate plan isn't limited to your will and related documents—it includes your retirement accounts, insurance policies, and much more. This review is especially critical when you move to a new state. State Estate and Inheritance Taxes can be a trap for the unwary.

The Federal Estate Tax exemption in 2022 is $12,060,000; it will be $12,920,000 in 2023. If all of your assets, including life insurance, bank accounts, real estate, stocks, bonds, etc. total under the exemption amount, you are not subject to the Federal Estate Tax. However, depending the state in which you live, you may be subject to that state's Estate Tax or Inheritance Tax.

Twelve states and the District of Columbia impose an Estate Tax. An Estate Tax focuses on how much the person who died (the decedent) owned at death. That tax can apply to estates as small as $1 million in Massachusetts or starting at $9.1 million in Connecticut. State Estate Taxes have recently changed frequently, so a flexible estate plan is critical.

A tax many are not aware of is the Inheritance Tax. An Inheritance Tax focuses on how much a specific person (the beneficiary) inherits from the decedent and treats the type of beneficiary differently based on how they are related to the decedent. New Jersey is one of only six states in the country to impose an Inheritance Tax. The other states are Iowa, Kentucky, Nebraska, Maryland, and Pennsylvania. Maryland is the only state to impose both an Inheritance Tax and an Estate Tax. We will take a closer look at the New Jersey Inheritance Tax and the Pennsylvania Inheritance Tax.

First, let us look at the New Jersey Inheritance Tax. As noted above, the New Jersey Inheritance Tax may be imposed when a decedent passes assets to a beneficiary. The amount of tax depends upon who the beneficiaries are and how they are related to the decedent, the date of death value of the assets that the decedent owned, what kind of assets the decedent owned, and if the decedent lived in New Jersey or another state. If the decedent did not legally live in New Jersey when she passed away, but the decedent owned assets in New Jersey, then she will still be subject to New Jersey Non-Resident Inheritance Tax on the value of that New Jersey based asset.

The New Jersey Inheritance Tax is based on the relationship between the beneficiary and the decedent, and the amount received. The beneficiaries for New Jersey are grouped into four classes.

- Class A include parents, grandparents, spouse, children, grandchild, stepchild, civil or domestic partner or a mutually acknowledged child.
- Class C include a brother or sister of the decedent or a spouse or surviving spouse of a child of the decedent (daughter or son-in-law.) or a civil union partner or surviving civil union partner of a child of the decedent.
- Class D anyone who is not in class A, C or E. This includes friends, siblings' spouses, and anyone else.
- Class E beneficiaries include qualified charities, religious institutions, educational and medical institutions, non-profit benevolent or scientific institutions or the State of New Jersey or any of its political subdivisions.

There is no New Jersey Inheritance Tax on the transfer of assets to Class A or Class E beneficiaries. Classes C or D have an Inheritance Tax imposed on the transfer of the assets. Class C beneficiaries have an exemption for the first $25,000 of assets passed to them. The tax rates for Class C beneficiaries are 11% for assets from $25,000 to $1,075,000 increasing gradually up to 16% for assets over $1,075,000. The rates for the Class D beneficiaries are 15% on the first $700,000 and 16% on amounts transferred over $700,000. Certain assets are exempt from New Jersey Inheritance Tax, such as life insurance payable to a named beneficiary, transfers to a beneficiary that are less than $500, and certain payments from New Jersey retirement systems and certain Federal civil service retirement benefits payable to a beneficiary. However, it can also include gifts made to class C and D beneficiaries made within three years of death. The New Jersey Inheritance Tax is due eight months after the decedent's date of death. This is earlier than the nine-month deadline for any federal Estate Tax. The good news is that currently, there is no Estate Tax in New Jersey.

The Pennsylvania Inheritance Tax is like the New Jersey Inheritance Tax. In Pennsylvania, like New Jersey, the tax rate varies depending on the relationship of the heir to the decedent. The rates for Pennsylvania Inheritance Tax are as follows:

- 0% percent on transfers to a surviving spouse or to a parent from a child that is age 21 or younger.
- 4.5% percent on transfers to direct descendants and lineal heirs (including adult children).
- 12% percent on transfers to your siblings.
- 15% percent on transfers to other heirs, except charitable organizations, exempt institutions and government entities exempt from tax.

Property owned jointly between spouses is exempt from Inheritance Tax. Other exceptions apply for certain farmland or for members of the armed forces.

Pennsylvania Inheritance Tax payments are due upon the death of the individual and are considered delinquent nine months after the individual's death. In Pennsylvania, if the Inheritance Tax is paid within three months of the decedent's death, a 5% percent discount is allowed. Like New Jersey, Pennsylvania also has no Estate Tax.

When you are updating your estate planning, review with your attorney any possible Estate and Inheritance Tax strategies that may reduce future potential Estate or Inheritance tax. Also, when moving to a new state, it is wise to have an estate planning attorney review your current estate planning documents to see if any changes are warranted.

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