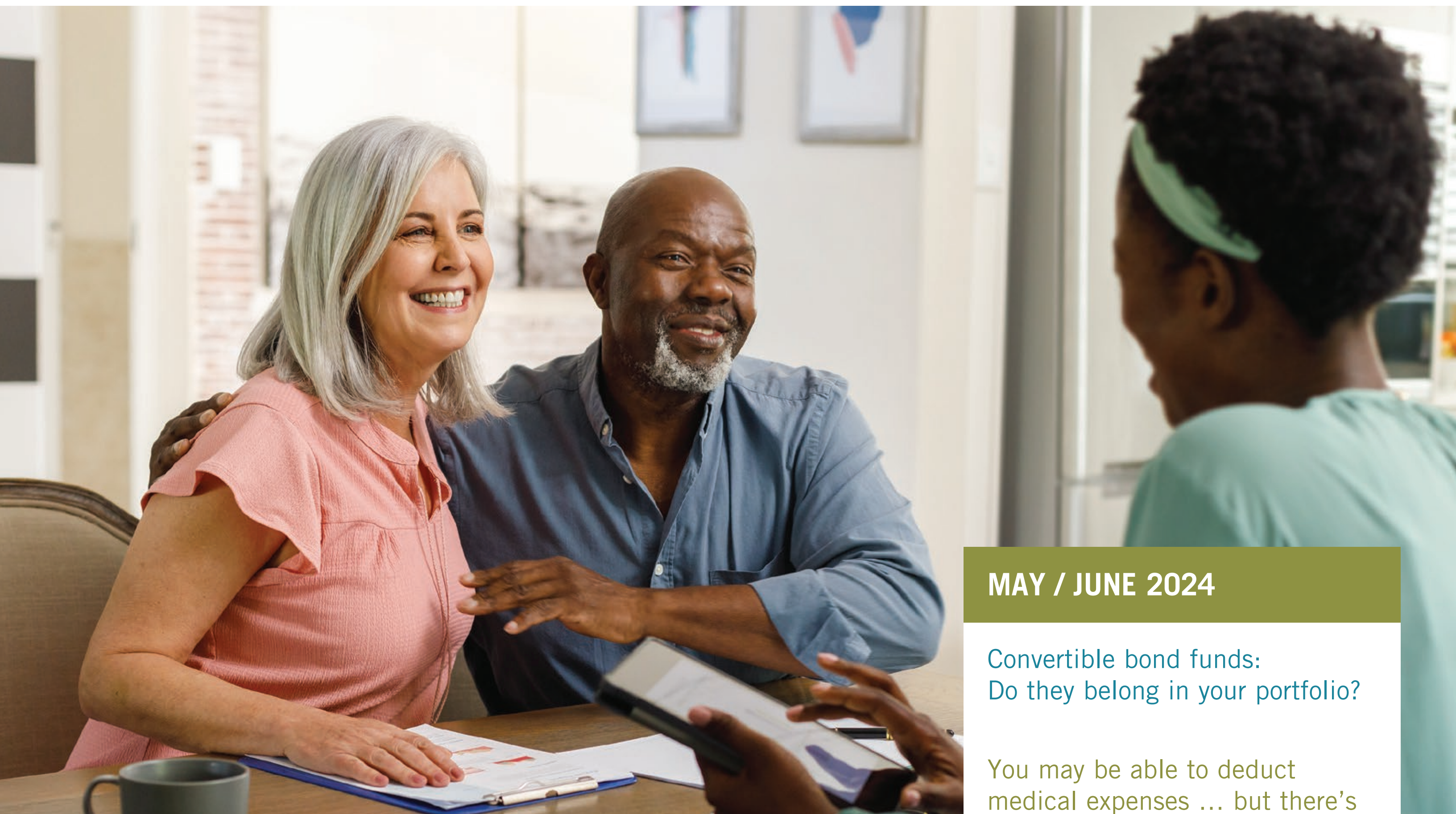
WEALTH MANAGEMENT ADVISOR



FUNDING YOUR REVOCABLE TRUST

Don't forget this critical estate planning step

MAY / JUNE 2024

Convertible bond funds:
Do they belong in your portfolio?

You may be able to deduct medical expenses … but there's a catch

Don't let fake charities benefit from your generosity

Funding your revocable trust

Don't forget this critical estate planning step

A revocable trust can be a powerful estate planning tool, but it only works fully if you fund it by transferring assets to the trust. Forgetting to fund a revocable trust is a common, but costly, mistake. It's a bit like opening a high-interest savings account but neglecting to deposit money in it. Following are some general guidelines on which assets belong in your revocable trust.

Several advantages over a will

A revocable trust (sometimes referred to as a "living trust") offers several advantages over a will alone. A properly funded revocable trust allows you to specify how the trust's assets will be managed and distributed after your death, without the time and expense of probate. Avoiding probate by using a revocable trust also helps keep your financial affairs private.

Another benefit: Unlike a will, a trust can be used to provide for the management of your financial affairs in the event you become incapacitated. And, as its name suggests, this type of trust is revocable, giving you the flexibility to amend, terminate or add assets to it at any time.

Assets to include

Assets typically used to fund a revocable trust include:

Real estate. It's common for people to hold their primary residences, vacation homes and other real estate in revocable trusts. Making the transfer is simply a matter of executing and recording a deed transferring title to the trust. For property subject to a mortgage, you should ask the lender whether it requires any additional steps or documents to complete the transfer.

WHAT ABOUT VEHICLES?

It's possible to transfer a vehicle's title to a revocable trust, but it's generally not advisable. Tax and registration requirements can make transferring title burdensome and expensive, and if the vehicle was financed by a loan, the lender may not allow you to transfer it. Also, ownership by a trust may expose other trust assets to liability should the vehicle be involved in an accident. Of course, keeping a vehicle out of your revocable trust may subject it to probate, but many states provide streamlined procedures for transferring vehicles to your heirs outside of probate.

Bank accounts. Bank accounts of significant value — including checking and savings accounts, certificates of deposit (CDs), money market accounts and even safe deposit boxes — generally should be transferred to your revocable trust. Follow your bank's procedures for making the transfer, which may involve furnishing a certificate of trust. One caveat: Before attempting to transfer CDs to a trust, find out whether doing so will trigger early withdrawal penalties. If so, consider postponing the transfer until the CDs mature.

Investments. You should transfer brokerage and other investment accounts to your revocable trust. Your financial advisors or the account custodians can help you complete the necessary paperwork. For individual investments such as stocks or bonds, you may need to request that the certificates are reissued in the name of your trust.

Business interests. If you own an interest in a privately held business (such as a closely held corporation, partnership or limited liability company) you may be able to transfer it to your revocable trust while maintaining your voting rights and other management powers. Be sure to consult the company's bylaws or operating agreement for any restrictions on transferring your interest.

Personal property. This category includes jewelry, electronics, furniture, artwork, antiques, clothing and collectibles. Typically, these items have no title or registration, but you can transfer ownership to your revocable trust by executing an assignment of personal property.

Be aware that revocable trusts usually provide little or no protection against creditors' claims during your life. If asset protection is a concern, you may want to consider other forms of ownership, such as a domestic or offshore asset protection trust.

Assets to exclude

Certain assets pass via beneficiary designation rather than through probate, so there's no need to transfer these nonprobate assets to your revocable trust. And for certain assets, transferring them to a trust may be prohibited or have negative consequences. If you wish to have nonprobate assets managed by your trust, one option is to name the trust as a primary or contingent beneficiary. To avoid unintended consequences, it's critical to coordinate your beneficiary designations with your overall estate plan.

Nonprobate assets include retirement accounts, such as IRAs and 401(k) plans. Transferring these accounts to a trust may be deemed a distribution, possibly triggering income taxes and early withdrawal penalties. You can name your trust as a beneficiary but be sure to discuss the potential tax implications with your advisors first.

Health Savings Accounts and medical savings accounts generally can't be owned by a trust, although you may be able to name your trust as a beneficiary. And because they pass by beneficiary designation, life insurance policies don't belong in your trust, either. That said, if you're concerned about asset protection or minimizing gift and estate taxes, it may make sense to set up an irrevocable life insurance trust to hold a life insurance policy.

Be aware that revocable trusts usually provide little or no protection against creditors' claims during your life.

Keep transferring acquisitions

Funding a revocable trust isn't a one-time event. As you acquire new assets, it's important to transfer them if it's appropriate. It's also a good idea to have a "pour-over will" as a fail-safe. A pour-over automatically transfers any assets still titled in your name at death to your trust. Those assets won't avoid probate, but the will helps ensure that they'll be distributed according to your wishes. ■

Convertible bond funds: Do they belong in your portfolio?

Convertible bonds are a hybrid form of debt security that can minimize downside risk and capture much of the equity market's upside potential. For most individual investors, the best way to gain exposure to these securities is through convertible bond funds, such as specialty mutual funds or exchange-traded funds.

Before you add these investments to your diversified investment portfolio, it's important to understand the different types available and how they work. Here's a brief overview.

From fixed income to equities

As the name suggests, a convertible bond is a bond that can be converted into shares of the issuer's common stock in the future. It provides the benefits of fixed income (albeit at lower yields than regular corporate bonds) and allows the holder to potentially benefit from growth if the issuer's stock price increases.

A convertible bond's "conversion price" is the price at which an investor can convert the bond into equity shares. Typically, the conversion price is higher than the stock price at the time the bond is issued. A bond's "conversion ratio" is its face value divided by the conversion price and represents the number of shares an investor would receive upon conversion. Here's an example:

Chris invests in a convertible bond with a face value of $100,000 and a conversion price of $200. The conversion ratio is $100,000 / 200, or 500, meaning Chris can exchange the bond for 500 shares of the company's stock. Suppose the company's stock price is $150 when the bond is issued. If the price increases to $250 ($50 over the conversion price), Chris will enjoy a $25,000 gain (500 x $50). On the other hand, if the price rises to only $180 ($20 less than the conversion price), the conversion will produce a $10,000 loss (500 x $20). So Chris would be better off not converting and receiving the bond's face value at maturity.

3 flavors

Convertible bonds come in three flavors:

1. Standard (also called "vanilla"), where the investor has the option to hold the bond to maturity or convert it to common stock,
2. Mandatory, where the bond automatically converts to common stock at a specified date, and
3. Reverse, where the *issuer* has the option to buy back the bond at face value or convert it to stock shares.

Standard convertible bonds are the most common form. Their yields are generally lower but offer the greatest upside potential. Mandatory and reverse convertible bonds offer higher yields but pose a greater risk of loss — particularly reverse convertibles because the issuer holds the option and will usually do what's best for the company rather than for the bondholder.

Advantages and risks

The biggest advantage of owning convertible bonds is control. With a standard convertible bond, the investor chooses to either hold the bond until maturity or convert it, depending on whether the stock price exceeds the conversion price. (This option isn't available with mandatory or reverse convertibles, generally making them less desirable to investors.) Even though these securities have lower yields than regular corporate bonds, they provide a guaranteed income stream and higher upside potential than corporate bonds.

Convertible bonds also offer some protection in the event the issuer runs into financial trouble. Should the issuer liquidate, convertible bond holders typically enjoy priority over common stockholders. However, these bonds are subordinate to other types of debt. In addition to their lower yields and lower liquidation priority, convertible bonds tend to be issued by companies with lower credit ratings. This can make them risky, and it's possible for investors to lose their original investment amount.

Maximizing upside

Historically, convertible bond funds have captured much of the equity market's upside while minimizing losses during market downturns. But there's no guarantee they'll always perform this way. Whether they belong in your portfolio depends on several factors, including what you already own, your investment goals and your risk tolerance. ■

You may be able to deduct medical expenses … but there's a catch

As you likely know, health insurance doesn't cover everything. In fact, multiple studies have found that out-of-pocket medical expenses are rising rapidly — even for the insured. If there's good news, it's that some unreimbursed health care costs can be tax-deductible in certain circumstances. Let's take a look.

7.5% rule

If you itemize deductions on your income tax return, you're permitted to deduct a variety of medical and dental expenses for yourself, your spouse and your dependents. But there's a catch: You can take the deduction only if these expenses exceed 7.5% of your adjusted gross income (AGI) — and then you can deduct only the amount over the 7.5% threshold. For example, if your AGI is $200,000, the floor above which the deduction begins is $15,000 ($200,000 x 7.5%). So if you have $20,000 in eligible health care expenses, you may claim a $5,000 deduction ($20,000 – $15,000).

Remember that this deduction is limited to *unreimbursed* expenses. You must reduce your

total deductible expenses by any reimbursements from insurance or other sources, regardless of whether you receive the reimbursement directly or it's paid on your behalf to a medical provider.

What qualifies?

Another potential stumbling block is the fact that not all medical and dental expenses qualify for the deduction. For example, expenses for cosmetic surgery, health-club dues, medical marijuana, vitamins and over-the-counter drugs (except insulin) generally aren't eligible. Fortunately, in addition to most office visits, hospital stays and prescription drugs, these costs typically are deductible:

- Health insurance and qualified long-term care insurance premiums (subject to limits),
- Inpatient alcohol and drug addiction treatment,
- Acupuncture sessions,
- Weight-loss programs for physician-diagnosed diseases,
- Smoking-cessation programs,
- In vitro fertilization (IVF) programs,
- LASIK vision correction surgery,
- Adaptive equipment, such as eyeglasses, contact lenses, hearing aids, dentures, crutches and wheelchairs,
- Nursing home care, including meals and lodging, if the availability of medical care is the principal reason for residence, and
- Transportation expenses essential to obtaining eligible medical care, such as the cost of taxis, buses, trains or ambulances, as well as personal vehicle mileage.

Note that although transportation expenses related to obtaining care can be deductible, lodging and meal costs typically aren't.

Tax tips for the self-employed

The self-employed can deduct 100% of the health insurance premiums they pay for themselves and their spouses, dependents and nondependent children under age 27, regardless of whether they itemize. (The deductible amount may be limited depending on the taxable income of the business.) You can even deduct premiums you pay for Medicare Part B, Medicare Part D or a medigap policy, if you continue to run your business after you qualify for Medicare. But be careful: You can't claim the self-employed health insurance deduction if you're eligible to participate in a subsidized health plan offered by an employer of yours or a family member.

If you're self-employed and eligible for the 20% qualified business income (QBI) deduction, also weigh potential benefits of the self-employed health insurance deduction against any resulting reduction in the QBI deduction. Depending on your circumstances, it may be more advantageous to claim insurance premiums as an itemized deduction so you can preserve a larger QBI deduction.

Planning opportunity

The IRS provides a list of all qualified medical expenses on its website. If it looks like you might reach the 7.5% of AGI threshold in 2024, review the list and think about scheduling appointments or deductible services or making purchases that qualify before the end of the year. ■

Don't let fake charities benefit from your generosity

The news lately has been filled with natural disasters, wars and other humanitarian crises around the globe. At the same time, you've likely received dozens of requests for donations to help with relief efforts. Many of these requests are from legitimate charitable organizations. But some may come from scammers attempting to take advantage of your generosity.

In recent guidance, the IRS explicitly advises taxpayers to be wary of criminals soliciting donations. As the IRS explains, if you fall victim to one of these scams, not only will your money end up in the pockets of criminals rather than with those who need it, but you'll lose the ability to claim a charitable tax deduction. Plus, any personal information you share with a fake charity may be used to steal your identity.

You can help reduce the risk by following four tips:

1. Verify the charity before donating. Scammers often promote fake charities with emails or fraudulent websites or by "spoofing" a real charity's caller ID. They may also use names that are similar, but slightly different, to well-known charities. Ask any promoter for the charity's exact name, website and mailing address and confirm the information independently. One resource is the Tax-Exempt Organization Search tool at irs.gov.

2. Don't give in to pressure. Legitimate charities should be happy to receive donations at any time. If someone pressures you to make an immediate payment or repeatedly contacts you to create a sense of urgency, that's usually a red flag.

3. Choose a safe payment method. The safest way to make donations is by physically delivering a check to the charity (or mailing it from the post office, to avoid potential mailbox theft) or by using a credit card online. If you choose the latter method, make sure the charity's payment processing app encrypts your data (look for SSL or TLS protocols). If a charity asks you to donate using gift cards or by wiring money, it's likely a scam.

4. Don't provide more information than necessary. The IRS advises taxpayers to "treat personal information like cash and not hand it out to just anyone."

With just a few extra minutes, you can ensure that your donations go to qualified, legitimate charities. Another option is to donate to a well-established nonprofit that responds to a wide range of emergencies, such as the Red Cross or Doctors Without Borders. ■

This publication was developed by a third-party publisher and distributed with the understanding that the publisher and distributor are not rendering legal, accounting, tax or other professional advice or opinions on specific facts or matters and recommend you consult with a professional attorney, accountant, tax professional, financial advisor or other appropriate industry professional. The hypothetical examples used are for illustrative purposes only and not intended to represent the value or performance of any specific product or to predict or guarantee actual results, which will vary. ©2024